mBank S.A.

IFRS Condensed Financial Statements for the first half of 2017

Contents

1. Selected financial data

The selected financial data are supplementary information to the condensed financial statements of mBank S.A. for the first half of 2017.

SELECTED FINANCIAL DATA FOR THE BANK		in PLN'000		in EUR'000	
		1st Half of 2017 period from 01.01.2017 to 30.06.2017	1st Half of 2016 period from 01.01.2016 to 30.06.2016	1st Half of 2017 period from 01.01.2017 to 30.06.2017	1st Half of 2016 period from 01.01.2016 to 30.06.2016
I.	Interest income	1 731 802	1 659 980	407 732	378 948
II.	Fee and commission income	686 234	559 751	161 566	127 782
III.	Net trading income	144 031	143 864	33 910	32 842
IV.	Operating profit	904 646	995 946	212 988	227 359
V.	Profit before income tax	677 745	876 080	159 567	199 995
VI.	Net profit	489 528	698 913	115 254	159 551
VII.	Net cash flows from operating activities	(3 828 941)	2 898 362	(901 479)	661 651
VIII.	Net cash flows from investing activities	(230 434)	217 386	(54 253)	49 626
IX.	Net cash flows from financing activities	(1 016 100)	738 915	(239 229)	168 683
X.	Net increase / decrease in cash and cash equivalents	(5 075 475)	3 854 663	(1 194 960)	879 960
XI.	Basic earnings per share (in PLN/EUR)	11.58	16.55	2.73	3.78
XII.	Diluted earnings per share (in PLN/EUR)	11.57	16.52	2.72	3.77
XIII.	Declared or paid dividend per share (in PLN/EUR)	-	-	-	-

SELECTED FINANCIAL DATA FOR THE BANK		in PLN'000			in EUR'000		
		As at			As at		
		30.06.2017	31.12.2016	30.06.2016	30.06.2017	31.12.2016	30.06.2016
I.	Total assets	123 939 705	128 215 265	123 336 035	29 324 430	28 981 751	27 869 401
II.	Amounts due to the Central Bank	-	-	1	-	-	0
III.	Amounts due to other banks	8 654 205	8 503 014	12 035 643	2 047 606	1 922 019	2 719 612
IV.	Amounts due to customers	96 113 526	98 960 320	90 418 073	22 740 690	22 368 969	20 431 154
V.	Own equity	13 655 732	13 023 803	12 764 681	3 230 979	2 943 898	2 884 348
VI.	Share capital	169 143	169 121	168 956	40 020	38 228	38 178
VII.	Number of shares	42 285 676	42 280 127	42 238 924	42 285 676	42 280 127	42 238 924
VIII.	Book value per share (in PLN/EUR)	322.94	308.04	302.20	76.41	69.63	68.29
IX.	Total capital ratio	25.12	24.07	21.35	25.12	24.07	21.35

The following exchange rates were used in translating selected financial data into EUR:

- for items of the statement of financial position – exchange rate announced by the National Bank of Poland as at 30 June 2017: EUR 1 = PLN 4.2265, 31 December 2016: EUR 1 = PLN 4.4240 and 30 June 2016: EUR 1 = PLN 4.4255.
- for items of the income statement – exchange rate calculated as the arithmetic mean of exchange rates announced by the National Bank of Poland as at the end of each month of the first half of 2017 and 2016: EUR 1 = PLN 4.2474 and EUR 1 = PLN 4.3805 respectively.

IFRS Condensed Financial Statements for the first half of 2017 PLN (000's)

2. Condensed financial data

Condensed income statement

	Note	Period from 01.04.2017 to 30.06.2017	Period from 01.01.2017 to 30.06.2017	Period from 01.04.2016 to 30.06.2016	Period from 01.01.2016 to 30.06.2016
Interest income		868 812	1 731 802	830 589	1 659 980
Interest expense		(196 075)	(401 342)	(233 917)	(476 839)
Net interest income		**672 737**	**1 330 460**	**596 672**	**1 183 141**
Fee and commission income		348 457	686 234	289 304	559 751
Fee and commission expense		(142 405)	(278 005)	(138 522)	(264 324)
Net fee and commission income		**206 052**	**408 229**	**150 782**	**295 427**
Dividend income		165 827	165 981	111 408	133 498
Net trading income, including:		62 451	144 031	58 063	143 864
Foreign exchange result		*57 281*	*136 421*	*63 755*	*135 797*
Other net trading income and result on hedge accounting		*5 170*	*7 610*	*(5 692)*	*8 067*
Gains less losses from investment securities, investments in subsidiaries and associates, including:		(10 556)	(8 920)	244 755	248 357
Gains less losses from investment securities		*(10 556)*	*(8 920)*	*244 755*	*248 799*
Gains less losses from investments in subsidiaries and associates		-	-	-	*(442)*
Other operating income		11 039	20 741	9 768	35 079
Net impairment losses on loans and advances		(104 437)	(184 701)	(104 192)	(167 947)
Overhead costs		(373 325)	(839 671)	(359 861)	(716 193)
Amortisation		(45 930)	(91 309)	(57 274)	(104 608)
Other operating expenses		(24 840)	(40 195)	(34 160)	(54 672)
Operating profit		**559 018**	**904 646**	**615 961**	**995 946**
Taxes on the Bank's balance sheet items		(87 349)	(173 103)	(85 066)	(139 865)
Share in profits (losses) of entities under the equity method		(106 600)	(53 798)	(32 327)	19 999
Profit before income tax		**365 069**	**677 745**	**498 568**	**876 080**
Income tax expense		(91 283)	(188 217)	(103 146)	(177 167)
Net profit		**273 786**	**489 528**	**395 422**	**698 913**

Net profit		**273 786**	**489 528**	**395 422**	**698 913**
Weighted average number of ordinary shares	5.25	**42 280 676**	**42 280 403**	**42 238 924**	**42 238 924**
Earnings per share (in PLN)	5.25	**6.48**	**11.58**	**9.36**	**16.55**
Weighted average number of ordinary shares for diluted earnings	5.25	**42 306 110**	**42 305 837**	**42 299 047**	**42 299 047**
Diluted earnings per share (in PLN)	5.25	**6.47**	**11.57**	**9.35**	**16.52**

IFRS Condensed Financial Statements for the first half of 2017 PLN (000's)

Condensed statement of comprehensive income

	Period from 01.04.2017 to 30.06.2017	Period from 01.01.2017 to 30.06.2017	Period from 01.04.2016 to 30.06.2016	Period from 01.01.2016 to 30.06.2016
Net profit	**273 786**	**489 528**	**395 422**	**698 913**
Other comprehensive income net of tax, including:	**72 349**	**137 310**	**(216 159)**	**(182 190)**
Items that may be reclassified subsequently to the income statement				
Exchange differences on translation of foreign operations (net)	319	275	156	84
Change in valuation of available for sale financial assets (net)	70 373	131 861	(220 166)	(182 572)
Cash flow hedges (net)	134	3 108	(556)	616
Share in other comprehensive income of entities under the equity method (net)	1 523	2 066	4 407	(318)
Items that will not be reclassified to the income statement				
Actuarial gains and losses relating to post-employment benefits (net)	-	-	-	-
Total comprehensive income net of tax, total	**346 135**	**626 838**	**179 263**	**516 723**

IFRS Condensed Financial Statements for the first half of 2017 PLN (000's)

Condensed statement of financial position

ASSETS	30.06.2017	31.12.2016	30.06.2016
Cash and balances with the Central Bank	5 808 672	9 158 751	6 311 795
Loans and advances to banks	7 113 557	7 308 769	4 785 219
Trading securities	3 343 084	3 837 606	3 345 350
Derivative financial instruments	1 331 117	1 818 306	2 423 129
Loans and advances to customers	73 169 273	72 304 131	72 677 379
Hedge accounting adjustments related to fair value of hedged items	-	-	73
Investment securities	29 607 690	30 467 780	30 784 494
Investments in subsidiaries	1 991 780	1 782 219	1 709 119
Non-current assets held for sale	81 314	-	-
Intangible assets	576 399	540 452	466 209
Tangible assets	447 122	481 695	453 454
Current income tax assets	2 256	1 067	-
Deferred income tax assets	83 797	146 693	80 661
Other assets	383 644	367 796	299 153
Total assets	**123 939 705**	**128 215 265**	**123 336 035**

LIABILITIES AND EQUITY			
Liabilities			
Amounts due to the Central Bank	-	-	1
Amounts due to other banks	8 654 205	8 503 014	12 035 643
Derivative financial instruments	1 154 083	1 644 250	2 209 098
Amounts due to customers	96 113 526	98 960 320	90 418 073
Hedge accounting adjustments related to fair value of hedged items	37 235	87 566	159 453
Other liabilities	1 842 388	1 792 740	1 615 844
Current income tax liabilities	64 205	77 475	46 000
Provisions for deferred income tax	82	100	86
Provisions	185 410	182 648	176 699
Subordinated liabilities	2 232 839	3 943 349	3 910 457
Total liabilities	**110 283 973**	**115 191 462**	**110 571 354**
Equity			
Share capital:	**3 554 016**	**3 551 096**	**3 535 758**
- Registered share capital	169 143	169 121	168 956
- Share premium	3 384 873	3 381 975	3 366 802
Retained earnings:	**9 978 589**	**9 486 890**	**8 978 171**
- Profit for the previous years	9 489 061	8 267 551	8 279 258
- Net profit for the current year	489 528	1 219 339	698 913
Other components of equity	**123 127**	**(14 183)**	**250 752**
Total equity	**13 655 732**	**13 023 803**	**12 764 681**
Total liabilities and equity	**123 939 705**	**128 215 265**	**123 336 035**

Total capital ratio	**25.12**	**24.07**	**21.35**
Common Equity Tier 1 capital ratio	**21.90**	**20.59**	**18.15**
Book value	**13 655 732**	**13 023 803**	**12 764 681**
Number of shares	**42 285 676**	**42 280 127**	**42 238 924**
Book value per share (in PLN)	**322.94**	**308.04**	**302.20**

IFRS Condensed Financial Statements for the first half of 2017 PLN (000's)

Condensed statement of changes in equity

Changes from 1 January to 30 June 2017

	Share capital		Retained earnings					Other components of equity					Total equity
	Registered share capital	Share premium	Other supplementary capital	Other reserve capital	General banking risk reserve	Profit from the previous years	Profit for the current year	Exchange differences on translation of foreign operations	Valuation of available for sale financial assets	Cash flows hedges	Actuarial gains and losses relating to post-employment benefits	Share in other comprehensive income of entities under the equity method	
Equity as at 1 January 2017	**169 121**	**3 381 975**	**4 384 011**	**26 891**	**1 095 143**	**3 980 845**	**-**	**(5 953)**	**(2 431)**	**(1 545)**	**(3 517)**	**(737)**	**13 023 803**
Total comprehensive income	-	-	-	-	-	-	**489 528**	**275**	**131 861**	**3 108**	-	**2 066**	**626 838**
Transfer to general banking risk reserve	-	-	-	-	20 000	(20 000)	-	-	-	-	-	-	-
Transfer to supplementary capital	-	-	2 761 506	-	-	(2 761 506)	-	-	-	-	-	-	-
Issue of shares	22	-	-	-	-	-	-	-	-	-	-	-	22
Stock option program for employees	-	2 898	-	2 171	-	-	-	-	-	-	-	-	5 069
- value of services provided by the employees	-	-	-	*5 069*	-	-	-	-	-	-	-	-	*5 069*
- settlement of exercised options	-	*2 898*	-	*(2 898)*	-	-	-	-	-	-	-	-	-
Equity as at 30 June 2017	**169 143**	**3 384 873**	**7 145 517**	**29 062**	**1 115 143**	**1 199 339**	**489 528**	**(5 678)**	**129 430**	**1 563**	**(3 517)**	**1 329**	**13 655 732**

Changes from 1 January to 31 December 2016

	Share capital		Retained earnings					Other components of equity					Total equity
	Registered share capital	Share premium	Other supplementary capital	Other reserve capital	General banking risk reserve	Profit from the previous years	Profit for the current year	Exchange differences on translation of foreign operations	Valuation of available for sale financial assets	Cash flows hedges	Actuarial gains and losses relating to post-employment benefits	Share in other comprehensive income of entities under the equity method	
Equity as at 1 January 2016	**168 956**	**3 366 802**	**4 384 011**	**32 976**	**1 065 143**	**2 791 517**	**-**	**(6 290)**	**441 758**	**859**	**(3 850)**	**465**	**12 242 347**
Total comprehensive income	-	-	-	-	-	-	**1 219 339**	**337**	**(444 189)**	**(2 404)**	**333**	**(1 202)**	**772 214**
Transfer to general banking risk reserve	-	-	-	-	30 000	(30 000)	-	-	-	-	-	-	-
Issue of shares	165	-	-	-	-	-	-	-	-	-	-	-	165
Other changes	-	-	-	-	-	(11)	-	-	-	-	-	-	(11)
Stock option program for employees	-	15 173	-	(6 085)	-	-	-	-	-	-	-	-	9 088
- value of services provided by the employees	-	-	-	*9 088*	-	-	-	-	-	-	-	-	*9 088*
- settlement of exercised options	-	*15 173*	-	*(15 173)*	-	-	-	-	-	-	-	-	-
Equity as at 31 December 2016	**169 121**	**3 381 975**	**4 384 011**	**26 891**	**1 095 143**	**2 761 506**	**1 219 339**	**(5 953)**	**(2 431)**	**(1 545)**	**(3 517)**	**(737)**	**13 023 803**

Changes from 1 January to 30 June 2016

	Share capital		Retained earnings					Other components of equity					Total equity
	Registered share capital	Share premium	Other supplementary capital	Other reserve capital	General banking risk reserve	Profit from the previous years	Profit for the current year	Exchange differences on translation of foreign operations	Valuation of available for sale financial assets	Cash flows hedges	Actuarial gains and losses relating to post-employment benefits	Share in other comprehensive income of entities under the equity method	
Equity as at 1 January 2016	**168 956**	**3 366 802**	**4 384 011**	**32 976**	**1 065 143**	**2 791 517**	**-**	**(6 290)**	**441 758**	**859**	**(3 850)**	**465**	**12 242 347**
Total comprehensive income	-	-	-	-	-	-	**698 913**	**84**	**(182 572)**	**616**	-	**(318)**	**516 723**
Transfer to general banking risk reserve	-	-	-	-	30 000	(30 000)	-	-	-	-	-	-	-
Other changes	-	-	-	-	-	(11)	-	-	-	-	-	-	(11)
Stock option program for employees	-	-	-	5 622	-	-	-	-	-	-	-	-	5 622
- value of services provided by the employees	-	-	-	*5 622*	-	-	-	-	-	-	-	-	*5 622*
Equity as at 30 June 2016	**168 956**	**3 366 802**	**4 384 011**	**38 598**	**1 095 143**	**2 761 506**	**698 913**	**(6 206)**	**259 186**	**1 475**	**(3 850)**	**147**	**12 764 681**

IFRS Condensed Financial Statements for the first half of 2017 PLN (000's)

Condensed statement of cash flows

	Period from 01.01.2017 to 30.06.2017	Period from 01.01.2016 to 30.06.2016
A. Cash flows from operating activities	**(3 828 941)**	**2 898 362**
Profit before income tax	**677 745**	**876 080**
Adjustments:	***(4 506 686)***	***2 022 282***
Income taxes paid	(174 599)	(187 765)
Amortisation	91 309	104 608
Foreign exchange (gains) losses related to financing activities	(725 853)	493 553
(Gains) losses on investing activities	50 257	(273 428)
Impairment of investments in subsidiaries	12 262	8 119
Dividends received	(165 981)	(133 498)
Interest income (income statement)	(1 731 802)	(1 659 980)
Interest expense (income statement)	401 342	476 839
Interest received	1 861 846	1 568 207
Interest paid	(364 104)	(446 653)
Changes in loans and advances to banks	(1 126 124)	1 000 372
Changes in trading securities	60 157	(110 492)
Changes in assets and liabilities on derivative financial instruments	44 932	(1 752)
Changes in loans and advances to customers	(980 157)	(1 356 243)
Changes in investment securities	1 132 389	(721 738)
Changes in other assets	(33 397)	(17 222)
Changes in amounts due to other banks	554 701	(966 948)
Changes in amounts due to customers	(3 474 491)	4 036 910
Changes in provisions	2 762	(48 645)
Changes in other liabilities	57 865	258 038
Net cash generated from/(used in) operating activities	**(3 828 941)**	**2 898 362**
B.Cash flows from investing activities	**(230 434)**	**217 386**
Investing activity inflows	**166 305**	**334 636**
Disposal of shares in subsidiaries, net of cash disposed	-	2 000
Disposal of intangible assets and tangible fixed assets	324	106
Dividends received	165 981	133 498
Other investing inflows	-	199 032
Investing activity outflows	**396 739**	**117 250**
Acquisition of shares in subsidiaries	223 822	-
Purchase of intangible assets and tangible fixed assets	172 917	117 250
Net cash generated from/(used in) investing activities	**(230 434)**	**217 386**
C. Cash flows from financing activities	**(1 016 100)**	**738 915**
Financing activity inflows	**791 742**	**1 009 635**
Proceeds from loans and advances from other banks	-	570 635
Proceeds from other loans and advances	-	439 000
Issue of ordinary shares	22	-
Security deposit due to issue of Eurobonds	791 720	-
Financing activity outflows	**1 807 842**	**270 720**
Repayments of loans and advances from other banks	-	89 670
Repayments of other loans and advances	6 754	6 422
Acquisition of shares in subsidiaries - increase of involvement	120 000	100 000
Decrease of subordinated liabilities	1 611 840	-
Payments of financial lease liabilities	3 668	4 497
Interest paid from loans and advances received from other banks, subordinated liabilities and long term issue	65 580	70 131
Net cash generated from/(used in) financing activities	**(1 016 100)**	**738 915**
Net increase / decrease in cash and cash equivalents (A+B+C)	**(5 075 475)**	**3 854 663**
Effects of exchange rate changes on cash and cash equivalents	14 992	40 695
Cash and cash equivalents at the beginning of the reporting period	14 987 684	6 892 431
Cash and cash equivalents at the end of the reporting period	**9 927 201**	**10 787 789**

3. Description of the relevant accounting policies

The most important accounting policies applied to the drafting of these condensed financial statements are presented below. These principles were applied consistently over all presented periods.

3.1. Accounting basis

The condensed financial statements of mBank S.A. ("Bank") have been prepared for the 6-month period ended 30 June 2017.

The presented condensed financial statements for the first half of 2017 fulfill the requirements of the International Accounting Standard (IAS) 34 "Interim Financial Reporting", concerning interim financial statements and adopted for application by the European Union.

The presented condensed financial statements for the first half of 2017 should be read in conjunction with the mBank S.A. Financial Statements for the year 2016, which have been prepared in accordance with IFRSs adopted for application by the European Union, on 1 March 2017 approved by the Bank's Management Board. Accounting policies applied to the preparation of the condensed consolidated financial statements are consistent with those applied in the annual consolidated financial statements for the year ended 31 December 2016, with the exception of the application of new or amended standards and interpretations binding for annual periods beginning on or after 1 January 2017 and described in Note 3.26.

The data presented in the mBank S.A. condensed financial statements for the 2016 year end data was audited by the auditor. The comparative data for the first half of 2016 was reviewed by the auditor.

The preparation of the financial statements in compliance with IFRS requires the application of specific accounting estimates. It also requires the Management Board to use its own judgment when applying the accounting policies adopted by the Bank. The issues in relation to which a greater degree of judgment is required, more complex issues, or such issues where estimates or judgments are material to the financial statements are disclosed in Note 4.

These condensed financial statements were prepared under the assumption that the Bank continues as a going concern in the foreseeable future, i.e. in the period of at least 12 months following the reporting date.

3.2. Interest income and expenses

All interest income on financial instruments carried at amortised cost using the effective interest rate method is recognized in the income statement as well as interest income from financial assets held for trading and available for sale.

The effective interest rate method is a method of calculation of the amortised initial value of financial assets or financial liabilities and allocation of interest income or interest expense to the proper periods. The effective interest rate is the interest rate at which the discounted future payments or future cash inflows in the expected life of the financial instrument, are equal to the net present carrying value of the respective financial asset or liability. When calculating the effective interest rate, the Bank estimates the cash flows taking into account all the contractual terms of the financial instrument, but without taking into account possible future losses on account of non-recovered loans and advances. This calculation takes into account all the fees paid or received between the parties to the contract, which constitute an integral component of the effective interest rate, as well as transaction expenses and any other premiums or discounts.

Following the recognition of an impairment loss on a financial asset or a group of similar financial assets, the interest income is calculated on the net value of financial assets and recognized using the interest rate at which the future cash flows were discounted for the purpose of valuation of impairment.

Interest income includes interest and commissions received or due on account of loans, inter-bank deposits or investment securities recognized in the calculation of the effective interest rate.

Interest income, including interest on loans, is recognized in the income statement and on the other side in the statement of financial position as part of receivables from banks or from other customers.

The calculation of the effective interest rate takes into account the cash flows resulting from only those embedded derivatives, which are strictly linked to the underlying contract.

Income and expenses related to the interest component of the result on interest rate derivatives and resulting from current calculation of swap points on currency derivatives classified into banking book are presented in the interest results in the position Interest income/expense on derivatives classified into banking book. The banking book includes transactions, which are not concluded for trading purposes i.e. not aimed at generating a profit in a short-term period (up to 6 months) and those that do not constitute hedging a risk arising from the operations assigned into trading book.

Interest income and interest expenses related to the interest measurement component of derivatives concluded as hedging instruments under fair value hedge are presented in the interest result in the position interest income/expense on derivatives under the fair value hedge accounting.

Interest income related to the interest measurement component of derivatives concluded as hedging instruments under cash flow hedge are presented in the interest result in the position interest income on derivatives under the cash flow hedge accounting.

3.3. Fee and commission income

Income on account of fees and commissions is recognized on the accrual basis, at the time of performance of the respective services. Fees charged for the granting of loans which are likely to be drawn down are deferred (together with the related direct costs) and recognized as adjustments of the effective interest rate charge on the loan. Fees on account of syndicated loans are recognized as income at the time of closing of the process of organisation of the respective syndicate, if the Bank has not retained any part of the credit risk on its own account or has retained a part of the risk of a similar level as other participants. Commissions and fees on account of negotiation or participation in the negotiation of a transaction on behalf of a third party, such as the acquisition of shares or other securities, or the acquisition or disposal of an enterprise, are recognized at the time of realisation of the transaction. Portfolio management fees and other fees for management, advisory and other services are recognized on the basis of service contracts, usually in proportion to the passage of time. The same principle is applied in the case of management of client assets, financial planning and custody services, which are continuously provided over an extended period of time.

Fee and commissions collected by the Bank on account of issuance, renewal and change in the limit of credit and payment cards, guarantees granted as well as opening, extension and increase of letters of credit are accounted for a straight-line basis.

Fee and commissions collected by the Bank on account of cash management operations, keeping of customer accounts, money transfers and brokerage business activities are recognized as upfront income directly in the income statement.

The Bank's fee and commission income comprises also income from offering insurance products of third parties. In case of selling insurance products that are not bundled with loans, the revenues are recognized as upfront income or in majority of cases settled on a monthly basis.

3.4. Revenue and expenses from sale of insurance products bundled with loans

The Bank treats insurance products as bundled with loans, in particular when insurance product was offered to the customer only with the loan, i.e. it was not possible to purchase from the Group the insurance product which is identical in a legal form, content and economic conditions without purchasing the loan.

Revenue and expenses from sale of insurance products bundled with loans are split into interest income and fee and commission income based on the relative fair value analysis of each of these products.

The remuneration included in interest income is recognized over time as part of effective interest rate calculation for the bundled loan. The remuneration included in fee and commission income is recognized partly as upfront income and partly including deferring over time based on the analysis of the stage of completion of the service.

Expenses directly linked to the sale of insurance products are recognized using the same pattern as in case of income observing the matching concept. A part of expenses is treated as an element adjusting the calculation of effective interest rate for interest income and the remaining part of expenses is recognized in fee and commission expenses as upfront cost or as cost accrued over time.

The Bank estimates also the part of remuneration which in the future will be returned due to early termination of insurance contract and appropriately decreases interest income or fee and commission income to be recognized.

In connection with entry into force of Recommendation U concerning best practices in the area of bancassurance, starting from 31 March 2015 the Bank does not receive remuneration from the sale of insurance products which would have been treated as boundled with loans.

3.5. Financial assets

The Bank classifies its financial assets to the following categories: financial assets valued at fair value through the income statement; loans and receivables; financial assets held to maturity; financial assets available for sale. The classification of financial assets is determined by the Management at the time of their initial recognition.

Standardised purchases and sales of financial assets at fair value through the income statement, held to maturity and available for sale are recognized on the settlement date – the date on which the Bank delivers or receives the asset. Changes in fair value in the period between trade and settlement date with respect to assets carried at fair value is recognized in profit or loss or in other components of equity. Loans are recognized when cash is advanced to the borrowers. Derivative financial instruments are recognized beginning from the date of transaction.

A financial asset is de-recognized if Bank loses control over any contractual rights attached to that asset, which usually takes place if the financial instrument is disposed of or if all cash flows attached to the instrument are transferred to an independent third party.

<u>Financial assets valued at fair value through the income statement</u>

This category comprises two subcategories: financial assets held for trading and financial assets designated at fair value through the income statement upon initial recognition. A financial asset is classified in this category if it was acquired principally for the purpose of short-term resale or if it was classified in this category by the Bank. Derivative instruments are also classified as "held for trading", unless they were designated for hedging according to IAS 39.

Disposals of debt and equity securities held for trading are accounted according to the weighted average method.

The Bank classifies financial assets/financial liabilities as measured at fair value through the income statement if they meet either of the following conditions:

- assets/liabilities are classified as held for trading i.e. they are acquired or incurred principally for the purpose of selling or repurchasing them in the near term, they are a part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit making or they are derivatives (except for derivatives that are designated as and being effective hedging instruments and financial guarantee contracts),
- upon initial recognition, assets/liabilities are designated by the entity at fair value through the income statement according to IAS 39.

If a contract contains one or more embedded derivatives, the Bank designates the entire hybrid (combined) contract as a financial asset or financial liability at fair value through the income statement unless:

- the embedded derivative(s) does not significantly modify the cash flows that otherwise would be required by the contract; or
- it is clear with little or no analysis when a similar hybrid instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortised cost.

The Bank also designates the financial assets/financial liabilities at fair value through the income statement when doing so results in more relevant information, because either:

- it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as "an accounting mismatch") that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel.

Financial assets and financial liabilities classified to this category are valued at fair value upon initial recognition.

Interest income/expense on financial assets/financial liabilities designated at fair value (Note 3.2), except for derivatives the recognition of which is discussed in Note 3.11, is recognized in net interest income. The valuation and result on disposal of financial assets/financial liabilities designated at fair value is recognized in trading income.

As presented in this financial statements reporting periods, the Bank did not designate any financial instrument on initial recognition as financial assets at fair value through the income statement.

<u>Loans and receivables</u>

Loans and receivables consist of financial assets not classified as derivative instruments, with payments either determined or possible to determine, not listed on an active market. They arise when the Bank supplies monetary assets, goods or services directly to the debtor without any intention of trading the receivable. Loans and receivables are entered into books on the transaction date.

Investments held to maturity

Investments held to maturity comprise listed on active markets financial assets, not classified as derivative instruments, where the payments are determined or possible to determine and with specified maturity dates, and which the Bank intends and is capable of holding until their maturity.

In the case of sale by the Bank before maturity of a part of assets held to maturity which cannot be deemed insignificant the held to maturity portfolio is tainted, and there with all the assets of this category are reclassified to the available for sale category.

In reporting periods presented in these financial statements, there were no assets held to maturity at the Bank.

Financial assets available for sale

Available for sale investments consist of investments which the Bank intends to hold for an undetermined period of time. They may be sold, e.g., in order to improve liquidity, in reaction to changes of interest rates, foreign exchange rates, or prices of equity instruments.

Interest income and expense from available for sale investments are presented in net interest income. Gains and losses from sale of available for sale investments are presented in gains and losses from investment securities.

Available for sale financial assets and financial assets measured at fair value through the income statement are valued at the end of the reporting period according to their fair value. Loans and receivables, as well as investments held to maturity are measured at adjusted cost of acquisition (amortised cost), applying the effective interest rate method. Gains and losses resulting from changes in the fair value of "financial assets measured at fair value through the income statement" are recognized in the income statement in the period in which they arise.

Gains and losses arising from changes in the fair value of available for sale financial assets are recognized in other comprehensive income until the derecognition of the respective financial asset in the statement of financial position or until its impairment: at such time the aggregate net gain or loss previously recognized in other comprehensive income is now recognized in the income statement. However, interest calculated using the effective interest rate is recognized in the income statement. Dividends on available for sale equity instruments are recognized in the income statement when the entity's right to receive payment is established.

The fair value of quoted investments in active markets is based on current market prices. If the market for a given financial asset is not an active one, the Bank determines the fair value by applying valuation techniques. These comprise recently conducted transactions concluded according to normal market principles, reference to other instruments, discounted cash flow analysis, as well as valuation models for options and other valuation methods generally applied by market participants.

If the application of valuation techniques does not ensure obtaining a reliable fair value of investments in equity instruments not quoted on an active market, they are stated at cost.

3.6. Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. The conditions mentioned above are not satisfied and offsetting is inappropriate when: different financial instruments are used to emulate the features of a single financial instrument, financial assets and liabilities arise from financial instruments having the same primary risk exposure but involve different counterparties, financial or other assets are pledged as collaterals for non-recourse financial liabilities, financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in the settlement of the obligation, or obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance contract.

3.7. Impairment of financial assets

Assets carried at amortised cost

At the end of the reporting period, the Bank estimates whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the future cash flows of the financial asset or group of financial assets that can be reliably estimated. Loss events were divided into definite ("hard") loss events of which occurrence requires that there is a need to classify the client into the default category, and indefinite ("soft") loss events of which occurrence may imply that there is a need to classify the client into the default category.

The Bank measures impairment of loan exposures in accordance with the International Accounting Standard 39. The classification of customers to default portfolio and calculation of impairment write-off has been described below:

Impairment triggers - corporate portfolio

Loss events were divided into definite ('hard') loss events of which occurrence requires the client to be classified into the default category, and indefinite ('soft') loss events of which occurrence may imply that there is a need to classify the client into the default category. Credit analyst assesses additionally whether the event impacted adversely the obligor's creditworthiness. Indefinite loss events have been introduced in order to signal situations that may increase the credit risk of the debtor, which may result in the loss of the debtor's ability to repay loan to the Bank.

<u>The list of definite loss events:</u>

1. The number of days past due is above 90 days (14 days in the case of banks) and the overdue amount exceeds PLN 3 000.
2. The Bank has sold exposures with a significant economic loss related to the decrease of the debtor creditworthiness.
3. The Bank performed enforced restructuring of the exposure, which resulted in the change of the loan/transaction service schedule due to the lack of possibility of the obligor to meet his obligations under loan/transaction agreement, as initially stipulated, which resulted in:
   a) remitting part of these obligations, or
   b) postponing the repayment of the substantial part of the principal, interest or (if it refers to) commission; provided that the lack of approval for restructuring would cause more than 90 calendar days delay in repayment of substantial part of the obligation.
4. Filing by the Bank, the parent or subsidiary entity of the Bank a bankruptcy motion against debtor or filing similar motion in respect of credit obligations of the debtor towards the Bank, the parent or subsidiary entity of the Bank.
5. Bankruptcy of debtor or acquiring by him a similar legal protection resulting in his evasion of or delay in repayment of credit obligations towards the Bank, the parent or subsidiary entity of the Bank.
6. Termination of part or whole credit agreement by the Bank and the beginning of restructuring/collection procedures.
7. Client's fraud.

<u>The list of required conditions for indefinite loss events is prepared separately for each following entity type:</u>

a) governments and central banks,
b) banks,
c) corporations, including specialised lending,
d) local government units,
e) insurers,
f) pension fund managing companies, investment fund managing companies.

Defining separately the conditions for indefinite loss events for particular types of entities aims at reflecting specificity of particular types of entities in identification of loss events.

In order to assess if the impairment loss has occurred, identification of credit exposures with premises for impairment is carried out. Subsequently the comparison of the gross balance sheet credit exposure with the value of estimated future cash flows discounted at the original effective interest rate is carried out, which leads to the conclusion whether the impairment loss has occurred. If the discounted value of future cash flow is higher than the gross balance sheet value, the impairment charge is not recognised.

In case of specific situation, when the future cash flows are clearly dependent on individual events (based on discrete metric), the Bank estimates the probability of such events as the basis for calculating the impairment charge.

Impairment triggers - retail portfolio

In the Bank in Poland, a debtor-oriented approach, including all exposures of the customers, is applied for identification of impairment triggers. Transactional approach, in which each exposure is analyzed independently, is applied in the foreign branches.

The main impairment trigger is delay in repayment, which is identified in different ways depending on the abovementioned approach. In the retail banking in Poland, impairment trigger is identified, when the total of all customer's exposures past due more than 30 days exceeds PLN 500 and the eldest delay exceeds 90 days.

In the Czech and Slovak branches, an individual exposure is considered impaired when the overdue amount exceeds CZK 3 000 or EUR 120, respectively, while the delay is more than 90 days.

Additionally, the following events are treated as impairment triggers in all branches:

a. enforced restructuring of debt,
b. bankruptcy of debtor,
c. recognition of the contract as fraudulent,
d. sale of the exposure with considerable economic loss,
e. uncollectable status of debt,
f. payout of low downpayment insurance by the insurance company.

Calculation of impairment losses and provisions - corporate portfolio

The intranet application IMPAIRMENT-KORPO is a tool used to calculate impairment losses for impaired exposures granted to corporate customers and banks. The classification of customers to default portfolio and calculation of impairment write-off is as follows:

a) identifying impairment indicator on individual basis (loss events) and if they exist, classifying a customer to a default category;

b) assessing estimated future cash flows both from collateral and from repayments by a customer;

c) calculating impairment losses taking into account the current amount of estimated future recovery discounted at the effective interest rate;

d) booking of impairment losses and provisions.

In the case of customers with evidence for impairment, a comparison of the carrying value of the gross credit exposure with the value of estimated future cash flows, discounted at the original effective interest rate is made. An impairment is recognized when the discounted value of future cash flows is lower than the gross carrying amount. This results in the impairment charge for balance sheet credit exposure and/or provision for off-balance sheet credit exposure.

In the case of exposures for which the discounted value of future cash flows is higher than the gross carrying amount, impairment is not recognized and the exposure is classified to the IBNR (Incurred But Not Reported loss) portfolio, covered by a group provision. IBNR group charge for this portfolio is created in the amount of 5% of the gross carrying amount.

Calculation of IBNR provision for portfolio with no evidence for impairment - corporate portfolio

The amount of provision is an estimate of incurred loss and is assumed at the expected level of exposure at the impairment date, considering the book value of loss (in percentage terms) and the probability of default.

The probability of disclosure of a loss is modelled using logistic regression based on financial indicators and qualitative data on financed entity. The model is calibrated on the Bank's internal data, comprising a several years' period of observation of the corporate portfolio. On the basis of the monitoring period existing in the Bank, it was estimated that 6-8 months (depending on the size of the company) is the average period between the loss event occurrence and the possibility of its identification by the Bank (loss identification period "LIP"). Therefore, the Bank performs calculations on the basis of 6-8-month horizon for probability of default obtained via scaling the original 12-month PD-rating coming from the corporate PD model. The value of incurred loss is assumed at the level of the expected value of exposure in case of default (EAD) multiplied by PD and LGD.

In the opinion of the Management Board, the profile of the corporate rating system as a model sensitive to changes in economic cycle (Point-in-Time) as well as recognition of interim financial data and warning indicators as rating assessment drivers should ensure adequate reflection of the amounts of the calculated portfolio provision to the changing market environment.

Calculation of impairment losses and provisions - retail portfolio

In the retail area, impairment charges and provisions are determined for the portfolio exposure both with evidence for impairment and with no evidence for impairment. For the purpose of measuring impairment in the retail area, the Bank applies two approaches for determining credit risk parameters. In the case of the Polish market, the Bank applies parameters analogous to those derived from the AIRB methodology (advanced internal ratings based approach for calculating capital requirement for credit risk), after necessary adjustments aimed at elimination of differences between AIRB and IAS 39. In the case of the Czech and Slovak markets, risk parameters are estimated based on migration matrices.

12-month loss identification period (LIP) based on the current internal data on banking processes and abilities to detect the incurred losses is applied in the retail area to estimate the probability of default.

Assets measured at fair value available for sale

At the end of the reporting period the Bank estimates whether there is an objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity instruments classified as assets available for sale, a significant or prolonged decline in the fair value of the security below its cost resulting from higher credit risk is considered when determining whether the assets are impaired. If such kind of evidence concerning available for sale financial assets exists, the cumulative loss – determined as the difference between the cost of acquisition and the current fair value – is removed from other comprehensive income and recognized in the income statement. The above indicated difference should be reduced by the impairment concerning the given asset which was previously recognized in the income statement. Impairment losses concerning equity instruments recorded in the income statement are not reversed through the income statement, but through other comprehensive income. If the fair value of a debt instrument classified as available for sale increases in a subsequent period, and such increase can be objectively related to an event occurring after the recording of the impairment loss in the income statement, then the respective impairment loss is reversed in the income statement.

Renegotiated agreements

The Bank considers renegotiations on contractual terms of loans and advances as impairment indicator unless the renegotiation was not due to the situation of the debtor but had been carried out on normal business terms. In such a case the Bank makes an assessment whether the impairment of such loans and advances should be recognised on either individual or group basis.

3.8. Financial guarantee contracts

The financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

When a financial guarantee contract is recognized initially, it is measured at the fair value. After initial recognition, an issuer of such a contract measures it at the higher of:

- the amount determined in accordance with IAS 37 "*Provisions, Contingent Liabilities and Contingent Assets*", and
- the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with IAS 18 "*Revenue*".

3.9. Cash and cash equivalents

Cash and cash equivalents comprise items with maturities of up to three months from the date of their acquisition, including: cash in hand and cash held at the Central Bank with unlimited availability for disposal, treasury bills and other eligible bills, loans and advances to other banks, amounts due from other banks and government securities acquired for the purpose of short-term resale. Cash and cash equivalents are settled using amortised cost.

3.10. Sale and repurchase agreements

Repo and reverse-repo transactions are defined as selling and purchasing securities for which a commitment has been made to repurchase or resell them at a contractual date and for a specified contractual price and are recognized when the money is transferred.

Securities sold with a repurchase clause (repos/sell buy back) are reclassified in the financial statements as pledged assets if the entity receiving them has the contractual or customary right to sell or pledge them as collateral security. The liability towards the counterparty is recognized as amounts due to other banks, deposits from other banks, other deposits or amounts due to customers, depending on its nature. Securities purchased together with a resale clause (reverse repos/buy sell back) are recognized as loans and advances to other banks or other customers, depending on their nature.

When concluding a repo or reverse repo transaction, mBank sells or buys securities with a repurchase or resale clause specifying a contractual date and price. Such transactions are presented in the statement of financial position as financial assets held for trading or as investment financial assets, and also as liabilities in the case of "sell-buy-back" transactions and as receivables in the case of "buy-sell-back" transactions.

Securities borrowed by the Bank in the "buy sell back" transactions are not recognized in the financial statements, unless they are sold to third parties. In such case the purchase and sale transactions are recorded with a gain or a loss included in trading income. The obligation to return them is recorded at fair value as amounts due to customers. Securities borrowed under "buy-sell-back" transactions and then lent under "sell-buy-back" transactions are not recognized as financial assets.

As a result of "sell-buy-back" transactions concluded on securities held by the Bank, financial assets are transferred in such way that they do not qualify for derecognition. Thus, the Bank retains substantially all risks and rewards of ownership of the financial assets.

3.11. Derivative financial instruments and hedge accounting

Derivative financial instruments are recognized at fair value from the date of transaction. Fair value is determined based on prices of instruments listed on active markets, including recent market transactions, and on the basis of valuation techniques, including models based on discounted cash flows and options pricing models, depending on which method is appropriate in the particular case. All derivative instruments with a positive fair value are recognized in the statement of financial position as assets, those with a negative value as liabilities.

The best fair value indicator for a derivative instrument at the time of its initial recognition is the price of the transaction (i.e., the fair value of the paid or received consideration). If the fair value of the particular instrument may be determined by comparison with other current market transactions concerning the same instrument (not modified) or relying on valuation techniques based exclusively on market data that are available for observation, then the Bank recognises the respective gains or losses from the first day in accordance with the principles described under Note 3.12.

Embedded derivative instruments are treated as separate derivative instruments if the risks attached to them and their characteristics are not strictly linked to the risks and characteristics of the underlying contract and the underlying contract is not measured at fair value through the income statement. Embedded derivative instruments of this kind are measured at fair value and the changes in fair value are recognized in the income statement.

In accordance with IAS 39 AG 30: (i), there is no need to separate the prepayment option from the host debt instrument for the needs of financial statements, if the option's exercise price is approximately equal on each exercise date to the amortised cost of the host debt instrument. If the value of prepayment option was not to be closely related to the underlying debt instrument, the option should be separated and fair valued in the financial statements of the Bank; (ii), exercise price of a prepayment option reimburses the lender for an amount up to the approximate present value of lost interest for the remaining term of the host contract. Lost interest is the product of the principal amount prepaid multiplied by the interest rate differential. The interest rate differential is the excess of the effective interest rate of the host contract over the effective interest rate the entity would receive at the prepayment date if it reinvested the principal amount prepaid in a similar contract for the remaining term of the host contract.

The assessment of whether the call or put option is closely related to the host debt contract is made before separating the equity element of a host debt instrument in accordance with IAS 32.

The method of recognising the resulting fair value gain or loss depends on whether the given derivative instrument is designated as a hedging instrument, and if it is, it also depends on the nature of the hedged item. The Bank designates some derivative instruments either as (1) fair value hedges against a recognized asset or liability or against a binding contractual obligation (fair value hedge), or as (2) hedges against highly probable future cash flows attributable to a recognized asset or liability, or a forecasted transaction (cash flow hedge). Derivative instruments designated as hedges against positions maintained by the Bank are recorded by means of hedge accounting, subject to the fulfilment of the criteria specified in IAS 39:

- at the inception of the hedge there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instruments effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk;
- the hedge is expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship;

- for cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect profit or loss;
- the effectiveness of the hedge can be reliably measured, i.e. the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured;
- the hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.

The Bank documents the objectives of risk management and the strategy of concluding hedging transactions, as well as at the time of concluding the respective transactions, the relationship between the hedging instrument and the hedged item. The Bank also documents its own assessment of the effectiveness of fair value hedging and cash flow hedging transactions, measured both prospectively and retrospectively from the time of their designation and throughout the period of duration of the hedging relationship between the hedging instrument and the hedged item.

Due to the split of derivatives classified into banking book and into trading book, the Bank applies a different approach to the presentation of interest income/expense for each of these groups of derivatives that is described in Note 3.2 "Interest income and expenses". The remaining result from fair value measurement of derivatives is recognized in Net trading income.

Fair value hedges

Changes in the fair value of derivative instruments designated and qualifying as fair value hedges are recognized in the income statement together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

In case a hedge has ceased to fulfil the criteria of hedge accounting, the adjustment to the carrying value of the hedged item for which the effective interest method is used is amortised to the income statement over the period to maturity. The adjustment to the carrying amount of the hedged equity security remains in other comprehensive income until the disposal of the equity security.

Cash flow hedges

The effective part of the fair value changes of derivative instruments designated and qualifying as cash flow hedges is recognized in other comprehensive income. The gain or loss concerning the ineffective part is recognized in the income statement of the current period.

The amounts recognized in other comprehensive income are transferred to the income statement and recognized as income or cost of the same period in which the hedged item will affect the income statement (e.g., at the time when the forecast sale that is hedged takes place).

In case the hedging instrument has expired or has been sold, or the hedge has ceased to fulfil the criteria of hedge accounting, any aggregate gains or losses recognized at such time in other comprehensive income remain in other comprehensive income until the time of recognition in the income statement of the forecast transaction. When a forecast transaction is no longer expected to occur, the aggregate gains or losses recorded in other comprehensive income are immediately transferred to the income statement.

Derivative instruments not fulfilling the criteria of hedge accounting

Changes of the fair value of derivative instruments that do not meet the criteria of hedge accounting are recognized in the income statement of the current period.

The Bank holds the following derivative instruments in its portfolio:

Market risk instruments:

- Futures contracts for bonds, index futures
- Options for securities and for stock-market indices
- Options for futures contracts
- Forward transactions for securities
- Commodity swaps

Interest rate risk instruments:

- Forward Rate Agreement (FRA)
- Interest Rate Swap (IRS), Overnight Index Swap (OIS)
- Interest Rate Options

Foreign exchange risk instruments:

- Currency forwards, fx swap, fx forward
- Cross Currency Interest Rate Swap (CIRS)
- Currency options.

3.12. Gains and losses on initial recognition

The best evidence of fair value of a financial instrument at initial recognition is the transaction price (i.e., the fair value of the payment given or received), unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.

The transaction for which the fair value determined using a valuation model (where inputs are both observable and non-observable data) and the transaction price differ, the initial recognition is at the transaction price. The Bank assumes that the transaction price is the best indicator of fair value, although the value obtained from the valuation model may differ. The difference between the transaction price and the model value, commonly referred to as "day one profit and loss", is amortised over the period of time.

The timing of recognition of deferred day one profit and loss is determined individually. It is either amortised over the life of the transaction, deferred until the instrument's fair value can be determined using market observable date, or realised through settlement. The financial instrument is subsequently measured at fair value, adjusted for the deferred day one profit and loss. Subsequent changes in fair value are recognized immediately in the income statement without reversal of deferred day one profits and losses.

3.13. Borrowings and deposits taken

Borrowings and deposits taken are initially recognized at fair value reduced by the incurred transaction costs. After the initial recognition, borrowings are recorded at adjusted cost of acquisition (amortised cost using the effective interest method). Any differences between the amount received (reduced by transaction costs) and the redemption value are recognized in the income statement over the period of duration of the respective agreements according to the effective interest rate method.

3.14. Intangible assets

The Bank measures intangible assets initially at cost. After initial recognition, intangible assets are recognized at their cost of acquisition adjusted by the costs of improvement (rearrangement, development, reconstruction or modernisation) less any accumulated amortization and any accumulated impairment losses. Amortization is accrued by the straight line method taking into account the expected period of economic useful life of the respective intangible assets.

<u>Computer software</u>

Purchased computer software licences are capitalised in the amount of costs incurred for the purchase and adaptation for use of specific computer software. These costs are amortised on the basis of the expected useful life of the software (2-11 years). Expenses attached to the maintenance of computer software are expensed when incurred. Expenses directly linked to the development of identifiable and unique proprietary computer programmes controlled by the Bank, which are likely to generate economic benefits in excess of such costs expected to be gained over a period exceeding one year, are recognized as intangible assets. Direct costs comprise personnel expenses directly related to the software.

Capitalised costs attached to the development of software are amortised over the period of their estimated useful life (2-11 years).

Computer software directly connected with the functioning of specific information technology hardware is recognized as "Tangible fixed assets".

<u>Development costs</u>

The Bank identifies development costs as intangible asset as the asset will generate probable future economic benefits and fulfil the following requirements described in IAS 38, i.e., the Bank has the intention and technical feasibility to complete and to use the intangible asset, the availability of adequate technical, financial and other resources to complete and to use the intangible asset and the ability to measure reliably the expenditure attributable to the intangible asset during its development.

"Development costs" useful lives are finite and the amortization period does not exceed 3 years. Amortization rates are adjusted to the period of economic utilisation. The Bank shows separately additions from internal development and separately those acquired through business combinations.

Development expenditure comprises all expenditure that is directly attributable to research and development activities.

Intangible assets are tested in terms of possible impairment always after the occurrence of events or change of circumstances indicating that their carrying value in the statement of financial position might not be possible to be recovered.

3.15. Tangible fixed assets

Tangible fixed assets are carried at historical cost reduced by accumulated depreciation and accumulated impairment losses. Historical cost takes into account the expenses directly attached to the acquisition of the respective assets.

Subsequent costs are included in the asset's carrying amount or are recognized as a separate asset, as appropriate, only where it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. Any other expenses incurred on repairs and maintenance are expensed to the income statement in the reporting period in which they were incurred.

Land is not depreciated. Depreciation of other fixed assets is accounted for according to the straight line method in order to spread their initial value reduced by the residual value over the period of their useful life which is estimated as follows for the particular categories of fixed assets:

Buildings and structures	25-40 years,
Equipment	2-10 years,
Vehicles	5 years,
Information technology hardware	2-5 years,
Investments in third party fixed assets	10-40 years, no longer than the period of the lease contract,
Office equipment, furniture	5-10 years.

Land and buildings consist mainly of branch outlets and offices. Residual values, estimated useful life periods and depreciation method are verified at the end of the reporting period and adjusted accordingly as the need arises prospectively.

Bank assesses at the end of each reporting period whether there is any indication that tangible asset may be impaired. If any such indication exists, the Bank estimates the recoverable amount of the asset. Depreciable fixed assets are tested for impairment always whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The value of a fixed asset carried in the statement of financial position is reduced to the level of its recoverable value if the carrying value in the statement of financial position exceeds the estimated recoverable amount. The recoverable value is the higher of two amounts: the fair value of the fixed asset reduced by its selling costs and the value in use.

If it is not possible to estimate the recoverable amount of the individual asset, the Bank shall determine the recoverable amount of the cash-generating unit to which the asset belongs (cash-generating unit of the asset).

Gains and losses on account of the disposal of fixed assets are determined by comparing the proceeds from their sale against their carrying value in the statement of financial position and they are recognized in the income statement.

The carrying amount of tangible fixed assets is derecognized on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from the derecognition of tangible fixed assets are included in profit or loss when the item is derecognized. Gains are not classified as revenue.

3.16. Non-current assets held for sale and discontinued operations

The Bank classifies a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sale of such assets and its sale must be highly probable, i.e., the appropriate level of management must be committed to a plan to sell the asset, and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Non-current assets held for sale are priced at the lower of: carrying value and fair value less costs to sell. Assets classified in this category are not depreciated.

When criteria for classification to non-current assets held for sale are not met, the Bank ceases to classify the assets as held for sale and reclassifies them into appropriate category of assets. The Bank measures a non-current asset that ceases to be classified as held for sale (or ceases to be included in a disposal group classified as held for sale) at the lower of:

- its carrying amount at a date before the asset (or disposal group) was classified as held for sale, adjusted for any depreciation, amortization or revaluations that would have been recognized had the asset (or disposal group) not been classified as held for sale, and
- its recoverable amount at the date of the subsequent decision not to sell.

Discontinued operations are a component of the Bank that either has been disposed of or is classified as held for sale and represents a separate major line of business or geographical area of operation or is a subsidiary acquired exclusively with a view to resale.

The classification to this category takes places at the moment of sale or when the operation meets criteria of the operation classified as held for sale, if this moment took place previously. Disposal group which is to be taken out of usage may also be classified as discontinued operation.

3.17. Deferred income tax

The Bank creates a deferred income tax on the temporary difference arising between the carrying amount of an asset or liability in the statement of financial position and its tax base. A taxable net difference is recognized in liabilities as "Provisions for deferred income tax". A deductible net difference is recognized under 'Deferred income tax assets'. Any change in the balance of the deferred tax assets and liabilities in relation to the previous accounting period is recorded under the item "Income Tax". The balance sheet method is applied for the calculation of the deferred corporate income tax.

Liabilities or assets for deferred corporate income tax are recognized in their full amount according to the balance sheet method in connection with the existence of temporary differences between the tax value of assets and liabilities and their carrying value. Such liabilities or assets are determined by application of the tax rates in force by virtue of law or of actual obligations at the end of the reporting period. According to expectations such tax rates applied will be in force at the time of realisation of the assets or settlement of the liabilities for deferred corporate income tax.

The main temporary differences arise on account of impairment write-offs recognized in relation to the loss of value of credits and granted guarantees of repayment of loans, amortization of fixed assets and intangible assets, finance leases treated as operating leases for tax purposes, revaluation of certain financial assets and liabilities, including contracts concerning derivative instruments and forward transactions, provisions for retirement benefits and other benefits following the period of employment, and also deductible tax losses.

The Bank reviews the carrying amount of a deferred tax assets at the end of each reporting period. The Bank reduces the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Deferred income tax assets are recognized to the extent it is probable that there will be sufficient taxable profits to allow them to recover. If the forecast amount of income determined for tax purposes does not allow the realisation of the asset for deferred income tax in full or in part, such an asset is recognized to the respective amount, accordingly. The above described principle also applies to tax losses recorded as part of the deferred tax asset.

The Bank presents the deferred income tax assets and liabilities netted against each other for each country separately where the Bank conducts its business and are obliged to settle corporate income tax. Such assets and provisions may be netted against each other if the Bank possesses the legal rights allowing it to simultaneously account for them when calculating the amount of the tax liability.

The Bank discloses separately the amount of negative temporary differences (mainly on account of unused tax losses or unutilised tax allowances) in connection with which the deferred income tax asset was not recognized in the statement of financial position, and also the amount of temporary differences attached to investments in subsidiaries and associates for which no deferred income tax provision has been formed.

Deferred income tax for the Bank is provided on assets or liabilities due to temporary differences arising from investments in subsidiaries and associates, except where, on the basis of any probable evidence, the timing of the reversal of the temporary difference is controlled by the Bank and it is possible that the difference will not reverse in the foreseeable future.

Deferred income tax on account of revaluation of available for sale investments and of revaluation of cash flow hedging transactions is accounted for in the same way as any revaluation, directly in other comprehensive income, and it is subsequently transferred to the income statement when the respective investment or hedged item affects the income statement.

3.18. Assets repossessed for debt

Assets repossessed for debt represents financial and non-financial assets acquired by the Bank in settlement of overdue loans. The assets are initially recognized at fair value when acquired and included in premises and equipment, financial assets or other assets depending on their nature and the Bank's intention in respect of recovery of these assets. In case the fair value of repossessed collateral exceeds the receivable from the debtor, the difference constitutes a liability toward the debtor.

Repossessed assets are subsequently measured and accounted for in accordance with the accounting policies relevant for these categories of assets.

3.19. Prepayments, accruals and deferred income

Prepayments are recorded if the respective expenses concern the months succeeding the month in which they were incurred. Prepayments are presented in the statement of financial position under "Other assets".

Accruals include costs of supplies delivered to the Bank but not yet resulting in its payable liabilities. Deferred income includes received amounts of future benefits. Accruals and deferred income are presented in the statement of financial position under the item "Other liabilities".

3.20. Leasing

mBank S.A. as a Lessee

The leases entered into by the Bank are primarily operating leases. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. Title may or may not eventually be transferred.

A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

The Bank determines whether an arrangement is, or contains, a lease based on the substance of the arrangement and assessment of whether fulfilment of the arrangement is dependent on the use of a specific asset and the arrangement conveys a right to use the asset.

3.21. Provisions

The value of provisions for contingent liabilities such as unutilised guarantees and (import) letters of credit, as well as for unutilised irreversible unconditionally granted credit limits, is measured in compliance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

According to IAS 37, provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events, it is more likely that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated.

3.22. Post-employment employee benefits and other employee benefits

Post-employment employee benefits

The Bank forms provisions against future liabilities on account of post-employment benefits determined on the basis of an estimation of liabilities of that type, using an actuarial model. The Bank uses a principle of recognition of actuarial gains or losses from the measurement of post-employment benefits related to changes in actuarial assumptions in other comprehensive income that will not be reclassified to the income statement. The Bank recognizes service cost and net interest on the net defined benefit liability in the "Overhead cost" and in other interest expenses, respectively.

Equity-settled share-based payment transactions

The Bank runs programmes of remuneration based on and settled in own shares as well as based on shares of the ultimate parent of the Bank and settled in cash. Equity-settled share-based payment transactions are accounted for in compliance with IFRS 2 Share-based Payment. In case of the part of the programme settled in shares, the fair value of the service rendered by employees in return for options and shares granted increases the costs of the respective period corresponding to own equity. The total amount which needs to be expensed over the period when the outstanding rights of the employees for their options and shares to become exercisable are vested is determined on the basis of the fair value of the granted options and shares. There are no market vesting conditions that shall be taken into account when estimating the fair value of share options and shares at the measurement date. Non-market vesting conditions are not taken into account when estimating the fair value of share options and shares but they are taken into account through adjustment on the number of equity instruments. At the end of each reporting period, the Bank revises its estimates of the number of options and shares that are expected to become exercised. In accordance with IFRS 2 it is not necessary to recognise the change in fair value of the share-based payment over the term of the programmes.

Cash-settled share-based payment transactions

In case of the part of the programme based on cash-settled share-based payments based on shares of the ultimate parent of the Bank, the fair value of the service rendered by employees in return for right to options/share appreciation rights increases the costs of the respective period, corresponding to liabilities. Until the liability related to the cash-settled share-based payments transactions is settled, the Bank measures the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognized in profit or loss for the period.

3.23. Equity

Equity consists of Bank's capital and own funds created in compliance with the respective provisions of the law, i.e., the appropriate legislative acts, the By-laws or the Company Articles of Association.

Registered share capital

Share capital is presented at its nominal value, in accordance with the By-laws and with the entry in the business register.

- Own shares

In the case of acquisition of shares in the Bank by the Bank the amount paid reduces the value of equity as own shares until the time when they are cancelled. In the case of sale or reallocation of such shares, the payment received in return is recognized in equity.

Share premium

Share premium is formed from the share premium obtained from the issue of shares reduced by the attached direct costs incurred with that issue.

Costs directly connected with the issue of new shares and options reduce the proceeds from the issue recognized in equity.

Moreover, share premium takes into account the settlements related to incentive programs based on Bank's shares.

Retained earnings

Retained earnings include:

- other supplementary capital,
- other reserve capital,
- general risk reserve,
- undistributed profit for the previous years,
- net profit (loss) for the current year.

Other supplementary capital, other reserve capital and general risk reserve are formed from allocations of profit and they are assigned to purposes specified in the By-laws or other regulations of the law.

Moreover, other reserve capital comprises valuation of incentive programs based on Bank's shares.

Dividends for a given year, which have been approved by the General Meeting but not distributed at the end of the reporting period, are shown under the liabilities on account of dividends payable under the item "Other liabilities".

Other components of equity

Other components of equity result from:

- valuation of available for sale financial instruments,
- exchange differences on translation of foreign operations.
- actuarial gains and losses relating to post-employment employee benefits,
- valuation of derivative financial instruments held for cash flow hedging in relation to the effective portion of the hedge.

3.24. Valuation of items denominated in foreign currencies

Functional currency and presentation currency

The items contained in financial reports of particular entities of the Bank, including foreign branches of the Bank, are valued in the currency of the basic economic environment in which the given entity conducts its business activities ("functional currency"). The financial statements are presented in the Polish zloty, which is the presentation currency of the Bank.

Transactions and balances

Transactions denominated in foreign currencies are converted to the functional currency at the exchange rate in force at the transaction date. Foreign exchange gains and losses on such transactions as well as balance sheet revaluation of monetary assets and liabilities denominated in foreign currency are recognized in the income statement.

Foreign exchange differences arising on account of such monetary items as financial assets measured at fair value through the income statement are recognized under gains or losses arising in connection with changes of fair value. Foreign exchange differences on account of such monetary assets as equity instruments classified as available for sale financial assets are recognized under other comprehensive income.

At the end of each reporting period non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction, and non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was measured.

When a gain or loss on a non-monetary item is recognized in other comprehensive income, any exchange component of that gain or loss is recognized in other comprehensive income. Conversely, when a gain or loss on a non-monetary item is recognized in profit or loss, any exchange component of that gain or loss is recognized in profit or loss.

Changes in fair value of monetary items available for sale cover foreign exchange differences arising from valuation at amortised cost, which are recognized in the income statement.

Items of the statement of financial position of foreign branches are converted from functional currency to the presentation currency with the application of the average exchange rate as at the end of the reporting period. Income statement items of these entities are converted to presentation currency with the application of the average exchange rates quoted by the National Bank of Poland on the last day of each month of the reporting period. Foreign exchange differences so arisen are recognized in other comprehensive income.

3.25. Trust and fiduciary activities

mBank S.A. operates trust and fiduciary activities including domestic and foreign securities and services provided to investment and pension funds.

These assets have not been presented in these financial statements as they do not belong to the Bank.

3.26. New standards, interpretations and amendments to published standards

These financial statements include the requirements of all the International Accounting Standards and the International Financial Reporting Standards endorsed by the European Union, and the related with them interpretations which have been endorsed and are binding for annual periods starting on 1 January 2017.

These financial statements do not include standards and interpretations listed below which await endorsement of the European Union or which have been endorsed by the European Union but entered or will enter into force after the balance sheet date.

In relation to standards and interpretations that have been approved by the European Union, but entered or will enter into force after the balance sheet date, the Bank did not use the possibility of early application.

<u>Published Standards and Interpretations which have been issued but are not yet binding or have not been adopted early</u>

Standards and interpretations approved by the European Union:

- IFRS 9, *Financial Instruments*, published by the International Accounting Standards Board on 24 July 2014, approved by European Union on 22 November 2016, represents the final version of the standard, replaces earlier versions of IFRS 9 and completes the International Accounting Standards Board's project to replace IAS 39 *Financial Instruments*: *Recognition and Measurement*. The new standard addresses classification and measurement of financial assets and financial liabilities, impairment methodology and hedge accounting. IFRS 9 does not include macro hedge accounting, which is a separate project of International Accounting Standards Board. The Bank continues to apply IAS 39 accounting for macro hedges. The new standard is effective for annual periods beginning on or after 1 January 2018.

  IFRS 9 introduces a new impairment model based on the concept of „expected credit losses", changes to the rules of classification and measurement of financial instruments (particularly of financial assets) as well as a new approach towards hedge accounting.

  In June 2015 the Bank launched an IFRS 9 implementation project which actively engages the Bank's and Group companies organizational units responsible for accounting, financial reporting and risk management as well as business, IT and organisation department.

The Bank is currently implementing necessary solutions for the particular requirements based on the results of gap analysis and defined methodological assumptions. The Bank intends to complete the project by December 2017.

As at 30 June 2017, it is not possible to estimate the overall impact of IFRS 9 implementation on the Bank's financial situation and own funds. In the Bank's opinion, disclosing quantitative data that would not reflect the potential impact of all aspects of IFRS 9 on the Bank's financial situation and own funds could have a negative impact on the informative value of the financial statement for its users. Nevertheless, taking into account the current regulations, changes in the requirements regarding classification and measurement and impairment of financial assets, would have moderately negative impact on the Bank's own funds. However, the impact of changes can be reliably estimated only in the consecutive periods.

Information about the impact of adopting the standard on the presentation and valuation of these instruments in the financial statements was presented under Note 2.26 of the mBank Financial Statements for the year 2016 published on 1 March 2017.

- IFRS 15, *Revenue from Contracts with Customers*, published by the International Accounting Standards Board on 28 May 2014, approved by European Union on 22 September 2016, binding for annual periods beginning on or after 1 January 2018.

  Amendments to IFRS 15 were published by International Accounting Standards Board on 11 September 2015, approved by European Union on 22 September 2016, binding for annual periods starting on or after 1 January 2018.

  IFRS 15 introduces new principles of revenue recognition. The core principle is that an entity recognizes revenue to depict the transfer of promised goods and services to customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. According to a new IFRS 15 revenue is recognized when the customer obtains control of these goods or services. Depending on the fulfilment of certain conditions revenues are either recognized over time throughout the duration of the contract if a performance obligation is satisfied over time, or at a point in time when the customer obtains control of these goods or services.

  The Bank is of the opinion that the application of the amended standard will have no significant impact on the financial statements in the period of its initial application.

Standards and interpretations not yet approved by the European Union:

- Amendments to IAS 12, *Recognition of Deferred Tax Assets for Unrealised Losses*, published by the International Accounting Standards Board on 19 January 2016, binding for annual periods starting on or after 1 January 2017.

  The Bank is of the opinion that the application of the amended standard will have no significant impact on the financial statements in the period of its initial application.

- Amendments to IAS 7, *Disclosure Initiative*, published by the International Accounting Standards Board on 29 January 2016, binding for annual periods starting on or after 1 January 2017.

  The Bank is of the opinion that the application of the amended standard will have no significant impact on the financial statements in the period of its initial application.

- Annual Improvements to IFRS Standards 2014-2016 Cycle, changing 3 standards (IFRS 1, IFRS 12, IAS 28), published by International Accounting Standards Board on 8 December 2016, binding for annuals periods starting on or after 1 January 2017 or on or after 1 January 2018.

  The Bank is of the opinion that the application of the amended standards will have no significant impact on the financial statements in the period of its initial application.

- Amendments to IFRS 15, *Clarifications to IFRS 15 Revenue from Contracts with Customers*, published by International Accounting Standards Board on 12 April 2016, binding for annuals periods starting on or after 1 January 2018.

  Amendments to IFRS 15 clarify the guidance on the identification of performance obligation, the accounting of licensing of intellectual property and principal versus agent considerations in the context of presenting income on gross or net basis. The practical expedients on transition when applying a new standard were also added.

  The Bank is of the opinion that the application of the standard will have no significant impact on the financial statements in the period of its initial application.

- IFRS 16, *Leases*, published by the International Accounting Standards Board on 13 January 2016, binding for annual periods starting on or after 1 January 2019.

IFRS 16 introduces new principles for the recognition of leases. The main amendment is the elimination of the classification of leases as either operating leases or finance leases and instead, the introduction of a single lessee accounting model. Applying a single accounting model, a lessee is required to recognize lease assets and corresponding liability in the statement of financial position, except for leases with a term of less than 12 months and leases with underlying asset of low value. A lessee is also required to recognize depreciation costs of lease asset separately from interest costs on lease liabilities in the income statement.

IFRS 16 substantially carries forward the lessor accounting approach. It means that lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

The Bank is of the opinion that the application of a new standard will have an impact on the recognition, presentation, measurement and disclosure of lease assets under operating lease and corresponding liability in the financial statements of the Bank as lessee. The Bank is of the opinion that the application of a new standard will have no significant impact on recognition of previous finance lease in the financial statements of the Bank.

- Amendments to IFRS 2, *Classification and measurement of share-based payment transactions*, published by International Accounting Standards Board on 20 June 2016, binding for annuals periods starting on or after 1 January 2018.

  The Bank is of the opinion that the application of the amended standard will have no significant impact on the financial statements in the period of its initial application.

- Amendments to IFRS 4, *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*, published by International Accounting Standards Board on 12 September 2016, binding for annual periods starting on or after 1 January 2018.

  The Bank is of the opinion that the application of the amended standard will have no significant impact on the financial statements in the period of its initial application.

- Amendments to IAS 40, *Transfers of Investment Property*, published by International Accounting Standards Board on 8 December 2016, binding for annual periods starting on or after 1 January 2018.

  The Bank is of the opinion that the application of the amended standard will have no significant impact on the financial statements in the period of its initial application.

- IFRIC Interpretation 22 *Foreign Currency Transactions and Advance Consideration*, published by International Accounting Standards Board on 8 December 2016, binding for annuals periods starting on or after 1 January 2018.

  The Bank is of the opinion that the application of interpretation will have no significant impact on the financial statements in the period of its initial application.

- IFRIC Interpretation 23 *Uncertainty over Income Tax Treatments*, published by International Accounting Standards Board on 7 June 2017, binding for annuals periods starting on or after 1 January 2019.

  The Bank is of the opinion that the application of interpretation will have no significant impact on the financial statements in the period of its initial application.

- IFRS 17, *Insurance contracts*, published by International Accounting Standards Board on 18 May 2017, binding for annuals periods starting on or after 1 January 2021.

  The Bank is of the opinion that the application of a new standard will have no significant impact on the financial statements in the period of its initial application.

3.27. Comparative data

The data as at 31 December 2016 and as at 30 June 2016 are comparable with the current accounting period data and therefore has not been adjusted.

3.28. Business segments

Data concerning business segments was presented in the Condensed Consolidated Financial Statements of mBank S.A. Group for the first half of 2017, prepared in compliance with the International Financial Reporting Standards.

4. Major estimates and judgments made in connection with the application of accounting policy principles

The Bank applies estimates and adopts assumptions which impact the values of assets and liabilities presented in the subsequent period. Estimates and assumptions, which are continuously subject to assessment, rely on historical experience and other factors, including expectations concerning future events, which seem justified under the given circumstances.

Impairment of loans and advances

The Bank reviews its loan portfolio in terms of possible impairments at least once per quarter. In order to determine whether any impairment loss should be recognized in the income statement, the Bank assesses whether any evidence exists that would indicate some measurable reduction of estimated future cash flows attached to the loan portfolio. The methodology and the assumptions, on the basis of which the estimated cash flow amounts and their anticipated timing are determined, are regularly verified. If the current value of estimated cash flows for portfolio of loans and advances which are impaired, change by +/-10%, the estimated loans and advances impairment would either decrease by PLN 27.6 million or increase by PLN 29.8 million respectively. This estimation was performed for portfolio of loans and advances individually assessed for impairment on the basis of future cash flows due to repayments and recovery from collateral.

The rules of determining write-downs and provisions for impairment of credit exposures have been described under Note 3.7.

Fair value of derivatives and other financial instruments

The fair value of financial instruments not listed on active markets is determined by applying valuation techniques. All the models are approved prior to being applied and they are also calibrated in order to assure that the obtained results indeed reflect the actual data and comparable market prices. As far as possible, observable market data originating from an active market are used in the models. Methods for determining the fair value of financial instruments are described in Note 3.16 of the mBank S.A. IFRS Financial Statements 2016 published on 1 March 2017. If the current value of interest rates used for valuation change by +/- 1 bp, the fair value of financial instruments would either decrease or increase by PLN 9.1 million respectively.

Impairment of available for sale investments

The Bank reviews its debt securities classified as available for sale investments at each reporting date to assess whether they are impaired. This requires similar judgment as applied to the individual assessment of loans and advances. The Bank also records impairment charges on available for sale equity investments when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is "significant" or "prolonged" decline in value requires professional judgment. In making this judgment, the Bank evaluates, among other factors, historical share price movements and duration and extent to which the fair value of an investment is less than its cost.

Deferred tax assets

Deferred tax assets are recognized in respect of tax losses to the extent that it is probable that future taxable profit will be available against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits.

Revenue and expenses from sale of insurance products bundled with loans

Revenue and expenses from sale of insurance products bundled with loans are split into interest income and fee and commission income based on the relative fair value analysis of each of these products.

The remuneration included in fee and commission income is recognized partly as upfront income and partly including deferring over time based on the analysis of the stage of completion of the service.

Now, the Bank leads in case of insurance policies bundled with loans to upfront recognition less than 10% of bancassurance income associated with cash and car loans and 0% to approximately 25% of bancassurance income associated with mortgage loans. Recognition of the remaining part of the income is spread over the economic life of the associated loans. Expenses directly linked to the sale of insurance products are recognized using the same pattern.

Liabilities due to post-employment employee benefits

The costs of post-employment employee benefits are determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, future salary increases, mortality rates and other factors. Due to the long–term nature of these liabilities, such estimates are subject to significant uncertainty.

Leasing classification

The Bank makes judgement classifying lease agreements as finance lease or operating lease based on the economic substance of the transaction based on professional judgment whether substantially all the risk and rewards incidental to ownership of an asset were transferred or not.

5. Selected explanatory information

5.1. Compliance with international financial reporting standards

The presented condensed financial statements for the first half of 2017 fulfils the requirements of the International Accounting Standard (IAS) 34 "Interim Financial Reporting" relating to interim financial reports.

5.2. Consistency of accounting principles and calculation methods applied to the drafting of the half year report and the last annual financial statements

A detailed description of the accounting policy principles of the Bank is presented in Note 3 and 4 of these condensed financial statements. The accounting policies were applied by the Bank consistently over all periods presented in the financial statements.

In addition, selected explanatory information contain additional information in accordance with the Regulation of the Minister of Finance dated on 19 February 2009 regarding the current and periodic information published by the issuers of securities and the conditions for recognising information required by laws of a non-member state (Journal of Laws No. 33, item 259 with further amendments) as the equivalent.

5.3. Seasonal or cyclical nature of the business

The business operations of the Bank do not involve significant events that would be subject to seasonal or cyclical variations.

5.4. Nature and values of items affecting assets, liabilities, equity, net profit/(loss) or cash flows, which are extraordinary in terms of their nature, magnitude or exerted impact

- Costs of the contribution to the Resolution Fund for the year 2017

In accordance with the Act of 10 June 2016 on the Bank Guarantee Fund (BFG), Deposit Guarantee Scheme and Resolution, and in connection with the letter from the BGF dated on 19 January 2017 addressed to the Polish Banks Association, in the first quarter of 2017 the Bank recognised in its income statement the amount of PLN 113 223 thousand, representing the full-year costs of the contribution to the resolution fund for the year 2017.

- Act on tax on certain financial institutions

On 15 January 2016 the Polish Parliament adopted the "Act on tax on certain financial institutions". The Act came into force on 1 February 2016.

The Act regulates the taxation of the assets of certain financial institutions. In the case of banks, the tax base is the excess of the total value of assets, resulting from the trial balance determined on the basis of the general ledger records as of the last day of the month in accordance with the accounting standards applied by banks, above the amount of PLN 4 billion, reduced by the value of own funds and treasury securities. The tax rate introduced by the Act is 0.0366% of the tax base per month. The cost of tax on certain financial institutions included in the results and equity of the Bank for the six months of 2017 amounted to PLN 170 860 thousand.

5.5. Nature and amounts of changes in estimate values of items, which were presented in previous interim periods of the current reporting year, or changes of accounting estimates indicated in prior reporting years, if they bear a substantial impact upon the current interim period

In the first half of 2017, events as indicated above did not occur in the Bank.

5.6. Issues, redemption and repayment of non-equity and equity securities

On 8 March 2017, the Bank repurchased subordinated bonds amounting to CHF 400 000 thousand (PLN 1 611 840 thousand at the average exchange rate of the National Bank of Poland as at 8 March 2017), issued on 8 March 2007, and acquired by Commerzbank AG.

5.7. Dividends paid (or declared) altogether or calculated per share, broken down by ordinary shares and other shares

On 30 March 2017, the 30th Ordinary General Meeting of mBank S.A., adopted the resolution on division of the profit for the year 2016 which does not provide for the payment of dividend for the year 2016.

5.8. Income and profit by business segment

Income and profit by business segment within the Bank are presented in Note 4 of the condensed consolidated financial statements for the first half on 2017.

5.9. Significant events after the end of the first half of 2017, which are not reflected in the financial statements

Events as indicated above did not occur in the Bank.

5.10. Effect of changes in the structure of the entity in the first half of 2017, including business combinations, acquisitions or disposal of subsidiaries, long-term investments, restructuring, and discontinuation of business activities

- On 2 June 2017, mBank S.A. signed a preliminary conditional agreement on the sale of mLocum S.A. shares to Archicom S.A. According to the agreement, mBank S.A. sells all shares held, representing 79.99% of the share capital of mLocum S.A. in two tranches.

  Upon conditions fulfilment (approval of the President of the Office of Competition and Consumer Protection (UOKiK), conclusion of guarantee agreement and registered pledge agreement between mBank S.A. and DKR Investment Sp. z o.o.- majority shareholder of Archicom S.A.), 14 120 880 shares, representing 51% of the share capital of mLocum S.A., will be sold. Sale of the remaining 8 026 120 shares representing 28.99% of the share capital of mLocum S.A. will take place no later than June 30, 2020.

  The sale transaction results from mBank Group's concentration on its core financial operations. Selling mLocum S.A. shares to a sector-leading company will allow to make better use of its potential and to achieve business objectives on the Polish market.

  In accordance with the principles described in Note 3.16 of these condensed financial statements the Bank classified mLocum S.A. shares as non-current assets (disposals groups) held for sale as at 30 June 2017.

- On 22 June 2017, the Future Tech Closed-End Investment Fund (the "Fund") was registered, in which mBank acquired 400 000 investment certificates accounting for 100% of the issue, worth in total PLN 221 200 thousand. As at 30 June 2017 Bank holds 100% of the certificates issued by the Fund, therefore mBank S.A. began the consolidation of the Fund starting from June 2017. Quercus Towarzystwo Funduszy Inwestycyjnych S.A. is the entity managing the Fund.

5.11. Changes in contingent liabilities

In the first half of 2017, there were no changes in contingent liabilities of credit nature, i.e., guarantees, letters of credit or unutilised loan amounts, other than resulting from current operating activities of the Bank. There was no single case of granting of guarantees or any other contingent liability of any material value for the Bank, except the transaction described below.

On 14 March 2017, the Bank's subsidiary mFinance France S.A. issued next tranche of Eurobonds with nominal value of CHF 200 000 thousand maturing on 28 March 2023. In this case, the guarantee was granted by the Bank on 14 March 2017 for the duration of the Programme, i.e. to 28 March 2023.

5.12. Write-offs of the value of inventories down to net realisable value and reversals of such write-offs

In the first half of 2017, events as indicated above did not occur in the Bank.

5.13. Revaluation write-offs on account of impairment of tangible fixed assets, intangible assets, or other assets as well as reversals of such write-offs

In the first half of 2017, events as indicated above did not occur in the Bank.

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5.14. Revaluation write-offs on account of impairment of financial assets

	Period from 01.01.2017 to 30.06.2017	Period from 01.01.2016 to 31.12.2016	Period from 01.01.2016 to 30.06.2016
Impairment of investments in subsidiaries	**-**	**(442)**	**(442)**
Impairment of debt investment securities	**(7 511)**	**-**	**-**
Impairment of equity investment securities	**(4 751)**	**(7 677)**	**(7 677)**
Net impairment losses on loans and advances, including:	**(184 701)**	**(312 195)**	**(167 947)**
Net impairment losses on amounts due from banks	(215)	(472)	629
Net impairment losses on loans and advances to customers	(190 736)	(314 228)	(170 978)
Net impairment losses on of contingent liabilities due to customers	6 250	2 505	2 402
Total impairment of financial assets	**(196 963)**	**(320 314)**	**(176 066)**

5.15. Reversals of provisions against restructuring costs

In the first half of 2017, events as indicated above did not occur in the Bank.

5.16. Acquisitions and disposals of tangible fixed asset items

In the first half of 2017, there were no material transactions of acquisition or disposal of any tangible fixed assets.

5.17. Material liabilities assumed on account of acquisition of tangible fixed assets

In the first half of 2017, events as indicated above did not occur in the Bank.

5.18. Information about changing the process (method) of measurement the fair value of financial instruments

In the first half of 2017, events as indicated above did not occur in the Bank.

5.19. Changes in the classification of financial assets due to changes of purpose or use of these assets

According to the information included under item 5.10 of the Selected explanatory information as at 30 June 2017, in relation to the sale agreement of mLocum S.A. shares the Bank classified mLocum as non-current assets (disposal groups) held for sale.

5.20. Corrections of errors from previous reporting periods

In the first half of 2017, there were no corrections of errors from previous reporting periods.

5.21. Default or infringement of a loan agreement or failure to initiate composition proceedings

In the first half of 2017, events as indicated above did not occur in the Bank.

5.22. Position of the management on the probability of performance of previously published profit/loss forecasts for the year in light of the results presented in the half year report compared to the forecast

mBank S.A. did not publish a performance forecast for the year 2017.

5.23. Registered share capital

The total number of ordinary shares as at 30 June 2017 was 42 285 676 shares (31 December 2016 - 42 280 127 shares, 30 June 2016 - 42 238 924 shares) at PLN 4 nominal value each. All issued shares were fully paid up.

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REGISTERED SHARE CAPITAL (THE STRUCTURE) AS AT 30 JUNE 2017						
Share type	**Type of preference**	**Type of restrictions**	**Number of shares**	**Series / issue value**	**Paid up**	**Year of registration**
ordinary bearer*	-	-	9 988 000	39 952 000	fully paid in cash	1986
ordinary registered*	-	-	12 000	48 000	fully paid in cash	1986
ordinary bearer	-	-	2 500 000	10 000 000	fully paid in cash	1994
ordinary bearer	-	-	2 000 000	8 000 000	fully paid in cash	1995
ordinary bearer	-	-	4 500 000	18 000 000	fully paid in cash	1997
ordinary bearer	-	-	3 800 000	15 200 000	fully paid in cash	1998
ordinary bearer	-	-	170 500	682 000	fully paid in cash	2000
ordinary bearer	-	-	5 742 625	22 970 500	fully paid in cash	2004
ordinary bearer	-	-	270 847	1 083 388	fully paid in cash	2005
ordinary bearer	-	-	532 063	2 128 252	fully paid in cash	2006
ordinary bearer	-	-	144 633	578 532	fully paid in cash	2007
ordinary bearer	-	-	30 214	120 856	fully paid in cash	2008
ordinary bearer	-	-	12 395 792	49 583 168	fully paid in cash	2010
ordinary bearer	-	-	16 072	64 288	fully paid in cash	2011
ordinary bearer	-	-	36 230	144 920	fully paid in cash	2012
ordinary bearer	-	-	35 037	140 148	fully paid in cash	2013
ordinary bearer	-	-	36 044	144 176	fully paid in cash	2014
ordinary bearer	-	-	28 867	115 468	fully paid in cash	2015
ordinary bearer	-	-	41 203	164 812	fully paid in cash	2016
ordinary bearer	-	-	5 549	22 196	fully paid in cash	2017
Total number of shares			**42 285 676**			
Total registered share capital				**169 142 704**		
Nominal value per share (in PLN)		**4**				

* As at the end of the reporting period

In connection with registration on 22 June 2017 by the National Depository of Securities (KDPW) of 5 549 shares of mBank S.A., the share capital of mBank S.A. increased by PLN 22 196 with the effect from 22 June 2017. The shares were issued as part of the conditional increase in the share capital of the Bank by issuance of shares with no subscription rights for the existing shareholders in order to enable beneficiaries of the incentive programmes to take up shares in mBank S.A.

On 30 March 2017, the 30th Ordinary General Meeting of mBank S.A., adopted the resolution on amending the By-laws of mBank S.A. and authorization of the Management Board of mBank S.A. upon the consent of the Supervisory Board of mBank S.A. to increase the share capital of mBank S.A. by an amount not higher than PLN 60 000 000 through the issue of bearer shares with the option to exclude pre-emptive rights of existing shareholders of mBank S.A. in whole or in part.

5.24. Material share packages

In the first half of 2017, there were no changes in the holding of material share packages of the Bank.

Commerzbank AG is a shareholder holding over 5% of the share capital and votes at the General Meeting and as at 30 June 2017 it held 69.42% of the share capital and votes at the General Meeting of mBank S.A.

On 20 March 2015, the Bank received from ING Otwarty Fundusz Emerytalny (currently Nationale-Nederlanden Otwarty Fundusz Emerytalny) (the Fund) a notification that the total numbers of votes controlled at the General Meeting of mBank S.A. increased over 5%.

Prior to the acquisition, the Fund held 2 110 309 shares of mBank S.A., which constituted 4.99% of mBank S.A. share capital and entitled it to exercise 2 110 309 votes at the General Meeting of mBank S.A. On 18 March 2015, in the brokerage account of the Fund there were 2 130 699 shares of mBank S.A., representing 5.05% of the share capital of mBank S.A. The shares entitle to 2 130 699 votes at the General Meeting of mBank S.A., which represent 5.05% of the total number of votes.

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5.25. Earnings per share

the period	from 01.01.2017 to 30.06.2017	from 01.01.2016 to 30.06.2016
Basic:		
Net profit	489 528	698 913
Weighted average number of ordinary shares	42 280 403	42 238 924
Net basic profit per share (in PLN per share)	**11.58**	**16.55**
Diluted:		
Net profit applied for calculation of diluted earnings per share	489 528	698 913
Weighted average number of ordinary shares	42 280 403	42 238 924
Adjustments for:		
- share options	25 434	60 123
Weighted average number of ordinary shares for calculation of diluted earnings per share	42 305 837	42 299 047
Diluted earnings per share (in PLN per share)	**11.57**	**16.52**

5.26. Proceedings before a court, arbitration body or public administration authority

As at 30 June 2017, the Bank was not involved in any proceedings before a court, arbitration body, or public administration authority concerning liabilities of the Bank or its subsidiaries, which represent at least 10% of the Bank's equity. Moreover, the total value of claims concerning liabilities of the Bank or its subsidiary in all proceedings before a court, an arbitration body or a public administration authority as at 30 June 2017 was also not higher than 10% of the Bank's equity.

The Bank monitors the status of all legal proceedings brought against the Bank and the level of required provisions.

Report on major proceedings brought against the Bank

1. Lawsuit brought by Bank Pekao SA (previously BPH SA) against Garbary Sp. z o.o. ("Garbary")

   BPH brought the case to court on 17 February 2005. The value of the dispute was estimated at PLN 42 854 thousand. The purpose was to cancel actions related to the creation of Garbary and the contribution in kind. The dispute focuses on determination of the value of the right to perpetual usufruct of land and related buildings that ZM Pozmeat SA contributed in kind to Garbary as payment for a stake in ZM Pozmeat SA share capital worth PLN 100 000 thousand. On 6 June 2006, the District Court in Poznań issued a verdict according to which the claims were dismissed in their entirety. The claimant filed an appeal against that verdict. On 6 February 2007, the Court of Appeal dismissed the claimant's appeal. The claimant filed the last resort appeal against the ruling of the Court of Appeal. On 2 October 2007, the Supreme Court revoked the ruling of the Court of Appeal and referred the case back. After re-examining the case, the Court of Appeal dismissed the ruling of the District Court in Poznań on 4 March 2008 and referred the case back. On 16 September 2010, the District Court in Poznań dismissed the claim in whole. On 19 October 2010, BPH filed an appeal against the ruling in question. On 24 February 2011, the Court of Appeal made a decision on revoking the ruling and discontinuance of proceedings involving Bank Pekao S.A. (the Bank entered in the proceedings as successor of BPH) justified by lack of title to bring the action before the court on the side of the Bank. The case was returned to the court of the first instance where it was continued with the participation of Pekao SA (previously BPH SA) as the claimant. Bank Pekao SA (previously BPH SA) filed the last resort appeal against the aforesaid decision with the Supreme Court. On 25 April 2012, the Supreme Court revoked the aforesaid decision of the Court of Appeal and referred the case back. On 9 April 2014 the Court of Appeal changed the ruling of the District Court and considered the activities connected with setting up the company Garbary and contribution in kind as ineffective in relation to Bank Pekao SA (previously BPH SA). The Bank filed an annulment appeal to the Supreme Court from above mentioned judgment. On 5 August 2015 the Supreme Court issued a decision in which it has declined acceptance of the complaint for consideration. Possibility of settlement of the dispute is being analyzed, with consideration of the legal conditions of efficient enforcement of the judgment.

2. Lawsuit brought by Bank Pekao SA (previously BPH SA) against the Bank and Tele-Tech Investment Sp. z o.o. ("TTI")

   On 17 November 2007, BPH brought to court a case for damages in the amount of PLN 34 880 thousand plus statutory interest from 20 November 2004 to the date of payment, due to alleged illegal actions such as the sale by ZM Pozmeat SA to TTI of all shares in the equity of Garbary Sp. z o.o. (previously Milenium Center Sp. z o.o.), an important part of its assets, while ZM Pozmeat SA was at risk of insolvency.

In its reply to the claim, the Bank petitioned the Court for dismissing the claim on the grounds of there being no legal basis for allowing the claim. On 1 December 2009, the Court decided to suspend the case until the completion of Pozmeat's bankruptcy proceedings. On 26 January 2011, the court has decided to reinstate suspended proceedings due to the closing of the insolvency procedure. On 5 June 2012, the court once again decided to suspend the proceedings until the case filed by Bank Pekao SA (previously BPH SA) against Garbary Sp. z o.o. is finally settled. In November 2015, a decision to resume the suspended proceedings was made.

3. Claims of clients of Interbrok

From 14 August 2008 170 entities who were clients of Interbrok Investment E. Dróżdż i Spółka Spółka jawna (hereinafter referred to as Interbrok) called the Bank for amicable settlement in the total amount of PLN 385 520 thousand and via the District Court in Warsaw. In addition, 9 legal compensation suits have been delivered to the Bank. Eight of the nine suits where placed by former clients of Interbrok for the total amount of PLN 800 thousand with the reservation that the claims may be extended up to the total amount of PLN 5 950 thousand. The Plaintiffs alleged that the Bank aided and abetted Interbrok's illegal activities, which caused damage to the Plaintiffs. Seven of the suits against mBank were dismissed on substantive grounds and thus ended with a valid court order. As regards the 8th case, the Plaintiff withdrew the action and the waiver of claims and the Regional Court discontinued the proceedings. In the 9th case the value of the subject of litigation amounts to PLN 275 423 thousand together with statutory interest and legal costs. The amount set forth in the petition is to cover the receivables, acquired by the Plaintiff by way of assignment, due to parties aggrieved by Interbrok on account of the reduction (as a result of Interbrok's bankruptcy) of the receivables by a return of the deposits paid by the aggrieved for making investments on the forex market. The Plaintiff claims the Bank's liability on the grounds of the Bank's aiding to commit the illicit act of Interbrok involving the pursuit of brokerage activity without a permit. At present, the case is being heard by the court of first instance.

The Bank moves for dismissal of the claims in entirety and objects to charges raised in the legal suits. The legal analysis of the abovementioned claims indicates that there are no significant grounds to state that the Bank bears liability in the said case.

4. Class action against mBank S.A. concerning changes in interest rate clause

On 4 February 2011, the Bank received a class action brought to the District Court in Łódź on 20 December 2010 by the Municipal Ombudsman who represents a group of 835 persons – retail clients of the Bank. The petitioners demand that a responsibility of the Bank is determined for improper performance of mortgage credit agreements. In particular, it was indicated that the Bank improperly applied provisions of the agreements concerning interest rates adjustment, namely that the Bank did not reduce interest rates on loans, although, according to the petitioners, it should have. The Bank rejects the above reasoning. On 18 February 2011, the Bank submitted a formal answer to the court, in which it applied for a dismissal of the claim as a whole.

On 6 May 2011, the District Court in Łódź decided to reject the application of mBank S.A. for dismissing the claim and decided that the case will proceed as a class action. On 13 June 2011, mBank S.A. lodged a complaint against this decision with the Court of Appeal in Łódź. On 28 September 2011, the Court of Appeal dismissed the complaint of mBank S.A. Currently, the case proceeds as a class action. The time for joining the class ended in March 2012. As at 17 October 2012, the approved class consisted of 1 247 members. Moreover, the District Court in Łódź ruled against setting up a cash deposit for mBank S.A. requested by the Bank. The Bank lodged a complaint against this ruling. On 29 November 2012, the Court of Appeal in Łódź dismissed the Bank's complaint about setting up the cash deposit. The ruling is valid and the Plaintiff is not obliged to pay the cash deposit. The final response to the petition was sent in January 2013, while the Plaintiff replied to it in a pleading filed on 15 February 2013. By a decision dated 18 February 2013, the District Court in Łódź decided to refer the case to mediation. In a letter dated 26 February 2013, the Municipal Consumer Ombudsman raised an objection to the mediation. On 22 June 2013, a trial was conducted, and on 3 July 2013, the Court announced its judgment in which it took into account the action in its entirety acknowledging that the Bank improperly performed the agreement whereby the consumers sustained a loss. On 9 September 2013, the Bank filed an appeal against the aforementioned verdict. Under the sentence of 30 April 2014, the Court of Appeal in Łódź dismissed the appeal of mBank, upholding the decision of the District Court expressed in the appealed verdict. The aforementioned verdict is legally valid, however, after having received its written justification, mBank lodged an annulment appeal to the Supreme Court. The annulment appeal was brought by mBank on 3 October 2014. On 7 October 2014 the Court of Appeal in Łódź ceased the enforceability of the judgement of District Court in Łódź until consideration of Bank's annulment appeal. On 18 February 2015, the Supreme Court received the annulment appeal filed by mBank. On 14 May 2015, the Supreme Court revoked the judgments of the Court of Appeal in Łódź and remanded the case to the Court of Appeal in Łódź for re-examination. On 24 September 2015 the Court of Appeal in Łódź admitted evidence from an opinion of an expert in order to verify the correctness of adjustments made by mBank in mortgage loan interest rates subject to class action in the period of 1 January 2009 to 28 February 2010.

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mBank received the expert's opinion in April 2016. Both parties filed pleadings, in which they commented on the opinion. On 22 June 2016, the Court of Appeal in Łódź obliged the expert to submit a supplementary opinion with respect to the comments made by the parties. The supplementary opinion was issued in September 2016. The expert sustained all the arguments and the standpoint presented in the initial opinion.

During the trial on 24 February 2017, the Court admitted an oral supplementary opinion of the expert as evidence. As the opinion did not allay the Court's doubts, by the resolution of 6 April 2017, the Court of Appeal admitted a written supplementary opinion of the expert as evidence.

5. Class action against mBank S.A. concerning indexation clauses

On 4 April 2016, the Municipal Ombudsman representing a group of 390 individuals, retail clients of mBank, who concluded agreements on CHF-indexed mortgage loans with mBank, filed a class action with the Regional Court in Łódź against mBank. With subsequent pleadings, the claimant reported other individuals who joined the class action and thus, the number of class action members now stands at 1 442 (960 agreements).

The class action includes alternative claims for declaring invalidity of the loan agreements in part i.e. in the scope of the provisions related to indexation, or in whole, or for finding that the provisions of the agreements related to indexation are invalid as they permit indexation of over 20% and below 20% at the CHF exchange rate from the table of exchange rates of mBank S.A. valid as at the date of conclusion of each of the loan agreements.

By its decision of 19 December 2016, the Regional Court in Łódź admitted the case to be heard as class action. mBank filed a complaint about this decision; however, the Court of Appeal in Łódź overturned the complaint on 15 March 2017.

By its decision of 9 May 2017, the Regional Court in Łódź ordered the announcement of the initiation of group proceedings and set a deadline of 3 months from the date of publication of the announcement to join the group of persons whose claims can be covered by the claim.

As at 30 June 2017, the Bank was not involved in any proceedings before a court, arbitration body, or public administration authority concerning receivables of the Bank or its subsidiaries, which represent at least 10% of the Bank's equity. The total value of claims concerning receivables of the Bank or its subsidiaries in all proceedings before a court, an arbitration body or a public administration authority underway at 30 June 2017 was also not higher than 10% of the Bank's equity.

Information regarding conducted tax audits

Within the period from 1 January 2016 to 30 June 2017 there were no tax audit conducted in mBank.

The tax authorities, may inspect and verify at any time the books and records within 5 years subsequent to the reported tax year, and may impose additional tax assessments and penalties. The Management Board is not aware of any circumstances, which may give rise to a potential tax liability in this respect.

5.27. Off-balance sheet liabilities

Off-balance sheet liabilities as at 30 June 2017, 31 December 2016 and 30 June 2016 were as follows:

	30.06.2017	31.12.2016	30.06.2016
1. Contingent liabilities granted and received	**39 151 367**	**37 656 294**	**32 932 860**
Commitments granted	**36 255 257**	**35 069 332**	**31 081 083**
- financing	21 905 164	21 695 678	20 633 633
- guarantees and other financial facilities	14 350 093	13 373 654	10 447 450
Commitments received	**2 896 110**	**2 586 962**	**1 851 777**
- financial commitments received	200 277	779	11 626
- guarantees received	2 695 833	2 586 183	1 840 151
2. Derivative financial instruments (nominal value of contracts)	**413 001 699**	**431 926 772**	**435 898 177**
Interest rate derivatives	315 425 819	335 475 955	335 544 606
Currency derivatives	87 647 499	89 992 538	93 872 371
Market risk derivatives	9 928 381	6 458 279	6 481 200
Total off-balance sheet items	**452 153 066**	**469 583 066**	**468 831 037**

5.28. Transactions with related entities

mBank S.A. is the parent entity of the mBank S.A. Group and Commerzbank AG is the ultimate parent of the Group as well as the direct parent of mBank S.A.

All transactions between the Bank and related entities were typical and routine transactions concluded on terms, which do not differ from arm's length terms, and their nature, terms and conditions resulted from the current operating activities conducted by the Bank. Transactions concluded with related entities as a part of regular operating activities include loans, deposits and foreign currency transactions.

The amounts of transactions, i.e. balances of receivables and liabilities and related costs and income as at 30 June 2017, 31 December 2016 and 30 June 2016 were as follows.

PLN (000's)	mBank S.A. subsidiaries			Commerzbank AG			Other companies of the Commerzbank AG Group excluding mBank S.A. subsidiaries		
As at the end of the period	**30.06.2017**	**31.12.2016**	**30.06.2016**	**30.06.2017**	**31.12.2016**	**30.06.2016**	**30.06.2017**	**31.12.2016**	**30.06.2016**
Statement of Financial Position									
Assets	14 852 059	13 390 749	12 066 544	720 673	698 299	541 650	8 463	1 783	13 815
Liabilities	8 204 048	7 800 587	5 615 611	7 290 602	9 570 604	12 547 359	28 059	34 643	-
Income Statement									
Interest income	122 445	192 094	86 510	58 367	125 233	66 671	199	785	373
Interest expense	(77 289)	(136 306)	(64 655)	(58 319)	(129 296)	(65 551)	(145)	(359)	(28)
Fee and commission income	6 563	10 671	7 002	550	-	-	23	-	-
Fee and commission expense	(48 004)	(99 261)	(55 289)	(3)	-	-	-	-	-
Other operating income	3 646	12 244	5 282	10	18	11	-	-	-
Overhead costs, amortisation and other operating expenses	(4 460)	(20 120)	(9 564)	(6 067)	(9 503)	(4 518)	-	-	-
Contingent liabilities granted and received									
Contingent liabilities granted	9 302 988	8 906 259	6 482 801	1 597 257	1 295 444	1 304 339	7 151	12 923	10 559
Contingent liabilities received	-	-	-	1 522 806	1 442 052	852 493	9 017	12 422	12 425

The total costs of remuneration of Members of the Supervisory Board, the Management Board and other key management personnel of the Bank that perform their duties from 1 January to 30 June 2017 recognised in the income statement for that period amounted to PLN 16 615 800 (in the period from 1 January to 30 June 2016: PLN 15 770 829).

With regard to the Management Board and other key management personnel the remuneration costs include also remuneration in the form of shares and share options.

5.29. Credit and loan guarantees, other guarantees granted in excess of 10% of the equity

As at 30 June 2017, the Bank's exposure under guarantees granted in excess of 10% of own funds related to the guarantee payment of all amounts to be paid in respect of debt securities issued by mFinance France S.A. (mFF), a subsidiary of the mBank S.A.

On 25 September 2013, mFF issued tranche of Eurobonds with nominal value of CHF 200 000 thousand maturing on 8 October 2018. In this case, the guarantee was granted on 25 September 2013 for the duration of the Programme, i.e. to 8 October 2018.

On 22 November 2013, mFF issued next tranche of Eurobonds with nominal value of CZK 500 000 thousand maturing on 6 December 2018. In this case, the guarantee was granted on 22 November 2013 for the duration of the Programme, i.e. to 6 December 2018.

On 24 March 2014, mFF issued next tranche of Eurobonds with nominal value of EUR 500 000 thousand maturing on 1 April 2019. In this case, the guarantee was granted on 24 March 2014 for the duration of the Programme, i.e. to 1 April 2019.

On 20 November 2014, mFF issued next tranche of Eurobonds with nominal value of EUR 500 000 thousand maturing on 26 November 2021. In this case, the guarantee was granted on 20 November 2014 for the duration of the Programme, i.e. to 26 November 2021.

On 21 September 2016, mFF issued next tranche of Eurobonds with nominal value of EUR 500 000 thousand maturing on 26 September 2020. In this case, the guarantee was granted on 21 September 2016 for the duration of the Programme, i.e. to 26 September 2020.

On 14 March 2017, mFF issued next tranche of Eurobonds with nominal value of CHF 200 000 thousand maturing on 28 March 2023. In this case, the guarantee was granted on 14 March 2017 for the duration of the Programme, i.e. to 28 March 2023.

5.30. Fair value of financial assets and liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement assumes that the transaction of selling the asset or transferring a liability occurs:

- on the main market for the asset or liability,

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- in the absence of a main market, for the most advantageous market for the asset or liability.

The main and the most advantageous markets must be both available to the Bank.

Following market practices the Bank values open positions in financial instruments using either the mark-to-market approach or is applying pricing models well established in market practice (mark-to-model method) which use as inputs market prices or market parameters, and in few cases parameters estimated internally by the Bank. All significant open positions in derivatives (currency or interest rates) are valued by market models using prices observable in the market. Domestic commercial papers are marked to model (by discounting cash flows), which in addition to market interest rate curve uses credit spreads estimated internally.

The Bank estimated that the fair value of short-term financial liabilities (less than 1 year) is equal to the balance sheet values of such items.

In addition, the Bank assumed that the estimated fair value of financial assets and financial liabilities longer than 1 year is based on discounted cash flows using appropriate interest rates.

The following table presents a summary of balance sheet values and fair values for each group of financial assets and liabilities not recognized in the statement of financial position of the Bank at their fair values.

	30.06.2017		31.12.2016		30.06.2016	
	Carrying value	Fair value	Carrying value	Fair value	Carrying value	Fair value
Financial assets						
Loans and advances to banks	**7 113 557**	**7 111 624**	**7 308 769**	**7 305 171**	**4 785 219**	**4 786 057**
Loans and advances to customers	**73 169 273**	**74 236 925**	**72 304 131**	**73 328 021**	**72 677 379**	**73 021 998**
Loans and advances to individuals	**41 975 756**	**43 007 861**	**43 195 950**	**44 244 310**	**43 367 721**	**43 841 591**
current accounts	6 439 749	6 485 822	5 843 990	5 885 276	5 584 612	5 613 759
term loans including:	35 536 007	36 522 039	37 351 960	38 359 034	37 783 109	38 227 832
- housing and mortgage loans	28 078 212	28 839 745	30 446 487	31 254 411	31 223 708	31 509 169
Loans and advances to corporate entities	**30 006 190**	**30 045 279**	**27 792 724**	**27 773 747**	**27 811 208**	**27 690 121**
current accounts	5 025 333	5 005 246	3 995 482	3 972 501	4 718 424	4 688 055
term loans	24 719 402	24 778 578	23 574 294	23 578 298	22 799 893	22 709 175
- corporate & institutional enterprises	13 116 504	13 121 967	12 704 969	12 696 003	12 560 421	12 523 237
- medium & small enterprises	11 602 898	11 656 611	10 869 325	10 882 295	10 239 472	10 185 938
reverse repo / buy sell back transactions	93 825	93 825	56 676	56 676	131 734	131 734
other	167 630	167 630	166 272	166 272	161 157	161 157
Loans and advances to public sector	**947 842**	**944 300**	**1 087 033**	**1 081 540**	**1 202 412**	**1 194 248**
Other receivables	**239 485**	**239 485**	**228 424**	**228 424**	**296 038**	**296 038**
Financial liabilities						
Amounts due to other banks	**8 654 205**	**8 716 504**	**8 503 014**	**8 525 938**	**12 035 643**	**11 910 532**
Amounts due to customers	**96 113 526**	**96 499 715**	**98 960 320**	**99 283 334**	**90 418 073**	**90 541 511**
Subordinated liabilities	**2 232 839**	**2 154 362**	**3 943 349**	**3 853 900**	**3 910 457**	**3 831 183**

The following sections present the key assumptions and methods used by the Bank for estimation of the fair values of financial instruments:

Loans and advances to banks and loans and advances to customers. The fair value for loans and advances to banks and loans and advances to customers is disclosed as the present value of future cash flows using current interest rates including appropriate credit spreads and is based on the expected maturity of the respective loan agreements. The level of credit spread was determined based on market quotation of median credit spreads for Moody's rating grade. Attribution of a credit spread to a given credit exposure is based on a mapping between Moody's rating grade and internal rating grades of the Bank. To reflect the fact that the majority of the Bank's exposures is collateralised whereas the median of market quotation is centred around unsecured issues, the Bank applied appropriate adjustments. The valuation does not include the risk of potential regulatory solutions for the CHF mortgage loan portfolio.

Available for sale financial assets. Listed available for sale financial instruments held by the Bank are valued at fair value. The fair value of debt securities not listed at an active market is calculated using current interest rates taking into account credit spreads for an appropriate issuer.

Financial liabilities. Financial instruments representing liabilities include the following:

- Contracted borrowings;
- Deposits;
- Issues of debt securities;
- Subordinated liabilities.

The fair value for these financial liabilities with more than 1 year to maturity is based on cash flows discounted using interest rates. For loans received from Commerzbank in CHF, the Bank used the curve based on quotations of Commerzbank CDS for exposures in EUR, and quotations of issued bonds under

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EMTN programme in EUR and CHF. For the loans received from European Investment Bank in EUR the Bank used the EBI yield curve.

In the case of deposits, the Bank has applied the curve constructed on the basis of quotations of money market rates as well as FRA and IRS contracts for appropriate currencies and maturities. In case of subordinated liabilities, the Bank used curves based on cross-currency basis swap levels taking into account the original spread on subordinated liabilities and their maturities.

The Bank assumed that the fair values of these instruments with less than 1 year to maturity was equal to the carrying amounts of the instruments.

The following tables presents the hierarchy of fair values of financial assets and liabilities recognised in the condensed statement of financial position of the Bank at their fair values.

30.06.2017	Including:	Level 1	Level 2	Level 3
		Quoted prices in active markets	Valuation techniques based on observable market data	Other valuation techniques
RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS				
TRADING SECURITIES	**3 343 084**	**3 075 717**	**-**	**267 367**
Debt securities	**3 339 048**	**3 071 681**	**-**	**267 367**
- government bonds	3 063 677	3 063 677	-	-
- treasury bills	4 987	4 987	-	-
- deposit certificates	12 093	-	-	12 093
- mortgage bonds	18 966	-	-	18 966
- banks bonds	82 352	-	-	82 352
- corporate bonds	156 973	3 017	-	153 956
Equity securities	**4 036**	**4 036**	**-**	**-**
- listed	4 036	4 036	-	-
DERIVATIVE FINANCIAL INSTRUMENTS	**1 331 117**	**-**	**1 331 117**	**-**
Derivative financial instruments held for trading	**1 206 623**	**-**	**1 206 623**	**-**
- interest rate derivatives	819 681	-	819 681	-
- foreign exchange derivatives	370 580	-	370 580	-
- market risks derivatives	16 362	-	16 362	-
Derivative financial instruments held for hedging	**124 494**	**-**	**124 494**	**-**
- derivatives designated as fair value hedges	115 965	-	115 965	-
- derivatives designated as cash flow hedges	8 529	-	8 529	-
INVESTMENT SECURITIES	**29 607 690**	**28 253 956**	**99 971**	**1 253 763**
Debt securities	**29 557 773**	**28 252 931**	**99 971**	**1 204 871**
- government bonds	27 018 950	27 018 950	-	-
- treasury bills	498 722	498 722	-	-
- money bills	99 971	-	99 971	-
- deposit certificates	220 656	-	-	220 656
- mortgage bonds	176 466	-	-	176 466
- banks bonds	135 729	-	-	135 729
- corporate bonds	1 369 404	735 259	-	634 145
- communal bonds	37 875	-	-	37 875
Equity securities	**49 917**	**1 025**	**-**	**48 892**
- unlisted	49 917	1 025	-	48 892
TOTAL FINANCIAL ASSETS	**34 281 891**	**31 329 673**	**1 431 088**	**1 521 130**

30.06.2017	Including:	Level 1	Level 2	Level 3
		Quoted prices in active markets	Valuation techniques based on observable market data	Other valuation techniques
FINANCIAL LIABILITIES				
Derivative financial instruments	**1 154 083**	**-**	**1 154 083**	**-**
Derivative financial instruments held for trading	**1 152 843**	**-**	**1 152 843**	**-**
- interest rate derivatives	803 245	-	803 245	-
- foreign exchange derivatives	330 516	-	330 516	-
- market risks derivatives	19 082	-	19 082	-
Derivative financial instruments held for hedging	**1 240**	**-**	**1 240**	**-**
- derivatives designated as fair value hedges	18 001	-	18 001	-
- derivatives designated as cash flow hedges	(16 761)	-	(16 761)	-
Total financial liabilities	**1 154 083**	**-**	**1 154 083**	**-**

TOTAL RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS	**34 281 891**	**31 329 673**	**1 431 088**	**1 521 130**
FINANCIAL LIABILITIES	**1 154 083**	**-**	**1 154 083**	**-**

IFRS Condensed Financial Statements for the first half of 2017 PLN (000's)

Assets Measured at Fair Value Based on Level 3 - changes in the period from 1 January to 30 June of 2017	Debt trading securities	Debt investment securities	Equity investment securities
As at the beginning of the period	**328 190**	**1 125 379**	**50 244**
Gains and losses for the period:	3 471	(2 416)	(2 252)
Recognised in profit or loss:	3 471	(7 511)	(4 751)
Net trading income	*3 471*	-	-
Gains less losses from investment securities, investments in subsidiaries and associates	-	*(7 511)*	*(4 751)*
Recognised in other comprehensive income:	-	*5 095*	*2 499*
Available for sale financial assets	-	*5 095*	*2 499*
Purchases	635 748	566 429	900
Redemptions	(96 509)	(72 092)	-
Sales	(6 179 051)	(641 941)	-
Issues	5 575 518	229 512	-
As at the end of the period	**267 367**	**1 204 871**	**48 892**

In the first half of 2017, there were no transfers of financial instruments between levels of the fair value hierarchy.

With regard to financial instruments valuated in repetitive way to the fair value classified as level 1 and 2 in hierarchy of fair value, any cases in which transfer between these levels may occur, are monitored by Financial Market Risk Department on the basis of internal rules. In case if there is no market price used to a direct valuation for more than 5 working days, the method of valuation is changed, i.e. change from marked-to-market valuation to marked-to-model valuation under the assumption that the valuation model for the respective type of this instrument has been already approved. The return to marked-to-market valuation method takes place after a period of at least 10 working days in which the market price was available on a continuous basis. If there are no market prices for a debt treasury bonds the above terms are respectively 2 and 5 working days.

31.12.2016	Including:	Level 1 Quoted prices in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS				
TRADING SECURITIES	**3 837 606**	**3 509 416**	**-**	**328 190**
Debt securities	**3 834 103**	**3 505 913**	**-**	**328 190**
- government bonds	3 503 029	3 503 029	-	-
- deposit certificates	16 146	-	-	16 146
- mortgage bonds	19 034	-	-	19 034
- banks bonds	128 516	-	-	128 516
- corporate bonds	167 378	2 884	-	164 494
Equity securities	**3 503**	**3 503**	**-**	**-**
- listed	3 503	3 503	-	-
DERIVATIVE FINANCIAL INSTRUMENTS	**1 818 306**	**-**	**1 818 306**	**-**
Derivative financial instruments held for trading	**1 635 609**	**-**	**1 635 609**	**-**
- interest rate derivatives	1 215 427	-	1 215 427	-
- foreign exchange derivatives	378 840	-	378 840	-
- market risks derivatives	41 342	-	41 342	-
Derivative financial instruments held for hedging	**182 697**	**-**	**182 697**	**-**
- derivatives designated as fair value hedges	154 511	-	154 511	-
- derivatives designated as cash flow hedges	28 186	-	28 186	-
INVESTMENT SECURITIES	**30 467 780**	**27 707 542**	**1 584 615**	**1 175 623**
Debt securities	**30 416 697**	**27 706 703**	**1 584 615**	**1 125 379**
- government bonds	27 348 734	27 348 734	-	-
- money bills	1 584 615	-	1 584 615	-
- deposit certificates	50 466	-	-	50 466
- mortgage bonds	223 494	-	-	223 494
- banks bonds	140 880	-	-	140 880
- corporate bonds	1 031 538	357 969	-	673 569
- communal bonds	36 970	-	-	36 970
Equity securities	**51 083**	**839**	**-**	**50 244**
- unlisted	51 083	839	-	50 244
TOTAL FINANCIAL ASSETS	**36 123 692**	**31 216 958**	**3 402 921**	**1 503 813**

IFRS Condensed Financial Statements for the first half of 2017 PLN (000's)

31.12.2016	Including:	Level 1 Quoted prices in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
FINANCIAL LIABILITIES				
Derivative financial instruments	**1 644 250**	**-**	**1 644 250**	**-**
Derivative financial instruments held for trading	**1 625 897**	**-**	**1 625 897**	**-**
- interest rate derivatives	1 237 989	-	1 237 989	-
- foreign exchange derivatives	356 947	-	356 947	-
- market risks derivatives	30 961	-	30 961	-
Derivative financial instruments held for hedging	**18 353**	**-**	**18 353**	**-**
- derivatives designated as fair value hedges	19 309	-	19 309	-
- derivatives designated as cash flow hedges	(956)	-	(956)	-
Total financial liabilities	**1 644 250**	**-**	**1 644 250**	**-**
TOTAL RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS	**36 123 692**	**31 216 958**	**3 402 921**	**1 503 813**
FINANCIAL LIABILITIES	**1 644 250**	**-**	**1 644 250**	**-**

Assets Measured at Fair Value Based on Level 3 - changes in 2016	Debt trading securities	Debt investment securities	Equity investment securities
As at the beginning of the period	**377 310**	**827 986**	**181 449**
Gains and losses for the period:	4 415	(14 343)	85 169
Recognised in profit or loss:	4 415	-	252 015
Net trading income	*4 415*	*-*	*7 959*
Gains less losses from investment securities, investments in subsidiaries and associates	-	-	*244 056*
Recognised in other comprehensive income:	-	*(14 343)*	*(166 846)*
Available for sale financial assets	-	*(14 343)*	*(166 846)*
Purchases	3 314 524	1 549 259	5 238
Redemptions	(589 093)	(54 750)	-
Sales	(11 442 434)	(1 774 404)	(221 612)
Issues	8 662 494	552 540	-
Transfers into Level 3	974	39 091	-
As at the end of the period	**328 190**	**1 125 379**	**50 244**

In 2016 there were two transfers from level 1 to level 3 of fair value hierarchy. One transfer resulted from unavailability of market price for communal bonds, and the other from low liquidity of bank bonds.

IFRS Condensed Financial Statements for the first half of 2017 PLN (000's)

30.06.2016	Including:	Level 1 Quoted prices in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS				
TRADING SECURITIES	**3 345 350**	**2 964 701**	**-**	**380 649**
Debt securities	**3 339 387**	**2 958 738**	**-**	**380 649**
- government bonds	2 954 760	2 954 760	-	-
- deposit certificates	1 009	-	-	1 009
- mortgage bonds	88 670	-	-	88 670
- banks bonds	184 243	1 056	-	183 187
- corporate bonds	110 705	2 922	-	107 783
Equity securities	**5 963**	**5 963**	**-**	**-**
- listed	5 963	5 963	-	-
DERIVATIVE FINANCIAL INSTRUMENTS	**2 423 129**	**-**	**2 423 129**	**-**
Derivative financial instruments held for trading	**2 174 922**	**-**	**2 174 922**	**-**
- interest rate derivatives	1 746 924	-	1 746 924	-
- foreign exchange derivatives	406 935	-	406 935	-
- market risks derivatives	21 063	-	21 063	-
Derivative financial instruments held for hedging	**248 207**	**-**	**248 207**	**-**
- derivatives designated as fair value hedges	212 961	-	212 961	-
- derivatives designated as cash flow hedges	35 246	-	35 246	-
INVESTMENT SECURITIES	**30 784 494**	**28 074 127**	**1 349 957**	**1 360 410**
Debt securities	**30 739 597**	**28 073 434**	**1 349 957**	**1 316 206**
- government bonds	28 032 443	28 032 443	-	-
- money bills	1 349 957	-	1 349 957	-
- mortgage bonds	224 297	-	-	224 297
- banks bonds	184 487	-	-	184 487
- corporate bonds	907 422	-	-	907 422
- communal bonds	40 991	40 991	-	-
Equity securities	**44 897**	**693**	**-**	**44 204**
- unlisted	44 897	693	-	44 204
TOTAL FINANCIAL ASSETS	**36 552 973**	**31 038 828**	**3 773 086**	**1 741 059**

30.06.2016	Including:	Level 1 Quoted prices in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
FINANCIAL LIABILITIES				
Derivative financial instruments	**2 209 098**	**-**	**2 209 098**	**-**
Derivative financial instruments held for trading	**2 209 044**	**-**	**2 209 044**	**-**
- interest rate derivatives	1 717 252	-	1 717 252	-
- foreign exchange derivatives	473 776	-	473 776	-
- market risks derivatives	18 016	-	18 016	-
Derivative financial instruments held for hedging	**54**	**-**	**54**	**-**
- derivatives designated as fair value hedges	54	-	54	-
Total financial liabilities	**2 209 098**	**-**	**2 209 098**	**-**
TOTAL RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS	**36 552 973**	**31 038 828**	**3 773 086**	**1 741 059**
FINANCIAL LIABILITIES	**2 209 098**	**-**	**2 209 098**	**-**

Assets Measured at Fair Value Based on Level 3 - changes in the period from 1 January to 30 June of 2017	Debt trading securities	Debt investment securities	Equity investment securities
As at the beginning of the period	**328 190**	**1 125 379**	**50 244**
Gains and losses for the period:	3 471	(2 416)	(2 251)
Recognised in profit or loss:	3 471	-	(4 751)
Net trading income	*3 471*	-	-
Gains less losses from investment securities, investments in subsidiaries and associates	-	-	*(4 751)*
Recognised in other comprehensive income:	-	*(2 416)*	*2 500*
Available for sale financial assets	-	*(2 416)*	*2 500*
Purchases	635 748	566 429	900
Redemptions	(96 509)	(72 092)	-
Sales	(6 179 051)	(641 941)	-
Issues	5 575 518	229 512	-
As at the end of the period	**267 367**	**1 204 871**	**48 893**

In the first half of 2016, there were no transfers of financial instruments between levels of the fair value hierarchy.

According to the fair value methodology applied by the Bank, financial assets and liabilities are classified as follows:

- Level 1: prices quoted on active markets for the same instrument (without modification);
- Level 2: prices quoted on active markets for the similar instruments or other valuation methods for which all significant input data are based on observable market data;
- Level 3: valuation methods for which at least one significant input data is not based on observable market data.

Level 1

As at 30 June 2017, at level 1 of the fair value hierarchy, the Bank has presented the fair value of held for trading government bonds in the amount of PLN 3 068 664 thousand and the fair value of investment government bonds and treasury bills in the amount of PLN 27 517 672 thousand (31 December 2016 respectively: PLN 3 503 029 thousand and 27 348 734 thousand, 30 June 2016 respectively: PLN 2 954 760 thousand and PLN 28 023 443 thousand). Level 1 also includes the fair value of corporate bonds in the amount of PLN 738 276 thousand (31 December 2016: PLN 360 853 thousand, 30 June 2016: PLN 2 922 thousand). As at 30 June 2016, the level 1 also included bonds issued by local government bonds in the amount of PLN 40 991 thousand as well as the fair value of bonds issued by banks in the amount of PLN 1 056 thousand.

In addition, as at 30 June 2017 level 1 includes the value of the registered privileged shares of Giełda Papierów Wartościowych in the amount of PLN 1 025 thousand (31 December 2016: PLN 839 thousand, 30 June 2016: PLN 693 thousand) and the value of the shares of listed companies in the amount of PLN 4 036 thousand (31 December 2016: PLN 3 503 thousand, 30 June 2016: PLN 5 963 thousand).

These instruments are classified as level 1 because their valuation is directly derived by applying current market prices quoted on active and liquid financial markets.

Level 2

Level 2 of the fair value hierarchy mainly includes the fair values of bills issued by NBP in the amount of PLN 99 971 thousand (31 December 2016: PLN 1 584 615 thousand, 30 June 2016: PLN 1 349 957 thousand), whose valuation is based on a NPV model (discounted future cash flows) fed with interest rate curves generated by transformation of quotations taken directly from active and liquid financial markets.

In addition, the level 2 includes the valuation of derivative financial instruments borne on models consistent with market standards and practices, using parameters taken directly from the markets (e.g., foreign exchange rates, implied volatilities of fx options, stock prices and indices) or parameters which transform quotations taken directly from active and liquid financial markets (e.g., interest rate curves).

As at 30 June 2017, 31 December 2016, and 30 June 2016, level 2 also includes the value of options referencing on the WIG20 index, listed on the Stock Exchange. For the valuation of index options on WIG20 the Bank applied an internal model (based on a model for implied volatility) for which market data have been used as input parameters.

Level 3

Level 3 of the hierarchy presents the fair values of commercial debt securities issued by local banks and companies (bonds and deposit certificates) in the amount of PLN 1 472 238 thousand (31 December 2016: PLN 1 434 363 thousand, 30 June 2016: PLN 1 696 855 thousand).

Level 3 includes also the fair value of local government bonds in the amount of PLN 37 875 thousand (31 December 2016: PLN 36 970 thousand, 30 June 2016 - 0).

The above mentioned debt instruments are classified as level 3 because in addition to parameters which transform quotations taken directly from active and liquid financial markets (interest rate curves), their valuation uses credit spread estimated by the Bank by means of an internal credit risk model and reflects the credit risk of the issuer. The model uses parameters (e.g., rate of recovery from collateral, rating migrations, default ratio volatilities) which are not observed on active markets and hence were generated by statistical analysis. In 2016 the above mentioned model was modified by taking into account the additional factor calibrating the spread to market levels.

Moreover, level 3 also includes the fair value of equity securities amounting to PLN 48 892 thousand (31 December 2016: PLN 50 244 thousand, 30 June 2016: PLN 44 204 thousand). As at 30 June 2017, these amount includes the value of preferred stock in Visa Inc. in the amount of PLN 41 272 thousand (31 December 2016: PLN 38 392 thousand, 30 June 2016: PLN 34 759 thousand). The other equity securities presented at level 3 have been valuated using the market multiples method. The market multiples method, consists of valuating the equity capital of a company by using a relation between the market values of the own equity capital or market values of the total capital invested in comparable companies (goodwill) and selected economic and financial figures.

5.31. Other information which the issuer deems necessary to assess its human resources, assets, financial position, financial performance and their changes as well as information relevant to an assessment of the issuer's capacity to meet its liabilities

Changes in the Management Board of mBank S.A.

- On 1 March 2017, Vice-President of the Management Board, Mr. Hans-Dieter Kemler resigned from his function at the Bank. The resignation took place on 30 April 2017. Mr. Kemler decided to resign as he was offered the position of a member of the management board in German Landesbank Hessen Thueringen (Helaba) responsible for financial markets, Treasury and asset management.
- On 30 March 2017, Vice President of the Management Board, Mr. Jarosław Mastalerz, resigned from his function in the Bank. The resignation took place on 31 March 2017. The reason for the Mr. Mastalerz resignation is his intention to engage in development and commercializing of new technologies in the finance sector within the project realized in cooperation with the Bank.
- On 30 March 2017, Vice President of the Management Board – Chief Financial Officer, Mr. Christoph Heins, resigned from his function in the Bank. The resignation took place on 30 June 2017.
- By the resolution of the Supervisory Board of mBank S.A., on 30 March 2017, Mr. Krzysztof Dąbrowski was appointed to the position of Vice President of the Management Board of mBank S.A. – the Head of Operations and Information Technology with the effect as of 1 April 2017 until the end of the current term of office of the Management Board.
- By the resolution of the Supervisory Board of mBank S.A., on 30 March 2017, Mr. Frank Bock was appointed to the position of Vice President of the Management Board of mBank S.A. - Head of Financial Markets with the effect as of 1 May 2017 until the end of the current term of office of the Management Board.
- By the resolution of the Supervisory Board of mBank S.A., on 30 March 2017, Mr. Andreas Böger was appointed to the position of Vice President of the Management Board of mBank S.A. - Chief Financial Officer with the effect as of 1 July 2017 until the end of the current term of office of the Management Board.

Changes in the Supervisory Board of mBank S.A.

On 30 March 2017, the 30th Ordinary General Meeting of mBank S.A., elected 12-member Supervisory Board of mBank S.A. for a joint term of three years, with the following composition:

1. Maciej Leśny – Chairman of the Supervisory Board,
2. Stephan Engels – Deputy Chairman of the Supervisory Board,
3. Tomasz Bieske – Member of the Supervisory Board,
4. Andre Carls – Member of the Supervisory Board,
5. Marcus Chromik – Member of the Supervisory Board,
6. Janusz Fiszer – Member of the Supervisory Board,
7. Mirosław Godlewski – Member of the Supervisory Board,
8. Jörg Hessenmüller– Member of the Supervisory Board,
9. Thorsten Kanzler – Member of the Supervisory Board,
10. Ralph Michael Mandel – Member of the Supervisory Board,
11. Teresa Mokrysz – Member of the Supervisory Board,
12. Agnieszka Słomka-Gołębiowska – Member of the Supervisory Board.

5.32. Other information

- Proposals concerning foreign currency mortgage loans restructuring

Some proposals of restructuring of foreign currency mortgage loans for individuals have been discussed recently, including the solutions presented by the Chancellery of the President of the Republic of Poland. At its meeting starting on October 19, 2016, the Parliament of the Republic of Poland has begun work on three draft laws governing in different ways the above issue: presented by the President of the Republic of Poland draft *law on the principles of reimbursement of certain claims arising from credit and loan agreements* and parliamentary drafts of *law on restructuring loans denominated in or indexed to a currency other than the Polish currency and to prohibiting granting of such loans and of law on special rules for the restructuring of foreign currency mortgage loans due to changes in foreign currency exchange rates in relation to the Polish currency*. At the moment of these financial statements publication the final form of the proposed solutions is not known yet. Therefore, at the moment, the Bank is not able to estimate reliably either the implementation probability of the discussed solutions or the potential impact of the final solutions on the financial statements of the Bank and the mBank Group.

- Recommendations of the Polish Financial Supervision Authority (KNF) regarding additional capital requirements

On 4 October 2016, Polish Financial Supervision Authority identified mBank S.A. as other systemically important institution and imposed on the Bank - on an individual and consolidated basis - the other systemically important institution buffer equivalent to 0.5% of the total risk exposure, calculated in accordance with Article 92 (3) of CRR Regulation.

On 20 October 2016, the Bank received the KNF decision concerning the maintenance of mBank S.A. own funds, on the individual basis, to cover the additional capital requirement securing the risk related to the foreign currency mortgage loans for households at the level of 3.81 p.p. above the total capital ratio level defined in article 92 item 1 letter c of the CRR Regulation, which should be covered at least in 75% by Tier 1 capital (equivalent to capital requirement of 2.86 p.p. above the level of Tier 1 capital ratio defined in article 92 item 1 letter b of the CRR Regulation) and at least in 56% by Common Equity Tier 1 capital (equivalent to capital requirement of 2.13 p.p. above the level of Common Equity Tier 1 capital ratio defined in article 92 item 1 letter a of the CRR Regulation). Earlier, mBank S.A. maintained its own funds covering additional capital requirement securing the risk related to the foreign currency mortgage loans for households at the level of 4.39 p.p. on the individual basis, covered at least in 75% by Tier 1 capital (equivalent to 3.29 p.p.).

On 15 December 2016, the Bank received the KNF decision concerning the maintenance of mBank S.A. own funds, on the consolidated basis, to cover the additional capital requirement securing the risk related to the foreign currency mortgage loans for households at the level of 3.25 p.p. above the total capital ratio. Simultaneously, for the Tier 1 capital ratio and Common Equity Tier 1 capital ratio additional capital requirement amounts to 2.44 p.p. and 1.82 p.p. respectively. Earlier, mBank S.A. maintained its own funds covering additional capital requirement securing the risk related to the foreign currency mortgage loans for households at the level of 3.72 p.p. on the consolidated basis, covered at least in 75% by Tier 1 capital (equivalent to 2.79 p.p.). The KNF also informed that the recommended by the KNF minimum capital ratios for mBank S.A., on the individual basis, amounted to 13.61% for the Tier 1 capital ratio and 17.56% for the total capital ratio, while on the consolidated basis, the minimum capital ratios amounted to 13.19% for the Tier 1 capital ratio and 17.00% for the total capital ratio.

At the date of publication of these financial statements, mBank S.A. fulfils the KNF requirements related to the minimum capital ratios on both individual and consolidated levels.

- Recommendations of Financial Stability Committee (FSC) on the restructuring of the FX housing loans portfolio

On 13 January 2017, FSC endorsed the resolution on the recommendation on the restructuring of the FX housing loans portfolio. The resolution includes a list of recommendations, the most important of which are:

- to increase the minimum LGD for exposures secured by mortgages on residential property, the purchase of which was financed by an FX loan by means of a dedicated resolution of the Ministry of Finance (this regulatory measure is addressed to banks that apply internal ratings based approach to the calculation of the capital charge for credit risk, among others to mBank S.A.);

- to increase by the KNF the additional capital requirements related to FX housing loans by taking into account additional risk types: operational risk, market risk and collective risk of default;

- to impose a systemic risk buffer of 3% by the Ministry of Finance that would apply to all exposures on the territory of the Republic of Poland;

- to increase the risk weight used by the banks to calculate capital requirements to the level of 150% for FX exposures secured by mortgages on immovable property by means of a dedicated resolution of the Ministry of Finance.

At the date of publication of these financial statements, the final method of implementation of the FSC recommendation is not known. Therefore, the Bank is not able at the moment to estimate the potential impact of the proposed solutions on the capital ratios and financial statements of mBank S.A. and mBank Group.

- The individual recommendation of the KNF concerning dividend for the year 2016

On 13 March 2017, the Bank received a letter from the Polish Financial Supervision Authority with individual recommendation to increase own funds by retaining total net profit generated by the Bank between 1 January 2016 and 31 December 2016. On 30 March 2017, the 30th Ordinary General Meeting of mBank S.A. adopted a resolution, according to which the net profit generated by the Bank in 2016 in the amount of PLN 1 219 339 249.57 will be allocated as follows: PLN 20 000 000.00 for the general banking risk reserve of mBank S.A., and the remaining part of profit in the amount of PLN 1 199 339 249.57 will be left undivided.

Date	First and last name	Position	Signature
27.07.2017	Cezary Stypułkowski	President of the Management Board	
27.07.2017	Lidia Jabłonowska-Luba	Vice-President of the Management Board, Chief Risk Officer	
27.07.2017	Frank Bock	Vice-President of the Management Board, Head of Financial Markets	
27.07.2017	Andreas Böger	Vice-President of the Management Board, Chief Financial Officer	
27.07.2017	Krzysztof Dąbrowski	Vice-President of the Management Board, Head of Operations and IT	
27.07.2017	Przemysław Gdański	Vice President of the Management Board, Head of Corporate & Investment Banking	
27.07.2017	Cezary Kocik	Vice-President of the Management Board, Head of Retail Banking	