# MANAGEMENT REPORT

# ON THE ACTIVITY OF

# POWSZECHNY ZAKŁAD UBEZPIECZEŃ

# SPÓŁKA AKCYJNA GROUP

# FOR 2011

**Warsaw, 14 March 2012**

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# B. INTRODUCTION

## 1. Summary of the consolidated financial results

In 2011 the financial results of the Powszechny Zakład Ubezpieczeń Spółka Akcyjna Group ("PZU Group") according to International Financial Reporting Standards ("IFRS"), and compared with the previous year, were mainly shaped by:

- an increase in written premium in the PZU Group in both segments of insurance activities – life and non-life (a total of ca. + 5.1%);
- improved profitability in the non-life segment, mainly in motor insurance and property insurance products:
  - a significantly lower rate of natural disasters in the analyzed period, which in 2010 related mainly to snow and flood claims (PZU's net share in the claims amounted to PLN 369.4 million);
- a decrease in the level of administrative expenses achieved thanks to the restructuring program implemented in 2011 and 2010 and the program for reducing fixed cost (-8.1%);
- a drop in income on investing activities resulting from the poor condition on the capital markets (-42.6%);
- consolidating the Armatura Group – a one-off impact on net profit of PLN 118.9 million.

In 2011, the net profit of the PZU Group amounted to PLN 2,343.9 million and was 3.9% lower in comparison to previous year.

As at the end of 2011, ROE[1] amounted to 18.3% and dropped by 2.0 p.p. compared with the end of the previous year.

[1]ROE – the ratio is calculated as the ratio of the net profit/loss to the average value of equity as at the end and at the beginning of the reporting period.

# 2. Macroeconomic environment in 2011

## 2.1 Basic trends in the economy and rate of economic growth

In 2011 GDP in Poland increased by 4.3%, which exceeded both expectations and last year's dynamics (3.9%). In 2011 the rate of increase in domestic demand slowed a little to 3.8% compared with 4.6% in 2010, and contrary to 2010, net exports contributed to the growth in GDP. Once again, in 2011 retail consumption was the most important factor behind economic growth and increased by 3.1% compared with 3.2% in 2010. However, in the 2nd half of the year, its dynamics started to decrease significantly due to the gradually lower increase in real income. Moreover, the domestic consumption was lower in 2010. In 2011 capital expenditure on fixed assets increased quarter on quarter, mainly as a result of public investments in infrastructure. During 2011 investments increased by 8.5%, compared with the drop of 0.2% in the prior year, and became a factor almost equally significant to GDP growth as retail consumption. In 2011 the input of investments to GDP was significantly lower than in 2010, and in the first quarter of 2011 it was for the first time negative since 2009.

On the supply side of economic growth, added value in the construction industry increased the most in 2011 (11.8% compared with 6.4% in 2010), thus confirming the important part played by infrastructural investments. Added value in the industrial sector increased at a lower pace in 2011 compared with 2010 (6.3% compared with 9.4%). The pace of growth of added value increased in trade and repairs of motor vehicles (4.6% compared with 2.6%).

## 2.2 Capital market

In 2011, despite the good financial position of companies and the relatively high increase in GDP, the key indices of the Polish equities market WIG and WIG20 noted drops of 20.8% and 21.9% respectively. Until April, the indices increased in line with the expectations of accelerated global economic growth. In the 2nd quarter, global growth perspectives dampened, which translated into investors' increased risk aversion on the global financial markets. In the 3rd quarter, the exacerbation of the global debt crisis in the euro zone, fiscal problems in the USA and the rating agencies' cutting of the highest financial credibility rating, as well as revised data on the country's GDP, contributed to the huge increase in aversion to risk on the global financial markets which also resulted in a drop in the WIG and WIG20 indices.

The return on Polish debt remained relatively stable during the turbulences on the financial markets in 2011. As the Eurozone debt crisis intensifies and investors become increasingly risk averse in the global debt market, the yield of Polish ten- and five-year treasury bonds dropped between the end of 2011 and the end of 2010 by 16 and 17 b.p., respectively. The yield of two-year bonds, however, increased by 7 b.p. In terms of annual average, the return on Polish debt was a little higher than in 2010 – in respect of two- and five-year bonds by 5 and 11 base points respectively, and in respect of 10-year bonds by 19 base points. The resilience of the Polish debt market to crisis events resulted among other things from the maintained relatively high economic growth, progress in reducing the budget deficit and efficient management of debt requirements financing.

## 2.3 Monetary policy, interest rates, inflation

In 2011 the average annual inflation (CPI) amounted to 4.3% compared with 2.6% in 2010, and at the end of the year prices of consumer goods were 4.6% higher than in 2010 (3.1% y/y in 2010). Acceleration of inflation in the 1st half of the year was the result of the impact of global trends – an increase in food prices and other raw materials (including mainly fuels), and increases in administered prices (including prices of energy for households) and an increase in the VAT rates. In the 2nd half of the year, in turn, a pro-inflationary factor was the huge weakening of the Polish zloty against key currencies. In 2011 net inflation also increased systematically (CPI, net of food and energy prices) achieving 3.1% at the end of the year. The Monetary Policy Council (RPP) increased interest rates four times during the first half of 2011, each time by 25 basis points. Since June, in view of the escalation of the debt crisis in the euro zone and an increase in the related uncertainty as to Poland's further economic growth, RPP decided to maintain the interest rates at an unchanged level (with the NBP reference rate at 4.5%).

## 2.4 Labour market and consumption

In 2011 conditions on the labour market deteriorated systematically. Despite the increase in employment in the corporate sector by ca. 124 thousand people in December 2011 compared with December 2010 (2.3% y/y compared with 2.4% y/y in 2010), since 2nd quarter the demand for employees dropped. The slowing down of employment dynamics accompanied by an insignificantly higher number of active employees contributed to maintaining the recorded unemployment rate at a higher level (annual average 12.4% compared with 12.1% in 2010, at the end of the year 12.5% compared with 12.4%). In these conditions the dynamics of wages and salaries remained moderate. Although average monthly remuneration in the national economy increased in nominal terms by 5.4% in 2011 compared with 3.9% in the prior year, in the 2nd half of the year, in the corporate sector, both the nominal and real dynamics of wages and salaries gradually dropped. At the end of 2011 the average monthly remuneration in the corporate sector after accounting for inflation was slightly lower than at the end of 2010. High inflation was a significant factor impacting the drop in dynamics of the real income of households in 2011, in particular due to the lower dynamics of social benefits. Therefore, individual consumption increased by 3.1% compared with 3.2% in 2010, but its dynamics in the 2nd quarter dropped visibly. In the 4th quarter of 2011 consumer satisfaction ratios dropped yet again.

## 2.5 Foreign exchange rates

Increased aversion to risk on the global financial markets related to the intensification of the debt crisis in the euro zone in the 2nd half of 2011 (especially in the 3rd quarter) contributed to weakening the Polish zloty and its increased volatility. The exchange rate of the EUR to PLN (NBP fixing) was 11.5% higher at the end of 2011 than at the end of 2010, and the USD to PLN rate increased by 15.3%. The changes in the annual average exchange rate of the PLN were lower – the EUR / PLN exchange rate increased by 3.1%, and the USD / PLN rate dropped by 1.7%. In conditions of increased aversion to risk, the CHF also strengthened against the PLN, and the CHF / PLN exchange rate was 14.8% higher at the end of 2011 than at the end of 2010.

## 2.6 Impact of macroeconomic factors on the insurance sector

The macroeconomic conditions had an ambiguous impact on the sales of insurance. On the one hand, the relatively high increase in GDP should contribute to an increase in demand for insurance services. However, on the other hand, especially in the 2nd half of the year, dynamics of real income dropped and thus the conditions for an increase in consumer demand deteriorated. The GDP increase was increasingly driven by investments, especially investments in infrastructure.

In 2011, among other things, production, imports and sales of cars dropped which led to the ageing of the car park in Poland and a drop in demand for comprehensive motor insurance (AC). Sales dynamics of durable consumer goods also fell. On the other hand, in 2011 corporate capital expenditure increased after the drop in 2010. The financial position of non-financial companies (data for the period from the 1st to the 3rd quarter of 2011) improved compared with the same period of 2010, contributing to the improvement in the conditions of sales of insurance products for corporate and SME clients.

The weakening of the zloty compared with the EUR had a negative impact on the loss ratio in motor insurance due to the impact of the imported spare parts (a process extended in time due to the importers' maintaining specific inventory balances).

In 2011 the credit market revived somewhat which could have a positive impact on the sales level and the related financial insurance. This phenomenon related mainly to corporate loans. The increase in mortgage loans was lower than in the previous year and the value of consumer loans granted dropped.

The drop in share prices in 2011 – resulting from a global increase in aversion to risk – had an unfavourable impact on investment income and on the demand for unit-linked investment insurance.

## 2.7 Market shares of PZU, PZU Życie and PTE PZU

### 2.7.1 General insurance market

Gross written premium in the whole Polish insurance sector according to Polish Accounting Standards ("PAS") as at the end of September 2011[2] amounted to PLN 57,150 million, which indicates an increase of 85.5% (+PLN 2,987 million) compared with the three quarters of the prior year.

### 2.7.2 Property and other personal (non-life) insurance

Premiums in non-life insurance for the 3rd quarter of 2011 increased by 11.3% to PLN 25,301 million compared with the three quarters of the previous year. The market increase was mainly the effect of an increase in motor insurance (there were many increases on the market in the period from the 2$^{nd}$ quarter of 2010 to the 1$^{st}$ quarter of 2011, which resulted in an increase in average premium in 2011).

The share of Powszechny Zakład Ubezpieczeń Spółka Akcyjna ("PZU", the "Issuer") measured by gross written premium on the Polish non-life insurance market was 32.6% as at the end of December

[2] Most current data published by the Polish Financial Supervision Authority ("KNF") as at the moment of preparing the PZU Group Directors' Report

2011. PZU remains the leader on the Polish insurance market, specifically in the motor insurance sector.

***Table 1: Non-life insurance market – gross written premium***

PLN million

| Property insurance market – gross written premium | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | PZU | Market | Market without PZU | PZU | Market | Market without PZU |
| Comprehensive (AC) insurance | 2 285 | 5 822 | 3 537 | 2 258 | 5 263 | 3 005 |
| Motor liability insurance | 2 891 | 8 725 | 6 101 | 2 591 | 7 674 | 5 083 |
| Other products | 3 071 | 10 754 | 7 416 | 2 935 | 9 804 | 6 869 |
| **TOTAL** | **8 247** | **25 301** | **17 054** | **7 784** | **22 741** | **14 957** |

*Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 4/2011, Rynek ubezpieczeń 4/2010, PZU data*

***Table 2: Non-life insurance market – analysis of gross written premium***

| Structure of written premium | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | PZU | Market | Market without PZU | PZU | Market | Market without PZU |
| Comprehensive (AC) insurance | 27,7% | 23,0% | 20,7% | 29,0% | 23,1% | 20,0% |
| Motor liability insurance | 35,1% | 34,5% | 35,8% | 33,3% | 33,8% | 34,0% |
| Other products | 37,2% | 42,5% | 43,5% | 37,7% | 43,1% | 46,0% |
| **TOTAL** | **100,0%** | **100,0%** | **100,0%** | **100,0%** | **100,0%** | **100,0%** |

*Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 4/2011, Rynek ubezpieczeń 4/2010, PZU data*

***Table 3: Non-life insurance market – PZU share in market premium***

| PZU SA share in market premium (in %) | 2011 | 2010 |
|---|---|---|
| Comprehensive (AC) insurance | 39,3% | 42,9% |
| Motor liability insurance | 33,1% | 33,8% |
| Other products | 28,6% | 29,9% |
| **TOTAL** | **32,6%** | **34,2%** |

*Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 4/2011, Rynek ubezpieczeń 4/2010, PZU data*

The main reason for the drop in PZU's market share in the property insurance market is its pursuit of the corporate insurance portfolio restructuring program, mainly in the area of motor insurance, aimed at lowering the loss ratio. Under this program a restrictive underwriting policy is pursued in respect of areas of operation with increased risk, where the key focus is on the security of the portfolio held and earning a technical profit.

*Table 4: Non-life insurance market – technical result*

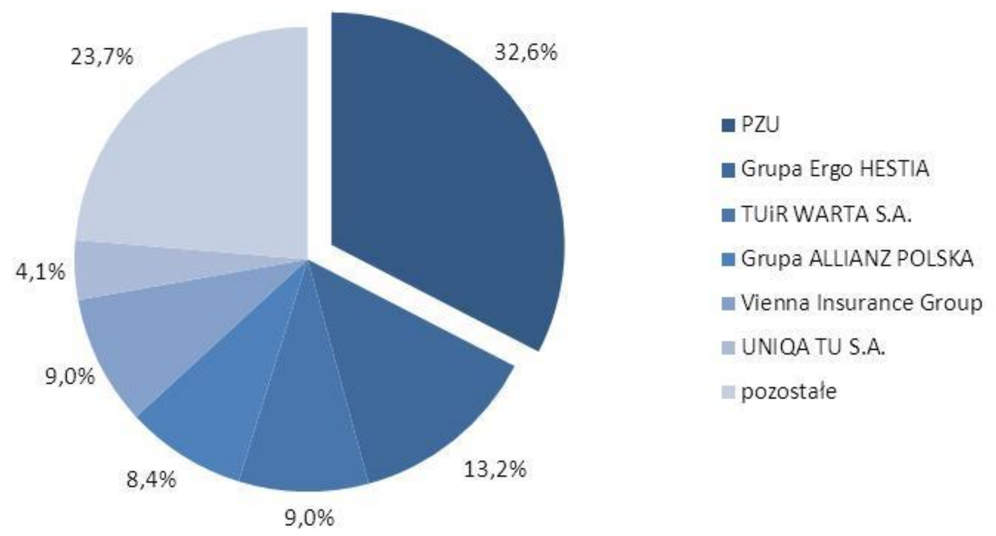
PLN million

| Technical result | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | **PZU** | **Market** | **Market without PZU** | **PZU** | **Market** | **Market without PZU** |
| Comprehensive motor insurance (AC) | 248 | 333 | 85 | (6) | (315) | (309) |
| Motor liability insurance | (105) | (512) | (407) | (160) | (908) | (748) |
| Other products | 189 | 608 | 419 | (163) | (53) | 110 |
| **TOTAL** | **332** | **429** | **97** | **(329)** | **(1 276)** | **(947)** |

*Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 4/2011, Rynek ubezpieczeń 4/2010, PZU data*

Due to the increase in rates and restructuring the quality of the motor insurance portfolio (speciically in the corporate client segment) and the absence of natural disasters which had such an impact on PZU's results for 2010, the Company achieved very good technical results compared with other companies on the market. This is specifically visible in motor insurance.

**Diagram 1: Share of largest non-life insurers in Poland**




*Pozostałe - Other*

*Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 4/2011, Rynek ubezpieczeń 4/2010, PZU data*

## 2.7.3 Life insurance

The gross written premium in life insurance has increased by +1.4% YoY, which implies a smaller growth than in the years 2010 vs. 2009, which amounted to +3.8%. The lower growth was visible in regular premium (+1.9% growth in 2011 vs. 2010, as compared to a +8.3% increase in the years 2010 vs. 2009). Single premium increased slightly (+0.9%, as compared to the years 2010 and 2009, when no growth had been reported). A slower growth of the regular premium results from higher unemployment, which entailed a gradual decrease in the growth of remunerations in the business sector. Stable level of single premium is the effect of reducing the supply of products combining the features of a life insurance policy and a bank deposit (poliso-lokata), which results from low profitability, significant capital requirements and a lower demand for unit-linked insurance (unstable situation in the financial markets and investing funds low-risk assets).

***Table 5: Life insurance market – gross written premium and technical result***

PLN million

| Life insurance market – gross written premium vs. technical result | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | PZU Życie | Market | Market without PZU Życie | PZU Życie | Market | Market without PZU Życie |
| **Gross written premium** | **9 806** | **31 849** | **22 043** | **9 300** | **31 422** | **22 122** |
| **Technical result** | **2 015** | **3 345** | **1 330** | **2 145** | **3 601** | **1 456** |

*Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 4/2011, Rynek ubezpieczeń 4/2010, PZU data*

In 2011 the market share of Powszechny Zakład Ubezpieczeń na Życie SA ("PZU Życie") increased to 30.8% (+1.2 p.p. compared with 2010). The dominating share in the Company's key segment of regular premium was maintained and amounts to 43.4%. Thanks to the cooperation with PKO BP SA and Millenium SA banks, the share of PZU Życie in the single premium segment increased by 1.9 p.p. to 19.5%.

The technical result of PZU Życie constitutes the majority of the results earned by all life insurance companies. It should be emphasized that despite the drop in technical result, in 2011 PZU Życie's technical profit margin on written premium still exceeds the margin earned by all the other companies offering life insurance by more than threefold (20.6% vs. 6.0%).

***Table 6. Life insurance market – gross written premium***

PLN million

| Life insurance market – gross written premium | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| | PZU Życie | Market | Market without PZU Życie | PZU Życie | Market | Market without PZU Życie |
| Periodic premium | 6 530 | 15 040 | 8 510 | 6 363 | 14 758 | 8 395 |
| Single premium | 3 276 | 16 808 | 13 532 | 2 937 | 16 664 | 13 727 |
| **TOTAL** | **9 806** | **31 849** | **22 042** | **9 300** | **31 422** | **22 122** |

*Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 4/2011, Rynek ubezpieczeń 4/2010, PZU data*

## 2.7.4 Pension insurance

***Table 7: Position of OFE PZU (open pension fund) on the pension market in Poland***

| Market for pension insurance | 31 December 2011 | | | 31 December 2010 | | |
|---|---|---|---|---|---|---|
| | OFE PZU | OFE market | OFE market without PZU | OFE PZU | OFE market | OFE market without PZU |
| Number of fund members | 2 214 995 | 15 493 373 | 13 278 378 | 2 193 502 | 14 930 991 | 12 737 489 |
| Net managed assets in PLN million | 30 523 | 224 720 | 194 197 | 30 660 | 221 251 | 190 592 |

*Source: KNF (www.knf.gov.pl). Pension market. Monthly data.*

***Table 8: Share of OFE PZU (open pension fund) in the pension market in Poland***

| Share of OFE PZU "Złota Jesień" in the market (in %) | 31 December 2011 | 31 December 2010 |
|---|---|---|
| Number of fund members | 14.3% | 14.7% |
| Net managed assets in PLN million | 13.6% | 13.8% |

*Source: KNF (www.knf.gov.pl). Pension market. Monthly data.*

As at the end of 2011, Otwarty Fundusz Emerytalny PZU "Złota Jesień" ("OFE PZU") had ca. 2,215 thousand members, which is 14.3% of the total number of open pension fund ("OFE") members and ranks OFE PZU third on the market. Compared with the end of the prior year, the number of OFE PZU members increased by 21.5 thousand people, i.e. 1.0%.

In 2011 the number of people underwriting contracts with open pension funds for the first time dropped by as much as 40% compared with 2010. The main reason for the drop was the limitation of acquisition activity of the funds indirectly caused by the statutory ban on acquisition on the secondary market, and an increase in the unemployment rate among graduates.

Moreover, the number of people who decided to change funds dropped (a drop of 5.0% compared with 2010). OFE PZU is among those funds which have a negative balance in transfers (-12,962 people); however, it is still the best result among the three largest funds (ING OFE noted a balance of minus 51 thousand people, and Aviva OFE minus 111 thousand people).

As at the end of 2011, the total value of net assets in all OFE amounted to PLN 224,720.1 million and increased by 1.6% compared with the end of 2010. OFE PZU assets dropped by 0.4% during the period, to PLN 30,523 million, which placed OFE PZU third among all OFEs operating on the market in terms of the asset level.

### 2.7.5 Investment funds

According to data provided by Izba Zarządzających Funduszami i Aktywami (Chamber of Fund and Asset Managers - "IZFA") as at the end of December 2011 the net asset value of investment funds in Poland amounted to ca. PLN 114.7 billion, and the drop in managed assets in 2011 amounted to ca. 4.8%. The balance of payments and redemptions amounted to minus PLN 3.3 billion. Most new fund inflows were noted in debt funds, money market funds and cash funds (of ca.. PLN 2.1 billion each). The largest outflows were noted in mixed funds (ca. PLN 5.8 billion) and equity funds (ca. PLN 2.9 billion). The share of the five largest investment fund management companies in terms of the net asset value of the managed investment funds as at the end of December 2011 amounted to 41.3%.

In terms of the net asset value of funds, TFI PZU ranks tenth among the 33 investment fund management companies covered by the IZFA report. At the same time, TFI PZU remains the leader in the segment of employee pension funds among Polish investment funds, with assets exceeding PLN 1.3 billion.

## 2.8 Macroeconomic factors which will have an impact on PZU Group's operations in 2012

The expected slowdown in the pace of economic growth with a possible insignificant deterioration on the labour market may have a negative impact on the demand dynamics for insurance products.

The Eurozone debt crisis will continue to pose a risk to Poland's economic development in 2012. It may also contribute to the sustained high volatility of financial asset prices and in the event of its further exacerbation – even to a drop, which would negatively impact income on investments.

As of 1 April 2012, so-called one-day bank deposits will be liquidated, which were structured on a loophole in the Act of 29 August 1997, the Tax Code (Journal of Laws No. 8 of 2005, item 60 as amended) which allowed refraining from calculating tax on capital gains if the amount did not exceed PLN 0.50. The amendments were legitimized by the Act of 22 December 2011 on amendments to some acts related to the realization of the Budget Act (Journal of Laws No. 291 of 2011, item 1707). When these amendments come into force, it will lead to increased interest of the market in so-called policy-linked investments" offered by life insurers, which for PZU Życie means an option to increase the sales potential for this type of insurance through the bancassurance channel and its network of own outlets.

# 3. Organization scheme of the PZU Group

## 3.1 Organization of the PZU Group

The PZU Group engages in various insurance services. PZU Group entities offer services in the area of life insurance, other personal and property insurance and manage client assets under an open pension fund and investment funds.

In the period from 1 January to 31 December 2011 no significant changes took place in the operations of the key PZU Group entities.

***Table 9: Companies of the PZU Group***

| No. | Entity name | Registered office | Date of taking up control / significant influence | % of share capital held directly or indirectly by PZU | | % of voting rights held directly or indirectly by PZU | | Business |
|---|---|---|---|---|---|---|---|---|
| | | | | 31 December 2011 | 31 December 2010 | 31 December 2011 | 31 December 2010 | |
| **Entities covered by consolidation** | | | | | | | | |
| 1 | Powszechny Zakład Ubezpieczeń S.A. | Warsaw | N/A | N/A | N/A | N/A | N/A | Property and other personal (non-life) insurance |
| 2 | Powszechny Zakład Ubezpieczeń na Życie S.A. | Warsaw | 18.12.1991 | 100.00% | 100.00% | 100.00% | 100.00% | Life insurance |
| 3 | Powszechne Towarzystwo Emerytalne PZU SA ("PTE PZU") | Warsaw | 08.12.1998 | 100.00% | 100.00% | 100.00% | 100.00% | Managing pension funds |
| 4 | PZU Centrum Operacji SA ("PZU CO") | Warsaw | 30.11.2001 | 100.00% | 100.00% | 100.00% | 100.00% | Auxiliary activities related to insurance and pension funds |

| No. | Entity name | Registered office | Date of taking up control / significant influence | % of share capital held directly or indirectly by PZU | | % of voting rights held directly or indirectly by PZU | | Business |
|---|---|---|---|---|---|---|---|---|
| | | | | 31 December 2011 | 31 December 2010 | 31 December 2011 | 31 December 2010 | |
| 5 | Tower-Inwestycje Sp. z o.o. ("Tower-Inwestycje") | Warsaw | 27.08.1998 | 100.00% | 100.00% | 100.00% | 100.00% | Other financial services, excluding insurance and pension funds |
| 6 | PrJSC IC PZU Ukraine ("PZU Ukraine") | Kiev, the Ukraine | 01.07.2005 | 100.00% | 100.00% | 100.00% | 100.00% | Property insurance |
| 7 | UAB DK PZU Lietuva ("PZU Lietuva") | Vilnius, Lithuania | 26.04.2002 | 99.76% | 99.76% | 99.76% | 99.76% | Property insurance |
| 8 | Ogrodowa-Inwestycje Sp. z o.o. | Warsaw | 15.09.2004 | 100.00% | 100.00% | 100.00% | 100.00% | Purchasing, using, leasing and selling properties |
| 9 | Armatura Kraków SA 1) | Kraków | 07.10.1999 | 63.83% | 64.63% | 63.83% | 64.63% | Manufacture of bathroom and kitchen taps. |
| 10 | Armatoora SA [3] | Nisko | 10.12.2008 | 63.83% | 64.63% | 63.83% | 64.63% | Manufacture of heaters and aluminium casts. |
| 11 | Armatoora SA i wspólnicy sp. k. 1) | Kraków | 10.02.2009 | 63.83% | 64.63% | 63.83% | 64.63% | Use of free cash flows, development investment projects |
| 12 | Armagor SA (until 5 April 2011: Armagor Sp. z o.o.) 1) | Gorzów Śląski | 06.09.2009 | 63.83% | 64.37% | 63.83% | 64.37% | Manufacture of valves, tool-related services |
| 13 | PZU Specjalistyczny Fundusz Inwestycyjny Otwarty Dłużny (specialist open debt fund)[4] | Warsaw | 15.12.2009 | 100.00% | 100.00% | N/A | N/A | Investing funds collected from fund members |
| | **Non-consolidated subsidiaries** | | | | | | | |
| 14 | PZU Pomoc SA | Warsaw | 18.03.2009 | 100.00% | 100.00% | 100.00% | 100.00% | Assistance services. |
| 15 | Ipsilon Sp. z o.o. | Warsaw | 02.04.2009 | 100.00% | 100.00% | 100.00% | 100.00% | Assistance services and provision of medical services. |
| 16 | Ipsilon Bis SA | Warsaw | 02.09.2011 | 100.00% | N/A | 100.00% | N/A | The Company does not conduct activities. |
| 17 | Omicron SA | Warsaw | 13.09.2011 | 100.00% | N/A | 100.00% | N/A | The Company does not conduct activities. |
| 18 | Syta Development Sp. z o.o. w likwidacji | Warsaw | 29.04.1996 | 100.00% | 100.00% | 100.00% | 100.00% | Purchasing and selling real property, intermediation in trading and real estate management. |
| 19 | Towarzystwo Funduszy Inwestycyjnych PZU SA ("TFI PZU") | Warsaw | 30.04.1999 | 100.00% | 100.00% | 100.00% | 100.00% | Establishing, representing and managing investment funds. |
| 20 | Sigma Investments Sp. z o.o. | Warsaw | 28.12.1999 | 100.00% | 100.00% | 100.00% | 100.00% | Investing activities |
| 21 | PZU Asset Management SA ("PZU AM") | Warsaw | 12.07.2001 | 100.00% | 100.00% | 100.00% | 100.00% | Managing third party portfolios of securities on consignment. |

[3] Consolidated under the full consolidation method as at 1 January 2011. Discussed under item 5.10.

[4] Consolidated under the full consolidation method as at 30 June 2011. Discussed under item 3.3.

| No. | Entity name | Registered office | Date of taking up control / significant influence | % of share capital held directly or indirectly by PZU | | % of voting rights held directly or indirectly by PZU | | Business |
|---|---|---|---|---|---|---|---|---|
| | | | | 31 December 2011 | 31 December 2010 | 31 December 2011 | 31 December 2010 | |
| 22 | Międzyzakładowe Pracownicze Towarzystwo Emerytalne PZU SA („MPTE PZU SA") | Warsaw | 13.08.2004 | 100.00% | 100.00% | 100.00% | 100.00% | Managing the employee pension fund. |
| 23 | PrJSC IC PZU Ukraine Life Insurance („PZU Ukraine Life") | Kiev, the Ukraine | 01.07.2005 | 100.00% | 100.00% | 100.00% | 100.00% | Life insurance |
| 24 | LLC SOS Services Ukraine | Kiev, the Ukraine | 01.07.2005 | 100.00% | 100.00% | 100.00% | 100.00% | Assistance services |
| 25 | Company with Additional Liability Inter-Risk Ukraine ("Inter Risk") | Kiev, the Ukraine | 01.07.2005 | 100.00% | 100.00% | 100.00% | 100.00% | Legal services |
| 26 | LLC Finansowa Kompania Idea-Kapitał | Kiev, the Ukraine | 06.10.2011 | 100.00% | N/A | 100.00% | N/A | Financial services |
| 27 | UAB PZU Lietuva Gyvybes Draudimas | Vilnius, Lithuania | 26.04.2002 | 99.34% | 99.34% | 99.34% | 99.34% | Life insurance |
| 28 | ICH Center SA[5] | Warsaw | 31.01.1996 | 90.00% | 90.00% | 90.00% | 90.00% | Servicing motor claims adjustment under the Green Card (from the beginning of 2011 the Company does not engage in operations). |
| **Associates** | | | | | | | | |
| 29 | Kolej Gondolowa Jaworzyna Krynicka SA | Krynica | 17.08.1998 | 37.53% | 37.53% | 36.71% | 36.71% | Managing ski and tourist lifts. |
| 30 | Nadwiślańska Agencja Ubezpieczeniowa SA | Tychy | 08.06.1999 | 30.00% | 30.00% | 30.00% | 30.00% | Insurance services |

## 3.2 PZU Group companies

### 3.2.1 PZU

The PZU Group's Parent Company is PZU, which was established as a result of the transformation of Państwowy Zakład Ubezpieczeń (a state-owned enterprise) into a joint-stock company where the State Treasury was the sole shareholder on the basis of art. 97 of the Act on insurance activities of 28 July 1990 (Journal of Laws No. 11 of 2010, item 66 as amended ("Insurance Act").

PZU's core business is conducting insurance and directly related activities in respect of section II insurance – Other property and personal insurance, in accordance with the categories specified in the Act on insurance activities.

1. Accident insurance, including accident at work and occupational disease;

[5] Based on Shareholders Resolution on 8 March 2012, the Company has started liquidation on 16 March 2012.

2. Sickness insurance;
3. Comprehensive insurance of land vehicles, with the exception of rail vehicles;
4. Comprehensive insurance of rail vehicles, covering damage to rail vehicles;
5. Comprehensive insurance of aircraft covering damage to aircraft;
6. Insurance of maritime and inland navigation and vessel comprehensive insurance;
7. Insurance of goods in transport covering damage to transported goods;
8. Insurance of damage caused by natural disasters;
9. Insurance of other damage to goods;
10. Insurance of all types of liability resulting from the ownership and use of land vehicles with their own propulsion, including shipper's liability;
11. Insurance of all types of liability resulting from the ownership and use of aircraft, including shipper's liability;
12. Insurance of general maritime and inland navigation liability resulting from the ownership and use of maritime and inland vessels, including shipper's liability;
13. Liability insurance (general liability insurance);
14. Loan insurance;
15. Insurance guarantees;
16. Insurance of various financial risks;
17. Insurance of legal cover;
18. Insurance in respect of providing assistance for people who have encountered difficulties during travel or absence in their place of residence.

Until 31 December 2011 PZU Życie could engage in acquisition activities on behalf of open pension funds in accordance with the provisions of the Act of 28 August 1997 on the organization and operations of pension funds (Journal of Laws No. 159 of 2004, item 1667 as amended - "Pension Fund Act"). In connection with the Act of 25 March 2011 on amendments to some acts related to the operation of social insurance coming into force on 1 January 2012 (Journal of Laws No. 75 of 2011, item 398), which amended, among other things, art. 92 of the Pension Fund Act, introducing a ban on acquisition by insurance companies on behalf of open pension funds; as of 1 January 2012 the Company does not engage in acquisition on behalf of OFE.

In 2011 and 2010 PZU did not file a request to change the scope of the permit to carry out insurance activities. Moreover, in 2011 and 2010 PZU permits for insurance activities with respect to one or more insurance class were not withdrawn and no receivership was established.

### 3.2.2 PZU Życie

PZU Życie's core business is conducting insurance and directly related activities in respect of section I insurance – Life insurance, in accordance with the categories specified in the Act on insurance activities:

1. Life insurance;
2. Dowry insurance, providing for children;
3. Capital fund-linked life insurance;
4. Annuity insurance.
5. Accident and sickness insurance, if they supplement the insurance referred to above in items 1-4.

Until 31 December 2011 PZU Życie could engage in acquisition activities on behalf of open pension funds in accordance with the provisions of the Pension Fund Act. At PZU, from 1 January 2012 the Company does not engage in acquisition on behalf of OFE.

In 2011 and 2010 PZU Życie did not file a request to change the scope of the permit to carry out insurance activities. Moreover, in 2011 and 2010 permits for insurance activities issued for PZU Życie were not withdrawn with respect to one or more insurance class and no receivership was established.

### 3.2.3 PTE PZU

According to its Memorandum of Association, the core business of PTE PZU is:

- establishing an open pension fund;
- managing the established open pension fund and representing it vis a vis third parties in a manner specified in the Memorandum of Association and managing more than one open pension fund.

According to the European Statistical Classification of Economic Activities, the basic business of PTE PZU is auxiliary activities related to insurance and pension fund.

PTE PZU manages the third largest open pension fund on the Polish market in terms of net assets - Otwarty Fundusz Emerytalny PZU "Złota Jesień" ("OFE PZU").

### 3.2.4 Lithuanian market

The PZU Group conducts activities on the Lithuanian market in the area of property and life insurance via two companies:

- PZU Lietuva – property and personal insurance;
- UAB PZU Lietuva Gyvybës Draudimas – life insurance.

### 3.2.5 Ukrainian market

The PZU Group conducts activities on the Ukrainian market in the area of property and life insurance via two companies:

- PZU Ukraine – property and personal insurance;
- PrJSC IC PZU Ukraine Life – life insurance.

### 3.2.6 TFI PZU

TFI PZU engages in establishing investment funds and, as their authority, in their management, including intermediation in selling and repurchasing participation units and representing funds vis-à-vis third parties.

Currently TFI PZU manages 21 investment funds and sub-funds with various investment strategies.

TFI PZU offers investment products and services for both retail and institutional clients, including additional savings programs under Pillar III of the social insurance program, which include:

- IKE (Individual Pension Accounts);
- Specialized Investment Programs;
- PPE (Employee Pension Plans);
- ZPI (Company Investment Plans).

### 3.2.7 PZU AM

PZU AM manages selected asset portfolios of PZU, PZU Życie companies and provides management services in respect of investment portfolios managed by TFI PZU on the basis of art. 46 clause 1 of the Act of 27 May 2004 on Investment Funds (Journal of Laws No. 234 of 2011, item 1391 as amended) and assets of Employee Pension Fund "Słoneczna Jesień" managed by Międzyzakładowe Pracownicze Towarzystwo Emerytalne PZU (intercompany pension fund management company) on the basis of art. 152 clause 1 of the Act of 28 August 1997 on the organization and operations of pension funds (Journal of Laws No. 232 of 2011, item 1378 as amended).

The operations of PZU AM comprise:

- conducting brokerage activities within the meaning of the Act of 19 July 2005 on trading in financial instruments (Journal of Laws No. 211 of 2010, item 1384 as amended), including managing investment portfolios of investment funds;
- providing portfolio management services.

### 3.2.8 PZU Pomoc SA

PZU Pomoc SA engages specifically in the following activities:

- organizing assistance services consisting of providing assistance to Clients;
- lease and rental of motor vehicles;
- conducting Internet auctions and Internet trading;

- managing loyalty programs as part of conducting other business supporting activities not classified elsewhere;
- managing post-accident assets;
- activities in the area of medical services.

### 3.2.9 Ogrodowa-Inwestycje Sp. z o.o.

The business of Ogrodowa-Inwestycje Sp. z o.o. is:

- rental and management of own or leased real estate;
- purchase and sale of real estate on own behalf;
- activities in the area of stationary telecommunications;
- other business and management advisory services.

### 3.2.10 PZU CO

The statutory activities of PZU CO cover business in the area of the following services:

- auxiliary activities related to insurance and pension and disability pension funds;
- constant intermediation in underwriting insurance contracts, financial and investment, and assistance contracts;
- Contact Center services;
- Data Center services;
- printing services;
- IT services.

## 3.3 Changes in the organizational structure of the PZU Group

***Transfer of part of financial investments to funds***

On 30 June and 29 September 2011 an additional portion of bonds issued by the State Treasury and held by PZU Życie and classified into the portfolio of financial instruments designated at fair value through profit or loss (classified as such at initial recognition) was transferred to PZU Specjalistyczny Fundusz Inwestycyjny Otwarty Dłużny (specialist open debt investment fund). The market value as at the transfer date amounted to PLN 954.2 million and PLN 1,004.3 million respectively; the sole participant in the fund is PZU Życie.

The transaction was aimed at improving the effectiveness of financial investment management by tax optimization (in respect of CIT on capital gains and VAT paid to-date to other PZU Group companies for managing securities portfolios and not deductible by PZU Życie).

The above transactions had no impact on the net assets or financial results of the PZU Group.

The presentation, qualification or method of measurement of the said assets in the consolidated financial statements of the PZU Group as at and for the year ended 31 December 2011 ("consolidated financial statements of the PZU Group") has not changed, and PZU Specjalistyczny Fundusz Inwestycyjny Otwarty Dłużny was covered by consolidation under the full consolidation method as at 30 June 2011.

***Transfer of PZU CO, TFI PZU and PZU AM from PZU Życie to PZU***

On 27 September 2011 (after receiving the consent of KNF for the transaction in 26 September 2011) PZU acquired all the shares which had been held by PZU Życie in the following companies:

- 50,000 registered shares in PZU CO (100.0% shares) for PLN 40,605 thousand which reflects the value of PZU CO shares recorded in the books of PZU Życie as at the date of signing the share sale agreement (according to PAS);
- 13,000 registered shares in TFI PZU (100.0% shares) for PLN 38,364 thousand which reflects the value of TFI PZU shares recorded in the books of PZU Życie as at the date of signing the share sale agreement (according to PAS);
- 25,001 registered shares in PZU AM (50.002% shares) for PLN 5,617 thousand, constituting the equivalent of the net assets of PZU AM represented by the shares acquired, resulting from the financial statements of the company prepared for the last reported period (according to PAS).

Currently PZU is the sole shareholder in those companies. The transaction was conducted in connection with, among other things, the expansion of the Tax Group, as described in item 14.6.

***Transfer of Centrum Obsługi Ubezpieczeń in Warsaw and part of Telecentrum from PZU Życie to PZU CO***

In October 2011, as a result of restructuring, Centrum Obsługi Ubezpieczeń in Warsaw ("COUW") and part of Telecentrum were transferred from PZU Życie to PZU CO. The number of employees transferred with COUW and Telecentrum amounted to 107 and 58 respectively. COUW is an organizational entity responsible for the comprehensive servicing of some of PZU Życie's insurance products.

The expected benefits for PZU Życie resulting from the transfer of COUW and part of Telecentrum to the external entity cover:

- a reduction in operating expenses by concentrating on basic business operations;
- the possibility of further optimizing activities related to the comprehensive servicing of insurance products by concentrating them in a specialized entity.

***Establishment of Ipsilon Bis SA***

On 9 August 2011 PZU established a joint-stock company, Ipsilon Bis SA, with a share capital of PLN 100 thousand which was registered with the National Court Register on 2 September 2011.

***Establishment of Omicron SA***

On 30 August 2011 PZU established a joint-stock company, Omicron SA, with a share capital of PLN 100 thousand which was registered with the National Court Register on 13 September 2011.

***Establishment of LLC Finansowa Kompania Idea-Kapitał***

On 6 October 2011 a new subsidiary of PZU Ukraine was established – LLC Finansowa Kompania Idea-Kapitał with a share capital of UAH 4,100 thousand.

***Sales of Inter-Risk***

On 22 December 2011 PZU Ukraine and PZU Ukraine Life concluded an agreement with PKO BP SA for the sale of Inter-Risk for a total of PLN 2,500 thousand.

On 16 January 2012 the ownership rights to shares in Inter-Risk were transferred to the acquirer.

# C. FINANCIAL RESULTS OF THE PZU GROUP IN 2011

## 4. Events with a significant impact on the operations and results of the PZU Group in 2011

The PZU Group's financial results in 2011 were mainly shaped by:

- changes in the structure of written premium in the property and personal insurance, due to:
  - restructuring of the corporate clients portfolio;
  - the effect of increases (as of 2010) of prices for retail clients;
- improved profitability in the non-life segment, mainly in motor insurance and property insurance products:
  - a significantly lower rate of natural disasters in the analyzed period, which in 2010 related mainly to snow and flood claims (PZU's net share in the claims amounted to PLN 369.4 million);
- stable increase in gross written premium in group protection insurance;
- a drop in administrative expenses due to strict cost discipline and the restructuring program conducted, including the process of group layoffs in local outlets;
- lower profits on investment activities compared with the prior year as a result of the poor conditions on the capital market, which includes the Warsaw Stock Exchange ("WSE").

## 5. Commentary to the consolidated financial results of the PZU Group

### 5.1 Premiums

Gross written premium on direct and indirect insurance for the year ended 31 December 2011 amounted to PLN 15,279.3 million (PLN 14,541.0 million in 2010). The PLN 738.2 million (+5.1%) increase compared with the prior year resulted from an increase in sales in both segments– life and non-life. The main product lines which noted increases in 2011 comprise: motor liability (OC) insurance in the mass client segment (+PLN 287.3 million), fire and other property damage insurance (+PLN 102.0 million) and group insurance (+ PLN 179.5 million).

Changes in premiums are described in detail in the comments to segment results (item 6.1 and item 6.2).

***Table 10: Analysis of gross written premium in the PZU Group***

PLN'000

| Gross written premium | 1 January – 31 December 2011 | 1 January – 31 December 2010 | % change |
|---|---|---|---|
| Gross written premium in property and personal insurance | 8 527 492 | 8 028 481 | *6.2%* |
| In direct insurance | 8 491 093 | 7 991 069 | 6.3% |
| In indirect insurance | 36 399 | 37 412 | *(2.7)%* |
| Gross written premium in life insurance | 6 751 770 | 6 512 541 | *3.7%* |
| Individual premiums | 2 401 961 | 2 342 210 | *2.6%* |
| In direct insurance | 2 401 961 | 2 342 210 | *2.6%* |
| Group insurance premiums | 4 349 809 | 4 170 331 | *4.3%* |
| In direct insurance | 4 349 809 | 4 170 331 | *4.3%* |
| **Gross written premiums** | **15 279 262** | **14 541 022** | ***5.1%*** |

## 5.2 Results on investing activities

Income on investing activities for the 12 months ended 31 December 2011 and 31 December 2010 amounted to PLN 1,593.8 million and PLN 2,777.8 million respectively (including investment contracts, i.e. contracts which do not include significant risk insured).

***Table 11: Results on investment activity***

PLN'000

| Results on investment activity | 1 January – 31 December 2011 | 1 January – 31 December 2010 | % change |
|---|---|---|---|
| Interest income | 1 835 917 | 1 772 869 | *3.6%* |
| Dividend income | 122 148 | 77 655 | 57.3% |
| Income from investment properties | 27 256 | 19 940 | 36.7% |
| Foreign exchange differences | 28 610 | (17 178) | - |
| Other | (43 677) | (28 768) | - |
| **Total net investment income** | **1 970 254** | **1 824 518** | **8.0%** |
| Net income on realized investments | (75 196) | 303 152 | - |
| Impairment allowance | (112 051) | (103 701) | - |
| **Total net result on realized investments and impairment losses** | **(187 247)** | **199 451** | **-** |
| **Net change in fair value of assets and liabilities measured at fair value** | **(189 181)** | **753 805** | **-** |
| **Income on investing activities** | **1 593 826** | **2 777 774** | **(42.6)%** |

The drop in the "net change in fair value of assets and liabilities measured at fair value" of PLN 943.0 million was caused mainly by a drop in prices of equity instruments on financial markets – the WIG index dropped by 20.8% in 2011, whereas in 2010 it grew by 18.8%.

Net income on realized investments was PLN 386.7 million lower than in the prior year, which was also due to a drop in the prices of equity instruments on the financial markets in 2011.

The increase in new investment income of PLN 145.7 million was due, among other things, to the impact of foreign exchange differences on financial instruments denominated in EUR - in 2011 on an annual average the PLN weakened by 3.1% against the EUR, contrary to the PLN's strengthening against the EUR by 1.7% in 2010. In 2011 interest income, income on dividend and investment properties were also higher than in the prior year.

The investing activities of the PZU Group are conducted by applying an appropriate degree of safety, liquidity and profitability. What is more, the PZU Group Companies don't apply hedge accounting.

Debt securities issued by sovereign governments both as at 31 December 2011 and as at 31 December 2010 constituted ca. 75% of the investment portfolio and Polish government bonds dominated in the portfolio. At the same time, the PZU Group had debt securities issued by other sovereigns in its portfolio (Germany – 1% share in financial assets, Lithuania – 0.3%, Iceland – 0.1% and the Ukraine and Hungary – 0.01% each).

The drop in the share and value of equity instruments was mainly due to the drop in their market value in 2011.

***Table 12: Structure of the financial asset portfolio***

PLN'000

| Portfolio structure | 31 December 2011 | 31 December 2010 | Structure 2011 | Structure 2010 |
|---|---|---|---|---|
| **Debt securities, including:** | **35 195 032** | **35 200 159** | **74,4%** | **76,9%** |
| issued by sovereign governments | 34 716 308 | 34 291 519 | 73,4% | 74,9% |
| Other | 478 724 | 908 640 | 1,0% | 2,0% |
| **Equity instruments** | **5 160 350** | **5 741 732** | **10,9%** | **12,5%** |
| quoted on the regulated market | 2 507 136 | 3 083 846 | 5,3% | 6,7% |
| other (participation units, investment certificates, unquoted shares) | 2 653 214 | 2 657 886 | 5,6% | 5,8% |
| **Debt, reverse repo transactions, term deposits with financial institutions** | **6 334 782** | **4 296 170** | **13,4%** | **9,4%** |
| **Investment property** | **534 222** | **441 014** | **1,1%** | **1,0%** |
| **Other** | **85 195** | **106 971** | **0,2%** | **0,2%** |
| **Total** | **47 309 581** | **45 786 046** | **100,0%** | **100,0%** |

## 5.3 Claims

A drop in net claims and benefits (of PLN 162.9 million, i.e. 1.6%) was noted exclusively in the non-life segment. In the life insurance segment the following had an impact on the increase in net claims and benefits paid and on the change in technical reserves amounted to PLN 115.3 million (2.5%) in 2011:

- an increase in benefits paid of 6.6%;

- a drop in reserves where the risk of the investment is borne by the insurant in 2011 (a loss on investments in this group of investments) compared with a strong increase in 2010.

In the non-life insurance segment, the drop was related to a significant decrease in property insurance, and it resulted mainly from the absence of claims in respect of natural disasters which took place in 2010 (intense snowfalls in the 1st quarter of 2010 and the flood in the 2nd quarter of 2010).

## 5.4 Acquisition and administrative expenses

In 2011 acquisition costs increased by PLN 50.7 million (+2.7%) compared with 2010. The increase resulted mainly from changes in sales in the non-life segment related to:

- an increase in written premium;
- changes in the structure of distribution channels (an increase in the share of commission channels offset by a drop in non commission channels and automatic renewals);
- changes in the area of sales made in recent years, among other things, by introducing additional bonuses supporting the effectiveness of agents and making their remuneration conditional on achieving goals (the so-called additional commission; in 2011 their role increased and they were implemented in new channels).

The drop in administrative expenses of PLN 121.9 million (-8.1%) was to a large extent the effect of the restructuring activities conducted in PZU Group companies, which covered both the Head Office and local entities of the PZU Group. In 2011 the employment restructuring program in local entities started two years ago was continued; it was aimed, among other things, at improving operating effectiveness in claims adjustment, centralization of the day-to-day handling of policies and creating new customer service standards (establishing an EU Group Network Department) which resulted in a significant decrease in the fixed costs of current operations. Moreover, the continuation of the fixed costs optimization program brought about positive effects and enabled expenses to be reduced in many areas, such as administration (office stationery, postal services), real estate management (costs of cleaning) and IT costs.

## 5.5 Other operating income and expenses

The balance of other operating income and expenses deteriorated by PLN 62.4 million in 2011 compared with the prior year (a change from PLN -212.1 million to PLN -274.5 million). The main reasons for the change were as follows:

- setting up a provision for reorganization and restructuring of PLN 96.8 million;
- adjusting the estimated settlements of reinsurers' commissions and shares in profit of PLN 91.8 million;
- setting up a provision for the costs of the penalty imposed by Urząd Ochrony Konkurencji i Konsumentów (Office for Competition and Consumer Protection – "UOKiK") (for applying the practice of limiting competition on the domestic market for sales of group NNW insurance to children, adolescents and personnel in educational establishments referred to in Note 52.1.2.2. of the consolidated financial statements of the PZU Group) of PLN 56.6 million; and

- starting the consolidation of the Armatura Group under the full method in the consolidated financial statements of the PZU Group, which led to recognizing one-off revenue of PLN 118.9 million in 2011.

## 5.6 Results and business ratios of the PZU Group

In 2011 operating profit amounted to PLN 2,956.7 million and was 4.3% lower than in the prior year, which resulted mainly from the lower results on investing activity (- 42.6%). The drop was largely offset by an increase in net premium earned of 4.8% and a drop in net insurance claims and benefits of 1.6%.

***Table 13: Data from the consolidated income statement of the PZU Group***

PLN'000

| Data from the consolidated income statement | 1 January – 31 December 2011 | 1 January – 31 December 2010 | *% change* |
|---|---|---|---|
| Gross written premium | 15 279 262 | 14 541 022 | *5.1%* |
| Net premium earned | 14 890 528 | 14 213 013 | *4.8%* |
| Fee and commission income | 281 351 | 288 037 | *(2.3)%* |
| Net result on investing activities | 1 593 826 | 2 777 774 | *(42.6)%* |
| Net claims and benefits | (10 221 122) | (10 384 062) | *(1.6)%* |
| Acquisition costs | (1 961 986) | (1 911 255) | *2.7%* |
| Administrative expenses | (1 383 897) | (1 505 784) | *(8.1)%* |
| Operating profit/(loss) | 2 956 727 | 3 088 085 | *(4.3)%* |
| Profit/(loss) before tax | 2 907 575 | 3 029 431 | *(4.0)%* |
| Net profit | 2 343 947 | 2 439 229 | *(3.9)%* |
| Profits (losses) of minority interests | (1 477) | (2) | *x* |
| Basic and diluted weighted average number of ordinary shares in issue | 86 352 300 | 86 352 300 | |
| Basic and diluted earnings per one ordinary share (in PLN) | 27,16 | 28,25 | *(3.8%)* |

***Table 14: Data from the consolidated cash flow statement of the PZU Group***

PLN'000

| Data from the consolidated cash flow statement | 1 January – 31 December 2011 | 1 January – 31 December 2010 | *% change* |
|---|---|---|---|
| Net cash from operating activities | 1 587 572 | 469 423 | *238.2%* |
| Net cash from investing activities | (288 686) | 5 329 478 | *(105.4)%* |
| Net cash from financing activities | (1 485 832) | (5 727 985) | *(74.1)%* |
| **Net increase/(decrease) in cash and cash equivalents** | **(186 946)** | **70 916** | ***(363.6)%*** |

***Table 15: Basic profitability ratios of the PZU Group***

| Gross written premium | 1 January – 31 December 2011 | 1 January – 31 December 2010 | % change |
|---|---|---|---|
| **Return on equity (ROE)** | 18.3% | 20.3% | *(2.0) p.p.* |
| *(net profit/loss /average equity*) x 100%* | | | |
| **Return on assets (ROA)** | 4.6% | 4.7% | *(0.1) p.p.* |
| *(net profit/loss /average assets*) x 100%* | | | |
| **Administrative expense ratio** | 9.3% | 10.6% | *(1.3) p.p.* |
| *(administrative expenses / net premium earned)* | | | |
| **Sales margin** | 15.3% | 16.8% | *(1.5) p.p.* |
| *(net profit (loss)/ gross written premium)x100%* | | | |

## 5.7 Analysis of assets and liabilities

The main component of assets are investments (financial assets and investment property) comprising 90.8% of total assets. As at the end of 2011 they amounted to PLN 47,309.6 million, which is an increase of 3.3% compared with the balance as at the end of 2010. The increase in the balance of financial assets as at the end of 2011, despite the drop in the prices of shares quoted on the capital markets, was a consequence of business development.

Equity was 0.5% higher than in the prior year and amounted to PLN 12,869.5 million.

The key component of total liabilities and equity were technical reserves ("RTU"), which comprised ca. 62.4% of the balance sheet total. As at the end of 2011 they amounted to PLN 32,522.7 million, which is an increase of 2.2% compared with the balance as at the end of 2010. The increase in RTU as at the end of 2011 was due to an increase in gross written premium in motor liability insurance in the mass client segment (+13.1%) and an increase in claims in this segment.

The increase in the balance compared with 31 December 2010 resulted mainly from liabilities to credit institutions of PLN 758.9 million in respect of sell-buy-back transactions.

***Table 16: Main balance sheet items of the PZU Group***

PLN'000

| Main balance sheet items | 31 December 2011 | 31 December 2010 | % change |
|---|---|---|---|
| **ASSETS, including** | 52 129 282 | 50 670 557 | 2.9% |
| Financial assets | 46 775 359 | 45 345 032 | 3.2% |
| Receivables | 1 734 636 | 1 734 274 | 0.0% |
| **LIABILITIES AND EQUITY, including:** | 52 129 282 | 50 670 557 | 2.9% |
| Equity | 12 869 505 | 12 799 926 | 0.5% |
| Technical reserves | 32 522 729 | 31 822 990 | 2.2% |
| Investment contracts | 3 471 772 | 3 544 515 | (2.1)% |
| Liabilities | 1 797 521 | 1 133 822 | 58.5% |
| Accruals and deferred income | 686 957 | 482 143 | 42.5% |

## 5.8 Material off-balance sheet items

As at 31 December 2011, the Group had PLN 86.0 million of disputed claims which were not approved by PZU Group companies and which are to be litigated by the creditors. As at 31 December 2010, disputed claims amounted to PLN 127.1 million.

Under a guarantee line agreement dated 26 September 2008 concluded by and between PZU and Bank Millennium SA, the bank grants bank guarantees (both in terms of bid bonds and performance bonds) to PZU in tenders for insurance services. The guarantee line is PLN 15.0 million and every year it is renewed for another year. As at 31 December 2011, 33 bank guarantees were in force under the guarantee line, for a total of PLN 6.4 million. Moreover, as at 31 December 2011 PZU had a warranty in respect of an agency agreement from Raiffeisen-Leasing Polska S.A. in the amount of PLN 11.0 million.

## 5.9 Solvency margin

In accordance with the Act on insurance activities, an insurer with its registered office in the territory of the Republic of Poland is obliged to have own funds no lower than the solvency margin and no lower than the guarantee capital.

There are no regulations that would define the calculation of the solvency margin and the amount of own funds for the capital group and therefore tables 17 and 18 present the data separately for PZU and PZU Życie.

*Table 17: Calculation of own funds to cover the solvency margin of the PZU (according to PAS)*

| Specification | 1 January - 31 December 2011 | 1 January - 31 December 2010 | *Change* |
|---|---|---|---|
| **Coverage of technical reserves with assets ratio** *(Assets covering technical reserves / technical reserves) x 100%* | 127.0% | 127.4% | *(0.3) p.p.* |
| **Solvency margin** (i PLN '000) | 1 338.8 | 1 338.8 | - |
| **Coverage of the solvency margin ratio** | 686.6% | 716.6% | *(30.0) p.p.* |
| **Guarantee capital** (PLN '000) | 446.3 | 446.3 | - |
| **Coverage of the guarantee capital ratio** | 2 059.8% | 2 149.7% | *(89.9) p.p.* |

*Table 18: Calculation of own funds to cover the solvency margin of the PZU Życie (according to PAS)*

| Specification | 1 January - 31 December 2011 | 1 January - 31 December 2010 | *Change* |
|---|---|---|---|
| **Coverage of technical reserves with assets ratio** *(Assets covering technical reserves / technical reserves) x 100%* | 106.9% | 112.4% | *(5.5) p.p.* |
| **Solvency margin** (i PLN '000) | 1 715.2 | 1 698.1 | *17.1%* |
| **Coverage of the solvency margin ratio** | 332.5% | 367.0% | *(34.5) p.p.* |
| **Guarantee capital** (PLN '000) | 571.7 | 566.0 | *5.7%* |
| **Coverage of the guarantee capital ratio** | 997.6% | 1 007.6% | *(10.0) p.p.* |

## 5.10 Impact of one-off events on operating results

### *Consolidation of the Armatura Group*

As of 1 January 2011 the consolidated data of the Armatura Group ("Armatura Group", covering the data of the following entities – Armatura Kraków SA, Armatoora SA, Armatoora i wspólnicy sp. k. and Armagora SA) are consolidated under the full consolidation method in the consolidated financial statements of the PZU Group. Consolidation of the Armatura Group is the effect of its exceeding materiality levels adopted by the PZU Group for the purpose of consolidated reporting.

In the table below, key items of the consolidated statement of financial position of the Armatura Group with reconciliation to the consolidated net assets of the Armatura Group as at 1 January 2011 (measured according to the PZU Group accounting principles):

***Table 19: Structure of assets of the Armatura Group***

PLN'000

| Reconciliation of net assets of the Armatura Group as at 1 January 2011 | Value |
|---|---|
| Property, plant and equipment | 159 199 |
| Investment properties | 23 767 |
| Receivables | 102 419 |
| Cash and cash equivalents | 1 849 |
| Assets held for sale (investment properties) | 76 000 |
| Other assets | 123 895 |
| **Total assets** | **487 129** |
| Liabilities | (236 582) |
| Minority interests | (75) |
| **Net assets** | **250 472** |

The difference between the carrying amount of the shares of Armatura Kraków SA as at 1 January 2011 and the share of the PZU Group in the net assets of the Armatura Group of PLN 118.9 million was recognized in the financial results for 2011 and disclosed in "Other operating income" of the consolidated income statement.

***Table 20: Impact of the consolidation of the Armatura Group on the consolidated results of the PZU Group***

PLN'000

| Impact of the consolidation of the Armatura Group on the consolidated results of the PZU Group | Value |
|---|---|
| Carrying amount of shares of Armatura Kraków SA (measurement at the historical purchase cost net of impairment) | 42 952 |
| Value of consolidated net assets of the Armatura Group as at 1 January 2011 | 250 472 |
| Share of the PZU Group in consolidated net assets of the Armatura Group as at 1 January 2011 (64.6250%) | 161 868 |
| **Effect on the consolidated financial results of the PZU Group** | **118 916** |

## 5.11 Changes in investments in subordinated entities

***Capital restructuring of insurance companies in the Ukraine***

In 2011 the capital restructuring of the Ukrainian companies of the PZU Group was completed. In connection with the resolution of the Extraordinary General Shareholders' Meeting of PZU Ukraine and PZU Ukraine Life passed in December 2010, on 18 January 2011 PZU's offer was accepted for concluding the following:

- with PZU Ukraine a sales agreement of 29,207,233 shares of UAH 7.19 each, amounted to UAH 210,000 thousand (the equivalent of USD 26,448 thousand - PLN 75,380 thousand) was received by PZU on 31 January 2011);
- with PZU Ukraine Life Insurance a sales agreement of 139,991 shares of UAH 21.43 each, amounted to UAH 3,000 thousand (the equivalent of USD 378 thousand - PLN 1,077 thousand) was received by PZU on 31 January 2011);

On 2 February 2011, based on the above agreements, PZU transferred ownership rights to the shares to their acquirers.

The remaining 27,998 shares in PZU Ukraine Life, which were to be redeemed were purchased from another shareholder - PZU Ukraine (based on an agreement concluded on 18 January 2011).

The decrease in share capital was registered by the Securities and Capital Markets Commission of the Ukraine on 28 April 2011.

Moreover, in 2011, under the capital restructuring process, the additional capitalization of the Ukrainian PZU Group was done without the participation of PZU – shares in the life insurance company were taken up by the property insurance company increasing its previous interest and the shares in the property insurance company were taken up by the life insurance company, thus becoming its shareholder. The process was registered on 13 October 2011. As a result of the share issues, PZU's direct interest in the capital and voting rights of the Ukrainian companies of the PZU Group changed (interest in the share capital of the property insurance company is currently 89.9678%, and in the life insurance company – 53.4723%). Indirectly, PZU still controls 100% of the Ukrainian companies' capital and voting rights.

To simplify the ownership structure of PZU Ukraine and to optimize the costs of the PZU Group, on 1 December 2011 a share sales agreement was concluded for the sale of shares in this company held by PZU CO to PZU Ukraine Life. As a result of the transaction, PZU CO exited the Ukrainian market.

***Capital deficit in PZU Ukraine Life***

As a result of decreasing the share capital, and the consecutive significant increase in the EUR/UAH exchange rate, PZU Ukraine Life stopped meeting the minimum share capital requirement which the Ukrainian Insurance Act specifies for insurance companies, i.e. EUR 1,500 thousand (in accordance with the binding EUR/UAH exchange rate, as at 31 March 2011 the requirement amounted to UAH 16,823 thousand, which leads to a capital deficit of UAH 622 thousand as at that date).

On 18 April 2011, at the meeting of the Supervisory Boards of PZU Ukraine and PZU Ukraine Life, a plan of mutual additional capitalization of the companies was presented in the amount of ca. UAH 8,000 thousand each, in such manner that the shares of PZU Ukraine Life would be taken up by PZU Ukraine and vice versa. This transaction was intended to enable meeting the licence requirements without the additional involvement of PZU funds.

On 30 June 2011, on the basis of the recommendation of their Supervisory Boards, the Extraordinary General Shareholders' Meeting of PZU Ukraine and PZU Ukraine Life passed resolutions on:

- increasing the share capital of PZU Ukraine Life by UAH 2,500 thousand, and equity of UAH 7,872 thousand by issuing 25,000 shares with a nominal value of UAH 100 per share and an issue price of UAH 314.88 per share,
- increasing the share capital of PZU Ukraine by UAH 1,800 thousand, and equity of UAH 7.517 thousand by issuing 180,000 shares with a nominal value of UAH 10 per share and an issue price of UAH 41.76 per share.

On 16 September 2011 the Ukrainian companies concluded share purchase agreements in accordance with the terms and conditions described above. The respective Memorandums of Association accounting for the capital increases were registered on 26 September 2011, and on 13 October 2011 share registration certificates were issued. The increased share capital of PZU Ukraine is UAH 17,954 thousand, and of PZU Ukraine Life - UAH 18,701 thousand.

# 6. Commentary to segment reporting

## 6.1 Property and personal (non-life) insurance

***Table 21: Income statement data – non-life insurance***

PLN'000

| Income statement data – non-life insurance | 1 January – 31 December 2011 | 1 January – 31 December 2010 | % change |
|---|---|---|---|
| Gross written premium, including: | 8 529 156 | 8 029 327 | 6.2% |
| external | 8 527 492 | 8 028 481 | 6.2% |
| intrasegmental | 1 664 | 846 | 96.7% |
| Net premium earned | 8 138 989 | 7 700 289 | 5.7% |
| Net result on investing activities* | 2 650 750 | 4 086 694 | (35.1)% |
| Net claims and benefits | (5 507 572) | (5 779 968) | (4.7)% |
| Acquisition costs | (1 539 194) | (1 510 903) | 1.9% |
| Administrative expenses | (696 851) | (748 725) | (6.9)% |
| **Operating profit/(loss)** | **2 726 518** | **3 613 184** | **(24.5)%** |

** including dividend from PZU Życie of PLN 1,987,282 thousand in 2011 and PLN 3,120,000 thousand in 2010 respectively*

In the non-life sector, 96.7% of gross written premium (excluding intrasegment adjustments) constituted premium collected by PZU. The remaining share comprised premium written by PZU Ukraine and PZU Lietuva.

As of 1 January 2011, PZU introduced a change consisting of recognizing revenue from premium written on the date of concluding the insurance contract instead of on the date of commencement of insurance cover. Additionally, the date of recognizing commission expense relating to the underwritten contracts was changed in an identical manner.

The change had no impact on the consolidated results or on the consolidated net assets of the PZU Group as it was offset by changes in the principles for calculating unearned premium reserves and for deferring acquisition costs.

Gross written premium in the non-life segment (after intrasegmental adjustments) for the year ended 31 December 2011 and 31 December 2010 amounted to PLN 8,527.5 million and PLN 8,028.5 million respectively. Motor insurance constituted 62.8% of the premium collected by PZU, i.e. 0.5 p.p. more than in 2010. Sales of motor liability insurance increased by PLN 295.0 million – in the mass client segment +13.1%, and in the corporate client segment +2.0% - mainly due to the increases in tariffs effected in 2010. In AC insurance, written premium increased by PLN 36.8 million – in the mass client segment, premiums increased by 3.8%, and in the corporate client segment dropped by 3.4% in connection with the profitability improvement policy (verification of unprofitable clients).

***Table 22. Written premium recognized by date of underwriting the policy – non-life segment***

PLN'000

| Gross written premium by product groups | 1 January – 31 December 2011 | 1 January – 31 December 2010 | % change |
|---|---|---|---|
| Motor liability insurance, including: | 2 890 917 | 2 595 912 | 11.4% |
| - individual* | 2 485 857 | 2 198 602 | 13.1% |
| - corporate | 405 060 | 397 310 | 2.0% |
| AC insurance, including: | 2 285 214 | 2 248 430 | 1.6% |
| - individual* | 1 640 540 | 1 581 230 | 3.8% |
| - corporate | 644 674 | 667 200 | (3.4)% |
| Total motor insurance | 5 176 131 | 4 844 342 | 6.8% |
| Fire and other property damage insurance | 1 723 671 | 1 621 623 | 6.3% |
| Other liability insurance (cat. 11, 12, 13) | 518 258 | 493 874 | 4.9% |
| Accident insurance (NNW) and others** | 829 181 | 820 662 | 1.0% |
| Total property and personal insurance net of motor insurance | 3 071 110 | 2 936 159 | 4.6% |
| **Total PZU** | **8 247 241** | **7 780 501** | 6.0% |
| Foreign operations*** | 281 915 | 248 826 | 13.3% |
| **Total non-life** | **8 529 156** | **8 029 327** | 6.2% |

** including SMEs*

*** This item includes loan guarantees and other financial insurance, travel insurance, assistance insurance, maritime, rail and air transport insurance.*

**** Gross written premium recognized by date of assuming liability by PZU Ukraine and PZU Lietuva.*

***Table 23. Written premium recognized by date of assuming insurance liability – non-life segment***

PLN'000

| Gross written premium by product groups | 1 January – 31 December 2011 | 1 January – 31 December 2010 | % change |
|---|---|---|---|
| Motor liability insurance, including: | 2 928 946 | 2 590 946 | 13.0% |
| - individual* | 2 505 077 | 2 208 286 | 13.4% |
| - corporate | 423 869 | 382 659 | 10.8% |
| AC insurance, including: | 2 338 058 | 2 257 857 | 3.6% |
| - individual* | 1 669 860 | 1 582 082 | 5.5% |
| - corporate | 668 198 | 675 776 | (1.1)% |
| Total motor insurance | 5 267 004 | 4 848 803 | 8.6% |
| Fire and other property damage insurance | 1 712 046 | 1 625 210 | 5.3% |
| Other liability insurance (cat. 11, 12, 13) | 525 274 | 488 051 | 7.6% |
| Accident insurance (NNW) and others** | 766 051 | 821 872 | (6.8)% |
| Total property and personal insurance net of motor insurance | 3 003 370 | 2 935 133 | 2.3% |
| **Total PZU** | **8 270 374** | **7 783 936** | 6.2% |
| Foreign operations | 281 915 | 248 826 | 13.3% |
| **Total non-life** | **8 552 290** | **8 032 762** | 6.5% |

** including SMEs*

*** This item includes loan guarantees and other financial insurance, travel insurance, assistance insurance, maritime, rail and air transport insurance.*

The drop in claims in the non-life sector of PLN 272.4 million resulted mainly from the absence of large natural disaster claims (in particular compared with the snow and flood claims in 2010). In the first half of the year the number of claims related to the effects of the poor condition of crops after winter increased, but had an insignificant effect on the results.

Income from investing activities in the non-life segment, adjusted by the dividend received from PZU Życie in 2011 and in 2010 amounted to PLN 663.5 million and PLN 966.7 million respectively. The drop in the "net change in fair value of assets and liabilities measured at fair value" was caused mainly by the bear conditions on the financial markets in 2011 (in 2011 the WIG index dropped by 20.8% in 2011, whereas in 2010 it grew by 18.8%). This drop was partly offset by an increase in "Net investment income" net of the dividend from PZU Życie (an increase of PLN 95.4 million) – the effect of the positive impact of foreign exchange differences on interest income on financial instruments denominated in EUR (in 2011 on an annual average the PLN weakened against the EUR by 3.1% contrary to its strengthening against the EUR of 1.7% in 2010).

In 2011 acquisition costs in the non-life segment increased by PLN 28.3 million (+1.9%) compared with the prior year as a result of an increase in sales, changes in the structure of distribution channels (an increase in the share of commission channels compared with non-commission bearing automatic renewals) and an increase in additional commissions (additional commissions supporting the effectiveness of agents and multi-agents conditioning their remuneration on the achievement of assumed goals and sales profitability).

In 2011 a model for allocating indirect costs to particular insurance products according to activity based costing (ABC method) was implemented in PZU, which led to transfers of particular costs between cost categories such as acquisition, administration, loss adjustment and investing activities. This has no impact on the overall volume of the indirect costs. The model assumptions were described in chapter 3.2.2.1 of the consolidated financial statements of the PZU Group. The ABC method led to changes in the cost structure in the years 2011 and 2010:

- administrative expenses dropped by PLN 245.6 million and PLN 221.7 million respectively;
- acquisition costs increased by PLN 133.5 million and PLN 125.3 million respectively;
- loss adjustment costs increased by PLN 103.4 million and PLN 89.1 million respectively;
- other costs increased by PLN 8.7 million and PLN 7.3 million respectively.

The deterioration in the balance of other operating income and expenses of PLN 185.4 million was mainly due to:

- adjusting the estimated settlements of reinsurers' commissions and shares in profit of PLN 91.8 million;
- setting up restructuring provisions of PLN 73.3 million;
- setting up provisions for the costs of the penalty imposed by Urząd Ochrony Konkurencji i Konsumentów (Office for Competition and Consumer Protection – "UOKiK") (for applying thepractice of limiting competition on the domestic market for sales of group NNW insurance to children, adolescents and personnel in educational establishments referred to in Note 52.1.2.2. of the consolidated financial statements of the PZU Group) of PLN 56.6 million.

Operating profit in the non-life insurance segment in 2011 and in 2010 amounted to PLN 2,726.5 million and PLN 3,613.2 million respectively. The PLN 886.7 million (24.5%) drop resulting from deteriorated results on investing activities (mainly lower dividend received from PZU Życie and a drop in prices of financial instruments on capital markets) and higher other operating expenses was partly offset by an increase in net premium earned and lower claims.

***Impact of one-off events on operating results***

In 2011, in the property insurance segment, no one-off events were noted which would have an impact comparable to those in the prior year (flood and snow claims). The events with a significant impact on the results for the period comprised:

- payment of claims in crop insurance – frost and poor conditions of crops after winter of PLN 128.4 million;
- setting up a provision for disputed settlements in respect of reinsurers' commissions and shares in profits of PLN 91.8 million;
- setting up provisions for the costs of the penalty imposed by Urząd Ochrony Konkurencji i Konsumentów (Office for Competition and Consumer Protection – "UOKiK") (for applying a

practice of limiting competition on the domestic market for sales of group NNW insurance to children, adolescents and personnel in educational establishments) of PLN 56.6 million.

***Assets covering technical reserves according to PAS - PZU***

The listing of PZU assets covering technical reserves according to PAS as at 31 December 2011 is presented in Table 24. The requirements for covering technical reserves with assets are specified in art. 154 and 155 of the Act on insurance activities. As at the end of 2011, the degree of coverage of the technical reserves with assets amounted to 127.0% (130.4% as at the end of 2010).

In accordance with the letter from KNF no. DN2/107/4/2004 MP dated 25 March 2004, PZU may include the share of technical reserves ceded to AXA France IARD in assets constituting the coverage for technical reserves in an amount exceeding 5% of the reserves.

***Table 24. Assets covering technical reserves in PZU***

PLN'000

| Description | Total | % RTU | Maximum limit % |
|---|---|---|---|
| **A. Technical reserves** | **14 572 028** | **100,0%** | |
| **B. Total assets** | **18 510 626** | **127,0%** | |
| 1. securities and bonds issued or warranted or guaranteed by the State Treasury, local authorities or associations of local authorities | 14 717 777 | 101.3% | no restrictions |
| 2. other fixed-income securities | 191 904 | 1.3% | 10% |
| 3. shares | 817 691 | 5.6% | 40% |
| 4. properties or their parts, with the exclusion of properties or their parts used for internal purposes | 68 672 | 0.5% | 25% |
| 5. bank deposits | 1 022 963 | 7.0% | no restrictions |
| 6. Receivables | 695 034 | 4.8% | 25% |
| 7. receivables from the State | 5 476 | 0.0% | no restrictions |
| 8. fixed assets other than properties, if they are depreciated at rates determined according to the prudence principle | 86 693 | 0.6% | 5% |
| 9. Cash and cash equivalents | 72 895 | 0.5% | 3% |
| 10. Deferred acquisition costs | 493 180 | 3.4% | no restrictions |
| 11. Ceded technical reserves | 338 341 | 2.3% | 25% |
| **C. Excess/(shortage) of assets for covering the technical reserves** | **3 938 598** | **27.0%** | |

** the given maximum limit is the maximum limit for covering technical reserves in receivables from assignors, reinsurers, insurants, insurance intermediaries and the ceded share of technical reserves, in total.*

## 6.2 Life insurance

***Table 25. Income statement data – life insurance***

PLN'000

| Income statement data – life insurance | 1 January – 31 December 2011 | 1 January – 31 December 2010 | % change |
|---|---|---|---|
| Gross written premium | 6 751 770 | 6 512 541 | 3.7% |
| Net premium earned | 6 752 929 | 6 514 124 | 3.7% |
| Net result on investing activities | 876 400 | 1 689 026 | (48.1)% |
| Net claims and benefits | (4 719 185) | (4 603 935) | 2.5% |
| Acquisition costs | (333 984) | (295 695) | 12.9% |
| Administrative expenses | (609 106) | (653 399) | (6.8)% |
| **Operating profit/(loss)** | **1 880 259** | **2 591 639** | **(27.4)%** |

***Table 26. Premium written by product group – life insurance segment***

PLN'000

| Premium written by product group – life insurance segment | 1 January – 31 December 2011 | 1 January – 31 December 2010 | % change |
|---|---|---|---|
| Group insurance | 4 349 809 | 4 170 331 | 4.3% |
| Retail insurance, including: | 2 401 961 | 2 342 210 | 2.6% |
| - continued individual insurance | 1 829 243 | 1 797 331 | 1.8% |
| – other individual insurance | 572 718 | 544 879 | 5.1% |
| **Total life insurance segment** | **6 751 770** | **6 512 541** | **3.7%** |

***Table 27. Premium written by type of payment – life insurance segment***

PLN'000

| Premium written by type of payment – life insurance segment | 1 January – 31 December 2011 | 1 January – 31 December 2010 | % change |
|---|---|---|---|
| Regular premium | 6 522 780 | 6 356 029 | 2.6% |
| Single premium | 228 990 | 156 512 | 46.3% |
| **Total life insurance segment** | **6 751 770** | **6 512 541** | **3.7%** |

The increase in gross written premium of PLN 239.2 million (3.7%) resulted mainly from the development of protective group insurance (an increase in average premium and in the number of insured) and from the growing sales of endowment insurance with a single premium in the bancassurance channel. An increase was also noted in premiums collected on Employee Pension Funds and health insurance underwritten in group form. In individually continued insurance premium, dynamics were achieved mainly due to upselling additional insurance (the number of insured dropped, mainly in D-type closed portfolio of continued insurance). The significant premium dynamics in individual insurance was the result of:

- developing a protection-linked savings and investment product with a regular premium “Plan na Życie” introduced to the offer in 2010;
- conducting six subscriptions of structured insurance with a single premium “Świat Zysków”;
- introducing, in cooperation with Bank Millenium SA, a new individual unit-linked product with a single premium;
- an increase in interest in the IKE (individual pension account) product;
- introducing an additional insurance package “PZU Ochrona Rodziny” (family protection) to the offer.

These changes were partly offset by the expiry of the endowment insurance portfolio underwritten in the 1990s.

The increase in net claims and benefits paid and the change in technical reserves of PLN 115.3 million (2.5%) was due to an increase in payments of endowment benefits of PLN 171.7 million (+55.5%) with a significant drop in reserves in insurance where the investment risk is borne by the insurant in 2011 (a technical loss in this group of investments) compared with the strong growth in 2010.

Gross claims and benefits with a change in gross technical reserves increased by PLN 290.2 million mainly as a result of higher benefits in group protective insurance (a small controlled growth in loss ratio), an increase in endowment benefits in short-term products of an investment nature, partly offset by a change in the actuarial reserve, higher endowment benefits from insurance underwritten in the 1990s, a drop in benefits in the continued portfolio and a lower value of insurance benefits from the so-called “old portfolio”.

The difference in the change in technical reserves (PLN -174.9 million) results mainly from a drop in the balance of reserves where the investment risk in borne by the insurant in 2011 as a result of a loss on investing activities compared with a significant increase in 2010. This effect was partly offset by a slowing in the rate of conversion of multi-year policies into annual renewable policies in protective group insurance (the conversion effect on technical reserves in protective group insurance in 2011 translated into releasing PLN 406.1 million of reserves, whereas in the prior year it was PLN 520.3 million), and a faster pace of increase in the actuarial reserve in continued insurance due to the ageing of the portfolio.

Income from investing activities in the life segment, adjusted by the dividend received from PTE PZU in 2011 and in 2010 amounted to PLN 876.4 million and PLN 1,689.0 million respectively. The drop in the “net change in the fair value of assets and liabilities measured at fair value” was caused mainly by the bear conditions on the financial markets in 2011 (in 2011 the WIG index dropped by 20.8% in 2011, whereas in 2010 it grew by 18.8%).

Acquisition costs in the life insurance segment in 2011 and 2010 amounted to PLN 334.0 million and PLN 295.7 million respectively. The 38.3 million (12.9%) change results mainly from:

- an increase in commission paid in respect of protective group insurance as a result of an increase in the portfolio and a growing share of premium underwritten through the brokerage channel, where the growth trend in the share of premium underwritten through this channel in the total gross written premium slowed significantly compared with prior years;
- an increase in commission in protective insurance distributed through the bancassurance channel due to the payment of their share in profits;
- an increase in commission in the savings and investment product with a protection element and regular premium "Plan na Życie" – the commission is prepaid.

Administrative expenses in the life insurance segment dropped by PLN 44.3 million (-6.8%), which was the effect of economizing, including reduction in employment and the fixed costs optimization program conducted in the PZU Group.

Other net operating income and expenses in the life insurance segment amounted to PLN -86.8 million and PLN -58.5 million in 2011 and 2010 respectively. The net change in the balance of other operating income and expenses of PLN 28.3 resulted, among other things, from implementing the statutory ban on open pension fund acquisition which was connected with discontinuing the distribution agreement with PTE PZU SA and a loss of part of the income in this respect. Additionally, as at 31 December 2011 the value of the provision for restructuring amounted to PLN 26.0 million, which meant an increase in the said provision of PLN 3.4 million in 2011 (when in 2010 it dropped by PLN 13.4 million).

In 2011 operating profit in the life insurance segment dropped by PLN 711.4 million (27.4%), mainly as a result of losses incurred on the equity part of the investment portfolio.

***Impact of one-off events on operating results***

In the life insurance segment no one-off events were noted which would have a significant impact on the operating results of the segment either in 2011 or in 2010.

***Assets covering technical reserves according to PAS – PZU Życie***

The listing of PZU Życie assets covering technical reserves according to PAS as at 31 December 2011 is presented in Table 28. The requirements for covering technical reserves with assets are specified in art. 154 and 155 of the Act on insurance activities. As at the end of 2011, the degree of coverage of the technical reserves with assets amounted to 106.9% (112.4% as at the end of 2010).

***Table 28. Assets covering technical reserves in PZU Życie***

PLN'000

| Description | Total | % RTU | Maximum limit % |
|---|---|---|---|
| **A. Technical reserves** | **22 059 093** | **100.0%** | |
| **B. Total assets** | **23 570 734** | **106.9%** | |
| 1. securities and bonds issued or warranted or guaranteed by the State Treasury, local authorities or associations of local authorities | 17 121 571 | 0.4% | no restrictions |
| 2. other fixed-income securities | 112 764 | 0.4% | 10% |
| 3. participation units or investment certificates in investment funds | 3 559 863 | 11.3% | 40% |
| 4. borrowings | 60 964 | 0.3% | 5% |
| 5. bank deposits | 2 146 588 | 10.6% | no restrictions |
| 6. receivables from insurants following from insurance contracts concluded with the exception of receivables which matured more than 3 months ago | 46 053 | 0.2% | 25% |
| 7. cash and cash equivalents | 116 926 | 0.6% | 3% |
| 8. liabilities in respect of transactions concluded on the financial market | (34 735) | (1.0)% | no restrictions |
| **C. Excess/(shortage) of assets for covering the technical reserves** | **1 511 641** | **6.9%** | |

## 6.3 Investment contracts

Investment contracts concluded by PZU Życie are shown in the segment "Unallocated (consolidation eliminations and other)". Investment contracts are accounted for under the deposit method, in consequence the transaction volumes from investment contracts do not constitute revenues according to IFRS.

***Table 29. Transaction volumes from investment contracts by product group***

PLN'000

| Transaction volumes from investment contracts by product group | 1 January – 31 December 2011 | 1 January – 31 December 2010 | % change |
|---|---|---|---|
| Group | 2 293 916 | 1 897 092 | 20.9% |
| Individual, including: | 760 434 | 890 566 | (14.6)% |
| - individual, continued | - | - | - |
| – other individual | 760 434 | 890 566 | (14.6)% |
| **Total** | **3 054 350** | **2 787 658** | **9.6%** |

*Table 30. Transaction volumes obtained from investment contracts*

PLN'000

| Transaction volumes obtained from investment contracts | 1 January – 31 December 2011 | 1 January – 31 December 2010 | % change |
|---|---|---|---|
| Regular payments | 7 446 | 7 136 | 4.3% |
| Single payments | 3 046 904 | 2 780 522 | 9.6% |
| **Total** | **3 054 350** | **2 787 658** | **9.6%** |

Transaction volumes obtained from investment contracts in 2011 and in 2010 amounted to PLN 3,054.4 million and PLN 2,787.7 million respectively. The PLN 266.7 million (9.6%) increase resulted mainly from higher sales of short-term endowment products both in the banking channel and in the proprietary channel. This change was partly offset by a drop in sales of unit-linked investment products distributed via the banking channel.

## 6.4 Activities in the area of pension funds

*Table 31. Selected results – the pension segment*

PLN'000

| Data from the consolidated income statement – pension insurance | 1 January – 31 December 2011 | 1 January – 31 December 2010 | % change |
|---|---|---|---|
| Fee and commission income | 231 638 | 246 915 | (6.2)% |
| Net result on investing activities | 12 563 | 16 121 | (22.1)% |
| Acquisition costs | (81 559) | (48 738) | 67.3% |
| Administrative expenses | (73 091) | (93 119) | (21.5)% |
| Operating profit/(loss) | 90 447 | 122 446 | (26.1)% |
| **Net profit/(loss)** | **73 735** | **99 571** | **(25.9)%** |

Fee and commission income in the pension segment in 2011 and 2010 amounted to PLN 231.6 million and PLN 246.9 million. The PLN 15.3 million (-6.2%) drop resulted mainly from a drop in the level of contributions transferred from ZUS (Social Insurance Institution) to OFE PZU from 7.3% to 2.3% of base pension insurance contributions (as of May 2011).

The increase in acquisition costs of PLN 32.8 million (67.3%) resulted mainly from settling the commission expense and an impairment write-down in respective assets in 2011 in connection with the drop in contributions transferred by ZUS to OFE PZU. Administrative expenses of PTE PZU dropped by PLN 20.0 million (-21.5%), which was mainly the effect of lower costs of the ZUS fee collected on contributions transferred to OFE PZU, and lower payments to the Guarantee Fund.

Operating profit dropped by PLN 32.0 million (-26.1%) and reflected the drop in fee and commission income and increase in operating expenses.

# 7. Risk factors which may have an impact on financial results in future periods

## 7.1 Property and personal (non-life) insurance

The risk factors which could have an impact on non-life insurance segment results in 2012 comprise mainly:

- the economic slowdown or stagnation which could give rise to an increased loss ratio on the financial insurance portfolio;
- the possible increase in the unemployment rate in 2012 and lower dynamics of retail consumption translating into a change in demand for insurance products;
- price pressure from competitors;
- increasing loss ratios, and specifically the loss frequency;
- an increase in the insurance brokers' role which could lead to increased acquisition costs;
- fluctuations in the return on Treasury securities dependent on the economic position of Poland and European Union countries - a drop in returns on the securities could lead to a drop in returns on investments and the potential need to change the technical rates applied by the company;
- the behaviour of the capital markets in 2012, and specifically of the WSE – part of the Company's investment income depends on the trends on this market;
- absence of a precisely defined scope of exemptions relating to e.g. medical insurance services in the amended Act of 11 March 2004 on Value Added Tax (Journal of Laws No. 54 of 2004, item 535 as amended);
- small flexibility of many product applications operating in PZU Group companies, hampering quick adaptation to changing market requirements;
- possible changes (amended regulations) in the principles of valuation of reserves for capitalized value of annuities – this could lead to the need to increase the level of prudence and an increase in the reserves;
- the growing average cost of personal claims resulting, among other things, from the growing share of non-public healthcare and the impact of monetary compensation on behalf of members of the deceased's family (art. 446 § 4 of the Act of 23 April 1964 the Civil Code (Journal of Laws No. 16 of 1964, item 93 as amended, "Civil Code")), which could lead to the need to increase reserves in motor liability insurance;
- the risk of an increase in the number and value of claims from clients and injured parties in connection with the Act of 17 December 2009 on pursuing claims in group proceedings (Journal of Laws No. 7 of 2010, item 44 as amended);
- changes in bank regulations which may have an impact on the reduction in the number of mortgage loans granted and borrowers' insurance.

## 7.2 Life insurance

The factors which could have an impact on PZU Życie's results in 2012 comprise mainly:

- the possible increase in the unemployment rate in 2012 and lower retail consumption dynamics translating into a change in the demand for insurance products;
- potential increase in competition in group insurance due to an increase in the role of brokers in this segment and the requirement to conduct tender procedures for group insurance by entities subject to the Act of 29 January 2004 on Public Procurement (Journal of Laws No. 223 of 2007, item 1655 "Act on Public Procurement");
- changes in the financial intermediation market, slowdown in the growth of popularity of independent financial advisory services thus limiting the number of channels for selling insurance products;
- fluctuations in the return on Treasury securities dependent on the economic position of Poland and European Union countries - a drop in returns on the securities could lead to a drop in returns on investments and the potential need to change the technical rates applied by PZU Życie and the amount of European Embedded Value;
- the behaviour of the capital markets in 2012, and specifically of the WSE – part of the Company's investment income depends on the trends on this market;
- all changes in universally binding legal regulations or their interpretation in the area of the technical servicing of group insurance by people designated for the task by insurants;
- changes in the current level of mortality and morbidity;
- small flexibility of many product applications operating in PZU Group companies, hampering quick adaptation to changing market requirements and the possibility of servicing some of the products within a timescale allowing efficient competition in the area of new investment products;

## 7.3 Pension funds

The risk factors which could have an impact on PTE PZU's results in 2012 comprise mainly:

- possible changes in the pension insurance system leading to a drop in the amount of pension contribution transferred by ZUS to OFE, creating sub-funds and acquisition principles on the market;
- possible increase in the unemployment rate in 2012 translating into a lower number of members acceding OFE;
- a low rate of increase in remuneration leading to the lower dynamics of contributions paid in by members of the pension funds;
- changes in the financial intermediation market, slowdown in the growth of popularity of independent financial advisory services thus limiting the number of sales channels;

- fluctuations in the return on Treasury securities dependent on the economic position of Poland and European Union countries - a drop in the returns on securities could lead to a drop in the returns on OFE PZU investments and management fees collected by PTE PZU;
- the behaviour of the capital markets in 2012, and specifically of the WSE – part of the OFE PZU investment income depends on the trends on this market which translates into the value of assets and amount of management fees collected by PTE PZU;

## 8. Management position on the previously published forecast results

The PZU Group did not publish forecasts of separate or consolidated financial results.

# D. PZU GROUP'S OPERATIONS IN 2011

## 9. Operations, key development directions and achievements of the PZU Group

### 9.1 Rating

PZU and PZU Życie are rated on a regular basis by the rating agencies. The rating granted to PZU and PZU Życie is an evaluation following from an analysis of the financial data, the competitive position, management and corporate strategy. The rating also includes a rating outlook, i.e. the future assessment of the company's position if specific circumstances arise.

As at the date of this Directors' Report the PZU Group both companies had a long-term credit rating and a financial strength rating (awarded by Standard & Poor's Ratings Services on 16 July 2009) of level A with a stable outlook. On 22 July 2011 Standard & Poor's Ratings Services upheld the above rating.

The table below shows the ratings granted to PZU and PZU Życie by Standard&Poor's with the ratings awarded a year earlier.

***Table 32. PZU and PZU Życie rating***

| Name | Rating and outlook | Date of update | Previous rating and outlook | Date of previous update |
|---|---|---|---|---|
| **PZU** | | | | |
| Rating of financial strength | A /stable/ | 22 July 2011 | A /stable/ | 5 July 2010 |
| Rating of creditworthiness | A /stable/ | 22 July 2011 | A /stable/ | 5 July 2010 |
| **PZU Życie** | | | | |
| Rating of financial strength | A /stable/ | 22 July 2011 | A /stable/ | 5 July 2010 |
| Rating of creditworthiness | A /stable/ | 22 July 2011 | A /stable/ | 5 July 2010 |

### 9.2 PZU's operations in 2011

#### 9.2.1 Sales

PZU offers a wide scope of property and personal insurance products, in particular motor, personal, agricultural and general liability insurance. As at the end of 2011, PZU offered over 200 insurance products. Motor insurance is the most important group of products offered by PZU, both in terms of the number of binding insurance contracts and the share of written premium in total gross written premium of PZU.

In 2011 PZU's activities concentrated mainly on improving returns on the corporate insurance portfolio and proactive sales of insurance for mass clients.

***Products – mass client***

- In 2011 motor insurance tariffs for individual clients and SMEs changed several times to adapt them to market conditions, and specifically to growing costs.
- Introducing the Premium Security Option in motor insurance is a novelty in PZU. The clients who buy this additional option to comprehensive and motor liability insurance will retain the bonus-malus deduction if an insured event occurs.
- tools for quoting and servicing fleet insurance of small and medium enterprises were developed.
- Tools enabling verification of the declaration of the insurance history were implemented (submitted by new clients upon underwriting a motor liability or comprehensive insurance contract) using the data of the Information Centre of the Insurance Guarantee Fund (Ośrodek Informacji Ubezpieczeniowego Funduszu Gwarancyjnego).
- In respect of property insurance a new version of home insurance was implemented PZU DOM and PZU DOM Plus, covering among other things PZU Pomoc w domu (help at home) insurance. Prices of home insurance were also adapted to flood risk in particular parts of the country, and at the same time an option to eliminate flood cover from the standard insurance contract was eliminated.
- The basic offer for SME clients was modified – the PZU Doradca (advisor) package. The changes were aimed at extending the availability of the product on all SME clients and improving the profitability of insurance. Depending on client needs, insurance may be expanded by assistance services and insurance of risks specific for a given business (such as the PZU HOTEL clause addressed to clients in the hotel and catering industry).
- Due to the high loss ratio in the mandatory subsidized insurance of agricultural cultivation, in the autumn season of 2011, changes were made to the offer of such insurance aimed at improving profitability.
- In accordance with amendments to legislation (package of health acts) a new offer was prepared for mandatory and voluntary insurance for healthcare facilities. Modifications to the insurance of payers of public benefits were introduced and the option to also insure other professional groups was introduced in respect of financial losses arising in connection with performing the function.
- In NNW insurance PZU Pomoc w Podróży (travel assistance) was added to the offer, covering insurance of the costs of treatment and assistance for people travelling in Poland and abroad. Special insurance for Euro 2012 Football Cup fans was also created, offered with Polish Pass cards.

***Products – corporate client***

- In accordance with the adopted strategy, PZU continued actions aimed at further improving the profitability of motor insurance (AC and motor liability), among other things through changing tariffs and modifying the general insurance terms and conditions for comprehensive insurance of corporate clients. As a result of the actions already conducted, there is a noticeable significant improvement in the technical results.

- In the area of property insurance as part of the activities related to improving profitability and portfolio quality, the essential role of underwriting was maintained through:
    - further limitation of sales to entities from high loss ratio industries;
    - improving the efficiency of the selection process, classification and risk assessment (including flood risk);
    - wider application of additional clauses and other technical insurance restrictions changing the scope of insurance.
- In general liability insurance, new risk assessment tools were applied and changes were introduced to the terms and conditions of insurance and quotation principles.

***Products – financial insurance***

- In 2011 two new products were added to the offer:
    - performance bond for removing and adjusting negative effects on the environment and environmental damage (the so-called environmental performance bond);
    - an insurance guarantee for the user contract in respect of accounts with deferred payments (the so-called e-toll guarantee).
- In respect of insuring monetary receivables and bank loans, a policy was pursued aimed at securing the portfolio held and earning a technical profit. This was realized by using restrictive risk assessment criteria, hedging the transactions concluded and maintaining safe legal regulations in the contracts concluded.

***Products – bank insurance***

- In 2011 cooperation was continued with its current business partners – lead banks on the Polish market – such as PKO BP SA, ING Bank Śląski SA, Bank Millennium SA, BGŻ SA. The offer was supplemented by new insurance being added to banking products, such as protection programs for payment cards and insurance of buildings and apartments added to mortgage loans and advances.
- Cooperation was continued with partners with large client bases or those handling mass payments such as telecoms, power companies and commercial chains. It comprised several new, specialized insurance products such as mobile phone and notebook insurance, insurance of loan repayment in case of loss of one's job.

***Sales network***

The organization of PZU's sales network is aimed at guaranteeing maintenance of high sales effectiveness while simultaneously ensuring high quality services. This is achieved by organizing sales in two dimensions:

- division by distribution channels;
- client segmentation.

As at 31 December 2011, PZU offered products in the following distribution channels:

- exclusive agents – PZU's own agent network:
    - office agents (347; sales-supporting agents in PZU's own outlets);
    - agents operating locally exclusively on a mobile basis (5,686);[6]
    - Group Agencies (6; pilot program – agents managing stationary outlets);
- multiagencies – agents cooperating with several insurance companies (2,215);[7]
- insurance brokers (ca. 800);
- bancassurance – sales via banks and other partners for whom insurance sales are an auxiliary activity;
- direct – telephone and Internet sales;
- PZU employees – sales in own outlets (470 people).

***General terms and conditions of insurance***

The general insurance terms and conditions are provided on the PZU website (www.pzu.pl) and in particular PZU outlets. In accordance with the Act on insurance activities, general insurance terms and conditions should be provided to the insurant before the insurance contract is concluded.

In accordance with the Regulations of the PZU Management Board, tariffs for mandatory and voluntary insurance are passed in the form of a resolution.

***Insurance contracts exceeding 25% of the total RTU and equity amount of PZU***

During the 12 months ended 31 December 2011, PZU did not conclude any insurance contracts for a sum of one net risk insured exceeding 25% of the total amount of technical reserves and equity.

### 9.2.2 Claims adjustment

In 2011 as part of the process of improving the loss adjustment effectiveness in motor insurance, the following actions were taken:

- electronic flow of documents was introduced;
- a procedure was implemented for simplified claims adjustment in a vehicle;
- cooperation started with ControlExpert in respect of automating the verification of the motor claims valuation process;
- a pilot solution was implemented to improve management of the PZU Repairs Network;
- a telephone service was launched "Proposed Vehicle Sales" in respect of partial damage to vehicles in motor liability insurance;

[6] Including dealers cooperating with PZU on the basis of exclusive contracts (182)

[7] Including dealers cooperating with PZU on the basis of multiagency contracts (964)

- the process for renting substitute cars was centralized for motor liability claims;
- an auction platform was launched to trade in vehicle remains after vehicles have been totally damaged.

The following changes took place in respect of property loss adjustment in 2011:

- electronic flow of claims documents was introduced;
- the loss adjustment system (SLS) was integrated with the expert claims valuation systems in buildings;
- a simplified system for valuing claims in buildings was implemented;
- new tools were used for property loss adjustment (among other things, Mini Mobile PZU Assistance Office).

In the area of personal loss adjustment, the following actions were conducted:

- a new model for cooperation with certifying physicians was implemented – four entities providing medical services for the purpose of certifying claims in motor liability and NNW were selected and cooperation with them commenced;
- a program for mental rehabilitation groups for children injured in motor accidents was implemented (under cooperation with Dom Misia Ratownika);
- a system automating payment of annuities was implemented.

## 9.3 PZU Życie's operations in 2011

### 9.3.1 Sales

PZU Życie offers a wide scope of life insurance products, and specifically protective group insurance, individual insurance and insurance offered in cooperation with banks. Protective group insurance constitute the most important group of products in terms of the share of gross written premium in the total gross written premium in PZU Życie.

***Products – group insurance***

In 2011, in the area of group insurance work was conducted related to the re-tariffication of group insurance, the effects of which were implemented as of 1 January 2012:

- new tariffication levels which will enable an increase in the price flexibility of the offers and systemizing the amount of discounts and the variability of commissions;
- new additional group insurance of rights to individual continuation of insurance with three types of continuation guarantees differentiated in terms of the amount of premium for the right to continue in the group phase and in the continuation phase;

- changes in the offer for group employee insurance of the P Plus type dedicated to the SME sector PZU Ochrona Plus (among other things: adding to the additional insurance offer, a guarantee of continuation in all protection packages).

The Company also emphasized the need to develop the PZU Club "Pomoc w Życiu" (help in life), which as at the end of 2011 had 2 million members. At the same time PZU Życie continued work on expanding its offer for Club members.

In 2011 PZU Życie continued to participate in the submission of tender offers for group insurance. In connection with the duty of applying the requirements resulting from the Act on Public Procurement to submitting orders for insurance services, there has been a visible increase in the number of public employers who have decided to apply tender procedures.

In continued group and individual insurance additional insurance with Karta Apteczna (Pharmacy Card) (general insurance terms and conditions – "OWU" – and the Regulations) were adapted to the amendments made as of 1 January 2012 to the Act of 6 September 2001 Pharmaceutical Law (Journal of Laws 126 of 2001 item 1381 as amended).

***Products – individual insurance***

In connection with the new legal regulations introducing the additional possibility of saving funds for retirement with financial relief, in 2011 PZU Życie conducted work on introducing a new product to the offer – an individual retirement security account (Indywidualne Konto Zabezpieczenia Emerytalnego - "IKZE"). As a result, as of 2 January 2012, the IKZE product was launched on the market and is directed to current and new clients. An indisputable merit of IKZE is the possibility of acquiring current tax relief by deducting the amounts paid to IKZE in a given year from the tax base.

In 2011 the sales of Plan na Życie insurance were continued, offering the possibility of investing and saving in insurance unit-linked funds which enjoy huge client interest. Under the "Plan na Życie" product clients may regularly invest their funds in investment funds or may use model funds and additionally set protection at a selected level – which given large freedom in managing one's contract.

In 2011, in connection with the continued interest in structured products observed on the market, PZU Życie's consistently pursued objective is the constant presence of those products on the market. Through the "Świat Zysków" insurance PZU Życie offers its Clients products that are an alternative or supplementary to other investment products. In 2011 six consecutive successful subscriptions of the product with different investment strategies were conducted. The insurance is still in the offer and in 2012 further subscriptions are planned. To better adapt the investment strategies proposed as part of the product to changing economic conditions and Client needs, it was decided to increase the number of subscriptions and shorten their duration.

In January 2011, a new product was launched which expanded the protection offer of PZU Życie, under the name "PZU Ochrona Rodziny" (family protection). This insurance is addressed to current clients who have unit-linked insurance, fixed term insurance and "Plan na Życie" insurance. The contract is constructed so as to ensure wide protection against various effects of accidents.

***Products – individual insurance for the banking channel***

In 2011 the product offer was being further developed under cooperation with former business partners and new banks.

In connection with the observed volatility on the financial markets, investment products with attractive potential returns and full capital protection gained interest – this was mainly structured insurance. The offer of products distributed jointly with the current partners was expanded. A new type of product was introduced in Bank Handlowy w Warszawie SA under consecutive subscriptions to structured insurance – autocall. In Bank Millennium SA a new, multicurrency unit-linked product was introduced, under which modern model funds and a guarantee fund were launched.

Endowment insurance with a single premium had the largest share in written premium (so-called "poliso-lokaty" (investment policies)). In accordance with the adopted strategy, the possibility of offering this type of product depends on the scope of cooperation with a given Partner in respect of other product lines.

In the area of protective insurance, cooperation with PKO BP SA was expanded by life insurance for borrowers of mortgage loans. In respect of other protective products, the Group concentrated on maintaining the current insurance portfolio and on work related to the planned implementation of insurance for consumer finance and mortgage banking clients.

***Products – health insurance***

In 2011 the product offer continued to be developed in the area of health insurance, concentrating on the area of group products directed at non-standard offers for corporate clients.

In the 3rd quarter of 2011 the group insurance offer was expanded by products based on the "fee for service" settlement model, due to a new medical service provider PZU Pomoc SA. Also in the second half of the year, under the Healthcare (Opieka Medyczna) product line, a pilot comprehensive health insurance program was adopted in respect of refunding drugs, organized in cooperation with the Polish Pharmaceutical Group (Polska Grupa Farmaceutyczna).

***Sales network***

The Company engages in sales of insurance both via its proprietary network and an agency network. Additionally, distribution channels, which are modern and popular on the Polish market, are used such as the banking channel or direct mailing. The key distribution channels are as follows:

- Corporate sales – employees of PZU Życie, whose key task is to sell and maintain the group insurance portfolio;
- Agency sales – a network of ca. 2.3 thousand exclusive agents and 181 Sales Team Managers, whose actions are aimed at selling group and individual insurance and maintaining and servicing the individual insurance portfolio;
- A network of proprietary outlets – a network of common PZU SA and PZU Życie outlets, which apart from the service functions also serve the selling functions, in particular in individual insurance (including individually continued cover);

- Direct sales – a distribution channel used to acquire individually continued insurance clients (including up-selling additional insurance);
- The banking channel – a network of banks in cooperation with which the Company distributes a wide scale of investment and protective products.

***General terms and conditions of insurance***

The general terms and conditions of insurance are provided on the PZU website (www.pzu.pl) and in particular PZU customer service points. In accordance with the Act on insurance activities, the general terms and conditions of insurance should be provided to the policyholder before the insurance contract is concluded.

In accordance with the Regulations of the PZU Życie Management Board, tariffs for mandatory and voluntary insurance and general terms and conditions of insurance are passed in the form of a resolution.

### 9.3.2 Benefit claims adjustment

In 2011, under the process of improving the process of benefit claims adjustment, the following actions were taken:

- a new system was implemented in the process of benefit claims adjustment in further product groups (group protection, continued, investment-linked), including total elimination of paper documents for handling claims;
- a new model for cooperation with certifying physicians was implemented – four entities providing medical services for the purpose of certifying benefit claims were selected and cooperation with them commenced;
- a new form of benefit payments was launched – Autowypłata;
- "old portfolio" benefit payments were centralized in a one instance benefit system.

## 9.4 Operations of PTE PZU in 2011

The key project realized in the Company in 2011 was the IKZE project. As a result of statutory changes, universal pension fund management companies were in the group of entities authorized to maintain individual retirement protection accounts (IKZE) and offering respective financial services for clients, related to saving for future retirement as of 1 January 2012. Respective operations will be conducted via the PZU Voluntary Pension Fund established by PTE PZU. PTE PZU was one of the first entities on the market which was allowed to engage in the respective activities by KNF (the decision of 22 November 2011 granting permission to establish Dobrowolny Fundusz Emerytalny PZU), thus approving the Memorandum of Association. The fund managed by PTE PZU was – as the first entity in this segment – entered in the Fund Register on 12 January 2012, thus having the possibility of commencing operating activities. The new product offered by PTE PZU under the 3rd pension insurance pillar enables those who make payments to IKZE to use personal income tax relief up to the amount of the annual limit specified by the regulator.

Acting in the interests of OFE PZU members, the Management Board of PTE PZU decided to change the bank which acts as Depositary, to ING Bank Śląski SA, which on 18 November 2011 obtained a KNF permit. The first day on which ING Bank Śląski SA performed this function was 14 January 2012. The change – while maintaining the former standards of services and security of the funds entrusted by members of OFE PZU - will enable limiting significantly the amount of fees paid on behalf of the Depositary in respect of keeping in trust OFE PZU assets.

## 9.5 Organizational structure of PZU and PZU Życie

The organizational structure of PZU and PZU Życie is based on functional and geographical coordination of tasks. Divisions coordinating particular functions have been developed in PZU and PZU Życie. Such functions include: sales management (for particular customer segments), loss adjustment, management of the distribution network, financial division and support. The geographical coordination is carried out through geographical structures of the companies (regional branches or appropriate structures of divisions/functional areas).

As at 31 December 2011, the organizational structure of PZU and PZU Życie comprised the following organizational units:

- head office – supporting the Management Boards of PZU and PZU Życie in the scope of managing the operations of the PZU Group; it prepares the key assumptions for the operations and organization of the companies in the PZU Group and constitutes the planning and management center;
- specialized units – specialized operational units responsible for mailing customer service and the call center, for managing insurance operations, loss adjustment, accounting and payroll services, administration and logistic support;
- regional branches (9) - with outlets.

Moreover, subsidiaries such as: PZU CO, PZU Pomoc SA, TFI PZU, PZU AM provide services to PZU and PZU Życie covering administration of insurance operations, the call center, loss adjustment and asset management.

## 9.6 IT area

In 2011 the functioning of common consolidated IT structures in the PZU Group stabilized. The following, among other things, were completed:

- the 1st stage of the project for a common ERP class system for PZU and PZU Życie was implemented, which is to gradually take over the currently operating systems;
- the system for supporting the creation of separate and consolidated financial statements was implemented (the Hyperion system);
- the process of automatic loading of policies issued in the sales system to the policy administration system was launched;

- tools were implemented aimed at reducing the costs of technical IT infrastructure and increasing its reliability (such as the process of accelerating the wide area network, tools for monitoring the operations of critical systems, modernizing the data maintenance and backup system).

Moreover, in 2011 several important initiatives were launched which could lead to implementing new IT tools, including commencing work on the project aimed at replacing the key policy system of PZU.

## 9.7 Key marketing activities in 2011

***Advertising, media and the Internet***

In 2011 the PZU Group conducted eight widespread advertising campaigns:

- in February and March a campaign was conducted relating to the fixed sum insured and door-to-door services, which was aimed at building the perception of a wide and comprehensive PZU motor insurance offer;
- at the turn of May and June the “Young drivers” campaign was conducted in which PZU’s offer addressed to drivers below 26 years of age was presented;
- in August and September the “PZU assistance at home” campaign was conducted which promoted the PZU home insurance offer;
- in October and November the e-szkoda (e-claim) campaign was conducted aimed at providing information about the possibility of complete loss adjustment via the Internet;
- in December the “ochrona znizek” [deduction protection] campaign was carried out aimed at presenting PZU’s motor insurance offer;
- at the turn of February/March and October/November two investment and protection campaigns were conducted in respect of insurance offered by PZU Życie, aimed at building the awareness of the PZU brand as a brand competent in savings and investments;
- at the turn of February/March and in October, a group insurance campaign was conducted connected to the option of the insured participating in the PZU Pomoc club in employment establishments.

All the above campaigns were conducted on TV and in the Internet, and in selected media other than on TV (such as radio, press).

***Marketing sales support***

In 2011, PZU and PZU Życie’s activites in the area of sales support were focused mainly on the mass product segment. Apart from activities consisting of preparing advertising banners and leaflets the following were conducted:

- a test mini loyalty program for PZU clients purchasing motor liability and comprehensive insurance as a package – thanks to this program clients may also make use of the Niezguba service (lost car keys are returned to the owner), and an additional assistance package and discount program;

- enhancing standard mass correspondence sent to clients with marketing communication (e.g. in the form of the newspaper Moje PZU and Moje PZU Dobry Rolnik, or leaflets informing clients how a claim lodged can be easily monitored);
- issuing PZU Business Club cards – a program directed to corporate clients of PZU and PZU Życie;
- marking the best PZU EU branches to improve awareness of the location of branches among potential clients.

## 9.8 Key activities in the HR area

***Restructuring process in PZU and PZU Życie***

On 29 December 2009 the Management Board of PZU and PZU Życie announced a plan for implementing a restructuring program for the years 2010-2012.

On 11 May 2011 the Management Board of PZU and PZU Życie passed a resolution on the intention to conduct group layoffs in 2011.

On 26 May 2011 an agreement was concluded relating to group layoffs between PZU and PZU Życie, and the labour unions operating in the companies. In accordance with the determinations from 13 June to 10 October 2011 employment restructuring and optimization processes were implemented under the group layoffs.

The employment restructuring process in 2011 are a continuation of the activities begun in 2010 and consisted of – among other things – further integration of particular teams which carry out similar tasks in PZU and PZU Życie, implementing IT tools and optimizing processes enabling the achievement of higher work effectiveness standards (ratios), and further centralization of some functions in central entities. The employment restructuring processes in 2011 mainly covered the following areas: transactions, finance, administration, HR and payroll, loss adjustment and benefits, and the network, in all areas, both in local entities and in central entities, including PZU's and PZU Życie's Head Office.

In 2011 a maximum of 3,303 PZU and PZU Życie employees were to be covered by the change, which include net layoffs, i.e. an assumed decrease in the number of employees of 1,199 people.

The people who were laid off or who did not accept the proposed change in the terms and conditions of employment were offered favourable resignation terms, better than those offered in accordance with the law in similar situations (the Act of 13 March 2003 on specific principles for terminating employment contracts for reasons not relating to employees (Journal of Laws No. 90 of 2003 item 844 as amended)).

The amount of additional severance payments depended on the level of remuneration of particular employees and their years of service with the PZU Group.

In 2011, 1,943 employees were covered by the layoff procedures, of which termination of contracts was initiated with 1,276 employees as a result of a termination agreement or handing them declarations about terminating the contracts or as a result of the employees not accepting the new terms and conditions of employment, not due to the fault of the employer. Moreover, employment contracts with 75 employees were terminated under individual layoff procedures, for reasons not relating to the employees, and the costs of the layoffs were also charged to the restructuring provision.

An outplacement program was launched for the laid-off employees, one of the largest support program for such employees realized in Poland in 2011.

Total restructuring expenses amounted to PLN 58.2 million in 2011 (in 2010: 147.8 million).

As at 31 December 2011, the restructuring provision costs amounted to PLN 113.0 million (as at 31 December 2010: PLN 75.3 million), which meant a change in the balance of the provision of PLN 37.7 million in 2011.

***Other activities in the HR area***

In 2011, a new project was conducted in the HR area "New Energy of PZU Leaders" – a development program for key PZU managers from the Mass Client department. The Project is aimed at permanently strengthening the competencies by PZU key sales managers and gaining a competitive edge on the market in respect of sales of property insurance for retail clients. 25 key managers are participating in the program.

## 9.9 Pursuing the strategy and development projects

Projects conducted in the previous year were directly related to the pursuit of the PZU Group strategy for the years 2009-2011 aimed at profitable growth and constructing a cost-effective organization aimed at satisfying client requirements.

In respect of profitable growth, the following actions were pursued:

- a process for implementing a chain of modern outlets was launched according to the physical presence model developed in 2010 - clearly visible, common for the whole PZU Group and sales-focused;
- work was completed on revitalizing the corporate property insurance sales area aimed at improving the competencies of sales teams and optimizing their geographic location;
- a tool was implemented to enable deeper segmentation of clients, which will be used for cross-selling campaigns (analytical CRM enabling the creation of a standardized PZU client database).
- analytical work was started on the concept for developing healthcare related business, including preparations for the potential reform of the public health insurance.

Under the actions aimed at building an effective organization, focused on satisfying client needs - in respect of loss adjustment and benefits – the following project activities were pursued:

- a new model for cooperation with certifying physicians and simplified and remote NNW loss adjustment procedures were implemented;
- the "auto-payment" ("autowypłata") process in respect of benefits was launched in PZU Życie;
- work was carried out related to expansion of Internet services in the area of claims and benefits – among other things, an application for Internet reporting of the claims for English speaking clients was launched (an innovation on the Polish market);

- a pilot program for directing clients to respective repair shops in the chain of garages was conducted;
- work was carried out on creating a centralized model for managing the process of renting substitute vehicles during repairs;
- under the process of developing the PZU Assistance concept an auction platform was developed PZU Pomoc Online (trading in vehicle remains after the vehicles have been totally damaged), and as part of building brand awareness, substitute cars used by clients under the door-to-door service were appropriately marked.

In the area of customer service, apart from the project mentioned above related to the construction of a chain of modern outlets, the following activities were pursued:

- 110 PZU branches were marked according to a unified standard, so as to improve their visibility and facilitate clients finding the outlet;
- the process of unifying management structures in the current PZU Group outlets and of front-office employees was continued to enable comprehensive servicing of life and property insurance clients in all outlets;
- IT tools were implemented to support office processes and handling correspondence from all channels and moreover a Central Office was opened which provides services to all PZU Group companies;[8]
- the functionality for servicing PZU Życie group insurance clients was expanded by the option of upselling or downselling other PZU products to the clients, and sales network training was conducted - this will enable using the cross-selling potential of Group products (cross-selling is planned to start in the 1st quarter of 2012).

Additionally, apart from the activities listed above, in 2011 several initiatives were conducted in the PZU Group aimed at improving process efficiency and cost optimization. They comprised, among other things:

- a further stage of employment restructuring as a result of which the employment level dropped by ca. 1,050 full-time positions;
- analytical work on a project aimed at developing PZU's operating model and as a result the PZU policy system will be replaced;
- stage 1 of joint implementation of the PZU and PZU Życie ERP class system - in 2011 unified processes in the area of financial accounting, procurement and a joint chart of accounts were implemented (start-up in 16 January 2012);
- starting analytical work related to the process of restructuring the real estate portfolio necessary from the perspective of PZU's and PZU Życie's statutory operations;
- creating the HR and remuneration service centre for contractors and intermediaries of PZU and PZU Życie, by the end of 2011 the servicing of all the branches of both companies was taken over;

[8] This does not relate to the Armatura Group companies

- launching the process of automatic loading of policies issued in the sales system to the policy administration system;
- further optimization of the costs of the functioning of the operations back-office;
- centralization and automation of the claims and annuities payment process was conducted;
- continuing the projects in progress related to the unification and centralization of the IT systems and IT servicing of the PZU Group in other areas, i.e. the Service Desk, systems for the authentication of users, e-mail system or the data warehouse.

## 9.10 Activities related to Corporate Social Responsibility in 2011

### 9.10.1 Business Ethics

The PZU Group applies the ethical principles of corporate social responsibility described in item 15.1.

## 9.11 Social commitment

As part of the educational activities, PZU maintains an Internet insurance-dedicated service – “JakieUbezpieczenie.pl”. The character of the site is purely informative and educational. It explains the benefits of insurance products in a simple and easily accessible manner.

Similarly to the preceding years, PZU also conducted preventive activities aimed at improving public safety and limiting various risks. In this respect the following actions were taken in 2011:

- cooperation with TOPR, GOPR and selected WOPR groups was continued;
- cooperation with Stowarzyszenie Misie Ratują Dzieci (Teddies Save Children Association) was initiated in the area of therapeutic and psychological help for children injured in accidents;
- the Bezpieczna Flota (Safe Fleet) project was undertaken addressed to selected fleet drivers.

PZU also was the sponsor and patron of various cultural and sports events, both countrywide and local. Key activities in this area include:

- sponsoring the Royal Castle in Warsaw;
- the PZU zone during the Night of Museums at the Royal Castle in Warsaw;
- close cooperation with the Nowe Sukiennice National Museum Department in Kraków;
- patron of the Royal Łazienki Museum;
- sponsoring the Grand Theatre in Warsaw;
- sponsoring the “Rzeszów Carpathia Festiwal 2011”;
- patron of Willa Decjusza in Kraków;
- sponsoring the “Droga na Harvard” (Way to Harvard) competition;
- sponsoring the Polish Presidency in 2011;

- sponsoring the educational program Akcjonariat Obywatelski (Citizens' Shareholdings).

## 9.12 The PZU Foundation

The mission of Fundacja PZU (the PZU Foundation) is acting in the interests of the public in the area of education, culture, art, healthcare, and social security. The PZU Foundation pursues its goals co-financing the projects carried out by non-governmental organizations and other organizational entities in the area of operations of the PZU Foundation.

In its activities in 2011, the PZU Foundation awarded subsidies under consecutive editions of the competitions and projects outside the competitions, and for individual aid.

In the area of "Education" the following action was taken:

- a competition subsidy "Wzbogacanie oferty edukacyjnej na terenach wiejskich i w małych miastach" (Expanding the educational offer in rural areas and in small towns);
- Partnership programs were introduced:
    - in cooperation with Fundacja Edukacyjna Przedsiębiorczości in Łódź – scholarships were founded for young people from rural areas and small towns;
    - two editions of historical workshops were co-financed organized by Fundacja Centrum im. prof. Bronisława Geremka in Warsaw;
    - financial support was offered for the project "Świetlica – Moje Miejsce" conducted in cooperation with Polska Fundacja Dzieci i Młodzieży in Warsaw;
    - three-year cooperation was established with the national children's fund Krajowy Fundusz na rzecz Dzieci in Warsaw under the program for helping the extremely gifted Program Pomocy Wybitnie Zdolnym;
    - one-off subsidies were awarded to Fundacja Pomoc Polakom na Wschodzie in Warsaw, Fundacja ABC XXI – Cała Polska czyta dzieciom in Warsaw, Fundacja dla Uniwersytetu Jagiellońskiego in Kraków and Fundacja Młodzieżowej Przedsiębiorczości.

In the area of "Culture and Art", the PZU Foundation supports cultural institutions such as the National Museum in Kraków and the National Museum in Warsaw by acquiring new collections on their behalf.

In the area of "Social care and social aid" subsidies were awarded:

- in the competition "Developing social activity in handicapped children and adolescents";
- to disadvantaged individuals, including PZU employees;
- to Stowarzyszenie Wspólnota Polska in Warsaw by financing insurance for children and adolescents from our eastern neighbours during their stay in Poland;
- to Mokotowskie Hospicjum Św. Krzyża (hospice) in Warsaw;
- to organizations indicated in the PZU employees commitment survey.

In the area of "Health Protection", initiatives aimed at widely-understood health prophylactics were financed. Subsidies were granted to the organizations listed below:

- to Stowarzyszenie Wspólnota Polska in Warsaw by financing insurance of the medical mission in the Ukraine and Moldavia;
- to Polska Unia Onkologii (oncological union) in Warsaw.

## 10. Planned key development directions

The strategy for the years 2012-2014 will, to a large extent, be a continuation of the pursuit of the goals under the strategy for the years 2009-2011. The objective of the PZU Group is maintaining profitable growth and its lead position on the Polish insurance services market.

In the foreseeable future, the operating model of the PZU Group will be transformed from an organization operating according to product lines to an organization operating according to client segments. These transformations will enable the Group to better understand the needs of its clients and to react appropriately to these needs. In consecutive years, further operating optimization of the PZU Group is planned.

Pro-client orientation and high operating effectiveness will allow the Group to maintain its lead position – the PZU Group will remain the largest and most profitable insurance firm in Central and eastern Europe.

These goals will be realized thanks to actions focused on:

- in the mass client segment:
  - maintaining the market share in the motor insurance and property insurance segment and introducing advanced principles for price-setting and reacting to market changes;
  - dynamic development of savings and investment products, and in particular long-term savings products;
  - further development in the area of mass sales, among other things, by developing basic distribution channels;
- in the group client segment:
  - maintaining the profitable lead position in life insurance;
  - creating a health insurance market to increase the scale of business in that area;
  - actively upselling products related to health and drug insurance to group clients;
  - strengthening direct relations with the insured thanks to PZU Club's offer "Pomoc w Życiu" (help in life);
- in the corporate client segment:
  - transforming PZU into a business partner with a strong expert position that is not only an entity selling insurance but also a client advisor;
  - maintaining the market position in motor insurance and increasing its market share in non-motor insurance;
- in the operating model:

- introducing a new product system in PZU which will enable an increase in operating effectiveness;
- implementing a new customer service model which assumes an integrated contact channel structure, compliant with customer expectations, and specifically building a network of modern sales and service outlets;
- further optimization in the area of loss adjustment and benefits, where the key initiatives are as follows:
  - a new management module which suggests, in a simple way, the optimum form of loss settlement and the best and closest cooperating enterprises;
  - implementing a mass printing service;
  - improving the current recourse servicing process;
  - recovering overdue recourse claims;
  - centralized adjustment of all motor claims with foreign elements;
  - implementing a simplified loss adjustment process for motor claims.

Additionally actions are planned aimed at:

- continuing operations focused on transforming the PZU Group into a results-oriented organization;
- increasing the scale of operations of the PZU Group through international expansion on the Central and East European markets;
- refreshing the brand which will enable its modernization and communicating the changes that have already been implemented in the PZU Group;
- introducing changes in the investment policy covering, among other things, a change in the structure of investments which will lead to an increase in profitability with a simultaneous reduction in the volatility of results on investing activities.

# 11. Risk management

## 11.1 Risk management policy

The risk management system implemented by the PZU Group is directed at risk control and at maintaining an appropriate capitalization level. Through identifying, analyzing, measuring, controlling, managing and reporting the risk related to the operating activities conducted, the PZU Group is able to discharge its obligations towards clients and business partners and fulfil the requirements arising from the provisions of the law and external regulations.

Risk management in the PZU Group is based on the following main principles:

- Taking controlled risk – financial strength and constant value growth are an integral part of the PZU Group’s business strategy. In order to achieve these objectives the PZU Group conducts operations in accordance with a clearly defined risk policy and within the established risk limits;

- Clearly defined responsibilities – the PZU Group operates in line with the principle of allocating tasks, competencies and responsibilities. The delegated employees are responsible for the risk they undertake, and their incentives are harmonized with the business objectives of the PZU Group;
- Adapting to changes occurring in the business environment – the ability to respond to changes occurring in the business environment, both those arising from external and internal conditions of the PZU Group, are an integral part of the risk control process in the PZU Group.

PZU and PZU Życie manage insurance risk by applying the following tools:

- calculating and monitoring the adequacy of technical reserves;
- tariff strategy and monitoring current estimates and assessing the adequacy of premium;
- reinsurance.

## 11.2 Sensitivity to risk

***Table 33: Sensitivity of the asset portfolio***

PLN million

| Sensitivity of the asset portfolio | Change in the risk factor | 31 December 2011 | | 31 December 2010 | |
|---|---|---|---|---|---|
| | | Effect on net profit/loss | Effect on equity | Effect on net profit/loss | Effect on equity |
| Interest rate risk | drop by 100 bp | 135 | 281 | 156 | 299 |
| | growth by 100 bp | (126) | (264) | (149) | (283) |
| Currency risk | increase by 20% | 232 | 232 | 167 | 167 |
| | decrease by 20% | (232) | (232) | (167) | (167) |
| Price risk of equity instruments | increase by 20% | 254 | 336 | 283 | 416 |
| | decrease by 20% | (254) | (336) | (283) | (416) |

The table above summarizes the results of the analysis of the sensitivity of net profit and equity on changes in interest rate risk, currency risk and price risk of equity instruments. The analysis does not take into account the effect on net profit and equity of changes the in investment valuation, which are taken into account when calculating the amount of provisions.

The decrease in sensitivity to interest rate risk as at the end of 2011 compared with the end of 2010 was due to the increased share of instruments measured at amortized cost in the portfolio.

Financial assets exposed to currency risk include deposit transactions and debt securities constituting security of the realization of expenses in respect of technical reserves denominated in foreign currencies, and exposure in equity instruments listed on stock exchanges other than the WSE, exposures in derivatives denominated in foreign currencies and financial assets of consolidated insurance companies in Lithuania and the Ukraine. The increase in sensitivity to currency risk at the end of 2011 compared with 2010 is mainly due to the increased exposure in deposits denominated in foreign currencies and the increase in foreign exchange rates.

The decrease in sensitivity of the financial assets portfolio to changes in the valuation of listed equity instruments at the end of 2011 compared with 2010 results from the lower exposure in equity instruments exposed to other price risk.

## 11.3 Stress tests

In connection with the obligation placed on insurance companies by the Polish Financial Supervision Authority, PZU and PZU Życie carried out stress tests relating to the financial data reported as of 31 December 2010, in line with the guidance obtained from the Polish Financial Supervision Authority and submitted the test results by the 31 July 2011 deadline. Additionally, the PZU Group participated in the European Stress Tests for the insurance sector carried out by EIOPA, the results of which were submitted to the PFSA. The stress tests showed that the PZU Group has sufficient capital to be able to safely continue its operations after the strong turbulence in the business environment has abated.

# 12. Selected other PZU Group companies – directions of development and results

## 12.1 PZU Lietuva

In 2011, PZU Lietuva improved its position and took 3rd place on the Lithuanian insurance market. The company's objective in 2011 was further improvement of the profitability of motor vehicle portfolios and improving its position on the corporate property insurance market. Despite the difficult situation on this market, the company increased its sales by nearly 10% and managed to reduce both the loss ratio and the ratio of operating expenses net of reinsurance.

In the reporting period, activities initiated in the previous year were continued aimed at full unification of property and life insurance of the PZU Lietuva Group. The objective of the process was to adapt the structure of PZU Lietuva to corporate governance guidance, among others, by reducing operating expenses.

## 12.2 PZU Ukraine

In 2011, PZU Ukraine recorded high premium dynamics accompanied by a small growth in the Ukrainian insurance market. After three quarters, the company maintained 10th position on the property and personal insurance market (data as at the end of the third quarter of 2011).

The modifications in the approach to the tariffication of motor vehicle insurance products, constituting a significant portion of the portfolio of PZU Ukraine, introduced in 2010, led to a considerable improvement in profitability in 2011.

## 12.3 TFI PZU

The key undertakings of TFI PZU in 2011 in the area of sales and marketing include:

- actively acquiring employee pension schemes;

- actions aimed at organizing the distribution network;
- promoting the best TFI PZU funds in the media.

In 2011, TFI PZU introduced changes to its product offer:

- nine open investment funds with a diversified investment policy were transformed into PZU FIO Parasolowy with sectioned off subfunds;
- PZU SFIO Ochrony Majątku was transformed into Fundusz PZU FIO Ochrony Majątku;
- two new closed investment funds were opened: PZU FIZ Sektora Nieruchomości 2 and FIZ RE Income.

Significant achievements of TFI PZU in 2011:

- honouring the Employee Pension Scheme maintained by TFI PZU with the Polish Promotion Emblem “Teraz Polska”;
- acquiring and handling 15 new Employee Pension Schemes;
- recognizing PZU Energia Medycyna Ekologia investment fund as the “DISCOVERY OF THE YEAR 2011” during the 7$^{th}$ edition of the Consumer/Client Laurels (“Laur Konsumenta/Klienta”) conducted by the editorial section of *Rzeczpospolita*;
- awarding four stars to the PZU Papierów Dłużnych POLONEZ Subfund in the Online Analyses Rating;
- launching a new unit-linked product with Towarzystwo Ubezpieczeniowe Benefia na Życie SA;
- forming and launching, together with PZU Życie, the Millennium Prestige 2 Investment Scheme;
- commencing works on launching a service for distributing units of TFI PZU funds through remote channels: the internet and phone.

As at the end of 2011, the net asset value of the investment funds managed by TFI PZU was PLN 5,371.2 million (an increase of 66.3% compared with the end of 2010). The increase in the net asset value resulted from own investments of the PZU Group companies in units of TFI PZU funds and in investment certificates of dedicated closed investment funds, a positive balance of payments and cancellations of fund participants and an increase in the value of fund investments.

## 12.4 PZU AM

As planned, in 2011 PZU AM provided services solely to the PZU Group companies, i.e. to PZU, PZU Życie, TFI PZU and MPTE PZU SA.

In accordance with the plans, in 2011 PZU AM began managing new investment portfolios (PZU FIZ Sektora Nieruchomości 2; FIZ RE Income; Model Funds for PZU Życie).

## 12.5 PZU Pomoc SA

In 2011, a number of new initiatives were launched, including:

- launching an auction platform "PZU Pomoc ONLINE" the purpose of which is to sell damaged vehicles and property;
- purchase of cars for providing roadside and home assistance;
- implementing loyalty programmes:
    - "Klub PZU Pomoc w Życiu" – for clients of PZU Życie holding life insurance in the group insurance sector;
    - "Karta Klienta PZU-niezguba" – for clients of PZU holding a motor vehicle insurance package (at least third party liability insurance and AC). The pilot scheme will end in December 2012;
    - "PZU Business Club" – for representatives of entrepreneurs having a business relation with PZU or PZU Życie, with a specified level of premium written or number of persons entered on the insurance;
- launching of operating activities in the scope of medical services.

  In July 2011, the company ended its preparations for launching activities in the scope of offering and organizing medical services, with more than 600 medical facilities signed up throughout Poland and the launch of a medical hotline.

  On 11 August 2011, the company signed a cooperation contract with PZU Życie for providing medical services to health insurance Clients of the PZU Group. Therefore, on 1 September 2011, PZU Życie received its first group of Clients (employees of PZU and PZU Życie) – a total of 8,255 insured.

## 12.6 PZU CO

In 2011, PZU CO executed a number of undertakings, which included:

- incorporating the Insurance Services Centre in Warsaw and a part of the Call Centre within the organizational structure of PZU CO (transferring a part of the operations of PZU and PZU Życie);
- carrying out the project for handling and distribution of the Individual Pension Insurance Account (IKZE) for PTE PZU and PZU Życie;
- creating the Internet Auction Platform -- PZU Pomoc;
- optimizing the service processes and resources utilized and, as a result, reducing the rates for PZU Group companies.

# E. ADDITIONAL INFORMATION

## 13. Shares or rights to shares held by members of management and supervisory bodies of PZU as at the date of submitting the annual report

***Table 34: Shares or rights to shares held by members of management and supervisory bodies of PZU***

| No. | Body / Name and last name | Number of shares held as at 15 March 2012 | Number of shares held as at 17 March 2011 | The resulting change in the period between those dates |
|---|---|---|---|---|
| | **Management Board** | | | |
| 1 | Andrzej Klesyk | 0 | 0 | X |
| 2 | Witold Jaworski | 0 | 0 | X |
| 3 | Przemysław Dąbrowski | 0 | 0 | X |
| 4 | Bogusław Skuza | 500 | n.d. | X |
| 5 | Ryszard Trepczyński | 0 | n.d. | X |
| 6 | Tomasz Tarkowski | 80 | n.d. | X |
| 7 | Marcin Halbersztadt (Board Member until 6.10.2011) | 0 | n.d. | X |
| | **Group Directors** | | | |
| 1 | Rafał Grodzicki | 0 | 0 | X |
| 2 | Dariusz Krzewina | 0 | 0 | X |
| 3 | Mariusz J. Sarnowski (Director of the Group until 20.06.2011) | 0 | 0 | X |
| 4 | Krzysztof Branny (Director of the Group until 16.08.2011) | 30 | 30 | X |
| | **Supervisory Board** | | | |
| 1 | Marzena Piszczek | 0 | 0 | X |
| 2 | Waldemar Maj | 30 | 30 | X |
| 3 | Piotr Kamiński (SB Member until 30.06.2011) | 0 | 0 | X |
| 4 | Grażyna Piotrowska-Oliwa (SB Member until 30.06.2011) | 0 | 0 | X |
| 5 | Zbigniew Ćwiąkalski | 0 | 0 | X |
| 6 | Krzysztof Dresler | 0 | 0 | X |
| 7 | Dariusz Filar | 0 | 0 | X |
| 8 | Dariusz Daniluk (SB Member until 30.06.2011) | 0 | n.d. | X |
| 9 | Zbigniew Derdziuk (SB Member until 30.06.2011) | 0 | n.d. | X |
| **Total** | | **640** | **60** | **X** |

n.d. - as at 17 March 2011 the persons were not Members of the Management Board

As at the date of preparing the Directors' Report of the PZU Group, the management and supervisory board members of PZU did not hold any shares in the remaining PZU Group companies.

# 14. Other information

## 14.1 Remuneration of Management and Supervisory Board Members of the PZU Group

Detailed information on the remuneration of the Management Board Members of PZU has been presented in Note 52.6.1 to the Consolidated Financial Statements of the PZU Group.

In the 12-month period ended 31 December 2011, PZU did not conclude any contracts with the Management Board Members providing for any compensation in the event of their resignation or dismissal from the position held without an important reason or when their dismissal takes place due to a business combination of the issuer by acquisition. The Management Board Members of PZU have standard non-competition agreements signed under which they are obliged not to undertake activities that are competitive with the activities of the employer for the period specified in the agreement after termination of their employment.

## 14.2 Issues, redemption and repayment of debt and equity securities

In the 12-month period ended 31 December 2011, PZU did not make any issues, redemption or repayment of debt and equity securities.

## 14.3 Employee stock ownership plan

In 2011 and 2010 no employee stock ownership plans were implemented.

## 14.4 Price of PZU shares

PZU made its debut on the Warsaw Stock Exchange on 12 May 2010. The Company's shares are continuously traded on the primary market. In 2011, the shares of PZU were included in the WIG, WIG20, WIG PL indices and from 1 February 2012 also in the RESPECT Index.

***Diagram 2: Dynamics of PZU share prices in 2011 compared with WIG20 31.12.2010 = 100%***


***Diagram 3: Prices of PZU shares in 2011***

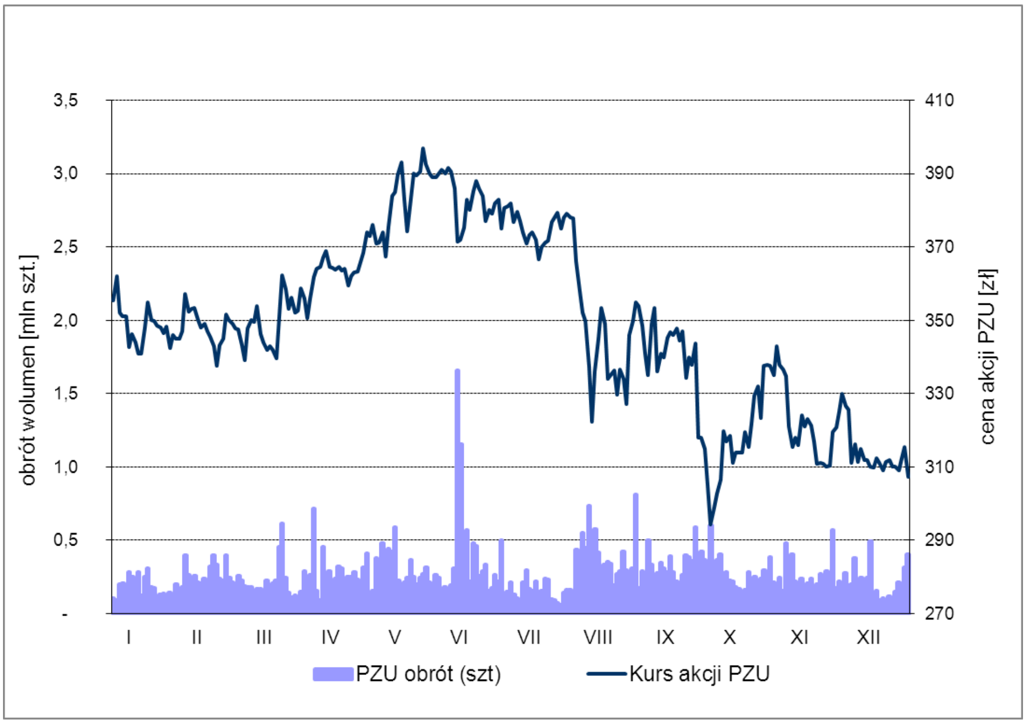


***Table 35: Basic information on PZU shares***

| measurement unit | | 1 January – 31 December 2011 | 1 January – 31 December 2010 |
|---|---|---|---|
| Number of shares as at the end of the year | units | 86 352 300 | 86 352 300 |
| Number of shares in trading | units | 86 344 698 | 86 340 692 |
| Closing price from the last trading day of the year | PLN | 309.00 | 355.50 |
| The highest closing price in the year | PLN | 396.80 | 411.00 |
| The lowest closing price in the year | PLN | 294.20 | 330.00 |
| Market value of PZU as at the end of the year | PLN | 26 682 860 700 | 30 698 242 650 |
| Average market price | PLN | 349.40 | 372.33 |
| Average trading volume per session | units | 265 862 | 317 391 |
| Dividend (gross) paid out in the financial year out of prior year profit distribution | PLN/share | 26.00 | 10.91* |

** excluding the dividend paid on 26 November 2009 as interim dividend on account of the dividend anticipated at the end of the financial year 2009 of PLN 12,749,917 thousand (PLN 147.69 per share).*

In 2011, the price of PZU shares was affected by not very optimistic factors shaping the situation on the WSE, and by the sentiments of global investors regarding the Eurozone and the Polish market. On the other hand, the decisions of investors interested in PZU securities were affected by the State Treasury selling a 10% package of PZU shares and the payment of dividend for 2010.

The closing price of PZU shares from the last trading session in 2011 was PLN 309.00, which represented a 13.1% decrease compared with the price on the last day of December 2010 of PLN 355.50. At the same time, WIG20 and WIG indices lost by 21.9% and 20.8% respectively. For the majority of 2011 the shares of PZU lost less than the market.

In 2011, PZU shares closed the trading sessions 124 times with drops, 122 times with increases, and they remained unchanged 5 times. The highest closing price (PLN 396.80) was achieved on 25 May and the lowest (PLN 294.20) on 4 October. The average market price of PZU shares in 2011 was PLN 349.40 which was PLN 22.93 lower than in 2010. The average daily trading volume of PZU shares in 2011 was 265,862 shares, with the highest level (1,659,172 shares) recorded on 9 June 2011.

In 2011, PZU was on the list of 21 domestic and foreign financial institutions whose analysts issued a total of 49 recommendations for PZU shares. “Buy”, “Accumulate” and “Overweight” prevailed – a total of 31 recommendations, 17 recommendations were neutral (“Hold” or “Neutral”) and 1 was “Underweight”.

***Table 36: Capital market ratios***

| **Capital market ratios for PZU as at** | **31 December 2011** | **31 December 2010** |
|---|---|---|
| P / BV | 2.07 | 2.40 |
| *Market price of shares / book value per share* | | |
| BVPS | 149.03 | 148.23 |
| *Book value per share* | | |
| P / E | 11.38 | 12.59 |
| *Price / net profit per share* | | |
| EPS (PLN) | 27.14 | 28.25 |
| *Net profit (loss) / number of shares* | | |
| DY Dividend yield (%) | 8.4% | 3.1% |
| *Dividend per share / market price of shares* | | |
| DPS (PLN) | 26.00 | 10.91* |
| *Dividend per share* | | |
| TSR Total shareholder return | (5.8)% | 17.3%** |
| *(Market price of shares at the end of the period – market price of shares at the start of the period + dividend paid out in the period) / market price of shares at the start of the period* | | |

** excluding the dividend paid on 26 November 2009 as interim dividend on account of the dividend anticipated at the end of the financial year 2009 of PLN 12,749,917 thousand (PLN 147.69 per share)*

*** Total Shareholder Return = (market price of shares at the end of the period – market price of shares in the offering + dividend paid in the period/market price of shares in the offering*

## 14.5 Dividend

***Dividend policy***

On 11 May 2011, the Management Board of PZU passed a resolution concerning the Issuer’s dividend policy.

The adopted dividend policy provides for the following:

1. The consolidated profit or loss of the PZU Group in accordance with the IFRS shall be the basis for establishing dividend to be paid out by PZU for a given financial year.
2. The amount of the dividend:

- shall not be lower than 50% or higher than 100% of the net profit shown in the consolidated IFRS financial statements;
- shall not be higher than the stand-alone net profit of PZU in accordance with the PAS;
- shall not result in reducing PZU's equity below the amount corresponding to 250% of the solvency margin;

- shall not result in reducing the financial strength of the PZU Group below the level corresponding to the AA rating according to the Standard & Poor's methodology;
- should take into account the additional capital requirements of PZU in a 12-month perspective from the moment of approval of the consolidated financial statements of the PZU Group for a given year by the Management Board of PZU.

3. The equity and solvency margin are calculated in accordance with the prudence norms established for the Polish insurance market.

The resolution on the dividend policy is binding from the date of coming into force of the articles referred to in Art. 311 of the Directive 2009/138/EC of the European Parliament and Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

***Appropriation of profit for the financial year 2010***

On 11 May 2011, the Management Board of PZU passed a resolution to accept the motion concerning the appropriation of the net profit of PZU for the year ended 31 December 2010 of PLN 3,516,709 thousand as follows:

- PLN 2,245,160 thousand for payment of dividend to shareholders;
- PLN 1,271,549 thousand to supplementary capital.

On 30 June 2011, the Annual General Shareholders' Meeting of PZU passed a resolution no. 7/2011 concerning the distribution of the net profit of PZU for the financial year ended 31 December 2010 according to which PLN 2,245,160 thousand, i.e. PLN 26.00 per one share was earmarked for payment of dividend. In accordance with the above-mentioned resolution, 30 September 2011 was the date according to which the list of shareholders entitled to payment of dividend for the financial year ended 31 December 2010 was established, and 21 October 2011 was the date of payment of the said dividend.

By the date of preparing this Directors' Report of the PZU Group, PZU's Management Board had not passed the resolution concerning profit appropriation for 2011.

## 14.6 PZU Tax Group

On 5 September 2008, the Management Boards of PZU and PZU Życie passed a resolution on PZU and PZU Życie forming a Tax Group (hereinafter referred to as "TG") as defined in the Corporate Income Tax Act of 15 February 1992 (*Journal of Laws* no. 74 of 2011, item 397, with further amendments "the CIT Act"). The TG comprised PZU and PZU Życie and was formed for a period of 3 years from 1 January 2009 to 31 December 2011.

On 27 September 2011, a new Tax Group agreement was signed between the PZU Group companies, comprising 9 companies: PZU, PZU Życie, TFI PZU, PZU AM, PZU CO, PZU Pomoc SA, Ipsilon BIS SA, Ogrodowa-Inwestycje Sp. z o.o., Ipsilon Sp. z o.o. The TG was formed for a period of 3 years from 1 January 2012 to 31 December 2014.

PZU is the parent company and the company representing the TG in both the above-mentioned agreements. In accordance with art. 25 clause 1 of the CIT Act, the TG conducts settlements with the Tax Office in monthly cycles. PZU makes tax advances to the Tax Office in respect of corporate income tax, which are due from all the companies belonging to the TG and the said companies transfer the CIT advances related to their business activities to PZU.

## 14.7 Main reinsurance contracts binding in 2011

The reinsurance cover of the PZU Group in 2011 constitutes security of the insurance activities and mitigates the effects of the occurrence of any catastrophic events which might have an adverse effect on the financial standing of the insurance companies. The task was executed by concluding obligatory reinsurance contracts with supplementary facultative reinsurance.

***Reinsurance contracts – PZU***

Based on the reinsurance contracts concluded, PZU mitigates its risks, among other things, by a disproportionate excess of loss agreement protecting PZU's portfolio against catastrophic losses (e.g. flood, hurricane), a disproportionate excess of loss agreements protecting the portfolios of property, technical, marine, aviation, third party, and third party motor vehicle insurance against the effects of large individual losses. Additionally, PZU mitigates its risks through a proportionate contract protecting the portfolio of financial insurance.

The main partners granting obligatory reinsurance protection to PZU in 2011 are the following reinsurers: Swiss Re, Hannover Re, Scor, Munich Re, Lloyd's. PZU's reinsurance partners have high ratings according to S&P, which ensures certainty of a good financial standing of the reinsurers to the Company.

PZU's activities in the scope of inward reinsurance are one of the support measures to PZU Lietuva and PZU Ukraine. The Company participates both in obligatory and facultative reinsurance contracts of the above-mentioned companies. Moreover, PZU obtains gross written premium from inward reinsurance from its operations on the domestic and foreign market, mainly through facultative reinsurance.

***Reinsurance contracts – PZU Życie***

The outward reinsurance contracts concluded by PZU Życie serve to protect the portfolio of PZU Życie against the accumulation of risks (catastrophe contract), the protection of individual insurance policies with higher insurance sums and the protection of the group insurance portfolio covering the serious illness of a child.

The following reinsurance companies are partners granting reinsurance protection to PZU Życie: RGA, Gen Re, Arch Re and Lloyd's. The reinsurance partners have high ratings according to S&P, which ensures certainty of a good financial standing of the reinsurers to PZU Życie.

## 14.8 Concluded and terminated loan agreements

The following companies from the PZU Group: Armatura Kraków SA, Armagor SA and Armatoora SA concluded or terminated loan agreements in 2011 with non-related entities in terms of equity. The table below present the total balance of loan agreements drawn, renewed and terminated.

***Table 37: Concluded and terminated loan agreements in the PZU Group***

PLN'000

| | Drawing and renewal of a loan in 2011 | Expiry of a loan in 2011 |
|---|---|---|
| Armatura Kraków SA | 81 000 | 48 000 |
| Armatoora SA | 31 000 | 3 000 |
| Armagor SA | 44 000 | 3 000 |

## 14.9 Loans granted, including loans granted to the Issuer's related entities

As for investment activities of PZU and PZU Życie in 2011, the entities extended loans totaling PLN 865 million maturing in the period from 2016 to 2018 at arm's length interest rates based on an appropriate WIBOR rate, margin or a fixed rate. Loans are collateralized in a manner typical for a given instrument.

## 14.10 Guarantees and warranties in respect of loans and borrowings granted and received, including those granted to the Issuer's related entities

In the 12-month period ended 31 December 2011, PZU or its related entities did not grant any warranties in respect of loans and borrowings or guarantees – in aggregate to one company or an entity related to that company - if the total value of the existing warranties or guarantees would constitute the equivalent of at least 10% of PZU's equity.

Based on the guarantee line agreement dated 26 September 2008 concluded between PZU and Bank Millennium SA, the bank grants bank guarantees (related to bid bonds and proper performance of the contract) to PZU in tenders for insurance services. The guarantee line is PLN 15 million and it is renewed every year for a period of another year. As at 31 December 2011, 33 guarantees for the total amount of PLN 6.4 million were active as part of the valid line.

Moreover, none of the remaining direct or indirect subsidiaries of PZU granted any warranties in respect of loans and borrowings or guarantees – in aggregate to one company or an entity related to that company, the total value of which would constitute at least 10% of the Issuer's equity.

## 14.11 Evaluation of financial resources management, taking into account the ability to cover the liabilities drawn, and identification of potential threats and action taken or planned by the Issuer in order to counteract those threats

The Issuer is in a very good financial situation and it fulfils all the safety criteria imposed on it by the Act on insurance activities and by the PFSA. The stable rating perspective of the Issuer confirms the fact that PZU has a strong business position, the level of its equity is high and it remains a competitive player on the insurance market.

Due to the Issuer's strong competitive position and very good financial standing, the Management Board of PZU does not currently perceive any threats to the Issuer's operations.

The Issuer has own funds which guarantee covering all liabilities to its clients.

## 14.12 Litigation pending before the court, the appropriate arbitration body or the public administration body

The PZU Group companies participate in numerous litigation cases before the court, arbitration and administrative proceedings. Typical litigation cases in which the PZU Group companies participate include disputes related to insurance contracts concluded, disputes related to employment relationships and disputes related to contractual obligations. Typical administration proceedings in which the PZU Group companies participate include proceedings related to ownership of real estate. The above proceedings and litigation cases are typical and repetitive in nature, usually none of them separately has a significant impact on the PZU Group.

The majority of the disputes with the participation of the PZU Group companies relate to two companies: PZU and PZU Życie. Additionally, PZU and PZU Życie are parties in proceedings before the President of the Office of Competition and Consumer Protection and proceedings before the Polish Financial Supervision Authority.

PZU and PZU Życie include disputed claims in the process of recording technical reserves for known claims taking into account the probability of an unfavourable resolution of the dispute and estimating the value of the probable adjudication. In the case of disputed claims related to the valorization of disability pensions in PZU Życie, the claims are recorded in other technical reserves in the amount of the annual value of the pensions above the corresponding amount of the reserve established as part of the arithmetic life insurance reserves.

In 2011 and by the date of signing these consolidated financial statements, in the PZU Group there were no litigation cases before the court, the appropriate arbitration body or the public administration body in respect of PZU's or its direct or indirect subsidiaries' obligations or debt, the unit value of which would represent respectively at least 10% of PZU's equity.

As at 31 December 2011, the value of all the 22,357 cases pending before the courts, appropriate arbitration bodies or public administration bodies in the PZU Group totalled PLN 1,643,448 thousand. Of this amount, PLN 1,275,625 thousand related to obligations and PLN 367,823 thousand to the PZU Group companies' debt, which represented 10.84% and 3.12% respectively of PZU's equity according to PAS.

The information on the proceedings of the Office of Competition and Consumer Protection against PZU and PZU Życie is provided in the Consolidated Financial Statements of the PZU Group for 2011 – Notes 52.1. and 52.2.

## 14.13 Information on significant contracts concluded

In 2011, no contract was concluded with PZU or its related company as one of the parties where the contract value would have amounted to at least 10% of PZU's equity or where the level of equity was not the criterion enabling proper assessment of the contract concluded - of the PZU Group's sales for the last four financial quarters.

## 14.14 Related party transactions

In the 12-month period ended 31 December 2010, PZU did not conclude one or a number of transactions with related entities if individually or in total they were material and were concluded on terms other than an arm’s length basis.

## 14.15 The seasonal or cyclical nature of the activities

The activities of the PZU Group are not seasonal or cyclical in nature to an extent that would justify applying the recommendations contained in the IFRS.

## 14.16 Significant post balance sheet events

On 28 February 2012, the Management Boards of PZU and PZU Życie gave notice of termination of Corporate Collective Labour Agreements (“CCLA”) for both companies. The CCLA was concluded in 2003 in PZU and in 2006 in PZU Życie, and it is an outdated solution which does not work in the current social and economic environment. The purpose of introducing the new remuneration system is to further modernize the PZU Group and improve its competitiveness. The Management Boards of PZU and PZU Życie intend to adjust the salaries to market standards and link individual employee objectives to the performance of the PZU Group's strategy.

## 14.17 Business combinations

In the period from 1 January 2011 to the date of preparing this Directors’ Report of the PZU Group, no business combinations were carried out between PZU and other companies.

## 14.18 Information on contracts concluded that are significant to the PZU Group’s operations, including those concluded between the shareholders

By the date of preparing this Directors’ Report of the PZU Group no contracts were concluded (including those concluded after the balance sheet date) as a result of which the current shareholding structure may change in the future.

## 14.19 Cooperation with international public institutions

In 2011 and 2010 the PZU Group companies did not cooperate with any international public institutions.

## 14.20 Contracts for audit and review of the financial statements

On 13 May 2011, the Supervisory Board of PZU selected Deloitte Audyt Sp. z o.o. with its seat in Warsaw, Al. Jana Pawła II 19, entered in the register of companies authorized to audit financial statements by the National Chamber of Registered Auditors under the number 73, as the registered audit company to carry out the audit of the annual financial statements of PZU prepared in accordance with the Accounting Act of 29 September 1994 (Journal of Laws No. 152 of 2009, item 1223 as amended) and of the annual consolidated financial statements of the PZU Group prepared in accordance with the International Financial Reporting Standards.

The contract for the review of the abridged interim consolidated financial statements of the PZU Group and the abridged separate financial statements of PZU for the 6 months ended 30 June 2011 and for the audit of separate financial statements of PZU and consolidated financial statements of the PZU Group for the financial year ended 31 December 2011 was concluded on 30 June 2011.

Information on the fee of the registered audit company is provided in the Consolidated Financial Statements of the PZU Group for 2011 – Note 54.7.

# F. REPRESENTATIONS OF THE MANAGEMENT BOARD OF PZU

## 15. Statement of compliance with corporate governance principles

### 15.1 The corporate governance principles

In 2011, PZU complied with “The Best Practices of Companies Listed on the Warsaw Stock Exchange” (hereinafter: “The Best Practices of WSE Listed Companies”) binding at the Warsaw Stock Exchange. The code of “The Best Practices of the WSE Listed Companies” is available on the website devoted to corporate governance on the Warsaw Stock Exchange at www.corp-gov.gpw.pl and on the Company's website www.pzu.pl in the section dedicated to PZU’s shareholders – “Investor Relations”.

Apart from the above-mentioned corporate governance principles, PZU applies ethical principles and social responsibility principles contained, among other things, in the following documents:

- Principles of Good Insurance Practices enacted on 8 June 2009 by the General Meeting of the Polish Insurance Association (“PIA”) which associates insurance companies operating on the Polish market. The principles adopted by PZU regulate the rules of conduct for insurance companies in relations with clients, insurance agents, the PFSA and the Polish Insurance Ombudsman and the media. They also regulate the relations between the insurers themselves and the actions of insurance companies acting as participants in public trading in securities. The document is available on the website of PIA: http://piu.org.pl/zasady-dobrych-praktyk/project/132/pagination/1;
- The Best Practices in PZU. The document underlines the role of ethical values binding in all the aspects of PZU's operations. It describes the best business practices in PZU. It promulgates and promotes the culture of compliance with the binding law, making decisions based on ethical criteria and responsibility for the decisions made. The document is available on PZU’s website:

  http://www.pzu.pl/c/document_library/get_file?uuid=f430d2f3-0ffa-4b72-add8-c53f3668c66a&groupId=10172;
- The social report of PZU. This is the first report concerning sustainable development and social activity of the Issuer, which has been prepared based on the guidance and standards of Global Reporting Initiative (GRI) using the Sustainability Reporting Guidelines & Financial Services Sector Supplement. The report is an element in the implementing of the corporate social responsibility (CSR) strategy in PZU and raises a number of issues in various areas, including: corporate governance, availability of services, product quality, data security, the effect of PZU's operations on the natural environment and PZU's active involvement in social activities. The document is available on PZU’s website: http://www.pzu.pl/grupa-pzu/dzialalnosc-spoleczna/raporty.

***Application of “The Best Practices of WSE Listed Companies”***

The year 2011 confirmed PZU’s devotion to the highest corporate governance standards. There were no violations of the rules specified in The Best Practices of WSE Listed Companies, as provided in chapters II, III and IV, in recognition of the recommendations indicated in points I.5. and I.9. of The Best Practices of WSE Listed Companies. The announcement of not fully complying with those recommendations was not made, in line with the exemption based on the resolution of the Management Board of WSE of 11 December 2007 concerning the obligation to publish reports referred to in § 29 clause 3 of the Rules and Regulations of WSE in respect of corporate governance rules contained in section I of The Best Practices of WSE Listed Companies.

With regards to chapter I of The Best Practices of WSE Listed Companies containing "Recommendations", two points require commenting on.

With reference to recommendation I.5 of The Best Practices of WSE Listed Companies concerning the remuneration policy for members of management and supervisory bodies, the decision on the remuneration of the Supervisory Board members lies within the competencies of the General Meeting of PZU and decisions on the remuneration of the Management Board members are made by a resolution of the Supervisory Board of PZU.

The remuneration of the Supervisory Board members is clearly specified in the resolution of the General Meeting. The level of remuneration depends on the function performed in the Supervisory Board and is not due in the month in which a given Supervisory Board member was absent from the meeting for an unjustified reason. The Supervisory Board decides by resolution whether the absence of the Supervisory Board member was justified or unjustified.

The principles for remunerating the Management Board members were specified by the Supervisory Board. The remuneration of the Management Board members is composed of several components and comprises the basic monthly salary, additional benefits and an annual bonus which is paid once a year and depends on the decision of the Supervisory Board made in the form of a resolution based on the economic and financial results for a given financial year.

The remuneration policy for members of management and supervisory bodies does not contain all the elements indicated in the Recommendation of the European Commission of 14 December 2004 fostering and appropriate regime for the remuneration of directors of listed companies (2004/913/EC), as supplemented by the Recommendation of the EC of 30 April 2009 (2009/385/EC)." Moreover, PZU has not presented a declaration disclosing the remuneration policy on the corporate website. The decision concerning full compliance with the above principle in the future will belong to the Supervisory Board and the General Meeting of PZU.

Another matter requiring clarification is the recommendation contained in point I. 9 of The Best Practices of WSE Listed Companies referring to ensuring the balanced participation of women and men in the company's bodies. PZU has always maintained a policy of appointing competent and creative persons who have appropriate professional experience and education as members of its bodies The composition of the Management and Supervisory Boards is determined by a decision of the Supervisory Board and the General Meeting, and other factors, including the person's gender, are not taken into account.

Currently, there is one woman in the seven-member Supervisory Board – Marzena Piszczek who is the Chairman of the Supervisory Board.

From 1 January 2012, in connection with the amendment to The Best Practices of WSE Listed Companies introduced by a resolution of the Board of WSE no. 20/1287/2011 and binding from

1 January 2012, PZU applies and will carry out the recommendations and principles of the amended best practices.

## 15.2 The General Meeting and shareholder rights

The Annual General Shareholders' Meeting of PZU should be held within six months after the end of each financial year of the Company.

An Extraordinary General Meeting is convened in the cases specified in the Commercial Companies Code Act dated 15 September 2000 (Journal of Laws 94 of 2000, item 1037 as amended, "the Commercial Companies Code"), the Insurance Activity Act, the Statute and when PZU's bodies or persons authorized to convene an Extraordinary General Meeting consider it appropriate.

In accordance with the provisions of the Statute, the Supervisory Board convenes:

- the Annual General Meeting when the Management Board fails to convene such Annual General Meeting within the prescribed deadline;
- an Extraordinary General Meeting when it considers it appropriate;
- an Extraordinary General Meeting when the Management Board fails to convene an Extraordinary General Meeting based on the motion of an authorized shareholder, authorized shareholders or the Supervisory Board within 14 days from the date of submitting the motion

The Statute also provides that the shareholders representing at least one half of the share capital or at least one half of the general number of votes in the Company may convene the Extraordinary General Meeting. These shareholders appoint the chairman of such Extraordinary General Meeting.

The Supervisory Board and the shareholder or shareholders of PZU representing at least one twentieth of the share capital may demand that individual matters be put on the agenda of the next General Meeting. The demand should contain justification for a draft resolution concerning the proposed point on the agenda and should be reported to the Management Board not later than twenty one days before the set date of the General Meeting. The Management Board is obliged to immediately announce changes in the agenda introduced on the demand of the shareholders, not later however than eighteen days before the set date of the General Meeting. The announcement should be made on PZU's website and in accordance with the procedure for announcing current information specified in the provisions of the Act dated 19 July 2005 on public offering and terms and conditions of introducing financial instruments to an organized trading system and on public companies (Journal of Laws No. 184 of 2005, item 1539 as amended, "the Act on public offering"), i.e. in the form of current reports.

Before the date of the General Meeting, PZU's shareholder or shareholders representing at least one twentieth of the company's share capital may submit to the company in writing or using electronic communication means, draft resolutions concerning matters introduced onto the agenda of the General Meeting or matters which are to be introduced onto the agenda. The Company immediately announces draft resolutions on its website. During the General Meeting, each shareholder of PZU may propose draft resolutions concerning matters introduced onto the agenda.

The General Meeting is convened by an announcement published on PZU’s website and in line with the procedure for providing of current information specified in the provisions of the Act on public offering, i.e. in the form of current reports. The announcement should be made at least twenty six days before the date of the General Meeting.

A properly convened General Meeting is valid, regardless of the number of present shareholders or shares represented during the meeting.

The General Meetings is held in Warsaw.

The right to participate in the General Meeting only falls to persons who were PZU's shareholders sixteen days before the date of the General Meeting (the date of registering participation in the General Meeting)

At the request of an entity authorized based on dematerialized shares of PZU submitted not earlier than after the announcement of the General Meeting being convened and not later than on the first working day after the date of registering participation in the General Meeting, the entity maintaining the securities account issues a named certificate of the right to participate in the General Meeting.

The certificates of the right to participate in the General Meeting issued by the entity maintaining the securities account shall constitute the basis for that entity to prepare a list, which shall then be sent to the National Depository for Securities (“KDPW”) as the entity maintaining the deposit of the securities. On this basis, KDPW shall prepare a list of the shares authorized to participate in the General Meeting. The list prepared by KDPW shall be sent to the Company and shall constitute the basis for PZU to prepare a list of shares authorized to participate in the General Meeting.

In the period between the date of registering participation in the General Meeting and the date of closing the General Meeting, a shareholder of PZU may transfer shares.

Each share gives the right to one vote at the General Meeting, taking into account the restrictions concerning the execution of voting rights. A shareholder may vote differently based on each of the shares held. PZU’s shareholders may participate in the General meeting and execute the voting rights in person or through a proxy.

***Competencies of the General Meeting***

The General Meeting is a body authorized to make decisions through resolutions in matters related to the PZU’s organization and operation. The resolutions passed by the General Meeting are reached by an absolute majority of votes, except for special cases provided for in the Commercial Companies Code or the Statute. In accordance with the Statute, the resolutions of the General Meeting concerning the following matters require a qualified majority of three fourth of the votes: (i) changing the Statute, (ii) reducing share capital, (iii) selling and leasing out the enterprise or its business unit and establishing a limited property right on them. The resolutions of the General Meeting relating to preference shares and matters of the Company’s business combination by transferring all its assets to another company or a merger by forming a new company, closing the Company (also as a result of moving its seat or main office abroad), its liquidation, transformation or reduction in share capital by cancellation of a portion of shares without at the same time increasing it, require a 90% majority of the votes cast.

The most significant competencies of the General Meeting specified in the Commercial Companies Code and the Statute of PZU include passing resolutions concerning, in particular, the following:

- reviewing and approving the Directors' Report and the financial statements for the prior financial year and granting a vote of approval to individual bodies of the Company for performing their duties;
- appropriation of profit or covering loss;
- making decisions relating to claims to remedy losses arising in the course of forming the Company or its management or supervision;
- selling and leasing the enterprise or its business unit and placing restricted property rights upon them;
- cancelling shares and issuing of bonds;
- formation of reserve capitals and deciding on their use or how to use them;
- demerger of the Company, the Company's merger with another company, liquidating or closing the Company;
- appointing and dismissing the Supervisory Board members, in recognition of the State Treasury's personal right to appoint and dismiss one Supervisory Board member.

On 8 February 2012, the Extraordinary General Meeting of the Company, in amending PZU's Statute, granted competence to the General Meeting to pass a resolution concerning the Company buying or selling real estate, perpetual usufruct or a share in real estate or in perpetual usufruct with a value exceeding the equivalent of EUR 30,000,000 (thirty million Euro), gross. The said change in the Statute has not yet been registered by the registration court.

***Entitlements and rights of the shareholders and the manner of their execution***

The shareholders' rights and entitlements arise from the provisions of the Commercial Companies Code and PZU's Statute.

The Company's shareholder has a right to view the list of the shareholders entitled to participate in the General Meeting and request a copy of the list, while reimbursing the costs of its preparation.

The Company's shareholder may request that the shareholders' list be sent to him free of charge by electronic mail, after giving the address to which the list should be sent.

Each shareholder of the Company has the right to request a copy of the motions concerning the issues on the agenda of the next General Meeting within one week before the General Meeting. The request should be submitted to the Management Board.

Immediately after selecting the chairman of the General Meeting, an attendance list should be prepared containing the list of participants at the General Meeting, including the number of Company shares represented by each one of them and the number of votes attached to them. The attendance list should be signed by the chairman of the General Meeting and displayed during the meeting.

At the request of shareholders holding one tenth of the share capital represented at the General Meeting, the attendance list should be verified by a commission elected for this purpose, composed of at least three persons. The persons tabling the motion have the right to elect one member of the commission.

At the request of the shareholders representing at least one fifth of the Company's share capital, the election of the Supervisory Board should be performed by the next General Meeting through voting in separate groups, even if the Statute provides for a different manner of appointing the Supervisory Board. The persons representing the proportion of the Shares at the General Meeting which is arrived at by dividing the total number of Shares represented at the General Meeting by the number of Supervisory Board members (in the Company's case – five members of the Supervisory Board) may form a separate group in order to elect one Supervisory Board member, but they may not participate in the election of the remaining Supervisory Board members. Mandates in the Supervisory Board not filled by an appropriate group of shareholders as part of the procedure described above, shall be filled by a vote of all the Company's shareholders who did not cast votes when electing the Supervisory Board members by voting in separate groups. In the event that shareholders representing at least one fifth of the Company's share capital filing a motion for electing the Supervisory Board by voting in separate groups, the provisions of the Statute providing for a different manner of appointing the Supervisory Board shall not apply in respect of such election of the Supervisory Board, in recognition of the fact that if the Supervisory Board contains a person appointed by an entity specified in a separate Act, only the remaining members of the Supervisory Board shall be elected.

During the General Meeting, the Management Board is obliged to provide a shareholder at his request with information concerning the Company, if it is justified for the purpose of evaluating the issue covered by the agenda of the General Meeting. The Management Board shall refuse to provide information if it could cause damage to the Company, its related company or a subsidiary company or cooperative, in particular be revealing technical, trading or organizational secrets of the enterprise. The Management Board member may refuse to provide information should it constitute a basis for his penal, civil law or administrative liability. A response shall be considered to have been given if the relevant information is available on the Company's PZU's website on the site designated for the shareholders to ask questions and for providing them with answers. In response to a request made by a shareholder, the Management Board may provide an answer in writing outside the General Meeting if there are valid reasons to do so. The Management Board is obliged to provide an answer not later than within two weeks from the date of making a request during the General Meeting. In the event of a shareholder making a request for information about the Company outside the General Meeting, the Management Board may provide the shareholder with an answer in writing, taking into account the restrictions concerning the possibility of causing damage, referred to above. In the documentation submitted to the next General Meeting, the Management Board reveals in writing the information provided to a shareholder outside the General Meeting, including the date of providing it and the person to whom the information was given. The information provided to the next General Meeting need not comprise the information announced to the public and provided during the General Meeting.

The shareholder to whom the information requested during a General Meeting was refused and who filed an objection in the minutes, may file an application with the registration court to oblige the Management Board to provide the information. The application should be submitted within one week of the closing of the General Meeting at which the information was refused. The shareholder may also file an application with the registration court to oblige the Company to publish the information provided to another shareholder outside the General Meeting. In accordance with the Decree of 19 February

2009 on current and periodic information to be prepared by issuers of securities and conditions for considering as equivalent the information required by the provisions of the law of a non-EU state (Journal of Laws No. 33 of 2009, item 259; “the Decree on current and periodic information”), the Company shall be obliged to provide, in the form of a Periodic Report, information provided to a shareholder due to Management Board having been obliged to do so by the registration court in the cases referred to above.

## 15.3 The Issuer’s management and supervisory bodies and their committees

***The Management Board of PZU***

In accordance with PZU’s Statute, the Management Board is composed of three to seven members appointed for a joint term of office which covers three full consecutive financial years. The members of the Management Board, including the Chairman, are appointed and dismissed by the Supervisory Board, and additionally, the Management Board Members are appointed and dismissed by the Supervisory Board on a motion tabled by the Chairman of the Management Board. The Chairman of the Management Board for the new term of office who is appointed before the expiry of the current term of office may submit a motion to the Supervisory Board to appoint the remaining Members of the Management Board for the new term of office before the expiry of the current term of office.

In the period from 1 January 2011 to 31 December 2011, the composition of the Management Board of PZU was as follows:

At 1 January 2011, the composition of the Management Board of PZU was as follows:

- Andrzej Piotr Klesyk – Chairman of the Management Board of PZU;
- Witold Jaworski – Board Member of PZU;
- Przemysław Dąbrowski - Board Member of PZU.

As of 21 April 2011, the Supervisory Board appointed Mr Tomasz Tarkowski member of the Management Board.

As of 15 May 2011, the Supervisory Board appointed Mr Marcin Halbersztadt member of the Management Board.

As of 1 July 2011, the Supervisory Board appointed Mr Bogusław Skuza and Mr Ryszard Trepczyński members of the Management Board.

On 6 October 2011, Marcin Halbersztadt resigned as a member of the Management Board of PZU.

As at 31 December 2011 and as at the date of publishing this Directors’ Report, the composition of the Management Board of PZU was as follows:

- Andrzej Piotr Klesyk – Chairman of the Management Board of PZU;
- Witold Jaworski – Board Member of PZU;
- Przemysław Dąbrowski - Board Member of PZU;
- Tomasz Tarkowski – Board Member of PZU;

- Bogusław Skuza - Board Member of PZU;
- Ryszard Trepczyński - Board Member of PZU.

The current term of office of the Management Board of PZU commenced on 28 June 2011 and will last for the next three full financial years. The mandates of the Management Board members shall expire at the latest on the date of holding the General Meeting to approve the financial statements for the last full financial year of their performing their functions.

***The functioning and competencies of the Management Board arising from the Statute***

The Management Board exercises all the rights in the scope of managing the Company, which are not reserved by the provisions of the law or the provisions of the Statute to the General Meeting or the Supervisory Board.

The Management Board enacts its rules and regulations which are approved by the Supervisory Board. The operations of the Management Board are directed by the Chairman of the Management Board who establishes the scope of responsibilities for individual Board Members. The resolutions of the Management Board are passed only in the presence of the Chairman of the Management Board or a person appointed to direct the work of the Management Board in his absence, and if at least one half of the Management Board Members are present at the meeting. The resolutions of the Management Board are passed by an absolute majority of votes and if the number of votes is equal, the Chairman of the Board has the casting vote. The Management Board, on the approval of the Chairman of the Board, may pass resolutions by circulation, in a written or electronic form (i.e. using remote means of communication and using a qualified electronic signature). The Statute also provides for the possibility of holding Management Board meetings using means of direct communication over a distance. Two Members of the Management Board acting jointly or one Member acting jointly with a proxy are authorized to represent the Company..

***The functioning and competencies of the Management Board arising from the rules and regulations of the Management Board***

The rules and regulations of the Management Board were enacted by the Management Board on 23 February 2010 and approved by the Supervisory Board by a resolution dated 4 March 2010.

The rules and regulations of the Management Board regulate: (i) the scope of competencies of the Management Board and the scope of actions requiring permission or approval by the Supervisory Board; (ii) the competencies of the Chairman of the Board and of the remaining Board Members; (iii) the rules and organization of the work of the Management Board, including organization of meetings and the procedure for making decisions; and (iv) the rights and obligations of the resigning Board Members.

In accordance with the rules and regulations of the Management Board, the following issues in particular require a resolution of the Management Board:

- adopting a long-term plan for the Company’s development and its functioning;
- adopting a plan for the operations and development of the PZU Group;
- adopting an annual financial plan and a report on its execution;

- adopting the financial statements for the prior financial year and the Directors' Report of the Company;
- adopting the proposition concerning appropriation of profit or covering loss;
- establishing a tariff for compulsory and voluntary insurance contributions and the general terms and conditions for voluntary insurance;
- establishing the scope and size of outward reinsurance and tasks in the scope of inward reinsurance;
- adopting the annual audit and control plan and report on its execution including conclusions;
- establishing the principles for investment, prevention and sponsorship activities;
- granting warranties and guarantees (excluding those which constitute insurance procedures) and drawing and granting loans and borrowings by the Company (excluding loans and borrowings granted from the Company Social Fund); and
- granting powers of attorney.

In accordance with the Rules and Regulations of the Management Board, the Board's meetings are held not less frequently than once every two weeks. The work of the Management Board is directed by the Chairman, whose competencies include in particular:

- establishing the scope of responsibilities for individual Board Members;
- convening the Management Board meetings;
- drawing up the agenda for Board meetings;
- applying to the Supervisory Board to appoint or dismiss members of the Management Board;
- appointing a person to direct the work of the Management Board in the absence of the Chairman of the Management Board.

The Chairman of the Management Board makes decisions in the form of directives and official orders. The remaining Board Members direct the Company's activities within the scope of responsibilities established by the Chairman of the Board.

The Statute of PZU does not specify any particular rights for the Management Board to make decisions on the issue or redemption of shares.

***The Supervisory Board***

The Supervisory Board is composed of eleven members: The number of the Supervisory Board members is established by the General Meeting. The Supervisory Board members are appointed by the General Meeting for a joint term of office lasting for three full consecutive financial years. At least one member of the Supervisory Board must have accounting or auditing qualifications as defined in and in accordance with the provisions of the Act of 7 May 2009 on registered auditors and their self-government, entities authorized to audit financial statements and on public supervision (Journal of Laws No. 649 of 2009, item 77, "the Act on registered auditors"). Additionally, at least one member of the Supervisory Board should meet all the independence criteria specified in the Statute (the

Independent Member) concerning, among others, professional relations or kinship, in particular with members of management and supervisory bodies of the Issuer and the PZU Group companies. The Independent Member is obliged to submit a written statement to the Company concerning his meeting all the independence criteria provided for in the Statute and inform PZU of ceasing to meet those criteria. Moreover, the Statute grants the State Treasury a personal right to appoint and dismiss one Supervisory Board member by virtue of a written statement submitted to the Management Board, if the share of the State Treasury in the Company drops below 50% of all of the Issuer's shares. The right shall expire on the State Treasury ceasing to be a shareholder in PZU.

As at 1 January 2011, the following persons sat on the Supervisory Board of PZU:

| | | |
|---|---|---|
| 1. | Marzena Piszczek | Chairman of the Board |
| 2. | Zbigniew Ćwiąkalski | Deputy Chairman of the Board |
| 3. | Krzysztof Dresler | Member of the Board |
| 4. | Dariusz Filar | Member of the Board |
| 5. | Waldemar Maj | Member of the Board |
| 6. | Piotr Maciej Kamiński | Member of the Board |
| 7. | Grażyna Piotrowska-Oliwa | Secretary of the Board |

On 30 June 2011, the Annual General Meeting appointed the following persons for the new term of office of the Supervisory Board of PZU:

| | | |
|---|---|---|
| 1. | Marzena Piszczek | Chairman of the Board |
| 2. | Zbigniew Ćwiąkalski | Deputy Chairman of the Board |
| 3. | Krzysztof Dresler | Secretary of the Board |
| 4. | Dariusz Filar | Member of the Board |
| 5. | Waldemar Maj | Member of the Board |
| 6. | Zbigniew Derdziuk | Member of the Board |
| 7. | Dariusz Daniluk | Member of the Board |

On 30 June 2011, the Supervisory Board of PZU was constituted. The Supervisory Board decided to entrust the function of its Chairman to Marzena Piszczek, the function of Deputy Chairman to Zbigniew Ćwiąkalski and the function of Secretary of the Board to Krzysztof Dresler.

The current term of office of the Supervisory Board of PZU started on 30 June 2011 and will end after three consecutive full financial years. The mandates of the Supervisory Board members shall expire at the latest on the date of holding the General Meeting to approve the financial statements for the last full financial year of their performing their functions, i.e. on the date of holding the Annual General Meeting in 2015.

***The functioning and competencies of the Supervisory Board arising from the Statute***

The Supervisory Board has constant supervision over the activities of PZU in all areas of its activities.

In accordance with the Statute, the competencies of the Supervisory Board include:

- evaluating the Directors' Report and the financial statements for the prior financial year in terms of their consistency with the books and documents and with the actual state;
- evaluating the propositions of the Management Board concerning appropriation of profit or covering loss;
- submitting a written report to the General Meeting on the results of the evaluation referred to in the points above and submitting a brief annual assessment of the Company's standing, including an assessment of the internal control system and the system for managing risks significant to the Company, and an annual report on the activities of the Supervisory Board;
- concluding, terminating and amending contracts with the Management Board members and establishing the principles for their remuneration as well as the level of remuneration;
- appointing, suspending and dismissing the Chairman of the Management Board, the Management Board Members and the entire Management Board as well as making decisions on ceasing any such suspension;
- granting approval for the transfer of a whole or part of the insurance portfolio;
- accepting the Management Board's motions concerning the purchase, taking up or selling of shares in companies and concerning the Company's participation in other entities – the Supervisory Board may specify up to what amount and on what terms and in what mode the Management Board can perform the aforementioned actions without the obligation to obtain the Supervisory Board's approval;
- delegating members of the Supervisory Board to temporarily perform the duties of the Management Board members who were dismissed, resigned or are unable to perform their duties for other reasons;
- accepting instructions concerning the execution of the voting rights by the Company's representatives at the General Meetings of PZU Życie in matters relating to: increasing or reducing share capital, issuing bonds, selling and leasing out the PZU Życie enterprise and establishing the right of use thereon, demerger of PZU Życie, merger of PZU Życie with another company, liquidation or closing of PZU Życie;
- electing the entity authorized to audit the financial statements to whom the audit of the Company's annual financial statements shall be entrusted;
- establishing a consolidated text of the amended Statute;
- approving the long-term development plans of the Company and the annual financial plans prepared by the Management Board**;**
- approving the rules and regulations of the Management Board;

- analyzing and giving opinions on issues brought by the Management Board for the consideration of the General Meeting.

Moreover, the competencies of the Supervisory Board include granting approval to:

- buy or sell real estate, perpetual usufruct or a share in real estate or in perpetual usufruct with a value exceeding the equivalent of EUR 3 million;
- the Company to conclude a significant contract with its related entity as defined in the Decree on current and periodic information, excluding typical contracts concluded by the Company on an arm's length basis as part of its operating activities (the requirement to obtain approval in this scope will come into force on the date of the first quoting of Shares on the WSE);
- the Company to conclude a contract with a subissuer referred to in Art. 433 § 3 of the Commercial Companies Code;
- make payments of interim dividends;
- form and close regional branches and foreign branches.

The Supervisory Board enacts the rules and regulations which regulate its organization and mode of operation. In accordance with the Statute, the Supervisory Board meetings are held at least once every quarter. The Supervisory Board may delegate its members to independently perform specific supervision tasks and appoint temporary commissions for this purpose. The scope of duties of a delegated member of the Supervisory Board and of a commission are specified in a resolution of the Supervisory Board.

Resolutions of the Supervisory Board are passed by an absolute majority of the votes. If the number of votes is equal, the Chairman of the Supervisory Board has the casting vote. The Supervisory Board may pass resolutions both using remote means of direct communication and in writing by circulation. Moreover, the Statute provides for the possibility of casting a vote in writing through another Supervisory Board member. In accordance with the Statute, the resolutions of the Supervisory Board are passed in an open ballot, except for the resolutions concerning the delegation of Supervisory Board members to temporarily perform the functions of the Management Board members and concerning the appointment, suspension and dismissal of the Chairman of the Management Board, Board Members or the entire Management Board, as well as making decisions on ceasing such suspension, which are made in a secret ballot. Moreover, a secret ballot can be ordered based on a motion tabled by a Supervisory Board member.

***The functioning and competencies of the Supervisory Board arising from the Rules and Regulations of the Supervisory Board***

The Rules and Regulations of the Supervisory Board were enacted by the Supervisory Board on 4 March 2010.

The Rules and Regulations of the Supervisory Board specify the composition and the manner of appointing the Supervisory Board as well as the scope of the Supervisory Board's operations and the method for convening the Supervisory Board and conducting meetings.

The Supervisory Board elects from among its members the Chairman and Deputy Chairman of the Supervisory Board. In accordance with the Rules and Regulations of the Supervisory Board, apart from appointing the IPO committee provided for in the Statute, the audit committee and the nominations and remuneration committee, in order to properly perform its supervisory duties the Supervisory Board may appoint other permanent advisory and consultative committees with competencies, in a composition, and with work procedures established in the rules and regulations of a given committee enacted by the Supervisory Board. The Rules and Regulations of the Supervisory Board provide for the possibility of the Supervisory Board and the committees appointed by it availing themselves of the services of experts and advisory firms. Members of the Management Board (invited by the Supervisory Board) and the Company's employees indicated by the Management Board competent in the matters discussed at the meeting may participate, among others, in the Supervisory Board's meetings without a voting right. The Supervisory Board of PZU may also invite to a joint meeting for a specific purpose members of the management and supervisory bodies of other PZU Group companies. Moreover, members of the Supervisory Board are entitled, on the approval of the Supervisory Board, to select not more than one advisor authorized to participate with an advisory vote in meetings of the Supervisory Board devoted to financial reports and financial statements, provided that such persons maintain confidentiality and sign a statement of obligation to maintain confidentiality.

***Committees functioning as part of the Supervisory Board***

***The Audit Committee***

The Statute provides for the Supervisory Board to appoint the audit committee. The committee is composed of three members, including at least one independent member with accounting or audit qualifications. The detailed tasks and principles for the appointment and operation of the audit committee are specified in the resolution of the Supervisory Board, which when electing the audit committee members takes into account the competencies and experience of the candidates in the matters entrusted to this committee.

In accordance with the rules and regulations of the audit committee adopted by a resolution of the Supervisory Board, the audit committee is an advisory and consultative body to the Supervisory Board and is appointed in order to increase the effectiveness of the supervisory activities performed by the Supervisory Board in the scope of examining the correctness of financial reporting, the effectiveness of internal control, including the internal audit and risk management system. Moreover, the audit committee may apply to the Supervisory Board to commission the performance of specified control activities in the Company, and the controls commissioned may be performed by an internal unit or an external company.

The audit committee was appointed by a resolution of the Supervisory Board on 3 June 2008. As at 31 December 2011, the audit committee was composed of the following persons: Marzena Piszczek (Chairman of the committee), Dariusz Filar (member of the committee) and Dariusz Daniluk (member of the committee). Dariusz Filar was indicated by the Supervisory Board as an independent member having accounting / audit qualifications as defined in Art. 86 clause 4 of the Act on Registered Auditors.

***The Nominations and Remuneration Committee***

In accordance with the Statute, from the moment of introducing the Company's shares to trading on the regulated market as defined in the Act on trading in financial instruments dated 29 July 2005 (Journal of Laws 183 of 2005, item 1538 as amended), the Supervisory Board may appoint the nominations and remuneration committee. The detailed tasks and principles for the appointment and operation of the nominations and remuneration committee are specified by the Supervisory Board in a resolution. The committee should include at least one independent member. If the Supervisory Board is composed of five members as a result of voting on its composition, the nominations and salary committee shall not be formed and its tasks shall be performed by the Supervisory Board as a whole.

The nominations and remuneration committee performs an advisory and consultative function for the Supervisory Board in the scope shaping the management structure, including organizational issues, the remuneration system and salaries and selecting staff with appropriate qualifications.

The Supervisory Board decided that the nominations and remuneration committee shall be composed of four persons. On 30 June 2011, the Supervisory Board appointed a nominations and remuneration committee composed of the following persons: Zbigniew Ćwiąkalski (Chairman of the committee), Marzena Piszczek (member of the committee), Zbigniew Derdziuk (member of the committee), Dariusz Filar (member of the committee). As at 31 December 2011, the composition of the nominations and remuneration committee had not changed. The committee shall be dissolved on the date of appointing five members of the Supervisory Board by voting in groups, and its rights shall be taken over by the Supervisory Board as a whole.

***The Strategy Committee***

In order to properly perform supervisory functions at the Company, the Supervisory Board may appoint permanent committees with an advisory and consultative role. On 30 June 2011, the Supervisory Board appointed a strategy committee composed of the following persons: Waldemar Maj (Chairman of the committee), Krzysztof Dresler (member of the committee), Marzena Piszczek (member of the committee) and Zbigniew Derdziuk (member of the committee). As at 31 December 2011, the composition of the strategy committee had not changed.

The objective of the strategy committee is to give opinions on all documents of a strategic nature submitted to the Supervisory Board by the Management Board (in particular, the Company's development strategy) and presenting recommendations to the Supervisory Board concerning planned investments which have a significant effect on the Company's assets.

***The Group Directors***

As at 1 January 2011, the following persons were PZU Group Directors:

- Dariusz Krzewina;
- Rafał Grodzicki;
- Przemysław Dąbrowski;
- Mariusz J. Sarnowski;

- Krzysztof Branny.

On 2 January 2011, Przemysław Dąbrowski resigned as PZU Group Director and on 24 January 2011, the Management Board of PZU dismissed Przemysław Dąbrowski from this post and appointed Tomasz Tarkowski Group Director from 1 February 2011.

On 4 May 2011, the Management Board of PZU dismissed Tomasz Tarkowski as PZU Group Director. On 7 July 2011, the Management Board dismissed Mariusz Sarnowski as PZU Group Director effective from 20 June 2011. On 24 August 2011, the Management Board of PZU dismissed Krzysztof Branny as PZU Group Director effective from 16 August 2011.

On 7 February 2012, the Management Board of PZU appointed Przemysław Henschke PZU Group Director as of 1 February 2012. As a result, as at the date of publishing the Directors' Report the following persons were PZU Group Directors:.

- Dariusz Krzewina;
- Rafał Grodzicki;
- Przemysław Henschke.

## 15.4 Discussion of the main features of the internal control and risk management systems applied in the issuer's enterprise in respect of the process of preparation of financial statements and consolidated financial statements

The process of preparing financial statements is performed by the Finance Division of PZU supervised by a Member of the Management Board of PZU.

The elements enabling proper performance of the process are: the accounting policies adopted by the Management Board of PZU and the chart of accounts with a commentary, which set out the main principles for recording the economic events of PZU, and the dedicated reporting systems.

The preparation of data in the source systems is subject to formalized operational and acceptance procedures, which define the scope of competencies of the individual persons.

PZU monitors changes in the external regulations concerning, for example, the accounting policies and the reporting requirements for insurance companies, and carries out appropriate adaptation processes in these areas.

The process of closing the books and preparing financial statements is regulated by detailed schedules covering the key actions and control points as well as allocating responsibilities for timely and proper execution.

The key controls in the process of preparing financial statements comprise:

- controls and regular monitoring of the quality of the input data, supported by financial systems in which data correctness rules have been defined in accordance with the internal documents of PZU regulating the principles for controlling the correctness of accounting data;

- mapping of data from the source systems to the financial statements, supporting the correct presentation of data;
- analytical review of financial statements by specialists in order to confront them with the knowledge of the business and the business transactions conducted;
- formal review of the financial statements in order to confirm compliance with the binding legal regulations and market practice in the scope of the required disclosures.

Stand-alone and consolidated financial statements of PZU are subject to:

- a registered auditor's review - in the case of bi-annual financial statements;
- an audit by a registered auditor - in the case of annual financial statements.

In accordance with the Statute of PZU, the Supervisory Board of PZU appoints an audit committee composed of three members, including at least one member with accounting or auditing qualifications as defined in and in accordance with the requirements of the Act on registered auditors. The audit committee is an advisory and consultative body to the Supervisory Board of PZU and is appointed in order to increase the effectiveness of the supervisory activities performed by the Supervisory Board of PZU within the scope of examining the correctness of the financial reporting of PZU, the effectiveness of internal controls, including the internal audit and risk management system.

***Consolidated financial reporting***

Coordination of activities in the scope of the consolidated financial reporting processes is achieved, among other things, by the organizational structure of the Finance Division in the Head Offices of PZU and PZU Życie, which is a joint unit, i.e. it is organized based on personnel unity, and additionally it also employs part-time key persons responsible for the reporting of the majority of the companies covered by consolidation with their seats in Poland. In the case of all the consolidated subsidiaries, PZU performs control functions through the Management and Supervisory Boards of these companies.

The process of consolidated financial reporting is regulated by a number of internal documents regulating the accounting policies adopted in the PZU Group and the applied reporting standards, and by detailed schedules covering the key actions and control points as well as allocating responsibilities for timely and proper execution.

## 15.5 The list of PZU shareholders directly or indirectly holding significant packages of shares

As at 31 December 2011, PZU's shareholders holding significant packages of shares are the State Treasury and ING Otwarty Fundusz Emerytalny. The State Treasury holds 30,385,253 shares, representing 35.19% of the Company's share capital and ING Otwarty Fundusz Emerytalny holds 4,339,308 shares, representing 5.02% of the Company's share capital.

The remaining shareholders hold a total of 51,627,739 shares, representing 59.7874% of the Company's share capital.

The share capital of the Issuer is divided into 86,352,300 ordinary shares with a nominal value of PLN 1 each, giving a right to 86,352,300 votes at the General Meeting.

***Table 38: Shareholding structure – as at 31 December 2010***

| Shareholders | 31 December 2010 | | |
|---|---|---|---|
| | **Number of shares** | **% share in share capital** | **Share of votes at the General Shareholders' Meeting** |
| State Treasury | 39 020 483 | 45.19% | 45.19% |
| Other shareholders | 47 331 817 | 54.81% | 54.81% |
| **Total** | **86 352 300** | **100.00%** | **100.00%** |

***Table 39: Shareholding structure – as at 31 December 2011***

| Shareholders | 31 December 2011 | | |
|---|---|---|---|
| | **Number of shares** | **% share in share capital** | **Share of votes at the General Shareholders' Meeting** |
| State Treasury | 30 385 253 | 35.19% | 35.19% |
| ING Otwarty Fundusz Emerytalny | 4 339 308 | 5.03% | 5.03% |
| Other shareholders | 51 627 739 | 59.79% | 59.79% |
| **Total** | **86 352 300** | **100.00%** | **100.00%** |

The Management Board of PZU is not aware of any contracts concluded as a result of which changes might occur in the future in the proportions of shares held by the current shareholders.

## 15.6 Holders of any securities which give special controlling rights, including a description of those rights

PZU did not issue any securities that would give special controlling rights to the shareholders.

## 15.7 Restrictions on execution of voting rights

In accordance with the Statute of PZU, the shareholders' voting rights have been restricted so that, at the General Meeting, none of them can have more than 10% of the total number of votes existing at the Company on the date of holding the General Meeting, with the reservation that for the purpose of establishing the obligations of the acquirers of significant packages of shares provided for in the Act on public offering and in the Act on insurance activities, this restriction of the voting right shall be considered non-existent.

The above restriction of the voting rights does not apply to:

- shareholders who on the date of passing the resolution of the General Meeting introducing the restriction had rights from shares representing more than 10% of the total number of votes at the Company;
- shareholders acting with the shareholders referred to in point 1 on the basis of concluded agreements concerning the joint execution of voting rights from shares.

## 15.8 Restriction concerning transferring of ownership rights to securities

The Statute of PZU does not introduce any restrictions concerning the transfer of ownership rights to securities issued by the Company.

## 15.9 The principles for amending the Statute of PZU

Amending the Statute of PZU lies within the competencies of the General Meeting and requires passing a resolution by a majority of three fourth of the votes, obtaining approval from the PFSA in the cases indicated in the Act on insurance activities and entry in the National Court Register. The Statute of PZU provides for the Supervisory Board’s competence to establish a consolidated amended text of the Company's Statute..

## 15.10 Amendments to the Statute of PZU

On 1 June 2011, based on a proposition of the State Treasury, the Extraordinary General Meeting of PZU passed a resolution on amending the Statute of PZU and enacted all the amendments proposed by the shareholder.

The amendments to PZU’s Statute concerned the following issues:

- editorial changes concerning deleting from the Statute of PZU transitional provisions in the period of PZU’s operations before and after entry to the regulated market in order to increase the transparency of the Statute of PZU by resigning from provisions which became redundant when the actual status described therein came true;
- restricting the voting rights of the shareholders, including the adoption the principles for the accumulation and reduction of votes;

  The shareholders' voting rights have been restricted so that none of them at the General Meeting can have more than 10% of the total number of votes existing in PZU on the date of holding the General Meeting, with the reservation that for the purpose of establishing the obligations of the acquirers of significant packages of shares provided for in the Act dated 29 July 2005 on public offering and the terms and conditions of introducing financial instruments to an organized trading system and on public companies (Journal of Laws No. 185 of 2005, item 1539 as amended) and in the Act on insurance activities, this restriction of the voting right shall be considered non-existent. For the purpose of restricting the voting rights, the votes of shareholders between whom there is a controlling or subsidiary relationship are added up.

The restrictions do not apply to the State Treasury and shareholders acting with it based on concluded agreements concerning joint execution of the voting rights from shares. The restrictions of the voting rights shall expire when the State Treasury's share in PZU's share capital drops below 5%.

- the procedure for appointing the Supervisory Board.

  Members of the Supervisory Board of PZU are appointed and dismissed by the General Meeting.

  Until such time as the State Treasury's share in PZU's share capital drops below 20%, half of the Supervisory Board members are appointed by the General Meeting from among the persons indicated by the State Treasury.

- At the moment of the expiry of the right due to the State Treasury, it shall be acquired by a different shareholder representing the highest share in the share capital of PZU if that shareholder holds at least 20% of the share capital.
- Additionally, until the State Treasury ceases to be a shareholder in the Company, it has the right, in accordance with Art. 354 § 1 of the Commercial Companies Code, to appoint and dismiss one member of the Supervisory Board by virtue of a written statement submitted to the Company's Management Board. Such appointment or dismissal shall be effective from the moment of delivery of the relevant statement to the Management Board and shall not require a resolution to be passed by the General Meeting.

On 6 June 2011, in accordance with Art. 32 clause 2 points 4 and 7 of the Act on insurance activities, PZU applied to the PFSA for approval of the amendments to the Statute of PZU. On 28 June 2011, the PFSA issued a decision approving the amendments.

The amendments to the Statute came into force on the date of their entry by the registration court. On 17 October 2011, PZU received the court's decision concerning entering the amendments to the Statue of PZU in the National Court Register with effect from 6 October 2011.

The above amendments to the Statute were dictated by the need to ensure the stabilization of PZU's position. They ensure stabilization of the execution of the voting rights from shares and thus demotivate any actions leading to speculative trading in PZU's shares, especially such as might lead to temporary investment decisions. The amendments related to the principles for appointing the Supervisory Board are intended to ensure long-term stabilization of PZU's management and consistent execution of the adopted objectives.

These amendments prevent a strategic investor entering PZU.

On 8 February 2012 the Extraordinary Shareholders' Meeting of PZU adopted resolution No. 3/2012 amending the By-laws of PZU by way of adding item 11 in Article 18 and changing the wording of Article 25.2.12 of the By-laws.

The changes of the By-laws of PZU concern the competences of the Company's bodies with respect to approving the acquisition or sale of real property, perpetual usufruct right or share in real property or perpetual usufruct right.

Under Article 393.4 of the Code of Commercial Companies the acquisition or sale of real property, perpetual usufruct right or a share in real property or perpetual usufruct right requires a consent of the general shareholders' meeting, unless the company by-laws provide for otherwise. The binding By-laws of PZU specify the competences of the Supervisory Board with respect to approving the acquisition or sale of real property, perpetual usufruct right or share in real property or perpetual usufruct right the value of which exceeds Euro 3,000,000 (Article 25.2.12 of the By-laws) and does not exclude such approvals from the competences of the General Shareholders' Meeting. Therefore, any acquisition or sale of real property, perpetual usufruct right or a share in real property or perpetual usufruct right by PZU requires the approval of the General Shareholders' Meeting, irrespective of the value of the transaction. Moreover, if the value of the transaction exceeds Euro 3,000,000, such transaction requires an additional approval of the Supervisory Board. The By-laws of PZU, however, do not specify whether the amount includes the VAT.

The amendments in question are aimed at dividing the competences in this respect between appropriate PZU's bodies and at eliminating interpretation differences which may occur due to the fact that there no clear instructions specifying if the amount of the transaction includes the VAT.

## 16. The truth and fairness of the presented financial statements

To the best knowledge of the Management Board of PZU, the consolidated financial statements of the PZU Group and the comparative figures have been prepared in accordance with the binding accounting policies and they give a true, fair and clear view of the financial position of the Group and its results, and the Directors' Report of the PZU Group presents a true picture of the PZU Group's development, achievements and situation, including a discussion of the main risks and threats.

## 17. Election of the registered audit company

The Management Board of PZU declares that a registered audit company Deloitte Audyt Sp. z o.o. - performing the audit of the consolidated financial statements of the PZU Group has been elected in accordance with the binding regulations and that the registered audit company and the registered auditors performing the audit met the conditions required for issuing an objective and independent opinion on the audited consolidated financial statements, in accordance with the binding regulations of the law and professional standards.

***Signatures of the Management Board Members of PZU:***

| **Name and surname** | **Position / Function** | |
|---|---|---|
| Andrzej Klesyk | Chairman of the Board of PZU | ......................................... (signature) |
| Przemysław Dąbrowski | Board Member of PZU | ......................................... (signature) |
| Witold Jaworski | Board Member of PZU | ......................................... (signature) |
| Tomasz Tarkowski | Board Member of PZU | ......................................... (signature) |

| | | |
|---|---|---|
| Bogusław Skuza | Board Member of PZU | |
| | | .......................................... (signature) |
| Ryszard Trepczyński | Board Member of PZU | |
| | | .......................................... (signature) |

Warsaw, 14 March 2012