

The Board of Commissioners' Report



“AMIDST OF ECONOMIC CONDITIONS TOWARDS "NEW NORMAL" PROCESS, BANK MANDIRI WAS STILL ABLE TO DEMONSTRATE POSITIVE PERFORMANCE BY THE SPIRIT OF "ONE HEART, ONE MANDIRI"”

Wimboh Santoso
President Commissioner

Dear respected shareholders and stakeholders,

First and foremost, please allow us to give thanks to the Almighty God for His guidance that has resulted in Bank Mandiri maintaining its business continuity in 2016.

In 2016, global economic growth has not been evenly distributed and the financial market was still on the recovery process. The IMF predicted the world economy growth in 2016 at 3.1%, or slightly declining than 2015 which was 3.2% YoY. Nevertheless, economic growth of developing countries, especially India and China which IMF predicted will still continue to grow above 6.5% has driven the global economic growth, as well as a few improvement in global commodity prices. Although it was still at a low level, the oil price increment has started to occur and potentially increase over the OPEC agreement to cut production. Meanwhile, the 45th US presidential election and the results of the British referendum

which decided to leave the European Union or the so-called Britain Exit (Brexit) has raised concerns over the outlook for global economic recovery in 2016. The European Union financial system in 2016 has yet to show significant changes compared to the previous year, besides the debt crisis in some EU countries, which are still ongoing.

From the regional perception, ASEAN economies are still the engine for world economy. The IMF predicted the ASEAN economies to grow 4.8% YoY in 2016, or has the ability to survive at the same growth rate in 2015 amidst the global economy recovery process. The ASEAN GDP still plays a large role in the world economy, with a contribution to the world GDP of 3.5% in 2015. In the future, global risks will remain to be considered in relation to the direction of US policy, fiscal policy and international trade, as well as the economy balancing process and restructuring the financial sector of China.

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The global and regional economic conditions have impacted Indonesia's economy. With relatively strong fundamentals, the Indonesian economy is still able to grow compared to other countries. Indonesian Economy 2016 is still under pressure, but it is still optimistic due to trends of improvement. Indonesia's economy has shown positive performance as supported by domestic demands. Bank Indonesia predicted that Indonesia's economic growth in 2016 will reach 5.0% YoY, an increase from 4.9% in 2015. Meanwhile, the inflation rate was relatively stable. Throughout the 2016 inflation was recorded at 3.0%, a drop due to the inflation in 2015 which was 3.5% YoY, and was at the lower limit of the inflation target range of Bank Indonesia at $4 \pm 1\%$. Though domestic economy recorded improved performance in 2016, The Rupiah exchange rate against the US Dollar was still experiencing the volatility into weakening direction against the US Dollar. Rupiah throughout 2016 has moved within the range of Rp12,955 - Rp13,964 against the US Dollar and closed at Rp13,473 against the US Dollar. The fluctuating exchange rate movement was caused by the global financial market turmoil.

In the midst of improving economic conditions and interest rate cuts of BI, the national banks' loan growth rate continued to slow even though the overall national financial system remained stable with the managed resilience of the banking system. Until end of November 2016, bank loans grew by only 7.9% YoY, lower than the growth of bank loan in 2015 which was 10.4%. Deceleration of loan was part of the national banking sector effort to consolidate in anticipating the level of non-performing loans. However, the Third Party Funds (DPK) fund has succeeded to grow. In the same period, DPK growth has increased to 9.6% from 7.3% YoY in 2015.

However, amid a slowdown in credit growth, with the implementation of "prudent" policy and strengthening fundamentals that were conducted by authorities, national banks are still able to record a good profit, although not as high as the previous years. This was reflected in the ratio of return on assets (ROA) which slightly decreased from 2.99% at the end of 2015 to 1.96% in 2016. It was indicated by a slightly increase in the ratio of operating costs to operating income (BOPO) of 74.28% at the end of 2015 to 83.5% in 2016.

Measurement of the Company and Board of Directors Performance

Macroeconomic condition significantly impact the operational and financial performance of Bank Mandiri. When seen from the consolidated financial position statement, the Board of Commissioners measured that Bank Mandiri has recorded an increase in total assets of Rp1,038.7 trillion, a hike of 14.1% compared to the previous year which was Rp910.1 trillion. The assets increment was mainly supported by loan increment of 11.2% from Rp595.5 trillion in 2015 to Rp662.0 trillion in 2016.

Bank Mandiri's capital looks stronger with total equity out of non-controlling interests grew by 28.5% from Rp117.1 trillion to Rp150.5 trillion. By having strong capital base, Bank Mandiri had sufficient ability to absorb various risks that may occur. The implementation of more conservative asset quality assessment was considered as an appropriate management policy by the Board of Commissioners. Through this conservative assessment (based on three pillars), the assets quality recorded a significant decline with an increase in NPL of 140 bps from 2.60% to 4.00% and back up costs rose by 113.8%.

Meanwhile, in the consolidated income statement, Bank Mandiri recorded an increase interest in income and premiums (net) in 2016 of 12.3% or became Rp54.5 trillion from the previous year's record of Rp48.5 trillion. Although numerous financial indicators have declined, Bank Mandiri was able to record a net profit of Rp13.8 trillion. The net profit have decreased by 32.1% YoY driven by an increased in provisioning costs which in consolidated basis hikes by 113.8%, to became Rp24.9 billion in 2016. Aside from the temporary performance declining in 2016, it was expected that the revenue will sustain in the future by the decreased NPL and increased profit. The Board of Commissioners understands the increased reserve costs occurred was the right management policy in order to improve prudence and anticipation of asset quality conditions.

A cumulative of third party funds which consist of giro, savings, and time deposits, on a consolidated basis in 2016 has reached Rp762.5 trillion or an increase of 12.7% compared to 2015. From the total DPK, giro recorded big increment of 8.6% to become Rp187.1 trillion, savings increased by 11.3% to become Rp302.3 trillion, while deposits increased by 17.5% to become Rp273.1 trillion. The fund management strategies have been carried out progressively to increase the cost of funds in all segments.

The realization of credit consolidated in 2016 has reached Rp662.0 trillion in 2016. The financing in the infrastructure sector in 2016 has increased, with a limit of financing reached to Rp104.6 trillion or up by 47.5% YoY. The funded sectors included the development of airports, seaports and railways with a limit of financing of Rp38.2 trillion. Other infrastructure projects that received funding from Bank Mandiri were electricity projects with a limit financing of Rp39.3 trillion, the construction of toll roads with a limit of financing of Rp14.5 trillion and telecommunications sectors of Rp12.6 trillion.

Throughout 2016, the retail segment loans grew by 12%, from Rp175.2 trillion to Rp196.2 trillion which was supported by the loan growth in the segment of Small, Medium and Micro Enterprises (SMMEs). Until the end of December 2016, Bank Mandiri has increased its SMME loan disbursement up to 6.0% or Rp80.3 trillion. The SMME loan disbursement was distributed to 952,248 debtors or increased by 12.8% compared to previous year which was dominated by the Trade and Agriculture sector.

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The loan disbursements are part of Bank Mandiri's commitment to contribute to the realization of the government's Nawacita programs, especially in the creation of Indonesia's economic independence which in turn may increase the value to the company, the interests of the nation and society.

The Bank's minimum capital adequacy ratio (Bank only) on December 31, 2016 by calculating loan risk, operational, and market was recorded at 21.4%. The CAR value was still above the limit of banking CAR and incentive Car set by Bank Indonesia at 15%. Meanwhile, the level of the Loan to Funding Ratio (LFR) of Bank Mandiri in 2016 was recorded at 85.4%. For that, it has fulfilled the criteria of "very liquid" in the bank rate as determined by Bank Indonesia with a maximum of LFR ratio at the level of 92%.

The Board of Commissioners also supports the steps that have been taken by the Board of Directors to perform various improvements and adjustment of Bank Mandiri to be more agile and anticipatory in facing the dynamics of macroeconomic developments and business climate. BOC contends that the Board of Directors has sought to maintain the growth of the Bank in a healthy and sustainable pace through the increase of loan disbursement in a more selective way and to continue to monitor the target growth according to the business plan, the quality of potential debtors, business sector condition and customers' business value chain also control the overhead costs through budget priority according to the business needs. The Board of Directors also considered to have actively restructured loans for debtors who are experiencing difficulties more aggressively recovered the debtors write-off and improved the monitoring of loan management in anticipation of asset quality deterioration.

The Board of Commissioners assessed that the Board of Directors has been able to manage risks proactively through stress-testing, intensive monitoring of each business segment, granular and specific portfolio management to every segment and in every region and a contingency plan. It was related to the implementation of credit policy, operational policy and a comprehensive and measured internal control system. Information Technology (IT) plays a very important role in the banking industry. In this case, the Board of Directors has demonstrated its capabilities to continuously modernize and improve its information technology infrastructure in order to advance its operational excellence internally while providing service to the customers, operational efficiency, and cross-selling transactions support.

The Board of Directors also considered to have applied a precautionary principle in order to encourage non-organic business growth in accordance with the input from the Board of Commissioners so that it can contribute optimally to the performance of Bank Mandiri.

The Board of Commissioners was also proud of the recognition from the public as shown from the various awards received by Bank Mandiri in 2016, namely the event of Banking Service Excellence (BSE) Award, which received the 1st Best Overall Performance for commercial bank category, Best Security Guard, Best Teller, Best ATM, to the Best Telephone. However, Bank Mandiri's proudest moment was being the recipient of the two highest awards given in the event which were The Most Consistence Excellence Award and Best Golden Trophy for Best Overall Performance 2009-2016.

The Board of Commissioners also appreciated the Board of Directors for the well-managed of Mandiri Group. Currently, Bank Mandiri has become a leading financial institution in Indonesia with the support of 11 subsidiaries with a variety of financial products in order to add values for Bank Mandiri's customers. Revenue contribution from the subsidiaries also continued to increase, driven by synergies between the Bank and its subsidiaries or between subsidiaries. Through increased synergies and adjustments to be more agile and anticipative in facing dynamic macro economy and business. Revenue contribution from its subsidiaries increased from 13.2% in 2015 to 14.3% in 2016. The contribution was expected to continuously increase at least up to 20% from total revenue of Mandiri Group in 2020.

This remarkable achievement has made us the catalyst to continue to work better moving forward to become a reputable and reliable Bank for the Indonesian people.

The Board of Commissioners believes that the success happened due to great synergy with other State-owned Enterprises. The Board of Commissioners expects that the well-established synergies will be maintained to optimize support to the national economic development which hopefully will deliver double impact in the future.

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Pro-active Monitoring Function

The Board of Commissioners will need to know the strategic angles for information to gain strategic understanding of the on-going issues. This will ensure that the decisions made can have substantially positive outcome, forward looking, and preventive at the same time.

Therefore, the Board of Commissioners has to monitor pro actively, particularly through its committees and also field observation results.

Generally, there are some key aspects as the focus of Board of Commissioners' supervision, including:

- Risk Management**
 Business risk management performed well through the control or maintain the inherent and conservative risk. Mandiri Group needs to continuously evaluate the integrated risk management and develop a system to monitor risk management of the Mandiri Group.
- Internal Control**
 Improving the quality of internal controls among others by improving working procedure of audit and compliance, improving audit data quality and upgrading the competence of audit and compliance risk units continuously.
- Compliance**
 Compliance culture is continuously conducted at all levels of Bank Mandiri's employees through socialization and evaluation. This prevents and minimizes any deviation from the provisions in place.
- Fund Management**
 The increase in low-cost funds are accompanied by the provision of a thorough solution to customers of Bank Mandiri and develop alliances based on value chain to meet customer requirements.
- Fund Disbursement**
 Fixed fund disbursement is still being done by observing the principles of prudence and adequate risk management practice and also the quality of credits distributed.
- Capital**
 Bank Mandiri has conducted an evaluation of its fixed assets as a part to strengthen its capital structure in order to strengthen the implementation of Basel III. In the implementation of the ASEAN economic community, the strengthening of company's capital can open up business opportunities in the future.

In conducting pro-active monitoring, the Board of Commissioners is always rooted on the aspects of openness and togetherness because these principles are believed to be able to build a good synergy with the strong checks and balances so as to increase public confidence and credibility of the company. With that basis, inputs to the Board of Directors were conducted through formal and informal dialogues. Formal dialogue has been carried out through joint meetings with all of the Board of Directors member and meetings with Directors partially. While the informal dialogue was also done very intensely to understand in detail the essence and root-cause any problems so that informal decision-making process can be more productive and effective. Throughout 2016 joint meetings with the Board of Directors has been conducted with a total of 12 (twelve) times, whereas informal dialogue or discussion can be done at any time without having to go through a meeting mechanism. While the committee meetings and Commissioners were held weekly.

The focus of topics discussed were strategic topics, which mainly deals with the bank's management in facing the economic pressures, internal consolidation, risk management and governance, customer services, operational stability, business sustainability and other strategic issues.

During meetings or informal discussions, the Board of Commissioners continues to provide input to the Board of Directors to evaluate each implemented program, by selecting the program that should be continued or require further evaluation for more improvement. This process was done to ensure that the program and strategy conducted by the Directors has proven to give maximum positive impacts for the Bank or it can resolve the problems faced fundamentally, not sporadic or ad-hoc.

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Implementation of Whistleblowing System at Bank Mandiri

One of pro-active monitoring conducted by the Board of Commissioners through Risk Monitoring Committee and Audit Committee is supervising the implementation of Whistleblowing System (WBS) at Bank Mandiri in the form of Letter of CEO (LTC), a reporting facility from employees or third party on indication or occurrence of fraud within Bank Mandiri. The complete implementation of WBS has been summarized in this Annual Report on Corporate Governance section page 392.

Assessment of the Committee Performance of the Board of Commissioners

In carrying out its monitoring functions, the Board of Commissioners has established an Audit Committee, Risk Monitoring Committee, Remuneration and Nominating Committee, and Integrated Corporate Governance Committee. In 2016, the entire Committee has done its duty and authorized activities in accordance with the applicable charter to each of the committees. These includes providing recommendations and reports to the Board of Commissioners on issues that require the attention of the Board in performing its duties and monitoring its functions as well as improvement with regards to supervision and responsibility of each committee.

In 2016, the Audit Committee carried out its responsibility in assisting the Board of Commissioners to evaluate the effectiveness of internal controls done by both internal and external auditors, while the Risk Monitoring Committee assisted the Board of Commissioners to evaluate the appropriateness of the risk management policies and their implementation, the Remuneration & Nomination assisted the Board of Commissioners in developing criterias and nomination of the Board of Directors and the Board of Commissioners, and provided advice regarding the Remuneration for the Board of Directors and the Board of Commissioners.

Evaluation and assessment of the entire committee performance are conducted every year using the methods determined by the Board of Commissioners. The evaluation done by the Board of Commissioners is to improve effective activities for each Committee in the coming year

Changes of the Board of Commissioners

On this occasion, the Board of Commissioners also reported that the composition of the Board of Commissioners has changed based on the results of The Annual General Meeting Of Shareholders (AGMS) held yearly on March 21, 2016, with the appointment of Mr. Ardan Adiperdana as Commissioner of Bank Mandiri. With his presence in the Board, it is expected that the quality of supervisory function can be more optimum. We need to convey that Mr. Suwhono had not served as a Commissioner of the Company effective since March 2016, where the change arrangement was under the authority of the shareholder of A Series (Ministry of SOEs) which will be reported in the 2017 AGMS.

Business Prospect in 2017

The prospect and optimism towards better Indonesia economy is still quite high. This can be seen from projections from a number of global economy institution, such as IMF and the World Bank, which estimates that Indonesia's economy will grow by 5.1% (IMF) and 5.3% (World Bank) in 2017, while the Indonesian government projected the growth by 5.1%. Nevertheless, there are a few things that must be considered. The increasing risk of foreign exchange rate, the fluctuations and flow of foreign promisory note in the stock market, and Government Promisory Notes (Surat Berharga Negara/SBN) which may affect the stability of the domestic economy. In addition to that is the risk of increased inflation in the country, expanding of fiscal deficit, and the increase trend of US interest rates in 2017 led to limited monetary and fiscalm. It is because of these reasons that the private sector role in improving the investment is needed to support the national economy.

Following the recovery in commodity prices and the global economic recovery, the banking industry growth is expected to improve inline with the success of the tax amnesty program that has been launched by the Government in July 2016. It is no doubt that tax amnesty has given a positive impact to the fundamentals of national economy as well as helping bank liquidity. We are also proud of Bank Mandiri's active involvement in the tax amnesty program as one of the perception bank.

Furthermore, the Financial Services Authority (FSA) estimated total assets, loans and third party funds (DPK) of banking industry in 2017 to grow by 11.3% YoY, 13.3% YoY and 11.9% YoY respectively. This results in Rp7,352 trillion on assets, Rp4,995 trillion on loans and Rp5,304 trillion on deposits.

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The Board of Commissioners welcomes the strategic plans of the Board of Directors in 2017 to strengthen its technology-based financial services, particularly in welcoming the digital revolution. The Board of Directors has carefully assessed and defined strategies and targets in 2017. The 2017 target implementation is also part of the implementation frame of Bank Mandiri Re-Start Long Term Plan in 2020 to focus on core competency (Corporate) and build a new core competency (Consumer). While, the Commercial and Business Banking segments are intended to advance the consolidation process within the next 1-2 years. In order to realize it, the Board of Commissioners understands the fine-tuning program in adjusting the organization which will be conducted in 2017. The Board of Directors is expected to run it carefully and cautiously through the implementation of management and solid risks mitigation.

The Board of Commissioners advocates that Bank Mandiri should have sustainable innovation and be prepared to understand and develop digital technology and manage its human resources to obtain an entrepreneurship mentality. The combination of innovation and entrepreneurship is intended to be able to differentiate products and services in order to seize business opportunities and overdrift deeper market. that can take advantage of business opportunities. Therefore, in the next one to two years, Bank Mandiri will be focus, excellent and leading the implementation and utilization of digital banking services that will boost a sustainable and higher business growth.

The Board of Commissioners provides input to the Board of Directors to keep running the implementation of corporate strategy plan of 2020 especially on the business focus, revising the business fundamentals, and strengthening infrastructure (enablers), as well as prioritizing on business sustainability instead of aiming for an aggressive growth. The Board of Commissioners also expects Bank Mandiri's business growth to be balanced with the improvement of infrastructure, human resources, and IT to avoid un-controlled business volatility and uncontrolled surprises..

Welcoming the year 2017, banking industry will also face various challenges such as marginal pressure, tight banking competition and liquidity pressure due to an increase in Cost of Fund (COF). For that, the Board of Commissioners urged the management to be optimistic but vigilant in executing the programs.

Concluding the report, on behalf of the Board of Commissioners, I would like to extend a big appreciation to the Board of Directors and all employees for their dedication and loyalty to the Company. Another appreciation I would like to address is given to all our customers, business partner, shareholders, and other stakeholders for trusting Bank Mandiri. Hopefully with the great synergy to date followed by business transformation and continuous innovation, Bank Mandiri will be able to maintain its positive growth following Bank Mandiri 2020 aspiration to become Indonesia's best, ASEAN's prominent.



Wimboh Santoso
President Commissioner