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Internal Control System



We Grow in Results

With us, trust grows based
on the value of transparency.

Internal Control System

The Group's internal control system includes a number of strategies, systems, processes, policies and procedures defined and approved by the Board of Directors, after appraisal by the Audit Committee. In turn, the Audit Committee supervises the independence, adequacy and efficacy of the internal control system as a whole.

As a basic principle, all of the policies, processes or procedures are controlled in a number of ways, aimed at ensuring that the following goals for the internal control system are accomplished:

- Prudent risk management in order to ensure the sustainability of the business in the medium and long-term (performance goals);
- The existence of timely, complete and trustworthy financial and management information and independent reporting mechanisms of this information to the management and supervisory bodies and to the internal control functions (information goals); and
- Compliance with the legal and regulatory provisions, whether of prudential or behavioural nature, naturally including those relative to the prevention of money laundering and terrorist financing (compliance goals).

Goals of the Internal Control System

Performance and Operational

- Efficient and profitable business performance in the medium/long-term
- Business continuity
- Risk management and control
- Asset & liability prudent assessment
- Protection against fraud

Information and Reporting

- Existence of complete, pertinent, reliable and timely **financial information**
- Existence of complete, pertinent, reliable and timely **management information** to support decision-making

Compliance

- Respect for the legal and regulatory provisions, standards, professional and ethical practices, for the Code of Conduct and all other internal and statutory rules

In general terms, the internal control system should enable the appropriate management of the risks of the Group's activity, in view of the risk profile defined by the Board of Directors, and promote a strong culture regarding risk and ethical behaviour.

The governance model of the internal control system is based on an approach of three lines of defence, as indicated below:

Governance Model of the Internal Control System

Board of Directors

Ensures the independence and autonomy of internal control functions (Risk, Compliance and Audit) and that these have the needed status to significantly influence the institution's analysis and decision-making process.

Audit Committee

Direct reporting lines with internal control functions, in order for you to have regular access to the information needed for the execution of your supervisory responsibilities.

Internal Control Committee

Monitors the evolution of Internal Control deficiencies detected by following up on the progress of the defined Action Plans.

Internal Audit 3rd Defence line

Ensures that all the other functions within the institution function as expected. You must perform your duties in a completely independent way.

Risk and Compliance 2nd Defence line

Develop policies and methodologies for risk management. They must have a significant intervention in the analysis and decision on risk-taking and the definition of the risk profile for the institution. They perform efficiency evaluation of 1st line controls.

Other Areas / Process Owners 1st Defence line

The business lines are the ones who, on a daily basis, expose the Bank to a set of risks, and it is up to them to defend the institution from the unwanted risk-taking, carrying out the defined controls and procedures and reporting to the 2nd line of defence of any identified faults.

- A first line of defence, entrusted with risk and control management, composed of the Retail Network Department — with front office duties responsible for carrying out level one controls — and the operational area (with back office duties responsible for a second check (4-eyes check) of most processes that are essentially initiated by CTT's Retail Network.
- A second line of defence, entrusted with monitoring risk, advising and supporting the first line of defence in identifying risks and controls. Compliance and Risk, responsible for monitoring the process and conducting regular tests on the effectiveness of the first line controls, and Planning and Control, Security, Legal, as well as the Human Resources and the Resource and Process Organisation areas are part of the second line of defence.
- The third line of defence is ensured by Internal Audit, which is responsible for independently examining and assessing the adequacy and effectiveness of policies, processes and procedures that support the internal control system, namely by carrying out effectiveness tests on implemented controls.

The Board of Directors is ultimately responsible for the internal control system, being responsible for defining, implementing, supervising and periodically reviewing the implemented governance model and ensuring its optimisation and efficacy. The Board of Directors is also responsible for monitoring the management information regarding Internal Control shortcomings, analysing the internal control system's assessment report and issuing an overall opinion on the

adequacy and effectiveness of the internal control system and, in this regard, issuing a statement on compliance with the Bank's remuneration policy.

The Audit Committee is responsible for the monitoring and constructive critique of the Group's strategy, and should appraise and constructively influence the control functions, namely with respect to its annual activities plan, assuring the Board of Directors that the persons responsible for the internal control functions have the necessary conditions to act with independence, by providing an appropriate endowment of human and material resources for them to be able to perform their duties in an effective manner.

The Internal Control Committee is the body responsible for defining the criteria and implementation of the non-financial risk management instruments (operational, compliance and reputational risk) and for the monitoring and continuous assessment of the efficacy of the internal control system, namely by following-up on any detected flaws. This body seeks to support the Board of Directors and Executive Committee on the issues referred to above, being composed by all the members of the Executive Committee, with the managers responsible for Risk, Compliance and Internal Audit participating in it on a permanent basis. In 2019 the Committee held monthly meetings.

In line with the regulatory requirements and best practices, the Group's internal control system is based on four components:

- **Control Environment** – the basis of the internal control as it reflects the commitment of the management bodies and all other employees thereto. In this regard, note should be made of the organisation's culture, which is geared towards the integrity of behaviour and ethical values set out in the Code of Conduct. At the same time, the entire organisation has been made aware of the importance of complying with the established procedures and carrying out the defined controls.
- **Risk Management System** – this refers to the identification, assessment, monitoring and control of all material risks, while striving to ensure that they remain at the levels previously defined by the Board of Directors. The operation of the Risk Management system is detailed in the following chapter.
- **Information and Communication System** – this component is pivotal for controls to be understood and carried out by the organisation. On the other hand, the existence of timely and trustworthy management information is essential for taking business decisions and for compliance with the strategy and goals established by the Board of Directors.
- **Monitoring Process** – this is subdivided into control procedures carried out by the second line of defence and the independent assessment carried out by internal audit. Therefore, the main goal of this component is to test the effectiveness of the implemented procedures and controls, given the defined risk tolerance, in order to ensure that the residual risk arising from the application of these controls falls below this value for the risk category in question. It mainly includes the efficacy measures and tests that are continually or occasionally developed by the risk and compliance functions. The goal is to identify shortcomings in the processes or controls that enable corrective

measures to be adopted in a timely fashion. The autonomous and independent assessments performed by internal audit are particularly relevant in ascertaining the efficacy of the internal control system as a whole.

The governance model of the Group's internal control system is duly documented and is in line with the requirements of Banco de Portugal Notice 5/2008, and with the Guidelines of the European Banking Authority on the internal governance of institutions which entered into force on 21 March 2018 (EBA/GL/2017/11). In fact, following the methods adopted in previous years, a self-assessment exercise was also conducted in the first semester of 2019 of the Bank's compliance with the requirements of Banco de Portugal Notice 5/2008 and the recent Guidelines of the European Banking Authority (EBA) on the internal governance of institutions (GL 11). The results of this exercise were analysed by the Internal Control Committee and reported to the Bank's management and supervisory bodies. It should be noted that around 280 requirements were assessed, with Banco CTT proving to be highly compliant with most of the internal governance requirements of the national (Banco de Portugal or BdP) and European (EBA) regulators. Without prejudice to the above, the implementation of the opportunities for improvement identified shall also enable fine-tuning any aspects of the Group's internal control system.

An organisational model project was started in 2019 aimed at enhancing the robustness of the corporate internal control system. The development of the initiatives for greater integration of the Group's control functions is also underway, namely for the establishment of common services in the areas where there are synergies, where the General Policy on Internal Control and Risk Management already defines the framework, at a group level, in which the internal control system of Banco CTT and its affiliates should be managed.

Components of the Internal Control System

