



Management Report

INTERNAL CONTROL SYSTEM

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With transparency
and reliability,
Banco CTT raised confidence
and solid performance.

3.1 Goals

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. The Audit Committee, in turn, supervises the independence, adequacy and effectiveness of the internal control system as a whole.

In fact, these policies, processes and procedures are associated with a set of controls that aims to ensure the medium and long-term sustainability of the Bank and its subsidiaries and the prudent exercise of their activity, through the objectives illustrated in the figure below:

GOALS

Performance and Operational	Information and Reporting	Compliance
<ul style="list-style-type: none"> • Compliance with the objectives defined in the strategic plan • Efficient performance of operations • Efficient use of resources • Safeguarding assets • Risk identification, assessment, monitoring and control 	<ul style="list-style-type: none"> • Existence of complete, relevant, reliable and timely financial and non-financial information • Adoption of solid accounting procedures 	<ul style="list-style-type: none"> • Respect for the legal and regulatory provisions and guidelines applicable to the activity • Compliance with internal regulations • Respect for professional and deontological rules and uses, Code of Conduct and other rules of relationship with clients

3.2 Governance Model

The composition of the governance model of the Group's Internal Control System is summarized in the following figure:

GOVERNANCE MODEL

Board of Directors	Ensures the independence and autonomy of internal control functions (Risk, Compliance and Internal 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.
Remuneration Committee	It assesses the definition and implementation of the remuneration policies and supervises the definition and application of the remuneration of those responsible for risk-taking and control functions.
Internal Control Committee	Monitors the evolution of Internal Control deficiencies detected by following up on the progress of the defined Action Plans.
Internal Audit <i>3rd Defence Line</i>	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 <i>2nd Defence Line</i>	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 <i>1st Defence Line</i>	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.

The **Board of Directors** is primarily responsible for the Group's internal control system and for ensuring its implementation, robustness and efficacy, in compliance with internal and external regulations on the matter. 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.

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 **Remuneration Committee** has responsibilities for assessing and supervising the remuneration policies and practices of all employees, including members of the Corporate Bodies, as detailed in chapter D - 'Remuneration' of the Corporate Governance Report.

The **Internal Control Committee** is the body responsible for defining the criteria and implementation of the non-financial risk management instruments and for the monitoring and continuous assessment of the efficacy of the internal control system, namely by following-up on any detected flaws. In 2020 the Committee held monthly meetings.

On the other hand, the governance model of the Group's internal control system is based on a three line of defence approach, which comprises:

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 Operations Department (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. The second line of defence consists of Compliance and Risk, responsible for the monitoring process, carrying out periodic tests on the effectiveness of the first-line controls, as well as the areas of Planning and Control, Security and Data Protection, Legal and Human Resources.

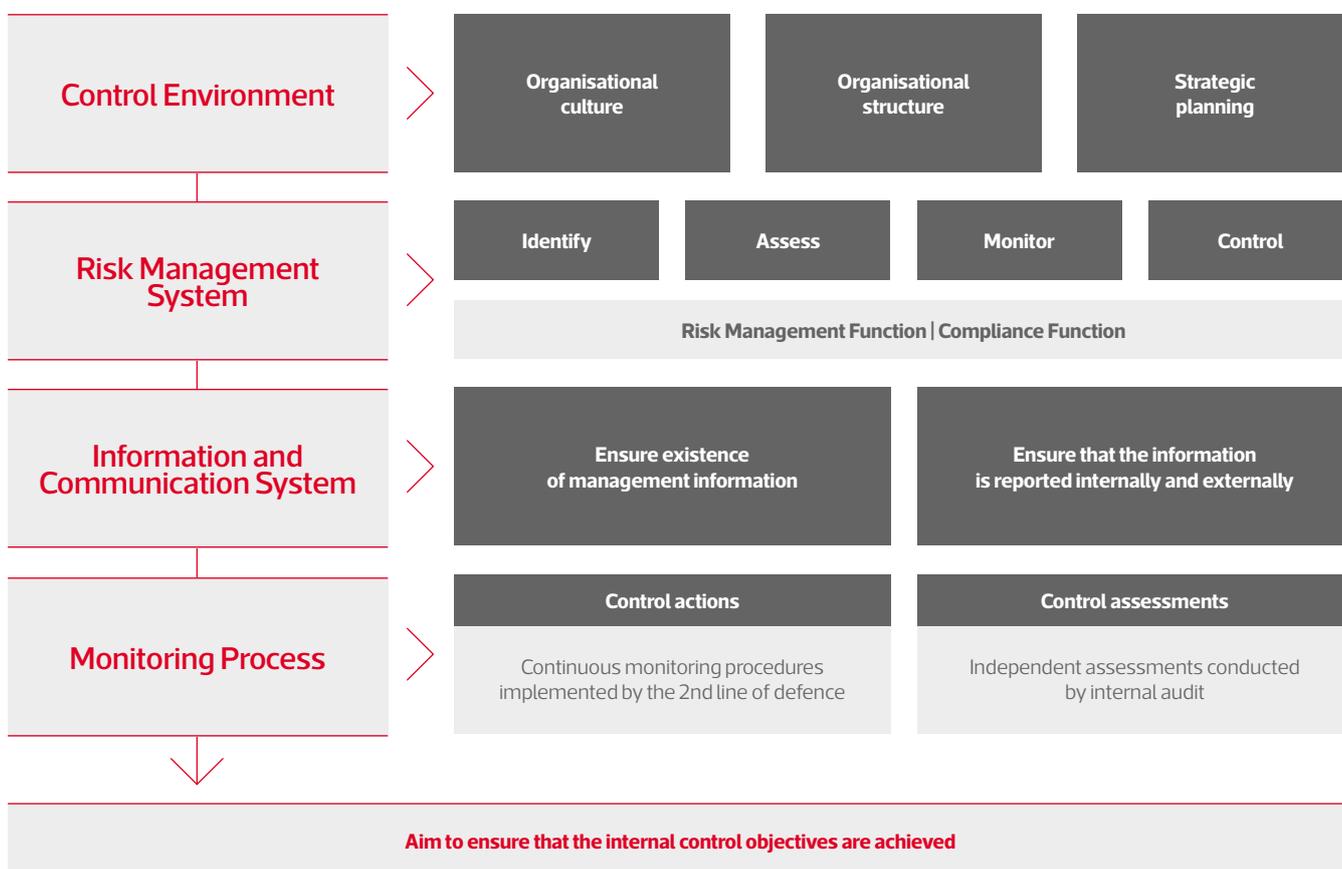
A **third line of defence**, ensured by Internal Audit, which is responsible for independently examining and assessing the adequacy and effectiveness of policies, processes and procedures that support the internal control system, namely by carrying out effectiveness tests on implemented controls.

3.3 Framework

The Group's internal control framework is based on four main components:

- > Internal Governance
- > Risk Management System
- > Information and Communication System
- > Monitoring

The following figure summarises these components of the internal control system adopted by the Group, which are described in greater detail below:



Internal Governance

The Group foresees in the development of its organisational culture the implementation of clear methodologies of risk management and internal control aimed, among others, to ensure a robust control environment and involving and holding all employees accountable. The Management Bodies and the Supervisory Bodies have a fundamental role in creating the conditions for the development of an effective control environment that allows the Group to achieve its objectives, essentially through the commitment to integrity and ethical values reflected in the Code of Conduct, and their behaviour should serve as an example for all employees ("lead by example") and the exercise of supervision, accountability and authority in the management and monitoring of risk management and internal control, formalised in the strategy, objectives, policies, processes and day-to-day action and deliberation.

On the other hand, the Group's Organisational Structure, which is defined in an integrated, objective, transparent and perceptible manner in the organisation and structure manual, supports the development of the Group's activity and the implementation of its internal control system, ensuring that the management and control of operations are carried out in a prudent manner. The Group's organisational structure is based on a coherent, clear and objective definition of the lines of reporting and authority, of the powers and responsibilities of each body, structure unit and function, as well as the degree and scope of cooperation between them and includes an adequate segregation of duties, ensuring that any situations of

potential conflict of interest are identified in advance, minimised and subject to careful and independent monitoring and is based on a sufficient number of members of the top management and middle management, as well as other employees, to carry out the defined responsibilities and duties.

Strategic planning is performed on the basis of well-founded assumptions, which are subject to sensitivity analyses and on reliable and understandable information, ensuring its timely adaptation in case of significant changes in assumptions, the definition of precise, clear and sustainable objectives for the Group's activity, covering its main products, activities, systems and processes, the determination of Risk Management Policies and the establishment of guidelines that support the development of the Group's internal control system.

Risk Management Model

The risk management model outlined by the Group is supported by a set of policies, procedures and appropriate risk tolerance limits, clearly defined and approved, which are periodically reviewed in compliance with the respective regulatory framework.

The risk management model includes four essential steps, namely: risk strategy definition, risk identification and assessment, risk response, and risk monitoring, control and reporting, as illustrated in the figure below:



In this regard, it should be noted that in 2020 the taxonomy of risks adopted by the Group was revised, in the light of the provisions of Annex I of Bank of Portugal Instruction 18/2020, taking into consideration the adaptation of the subcategories to the activity of the Bank and its subsidiaries.

Additionally, it is particularly important that the Group's risk management system covers all its products, activities, processes and systems and integrates the provisions of recovery plans, incorporating policies and procedures aimed at ensuring the timely recovery of situations of financial imbalance of the Group, as well as the provisions of other processes and policies related to risk management.

Information and Communication System

The Group ensures the implementation of mechanisms to collect, produce and process information to support management, decision-making and compliance with obligations to supervisory bodies.

The Group's information and communication is governed by the principles of substance, timeliness, comprehensibility, consistency, punctuality and reliability and ensures a complete and integral vision of its financial situation, the development of its activities, the execution of its strategy and the fulfilment of the objectives defined, its overall risk profile, and the behaviour, evolution and risk profile of

the market in which the Bank and its subsidiaries operate.

With regard to communication, the Group has formal, transparent, relevant processes which are adjusted to its needs, ensuring effective communication throughout the organisation and facilitating the decision-making process.

Within the scope of the risk management processes and resulting from the internal control system, several reports are made with different responsible persons, categories and periodicities. These include current reports, which should be prepared by the Risk and Compliance Departments based on the monitoring of risks and risk events, and cyclical reports, which are drawn up by the different structure bodies with a predefined frequency, as part of their specific activities and procedures under the aegis of risk management and internal control.

In compliance with Article 5 of Bank of Portugal Instruction 18/2020, the Group must now send to the Bank of Portugal, by the end of December each year, its annual self-assessment report, as provided for in Article 4, as well as an individual report for the Bank and each of its subsidiaries covered by Bank of Portugal Notice 3/2020. The process of implementation of this Notice was triggered in 2020 and included the preparation of the Report, to be submitted (exceptionally in this first year) to Banco de Portugal by 1 March 2021.

Monitoring

The Group's internal control includes a set of processes whose main goal is to ensure the effectiveness and/or efficiency of the implemented controls. In this sense, the internal control system establishes the use of controls as a means to mitigate risk or to mitigate the occurrence of certain risk events whose impact could jeopardise the Group's activity, especially in the case of those that are above the defined risk appetite.

In order to operationalise the internal control model, procedures were defined to promote efficient and effective management of the internal control system, which enhances the ability of the Bank and its subsidiaries to achieve objectives and adapt to operational and business changes. This methodology also defines the procedures to be followed by the various areas in the identification and management of internal control deficiencies, as well as the monitoring of the respective Action Plans by the control areas and the performance of the Compliance function in the systematisation of information, in order to ensure the effectiveness of the internal control system.

The information that results from the continuous monitoring of the Internal Control System is materialised in the deficiencies resulting from the internal control system, which, particularly those with a material impact on the Bank and its subsidiaries, are recorded, documented and communicated to senior management, ensuring their effective treatment and the timely implementation of imme-

diately corrective measures. In this regard, we would highlight the methodology for assessing these deficiencies, which was reviewed in 2020, in the light of the provisions of Annex II of Banco de Portugal Instruction 18/2020.

3.4 Implementation of Notice 3/2020

The project to implement Notice 3/2020 involved an in-depth analysis of the Group's internal control and risk management system. This process was coordinated by the Bank's Compliance Department, in close cooperation with other areas of the Group, in particular the Internal Control Functions (Risk Department, Internal Audit Department), the Internal Control Area of 321 Crédito and the Legal Services Department and General Secretariat of the Bank, and was very closely monitored by the Management and Supervisory Bodies of the Bank and its subsidiaries, in order to ensure consistency of the Group's internal control and corporate governance systems.

The work undertaken in relation to the adoption of the Notice included the following main activities:

> Gap Analysis exercise

Following the methodology previously adopted by the Bank, the Gap Analysis exercise was performed to assess the Group's compliance with the requirements of Banco de Portugal Notice 3/2020 and Instruction 18/2020. 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 the results of the gap analysis exercise show a high degree of alignment of the Banco CTT Group's internal control system and governance model with most of the requirements already contained in previous regulations (Notice 5/2008 and EBA GL 11), with the main gaps having been identified in the areas that the new Notice has changed in greater depth.

In fact, for the requirements for which gaps were identified in relation to the new regulations, initiatives were defined with a view to compliance, as well as the respective activities, deadlines and persons responsible for implementation, which will also allow some aspects of the Group's internal governance model to be improved.

> Review of organisational structure and responsibilities

The organisational structure was revised in order to ensure compliance with the additional requirements imposed by BdP Notice 3/2020.

Considering the increased responsibilities of the collegiate bodies and the control functions in the matters set out in the Notice, the process of reviewing their Regulations was also triggered, in order to ensure compliance with the new regulations.

> Review of internal regulations

The updating of a set of internal Policies and Procedures was also triggered, whose matters underwent significant changes with the entry into force of these regulations. Special reference should be made to the review of the General Policy on Internal Control and Risk Management, which included updating the taxonomy of Risks and defining a new classification model for internal control deficiencies, to be applied across the board by the Group's Control Functions within the scope of their activities, in the light of the provisions of Banco de Portugal Instruction 18/2020.

> Quality of information

Finally, with a view to strengthening the processes of producing, collecting and processing data and information circuits that ensure the quality of the information supporting the Group's internal decisions and information disclosed to the public and the information submitted to the supervisor (as provided for in Articles 29 and 30 of the Notice), the survey of the processes in question, which include not only the production and processing of financial and accounting information, but also information relating to risks and, where applicable, non-financial information, was initiated.

This process, being transversal and progressive, insofar as it must accompany the evolution of the Group's activity, includes not only the survey of these information flows and their formalisation, but also the definition of control mechanisms that allow the mitigation of the risks underlying the treatment of these data, ensuring that the information produced is reliable, complete, consistent, complete, current, timely, accessible and granular.

