MANAGEMENT REPORT ON THE ACTIVITY OF POWSZECHNY ZAKŁAD UBEZPIECZEŃ SPÓŁKA AKCYJNA GROUP FOR THE 1ST HALF OF 2013

Contents

INTRODUCTION

1. Overview

According to the Polish Financial Supervision Authority ("PFSA"), the Powszechny Zakład Ubezpieczeń Spółka Akcyjna Group ("**PZU Group**") is one of the oldest and largest insurance groups in Poland in terms of gross written premium. The offer comprises a wide range of insurance and financial products.

The PZU Group engages in operations in four basic areas:

- property and casualty insurance – offered in Poland by Powszechny Zakład Ubezpieczeń Spółka Akcyjna ("PZU", "the Issuer");
- life insurance – offered in Poland by Powszechny Zakład Ubezpieczeń na Życie SA ("PZU Życie");
- open pension funds – offered by Powszechne Towarzystwo Emerytalne PZU ("PTE PZU"), which manages the open pension fund Otwarty Fundusz Emerytalny PZU "Złota Jesień" ("OFE PZU"); and
- investment funds – offered by Towarzystwo Funduszy Inwestycyjnych PZU SA ("TFI PZU").

PZU is the leader on the Polish property and casualty insurance market in terms of gross written premium (a 33.4% market share as at the end of Q1 2013[1]). The core product group offered by PZU is motor insurance, both to individual and corporate customers.

PZU Życie is the leader on the Polish life insurance market in terms of gross written premium (a 34.0% market share as at the end of Q1 2013[2]). The core group of products offered by PZU Życie is group and individual life insurance.

PTE PZU manages the open pension fund OFE PZU Złota Jesień, which as at the end of the first half of 2013 ranked third in Poland in terms of the number of members (2.2 million members[3]) and net assets (PLN 36.6 billion[4]).

TFI PZU offers:

- participation units in open-ended investment funds, including specialist open investment funds;
- investment certificates of closed-end investment funds;
- investment plans; and
- pension plans, including Employee Pension Plans and Individual Pension Accounts.

The net asset value of investment funds managed by TFI PZU amounted to PLN 20.87 billion as at the end of the first half of 2013 (1st place on the market[5]).

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[1] Source: PFSA (www.knf.gov.pl). Quarterly bulletin. Insurance market 1/2013

[2] Source: PFSA (www.knf.gov.pl). Quarterly bulletin. Insurance market 1/2013

[3] Source: PFSA (www.knf.gov.pl). Monthly OFE data 6/2013.

[4] Source: PFSA (www.knf.gov.pl). Monthly OFE data 6/2013.

[5] Source: IZFiA (www.izfa.pl) Assets of investment funds as at 30 June 2013.

According to International Financial Reporting Standards (IFRS), the **net profit of the PZU Group** amounted to **PLN 1,675.7 million** in the first half of 2013 and was 2.4% lower than the net profit for the first half of the previous year.

ROE[6] for the period from 1 January to 30 June 2013 amounted to 24.3%, which is a drop of 2.5 p.p. compared with the first half of the prior year.

The following elements had an impact on the net result of the PZU Group compared with the first half of the prior year:

- an increase in gross written premium as a result of maintained high sales growth rate of insurance with single premium in the bancassurance channel, partly offset by the drop in written premium in motor insurance in the corporate and mass insurance segments, and in hospital accident insurance in effect of legislative changes;
- improvement in profitability in the mass and corporate segment, including:
    - in motor insurance due to lower frequency of losses;
    - in agricultural insurance due to a significantly lower level of claims caused by fire and natural forces; and
    - in financial insurance due to the prior year's slump on the construction market;
- higher profitability of life insurance in group and individually continued segment, without conversion effect from long-term into yearly-renewable term business in type P insurance;
- lower income from investments as a result of a drop in the valuation of equity instruments (bear market on the Warsaw Stock Exchange "WSE") and debt instruments (an increase in yields on bonds);
- one-off income from consolidating investment funds;
- one-off income from concluding a conciliatory agreement with the reinsurer in respect of Green Card insurance (partial reversal of the adjustment of estimates with the reinsurer, decreasing the result for 2011);
- maintaining discipline of fixed costs (a drop in personnel costs as a result of the restructuring activities conducted in recent years) while continuing project activities aimed at streamlining and automating customer service processes.

PZU and PZU Życie have a long-term credit rating and financial strength rating (awarded by Standard & Poor's Ratings Services) at **A level with a stable outlook.**

2. Macroeconomic trends in 2013

2.1. Key economic trends and economic growth

In the first quarter of 2013 GDP dynamics dropped to 0.5% y/y compared with 0.7% y/y in the last quarter of the prior year. In view of the drop in domestic demand of 0.9% y/y (in the fourth quarter of 2012 it was -1.6% y/y), the net export was decisive for maintaining economic growth in that period. The exports volume increased by 1.3% y/y accompanied by a simultaneous drop in imports of 1.7% y/y. Good economic results in June contributed to an acceleration in economic growth in the second quarter to 0.8% y/y.[7]

Individual consumption in the first quarter of 2013 was at the level of the first quarter in the prior year, after having dropped by 0.2% y/y in the fourth quarter of 2012. In this period the gross disposable income of households increased in real terms; however, the difficult situation on the labour market did not contribute to an increase in consumption, and induced saving. Nevertheless, in consecutive quarters the stagnation in individual

[6] ROE – annualized ratio calculated as net profit (loss) divided by the average equity as at the end and as at the beginning of the reporting period.

[7] Data according to a quick estimate by GUS dated 14 August 2013

consumption should be suppressed in view of the continued increase in real income, improved consumption ratios (in this case lower unemployment concerns) and an increase in consumer loans. In the second quarter of 2013 individual consumption should be on the up y/y. This is indicated, among other things, by the retail sales accelerating on real terms in May and June.

Gross expenditure on fixed assets decreased in the first quarter of 2013 by 2.0% y/y – clearly less than in the previous quarter (-4.1% y/y). The investment activity of enterprises was low during that period, and was accompanied by limited financing of development activities with bank loans. No quick turnaround of the drop trend in investments should be expected. Enterprises are very prudent in assessing the state of business and their perspectives, and public investments in infrastructure will probably only start to grow in the first months of 2014.

In the first quarter of 2013 activity in the construction industry decreased – added value dropped to -12.4% y/y compared with -2.6% y/y in the last quarter of the prior year. During this period added value in industry and trade, and in repairs of vehicles dropped by 0.3% y/y and 0.2% y/y respectively. These drops were smaller than those noted in the last quarter of the prior year (of -1.6 % and -1.9% y/y respectively). In the second quarter of 2013 the drop in the construction industry deepened. On the other hand, the drop trend in the dynamics of industrial products sold reversed and the PMI ratio for the processing industry exceeded 50 points in June – the conventional threshold of a growth trend in economic activity.

2.2. Capital market

In the first half of 2013 conditions on the international markets had a strong impact on the Polish capital market. Asset prices on the Polish capital market were characterized by high volatility, especially in the second quarter. After the end of 2012, which was very favourable for the Polish share market, from January to April 2013 a distinctive drop trend was noted on the Warsaw Stock Exchange. In the second half of April WIG and WIG20 indices were already losing value compared to the end of 2012 by 9.1% and 12.1% respectively, which was caused among other things by macroeconomic data flowing in from Poland and the Euro Area in the first quarter of 2013, which were disappointing for investors. In May signs of improvement in the Euro area conditions were the growth impulse for Polish indices. However, June brought about further drops – the main reason for them being the information on the possible reduction in quantitative easing in the USA before the end of the current year. Concerns about the consequences of changes in the Polish pension system could also have a negative impact on the capital market. Ultimately, over the first half of 2013 the WIG index decreased by 5.7%, and the WIG20 index by 13.1%.

In the first days of 2013 there were corrections to the valuations of Polish Treasury bonds. Returns on 1-year instruments increased in particular, which could be the effect of the Monetary Policy Council ("RPP") signalling the end of the period of loosening monetary policy at that time. In consecutive weeks the profitability curve remained flat and stable. March and April of 2013 proved extremely favourable for Polish Treasury bonds which were valued exceptionally high. Returns on 10-year and 1-year instruments dropped by 100 basis points during that period. Data indicating a slower increase in GDP in the USA and China and lack of improvement in the economic conditions in the Euro area, as well as the Bank of Japan's announcement of significant quantitative easing contributed to the increase in bond prices. At the same time, RPP resumed the cycle of interest rate reductions. Since then, conditions on international markets had a major impact on the Polish bond market, although local monetary policy also influenced financial instruments – especially those which mature within shorter periods. In May and June 2013 there was a strong revision of the extremely high levels of Polish Treasury bond prices, which mainly reflected investors' concerns related to the divergence from quantitative easing signalled by the Fed and increased uncertainty as to the date of increasing interest rates in the USA. Ultimately, in the first half of 2013 the return on 10-year bonds increased to 4.25% compared with 3.73% as at the end of 2012, returns on 5-year bonds increased by 45 basis points during that period to 3.66%, while 2-year bonds dropped by 10 basis points to 3.01%. In consequence, the Polish profitability curve became decidedly steeper.

2.3. Monetary policy, interest rates, inflation

The annual dynamics of consumer goods and services prices (CPI) in the first half of 2013 systematically dropped, reaching probably the lowest level of the cycle in June (0.2% y/y compared with 2.4% y/y at the end of 2012). On average, in the first half of 2013 annual CPI dropped to 0.9% y/y compared with 3.4% y/y in the second half of 2012 and 4.0% y/y in the first half of 2012. The decrease in dynamics of energy prices due both to domestic factors (a drop in administered natural gas prices) and global factors (lower raw material prices) contributed to a slower pace of growth in prices. The drop in food prices and continued slowing of demand in the economy, as well as the absence of wage pressures contributed to the drop in inflation. Net inflation (excluding food and energy prices) decreased in June to 0.9% y/y compared with 1.4% at the end of 2012, and in the first half of the year it amounted to 1.1% y/y on average compared with 1.9% y/y and 2.5% y/y respectively in the second and first half of 2012.

With inflation distinctly below the target, in the first half of 2013 RPP continued the cycle of loosening the monetary policy initiated in November 2012. In January and February all official NBP interest rates were reduced by 25 basis points, and in March by 50 basis points. Despite the fact that in March RPP signalled that it was about to end this sequence of loosening the monetary policy, in May, June and July 2013 interest rates were reduced by 25 basis points respectively. In July RPP announced discontinuing the reduction in interest rates in this cycle, with the NBP reference rate at 2.50% compared with 4.75% in October 2012, before initiating the cycle loosening the monetary policy.

2.4. Labour market and consumption

In the first half of 2013 conditions on the labour market were worse than in the same period of 2012; however, in the second quarter the situation showed signs of stabilization. According to BAEL[8] the number of employees dropped by 0.7% y/y in the 1st quarter of 2012 compared with the 0.1% y/y increase in the previous quarter. At the same time, according to these statistics, unemployment in the first quarter of the current year increased to 11.3% compared with 10.1% in the fourth quarter of 2012 and 10.5% in the first quarter of the prior year. The dynamics of average monthly gross remuneration in the enterprise sector in the first half of 2013 dropped to -1.0% y/y compared with -0.3% y/y in the second half of 2012. However, in May and June the downward trend in employment dynamics in enterprises was reversed. Although the unemployment rate registered in June 2013 amounted to 13.2% compared with 12.3% in June 2012, its drop until June compared with the seasonal high in February was a little quicker in 2013.

In conditions of a serious economic slowdown, the labour market reacted with a decided drop in wage dynamics. The dynamics of average monthly remuneration in the enterprise sector in the first half of 2013 amounted to 2.5% y/y compared with 2.8% y/y in the second half of 2012. Remuneration dynamics in the national economy in the first half of 2013 were almost 3% y/y, and in the second quarter they increased to 3.3% y/y compared with 2.6% y/y in the first quarter of 2013 and 2.9% y/y in the previous quarter. However, the systematic and decided drop in inflation caused the real dynamics of remuneration to be positive in the first half of 2013 compared with the drop in dynamics in the second half of 2012. The real pace of growth of payroll in the enterprise sector in the first half of 2013 amounted to 0.3% y/y on average compared with -1.0% y/y in the second half of 2012. In the first quarter of 2013 the real gross disposable income of households increased. In conditions of increasing real income and improving consumer sentiments, the slowing deterioration in market conditions and increase in consumer loans, we may expect an increase in individual consumption on an annual scale in the second quarter.

2.5. Foreign exchange rates

The volatility of the zloty (PLN) in the first half of 2013 was lower than in 2012, and the range of fluctuations compared with the main foreign currencies (euro, American dollar) did not exceed 0.3 PLN. Ultimately, between the end of 2012 and the end of June 2013, the position of the zloty weakened compared to the USD by 7.0% and

[8] BAEL – survey of the population's economic activity.

to the euro by 5.9%. It seems that two factors were responsible for this: the outflow of investors from our region of Europe in May and June 2013 and systematic decreases in the NBP reference rate, which led to a decrease in interest rate parities between Poland and other countries. On the other hand, the drop in the trade deficit in the current account of the balance of payments to the GDP had a stabilizing impact on the Polish currency.

2.6. Impact of macroeconomic factors on the insurance sector

Weak economic growth in the first half of 2013 did not contribute to an increase in demand for insurance products. Despite the real growth in household income, stagnation in individual consumption only started to rebound at the end of the period. Although the financial position of the enterprises in general was worse than a year ago, exporters were relatively better off than enterprises operating exclusively on the Polish market. Investment activity was lower than a year ago, and simultaneously bank loans to finance capital expenditure were restricted. The construction industry continued to be a source of significant risk for insurers. Weakening of the PLN through the increase in prices of imported spare parts had a negative impact on the loss ratio. Sales dynamics in respect of vehicles in the first half of 2013 were distinctly lower than in the first half of 2012, which reduced the possibility of increasing written premium year on year. At the same time, conditions on the capital market in the first half of 2013 did not contribute to an increase in financial investments.

3. Insurance and pension market versus the market share of PZU Group companies

3.1. Total insurance market

Gross written premium in the whole Polish insurance sector according to Polish Accounting Standards ("PAS") as at the end of the first quarter of 2013[9] amounted to PLN 15,014.4 million, which indicates a drop of 8.8% (PLN -1,457.0 million) year on year.

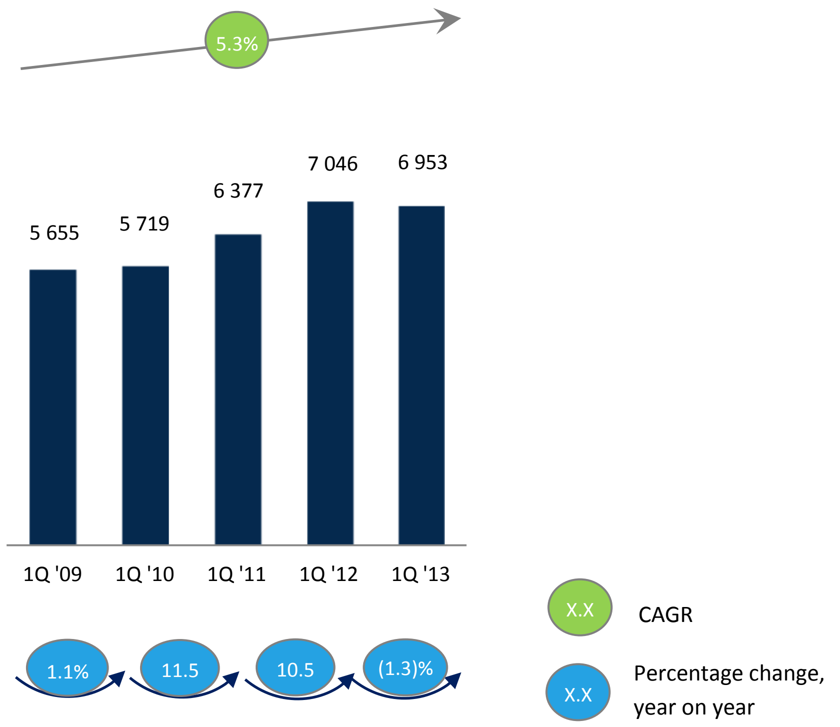
The total value of investments of all insurance companies (excluding shares in subordinated entities) amounted to PLN 91.6 billion as at the end of the first quarter of 2013 and increased by 1.8% since the end of 2012.

3.2. Property and casualty insurance in Poland

In the first quarter of 2013 the market shrank by PLN 93.2 million compared with the same period of the prior year (-1.3% year on year), mainly as a result of a drop in sales of Casco insurance (a drop of PLN 118.4 million, -8.0% year on year) and MTPL insurance (a drop of PLN 110.9 million, -4.9% year on year), in particular in effect of a reduction in tariffs both for enterprises and individual customers. These changes resulted mainly from the standstill in the number of policies for individuals in MTPL insurance and a drop in the number of policies for enterprises in motor third party liability and Casco insurance. Those drops were offset by increases in premiums in insurance caused by natural forces and general liability insurance, and a stable increase in the number of policies insuring other tangible damage.

[9] Most up to date data published by the Polish Financial Supervision Authority ("PFSA") as at the moment of preparing the Managament Report on the activity of PZU Group.

Chart 1: Gross written premium of property and casualty insurance companies in Poland



Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń (Insurance market) 1/2013, Rynek ubezpieczeń 1/2012, Rynek ubezpieczeń 1/2011, Rynek ubezpieczeń 1/2010

The property and casualty insurance market earned a net profit of PLN 752.6 million in the first quarter of 2013 (+34.8% compared with the same period of the prior year).

The technical result on property and casualty insurance – which usually does not include investment income – increased by PLN 320.2 million to PLN 531.5 million (+151.5% y/y). The key factor which led to better results was the drop in the loss ratio in insurance of other tangible damage and motor casco insurance.

At the same time, in the first quarter of 2013 higher disbursements in respect of damage caused by natural forces, guarantee insurance and loan insurance were noted. Payments in respect of guarantee and loan insurance, which may be analyzed as insurance directly related to the condition of Polish enterprises, increased by PLN 87.8 million, i.e. 110.9% compared with the same period of the prior year. Higher guarantee insurance disbursements were determined specifically by bankruptcies of companies from the construction sector in the prior year.

The negative impact of claims paid in respect of insurance losses caused by fire and natural forces, guarantee and loan insurance was offset by releasing loss provisions set up in the prior year, which ultimately had a positive effect on the technical result.

The situation was the reverse in MTPL (Motor Third Party Liability). In the first quarter of 2013 a drop in gross claims paid of PLN 24.0 million, i.e. 1.7% year on year, was noted, however, due to additional claims provisions being set up in the analyzed period, the value of claims and benefits increased by PLN 100.0 million, i.e. by 1.4% year on year.

The total value of investments of property and casualty insurance companies (without including shares in subordinated entities) amounted to PLN 43.7 billion as at the end of the first quarter of 2013 and increased by 3.1% since the end of 2012. As at the end of the first quarter of 2013, a large portion of those investments comprised securities issued, warranted or guaranteed by the State Treasury and local authorities – 52.8% (PLN

23.2 billion). The increase in yields on Treasury bonds in the first quarter of 2013 had a negative impact on the valuation of those instruments in the insurers' portfolios compared with the end of 2012. As at 31 March 2013 the value of debt securities and other fixed-income securities in the property and casualty insurers' balance sheets dropped by 3.8%.

Property and casualty insurers assessed the total value of their technical provisions at PLN 41.0 billion, which was a 2.5% increase compared with the end of 2012.

Table 1. Property and casualty insurance market – gross written premium

PLN million

Property insurance market – gross written premium	1 January– 31 March 2013			1 January– 31 March 2012		
	PZU	Market	Market without PZU	PZU	Market	Market without PZU
Casco insurance (AC)	518	1 361	843	567	1 479	912
MTPL insurance	734	2 143	1 409	754	2 254	1 500
Other products	1 068	3 449	2 381	1 120	3 313	2 193
TOTAL	**2 320**	**6 953**	**4 633**	**2 441**	**7 046**	**4 605**

Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 1/2013, Rynek ubezpieczeń 1/2012, PZU data

Table 2. Property and casualty insurance market – analysis of gross written premium

Structure of written premium	1 January– 31 March 2013			1 January– 31 March 2012		
	PZU	Market	Market without PZU	PZU	Market	Market without PZU
Casco insurance (AC)	22.3%	19.6%	18.2%	23.2%	21.0%	19.8%
MTPL insurance	31.6%	30.8%	30.4%	30.9%	32.0%	32.6%
Other products	46.0%	49.6%	51.4%	45.9%	47.0%	47.6%
TOTAL	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 1/2013, Rynek ubezpieczeń 1/2012, PZU data

Table 3. Property and casualty insurance market – PZU share in market premium

PZU SA share in market premium (in %)	1 January– 31 March 2013	1 January– 31 March 2012
Casco insurance (AC)	38.1%	38.4%
MTPL insurance	34.3%	33.4%
Other products	31.0%	33.8%
TOTAL	**33.4%**	**34.6%**

Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 1/2013, Rynek ubezpieczeń 1/2012, PZU data

PZU is the leader on the Polish property and casualty insurance market in terms of gross written premium with a 33.4% market share. At the same time, in order to maintain its profitability, for several years PZU has been conducting corporate insurance portfolio restructuring, which was related to a drop in premiums. With all the activity going on, PZU kept its high market position in terms of gross written premium – 49.2% for MTPL insurance and 42.8% in Casco Insurance in the enterprise sector as at the end of the first quarter of 2013.

In total, technical result in property and casualty insurance increased by PLN 320.2 million, i.e. 151.5% year on year, of which PZU profit was PLN 296.7 million, i.e. 171.1% higher.

Table 4. Property and casualty insurance market – technical result

PLN million

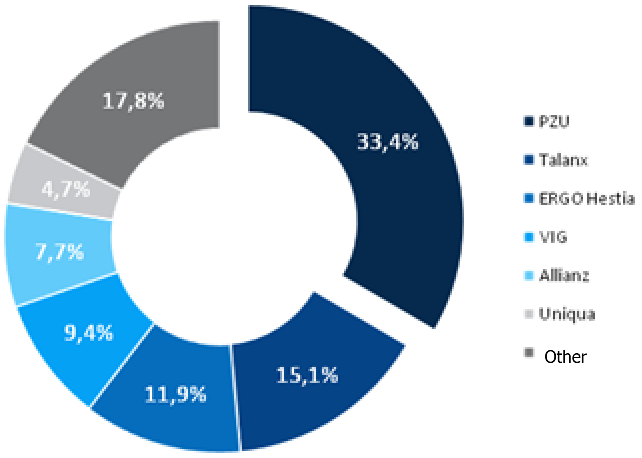
Technical result	1 January– 31 March 2013			1 January– 31 March 2012		
	PZU	Market	Market without PZU	PZU	Market	Market without PZU
Casco Insurance (AC)	75	122	47	73	121	48
MTPL insurance	159	57	(102)	80	27	(53)
Other products	237	353	116	21	63	42
TOTAL	**471**	**532**	**61**	**174**	**211**	**37**

Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 1/2013, Rynek ubezpieczeń 1/2012, PZU data

The share of PZU's net profit in the net market result as at the end of the first quarter of 2013 amounted to 65.8% (+7.8 p.p. year on year), which, considering the market share of 33.4% calculated in terms of gross written premium, confirms the high profitability of insurance and effective capital management in the period in which the activities of competitors intensified, which was reflected in reducing motor insurance tariffs.

Moreover, despite the effects of the intensification of activities aimed at acquiring customers which was plainly visible on the market, the share of PZU's technical result in total market profits as at the end of the first quarter of 2013 amounted to 88.6%, which is an increase of 6.1 p.p. compared with the same period of the previous year. Unvaryingly, for many years PZU has been the unchallenged leader both in terms of premium written and profitability.

Chart 2: Share of the largest property and other personal insurance companies in Poland



Groups Allianz - Alllianz, Euler Hermes; Ergo Hestia - Ergo Hestia, MTU; Talanx - Warta, Europa, HDI; VIG - Compensa, Benefia, Inter-Risk, PZM (as of 31 July 2012 merger of Inter-Risk and PZM)

Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 1/2013, Rynek ubezpieczeń 1/2012

3.3. Life insurance

Gross written premium on the life insurance market as at the end of the first quarter of 2013 dropped by 14.5% compared with the same period of the prior year. The drop in premium written throughout the market resulted from single premiums being 25.4% lower. In particular, the lower interest on deposits contributed to the drop in the attractiveness of life products offered through the bancassurance channel.

As at the end of the first quarter of 2013, premium written through the bancassurance channel dropped by 29.2% year on year, which translated into a significant drop in premium written in the whole group customer segment, which is described in detail below. Such a significant drop was caused by a decrease in sales of investment products through this channel. The drop in premium written through the bancassurance channel on *unit-linked* products with a regular or single premium, life insurance products with embedded deposits or structured policies, irrespective of the break-down into the protection and investment portion, amounted to -39.2% year on year. This contributed to a drop in the share of investment products written through the bancassurance channel from 89.8% as at the end of the first quarter of 2012 to 77.0% as at the end of the first quarter of 2013, with a simultaneous increase in the share of protection products linked to banking products written (only securing repayment of debt) from 9.7% as at the end of the first quarter of 2012 to 22.2% as at the end of the first quarter of 2013.

Regular premium, which is PZU Życie's competitive advantage, was maintained at a stable level as at the end of the first quarter of 2013 (an increase of 0.5% compared with the respective period of the prior year).

These changes compared year on year are the effect of a high base, as in the first quarter of 2012 market written premium increased by 23.3% year on year. At that time, the increase resulted mainly from the uneven growth spurts in single premiums of 40.9% year on year. Comparing total written premium in the first quarter of 2013 with the first quarter of 2011, an increase of 5.4% was noted, and in respect of single premium written the increase was 5.1%.

Moreover, analyzing premium written as a result of direct business of the life insurance sector, which reflected both in the first quarter of 2013 and in the first quarter of 2012, 99.9% of the total premium written on the market. The first quarter of 2013 showed a significant drop in written premium in the group customer channel (a drop of -18.1%), which fundamentally related to life insurance (a drop of -26.8%). Further analyzing premium written in direct activities, in the individual customer segment (where total premium written dropped by -9.1% year on year) the largest drop is visible in the life insurance group (-32.5% year on year). Apart from the drop in the popularity of investment products, the changes are also the consequence of a high base. In the first quarter of 2012 the increase in premium for group customers amounted to +38.0% compared with the same period of the prior year, and for the individual customer the increase was +7.9% at that time.

At the same time from the market , in the analysed period, PLN 1.5 billion of regular premiums were collected on the unit-linked products, which was an increase of 0.1%.

In total, in the first quarter of 2013 life insurance companies paid out claims of PLN 6.5 billion, of which PLN 6.4 billion constituted one-off payments, in particular from short-term investment contracts.

Total technical result dropped by PLN 183.2 million (-21.7%), mainly as a result of lower profitability in the life insurance group – a drop in technical result of PLN 190.2 million (-69.0%).

During the period, life insurance companies earned net profit of PLN 615.0 million, which was a drop of – 25.8% (PLN -213.8 million). Despite the worse data, PZU Życie maintains profitability measured as the ratio of the technical result to gross written premium much above the average market profitability.

Despite unfavourable conditions on the capital market and an increase in yields on Treasury bonds, the value of investments in life insurance companies (including Net unit-linked assets) was maintained at a stable level since the end of 2012 and amounted to PLN 94.7 billion (an increase of +0.4%). Net unit-linked assets as at the end of the first quarter of 2013 amounted to PLN 45.1 billion, and their drop of 0.1% quarter on quarter is indirectly related to a drop in interest in investment products.

Life insurers assessed the total value of their technical provisions at PLN 80.8 billion, which was 85.3% of total investments.

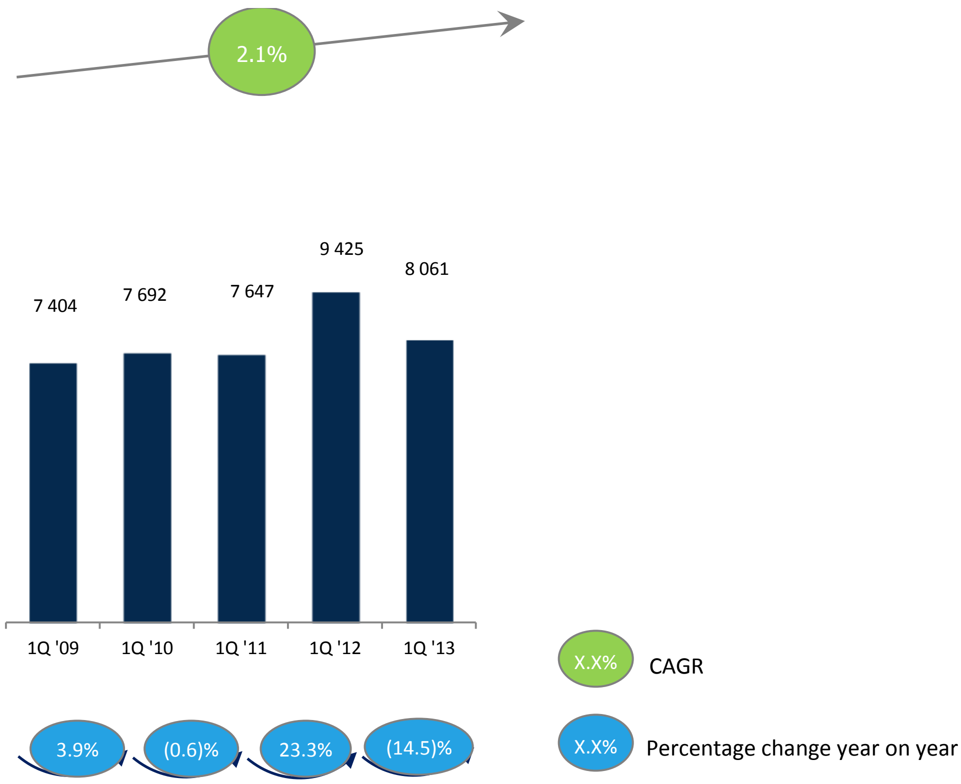
Table 5. Life insurance market – gross written premium and technical result

PLN million

Life insurance market – gross written premium vs. technical result	1 January– 31 March 2013			1 January– 31 March 2012		
	PZU ŻYCIE	Market	Market without PZU Życie	PZU ŻYCIE	Market	Market without PZU Życie
Written premium	**2 737**	**8 061**	**5 324**	**2 831**	**9 425**	**6 594**
Technical result	**336**	**661**	**325**	**483**	**844**	**361**

Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 1/2013, Rynek ubezpieczeń 1/2012, PZU data

Chart 3: Gross premium written by life insurers in Poland



Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 1/2013, Rynek ubezpieczeń 1/2012, Rynek ubezpieczeń 1/2011, Rynek ubezpieczeń 1/2010

PZU Życie continues to be the leader in the regular premium segment with a market share of 43.7% as at the end of the first quarter of 2013, which is an increase in the market share by 1.4 p.p. year on year. An increase in the market share in single premiums was also achieved (by 3.3 p.p. to 24.4%), i.a. as a result of cooperation with such banks as Bank Millennium SA and Bank Handlowy w Warszawie SA.

The technical result of PZU Życie constitutes the majority of the results earned by all life insurance companies. This is proof of high returns on the products offered. It should be emphasized that PZU Życie's technical result margin on written premium exceeds more than twofold the margin earned by the total of all other companies offering life insurance (12.3% vs. 6.1%).

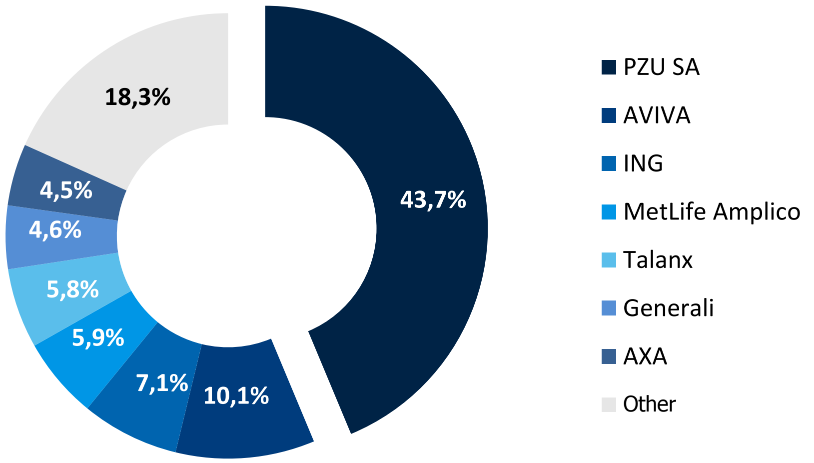
Table 6. Life insurance market – gross written premium

PLN million

Life insurance market – gross written premium	1 January– 31 March 2013			1 January– 31 March 2012		
	PZU ŻYCIE	Market	Market without PZU Życie	PZU ŻYCIE	Market	Market without PZU Życie
Regular premium	1 743	3 991	2 248	1 679	3 970	2 291
Single premium	994	4 070	3 076	1 152	5 455	4 303
TOTAL	**2 737**	**8 061**	**5 324**	**2 831**	**9 425**	**6 594**

Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 1/2013, Rynek ubezpieczeń 1/2012, PZU data

Chart 4: Share of the largest life insurers in Poland in regular premium



Capital Groups: Talanx - Warta, Europa, HDI, Open Life; VIG - Compensa, Benefia, Polisa Życie; Aviva – Aviva TUnŻ, BZ WBK-Aviva TUnŻ

Source: KNF (www.knf.gov.pl). Quarterly Bulletin. Rynek ubezpieczeń 1/2013, Rynek ubezpieczeń 1/2012

3.4. Pension insurance

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

Market for pension insurance	30 June 2013			30 June 2012		
	OFE PZU	OFE market	OFE market without PZU	OFE PZU	OFE market	OFE market without PZU
Number of fund members	2 227 036	16 209 162	13 982 126	2 220 691	15 735 064	13 514 373
Net managed assets in PLN million	36 594	272 150	235 556	32 517	241 069	208 552

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 %)	30 June 2013	30 June 2012
Number of fund members	13.7%	14.1%
Net managed assets	13.4%	13.5%

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

As at the end of the first half of 2013, there were 2,227 thousand members of OFE PZU which constituted 13.7% of the total number of open pension fund members and gave OFE PZU third place on the market in this respect. Drops in market shares of the three largest funds compared with the end of the first half of 2012 – ING OFE (-0.2 p.p.), OFE PZU (-0.4 p.p.) and Aviva OFE (-0.5 p.p.) are the effect of the fact that as of 1 January 2012 acquisition activities on open pension fund markets is fully banned and the only allowed procedure for concluding an agreement with OFE is by correspondence. Large funds *de iure* do not participate in draws, in January 2013 217 thousand people were assigned (89% of all those who acceded OFE) to Amplico OFE.

As at the end of the first half of 2013 the total value of net assets of all OFEs amounted to PLN 272,150 million and increased by 12.9% compared with the end of June 2012. OFE PZU assets increased by 12.5% during the period, to PLN 36,594 million, which placed OFE PZU third among all OFEs operating on the market in terms of the asset level.

3.5. Investment funds

According to data provided by the Chamber of Fund and Asset Managers ("IZFA") as at the end of June 2013 the net asset value of investment funds in Poland was at its highest historical level and amounted to over PLN 166 billion. This is a 28.6% increase y/y. Moreover, in June 2013, for the thirteenth month in a row the fund market noted an increase in the value of managed assets.

As at the end of June 2013 most assets continued to be invested in debt funds. Next in terms of the value of assets in the structure of accumulated funds were non-public asset funds and equity funds.

Table 9. Net asset value of segments and their share in the investment fund market in Poland

PLN million

Net segment assets and their share in the market	30 June 2013	31 December 2012	Dynamics	Share – 30 June 2013	Share – 30 June 2012
Debt	44 204	41 233	7.2%	26.6%	28.3%
Non-public assets	26 594	23 352	13.9%	16.0%	16.0%
Equities	25 629	24 604	4.2%	15.4%	16.9%
Mixed	19 499	20 163	(3.3)%	11.7%	13.8%
Cash and monetary	18 697	13 795	35.5%	11.3%	9.5%
Absolute rate of return	5 504	4 419	24.5%	3.3%	3.0%
Real estate	2 903	3 486	(16.7)%	1.7%	2.4%
Capital protection	2 252	2 281	(1.3)%	1.4%	1.6%
Securitization	1 721	2 071	(16.9)%	1.0%	1.4%
Commodities markets	274	519	(47.2)%	0.2%	0.4%
Unspecified	18 836	9 898	90.3%	11.3%	6.8%
TOTAL	**166 113**	**145 821**	**13.9%**	**100.0%**	**100.0%**

*fund assets provided in aggregated form, mainly from non-public asset funds, but also from other fund groups (such as mixed, real estate, securitization, equity)

Source: www. izfa.pl; Monthly report– assets – June 2013

As at the end of June 2013 the share of five largest TFIs (in terms of net asset value of the investment funds managed by them) amounted to 43.4% and increased by +0.8% compared with the end of December 2012.

Since the beginning of 2013 TFI PZU has been the leader of investment fund management companies among the 38 investment fund management companies covered by the IZFA report. Assets accumulated as at the end of the first half of 2013 by TFI PZU amounted to nearly PLN 20.9 billion, which is an increase in the market share to 12.6% (from 10.5% as at the end of 2012). At the same time, TFI PZU remains in the lead of the segment of employee pension funds among Polish investment fund management companies, with assets exceeding PLN 1.9 billion.

3.6. Property and casualty and life insurance market in Ukraine

According to the latest data as at 31 December 2012, the insurance market in Ukraine covered 414 insurance companies (including 350 property insurance companies), of which over 100 are companies with participation of foreign capital. In 2012 the State Commission for Regulation of Financial Services Markets registered 6 new companies (including one with participation of foreign capital) and deleted 28 companies (including 26 asset companies) from the register.[10]

Table 10. Analysis of gross written premium for property and casualty insurance in the Ukraine

Structure of written premium	2012	2011
Motor insurance	**30.00%**	**27.40%**
Casco Insurance (AC)	17.80%	16.60%
MTPL	12.20%	10.80%
Non-motor insurance	**70.00%**	**72.60%**
Property insurance, including fire and chance event insurance	24.20%	26.90%
Voluntary medical insurance	6.70%	5.50%
Cargo	5.40%	7.00%
Accident insurance	4.20%	3.20%
Green Card	1.80%	1.40%
Insurance of treatment costs	1.60%	1.40%
Air risks insurance	1.60%	1.20%
Other products	24.50%	26.00%
TOTAL	**100.00%**	**100.00%**

According to the results for the 12 months, gross written premium on the property market amounted to UAH 19.7 billion, i.e. 7.7% less than in the same period of 2011. It is estimated that gross premium written on the classic insurance market amounted to UAH 11.08 billion, i.e. 7.93% more than in the same period of 2012.[11] Gross premium written on the property and casualty insurance market in Ukraine in 2012 related mostly to motor insurance (ca. 30%) and property insurance (ca. 24.2%).

In 2012 the insurance market in Ukraine was stagnant. To a large extent this was related to the economic conditions in the country and the banks' policies in respect of granting loans, which constitute a major (ca. 40%) source of financing vehicle purchases (instalment purchases).[12]

Gross written premium in life insurance in 2012 amounted to UAH 1.8 billion, i.e. 34.4% more than in the same period of 2011. The positive dynamics of written premium were mainly the result of a significant increase in the dynamics of premium collected through the bancassurance channel (ca. 29%).

The insurance market in Ukraine is still unpopular with the people and is not viewed as reliable in terms of its effectiveness. Additionally, both in 2012 and in 2013 severe price competition could be observed and relatively high costs related to sales of insurance products. Despite these difficulties, the insurance market in Ukraine has growth potential and remains interesting for foreign investors.

According to initial data[13] in the first quarter of 2013 gross written premium on the property market amounted to UAH 7.7 billion (i.e. 85% more than in the same period of 2012). Such a large increase was related to a fourfold increase in reinsurance transactions, due to amendments in the tax law coming into force, which eliminated reinsurance payments made to resident reinsurers from the tax base. Additionally, in the first quarter of 2013 a drop in sales of MTPL insurance (of 3.5% compared with the first quarter of 2012 – to UAH 561.1 million) and lower payments of claims in this group of insurance (5.3% lower – drop to UAH 238.2 million) were noted. According to the same data the life insurance market recorded gross written premium at a level of ca. UAH 450

[10] Insurance TOP, #1(41)2013.

[11] The State Commission for Regulation of Financial Services Markets – "Consolidated reporting data".

[12] Insurance Organizations League in Ukraine.

[13] Insurance TOP, #2(42)2013.

million (16.5% more than in the same period of 2012), thanks to the growth of the banking channel (of ca. 60% compared with the first quarter of 2012), at the same time the share of corporate insurance dropped from 10.5% (Q1 2012) to 6%.

3.7. Property and casualty insurance market in Lithuania

According to the data of the Bank of Lithuania in the first half of 2013 gross written premium of property and casualty insurance companies amounted to LTL 660.4 million, which constituted a 9.9% increase compared with the first half of 2012 when they had amounted to LTL 600.7 million. Motor insurance, including MTPL insurance which increased by 10.6% (from LTL 213.0 million to LTL 235.7 million) and Casco Insurance which increased by 10.0% (from LTL 138.6 million to LTL 152.4 million) had a material impact on the positive dynamics of premiums.

Looking at the structure of the premium in property and casualty insurance, we can see the domination of motor insurance which comprised 58.8% of gross written premium in total, and the share of MTPL insurance was 35.7%, and Casco Insurance was 23.1%. Next came property insurance and accident insurance, including health insurance, which came up to 19.7% and 9.7% of the premium. The structure of key insurance groups was stable and remained at a level similar to that from the first half of 2012.

As at 30 June 2013 14 insurance companies operated in Lithuania which engaged in activities in the property and casualty insurance sector (including 10 branches of insurance companies registered abroad in other member states). The largest property and casualty insurance company in Lithuania is Lietuvos Draudimas, whose market share in terms of gross written premium is 29.9%. PZU Lietuva ranked third with a market share of 13.5%, coming slightly behind BTA (13.9% market share).

3.8. Life insurance market in Lithuania

In the first half of 2013, the gross written premium of life insurance companies amounted to LTL 279.7 million, which constituted a 9.8% increase compared with the first half of 2012. The positive dynamics resulted specifically from single premium insurance (an increase of 47.9%), whereas insurance at a regular premium noted a 5.5% increase. Analyzing particular insurance groups, the largest increase was noted in term insurance (17.1%, *unit-linked* insurance grew +10.9%) and traditional life insurance (+6.2%).

In the structure of life insurance as at the end of the first half of 2013 unit-linked insurance dominated (in terms of gross written premium their share was 68.9%). Traditional life insurance had a 24.8% share in terms of total premium. Next came term and annuity insurance, which came up to 4.7% and 1.6% respectively. Compared with the same period of the prior year, the market structure has not changed significantly (a small increase in the share of *unit-linked* insurance compared with a drop in traditional insurance was noted).

The Lithuanian life insurance market is characterized by high concentration. As at 30 June 2013 the share of three largest life insurers in gross written premium was 59.7%, and of five largest life insurers went up to 80.5%.

As at the end of June 2013, 9 life insurance companies operated in Lithuania (including 4 branches of insurance companies registered abroad in other member states). The market share of PZU Lietuva was 4.4% (compared with 3.7% as at the end of 2012).

4. Regulatory environment of the PZU Group

4.1. Regulations relating to the insurance market in Poland

Below we present the key legal regulations relating to insurance which have come into force or were passed or published in the first half of 2013, and could have an impact on the change in the operations or organization of the PZU Group:

The Act of 14 December 2012 on amending the Act of 22 May 2003 on insurance activities (Journal of Laws from 14 January 2013, item 53) – it came into force on 29 January 2013 and amended Polish legislature in accordance with the ruling of the European Court of Justice dated 1 March 2011 in the case C-236/09 Test-Achats with reference to the inability to differentiate premiums or benefits on account of gender of the insured.

Effects of the Act on the PZU Group:

- need to make changes to some products and product tariffs, including eliminating one product from the offer – individual insurance in respect of daily hospital services;
- risk of lower sales in the group of customers for whom the premium will grow significantly, offset by better sales in the group of customers for whom the premiums will drop.

The legal amendment relates mainly to the subsidiary – PZU Życie. The new wording of the Act still allows insurance companies to use the gender criterion in calculating insurance premiums and benefits, but only on condition that it will not lead to differentiating insurance premiums and benefits of particular individuals.

Decree of the Ministry of Agriculture and Rural Development dated 29 November 2012 on the maximum sums insured in respect of particular crops and farm animals in 2013 (Journal of Laws of 30 November 2013, item 1338) – came into force on 25 December 2012 and specifies the maximum sums insured in respect of particular crops and farm animals.

Decree of the Minister of Finance dated 8 March 2013 amending the decree of the Minister of finance dated 24 November 2003 on the percentage share of the contribution made by insurers to the Insurance Guarantee Fund (UFG) and the dates for paying the contribution in (Journal of Laws of 13 March 2013, item 344) – binding since 31 March 2013**.** In accordance with the decree, insurers will make contributions to UFG of 1.3% (an increase of 0.3 p.p.) of gross written premium in a given calendar year from MTPL insurance and farmers' liability insurance. The increase in the contribution is justified as follows: higher value of claims paid by UFG to victims of accidents caused by uninsured drivers or by unknown perpetrators, development of the OC and AC policy databases, changes in the accounting policies of UFG.

Effects of the increase for the PZU Group: need to recalculate the liability policy premiums in respect of the risks, probable increase in motor insurance liability policies, departure from the policy applied by insurers of compensating cheap liability insurance with expensive Casco Insurance.

Decree of the Minister of Finance dated 27 December 2012 on mandatory liability insurance of air carriers, enterprises which perform on-ground services and institutions which ensure air transport services (Journal of Laws of 16 January 2013, item 67) – which is in force as of 16 February 2013 and specifies the detailed scope and amount of minimum guarantee sums in mandatory liability insurance: of air carriers for claims caused by delays in passenger, luggage or goods transport, air carriers for claims arising from transport of mail, enterprises engaged in on-ground services for claims arising from the air activities in which they engage, institutions which ensure air transport services for claims arising from the air activities in which they engage.

Decree of the Minister of Finance dated 19 April 2013 on the minimum amount of bank or insurance guarantee required in connection with engaging in organization of travel and acting as a travel agent (Journal of Laws dated 29 April 2013, item 511) – which has been in force since 14 May 2013 and specifies the minimum amount of banking and insurance guarantee required in connection with the activities performed by travel organizers and travel agents.

Decree of the Minister of Finance dated 22 April 2013 on mandatory insurance on behalf of customers in connection with activities performed by travel organizers and travel agents (Journal of Laws dated 29 April 2013, item 510) – which has been binding as of 14 May 2013 and specifies the detailed scope (date of the obligation arising and minimum guarantee sum) of mandatory insurance on behalf of customers of an enterprise engaged in the business of organizing travel events and intermediating at customer's request in concluding travel service agreements.

Draft Act on insurance activities in connection with the implementation of the Solvency II Directive

In May 2012 the Ministry of Finance published another draft of the assumptions to the new act on insurance activities which i.a. is to implement the Solvency II Directive regulations relating to solvency requirements to the Polish law (Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II). The date of these amendments coming into force is not yet known.

In accordance with the draft, capital requirements will increase and they should reflect the specific risk profile of a given insurance or reinsurance company. The Company's own funds must be at a level sufficient to guarantee covering potential losses, and paying the required benefits to the insurants and beneficiaries. The draft act expands requirements in respect of internal risk management procedures and increases information duties of insurers in respect of capital safety and risk management. The insurers will be obliged to implement not only procedures related to insurance risk, but also to credit risk, market risk, liquidity risk, operational risk, and also to submit reports on their financial condition to the regulators. The draft also stipulates changes in the current regulations relating to the duties of insurers in respect of concluding and executing insurance contracts.

PZU actively participates in the process of industry consultations and respectively adapts its activities. Moreover, as part of the work to implement Solvency II, PZU engages in quantitative research, in accordance with the guidelines of PFSA.

Effects of the Draft Act on the PZU Group: Material changes in operations and in corporate finance of insurers and reinsurers, which will be related to the need to make many organizational changes and incurring significant costs. Currently they cannot be estimated. These expenses will probably be deferred in time.

Judicature and Register of Prohibited Clauses

In the first half of 2013 judicature also had an impact on the operations of PZU and PZU Życie (although issued in 2012) and the clauses entered to the Register of Prohibited Clauses maintained by the President of the Office of Competition and Consumer Protection (UOKiK), including those relating to assistance services and provisions of accident insurance.

In several resolutions issued in 2012 (such as Resolution dated 7 November 2012, file no. III CZP 67/12 and Resolution dated 20 December 2012, file no. III CZP 93/12) the Supreme Court gave its opinion that:

- the court may award to the closest relative of a deceased person monetary compensation for harm incurred also if the death resulting from injury or detriment to health occurred before 3 August 2008 (that was the date when the provisions of art. 446 §4 of the Civil Code came into force, granting the entitlement to members of the deceased's closest family);
- the insurance company is responsible for the harm incurred as a result of the death of a close relative under the MTPL policy on the basis of art. 34, clause 1 of the Act of 22 May 2003 on mandatory insurance, Insurance Guarantee Fund and the Polish Motor Insurance Office in the wording from before the amendment on 11 February 2012 (the amendment makes the insurer responsible for the harm *expressis verbis*).

Effects for the PZU Group: Possible increase in the number of rulings adjudging compensation for harm incurred as a result of the death of a close relative as a result of a motor accident from PZU to members of the family of the deceased. To minimize the potential risks related to rulings unfavourable for PZU, PZU and other PZU Group companies review the Rulings of the Supreme Court on a current basis and acquaint themselves with the clauses entered to the Register of Prohibited Clauses maintained by the President of the Office of Consumer and Competition Protection.

4.2. Other regulations in Poland

Below we present legal regulations other than insurance-related, which have come into force or which were published in 2013, and which could have an impact on the change in the operations or organization of the PZU Group:

Act of 28 May 2013 on amending the Act – the Labour Code and several other acts (Journal of Laws of 13 June 2013, item 675) – it has been in force since 17 June 2013 and in particular introduced a new type of leave granted when a child is born – new parent's leave. Parents of the newborn are entitled to additional leave which lasts 26 weeks. Jointly with maternity leave (20 weeks) and the extended (as of 17 June) additional maternity leave (6 weeks) it will enable parents to take care of a newborn child for 52 weeks. All parents of children born in 2013 are entitled to paid 12-month leave.

Effects of the Act on the PZU Group: An increase in costs of operations on the part of employers in connection with the longer absence of employees and the need to increase the number of substitute employees.

4.3. Regulatory environment on the Ukrainian market

As of 1 January 2013 amendments to the Tax Code came into force on the Ukrainian market – Act № 5412-VI of 2 October 2012 "On introducing amendments to the Ukrainian Tax Code relating to the regulation of certain tax issues". In the new Tax Code the Parliament of Ukraine ensured that insurers will be entitled to pay 3% tax on gross written premium, without the need to transfer to the general taxation system. At the same time the method of calculating the tax base changed, as reinsurance payments made on behalf of resident reinsurers were eliminated from the tax base.

To stabilize the Ukrainian market for the "Green Card" and to confirm Ukrainian status as a full member of the International Green Card Insurance System, Ukrainian insurers who are members of the Ukrainian Motor Insurance Office ("MTSBU") adopted and implemented – as of 1 January 2013 – a project for administering the "Green Card" (report no. 110/2012 dated 29 November 2012 "Order of mutual financial settlements between insurers – full members of MTSBU ensuring unconditional exercising of duties following from international insurance contracts). The new mechanism stipulates transfer of 45% to 55% of insurance premiums from "Green Card" insurance to the insurance guarantee fund by full members of MTSBU, and MTSBU ensures timely and high-quality settlement of insurance claims based on the respective contracts. When the new mechanism was implemented, during the 6 months of 2013 the average period of waiting for compensation dropped threefold (from 60 to 20 days).

On 8 January 2013 the State Commission for Regulation of Financial Services Markets approved the decree "On making changes to the order of registering reinsurance treaties", which modified the mechanism of registration of reinsurance treaties – in accordance with the decree the threshold for reinsurance treaties with residents, which when exceeded requires registration by the insurant, increased from UAH 150 thousand to UAH 1 million a year; the period for filing documents for registration of reinsurance treaties with non-residents increased from 15 to 90 days. The Decree came into force on the date of its publication.

On 18 April 2013, the State Commission for the Regulation of Financial Services Markets approved Decree No. 1270 "On approving the order of registration of insurance agents engaged in mandatory legal and liability insurance of owners of land vehicles". The document states that insurance agents (individuals or legal entities) are entitled to engage in intermediary activities in respect of MTPL insurance on condition of being registered with MTSBU. The Regulation comes into force on 7 December 2013.

On 5 February 2013 amendments (no. 5090-VI dated 05.07.2012) to the Act No. 1961-IV dated 1 July 2004 "On mandatory liability insurance for owners of land vehicles", as amended, came into force. The amendments will change the mechanism for calculating compensation in respect of detriment to the health and life of the injured - for each day of treatment (up to 120 days) the injured person may receive at least 1/30 of the minimum wage at the amount valid on the date of the accident occurring (as at 30 June 2013 – UAH 1147).

In 2012 work was carried out, also at parliamentary level, on the Act "On insurance" (No. 2774-IV dated 7 July 2005) to adapt to the recommendations of the Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II). The draft act assumptions take into consideration, among other things:

- an increase in capital requirements relating to insurers;
- implementing prudential supervision over market participants by the regulator;
- possibility of the insurers establishing, administering and managing the assets of non-state pension funds (NFE);
- abolishing the need to register the terms and conditions of insurance (insurers will be able to engage in activities based on predetermined company operating conditions, which will form the basis for developing all insurance products in the future);
- possibility of underwriting insurance contracts in an electronic form (and not only on paper) and the possibility of using a digital signature (for electronic policies) and/or facsimile of the party's signature – which should have a positive impact on the development of *direct* sales in Ukraine.

On 16 May 2013 amendments to the Act "On insurance" came into force (appropriate amendments were already introduced to the Act in 2006; however, they became binding in accordance with the Act, five years after the Ukraine joined the WTO). The amendments related to:

- enabling Ukrainian insurance brokers to conclude basic all risks insurance contracts on behalf of Ukrainian customers with foreign insurers. Before the amendment, only risks related to maritime transport, commercial air transport, launching spaceships and freight (including satellites) could have been insured directly with foreign insurers. Additionally, direct cooperation was possible only when the subject matter of the insurance were property interests related to carrying goods and the related means of transport, also any liability arising from the transport could have been insured;
- the amount of share capital needed to establish life insurance companies in Ukraine – the necessary capital was increased from EUR 1.5 million to EUR 10 million (equivalent in UAH) and the requirement will not relate to insurance companies already in operation.

4.4. Regulatory environment on the Baltic market (Lithuania)

On 21 December 2012 the Bank of Lithuania passed Resolution No. 03-287 on the amount of costs of supervision over insurance companies (the amendment has been in force since 1 January 2013). In accordance with the Resolution the fee changed from 0.16% to 0.182% of gross written premium per year. In 2013 amendments were adopted to the Insurance Act of the Republic of Lithuania No. 94-4246; 2011, No. 145-6816), on the basis of which insurance companies, when calculating the amount of premium and insurance benefit are not allowed to take into account the gender of the insured, which may have an impact on the insurance risk.

By way of resolutions (dated 10 January 2013, Resolution No. 03-2; 09 April 2013, Resolution No. 03-76; 11 July 2013, Resolution No. 03-113), the Bank of Lithuania changed the maximum technical rate. Currently it is 2.08%. On 28 March 2013 the Bank of Lithuania adopted a Resolution on guidelines relating to counteracting money laundering, in accordance with which insurance companies must guarantee that the guidelines are complied with by their foreign branches.

By way of the Decree of the Minister of Finance of the Republic of Lithuania dated 28 January 2013 No. 1K-040 the fee charged on written premium on behalf of the Lithuanian vehicle office changed from 4.6% to 4.1%.

5. PZU Group organisation description

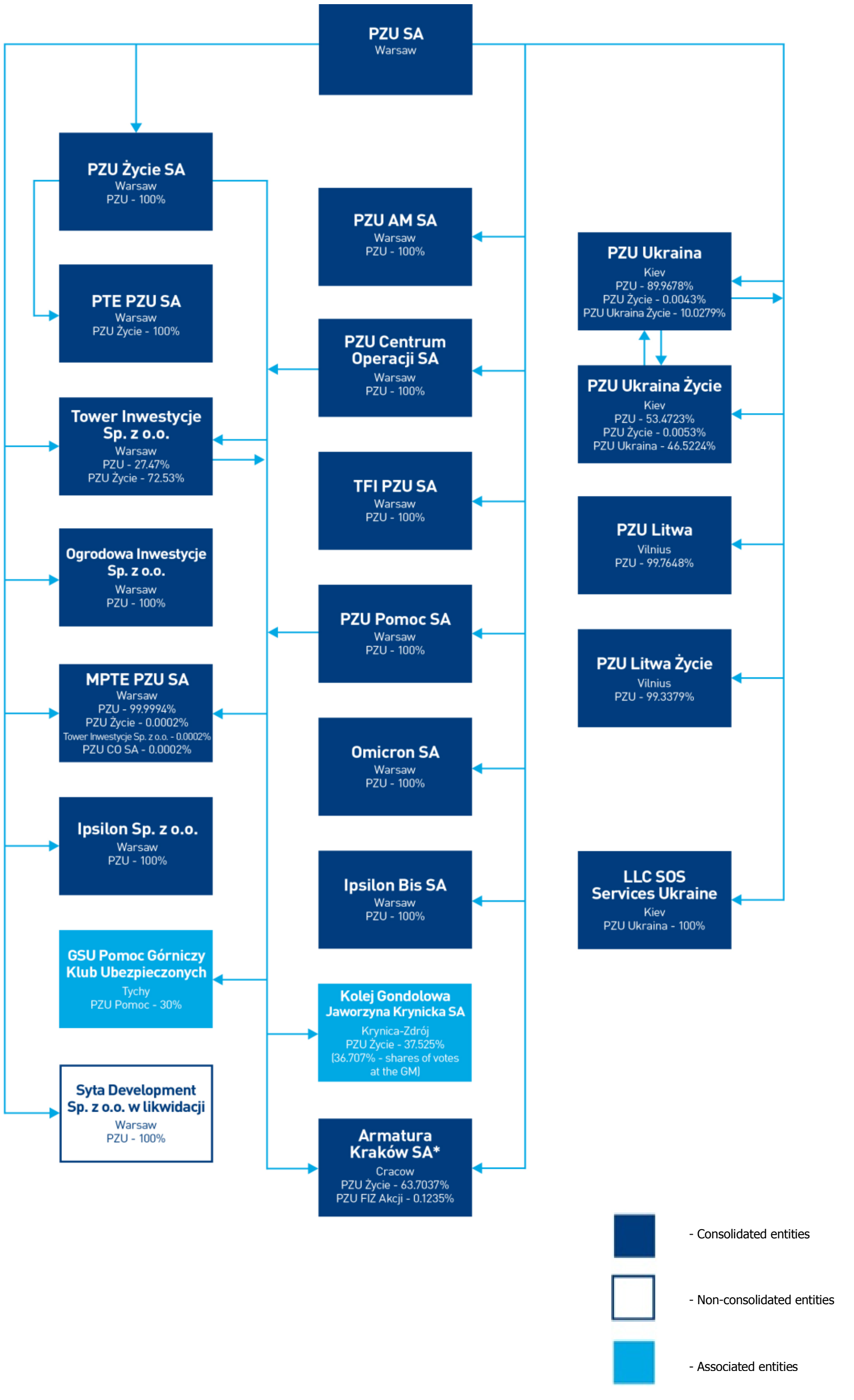
5.1. Organization of the PZU Group

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 30 June 2013 no significant changes took place in the operations of the key PZU Group entities.

Chart 5: Structure of the PZU Group as at 30 June 2013

Chart does not include consolidated investment funds managed by TFI PZU and subject to such consolidation nor the associated entity EMC Instytut Medyczny SA owned by investment funds



*) Armatura's Group consists of the following companies: Armatura Kraków SA, Armatoora SA, Armatoora SA i wspólnicy sp. k., Armagor SA, Armadimp SA

Table 11. The PZU Group's structure

No.	Name of entity	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
				30 June 2013	31 December 2012	30 June 2013	31 December 2012	
Entities covered by consolidation								
1	Powszechny Zakład Ubezpieczeń SA	Warsaw	n/a	n/a	n/a	n/a	n/a	Property and casualty insurance
2	Powszechny Zakład Ubezpieczeń na Życie S.A. ("PZU Życie")	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
5	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.
6	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.
7	PZU Pomoc SA	Warsaw	18.03.2009	100.00%	100.00%	100.00%	100.00%	Assistance services.
8	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.
9	PrJSC IC PZU Ukraine ("PZU Ukraine")	Kiev, the Ukraine	01.07.2005	100.00%	100.00%	100.00%	100.00%	Property insurance
10	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
11	UAB DK PZU Lietuva ("PZU Lietuva")	Vilnius, Lithuania	26.04.2002	99.76%	99.76%	99.76%	99.76%	Property insurance
12	UAB PZU Lietuva Gyvybes Draudimas ("PZU Lietuva Life")	Vilnius, Lithuania	26.04.2002	99.34%	99.34%	99.34%	99.34%	Life insurance

13	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
14	Ogrodowa-Inwestycje Sp. z o.o.	Warsaw	15.09.2004	100.00%	100.00%	100.00%	100.00%	Purchasing, using, leasing and selling properties
15	Armatura Kraków SA	Kraków	07.10.1999	63.83%	63.83%	63.83%	63.83%	Distribution of the Armatura Group products, Group administration and management.
16	Armatoora SA	Nisko	10.12.2008	63.83%	63.83%	63.83%	63.83%	Manufacture and sales of heaters and sanitary fixtures
17	Armatoora SA i wspólnicy sp. k.	Kraków	06.09.2009	63.83%	63.83%	63.83%	63.83%	Use of free cash flows, development investments
18	Armagor SA	Kraków	06.09.2009	63.83%	63.83%	63.83%	63.83%	Manufacture of water, gas and central heating fixtures and fittings
19	Armadimp SA	Kraków	20.07.2012	63.83%	63.83%	63.83%	63.83%	Manufacture of ceramic sanitary equipment
20	Ipsilon Sp. z o.o.	Warsaw	02.04.2009	100.00%	100.00%	100.00%	100.00%	Assistance services and provision of medical services.
21	Ipsilon Bis SA	Warsaw	02.09.2011	100.00%	100.00%	100.00%	100.00%	The Company does not conduct activities.
22	Omicron SA	Warsaw	13.09.2011	100.00%	100.00%	100.00%	100.00%	The Company does not conduct activities.
23	LLC SOS Services Ukraine	Kiev, the Ukraine	01.07.2005	100.00%	100.00%	100.00%	100.00%	Assistance services
24	PZU SFIO Dłużny	Warsaw	15.12.2009	n/a	n/a	n/a	n/a	Investing funds collected from fund members
25	PZU FIZ Akcji	Warsaw	27.01.2010	n/a	n/a	n/a	n/a	As above
26	PZU FIZ Dynamiczny	Warsaw	27.01.2010	n/a	n/a	n/a	n/a	As above
27	PZU FIZ Sektora Nieruchomości [1)]	Warsaw	01.07.2008	n/a	n/a	n/a	n/a	As above
28	PZU FIZ Sektora Nieruchomości 2 [1)]	Warsaw	21.11.2011	n/a	n/a	n/a	n/a	As above
29	PZU FIZ Sektora Nieruchomości 3 [1)]	Warsaw	24.02.2012	n/a	n/a	n/a	n/a	As above

30	PZU FIZ Aktywów Niepublicznych BIS 1	Warsaw	12.12.2012	n/a	n/a	n/a	n/a	As above
31	PZU FIZ Aktywów Niepublicznych BIS 2	Warsaw	19.11.2012	n/a	n/a	n/a	n/a	As above
32	PZU Energia Medycyna Ekologia	Warsaw	20.12.2007	n/a	n/a	n/a	n/a	As above
33	PZU Dłużny Rynków Wschodzących	Warsaw	20.11.2006	n/a	n/a	n/a	n/a	As above
34	PZU FIZ Forte	Warsaw	27.12.2012	n/a	n/a	n/a	n/a	As above
35	PZU FIZ RE Income [1]	Warsaw	08.11.2011	n/a	n/a	n/a	n/a	As above
36	PZU FIO Gotówkowy[2]	Warsaw	01.07.2005	n/a	n/a	n/a	n/a	As above
Non-consolidated entities								
37	Syta Development Sp. z o.o. w likwidacji	Warsaw	29.04.1996	100.00%	100.00%	100.00%	100.00%	Purchasing and selling properties intermediation in trading and administering properties.
Associated entities valued under the equity method								
38	Kolej Gondolowa Jaworzyna Krynicka SA	Krynica	17.08.1998	37.53%	37.53%	36.71%	36.71%	Running ski and tourist lifts.
39	GSU Pomoc Górniczy Klub Ubezpieczonych SA	Tychy	08.06.1999	30.00%	30.00%	30.00%	30.00%	Insurance services.
40	EMC Instytut Medyczny SA [3]	Wrocław	18.06.2013	24.86%	9.95%	21.06%	8.43%	Health protection, R&D in medical sciences and pharmacy

[1] As at 30 June 2013 the funds PZU FIZ Sektora Nieruchomości, PZU FIZ Sektora Nieruchomości 2, PZU FIZ Sektora Nieruchomości 3, PZU FIZ RE Income conducted investment operations through SPEs which invested in particular properties, the number of which for particular funds amounted to: 34, 8, 12, 6 (1 January 2013: 33, 8, 12, 6).

[2] Consolidated as of 1 April 2013.

[3] Purchase of the entity is described in point 5.3.3.

5.2. PZU Group companies

5.2.1. 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, "the Act on insurance activities").

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

1. Accident insurance, including accident at work and occupational disease;
2. Sickness insurance;
3. Casco Insurance of land vehicles other than railway rolling stock;
4. Casco Insurance of rail vehicles, covering damage to rail vehicles;
5. Casco Insurance of aircraft covering damage to aircraft;
6. Insurance of maritime and inland water navigation and vessel Casco Insurance;
7. Insurance of goods in transport covering damage to transported goods;
8. Insurance of damage caused by natural forces;
9. Insurance of other damage to goods;
10. MTPL - Insurance of all types of liability resulting from the ownership and use of land vehicles with their own drive, including the shipper's liability;
11. Insurance of all types of liability resulting from the ownership and use of aircraft, including the shipper's liability;
12. Insurance of general maritime and inland water navigation liability resulting from the ownership and use of maritime and inland water vessels, including the 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 on behalf of people who have encountered difficulties during travel or absence in place of residence.

From 1 January 2013 to the date of preparing the financial statements for the first half of 2013 PZU did not file any motions for changing the scope of the licence for conducting insurance activities. Additionally, no licences were withdrawn from PZU in that period for conducting operations in respect of one or more insurance groups, and no official receivership was established.

5.2.2. PZU Życie

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

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

From 1 January 2013 to the date of preparing the financial statements for the first half of 2013 PZU Życie did not file any motions for changing the scope of the licence for conducting insurance activities. Additionally, no licences were withdrawn from PZU Życie in that period for conducting operations in respect of one or more insurance groups, and no official receivership was established.

5.2.3. PTE PZU

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

- establishing an open pension fund;
- managing the open pension fund and representing it vis-à-vis third parties in the manner specified in the Memorandum of Association, and managing more than one open pension fund in cases and on the terms and conditions specified in the provisions of the Act of 28 August 1997 on the organization and operation of pension funds (i.e. (Journal of Laws No. 34 of 2010, item 189, as amended);
- establishing a voluntary fund with the operating objective of maintaining an individual pension account (IKE) or an individual pension security account (IKZE), as described in the Act of 20 April 2004 on individual pension accounts and individual pension security accounts (Journal of Laws No. 116 of 2004, item 1205, as amended).
- managing the voluntary open pension fund and representing it vis-à-vis third parties in a manner specified in the Memorandum of Association.

The basic business of PTE PZU according to the European Statistical Classification of Economic Activities is activities related to funds.

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"). Since January 2012 PTE PZU also manages the voluntary pension fund Dobrowolny Fundusz Emerytalny PZU ("DFE PZU"). As at the end of June 2013 DFE PZU was one of the leaders in terms of accumulated assets from among the nine operating voluntary pension funds.

5.2.4. The Baltic market

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

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

On 15 October 2012 PZU Lietuva opened a branch in Latvia and on 14 November 2012 a branch in Estonia. In the first half of 2013 the branches established in Latvia and Estonia continued their operations.

5.2.5. The 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 casualty insurance;
- PrJSC IC PZU Ukraine Life – life insurance.

Additionally, LLC SOS Services Ukraine performs assistance services.

5.2.6. TFI PZU

TFI PZU engages in establishing investment funds, managing them and intermediating in selling and repurchasing participation units and representing funds vis-à-vis third parties.

TFI PZU also obtained a permit from the PFSA to manage portfolios which include one or more financial instruments and as of 2013 it started managing PZU Group company portfolios, i.e. PZU and PZU Życie.

Currently TFI PZU manages 25 investment funds and sub-funds with various investment strategies.

TFI PZU offers investment products and services both to retail and corporate 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).

5.2.7. PZU AM

PZU AM provides management services in respect of investment portfolios in investment funds managed by TFI PZU on the basis of art. 46.1 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.

PZU AM is a service company for PZU Group companies.

5.2.8. PZU Pomoc

PZU Pomoc 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.

PZU Pomoc SA is a service company for PZU and PZU Życie.

5.2.9. Ogrodowa-Inwestycje Sp. z o.o.

According to the Memorandum of Association, Ogrodowa - Inwestycje Sp. z o.o. engages in:

- 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;
- hotels and similar hospitality facilities;
- restaurants and other permanent catering facilities;
- other business and management advisory services.

Ogrodowa inwestycje is the owner of the City-Gate office building (Ogrodowa 58, Warsaw) and the lessee of 3 holiday resorts (Pensjonat Albatros in Jastrzębia Góra, Hotel Polanica in Polanica Zdrój, Hotel Karłów in Karłów).

Ogrodowa - Inwestycje Sp. z o.o. engages in activities on behalf of PZU Group companies and external customers.

5.2.10. 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.

PZU CO is a service company for PZU Group companies.

5.2.11. Armatura Group

PZU Życie has 63.7% shares in the share capital of Armatura Kraków SA, and thus also 63.7% votes at the General Shareholders' Meeting. Since 1 January 2011, the Company has been consolidated in the consolidated financial statements of the PZU Group. The Management Board of PZU took the decision on beginning consolidation of the Company exclusively due to exceeding materiality limits.

Armatura Kraków SA is the Parent Company of the Armatura Group and since 2007 it has been listed on the Warsaw Stock Exchange. The Armatura Group comprises: Armatura Kraków SA, Armatoora SA, Armagor SA, and

Armadimp SA. The Armatura Group engages in business activities outside the financial and insurance services areas. It is the lead manufacturer of sanitary and heating fixtures and fittings in Poland. The Armatura Group companies specialize in the manufacture of bathroom and kitchen fixtures and fittings, aluminium central heating radiators, a wide range of valves and sanitary fittings.

PZU Życie has had equity interests in the company since October 1999.

5.2.12. MPTE PZU SA

MPTE PZU SA runs 3rd Pillar pension plans for PZU and PZU CO employees. The plans are defined contribution plans, co-financed by the employer above the remuneration determined in the employment contract, constituting 7% of gross remuneration.

5.2.13. Tower-Inwestycje

Tower-Inwestycje Sp. z o.o. (former PZU Tower Sp. z o.o.) was established in 1998 as a special purpose entity of the PZU Group. The Company is owned by PZU and PZU Życie.

In the years 1998 – 2008 the company engaged in acquiring and selling properties, providing services related to the construction and development of properties and administering them, and renting premises for office purposes.

In 2008 PZU and PZU Życie began activities aimed at restructuring the Company. The purpose of the restructuring was to reduce the operating expenses of PZU and PZU Życie by eliminating VAT on rental of office space in the PZU Tower building (which at the time belonged to the current Tower Inwestycje Sp. z o.o.).

Under the restructuring activities i.a. the City Gate building was sold (which then belonged to the current Tower Inwestycje Sp. z o.o.) to Ogrodowa- Inwestycje Sp. z o.o., and then PZU Tower (which was then owned by the current Tower Inwestycje Sp. z o.o.) was sold to the new co-owners PZU and PZU Życie.

Currently, the operations of Tower Inwestycje cover mainly investing free cash flows. In 2012, the Company also engaged in training activities. As of 2013 the Company started providing accounting and HR and payroll services to PZU Group companies (PZU AM, PZU TFI).

5.2.14. Kolej Gondolowa Jaworzyna Krynicka SA

PZU Życie holds 310,620 shares of KGJK, which constitutes 37.5% of the share capital and 36.7% of the total voting rights at the company's General Shareholders' Meeting. An identical KGJK's shares package is held by PKO BP SA. The share capital of KGJK is PLN 41.4 million and is made up of 827,763 registered preference shares with a nominal value of PLN each. PZU Życie and PKO BP SA took up the Company's shares at a price equal to their nominal value, i.e. at PLN 50 per share. The value of the KGJK's shares package held by PZU Życie at acquisition cost is PLN 15.53 million. PZU Życie purchased the Company's shares in 1997, 1998, 2000 and 2003.

KGJK is mainly engaged in transporting people by cable cars and ski lifts, and in hospitality services.

PZU Życie, in cooperation with PKO BP SA, started selling KGJK shares. For this purpose in July 2012 a new agreement was signed between PZU Życie and PKO BP SA regulating the policies for shareholder cooperation in the process of sales of the Company's shares. Next, an advisor was selected for the process. In the first half of 2013 the valuation and offering processes were finalized. Potential purchasers were selected and negotiations are in progress. It is stipulated that the sale of the Company will be finalized in 2013.

5.2.15. GSU Pomoc Górniczy Klub Ubezpieczonych SA (formerly Nadwiślańska Agencja Ubezpieczeniowa SA)

GSU Pomoc Górniczy Klub Ubezpieczonych SA (formerly Nadwiślańska Agencja Ubezpieczeniowa SA) was established on 3 February 1999, i.a. by PZU Życie, to intermediate in the sale of insurance of the PZU Group in companies and mines of the former Nadwiślańska Spółka Węglowa SA (currently Kompania Węglowa SA). On 22 June 2012 PZU Życie sold the whole package of shares it held in the Company to PZU Pomoc SA.

5.3. Changes in the organization of the PZU Group

5.3.1. Continued process of funding financial investments

Debt instruments

On 25 February 2013 PZU and PZU Życie subscribed for investment certificates in PZU Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych BIS 1, making the following payments:

- PZU – in the form of debt instruments with a value of PLN 1,244.1 million and in cash of PLN 500.0 million;
- PZU Życie – in the form of debt instruments with a value of PLN 1,361.8 million and in cash of PLN 290.0 million.

On 5 March 2013 TFI PZU allotted the investment certificates with a value of PLN 1,744.1 million and PLN 1,651.8 million to PZU and PZU Życie respectively.

Equity instruments

On 27 March 2013 PZU and PZU Życie subscribed for investment certificates in PZU Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych BIS 2, making payments in the form of shares with a value of:

- PZU – PLN 724.4 million;
- PZU Życie – PLN 421.3 million.

On 28 March 2013 TFI PZU allotted the investment certificates with a value equal to the payments made to PZU and PZU Życie respectively.

Additionally PZU (on 17 April 2013) and PZU Życie (on 18 April 2013) made cash payments for investment certificates of PZU Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych BIS 2 in the following amounts:

- PZU – PLN 200.0 million;
- PZU Życie – PLN 100.0 million.

On 18 April 2013 TFI PZU allotted the investment certificates with a value equal to the payments made to PZU and PZU Życie respectively.

5.3.2. Finalizing the liquidation of PZU Group companies

On 26 March 2013 the General Shareholders' Meeting of Sigma Investments Sp. z o.o. in liquidation passed a resolution to terminate the Company's liquidation. On 11 May 2013 the Company was deleted from the register.

On 23 April 2013 the General Shareholders' Meeting of ICH Center SA in liquidation passed a resolution to terminate the Company's liquidation. On 20 May 2013 the Company was deleted from the register.

5.3.3. Acquisition of a EMC Instytut Medyczny SA shares package

After the acquisition of shares at the stock exchange on 18 June 2013, the stake of the PZU Group entities (mainly investment funds managed by TFI PZU) went up to 1,969,817 shares in EMC Instytut Medyczny SA ("EMC"), accounting for 23.66% of interest in the share capital of that company and 20.04% of votes at its General Shareholders' Meeting. The acquisition value amounted to PLN 34.1 million.

As at the date of signing these interim consolidated financial statements, the PZU Group entities (mainly investment funds managed by TFI PZU) had a total of 2,487,268 shares in EMC Instytut Medyczny SA, accounting for 29.87% of interest in the share capital of that company and 25.31% of votes at its General Shareholders' Meeting. The acquisition value amounted to PLN 44,213 thousand.

EMC had not been measured using the equity method in these interim consolidated financial statements as at 30 June 2013, because the acquisition of EMC will be settled on the basis of the consolidated financial statements of EMC prepared as at 30 June 2013. The measurement of EMC using the equity method will be presented in the consolidated financial statements of the PZU Group effective from 1 July 2013.

FINANCIAL RESULTS OF THE PZU GROUP IN THE 1ST HALF OF 2013

6. Events with a significant impact on the operations and results of the PZU Group in the first half of 2013

The financial results of the PZU Group in the first half of 2013 were shaped mainly by:

- an increase in gross written premium as a result of maintained high sales dynamics of insurance with single premium through bancassurance channel, partly offset by the drop in written premium in motor insurance in the corporate and mass insurance segments, and in hospital accident insurance in effect of legislative changes;
- improved profitability in the mass and corporate segment, including:
  - in motor insurance due to lower frequency of losses;
  - in agricultural insurance due to a significantly lower level of claims caused by fire and natural forces; and
  - in financial insurance due to the prior year's slump on the construction market;
- higher profitability of life insurance in the group and individually continued segment, without conversion effect from long-term into yearly-renewable term business in type P insurance;
- lower income from investments as a result of a drop in the valuation of equity instruments (bear market on the Warsaw Stock Exchange "WSE") and debt instruments (an increase in the profitability of bonds);
- one-off income from consolidating investment funds; one-off income from concluding a conciliatory agreement with the reinsurer in respect of the Green Card insurance (partial reversal of the adjustment of estimates with the reinsurer, decreasing the result for 2011);
- maintaining discipline over fixed costs (a drop in personnel costs in effect of restructuring activities conducted in recent years) while continuing project activities aimed at streamlining and automating customer service processes.

7. Commentary to the consolidated financial results of the PZU Group

7.1. Premiums

Gross written premium from direct and indirect insurance amounted to PLN 8,495.3 million in the first half of 2013 (PLN 8,246.3 million in the first half of 2012). The PLN 249.0 million (+3.0%) increase compared with the first half of the prior year resulted from an increase in sales, in particular in life insurance (+8.2%). The main product lines which noted increases in the first half of 2013 comprised:

- individual insurance with single premium (+PLN 252.8 million), in particular the unit-linked products in the bancassurance channel;
- group and continued insurance with regular premium, mainly protection cover (+PLN 71.6 million) – the effect of higher average premium (including the impact of additional sales of supplementary covers in individually continued insurance) and of the number of insured (re. type P group insurance, group health insurance and banking protection insurance).

Moreover, the start of the consolidation of PZU Ukraine Life and PZU Lietuva Life contributed to the increase in premiums written in 2013 in comparison to the previous year.

At the same time, a drop was noted in gross written premium:

- in the corporate insurance segment (-PLN 85.1 million), including:

  on behalf of patients in respect of medical events (hospital accident insurance ; -PLN 62.9 million) – in the first half of 2012 medical entities were obliged to conclude insurance contracts on behalf of patients in respect of medical events; as a result of legislative changes the duty was deferred to 2014;

motor – as a result of high competition and maintained weak condition of the domestic automotive market;

- in the segment of group insurance – short-term products with single premium, mainly in the bancassurance channel, as a result of withdrawing from these type of products due to their low profitability.

Table 12. Analysis of gross written premium in the PZU Group

PLN'000

Gross written premium	1 January – 30 June 2013	1 January – 30 June 2012	% change
Gross written premium in property and casualty insurance - Poland	4 337 003	4 436 623	*(2.2)%*
Corporate insurance	956 163	1 041 265	*(8.2)%*
Mass insurance	3 380 840	3 395 358	*(0.4)%*
Gross written premium in life insurance - Poland	3 943 651	3 646 412	*8.2%*
Group and individually continued insurance	3 198 857	3 168 846	*0.9%*
Individual insurance	744 794	477 566	*56.0%*
Gross written premium – Ukraine and Baltic States	216 067	163 751	*31.9%*
Ukraine	90 928	64 717	*40.5%*
Baltic States	125 139	99 034	*26.4%*
Gross premium written between segments – consolidation adjustment	(1 470)	(512)	*x*
Gross written premium	**8 495 251**	**8 246 274**	***3.0%***

7.2. Claims

The drop in net claims and benefits (of PLN 55.2 million, i.e. 1.0%) resulted mainly from.

- a low level of claims related to the negative effects of overwintering in agricultural insurance; it should be stressed that in the years 2011 – 2012 a high level of claims was noted in this respect which led to negative returns on the product;
- maintained low loss history in motor insurance thanks to more favourable road conditions and lower traffic (low loss frequency), and in consequence of changes in underwriting policies (limiting the number of unprofitable customers) in the corporate customer segment;
- a significant drop in claims and benefits in financial insurance compared with the same period of the prior year – the higher loss ratio in the prior year was related to a series of bankruptcies in the construction industry;
- a low level of claims with a significant scale of payments and no catastrophic events in property insurance;
- a drop in technical provisions in unit-linked products in effect of negative results on investing activities;
- a drop in the technical provisions in short-term life and endowment products in the bancassurance channel as a result of limiting sales of the product in the current year.

On the other hand, the following had an impact on the increase in net claims and benefits in this category:

- an insignificant deterioration in the loss ratio in Casco Insurance related to losses resulting from tempest rains and hail in mass client segment;
- a lower rate of conversion effect from long-term into yearly-renewable term business in type P insurance (the conversion effect[14] in the first half of 2013 translated to releasing PLN 84.1 million of provisions, PLN 47.7 million less than in the same period of 2012);
- an increase in the number of events resulting from death in January 2013 (confirmed with GUS data on the increase in the number of deaths in Poland) in group protection insurance and in continued insurance.

7.3. Benefits and changes in the valuation of investment contracts

The balance of benefits and conversions of investment contracts as at the end of the first half of 2013 and 2012 amounted to PLN -11.7 million and PLN -87.0 million respectively. This change derived in particular from a lower level of payments in respect of endowment in short-term investment contracts.

7.4. Acquisition and administrative expenses

In the first half of 2013 acquisition costs dropped by PLN 26.2 million (-2.6%) compared with the same period of the prior year. This drop resulted mainly from:

- lower acquisition costs in type P group protection insurance – limitation of modifications;
- negative sales dynamics in the corporate and mass insurance segment;

At the same time, an increase in acquisition costs was noted in respect of:

- the dynamic development in sales of investment products through the bancassurance channel, specifically of the *unit-linked* product characterized by high acquisition costs;
- an increase in the share of more expensive distribution channels in sales for mass client.

The drop in administrative expenses of PLN 45.4 million (-6.6%) was mainly the effect of a lower number of employees and lower advertising expenses (the effect of the 2012 image campaign) accompanied by an increase in costs of project activities aimed at streamlining and automating customer service processes.

7.5. Other operating income and expenses

[14] Effect of conversion calculated based on data by IFRS

The balance of other operating income and expenses in the first half of 2013 was PLN 25.2 million higher than in the same period of the prior year (change from –PLN 84.3 million to –PLN 59.1 million). The main reason for the change was recognizing one-off income in respect of a conciliatory agreement concluded with the reinsurer (one-off impact on other operating income of the first half of 2013 +PLN 73.3 million, total impact on profit before tax +PLN 53.2 million). The conciliatory agreement was concluded to settle reinsurance commissions in the Green Card product which in 2011 had been adjusted, thus decreasing the results for that period by PLN 91.8 million. This effect was partly offset by an increase in other operating expenses in consolidated entities.

7.6. Results and business ratios of the PZU Group

Table 13. Data from the consolidated income statement of the PZU Group

PLN'000

Data from the consolidated income statement	1 January – 30 June 2013	1 January – 30 June 2012	*% change*
Gross written premium	8 495 251	8 246 274	*3.0%*
Net premium earned	8 177 240	7 866 736	*3.9%*
Fee and commission income	143 270	116 359	*23.1%*
Net result on investing activities	969 318	1 523 904	*(36.4)%*
Net claims and benefits	(5 459 405)	(5 514 635)	*(1.0)%*
Acquisition costs	(972 660)	(998 877)	*(2.6)%*
Administrative expenses	(641 314)	(686 707)	*(6.6)%*
Operating profit/(loss)	2 145 693	2 135 556	*0.5%*
Financial costs	(37 826)	(12 805)	*195.4%*
Profit/(loss) before tax	2 109 723	2 122 751	*(0.6)%*
Net profit/(loss), including:	1 675 716	1 716 449	*(2.4)%*
Profits /(losses) attributable to owners	1 675 348	1 716 933	*(2.4)%*
Profits (losses) of minority interests	368	(484)	*x*
Basic and diluted weighted average number of ordinary shares in issue	86 352 300	86 352 300	-
Basic and diluted earnings of the PZU Group per one ordinary share of the Issuer (in PLN)	19.41	19.88	*(2.4)%*
Net profit of PZU (the Issuer)	4 679 913	1 895 361	*146.9%*
Basic and diluted earnings of the Issuer per one ordinary share (in PLN)	54.20	21.95	*146.9%*

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

PLN'000

Net change in cash and cash equivalents of PZU	1 January –	1 January –	% change

	30 June 2013	30 June 2012	
Net cash from operating activities	1 685 662	1 227 568	*37.3%*
Net cash from investing activities	(2 147 660)	(460 561)	*366.3%*
Net cash from financing activities	622 743	(833 048)	*X*
Net increase/(decrease) in cash and cash equivalents	160 745	(66 041)	*X*

Table 15. Basic profitability ratios of the PZU Group

Ratios	1 January – 30 June 2013	1 January – 30 June 2012	% change
Return on equity (ROE) *(net profit/loss y/y /average equity) x 100%*	24.3%	26.8%	*(2.5) p.p.*
Return on assets (ROA) *(net profit/loss y/y /average assets) x 100%*	5.7%	6.5%	*(0.8) p.p.*
Administrative expense ratio *(administrative expenses / net premium earned)*	7.8%	8.7%	*(0.9) p.p.*
Sales margin *(net profit (loss)/ gross written premium) x 100%*	19.7%	20.8%	*(1.1) p.p.*

In the first half of 2013 the positive effect of improved profitability resulting from lower loss ratio in mass and corporate segment insurance was offset by weak investment results (-PLN 554.6 million, i.e. -36,4%). In consequence, net profit in the first half of 2013 amounted to PLN 1,675.7 million and was PLN 40.7 million, i.e. 2.4% lower than in the first half of the prior year. Return on equity, despite the 2.5 p.p. drop, remained at a high level (24.3%).

7.7. Analysis of assets and liabilities

Assets

Assets consist mainly of investments[15] (financial assets, entities accounted for under the equity method, and investment properties), which at the end of the first half of 2013 amounted to 89.4% of total assets. They amounted to PLN 55,931.9 million and were 9.7% higher than as at the end of 2012. This increase (of PLN 4,944.4 million) was specifically the result of business development and consolidation of subordinated entities, including investment funds (the effect of discontinuing the use of the materiality criterion in determining the list of subsidiaries covered by consolidation as of 1 January 2013).

Compared with the same period of the prior year investments increased by 13.2%. The increase was due to a higher price of debt instruments (lower market returns) and an increase in the valuation of equity instruments between 30 June 2012 and 30 June 2013 (an increase in the WIG index of 9.6%).

The significant increase in the balance of investment properties (+184.2% compared with the balance as at 31 December 2012) was – as indicated above – the effect of starting to consolidate investment funds.

The high balance of receivables, including receivables on insurance contracts (PLN 3,555.6 million compared with PLN 1,835.8 million as at the end of 31 December 2012) resulted from unsettled sales of financial instruments made before 30 June 2013 (with settlement dates after the balance sheet date).

[15] Investments without negative value of derivatives.

Table 16. Selected balance sheet items of the PZU Group – interim consolidated statement of financial position - assets

PLN'000

Assets	30 June 2013	31 December 2012	% change
Intangible assets	200 705	183 238	9.5%
Goodwill	8 651	8 474	2.1%
Property, plant and equipment	969 986	992 317	(2.3)%
Investment properties	1 604 253	564 404	184.2%
Entities valued under the equity accounting method	604	0	X
Financial assets	54 327 057	50 423 076	7.7%
Receivables, including receivables from insurance contracts	3 555 561	1 835 793	93.7%
Reinsurers' share in technical provisions	501 214	749 334	(33.1)%
Estimated recourse and recoveries	104 664	121 632	(14.0)%
Deferred tax assets	13 549	13 963	(3.0)%
Current income tax receivables	87 321	80 646	8.3%
Deferred acquisition costs	586 406	574 489	2.1%
Prepayments and deferred costs	93 686	94 942	(1.3)%
Other assets	85 236	83 704	1.8%
Cash and cash equivalents	297 526	136 586	117.8%
Assets related to continued activities	**62 436 419**	**55 862 598**	**11.8%**
Non-current assets held for sale and assets included in groups of assets for sale	162 078	46 962	245.1%
Total assets	**62 598 497**	**55 909 560**	**12.0%**

Equity

Table 17. Selected balance sheet items of the PZU Group – interim consolidated statement of financial position - equity

PLN'000

Equity	30 June 2013	31 December 2012	% change
Share capital	86 352	86 352	-
Supplementary capital	8 816 731	8 780 212	0.4%
Revaluation reserve	263 495	363 242	(27.5)%
Currency translation differences on subordinated entities	(31 682)	(38 004)	(16.6)%
Retained earnings/(Accumulated losses)	2 398 738	1 743 148	37.6%
Net profit/(loss)	1 675 348	3 255 181	(48.5)%
Non-controlling interests	79 724	79 138	0.7%
Total equity	13 288 706	14 269 269	(6.9)%

Equity was 4.3% higher than in the same period of the prior year and amounted to PLN 13,288.7 million.

Compared with 31 December 2012 equity decreased by 6.9% i.a. as a result of recognizing dividend to shareholders of PLN 2,567.7 million.

Liabilities

The main component of total liabilities and equity were the net technical provisions, which constituted 58.3% of the balance. As at the end of the first half of 2013 technical provisions amounted to PLN 36,518.1 million and were 3.2% higher than as at the end of 2012. This increase was specifically the result of development of continued insurance and high sales of single premium investment insurance through the bancassurance channel, which resulted in setting up life insurance provisions and life insurance provisions where the risk is borne by the policyholders. Compared with the same period of the prior year, technical provisions were 8.7% higher, mainly in consequence of PZU and PZU Życie using higher technical interest rates in 2012.

The balance of investment contracts dropped by PLN 96.9 million compared with 31 December 2012, mainly as a result of surrenders in the unit-linked products offered through the bancassurance channel (the product which is an investment contract was replaced with an insurance contract). Compared with 30 June 2012 the balance of investment contracts dropped by PLN 1,270.4 million, mainly due to higher endowment payments in respect of short-term endowment contracts in the bancassurance channel, with lower sales of the products through this channel over the last year.

The increase in other liabilities compared with the end of 2012 of PLN 6,732.0 million was in particular the result of:

- higher liabilities to credit institutions in respect of sell-buy-back transactions;
- the dividend payable to shareholders of PZU;
- higher liabilities in respect of unsettled securities purchase transactions as at the balance sheet date.

Table 18. Selected balance sheet items of the PZU Group – interim consolidated statement of financial position - liabilities

PLN'000

Liabilities	30 June 2013	31 December 2012	% change
Technical provisions	36 518 122	35 400 778	3,2%
Unearned premium and unexpired risk provisions	4 764 051	4 537 167	5.0%
Life insurance provisions	15 948 486	15 675 243	1.7%
Outstanding claims provisions	6 150 934	5 878 445	4.6%
Provisions for the capitalized value of annuities	5 697 792	5 660 281	0.7%
Provisions for premiums and discounts for the insured	3 238	4 227	(23.4)%
Other technical provisions	503 182	531 617	(5.3)%
Technical life insurance provisions where the investment risk is borne by the policyholders	3 450 439	3 113 798	10.8%
Investment contracts	2 202 234	2 299 147	(4.2)%
Provisions for employee benefits	61 212	60 649	0.9%
Other provisions	245 050	267 456	(8.4)%
Provision for deferred income tax	310 048	357 557	(13.3)%
Derivative instruments	258 316	129 921	98.8%
Other liabilities, including current income tax liabilities	9 230 880	2 441 813	278.0%
Accruals and deferred income	483 929	682 970	(29.1)%
Total liabilities	**49 309 791**	**41 640 291**	**18.4%**
Total equity and liabilities	**62 598 497**	**55 909 560**	**12.0%**

7.8. Impact of one-off events on operating results

The following one-off events had an impact on the gross results of the PZU Group in the first half of 2013:

- income resulting from the consolidation of investment funds PLN +172.8 million – the effect of discontinuing using the materiality criterion in determining the list of subsidiaries covered by consolidation as of 1 January 2013;
- one-off income from the conciliatory agreement signed with the reinsurer in respect of the Green Card of PLN +53.2 million – the purpose of the agreement was to settle the reinsurance commissions related to the Green Card product, in respect of which an adjustment was made in 2011 reducing the result for that period by PLN 91.8 million;
- In the first half of 2012 PZU reassessed claims provisions in respect of contract guarantees and reduced the estimated income from shares in reinsurers' profits in connection with the bankruptcies in the construction industry (impact on results of PLN 132.6 million).

8. Commentary to segment reporting

8.1. Corporate insurance – Property and casualty insurance

Table 19. Gross written premium in the corporate insurance segment (property and casualty)

PLN'000

Gross written premium by product groups	1 January – 30 June 2013	1 January – 30 June 2012	% change
MTPL insurance	177 761	209 225	(15.0)%
Casco insurance (AC)	232 688	296 656	(21.6)%
Total motor insurance	410 449	505 881	(18.9)%
Fire and other property damage insurance	266 590	184 342	44.6%
Other liability insurance (cat. 11, 12, 13)	208 346	208 622	(0.1)%
Accident insurance and others*	70 778	142 420	(50.3)%
Total property and casualty insurance net of motor insurance	545 714	535 384	1.9%
Total corporate segment insurance (property and casualty)	**956 163**	**1 041 265**	**(8.2)%**

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

In the first half of 2013 in the corporate insurance segment the drop in gross written premium of PLN 85.1 million (-8.2%) compared with the first half of 2012 resulted in particular from lower sales:

- of patient insurance in respect of medical events (hospital accident insurance ; PLN - 62.9 million) – in the first half of 2012 medical entities were obliged to conclude insurance contracts on behalf of patients in respect of medical events; as a result of legislative changes the duty was deferred to 2014;
- motor insurance – strong competition and maintained weak condition of the Polish automotive market.

At the same time, an increase in written premium was noted in insurance against fire and other property insurance of PLN +82.2 million as a result of an increase in sales of insurance to the fuel and energy industry and to the mining industry.

Table 20. Results of the corporate insurance segment (property and casualty)

PLN'000

Data from the income statement - corporate insurance (property and casualty)	1 January – 30 June 2013	1 January – 30 June 2012	% change
Gross written premium	956 163	1 041 265	*(8.2)%*
Net premium earned	786 173	881 205	*(10.8)%*
Investment income	79 280	62 995	*25.9%*
Net claims and benefits	(406 143)	(616 841)	*(34.2)%*
Acquisition costs	(151 863)	(171 873)	*(11.6)%*
Administrative expenses	(50 297)	(49 283)	*2.1%*
Reinsurance commission and share in profits	3 151	(9 428)	*X*
Other	(23 943)	(6 569)	*264.5%*
Operating profit/(loss)	**236 358**	**90 206**	***162.0%***
acquisition cost ratio (in consideration of reinsurance commission)*	18.9%	20.6%	*(1.7) p.p.*
administrative expense ratio*	6.4%	5.6%	*0.8 p.p.*
loss ratio*	51.7%	70.0%	*(18.3) p.p.*
combined ratio (COR)*	77.0%	96.2%	*(19.2) p.p.*

* ratios calculated with reference to net premium earned

In the first half of 2013 net claims and benefits dropped by 34.2% compared with the first half of 2012, which despite the premium earned being 10.8% lower indicates a drop in the loss ratio of 18.3 p.p.

Good results in claims handling were achieved thanks to a lower level of claims and benefits in motor insurance (a 7.8 p.p. improvement in the loss ratio to 61.3%) as a result of:

- verifying the insurance portfolio in connection with changes in underwriting policies in the last few years (i.a. by limiting the number of unprofitable clients);
- low frequency of losses as a result of favourable road conditions and lower traffic;
- partial release of the IBNR provision – dictated by the continuing drop in respective insurance claims.

Additionally, a significant drop in claims and benefits was noted in financial insurance – which to a large extent was the consequence of a high loss ratio in the prior year (the slump in the construction sector in mid 2012) and the related introduction of a new pricing policy which provided for more stringent risk assessment and thus reduced loss ratio in respect of guarantees.

In other types of insurance (with the exception of other financial insurance) there was a drop in claims and benefits in connection with:

- a lower number of claims reported and paid in respect of large single risks;
- no significant catastrophic events;
- a change in approach to individual risk assessment (selection of unprofitable customer portfolio).

The 25.9% higher investment income (allocated at transfer prices) resulted mainly from the increase in valuation of portfolios hedging insurance liabilities denominated in foreign currencies (in the first half of 2012 a drop in value, in the current year an increase). The rate of return on allocated assets from the remaining part of the portfolio dropped slightly (the interest rate used to calculate income on investments hedging liabilities denominated in PLN was reduced due to changes in the valuation of Polish securities on the financial markets).

Acquisition costs in corporate insurance dropped by 11.6% compared with the first half of 2012, mainly as a result of lower sales and lower indirect costs (and specifically no personnel costs).

At the same time, the share of total commission in written premium increased by 0.2 p.p., specifically due to the higher share of commission in the premium in the brokerage channel (the effect of the drop in sales of medical events insurance to patients which is characterized by lower commission rates).

The 2.1% increase in administrative expenses was caused by the project to optimize customer service processes, among other things, by implementing a new product system and building a positive image of the PZU Group. This effect was partly offset by a drop in marketing expenses.

In the first half of 2013 and in the first half of 2012 operating profit in the corporate insurance segment amounted to PLN 236.4 million and PLN 90.2 million respectively. The low loss ratio in motor insurance and improvement in returns on financial insurance had an impact on the increase in operating profit.

8.2. Mass insurance – property and casualty

Table 21. Gross written premium in the mass insurance segment (property and casualty)

PLN'000

Gross written premium by product groups	1 January – 30 June 2013	1 January – 30 June 2012	% change
MTPL insurance	1 257 851	1 304 242	(3.6)%
Casco insurance (AC)	795 119	819 419	(3.0)%
Total motor insurance	2 052 970	2 123 661	(3.3)%
Fire and other property damage insurance	815 736	782 660	4.2%
Other liability insurance (cat. 11, 12, 13)	207 821	187 160	11.0%
Accident insurance and others*	304 313	301 877	0.8%
Total property and casualty insurance net of motor insurance	1 327 870	1 271 697	4.4%
Total mass segment insurance (property and casualty)	**3 380 840**	**3 395 358**	**(0.4)%**

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

In the first half of 2013 in the mass insurance segment gross written premium dropped by PLN 14.5 million (-0.4%) compared with the first half of 2012. This change resulted mainly from:

- lower written premium in MTPL insurance mainly as a result of a lower than expected level of renewals, competitive price pressures and the weaker condition of the automotive market (low rate of increase in the number of cars);
- a drop in written premium in Casco insurance – an insignificant increase in the number of insurance contracts accompanied by a drop in the average premium as a result of ageing of the portfolio (lower sums insured), higher no-claim bonuses and competitive price pressures;
- an increase in the sums insured in mandatory farm building insurance (realistic valuation of the buildings) and increases in farmers' liability insurance premiums;
- higher sales of PZU Dom Plus insurance and liability insurance of Individuals and SMEs engaged in medical treatment.

Table 22. Results of the mass insurance segment (property and casualty)

PLN'000

Data from the income statement - mass insurance (property and casualty)	1 January – 30 June 2013	1 January – 30 June 2012	% change
Gross written premium	3 380 840	3 395 358	*(0.4)%*
Net premium earned	3 261 441	3 202 969	*1.8%*
Investment income	302 254	264 864	*14.1%*
Net claims and benefits	(1 995 488)	(2 016 550)	*(1.0)%*
Acquisition costs	(542 357)	(558 903)	*(3.0)%*
Administrative expenses	(231 398)	(251 702)	*(8.1)%*
Reinsurance commission and share in profits	75 454	(3 806)	*X*
Other	(115 882)	(125 380)	*(7.6)%*
Operating profit/(loss)	**754 024**	**511 492**	***47.4%***
acquisition cost ratio (in consideration of reinsurance commission)*	14.3%	17.6%	*(3.3) p.p.*
administrative expense ratio*	7.1%	7.9%	*(0.8) p.p.*
loss ratio*	61.2%	63.0%	*(1.8) p.p.*
combined ratio (COR)*	82.6%	88.4%	*(5.8) p.p.*

* ratios calculated with reference to net premium earned

Claims and benefits dropped by 1.0% y/y during the first half of 2013 despite the increase in net premium earned by 1.8%. The good results in the area of claims handling were achieved as a result of:

- significantly lower claims in agricultural insurance caused by natural forces, i.e. the negative effects of overwintering and frost;
- an improvement in the loss ratio in MTPL insurance which was related to low frequency of losses (a drop in road traffic).

These positive changes were partly offset by:

- an insignificant deterioration in the loss ratio in Casco Insurance resulting from many losses arising from torrential rain and hail;
- a drop in profit in property insurance due to the number of losses caused by bad atmospheric conditions in the second quarter of 2013 (hail, flooding and inundating) and several losses occurring with a large unit value.

The 14.1% higher investment income (allocated at transfer prices) resulted mainly from the increase in valuation of portfolios hedging insurance liabilities denominated in foreign currencies (in the first half of 2012 a drop in value, in the current year an increase). The rate of return on allocated assets from the remaining part of the portfolio dropped slightly (the interest rate used to calculate income on investments hedging liabilities denominated in PLN was reduced due to changes in the valuation of Polish securities on the financial markets).

Acquisition costs in the mass insurance segment dropped by 3.0% as a result of a lower level of indirect costs (lower personnel costs). At the same time, direct acquisition costs increased as a result of the growing share of more expensive distribution channels (including: broker, agency and multiagency).

The drop in administrative expenses in the first half of 2013 (PLN -20.3 million) compared with the same period of 2012 resulted from lower personnel costs which in turn was the consequence of restructuring and reorganizing, and a drop in advertising expenses (the rebranding campaign in the second quarter of 2012).

Improved profitability in agricultural insurance (low level of claims resulting from negative overwintering effects) and in other liability insurance (a drop in the loss ratio as a result of the absence of large losses) was decisive for the increase in operating profit in the mass insurance segment of PLN 242.5 million (+47.4%) compared with the first half of 2012.

8.3. Group and individually continued insurance in the life sector

Table 23. Gross written premium in the group and individually continued insurance segment

PLN'000

Written premium by type of payment – group and individually continued insurance	1 January – 30 June 2013	1 January – 30 June 2012	% change
Regular premium	3 198 157	3 126 582	*2.3%*
Single premium	700	42 264	*(98.3)%*
Total	**3 198 857**	**3 168 846**	***0.9%***

The increase in regular gross written premium of PLN 71.6 million (+2.3%) resulted mainly from:

- the development of protective group insurance (an increase in the average premium and in the number of insured, including high new sales) – the Company effectively guards its market position despite pressure from competitors;
- supplementary sales of additional covers and increasing the sum insured in individually continued products;
- acquiring premiums from health insurance underwritten in group form (new clients in ambulatory insurance and introducing a new drug product to the offer);
- continued cooperation with banking intermediaries in sales of protective insurance – in the first half of 2013 the highest (fivefold) increase in sales was noted in protection products for borrowers offered together with Bank PKO BP SA.

At the same time a drop was noted in sales of short-term endowment insurance with single premium in the bancassurance channel, as a result of withdrawing from these type of products due to their low profitability.

Table 24. Results of the group and individually continued insurance segment

PLN'000

Data from the income statement – group and individually continued insurance	1 January – 30 June 2013	1 January – 30 June 2012	% change
Gross written premium	3 198 857	3 168 846	*0.9%*
Group insurance	2 252 122	2 236 327	*0.7%*
Individually Continued insurance	946 735	932 519	*1.5%*
Net premium earned	3 197 595	3 168 032	*0.9%*
Investment income	309 899	441 019	*(29.7)%*
Net claims and benefits	(2 206 679)	(2 104 649)	*4.8%*
Change in other net technical provisions	(58 645)	(221 193)	*(73.5)%*
Acquisition costs	(156 434)	(162 975)	*(4.0)%*
Administrative expenses	(258 976)	(288 138)	*(10.1)%*
Other	(28 897)	(29 924)	*(3.4)%*
Operating profit/(loss)	**797 863**	**802 172**	***(0.5)%***
Operating profit/(loss) without effect of coversion[16]	**713 759**	**661 701**	***7.9%***
acquisition cost ratio*	4.9%	5.1%	*(0.2) p.p.*
administrative expense ratio*	8.1%	9.1%	*(1.0) p.p.*
operating profit margin*	24.9%	25.3%	*(0.4) p.p.*

* ratios calculated with reference to gross written premium

[16] Effect of conversion calculated based on by PAS

The increase in the net amount of claims and benefits (of PLN 102.0 million, i.e. 4.8%) was the effect of an increase in the number of events resulting from death in January 2013 (confirmed with GUS data on the increase in the number of deaths in Poland) in group protection insurance and in continued insurance. Additionally higher amounts of surrenders of group employee pension plan insurance policies which was i.a. the effect of layoffs of employees had an impact on the amount of claims and benefits (offset by a change in the technical provisions).

The difference in change of technical provisions (an increase PLN 162.5 million lower than in the same period of the prior year) resulted from:

- lower technical provisions in unit-linked products in effect of negative results on investing activities;
- a drop in technical provisions in short-term life and endowment products in the bancassurance channel as a result of limiting sales of the product in the current year;
- lower increase in the technical provisions in protective insurance continued in effect of modifying the product, which had an impact on the amount of technical provisions set up upon the insured's transfer to the individually continued phase;
- the above factors were partly offset by a slower pace of conversion effect from long-term into yearly-renewable term business in type P insurance (the conversion effect in the first half of 2013 translated to releasing PLN 84.1 million of technical provisions, PLN 56.4 million less than in the same period of 2012).

Income from investing activities comprises income allocated at transfer prices and income from investment-type products. In the group and individually continued insurance segment investment income dropped by PLN 131.1 million, mainly due to the loss on investment activities in respect of investment products in 2013 – the effect of unfavourable conditions on the financial markets and an increase in yields on debt instruments in the first half of 2013 (drop in current value). Income allocated at transfer prices remained at a similar level (a drop of PLN 13.9 million).

In the first half of 2013 acquisition costs in group and individually continued insurance segment dropped by PLN 6.5 million (-4.0%) compared with the first half of the prior year. This was due to the following factors:

- a drop in direct and indirect acquisition costs in type P protective group insurance – limitation of modifications to the portfolio in order to maintain profitability;
- an increase in commissions in protective group insurance in the bancassurance channel as a result of an increase in sales of policies.

The drop in administrative expenses in the first half of 2013 compared with the same period of 2012 of PLN 29.2 million (-10.1%) resulted mainly from lower personnel costs which in turn was the consequence of restructuring and reorganizing, and a drop in advertising expenses (the rebranding campaign in the second quarter of 2012).

Operating profit in the group and individually continued insurance segment dropped by PLN 4.3 million (-0.5%) in the first half of 2013 compared with the same period of 2012, mainly as a result of a lower effect of the conversion of long-term contracts into renewable contracts in type P group insurance. The operating profit after eliminating the conversion effect increased by PLN 52.1 million (+7.9%) y/y – mainly as a result of an increase in the portfolio, modification of individual continuations and economies in administrative expenses.

8.4. Individual insurance – life insurance

Table 25. Gross written premium in the individual insurance segment

PLN'000

Premium written by type of payment – individual insurance	1 January – 30 June 2013	1 January – 30 June 2012	% change
Regular premium	243 168	228 740	*6.3%*
Single premium	501 626	248 826	*101.6%*
Total	**744 794**	**477 566**	***56.0%***

The increase in gross written premium of PLN 267.2 million (+56.0%) compared with the first half of 2012 was the result of:

- the continued high growth rates of sales of the individual unit-linked insurance product with single premium introduced in November 2011 in cooperation with Bank Millenium SA;
- good sales results in respect of a structured product in cooperation with Bank Handlowy w Warszawie S.A.;
- higher sales of the "Świat Zysków" (World of Profits) structured product with single premium through PZU's own channel compared with the same period of the prior year;
- high inflows to accounts in the IKE product in the first half of 2013;
- constant development of the savings and investment product with a protective element and regular premium, "Plan na Życie" (Plan for Life).

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

Table 26. Results of the individual insurance segment

PLN'000

Income statement data – individual insurance	1 January – 30 June 2013	1 January – 30 June 2012	% change
Gross written premium	744 794	477 566	*56.0%*
Net premium earned	747 271	480 632	*55.5%*
Investment income	88 866	150 084	*(40.8)%*
Net claims and benefits	(295 543)	(267 690)	*10.4%*
Change in other net technical provisions	(402 024)	(214 083)	*87.8%*
Acquisition costs	(53 684)	(40 497)	*32.6%*
Administrative expenses	(22 306)	(24 909)	*(10.5)%*
Other	4 859	4 251	*14.3%*
Operating profit/(loss)	**67 439**	**87 788**	***(23.2)%***
acquisition cost ratio*	7.2%	8.5%	*(1.3) p.p.*
administrative expense ratio*	3.0%	5.2%	*(2.2) p.p.*
operating profit margin*	9.1%	18.4%	*(9.3) p.p.*

* ratios calculated with reference to gross written premium

The increase in the net amount of claims and benefits (of PLN 27.9 million, i.e. 10.4%) was the effect of:

- higher endowment disbursements from the Świat Zysków structured product compared with 2012 (maturities of consecutive tranches of the product offset with the change in the technical provisions);
- higher surrenders in the IKE and unit-linked products in the bancassurance channel (offset by a change in the technical provisions);
- offset in part by lower payments from old individual endowment policies underwritten in the 1990s.

The difference in change of technical provisions (an increase in provisions by PLN 402.0 million, PLN 187.9 million higher than in corresponding period of 2012) resulted mainly from high new sales of investment insurance through the bancassurance channel (unit-linked insurance product offered jointly with Bank Millennium SA and structured product offered jointly with Bank Handlowy w Warszawie S.A.). The effect was offset by a drop in the provision in respect of unit-linked products offered through the traditional channel as a result of investment activity losses and high surrenders.

Income from investing activities comprises income allocated at transfer prices and income from investment-type products. In the individual segment it dropped by PLN 61.2 million y/y, mainly due to losses related to investment products – in effect of the deterioration in the conditions on the financial markets and an increase in yields on debt instruments in the first half of 2013 (a drop in the current value). Income allocated at transfer prices remained at a similar level.

The increase in acquisition costs in this segment (of PLN 13.2 million, i.e. 32.6%) resulted mainly from the dynamic growth of sales of investment products through the bank channel, and in particular of the unit-linked product characterized by high acquisition costs.

Administrative expenses in the individual segment dropped by PLN 2.6 million (-10.5%) in the first half of 2013 compared with the same period of 2012 as a result of lower personnel costs resulting from reorganization and restructuring, and of a drop in advertising expenses (the rebranding campaign in the second quarter of 2012).

In consequence of the events described above (mainly an increase in acquisition costs) the operating profit of the segment dropped by PLN 20.3 million to PLN 67.4 million.

8.5. Investments

In the first half of 2013 income from investing activities[17] of the PZU Group dropped by 36.4% compared with the same period of the prior year.

Income from investing activities in the investment segment[18] comprise the excess of income from PZU and PZU Życie investments over the income allocated at transfer prices to insurance segments (corporate insurance segment, mass, group and individually continued, and individual insurance segment) and investment contracts, as well as other free cash flows in the PZU Group. This income dropped by PLN 248.9 million.

Table 27:Results of investing activities – by segment

PLN'000

Results of investing activities – by segment	1 January – 30 June 2013	1 January – 30 June 2012	% change
Investment segment (external operations)	349 100	597 997	(41.6)%
Insurance activity segments (PZU and PZU Życie)	780 299	918 962	(15.1)%
Other segments and adjustments	(160 081)	6 945	X
Total	**969 318**	**1 523 904**	**(36.4)%**

Table 28. Results on investment activity

PLN'000

Results on investment activity	1 January – 30 June 2013	1 January – 30 June 2012	% change
Equity instruments	24 069	299 926	(92.0)%
Interest-earning financial assets	952 973	1 271 377	(25.0)%
Investment properties	15 316	41	X
Derivative instruments	(73 950)	65 881	X
Receivables	(84 980)	(92 742)	X
Other	135 890	(20 579)	X
Total	**969 318**	**1 523 904**	**(36.4)%**

[17] Sum of the following categories: net investment income, net result on exercised transactions and impairment allowances on investments, net change in the fair value of assets and liabilities carried at fair value.

[18] Income covers "Investment income" in the Investment segment (external operations).

A drop in results on investing activities of the PZU Group and in the investment segment was caused, i.a. by lower valuation of:

- equity instruments on the financial markets (the WIG index dropped by 5.7% in the first half of 2013 whereas a year earlier in gained 8.6%), and
- Treasury bonds (returns on 5-year and 10-year Treasury bonds increased by 46 and 59 basis points respectively in the first half of 2013, while in the first half of 2012 they dropped by 60 and 73 basis points respectively).

In the first half of 2013 lower results were also achieved on derivatives, which are purchased mainly to appropriately manage the risk of investment portfolios.

In connection with starting to consolidate real estate funds as of 1 January 2013, in the first half of 2013 one-off income (gross) of PLN 172.8 million was recognized in the item "Other" in the table above.

Table 29. Investments (including investment contracts)

PLN'000

Investments (including investment contracts)[19]	30 June 2013	Structure as at 30 June 2013	31 December 2012	Structure as at 31 December 2012
Equity instruments, including:	6 042 218	10.9%	6 325 626	12.4%
Equity instruments measurable at fair value – listed	3 768 117	6.8%	2 403 641	4.7%
Equity instruments measurable at fair value – other	2 268 964	4.1%	3 795 637	7.5%
Equity instruments not measurable at fair value	5 137	0.0%	126 348	0.2%
Interest-earning financial assets, including:	47 994 363	86.2%	43 933 051	86.4%
Debt securities – government	36 220 148	65.1%	33 494 446	65.9%
Debt securities – other	2 413 744	4.3%	2 435 153	4.8%
Reverse repo transactions and deposits	7 844 659	14.1%	6 982 331	13.7%
Borrowings	1 515 812	2.7%	1 021 121	2.0%
Investment properties	1 604 253	2.9%	564 404	1.1%
Derivatives (net value)	32 109	0.1%	34 149	0.1%
Other	51	0.0%	329	0.0%
Total	**55 672 994**	**100.0%**	**50 857 559**	**100.0%**

Investing activities of the PZU Group are conducted in compliance with the statutory requirements, by applying an appropriate degree of safety, liquidity and profitability. Government debt securities constituted over 65% of the investments portfolio both as at 30 June 2013 and as at 30 June 2012. As at 30 June 2013 and as at 31 December 2012 exposure to debt securities issued by governments other than the Republic of Poland amounted to: 3.6% and 2.5% of the balance of investments respectively.

The drop in the share and value of equity instruments was caused, among other things, by the drop in their market valuation in the period from the end of 2012 to the end of the first half of 2013 (the WIG index in this period was 5.7% lower).

Covering closed-end real estate investment funds with consolidation on the acquisition basis had an impact on increasing the share and value of investment properties.

The increase in the share and value of money market instruments (*reverse repo* transactions and deposits) was caused i.a. by concluding transactions on the interbank market to increase investment activities and adapting the investment portfolios to their benchmarks.

[19] Financial assets, investment properties including negative valuation of derivatives.

8.6. Pension insurance

Table 30. Results of the pension insurance segment

PLN'000

Income statement data – pension insurance segment	1 January – 30 June 2013	1 January – 30 June 2012	% change
Income on basic activities of non-insurance entities	101 668	96 308	5.6%
Acquisition costs	(8 300)	(11 222)	(26.0)%
Administrative expenses	(34 798)	(32 501)	7.1%
Other	6 041	6 123	(1.3)%
Operating profit/(loss)	**64 611**	**58 708**	**10.1%**

Fee and commission income ("Income on basic activities of non-insurance entities") in the pension insurance segment amounted to PLN 101.7 million and PLN 96.3 million respectively for the first half of 2013 and the first half of 2012. The PLN 5.4 million (5.6%) increase resulted in particular from:

- an increase of PLN 2.8 million (+15.9%) in the fees on contributions (since 2013 the level of contributions transferred from ZUS (Social Insurance Institution) to OFE increased from 2.3% to 2.8% of the base pension insurance contributions;
- an increase of PLN 8.6 million (+11.8%) in the management fee resulting from a higher level of assets of OFE PZU;

Moreover, income from the premium/reserve account which was PLN 6.4 million lower had a significant impact on the dynamics of fee and commission income. This was caused by the rate of return on OFE PZU for the period from 31 March 2007 to 29 March 2013 coming below the CPI ratio for the same period.

Administrative expenses increased by PLN 2.3 million (+7.1%), mainly as a result of an increase in the costs of maintaining registers of fund members of PLN 3.9 million (+28.2%), including setting up a provision for an additional fee for the transfer agent due to achieving the level of quality measures set by PTE PZU. The increase in contributions transferred to OFE led to an increase in the fees collected by ZUS of PLN 0.6 million (+16.2%). Moreover, changes in net assets of OFE PZU as at the end of particular quarters had an impact on the drop in costs of mandatory payments to the main part of the Guarantee Fund of PLN 1.2 million (-89.1%).

The drop in acquisition costs of PLN 2.9 million (-29.0%) resulted specifically from the systematic settlement of commissions and the statutory ban on acquisition activities on behalf of OFE as of 2012.

In the first half of 2013 operating profit increased from PLN 58.7 million to PLN 64.6 million (+10.1%) compared with the prior year.

As a result of statutory provisions OFE PZU as one of the largest funds on the market does not participate in draws, which has an impact on the share of OFE PZU in the market in terms of the number of members. As at the end of June 2013 2,227 thousand people were members of OFE PZU, which was 13.7% of the total number of members of open pension funds and which placed OFE PZU third in the market in this respect. Compared with the end of June of the prior year, the number of OFE PZU members increased by 6.3 thousand people, i.e. 0.3%, whereas the total number of OFE members increased by 3.0%.

In the first half of 2013 the assets of OFE PZU increased by 0.9%, and their value amounted to PLN 36,594 million. The level of contributions transferred from ZUS had an impact on the increase in assets. In the first half of 2013 ZUS transferred PLN 589.7 million of contributions to OFE PZU, i.e. over 15.8% more than in the first half of 2012. The change in the level of contributions is mainly caused by the increase in the share of contributions transferred by ZUS to OFE from 2.3% to 2.8%.

8.7. Ukraine

Table 31. Results of the segment – Ukraine

PLN'000

Income statement data – the Ukraine segment – total property and life insurance	1 January – 30 June 2013	1 January – 30 June 2012	% change
Gross written premium	90 928	64 717	40.5%
Net premium earned	80 270	53 167	51.0%
Investment income	11 788	10 011	17.8%
Net claims and benefits	(37 845)	(26 124)	44.9%
Acquisition costs	(28 896)	(17 711)	63.2%
Administrative expenses	(16 906)	(13 436)	25.8%
Operating profit/(loss)	**8 411**	**5 907**	**42.4%**
UAH to PLN exchange rate	0.3947	0.4044	(2.4)%

The Ukraine segment comprises two companies which offer life and property and casualty insurance.

Due to a change in the accounting policies in the PZU Group consisting of discontinuing the use of the materiality principle, as of 1 January 2013 the Company offering life insurance started to be covered by consolidation. The table above presents the data of the two Companies from 1 January to 30 June 2013, and for the period from 1 January to 30 June 2012 – exclusively the data of the property insurance company covered by consolidation.

Table 32. Ukraine segment – property insurance - PZU Ukraine

PLN'000

Income statement data – Ukraine segment – property insurance	1 January – 30 June 2013	1 January – 30 June 2012	% change
Gross written premium	70 048	64 717	8.2%
Net premium earned	59 346	53 167	11.6%
Investment income	6 546	10 011	(34.6)%
Net claims and benefits	(24 609)	(26 124)	(5.8)%
Acquisition costs	(19 679)	(17 711)	11.1%
Administrative expenses	(14 325)	(13 436)	6.6%
Operating profit/(loss)	**7 280**	**5 907**	**23.2%**
UAH to PLN exchange rate	0.3947	0.4044	(2.4)%
acquisition cost ratio*	33.2%	33.3%	(0.1) p.p.
administrative expense ratio*	24.1%	25.3%	(1.2) p.p.
loss ratio*	41.5%	49.1%	(7.6) p.p.
combined ratio (COR)*	98.8%	107.7%	(8.9) p.p.

* ratios calculated with reference to net premium earned

The increase in gross written premium of PLN 5.3 million (+8.2%) in the first half of 2013 compared with the same period of 2012 resulted both from an increase in the premium acquired via third parties (banks, travel agencies, etc.) and from own sales. Travel insurance, the Green Card, corporate property insurance and motor insurance played a special role in the increase in written premium.

In the first half of 2013 a drop in the loss ratio by 7.6 p.p. was noted compared to the first half of 2012, which resulted, i.a. from limiting the popular, but high-loss medical insurance and balancing the portfolio with a profitable property insurance portfolio.

Acquisition costs were PLN 2.0 million (+11.1%) higher than in the first half of 2012, which was the result of the dynamics of the net premium earned, including an increase in sales of property insurance to individuals, motor and travel insurance, in Ukraine characterized by higher charges on the sales revenue acquired.

Administrative expenses increased by PLN 0.9 million (+6.6%%), mainly as a result of a change in the manner of setting up provisions for holiday pay and remuneration-related bonuses – they are updated monthly and not, as in 2012, at the end of the year, and of the payroll indexation conducted in June 2012.

The increase in operating profit of PLN 1.4 million resulted mainly from positive dynamics of net premium earned, a drop in the net loss ratio from 49.1% to 41.5% and was partly offset by a drop in investment income.

Table 33. Ukraine segment – life insurance – PZU Ukraine Life

PLN'000

Income statement data – Ukraine segment – life insurance	1 January – 30 June 2013	1 January – 30 June 2012	% change
Gross written premium	20 880	17 160	21.7%
Net premium earned	20 924	16 947	23.5%
Investment income	5 241	3 198	63.9%
Net claims and benefits	(13 236)	(10 076)	31.4%
Acquisition costs	(9 217)	(7 977)	15.5%
Administrative expenses	(2 581)	(2 505)	3.0%
Operating profit/(loss)	**1 131**	**(414)**	**(373.0)%**
UAH to PLN exchange rate	0.3947	0.4044	(2.4)%
acquisition cost ratio*	44.1%	46.5%	(2.4) p.p.
administrative expense ratio*	12.4%	14.6%	(2.2) p.p.
operating profit margin*	5.4%	(2.4)%	7.8 p.p.

* ratios calculated with reference to gross written premium

The increase in gross written premium of PLN 3.7 million (+21.7%) in the first half of 2013 compared with the same period of 2012 resulted both from an increase in dynamics of premium acquired via third parties (banks, brokers, etc.) and from the Company's own agency network in respect of sales of all product lines.

The increase in investment income of PLN 2.0 million (+63.9%) compared with the first half of 2012 resulted from higher returns on liquid financial instruments (deposits, bonds) and an increase in the liquid asset base.

Acquisition costs were PLN 1.2 million (+15.5%) higher than in the first half of 2012, which was caused by a higher than planned share of "new business" in sales, active cooperation with brokers and an increase in sales through the bancassurance channel, which is characterized by higher commission charges.

Administrative expenses increased slightly by PLN 0.08 million (+3.0%), mainly as a result of a change in the manner of setting up provisions for holiday pay and remuneration-related bonuses – they are updated monthly and not, as in 2012, at the end of the year, and of the payroll indexation conducted in June 2012.

The increase in operating profit of PLN 1.5 million resulted mainly from higher technical reserves correlated with the positive "new business" sales dynamics, a higher level of "old business" in the agency network and income with an impact on the bonus provisions.

8.8. Baltic countries

Table 34. Results of the Baltic countries segment

PLN'000

Income statement data – the Lithuanian segment – total property and life insurance	1 January – 30 June 2013	1 January – 30 June 2012	% change
Gross written premium	125 139	99 034	26.4%
Net premium earned	105 233	81 098	29.8%
Investment income	1 449	3 960	(63.4)%
Net claims and benefits	(65 481)	(50 774)	29.0%
Acquisition costs	(32 433)	(24 153)	34.3%
Administrative expenses	(12 119)	(8 687)	39.5%
Operating profit/(loss)	**(3 351)**	**1 444**	**x**
LTL to PLN exchange rate	1.2205	1.2235	(0.2)%

The Baltic countries segment comprises two companies which offer life and property insurance.

Due to a change in the accounting policies in the PZU Group consisting of discontinuing the use of the materiality principle, as of 1 January 2013 the company offering life insurance started to be covered by consolidation. The table above presents the data of the two companies from 1 January to 30 June 2013, and for the period from 1 January to 30 June 2012 – exclusively the data of the property insurance company which at that time was covered by consolidation.

Table 35. The Baltic countries segment – property insurance – PZU Lietuva

PLN'000

Income statement data – the Lithuanian segment – property insurance	1 January – 30 June 2013	1 January – 30 June 2012	% change
Gross written premium	110 129	99 034	11.2%
Net premium earned	90 321	81 098	11.4%
Investment income	1 986	3 960	(49.9)%
Net claims and benefits	(57 580)	(50 774)	13.4%
Acquisition costs	(27 122)	(24 153)	12.3%
Administrative expenses	(10 680)	(8 687)	22.9%
Operating profit/(loss)	**(3 075)**	**1 444**	**(313.0)%**
LTL to PLN exchange rate	1.2205	1.2235	(0.2)%
acquisition cost ratio*	30.0%	29.8%	0.2 p.p.
administrative expense ratio*	11.8%	10.7%	1.1 p.p.
loss ratio*	63.8%	62.6%	1.2 p.p.
combined ratio (COR)*	105.6%	103.1%	2.5 p.p.

* ratios calculated with reference to net premium earned

In the first half of 2013 gross written premium increased by 11.2%, mainly due to increased sales of property insurance (an increase of 30.1%), Casco Insurance (an increase of 12.0%) and MTPL insurance (an increase of 9.4%). The largest share in the portfolio (59.4%) related to Casco insurance. The share of MTPL insurance dropped slightly and amounted to 36.9% (37.6% in the first half of 2012), and the share of Casco insurance increased slightly (20.6% compared with 20.5% in the same period of the prior year). The share of property insurance was 16.4% (compared with 14.1%).

Income from investment activities in the first half of 2013 amounted to PLN 2.0 million, i.e. 49.9% less than in the same period of the prior year. The drop in investment income was caused by the unfavourable conditions on the equity markets in the first half of 2013.

Acquisition cost dynamics (+12.3%) were at a slightly higher level than the growth dynamics of gross written premium. This increase resulted mainly from changes in the structure of the property insurance portfolio (an increase in the share of products and distribution channels with higher commission).

Administrative expenses increased by 22.9%, mainly due to the costs related to the development of branches on foreign markets (Latvia, Estonia) and the increase in remuneration costs caused by the necessity of setting up provisions for unused holiday pay (a cyclic phenomenon in the first half of the year).

Net operating loss of PLN 3.1 million (compared with a net operating profit of PLN 1.4 million in the same period of the prior year) resulted mainly from losses on investing activities.

Table 36. The Baltic countries segment – life insurance – UAB PZU Lietuva Life

PLN'000

Income statement data – the Baltic countries segment – life insurance	1 January – 30 June 2013	1 January – 30 June 2012	% change
Gross written premium	15 010	12 197	23.1%
Net premium earned	14 912	12 106	23.2%
Investment income	(537)	1 155	x
Net claims and benefits	(7 901)	(6 995)	13.0%
Acquisition costs	(5 311)	(4 442)	19.6%
Administrative expenses	(1 439)	(1 498)	(3.9)%
Operating profit/(loss)	**(276)**	**326**	**x**
LTL to PLN exchange rate	1.2205	1.2235	(0.2)%
acquisition cost ratio*	35.4%	36.4%	(1.0) p.p.
administrative expense ratio*	9.6%	12.3%	(2.7) p.p.
operating profit margin*	(1.8)%	3.1%	(4.9) p.p.

* ratios calculated with reference to gross written premium

In the first half of 2013 PZU Lietuva Life noted written premium of PLN 15.0 million, i.e. 23.1% more than in the same period of the prior year. New sales in the individual customer segment increased twofold. Over 70% of the sales channels was the Company's own network which noted an almost 130% increase compared to the same period of the prior year.

The drop in investment income of PLN 1.7 million was caused by the unfavourable conditions on the equity markets in the first half of 2013. High new sales contributed to an almost 20% increase in acquisition costs.

Net operating loss of PLN 0.3 million (compared with a net operating profit of PLN 0.3 million in the prior period) resulted mainly from losses on investing activities.

8.9. Investment contracts

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 37. Gross written premium in the investment contracts segment

PLN'000

Gross written premium by type of payment – investment contract segments	1 January – 30 June 2013	1 January – 30 June 2012	% change
Regular premium	28 356	7 157	*296.2%*
Single premium	829 362	1 537 882	*(46.1)%*
Total	**857 718**	**1 545 039**	***(44.5)%***

Sales of investment contracts in the first half of 2013 dropped by PLN 687.3 million (-44.5%) compared with the same period of the prior year. Changes in the level of gross written premium resulted mainly from:

- lower sales of short-term endowment products through the bancassurance channel and own channel – the effect of the strategy consisting of withdrawing from this type of policy;
- an increase in premium as a result of introducing a new investment product to sales as of the beginning of 2012 – the individual pension security account – Indywidualne Konto Zabezpieczenia Emerytalnego IKZE.

Table 38. Results of the investment contracts segment

PLN'000

Income statement data – investment contracts	1 January – 30 June 2013	1 January – 30 June 2012	% change
Gross written premium	857 718	1 545 039	*(44.5)%*
Group insurance	671 320	1 311 919	*(48.8)%*
Individual insurance	186 398	233 120	*(20.0)%*
Net premium earned	858 201	1 544 232	*(44.4)%*
Investment income	24 479	94 264	*(74.0)%*
Net claims and benefits	(953 153)	(1 621 671)	*(41.2)%*
Change in other net technical provisions	92 193	1 446	*x*
Acquisition costs	(8 422)	(13 552)	*(37.9)%*
Administrative expenses	(5 034)	(6 871)	*(26.7)%*
Other	6 271	6 317	*(0.7)%*
Operating profit/(loss)	**14 535**	**4 165**	***249.0%***
operating profit margin*	1.7%	0.3%	*1.4 p.p.*

* ratios calculated with reference to gross written premium

Income on investing activities in the investment contracts segment dropped by PLN 69.8 million (-74.0%) in effect of a drop in the balance of investments and deteriorating conditions on the financial markets and a drop in the y/y returns on investments and debt instruments.

The drop in net claims and benefits compared with the same period of the prior year of PLN 668.5 million (-41.2%) resulted from a much lower amount of endowment payments from short-term investment endowment policies, mainly in the bancassurance channel.

The difference in the change of technical provisions in the first half of 2013 compared with the same period of 2012 was the effect of changes in the short-term investment endowment insurance portfolio, mainly through the bancassurance channel – lower: sales, endowment payment, and income from investing activity.

The drop in acquisition costs of PLN 5.1 million (-37.9%) resulted mainly from a drop in the volume of sales and the absence of the 2012 effect – the cost of introducing IKZE to sales.

The segment's operating profit amounted to PLN 14.5 million, which is a PLN 10.4 million increase compared with the same period of the prior year. The main reason for the change was a drop in acquisition costs and fixed allocated costs as a result of a drop in the contracts portfolio.

9. Risk factors which may affect financial performance in the following periods

9.1. Property and casualty insurance

The risk factors which could have an impact on the mass and corporate insurance segment (property and casualty insurance) results in 2013 comprise mainly:

- occurrence of catastrophic events (flood, hurricane, drought, frost);

- the economic slowdown or stagnation which could give rise to an increased loss ratio on the financial and property insurance portfolio as a result of taking excessive risk;
- a drop in sales of new cars resulting in a decreased number of motor insurance policies sold and a lower average value of motor vehicles on the market;
- legal or regulatory changes related to business activity, namely amendments to the Act on insurance activities, introduction of new standards by the PFSA and pro-consumer judicature of the Supreme Court;
- growing consumer awareness which may translate into an increased number of claims, as a result of, i.a., the activities of consumer-oriented institutions, such as Office for Competition and Consumer Protection (UOKiK), the Polish Insurance Ombudsman, the PFSA;
- the growing role of insurance claim law firms in the claims handling process, which translates into the increased value and number of claims of the insured, including claims reported in previous years;
- increased insurance frauds;
- higher number of drivers not having MTPL insurance due to the new principles for terminating MTPL insurance contracts (amendment to the Act on compulsory insurance);
- higher rate of unemployment and weaker dynamics of individual consumption, which translate into the demand for insurance products not increasing;
- price pressure from competitors resulting mainly from reducing the loss ratio of motor insurance in 2012;
- returning to upward trends, in particular with respect to loss frequency;
- 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 provisions in MTPL 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);
- an increase in the insurance brokers' role which could lead to increased acquisition costs;
- 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);
- the unknown date and scope of implementation of the Solvency II Directive, which may affect the level of capital requirements in the PZU Group;
- changes in bank regulations which may have an impact on the reduction in the number of mortgage loans granted and borrowers' insurance.

9.2. Life insurance

The risk factors which could have an impact on the group insurance, individually continued and individual (life insurance) segment results in 2013 comprise mainly:

- increase in the unemployment rate translating into a drop 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");
- lower interest life insurance products with embedded deposits and structured products as a result of planned amendment to tax on capital gains for these products from 1 January 2014;

- legal or regulatory changes related to business activity, namely amendments to the Act on insurance activities, introduction of new standards by the PFSA and pro-consumer judicature of the Supreme Court;
- growing consumer awareness which may translate into an increased number of claims, as a result of, i.a., the activities of consumer-oriented institutions, such as Office for Competition and Consumer Protection – (UOKiK), the Polish Insurance Ombudsman, the PFSA;
- the growing role of insurance claim law firms in the claims handling process, which translates into the increased value and number of claims of the insured, including claims reported in previous years;
- 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;
- changes in the current level of mortality and morbidity;
- changes on the individual insurance market caused by product modifications in accordance with the Council Directive 2004/113/EC and the ruling of the judgement of the Court of Justice of the European Union (judgement in Case C-236/09 (Test-Achats) dated 1 March 2011), which may have a significant effect on the value of new sales and technical result.
- the behaviour of the capital market, and specifically of the WSE – interest in capital products offered by PZU is positively correlated with the situation on the capital markets;
- absence of a precisely defined scope of exemptions relating to e.g. insurance services or medical services in the amended Act on Value Added Tax;
- the unknown date and scope of implementation of the Solvency II Directive, which may affect the level of capital requirements in the PZU Group.

9.3. Pension funds

The risk factors which could have an impact on PTE PZU's results in 2013 comprise mainly:

- change propositions of the government concerning significant reduction or liquidation of the capital part of the universal pension system;
- continued growth trends in the unemployment rate 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;
- fluctuations in the return on Treasury securities dependent on the economic position of Poland and European Union countries – an increase in the returns on securities could lead to lower pricing of investments managed by PTE PZU;
- the behaviour of the capital market, 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.

9.4. Investment activities

The risk factors which may affect the results on investment activities in 2013 include mainly:

- fluctuations in the return on Treasury securities dependent on the economic situation of Poland and European Union countries – an increase in the returns on securities could lead to lower pricing of investments;
- the behaviour of the capital market, and specifically of the WSE – part of the investment income of the companies depends on the trends on this market. Moreover interest in capital products offered by PZU is positively correlated with the situation on the capital markets;
- changes in the financial intermediation market, slowdown in the growth of popularity of independent financial advisory services and limiting the number of sales channels and lower interest in financial instruments by savers.

10. Management Board's position concerning previous performance projections

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

In 2012, the PZU Group Strategy for the years 2012–2014 was published. Chapter 11.12 includes information on the execution of the Strategy in the last year.

PZU GROUP ACTIVITIES IN THE FIRST HALF OF 2013

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

11.1. 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. a future assessment of the Company's position if specific circumstances arise.

As at the date of this Directors' Report of 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 12 July 2013, Standard & Poor's Ratings Services verified and upheld the above rating for PZU and PZU Życie of 23 July 2012, taking into account the changed criteria of rating assessment for insurance companies.

At the same time, this is one of the highest ratings granted to Polish companies. The long-term credit rating in the local currency for Poland as at the date of this Directors' Report of the PZU Group is A with a stable outlook.

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

Table 39: 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/	23 July 2012	A /stable/	22 July 2011
Rating of creditworthiness	A /stable/	23 July 2012	A /stable/	22 July 2011
PZU ŻYCIE				
Rating of financial strength	A /stable/	23 July 2012	A /stable/	22 July 2011
Rating of creditworthiness	A /stable/	23 July 2012	A /stable/	22 July 2011

11.2. Property and casualty insurance

Property and casualty insurance

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

In the first half of 2013, PZU's activities concentrated largely on pro-sales activities in both client segments and adapting and enriching PZU's motor insurance offer, which will be available in the new information system (work conducted under the Everest project).

Products – mass client

- As of 1 May 2013, tariff changes for MTPL and Casco Insurance were introduced for individual clients and SMEs in order to adapt them to market conditions
- General insurance terms and wide range of tariffs were established for motor insurance for individual clients and entrepreneurs owning a small fleet and for property insurance (PZU DOM), for the purpose of insurance contracts to be recorded in the new IT system from the fourth quarter of current year and first quarter of 2014 respectively;
- A new application "UFG Browser" has been launched which enables the selling party and PZU employees concluding contracts to check in the Information Centre of the Insurance Guarantee Fund (Ośrodek Informacji Ubezpieczeniowego Funduszu Gwarancyjnego - OI UFG) the number of claims of motor vehicle owners from compulsory MTPL insurance and Casco Insurance, which constitutes a part of the declaration of the insurance history;
- In connection with the European Commission guidance the EU Directive on Sex Equality, the only product diversifying the premium depending on gender was withdrawn from PZU's offer – individual insurance for ambulatory hospital treatment;
- In the first half of 2013 changes were introduced in the following products: Wojażer PZU Pomoc w Podróży (travel assistance); accident insurance to children, adolescents and personnel; Individual and family accident insurance; Group accident insurance; Corporate accident insurance.

  Changes in the above-mentioned products resulted i.a. from entering the new prohibited clause in the Office of Competition and Consumer Protection (UOKiK) Register of Prohibited Clauses which mainly relate to problems occurring in assistance insurance, accident insurance and treatment cost insurance.
- Due to the high loss ratio in the mandatory subsidized insurance of agricultural cultivation, in the years 2011-2012 and in the spring season of 2013, changes were made to the offer of such insurance aimed at improving yield.

Products – corporate client

- In accordance with the adopted strategy, PZU continued actions aimed at further improving the profitability of motor insurance (AC and MTPL), while gradually increasing pressure on sales, among other things, through:
  - undertaking activities to improve insurance profitability (selective underwriting policy), accompanied by focusing on gaining new clients;
  - modification of the offer addressed to lease firms and fleet managers;
  - introducing additional clauses, extending the scope of protection to make the offer more attractive and strengthen sales.
- In the area of property insurance:
  - improving the classification and risk assessment process was continued;
  - the quotation principles were made more flexible.
- In general liability insurance:
  - risk assessment tools were applied consistently;
  - the quotation principles were made more flexible, while maintaining the risk assessment principles;
  - in the scope of handling insurance dedicated to medical entities, work was completed on the electronic system to support the risk assessment process for these entities.

Products – financial insurance

Corporate client segment

- In April 2013, based on the decision of PZU Management Board, sales of insurance guarantees granted as security of construction contracts to the Corporate Client segment was partly resumed. However at present, after the experience from 2012, the sales are performed based on tightened risk assessment principles and new sales policy.

Products – bank insurance

Mass client segment

- In the first half of 2013, cooperation was continued with current business partners, lead banks on the Polish market – such as Bank Handlowy w Warszawie S.A., Bank Millennium S.A. 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 and negotiations were commenced with new partners, including information and communication technology firms, electricity distribution companies and commercial networks. It comprised the introduction of specialized insurance products such as mobile phone and notebook insurance, insurance of loan repayment in case of loss of one's job.

11.3. Life insurance

Products – group insurance

- In the first half of the year, the prior year's activity was continued aimed at increasing the knowledge of employees / insurers in the wide range of additional covers offer in PZU Życie. The main emphasis was placed on *assistance* insurance, mainly due to low saturation of the portfolio and thus high development potential.
- The PZU Club "Pomoc w Życiu" (help in life) has also been consistently used as a platform for exchange of information with Client and a place for offering assistance services and rebate programmes.

Products – Individual insurance

- In the first half of 2013, sales of the individual retirement security account (Indywidualne Konto Zabezpieczenia Emerytalnego – "IKZE") introduced into the offer in 2012 were continued. IKZE is a product which offers the possibility of voluntary saving for pension and acquiring tax relief in annual tax returns. At the end of 2012, PZU Życie was the decided leader in IKZE sales in Poland, considerably outstripping other insurance companies with the number of Clients. In the second quarter of 2013, information campaigns were carried out, addressed to persons who hold IKZE, in order to encourage these Clients to make payments by pointing to tax benefits and reminding them of the need to save regularly for their future pension. The volume of funds paid into IKZE in the first half of 2013 was higher than in the corresponding period of the prior year;
- In 2013, sales of the Individual unit-linked life insurance "Plan na Życie" were continued. In 2012, the supervisory bodies started to level charges on the insurance market related to the manner of offering and the form of the unit-linked insurance products, including liquidation fees. The Polish Insurance Ombudsman published a report entitled "Unit-linked life insurance". The report indicates that there is a problem with selling unit-linked insurance. In the opinion of the Ombudsman, Clients are not aware of investment risk and the lack of capital protection in unit-linked products, neither are they aware of liquidation fees collected or the long-term of investment. The Ombudsman's report does not refer

directly to the PZU Życie offer but its presentation gave rise to a number of press publications describing the UL products in a negative light, which had an effect on the entire market. In the first half of 2013, PZU Życie actively participated in a project of the Polish Insurance Association (Polska Izba Ubezpieczeń – PIU) aimed at developing recommendations on disclosure best practice. The recommendation relates to unit-linked insurance policies. The main point of the recommendation is the Product Card which will regulate disclosure requirements towards clients and the form of information to be provided. Moreover, it will allow a simple comparison of the cost of each insurance with unit-linked insurance. Work on the final wording of the recommendation and the Product Card is currently being finalized, after obtaining the opinion of the Polish Insurance Ombudsman, the Ministry of Finance, the PFSA and Office of Competition and Consumer Protection (UOKiK);

- Since January 2013, six new subscriptions have been successfully carried out of structured insurance Świat Zysków. The product, based on diversified investment strategies and enabling diversification of own investment portfolio risk based on up-to-date methods, became a significant component of the PZU Życie investment offer. In connection with continuous changes on financial markets, the strategies proposed as part of the Świat Zysków product are constantly changing to best adapt to the current Clients' needs. In the first half of 2013 the insurance cover was extended from 3 to 5 years for "Świat Zysków" product and the index based on PZU TFI funds was introduced. The purpose of the above changes was to be able to continue offering attractive product terms to clients, while maintaining 100% capital guarantee, in spite of unfavourable market conditions. In connection with the observed unwavering interest in structured products, the Company's continued goal is that Świat Zysków should be constantly available in the PZU Życie offer and in view of that, new issues of the product are planned.
- Due to continuing uncertainty as to the stability of financial markets and economies of a number of countries. PZU Życie observed growing interest of the Clients in traditional life insurance – protective or protection and saving. The sales of these products in the first half of 2013 were higher than in the corresponding period of 2012.

Products – bank insurance

<u>The segment of group and continued insurance and individual insurance</u>

In the first half of 2013 the main pressure among investment insurance was placed on unit-linked products and structured insurance. The former policy concerning short-term life and endowment insurance was executed consistently. The possibility of distributing these products has gradually been restricted for several years now (only the product offered with Bank Millenium was present in the offer). Due to the recommendations of the supervisory bodies concerning bancassurance investment insurance a number of modifications were introduced to the existing products.

Continued sales of "Wielowalutowy Program Inwestycyjny" introduced at the end of 2011 with Bank Millennium S.A. met with great interest both among sellers and clients.

As a continuation of the cooperation with Bank Handlowy w Warszawie S.A., 2 subscriptions were carried out for Individual Investment Life Insurance, under which a record premium sum was collected.

Group life and endowment SPE insurance offered by Bank Millennium S.A. was modified in June 2013 to become an individual insurance called individual life and endowment insurance Polisa Oszczędnościowa. Among other things, the change was introduced in an effort to unify the investment product offer at Bank Millennium where PZU Życie offers, also in an individual form, the Multicurrency Investment Programme (unit-linked with single premium). Moreover, the modification introduced was in line with the expectations of the supervisory bodies expressed, among others, in an official letter sent by the PFSA in 2012 to insurance companies.

In the area of protective insurance, the emphasis in the first part of 2013 was placed on maintaining the insurance portfolio and on work related to the planned implementation of insurance for *consumer finance* and mortgage banking clients.

Products – health insurance

Group and continued insurance segment

In the first half of 2013, the Company continued the development of the product offer based on a *fee for service* settlements through the intermediation of a medical benefit and service provider PZU Pomoc. In this period, a number of elements were introduced to improve the service process and the process of making medical appointments. They included reminder text messages, e-mail messages and automatic messages in Outlook calendars. In the period under analysis, the number of medical partners cooperating with PZU Pomoc under the fee for service model exceeded 870 facilities.

Moreover, in the first half of 2013, a modification of drug insurance was introduced which comprised mainly a more flexible product offer as regards the insurance sum and the percentage of payment to be made for drugs by the patients. Another important activity in the area of drug insurance was the introduction of a new variant of this product in June 2013, which enables buying all antibiotics and chemotherapeutic drugs available on the Polish market with 80% financing by PZU.

In the same period, a pilot programme was carried out for a drug insurance Antybiotyk under the additional offer for Individual Continuation Clients.

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 and PZU Życie Management Board, tariffs for mandatory and voluntary insurance are passed in the form of a resolution.

11.4. Distribution channels

The PZU Group has the largest network of sale and service outlets among all Polish insurance companies.

Property and casualty insurance

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

- division by distribution channels;
- client segmentation.

Presented below are the main distribution channels:

- Exclusive agents
    - PZU's own agent network as at 30 June 2013 comprised 5,891 mobile agents (including 313 office agents) and 27 partner agencies as part of which agents manage stationary outlets;
    - the agency channel mainly conducts sales in the Mass Client channel, selling all types of insurance, and especially motor and property insurance.
- Multiagencies
    - 2,576 agents cooperating with several insurance companies mainly make sales to the Mass Client;
    - all types of insurance are sold through this channel, and especially motor and property insurance.

- Insurance brokers
  - the Corporate Client Division especially cooperated with approx. 821 insurance brokers.
- PZU employees
  - PZU employees are mainly engaged in preparation (including the documents necessary to participate in announced tenders) and negotiation of offers for Corporate Clients.
- Bancassurance
  - in 2012, PZU cooperated with 9 banks and 3 strategic partners owning large databases of clients or handling mass payments (telecoms, airlines);
  - sales through this channel in the scope of property insurance mainly relate to insurance linked to bank products or the basic service of a strategic partner.
- Direct
  - sales to the Mass Client are made by telephone and through the Internet.

Life insurance

PZU Życie runs the distribution of insurance through both is own network and the agency network. Additionally, modern and popular distribution channels on the Polish market are used, such as the bank channel or direct sales (mailing). The key distribution channels are:

- Exclusive agents
  - as of 30 June 2013, sales of individual and group life insurance were conducted through a network of over 2,100 exclusive agents and 152 sales team managers, managed by sales directors as part of 36 agency sales units grouped in 5 regions;
  - in the first half of 2013, 481 new agents were recruited
- Multiagencies
  - the number of external entities offering regular and group products at PZU Życie was 249 – as at 30 June 2013, and including the individuals performing acquisition activities (OFWCA) registered with these entities, there are 740 sales agents operating in external sales networks;
  - in the first half of 2013, 159 sales agents were recruited to the external sales networks
- PZU employees
  - important distribution channel for group insurance are employees of PZU Życie;
  - in terms of individual insurance and individual continued insurance workers continued joint network of PZU and PZU Życie which apart from the service functions (e.g. claims handling) also perform the sales functions;
- Bancassurance
  - a network of bank in cooperation with which PZU Życie distributes a wide range of investment products and protection products;
- Direct
  - a distribution channel used to gain clients of individually continued insurance (including sales of additional insurance);
- Brokers
  - sale of group insurance is also performed with the cooperation of brokers network.

11.5. Claims handling

The claims handling process is conducted in 8 Regional Claims handling Centres located throughout the country and in the Claims handling Operational Centre in Warsaw. The model of equal workload for the individual claims handling units was applied to the process based mainly on electronic information (in the form of document images and data from operating systems) and the services being located away from the place of residence of the insured / from the event. During 2013, number of organizational changes were introduced in the Claims Handling Division, including:

- the annual operational costs of the claims handling area were reduced;
- a new remuneration system was introduced for claims handling employees, which promotes those employees who are the most effective and who maintain the highest quality;
- telework system was introduced for approx. 380 claims handling employees;
- the following processes were centralized: Client relationship service, personal claim and annuities payment, payment of claims from general liability insurance, simplified communication claims handling;
- pilot implementation of LEAN tools in Regional Claims Handling Centre in Warsaw, in the teams handling medical benefits and the outcome of accidents;
- a mechanism for automatic assigning of cases to the individual claims handling employees;
- a systemic method of handling client contacts was adopted;
- a new client communication channel was implemented – possibility of manual or automatic notification of the client through a text message;
- the principles for verifying the costs of renting substitute vehicles incurred by the clients renting the vehicles without PZU's participation were unified;
- an application was implemented for handling assignments of property inspection by external parties;
- the scope of cooperation between insurance companies was extended as regards cooperation in mutual recognition of recourse claims in the area of property insurance;
- the claims handling system (SLS) was integrated with selected brokers' systems ("E-szkoda").

Additionally, PZU has been active for several years in the area of counteracting widely defined insurance frauds. In order to increase the effectiveness of activities conducted in this area, training was carried out for claims handling specialists dealing with centralized personal claims handling from third party liability insurance. Moreover, the principles were established for this team's cooperation with the Insurance Fraud Counteracting Team at the Claims handling Office.

11.6. Pension insurance

In the first half of 2013, PTE PZU undertook marketing activities encouraging joining OFE PZU. These activities helped the Fund to maintain the position of one of the most frequently chosen open pension funds. OFE PZU continues to occupy the third position on the market both in terms of the number of members and the value of the accumulated assets. In June 2013, OFE PZU was nominated to the *IPO Summit Warsaw Award* in the category of best domestic emerging market long fund.

In the 1st half of 2013, PTE PZU actively participated in the consultation process related to the proposed changes in the legal regulations regarding pension insurance and the entire social insurance system. PTE PZU brought forward arguments and solutions which were mainly aimed at securing the interest of the clients of both OFE PZU and DFE PZU, and ensuring further development of the pension products market.

In connection with the review of the pension system being in progress and the expected changes in pension funds operation, additional actions were undertaken to obtain expert opinions and to publish them in the media. These initiatives are executed jointly with other universal pension funds as part of the Polish Chamber of Pension Funds and the Polish Confederation of Private Employers Lewiatan. If based on the review of the pension system a solution allowing free choice between Open Pension Funds (OPF) and ZUS is implemented, it will be necessary to take action in order to increase the awareness of OPF participants of the benefits arising from belonging to the funds. The Company has already decided to carry out an educational and information campaign on OPF with other universal pension funds, which will be executed in cooperation with Lewiatan.

In 2013, PTE PZU's focus is on post-sales activities and educational initiatives, raising awareness about the necessity of saving for retirement, for example by opening an Individual Pension Account (IPA). The IPA is offered to the clients who look for an opportunity of saving additional funds for their future pension benefits. Activities in this respect are conducted by a voluntary pension fund Dobrowolny Fundusz Emerytalny PZU ("DFE PZU") established by those PTE PZU that have the statutory right to keep Individual Pension Accounts. The new product offered by PTE PZU as the third pillar pension makes IPA payers eligible for a personal income tax relief. At the end of 2013, DFE PZU maintained 116.5 thousand Individual Pension Accounts with PLN 3.5 million of assets managed. DFE PZU sells Individual Pension Accounts in cooperation with PZU CO which is the distributor. As regards sales results, the Fund is a leader among Polish financial institutions offering Individual Pension Accounts. Having substantial experience on the pension product market, highly qualified management and a well-established market position, PTE PZU is developing this line of its business providing clients with the opportunity to increase their funds held in OFE PZU and in DFE PZU in a safe manner. The 49% yield on investment offered by DFE PZU at the end of December 2012 was the best among all voluntary pension funds. The Company was appreciated and honored for that achievement with the Golden Portfolio Award of the "Parkiet" publication for stock exchange investors. As the end of June 2013, the yield for a period of 18 months (commencement of DFE PZU's activities) was 54%.

11.7. Investment funds

As at the end of June 2013, TFI PZU had in its offer a total of 25 funds and subfunds, of which 16 are offered to Clients from outside the PZU Group. As at the end of June 2013, the net asset value of the investment funds managed by TFI PZU was PLN 20,867.9 million (an increase of 35.8% compared with the end of 2012). In terms of the net asset value TFI PZU is ranked first on the market, with a 12.6% share. The increase was mainly due to:

- continuing the policy of transferring the PZU Group's assets to funds;
- continued expansion of the external sales network, which translates into the increased importance of this distribution channel in accumulated net assets;
- strengthening the leading position on the market of employee pension funds – a total of 6 employee pension funds had been implemented since the start of the year, including 4 prepared from scratch and 2 taken over from the other managing entities;

Table 40: Rate of return from funds

Funds	Return* in the period from 28 December 2012 - 28 June 2013	Return* in the period from 30 December 2011 - 29 June 2012
PZU Energia Medycyna Ekologia	13.97%	7.41%
PZU Akcji Małych i Średnich Spółek	9.34%	11.89%
PZU Akcji Rynków Rozwiniętych	6.62%	2.20%
PZU FIO Ochrony Majątku	0.97%	1.70%
PZU SEJF+	0.92%	2.05%
PZU Gotówkowy	0.81%	2.93%
PZU Dłużny Rynków Wschodzących	(2.11)%	5.97%
PZU Papierów Dłużnych POLONEZ	(2.66)%	4.89%
PZU Zrównoważony	(3.89)%	7.93%
PZU Stabilnego Wzrostu MAZUREK	(5.31)%	5.19%
PZU Akcji Spółek Dywidendowych	(5.52)%	5.19%
PZU Akcji KRAKOWIAK	(6.70)%	7.07%
PZU Akcji NOWA EUROPA	(11.40)%	6.12%
PZU Akcji Rynków Wschodzących	(14.21)%	(0.76)%

** The historical results presented do not reflect tax on capital gains and handling fees. The handling fees table is available on pzu.pl website, at the seat of TFI PZU (al. Jana Pawła II 24 in Warsaw) and in places where units are sold and repurchased.*

The main distribution channels include:

- External channel
  - In the first half of 2013 the share of assets obtained through external distributors in the total net sales (excluding the PZU Group's assets) increased and it currently exceeds 50%;
- Direct sales
  - in the direct sales channel the leading role is played by the Employee Pension Funds (Pillar III). Nearly 41% of total net sales were achieved through the existing and new programmes (excluding the PZU Group's assets).

11.8. Organizational structure

The organizational structure of PZU and PZU Życie from the management perspective is based on functional and geographic coordination of tasks. As part of the functional coordination, PZU and PZU Życie have separate departments and functional areas which coordinate specific functions, such as management of sales in the client segments, claims handling, managing the chain of outlets, the operations department, the finance department, the HR department, the investment department and functional departments and areas responsible for the support functions. Geographic coordination is achieved by territorial structures (regional branches and appropriate structures of functional departments, including specialist units). A significant part of the structures on each organizational level (head office, specialist units, regional branches, PZU branches) is fully integrated and performs its functions to the benefit of both PZU and PZU Życie.

As at 30 June 2013, the following organizational units form the organizational structure of PZU and PZU Życie:

- the head office – which supports the Management Board of PZU in the scope of managing the companies' operations and coordinating activities as part of the PZU Group; it creates assumptions and development directions for the PZU Group's operations and organization, it constitutes the planning and management centre by setting business goals, defining strategy and coordinating its implementation;
- specialist units – specialist operational centres which execute their tasks for the companies or in their designated area of the country in the scope of: Contact Centre, insurance transactions, claims handling,

accounting operations (insurance and non-insurance); HR and payroll operations, debt collection activities, administrative support;

- regional branches including the network of PZU branches – points of direct, all-inclusive Client services in the scope of property and life insurance.

It should be noted that some of the activities are performed by subsidiaries (including PZU Pomoc SA in the scope of claims handling (assistance) and TFI PZU SA in the scope of investment portfolio management) and through outsourcing.

In the organizational structure of PZU and PZU Życie there are committees – collegial bodies with decision-making competencies which act as opinion leaders.

As part of optimizing the organizational structure and adaptation to the business strategy and to the changing environment, the following key organizational changes had been introduced by the end of June 2013:

- reorganization of investment products management – forming a competence centre in the Investment Department for the purpose of developing and selling investment products;
- continuing the centralization of claims handling – reducing the number of Regional Claims handling Centres, centralization of adjustment of certain types of claims in selected Regional Claims Handling Centre;
- opening the Compliance Office as part of the process of adapting the PZU and PZU Życie operations to Solvency II requirements.

11.9. IT area

In the first half of 2013 IT activities focused on streamlining IT processes and applications aimed at reducing time necessary to launch new insurance and financial products on the market and on optimizing costs of operating WANs.

Guidewire

Everest strategic project concerning implementation of a new operation system is in progress. The new system will result in an entire transformation of PZU processes, in particular a substantial reduction of time-to-market. Apart from the IT department, all key business areas from the sales department (including distribution channel management), operations, product management, claims handling, collections to accounting were involved in the implementation process. The entire transformation will last 3-4 years and will cover integration of products, sales support, operations, policy management and claims handling.

The project is being performed in line with the time schedule assumed. In the first half of 2013, the system was customized and integrated with the IT architecture of PZU. Commissioning and implementation to production of the first version of the Guidewire system is planned for the fourth quarter of 2013.

Other activities

A number of activities were performed in support of significant business initiatives and optimization of technical infrastructure and processes, in particular:

- extensive integrated changes were introduced in 22 IT systems in the area of support the sale for Mass Client;
- work was continued on improving the IT tools in the area of investment fund and asset management;
- the third phase of joint implementation for PZU and PZU Życie of ERP class system was completed - from January 2013 new processes were implemented including the area of insurance accounting for PZU and PZU Życie;
- the project involving consolidation of IT infrastructure in the scope of disc resources was completed; and their effective use within the PZU Group has now been achieved;
- considerable cost savings were made in connection with optimization of the WAN networks;
- the process of measuring the efficiency and effectiveness of IT processes and expenses based on the cost allocation model was improved;

- Monitoring of the PZU Group critical business systems and applications was introduced to eliminate the risk of long-term failures thus reducing downtime of the critical system;
- Work is underway to improve the safety of the PZU Group's IT network.

A significant step was also taken to unify the IT area within the PZU Group by standardizing the oversight, structure and management of IT areas in all service companies of the PZU Group.

11.10. The main marketing activities in the first half of 2013

Since the start of 2013, marketing communication of PZU is based on new positioning "You can rely on us". The positioning of the PZU brand is based on the concept of reliance on the insurance company, which translates into peace of mind which a client gains on purchasing insurance.

The first wide-reach campaign in the new format was the campaign "Nostres" aimed at showing that PZU guarantees as a standard Casco Insurance in the *all risks* formula. The campaign started on 25 February and lasted 2 months. This was the first large product campaign of the PZU Group since the last year's rebranding.

In February of this year, an advertising campaign of the TFI company was carried out. The campaign showed that TFI PZU is number 1 in terms of the value of managed assets on the investment funds market. The objective was to present PZU as well able to manage money, which it pays to entrust one's savings – the rate of return in 2012 of PZU Zrównoważony subfund was amounted to 24.52%.

At the start of March 2013, an advertising campaign was launched of the traineeship and secondment programme offered by PZU to students and young graduates. The campaign was conducted under the slogan "Work with a capital W" [*Praca przez dużo P*] – it underlines the merits and opportunities posed by traineeships and secondments at PZU.

At the end of May of this year, the next stage of PZU's advertising campaign was launched with Captain Nostres in the leading role. The title of the campaign was "Highly helpful agents" [*Agenci mocno pomocni*] and its purpose was to show to the clients that PZU agents are trustworthy and reliable in every situation. A real PZU agent was one of the campaign's characters. BTL support and events at airports were developed for the campaign's purposes.

At the start of June, OPF's campaign was launched. The campaign started before the draw organized by ZUS and its purpose was to show that the open pension fund at PZU means certainty resulting from the safe investment policy thanks to which PZU has now ensured above-average results to its clients for more than 10 years.

The Wojażer campaign promoting tourist insurance also started in June. As part of the campaign, support materials were prepared to agents and branches (leaflets, posters, fliers, postcards and baggage tags).

In the first half of 2013, a new format for leaflets was developed, which particular features were simple language and unified tone.

In 2013, work was completed on the marketing segmentation of Mass Clients by the use of analytical CRM tool. The purpose of the classification into target groups was to adapt the sales offer to the needs and expectations of particular client groups.

11.11. Key activities in the HR area

11.11.1. Employment in the PZU Group

In order to develop modern insurance products tailored to Client needs and build proper relationships with the insured by developing distribution channels and ensuring a high quality of service, including claims handling, PZU invests in people with various competencies and interests. At the same time, through training programmes, both group and individual, the employees are able to extend their knowledge in the areas of insurance, finance, sales techniques, new technologies and management.

The summaries below present the employment structure at PZU and PZU Życie in the first half of 2013 and at the end of 2012 and 2011. The employees of these companies constitute a significant part of the total number of employees of the PZU Group. The consequences of the restructuring activities at the PZU Group include reducing the average age of the employees in the PZU Group and increasing the number of employees with university level education.

Table 41: PZU and PZU Życie – employment structure by age

age group	1st half of 2013	2012	2011
up to 25 years	3.2%	3.6%	3.2%
over 25 to 34 years	31.1%	31.2%	29.9%
over 34 to 44 years	33.7%	33.1%	31.8%
over 44 to 54 years	20.2%	20.8%	23.1%
over 54 to 64 years	11.7%	11.3%	11.9%
above 64	0.1%	0.1%	0.1%

Table 42: PZU and PZU Życie – employment structure by education

education level	1st half of 2013	2012	2011
University	74.6%	73.4%	69.7%
high school	24.7%	26.0%	29.9%
other*	0.7%	0.6%	0.5%

* below high school

Table 43: PZU and PZU Życie - employment of women

data	1st half of 2013	2012	2011
Percentage of women in senior management	31.2%	29.7%	31.9%
General percentage of women in the number of employees	64.0%	64.4%	66.0%

Activities conducted in the HR area in 2012 were aimed in particular at increasing motivation, promoting cooperation and initiative among employees and building a positive image of the employer.

The projects were continued in the first half of 2013.

By changing the performance management system and setting the principles for granting bonuses in 2012, the strategic goals of the PZU Group were linked to the remuneration system at all levels of the organization.

In 2013, employee assessment for 2012 was carried out for the first time. The purpose of the assessment is mainly to promote appropriate attitudes based on cooperation, knowledge sharing and feedback. To this end, employee's DNA and the PZU Leader's DNA were created, which form the basis for the annual employee assessment. In order to strengthen the individual genes within the DNA, each employee and his/her superior may choose trainings from the offer proposed by the HR department.

PLUS program was launched offering a rich program of e-learning and stationary trainings for all PZU and PZU Życie employees focused on the development of core competencies in the DNA.

Thanks to launching the e-learning platform, information on HR activities was distributed, including the information on implementing new systems: the remuneration and DNA system. Statistically, in 2012, each employee devoted 8 hours to training through the platform. The training offer is successively enlarged for additional modules of soft skills and industry training. Extending industry knowledge is also achieved through access to various electronic materials (including media monitoring) and industry magazines and press.

Additionally, a package of stationary training was developed: challenges of management, Manager's CV, coaching, individual training, group training, studies and specialist forms of professional development, language courses, MBA programmes. The Lider 2.0 development programme for management was launched. Its objective is to strengthen key PZU managers in their role of versatile leaders.

Mechanisms for entry and exit from the organization were developed and implemented. The process of accustoming a new employee is aimed at building involvement and loyalty in an atmosphere of openness and cooperation. Each person leaving the organization by mutual agreement is asked for feedback on his/her work at PZU and the reasons why he/she decided to change employer. New employees' recruitment period was shortened to 28 days.

Moreover, as a result of research on commitment carried out among PZU employees, the Project TOP 30 - Change leaders was implemented. Its goal is to develop initiatives which would increase the employees' commitment in 5 areas: "People – the key resource of PZU", "We pay for performance", "Develop with PZU", "Clients first", "PZU Ambassadors".

Additional platform for communication between employees and HR department was carried out in the first half of 2013 the employee commitment survey

As part of the activities aimed at strengthening PZU's position as a preferred employer, a Programme of traineeships and secondments was launched, which enables students and graduates to extend their knowledge and skills and to apply them in business. Moreover, PZU became involved in a number of initiatives addressed to young talents, including: Written by Knowledge [*Wiedzą Pisane*] Competition or PZU's Ambassador Programme. It should be noted that the result of the aforementioned activities is that the value of the PZU brand as a good employer is growing (it has been ranked 5th in the 3rd edition of Antal International survey "The Most Desired Employers 2012 in the Opinion of Professionals and Managers").

11.11.2. The restructuring process in PZU

The restructuring plan for 2013

On 27 December 2012, the Management Boards of PZU and PZU Życie announced the principles for the restructuring plan in 2013, which was to cover mainly the areas of claims handling and finance, but also to a considerably smaller extent the support functions (administration, logistics, IT).

On 13 February 2013, the Management Boards of PZU and PZU Życie announced their intention to carry out group redundancies based on the Act of 13 March 2013 on special principles for terminating employment relationships for reasons not related to employees, Journal of Laws No. 90 of 2003, item 844, as amended ("the Act on special principles of terminating employment relationships").

The employment restructuring was planned for the period from 18 March to 15 June 2013. The restructuring was to cover up to 3,145 persons from PZU and PZU Życie, of which according to estimates the redundancies were to apply up to 630 employees of PZU and PZU Życie, which represented 5.5% of the total number of employees in both companies.

On 28 February 2013, PZU and PZU Życie and the workers unions operating at these companies concluded an agreement specifying the terms and conditions of the employment restructuring. The final version of the document was prepared based on experience and solutions developed during similar negotiations in previous years.

The employment restructuring was carried out in the planned period and it eventually covered 2,250 persons at PZU and PZU Życie, including redundancies which covered 544 employees of PZU and PZU Życie.

The persons who were dismissed or who did not accept the proposed changes to the terms of employment (as during all other employment restructuring stages, i.e. in the years 2010–2012) were offered more beneficial terms for termination of employment than those provided for by law in similar situations (the Act on special principles for terminating employment relationships). The amount of additional gratuity depended on the years of work at the PZU Group and the salary level of a given employee.

The total restructuring costs recognized in the burden of provisions for restructuring costs in the first half of 2013 amounted to PLN 20.2 million (throughout 2012: PLN 75.9 million).

As of 30 June 2013, the provision for restructuring costs amounted to PLN 38.0 million (as at 31 December 2012: PLN 58.2 million).

The table below shows changes in the number of employees in the PZU Group in recent years.

Table 44: PZU and PZU Życie – number of employees at the end of given period

'000 full time positions

Company	1st half of 2013	2012	2011	2010	2009
PZU	8.05	8.34	8.66	9.36	10.95
PZU Życie	3.24	3.24	3.41	3.81	4.06
Total	**11.29**	**11.58**	**12.07**	**13.17**	**15.01**

11.12. Pursuing the strategy and development projects

In 2012 the PZU Group published its strategic goals for the years 2012–2014. Execution of the strategic goals is summarized below.

Goal	Execution – summary of actions taken in the 1st six months of 2013
Business pillars:	
The mass client	
Maintaining the position in Property Insurance in a profitable manner	1. The profit from operating activities in the mass insurance segment for the first half of 2013 was 47.4% higher than in the first six months of 2012. 2. According to the PFSA data, the market leader after the first quarter of 2013 in the individual clients category – 38.6% share in the market of individual clients, including 34.0% in Casco insurance (AC), 28.5% in MTPL insurance, and 61.9% in property insurance. 3. New sales campaigns were carried out based on the sales tool to which new functionalities were added (analytical CRM). 4. The implementation of the new product system (Everest project) was continued. The system will contribute to the flexibility and sophistication of products and provide new functionalities for individual distribution channels.
Life insurance development	1. Increase in gross written premium in the individual insurance segment in the first six months of 2013 of 56.0% compared with the first six months of 2012. 2. Work on the new strategy for the individual life insurance segment associated with the change in the market conditions was continued. 3. Work on implementation of a sales support tool (analytical CRM) for PZU Życie was commenced.
Building position in the Investments sector	1. TFI PZU ranked first in terms of the net asset value as at the end of June 2013 according to the Chamber of Fund and Asset Management (IZFA). 2. In the period from January to June 2013, TFI PZU had positive net sales. 3. The value of assets managed by TFI PZU, including the net sales and the PZU Group assets, increased by 35.8% in the first six months of 2013 compared with the 31 December 2012.
The group client	
Maintaining the leading position in life insurance in	1. The profit from operating activities, excluding the conversion effect, in the group and continued insurance segment for the first half of 2013 was 7.9%

Goal	Execution – summary of actions taken in the 1st six months of 2013
a profitable manner	higher than in the first six months of 2012. 2. Consistent growth in gross written premium and profitability of basic type "P" insurance. 3. Introduction of new individual continuation agreements for group life insurance.
Development of individual relations (the PZU Pomoc w Życiu Club)	1. Implementation of the PZU Pomoc w Życiu Club in the workplaces of persons insured with PZU Życie was continued. The range of services and discounts offered by the PZU Pomoc w Życiu Club is constantly updated and adjusted to the Clients' needs. 2. Events promoting the PZU Pomoc w Życiu Club were organized in selected employment establishments. These events encouraged employees to activate their club cards and enhanced the positive image of PZU.
Dynamic development of health insurance	1. Increase in written premium on group health insurance in the first six months of 2013 of 17.3% compared with the first six months of 2012. 2. Increase in the number of risks in group health insurance in the first six months of 2013 of 3.8% compared with the first six months of 2012. 3. Increase in the new sales result in group insurance (in terms of the number of risks) in the first six months of 2013 of 46.2% compared with the first six months of 2012. 4. Further improvement and development of the ambulatory healthcare offer addressed to corporate clients, including further development of the network of service providers and improvement in the functioning of TPA (third party agreement). 5. The Group worked on the launch of a new product – Ubezpieczenie Antybiotyk (Antibiotic Insurance) as part of Individually Continued insurance.
The corporate client	
Regaining market position and maintaining yield	1. The operating profit for the first six months of 2013 in the corporate insurance segment was 162.0% higher than in the first six months of 2012. 2. According to PFSA data, the market leader after the first quarter of 2013 in the category of enterprises and other entities, with an overall market share of 29.1%, including 42.8% in Casco insurance (AC), 49.2% in MTPL insurance. 3. Work was carried out on improving the quality of client service, which was increased to a satisfactory level (in the clients' opinion).
Other areas of activity	
Effective capital and investment policy	1. Standard&Poor's financial strength rating and credit rating of PZU and PZU Życie were at the "A" level (with a stable outlook) – one of the highest ratings awarded to companies in Poland. 2. Works were carried out to prepare the PZU Group to comply with the regulatory requirements associated with the Solvency II directive.
A new international expansion model – PZU International	1. Development of operations in Baltic countries – PZU is present in Lithuania and, from 2012, in Latvia. In the first six months of 2013, the sale of policies was commenced in Estonia. 2. With its high capital base, PZU is looking for investment opportunities both in Poland and abroad.

Goal	**Execution – summary of actions taken in the 1st six months of 2013**
Strategic marketing / Corporate Social Responsibility	1. Work on the preparation of a report on the effects of corporate social responsibility activities are in progress. The new report will be the second one in the history of PZU and it will discuss the achievements from the last two years and plans for the future which are a response to the challenges and stakeholders' expectations.
Conditions for implementation	
Middle-office: a modern and integrated client service model	1. The process of implementing a network of modern PZU Branches – visible, uniform in the whole PZU Group and focused on sales, was continued. 2. Work was continued on further optimization of the claims handling and benefits area, including in particular: • completing the actions aimed at introducing telecommuting as an alternative to stationary work; • centralization of operations of selected teams; • completing another stage of development of the "E-szkoda" communication platform, including its integration with selected brokers; • works aimed at partial automation of benefit claims handling.
Back-office: efficient operations and flexible IT	1. Work on the implementation of a product system for property insurance was continued. 2. Further activities associated with centralization and optimization of operating processes were carried out. Another two Operating Centres were centralized in 2013 and their activities were transferred to the Centres in Łódź and Opole. 3. The 3rd stage of implementation of a common ERP class system for PZU and PZU Życie was completed – from January 2013 ,a number of processes in the area of insurance accounting were implemented for PZU and PZU Życie. 4. File servers were centralized as part of the PZU infrastructure, as a result of which the utilization of lines by PZU was reduced, leading to a decrease in the payments in this respect and more efficient utilization of the lines. 5. Critical systems and business applications in place at the PZU Group were monitored in order to eliminate the risk of long-lasting failures. As a result, the time of the unavailability of critical systems was reduced. 6. Work on increasing the safety of the IT network at the PZU Group was commenced.
HR: business partner / committed employees / result-oriented culture	1. The system of assigning targets, implemented in the 4th quarter of 2012, was stabilized. 2. The programme PLUS was launched. It offers an extensive training programme for all PZU and PZU Życie employees, which is focused on the development of key competencies as part of DNA. 3. As part of the activities aimed at strengthening the position of PZU as the preferred employer, another cycle of training and apprenticeships was launched at the PZU Group in June 2013.

Goal	Execution – summary of actions taken in the 1st six months of 2013
	4. The PZU Sport Team initiative was launched to provide an opportunity for PZU employees to play selected sports together. 5. A survey of the PZU employees' commitment was conducted with the participation of as many as 87% of employees.
Branding: PZU is a modern, client-oriented firm.	1. The following advertising campaigns were carried out: • The Nostres campaign: was aimed at encouraging clients to buy PZU Casco insurance (AC). This insurance covers all motor risks. • The Agent campaign, aimed at presenting the PZU agents as being both professional and human, and close to clients whenever they need them.

11.13. Social commitment

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

As in 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 the first six months of 2013:

- cooperation with TOPR, GOPR and selected WOPR groups was continued;
- cooperation with Stowarzyszenie Misie Ratują Dzieci (Teddies Save Children Association) was continued in the area of therapeutic and psychological help for children injured in accidents;
- the Bezpieczna Flota (Safe Fleet) project addressed to selected fleet drivers was continued;
- in cooperation with Stowarzyszenie Pomocy Niepełnosprawnym Kierowcom (Disabled Drivers Aid Association), PZU carried out the Auto Mobility Centrum programme focused on reducing the mobility barriers by providing disabled drivers with aids which enable them to drive safely despite physical dysfunctions;
- in cooperation with the Special Olympics Poland, PZU organized sports competitions for persons with a mental disability;
- actions were taken to improve safety in the Łazienki Królewskie Museum in the form of a programme for extending the technical security system in the buildings and physical protection of people and property at the museum.

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

- patron of the Royal Castle in Kraków and the Łazienki Królewskie Museum in Warsaw;
- close cooperation with the Royal Castle in Warsaw;
- the "Nieconocna Noc Muzeów z PZU" (Not Every-night Night of Museums with PZU) action during the Night of Museums at the Royal Castle in Warsaw, the Łazienki Królewskie Museum in Warsaw, and in the Sukiennice Gallery of 19th Century Polish Art (a Branch of the National Museum in Kraków);
- patron of Willa Decjusza in Kraków;
- sponsor of the Malta Festival in Poznań;
- sponsor of the "PZU Strefa Ciszy Royal Łazienki Music Festival" in cooperation with the Łazienki Królewskie Museum in Warsaw;
- sponsor of the 9th International Rzeszów Carpathia Festival;

- cooperation with the Kraków Festival Office, including sponsorship of the following projects: The Czesław Miłosz Festival of Literature, OPERA RARA, Grolsch Art Boom Festival, Jarmark Świętojański, Wianki, the Sacrum Profanum Festival;
- sponsoring the "Droga na Harvard" (Way to Harvard) competition;
- sponsoring the educational program Akcjonariat Obywatelski (Citizens' Shareholdings);
- sponsoring the Forbes Great Ball;
- sponsoring the Capital Market Leaders Academy;
- patron of the Hewelianum Scientific Centre in Gdańsk;
- sponsoring the 5th Women's Congress;
- sponsoring the WallStreet Conference;
- patron of the Bukowina Tatrzańska commune.

12. Planned key development directions

In accordance with the Strategy for the years 2012–2014, in the coming years 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.

Goal	Planned development directions in 2013
Business pillars	
The mass client	
Maintaining the position in Property Insurance in a profitable manner The development of life insurance Build the position in the Investments area	1. Maintaining the market share in the motor insurance and property insurance segment. 2. Development of savings and investment products, and in particular long-term savings products. 3. Further development in the area of mass sales, among other things, by developing basic distribution channels.
The group client	
Profitable maintain leadership position in the life insurance Developing individual relations (PZU Club Pomoc w Życiu) The dynamic growth in the health insurance	1. Maintaining the profitable lead position in life insurance. 2. Creating a health insurance market to increase the scale of business in that area. 3. Actively upselling products related to health and drug insurance to group clients. 4. Strengthening direct relations with the insured thanks to the PZU Club's offer "Pomoc w Życiu" (help in life).
The corporate client	
Regaining the market position and maintaining profitability	1. Transforming PZU into a business partner with a strong expert position that is not only an entity selling insurance but also a client advisor. 2. Maintaining the market position in motor insurance and increasing the

	market share in non-motor insurance.
Other areas of activity	
Effective capital structure and investment policy	1. Introducing further changes in the investment policy covering, among other things, a change in the structure of investments which will lead to an increase in yield with a simultaneous reduction in the volatility of results on investing activities.
A new international expansion model – PZU International	1. If any interesting opportunities arise, increasing the scale of operations of the PZU Group through international expansion on the markets of Central and Eastern Europe.
Strategic marketing / Corporate Social Responsibility	1. Continuation of actions supporting the image of PZU as an institution that helps ensure safe future.
Conditions for implementation	
Middle-office: a modern and integrated client service model	1. Implementing a new client service model which assumes an integrated contact channel structure, compliant with clients' expectations, and specifically building a network of modern sales and service outlets. 2. Further optimization in the area of claims handling and benefits.
Back-office: efficient operations and flexible IT	1. Continuation of activities aimed at implementing a new product system at PZU, which will make it possible to increase operating efficiency. 2. Further optimization of operating processes.
HR: business partner / committed employees / result-oriented culture	1. Continuing operations focused on transforming the PZU Group into a results-oriented organization. 2. Strengthening the position of PZU as a preferred employer through implementing a new edition of the training and apprenticeship programme.

13. Risk management

13.1. Risk management objective

The risk management objective is to ensure that PZU and PZU Życie pursue their business goals, monitor and manage their investment and insurance portfolios and operational risk in a safe manner, adequately to the scale of the risks incurred. The risk management strategy is an integral part of the management process in place at PZU and PZU Życie. The main elements of the risk management strategy include:

- the system of acceptable risk level limits and restrictions defined by the Supervisory Board, the Management Board and adequate Committees, including the risk appetite level;
- the processes of identification, measurement and assessment, monitoring, reporting and management actions with respect to individual risks;
- the risk management organizational structure, in which the Supervisory Board, the PZU and PZU Życie Management Boards, and the following Committees: the Asset-Liability Committee (ALCO), the Credit Risk Committee (CRC) play a key role.

13.2. Risk appetite

Risk appetite is understood as the level of risk that PZU and PZU Życie are prepared to accept in pursuing their business goals. This definition of risk appetite determines the limitations of the risk management strategy.

The appetite for individual risks is defined in the form of limits approved by the Management Board or a competent Committee. The limits defined for PZU or PZU Życie are allocated to organizational units functioning at lower levels of the organizational structure.

13.3. Risk management process

Through structured identification, measurement, assessment, monitoring, reporting and management of the risks, PZU and PZU Życie successfully implement their risk management strategy. PZU and PZU Życie apply the individual elements of this process to the key areas of their activity, i.e. from the moment when a new insurance or investment product is proposed to the moment of expiry of the liabilities, receivables or other product-related actions and supporting areas.

13.4. Organizational structure and responsibility in the risk management process

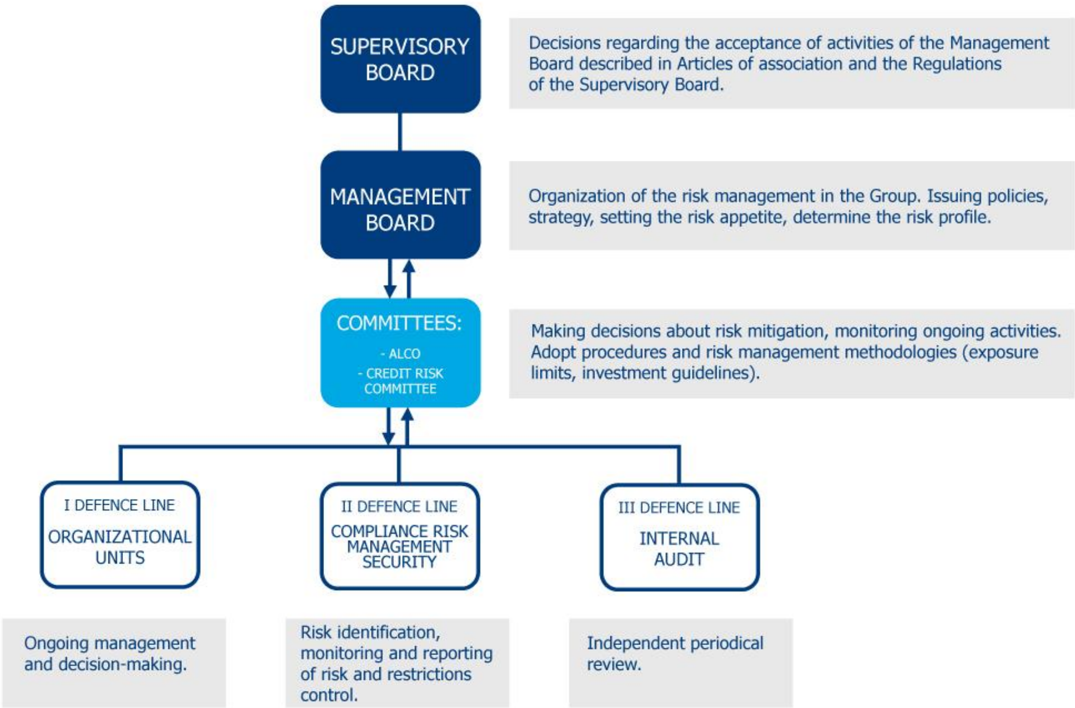
The risk management structure is based on four competence levels. The first three competence levels comprise:

1) the Supervisory Boards, which supervise the risk management process and assess its adequacy and effectiveness as part of their powers defined in the Statute of PZU and PZU Życie and the Supervisory Board rules and regulations;
2) the Management Boards, which organize the risk management system and ensure its functionality through approving strategies and policies and determining appetite for individual categories of risk;
3) the Committees (ALCO and CRC), which make decisions on reducing the individual risks to the levels determined by the risk appetite. The Committees implement the procedures and methodologies for mitigating the individual risks and accept individual risk limits.

The fourth competence level is associated with the operating level, on which the risk management activities are divided among the three defence lines:

1) The first line of defence: risk management on the business unit (organizational unit) level on the basis of the procedures, guidelines and limits which are in place. Risk management at this level is additionally supported by the applicable internal control principles, including the control functions performed by superiors as part of the on-going and periodical control, and the controls embedded in the procedures and processes executed by a given organizational unit.
2) The second line of defence: risk management by specialized units and committees (established to manage specific types of risk) as part of the existing risk management structure based on the applicable principles, methodologies and procedures. At this level, the tasks performed include identification, measurement and control of risk, development of guidelines, reporting and preparing management information on risk exposure.
3) The third line of defence: internal audit, which performs independent inspections and audits of the key elements of the risk management system and control activities embedded in the operations of PZU and PZU Życie, on the basis of the internal audit and control methodologies, which are constantly being improved. Additionally, this function is responsible for monitoring the implementation of the registered auditor's recommendations.

Diagram 6: The organizational structure of risk management – roles/tasks



13.5. Types of risk

The risk profiles of PZU and PZU Życie did not change significantly in the first six months of 2013. The main risks incurred by these companies include: insurance risk, market risk, credit risk, concentration risk, operational risk and compliance risk.

The following summary presents definitions of the individual types of risk, tools used to manage them and the main risk mitigation methods used in the first six months of 2013.

Insurance risk

Insurance risk is understood at PZU and PZU Życie as a risk of a loss or adverse change in the value of insurance liabilities due to inadequate assumptions concerning valuation and provisions. Insurance risk is the most important type of risk incurred by PZU and PZU Życie.

The process of insurance risk management at PZU and PZU Życie begins when a new insurance product is proposed.

Insurance risk assessment consists of recognizing the degree of exposure or a group of exposures associated with the possibility of incurring a loss and analyzing the risk elements in order to make a decision on accepting the risk for insurance and assuming liability by the company. The insurance risk analysis takes into account the scope of insurance cover granted, the amount of premium, and (in financial insurance) the level of security.

The insurance risk assessment also involves actions relating to:

- prevention, i.e. insurance risk management aimed at:
    - reducing the frequency of losses;
    - reducing the amount of losses;
- reinsurance of risks characterized by the largest amount and exposure.

PZU and PZU Życie measure insurance risk in particular with the use of the following tools:

- analysis of selected ratios;
- the scenario method – analysis of impairment resulting from the assumed change in risk factors;
- the factor method – a simplified version of the scenario method, reduced to one scenario per one risk factor;
- statistical data;
- exposure and sensitivity measures;
- expertise of the Company's employees.

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

- determining tolerance to insurance risk and monitoring it;
- business decisions and sales plans;
- calculating and monitoring the adequacy of technical provisions;
- tariff strategy and monitoring current estimates and assessing the adequacy of premium;
- the process of assessment, measurement and acceptance of insurance risk;
- using insurance risk mitigation tools, including in particular reinsurance and prevention.

In the event of the occurrence of any circumstances that imply adverse changes in insurance liabilities or a financial loss resulting from changes in the occurrence, frequency or scale of insured events or in the occurrence of claims and benefits payments, PZU and PZU Życie take actions aimed at:

- modifying the tariffs;
- modifying the scope of PZU and PZU Życie liability with respect to individual products;
- introducing new exemptions in general terms of insurance;
- modifying the underwriting principles;
- developing co-insurance programmes;
- developing reinsurance programmes;
- withdrawing a product from sale.

PZU and PZU Życie take the following actions to mitigate the insurance risk:

- defining the scopes of and/or exemptions from liability in general terms of insurance;
- co-insurance and reinsurance actions;
- adequate tariff policies;
- adopting conservative assumptions for the calculation of provisions with the use of methods that comply with the applicable legal regulations;
- underwriting procedure;
- claims handling procedure;
- sales decisions and plans;
- prevention.

Market risk

PZU and PZU Życie understand market risk as a risk of a loss or adverse change in the financial situation, which directly or indirectly results from fluctuations and changes in market prices of assets, liabilities and financial instruments.

Market risk identification involves recognizing the actual and potential sources of such risk. Risk identification is performed for all types of instruments, both those whose risk has been accepted and those which are at the planning stage.

In the case of assets, the market risk identification process begins when a decision is made to commence transactions on a given type of financial instruments. Units which decide to commence transactions on a given type of financial instrument prepare a description of the instrument, including in particular a description of the risk factors, and submit it to the Risk Office, which identifies and assesses market risk on this basis. The process of identifying market risk associated with insurance liabilities commences simultaneously with the process of creating an insurance product and involves identifying the relationship between the amount of financial flows associated with this product and the market risk factors.

The materiality of identified market risks is assessed. Market risk is measured with the use of the following risk measures:

- VaR;
- the factor method – analysis of impairment resulting from the assumed change in risk factors, based on one scenario per risk factor;
- exposure and sensitivity measures;
- accumulated monthly loss.

The following stages of the market risk measurement process can be distinguished:

- collecting information on assets and liabilities that generate market risk;
- calculating the risk amount.

The risk measurement is performed:

- daily – to measure exposures and sensitivity of instruments included in the Kondor+ transaction system;
- monthly, with the use of a partial internal model, with the exception of properties used for the Group's own needs, whose status is updated quarterly, and properties held by property funds, whose valuation is updated semi-annually.

Market risk is monitored on two levels: internally at the organizational units responsible for operating market risk management and independently by the Risk Office. Market risk monitoring involves analysing the risk level and the utilization of limits and is performed in daily or monthly cycles, adequately to the limits defined.

Management actions concerning market risk include in particular:

- concluding transactions aimed at mitigating market risk, such as the sale of a financial instrument, closing of a derivative instrument, purchase of a hedging derivative instrument;
- diversification of the portfolio of assets, in particular with respect to market risk categories, maturities of instruments, concentration of exposure in one entity, geographical concentration;
- investing in highly liquid instruments;
- setting market risk restrictions and limits.

Setting limits constitutes the main management tool aimed at maintaining risk positions within acceptable risk tolerance levels. The structure of limits for the individual market risk categories and PZU and PZU Życie organizational units is determined by ALCO taking into account the risk tolerance determined by the Management Board. ALCO sets additional detailed market risk limits.

Credit risk and concentration risk

PZU and PZU Życie understand credit risk as the risk of incurring a loss or an adverse change in the financial situation to which PZU and PZU Życie are exposed, resulting from changes in the credibility and creditworthiness of issuers of securities, business partners and any debtors, due to which they could fail to meet their obligations or credit spread could increase.

Credit risk is measured with the use of the following tools:

- exposure measures (credit exposure amount and maturity-weighted credit exposure);
- VaR, i.e. Value at Risk – a risk measure quantifying the potential economic loss, which under normal market circumstances will not be exceeded over a period of one year with 99.5% probability.

Credit risk measurement with respect to a single entity is estimated as the sum of single exposures, calculated as the product of the following two values:

- risk weight for internal rating;
- net maturity-weighted credit exposure.

Concentration risk measurement for a single entity is calculated as the product of the following two values:

- amount of exposure to this entity over the excessive concentration level;
- concentration risk ratio determined for every internal rating.

The total concentration risk at PZU and PZU Życie is measured as the sum of concentration risks of individual entities. In the case of related entities, concentration risk is determined for all related entities cumulatively.

Credit and concentration risk monitoring involves analysing the risk level, assessing creditworthiness and determining the level of utilization of the levels set.

Monitoring is performed in the following cycles:

- monthly – for financial insurance exposures;
- semi-annual – for Reinsurance Office exposures;
- daily – for other exposure limits;
- monthly – for VaR limits.

Management actions with respect to credit risk and concentration risk involve in particular:

- concluding transactions aimed at mitigating credit risk, such as sale of a financial instrument, closing of a derivative instrument, purchase of a hedging derivative instrument;
- accepting security;
- reinsurance of a financial insurance portfolio;
- diversification of a portfolio of financial assets and insurance, mainly with respect to the state, sector;
- setting limits of exposure to a single entity, group of entities, sectors, states.

The structure of credit and concentration risk limits for the individual issuers is determined by the CRC in line with the risk tolerance determined by the Management Board. Additionally, the CRC sets detailed amount limits and qualitative restrictions.

Operational risk

Operational risk is defined as the possibility of incurring a loss resulting from inappropriate or incorrect internal processes, human action, operation of systems or external events.

Operational risk management is aimed at optimizing the level of operational risk and operating efficiency, leading to a reduction in losses and costs resulting from such risks and ensuring adequate and effective controls, with the use of appropriate organizational, procedural and technical solutions.

The level of operational risk is identified and assessed by collecting and analyzing information on this risk for the following areas: security, human resources, IT and legal. In this way, the scale of exposure to operational risk can be determined.

The following solutions are applied to mitigate the operational risk level:

- updating and optimizing processes and procedures;
- changing the structure of checkpoints, reconciliation and validation;
- automation of control systems;
- contingency plans;
- monitoring and analyzing the number of security incidents;
- analysis of employee turnover and actions taken to minimize the risk level in this area, such as: appropriate staff selection, improving employees' qualifications, incentive systems;
- monitoring and analyzing the reasons for failures of the key IT systems.

The Management Board and Supervisory Board members regularly receive information on the operational risk level.

Compliance risk

Compliance risk is the risk of legal sanctions, financial losses or a loss of reputation occurring due to non-compliance of PZU and PZU Życie, the employees of PZU and PZU Życie or persons acting on their behalf with the law, internal regulations or standards of conduct adopted by PZU and PZU Życie, including norms of ethics.

PZU and PZU Życie manage compliance risk on the basis of the Compliance Policy and the Methodology for Identification and Assessment of Compliance Risk for Internal Processes.

The division of powers with respect to systemic and on-going compliance risk management is based on the above-mentioned regulations. On-going management of compliance risk relating to specific processes is the responsibility of the managers of the individual organizational areas and units within PZU and PZU Życie.

The activities in the compliance area include in particular:

- promoting observance of the standards of conduct in the area of compliance at PZU and PZU Życie;
- developing and monitoring solutions for compliance risk management;
- monitoring observance of the standards of conduct in the area of compliance at PZU and PZU Życie;
- monitoring the compliance risk management process at PZU and PZU Życie, including in particular:
    a. issuing opinions on the compliance of draft internal regulations, information, advertising and marketing materials addressed to clients and investors;
    b. conducting training and internal communication campaigns in the area of compliance.

The Management Board is responsible for making strategic decisions concerning compliance risk and accepting risk levels in this area.

Until 30 June 2013, the compliance risk management process was coordinated by the Risk Office. From 1 July 2013, the newly-organized Compliance Office will be responsible for coordinating this process.

Compliance risk identification and assessment (measurement) are performed by the managers of PZU and PZU Życie organizational units and, additionally, by the Compliance Office. Compliance risk is identified and assessed for individual internal processes of the insurance company defined in the Classification by the managers of organizational units, in line with the division of reporting responsibilities. Additionally, the Compliance Office identifies compliance risk on the basis of entries in the register of conflicts of interest, gifts, benefits and irregularities, as well as the inquiries received.

Compliance risk is assessed and measured by determining the effects of materialization of the following risks:

- financial, resulting e.g. from:
    c. administrative penalties;

   d. court judgments;
   e. contractual penalties;
   f. claims payments.

- intangible, such as loss of reputation, including damage to the PZU image and brand.

Compliance risk is monitored mainly through:

- analyzing quarterly reports received from managers of organizational units;
- reviewing regulatory requirements;
- participating in legislation work on amending the generally applicable regulations;
- activity in professional organizations;
- reviewing the Compliance Office recommendations.

Compliance risk is reported to the Compliance Office on a quarterly basis. Risk reports for PZU and PZU Życie are submitted to the Management Board every year by 15 March of the following year. No material compliance risk incidents were identified in the first six months of 2013.

Management actions taken in response to the compliance risk comprise in particular:

- acceptance of risk, e.g. in connection with legal or regulatory changes;
- mitigation of risk, including adjustment of procedures and processes to regulatory requirements, issuing opinions and drafting internal regulations from the perspective of compliance, participating in the process of agreeing marketing activities;
- avoiding risk through preventing the involvement of PZU and PZU Życie companies in activities which do not comply with the regulatory requirements or good market practices or which could have an adverse effect on their image.

13.6. Significant events in the area of risk in the first half of 2013

Organizational changes

On 1 July 2013, the Compliance Office was established (it was separated from the Risk Office and the Management Office). The Management Boards of PZU and PZU Życie decided that the Compliance Office would coordinate the compliance risk management process.

Review of the risk management strategy and policies

PZU SA and PZU Życie SA reviewed their risk management processes. The Risk Management Strategy was developed for each company and the following documents were adopted:

- Insurance risk management policy;
- Market risk management policy;
- Credit risk and concentration risk management policy;
- Operational risk management policy.

In the Risk Management Strategy, the Management Boards of PZU and PZU Życie determined risk appetite, defined risk profiles and set risk tolerance levels. The risk maps for PZU and PZU Życie were implemented on this basis.

The Solvency II Directive

In 2012, a strategic project for adapting PZU to the requirements of the Solvency II Directive was launched at PZU. The project work is carried out in accordance with the originally adopted schedule. PZU takes part in the preparatory works for the implementation of the Directive in cooperation with the Polish Financial Supervision Authority. In particular, it takes part in all quantitative surveys. Additionally, in the first six months of 2013 PZU prepared and submitted comments to draft guidelines for the preparation of Solvency II implementation issued by EIOPA.

14. Other selected PZU Group companies – development directions and results of activities

14.1. PZU Lietuva

PZU Lietuva improved its position by increasing its market share from 13.3% at the end of 2012 to 13.5% at the end of the first six months of 2013. The Company's goals for 2013 are further improvement in the profitability of motor insurance portfolios and strengthening its position on the property insurance market. In the analyzed period, the Company worked intensively on the development of its operations on the Latvian and Estonian market. The Company is working on developing new products, which are adapted to the requirements of the local markets. At the same time, the recruitment of employees and integration of IT systems are under way. In addition to foreign expansion, the Company's activities are focused on the development of new sales channels (Call Centre, sales through car dealer network, tourist offices). The Company also invests in technical infrastructure (integration of systems with the real estate register, development of a platform for selling insurance online). Work on simplifying the claims payment process is also being continued.

14.2. PZU Lietuva Life

In the first six months of 2013, the Company was developing rapidly and achieved a sales growth twice as high as that of the market as a whole. The large increase in premium was due to the development of the Company's own sales network, as well as intensified cooperation with the external network (brokers, multi-agents). The Company will continue to focus on *endowment* life insurance. At the same time, intensive work on the development of group insurance is being carried out. The Company is continuing to work on the development of IT systems. In the first six months of 2013, an innovative life insurance sale system was implemented. It simplifies and automates the processes of offering insurance policies, their calculation and verification, and signing agreements.

Increase in the capital of PZU Lietuva

On 21 June 2013, the Management Board of PZU passed a resolution on granting consent to increasing the capital of PZU Lietuva by LTL 5 million.

On 25 June 2013, the Extraordinary General Shareholders' Meeting of PZU Lietuva passed a resolution to the same effect, and PZU transferred the funds with a value date of 26 June 2013.

The said capital increase was aimed at ensuring PZU Lietuva's compliance with the regulatory requirements relating to solvency margin coverage. It is part of the capital increase plan for the years 2013–2014 amounting to LTL 24 million, following from the business plan of PZU Lietuva concerning investment in Latvia and Estonia. Non-compliance with the regulatory requirements concerning the solvency margin (105% in Lithuania) was mainly due to the sales growth on the Lithuanian market being higher than planned and the development of operations on foreign markets.

14.3. PZU Ukraine

In 2013, PZU Ukraine recorded growth of premium written. According to data for the 1st quarter of 2013, the company was 13th on the market of classic property and casualty insurance and 6th on the market of life insurance.[20]

Further modifications in the approach to the tariffication of motor insurance products, constituting a significant portion of the portfolio of PZU Ukraine, increase in the share in the property insurance portfolio and reduction in medical insurance led to a considerable yield improvement in 2013.

[20] Insurance TOP, #2(42)2013

14.4. PZU AM

Due to the fact that TFI PZU obtained permission for managing the portfolios including one or more financial instruments and took over the management of the PZU and PZU Życie portfolios, in 2013 PZU AM limited the number of PZU Group entities to which it provides services to TFI PZU and MPTE PZU SA.

Since the management of some of the funds was transferred from PZU AM to TFI PZU, in 2013 PZU AM will manage 4 funds (PZU FIZ Sektora Nieruchomości, PZU FIZ Sektora Nieruchomości 2, PZU FIZ Sektora Nieruchomości 3 and PZU FIZ RE Income).

14.5. PZU Pomoc

In the area of loyalty programmes, the Company continued the optimization of service processes and implementation of the PZU Pomoc w Życiu Club, which significantly reduced the use of paper documents (among other things). In 2013, the PZU Pomoc w Życiu Club will be developed in accordance with the clients' expectations, with a particular focus on making the Club's offer more attractive. The offer will be based on PZU Pomoc competencies. At the same time, the operations and strategy of the PZU Group will be supported.

As far as medical services are concerned, as at the end of the first six months of 2013, the Company had a network of 800 medical facilities in all parts of Poland. Service processes in this area were also optimized, which significantly reduced the costs of operations while client satisfaction standards remained high.

The Company became the market leader in the area of intermediation in selling damaged vehicles with the use of an online auction platform. An innovative product was launched in 2013: car window replacement auctions. On the basis of the results achieved, a significant reduction in the claims handling costs can be expected in this area.

The POMOC ONLINE platform is developed continuously so that the auction model could be applied in the subsequent claims handling processes at the PZU Group.

14.6. PZU CO

In the first six months of 2013, PZU CO executed a number of projects in the area of development, support and improvement in operations. The most important ones are listed below.

- a new *Contact Centre* location was opened in Bydgoszcz to serve PZU and PZU Życie;
- the Company took over the provision of IT services to TFI PZU and PZU AM.

ADDITIONAL INFORMATION

15. Shares or rights to shares held by members of management and supervisory bodies of PZU as at the date of submitting the half year report

Table 45: 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 May 2013	Number of shares held as at 5 August 2013	The resulting change in the period between those dates
	Management Board			
1	Andrzej Klesyk	0	0	X
2	Przemysław Dąbrowski	0	0	X
3	Dariusz Krzewina (Board Member from 15 March 2013)	0	0	X
4	Bogusław Skuza	500	500	X
5	Barbara Smalska (Board Member from 15 March 2013)	0	0	X
6	Ryszard Trepczyński	0	0	X
7	Tomasz Tarkowski	80	80	X
	Group Directors			
1	Rafał Grodzicki	0	0	X
2	Przemysław Henschke	0	0	X
3	Sławomir Niemierka	0	0	X
	Supervisory Board			
1	Waldemar Maj	30	30	X
2	Zbigniew Ćwiąkalski	0	0	X
3	Tomasz Zganiacz	0	0	X
4	Dariusz Daniluk	0	0	X
5	Zbigniew Derdziuk			X
6	Dariusz Filar	0	0	X
7	Włodzimierz Kiciński	30	30	X
8	Alojzy Nowak	0	0	X
9	Maciej Piotrowski	0	0	X
Total		**640**	**640**	**X**

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

16. Other information

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

In the first half of 2013, 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.

16.2. 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 the first half of 2013, PZU's shares were a part of WIG, WIG20, WIG PL, RESPECT Index and WIGdiv indices. Since 24 December 2012, PZU has also been a part of the CEERIUS (CEE Responsible Investment Universe) balanced growth index. CEERIUS is an index of the Vienna Stock Exchange for the Central and Eastern Europe (CEE) region. PZU's shares have been included in the WIG30 index which will be published by the WSE starting from the 23 September 2013 session.

Chart 7: Dynamics of PZU share prices in the first half of 2013 compared with WIG20 31.12.2012 = 100%

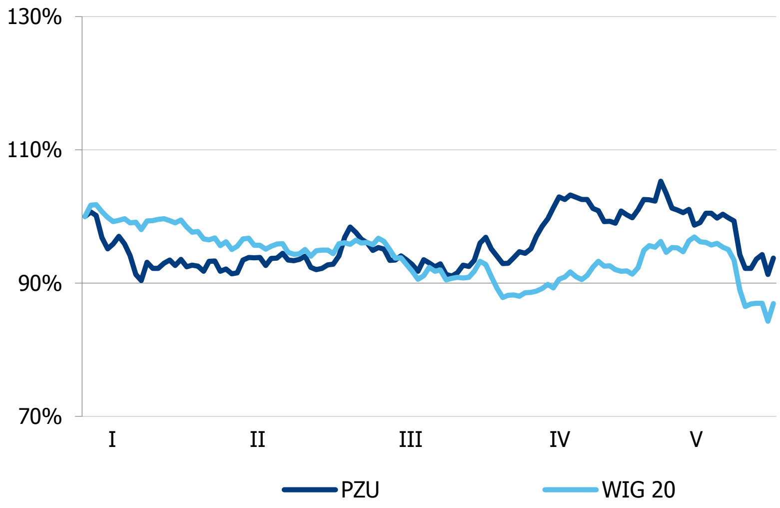


Chart 8: Prices of PZU shares in the first half of 2013

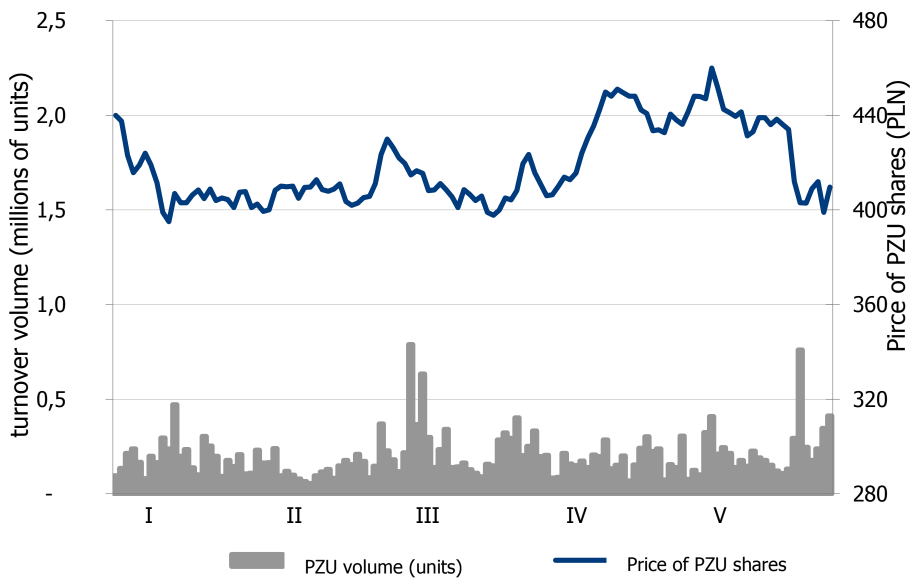


Table 46: Basic information on PZU shares

measurement unit		1 January - 30 June 2013	1 January - 30 June 2012
Number of shares as at the end of the year	units	86 352 300	86 352 300
Number of shares in trading	units	86 348 289	86 344 698
Closing price from the last trading day of the period	PLN	409.70	334.00
The highest closing price in the period	PLN	460.00	348.00
The lowest closing price in the period	PLN	395.00	292.10
Market value of PZU as at the end of the period	PLN	35 378 537 310	28 841 668 200
Average market price	PLN	418.88	321.97
Average trading volume per session	units	202 150	216 310
Dividend (gross) out of prior year profit distribution	PLN/share	29.70	22.43

In the first half of 2013, the prices of PZU shares were significantly affected by the Company's very good results compared with other financial sector companies, the situation on the Polish Treasury bond market, volatile behaviour of financial markets and the announcement of changes in the pension system. The Polish government's proposals of significantly limiting the role of Open Pension Funds which are among the largest investors on the Warsaw Stock Exchange, were a signal in June 2013 for price reductions of securities quoted on the WSE, the largest since September 2011. Out of the main indices, the WIG20 index was the most affected by the price reduction wave as it lost by 9.7% in June, the WIG market-wide index lost by 6.4%, mWIG40 by 1.3% and only sWIG80 gained by 1.7%.

The closing price of PZU shares from the last trading session in the first half of 2013 was PLN 409.70, which represented a 6.25% decrease compared with the price on the last day of December 2012 of PLN 437.00. At the same time, WIG20 and WIG indices lost by 13.06% and 5.72% respectively.

In the first half of 2013, PZU shares closed the trading sessions with drops 61 times, with increases 58 times, and 3 times they remained unchanged. The highest closing price (PLN 460.00) was achieved on 29 May and the lowest (PLN 395.00) on 16 January. The average market price of PZU shares in the reporting period was PLN 418.88 and it was PLN 96.91 lower than in 2012. The average daily trading volume of PZU shares in the first half of 2013 was 202,150 shares, with the highest level (787,905 shares) recorded on 13 March 2013.

As at 30 June 2013, PZU was on the list of 22 domestic and foreign financial institutions whose analysts issued a total of 28 recommendations for PZU shares in the first half of 2013. Neutral recommendations ("Hold" or "Neutral") prevailed – a total of 16 recommendations, 8 recommendations related to buying PZU shares ("Buy", "Accumulate", "Overweight") and 4 related to selling ("Underweight" or "Reduce").

Table 47: Capital market ratios for the PZU Group

Capital market ratios for the PZU Group as at	1 January - 30 June 2013	1 January - 30 June 2012
P / BV *Market price of shares / book value per share*	2.66	2.26
BVPS *Book value per share*	153.89	147.54
P / E *Price / net profit per share*	21.11	16.80
EPS (PLN) *Net profit (loss) / number of shares*	19.41	19.88
DY Dividend yield (%) *Dividend per share / market price of shares*	7.2%	6.7%
DPS (PLN) *Dividend per share*	29.70	22.43
TSR Total shareholder return *(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*	(6.2)%	8.1%

16.3. Dividend

Current dividend policy

1. The dividend policy of PZU was regulated by a resolution of the Management Board of PZU dated 11 May 2011, which provides that:
2. The consolidated profit or loss of the PZU Group in accordance with the International Financial Reporting Standards (IFRS) shall be the basis for establishing dividend to be paid out by PZU for a given financial year.
3. 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 methodology of Standard & Poor's;
   - should take into account additional capital requirements of PZU in the 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.
4. The own funds and solvency margin are calculated in accordance with the prudence norms established for the Polish insurance market.

In December 2012, the Chairman of the Polish Financial Supervision Authority, similarly to the recommendation concerning payment of dividend for 2011, recommended that insurance companies should adopt a conservative dividend policy and designate the profit generated for 2012 for strengthening their capital position.

The supervision authority recommended that only the insurance companies which meet strictly specified criteria (described in detail in the recommendation) should consider the appropriateness of paying out dividend. They should limit the payment of dividend to a maximum of 75% of the profit generated for 2012, maintaining the ratio of capital requirements cover after the payment of dividend at a level of at least 110%.

At the same time, the recommendation permits payment of dividend equal to 100% of profit for 2012 if the capital requirement cover after the payment of dividend is maintained at above 160% in the case of Section I insurance companies and 200% in the case of Section II insurance companies (as at 31 December 2012), and if based on the recently performed stress tests for all the risk types examined the capital requirement cover ratio amounted to at least 110% and the technical provisions cover with appropriate assets was at least 100%.

As at 31 December 2012, after taking account of the dividend included in the financial plan, PZU meets the criterion of capital requirement cover at 200%.

Moreover, in accordance with the stress tests performed, taking into account the balances as at 31 December 2012 adjusted for the amount of dividend corresponding to the entire profit generated for 2012, the capital requirement cover criterion was met at the level of at least 110% and the criterion of technical provisions cover with assets was met at the level of at least 100%.

Distribution of profit for the financial year 2012

On 23 May 2013, the Annual General Meeting of PZU appropriated the net profit for the financial year 2012 of PLN 2,580.7 million as follows:

- PLN 2,564.7 million for payment of dividend to the shareholders, i.e. PLN 29.70 per share;
- PLN 6.1 million to be transferred to supplementary capital;
- PLN 10.0 million to the Company's Social Benefit Fund.

In accordance with the resolution on appropriation of the net profit for the financial year ended 31 December 2012, 23 August 2013 is the date according to which the list of shareholders entitled to the payment of dividend will be established, and 12 September 2013 is the date of payment of the said dividend.

New capital and dividend policy

On 26 August 2013 the Management Board of PZU accepted new capital and dividend policy what is described in point 16.9.

According to introduced capital and dividend policy, the Management Board of PZU is planning to distribute advance payment for dividend expected at the end of 2013 in amount of PLN 1,727.0 million , i.e. PLN 20.00 per share, what is described in point 16.9.

16.4. Investor relations

In an effort to meet the highest standards in the scope of information governance around listed companies and to meet the information needs of various stakeholder groups, the Management Board of PZU undertakes numerous activities in the area of Investor Relations ("IR") aimed at increasing PZU's transparency. "The principles for conducting PZU's information policy towards capital market participants" which constitute the declaration of the Management Board concerning distribution of information on the Company's situation and maintaining communication with capital market participants are available on PZU's website in the Investor Relations section.

The overriding goal of IR is to create value of PZU on the level of active communication with capital market participants with whom the Company wishes to build long-term relations. In the first half of 2013, the main objective of the IR was to: inform of the PZU Group's activities and results in a transparent manner and improve the quality of selected indirect communication channels.

IR activities carried out in the first half of 2013

The results of PZU (for 2012 and for the first quarter of 2013) were presented and discussed by the Company's Management Board at meetings with capital market analysts. These meetings, as the Annual Shareholders' Meeting, were each time transmitted live through the Internet.

In the first half of 2013, the representatives of PZU participated in three Non-Deal Roadshows in Europe and the United States organized after publication of annual results, at 4 financial conferences abroad with the participation of global investors, at 2 conferences in Poland and numerous group meetings, one-on-one and teleconferences with investors and share portfolio managers at PZU's seat. In the first half of 2013, there were 90 meetings in total with almost 160 institutional investors and nearly 60 meetings with analytics issuing recommendations for PZU shares.

Additionally, communication activities were conducted, which were addressed to individual investors. PZU representatives participated in the WallStreet conference in Karpacz (17th edition), which is the biggest meeting of individual investors in Central and Eastern Europe organized by the Individual Investors Association.

Additionally, 2 chats were organized with individual investors with the participation of the PZU Board Member responsible for the Financial Division in the PZU Group, after the publication of PZU's annual results for 2012 and for the first quarter of 2013.

In the first half of 2013, PZU actively participated in the "10 in 10 - Communicate Effectively" [*10 na 10 – Komunikuj się skutecznie*] programme. It is the original programme of the Individual Investors Association and its objective is to build high standards in communication of listed companies with individual investors.

Since its stock exchange debut, PZU is also a partner and an active participant of the Civil Shareholders programme. Civil Shareholders is a programme for individual investors which was started by the Ministry of State Treasury during the debuts of the following listed companies: PZU, Tauron Polska Energia and the Warsaw Stock Exchange.

Prizes and awards

IR activities conducted in the first half of 2013 were appreciated by investors and analysts and acknowledged by capital market institutions.

In June 2013, the PZU Board Member responsible for the Financial Division won the first prize in the category of the Top CFO Best for Investor Relations in Poland. The Investor Relations team of PZU was ranked fourth among 26 Polish companies assessed in the category of best investor relations in Poland. The Extel Survey was conducted by Thomson Reuters. The results of the survey are considered one of the most important rankings and treated as a source of knowledge on model practices on the capital market. They present the communication of companies with investors throughout the world in various aspects. This year, the survey covered Poland for the first time.

During the WallStreet conference organized by the Polish Individual Investors Association (SII), PZU was awarded a certificate of "Investor-Friendly Company". It is a prize awarded to companies which meet the strict criteria in the scope of investor relations and compliance with disclosure obligations. Compliance with these criteria is confirmed by quarterly external audits carried out by SII.

PZU has passed all the audits so far and is the first company to receive the certificate as part of the SII programme "10 in 10 - Communicate Effectively".

Moreover, PZU was awarded the title of "Capital Market Hero" as a company meeting the highest standards in investor communication.

16.5. Main reinsurance contracts binding in the first half of 2013

The reinsurance cover of the PZU Group in 2013 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 Group. 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 risk against catastrophic losses (e.g. flood, hurricane), among other things, by catastrophic disproportionate excess of loss agreements; and against the effects of large individual claims under disproportionate reinsurance agreements protecting the portfolios of property, technical, marine, aviation, third party liaibility and motor third party liability insurance. Additionally, PZU mitigates its risks through reinsurance of the financial insurance portfolio.

The main partners granting obligatory reinsurance protection to PZU in 2013 are the following reinsurers: Swiss Re, Hannover Re, Scor, Lloyd's and Endurance. PZU's reinsurance partners have good financial standing, as confirmed by high ratings according to S&P.

PZU's activities in the scope of inward reinsurance are one of the support measures to PZU Lietuva and PZU Ukraine. PZU 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 the protection of 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 portfolio of group insurance covering the serious illness of a child.

The following reinsurance companies are partners granting reinsurance protection to PZU Życie: RGA, Gen Re and Partner Re. PZU's reinsurance partners have good financial standing, as confirmed by high ratings according to S&P.

16.6. Litigation pending before the court, the appropriate arbitration body or the public administration body

The entities in the PZU Group are parties to a number of court and arbitration disputes and administrative proceedings. The typical court disputes are those related to insurance contracts, employment contracts and contractual obligations. The typical administrative proceedings are those related to own real estate. The proceedings and disputes are typical and repetitive and, usually, individually they are not significant for the PZU Group.

Most disputes the PZU Group companies are parties to pertain to two companies: PZU and PZU Życie. In addition PZU and PZU Życie participate in the proceedings before the President of the Office of Competition and Consumer Protection (UOKiK).

PZU and PZU Życie consider such claims when creating technical provisions for reported damages, considering the probability of an unfavorable decision of the court and estimating the value of probable settlement. Disputable claims regarding revaluation of annuities at PZU Życie are recognized in other technical provisions in the amount of annual annuity in excess of the corresponding provision amount as determined under mathematical provisions for life insurance purposes.

In the period of 6 months ended 30 June 2013 and by the date of submission of these consolidated financial statements, the PZU Group did not take part in any proceedings before court, body competent to hear arbitration proceedings or public authority body concerning liabilities or receivables of PZU or its direct or indirect subsidiary of the value or the total value of at least 10% of the equity of PZU.

As of 30 June 2013 the total value of all 50,690 cases held by courts, bodies competent to hear arbitration proceedings or public authority bodies involving the PZU Group companies was PLN 2,485.9 million. The amount includes PLN 1,890.0 million of liabilities and PLN 595.8 million of receivables of the PZU Group companies, which constituted 15.2 % and 4.8 % of PZU equity calculated in line with PAS, respectively.

16.7. Information on significant contracts concluded

From 1 January 2013 till the date of preparing the report for the first half of 2013, no contract was concluded with PZU or its related company as one of the parties where the contract value would amount to at least 10% of PZU's equity or if the level of equity is not the criterion enabling proper assessment of the contract concluded – of the PZU Group's sales for the last four financial quarters.

16.8. Related party transactions

In the period of 6 months ended 30 June 2013, 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.

16.9. Significant events after the balance sheet date

New Capital Structure and Dividend Policy

On 26 August 2013, the Management Board of PZU SA approved a Capital Structure and Dividend Policy of the PZU Group for the years 2013-2015 ("Capital Structure and Dividend Policy"). At the same time, the Management Board of PZU SA decided to file a request to the Supervisory Board of PZU to adopt a resolution to approve the Policy in question.

In accordance with the request, on 26 August 2013 the Supervisory Board of PZU approved the Capital Structure and Dividend Policy with the wording prepared by the Management Board.

The key objective of the Capital Structure and Dividend Policy is to reduce the cost of capital through optimization of the balance sheet structure by way of replacing equity with less expensive borrowed capital at the same time ensuring high security and maintaining funds for development.

The Capital Structure and Dividend Policy of the PZU Group for the years 2013-2015 assumes payment of dividend calculated based on a consolidated net profit and capital surplus, where the total dividend to be paid out based on capital surplus in the years 2013 – 2015 cannot exceed PLN 3 billion. Consequently, ROE will remain high and the Total Shareholder Return will increase.

The planned new capital policy implementation schedule assumes: (i) payment of a portion of the capital surplus in the form of advanced payment for the dividend expected at the end of 2013 of PLN 1.7 billion, (ii) issue of subordinated debt of PLN 3 billion, (iii) payment of the remaining portion of the capital surplus in the form of dividend of PLN 1.3 billion at maximum, in the years 2014 and 2015.

Dividend payment from capital surplus will depend on the issue of subordinated debt (of PLN 3 billion) in line with the requirements of the Act on Insurance Activity and Solvency II. If the subordinated debt is not issued or it its amount is insufficient, or in case the Polish Financial Supervision Authority does not approve classification of the subordinated debt to own funds, special dividend will not be paid in its entirety or in portion and the advanced payment for the dividend expected at the end of 2013 will constitute a portion of a dividend calculated based on the consolidated net profit for 2013.

Key principles of the new capital policy are the following: (i) focus on TSR, (ii) maintaining a secure level of own funds ensured by: (a) solvency margin coverage ratio of the PZU Group of ca. 400% and solvency margin coverage with own funds excluding subordinated debt of at least 250%, (b) equity level corresponding to Standard & Poor's AA rating, (iii) sufficient funds for development and acquisitions in the coming years.

In the next few years the Management Board does not intend to increase the share capital through the issue of shares.

Advance payment for dividend expected at the end of 2013

In accordance with the new Capital Structure and Dividend Policy and Article 349 of the Code of Commercial Companies, the Management Board of PZU plans for paying an advanced payment for the dividend expected at the end of 2013 of PLN 1,727.0, i.e. PLN 20.00 per share from the profit for the period of six months ended 30 June 2013 of PLN 4,679.9 million disclosed in the separate financial statements of PZU for that period prepared in accordance with Polish Accounting Standards.

16.10. 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 Management Report on the activity 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.

16.11. Agreement on audit and review of the financial statements

The agreement on the review of the condensed interim consolidated financial statements of the PZU Group and the condensed interim separate financial statements of PZU for the 6 months ended 30 June 2012 and 30 June 2013 and for the audit of separate financial statements of PZU and consolidated financial statements of the PZU Group for the financial years ended 31 December 2012 and 31 December 2013 was concluded on 16 July 2012.

The Annex dated 2 August 2013 amended the scope of work specified in the aforementioned contract in respect of the separate financial statements of PZU for the period of 6 months ended 30 June 2013 so that the review of the condensed interim separate financial statements of PZU was replaced with an audit of the separate financial statements of PZU.

16.12. 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 Management Board Members, 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 the motion of the Chairman of the Management Board. The Chairman of the Management Board for the new term of office 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 current term of office expires.

Composition of the Management Board as at 1 January 2013:

- Andrzej Klesyk - Chairman of the Board;
- Przemysław Dąbrowski - Member of the Board;
- Bogusław Skuza - Member of the Board;
- Tomasz Tarkowski - Member of the Board;
- Ryszard Trepczyński - Member of the Board.

On 12 March 2013, the Supervisory Board of PZU appointed Mr. Dariusz Krzewina and Ms. Barbara Smalska for the positions of Members of the Management Board of PZU effective from 15 March 2013.

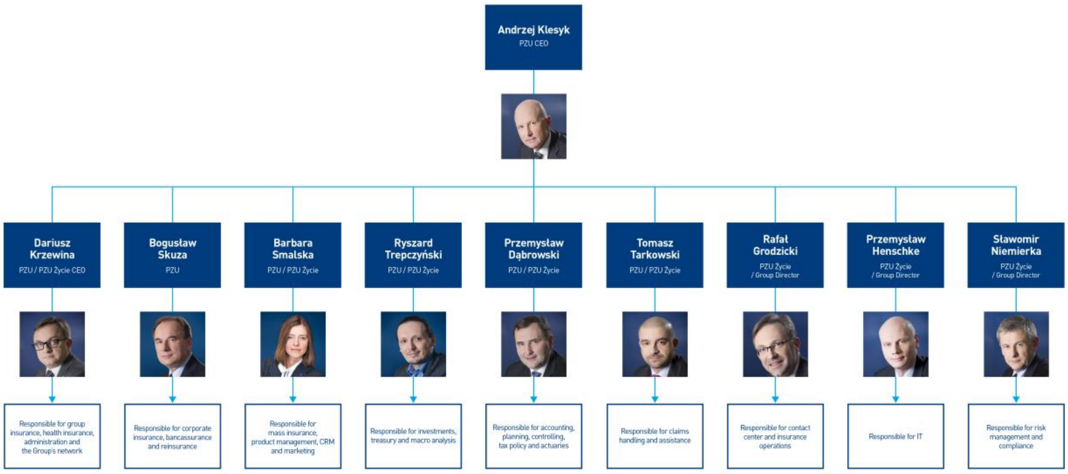
In the period from 15 March 2013 until the date of signing these interim financial statements, the composition of PZU Management Board was as follows:

- Andrzej Klesyk - Chairman of the Board;
- Przemysław Dąbrowski - Member of the Board;
- Dariusz Krzewina - Member of the Board;
- Bogusław Skuza - Member of the Board;
- Barbara Smalska - Member of the Board;
- Tomasz Tarkowski - Member of the Board;

- Ryszard Trepczyński - Member of the Board.

The current term of office of the Management Board of PZU commenced on 1 July 2011 and will last for three consecutive 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.

Chart 9: Organizational structure of the PZU Group – distribution of responsibilities



Below is information on the experience and competencies of the Management Board Members of PZU and PZU Życie:

Andrzej Klesyk, Chairman of the Management Board of PZU

Mr Andrzej Klesyk has been the Chairman of PZU's Management Board since December 2007. In the years 2003-2007, he was a Partner and Managing Director of The Boston Consulting Group in Warsaw where he cooperated, among others, with PZU on the execution of insurance projects. He is the author and head of Inteligo, a pioneer internet banking project. Previously, he headed the team which created Handlobank – the retail section of Bank Handlowy w Warszawie SA. In the years 1993–2000 he worked in the London branch of McKinsey. In 1991 he left for the United States where he worked at: Kidder, Peabody and Coopers & Lybrand in New York. Andrzej Klesyk graduated in economics at the Catholic University of Lublin. He was one of the first Polish graduates of the two-year studies at Harvard Business School in the United States obtaining the MBA title. He is a member of The Geneva Association, a non-profit organization uniting 80 Chairmans of Management Boards of the largest insurance companies in the world. He represents PZU during annual meetings of the World Economic Forum in Davos and at the Institute of International Finance in Washington.

Przemysław Dąbrowski, Board Member of PZU

Mr Przemysław Dąbrowski graduated from the University of Warsaw specializing in information technology and completed a postgraduate course in management. He obtained an MBA from the University of Illinois and completed a Warsaw--Illinois Executive MBA program. He has extensive experience in managing the finances of insurance companies, managing financial investments and closing large financial deals. He also has practical and theoretical knowledge of accounting, tax issues and elements of actuarial mathematics. He started his professional career in 1993. From 1993 to 1998, he worked as a financial analyst and controller at Whirlpool Polska Sp. z o.o. On 1998–2000, he served as the Treasurer at AIG Polska. In 2000–2001, Mr Dąbrowski was the

Financial Director and a Management Board Member at Creative Team SA (Elektrim Group). In 2001–2006, he headed PZU's Planning and Controlling Department. In 2006–2008, he worked for the consulting firms AT Kearney and Accenture as a Manager and, subsequently, as a Senior Manager. From October 2008 to March 2009, he discharged the function of Director and Deputy Head of the financial division at the PZU and PZU Życie Head Office. From November 2008 to February 2009, he worked as the Director of the Planning and Controlling Department at PZU and PZU Życie Head Office. Then in March 2009, he became the Director of the Information Management Department at PZU and PZU Życie Head Office. Since January 2010, he has been a Management Board Member of PZU Życie. Since December 2010, he has been a Management Board Member of PZU. He is responsible for the Finance Division.

Dariusz Krzewina, Board Member of PZU

Mr Dariusz Krzewina is a graduate of the Economic and Sociology Faculty at the University of Łódź and a post-graduate course of study on insurance at the Warsaw School of Economics. He has worked in the insurance industry for many years. From September 1993 to August 1998, he was employed with PZU Życie, where he was Head of the Sales Department, Deputy Director and Director of the Insurance Department. From September 1997 to September 1998, he was a Management Board Member of PZU Życie. From September 1998 to March 2000, he was the General Director responsible for Sales, and from April 2000 to August 2001, he was a Member of the Management Board of STUnŻycie ERGO HESTIA SA. From April 2002, he was Sales Director and from October 2002 to June 2004, Chairman of the Management Board and Sales Director of SAMPO Towarzystwo Ubezpieczeń na Życie SA. From August 2004, he held the position of Director of the Group Insurance Department at PZU Życie; from January 2006 he was Corporate Client Coordinating Director. From March 2007, he has been on the Management Board of PZU Życie, and since August 2007, he has been Chairman of the Company's Management Board. From February 2010 to 14 March 2013, he was Director of the PZU Group. From 15 March 2013, he has been a Member of PZU's Management Board. He is responsible for group and health insurance, administration, the HR Department and the PZU Group's Networks.

Bogusław Skuza, Board Member of PZU

Mr Bogusław Skuza is a graduate of the Department of Transportation Economics at the University of Gdańsk with a specialization in the Economics of Foreign Trade. He has extensive experience in the financial industry, especially in the insurance industry. He commenced his career in 1979–1985 at TUiR Warta SA as an employee of the Claims handling Department. In 1985–1991 he worked as General Representative of TUiR WARTA SA for the US and Canada. In 1991–1992 has was employed as Manager of the Insurance and Claims Department at Gdynia America Line Inc. From 1992 to 1999 he served as the Country Manager and Vice- Chairman of the Management Board of Marsh & McLennan Polska Sp. z o.o. In 1998–2000 he was appointed Vice-Chairman of the Management Board of Towarzystwo Ubezpieczeń Życiowych i Emerytalnych Petrus SA and Chairman of the Management Board of Fiat Ubezpieczenia SA. From 2000–2008 he was Chairman of the Management Board of Skandia Życie Towarzystwo Ubezpieczeń SA. In 2008-2010 he acted as Member of the Group's Management Board and Regional Managing Director for Central and Eastern Europe at Intrum Justitia AB. Furthermore, Mr Bogusław Skuza was Chairman of the Supervisory Board of Intrum Justitia's companies in Poland, the Czech Republic, Slovakia and Hungary. In 1992–1998, Mr Skuza was a founding member and Secretary General of the Association of Polish Insurance and Reinsurance Brokers, while in 2002-2008 he was a Management Board Member of the Polish Chamber of Insurance. Since May 2009 he has been a Member of the Best Practices Council in the Polish Chamber of Insurance. Since July 2011, he has been a Management Board Member of PZU. He is responsible for the Corporate Client Division, reinsurance and bancassurance.

Barbara Smalska, Board Member of PZU

Ms Barbara Smalska is a particle physicist by education. She holds a Ph.D. from the Faculty of Physics at the University of Warsaw in collaboration with the Deutsches Elektronen Synchrotron Center in Hamburg. In 2002–2008, she worked in the Warsaw office of The Boston Consulting Group. As a strategic advisor for the largest Polish banks, insurers and telecommunications firms she mainly dealt with business strategy, operating models, distribution strategy, and organization and activization of the sales networks – especially in the segments of retail clients and SME. Affiliated with the PZU Group since November 2008, where she was Director of the Product Management Department, the Mass Market Managing Director and Managing Director of Marketing and Individual Products. She was appointed to the Management Board of PZU Życie on 1 February 2013. She was Director of the PZU Group from 5 February 14 March 2013. On 15 March 2013, she was appointed Member of the Management Board of PZU. She is responsible for mass insurance, product management, CRM and marketing.

Tomasz Tarkowski, Board Member of PZU

Mr Tomasz Tarkowski is a graduate of the Department of Automobiles and Working Machinery at the Warsaw Technical University and Higher School of Insurance and Banking. He also completed the Advanced Management Program at the IESE Business School University of Navarra and post-graduate studies in road traffic safety and business insurance. He has been affiliated with the PZU Group since 1996. Initially, he dealt with internal control and combatting insurance fraud. In 2002–2005 he worked in the claims handling division as the Head of the Technical Sub-Department in the Claims handling Department. In 2006–2007 he was Director of the Claims handling Center and Claims handling Director at the District Branch of PZU in Warsaw. In 2007–2011 he oversaw claims handling, product management and underwriting as a Management Board Member of PZU Ukraine. As a Supervisory Board Member of SOS Service Ukraine, a subsidiary of PZU Ukraine he was responsible for the assistance business. Since February 2011 he has been a PZU Group Director in the PZU Head Office and the Management Board Plenipotentiary responsible for Claims handling in PZU Życie. Since April 2011, he has been a Management Board Member of PZU. Since July 2011, he has also been a Management Board Member of PZU Życie. He is responsible for claims handling and assistance.

Ryszard Trepczyński, Board Member of PZU

Mr Ryszard Trepczyński graduated from the Faculty of Management and Marketing at the Warsaw School of Economics. He has been affiliated with the capital market from the outset of his career. He has wide experience in building and implementing investment strategies as well as in devising investment policies. He is experienced in managing high value asset portfolios with a divergent asset composition. He participated in building structures to manage strategic asset allocation, liquidity and investment risk. In 1994–1996 he worked as a broker in Centrum Operacji Kapitałowych Banku Handlowego w Warszawie SA. In 1996–2002 he was employed in the Financial Investment Department of PZU Życie – initially as an asset manager and later as Head of the Debt Portfolio Management Sub-Department. From December 2002 to June 2011, he was associated with Pioneer Pekao Investment Management S.A., where he held the positions of Director of the Debt Securities Department, Director of the Asset Management Department and since March 2009 he has been Vice-Chairman of the Management Board overseeing the Investment Division. Since July 2011, he has been a Management Board Member of PZU and PZU Życie. He is responsible for the Investment Division.

Rafał Grodzicki – Board Member of PZU Życie, Director of the PZU Group

Mr Rafał Grodzicki graduated from the Warsaw School of Economics. He has many years of experience in performing management functions in the banking and insurance sectors, which he has built in various Polish and foreign institutions. In 1991–2004, he worked at Bank Handlowy w Warszawie SA, where he managed the Small Enterprise Division, responsible for implementing the product offer, sales, acquisition, development of distribution channels and the credit risk management process. Mr Grodzicki has been affiliated with the PZU Group since February 2004. He was Director of the SME Insurance Department, the Coordinating Director for Agency Network Development and the Managing Director responsible for Insurance Products – Head of the Mass Client Division. In 2010, he also discharged the function of the PZU Management Board's Plenipotentiary for IPO, responsible for the process of introducing PZU to the stock exchange. Since 2013, he has been a member of the Audit Committee of the Polish Chamber of Insurance (PIU) and the Board Chairman of the Insurance Guarantee Fund (UFG). For over 10 years, he has been a member of the Supervisory Boards of various financial and insurance institutions. He has been on the Management Board of PZU Życie from August 2008. From February 2010, he has been Director of the PZU Group. He is responsible for the Operations Division (Contact Center and Operations Centers).

Przemysław Henschke - Board Member of PZU Życie, Director of the PZU Group

Mr Przemysław Henschke graduated from the Warsaw Technical University. He has more than 20 years of experience in IT and financial services. In his career, he worked both on the suppliers side (as Project Manager, advisor) and on the service recipients side, as an IT Architect, CIO. The first significant undertaking was the Handlobank implementation project, which he headed as a Project Manager on the supplier's side. He was one of the co-founders and authors of Inteligo, where he acted as the IT architect, implementation project manager and then CIO. He was the CIO at Lukas Bank, where he carried out the replacement of the banking system and IT reorganization as part of the Credit Agricole Group in Poland. The next stage was starting Polbank EFG, which he conducted as the CIO responsible for implementing the branch in Poland and co-author of the universal IT architecture for CEE countries as part of the EFG Group. After launching Polbank, from 2007 he assisted the Management Boards and CIOs of leading European and Middle East banks and insurance companies as a strategic advisor at McKinsey. He dealt with the optimization of operations and IT costs, supported reorganizations and strategy and IT architecture development projects, supervised large implementation projects, and above all, supported the building of communication and understanding between Business and IT. Next, as the Group CIO at Banque Audi, one of the largest banking groups operating in the Middle East, with the Head Office in Beirut, he developed the strategy and IT architecture for the group and began the execution of these plans. He was appointed to the Management Board of PZU Życie on 3 February 2012. He has been Director of the PZU Group since 7 February 2012. He is responsible for the Technology Division.

Sławomir Niemierka - Board Member of PZU Życie, Director of the PZU Group

Mr Sławomir Niemierka graduated from the Law and Administration Department at the University of Warsaw and has post-graduate studies in European Union Law and Economics. He is a licensed legal adviser. He is an author and co-author of numerous publications on finance law and banking supervision. In 1994–2007, he was a lecturer in post-graduate studies at the Polish Academy of Science, at the University of Warsaw, and at the Higher School of Insurance and Banking. He worked for many years at the National Bank of Poland – the General Inspectorate for Banking Supervision, where for eight years he led the Inspection Department responsible for inspection activities at banks, foreign bank branches and lending institutions in Poland, including in particular internal control systems and risk management. Member of the Steering Committee of the General Inspectorate of Banking Supervision for the implementation of Basel II, responsible for control over risk models, operating risk and accounting standards. Member of the Risk Management System Development Team at the NBP. In 2010–2011, he was a member of the Management Board of the Bank Guarantee Fund, where he supervised the operational risk management system and inspections and monitoring of banks availing themselves of the Fund's financial support. He has been affiliated with the PZU Group since 2008 as the Managing Director responsible for Audit. On 19 March 2012, he was appointed Member of the Management Board of PZU Życie SA. He has been Director of the PZU Group from 19 March 2012. He is responsible for the areas of security, compliance and risk management.

Supervisory Board

As at 1 January 2013, the following persons were on the Supervisory Board of PZU:

- Waldemar Maj — Chairman of the Supervisory Board;
- Zbigniew Ćwiąkalski — Deputy-Chairman of the Board;
- Tomasz Zganiacz — Secretary of the Board;
- Dariusz Daniluk — Member of the Board;
- Zbigniew Derdziuk — Member of the Board;
- Dariusz Filar — Member of the Board;
- Włodzimierz Kiciński — Member of the Board;
- Alojzy Nowak — Member of the Board;
- Maciej Piotrowski — Member of the Board.

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 Group Directors

As at 1 January 2013, the following persons were PZU Group Directors:

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

On 5 February 2013, the Management Board of PZU appointed Ms Barbara Smalska as Director of the PZU Group.

On 14 March 2013, the Management Board of PZU dismissed Dariusz Krzewina and Barbara Smalska as Directors of the PZU Group.

16.13. The list of PZU shareholders holding directly or indirectly significant packages of shares

As at the date of preparing this Directors' Report of the PZU Group, the shareholding structure of PZU, taking into account the shareholders holding at least 5% of votes at the General Meeting was as follows:

Table 48: The shareholding structure of PZU

No.	Shareholder's name	Number of shares and votes and the GSM	% share in share capital and in the general number of votes at the GSM
1	State Treasury	30 385 253	35.19%
2	Other shareholders	55 967 047	64.81%
Total		**86 352 300**	**100.00%**

In the period from 1 January 2013 to the date of preparing this Directors' Report of the PZU Group, there were significant changes in the ownership structure of significant PZU's shares packages.

As a result of purchasing PZU shares in transactions settled at the WSE on 1 February 2013, ING Otwarty Fundusz Emerytalny ("ING Fund"), managed by ING Powszechne Towarzystwo Emerytalne S.A. became the holder of 4,356,139 PZU shares, representing a 5.0446% share in the share capital of PZU and in the total number of votes at the GSM. As at 31 December 2012, the ING Fund held 4,281,972 shares, representing 4.9587% of PZU's share capital and the same share in the total number of votes at the GSM.

Subsequently, there was a significant change in the ownership structure of significant PZU's shares packages, due to a reduction in the ownership of PZU shares by ING Otwarty Fundusz Emerytalny, managed by ING Powszechne Towarzystwo Emerytalne S.A. As a result of selling shares in transactions settled on 31 May 2013, ING Otwarty Fundusz Emerytalny reduced its ownership of PZU shares to less than 5% of votes at the Company's General Meeting. Before selling the shares, ING Otwarty Fundusz Emerytalny held 4,333,185 shares of PZU, representing 5.02% of the Company's share capital and the same share in the total number of votes. After the change, ING Otwarty Fundusz Emerytalny holds 4,222,963 shares in the Company, representing a 4.89% share in the share capital and total number of votes.

16.14. 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.

16.15. Restrictions on the execution of voting rights

In accordance with the Statute of PZU, the shareholders' voting rights have been restricted so that none of them can execute at the General Meeting more than 10% of the total number of votes existing at 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 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:

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

For the purpose of restricting the voting rights, the votes of the shareholders between whom there is a controlling or subsidiary relationship are added up in line with the principles described in the PZU Statute.
In the event of any doubts as to the interpretation, the decisions concerning the limitation of the voting rights should be made in accordance with art. 65 §2 of the Civil Code.

In accordance with the Statute of PZU, the above-mentioned restrictions of shareholders voting rights shall expire from the moment when the share of the shareholder who on the date of passing the resolution by the General Meeting introducing the restriction had been entitled to shares representing more than 10% of the total number of votes existing at PZU, drops below 5% of the Company's share capital.

16.16. Amendments to the Statute of PZU

In 2013, the Statute of PZU did not change.

The Statute were last amended in 2012. On 28 June 2012, the Supervisory Board of PZU passed Resolution No. URN/40/2012 on establishing the consolidated text of the PZU's Statute. On 18 July 2012, the District Court for the Capital City of Warsaw, 12th Business Department of the National Court Register registered the amendments to the PZU Statute.

REPRESENTATIONS OF THE MANAGEMENT BOARD OF PZU

17. Truth and fairness of the presented financial statement

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 give a true, fair and clear view of the financial position of the PZU 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.

18. Appointment of the entity authorized to audit financial statements

The Management Board of PZU declares that the entity authorized to audit financial statements Deloitte Polska spółka z ograniczoną odpowiedzialnością spółka komandytowa performing the review of the consolidated financial statements has been elected in accordance with the binding regulations and that the enitty authorized to audit financial statements and registered auditors performing the review met the conditions required for issuing an objective and independent auditor's report on the review of the interim consolidated financial statemets, 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)
Dariusz Krzewina	Board Member of PZU	.... (signature)
Bogusław Skuza	Board Member of PZU	.... (signature)
Barbara Smalska	Board Member of PZU	.... (signature)
Tomasz Tarkowski	Board Member of PZU	.... (signature)
Ryszard Trepczyński	Board Member of PZU	.... (signature)

Warsaw, 26 August 2013