PZU

REPORT ON THE ACTIVITIES OF

THE CAPITAL GROUP OF POWSZECHNY ZAKŁAD UBEZPIECZEŃ SPÓŁKA AKCYJNA IN 2009

PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS

Warsaw, 7 March 2010

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1. Introduction

This Report on the activities of the Capital Group of Powszechny Zakład Ubezpieczeń Spółka Akcyjna in 2009 constitutes the Management Board's evaluation of the business activities of the PZU Group for the financial year ended 31 December 2009, its financial position as at the balance sheet date, changes in the structure and the business environment also in the areas which do not fall directly within the scope of the obligatory financial information presented in the consolidated financial statements of the Capital Group of Powszechny Zakład Ubezpieczeń Spółka Akcyjna prepared in accordance with the International Financial Reporting Standards ("IFRS") as endorsed by the European Commission (the "European Commission").

The Report presents:

- general information, including organization and composition of the PZU Capital Group, information on the areas of its business operations as well as statutory activities of the major entities of the PZU Group;
- key profit-generating factors and their impact on the financial profit/loss;
- key developments and implementation of the PZU Group's strategy;
- data on the nature and scope of operational and financial risk as well as financial risk management.

2. Structure and scope of activities of the PZU Capital Group

PZU, a joint-stock company with its registered office in Warsaw at Al. Jana Pawła II 24, is the Parent of the Capital Group of Powszechny Zakład Ubezpieczeń Spółka Akcyjna (the "PZU Group"). It was established as a result of transformation of Państwowy Zakład Ubezpieczeń into a joint-stock company wholly owned by the State Treasury pursuant to Article 97 of the Act on insurance activity of 28 July 1990 (consolidated text: Dz.U. No. 11 of 1996, item 62 with subsequent amendments).
In line with NACE classification, the core business of PZU includes non-life insurance (NACE 66.03).

As at 31 December 2009, the PZU Group comprised 29 related parties being joint-stock or limited liability companies.

2.1. Subsidiaries subject to consolidation

1. Powszechny Zakład Ubezpieczeń SA (PZU SA)
2. Powszechny Zakład Ubezpieczeń na Życie SA (PZU Życie SA)
3. Powszechne Towarzystwo Emerytalne PZU SA (PTE PZU)
4. PZU Centrum Operacji SA (PZU CO) – formerly: Centrum Informatyki Grupy PZU SA
5. PZU Tower Sp. z o.o. (PZU Tower)
6. PrJSC Insurance Company PZU Ukraine
7. UAB DK PZU Lietuva (PZU Lietuva)
8. Ogrodowa-Inwestycje Sp. z o.o.
9. PZU Fundusz Inwestycyjny Otwarty Papierów Dłużnych Polonez ("Polonez" Fund)

2.2. Subsidiaries not subject to consolidation

10. PZU Pomoc SA
11. Ipsilon Sp. z o.o.
12. SYTA Development Sp. z o.o. in liquidation
13. Towarzystwo Funduszy Inwestycyjnych PZU SA (TFI PZU)
14. Sigma Investments Sp. z o.o.
15. PZU Asset Management SA (PZU AM)
16. Międzyzakładowe Pracownicze Towarzystwo Emerytalne PZU SA (MPTE)
17. PrJSC IC PZU Ukraine Life Insurance
18. LLC SOS Services Ukraine
19. Company with Additional Liability Inter-Risk Ukraine
20. UAB PZU Lietuva Gyvybes Draudimas
21. Krakowska Fabryka Armatur SA
22. Armatoora SA
23. Armatoora SA i wspólnik sp. k.
24. Armagor Sp. z o.o.
25. ICH Center SA

26. Kolej Gondolowa Jaworzyna Krynicka SA
27. Nadwiślańska Agencja Ubezpieczeniowa SA
28. Polskie Towarzystwo Reasekuracji SA

2.3. Changes in investments in subsidiaries

Sale of shares in PTR

On 12 January 2009, PZU SA sold all shares (12 500 thousand) in an associate, PTR, for PLN 20 000 thousand, i.e. PLN 1.60 per share, and the transaction increased the gross financial profit for 2009 by PLN 7 221 thousand.

PZU Pomoc

A notarized deed incorporating PZU Pomoc was signed on 24 February 2009. The share capital of PZU Pomoc is PLN 3 000 thousand and it is divided into 300 000 A series shares with the nominal value of PLN 10.00 each. PZU is the sole founder and shareholder. The capital was fully paid up on 4 March 2009. PZU Pomoc was entered in the Register of Entrepreneurs on 18 March 2009, by the Registry Court for the capital city of Warsaw, XII Business Division of the National Court Register.

PZU Pomoc has been operating since 8 May 2009, and the scope of its activities includes mainly assistance and medical services.

On 18 December 2009, the Extraordinary Shareholders' Meeting of PZU Pomoc adopted a resolution on increasing the share capital of the Company by PLN 865 thousand by means of issuing 86,500 ordinary registered shares, B series, with the nominal value of PLN 10 each. The issue price was PLN 91.60 per share, i.e. PLN 7,923 thousand in total. Pursuant to the agreement for acquisition of all shares by PZU, concluded between PZU and PZU Pomoc on 21 December 2009, PZU made a payment for the shares on 23 December 2009.

Ipsilon

A deed incorporating Ipsilon was signed on 24 February 2009.
The share capital of the Company is PLN 50 thousand and it is divided into 1 000 shares with the nominal value of PLN 50 each. PZU is the sole founder and shareholder. The capital was fully paid up on 18 March 2009.
By the date of signing the financial statements, Ipsilon had not started its operating activities.

Change in the legal form of Ukrainian insurance companies

The Ukrainian Joint-Stock Companies Act, which came into force on 30 April 2009, changed the classification of joint-stock companies. The act replaced the existing division into open and closed joint-stock companies and introduced public and private companies.

On 16 November 2009, the Extraordinary Shareholders' Meetings of OJSC IC PZU Ukraine and OJSC IC PZU Ukraine Life Insurance adopted resolutions to change the organization of the entities from open joint-stock companies to private joint-stock companies. Since the day of registration of changes in the articles of association on 17 November 2009 the companies have been operating under the following business names:

- Private Joint-Stock Insurance Company PZU Ukraine (PrJSC IC PZU Ukraine);
- Private Joint-Stock Insurance Company PZU Ukraine Life Insurance (PrJSC IC PZU Ukraine Life Insurance).

2.4 Scope of activities of the PZU Group and the Group companies

The scope of the business activities of the PZU Group includes provision of comprehensive insurance services. The Group companies offer services relating to life, other personal and property insurance as well as asset management on behalf of their customers in the form of an open pension fund and investment funds.

In 2009 the scope of activities of the major PZU Group companies did not change substantially.

The scope of statutory activities of **PZU SA** includes organizing and carrying out:

- direct insurance and indirect (reinsurance) activities in Poland and abroad;
- activities aimed at prevention of losses and limitation of their size;
- claims adjustment activities, i.e. determination of the size of losses, securing recourse claims, pursuing claims as well as performing other claims adjustment activities under agreements or requests filed by other insurers;
- other insurance and reinsurance services;
- acquisition activities for open pension funds based on the provisions on organization and operation of pension funds.

Insurance activity concerns other personal and property insurance (Section II of the Appendix to the Act of 22 May 2003 on insurance activity – Dz. U. No. 124 of 2003, item 1151, the "Insurance Act").
The basic scope of the Company's business in accordance with the Statistical Classification of Economic Activities in the European Community is insurance (NACE 6603).

In line with the Articles of Association effective as at the date of the report, the scope of the business activities of **PZU Życie SA** included insurance and activities directly related to insurance. The Company was allowed to carry out acquisition activity for open pension funds based on the Act on organization and operation of pension funds.
Pursuant to the Articles of Association adopted by the General Shareholders' Meeting on 28 November 2005 and registered in the National Court Register on 15 March 2006, the Company's scope of activities includes insurance and activities directly related to insurance. The Company may carry out the following activities directly or through insurance intermediaries:

- acquisition activities for open pension funds, based on the Act on organization and operation of pension funds of 28 August 1997;
- mediation for and on behalf of entities carrying out banking activity stipulated in Article 5 clause 1 and 2 of the Banking Act of 29 August 1997 in concluding contracts related to such activity in accordance with the principles laid down in the Banking Act;
- mediation in selling and redemption of investment fund units or units in foreign funds, open-end investment funds with registered offices in European Union countries and open-end investment funds with registered offices in OECD counties other EU-member states, in accordance with the Act on investment funds of 27 May 2004.

On 12 January 2007 the Company received a permission of the Polish Financial Supervision Authority to mediate in selling and redemption of units in open-end investment funds and specialized open-end investment funds. The Company started its acquisition activity for the benefit of TFI PZU SA on 1 May 2007.

The Company carries out life insurance activity (Section I), in line with the classes defined in the Appendix to the Act on insurance activity of 22 May 2003:

- life insurance;
- marriage insurance, birth insurance;
- life insurance linked to insurance capital fund;
- annuity insurance;
- accident and sickness insurance, if supplemental to the insurance referred to in items 1 to 4.

Based on the Articles of Association, the key business of **PTE PZU SA** is:

- establishing an open pension fund;
- managing the established open pension fund, representing it before third parties in a manner specified in the Articles of Association and managing more than one open pension fund in the cases and under the terms and conditions set forth in the Act on organization and operation of pension funds of 28 August 1997 (Dz. U. 04.159.1667 with subsequent amendments, the "Act on pension funds").

Based on NACE classification, the core business of PTE PZU SA is auxiliary activities related to insurance as well as a pension and annuity fund.

In line with its Articles of Association, the scope of the business activities of **PZU Tower Sp. z o. o.** includes:

- development and sale of real property on own account;
- acquisition and sale of real property on own account;
- rental of real property on own account;
- residential property management;
- non-residential property management;
- agency in acquisition, sale, rental and valuation of property;
- advertising activities;
- facility cleaning and maintenance;
- fair organization services;
- fixed line telephony and telegraphy;
- data transmission;
- other telecommunication activities.

Ogrodowa–Inwestycje Sp. z o. o., formerly (until 24 September 2008) PZU International Sp. z o. o. (the "Company"), was established by a Notarized Deed of 15 September 2004.
The Company is recorded in the Register of Entrepreneurs of the National Court Register kept by the District Court, XII Business Division of the National Court Register, under number KRS 0000218215.
According to its Articles of Association, the Company's core business includes:

- rental and management of own or leased real property;
- acquisition and sale of real property on own account;
- wire communication services;
- other business and management consulting services.

PZU SA is the Company's Parent.

The scope of statutory activities of **CIG PZU SA** includes:

- auxiliary activities related to insurance as well as pension and annuity funds (PKD 67.20) and performance of other functions relating to investment fund management and life and pension insurance settlements (PKD 67.13);

- computer consulting services (PKD 72.10), software related services (PKD 72.20), data processing (PKD 72.30) as well as database related services (PKD 72.40);
- all types of commercial activities and services on own account and in cooperation with other entities.

TFI PZU SA carries out its business activities pursuant to the Act on investment funds of 27 May 2004. Their scope includes establishment and management of investment funds (as their body), including intermediation in the disposal and redemption of participation units as well as representing the funds before third parties. The investment fund management company, which was established in 1999, is a subsidiary of PZU Życie SA.
At present the Company manages 14 investment funds pursuing various investment strategies.

Its offer includes investment products and services addressed to both individual and institutional customers as well as additional savings schemes under pillar III of the social insurance system, such as:

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

PZU AM SA has been operating within the structure of the PZU Group since 2001. In 2005 it took over functions related to management over selected asset portfolios of the following PZU Group companies: PZU SA, PZU Życie SA, TFI PZU SA and Międzyzakładowe Pracownicze Towarzystwo Emerytalne PZU S.A.

In line with its Articles of Association, the scope of the business activities of PZU Asset Management S.A. includes:

- brokerage activities within the meaning of Article 69 of the Act on trading in financial instruments of 29 July 2005, including investment portfolio management on behalf of investment funds (Dz. U. No. 183, item 1538, with subsequent amendments);
- provision of portfolio management services with respect to:
    - property, financial instruments or property rights in entities investing in the property sector;
    - financial instruments not admitted to organized trading or property rights to companies;
    - funds or other entities investing their assets in property rights or financial instruments.

In 2009, the Company provided only security management services on behalf of its customers. It did not maintain securities or cash accounts for its customers.

As at 31 December 2009, the total value of net assets under management of PZU AM was PLN 16.4 billion.

The PZU Group has been active in the Lithuanian market since 2002. Since 2004 it has been operating under the name of **PZU Lietuva**. The PZU Group carries out property and life insurance activities through two entities:

- UAB DK PZU Lietuva (99.76% of shares held by PZU) – property and personal insurance;
- UAB PZU Lietuva Gyvybės Draudimas (99.34% of shares held by PZU) – life insurance.

Since 2005 the PZU Group has also been present in the Ukrainian market through **PZU Ukraine**:

- OJSC IC PZU Ukraine (100.0% of shares held by PZU) – property and personal insurance;
- OJSC IC PZU Ukraine Life - (72.0% of shares held by PZU) – life insurance.

It conducts two major types of business:

- all types of obligatory and voluntary insurance and reinsurance;
- financial activities related to investing accumulated funds (holding cash on current accounts and bank deposits, investing in shares and other securities, purchasing shares in companies, investing in property, issuing and selling securities).

A detailed description of the business activities carried out by the organizational entities included in the consolidated financial statements has been presented in the separate management boards' reports on their activities in 2009.

3. EVALUATION OF THE BUSINESS ACTIVITY OF THE PZU GROUP IN 2009

3.1 Material events

- Settlement Agreement concluded by the State Treasury, EUREKO B.V, PZU SA and Kappa SA on 1 October 2009. The Agreement ended a long-lasting dispute between the major shareholders of PZU SA;
- advance dividend payment – PLN 12,749.9 million;
- "A" rating by S&P maintained in October 2009 (confirmation of a stable rating outlook despite payments of a considerable dividend);
- implementation of a restructuring program at the Head Office of the PZU Group Companies.

3.2 Key factors affecting the performance and activities of the PZU Group

- consistent implementation of the Strategy of the PZU Group for the years 2009-2011;
- continued conservative investment policy;
- decrease in the written premium in comprehensive car insurance and third-party liability motor insurance mainly due to the crisis in the automotive industry;
- slowdown in the regular premium insurance (-1.4 % YoY), considerable decline in the single-premium insurance market (-36.3% YoY);
- improved condition of the capital markets translating into better performance as regards the investing activities of companies operating in the financial sector;
- increased payments under third-party liability motor insurance and property insurance as well as higher value of claims paid in relation to bancassurance and group insurance products.

3.3 Key activities of the Management Boards of the PZU Group Companies in 2009

In 2009, one of the key activities of the Management Boards was implementation of the development strategy adopted in September 2008 (Strategy of the PZU Group for the years 2009-2011), which aims at stable development and maintenance of the leading position in the insurance market. This will not be achieved if the negative trends, such as lower market share of PZU and falling profitability in the area of insurance activity, are not reversed. One of the elements of the strategy implemented in 2009 were activities related to cost optimization and creation of an image of a modern and 'pro-customer' company due to a strong price pressure exerted by the competition.

Other key activities in 2009 include:

- advance dividend calculation and payment;
- implementation of the process of employment restructuring at the Head Office of the PZU Group by way of group redundancies;
- unification of management structures in the PZU Group to ensure better coordination of activities and benefit from the synergy;
- improvement of the corporate governance in the PZU Group to strengthen the transparency of the PZU Group in the area of management and supervisory standards;
- development initiatives:
  - launching pilot offices of the PZU Group Agency compliant with the new design developed in the project;
  - completed implementation of the model of segmentation and management of the agency network under the New Era of Sales project (NES);
  - implementation phase of the New Organization of Loss Adjustment project, which will allow to generate substantial savings;
  - continued implementation of the Group Insurance Registration (eRU) tool by enterprises – an IT tool used for group insurance management;
  - initiatives aimed at streamlining the claims adjustment process and improving customer service quality, including establishment of a new entity to support assistance activities (PZU Pomoc);
  - update of strategic activities in the next few years and commencement of work on the projects centralizing the back-office functions (restructuring program).

At **PZU SA** motor insurance products accounted for 62.95% of the premium collected, i.e. 4.59 p.p. less than in 2008. A substantial increase of the share in the written premium structure compared to 2008 was observed in property insurance, whose share rose from 13.53% to 15.19% of the total premium. Agricultural insurance accounted for 6.47%, whereas accident and sickness insurance for 6.7% of the total written premium.

In addition to modification of the existing products, PZU SA extended its offer with new products: PZU Auto Pomoc (the most comprehensive motor assistance package available in the market, including services rendered by an entity operating within the structure of the PZU Group – PZU Pomoc SA) and PZU AutoSzyba (insurance of car glass). Considering a strong price pressure in the market of motor insurance for retail customers, various product and sales initiatives were implemented with the objective to reduce the number of clients choosing competitive insurers and to increase the number of new customers acquired.

In 2009, **PZU Życie SA** focused on maintaining its market share in the market of group cover insurance products sold in enterprises. A 5.4% rise was observed in the premium. The dynamic increase in sales of individual and individually continued insurance products continued (+10.3% and +2.8%, respectively).
In 2009 the Management Board implemented also a number of key initiatives and activities which will affect the Company's development in the long term.
Group insurance products are the key life insurance class in terms of profitability, for which the written premium constitutes 39.1% of total gross written premium.

The Management Board of **PTE PZU SA** strived to maintain the leading market position of the Fund both in terms of the number of members and the value of net assets and to maintain the growth of the accounting unit value at least at the level of the average change in the value of units of all pension funds weighted by their assets. What is more, in 2008 the Management Board focused on further improvement of customer service standards and maintaining positive customer relationships with the objective to strengthen the market position of the PZU brand. It also made efforts to reduce operating expenses of the Pension Society by maintaining the budget discipline.
In the year ended 31 December 2009, PTE PZU generated a profit of PLN 116.9 million, accounting for 3.1% of the annual profit of the PZU Group.

In 2009, the **Lithuanian Companies** began to implement changes aimed at increasing customer loyalty, introducing cross sale based on its databases as well as customer databases made available by the partner banks, modifying the product offer as well as establishment of a Contact Center as part of a project carried out in cooperation with the asset company.

As a result of corrective actions implemented in 2007 and 2008 in the field of management and finance, in 2009 the **Ukrainian Companies** of the PZU Group managed to maintain the gross written premium on a rising trend despite the shrinking market. For PZU Ukraine, the rise in the gross written premium in 2009 was 27.8% and for PZU Ukraine Life it was at the level of 86% mainly due to reorganization of the sales network and development of assistance services.

3.4 Corporate governance at the PZU Group Companies

The Management Board of PZU SA follows the corporate governance principles. It makes best efforts to ensure that all shareholders have equal access to information about the company and their rights are respected regardless of the number of shares they hold.

PZU has implemented the "Code of Good Insurance Practice" adopted on 8 June 2009 by the General Meeting of the Polish Chamber of Insurance ("PIU"), which is an organization for insurance companies operating in the Polish market. The document is the code of conduct for insurance companies specifying their relationship with customers, insurance intermediaries, supervisory body and the Insurance Ombudsman as well as media; governing the relationships between the insurers and setting standards of operation of insurance companies which participate in public trading in securities.

Application of the rules laid down in the document is controlled by the Council for Good Insurance Practice at PIU. Moreover, the major Group companies adopted internal regulations and codes applying to individual groups of employees, in particular, the "Regulations for application of good practices in financial and equity investments by PZU employees" and the "Code of Ethics for Auditors and Internal Controllers". PZU SA has also adopted the "Code of ethics for members of management and supervisory boards of companies whose shares are held by the PZU Group companies, recommended by the PZU Group companies".

PZU SA, which is the parent of the capital group, exercises ownership supervision over its subsidiaries and whenever possible uses the economy of scale and synergy.

4. EVALUATION OF THE FINANCIAL POSITION OF THE PZU GROUP IN 2009

4.1 Financial performance

The consolidated net profit generated by the PZU Group in 2009 (in accordance with IFRS) was at the level of PLN 3,762.9 million, i.e. 61.5% higher year-on-year (PLN 2,329.7 million).

The increase in the net profit of the PZU Group was mainly driven by a higher gain on investments made by the major insurance companies of the Capital Group. A rise in the investment income resulted mainly from increasing share prices on the Warsaw Stock Exchange.

The net profit in the property and personal insurance segment for the years ended 31 December 2009 and 31 December 2008 was PLN 2,493.9 million and PLN 2,887.0 million, respectively.

The net profit in the life insurance segment for the years ended 31 December 2009 and 31 December 2008 was PLN 2,677.5 million and PLN 1,615.1 million, respectively.

The net profit generated by PTE PZU in the pension fund segment for the years ended 31 December 2009 and 31 December 2008 was PLN 116.9 million and PLN 107.7 million, respectively.

Basic financial data of the PZU Group for 2009

- net gain on investments: PLN 3,469.0 million;
- net profit: PLN 3,762.9 million;
- return on equity (ROE): 18.8%;
- coverage of the solvency margin in property insurance: 617.1%;
- coverage of the solvency margin in life insurance: 440.8%;
- total assets: PLN 53,176.2 million.

Structure of the consolidated financial profit of the PZU Group: *(in PLN '000)*

	2009	2008
PZU	2,532,644	2,938,045
PZU Lithuania	-14,750	-6,685
PZU Ukraine	-24,073	-42,063
Inter-segment consolidation adjustment	124	-2,275
Total property and personal insurance	**2,493,945**	**2,887,022**
PZU Życie	2,666,808	1,612,888
Inter-segment adjustment	10,712	939
Total life insurance	**2,677,520**	**1,613,827**
Open pension fund activity	116,882	107,661
Other (consolidation, eliminations and adjustments)	-1,525,436	-2,280,072
Total PZU Group	**3,762,911**	**2,329,718**

Revenue from insurance premiums

Gross written premiums for the years ended 31 December 2009 and 31 December 2008 amounted to PLN 14,362.7 million and PLN 14,563.1 million, respectively. A drop by PLN 200.4 million, i.e. 1.4%, resulted mainly from a decrease in the property and personal insurance segment due to declining motor insurance sales. The drop was partially set off by an increase in the gross written premiums in group life insurance.

Written premiums net of reinsurance for the years ended 31 December 2009 and 31 December 2008 amounted to PLN 14,200.0 million and PLN 14,432.8 million, respectively. A drop by PLN 232.8 million, i.e. 1.6%, resulted mainly from the aforementioned decrease recorded in the property and personal insurance segment and partially, from an increase in the share of reinsurance.

Written premiums net of reinsurance for the years ended 31 December 2008 and 31 December 2007 amounted to PLN 14,432.8 million and PLN 13,896.7 million, respectively. A rise by PLN 536.1 million, i.e. 3.9%, resulted mainly from an increase in the value of written premiums due to group life insurance and an overall rise in the value of premiums in the property and personal insurance segment.

Investing activity

Net investment income for the years ended 31 December 2009 and 31 December 2008 amounted to PLN 3,469.0 million and PLN 579.9 million, respectively. Net investment income remained relatively stable, though significant changes could be observed in realized and unrealized gains on investments. An increase by PLN 2,889.1 million resulted mainly from a reversal of trends regarding the value of listed companies and investment funds. In the year ended 31 December 2009 a net gain of PLN 810.8 million was recorded on equity instruments compared to a net loss of PLN 2,007.7 million in the year ended 31 December 2008.

(in PLN '000)	2009	2008
Interest income	2,273,225	2,230,345
Dividend income	79,290	135,814
Income on investment property	22,678	15,464
Exchange differences	14,609	54,961
Other	-26,418	-24,829
Total net investment income	2,363,384	2,411,755
Net gain/loss on realization of investments	353,480	-628,483
Impairment losses	-92,170	-227,412
Total net gain/loss on realization on investments and impairment losses	261,310	-855,895
Net change in the value of financial assets and liabilities measured at fair value	844,307	-975,962
Net revenue from investing activity	3,469,001	579,898

Claims and operating expenses

Claims paid and the change in technical provisions for the year ended 31 December 2009 increased up to the level of PLN 9,470.2 million from PLN 8,503.2 million in the year ended 31 December 2008. A rise by PLN 967.0 million, i.e. 11.4%, resulted mainly from higher costs of claims in motor, fire and property insurance. The value of death related claims paid in the life insurance segment increased as well. A rise in the value of the aforementioned payments was partially set off by a release of technical provisions following conversion of group life insurance policies into policies renewed on an annual basis.

Acquisition costs for the year ended 31 December 2009 increased up to the level of PLN 1,839.6 million from PLN 1,668.0 million in the year ended 31 December 2008. A rise by PLN 171.6 million, i.e. 10.3%, resulted mainly from a change in the product offer in the property and personal insurance segment leading to increased sales of products with a higher commission share. The above increase was also driven by a rise in the value of commissions due to growing competition, which included additional bonuses under the agent incentive scheme linking their remuneration with performance.

Administrative expenses for the year ended 31 December 2009 increased up to the level of PLN 1,808.9 million from PLN 1,774.8 million in the year ended 31 December 2008. The above rise by PLN 34.1 million, i.e. 1.9%, resulted mainly from an increase in the value of commissions paid for group life insurance policyholder administration and a rise in advertising costs in the life, property and personal insurance segments. The rise in administrative expenses was partially set off by a decrease in costs of external advisors and third party service providers as well as lower costs of rental, telephone services and WAN.

Selected balance sheet data

As at 31 December 2009 the consolidated balance sheet total was PLN 53,176.2 million, which was 10.4% lower than the balance sheet total as at 31 December 2008.

As at 31 December 2009 and 31 December 2008, equity amounted to PLN 11,266.9 million and PLN 20,052.4 million, respectively. A drop in the value of equity by PLN 8,785.5 million in 2009 resulted from the agreed dividend payment from previous year profit as well as advance dividend payment for 2009.

As at 31 December 2009 and 31 December 2008, the remaining liabilities amounted to PLN 11,427.5 million and PLN 8,539.2 million, respectively. A rise by PLN 2,888.3 million resulted mainly from liabilities relating to a repo transaction effected in 2009. The increase was partially set off by a lower number of investment contracts concluded through the bancassurance channel.

(in PLN '000)

	2009	2008
Equity	11,266,879	20,052,390
Net profit	3,762,911	2,329,718
Return on equity (ROE)	18.8%	13.1%
Investments	48,237,593	54,220,993
Other assets	4,938,616	5,138,048
Total assets	53,176,209	59,359,041
Insurance liabilities	30,481,797	30,767,412
Non-current liabilities	-	-
Other liabilities	11,427,533	8,539,239

4.2 Performance indicators and solvency ratios

Return on equity (ROE) is calculated by dividing the net profit by the opening balance of equity for a given reporting period. ROE for the years ended 31 December 2009 and 2008 was at the level of 18.8% and 13.1%, respectively. An increase by 5.7 p.p. in 2009 resulted mainly from a rise in the investment income, which was partially set off by an increase in the net earned premiums.

It should be emphasized that both PZU Group companies maintained a very high level of the solvency ratio determined for insurance companies in accordance with Polish legal acts governing insurance activity.

Own funds and the required solvency margin are regarded as the basic solvency measures, whereas the solvency margin must be covered with own funds.
Solvency ratios exceed the capital requirements several times and indicate a substantial surplus of own funds, which shows that the solvency of the PZU Group companies is excellent.
For both the insurance companies, the coverage of the required solvency margin with own funds remains at a very high level. In 2009 it was at the level of 617.1% at PZU SA and 440.8% at PZU

Życie SA. Therefore, own funds of both the insurance companies are sufficient to guarantee that all liabilities to their customers will be repaid.

	2009	2008
Solvency I – PZU		
Required solvency margin	1,338,798	1,338,798
Own funds (in line with statutory requirements)	8,261,644	16,618,912
....		
Solvency I – PZU Życie		
Required solvency margin	1,638,968	1,734,314
Own funds (in line with statutory requirements)	7,223,775	5,594,240
....		

4.3 Risk assessment and the adopted operational and financial risk management policy

The PZU Group developed and implemented a risk management system focusing on both risk control and ensuring the adequate level of capitalization. Operational risk identification, analysis, measurement, control, management and reporting allow the PZU Group to meet its obligations to customers and business partners and to satisfy the requirements resulting from legal provisions and external regulations.

Risk management is based on three lines of defense:

- Line 1: risk management at the business (organizational) unit level in accordance with valid procedures, guidelines and limits. At this level, risk management is additionally supported by internal control principles.
- Line 2: risk management through specialized units and committees (established for the purpose of specific risk management) within the existing risk management framework, based on the applicable principles, methodologies and procedures.
- Line 3: the internal audit, whose tasks include independent control and audit of key risk management system elements and control activities embedded in the Group's operations.

Controlled risk is assumed on the basis of the following processes:

- identification of risk related to operations, products and investing activities;
- risk assessment based on the adopted methodologies, historical data and market parameters;
- laying down rules/guidelines for entities responsible for assuming risk, including those relating to reflecting the risk in the price of products offered;
- risk mitigation by accepting collateral or by reinsurance;
- measurement and control of the assumed risk reported within the risk management process.

The risk appetite reflects the maximum level of acceptable risk that may be assumed by the organization and it is closely related to the business strategy and financial objectives. It may be described both in terms of quality and quantity.

In the PZU Group the risk appetite is determined by the level of equity that ensures a long-term AA credit rating assigned by Standard&Poor's Ratings Services (S&P), and for market risk it is determined using the Value at Risk (VaR) method.

The risk appetite is defined in the form of limits approved by the Management Board or one of the following committees:

- the Asset and Liability Management Committee of the PZU Group (ALCO);
- the Financial Insurance and Guarantee Risk Committee at PZU.

The next step involves allocation of risk limits to organizational units at lower levels of the organizational structure.

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

- controlled risk acceptance: financial strength and sustainable value growth are an integral part of the business strategy adopted by the PZU Group. In order to achieve the above objectives, the Group's operations are carried out in compliance with a clearly defined risk policy and subject to risk limitations;
- clear responsibility: the operations of the PZU Group are based on assignment of tasks, competencies and responsibilities. Designated employees are accountable for the risk they undertake, and their incentives are aligned with the business objectives of the PZU Group;
- adaptation to changes in the business environment: the ability to respond to changes in the business environment resulting from both external conditions and internal changes is an integral part of the risk control process in the PZU Group.

The following units participate in risk management process at PZU and PZU Życie SA:

- the Supervisory Board of PZU / PZU Życie;
- the Management Board of PZU / PZU Życie;
- the ALCO;
- the Financial Insurance and Guarantee Risk Committee;
- selected offices and teams of PZU and PZU Życie SA;
- PZU AM.

If individual risks are identified both at PZU and PZU Życie, the risk management process is centralized. The foregoing applies to market risk, credit risk relating to investments and reinsurance as well as liquidity risk. Insurance risk is managed at the level of individual companies depending on the nature of their operations. Credit risk related to insurance and financial guarantees is managed at the level of PZU as such operations are carried out only by that entity.

Risk management at PZU and PZU Życie is focused on identification and management of material risks occurring in individual business areas through setting appropriate limits (definition of the risk appetite), monitoring and clear division of obligations and responsibilities relating to risk management in a given area. The risk profile is reported to the Management Boards of PZU and PZU Życie.

Definition of risks

Insurance risk is the risk of financial losses or unfavorable changes in the value of insurance liabilities resulting from volatility of occurrence, frequency and scale of insured events and from volatility of claim payments.

Market risk is the risk that the fair value of a financial instrument or future cash flows related to the instrument will fluctuate as a result of changes in market prices. It includes three risk types: currency risk, interest rate risk and other price risks.

Credit risk is the risk of financial losses due to default on the obligations of issuers of securities, counterparties as well as clients of the beneficiaries of guarantees given. Credit risk includes also the risk of concentration related to financial losses resulting from too large exposure to an entity.

Insurance risk at PZU and PZU Życie comprises:

- for property and personal insurance (PZU):
  - ***premium risk*** - the risk of inappropriate estimation of tariffs and possible deviation of the written premiums from the expected level, resulting from the volatility of occurrence, frequency and scale of insured events;
  - ***provision risk*** - a risk that the technical provision level estimate is incorrect and that actual claims may fluctuate around the statistical average due to the stochastic nature of future claim payments;
  - ***longevity risk*** - a risk of losses or unfavorable changes in the value of insurance liabilities resulting from changes in the level, trend or volatility of the mortality rate if its decrease leads to a rise in the value of insurance liabilities;
  - ***annuity revision risk*** - a risk of losses or unfavorable changes in the value of insurance liabilities resulting from changes in the level, trend or volatility of annuity revision indicators in TPL insurance related to changes in the legal environment or the health of the insured;
  - ***catastrophe risk*** - a risk of catastrophes, such as natural disasters or terrorist attacks.
- for life insurance (PZU Życie):
  - ***mortality risk*** - a risk of losses or unfavorable changes in the value of insurance liabilities resulting from changes in the level, trend or volatility of the mortality rate if its increase leads to a rise in the value of insurance liabilities;
  - ***longevity risk*** - a risk of losses or unfavorable changes in the value of insurance liabilities resulting from changes in the level, trend or volatility of the mortality rate if its decrease leads to a rise in the value of insurance liabilities;

- ***disability risk*** - a risk of losses or unfavorable changes in the value of insurance liabilities resulting from changes in the level, trend or volatility of the disability rate and the incidence of disease;
- ***risk related to costs incurred*** - a risk of losses or unfavorable changes in the value of insurance liabilities resulting from changes in the level, trend or volatility of costs incurred for insurance or reinsurance contract management;
- ***risk of contract termination*** - a risk of losses or unfavorable changes in the value of insurance liabilities resulting from changes in the level, trend or volatility of the contract termination, policy termination and surrender rates;
- ***catastrophe risk*** - a risk of catastrophes, such as pandemic.

PZU and PZU Życie manage their insurance risk using the following tools:

- calculation and monitoring of the adequacy of technical provisions;
- tariff strategy, current estimate monitoring and premium adequacy assessment;
- reinsurance.

PZU and PZU Życie manage the risk of adequacy of their technical provisions through application of an appropriate calculation methodology and by controlling the processes related to determination of the value of such provisions.

The objective of the tariff policy implemented by PZU and PZU Życie is to ensure an adequate premium level (i.e. sufficient to cover the current and future liabilities arising from policies).

PZU introduced an underwriting process which is independent from the sales function, involving risk assessment and taking risk acceptance decisions. The underwriting process includes a three-level risk acceptance system depending on the scopes of competencies and limits (Branch Sales Team, Branch Underwriting Team, Head Office).

The objective of the reinsurance program at PZU is to secure its core business by mitigation of catastrophe risk that may have an adverse impact on the financial position of the Company. The above goal is achieved through obligatory reinsurance contracts with additional facultative reinsurance.

Reinsurance contracts entered into by the Company reduce the risk of PZU – among others by a non-proportional reinsurance contracts that protect PZU's portfolio from catastrophic claims (such as floods or hurricanes), non-proportional reinsurance contracts protecting property, technical, TPL and TPL motor insurance portfolios from the effects of substantial single claims. Additionally, PZU's risk is mitigated by a proportional contract protecting the financial insurance portfolio.

The Company has developed its own catastrophic claims model. The results of the model as well as those produced by third party models, are used to optimize the reinsurance program in terms of protection against catastrophic claims.

Price and credit risk

In 2009 the Companies followed an interest rate risk mitigation policy involving:

- buying and selling derivatives;
- diversifying the portfolio by buying instruments with various maturity dates.

A larger exposure to a portfolio of financial instruments exposed to the price risk (listed shares, pre-emption and subscription rights in the available-for-sale and the held-for-trading portfolio) was caused by rising prices in capital markets (measurement) and growing portfolios of listed shares. In 2009, just as before, the Company reduced the risk by setting limits on the maximum exposure to listed shares.

Additionally, the PZU Group Companies followed a restrictive credit risk management policy. The strategy of the Company limited the possibilities of investment in commercial debt securities to instruments in the case of which the investment rating of issuers or underwriters was at least BBB- according to Standard&Poor's or were quoted on a stock exchange (with limited individual risk exposure). Any plans of acquiring securities underwent an internal scoring process.

The Companies also managed their exposure to credit risk towards individual banks. The value of deposits with individual banks was subject to limits set on the basis of financial performance, rating and other ratios characteristic of banks.

The mortgage policy implemented by PZU stipulated that such loans could be granted only to subsidiaries or indirect subsidiaries.

In 2009, the Companies did not apply hedge accounting.

5. MACROECONOMIC AND MARKET ENVIRONMENT

5.1 Macroeconomic conditions

In 2009 Poland was the only EU country to avoid recession, which for the majority of developed economies turned out to be the most painful crisis since World War II. In such conditions the real GDP in Poland increased by ca. 1.6%-1.7% in 2009 as compared to 5% in 2008. Economic growth in Poland was possible mainly thanks to significant improvement in the balance of foreign trade. The value of import dropped much faster that that of export, giving space for domestic production. The deterioration of gross investments in fixed assets was not as significant as expected owing to infrastructure investment projects financed by the EU.

Thanks to a flexible reaction of companies and trade unions, a significant increase in the unemployment rate could be avoided - in 2009 the registered unemployment rate increased to 11.9% (9.5% at the end of 2008). The increase in the average nominal pay in the national economy fell down to ca. 5.1% (projection) as compared to 10.1% in 2008.

As the value of the Polish zloty decreased considerably, the results of which could be observed in the first months of 2009, and the administered prices and the prices of energy and food increased in the first half of the year, inflation drop was not possible in 2009, despite slower economic growth and the deterioration in the situation in the labor market. In 2009 the average annual inflation (CPI) dropped to 3.5% as compared to 4.2% in 2008.

The global financial markets anticipated a rebound in the world economy. In mid-February 2009, Polish stock exchange indexes were the lowest in this cycle, but afterwards they started to grow significantly. The trend was maintained until the end of the year. In 2009, the WIG index increased by 46.9% and WIG20 grew by 33.5%. A rise in the global stock market indexes was also driven by very low interest rates maintained by the major global central banks. Stabilization in the global financial markets and lower risk aversion was accompanied by a gradual growth in the yield on bonds in base markets. In Poland the yield on long bonds grew significantly at the beginning of 2009 and since that time it has remained relatively stable.

In the first half of 2009, the Polish zloty depreciated substantially, which reflected the higher risk aversion to investments in assets in Central and Eastern Europe. In the second half of the year, the Polish currency started to appreciate thanks to stabilizing financial markets and a spectacular reduction of the current account deficit in the Polish balance of payments and the related reduction of liquidity risk in foreign currency settlements.

The growth of the Polish economy is expected to increase slightly in 2010. A GDP growth rate increase is forecast from 1.4% in 2009 to 2.3% in 2010. The average real GDP growth rate in 2009 and 2010 will be 1.9%. In 2010 the unemployment rate will rise by 1.7%. A slow recovery from the recession of European economies being the major commercial partners of Poland combined with the crisis in the global financial markets are the two key external factors slowing down the growth rate in Poland.

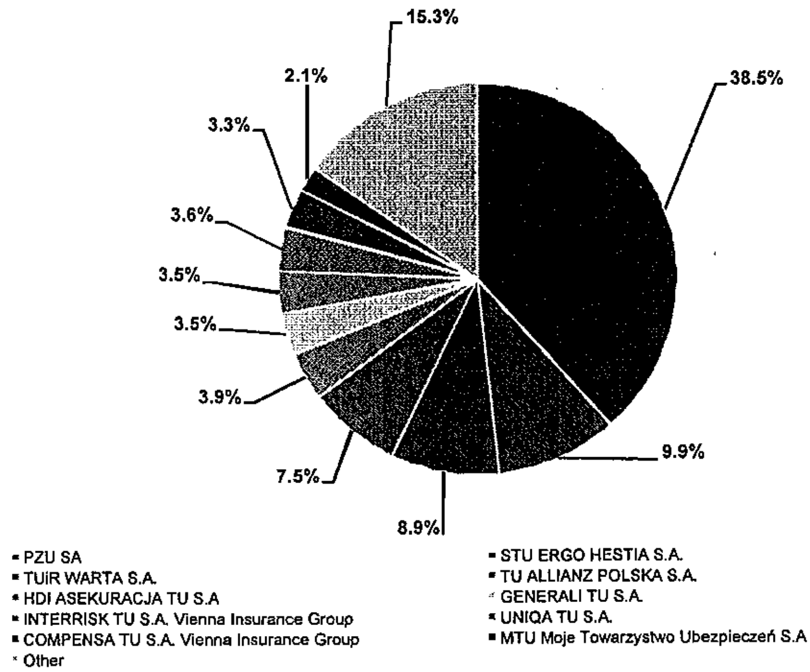
5.2 PZU Group Companies in the Polish insurance and pension fund market in 2009

In the period of three quarters of 2009 the Polish **insurance sector** recorded the total drop in the value of the gross written premium by 14.5% (year-on-year), to the level of PLN 44 872.1 billion.
Both Powszechny Zakład Ubezpieczeń Spółka Akcyjna ("PZU SA") and Powszechny Zakład Ubezpieczeń na Życie SA ("PZU Życie SA") are the leading companies in the property and life insurance market. However, the share of the PZU Group in the insurance market measured by the gross written premium has been decreasing steadily.

In 2009, the **property and other personal insurance market** measured by the gross written premium in direct business increased by 4.3% (data for Q3 2009), which shows a market growth rate decrease by 8 p.p. year-on-year. The share of the key segment – motor insurance market (third party liability motor insurance and comprehensive car insurance) – decreased by 3.9 p.p. (the share in the market after three quarters of 2009 was 57.2%). The key reason for the slower rate of growth of the insurance market in 2009 was the crisis in the automotive industry (new and second-hand cars).

The share of PZU SA in the property insurance market was 38.5% as at the end of Q3 2009 (-3.1 p.p. year-on-year).

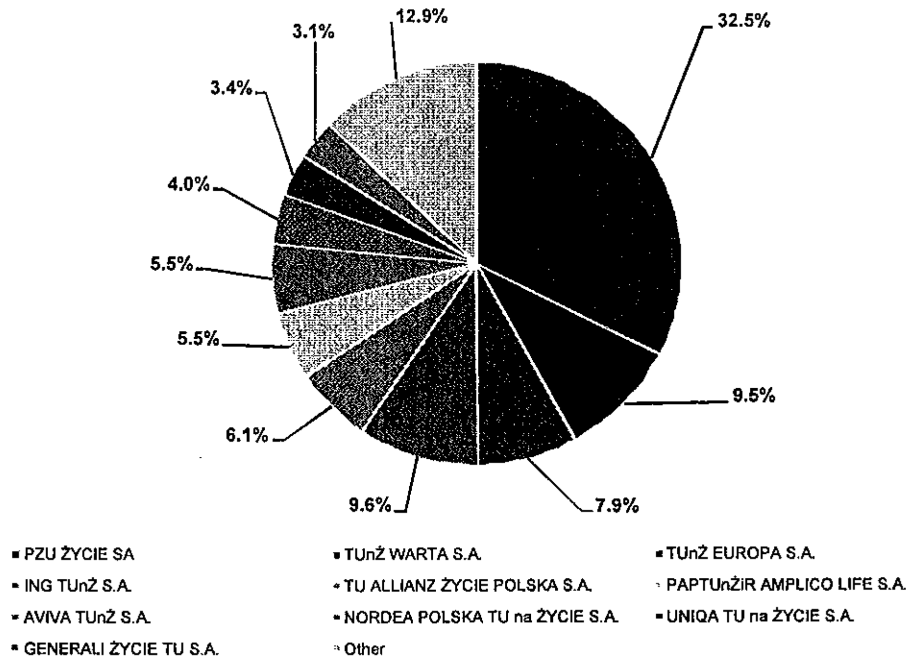
The share of PZU SA in the insurance market (section II) as at 30 September 2009



In 2009 a significant slowdown was observed **in the life insurance market**. During the first 9 months of the year, the gross written premium dropped by ca. 24.3% (including regular premium – by 1.4% and single premium – by 36.3%). A lower regular premium was directly related to the economic slowdown and redundancies made by numerous Polish companies in 2008 and 2009. A substantial drop in the value of the single premium resulted from risk aversion and was a consequence of the financial crisis observed in the preceding year.

The year 2009 brought an insignificant decrease in the market share of PZU Życie SA, resulting from a lower value of single written premium obtained through the bancassurance channel. At the end of 3Q 2009 the market share of PZU Życie SA measured by the gross written premium amounted to 32.5% and dropped by 3.9 p.p. compared to the end of September 2008.

The share of PZU Życie SA in the insurance market (section I) as at 30 September 2009



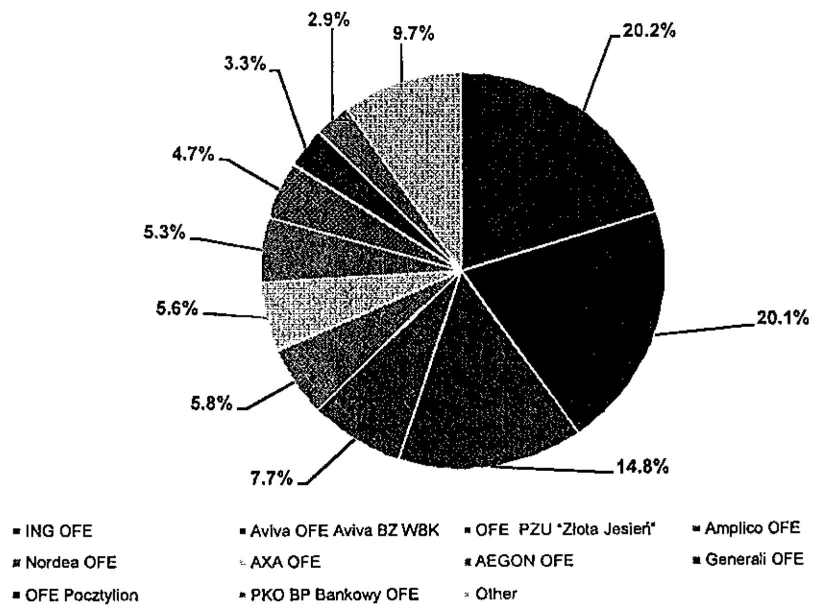
PTE PZU manages **OFE PZU**, which, according to data provided by the Polish Financial Supervision Authority, was the third open pension fund in the Polish market both in terms of the number of members and the value of net assets as at the end of 2009.
The value of assets of all pension funds increased in 2009 up to the level of PLN 178.6 billion (+3.04%), whereas the value of assets of OFE PZU "Złota Jesień" rose by PLN 757.0 million (+3.15%). As at the end of December 2009 the assets of OFE PZU "Złota Jesień" amounted to PLN 24,751.3 million, which accounted for 13.8% of the open pension fund market.

The profit on management had the most significant impact on the rise in the value of assets thanks to favorable stock market conditions.

The average value of an accounting unit of OFE PZU was PLN 27.70 in December, with the weighted average value of an accounting unit for the open pension fund market as a whole at the level of PLN 27.62.

At the end of December the number of pension fund members in the Polish open pension fund market was 14,360.6 thousand. At the end of December, the number of members of OFE PZU "Złota Jesień" was 2,119.1 thousand, while the market share measured by the number of members was 14.76% (third position in the market according to data provided by the Polish Financial Supervision Authority).

Pension fund market by the number of members as at the end of 2009



source: Polish Financial Supervision Authority - "Biuletyn Kwartalny. Rynek OFE 4/2009"
Polish Financial Supervision Authority - "Biuletyn Kwartalny. Rynek ubezpieczeń 3/2009"

6. EXPECTED DEVELOPMENT OF THE PZU GROUP

The PZU Group will strive to strengthen its position as the leading financial institution in Poland and in the Central and Eastern European market by continuing a dynamic rise in its revenue from core activities as well as maintaining a strong capital position and financial security. The related assumptions have been made in the PZU Group Strategy, which defines the Group's objectives and developments for the years to come.

One of the key initiatives planned by **PZU SA** in 2010 will be activities related to the initial public offering of the Company's shares. The processes accompanying the IPO include those planned to be carried out with the objective to satisfy the flotation requirements and ensuring fast flow of information as well as effective communication with the investors.

The key objectives of the business activities of PZU SA in 2010 resulting mainly from the Strategy adopted in 2008 and the current market situation include:

- slowing down the decrease in the share in the Polish insurance market (long-term objective) through:
  - tariff changes aimed at rate optimization in the sales segments observing the most significant loss of customers;

- introduction of new car insurance packages;
  - development of cooperation with dealers;
  - non-standard advertising campaigns;
  - sales of property insurance supplementary to motor insurance;
- more effective use of the potential of the PZU Group's customers, i.e. reliance on the client base of PZU Życie in the sales of PZU products as well as development of supplementary sales (cross-sell and up-sell);
- following a restrictive policy aimed at improvement of the technical profit in the corporate customer segment as well as elimination of claim-related risks from the portfolio;
- following a conservative investment and technical provisioning policy;
- maintaining cost discipline with the objective to limit the fixed cost increase;
- implementation of projects aimed at centralizing the support functions and streamlining the Company's operations (restructuring program).

The key objectives of the business activities of **PZU Życie SA** in 2010 resulting mainly from the Strategy adopted in 2008, strategic programs and the current market situation include:

- maintaining a strong position in the group insurance market and appropriate profitability;
- modernization of the product portfolio and development of the product offer for all sales channels, with special focus on middle class customers and retail customers of group and individual insurance;
- developing the offer and maintaining the corporate client portfolio, using the cross-sell potential of the group insurance customer base to sell property insurance;
- developing the bancassurance offer based on the existing and new insurance products in cooperation with the existing and new business partners, following at the same time the policy of mitigating asset concentration risk;
- growing sales of health insurance and development of cooperation with providers of medical services;
- improving efficiency of the sales network;
- development of sales initiatives specified in the New Era of Sales Life and the PZU Group Agency projects;
- brand - simultaneous internal and external brand refresh initiatives – Brand Refresh Day;

- following a cost discipline strategy based on a number of cost optimization initiatives, such as centralization of loss adjustment processes, combination of front-office process at PZU Życie SA and PZU SA;
- following a conservative investment policy;
- following a conservative technical provisioning policy;
- maintaining high solvency ratios.

All the initiatives implemented by **PTE PZU SA** in 2010 will be aimed at maintaining and strengthening the current market position of OFE PZU "Złota Jesień". The above goals are to be achieved by implementation of an investment policy aimed at ensuring further growth of the accounting unit value thus increasing the value of Fund members' financial assets as well as effective communication with Fund members using state-of-the-art and generally available communication tools (the Internet, hotline etc.).

In the years to come PTE PZU SA is planning to achieve good financial performance in order to strengthen the Company's image and its market position, which will depend, to a considerable extent, on premium transfer and repayment of all liabilities to Fund members relating to overdue premium transfer by the Social Insurance Institution as well as compliance with the budget discipline rules by all organizational units of the Company.

In 2010 activities will be continued aimed at ensuring compliance of the Company's corporate regulations with the requirements applicable to the PZU Group as a whole, including implementation of solutions and corporate governance rules consistent with the highest market standards to the internal regulations of the Pension Society.
Furthermore, the planned initial public offering of PZU SA and the related issuer's obligations will also result in strengthening the positive image and the market position of Otwarty Fundusz Emerytalny PZU "Złota Jesień" managed by PTE PZU SA.

7. RISK FACTORS AND THREATS

The key risk factors that can affect the performance of the PZU Group Companies in 2010 include:

- the forecast unemployment rate in 2009 translating into lower demand for insurance products;
- slowdown in the growth rate of individual consumption;
- stronger position of insurance brokers;
- changes in the financial brokerage market, reduced growth in popularity of independent financial advisory services thus limiting the number of sales channels of the Companies;

- changing profitability of treasury securities depending on the situation in the Polish and EU economy; a drop in profitability may result in a lower return on investments and the need to change the technical rates applied by the Company;

- situation in the capital market in 2010, in particular on the Warsaw Stock Exchange – a portion of the Company's investment income is conditional on market trends;

- growing competition and reduced market concentration resulting in an increase in the share of smaller entities in the market of property and other personal insurance at the expense of PZU SA;

- growing product competition in the structured product segment, substituting traditional investment fund-based insurance;

- too low flexibility of numerous product applications in the Companies impeding fast changes in the product range and responding to the needs of the clients (required IT management of new products).

Signatures of members of the Management Board of PZU SA:

Andrzej Klesyk – Chairman of the Board ....

(signature)

Rafał Stankiewicz – Member of the Board ....

(signature)

Witold Jaworski – Member of the Board ....

(signature)

Warsaw, 7 March 2010