Supervisory Board's Assessment of ING Bank Śląski S.A. Group Operations in 2020

The coronavirus pandemic and related sanitary restrictions have led to the first since 1991 downturn in Poland's GDP. According to the Central Statistical Office (GUS), in 2020 Poland's GDP fell in real terms by 2.7% y/y, whereas a year earlier it went up by 4.5%. Despite the decline, its scale in 2020 was about 1/3 of that from the beginning of the transformation period (then, GDP fell by 7% y/y) and about 1/2 of what was indicated by estimates made in the spring during the first wave of the pandemic. In 2020, there was a drop by 3.0% y/y in private consumption and a decline by 8.4% y/y in investments. Economic upturn in Poland was strongly stabilised by net export. Its contribution to GDP growth in 2020 was positive (+1.0 p.p.) and was related, among others, to a strong improvement in global manufacturing in the second half of 2020. This was the result of an economic upturn in Asia and a shift in household demand from unavailable services to durable goods. This was conducive to a faster rebound in exports and industrial value added in the second half of 2020. Just as in other countries, also in Poland the economy supported by the huge fiscal package (6.5% of GDP) steadily adjusted to administrative constraints. The autumn wave of COVID-19 was marked with a sharp increase in the number of coronavirus patients compared to the spring wave, but as the ING Economic Freeze Index indicated, the associated restrictions were 1/4-1/2 less onerous in Poland, and the q/q decline in GDP in Q4 2020 was only about 1/13 of that in Q2 2020 (-0.7% q/q vs. -9% q/q).
Despite a much worse economy, average annual inflation in 2020 accelerated to 3.4% y/y from 2.3% y/y in 2019. This is a consequence of an almost 5% y/y increase in energy prices and a strong acceleration in core inflation pace (to 3.9% y/y from 2.0% in 2019). The increase in core inflation resulted from a strong increase in the price of services (up 6.9% y/y), including wastes collection, health-related services, communications and the cost of financial services. Despite all that, after their initial reaction to the pandemic shock and cutting rates three times, the Monetary Policy Council has kept the rates at historically low levels since May (reference rate 0.1%). The economy was additionally supported by the Monetary Policy Council by launching a programme to buy back bonds issued and guaranteed by the State Treasury. In 2020, NBP bought back bonds worth approximately 4.6% of Poland's GDP. Last year, the volatility of the Polish zloty was affected by global factors and the NBP's currency interventions, which began in December 2020. EUR/PLN rate as at the yearend was 4.61 whereas at the end of 2019 it was 4.26.

Undoubtedly, it was the COVID-19 pandemic that had the strongest and multidimensional impact on the banking sector in 2020, outcome of the government's protective measures included. The sector had to face a threefold reduction in interest rates in the first half of the year, a rocketing increase in deposits of corporate customer at the end of the second quarter and the beginning of the third quarter, or the increased volatility and unpredictability of financial markets. At this point, we should also mention the further increase in the sector's regulatory costs, including most of all the costs of the Bank Guarantee Fund, which in 2020 increased by 14% y/y.

Furthermore, the banking sector's old problem concerning mortgage loans extended in foreign currency, and in particular in Swiss franc, still remains unresolved. Following the ruling of the European Court of Justice (CJEU) in October 2019, the number of litigations in the sector has increased rapidly. This is one of the reasons why, in December 2020, the Chair of the KNF presented a proposal to solve this problem by concluding the so-called voluntary settlements by and between the customer and the bank whereby a foreign currency loan would be converted into a PLN one. The calculation of losses for the bank (resulting from partial principal forgiveness offered to the client) assumes conversion of the loan agreement and repayments made by the borrower as if the loan had been granted in PLN from the very beginning. According to the KNF data, such solutions may cost the banking sector around PLN 35 billion. In addition, some banks still experience the negative consequences of the CJEU's ruling of September 2019 on early repaid consumer loans - before the contractual due date, making provisions for historical exposures repaid before the date of the ruling itself.

Despite so many negative factors affecting the Polish economy and the banking sector in 2020, ING Bank Śląski S.A. Group generated net profit of PLN 1,337.6 million, a significantly lower decrease than the result of the entire sector, namely -19% for ING Bank Śląski Group compared to -44% for the sector. This lower net profit in ING Bank Śląski Group results mainly from a significantly higher risk cost within the Group, up 40% y/y to PLN 804.6 million - mostly due to the revision of the macroeconomic assumptions used in the provisioning models (the effect of PLN 242.5 million), and additional provisioning for the legal risk attributable to FX mortgage loans of PLN 270.3 million compared to PLN 31.2 million in 2019. As a consequence thereof, the provision coverage ratio for loans and other receivables in Stage 3 went up y/y by 6.6 p.p. to 60.7%; and the FX mortgages coverage by legal risk provisions is the highest in the sector and it is 33.6% as at the end of 2020. It is worth emphasizing that the Group's operating result before cost of risk went up by 5% y/y to PLN 3,468.2 million, even despite so many negative trends in the sector. Result on core activities increased by 7% y/y, mainly due to a significant improvement in commission income by 14% y/y. On the other hand, the Group's general and administrative expenses went up by 11% y/y, including regulatory costs (BFG and KNF) up by 38% and own costs by 8% y/y. Finally, as a consequence of the increase in balance sheet total (+18% y/y), the cost related to the so-called bank tax was also higher (+11% y/y).

The Supervisory Board exercises oversight over the Company's operations by keeping watch over the Company's adherence to the relevant regulations in the area of accounting, finance and reporting of public companies. The powers of the Supervisory Board also include supervision of the individual risk management processes at ING Bank Śląski S.A. with the support of the Risk Committee and Audit Committee. Based on the recommendations of those Committees, the Supervisory Board accepts and approves the business risk management strategy of the Bank, the key principles of the policy and the related risk appetite. Further, the Supervisory Board monitors the utilisation of internal limits vis-à-vis the current strategy of the Bank.

The Risk Committee supports the Supervisory Board in monitoring the risk management process, including operational risk, liquidity risk, credit risk and market risk. The Committee also supervises the risk management process as well as the assessment of internal capital, capital adequacy, and of the risk of capital-related models and other models. The Committee voices its opinion about the overall readiness of the Bank to take the risk in the current and long term perspective.

Monitoring of the financial reporting process is among the tasks of the Audit Committee. In this context, the Audit Committee periodically analyses the Bank financial statements and the results of their audit. Further, the Chairman of the Audit Committee – who is the Chairman of the Supervisory Board and an independent member of the Board at the same time – holds periodic meetings with the Vice-President of the Management Board in charge of the CFO Division during which the Chairman is updated on the interim financial results of the Bank prior to their publication. The Audit Committee also analyses the performance of works by the entity authorised to audit financial statements, safeguarding its independence and effectiveness. Furthermore, the Audit Committee monitors the effectiveness of internal control and internal audit systems, and also assesses the effectiveness of measures used to mitigate the compliance risk and the said risk management quality.

There was also established the Remuneration and Nomination Committee within the Supervisory Board, which monitors i.a. the situation of the labour market in the context of salaries, the employee turnover process, and also staff satisfaction survey results. The Committee regularly monitors the remuneration system of the Bank, the payroll and bonus policy included. In 2020, the Committee conducted a re-assessment of the suitability of the members of the Supervisory Board (including collective suitability) and, in connection with changes to the Supervisory Board, an assessment of the suitability of new members of the Supervisory Board. The Committee also carried out an assessment of the suitability of the Management Board members appointed for a new term of office (including collective suitability) based on the results of the suitability assessment carried out by an external entity. Furthermore, the Committee carried out a suitability assessment and decided to recommend to the Supervisory Board the appointment of new Management Board Members in charge of the Wholesale Banking Division and the Business Clients Division. The Committee also assessed the collective suitability of the Management Board, the newly appointed Management Board Members included.

In the opinion of the Supervisory Board, the risk management system at the ING Bank Śląski S.A. Group covers all material risks. Moreover, the instruments and techniques used to identify, measure, manage and report risks are adequate for a given risk type. In 2020, ING Bank Śląski S.A. satisfied all the requirements of sound business operations and capital adequacy, and in particular the Bank:

- pursued prudent lending policy. The lending processes and procedures were compliant with the regulatory requirements and best practices on the market. In 2020, the Bank took account of the economic situation in its lending policy and applied more restrictive procedures towards sectors characterised by increased risk. The Bank's lending portfolio was diversified with a significant share of high-quality loans granted to business entities. Within the Bank Group, credit receivables in Stage 3 represented 3.3% of the total gross exposure (measured at amortised cost), which is significantly less than the average for the entire banking sector (6.5%);

- had systems and procedures in the market risk management area (for interest rate or currency risk, among others) that meet the top market standards. Throughout 2020, individual market risk categories were managed actively so that their levels were within the limits effective at the Bank. The balance sheet structure of the Bank is balanced from the currency perspective; its distinctive feature is the low share of FX receivables in the total mortgage receivables, among other things;
- maintained good liquidity. As at 2020 yearend, the LtD ratio settled at 82.6%. The sound liquidity position of the Group is attributable to one of the largest among Polish banks (and still growing) stable household deposits base;
- had an adequate level of own funds meeting supervisory requirements. In December 2020, the total capital ratio of the ING Bank Śląski S.A. Group was 18.72%, while the Tier 1 ratio stood at 16.09%.

Furthermore, the internal control system used by the Bank is effective enough to secure the Bank against unexpected developments in terms of the financing granted, non-financial risk, market risk, liquidity or capital adequacy.

Despite an expected dynamic rebound in the pace of economic growth and increasing COVID-19 vaccination rates, 2021 is still greatly affected by pandemic developments in Poland and worldwide. This is why, the Supervisory Board is of the opinion that the Bank should continue to focus on the actions enhancing its own security, security of its employees and customers as well as actions ensuring availability and competitiveness of products and customer experience, such as:

- adequate capital management in order to ensure safe lending growth as well as fulfilment of all present and future regulatory requirements;
- further development of the product offer and electronic distribution channels. In the time of ongoing pandemic and stiff competition, it is possible to increase revenues by expanding the customer base through acquiring new customers and increasing loyalty of the existing ones. Such an approach boosts customer balances and transactions' volumes;
- increase of lending capabilities, while being prudent when assessing clients' risk. That will foster keeping high quality of the portfolio and boost net interest income;
- maintenance of adequate stable deposits. It will ensure liquidity indispensable to develop lending;
- further improvement of cost effectiveness while maintaining high quality of processes through optimal use of existing resources and benefits resulting from the increased scale of operations.

According to the Supervisory Board, the strategy pursued by the Bank over the last few years to increase the scale of its operations proved to be successful which is reflected in the achieved financial and commercial results. The hitherto success of the strategy justifies the intention of its continuation by the Bank in the coming year while maintaining the appropriate level of capital.