Financial Statements of mBank Hipoteczny S.A. according to the International Financial Reporting Standards (IFRS) for 2019

Selected financial data

The selected financial data presented below are supplementary information to the Financial Statements of mBank Hipoteczny S.A. for 2019.

Selected financial data		in PLN `000		in PLN `000	
		Year ended 31.12.2019	Year ended 31.12.2018	Year ended 31.12.2019	Year ended 31.12.2018
I.	Interest income	454 195	427 181	105 583	100 115
II.	Fee and commission income	2 203	3 038	512	712
III.	Net trading income	5 096	1 210	1 185	284
IV.	Operating result	91 294	88 262	21 222	20 685
V.	Profit before income tax	59 068	60 694	13 731	14 224
VI.	Net profit attributable to shareholders of mBank Hipoteczny S.A.	37 084	41 237	8 621	9 664
VII.	Net cash flows from operating activities	1 233 982	608 159	286 852	142 529
VIII.	Net cash flows from investing activities	(19 485)	(22 383)	(4 529)	(5 246)
IX.	Net cash flows from financing activities	(1 110 084)	(564 634)	(258 051)	(132 329)
X.	Total net cash flows	104 413	21 142	24 272	4 955
XI.	Basic earnings per ordinary share / Diluted earnings per ordinary share (in PLN/EUR)	11,14	12,85	2,59	3,01

Selected financial data		in PLN `000		in EUR `000	
		as at		as at	
		31.12.2019	31.12.2018	31.12.2019	31.12.2018
I.	Total assets	13 187 908	12 385 908	3 096 843	2 880 444
II.	Amounts due to other banks	2 816 822	3 179 878	661 459	739 507
III.	Amounts due to customers	8 934	3 099	2 098	721
IV.	Equity attributable to shareholders of mBank Hipoteczny S.A.	1 267 520	1 085 947	297 645	252 546
V.	Share capital	336 000	321 000	78 901	74 651
VI.	Number of shares	3 360 000	3 210 000	3 360 000	3 210 000
VII.	Book value per share / Diluted book value per share (in PLN/EUR)	377,24	338,30	88,58	78,67
VIII.	Total capital ratio (%)	18,23	16,25	18,23	16,25

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

- for items of the statement of financial position – exchange rate announced by the National Bank of Poland as at 31 December 2019: EUR 1 = PLN 4.2585 and obligated for 31 December 2018: EUR 1 = PLN 4.3000,
- for items of the income statement and statement of cash flow – 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 2019 and 2018: EUR 1 = PLN 4.3018 and EUR 1 = PLN 4.2669.

TABLE OF CONTENTS

for 2019 (in PLN thousand)

Income statement

	Note	Year ended 31 December	
		2019	**2018**
Interest income, including:	7	454 195	427 181
Interest income calculated using the effective interest rate method		*417 477*	*387 812*
Income similar to interest - financial assets measured at fair value through profit or loss		*36 718*	*39 369*
Interest expense	7	(268 126)	(250 904)
Net interest income		**186 069**	**176 277**
Fee and commission income	8	2 203	3 038
Fee and commission expenses	8	(10 404)	(5 540)
Net fee and commission income		**(8 201)**	**(2 502)**
Net trading income, including:	9	5 096	1 210
Foreign exchange result		*287*	*2 286*
Gains or losses on financial assets and liabilities held for trading		*243*	*916*
Gains or losses from hedge accounting		*4 566*	*(1 992)*
Net income on modification	10	(1 776)	(3 312)
Net income on derecognition of financial instruments not measured at fair value through proft and loss	11	(185)	1 627
Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss	12	(2 844)	(4 556)
Other operating income	13	1 030	1 202
Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss	16	(20 003)	(16 712)
Overhead costs	14	(59 586)	(59 849)
Amortisation and depreciation	25, 26	(6 915)	(3 798)
Other operating expenses	15	(1 391)	(1 325)
Operating result		**91 294**	**88 262**
Taxes on the Bank balance sheet items		(32 226)	(27 568)
Profit before income tax		**59 068**	**60 694**
Income tax	17	(21 984)	(19 457)
Net profit		**37 084**	**41 237**
Net profit attributable to shareholders of the mBank Hipoteczny S.A.		**37 084**	**41 237**
Weighted average number of ordinary shares / Diluted weighted average number of ordinary shares	18	**3 327 945**	**3 210 000**
Earnings per ordinary share / Diluted earnings per ordinary share (in PLN)	18	**11,14**	**12,85**

The entire profit of mBank Hipoteczny S.A. for the 2019 and 2018 pertains to the performance of continuing operations.

Notes presented on pages 7 to 113 constitute an integral part of these Financial Statements.

for 2019 (in PLN thousand)

Statement of comprehensive incomes

		Year ended 31 December	
	Note	**2019**	**2018**
Net profit		**37 084**	**41 237**
Other comprehensive income net of tax including:	19	**(5 423)**	**1 680**
Items that may be reclassified to the income statement		**(5 443)**	**1 678**
Change in the valuation of debt financial instruments valued at fair value through other comprehensive income (gross)		(3 006)	2 072
Deferred tax on debt financial instruments measured at fair value through other comprehensive income	31	571	(394)
Change in the valuation of debt financial instruments measured at fair value through other comprehensive income (net)		(2 435)	1 678
Change in valuation due to cash flow hedge (gross)	21	(3 714)	-
Deferred tax due to cash flow hedges		706	-
Net cash flow hedge		(3 008)	-
Items that will not be reclassified to the income statement	19	**20**	**2**
Actuarial gains and losses on post-employment benefits (gross)	30	24	3
Deferred tax on actuarial gains and losses on post-employment benefits	31	(4)	(1)
Actuarial gains and losses on post-employment benefits (net)		20	2
Total comprehensive income net of tax		**31 661**	**42 917**
Net total comprehensive income attributable to shareholders of the mBank Hipoteczny S.A.		**31 661**	**42 917**

Notes presented on pages 7 to 113 constitute an integral part of these Financial Statements.

for 2019 (in PLN thousand)

Statement of financial position

ASSETS	Note	31.12.2019	31.12.2018
Cash and balances with the Central Bank	20	35 234	16 294
Financial assets held for trading and derivatives held for hedges	21	48 217	36 658
Non-trading financial assets mandatorily at fair value through profit or loss, including:	22	157 714	208 181
Loans and advances to customers		157 714	208 181
Financial assets at fair value through other comprehensive income	23	1 221 735	1 069 392
Financial assets at amortised cost, including:	24	11 642 344	10 988 966
Loans and advances to banks		*13 912*	*58 432*
Loans and advances to customers		*11 628 432*	*10 930 534*
Intangible assets	25	48 620	40 021
Tangible assets	26	16 301	8 678
Deferred income tax assets	31	10 123	12 586
Other assets	27	7 620	5 132
TOTAL ASSETS		**13 187 908**	**12 385 908**

LIABILITIES AND EQUITY			
Liabilities			
Financial liabilities held for trading and derivatives held for hedges	21	7 600	2 032
Financial liabilities measured at amortised cost, including:	28	11 883 589	11 253 826
Amounts due to banks		*2 816 822*	*3 179 878*
Amounts due to customers		*8 934*	*3 099*
Debt securities issued		*8 857 401*	*7 870 443*
Subordinated liabilities		*200 432*	*200 406*
Provisions	29	2 276	2 557
Current income tax liabilities		8 418	12 704
Other liabilities	30	18 505	28 842
TOTAL LIABILITIES		**11 920 388**	**11 299 961**
Equity			
Share capital:		**884 631**	**734 719**
- Registered share capital	31	336 000	321 000
- Share premium	36	548 631	413 719
Retained earnings:	37	**382 832**	**345 748**
- Profit from the previous years		345 748	304 511
- Profit for the current period		37 084	41 237
Other components of equity	**38**	**57**	**5 480**
		-	-
TOTAL EQUITY		**1 267 520**	**1 085 947**
TOTAL LIABILITIES AND EQUITY		**13 187 908**	**12 385 908**

Notes presented on pages 7 to 113 constitute an integral part of these Financial Statements.

for 2019 (in PLN thousand)

Statement of changes in equity

Changes in equity from 1 January 2019 to 31 December 2019

	Share capital		Retained earnings				Other components of equity			Total
	Registered share capital	Share premium	Other supplementary capital	General banking risk reserve	Retained profit from the previous years	Profit for the current period	Zabezpieczenie przepływów pieniężnych	Valuation of financial assets at fair value through other comprehensive income	Actuarial gains and losses relating to post-employment benefits	
As at 1 January 2019	**321 000**	**413 719**	**273 082**	**44 800**	**27 866**	**-**	**-**	**5 476**	**4**	**1 085 947**
Net profit	-	-	-	-	-	37 084	-	-	-	37 084
Other comprehensive income (gross)	-	-	-	-	-	-	(3 714)	(3 006)	24	(6 696)
Deferred tax on other comprehensive income	-	-	-	-	-	-	706	571	(4)	1 273
Total comprehensive income	**-**	**-**	**-**	**-**	**-**	**37 084**	**(3 008)**	**(2 435)**	**20**	**31 661**
Transfer to general banking risk reserve	-	-	-	-	-	-	-	-	-	-
Transfer to supplementary capital	-	-	27 866	-	(27 866)	-	-	-	-	-
Issue of shares	15 000	135 000	-	-	-	-	-	-	-	150 000
Share issue costs	-	(88)	-	-	-	-	-	-	-	(88)
As at 31 December 2019	**336 000**	**548 631**	**300 948**	**44 800**	**-**	**37 084**	**(3 008)**	**3 041**	**24**	**1 267 520**

Changes in equity from 1 January 2018 to 31 December 2018

	Share capital		Retained earnings				Other components of equity		Total
	Registered share capital	Share premium	Other supplementary capital	General banking risk reserve	Retained profit from the previous years	Profit for the current period	Valuation of financial assets at fair value through other comprehensive income	Actuarial gains and losses relating to post-employment benefits	
As at 1 January 2018	**321 000**	**413 719**	**245 253**	**44 800**	**27 829**	**-**	**3 798**	**2**	**1 056 401**
Effects of IFRS 9 implementation	-	-	-	-	(13 371)	-	-	-	(13 371)
Restated equity as at 1 January 2018	**321 000**	**413 719**	**245 253**	**44 800**	**14 458**	**-**	**3 798**	**2**	**1 043 030**
Net profit	-	-	-	-	-	41 237	-	-	41 237
Other comprehensive income (gross)	-	-	-	-	-	-	2 072	3	2 075
Deferred tax on other comprehensive income	-	-	-	-	-	-	(394)	(1)	(395)
Total comprehensive income	**-**	**-**	**-**	**-**	**-**	**41 237**	**1 678**	**2**	**42 917**
Transfer to general banking risk reserve	-	-	-	-	-	-	-	-	-
Transfer to supplementary capital	-	-	27 829	-	(27 829)	-	-	-	-
Issue of shares	-	-	-	-	-	-	-	-	-
Share issue costs	-	-	-	-	-	-	-	-	-
As at 31 December 2018	**321 000**	**413 719**	**273 082**	**44 800**	**(13 371)**	**41 237**	**5 476**	**4**	**1 085 947**

Notes presented on pages 7 to 113 constitute an integral part of these Financial Statements

for 2019 (in PLN thousand)

Statement of cash flows

	Note	Year ended 31 December	
		2019	2018
A. Cash flows from operating activities		**1 233 982**	**608 159**
Profit before income tax		**59 068**	**60 694**
Adjustments:		**1 174 914**	**547 465**
Income tax paid		(23 806)	(13 708)
Amortisation and depreciation	25, 26	6 915	3 798
(Profits) losses on investing activities	11	-	(149)
Interest income (income statement)	7	(454 195)	(427 181)
Interest expenses (income statement)	7	268 126	250 904
Interest received		420 152	388 961
Odsetki zapłacone		(26 985)	(11 763)
Change in assets and liabilities on derivative financial instruments		3 078	25 815
Change in loans and advances to customers		(630 207)	(366 824)
Change in the balance of financial assets at fair value through other comprehensive income		(19 915)	176 807
Change in other assets	27	(2 488)	5 544
Change in amounts due to other banks		1 928 538	595 510
Change in amounts due to customers		8 459	(1 039)
Change in debt securities in issue		(288 488)	(85 195)
Change in provisions		(281)	(997)
Change in other liabilities	29	(10 337)	3 274
Result on disposal of intangible assets and tangible fixed assets	15	(85)	1
Adjustments to intangible assets and property, plant and equipment	25, 26	(3 567)	3 707
Net cash from operating activities		**1 233 982**	**608 159**
B. Cash flows from investing activities		**(19 485)**	**(22 383)**
Investing activity inflows		**42**	**2**
Due to the disposal of intangible assets and tangible fixed assets		42	2
Investing activity outflows		**19 527**	**22 385**
Due to the purchase of intangible assets and tangible fixed assets	25, 26	19 527	22 385
Net cash from investing activities		**(19 485)**	**(22 383)**
C. Cash flow from financing activites		**(1 110 084)**	**(564 634)**
Financing activity inflows		**1 992 462**	**2 189 482**
Due to the loans and advances from banks		-	250 000
Due to the issue of debt securities		1 842 550	1 831 760
Due to take a subordinated loan	28	-	100 000
Due to the issue of shares		149 912	-
Interest received from hedging derivative financial instruments		-	7 722
Financing activities outflows		**3 102 546**	**2 754 116**
Due to the repayment of loans and advances from banks		2 291 096	1 494 612
Due to the issue of debt securities		572 925	931 602
Due to repayment a subordinated loan	28	-	100 000
Payments of leasing liabilities		2 924	-
Interest paid on loans received, debt securities in issue, subordinated loan		234 268	227 902
Interest paid on derivative hedging instruments		1 333	-
Net cash from financing activities		**(1 110 084)**	**(564 634)**
Net increase / decrease in cash and cash equivalents, total (A+B+C)		**104 413**	**21 142**
Cash and cash equivalents as at the beginning of the reporting period, including:	**40**	**164 715**	**143 573**
Cash and balances with the central bank		16 294	1 351
Amounts due from other banks		58 432	18 737
Investment securities with maturity of up to 3 months from the date of purchase		89 989	123 485
Cash and cash equivalents as at the end of the reporting period, including:	**40**	**269 128**	**164 715**
Cash and balances with the central bank		35 234	16 294
Amounts due from other banks		13 912	58 432
Investment securities with maturity of up to 3 months from the date of purchase		219 982	89 989

Notes presented on pages 7 to 113 constitute an integral part of these Financial Statements.

Explanatory notes to the standalone financial statements

1. Information on mBank Hipoteczny S.A.

By the decision of the District Court for the Capital City of Warsaw 16th Commercial Department on 16 April 1999 mBank Hipoteczny S.A. (hereinafter referred to as the "Bank") was entered into the Commercial Register under registration number 56623.

On 27 March 2001 the District Court in Warsaw issued a decision to enter the Bank in the National Court Register (KRS) under KRS No. 0000003753.

As per the Polish Classification of Activities the Bank business is designated as 64.19.Z "Other monetary intermediation".

On 29 November 2013 District Court for the Capital City of Warsaw, 12th Commercial Department of the National Court Register registered the change of the Bank's Articles of Association resulting from resolution no. 1 of the Extraordinary General Meeting of BRE Bank Hipoteczny S.A. dated 30 October 2013. Together with the registration of the change in the Articles of Association the name of the Bank has been changed from BRE Bank Hipoteczny Spółka Akcyjna to mBank Hipoteczny Spółka Akcyjna. The Bank can use the following abbreviation: mBank Hipoteczny S.A.

According to the Bank's Articles of Association, the Bank's scope of activity is provision of banking services to natural and legal persons, as well as to unincorporated organisational units both in PLN and foreign currencies.

The Bank operates in the territory of the Republic of Poland.

Registered office of the Bank is located in Warsaw, at 26 Armii Ludowej Av (previously at 26 Lecha Kaczyńskiego St.).

The Bank was established for an indefinite period of time.

mBank Hipoteczny S.A. is a specialised mortgage bank of which primary purpose is to issue mortgage bonds, which are intended to constitute the main source of long-term financing for loans secured with real estate property. There are two business lines in the Bank:

- retail line, focusing on the purchase of receivables from housing mortgage loans from mBank S.A.,
- commercial line, covering the financing of income-generating real property such as office buildings, shopping centres, hotels, warehouses and distribution premises, as well as financing of residential property (apartments and houses), carried out by housing developers.

In the second half of 2017, the Bank discontinued granting housing mortgage loans to private individuals in cooperation with mBank S.A. (the so-called agency model). At present, within retail business line operates only a so-called pooling model consisting of purchasing receivables on account of housing mortgage loans from mBank S.A.

Since the end of 2012, the Bank has not been providing financing to local government units or other entities with a surety of local government units. However, the Bank had a legacy portfolio of loan transactions for this segment which was the basis for the issue of public sector covered bonds.

Activities of mBank Hipoteczny S.A. are carried out in the segments described in detail in Note 6.

mBank Hipoteczny S.A. is not a parent company or a major investor to associate companies nor jointly controlled companies. Therefore, mBank Hipoteczny S.A. does not prepare consolidated financial statements. The parent company of mBank Hipoteczny S.A. is mBank S.A., which prepares consolidated financial statements of mBank Capital Group.

As at December 31, 2019 the employment in the mBank Hipoteczny S.A. was 130 FTEs and 140 persons (December 31, 2018: 161 FTEs; 170 persons).

Average employment in 2019 was 140 employees, in 2018 it was 170 employees.

These financial statements were approved by the Management Board of mBank Hipoteczny S.A. on March 26, 2020.

2. Description of the relevant accounting policies

The most important accounting policies applied by the Bank to the drafting of these Financial Statements are presented below. The accounting principles adopted by the Bank were applied on an ongoing basis for all periods presented in the financial statements, except for the accounting principles applied in connection with the implementation of IFRS 9 as of 1 January 2018, as described in detail under Note 2.25 Comparative data and changes in the presentation of data in the profit and loss account described in Note 2.26.

2.1. Accounting basis

Financial Statements of mBank Hipoteczny S.A. have been prepared for the 12-month period ended 31 December 2018. Comparative data presented in these financial statements relate to the period of 12 months ended on 31 December 2017. Presented financial statements are standalone financial statements.

As at 31 December 2018 and as at 31 December 2017 mBank Hipoteczny S.A. had no subsidiaries.

The Financial Statements of mBank Hipoteczny S.A. have been prepared in compliance with the International Financial Reporting Standards (IFRS) as adopted for use in the European Union, according to the historical cost method, as modified by the revaluation of financial assets at fair value through other comprehensive income, financial assets and financial liabilities measured at fair value through the income statement, including all derivative contracts and adjustments resulting from hedge accounting.

The preparation of the financial statements in compliance with IFRS requires the application of specific accounting estimates. It also requires the Management Board of the Bank to use its own judgment when applying the accounting policies adopted by the Bank. The issues in relation to which a significant professional judgement is required, more complex issues, or such issues where estimates or judgments are material to the financial statements are disclosed in Note 5.

The financial statements of mBank Hipoteczny S.A. were prepared under the going concern assumption. There are no circumstances indicating any risks associated with the going concern in the foreseeable future, i.e. in the period of at least 12 months following the balance sheet date.

Due to the current situation with regard to COVID-19, based on the analyzes carried out at the moment, no significant uncertainty for the continuation of operations has been identified.
In the Bank's view, the areas of adverse effect of the epidemic on business processes are as follows: credit risk, liquidity risk, financial stability risk and operational risk. Based on internal analyses of current liquidity and stress scenarios concerning the development of the Bank's regulatory indicators in the future, in the opinion of the Board of Executives, the Bank does not identify significant uncertainties related to the assumption of continuing operations in the foreseeable future. More information is included in note 46.

Financial statements are prepared in compliance with materiality principle. Omissions or misstatements of positions of financial statements are material if they could, individually or collectively, influence the economic decisions that users make on the basis of Bank's financial statements. Materiality depends on the size and nature of the omission or misstatement of the position of financial statements or a combination of both. The Bank presents separately each material class of similar positions. The Bank presents separately positions of dissimilar nature or function unless they are immaterial.

2.2. 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 measured at fair value through other comprehensive income and measured at fair value through profit or loss.

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 that exactly discounts estimated future cash payments or receipts through the expected life of the financial assets or financial liability to the gross carrying amount of a financial asset or to the amortized cost of a financial liability. When calculating the effective interest rate, the Bank estimates the expected cash flows taking into account all the contractual terms of the financial instrument, but without taking into account the expected credit losses. This calculation takes into account all the fees and points 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.

In case of reclassification to the stage 3 of 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.

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 Bank does not conduct commercial activity, all transactions on derivatives are classified in the banking book.

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

Interest expenses include paid and accrued interests as well as commissions settled over time using effective interest rate from received loans, other financial liabilities with deferred payment term, subordinated loans, debt securities issued (legal costs, rating costs and audit costs) and cash collateral and leasing.

2.3. Fee and commission income and expenses

Fee and commission income is recognized at the time of performance of the respective services. Commissions for granted loans are recognised using the effective interest rate method and included in interest income. Commissions related to agreements that were not orginated on the date of collection or payment of commission adjust the value of effective interest rate on the date of disbursement of funds. Commissions for loan agreements that were not orginated are included as one-off items in the income statement on the date of termination of a loan agreement. Commissions for loan tranches (for exposure) placed at the disposal of a client are calculated evenly over the period of provision of the service. The amount of commission is recognized over time linearly over the period covering the transaction that is subject to commission. Income and cost for fees and commissions for which the method of effective interest rate is not applied are generally recognised in accordance with the accrual basis at the time of provision of the service.

Fee and commission income is recognised in accordance with IFRS 15 using a 5-step model for revenue recognition, which consists of:

Step 1: Identifying the contract’s with a customer

Step 2: Identifying performance obligations in the contract

Step 3: Determining the transaction price

Step 4: Allocating the transaction price to the preformance obligation

Step 5: Recognition of revenue when (or as) the Group satisfies a performance obligation

Revenues recognized in accordance with mssf 15 do not constitute a significant part of the revenues generated by the bank

Accounting policies regarding the recognition of commission income from the sale of insurance products related to loans and borrowings are described in Note 2.4

Commission expenses related to amounts paid on received loans, issued securities adjust the value of effective interest rate on the date of the orgination of the funds or on the day of payment, if it took place after the day of orgniation of the funds, are presented in the line of interest expenses.

The costs of commissions on other operations, including costs related to the after-sales service of portfolios under outsourcing agreements and the issue of mortgage bonds are included in the profit and loss account once.

2.4. 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 is offered to the customer only with the loans, i.e. it is not possible to purchase from the Bank the insurance product which is identical in a legal form, content and economic conditions without purchasing the loan.

The Bank does not offer insurance products which are not bundled with loans.

Revenue 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 recognised over time as part of effective interest rate calculation for the bundled loan. The remuneration included in commission income is recognised 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 recognised 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 recognised in fee and commission expenses as upfront cost or as cost accrued over time.

For insurance products considered as bundled with loans 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 recognised.

In case of related products, when the premium is charged on a monthly basis, and a client may join insurance or discontinue it on a regular basis, revenue is recognised monthly on a cash basis in commission income.

For the purpose of recognition of interest income in terms of insurance associated with a mortgage loan, the income from a one-off premium charged for a period of the first two years is recognized by the Bank on a linear basis within the interest income, on a level that equals the level of subsequent consideration it receives from a regular premium charged on a monthly basis after the second year of insurance protection.

Since 31 March 2015, due to the termination on this date of agreement on cash bonus, which was concluded on 7 January 2014 between the Bank and BRE Ubezpieczenia Sp. z.o.o. (currently mFinanse S.A.) the Bank does not receive remuneration for offered insurance products associated with a loan product.

2.5. Segment reporting

An operating segment is a component of the entity:

- which engages in business activities and in connection with which revenues may be earned and costs incurred (including revenues and costs relating to transactions with other components of the same entity),
- whose operating results are regularly reviewed by the chief operating decision maker in the entity and using those results to make decisions on resources allocated to a given segment and assessing the results of operations of the segment, and
- in respect of which separate financial information is available.

Operating segments are reported on the same basis as that used for internal reporting (reporting to management). The management is a function that allocates resources to the operating segments and assesses the performance thereof. As defined in IFRS 8, the Bank has determined the Management Board of the Bank as its "management".

In accordance with IFRS 8, the Bank distinguished the following operating segments: „Corporate Banking Segment", „Retail Banking Segment", „Treasury Segment", described in detail in Note 6.

2.6. Financial assets/financial liabilities

The Bank classifies its financial assets to the following categories: financial assets valued at fair value through profit or loss, financial assets valued at fair value through other comprehensive income for which gains or losses may be reclassified subsequently to the income statement, financial assets valued at fair value through other comprehensive income for which gains or losses will not be reclassified subsequently to the income statement at derecognition and financial assets valued at amortized cost. Classification of the debt financial asset to the one of the above categories takes place at its initial recognition based on business model for managing financial assets and contractual cash flow characteristics. An equity instrument is classified as a financial asset at fair value through profit or loss.

Financial liabilities as at the date of their acquisition or creation are classified into the following categories:

- financial liabilities valued at fair value through profit or loss,
- other financial liabilities valued at amortized cost.

A financial liability is classified into one of the categories at the time of its acquisition in accordance with the Bank's intention as to its intended use.

Standardised purchases and sales of financial assets at fair value through profit or loss and measured at fair value through other comprehensive income 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 / on the date of transaction. 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.

As financial asset measured at fair value through profit or loss, the Bank classifies derivative financial instruments and financial assets (loans and advances granted by the Bank) of which contractual terms and conditions result in cash flows at a given time that are not merely a repayment of principal and interest on the principal outstanding (loans that do not meet the SPPI criterion in the category of assets with debtor's limited liability – non-recourse assets category).

<u>Financial instruments valued at fair value through profit or loss</u>

A financial asset shall be measured at fair value through profit or loss unless it is measured at amortized cost or at fair value through other comprehensive income.

The Bank, at the initial recognition, irrevocably designate a the financial assets/financial liabilities at fair value through profit or loss 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, of which interest profit or loss on derivatives, is recognized in net interest income. The valuation and result on disposal of financial assets/financial liabilities valued at fair value through profit or loss are included as follows:

- on trading income, in case of financial derivatives,

- in the item profits or losses on non-trading financial assets mandatorily measured at fair value through profit or loss.

Financial assets measured at amortized cost

Financial assets measured at amortized cost are assets that meet both of the following conditions, unless the Bank designated them to fair value through profit or loss: the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flow characteristics and contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding Financial assets at amortized cost are entered into books on the transaction date / at the time of disbursement of cash to the borrower.

Financial assets measured at fair value through other comprehensive income

Financial assets measured at fair value through other comprehensive income are assets that meet both of the following conditions, unless the Bank designated them to fair value through profit or loss: the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

In the reporting periods presented in these financial statements, the Bank classified investments in debt securities as financial assets at fair value through other comprehensive investment income.

Interest income and expense from financial assets measured at fair value through other comprehensive income are presented in net interest income. Gains and losses from sale of financial assets measured at fair value through other comprehensive income are presented as a result of investment securities.

Financial assets measured at fair value through other comprehensive income and financial assets measured at fair value through profit or loss are valued at the end of the reporting period according to their fair value. Financial assets measured at amortized cost, 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 profit or loss are recognized in the income statement in the period in which they arise.

Gains and losses arising from changes in the fair value of financial assets measured at fair value through other comprehensive income are recognized in other comprehensive income until the derecognition of the respective debt instrument 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. If the fair value of a debt instrument measured at fair value through other comprehensive income 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.

Capital instrument

Dividends on 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.

In reporting periods presented in these financial statements, there were no equity instruments at the Bank.

Modification of contractual terms for financial assets

The Bank settles previously recognized financial assets and re-recognizes the financial assets in accordance with the requirements for initial recognition in case of substantial modification of contractual terms of financial assets. As substantial modification the Bank defines such a modification that meets one of the following criteria:

- substantial increase of the credit amount of more than 10%,
- substantial prolongation of the contractual maturity of more than 12 months,

- change of the currency – when the original contract does not provide for an unconditional conversion option,
- change of the borrower – only if the current borrower is exempted from the debt (not applicable if another borrower participates in the contract),
- change of the cash flow criterion from 'SPPI compliance',
- change of the financed asset.

In the event of substantial modification the deferred income and expense related to this assets is recognized in the income statement and the provision is released. At the same time there is re-recognition of financial assets in accordance with the requirements for initial recognition. Any other modifications of contractual terms that do not cause derecognition of financial assets are treated as not substantial modifications and the gain or loss on modification is recognized. The effect of all identified not substantial modifications of cash flows are treated as not related to credit risk. The result on modification is the difference between present value of the modified cash flows discounted using the old effective interest rate and the effective loan exposure. Commissions received related to minor modification are settled over time using effective interest rate.

Purchased or originated credit impaired financial assets (POCI assets)

POCI are financial assets measured at amortized cost that at initial recognition are credit impaired. POCI are also financial assets that are credit impaired at the moment of substantial modification. At the initial recognition POCI assets are recognized at fair value. The fair value of POCI assets at the initial recognition is calculated as present value of estimated future cash flows including credit risk discounted for the risk free rate. After the initial recognition POCI assets are measured at amortized cost. With respect to these financial assets the Bank uses credit adjusted effective interest rate in order to determine the amortized cost of financial asset and the interest income generated by these assets – CEIR. In case of POCI exposures the change of the expected credit losses relative to the estimated credit losses at the date of their initial recognition is recognized as an impairment loss. Its value can both reduce the gross value of POCI exposure and increase it in the event of a decrease of expected losses relative to its value at the date of initial recognition.

Reclassification of financial assets

Financial assets are reclassified when, and only when, the Bank changes its business model for managing financial assets. In such a case the assets affected by the change of business model are subject to reclassification.

Reclassification of financial liabilities

Financial liabilities are not subject to reclassification by the Bank.

2.7. 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 recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. The only assets and liabilities that the Bank compensates for are those related to hedge accounting.

2.8. Impairment of financial assets

Financial instruments subject to estimation of allowance and provision are: financial assets measured at amortized cost, financial assets measured at fair value through other comprehensive income, loan commitments if not measured at fair value through profit or loss.

Financial assets measured at amortized cost - how exposures are classified to stages

The transfer logic is an algorithm used to classify exposures to one of the four Stages: 1, 2, 3, POCI. Stage POCI contains assets identified as credit-impaired at initial recognition. Other loans and advances can be classified up to stage 1, 2 or 3. Stage 1 includes exposures for which provisions/write-downs are calculated on a 12-month basis. Stage 2 contains exposures for which, as at the reporting date, a significant deterioration in credit quality was identified compared to the date of their initial recognition – provisions/write-downs are calculated on a lifetime period. Stage 3 contains exposures identified as credit-impaired. Once the quantitative or qualitative criteria that were used to classify the exposure in Stage 2 at the reporting date are no longer met, (the client and the exposure assigned to him or her no longer meet any of the Transfer Logic qualitative criteria or quantitative criteria), the exposure will be moved from Stage 2 to Stage 1. The exposure may also be transferred from Stage 3 to Stage 2 and from Stage 3 to Stage 1 (when no longer credit-impaired).

In the case of the retail portfolio acquired in cooperation with mBank S.A., there is no grace period and the exposure leaves basket 3 to basket 1 or 2 after the impairment premise ceases. There is also no grace period when switching from basket 2 to basket 1.

In the case of the commercial portfolio, the transfer from Cart 3 is preceded by a minimum 90-day quarantine period.
The transfer from Cart 2 to Cart 1 is possible after the appropriate period:

- for the Forborne flag (customer's status indicating his difficulties in paying off the credit obligation in accordance with the Forborne definition used in the Bank) - after a minimum of two years;
- for the Watch flag (the Bank's internal process indicating corporate customers subject to special observation with respect to changes in their credit quality, in accordance with the rules of classification into the Watch List adopted by the Bank) - after meeting the conditions for exit from the WL;
- for overdue receivables by more than 30 days - immediately after the condition is fulfilled.

<u>Retail portfolio obtained in cooperation with mBank S.A.</u>

In the area of impairment allowances and provisions calculation for the portfolio acquired in cooperation with mBank, group credit risk models are used, of which the Bank is a local user.

An impairment indication with respect to credit exposures of a given debtor is a credit risk event as a result of which, based on information held, the Bank recognizes that the debtor is unlikely to repay a given credit obligation in full, without fulfilling the accepted collateral.

In case of the retail portfolio obtained in cooperation with mBank S.A., it is assumed that there is an evidence of loss of value of a retail exposure, when a natural person obliged due to a given product is in default state, which means:

- that the overdue of at least one loan liability of the debtor is maintained for a period exceeding 90 days and the total amount of overdue on all loan exposures of the debtor (overdue by over 31 days) exceeds PLN 500,
- one of the client's transactions is subject to restructuring,
- loan claim is sold with significant economic credit loss,
- the Bank submits a motion to commence execution proceedings, bankruptcy or recovery proceedings (resulting with possible omission or delay in repayment) by the debtor,
- loss impairment was made as a result of significant deterioration of the client's creditworthiness.

A credit exposure provides indication of impairment where:

- recovery actions are taken at the court stage or the contract is prepared for write-off,
- a payment of a benefit on account of low own contribution insurance was made by the insurance company,
- the transaction was deemed fraudulent (there was a case of falsification or of providing false data in documents establishing the identity of the debtor or in documents relating to collateral accepted).

<u>Significant deterioration of credit quality</u>

A significant deterioration in credit quality is recognised for the asset concerned on the basis of quantitative and qualitative criteria, with the asset being transferred to Stage 2 once at least one of such qualitative or quantitative criteria is met.

<u>Qualitative criteria</u>

Qualitative criteria are:

- where an amount is more than 30 days past due (days past due, with an activation threshold – the number of days for which the longest overdue amount of the exposure concerned is greater than or equal to 31 days),
- occurrence of the Forborne flag (the client status shows that he or she is experiencing difficulties in repaying the loan commitment, as defined by the Bank).

Quantitative criteria

The quantitative criterion of the Transfer Logic is based on a significant deterioration in credit quality, which is assessed on the basis of a relative long-term change in Probability of Default (PD), specified for the exposure at the reporting date, relative to the long-term PD specified on initial recognition. Where a relative change in long-term PD exceeds "the transition threshold", the exposure is moved to Stage 2. Initial date re-recognition is determined for the exposures for which substantial modification of contractual terms took place. Each change of initial recognition date results in recalculation taking into account the new exposure characteristics, initial PD parameter at the new initial recognition date, against which the credit quality deterioration is examined.

Estimating expected credit losses (ECL)

Valuation allowances and provisions are measured at the level of a single contract by measuring expected credit losses (ECL). In the portfolio approach, expected credit losses are the multiplication of individual for each exposure estimated value of PD, LGD and EAD and the final value of expected credit losses is the sum of expected credit losses in particular periods discounted with the effective interest rate. If on the reporting date the exposure credit risk did not increase significantly since the initial recognition, the Bank calculates impairment provisions in the amount equal to 12-month expected credit losses (12m ECL). If the exposure credit risk increased significantly since the initial recognition (exposure is in the stage 2), the Bank calculates impairment provisions in the amount equal to life-time expected credit losses (Lt ECL). An expected loss is measured for non-zero exposures that are active at the reporting date (balance sheet and off-balance sheet). An expected credit loss is estimated separately for the balance- and off-balance-sheet part of the exposure. The parameters used to calculate an expected credit loss in Stage 1 are identical to those used to calculate a long-term credit loss in Stage 2 for t=1, where 't' stands for the first year of the forecast.

Use of macroeconomics scenarios in ECL estimation

The Bank is required to set an expected credit loss in a way which meets the expectations for various forward-looking macroeconomic scenarios in case of portfolio estimation of ECL. Therefore, the non-linearity factor (NLF) is set in order to adjust the value of an expected credit loss (calculated every month). The NLF factor is determined once a year. NLFs are used as scaling factors for individual ECLs (both 12-month and lifetime) that are determined at the level of individual exposures. NLFs are calculated based on results from 3 simulation calculations at the same reporting date, which result from relevant macroeconomic scenarios.

In particular, NLF is calculated as:

1. the probability-weighted average of the expected loss from 3 macroeconomic scenarios ('average estimation') comprising:
    a. baseline scenario,
    b. optimistic scenario,
    c. pessimistic scenario,
2. divided by the expected loss determined under baseline scenario (reference estimate).

Simulation calculations, whose results are used to calculate NLF, are carried out on the basis of the same input data on exposure characteristics, but involve different risk parameter vectors, if the macroeconomic expectations defined in the scenarios are such as to affect the value of these parameters.

Impairment corporate portfolio

Corporate exposures, i.e. all non-retail credit exposures of the Bank (specialist loan portfolio, housing developers, local government units portfolio and other commercial exposures), are deemed to be credit-impaired where the results of an impairment test demonstrate the need to establish valuation allowances/provisions. A client is reclassified as in default when one or more of the following criteria are met:

a) deterioration of counterparty/transaction loan quality. The Bank recognises that the debtor probably will not fully fulfil its loan obligations against the Bank, parent entity of the Bank without actions of the Bank, such as implementation of collateral, if such exists,

b) delay in payments for over 90 days. Any of the exposures of a nature of debtor loan obligation against the Bank, parent entity of the Bank is overdue for more than 90 days, provided that the overdue amount exceeds PLN 3 000,

c) qualification of an entity to a default situation by the Bank's parent entity.

The following elements constitute "hard" evidence of failure to fulfil obligation and indicate deterioration of loan quality of a client/transaction in accordance with the above definition:

a) preparation of a loss impairment as a result of significant deterioration of debtor's creditworthiness,
b) sale by the Bank of an exposure with significant economic loss associated with changes in its creditworthiness,
c) the Bank's permission for forced restructuring of loan liability, if it may cause reduction of financial liabilities through amortisation of significant part of the liability or deferring of payment of the principal amount, interests or - if applicable - commission,
d) filing by the Bank a bankruptcy motion against debtor or filing similar motion in respect of loan obligations of the debtor towards the Bank, the parent of the Bank.
e) bankruptcy of debtor or acquiring by him a similar legal protection resulting in his evasion of or delay in repayment of loan obligations towards the Bank, the parent entity of the Bank,
f) fraud of the client (provision of false data at the time of granting of a loan or during its monitoring, credit fraud etc.),
g) termination of an agreement (in whole or in part) and/or initiation of debt collection activities.

Apart from hard evidence, which determine occurrence of default event, the Bank identifies soft evidence. Occurrence of a soft evidence does not automatically cause necessity for classification as a default event. Soft evidences have supplementary nature. These are issues which Bank should additionally consider during analysis of the situation of the borrower and which may indicate its deterioration. If in the Bank's assessment identified soft evidence have significant meaning for a particular case, the Bank should proceed with an assessment whether a default event occurred regardless of lack of hard evidence.

<u>Significant deterrioration</u>

A significant deterioration in credit quality is recognised for the asset concerned on the basis of qualitative criteria.

Qualitative criteria are:

- where an amount is more than 30 days past due and exceeds PLN 3 000 (days past due, with an activation threshold – the number of days for which the longest overdue amount of the exposure concerned is greater than or equal to 31 days),
- occurrence of the Forborne flag (the client status shows that he or she is experiencing difficulties in repaying the loan commitment, as defined by the Bank).
- occurrence of the Watch flag (the Bank's internal process designed to identify corporate clients who are subject to increased monitoring in terms of changes in credit quality, in accordance with the Watch List classification rules adopted by the Bank).

<u>Estimating expected credit losses (ECL)</u>

Valuation allowances and provisions are measured at the level of a single contract by measuring expected credit losses (ECL). In the portfolio approach, expected credit losses are the multiplication of individual for each exposure estimated value of PD, LGD and EAD and the final value of expected credit losses is the sum of expected credit losses in particular periods, the element of discounting expected losses determined for subsequent periods is included in the EAD parameter. If on the reporting date the exposure credit risk did not increase significantly since the initial recognition, the Bank calculates impairment provisions in the amount equal to 12-month expected credit losses (12m ECL). If the exposure credit risk increased significantly since the initial recognition (exposure is in the stage 2), the Bank calculates impairment provisions in the amount equal to life-time expected credit losses (Lt ECL). An expected loss is measured for non-zero exposures that are active at the reporting date (balance sheet and off-balance sheet). An expected credit loss is estimated separately for the balance- and off-balance-sheet part of the exposure. The parameters used to calculate an expected credit loss in Stage 1 are identical to those used to calculate a long-term credit loss in Stage 2 for t=1, where 't' stands for the first year of the forecast.

In the individual approach (all balance sheet and off-balance sheet credit exposures with an impairment in the corporate loan portfolio are treated as individually significant), the expected credit losses are calculated as a difference between the gross carrying amount of the asset and the present value of the estimated future cash flows discounted with the effective interest rate. The method of calculating the expected recoveries takes place in scenarios and depends on the Bank's chosen strategy for the client. In case of restructuring strategy, the scenarios considered assume a significant share of recoveries from the customer's own payments. In case of vindication strategy, the scenarios are based on collateral recoveries.

<u>Use of macroeconomics scenarios in ECL estimation</u>

The Bank is required to set an expected credit loss in a way which meets the expectations for various forward-looking macroeconomic scenarios in case of portfolio estimation of ECL for corporate portfolio, this element is considered in the process of determining PD and LGD.

Determination of the risk of corporate client's insolvency within the credit maturity horizon is based on generation of income from lease of various properties, taking into account models of risk factors influencing changes in the amount of such income. As part of the modelling process, both specific market data (exchange rates, interest rates) as well as specific property data (expected revenue forecasts, schedule liabilities) are subject to distortions in order to determine the value of revenues, liabilities, property value and LTV ratios over the loan maturity horizon. The likelihood of an adverse economic situation, which may lead to or contribute to default, is modelled on the basis of a set of default conditions (independent of the regulatory definition of default), in a Monte Carlo simulation, which ensures that a wide range of scenarios for possible future macroeconomic developments considered.

Determination of the LGD level for a corporate client in the horizon up to the loan maturity is made on the basis of forecasted LtV levels, which in turn are affected by forecasted rental price levels, vacancy levels and exchange rates.

<u>Loan receivable write-off</u>

Loan receivable write-off can be partial or total. In case of retail banking, writing off receivables can be done in the case of:

1. Debt recovery is not possible e.g.:
a. the claim limitation,
b. fraud – inability to identify the debtor,
c. limitation of inheritors' liability,
d. the claim was questioned by the debtor in court.

2. The lack or exhaustion of recovery capacity, in particular:
a. the discontinuance of enforcement proceedings due to its ineffectiveness,
b. rejection of the application for bankruptcy or closure of bankruptcy proceedings on the grounds that the debtor's assets are insufficient to cover the costs of the proceedings,
c. the recognition of the claim as irrecoverable - the costs of recovery exceed the potential recovery.

2.9. 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 banks, amounts due from other banks and government securities acquired for the purpose of short-term resale.

2.10. Derivative financial instruments and hedge accounting

Derivative financial instruments are recognised 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 recognised 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 in note 2.11.

Derivative instruments, which are designated and constitute effective hedging instruments, are subject to the principles of hedge accounting.

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 Group designates some derivative instruments either as (1) fair value hedges against a recognised 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 recognised 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 fulfillment 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 relationshi;
- 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 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 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.

<u>Fair value hedges</u>

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 liability that are attributable to the hedged risk. The Bank presents the adjustment of balance sheet value of the hedged instrument as the separate line of the statement of financial position. The gain or loss on hedging a hedged item adjusts the carrying amount of the hedged item.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.

Cash flow hedges

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

2.11. 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.

If the Bank determines that the fair value on initial recognition differs from the transaction price, it recognises the difference between the two values on that date as follows:

- as a gain or loss if the fair value is evidenced by the price quoted in an active market for an identical or identical asset or is based on a valuation technique that uses only data from observable markets,

- in other cases, including for CIRS transactions, is deferred.

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 Group 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 data, 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 recognised immediately in the income statement without reversal of deferred day one profits and losses.

2.12. Financial liabilities measured at amortised cost

Financial liabilities measured at amortized cost include borrowings, deposits taken, debt securities issued and subordinated liabilities. These liabilities are initially recognized at fair value reduced by the incurred transaction costs. After the initial recognition, these liabilities 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.

2.13. Intangible assets

Initially the Bank recognises intangible assets at acquisition cost. Subsequently intangible assets are recognised at their cost of acquisition adjusted by the costs of improvement (rearrangement, development, reconstruction, adaptation or modernisation) less any accumulated amortization and any impairment losses. Accumulated amortization is accrued by the straight line method taking into account the expected period of economic useful life of the respective intangible assets. Expenditures on an intangible asset are included in costs as they are incurred, unless they constitute an element of the purchase price or cost of creation of an intangible asset that meets the criteria of recognition.

On each balance sheet day the company carries out an assessment whether or not any indications exist for possible value impairment of any asset item. If any such indication exists, the company estimates the recoverable amount of such respective asset.

Computer software

Purchased computer software licences are capitalised in the amount of costs incurred for the purchase and adaptation for use of specific computer software. Capitalised costs are amortised on the basis of the expected useful life of the software (2-10 years). Expenses attached to the development or maintenance of computer software are expensed when incurred. Expenses directly linked to the development of identifiable 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 recognised as intangible assets.

Capitalised costs attached to the development of software are amortised over the period of their estimated useful life.

Development costs

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 ability to complete and to use the generated intangible asset, the availability of adequate technical and financial resources to complete and to use the generated intangible asset and the ability to measure reliably the expenditure attributable to the generated 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.

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.

2.14. 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.

Purchase price or cost of production of a given tangible fixed asset is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction. The purchase price or cost of production also consist in all directly attributable costs incurred in order to adjust an asset to place and conditions necessary to begin its functioning, including also costs of demounting, removal of an asset or renovations to which the Bank is obliged. The purchase price or cost of production also cover expenditures incurred at a later date in order to increase the asset's useful life, change of its component or its renewal.

The value, which is either a purchase price or cost of production of specific assets or fair value established in other way reduced by the residual value of this asset, should be depreciated.

The depreciation is a systematic distribution of value subject to amortisation over the useful life of an asset. Impairment loss is recognised in the amount by which the carrying value of given asset item exceeds its recoverable value.

The recoverable value corresponds to the net selling price of an asset or its use value depending on which is higher.

The residual value of the asset is the amount, which according to the forecast the company could currently obtain taking into consideration the age and state at the end of its life (after deducting the estimated selling costs).

Depreciation period and annual depreciation rate are determined considering the economic usability period of given tangible fixed assets. Correctness of the applied periods and rates for depreciation is subject to periodical review - not later than at the start of each fiscal year. If the expected useful life of the asset is different from previous estimates, the depreciation period is changed accordingly. The above changes are presented by the Bank as changes in estimates and their effect is taken to profit or loss in the period when the estimate changes.

The Bank depreciates tangible fixed assets using the straight-line method by distributing its initial value or revalued amount reduced by residual value by estimated useful life. The residual value of useful life of an asset is verified at the end of each financial year and in case when expectations differ from previous estimations, the change is recognised as the change of estimated values.

Useful life of an asset is a period in which according to expectations a given asset will be used.

Useful lives of individual groups of tangible fixed assets amount to:

- Technical equipment and machinery	5 - 10 years,
- IT equipment	4 - 5 years,
- Equipment and vehicles	5 - 10 years,
- Leasehold improvements	in the expected lease/rent period,
- Office equipment and furniture	5 - 12 years

If for a given tangible fixed asset expected useful life is different than the one specified above, the period of depreciation for a given asset may be determined with consideration of this difference.

Depreciable fixed assets are tested for impairment always whenever events or changes in circumstances indicate that the carrying value may not be recoverable and at the end of each reporting period. 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 an individual asset, the Bank determines the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).

The balance sheet value of tangible fixed assets is removed from the statement of financial situation upon disposal of this item or when no future economic benefits resulting from its use or disposal are expected.

The Bank does not increase the balance sheet value of tangible fixed assets by the costs of current maintenance of those assets. Repair and maintenance costs are recognized in the income statement in the period in which they occurred.

In case of replacement of a component of a tangible fixed asset, the Bank recognises costs of replacement of parts of those items in the balance sheet value of tangible fixed assets as they are incurred. The balance sheet value of components is written off in accordance with conditions of removal from the statement of financial situation.

Profits and losses resulting from the removal of a tangible fixed asset item from the statement of financial situation are established as the difference between net disposal proceeds and the balance sheet value of this item and are recognised in the income statement at the moment of removal of this position from the statement of financial situation.

2.15. Current and deferred income tax

Income tax is recognized as current tax and deferred tax. The current income tax is recognized in the income statement. The deferred income tax is recognized in the income statement or in other comprehensive income depending on the source of origin of temporary differences. The current tax is a tax liability relating to taxable income using a current tax rate, with all adjustments to the tax liability for the previous years.

Deferred tax liabilities and 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. Liabilities or assets for deferred corporate income tax are recognised 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. Temporary differences are differences between the carrying amount of an asset or liability and its tax value. Positive net differences are shown in liabilities as “Deferred income tax provision". Negative net differences are recognized as "Deferred income tax assets". Changes in the deferred income tax provision and deferred income tax assets in relation to the previous financial period are included in the item "Income tax".

Balance sheet value of deferred income tax assets is subject to review as at each balance sheet date and relevant correction is recognised, by the amount corresponding to the correction of the expected future taxable income that will enable partial or full utilisation of such deferred income tax assets. Unrecognised deferred income tax asset is subject to reassessment for each balance sheet date and is recognised up to the amount reflecting probability of achieving future taxable income which will allow for recovery of this asset.

The Bank presents the individual deferred income tax assets and liabilities netted in the statement of financial position, if the Bank has a legally enforceable right to their simultaneous consideration in calculating the tax liability.

Deferred income tax due to revaluation of available-for-sale financial assets and due to actuarial profits and losses on valuation of pension benefits is recognised in the same manner as revaluation and actuarial profits and losses, directly in the other comprehensive income.

The Bank uses the accounting method to determine exchange differences as of January 1, 2015.

2.16. Inventories

Assets repossessed for debt are classified by the Bank as inventories. At initial recognition assets repossessed for debt are valued at their fair value and then are stated at the lower of: purchase price or net sales price. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling costs. The amount of any inventory write-downs to the net realisable value and any inventory losses are recorded as costs of the period in which a write-down or a loss occurred. Reversals of inventory write-downs resulting from increases in their net realisable value are recorded as other operating income.

2.17. 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".

2.18. Provisions

Loan committments and financial guarantee contracts are subject to loan loss provisions requirements according to IFRS 9 Financial Instruments.

According to IAS 37, provisions are recognised 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.

2.19. Post-employment employee benefits and other employee benefits

Provision for retirement and similar 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. Current employment costs and net interest are recognized in the income statement under "Overhead costs". Actuarial profits and losses are recognised in other comprehensive incomes which will not be reclassified to the income statement.

Phantom share-based benefits settled in cash

The Bank runs a remuneration program for the Management Board and persons having a significant impact on the risk profile of the Bank based on phantom shares settled in cash. These benefits are accounted for in accordance with IAS 19 "Employee Benefits". Measurement value of phantom shares increases costs incurred in a given period in correspondence with the commitments. The costs are accounted for over the vesting period and recognised in the item "Overhead costs". Phantom shares are granted in quantity based on the valuation of these shares for the appraisal period. The phantom share valuation is calculated each time at the end of the reporting period as the Bank carrying value divided by the number of ordinary shares. The payout under phantom shares depends on the average valuation of these shares obtained on the basis of two values: the phantom share value at the end of the annual period preceding the payment date and the phantom share value at the end of the first half of the year in which the payment is due in a given reporting period. The aforementioned average value is multiplied by the number of phantom shares to be executed in a given period, and the outcome determines the amount of the cash payment resulting from phantom shares held. The final value of the bonus, which constitutes the product of the number of shares, and their expected value on the balance sheet date preceding the implementation of each of deferred trenches is actuarially discounted on the reporting day. The discounted amount is reduced by actuarially discounted amount of annual allocation to the reserve for the same day. The actuarial discount means the product of financial discount and probability of reaching the moment of complete purchase of entitlements to each of deferred trenches by each of participants individually. Amounts of annual allocations are calculated in accordance with projected unit credit method. The probability referred to above was established using Multiple Decrement Model, where the three following risks were taken into account: the probability of dismissal from work, risk of total incapacity to work, risk of death. Details of the programme are provided in Note 39.

2.20. Issue of securities

The Bank's liabilities resulting from issue of securities (covered bonds, bonds) upon initial recognition are valuated according to the fair value, taking into account the costs of transaction that may be directly assigned to the issue, and throughout the entire duration of the transaction they are valued to the amount of amortised cost including the effective interest rate. The amount of the reversal is recorded in the income statement in "Interest expense".

2.21. Loans and advances received

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

2.22. Equity

Equity consists of capital and own funds attributable to owners of the Bank, and non-controlling interest created in compliance with the respective provisions of the law, i.e., the appropriate legislative acts, the Bank by-laws.

<u>Registered share capital</u>

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

<u>Share premium</u>

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

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

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

<u>Retained earnings</u>

Retained earnings include

- other supplementary 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.

<u>Inne pozycje kapitałów</u>

<u>Inne pozycje kapitałów tworzone są w wyniku:</u>

- valuation of financial assets at fair value through other comprehensive income,,
- actuarial gains and losses relating to post-employment benefits,
- applying cash flow hedge accounting

2.23. Leasing

The Bank acts as the lessee. Leases are recognized as the right to use an asset together with the corresponding lease liability determined at the amount of discounted future payments over the lease term, except for short-term leases of up to 12 months and leases involving insignificant assets.

Expenses related to the use of leased assets are classified as amortization costs and interest costs.

Assets by virtue of the right of use are depreciated on a straight-line basis, while liabilities by virtue of leasing contracts are settled taking into account the effective interest rate.

<u>mBankHipoteczny S.A. as a lessee</u>

If lease definition is fullfilled, the Bank recognizes the right to use of the leased asset and a financial liability representing its obligation to make future lease payments in the amount of discounted future cash flows throughout the lease period. The Bank as a lessee applies simplified approach and it does not apply the requirements in terms of recognition, measurement and presentation for short-term lease contracts lasting no longer than 12 months for each class of underlying asset as well as for lease contracts for which the underlying asset is of low value, i.e. less than PLN 20 000 for separate leases. Lease payments are recognized as costs using straight-line method throughout the lease period for lease contracts for which the Group applies simplified approach. Perpetual usufruct right is classified as a lease according to IFRS 16 due to the occurrence of future fees for the use of this right. The Group assumed that the lease period for this type of contracts is the remaining period of the right granted since the transition to IFRS 16.

Group shall determine the lease term as the non-cancellable period of a lease, together with both:

- periods covered by an option to extend the lease if the Bank as a lessee is reasonable certain to exercise that option, and
- periods covered by an option to terminate the lease if the Bank as a lessee is reasonable certain not to exercise that option.

The Bank shall reassess whether it is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease. The Bank shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise an option to extend a lease, or not to exercise an option to terminate a lease. The Bank shall reassess whether it is reasonably certain to exercise an extension option, or not to exercise a termination option, upon the occurrence of either a significant event or a significant change in circumstances that is within the control of the Bank as a lessee, and that affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term. The Bank shall revise the lease term if there is a change in the non-cancellable period of a lease.

- the amount of the initial measurement of the lease liability
- any lease payments made at or before the commencement date, less any lease incentives received,
- initial direct costs incurred by the Group as a lessee in connection with the conclusion of the leasing contract and

- an estimate of the costs to be incurred by the Group as a lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories.

After the commencement date, the Group as a lessee shall measure the right-of-use asset at cost:

- less any accumulated depreciation and any accumulated impairment losses and,
- adjusted for any remeasurement of the lease liability.

The Bank applies the depreciation requirements in IAS 16 Property, Plant and Equipment in depreciating the right-of-use asset and requirements in IAS 36 Impairment of Assets to determine whether the rightof-use asset is impaired. At the commencement date, the Group shall measure the lease liability at the present value of the lease payments that are not paid at that date. At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments

- fixed lease payments less any lease incentives,
- variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date,
- amounts expected to be payable by the lessee under residual value guarantees,
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option and,
- payment of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Variable lease payments that depend on an index or a rate include, for example, payments linked to a customer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates. After the commencement date, the Group shall measure the lease liability by:

- increasing the carrying amount to reflect interest on the lease liability,
- reducing the carrying amount to reflect the lease payments made and,
- remeasuring the carrying amount to reflect any reassessment or lease modifications or to reflect revised in-substance fixed lease payments

The Group discounts lease payments using the interest rate of lease if this rate can be easily determined. Otherwise, the Group applies the marginal interest rate of lessee. As the lessee the Group estimates the discount rate taking into account the duration and the currency of the contract.Cash payments of lease liabilities are classified in statement of cash flows within financial activities. Short term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability are classified in statement of cash flows within operating activites. The total inflow from leasing recognized in accordance with IFRS 16 and other types of leasing, i.e. short-term leasing fees, leasing fees including low-value assets and variable leasing fees is PLN 3,848 thousand.

Before the implementation of IFRS 16, the Bank, as a lessee, classified lease agreements existing in the Bank as operating lease agreements. All lease payments made under operating lease were charged to costs on a straight-line basis over the lease term. There were no financial lease agreements in the Bank.

2.24. Valuation of items denominated in foreign currencies

Functional currency and presentation currency

The financial statements are presented in PLN thousand, with PLN being the functional and presentation currency of the Bank.

Transactions and balances

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

Foreign exchange differences arising on account of such monetary items as financial assets measured at fair value through profit or loss are recognised under gains or losses arising in connection with changes of fair value.

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

2.25. Tax from the off-balance sheet positions of the Bank

The Bank presents the tax from the off-balance sheet positions of the Bank in the separate line of the income statement, below the operating result.

2.26. 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 binding for annual periods starting on 1 January 2019.

IFRS 16 Leases

The Standard was issued by International Accounting Standards Board (IASB) on 13 January 2016 and it has been accepted by the European Union. IFRS 16 applies for annual reporting periods beginning in or after 1 January 2019. The incoming standard supersedes regulations effectual until the end of 2018: IAS 17 Leasing, IFRIC Interpretation 4 and SIC Interpretations 15 and 27.

The incoming standard introduces a single lessee accounting model. As per IFRS 16, the contract is, or contains, a lease, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Transfer of the right of use occurs when it concerns an identified asset, for which the lessee possesses the right to obtain substantially all of the economic benefits and controls use of the asset throughout the particular period.

If the lease definition is met, a company recognizes the right to use of the leased asset together with a lease liability equivalent to discounted future lease payments during the lease term, excluding short-term lease contracts lasting no longer than 12 months and lease contracts concerning immaterial lease assets.

The expenses related to the use of leased assets, previously presented as overhead costs, currently are to be classified as depreciation and interest expenses.

Right-of-use assets are depreciated on a straight-line basis, while liabilities under lease contracts are settled using the effective interest rate.

Impact of IFRS 16 on financial statements

In the first quarter of 2019, the Bank completed the implementation of IFRS 16 (project), which was planned in three stages:

- stage I – analysis of all contracts for purchase of services, regardless of the current qualification, aimed at selecting those contracts on the basis of which the Bank uses assets belonging to suppliers,

- stage II – assessment of contracts identified in the first stage in terms of meeting the criteria to be classified as lease in accordance with IFRS 16,

- stage III – implementation of IFRS 16 based on the developed concept.

The object of the analyzes covered all financial leases, operating leases, rental and tenancy agreements. In addition, the transactions of acquired services (costs of external services within operating activities) were analyzed in terms of the use of an identified asset.

As part of the project, the Bank made relevant changes to the accounting policy and operational procedures. Methodologies for the correct identification of contracts that are leasing and the collection of data necessary for the correct accounting treatment of these transactions have been developed and implemented.

The Bank decided to implement the standard as of 1 January 2019. In accordance with the transitional provisions included in IFRS 16, the new principles were adopted retrospectively with reference to the cumulative effect of the initial application of the new standard to equity as at 1 January 2019. Therefore, comparative data for the financial year 2018 have not been restated (modified retrospective approach).

Individual adjustments to the opening balance sheet as at 1 January 2019, resulting from the implementation of IFRS 16 are described below.

Description of adjustments

(a) Recognition of lease liabilities

After the adoption of IFRS 16, the Bank recognizes lease liabilities in connection with a lease that was previously classified as an operating lease in accordance with the principles of IAS 17 Leasing. The liabilities result primarily from lease contracts for real estate and car leasing. These liabilities have been measured at the present value of lease payments remaining to be paid at the date of application of IFRS 16, discounted discounted using the leasing interest rate as at 1 January 2019, calculated on the basis of the Bank's incremental borrowing rate.

In order to calculate discount rates for IFRS 16, the Bank assumed that the discount rate should reflect the cost of financing that would be incurred to purchase the leased asset.

As at 1 January 2019, the discount rates calculated by the Bank amounted to:

- for contracts in PLN: 1.95%;

- for contracts in EUR: 0.02%.

(b) Recognition of right-of-use assets

Right-of-use assets are measured at cost and presented in the statement of financial position together with the assets owned by the Bank along with the breakdown of additional information in the explanatory notes.

As at 1 January 2019, the cost of right-of-use assets included the amount of the initial measurement of the lease liability.

(c) Application of estimates

The implementation of IFRS 16 required making certain estimates and calculations of the interest rate used to discount future cash flows that have an impact on the valuation of financial lease liabilities and right-of-use assets. Discount rates of mBank Hipoteczny S.A. and mBank S.A. slightly differ, and therefore a decision was taken to use the same discount rate, and the discount rate of mBank S.A. was used.

(d) The use of practical simplifications

When applying IFRS 16 for the first time, the Bank applied the following practical simplifications allowed by the standard:

- applying one discount rate to the portfolio of lease contracts with similar features;

- operating lease contracts with the remaining lease term of less than 12 months as at 1 January 2019 will be treated as short-term leases;

- for operating leases for which the underlying asset is of low value (less than PLN 20,000), the Bank did not recognize any financial liabilities or related right-of-use assets. Lease payments on this account are recognized as expenses during the lease period;

- the exclusion of initial direct costs in the measurement of right-of-use assets on the date of initial application; and

for 2019 (in PLN thousand)

- using the time perspective (using the knowledge gained after the fact) in determining the lease term, if the contract includes options for extending or terminating the lease contract.

Impact on the statement of financial position

The impact of the implementation of IFRS 16 on the recognition of additional financial liabilities and related right-of-use assets is presented in the tables below:

	31.12.2018 without the effect of implementing IFRS 16	The effect of implementing IFRS 16	01.01.2019 with include the effect of implementing IFRS 16
Assets			
Tangible assets	8 678	8 070	16 748
including: the right to use	-	8 070	8 070
TOTAL LIABILITIES AND EQUITY			
Financial liabilities measured at amortised cost	11 253 826	8 994	11 262 820
including: liabilities from leasing	-	8 994	8 994

The reconciliation of the difference between the amounts of future lease payments due to irrevocable operating leases as at the end of 2018 and the lease liabilities recognized as at the date of first application of IFRS 16 are as follows:

	2019
Liabilities from the operating lease title on 31.12.2018 (without discount)	9 209
Exemption from short-term contracts	(109)
The impact from the discount using the Bank's marginal interest rate	(106)
Financial liabilities due to leasing on 01.01.2019	**8 994**
Other adjustments affecting the value of the right to use	(924)
Right to use on 01.01.2019	**8 070**

Impact on the income statement

Since 2019 in the Bank’s income statement, a change in the classification of costs will appear (rental costs will be replaced by depreciation and interest expense) and the time of recognition (recognition of leasing costs will be faster due to recognition of interest cost using the effective interest rate method which was previously not applied to contracts other than those classified as finance leases in accordance with IAS 17).

Impact on equity

The implementation of IFRS 16 does not affect retained earnings and equity of the Bank as at 1 January 2019.

Impact on capital ratios

Due to the inclusion of leases in the Bank’s balance sheet as at 1 January 2019, the total amount of risk exposures increased, and thus the total capital ratio of the Bank decreased by ca. 2 base points.

Standards and interpretations approved by the European Union

Published Standards and Interpretations that have been previously applied

- Amendments to IFRS 9, IAS 39 and IFRS 7, Interest Rate Benchmark Reform, published by International Accounting Standards Board on 26 September 2019, endorsed by European Union on 16 January 2020, binding for annuals periods starting on or after 1 January 2020.

  Amendments to IFRS 9, IAS 39 and IFRS 7 conclude phase one of the International Accounting Standards Board’s work to respond to the effects of Interbank Offered Rates (IBOR) reform on financial reporting. The amendments provide temporary reliefs which enable hedge accounting to continue during the period of uncertainty before the replacement of an existing interest rate benchmark with an alternative risk-free interest rate. As a result of interest rate benchmark reform, there may be uncertainties about the timing and amount of benchmark-based cash flows of the hedged item or the hedging instrument during the period before the replacement of an existing interest rate benchmark with an alternative nearly risk-free interest rate. This may lead to uncertainty whether a forecast transaction is highly probable and whether prospectively the hedging relationship is expected to be highly effective. The Bank exercised its right to apply earlier the amendments to the standards and therefore it did not verify effectiveness of hedging relationships.

Published Standards and Interpretations which have been issued but are not yet binding or have not been adopted earl

- Amendments to IAS 1 and IAS 8, Definition of Material, published by the International Accounting Standards Board on 31 October 2018, endorsed by European Union on 10 December 2019, binding for annual periods starting on or after 1 January 2020.

  Amendments to IAS 1 and IAS 8 clarify the definition of material and its application by aligning the wording of the definition of material across IFRS Standards and other publications and making minor improvements to that wording, as well as including some of the supporting requirements in IAS 1 Presentation of Financial Statements in the definition to give them more prominence. The explanation accompanying the definition of material was clarified. The amendments have the objective to help entities make better materiality judgements without substantively changing existing requirements.
  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 their initial application

- Amendments to References to the Conceptual Framework in IFRS Standards (issued on 29 March 2018), endorsed by European Union on 6 December 2019 and effective for financial years beginning on or after 1 January 2020. Amendments to References to the Conceptual Framework in IFRS Standards is a document that sets out the objective of the financial reporting, the qualitative characteristics of useful financial information, a description of the reporting entity, definitions of an asset, a liability, equity, income and expenses, criteria of recognition assets and liabilities in financial statements and guidance on when to derecognize them, measurement bases and guidance on when to use them, as well as concepts and guidance on presentation and disclosure. The Group is of the opinion that the application of the interpretation will have no significant impact on the financial statements in the period of their initial application.

Standards and interpretations not yet approved by the European Union

These financial statements do not reflect the standards and interpretations listed below, which are pending approval by the European Union but have entered into force or will enter into force only after the balance sheet date.

- IFRS 17, Insurance contracts, published by the International Accounting Standards Board ("IASB") on 18 May 2017, binding for annual periods starting on or after 1 January 2021.

  IFRS 17 defines a new approach to the recognition, valuation, presentation and disclosure of insurance contracts. The main purpose of IFRS 17 is to guarantee the transparency and comparability of insurers' financial statements. In order to meet this requirement the entity will disclose a lot of quantitative and qualitative information enabling the users of financial statements to assess the effect that insurance contracts within the scope of IFRS 17 have on the financial position, financial performance and cash flows of the entity. IFRS 17 introduces a number of significant changes in relation to the existing requirements of IFRS 4. They concern, among others: aggregation levels at which the calculations are made, methods for the valuation of insurance liabilities, recognition a profit or loss over the period the entity provides insurance coverage, reassurance recognition, separation of the investment component and presentation of particular items of the balance sheet and profit and loss account of reporting units including the separate presentation of insurance revenues, insurance service expenses and insurance finance income or expenses.

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

- Amendments to IFRS 3, Definition of a Business, published by the International Accounting Standards Board on 22 October 2018, binding for annual periods starting on or after 1 January 2020.
  Amendments to IFRS 3 clarify the definition of a business, with the objective of assisting entities to determine whether a transaction should be accounted for as a business combination or as an asset acquisition. The main amendments are to clarify that to be considered a business, an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. The assessment of whether the market participants are capable of replacing any missing inputs or processes and continuing to produce outputs has been removed. Moreover, guidance and illustrative examples have been added to help entities assess whether a substantive process has been acquired, and the definitions of a business and of outputs have been narrowed by focusing on goods and services provided to customers and by removing the reference to an ability to reduce costs. An optional concentration test has been added that permits a simplified assessment of whether an acquired set of activities and assets is not a business.

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

- Amendments to IAS 1, Classification of liabilities as current or non-current, published by International Accounting Standards Board on 23 January 2020, binding for annuals periods starting on or after 1 January 2022. Amendments to IAS 1 affect the requirements for the presentation of liabilities in the financial statements. In particular, they explain one of the criteria for classifying liabilities as non-current. The Group is of the opinion that the application of the interpretation will have no significant impact on the financial statements in the period of their initial application.

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

- Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture (issued on 11 September 2014) – the endorsement process of these Amendments has been postponed by EU – the effective date was deferred indefinitely by IASB.

3. Financial risk management

3.1. Credit risk

The Bank is exposed to credit risk consisting in counterparty’s failure to fulfil obligation against the Bank in the full amount within the prescribed period. In order to limit the credit risk, the Bank conducts lending activity in accordance with internal procedures as well as policy of credit decision-making and credit risk assessment.

The maximum exposure to credit risk equals to the amount of positions presented in the statement of financial position and off-balance sheet data presented in the note 22.

3.1.1. Collaterals

The Bank’s Policy in terms of loan collaterals and their valuation includes regulation of acts: on covered bonds and mortgage banks, banking law, Act on registered pledge and pledge register, Act on land and mortgage, provisions of the Commercial Companies Code, provisions of the Civil Code and other Acts. Additionally, the issues of legal safeguard cover Guidelines and Recommendations of the Banking Supervision Commission (currently Polish Financial Supervision Authority - PFSA), including Recommendation S and J as well as provisions of internal banking regulations.

The Bank hold and applies Regulations of Establishing of banking and mortgage real estate value approved by the Banking Supervision Commission (currently Polish Financial Supervision Authority), issued on the basis of the Act dated 29 August 1997 on covered bonds and mortgage banks (consolidated text Journal of Laws 2003 No. 99, item 919 as amended) including provisions of Recommendation F regarding basis criteria applies by the Financial Supervision Authority for approval of regulations of establishing the banking and mortgage lending value of the property issued by mortgage banks. Thereby, the Bank ensures that the value of credit exposure collateral secured by mortgage is sufficient for the entire duration of the agreement. This assurance is based on analysis of long-term profitability of a given real estate, completed by establishing of the amount of capitalised net proceeds possible in long-term to achieve from a given real estate.

The Bank may conduct or order conducting revaluation of collaterals, including the real estate constituting mortgage collateral, provided that in the period from the last valuation events occurred that could have significant influence on the value of a given collateral or in case of real estate which constitutes collateral of loans for which the loss of value was recognised.

As a mandatory legal collateral of repayment of a granted loan the Bank accepts:

- mortgage on real estate that is subject to lending, entered into mortgage and land register in the first place - in case of loans for refinancing, loans to commercial developers, loans to housing developers, loans for land purchase, loans to natural persons, loans to natural persons - agency model, pooling,
- assignment of rights from insurance policy against fire and other random events of a real estate mortgaged to the Bank or assignment of rights from policy against any construction risk of the financed real estate (depending on whether financing covers a completed real estate or an estate under construction) - in case of loans for refinancing, loans to commercial developers, loans to housing developers, loans to natural persons, loans to natural persons - agency model, pooling,
- assignment or pledge on receivables under lease agreements - in case of loans for refinancing, loans to commercial developers,
- blank promissory note of the borrower with bill declaration - in case of loans granted to local government units,
- guarantee of local government units according to civil law - in case of loans for health care facilities and companies appointed by local government units.

In case of commercial loans a dominating organisational form of borrowers of the Bank are so called special purpose companies. To the best knowledge of the Bank, Members of the Management Board and employees of the Bank do not hold positions in bodies of companies that are borrowers of the Bank.

According to IFRS 10, the Bank conducts analysis of exercising of control over units by the Bank. The Bank did not invest in securities and shares of other business units giving it a possibility to exercise current management over significant activities of those units and has no subsidiaries or associated, thus the analysis is related to possible interactions between the Bank and entities credited by it.

If those companies are companies with share capital, i.e. limited liability companies and joint stock companies, the Bank accepts registered pledge on shares or stocks as a legal collateral for repayment of a loan. Therefore, there is also significant concentration of registered pledges on shares or stocks as legal collateral of loan repayment. In case of financing of limited and limited joint stock companies, as legal collateral of repayment of loan the Bank accepts a pledge on shares/stocks of a general partner - an entity authorised to manage affairs of a limited or limited joint stock company.

Regardless of collaterals referred to above, the Bank may accept additional legal forms of collaterals for loans, in particular:

a) bank guarantee,
b) guarantee under civil law or according to the law on bills of exchange,
c) registered pledge on rights or receivables,
d) pledge according to the civil code on rights or receivables,
e) transfer of receivables other than those referred to above,
f) reservation of money on accounts,
g) power of attorney to account,
h) accession to a loan debt,
i) loan insurance,
j) debtors declaration on submission to execution,
k) deposit,
l) borrower’s shareholders’ obligations
m) other forms provided by law.

The Bank establishes the form and value of legal collateral taking into account the specificity of a transaction, i.e. considering:

a) type and amount of loan and period of lending,
b) borrower's legal status,
c) borrower's financial situation,
d) history of cooperation with the borrower and capital group to which the borrower belongs,
e) costs of establishing collateral,
f) possibility of satisfying from accepted collateral of claims of the Bank in the shortest possible time.

In the scope of bank guarantees and assignment of rights from insurance policies, the Bank while selecting counterparties pays attention to financial results and rating of collateral issuers, accepting collaterals from reliable banks and insurance companies only.

3.1.2. Description of the rating system and credit risk management

For the analysis of the loan portfolio the Bank uses rating models which are updated annually. Rating systems currently cover 97.24% of total sum of risk-weighted exposures with standard method including portfolios covered with a plan of gradual implementation and 55.96% without including those portfolios. The difference results from the fact, that 41.28% of the total sum of risk-weighted exposures with standard method are retail exposures gained from the cooperation with mBank S.A., which are part of gradual implementation of the IRB method, accepted by the Polish Financial Supervision Authority. The Bank intends to apply in the future for the acceptance to use the statistical methods to measure regulatory capital requirements for the credit risk of these exposures.

The Bank applies rating models:

- for the purposes of credit risk management, including making credit decisions, assessment of credit risk of a transaction and capital adequacy - in case of commercial portfolio;
- for the purposes of credit risk management, including making credit decisions, assessment of credit risk of a transaction, determination of loss impairments, and eventually also for the purposes of capital adequacy - for exposures in the scope of the retail portfolio obtained in cooperation with mBank S.A.

<u>Commercial portfolio including commercial receivables purchased from mBank S.A.</u>

In the area of commercial credits the Bank applies its own rating system for the purposes of assessment of a transaction risk, covering 11 rating models dedicated to particular commercial real estate market segments and a transfer function model allowing for determination of supervisory category on the basis of scoring assigned in the scope of internal model.

Ratings that analyse the structure of transaction are applicable to financing implemented:

- using "project finance", where as a principle a special purpose company is a borrower,
- for different types of transactions related to financing or refinancing of construction/purchase of office, service and commercial buildings, commercial and service spaces, warehouses, single- and multi-family housing estates for rental or sale, hotels and business premises for commercial activity, offices or warehouses.

Bank's models cover various stages of financing of a transaction - financing of construction or financing of a purchase/refinancing of completed real estate. Criteria cover area associated with:

- real estate: location, legal status, functional features of the facility;
- features of a local market: relation between demand and supply for a given type of facilities, business activity indicator in the region;
- analysis of financial flows generated by a real estate: amount, stability, currency adjustment, stress tests;
- quality assessment of the project's sponsor and its financial potential and will to support the project.

The Bank uses a grouping method that assigns exposure to appropriate risk categories, specifying supervisory values of expected loss (EL) and risk weight.

Assignment of appropriate supervisory categories takes place subsequent to risk assessment of a transaction with application of developed by the Bank internal rating models and transfer function model which transforms scoring assigned in the scope of the above mentioned internal models to supervisory categories.

Retail portfolio obtained in cooperation with mBank S.A.

For the purposes of assessment of reliability of a client applying for a retail loan product secured with mortgage and monitoring/reporting of credit risk for this portfolio, group credit risk models, which the Bank is a local user, are applied. Detailed rules and scope of cooperation between Banks in terms of group risk models are specified by provisions of a separate agreement on cooperation in the scope of risk management. The capital requirement for credit risk for this part of the portfolio is calculated using the standard method, since as at 31 December 2019 it is covered by a plan of gradual implementation.

The following models comprised by the rating system are used in the retail banking area:

- Loss Given Default (LGD) model. In the model, loss is defined as a function dependent on the level of recovery from clients' own payments and possible value of collateral using real estate collected during enforcement procedures,
- Credit Conversion Factor (CCF) model. This factor is an integral part of the EAD model (CCF as a degree of implementation of off-balance sheet liabilities by the client on the day of default occurrence),
- probability of default model (PD) which is a modular model that integrates application and behavioural models as well as models based on external data from Credit Information Bureau (BIK), functioning in the area of retail banking.

Additional information

Ratings assigned by external rating agencies have very limited significance in the credit risk assessment of the Bank due to dominating organisational form of borrowers - special purpose companies.

Risk weighted exposure amounts for credit risk calculated using internal ratings method are presented in Note 42.

Assessment of quality of the Bank's loan portfolio is made on the basis of monitoring of timely repayments and monitoring of analysis of economic and financial situation of the borrower.

Loans to natural persons are monitored monthly for timely repayments and regularities in terms of established effective mortgage collaterals. All contractual obligations of the client are realised in the same monitoring period (including insuring of the real estate and assignment of the rights under insurance policies).

Commercial and public sector portfolio is monitored monthly for timely repayments, while the economic and financial situation is monitored quarterly or semi-annually depending on risk assessment of a transaction measured with obtained amount of points in the rating model. Additionally, the implementation of investment and settlement with contractors is also subject to monthly monitoring - in case of financing of a construction.

3.1.3. Repossessed collateral

The Bank may acquire a real estate of the debtor of the Bank on which mortgage that secures the repayment of loan was established in exchange for cancellation of the loan liability or part thereof resulting from the loan agreement, directly to its assets.

The Bank repossesses real estates of the debtor that constitute subject of mortgage collateral of repayment of liabilities arising from loan agreement or other real estates indicated by the Bank's debtor and accepted by the Bank as a subject of repossession.

The Bank is obliged to take measures aimed at sale of repossessed real estate or part thereof immediately after its purchase/repossession.

The decision regarding the strategy of sale of repossessed/purchased by the Bank real estate or part thereof and its procedure is taken by the Management Board of the Bank.

In both 2019 and 2018, the Bank did not take over any collaterals.

for 2019 (in PLN thousand)

3.1.4. The policy of mBank Hipoteczny S.A. in terms of forbearance

For customers, who are temporarily in financial distress and are unable to meet their original contractual repayment terms, the Bank offers agreements with less restrictive terms of repayment, without which financial difficulties would prevent satisfactory repayment under the original terms and conditions of the contract.

Changes to these agreements may be initiated by the customer or the Bank and include e.g. debt restructuring, new repayments schedule, capital repayments deferrals with interest repayments kept.

The type of concession offered should be appropriate to the nature and the expected duration of the customer's financial distress. If the customer wants to conclude an agreement it must convince the Bank about its willingness and ability to repay the loan. Prior to granting any concession, an assessment of its impact on improving customer's ability to repay the loan is carried out.

The Bank renegotiates loan agreements with customers in financial difficulties to maximise possibility of loan receivables repayment and minimise the risk of client's default.

In case of retail customers, in accordance with the forbearance policy, forborne activities may take on various forms depending on the type and scale of the customer's financial problems. Activities of short-term nature are subject mainly to temporary reduction of the amounts of instalments or suspension of capital instalments while maintaining payment of interests. For customers under long term financial distress extension of contractual repayment schedule may be offered by the Bank which can include instalments reduction.

For the corporate clients in financial distress the Bank uses, in accordance with the forbearance policy, a wide range of activities aimed at supporting of the business process, starting from omission of actions to which the Bank is entitled in case of breach of contractual provisions or covenants, and finishing on restructuring of loan agreements. At the same time restructuring agreements may repeal or alleviate additional conditions concluded in the original agreement, if it is an optimum strategy for survival of the customer's business.

The risk of no repayment of the product portfolio subject to the forbearance policy is mitigated with the amount of PLN 462 200 thousand of accepted collaterals (the mortgage lending value of the property that constitute the collateral of the loan), therefore, the possible influence of this portfolio on deterioration of the entire portfolio of the Bank is significantly limited.

The analysis conducted for the above reporting periods showed a negligible share of exposures that leave and return to forbearance status within one year.

The structure of the loan portfolio measured at amortized cost in the forbearance category in mBank Hipoteczny S.A. as at 31 December 2019 is as follows:

31.12.2019	Gross value	Of which defaulted	Write-downs created	Net value
Loans and advances to customers, including:	227 959	164 578	53 463	174 496
Corporate customers	194 993	159 407	51 657	143 336
Individual customers	32 966	5 171	1 806	31 160
Total balance sheet data	**227 959**	**164 578**	**53 463**	**174 496**

The structure of the loan portfolio measured mandatorily at fair value through profit or loss in the forbearance category in mBank Hipoteczny S.A. as at 31 December 2019 is as follows:

31.12.2019	Fair value	Of which defaulted
Non-trading financial assets mandatorily at fair value through profit or loss - loans and advances to customers, including:	26 210	24 056
Corporate customers	26 210	24 056
Total	**26 210**	**24 056**

The structure of the loan portfolio measured at amortized cost in the forbearance category in mBank Hipoteczny S.A. as at 31 December 2018 is as follows:

for 2019 (in PLN thousand)

31.12.2018	Gross value	Of which defaulted	Write-downs created	Net value
Financial assets at amortised cost - loans and advances to customers, including:	219 547	180 210	33 362	186 185
Individual customers	24 982	1 477	802	24 180
Corporate customers	194 565	178 733	32 560	162 005
Total	**219 547**	**180 210**	**33 362**	**186 185**

The structure of the loan portfolio measured mandatorily at fair value through profit or loss in the forbearance category in mBank Hipoteczny S.A. as at 31 December 2018 is as follows:

31.12.2018	Fair value	Of which defaulted
Non-trading financial assets mandatorily at fair value through profit or loss - loans and advances to customers, including:	31 982	24 190
Corporate customers	31 982	24 190
Total	**31 982**	**24 190**

The size of the portfolio of the customers to whom the Bank has granted relief is still small compared with the total size of the Bank's loan portfolio. The forbearance portfolio represents 2.14% (2.24% as at 31.12.2018) of the entire portfolio. As at 31 December 2019, the forbearance exposure portfolio in the default category represented 74.22% of the forbearance portfolio (81.26% as at 31.12.2018). 31.48% of the portfolio of default exposures was covered with allowances (18.14% as at 31.12.2018).

The risk of default on the forbearance portfolio is mitigated with the accepted collateral in the form of a mortgage on a property with a mortgage lending value of PLN 462 200 thousand (PLN 467 013 thousand as at 31.12.2018), including PLN 347 971 thousand in the default category (PLN 390 345 thousand as at 31.12.2018).

Changes in the carrying amount of the forbearance exposures measured at amortized cost in 2019:

	Gross value	Of which defaulted	Write-downs created	Net value
Saldo 01.01.2019	**219 547**	**180 210**	**33 362**	**186 185**
Outputs from forbearance	(11 496)	(8 317)	7 504	(19 000)
Change in exposure	(33 120)	(31 768)	3 646	(36 766)
New forbearance	53 028	24 453	8 951	44 077
Saldo 31.12.2019	**227 959**	**164 578**	**53 463**	**174 496**

Changes in the fair value of the forbearance exposures which is mandatorily at fair value through profit or loss in 2019:

	Fair value	Of which defaulted
Saldo 01.01.2019	**31 982**	**24 190**
Outputs from forbearance	-	-
Change in exposure	(5 772)	(134)
New forbearance	-	-
Saldo 31.12.2019	**26 210**	**24 056**

Changes in the carrying amount of the forbearance exposures measured at amortized cost in 2018:

	Gross value	Of which defaulted	Write-downs created	Net value
Saldo 01.01.2018	**194 933**	**123 834**	**28 131**	**166 802**
Outputs from forbearance	(29 473)	-	(502)	(28 971)
Change in exposure	(24 004)	(7 840)	(15 202)	(8 802)
New forbearance	78 091	64 216	20 935	57 156
Saldo 31.12.2018	**219 547**	**180 210**	**33 362**	**186 185**

Changes in the fair value of the forbearance exposures which is mandatorily at fair value through profit or loss in 2018:

	Fair value	Of which defaulted
Saldo 01.01.2018	**26 139**	**26 139**
Change in exposure	(1 949)	(1 949)
New forbearance	7 792	-
Saldo 31.12.2018	**31 982**	**24 190**

for 2019 (in PLN thousand)

Forbearance exposures measured at amortized cost by type of concession as at 31 December 2019

Type of concession (31.12.2019r.)	Gross value	Of which defaulted	Write-downs created	Net value
Refinancing	11 964	11 964	1 037	10 927
Modification of terms and conditions	215 995	152 614	52 426	163 569
Total	**227 959**	**164 578**	**53 463**	**174 496**

Forbearance exposures measured mandatorily at fair value through profit or loss by type of concession as at 31 December 2019

Type of concession (31.12.2019r.)	Fair value	Of which defaulted
Refinancing	-	-
Modification of terms and conditions	26 210	24 056
Total	**26 210**	**24 056**

Forbearance exposures measured at amortized cost by type of concession as at 31 December 2018

Type of concession (31.12.2018r.)	Gross value	Of which defaulted	Write-downs created	Net value
Refinancing	11 251	11 251	643	10 608
Modification of terms and conditions	208 296	168 959	32 719	175 577
Total	**219 547**	**180 210**	**33 362**	**186 185**

Forbearance exposures measured mandatorily at fair value through profit or loss by type of concession as at 31 December 2018

Type of concession (31.12.2018r.)	Fair value	Of which defaulted
Refinancing	-	-
Modification of terms and conditions	31 982	24 190
Total	**31 982**	**24 190**

Forbearance exposures measured mandatorily at fair value through profit or loss per length of overdue period as at 31 December 2019

31.12.2019 Past due period	Fair value	Of which defaulted
Not overdue	2 154	-
up to 30 days	-	-
31 to 90 days	5 162	5 162
over 90 days	18 894	18 894
Total	**26 210**	**24 056**

Forbearance exposures measured mandatorily at fair value through profit or loss per length of overdue period as at 31 December 2018

31.12.2018	Fair value	Of which defaulted
Not overdue	7 792	-
more than 90 days	24 190	24 190
Total	**31 982**	**24 190**

Forbearance exposures measured at amortized cost without recognised loss impairment per length of overdue period as at 31 December 2019

Forbearance exposures without impairment recognised (31.12.2019r.)	Gross value	Of which defaulted	Write-downs created	Net value
Not overdue	58 481	-	1 428	57 053
up to 30 days	1 821	-	41	1 780
31 to 90 days	2 974	-	151	2 823
over 90 days	328	328	8	320
Total	**63 604**	**328**	**1 628**	**61 976**

Forbearance exposures measured at amortized cost without recognised loss impairment per length of overdue period as at 31 December 2018

for 2019 (in PLN thousand)

Forbearance exposures without impairment recognised (31.12.2018r.)	Gross value	Of which defaulted	Write-downs created	Net value
Not overdue	30 800	-	459	30 341
up to 30 days	6 153	-	109	6 044
31 to 90 days	2 384	-	101	2 283
Total	**39 337**	**-**	**669**	**38 668**

Forbearance exposures measured at amortized cost with recognised loss impairment per length of overdue period as at 31 December 2019

Forbearance exposures with impairment recognised (31.12.2019r.)	Gross value	Of which defaulted	Write-downs created	Net value
Not overdue	76 875	76 770	20 863	56 012
up to 30 days	7 856	7 856	247	7 609
31 to 90 days	821	821	(6)	827
over 90 days	78 803	78 803	30 731	48 072
Total	**164 355**	**164 250**	**51 835**	**112 520**

Forbearance exposures measured at amortized cost with recognised loss impairment per length of overdue period as at 31 December 2018

Forbearance exposures with impairment recognised (31.12.2018r.)	Gross value	Of which defaulted	Write-downs created	Net value
Not overdue	52 473	52 473	20 825	31 648
up to 30 days	54 424	54 424	5 371	49 053
31 to 90 days	8 785	8 785	7	8 778
more than 90 days	64 528	64 528	6 490	58 038
Total	**180 210**	**180 210**	**32 693**	**147 517**

Forbearance exposures measured mandatorily at fair value through profit or loss by industry as at 31 December 2019

As at 31 December 2019	Fair value	Of which defaulted
Activity related to the real estate market	17 937	15 783
Building industry	8 273	8 273
Total	**26 210**	**24 056**

Forbearance exposures measured at amortized cost by industry as at 31 December 2019

As at 31 December 2019	Gross value	Of which defaulted	Write-downs created	Net value
Activity related to the real estate market	124 085	88 499	23 961	100 124
Building industry	70 908	70 908	27 696	43 212
Natural persons	32 966	5 171	1 806	31 160
Total	**227 959**	**164 578**	**53 463**	**174 496**

Forbearance exposures measured mandatorily at fair value through profit or loss by industry as at 31 December 2018

As at 31 December 31.12.2018 r.	Fair value	Of which defaulted
Activity related to the real estate market	24 215	16 423
Building industry	7 767	7 767
Total	**31 982**	**24 190**

Forbearance exposures measured at amortized cost by industry as at 31 December 2018

As at 31 December 31.12.2018 r.	Gross value	Of which defaulted	Write-downs created	Net value
Activity related to the real estate market	120 340	104 507	18 673	101 667
Building industry	74 226	74 226	13 887	60 339
Natural persons	24 982	1 477	802	24 180
Total	**219 548**	**180 210**	**33 362**	**186 186**

Interest income related to forbearance exposures at the end of 2019, amounted to PLN 7 440 thousand (for the period ended 31 December 2018: PLN 8 488 thousand).

Retail Banking

The Bank does not consider loans with modified terms as falling under the forbearance policy in the case when changes result from the customer's application and there are no current or anticipated customer's financial difficulties, and, in addition, modifications of the contract meet the criteria of decision-making policy for a healthy portfolio. In the normal course of cooperation with a customer, the customer who is not in financial distress submits application to change the conditions of agreement, for example, in the scope of renegotiation of pricing conditions due to change of market conditions or in order to increase its ability to service another loan. If such application meets all decision criteria and is granted according to market conditions, then such loan is not classified to the forbearance category.

If case when a customer applies for prolongation of the repayment term, reduction of the amount of paid instalments or other alleviation of conditions, when it is caused by financial distress of the customer, modified agreements are treated as forborne products subject to the forbearance policy and are appropriately reported in the financial statement.

Forborne products (forbearance) available in retail banking are offered only to customers who are in financial distress. The type of offered forborne product depends of the scale and nature of the customer's financial distress.

The following list of forborne activities does not exhaust all possible actions that are subject to forbearance policy, but it includes the most common:

- individual repayment schedule,
- maturity extension/ extension of loan duration,
- restructuring,
- interest deferrals,
- principal deferrals,

with assumption that the failure to apply changes could result with no repayment of loan and in consequence the loss on the side of the Bank.

Forborne activities of short-term nature are focused on temporary reduction of the amount of instalments and may consist in suspension of repayments of capital with maintaining repayment of interests.

For customers under long term financial distress extension of contractual repayment schedule or refinancing of debt, which can be evidence for classification of the customer to the default category, may be offered.

The necessity to grant another forborne product causes reclassification of the product to non-performing category, and in case of lack of regular servicing, when overdue exceeds 90 days, the customer is reclassified to the default category.

This portfolio is subject to regular reviews and reporting to the management of the Risk Division. The effectiveness of undertaken actions, regularity of restructured products service in respect of types of product and client's segment are subject to assessment.

The Bank ceases to recognise the product as forbearance in the following cases:

- repayment of loan is considered as performing,
- at least 2 years passed since an attempt to recognise exposure as performing, or the contract was in the non-performing category at the moment of granting of a concession,
- there were regular inflows from receivables or interests (delays is payment on the contract not exceeding 31 DPD in significant amount), since at least from the half of the sample period,
- no exposure of debtors is overdue by over 31 days at the end of sample period in the amount greater than PLN 500.

The portfolio of products of forbearance status in the retail part as at 31 December 2019 amounted to PLN 32 966 thousand (PLN 24 982 thousand as at 31.12.2018).

<u>Corporate banking</u>

Credit relationships between the Bank and corporate clients are based on products the granting conditions of which take into account the type of business activity conducted by the client and are subject to negotiations.

Mortgage loans renegotiated for commercial reasons, e.g. in cases of significant improvement of the client's financial situation or in order to maintain relationship with a client without difficult credit situation are not treated as forbearance and are not subject to the following disclosure.

Forbearance occurs when, due to current or future financial distress of a client, the Bank grants products on conditions that are below standard conditions applicable in the Bank, which in other circumstances would not be accepted.

The change of conditions is treated as a relief subject to the forbearance policy, when it improves the client's ability to repay the debt or prevents the client's default.

For corporate clients in financial distress the Bank applies a wide range of action aimed at supporting of the Client's business process, wherein the following list of possible restructuring actions subject to the forbearance policy do not exhaust all available actions, but includes the most commonly used:

- loan increase,
- change of scheduled repayments,
- extension of the tenor,
- restructuring (medium or long term refinancing),
- capitalization of interest,
- lowering of the Bank's margin,
- granting of a grace period for repayment of capital while maintaining payment of interests,
- suspending, waiving from realization of actions resulting from additional conditions in agreement (so-called covenants).

The assessment of impairment on the basis of individual analysis is performed in every situation in which any criterion of recognising exposure as default in accordance with methodology applicable in the Bank occurred.

The portfolio of loans classified to the forbearance category in the Bank is subject to particular monitoring by all units participating in the lending process and constant assessment whether any evidence of permanent impairment of the Bank's receivable occurred. Transactions qualified to this category remain in this portfolio and are reported as forbearance for minimum 24 months from the day of granting of a concession (so called trial period). In order to conclude that the customer has returned to the regular category the debt and interest must be serviced in a proper manner (delays in payment not exceeding 31 DPD) at least until the mid trial period and there must be no amount overdue at the end of the trial period. None of the debtor's exposures above PLN 3,000 is past due for more than 30 days at the end of the reporting period.

A client may be removed from the forbearance portfolio before the end of the trial period only in case of complete repayment of the debt.

All loan products granted to a client serviced in the area of restructuring in the scope of the Bad Loans Section in the Commercial Loans Risk Department have the forbearance status and are subject to disclosure.

The portfolio of products of forbearance status in the corporate part as at 31 December 2019 amounted to PLN 194 993 thousand for assets measured at amortized cost and PLN 26 210 thousand for the portfolio measured mandatorily at fair value through profit or loss (PLN 194 565 thousand as at 31.12.2018 and PLN 31 982 thousand for the portfolio measured mandatorily at fair value through profit or loss).

3.1.5. Counterparty risk arising from transactions in derivatives

The Bank makes derivative transactions only to hedge against the currency risk and interest rates risk. The Bank does not run trading activities, all derivative transactions are classified to the banking portfolio. The Bank has in its derivative portfolio interest rate swaps (IRS) and currency swaps (FX SWAP contracts and CIRS). The Management Board of the Bank approves the limits for the Bank's exposure in derivative transactions. The limits of exposure for particular banks are monitored and verified at least once a year. The Bank determines the limits only for the banks with the signed ISDA (International Swaps and Derivatives Association) agreement with CSA annex (Credit Support Annex) for the banks with which it plans to conclude ISDA agreements with CSA annex and the central clearing houses in which the derivative transactions will be settled. The counterparty risk is limited by the choice of the individual segregated account structure in the clearing house. The use of the exposure limits is monitored on the daily basis. The limits were not exceeded in both 2019 and 2018. As at 31 December 2019, all transactions in derivative financial instruments were transactions concluded originally with mBank S.A. and the central clearing house. Therefore, in the Bank's opinion the credit risk associated with the derivative instruments is limited.

3.1.6. Debt securities - financial assets at fair value through other comprehensive income

The value of debt securities (financial assets at fair value through other comprehensive income) as at 31 December 2019 amounted to PLN 1 221 735 thousand, and as at 31 December 2018 amounted to PLN 1 069 392 thousand. Debt securities on both 31 December 2019 and 31 December 2018 had AAA rating in the scale of Standard & Poor's (S&P) Ratings.

Net balance sheet value of investment securities constituting additional collateral of liabilities for issued mortgage covered bonds:

- as at 31 December 2019 amounted to PLN 239 815 thousand,
- as at 31 December 2018 amounted to PLN 201 877 thousand.

Net balance sheet value of debt securities constituting collateral of liabilities under the guaranteed means protection fund:

- as at 31 December 2019 amounted to PLN 0 thousand,
- as at 31 December 2018 amounted to PLN 1 047 thousand.

Investment securities on which collateral was established are presented in Note 34.

Both as at 31 December 2019 and 31 December 2018 all investment securities were not past due instruments, without impairment.

3.2. Concentration of assets, liabilities and off-balance sheet items

<u>Risk of geographical concentration</u>

Assets, liabilities and off-balance sheet items are not presented according to geographical areas in the Bank due to insignificance of geographical differentiation of risks. The Bank operates only in the territory of the Republic of Poland. Bank stosuje wewnętrzne limity koncentracji geograficznej w podziale na województwa dla ekspozycji z portfela korporacyjnego.

<u>The risk of concentration of large exposures, the risk of concentration of exposures</u>

Concentration risk is a risk that can significantly influence stability and security of the Bank's actions through failure to perform liability by a single entity, entities related in capital or organisationally as well as through group of entities in case of which the probability of failure to perform this liability depends on common factors.

In the scope of concentration risk management the Bank identifies risk, measures, monitor and report it.

Measurement of concentration risk in the Bank is performed through establishing of the size of an exposure that generates the risk of concentration and relate this amount to established limits resulting from provisions of law and internal limits.

The Bank limits credit risk using internal exposure concentration limits, specified in internal procedures.

While establishing proposal of the level of internal exposure concentration limits, the Bank takes into account the following issues:

a) the macroeconomic situation in the country,
b) situation on the real estate market in the country,
c) situation on financial markets in the country,
d) implementation of credit policy of the Bank in previous years,
e) results of restructuring and debt collection actions of the Bank,
f) information from reliable sources (academic centres) on economic situation of entities, branches, industry sectors, according to the recommendations of Resolution No. 384/2008 PFSA,
g) economic and quality information regarding the process of management in entities against which it holds exposure from which the concentration risk results,

h) factors resulting from other types of risk associated with identified exposures from which the risk of concentration arises (e.g. of interest rate, liquidity, operational and political) that may negatively influence an increase of concentration risk,
i) stress test results.

Internal exposure limits are specified in relation to the amount of own funds of the Bank and in relation to the sum of exposures of the Bank.

The Bank conducts monthly reporting of monitored concentration risk in relation to:

a) capital groups monitoring,
b) exposures concentration limit monitoring,
c) large exposures limit monitoring,
d) monitoring of the limit of loans granted to Bank's related entities,
e) internal limits monitoring.

Sector concentration risk

The Bank focuses its activity on granting of loans secured with mortgage established on real estate to legal entities, loans to local government units and loans secured with guarantee or guarantee of local government units. Regardless of external loan concentration limits the Management Board of the Bank establishes internal limits associated with e.g.:

a) industry concentration according to the type of financed real estate,
b) financing of real estates under construction and land purchases,
c) share of the financing of particular types of real estates in the loan portfolio,
d) geographical concentration, currency concentration,
e) type of applied in the Bank interest rates (fixed and variable interest rates),
f) lending period.

As at 31 December 2018 no exceeding of exposure limit against an entity or a group of affiliated clients specified in Art. 395.1 of the CRR Regulation occurred in the Bank.

The assessment of individual credit risk in case of financing of commercial real estates is made on the basis of assessment of borrowers' creditworthiness, credit transaction ratings which include selected quantitative indicators, i.e. debt service coverage ratio (DSCR), interests service coverage ratio (ISCR), level of own funds, and in case of housing developers the level of benchmark price and quality measures, e.g. the means of project management and identification of default event. Ratings in the Bank cover different segments of specialist financing defined in bank procedures in terms of their distinction as to the type and investment phase. The Bank assesses the risk of credit transactions through risk parameters estimates. In particular the Bank, whose activity is subject to credit risk, before concluding a transaction or over its course - in monitoring mode - conducts risk assessment based on individualised rating systems that were created on the basis of an expert approach.

Credit risk management in financing of commercial real estate also includes: creation of impairment losses provisions for balance sheet credit exposures and write-offs for off-balance sheet credit exposures, indicators of creation and release of write-offs, application of limits, stress tests, scenario analyses, receivables concentration limits monitoring, application of credit collaterals, application of conservative rules of specifying of mortgage lending value of the property, application of statistical models for revaluing properties.

The table below presents the structure of concentration of balance sheet exposures in particular sectors.

No.	Trade	31.12.2019		31.12.2018	
		Net carrying amount (PLN '000)	Share in the portfolio (%)	Net carrying amount (PLN '000)	Share in the portfolio (%)
1.	Natural persons	7 484 793	63,49	6 177 906	55,46
2.	Activity related to the real estate market	2 644 120	22,44	3 127 446	28,08
3.	Building industry	1 283 594	10,89	1 429 931	12,84
4.	Professional, scientific and technical activity	171 967	1,46	180 446	1,62
5	Activity related to culture, entertainment and leisure	66 678	0,57	72 371	0,65
6	Public administration and defence; Compulsory social security	50 517	0,43	57 936	0,52
7.	Health protection and social welfare	40 264	0,34	43 267	0,39
8.	Financial activities	32 622	0,28	31 943	0,28
9.	Activity related to accommodation and catering services	10 734	0,09	15 205	0,14
10.	Water supply; Sewage and waste management and activity related to reclamation	-	0,00	1 275	0,01
11.	Other	857	0,01	989	0,01
	Razem	**11 786 146**	**100,00**	**11 138 715**	**100,00**

3.3. Strategy for use of financial instruments

The Bank in its activity uses financial instruments including also derivative instruments. The Bank issues covered bonds and bonds. The Bank's liabilities bear both variable and fixed interest rates. The Bank invests raised funds in assets of acceptable level of risk in order to increase interest margin. In order to secure currency risk and interest rate risk the Bank concludes transactions on derivative instruments.

While concluding the above mentioned transactions the Bank maintains the level of liquidity sufficient to settle all arising liabilities.

Derivative instruments

The Bank strictly controls open net derivative items, i.e. difference between purchase and sale contracts, both in terms of the nominal value of the contract and the period of validity. The amount subject to credit risk at any time is limited to current fair value of instruments which valuation is positive (i.e. assets), which, in relation to derivative instruments, constitutes only small fraction of value of agreement or nominal values used to express the volume of existing instruments.

Off-balance sheet liabilities of credit nature

Off-balance sheet liabilities of credit nature relate to not used part of granted loans. The Bank reserves the possibility to non-payment of unused part of loan in case of deterioration of the client's creditworthiness. Therefore, the probable amount of resulting loss is significantly lower than the entire amount of unused liabilities from loans.

The Bank has organisational solutions that ensure formal and factual separation of credit risk assessment processes from processes of credit decision-making. Credit decisions are taken collectively, according to the decision-making powers, after consideration of recommendation presented by the director of department responsible for the credit risk analysis.

3.4. Market risk

The Bank is exposed to market risk understood as risk of changes of current valuation of financial instruments that constitute the portfolios of the Bank which result from changes in pricing and value of market parameters. Market risk exposure of the Bank results from open items on interest, currency instruments that are exposed to market change of value of appropriate risk factors, and in particular to change of value of interest rates, exchange rates and credit spread.

The risk profile results from the Bank's operational strategy. The Bank offers products based on variable and fixed interest rate, wherein the products based on variable interest rate are preferred. The Bank offers products in foreign currencies EUR and USD. The Bank does not perform operations at its own account for trade purposes, it only has the bank portfolio. The main method of market risk management in the Bank is application of natural security, that is obtaining of funds for financing in currencies and of interest rates directly adjusted to corresponding assets. Due to the nature of the Bank's activity, the exposure to market risk should be maintained at the lowest possible level. The Bank aims to limit the exposure to market risk resulting from the structure of assets and liabilities through concluding hedging transactions, the catalogue of which is approved by the Management Board of the Bank. Identification of market risks and liquidity takes into account internal and external factors.

Internal factors include factors such as: the specificity of lending activity and the specificity of refinancing structure. External factors include factors constituting the surroundings of the Bank: interbank market, behaviour of financial markets, strategy and policy of shareholder against the Bank. The market risk is identified in all types of products and types of activities. Widely recognised methods are applied in the process of identification. The Bank specified the level of risk through measurement of the value exposed to risk (Value at Risk - VaR) and through stress tests.

VaR is a statistical measurement of the market risk level which expresses a potential loss to which a portfolio is exposed during specified period of time, for a given level of confidence, in normal market conditions, due to changes of risk factors (foreign exchange rates, interest rates, credit spreads). The potentiality of a loss means that with previously established large probability (confidence level), at which fair value is determined, within a specified time period a loss lower than determined VaR value may be expected.

Value at risk in the Bank is determined using historical simulation method. This method consists in determination of distribution of changes in the value of portfolio on the basis of historical distribution of changes of risk factors, observed over a specified period of time. VaR is determined in one day time horizon on the basis of 254 historical observations and is monitored at confidence level of 97.5%.

As at 31 December 2019, VaR amounted to PLN 2 531,9 thousand compared with PLN 498,1 thousand as at 31 December 2018, with a confidence level of 97.5%. The increase in VAR was influenced by the CIRS transaction securing the issue of mortgage bonds in EUR.

The list below presents the value of average and maximum VaR of the Bank during the period from 1 January 2019 until 31 December 2019 and from 1 January 2018 until 31 December 2018.

PLN '000	12 months until 31.12.2019		12 months until.31.12.2018	
	average	maximum	average	maximum
Credit spread risk	748	962	492	570
Interest rate risk	470	2 549	192	273
Currency risk	24	72	21	123
Total VaR	**957**	**2 775**	**518**	**625**

Stress test and scenario analyses

An additional measure of market risk, supplementing the measurement of value at risk, is a stress test which shows a hypothetical change in the current valuation of the Bank's portfolio, that would take place as a result of risk factors (foreign exchange rates, interest rates, credit spreads) assuming the defined extreme values within a one-day time horizon. The Bank makes use of standard and expanded scenarios of big changes in the values of risk factors. As at 31 December 2019, the risk amount arising from an expanded scenario was PLN 53 509 thousand, whereas the average risk amount for this scenario in the period from 1 January 2019 to 31 December 2019 was PLN 28 925 thousand. The increase in risk vale resulting from stress tests was significantly influenced by the CIRS transaction securing the issue of mortgage bonds in EUR.

Below is a decomposition of amount of risk resulting from described stress test to the amount assigned to interest rate risk and currency risk.

Stress test	31.12.2019				31.12.2018			
	Total	Interest rate risk	Currency risk	Credit spread risk	Total	Interest rate risk	Currency risk	Credit spread risk
Amount of risk in PLN '000	(53 509)	(33 761)	(642)	(19 105)	(23 253)	(5 858)	(1 509)	(15 886)

for 2019 (in PLN thousand)

3.5. Currency risk

Exchange rate risk results from exposure of current value of exposures of the Bank in assets, liabilities and off-balance sheet items expressed in PLN to adverse effect of changes of market exchange rates.

The Bank is exposed to currency risk to a small degree, as it does not maintain significant currency mismatch of assets and liabilities (currency positions) through adaptation of currency structure of conducted lending action and sources of refinancing as well as closing of open currency positions with derivative contracts (Note 19). The risk of influence of changes of exchange rates to the financial result of the Bank is limited, and existing in the Bank procedures for control and reporting significantly eliminate possibility of its arising. In the scope of currency risk management, the Bank assesses the scale and structure of currency risk only on the basis of current currency position of the Bank. Monitoring also covers currency position including expected repayments and payment of loans that influence currency risk. The Bank manages currency position by performing currency purchase/sale transactions with immediate or future terms and by concluding transaction of the SWAP type.

The following table presents exposures of the Bank to currency risk as at 31 December 2019 and 31 December 2018. The table presents assets and liabilities of the Bank according to balance sheet amount broken down by particular currencies of transactions.

31.12.2019	**PLN**	**EUR**	**USD**	**Total**
Assets				
Cash and balances with the central bank	35 233	-	-	**35 233**
Financial assets held for trading and derivatives held for hedges	3 144	44 736	336	**48 217**
Non-trading financial assets mandatorily at fair value through profit or loss, including:	83 219	122 998	-	**206 217**
Loans and advances to customers	83 219	122 998	-	**206 217**
Financial assets at fair value through other comprehensive income	1 221 735	-	-	**1 221 735**
Financial assets at amortised cost:	8 441 349	3 114 698	37 795	**11 593 842**
Loans and advances to banks	794	13 021	98	**13 913**
Loans and advances to customers	8 440 555	3 101 676	37 697	**11 579 928**
Intangible assets	48 620	-	-	**48 620**
Tangible fixed assets	16 301	-	-	**16 301**
Deferred income tax assets	10 123	-	-	**10 123**
Other assets	7 620	-	-	**7 620**
TOTAL ASSETS	**9 867 345**	**3 282 432**	**38 131**	**13 187 908**
Liabilities				
Financial liabilities held for trading and derivatives held for hedges	-	7 525	75	**7 600**
Financial liabilities measured at amortised cost, including:	7 665 146	4 218 442	1	**11 883 589**
Amounts due to banks	2 816 822	-	-	**2 816 822**
Amounts due to customers	6 443	2 491	1	**8 935**
Debt securities issued	4 641 449	4 215 951	-	**8 857 400**
Subordinated liabilities	200 432	-	-	**200 432**
Provisions	-	-	-	**-**
Current income tax liabilities	7 482	-	-	**7 482**
Other liabilities	20 781	-	-	**20 781**
TOTAL LIABILITIES	**7 693 409**	**4 225 967**	**76**	**11 919 452**
Net balance sheet position	**2 173 936**	**(943 535)**	**38 055**	**1 268 455**
Loan commitments	**338 242**	**111 397**	**-**	**449 639**

31.12.2018	PLN	EUR	USD	Razem
Assets				
Cash and balances with the central bank	16 294	-	-	**16 294**
Financial assets held for trading and derivatives held for hedges	4 045	32 613	-	**36 658**
Non-trading financial assets mandatorily at fair value through profit or loss, including:	88 213	119 968	-	**208 181**
Loans and advances to customers	88 213	119 968	-	**208 181**
Financial assets at fair value through other comprehensive income	1 069 392	-	-	**1 069 392**
Financial assets at amortised cost:	7 361 828	3 587 742	39 396	**10 988 966**
Loans and advances to banks	409	57 893	130	**58 432**
Loans and advances to customers	7 361 419	3 529 849	39 266	**10 930 534**
Intangible assets	40 021	-	-	**40 021**
Tangible fixed assets	8 678	-	-	**8 678**
Deferred income tax assets	12 586	-	-	**12 586**
Other assets	5 059	73	-	**5 132**
TOTAL ASSETS	**8 606 116**	**3 740 396**	**39 396**	**12 385 908**
Liabilities				
Financial liabilities held for trading and derivatives held for hedges	2 032	-	-	**2 032**
Financial liabilities measured at amortised cost, including:	8 065 980	3 187 845	1	**11 253 826**
Amounts due to banks	3 179 878	-	-	**3 179 878**
Amounts due to customers	2 582	516	1	**3 099**
Debt securities issued	4 683 114	3 187 329	-	**7 870 443**
Subordinated liabilities	200 406	-	-	**200 406**
Provisions	1 884	673	-	**2 557**
Current income tax liabilities	12 704	-	-	**12 704**
Other liabilities	28 652	190	-	**28 842**
TOTAL LIABILITIES	**8 111 252**	**3 188 708**	**1**	**11 299 961**
Net balance sheet position	**494 864**	**551 688**	**39 395**	**1 085 947**
Loan commitments	**1 051 749**	**454 679**	**-**	**1 506 428**

3.6. Interest rate risk

Interest rate risk is a risk resulting from exposure of current and future financial result and capital of the Bank to adverse impact of changes in interest rates. The Bank manages the interest rate gap through matching of terms of revaluations of assets and liabilities. In case of such mismatch appropriate hedging instruments are applied (IRS derivative instruments, Basic Swap, CIRS). Derivative transactions to interest rate are concluded exclusively in order to secure positions resulting from lending activity and its financing.

The measure of interest rate risk are revaluation terms mismatch gap and specified on its basis interest income exposed to risk (“EaR”).

A sudden change of interest rates by 100 BP for all maturity dates if it had a permanent nature and adverse direction and would cause reduction of annual interest income by:

EaR (in PLN '000)	31.12.2019	31.12.2018
for items expressed in PLN	8 002	6 487
for items expressed in USD	20	2
for items expressed in EUR	510	705

When calculating those values it was assumed that the structure of assets and liabilities recognised in financial statements as at 31 December 2019 and as at 31 December 2018 will not change in the course of next year and that the Bank will not take any action in order to change exposure at risk.

Maintaining of interest rate risk level in 2019 on similar level as in 2018 is a result of current adjustment of revaluation terms of granted loans and corresponding financing sources.

for 2019 (in PLN thousand)

Additionally, the Bank concludes hedging transaction of IRS type in order to limit interest rate risk and CIRS.

The Bank's exposures to interest rate risk are presented below. Data in the table present financial assets and financial liabilities per balance sheet value, sorted according to terms of interest rate change arising from agreement or relates to their maturity.

31.12.2019	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Non-interest rate items	Total
Assets							
Cash and balances with the central bank	35 233	-	-	-	-	-	**35 233**
Financial assets held for trading and derivatives held for hedges	7 285	23 046	17 886	-	-	-	**48 217**
Non-trading financial assets mandatorily at fair value through profit or loss	35 456	160 416	10 344	-	-	-	**206 216**
Financial assets at fair value through other comprehensive income	827 953	-	151 455	242 328	-	-	**1 221 736**
Financial assets at amortised cost - loans and advances to banks	13 912	-	-	-	-	-	**13 912**
Financial assets at amortised cost - loans and advances to customers	1 991 409	9 009 786	580 977	-	-	-	**11 582 172**
TOTAL ASSETS	**2 911 248**	**9 193 248**	**760 662**	**242 328**	**-**	**-**	**13 107 486**
Liabilities							
Financial liabilities held for trading and derivatives held for hedges	77	7 523	-	-	-	-	**7 600**
Financial liabilities measured at amortised cost - amounts due to banks	710 338	2 106 484	-	-	-	-	**2 816 822**
Financial liabilities measured at amortised cost - amounts due to customers	-	-	-	-	-	8 934	**8 934**
Zobowiązania finansowe wyceniane w zamortyzowanym koszcie - zobowiązania z tytułu emisji dłużnych papierów wartościowych	420 568	4 044 398	737 520	625 336	3 029 579	-	**8 857 401**
Subordinated liabilities	-	200 432	-	-	-	-	**200 432**
TOTAL LIABILITIES	**1 130 983**	**6 358 837**	**737 520**	**625 336**	**3 029 579**	**8 934**	**11 891 189**
Balance sheet gap	**1 780 265**	**2 834 411**	**23 142**	**(383 008)**	**(3 029 579)**	**(8 934)**	**1 216 297**

31.12.2018	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Non-interest rate items	Total
Assets							
Cash and balances with the central bank	16 294	-	-	-	-	-	**16 294**
Financial assets held for trading and derivatives held for hedges	7 412	17 438	11 808	-	-	-	**36 658**
Non-trading financial assets mandatorily at fair value through profit or loss	37 437	155 557	15 187	-	-	-	**208 181**
Financial assets at fair value through other comprehensive income	681 725	-	123 117	264 550	-	-	**1 069 392**
Financial assets at amortised cost - loans and advances to banks	58 432	-	-	-	-	-	**58 432**
Financial assets at amortised cost - loans and advances to customers	1 991 832	8 143 641	795 061	-	-	-	**10 930 534**
TOTAL ASSETS	**2 793 131**	**8 316 636**	**945 173**	**264 550**	**-**	**-**	**12 319 490**
Liabilities							
Financial liabilities held for trading and derivatives held for hedges	1 796	236	-	-	-	-	**2 032**
Financial liabilities measured at amortised cost - amounts due to banks	485 723	2 694 155	-	-	-	-	**3 179 878**
Financial liabilities measured at amortised cost - amounts due to customers	-	-	-	-	-	3 099	**3 099**
Financial liabilities measured at amortised cost - debt securities issued	852 558	3 828 944	534 741	802 111	1 852 089	-	**7 870 443**
Subordinated liabilities	-	200 406	-	-	-	-	**200 406**
TOTAL LIABILITIES	**1 340 077**	**6 723 741**	**534 741**	**802 111**	**1 852 089**	**3 099**	**11 255 858**
Balance sheet gap	**1 453 054**	**1 592 895**	**410 432**	**(537 561)**	**(1 852 089)**	**(3 099)**	**1 063 633**

3.7. Liquidity risk

Liquidity risk is a threat of losing the ability to finance the assets and discharge the liabilities on a timely basis in the course of the Bank's ordinary operations or in other conditions that can be predicted, which makes it necessary to incur unacceptable losses.

Strategic objective in terms of liquidity risk management is ensuring the ability of the Bank to timely repayment of liabilities and financing of steadily growing assets and minimisation of impact of this risk to the financial result of the Bank.

The Bank manages liquidity risk so as to ensure that intraday, short-term, mid-term and long-term liquidity is maintained. The Bank lays down the principles for identifying, measuring, assessing, monitoring and reporting risk. As part of managing market liquidity risk, the Bank diversifies the sources of financing mainly as part of cooperation with mBank S.A. The Bank finances its long-term assets primarily with mortgage bonds with long maturities and credit lines, and it satisfies its current cash needs on the interbank market and by issuing short-term bonds.

for 2019 (in PLN thousand)

The Bank has emergency plan in case of liquidity crisis. The plan specifies cases of crisis situations that cause risk of liquidity loss or arising of another hazard for currency and interest risk management, identifies reserve funding sources of the Bank, indicates general procedures for the Bank in crisis situations.

The Bank ensures intraday liquidity by maintaining a liquidity portfolio which consists of instruments which can be liquidated quickly.

The Bank manages and monitors liquidity risk using cumulative liquidity gap limits, check digits (MAT) and statutory limits, in particular the liabilities limit (referred to in Article 15, clause 2 of the Act on Mortgage Bonds and Mortgage Banks) as well as the limits on supervisory measures of short-term and long-term liquidity specified in the PFSA Resolution and the Regulation.

In 2019 and 2018, the Bank monitored all liquidity measures specified in the resolution of PFSA 386/2008 dated 17 December 2008:

- M1 - short-term liquidity gap,
- M2 - short-term liquidity ratio,
- M3 - coverage ratio of illiquid assets with own funds,
- M4 - coverage ratio of illiquid assets and assets of limited liquidity with own funds and stable external funds.

The table below presents values of liquidity measures M1 - M4 and the LCR measure as at 31 December 2019 and their average, minimum and maximum values:

liquidity norm*	value as at 31.12.2019	average	minimum	maximum
M3	80.225	80.871	63.890	130.480
M4	1.075	1.065	1.047	1.085
LCR	1366%	1395%	628%	2683%

Norma płynności*	wartość według stanu na 31.12.2018	średnia	minimum	maksimum
M3	130,479	101,957	94,062	141,287
M4	1,067	1,078	1,045	1,170
LCR	1081%	1063%	567%	1812%

* M2, M3 and M4 measures are relative measures expressed as decimal fraction

LCR (Liquidity Coverage Ratio) – the ratio of coverage of net cash outflows determining the relationship of the liquidity buffer to its net liquidity outflows over a 30 calendar day stress period.

In 2019 and 2018 no exceeding of liabilities limit and any form of liquidity took place.

3.7.1. Cash flows from transactions in non-derivative financial instruments

3.7.2.

The table below includes not discounted values of cash flows required to pay or receive by the Bank. The cash flows have been presented as at the year-end date, categorised by the remaining contractual maturities. The amounts denominated in foreign currencies were converted to Polish zloty at the average rate of exchange announced by the National Bank of Poland at the year-end date.

for 2019 (in PLN thousand)

Liabilities (by contractual dates of maturity) as at 31 December 2018

	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Assets (by expected dates of maturity)						
Cash and balances with the central bank	16 293	-	-	-	-	16 293
Non-trading financial assets mandatorily at fair value through profit or loss	1 170	2 728	14 061	76 640	175 115	269 714
Financial assets at fair value through other comprehensive income	255 162	-	137 168	554 009	151 335	1 097 674
Financial assets at amortised cost - loans and advances to banks	58 542	-	-	-	-	58 542
Financial assets at amortised cost - loans and advances to customers	64 011	149 234	769 208	4 192 632	9 579 736	14 754 821
Total assets	**395 179**	**151 962**	**920 437**	**4 823 281**	**9 906 186**	**16 197 045**
Planned payments of the off-balance sheet liabilities to grant loans or guarantees	**119**	**2 054**	**19 972**	**1 096 930**	**387 355**	**1 506 430**
Total asstes and off-balance sheet	**395 298**	**154 016**	**940 409**	**5 920 211**	**10 293 541**	**17 703 475**
Liabilities (by contractual dates of maturity)						
Financial liabilities measured at amortised cost - amounts due to banks	60 112	16 088	234 406	2 564 561	599 676	3 474 843
Financial liabilities measured at amortised cost - amounts due to customers	3 099	-	-	-	-	3 099
Financial liabilities measured at amortised cost - debt securities issued	86 542	40 641	894 982	5 172 863	2 223 770	8 418 798
Financial liabilities measured at amortised cost - subordinated liabilities	-	2 396	7 516	39 760	234 080	283 752
Total liabilities	**149 753**	**59 125**	**1 136 904**	**7 777 184**	**3 057 526**	**12 180 492**
Off-balance sheet liabilities to grant loans or guarantees	**370 811**	**168 427**	**569 115**	**398 075**	**-**	**1 506 428**
Total liabilites and off-balance sheet	**520 564**	**227 552**	**1 706 019**	**8 175 259**	**3 057 526**	**13 686 920**
Net liquidity gap	**(125 266)**	**(73 536)**	**(765 610)**	**(2 255 048)**	**7 236 015**	**4 016 555**

Liabilities (by contractual dates of maturity) as at 31 December 2019

	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Assets (by expected dates of maturity)						
Cash and balances with the central bank	35 233	-	-	-	-	35 233
Non-trading financial assets mandatorily at fair value through profit or loss	1 023	2 907	10 026	58 724	148 527	221 207
Financial assets at fair value through other comprehensive income	375 370	-	122 419	680 775	82 148	1 260 712
Financial assets at amortised cost - loans and advances to banks	14 050	-	-	-	-	14 050
Financial assets at amortised cost - loans and advances to customers	72 576	206 312	711 610	4 167 916	10 541 639	15 700 053
Total assets	**498 252**	**209 219**	**844 055**	**4 907 415**	**10 772 314**	**17 231 255**
Planned payments of the off-balance sheet liabilities to grant loans or guarantees	**56**	**141**	**3 285**	**358 976**	**87 178**	**449 636**
Total asstes and off-balance sheet	**498 308**	**209 360**	**847 340**	**5 266 391**	**10 859 492**	**17 680 891**
Liabilities (by contractual dates of maturity)						
Financial liabilities measured at amortised cost - amounts due to banks	121 716	12 582	48 897	2 899 541	-	3 082 736
Financial liabilities measured at amortised cost - amounts due to customers	8 934	-	-	-	-	8 934
Financial liabilities measured at amortised cost - debt securities issued	55 144	143 646	1 287 530	4 619 730	3 152 488	9 258 538
Financial liabilities measured at amortised cost - subordinated liabilities	-	2 468	7 432	39 654	223 986	273 540
Total liabilities	**185 794**	**158 696**	**1 343 859**	**7 558 925**	**3 376 474**	**12 623 748**
Off-balance sheet liabilities to grant loans or guarantees	**139 171**	**78 144**	**127 883**	**104 442**	**-**	**449 640**
Total liabilites and off-balance sheet	**324 965**	**236 840**	**1 471 742**	**7 663 367**	**3 376 474**	**13 073 388**
Net liquidity gap	**173 343**	**(27 480)**	**(624 402)**	**(2 396 976)**	**7 483 018**	**4 607 503**

The amounts disclosed in maturity dates analysis are undiscounted contractual cash flows. Liabilities due to leases fall under the item: financial liabilities valued at the motorized cost cost - payable to clients and banks. Maturity structure of liabilities due to leasing was presented in note 28.

for 2019 (in PLN thousand)

3.7.3. Cash flows from transactions in derivative financial instruments

Derivative financial instruments settled in net amounts

Derivative financial instruments settled by the Bank on the net basis include interest rate swap contracts (IRS).

The following table presents derivative financial liabilities of the Bank which will be settled on the net basis, broken down by particular maturity dates as at balance sheet date. The amount in foreign currencies has been converted to PLN according to average exchange rate of NBP from balance sheet date. Amounts recognised in the table are not discounted contractual cash outflows.

31.12.2019

Derivative financial instruments to be settled on a net basis	within 1 month	from 1 to 3 months	from 3 months to 1 year	from 1 to 5 years	over 5 years	Total
Interest rates swaps (IRS)	(878)	17 386	9 337	76 946	38 495	**141 286**
Total net valuation	**(878)**	**17 386**	**9 337**	**76 946**	**38 495**	**141 286**

31.12.2018

Derivative financial instruments to be settled on a net basis	within 1 month	from 1 to 3 months	from 3 months to 1 year	from 1 to 5 years	over 5 years	Total
Interest rates swaps (IRS)	(188)	14 468	4 565	35 572	6 048	**60 465**
Total net valuation	**(188)**	**14 468**	**4 565**	**35 572**	**6 048**	**60 465**

Derivative financial instruments settled in gross amounts

Derivative financial instruments settled by the Bank on the gross basis include derivative currency financial instruments: SWAP currency contracts on the date of SPOT and FORWARD currency and CIRS.

The table below presents derivative financial instruments of the Bank which will be settled on the gross basis, broken down by particular maturity periods as at balance sheet date. The amounts in foreign currencies have been converted to PLN according to average exchange rate of NBP as at balance sheet date.

31.12.2019

Derivative financial instruments to be settled on a gross basis	within 1 month	from 1 to 3 months	from 3 months to 1 year	from 1 to 5 years	over 5 years	Total
Currency SWAP contracts:						
- outflows	**113 544**	**11 013**	**127 755**	-	-	**252 312**
- inflows	115 130	11 152	129 489	-	-	**255 771**
Interest-rate contracts CIRS:	**-**	**-**	**-**	**-**	**-**	**-**
- outflows	-	8 249	24 933	133 037	1 303 772	**1 469 991**
- inflows	**-**	**-**	**2 602**	**12 367**	**1 280 642**	**1 295 611**

31.12.2018

Derivative financial instruments to be settled on a gross basis	within 1 month	from 1 to 3 months	from 3 months to 1 year	Total
Currency SWAP contracts:				
- outflows	337 352	103 517	307 450	**748 319**
- inflows	335 807	103 519	310 625	**749 952**

4. 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 either:

- on the main market of a given element of assets or liability,
- 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 marked-to-model using prices or parameters observable in the market.

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

The Bank assumed 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 assumes 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.

<u>Loans and advances to banks</u>

The Bank assumed that the fair value of deposits of variable interest rates and deposits of fixed interest rates below 1 year is their carrying value. The Bank does not hold deposits opened for a period longer than 1 year.

<u>Receivables due to loans and advances granted to clients</u>

The fair value for 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.

Receivables due to loans and advances granted to clients are presented on the level 3 in the hierarchy of fair value.

<u>Financial assets at fair value through other comprehensive income.</u>

During initial recognition in books the fair value of payment are reported. Costs of transaction are included in valuation of initial value using effective interest rate method.

On the balance sheet day, the Bank valuates debt security listed on stock exchange or for which there is an active market according to the fair value (current market price), the valuation is made on the basis of the closing price of the session.

Any increases or loss of values are accounted for the day of valuation, i.e. at the end of a month, separately for each type of securities.

Securities in the Bank’s portfolio of the same issuer, of the same series, and purchased in different periods and at different prices are sold by the Bank using the FIFO principle - outflow of securities takes place in the order of their purchase.

<u>Financial instruments representing liabilities include the following:</u>

- loans received,
- other financial liabilities with deferred payment term,
- subordinated loans received,
- liabilities in respect of cash collateral,
- liabilities due to issued by the Bank covered bonds and bonds,
- other liabilities due to customers.

for 2019 (in PLN thousand)

The Bank does not hold financial instruments on the side of liabilities of fixed interest rate of above 1 year apart from liabilities due to covered bonds issued by the Bank.

The Bank assumed that the fair value of liabilities arising from received loans, other financial liabilities with deferred payment term, received subordinated loans, liabilities in respect of cash collateral and other liabilities due to customers is equal to their carrying value since these are liabilities with variable interest rates.

Liabilities arising from issuing of securities (covered bonds and bonds)

The Bank estimated fair value for issued covered bonds and unsecured corporate bonds of high rating using credit spread. For trenches subject to secondary trade issued so far it was assumed that the value of credit spread is the same as for issuing on the primary market with the same period until maturity. Clean price of particular trenches of covered bonds in trade was estimated taking into account the period remaining until maturity, value of expected credit spread for issuing on secondary market and quotations from swap curve.

Liabilities arising from issuing of debt securities are presented on the level 3 in the hierarchy of fair value.

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

Financial assets and liabilities	31.12.2019		31.12.2018	
	Carrying value	Fair value	Carrying value	Fair value
Aktywa finansowe wyceniane w zamortyzowanym koszcie				
Cash and balances with the central bank	**35 234**	**35 234**	**16 294**	**16 294**
Amounts due from other banks	**13 912**	**13 912**	**58 432**	**58 432**
Loans and advances to customers, including:	**11 628 432**	**12 163 792**	**10 930 534**	**11 373 116**
Individual customers	7 500 053	7 951 968	6 194 760	6 520 829
Corporate customers	3 997 350	4 078 548	4 592 460	4 705 467
Public sector customers	98 407	100 654	111 371	114 877
Other financial institutes	32 622	32 622	31 943	31 943
Total financial assets	**11 677 578**	**12 212 938**	**11 005 260**	**11 447 842**
Financial liabilities at amortised cost				
Amounts due to other banks	**2 816 822**	**2 816 822**	**3 179 878**	**3 179 878**
Amounts due to customers, including:	**8 934**	**8 934**	**3 099**	**3 099**
Corporate customers	8 752	8 752	2 918	2 918
Individual customers	139	139	138	138
Public sector customers	43	43	43	43
Debt securities in issue	**8 857 401**	**8 850 860**	**7 870 443**	**7 890 107**
Subordinated liabilities	**200 432**	**200 432**	**200 406**	**200 406**
Total financial liabilities	**11 883 589**	**11 877 048**	**11 253 826**	**11 273 490**

The tables below present the fair value hierarchy of financial assets and liabilities recognised in the statement of financial position of the Bank at their fair values as of 31 December 2019.

for 2019 (in PLN thousand)

31.12.2019	including:	Level 1 Prices quoted in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS				
Financial assets held for trading and derivatives held for hedges	**48 217**	**-**	**48 217**	**-**
Derivative financial instruments, including:	**48 217**	**-**	**48 217**	**-**
Derivative financial instruments held for trading:	**5 756**	**-**	**5 756**	**-**
- Interest rate derivatives	3 299	-	3 299	-
- Foreign exchange derivatives	2 457	-	2 457	-
Derivative financial instruments held for hedging:	**42 461**	**-**	**42 461**	**-**
Derivatives designated as fair value hedges	42 461	-	42 461	-
Non-trading financial assets mandatorily at fair value through profit or loss	**157 714**	**-**	**-**	**157 714**
Loans and advances to custumers	**157 714**	**-**	**-**	**157 714**
Corporate customers	157 714	-	-	157 714
Financial assets at fair value through other comprehensive income	**1 221 735**	**1 221 735**	**-**	**-**
- Treasury bonds	1 001 753	1 001 753	-	-
- Money bills	219 982	219 982	-	-
TOTAL FINANCIAL ASSETS	**1 427 666**	**1 221 735**	**48 217**	**157 714**

31.12.2019	including:	Level 1 Prices quoted in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
FINANCIAL LIABILITIES				
Derivative financial instruments, including:	**7 600**	**-**	**76**	**7 524**
Derivative financial instruments held for trading:	**253**	**-**	**253**	**-**
- Interest rate derivatives	177	-	177	-
- Foreign exchange derivatives	76	-	76	-
Derivative financial instruments held for hedging:	**7 347**	**-**	**(177)**	**7 524**
-Derivatives designated as fair value hedges	**(177)**	**-**	**(177)**	**-**
- Derivatives designated as cash flow hedges	7 524	-	-	7 524
TOTAL FINANCIAL LIABILITIES	**7 600**	**-**	**76**	**7 524**
RECURRING FAIR VALUE MEASUREMENTS				
TOTAL FINANCIAL ASSETS	**1 427 666**	**1 221 735**	**48 217**	**157 714**
TOTAL FINANCIAL LIABILITIES	**7 600**	**-**	**76**	**7 524**

<u>Derivatives designated as cash flow hedges</u>

The derivative designated as a cash flow hedge is a CIRS (Cross-Currency Interest Rate Swap), which was classified at level 3 of the fair value hierarchy, where the Bank pays a variable rate based on WIBOR and receives a fixed rate in EUR. In the case of announced bankruptcy of mBank Hipoteczny S.A., the CIRS transaction is not completed and continues until the date of completion of the transaction in accordance with the parameters set on the transaction date. Moreover, the transaction in question is characterised by a high denomination and a unilateral obligation to make a security deposit, where mBank Hipoteczny S.A. is exempt from the obligation to make it.

For the purposes of cash flow hedge accounting, the Bank enters into two hedging relationships simultaneously:

- by decomposition of the actual part of a CIRS transaction securing a PLN loan portfolio with a variable interest rate (hedging against interest rate risk), and

- by decomposing the part of the actual CIRS transaction securing the obligation in EUR (hedging against currency risk).

For the purpose of calculating changes in the fair value of future cash flows of items being hedged, the Bank applies the "hypothetical derivative" method, which assumes the possibility of reflecting the hedged item and the characteristics of the hedged risk.
in the form of a derivative. The rules of valuation are analogous to those of interest rate derivatives.

for 2019 (in PLN thousand)

Due to the properties of a CIRS transaction concluded by the Bank, containing non-standard and non-quoted price components, the margin on the leg paid by the Bank was higher than the margin of a standard, analogous CIRS transaction, which is resolved in the case of bankruptcy of a counterparty with a bilateral exchange of margin. This fact was confirmed by an independent quotation of CIRS transactions obtained by the Bank. At the same time, before concluding the transaction, the Bank checked other market quotations of high-rated counterparties and they showed convergence with the finally obtained transaction quotation. Thus the transaction was classified as a transaction concluded on market conditions, not having an option character, free of additional fees at the time of its conclusion and was considered a transaction in which there are parameters unobservable on an active market influencing its valuation.

Due to the non-standard character of the CIRS transaction concluded by the Bank, the valuation of this transaction consists of three elements - the value of discounted expected flows from the CIRS transaction, CVA/DVA adjustments and linear depreciation over time until the maturity date of the difference between the valuation of a non-standard CIRS transaction (including CVA/DVA adjustments corresponding to the nature of this transaction) and the valuation of a standard CIRS transaction (including CVA/DVA adjustments resulting from the profile of this transaction) determined on the transaction date. The amount depreciated on a straight-line basis, taken into account in the valuation of IRS transactions, determined at the time of concluding the transaction is PLN 7,216 thousand. Due to the fact that at the moment of establishing the NPV relation of the original CIRS transaction was transferred to the IRS transaction, therefore DVA as a significant valuation component was included in its valuation, and CVA due to its insignificant value was included in the valuation of the CIRS transaction.

For a CIRS transaction concluded by the Bank for the purpose of cash flow hedge accounting, there is no active market that would reflect the valuation of a transaction with similar characteristics. Commonly available quotations of CIRS transactions refer to contracts that are settled at the moment of counterparty's bankruptcy, take into account bilateral collateral with a margin and have a denomination that is actively traded on the market. In the Bank's opinion, these are arguments for the fact that there are no prices on the actively available market that can properly reflect the fair value of the CIRS transaction concluded by the Bank.

The tables below present the fair value hierarchy of financial assets and liabilities recognised in the statement of financial position of the Bank at their fair values as of 31 December 2018.

31.12.2018	including:	Level 1	Level 2	Level 3
		Prices quoted in active markets	Valuation techniques based on observable market data	Other valuation techniques
RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS				
Financial assets held for trading and derivatives held for hedges	**36 658**	**-**	**36 658**	**-**
Derivative financial instruments, including:	**36 658**	**-**	**36 658**	**-**
Derivative financial instruments held for trading:	**4 045**	**-**	**4 045**	**-**
- Interest rate derivatives	2 895	-	2 895	-
- Foreign exchange derivatives	1 150	-	1 150	-
Derivative financial instruments held for hedging:	**32 613**	**-**	**32 613**	**-**
Derivatives designated as fair value hedges	32 613	-	32 613	-
Non-trading financial assets mandatorily at fair value through profit or loss	**208 181**	**-**	**-**	**208 181**
Loans and advances to custumers	**208 181**	**-**	**-**	**208 181**
Corporate customers	208 181	-	-	208 181
Financial assets at fair value through other comprehensive income	**1 069 392**	**979 403**	**89 989**	**-**
- Treasury bonds	979 403	979 403	-	-
- Money bills	89 989	-	89 989	-
TOTAL FINANCIAL ASSETS	**1 314 231**	**979 403**	**126 647**	**208 181**

31.12.2018	including:	Level 1 Prices quoted in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
FINANCIAL LIABILITIES				
Derivative financial instruments, including:	**2 032**	**-**	**2 032**	**-**
Derivative financial instruments held for trading:	**2 032**	**-**	**2 032**	**-**
- Interest rate derivatives	-	-	-	-
- Foreign exchange derivatives	2 032	-	2 032	-
Derivative financial instruments held for hedging:	**-**	**-**	**-**	**-**
- Derivatives designated as fair value hedges	-	-	-	-
TOTAL FINANCIAL LIABILITIES	**2 032**	**-**	**2 032**	**-**
RECURRING FAIR VALUE MEASUREMENTS				
TOTAL FINANCIAL ASSETS	**1 314 231**	**979 403**	**126 647**	**208 181**
TOTAL FINANCIAL LIABILITIES	**2 032**	**-**	**2 032**	**-**

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 appropriate department on the basis of internal rules.

In 2019, there were no transfers of financial instruments between levels of the fair value hierarchy.

5. Major estimates and assessments made in connection with the application of accounting 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 establish whether the impairment should be reported in the income statement, the Bank assesses whether there are any evidence indicating possible to measure decrease of estimated future cash flows arising from granted loans and advances. If there is objective evidence of impairment of loan, the amount of impairment is calculated as a difference between balance sheet value for a given element of asset and current value of estimated future cash flows, discounted according to original effective interest rate of a given element of financial assets. If the current value of estimated cash flows for the portfolio of loans with recognized individual impairment changed by +/- 10%, as at 31 December 2019 the estimated amount of loan impairment would decrease by PLN 13 601 thousand or increase by PLN 20 242 thousand respectively (as at 31 December 2018, the amount of estimated cash flows would decrease by PLN 17 557 thousand or increase by PLN 21 540 thousand respectively). This estimate was made for a portfolio of loans in the case of which impairment is recognized on the basis of an individual analysis of future cash flows from recoveries from collateral (stage 3). The principles for measuring impairment are described in Note 2.8. The amount of losses incurred in 2019 was higher than the amount of losses incurred in 2018. The main factor that caused the increase was the need to create a write-down for identified defaults in the individual method, and the deterioration of factors influencing LAG estimates in the portfolio analysis - the deterioration of the ratio indicating the relation between the value of recoveries and the value of collaterals and the ratio of zero loss in case of default.

In the case of the retail portfolio acquired under the cooperation with mBank S.A., in 2019 there were changes in the group credit risk models used (changes implemented by the Model Competence Centre). As regards the changes that had a significant impact on the level of estimated write-downs, a change in the basket allocation model (Transfer Logic) was implemented, consisting in changing the quantile of the percentage of the portfolio going to basket 2 from 10 per cent to 5 per cent in the case of mortgage loans to individuals - a decrease in the amount of write-downs about PLN 1,1 milion, and the implementation of cyclical recalibrations of the PD model in January - a decrease in the amount of write-downs about 0,8 milion and July a decrease in provision about 1 PLN million.

Deferred tax assets

The Bank recognizes a deferred income tax asset if there is sufficient assurance that future taxable profits will be generated, allowing its use. The carrying amount of deferred tax asset is reviewed at each balance sheet date and reduced by the extent no longer probable for sufficient taxable profit to be available and allowing all or part of the deferred tax asset to be utilised.

In deferred tax the Bank capitalises write-offs for loan losses, along with the adjustment to fair value, not recognized as tax-deductible cost, in part attributable to equity, which according to tax regulations may, in the future, become a tax-deductible cost in a form of a write-off for loan losses, after meeting the statutory requirements regarding the receivable becoming overdue or plausibly uncollectible, or as the cost of uncollectible capital after documenting the uncollectibility of receivables. Write-offs for credit losses, which according to the CIT Act will not become a tax cost, were excluded from the calculation of income tax.

Phantom share-based benefits

The Bank conducts a remuneration program for the Management Board of the Bank and employees having significant influence on the risk profile of the Bank based on phantom shares settled in cash.

The description of the structure of the Program is presented in Note 41.

According to IAS 19 Bank used the Projected Unit Credit Method to measure the present value of the liabilities for the employee benefits. The basis to measure the provision for the deferred part of the variable remuneration for the entitled employees of the Bank is the amount of bonus, which Bank is obliged to pay based on the remuneration policy for persons having significant influence on the Bank's risk profile.

Phantom shares are granted in quantity based on the valuation of these shares for the appraisal period. The phantom share valuation is calculated each time at the end of the reporting period as the Bank carrying value divided by the number of ordinary shares. The payout under phantom shares depends on the average valuation of these shares obtained on the basis of two values: the phantom share value at the end of the annual period preceding the payment date and the phantom share value at the end of the first half of the year in which the payment is due in a given reporting period. The aforementioned average value is multiplied by the number of phantom shares to be executed in a given period, and the outcome determines the amount of the cash payment resulting from phantom shares held. The final value of the bonus, which constitutes the product of the number of shares, and their expected value on the balance sheet date preceding the implementation of each of deferred trenches is actuarially discounted on the reporting day. The discounted amount is reduced by actuarially discounted amount of annual allocation to the reserve for the same day. The actuarial discount means the product of financial discount and probability of reaching the moment of complete purchase of entitlements to each of deferred trenches by each of participants individually. Amounts of annual allocations are calculated in accordance with projected unit credit method. The probability referred to above was established using Multiple Decrement Model, where the three following risks were taken into account: the probability of dismissal from work, risk of total incapacity to work, risk of death.

As at 31 December 2019, the value of the provision for variable remuneration amounted to PLN 4 854 thousand; as at 31 December 2018, it amounted to PLN 4 381 thousand.

Fair value of derivatives and other financial instruments

The fair value of financial instruments not listed on active markets is determined using valuation techniques. All models are approved before use and calibrated to ensure that the results obtained reflect actual data and comparable market prices. Whenever possible, the models use only observable data from an active market. The methods of determining fair value of financial instruments are described in note 4.

Classification for forbearance exposures

In accordance with the Bank's forbearance policy presented under Note 3.1.4, the Bank classifies exposure / customers which are subject to the forbearance policy on the basis of professional judgment.

Lease classification

The Bank makes the assessment while classifying a lease as a finance lease or an operating lease based on the analysis of the commercial substance of the transaction, on the basis of professional judgement, whether substantially all the risks and rewards incidental to ownership of the lease subject were transferred or not.

Significant modification

A change in the contractual terms of a financial instrument that leads to the removal of a modified asset from the balance sheet and recognition of a new one. In the case of a significant modification resulting in the exclusion of an asset from the balance sheet, all unsettled commissions and all commissions charged for modification of this asset are settled once in the profit and loss account. The modified assets are derecognized in the net amount, i.e. taking into account previously recognized credit risk write-offs (in the case of assets with recognized impairment). The new asset is recognized at fair value (possibly adjusted for new commissions relating to the newly created asset) and a new effective interest rate is calculated for it. The assessment whether a given modification of financial assets is an important or insignificant modification depends on meeting the quality and quantity criteria, which have been described in note 2.6.

Prepayments of retail loans

CJEU ruled on 11 September 2019 that in case concerning consumer loans paid off prematurely the consumer has the right to a reduction in the total cost of the loan in the event of early repayment of the credit. As at 31 December 2019, the provision shown under provisions for future liabilities (Note 29) concerning the costs of potential fee refunds for early repayment of loans made before the date of the CJEU judgment was PLN 473 thousand.

The above estimates are burdened with significant uncertainty regarding the number of customers who will apply to the Bank for the reimbursement of commissions for early repayments made before the CJEU judgment, as well as the expected loan prepayment rate in the future.

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

6. Operating segments

Following the adoption of "management approach" of IFRS 8, operating segments are reported in accordance with the internal reporting provided to the Bank's Management Board, which is responsible for allocating resources to the reportable segments and assesses their performance.

mBank Hipoteczny S.A. is a specialised mortgage bank of which primary purpose is to issue mortgage bonds, which are intended to constitute the main source of long-term financing for loans secured with real estate property. There are two business lines in the Bank:

- retail line, focusing on the purchase of receivables from housing mortgage loans from mBank S.A.,
- commercial line, covering the financing of income-generating real property such as office buildings, shopping centres, hotels, warehouses and distribution premises, as well as financing of residential property (apartments and houses), carried out by housing developers.

As of 22 July 2017, the sales process of retail loans has been transferred to mBank, but the Bank still has a retail loan portfolio which is to be extended within the framework of regular pooling transactions.

Since the end of 2012, the Bank has not been providing financing to local government units or other entities with a surety of local government units. However, the Bank has a legacy portfolio of loan transactions for this segment which is the basis for the issue of public sector covered bonds.

In 2018, the Bank withdrew from the existing product segmentation due to adapting to the rules of presentation of segment results in the mBank Group. The data presentation method introduced is consistent with Bank's business profile and facilitates the receipt of management information by the users of statements. Moreover, the dynamic growth of the portfolio of retail mortgage loans, as the second major area of Bank's credit activity, resulted in a need to allocate internal interest expenses, set business objectives and settle segment results. The Bank introduced segmentation of the result into three business segments, which were distinguished from the point of view of specific customer groups and products according to uniform transaction characteristics:

1. The Corporate Banking Segment – is a segment of the Bank’s business that includes the following loans:
   - for refinancing — loans for refinancing or purchase of existing commercial properties (office buildings, warehouses, shopping centres and malls, logistics centres, hotels, guest houses, commercial premises, etc.), including commercial loans acquired from mBank S.A.,
   - to housing developers — loans for the financing of housing development projects (estates with single/multi-family houses for sale or rent),
   - loans to commercial developers — loans for the financing of commercial real estate projects that are consistent with the Bank’s credit policy,
   - historically to local government units — loans to local government units (municipalities, districts, provinces) as well as loans secured by local government units (commercial companies established by local governments, public health care institutions).
2. The Retail Banking Segment – is a segment of the Bank’s business that includes the loans to natural persons, those that may form a basis for the issue of mortgage bonds:
   - loans granted for housing purposes in PLN, the sale of which was under an agency agreement with mBank S.A. – agency model,
   - loans in PLN, secured with a mortgage on a housing property, acquired from mBank S.A. – pooling,
   - loans to natural persons granted not in cooperation with mBank S.A. The Bank discontinued the sales in this segment in 2004.
3. Treasury Segment – a segment of Bank's activities, comprising financing acquisition, in particular issuance of mortgage bonds, liquidity management, and Bank's interest rate and currency risk management. Revenues of the segment result from the maintenance of the liquidity portfolio and reclassification of internal interest costs from retail banking and corporate banking segments. Costs of the segment pertain to acquiring financing and, as of 2018, include a part of administrative expenses too.

The basic and sole division is the division into segments of Bank's activities. Due to the fact that the Bank operates only in the Republic of Poland, it does not apply geographical segmentation. There are no inter-segment transactions in the Bank. On the basis of the above adopted segmentation, the gross result of particular segments of activities is determined, considering all items of the profit and loss account.

The main purpose of profit and loss segmentation is to present the profitability of each individual segment of Bank’s operations as closely as possible (excluding the Treasury segment which finances other segments in the Mortgage Bank and by assumption is not expected to generate a positive financial result). In order to achieve this, the Bank assigns all direct income such as interest income, fee and commission income as well as impairment write-downs at the loan agreement level.

The Bank does not allocate the income tax charge to individual segments, accordingly the operating segments profit/loss data is presented on profit before income tax level. Data concerning operating segments is measured according to the same principles as those disclosed in the accounting policy.

The segmentation of assets and profit and loss has been made using the information that Bank uses for controlling and management purposes. Assets and liabilities, income and costs attributable to these assets have been assigned to individual segments of the Bank. The Treasury segment includes assets and liabilities related to hedging derivatives and liabilities on account of external financing. The segment results include all profit and loss positions.

Profit before tax for each operating segments of the Bank is presented with the reconciliation to the positon of the income statements, prepared for the purposes of the audited financial statements.

for 2019 (in PLN thousand)

Business segment reporting on the activities of mBank Hipoteczny S.A. – positions from income statement

Period from 01.01.2019 to 31.12.2019	Corporate Banking	Retail Banking	Treasure Segment	Total
Net interest income	**103 313**	**83 785**	**(1 029)**	**186 069**
Net fee and commission income	**(1 453)**	**(1 051)**	**(5 697)**	**(8 201)**
Other operating income/expenses	(360)	35	(36)	(361)
Net trading income	-	-	5 096	5 096
Result from non-substantial modificationj	(1 767)	(9)	-	(1 776)
Wynik z tytułu zaprzestania ujmowania instrumentów finansowych niewycenianych do wartości godziwej przez rachunek zysków i strat	(185)	-	-	(185)
Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss	(2 844)	-	-	(2 844)
Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss	(19 669)	(334)	-	(20 003)
Overhead costs	(26 183)	(25 941)	(7 462)	(59 586)
Depreciation	(1 374)	(5 055)	(486)	(6 915)
Tax on the Bank's balance sheet items	(13 390)	(18 836)	-	(32 226)
Segment result (gross)	**36 088**	**32 594**	**(9 614)**	**59 068**

Period from 01.01.2018 to 31.12.2018	Corporate Banking	Retail Banking	Treasure Segment	Total
Net interest income	**103 898**	**75 532**	**(5 138)**	**174 292**
Net fee and commission income	**2 497**	**(2 348)**	**(2 651)**	**(2 502)**
Other operating income/expenses	(208)	375	(140)	27
Net trading income	-	-	1 210	1 210
Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss	(4 556)	-	-	(4 556)
Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss	(14 441)	(2 120)	-	(16 561)
Overhead costs	(26 622)	(24 607)	(8 620)	(59 849)
Depreciation	(1 718)	(1 719)	(361)	(3 798)
Tax on the Bank's balance sheet items	(13 391)	(14 178)	-	(27 569)
Segment result (gross)	**45 459**	**30 935**	**(15 700)**	**60 694**

Business segment reporting on the activities of mBank Hipoteczny S.A. – positions from statement of financial position

	Corporate Banking	
	31.12.2019	31.12.2018
Segment Assets	4 268 893	4 928 865
Segment Liabilities	20 510	44 008

	Retail Banking	
	31.12.2019	31.12.2018
Segment Assets	7 485 063	6 177 906
Segment Liabilities	17 624	95

	Treasure Segment	
	31.12.2019	31.12.2018
Segment Assets	1 351 720	1 212 719
Segment Liabilities	11 882 254	11 255 858

	31.12.2019	31.12.2018
Other assets not allocated to segments	82 232	66 417

Other assets not allocated to segments include intangible assets, tangible assets, deferred tax assets and other assets.

for 2019 (in PLN thousand)

7. Net interest income

	Year ended 31 December	
	2019	2018
Interest income		
Interest income of financial assets at amortised cost, including:	**396 372**	**366 114**
- Loans and advances	395 377	365 460
- Cash and short-term placements	725	643
- Cash collateral	270	11
Interest income on financial assets at fair value through other comprehensive income	**21 105**	**21 698**
- Debt securities	21 105	21 698
Income similar to interest on financial assets at fair value through profit or loss, including:	**36 718**	**39 369**
Non-trading financial assets mandatorily measured at fair value through profit or loss, including:	7 064	8 456
- Loans and advances	7 064	8 456
Interest income on derivatives classified into banking book	7 901	12 329
Interest income on derivatives concluded under hedge accounting	21 753	18 584
Total interest income	**454 195**	**427 181**

	Year ended 31 December	
	2019	2018
Interest expense		
Financial liabilities valued at amortized cost, including:	(264 064)	(250 904)
-Due to the issue of debt securities	(161 039)	(158 481)
-Loans received	(71 589)	(79 807)
-Due to subordinated loan	(9 938)	(10 941)
-Other financial liabilities	(21 498)	(1 675)
Interest expenses on derivatives concluded under the cash flow hedge	(4 033)	-
Interest expenses on leasing	(29)	-
Total interest expense	**(268 126)**	**(250 904)**

In 2019, interest income related to impaired financial assets measured at amortised cost, stood at PLN 8,497 thousand (for the period ended on 31 December 2018: PLN 8,603 thousand).

for 2019 (in PLN thousand)

Net interest income broken down by individual sectors is as follows:

	Year ended 31 December	
	2019	**2018**
Interest income		
From banking sector	37 139	23 096
From other entities, including:	417 056	404 085
- from corporate customers	172 802	172 046
- from individual customers	241 659	209 467
- from public sector	2 595	22 572
Total interest income	**454 195**	**427 181**
Interest expense		
From banking sector	(92 978)	(81 350)
From other entities, including:	(138)	(132)
- from corporate customers	(138)	(132)
From own issuances	(161 039)	(158 481)
Subordinated capital	(9 938)	(10 941)
Interest expenses on derivatives concluded under the cash flow hedge	(4 033)	-
Total interest expense	**(268 126)**	**(250 904)**

Interest income generated on monetary bills is presented in the item "Interest income from the banking sector", whereas interest income from treasury bonds in the item "Interest income from the public sector".

8. Net fee and commission income

	Year ended 31 December	
	2019	**2018**
Fee and commission income		
Credit-related fees and commissions	2 203	3 038
Total fee and commission income	**2 203**	**3 038**
Fee and commission expenses		
Fee and commission expenses	(4 541)	(2 331)
Commission expense from loan received and stand-by credit line	(1 330)	(1 429)
Costs related to the debt securities issue program (covered bonds and bonds)	(4 274)	(1 116)
Costs of real estate analyses and valuations related to the lending activity	(3)	(405)
Commission for transfers for billing	(92)	(96)
Other	(164)	(163)
Total fee and commission expense	**(10 404)**	**(5 540)**
Total net fee and commission income	**(8 201)**	**(2 502)**

All income and expenses relating to fees and commissions presented in the table above relate to items not measured at fair value through profit or loss.
The costs of servicing credit products increased as a result of a new outsourcing agreement with mBank S.A. for after-sales service of the commercial portfolio (in the amount of PLN 3 436 thousand).
The cost of servicing related to the debt securities issue program includes mainly legal services for the amount of PLN 1 054 thousand. PLN, letters rating at PLN 983 thousand zł.

for 2019 (in PLN thousand)

9. Net trading income

	Year ended 31 December	
	2019	**2018**
Foreign exchange result	**287**	**2 286**
Net exchange differences on translation	(4 961)	19 975
Valuation of foreign currency derivatives	5 248	(17 689)
Other net trading income and result on hedge accounting	**4 809**	**(1 076)**
Interest rate risk instruments	243	916
Hedge accounting, including:	4 566	(1 992)
- net profit on hedged items	(45 734)	(33 740)
- net profit on hedging instruments	51 702	31 748
- result from the valuation of Cash flow hedging instruments	(1 402)	-
Total net trading income	**5 096**	**1 210**

Foreign exchange result covers realised and unrealised, positive and negative exchange rate differences, as well as profits and losses on spot transactions and futures contracts. The result on operations on interest-bearing instruments covers the result on interest rate swap contracts which have not been designated as hedging instruments.

The Bank applies fair value hedge accounting. The interest rate risk is the only type of risk hedged for which hedge accounting is applied. The result on hedged item and hedging instruments is presented in the Note 21. The hedge is assessed on an ongoing basis and determined to have been highly effective. The Bank documents its own assessment of the effectiveness of fair value 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.

10. Net income on modification

Net income on modification of financial assets is presented broken down by financial instruments:

- measured at amortised cost,
- measured at fair value through other comprehensive income,
- measured at fair value through profit and loss

The matters related to recognition of the net income on insubstantial modification are described in note 2.6.

	Year ended 31 December	
	2019	**2018**
Result from non-substantial modification for financial assets at amortised cost	(1 776)	(3 312)
Result from non-substantial modification	**(1 776)**	**(3 312)**

11. Net income on derecognition of financial instruments not measured at fair value through proft and loss

Profit or loss on derecognition of financial assets and liabilities not measured at fair value through profit and loss (including on sale or substantial modification) is presented broken down by accounting portfolios:

- measured at fair value through other comprehensive income,
- measured at amortised cost

for 2019 (in PLN thousand)

	Year ended 31 December	
	Gains	**Losses**
Loans and advances	28 601	(28 786)
Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss	**28 601**	**(28 786)**

	Year ended 31 December 2018	
	Gains	**Losses**
Debt securities	149	0
Loans and advances	11 926	(10 448)
Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss	**12 075**	**(10 448)**

The matters related to recognition of the net income on the sale of debt securities measured at fair value through other comprehensive income and the net income on substantial modification are described in note 2.6.

12. Profit or loss on financial assets not held for trading mandatorily measured at fair value through net financial income

	Year ended 31 December	
	2019	**2018**
Loans and advances	(2 844)	(4 556)
- Corporate customers	(2 844)	(4 556)
Gains or losses from non-trading financial assets mandatorily at fair value through profit or loss	**(2 844)**	**(4 556)**

13. Other operating income

	Year ended 31 December	
	2019	**2018**
Income from release of prior year provisions	745	587
Income from sales of services	63	514
Income from sales of inventories	-	55
Income from recovering receivables designated previously as prescribed, remitted or uncollectible	157	17
Other	65	29
Total other operating income	**1 030**	**1 202**

for 2019 (in PLN thousand)

14. General administrative expenses

	Year ended 31 December	
	2019	2018
Staff-related costs	(25 786)	(30 448)
Material costs, including:	(16 901)	(22 410)
- logistic cost	(5 892)	(9 198)
- IT cost	(8 100)	(7 402)
- marketing cost	(785)	(3 550)
- consulting services cost	(1 542)	(1 685)
- other overheads cost	(582)	(575)
Contributions and transfers to the Bank Guarantee Fund	(13 315)	(5 274)
Taxes and fees	(3 388)	(1 508)
Contributions to the Social Benefits Fund	(196)	(209)
Total overhead costs	**(59 586)**	**(59 849)**

The "Logistics costs" item includes costs related to short-term leasing contracts, costs related to low value assets leasing contracts and costs related to variable elements of remuneration (not included in the leasing obligation). The total cost of leasing included in general administrative costs as at 31 December 2019 amounted to PLN 924 thousand.

The item Logistics Costs includes costs of real property rental and costs of leasing means of transport of (2018: PLN 4,003 thousand).

Pursuant to the Resolution of the Bank Guarantee Fund Council of 11 April 2019 on determining the amount of contributions to the forced bank restructuring fund for 2019, in the current reporting period, the Bank recognised a contribution of PLN 13,315 thousand (for 2018: PLN 5,274 thousand) in the profit and loss account.

Staff-related expenses

	Year ended 31 December	
	2019	2018
Wages and salaries	(20 866)	(24 990)
Social security expenses	(3 353)	(3 748)
Costs of retirement benefits	(16)	(15)
Provision for unused holidays	-	(249)
Remuneration payment in the form of phantom shares settled in cash	(753)	(479)
Other employee benefits	(798)	(967)
Staff-related costs, total	**(25 786)**	**(30 448)**

for 2019 (in PLN thousand)

15. Other operating expenses

	Year ended 31 December	
	2019	**2018**
Inventory write-downs	-	(437)
Costs of enforcement proceedings	(517)	(330)
Provision for disputes	-	(88)
Writing down investments	(266)	(43)
Compensations, penalties and fines paid	-	(29)
Donations	-	(16)
Loss on sales or liquidation of tangible fixed assets and intangible assets	(253)	(1)
Provisons for future liabilities	(248)	-
Other	(107)	(381)
Total other operating expenses	**(1 391)**	**(1 325)**

16. Impairment or reversal of impairment on financial assets not measured at fair through net financial income

	Year ended 31 December	
	2019	**2018**
Financial assets at amortised cost, including:	**(20 746)**	**(17 829)**
- Loans and advances	**(20 746)**	**(17 829)**
Stage 1	(2 720)	(2 267)
Stage 2	(1 931)	2 332
Stage 3	(22 704)	(18 306)
POCI	6 609	412
Commitments and guarantees given	**743**	**1 117**
Stage 1	888	447
Stage 2	(145)	670
Net impairment losses on financial assets not measured at fair value through profit or loss	**(20 003)**	**(16 712)**

for 2019 (in PLN thousand)

17. Income tax

	Year ended 31 December	
	2019	**2018**
Current income tax	(18 249)	(16 869)
Deferred income tax (Note 29)	(3 735)	(2 588)
Total income tax	**(21 984)**	**(19 457)**

Profit before tax	**59 068**	**60 694**
Income tax calculated at the rate applicable in a given fiscal year (19%)	(11 223)	(11 532)
Non-taxable income	-	1
- other non-taxable income	-	1
- other non-taxable income	(10 738)	(8 082)
- tax on the Bank's balance sheet items	(6 123)	(5 238)
- value of write-downs on receivables	(1 736)	(1 665)
- contribution and payments to the Bank Guarantee Fund	(2 530)	(1 002)
- other	(349)	(177)
Adjustments in respect of current tax from prior years	(23)	717
Other permanent differences	-	(561)
Total income tax expense	**(21 984)**	**(19 457)**

Effective tax rate calculation		
Profit before income tax	59 068	60 694
Income tax	(21 984)	(19 457)
Effective tax rate	**37,22%**	**32,06%**
Nominal tax rate	**19,00%**	**19,00%**

Tax authorities may inspect the correctness of tax settlements over a period of 5 years from the end of the year in which the deadline for submitting a tax return had expired. Since the beginning of the Bank's operations, no tax inspections were carried out by the tax authorities with regards to corporate income tax.

18. Profit per share

	Year ended 31 December	
	2019	**2018**
Basic:		
Net profit from activities attributable to shareholders of mBank Hipoteczny S.A.	37 084	41 237
Weighted average number of ordinary shares	3 327 945	3 210 000
Basic net profit per share (in PLN per share)	**11,14**	**12,85**
Diluted:		
Net profit attributable to shareholders of mBank Hipoteczny S.A., applied during the estimation of diluted earnings per share	37 084	41 237
Weighted average number of ordinary shares	3 327 945	3 210 000
Diluted net profit per share (in PLN per share)	**11,14**	**12,85**

Basic earnings per share are computed as the quotient of the profit attributable to the Bank's shareholders and the weighted average number of ordinary shares during the year.

Diluted earnings per share are equal to basic earnings per share, as there are no dilutive elements.

The weighted average number of ordinary shares outstanding during the period is the number of ordinary shares at the beginning of the period, adjusted by the number of ordinary shares bought back or issued during the period multiplied by a time-weighting factor. The time-weighting factor is the number of days that the shares are outstanding as a proportion of the total number of days in the period.

for 2019 (in PLN thousand)

19. Other comprehensive income

Presented below is detailed information on other net comprehensive income for 2019 and 2018

	Year ended 31 December	
	2019	**2018**
Items that may be reclassified to the income statement, including:	**(5 443)**	**1 678**
Change in valuation of available for sale financial assets (net)	(2 435)	1 678
Change in the valuation of debt financial instruments valued at fair value through other comprehensive income (net)	(3 008)	-
Items that will not be reclassified to the income statement, including:	**20**	**2**
Actuarial gains and losses on post-employment benefits	20	2
Total other comprehensive income, net	**(5 423)**	**1 680**

20. Cash and balances with the central bank

As at 31 December 2019, the Bank has a current account with the National Bank of Poland, with a balance amounting to PLN 1 034 thousand and an O/N deposit of PLN 34,200 thousand. As at 31 December 2018, the Bank maintained PLN 94 thousand in the current account and an O/N deposit of PLN 16,200 thousand.

On the basis of the National Bank of Poland Act dated 29 August 1997, mBank Hipoteczny S.A. maintains a mandatory reserve deposit. The arithmetic mean of daily balances of the mandatory reserve which the Bank is required to maintain during a given period in the current account with NBP amounted to:

- PLN 605 thousand for the period from 31 December 2019 to 30 January 2020,
- PLN 0 thousand in the period from 31 December 2018 to 30 January 2019.

As at 31 December 2019, the interest rate on the cash maintained as a mandatory reserve was 0.50% (31 December 2018).

21. Financial assets and liabilities held for trading and derivative hedging instruments

The Bank has the following derivative instruments in its portfolio:

Interest rate risk instruments:

- Interest Rate Swap (IRS),

Currency risk instruments

- FX SWAP contracts,

Instrument for interest rate risk and exchange rate risk

- Cross Currency Interest Rate Swap (CIRS)

All derivative transactions are concluded for the purpose of hedging against currency risk and interest rate risk. The Bank is not engaged in trading; all derivative transactions are included in the banking portfolio.

for 2019 (in PLN thousand)

	Nominal amount		Fair value	
	purchase	disposal	assets	liabilities
As at 31 December 2019				
Derivative financial instruments held for trading				
Foreign exchange derivatives	3 621	3 620	1	-
- FX swap contracts	255 771	252 312	2 456	76
Total OTC derivatives	**259 392**	**255 932**	**2 457**	**76**
Total foreign exchange derivatives	**259 392**	**255 932**	**2 457**	**76**
Interest rate derivatives				
- IRS contracts	1 274 897	1 274 897	3 299	177
Total OTC interest rate derivatives	**1 274 897**	**1 274 897**	**3 299**	**177**
Total interest rate derivatives	**1 274 897**	**1 274 897**	**3 299**	**177**
	-	-	-	-
Total assets / liabilities held for trading	**1 534 289**	**1 530 829**	**5 756**	**253**
Interest rate derivatives				
Derivatives designated as fair value hedges	2 456 729	2 456 729	111 251	-
- IRS contracts	2 456 729	2 456 729	111 251	-
Derivatives designated as cash flow hedges				
- CIRS	1 277 550	1 278 930	-	7 524
Total derivatives held for hedging	**3 734 279**	**3 735 659**	**111 251**	**7 524**
Total recognised derivative assets /liabilities	**5 268 568**	**5 266 488**	**117 007**	**7 777**
Net-off effect	**-**	**-**	**(68 790)**	**(177)**
Total recognised derivative assets /liabilities held for trading	**5 268 568**	**5 266 488**	**48 217**	**7 600**
Short-term (up to 1 year)	1 662 044	1 658 584	8 159	253
Long-term (over 1 year)	3 606 524	3 607 904	40 058	7 347

As at December 31, 2019 except of valuation of derivatives, the netting effect includes PLN 68,613 thousand of collaterals received in connection with the derivative transactions subject to netting.

	Nominal amount		Fair value	
	purchase	disposal	assets	liabilities
As at 31 December 2018				
Derivative financial instruments held for trading				
Foreign exchange derivatives				
Foreign exchange transactions (FX forward)	13 553	13 545	11	4
- FX swap contracts	749 952	748 328	1 139	2 028
Total OTC derivatives	**763 505**	**761 873**	**1 150**	**2 032**
Total foreign exchange derivatives	**763 505**	**761 873**	**1 150**	**2 032**
Interest rate derivatives				
- IRS contracts	150 000	150 000	2 895	-
Total OTC interest rate derivatives	**150 000**	**150 000**	**2 895**	**-**
Total interest rate derivatives	**150 000**	**150 000**	**2 895**	**-**
Total assets / liabilities held for trading	**913 505**	**911 873**	**4 045**	**2 032**
Derivatives held for hedging				
Derivatives designated as fair value hedges	2 480 670	2 480 670	62 409	4 894
- IRS contracts	2 480 670	2 480 670	62 409	4 894
Total derivatives held for hedging	**2 480 670**	**2 480 670**	**62 409**	**4 894**
Total recognised derivative assets /liabilities	**3 394 175**	**3 392 543**	**66 454**	**6 926**
Net-off effect	**-**	**-**	**(29 796)**	**(4 894)**
Total recognised derivative assets /liabilities held for trading	**3 394 175**	**3 392 543**	**36 658**	**2 032**
Short-term (up to 1 year)	763 505	761 873	1 150	2 032
Long-term (over 1 year)	2 630 670	2 630 670	35 508	-

As at December 31, 2018 except of valuation of derivatives, the netting effect includes PLN 24,902 thousand of collaterals received in connection with the derivative transactions subject to netting.

Hedge accounting

In accordance with the IFRS9 provisions, only on the roll-out day the Bank had the opportunity to choose as its accounting policy element to continue to apply the IAS 39 hedge accounting requirements instead of the requirements indicated in IFRS 9.

IFRS 9 requires the Bank to ensure that its hedging relationships are compliant with the risk management strategy applied by the Bank and with its objectives. IFRS 9 introduces new requirements, among others, with regard to the assessment of the effectiveness of the hedging relationship and of the mechanism for its rebalancing as well as it prohibits the Bank from discontinuing hedge accounting by its subjective decision (i.e. in the absence of reasons to discontinue hedge accounting as defined in the Standard).

The Bank decided to continue from 1 January 2018 to apply the hedge accounting requirements in accordance with IAS 39.

The Bank determines the hedge ratio based on the nominal value of the hedged item and hedging instrument and it is 1:1.

The sources of hedge ineffectiveness for hedging relationships for which the ineffectiveness arises include mismatch of cash flow dates and repricing periods, base mismatch (e.g. another WIBOR), CVA/DVA mismatch which is in hedging instrument and is not in hedged instrument and mismatch due to initial valuation of hedging instruments if a previously acquired derivative was included in hedging relationship.

a) Fair value hedge accounting

The Bank applies fair value hedge accounting. The interest rate risk is the only type of risk hedged for which hedge accounting is applied. The result on hedged items and hedging instruments is presented in the following tables. The hedge is assessed on an ongoing basis and determined to have been highly effective. The Bank documents its own assessment of the effectiveness of fair value 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.

The Bank applies fair value hedge accounting, under which the only kind of hedged risk is the risk of changes in interest rates. At the end of each month, the Bank evaluates effectiveness of the applied hedging by carrying out analysis of changes in fair value of the hedged and hedging instruments in respect of the hedged risk in order to confirm that hedging relationships are effective in accordance with the accounting policy described in Note 2.10.

<u>Description of the hedging relationship</u>

The Bank hedges against the risk of change in fair value of fixed-interest rate mortgage covered bonds issued by the Bank. The hedged risk results from changes in interest rates.

<u>Hedged items</u>

The hedged items are fixed-interest rate mortgage covered bonds with the nominal value of EUR 576,900 thousand.

<u>Hedging instruments</u>

Interest Rate Swap transactions are the hedging instruments swapping the fixed interest rate for a variable interest rate.

<u>Presentation of the result from hedged and hedging transactions</u>

Fair value adjustment of the hedged liabilities as well as valuation of the hedging instruments is recognised in the income statement as the income from trading operation, except for interest income and expenses related to the interest measurement component of hedging instruments, which are presented in the position of interest income/expenses on derivatives concluded under the hedge accounting.

Pledged letters being a hedged instrument are presented in the statement of financial position under Liabilities arising from the issue of debt securities.

The following table presents hedged items as at 31 December 2019. In the following table, the nominal value is presented in EUR thousands, while the value of liability measured at amortised cost, hedge accounting adjustments related to fair value, carrying amount of a liability and the change of fair value resulting from hedge accounting, in PLN thousands.

As at 31.12.2019

Debt financial instruments by type	Nominal value	Interest rate as at 31.12.2019	Redemption date	Liability amount measured at amortised cost	Hedge accounting adjustments related to fair value of hedged items	Carrying amount of liability	Change of fair value due to hedge acounting
Mortgage covered bonds (EUR)	30 000	2,75%	28.07.2020	129 018	1 018	130 036	1 524
Mortgage covered bonds (EUR)	8 000	3,50%	28.02.2029	34 581	5 879	40 460	(1 587)
Mortgage covered bonds (EUR)	15 000	3,50%	15.03.2029	64 855	11 072	75 927	(2 990)
Mortgage covered bonds (EUR)	20 000	3,20%	30.05.2029	85 624	14 721	100 345	(4 081)
Mortgage covered bonds (EUR)	20 000	1,135%	25.02.2022	85 700	1 412	87 112	28
Mortgage covered bonds (EUR)	11 000	1,285%	24.04.2025	47 038	1 415	48 453	(1 133)
Mortgage covered bonds (EUR)	13 000	1,180%	20.09.2026	55 370	784	56 154	(2 345)
Mortgage covered bonds (EUR)	35 000	1,183%	20.09.2026	149 116	3 411	152 527	(6 106)
Mortgage covered bonds (EUR)	24 900	0,94%	01.02.2024	106 759	2 787	109 546	(1 371)
Mortgage covered bonds (EUR)	100 000	0,61%	22.06.2022	426 641	4 524	431 165	(1 188)
Mortgage covered bonds (EUR)	300 000	1,073%	05.03.2025	1 285 875	50 260	1 336 135	(26 485)
Mortgage covered bonds (EUR)	300 000	0,242%	15.09.2025	1 274 659	-	1 274 659	-
Total hedged items				**3 745 236**	**97 283**	**3 842 519**	**(45 734)**

* The item „Hedge accounting adjustments related to fair value of hedged items" concerning the adjustment to fair value mortgage covered bonds forming secured items within applied hedge accounting

The following table presents hedged items as at 31 December 2018. In the following table, the nominal value is presented in EUR thousands, while the value of liability measured at amortised cost, hedge accounting adjustments related to fair value, carrying amount of a liability and the change of fair value resulting from hedge accounting, in PLN thousands.

As at 31.12.2018

Debt financial instruments by type	Nominal value	Interest rate as at 31.12.2018	Redemption date	Liability amount measured at amortised cost	Hedge accounting adjustments related to fair value of hedged items	Carrying amount of liability	Change of fair value due to hedge acounting
Mortgage covered bonds (EUR)	30 000	2,75%	28.07.2020	129 886	2 541	132 427	1 015
Mortgage covered bonds (EUR)	8 000	3,50%	28.02.2029	34 879	4 292	39 171	(352)
Mortgage covered bonds (EUR)	15 000	3,50%	15.03.2029	65 423	8 081	73 504	(665)
Mortgage covered bonds (EUR)	20 000	3,20%	30.05.2029	86 367	10 640	97 008	(924)
Mortgage covered bonds (EUR)	20 000	1,135%	25.02.2022	86 402	1 441	87 843	(445)
Mortgage covered bonds (EUR)	11 000	1,285%	24.04.2025	47 459	282	47 742	(691)
Mortgage covered bonds (EUR)	35 000	1,183%	20.09.2026	150 513	(2 695)	147 818	(2 311)
Mortgage covered bonds (EUR)	13 000	1,180%	20.09.2026	55 887	(1 561)	54 326	(907)
Mortgage covered bonds (EUR)	24 900	0,94%	01.02.2024	107 757	1 416	109 172	(1 277)
Mortgage covered bonds (EUR)	100 000	0,61%	22.06.2022	430 591	3 336	433 927	(3 781)
Mortgage covered bonds (EUR)	300 000	1,073%	05.03.2025	1 295 900	23 775	1 319 676	(23 775)
Total hedged items				**2 491 064**	**51 549**	**2 542 613**	**(34 113)**

* The item „Hedge accounting adjustments related to fair value of hedged items" concerning the adjustment to fair value mortgage covered bonds forming secured items within applied hedge accounting

The following table presents hedged items as at 31 December 2018. In the following table, the nominal value is presented in EUR thousands, while fair value and the change of fair value resulting from hedge accounting, in PLN thousands.

The change in the fair value due to hedge accounting for the transaction ended as at 31 December 2018 is PLN (373) thousand.

The following table presents hedged items as at 31 December 2019. In the following table, the nominal value is presented in EUR thousands, while the fair value and the change of fair value resulting from hedge accounting, in PLN thousands.

for 2019 (in PLN thousand)

As at 31.12.2019

Derivatives	Nominal value	End of transaction	Fair value of asset	Fair value of liabilities	Change of fair value due to hedge acounting
IRS (EUR)	30 000	28.07.2020	2 403	-	(2 154)
IRS (EUR)	8 000	28.02.2029	7 172	-	1 727
IRS (EUR)	15 000	15.03.2029	13 238	-	3 278
IRS (EUR)	20 000	30.05.2029	15 044	-	4 711
IRS (EUR)	20 000	25.02.2022	1 791	-	123
IRS (EUR)	11 000	24.04.2025	1 556	-	1 212
IRS (EUR)	13 000	20.09.2026	745	-	2 467
IRS (EUR)	35 000	20.09.2026	3 286	-	6 459
IRS (EUR)	24 900	01.02.2024	3 446	-	1 439
IRS (EUR)	100 000	22.06.2022	5 551	-	2 201
IRS (EUR)	300 000	05.03.2025	57 019	-	30 239
Total hedging items			**111 251**	**-**	**51 702**

As at 31.12.2018

Derivatives	Nominal value	End of transaction	Fair value of asset	Fair value of liabilities	Change of fair value due to hedge acounting
IRS (EUR)	30 000	2020-07-28	4 506	-	(1 583)
IRS (EUR)	8 000	2029-02-28	5 436	-	296
IRS (EUR)	15 000	2029-03-15	9 952	-	575
IRS (EUR)	20 000	2029-05-30	10 346	-	928
IRS (EUR)	20 000	2022-02-25	1 626	-	587
IRS (EUR)	11 000	2025-04-24	340	-	752
IRS (EUR)	35 000	2026-09-20	-	(3 172)	2 468
IRS (EUR)	13 000	2026-09-20	-	(1 722)	964
IRS (EUR)	24 900	2024-02-01	1 976	-	1 350
IRS (EUR)	100 000	2022-06-22	3 357	-	4 083
IRS (EUR)	300 000	2025-03-05	24 870	-	21 681
Total hedging items			**62 409**	**(4 894)**	**32 101**

Change in fair value due to hedge accounting for a transaction completed on 31 December 2018 amounts to PLN (353) thousand.

Total result on fair value hedge accounting recognised in the income statement in 2019 and 2018

	Year ended 31 December	
	2019	**2018**
Interest income on derivatives as part of fair value hedge accounting	21 753	18 584
Result from the valuation of the hedged	(45 734)	(33 740)
Result on the valuation of hedging instruments	51 702	31 748
Total result on fair value hedge accounting	**27 721**	**16 592**

b) Cash flow hegde accounting

The bank began applying hedge accounting in terms of cash flow in November 2019. The purpose of the hedging strategy is to eliminate the risk of volatility of cash flows generated by mortgage loans in PLN due to changes in reference interest rates and mortgage bonds denominated in a convertible currency due to exchange rate changes using currency interest rate swaps (CIRS).

As part of hedge accounting, the Bank designates a hedged item consisting of:

- parts of the portfolio of housing loans for retail customers entered in the collateral register for mortgage covered bonds, denominated in PLN with an interest rate indexed to 3M WIBOR, the loan margin is excluded from collateral**;**
- mortgage bonds issued by the Bank in EUR with a fixed interest rate.

As hedging instruments, the Bank uses CIRS derivative transactions in which, as a party to the transaction, it pays variable interest flows in PLN increased by a margin, and receives fixed interest rates in EUR and the denominations are exchanged at the beginning and at the end of the transaction. As transactions concluded by a mortgage bank, CIRS transactions are subject to entry in the Register of covered bond collateral. In addition, if the bank's bankruptcy is announced by the court, it will not be immediately terminated, it will last until the end of the original maturity on the conditions specified on the date of the transaction (they will not be extended beyond the original maturity).
In accordance with the adopted methodology, the Bank hedges the interest rate risk and currency risk within one economic relationship between the concluded CIRS transactions and part of the loan portfolio in PLN and mortgage bonds financing them in EUR. For the purposes of cash flow hedge accounting, the Bank simultaneously establishes two hedging relationships:

- by decomposing the part of the actual CIRS transaction securing the portfolio of loans in PLN with a variable interest rate (hedging against interest rate risk) and
- by decomposing the actual portion of the CIRS transaction securing the liability in EUR (protection against currency risk).

For the purpose of calculating changes in the fair value of future cash flows of items being hedged, the Bank uses the "hypothetical derivative" method, which assumes the possibility of reflecting the hedged item and the characteristics of the risk being hedged
in the form of a derivative. The valuation principles are analogous to the principles for the valuation of interest rate derivatives.

SECURED POSITIONS	NOMINAL VALUE OF SECURED POSITIONS	POSITION IN THE FINANCIAL POSITION	CHANGES TO THE FAIR VALUE OF PROTECTED ITEMS
31.12.2019			
Loans in PLN with a variable interest rate	1 278 930	Loans in PLN with a variable interest rate	455
Mortgage bonds issued in a convertible currency at a fixed rate	1 277 550	Liabilities due to issued mortgage bonds	4 772

SECURED POSITIONS		NOMINAL VALUE OF SECURED POSITIONS	POSITION IN THE FINANCIAL POSITION	CHANGES TO THE FAIR VALUE OF PROTECTED ITEMS
31.12.2019				
CIRS	Fixed leg EUR	1 277 550	Other equity items	(4 756)
	Variable leg PLN	1 278 930		(338)

The average constant rate weighted by denomination for a fixed leg as at December 31, 2019 was 0.24%.
The average constant rate weighted by the nominal value of the variable leg in PLN as at 31 December 2019 was 2.42%.

31.12.2019	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
INTEREST RATE RISK						
Interest rate swap (CIRS) transaktions hedging the cash flows available from loans with variable interest rates denominated in PLN						
Nominal value (in thousand PLN)	-	-	-	-	1 277 550	**1 277 550**
Average interest rate on a fixed leg	-	-	-	-	0,242%	

In the case of established relationships, the period in which cash flows are expected and when they should be expected to influence the results is the period from November 2019 to September 2025.
Efficiency tests include the valuation of hedging transactions after deducting accrued interest and exchange differences on the nominal value of hedging transactions. Hedge effectiveness is verified

for 2019 (in PLN thousand)

by applying prospective and retrospective effectiveness tests. The tests are performed on a monthly basis.
The main sources of hedge ineffectiveness can be:

- taking into account the CVA / DVA correction only on the hedging instrument side,
- minimal differences in the construction method and basic parameters of hedging transactions and hedged items

Changes in the fair value of a derivative hedging instrument designated as a cash flow hedge are recognized directly in other comprehensive income in the portion that forms the effective portion of the hedge. The ineffective portion of the hedge is recognized in the income statement in the position 'Result on financial instruments measured at fair value' or 'Result on exchange position'. In addition, amounts charged directly to other comprehensive income are transferred to the profit and loss account respectively of the item 'Net interest income' and 'Net foreign exchange gains' in the same period or periods in which the inflow of the hedged transaction is referred to the profit and loss account and precipitate.

The following note presents other comprehensive income from cash flow hedges in the period from January 1 to December 31, 2019

CUMULATED OTHER TOTAL REVENUE FOR PROTECTION OF CASH FLOWS AND IMPACT ON OTHER TOTAL INCOME	Ending year 31.12.2019
Accumulated other comprehensive income from cash flow hedges at the beginning of the gross period	-
Profits / (Losses) recognized in other comprehensive income in the period	**(9 127)**
The amount transferred during the period from other comprehensive income to the profit and loss account	**5 413**
- Net interest income	4 033
- Result on exchange position	1 380
Accumulated other comprehensive income from cash flow hedges at the end of the gross period	**(3 714)**
Tax effect	706
Accumulated other comprehensive income from cash flow hedges at the end of the net period	**(3 008)**
Ineffective portion of cash flow hedges recognized in the income statement	-
Impact during the period on other gross comprehensive income	**(3 714)**
Deferred tax due to cash flow hedges	706
Impact during the period on other net comprehensive income	**(3 008)**

Total result on cash flow hedge accounting recognized in the profit and loss account	Ending year 31.12.2019
Net interest income on derivatives under cash flow hedge accounting	(4 033)
Result on exchange position	(1 380)
Result of the first day	(1 402)
Total	**(6 815)**

BALANCE SHEET / FAIR VALUE OF DERIVATIVE INSTRUMENTS FOR PROTECTING CASH FLOWS	Liabilities
31.12.2019	
IRS (decomposed part of the actual CIRS transaction hedging against interest rate risk - Relation A)	1 265
CIRS (decomposed part of the actual CIRS transaction as hedging against currency risk - Relation B)	6 259
Total	**7 524**

NOMINAL VALUE OF SECURITY INSTRUMENTS BY DURATION FOR IMPLEMENTATION	up to 1 month	over 1 month to 3 months	over 1 year to 5 years	over 5 years Total	Total
31.12.2019					
CIRS					
PLN float sale	-	-	-	1 278 930	**1 278 930**
Fixed EUR purchase (original currency)	-	-	-	300 000	**300 000**

for 2019 (in PLN thousand)

Estimates and assessments

The fair value of derivatives is determined using valuation models based on discounted future cash flows from a given financial instrument. The variables in the model and the assumptions used for valuation include, if available, data from observable markets (e.g. deposit rates on the interbank market, currency exchange rates, IRS and CCBS transaction quotes). The fair value of derivatives includes DVA's own credit risk (debit value adjustment) as well as the credit risk of the counterparty CVA (credit value adjustment). The process of calculating CVA and DVA adjustments involves choosing a method to determine the spread on the counterparty or Bank's credit risk as well as estimating the probability of the contractor or Bank's insolvency and the recovery rate. In addition, to reflect the impact of non-standard transaction parameters on the valuation level, the model uses historical prices used in CIRS transactions with similar parameters for which quotes can be obtained from active markets.

Estimate calculation

The Bank conducted a simulation to determine the possible impact of changes in yield curves on the transaction valuation.

ESTIMATED CHANGE IN VALUATION WITH A PARALLEL INCOME SHIFT	Scenario + 50 bp.	Scenario -50 bp.
31.12.2019		
CIRS	(36 121)	36 143

Impact of the IBOR reform

In connection with the amendments to the standards IFRS 9, IAS 39 and IFRS 7, Interest Rate Benchmark Reform, described in the Note 2.26, the Group took advantage of the possibility of earlier adoption of these changes in 2019 and it did not verify effectiveness of hedging relationships in hedge accounting. The amendments provide temporary reliefs which enable the Bank's hedge accounting to be continued during the period of uncertainty, before the replacement of an existing interest rate benchmark with an alternative risk free interest rate.

As a result of an ongoing reform of the interest rate reference benchmark and its replacement with a risk free alternative interest rate, the Bank has established a project to manage the transition for any of its contracts that could be affected. The table below indicates the nominal amount and weighted average maturity of derivatives in hedging relationships that will be affected by IBOR reform, analyzed by interest rate basis. The derivative hedging instruments provide a close approximation to the extent of the risk exposure the Bank manages through hedging relationships.

31.12.2019	Nominal value	Weighted average maturity (in years)
Interest rate swap contracts in foreign currency (CIRS)		
LIBOR EUR (3 month)	1 277 550	5,8
Interest rate swap contracts in foreign currency (CIRS), total	1 277 550	

22. Financial assets not held for trading mandatorily measured at fair value through net financial income

	31.12.2019	31.12.2018
Loans and advances	**157 714**	**208 181**
- Corporate customers	157 714	208 181
Financial assets not held for trading mandatorily measured at fair value through net financial income, total	**157 714**	**208 181**

The credit quality non-trading financial assets mandatorily at fair value through profit or loss according to an internal rating as at December 31, 2019 and December 31, 2018.

for 2019 (in PLN thousand)

	score z modeli wewnętrznych		31.12.2019
	[SCOREmin	SCOREmax)	
Exposures subject to the IRB approach — specialised lending, including	-	-	157 714
- supervisory category 2	23	45	97 303
- supervisory category 3	11	23	27 238
- supervisory category 5	default	default	33 173
Total			**157 714**

	score from internal models		31.12.2018
	[SCOREmin	SCOREmax)	
Exposures subject to the IRB approach — specialised lending, including	-	-	208 181
- regulatory category 2	23	45	143 976
- regulatory category 3	11	23	29 532
- regulatory category 5	default	default	34 673
Total			**208 181**

23. Financial assets measured at fair value through other comprehensive income

31.12.2019	Carrying value
Debt securities	**1 221 735**
- Central banks	219 982
- General governments, including::	1 001 753
pledged securities	*202 070*
Total financial assets at fair value through comprehensive income	**1 221 735**
Short-term (up to 1 year)	483 414
Long-term (over 1 year)	738 321
Based on fixed interest rate	577 846
Based on floating interest rate	643 889

All securities other than shares were classified in Stage 1. Financial assets in form of money bills and Treasury bond are consideres as financial assets with low credit risk due to the fact that they are characterizes as default risk.

Movements in the balance of financial assets measured at fair value through other comprehensive income.

	31.12.2019
As at the beginning of the period	**1 069 392**
Additions	11 430 323
Disposals (sale, redemption and forfeiture)	(11 274 940)
Gains / losses from changes in fair value	(3 040)
As at the end of the period	**1 221 735**

for 2019 (in PLN thousand)

31.12.2018	Wartość bilansowa
Debt securities	**1 069 392**
- Central banks	89 989
- General governments, including::	979 403
pledged securities	*202 894*
Total financial assets at fair value through comprehensive income	**1 069 392**
Short-term (up to 1 year)	377 879
Long-term (over 1 year)	691 513
Based on fixed interest rate	483 725
Based on floating interest rate	585 667

Movements in the balance of investment securities

	31.12.2018
As at the beginning of the period	**1 277 127**
Additions	8 717 353
Disposals (sale, redemption and forfeiture)	(8 927 160)
Gains / losses from changes in fair value	2 072
As at the end of the period	**1 069 392**

Both as at 31 December 2019 and as at 31 December 2018, debt instruments had a rating of AAA on the scale of Standard & Poor's (S&P) rating agency.

Pledged assets are not subject to resale or further pledging.

24. Financial assets measured at amortised cost

31.12.2019	Carrying value	Gross carrying amount				Accumulated impairment			
		Stage 1	Stage 2	Stage 3	POCI	Stage 1	Stage 2	Stage 3	POCI
Loans and advances to banks	13 912	13 912	-	-	-	-	-	-	-
Loans and advances to customers	**11 628 432**	**10 491 496**	**940 227**	**940 227**	**24 404**	**(12 093)**	**(13 394)**	**(92 527)**	**53**
Individual customers	7 500 054	6 957 216	529 232	529 232	434	(1 976)	(5 159)	(10 975)	-
Corporate customers	3 997 349	3 404 203	410 995	410 995	23 970	(10 088)	(8 235)	(81 487)	53
Public sector customers	98 407	97 455	-	-	-	(29)	-	(65)	-
Financial institutions	32 622	32 622	-	-	-	-	-	-	-
Financial assets at amortised cost, total	**11 642 344**	**10 505 408**	**940 227**	**940 227**	**24 404**	**(12 093)**	**(13 394)**	**(92 527)**	**53**

Short-term (up to 1 year)	724 009
Long-term (over 1 year)	10 918 335

Loan structure by past due days

Loan structure by past due days (31.12.2019r.)	Loans and advances to banks	Financial istitutions	Corporate customers	Individual customers	Public sector customers	Total
Not overdue or up to 30 days	13 912	32 622	3 894 471	7 473 086	97 426	11 511 517
31 to 60 days	-	-	40 595	13 024	-	53 619
61 to 90 days	-	-	11 560	3 934	-	15 494
over 90 days	-	-	50 724	10 009	981	61 714
Total	**13 912**	**32 622**	**3 997 350**	**7 500 053**	**98 407**	**11 642 344**

for 2019 (in PLN thousand)

31.12.2018	Carrying value	Gross carrying amount				Accumulated impairment			
		Stage 1	Stage 2	Stage 3	POCI	Stage 1	Stage 2	Stage 3	POCI
Loans and advances to banks	58 432	58 432	-	-	-	-	-	-	-
Loans and advances to customers	**10 930 534**	**9 641 442**	**1 083 595**	**287 028**	**8 521**	**(9 393)**	**(11 340)**	**(76 870)**	**7 551**
Individual customers	6 194 760	5 299 566	893 655	18 705	475	(1 558)	(8 132)	(7 951)	-
Corporate customers	4 592 460	4 199 462	189 940	267 323	8 046	(7 802)	(3 208)	(68 852)	7 551
Public sector customers	111 371	110 471	-	1 000	-	(33)	-	(67)	-
Financial institutions	31 943	31 943	-	-	-	-	-	-	-
Financial assets at amortised cost, total	**10 988 966**	**9 699 874**	**1 083 595**	**287 028**	**8 521**	**(9 393)**	**(11 340)**	**(76 870)**	**7 551**

Short-term (up to 1 year)	757 415
Long-term (over 1 year)	10 231 551

Loan structure by past due days

Loan structure by past due days (31.12.2018r.)	Loans and advances to banks	Financial istitutions	Corporate customers	Individual customers	Public sector customers	Total
Not overdue or up to 30 days	58 432	31 943	4 480 090	6 168 723	110 438	10 849 626
31 to 60 days	-	-	40 851	16 983	-	57 834
61 to 90 days	-	-	-	4 820	-	4 820
over 90 days	-	-	71 027	4 726	933	76 686
Total	**58 432**	**31 943**	**4 591 968**	**6 195 252**	**111 371**	**10 988 966**

As at 31 December 2019, in the Bank's credit portfolio measured at amortised cost, the gross value of loans to corporate customers, individual customers and the public sector in the Bank's loan portfolio, carrying floating interest rates, amounted to PLN 11,713,719 thousand (2018: 10 988 589 TPLN), and the gross value of loans carrying fixed-to-floating interest rates amounted to PLN 52 thousand (54 TPLN).

The item "Other financial institution" includes cash collateral (Initial margin) placed by the Bank as a security for derivative transactions with the central clearing house.

The gross carrying amount of the portfolio of retail loans acquired as part of cooperation with mBank S.A, as at 31 December 2019, was PLN 7,480,886 thousand (2018: 6 170 484 TPLN), including as part of agency sales PLN 4 256 423 thousand (2018: 4 613 484) and of retail pooling 3 224 463 PLN (2018: 1 557 000 thousand).

The gross carrying amount of the portfolio of commercial loans transferred as part of commercial pooling from mBank S.A, as at 31 December 2019 was PLN 166,874 thousand (as at 31 December 2018, was PLN 179,154 thousand).

In connection with the SARS-CoV-2 coronavirus epidemic, the Bank identifies the negative impact of the epidemic on credit risk in future periods. The impact of the epidemic is described in note 46.Credit quality of financial assets measured at amortised cost measurement and financial assets not held for trading mandatorily measured at fair value through financial income broken down by rating

	score from internal models		Stage 1	Stage 2	Stage 3	POCI	31.12.2019
	[SCOREmin	SCOREmax)					
Exposures permanently exempted from the IRB approach	no rating	no rating	221 967	4 318	3 047	434	229 766
Exposures temporarily exempted from the IRB approach — retail portfolio acquired in cooperation with mBank S.A.	-	-	6 928 969	520 335	18 240	-	7 467 544
Exposures subject to the IRB approach — specialised lending, including	-	-	3 523 516	207 131	176 452	24 023	3 931 122
- supervisory category 1	45	54	3 090	-	-	-	3 090
- supervisory category 2	23	45	3 430 260	80 068	-	-	3 510 328
- supervisory category 3	11	23	90 166	110 610	-	-	200 776
- supervisory category 4	1	11	-	16 453	-	-	16 453
- supervisory category 5	default	default	-	-	176 452	24 023	200 475
Total			**10 674 452**	**731 784**	**197 739**	**24 457**	**11 628 432**

for 2019 (in PLN thousand)

	score from internal models		Stage 1	Stage 2	Stage 3	POCI	31.12.2018
	[SCOREmin	SCOREmax)					
Exposures permanently exempted from the IRB approach	no rating	no rating	248 484	2 364	2 414	0	253 262
Exposures temporarily exempted from the IRB approach — retail portfolio acquired in cooperation with mBank S.A.	-	-	5 264 079	883 914	9 770	-	6 157 763
Exposures subject to the IRB approach — specialised lending, including	-	-	4 119 488	185 978	198 447	15 596	4 519 509
- supervisory category 1	45	54	5 931	-	-	-	5 931
- supervisory category 2	23	45	4 008 068	158 185	-	-	4 166 253
- supervisory category 3	11	23	88 190	27 793	-	-	115 983
- supervisory category 4	1	11	17 299	-	-	-	17 299
- supervisory category 5	default	default	-	-	198 447	15 596	214 043
Total			**9 632 051**	**1 072 256**	**210 631**	**15 596**	**10 930 534**

To calculate the capital requirement in respect of credit risk, the Bank applies the advanced internal rating-based (IRB) approach, with the use of the supervisory approach with regard to assigning risk categories to specialised lending exposures. The assignment to a relevant supervisory category is conducted after the transaction risk assessment, using internal rating models developed by the Bank and the conversion function model, providing a transformation of the score assigned as part of the internal models into supervisory categories. Individual supervisory categories listed in the table above specify the supervisory risk weights and expected losses.

In accordance with the original version of the Roll-Out Plan, the IRB approach was to cover specialised lending exposures in the commercial portfolio, but as a result of business strategy implementation and of the expected significant increase in the share of retail exposures in the Bank's balance sheet total, on 10 December 2013, the Bank adopted an internal resolution concerning a modification of the scope of the IRB roll-out, and on 12 December 2013, the extension of the gradual IRB Roll-out Plan to include the retail portfolio acquired within the scope of cooperation with mBank S.A. was notified to the KNF.

There are ongoing works at the Bank – initiated with the submission of the Prevalidation Application in H2 2016 – focusing on obtaining the consent of the Supervision Authority to apply the A-IRB approach to the retail portfolio acquired within the scope of cooperation with mBank S.A., based on the adaptation of the models applied in mBank S.A. In Q4 2017, the Bank obtained an official position from the Polish (PFSA) and the European (ECB) supervision authority, which is the result of the observations from the inspection carried out in Q4 2016, as well as of the answers of the Bank to the initial evaluation results, addressed at the beginning of 2017 by the PFSA.

A substantial part of the recommendations identified during the inspection was addressed by the Bank, among other things, by rebuilding the LGD model, however the mBank Group intends to fulfil all the expectations of the supervision authority in 2019, which shall result in the submission of the final Request for the application of the statistical methods for calculating the capital requirements for the credit risk for the retail portfolio acquired within the scope of the cooperation with mBank S.A. A project team was appointed in June 2018 for the purposes of submitting the final request. At present, changes in the model are in the process of approval by the supervision authorities (PFSA, ECB).

Movements in the balance of loss allowances and provisions (31.12.2019)

	Opening balance	Transfered to stage 1	Transfered to stage 2	Transfered to stage 3	Increase due to given and repossess	Decreases caused by deletion from the balance sheet	Change due to modyfications that do not result in removal from the balance sheet (net)	Decreases due to amounts taken against allowances	other adjustments	Closing balance
Loans	**(90 052)**	**-**	**-**	**-**	**(1 300)**	**4 734**	**(24 522)**	**(7 060)**	**239**	**(117 961)**
Stage 1	(9 393)	(3 775)	761	3	(711)	1 076	(48)	-	(6)	(12 093)
Stage 2	(11 340)	3 768	(926)	1 437	(527)	1 051	(6 866)	-	9	(13 394)
Stage 3	(76 870)	7	165	(1 440)	(62)	2 607	(24 217)	7 047	236	(92 527)
POCI	7 551	-	-	-			6 609	(14 107)		53
Provision related to financial assets, total	**(90 052)**	**-**	**-**	**-**	**(1 300)**	**4 734**	**(24 522)**	**(7 060)**	**239**	**(117 961)**

In position „Decreases due to amounts taken against allowances" positive repayment shown Accumulated impairment for POCI

Movements in the balance of loss allowances and provisions (31.12.2018)

for 2019 (in PLN thousand)

	Opening Balance	Transfered to stage 1	Transfered to stage 2	Transfered to stage 3	Increases due to given and repossess	Decreases caused by deletion from the balance sheet	Changes due to change in credit risk (net)	Changes due to modifications that do not result in removal from the balance sheet (net)	Changes resulting from updating the methodology for estimating impairment losses (net)	Decreases due to amounts taken against allowances	Other adjustments	Closing balance
Loans	**(92 944)**	**9 162**	**(11 816)**	**(13 539)**	**(1 200)**	**12 450**	**-**	**807**	**-**	**7 866**	**(838)**	**(90 052)**
Stage 1	(7 052)	(1 024)	1 736	2	(858)	1 211	-	(3 299)	-	-	(109)	(9 393)
Stage 2	(13 586)	10 000	(13 856)	1 673	(278)	486	-	4 298	-	-	(77)	(11 340)
Stage 3	(72 306)	186	304	(15 214)	(64)	10 753	-	(7 743)	-	7 866	(652)	(76 870)
POCI	-	-	-	-	-	-	-	7 551	-	-	-	7 551
Provision related to financial assets, total	**(92 944)**	**9 162**	**(11 816)**	**(13 539)**	**(1 200)**	**12 450**	**-**	**807**	**-**	**7 866**	**(838)**	**(90 052)**

Positive valuation of accumulated impairment results from the presentation of interest accrued in this item

Explanation of substantial changes in the gross carrying amount of financial instruments during the period impacting changes in expected credit loss allowance (31.12.2019)

	Opening balance	Transfered to stage 1	Transfered to stage 2	Transfered to stage 3	Increase due to given and repossess	Decreases caused by deletion from the balance sheet	Change due to modyfications that do not result in removal from the balance sheet (net)	Decreases due to amounts taken against allowances	other adjustments	Closing balance
Receivables from banks	**58 432**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(44 520)**	**13 912**
Stage 1	58 432	-	-	-	-	-	-	-	(44 520)	13 912
Loans	**11 020 586**	**-**	**-**	**-**	**1 878 522**	**(899 557)**	**-**	**(12 830)**	**(240 329)**	**11 746 393**
Stage 1	9 641 442	515 380	(473 815)	(3 396)	1 799 077	(816 269)	-	-	(170 923)	10 491 496
Stage 2	1 083 596	(515 380)	473 815	(68 537)	79 149	(77 700)	-	-	(34 716)	940 227
Stage 3	287 028	-	-	17 749	296	(5 588)	-	(5 129)	(4 090)	290 266
POCI	8 521	-	-	54 184	-	-	-	(7 701)	(30 600)	24 404
Gross carrying amount of financial assets at amortized cost	**11 079 018**	**-**	**-**	**-**	**1 878 522**	**(899 557)**	**-**	**(12 830)**	**(284 849)**	**11 760 305**

Explanation of substantial changes in the gross carrying amount of financial instruments during the period impacting changes in expected credit loss allowance (31.12.2018)

	Opening Balance	Transfered to stage 1	Transfered to stage 2	Transfered to stage 3	Increases due to given and repossess	Decreases caused by deletion from the balance sheet	Changes resulting from updating the methodology for estimating impairment losses (net)	Decreases due to amounts taken against allowances	Other adjustments	Closing balance
Receivables from banks	**18 737**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**39 695**	**58 432**
Stage 1	18 737	-	-	-	-	-	-	-	39 695	58 432
Loans	**10 626 574**	**-**	**-**	**-**	**1 482 674**	**(1 090 855)**	**-**	**(7 866)**	**10 059**	**11 020 586**
Stage 1	9 206 936	377 544	(403 718)	(10 656)	1 432 258	(1 014 804)	-	-	53 882	9 641 442
Stage 2	1 161 006	(376 568)	405 206	(64 315)	49 949	(75 000)	-	-	(16 683)	1 083 595
Stage 3	257 573	(976)	(1 488)	74 971	-	(1 051)	-	(7 866)	(34 135)	287 028
POCI	1 059	-	-	-	467	-	-	-	6 995	8 521
Gross carrying amount of financial assets at amortized cost	**10 645 311**	**-**	**-**	**-**	**1 482 674**	**(1 090 855)**	**-**	**(7 866)**	**49 754**	**11 079 018**

Financial effect of collaterals

As at 31 December 2018	Gross amount	Established impairment write-downs	Impairment write-downs without the collateral cash flows	Financial effect of collaterals
Balance sheet data				
Amounts due from other banks	**13 912**	**-**	**-**	**-**
Loans and advances to customers, including:	**11 746 393**	**(115 717)**	**(192 614)**	**76 897**
Corporate customers	4 097 108	(97 513)	(164 357)	34 603
Individual customers	7 518 162	(18 110)	(28 163)	10 053
Public sector customers	98 501	(94)	(94)	(29)
Other receivables	32 622	-	-	-
Total balance sheet data	**11 760 305**	**(115 717)**	**(192 614)**	**76 897**
Off-balance sheet data				
Loan commitments	449 612	(1 568)	-	(1 568)
Total off-balance sheet data	**449 612**	**(1 568)**	**-**	**(1 568)**

for 2019 (in PLN thousand)

As at 31 December 2018	Gross amount	Established impairment write-downs	Impairment write-downs without the collateral cash flows	Financial effect of collaterals
Balance sheet data				
Amounts due from other banks	**58 432**	**-**	**-**	**-**
Loans and advances to customers, including:	**11 020 586**	**(90 052)**	**(134 142)**	**44 090**
Corporate customers	4 664 771	(72 311)	(110 865)	38 554
Individual customers	6 212 401	(17 641)	(23 177)	5 536
Public sector customers	111 471	(100)	(100)	-
Other receivables	31 943	-	-	-
Total balance sheet data	**11 079 018**	**(90 052)**	**(134 142)**	**44 090**
Off-balance sheet data				
Loan commitments	1 506 428	2 313	-	2 313
Total off-balance sheet data	**1 506 428**	**2 313**	**-**	**2 313**

The bank may modify the terms of the credit agreement during the loan period due to multiple reasons. If the terms of the financial asset agreement change, the bank examines, if the cash flow generated by the modified asset, differs significantly from the cash flow from before the change of the agreement. The assessment, if the assets modification is significant or insignificant, depends on meeting the qualitative and quantitative criteria (Note 2.6).

The table below presents the information on financial assets, which were the subject to modification, that not resulted in the exclusion from the balance sheet. For the assets below the reserve due to expected loss was calculated during the credit exposure period.

	31.12.2019	31.12.2018
Financial assets that were subject to modification in the period		
Gross carrying amount of financial assets at amortized cost before modification, for which the write-down for expected credit losses was calculated in the lifetime horizon	98 637	112 536
Net profit / loss due to modification	829	3
Financial assets modified from the moment of initial recognition		
Gross carrying amount of financial assets whose valuation horizon of the write-off for expected credit losses during the period changed from lifetime to 12-month	-	-

25. Intangible assets

	31.12.2019	31.12.2018
Concessions, patents, licences and similar assets, including:	11 972	8 670
- computer software	11 972	8 670
Intangible assets under development	36 648	31 351
Intangible assets, total	**48 620**	**40 021**

Movements in intangible assets

for 2019 (in PLN thousand)

Movements in the period from 01.01.2019 to 31.12.2019	Acquired computer software	Intangible assets under development	Total
Gross value of intangible assets as at the beginning of the period: 01.01.2019	**23 404**	**31 351**	**54 755**
Increase (due to)	**5 539**	**10 368**	**15 907**
- purchase	1 463	10 368	11 831
- transfer from intangible assets under development	4 076	-	4 076
Decrease (due to)	**(196)**	**(5 071)**	**(5 267)**
- transfer from intangible assets under development	-	(4 076)	(4 076)
- liquidation	(196)	-	(196)
- other decreases	-	(995)	(995)
Gross value of intangible assets as at the end of the period 31.12.2019	**28 747**	**36 648**	**65 395**
Accumulated amortisation as at the beginning of the period: 01.01.2019	**(14 734)**	**-**	**(14 734)**
Amortisation for the period (due to):	**(2 041)**	**-**	**(2 041)**
- amortisation	(2 069)	-	(2 069)
- likwidacji	28	-	28
Accumulated amortisation as at the end of the period : 31.12.2018	**(16 775)**	**-**	**(16 775)**
Net value of intangible assets as at the end of the period: 31.12.2018	**11 972**	**36 648**	**48 620**

Movements in the period from 01.01.2018 to 31.12.2018	Acquired computer software	Intangible assets under development	Total
Gross value of intangible assets as at the beginning of the period: 01.01.2018	**19 043**	**19 645**	**38 688**
Increase (due to)	**4 361**	**17 487**	**21 848**
- purchase	2 262	17 487	19 749
- transfer from intangible assets under development	2 099	-	2 099
Decrease (due to))	**-**	**(5 781)**	**(5 781)**
- transfer from intangible assets under development	-	(2 099)	(2 099)
- other decreases	-	(3 682)	(3 682)
Gross value of intangible assets as at the end of the period 31.12.2018	**23 404**	**31 351**	**54 755**
Accumulated amortisation as at the beginning of the period: 01.01.2018	**(13 161)**	**-**	**(13 161)**
Amortisation for the period (due to):	**(1 573)**	**-**	**(1 573)**
- amortisation	(1 573)	-	(1 573)
Accumulated amortisation as at the end of the period : 31.12.2018	**(14 734)**	**-**	**(14 734)**
Net value of intangible assets as at the end of the period: 31.12.2018	**8 670**	**31 351**	**40 021**

for 2019 (in PLN thousand)

26. Property, plant and equipment

	31.12.2019	31.12.2018
Technical equipment and machinery	6 338	6 002
Vehicles	-	8
Other fixed assets	1 613	1 948
Fixed assets under construction	1 711	720
Right to use:	**6 639**	***n/a***
building	6 166	*n/a*
Vehicles	473	*n/a*
Tangible fixed assets, total	**16 301**	**8 678**

for 2019 (in PLN thousand)

Movements in tangible fixed assets

Movements in the period from 01.01.2019 to 31.12.2019	Equipment	Vehicles	Other fixed assets	Fixed assets under construction	Right to use		Total
					Building	Vehicles	
Gross value of tangible fixed assets as at the beginning of the period: 01.01.2019	**22 122**	**76**	**6 794**	**720**	**7 777**	**293**	**37 782**
Increase (due to)	**2 252**	**-**	**302**	**991**	**636**	**361**	**4 542**
- purchase	2 252	-	302	991	-	-	3 545
- other increase	-	-	-	-	636	361	997
Decrease (due to)	**(1 394)**	**(76)**	**(390)**	**-**	**-**	**(19)**	**(1 879)**
- sale	(66)	(76)	(222)	-	-	-	(364)
- liquidation	(1 328)	-	(168)	-	-	-	(1 496)
- other decrease	-	-	-	-	-	(19)	(19)
Gross value of tangible fixed assets as at the end of the period: 31.12.2019	**22 980**	**-**	**6 706**	**1 711**	**8 413**	**635**	**40 445**
Accumulated amortisation as at the beginning of the period: 01.01.2019	**(16 120)**	**(68)**	**(4 846)**	**-**	**-**	**-**	**(21 034)**
Amortisation for the period (due to):	**(522)**	**68**	**(247)**	**-**	**(2 247)**	**(162)**	**(3 110)**
- amortisation	(1 802)	-	(632)	-	(2 247)	(165)	(4 846)
- sale	66	68	217	-	-	-	351
- likwidacji	1 214	-	168	-	-	-	1 382
- other changes	-	-	-	-	-	3	3
Accumulated amortisation as at the end of the period: 31.12.2019	**(16 642)**	**-**	**(5 093)**	**-**	**(2 247)**	**(162)**	**(24 144)**
Impairment charge as at the beginning of the period: 01.01.2019	**-**	-	**-**	**-**	**-**	**-**	**-**
- decrease	-	-	-	-	-	-	-
Impairment charge as at the end of the period: 31.12.2019	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Net value of tangible fixed assets as at the end of the period: 31.12.2019	**6 338**	**-**	**1 613**	**1 711**	**6 166**	**473**	**16 301**

Movements in the period from 01.01.2018 to 31.12.2018	Equipment	Vehicles	Other fixed assets	Fixed assets under construction	Total
Gross value of tangible fixed assets as at the beginning of the period: 01.01.2018	**20 480**	**76**	**6 781**	**501**	**27 838**
Increase (due to)	**1 981**	**-**	**411**	**537**	**2 929**
- purchase	1 981	-	118	537	2 636
- transfer from tangible assets under construction	-	-	293	-	293
Decrease (due to)	**(339)**	**-**	**(398)**	**(318)**	**(1 055)**
- sale	(9)	-	(124)	-	(133)
- liquidation	(330)	-	(274)	-	(604)
- transfer from tangible assets under construction	-	-	-	(293)	(293)
- other decrease	-	-		(25)	(25)
Gross value of tangible fixed assets as at the end of the period: 31.12.2018	**22 122**	**76**	**6 794**	**720**	**29 712**
Accumulated amortisation as at the beginning of the period: 01.01.2018	**(14 766)**	**(68)**	**(4 709)**	**-**	**(19 543)**
Amortisation for the period (due to):	**(1 354)**	**-**	**(137)**	**-**	**(1 491)**
- amortisation	(1 693)		(532)	-	(2 225)
- sale	9	-	122	-	131
- liquidation	330	-	273	-	603
Accumulated amortisation as at the end of the period: 31.12.2018	**(16 120)**	**(68)**	**(4 846)**	**-**	**(21 034)**
Impairment charge as at the beginning of the period: 01.01.2018	**-**	-	**-**	**-**	**-**
- decrease	-	-	-	-	-
Impairment charge as at the end of the period: 31.12.2018	**-**	**-**	**-**	**-**	**-**
Net value of tangible fixed assets as at the end of the period: 31.12.2018	**6 002**	**8**	**1 948**	**720**	**8 678**

for 2019 (in PLN thousand)

27. Other assets

	31.12.2019	31.12.2018
Other, including:	**7 620**	**5 132**
- other prepayments	3 354	2 597
- receivables from the portfolio of retail loans acquired as part of cooperation with mBank S.A.	3 160	1 733
- income receivable	120	246
- debtors	972	535
- other	13	21
Total other assets	**7 620**	**5 132**
Short-term (up to 1 year)	7 620	5 132

As at December 31, 2019 and December 31, 2018, the bank did not have any assets taken over for debts.

28. Financial liabilities measured at amortised cost

Amounts due to other banks and customers

31.12.2018	Amount due to banks	Amount due to customers	including:		
			Individual customers	Corporate customers	Public sector customers
Loans received	**3 036 313**	**-**	**-**	**-**	**-**
Other financial liabilities:	**143 565**	**3 099**	**138**	**2 918**	**43**
Liabilities for deferred payments	113 533	-	-	-	-
Liabilities in respect of cash collaterals	30 032	498	49	449	-
Leasing liabilities	nd	nd	nd	nd	nd
Other liabilities	-	2 601	89	2 469	43
Tota	**3 179 878**	**3 099**	**138**	**2 918**	**43**
Short-term (up to 1 year)	210 537	2 677			
Long-term (over 1 year)	2 969 341	422			

31.12.2019	Amount due to banks	Amount due to customers	including:		
			Individual customers	Corporate customers	Public sector customers
Loans received	**2 469 049**	**-**	**-**	**-**	**-**
Other financial liabilities:	**347 773**	**8 934**	**139**	**8 752**	**43**
Liabilities for deferred payments	47 035	-	-	-	-
Liabilities in respect of cash collaterals	296 413	-	49	443	-
Leasing liabilities	4 325	-	-	2 742	-
Other liabilities	-	-	90	5 567	43
Total	**2 816 822**	**8 934**	**139**	**8 752**	**43**
Short-term (up to 1 year	67 266				
Long-term (over 1 year)	2 758 490				

As at 31 December 2018, other financial liabilities with deferred payment term relate to a liability resulting from agreements concluded with mBank S.A. on 30 November 2018 on the transfer of a portfolio of retail loans secured with a mortgage on real estate. Other financial liabilities with deferred payment term were liabilities at variable interest rate. The transactions are described in Note 42.

Liabilities in respect of cash collateral relate to the value of the variation margin for derivatives.

for 2019 (in PLN thousand)

All loans received were based on floating interest rates.

mBank Hipoteczny S.A. did not provide any collateral to its lenders. The Bank did not register any violations of contractual terms related to liabilities in respect of loans raised.

9 October 2016 was the effective date of the Act of 10 June 2016 on the Bank Guarantee Fund, Deposit Guarantee Scheme and Resolution, amending the Act on Covered Bonds and Mortgage Banks resulting in there no longer being a possibility for mortgage banks to offer bank accounts intended to support investment projects carried out using loans granted by mortgage banks, and to accept term deposits. Consequently, on 12 July 2016, the Bank's Management Board in its Resolution
No. 85/2016 adopted a decision to transfer the Bank's existing customer service in the area of escrow accounts and closed trust accounts to mBank by jointly offering to customers mBank S.A. products meeting the defined functionality requirements. In December 2016, pursuant to the decision of the President of the Bank's Management Board, the remaining escrow accounts, which had not been transferred, were closed.

In the above table, the item "Other" mainly presents funds that were not yet cleared after the closing of escrow accounts, and remained in the transitory account until the account holder made relevant instructions as to the balance settlement.

<u>Leasing liabilities</u>

Below are the liabilities due to leasing by maturity dates

	31.12.2019
Leasing liabilities by maturity dates (undiscounted)	
Up to 3 months	737
3 – 12 months	2 191
1 – 5 years	2 197
Over 5 years	2 081
Total	**7 206**

Liabilities from debt securities in issue

Receivables secured with mortgage entered as the first position in the land and mortgage register were the basis for the issue of mortgage covered bonds.

The issue of covered bonds may also be based on the Bank's funds placed in Treasury Securities, in the National Bank of Poland or in cash, hereinafter referred to as "Substitute Collateral".

<u>Rules of admissible amount of the Substitute Collateral</u>

The Bank is obliged to keep, for mortgage covered bonds, a surplus created from the funds representing Substitute Collateral, of no less than the total amount of the nominal value of interest on mortgage covered bonds in trading, to be paid out within the next 6 months (hereinafter referred to as the "Surplus"). The funds representing the Surplus cannot represent the basis for issuing covered bonds.

<u>Rules of statutory overcollateralisation for covered bonds</u>

The sum of nominal amounts of the Bank's receivables from mortgage-backed loans and Substitute Collateral, entered in the register of collaterals of covered bonds, constituting the basis for issuing mortgage covered bonds, cannot be lower than 110% of the total amount of nominal values of the mortgage covered bonds currently traded on, and the sum of nominal amounts of the Bank's mortgage-backed receivables constituting the basis for issuing mortgage covered bonds cannot be lower than 85% of the total amount of nominal values of the mortgage covered bonds currently traded on.

<u>Rules of loan refinancing from funds obtained from the issue of covered bonds</u>

In accordance with the Act on Covered Bonds and Mortgage Banks, the Bank may use funds obtained from the issue of covered bonds to refinance mortgage-backed loans and other banks' receivables from mortgage-backed loans granted by them and acquired by the Bank; refinancing of an individual loan or individual amount receivable may not, however, exceed an amount representing 60% of the mortgage lending value of the real estate, and for residential real estates, 80% of the mortgage lending value of the real estate.

for 2019 (in PLN thousand)

The tables below present data related to the issue of covered bonds as at 31 December 2019 and as at 31 December 2018.

Mortgage covered bonds	31.12.2019	31.12.2018
1. Nominal value of covered bonds listed on the market	8 225 129	7 170 670
2. The nominal value of receivables entered in the collateral register of covered bonds underlying the issue of covered bonds (value on not matured capital)	10 232 614	9 349 392
3. Cash in Bank, as a treasury bonds, entered in the collateral register of covered bonds additionaly underlying the issue of covered bonds (Substitute collateral)	118 409	119 500
4. Level of collateral the covered bonds by receivables (2/1)	124,41%	130,38%
5. Total covered bonds collateral level (2+3) / 1	125,85%	132,05%
6. The value of receivables as collateral issue of mortgage covered bonds to the part which not exceeding 60% of the mortgage lending value of real estate for commercial real estate	3 301 729	3 502 082
7. The value of receivables as collateral issue of mortgage covered bonds to the part which not exceeding 80% of the mortgage lending value of real estate for residential property	6 098 962	4 927 634

Permissible value of Substitute collateral as at 31.12.2018	31.12.2019	31.12.2018
1. Cash invested in treasury bonds	200 000	200 000
2. Interests from covered bonds on the market which will be paid in the next 6 months (Surplus)	81 591	80 500
3. Permissible value of Substitute collateral (1-2)	118 409	119 500

The total nominal value of covered bonds currently traded on, both as at 31 December 2019 and as at 31 December 2018 was listed on two markets as part of CATALYST: regulated market operated by BondSpot S.A. and regulated parallel market operated by Warsaw Stock Exchange.

The foreign issue carried out in 2018 as part of the global covered bond programme as at 31 December 2018 was listed on the regulated market operated by Luxembourg Stock Exchange.

On 11 July 2019, the Financial Supervision Authority in Luxembourg approved a new foreign base prospectus of mBank Hipoteczny S.A. establishing a mortgage bond issue programme of EUR 3,000,000,000.

for 2019 (in PLN thousand)

Stan na 31.12.2019r.

Debt financial instruments by type	Nominal value	Interest rate as at 31.12.2018	Guarantee / collateral	Redemption date	Liability amount measured at amortised cost	Hedge accounting adjustments related to fair value of hedged items	Carrying amount of liability
Long-term issues (with original maturity of over 1 year)							
Mortgage covered bonds (PLN)	50 000 000	2,91%	Mortgage covered bonds register	28.04.2020	50 969	-	50 969
Mortgage covered bonds (PLN)	100 000 000	2,91%	Mortgage covered bonds register	28.04.2020	101 938	-	101 938
Mortgage covered bonds (EUR)	50 000 000	0,29%	Mortgage covered bonds register	24.06.2020	212 869	0	212 869
Mortgage covered bonds (EUR)	30 000 000	2,75%	Mortgage covered bonds register	28.07.2020	129 019	1 017	130 036
Mortgage covered bonds (PLN)	500 000 000	2,80%	Mortgage covered bonds register	10.09.2020	500 627	-	500 627
Mortgage covered bonds (PLN)	300 000 000	2,91%	Mortgage covered bonds register	05.03.2021	300 426	-	300 426
Mortgage covered bonds (EUR)	50 000 000	0,47%	Mortgage covered bonds register	21.06.2021	212 772	-	212 772
Mortgage covered bonds (PLN)	255 000 000	2,850%	Mortgage covered bonds register	20.09.2021	254 966	-	254 966
Mortgage covered bonds (EUR)	20 000 000	1,14%	Mortgage covered bonds register	25.02.2022	85 700	1 412	87 112
Mortgage covered bonds (PLN)	200 000 000	2,570%	Mortgage covered bonds register	28.04.2022	200 624	-	200 624
Mortgage covered bonds (EUR)	100 000 000	0,61%	Mortgage covered bonds register	22.06.2022	426 641	4 524	431 165
Mortgage covered bonds (PLN)	300 000 000	2,720%	Mortgage covered bonds register	28.07.2022	303 000	-	303 000
Mortgage covered bonds (PLN)	500 000 000	2,450%	Mortgage covered bonds register	10.09.2022	499 917	-	499 917
Mortgage covered bonds (PLN)	200 000 000	2,72%	Mortgage covered bonds register	20.02.2023	201 600	-	201 600
Mortgage covered bonds (PLN)	1 000 000 000	2,52%	Mortgage covered bonds register	15.09.2023	998 859	-	998 859
Mortgage covered bonds (PLN)	250 000 000	2,66%	Mortgage covered bonds register	16.10.2023	250 827	-	250 827
Mortgage covered bonds (EUR)	24 900 000	0,940%	Mortgage covered bonds register	01.02.2024	106 759	2 787	109 546
Mortgage covered bonds (PLN)	208 000 000	2,28%	Mortgage covered bonds register	10.06.2024	207 983	-	207 983
Mortgage covered bonds (PLN)	51 100 000	2,28%	Mortgage covered bonds register	10.06.2024	50 983	-	50 983
Mortgage covered bonds (PLN)	40 000 000	2,280%	Mortgage covered bonds register	10.06.2024	39 997	-	39 997
Mortgage covered bonds (PLN)	900 000	2,28%	Mortgage covered bonds register	10.06.2024	900	-	900
Mortgage covered bonds (PLN)	10 000 000	2,28%	Mortgage covered bonds register	10.06.2024	9 967	-	9 967
Mortgage covered bonds (EUR)	300 000 000	1,07%	Mortgage covered bonds register	05.03.2025	1 285 874	50 261	1 336 135
Mortgage covered bonds (EUR)	11 000 000	1,29%	Mortgage covered bonds register	24.04.2025	47 038	1 415	48 453
Mortgage covered bonds (EUR)	300 000 000	0,242%	Mortgage covered bonds register	15.09.2025	1 274 659	-	1 274 659
Mortgage covered bonds (EUR)	13 000 000	1,180%	Mortgage covered bonds register	20.09.2026	55 370	784	56 154
Mortgage covered bonds (EUR)	35 000 000	1,18%	Mortgage covered bonds register	20.09.2026	149 116	3 411	152 527
Mortgage covered bonds (PLN)	100 000 000	2,50%	Mortgage covered bonds register	20.12.2028	99 807	-	99 807
Mortgage covered bonds (EUR)	8 000 000	3,50%	Mortgage covered bonds register	28.02.2029	34 581	5 879	40 460
Mortgage covered bonds (EUR)	15 000 000	3,50%	Mortgage covered bonds register	15.03.2029	64 855	11 072	75 927
Mortgage covered bonds (EUR)	20 000 000	3,20%	Mortgage covered bonds register	30.05.2029	85 624	14 721	100 345
Bonds (PLN)	50 000 000	2,17%	Mortgage covered bonds register	09.01.2020	50 249	-	50 249
Bonds (PLN)	100 000 000	2,16%	Mortgage covered bonds register	25.03.2020	100 018	-	100 018
Bonds (PLN)	200 000 000	2,16%	Mortgage covered bonds register	27.07.2020	200 002	-	200 002
Bonds (PLN)	100 000 000	2,31%	Mortgage covered bonds register	28.06.2021	99 956	-	99 956
Bonds (PLN)	65 000 000	2,39%	Mortgage covered bonds register	21.01.2022	65 626	-	65 626
Debt securities in issue (carrying value)					**8 760 118**	**97 283**	**8 857 401**

for 2019 (in PLN thousand)

As at 31.12.2018

Debt financial instruments by type	Nominal value	Interest rate as at 31.12.2018	Guarantee / collateral	Redemption date	Liability amount measured at amortised cost	Hedge accounting adjustments related to fair value of hedged items	Carrying amount of liability
Long-term issues (with original maturity of over 1 year)							
Mortgage covered bonds (PLN)	80 000	2,79%	Mortgage covered bonds register	2019-06-21	80 061	-	80 061
Mortgage covered bonds (EUR)	30 000	2,75%	Mortgage covered bonds register	2020-07-28	129 886	2 541	132 427
Mortgage covered bonds (EUR)	8 000	3,50%	Mortgage covered bonds register	2029-02-28	34 878	4 293	39 171
Mortgage covered bonds (EUR)	15 000	3,50%	Mortgage covered bonds register	2029-03-15	65 423	8 081	73 504
Mortgage covered bonds (EUR)	20 000	3,20%	Mortgage covered bonds register	2029-05-30	86 368	10 640	97 008
Mortgage covered bonds (PLN)	300 000	2,71%	Mortgage covered bonds register	2022-07-28	302 786	-	302 786
Mortgage covered bonds (PLN)	200 000	2,71%	Mortgage covered bonds register	2023-02-20	201 474	-	201 474
Mortgage covered bonds (EUR)	50 000	0,552%	Mortgage covered bonds register	2019-10-15	215 161	-	215 161
Mortgage covered bonds (PLN)	200 000	2,57%	Mortgage covered bonds register	2022-04-28	200 491	-	200 491
Mortgage covered bonds (EUR)	20 000	1,135%	Mortgage covered bonds register	2022-02-25	86 402	1 441	87 843
Mortgage covered bonds (PLN)	250 000	2,66%	Mortgage covered bonds register	2023-10-16	250 682	-	250 682
Mortgage covered bonds (EUR)	11 000	1,285%	Mortgage covered bonds register	2025-04-24	47 460	282	47 742
Mortgage covered bonds (EUR)	50 000	0,381%	Mortgage covered bonds register	2020-06-24	214 827	-	214 827
Mortgage covered bonds (PLN)	500 000	2,82%	Mortgage covered bonds register	2020-09-10	500 331	-	500 331
Mortgage covered bonds (PLN)	255 000	2,87%	Mortgage covered bonds register	2021-09-20	254 815	-	254 815
Mortgage covered bonds (PLN)	300 000	2,92%	Mortgage covered bonds register	2021-03-05	300 248	-	300 248
Mortgage covered bonds (EUR)	50 000	0,559%	Mortgage covered bonds register	2021-06-21	214 729	-	214 729
Mortgage covered bonds (PLN)	50 000	2,91%	Mortgage covered bonds register	2020-04-28	50 932	-	50 932
Mortgage covered bonds (PLN)	100 000	2,91%	Mortgage covered bonds register	2020-04-28	101 869	-	101 869
Mortgage covered bonds (EUR)	35 000	1,183%	Mortgage covered bonds register	2026-09-20	150 513	(2 695)	147 818
Mortgage covered bonds (EUR)	13 000	1,18%	Mortgage covered bonds register	2026-09-20	55 887	(1 561)	54 326
Mortgage covered bonds (EUR)	24 900	0,94%	Mortgage covered bonds register	2024-02-01	107 756	1 416	109 172
Mortgage covered bonds (PLN)	500 000	2,47%	Mortgage covered bonds register	2022-09-10	499 633	-	499 633
Mortgage covered bonds (PLN)	1 000 000	2,54%	Mortgage covered bonds register	2023-09-15	998 229	-	998 229
Mortgage covered bonds (EUR)	100 000	0,612%	Mortgage covered bonds register	2022-06-22	430 591	3 336	433 927
Mortgage covered bonds (EUR)	300 000	1,073%	Mortgage covered bonds register	2025-03-05	1 295 901	23 775	1 319 676
Mortgage covered bonds (PLN)	208 000	2,30%	Mortgage covered bonds register	2024-06-10	207 921	-	207 921
Mortgage covered bonds (PLN)	51 100	2,30%	Mortgage covered bonds register	2024-06-10	50 944	-	50 944
Mortgage covered bonds (PLN)	40 000	2,30%	Mortgage covered bonds register	2024-06-10	39 985	-	39 985
Mortgage covered bonds (PLN)	900	2,30%	Mortgage covered bonds register	2024-06-10	900	-	900
Mortgage covered bonds (PLN)	10 000	2,30%	Mortgage covered bonds register	2024-06-10	9 957	-	9 957
Bonds (PLN)	20 000	3,23%	no collateral	2019-01-16	20 298	-	20 298
Bonds (PLN)	60 000	3,17%	no collateral	2019-01-21	60 368	-	60 368
Bonds (PLN)	200 000	2,16%	no collateral	2019-08-14	200 980	-	200 980
Bonds (PLN)	50 000	2,17%	no collateral	2020-01-09	50 224	-	50 224
Short-term issues (with original maturity up to 1 year)							
Bonds (PLN)	300 000	2,14%	no collateral	2019-06-27	299 984	-	299 984
Debt securities in issue (carrying value)					**7 818 894**	**51 549**	**7 870 443**

Movements in the balance of debt securities issued

	Year ended 31 December	
	2019	2018
As at the beginning of the period	**7 870 443**	**7 043 125**
Increase (due to)	2 056 985	2 734 567
- issue	1 848 640	2 453 760
- accured interest, interest non-linearity adjustments, EIR commission	161 059	163 834
- exchange differences	-	81 844
- hedge accounting adjustments related to fair value of hedged items	47 286	35 129
Decrease (due to)	(1 070 027)	(1 907 249)
- redemption	(874 745)	(1 754 301)
- interest repayment, interest non-linearity adjustments, EIR commission,	(159 294)	(151 425)
- exchange differences	(34 436)	(134)
- hedge accounting adjustments related to fair value of hedged items	(1 552)	(1 389)
As at the end of the period	**8 857 401**	**7 870 443**

Short-term (up to 1 year)	1 457 952	944 773
Long-term (over 1 year)	7 399 449	6 925 670

Fixed interest rate debt securities issued	3 995 427	2 695 414
Floating interest rate debt securities issued	4 861 974	5 175 029

Subordinated financial liabilities

Subordinated liabilities	Nominal value	Currency	Interest rate as at 31.12.	Maturity / redemption date	Balance of liability (PLN '000)
As at 31 December 2019					
mBank S.A.	100 000	PLN	5,22%	15.12.2025	**100 213**
mBank S.A.	100 000	PLN	4,72%	15.12.2028	**100 193**

Subordinated liabilities	Nominal value	Currency	Interest rate as at 31.12.	Maturity / redemption date	Balance of liability (PLN '000)
As at 31 December 2018					
mBank S.A.	100 000	PLN	5.20%	15.12.2025	**100 227**
mBank S.A.	100 000	PLN	4,70%	15.12.2028	**100 205**

Both as at 31 December 2019 and as at 31 December 2018, subordinated liabilities were variable interest rate liabilities.

for 2019 (in PLN thousand)

Movements in the balance of subordinated liabilities

	Year ended 31 December	
	2019	2018
As at the beginning of the period	**200 406**	**200 484**
Increase (due to)	26	110 940
- interest on a loan	26	10 940
- taking out a loan	-	100 000
Decrease (due to)	-	(111 018)
- repayment of interest on a loan	-	(11 018)
- repayment of a loan	-	(100 000)
Subordinated liabilities as at the end of the period	**200 432**	**200 406**
Short-term (up to 1 year)	432	406
Long-term (over 1 year)	200 000	200 000

On 12 July 2018, a subordinated loan agreement was concluded between mBank S.A. and mBank Hipoteczny S.A. for the amount of PLN 100,000 thousand to increase the Bank’s equity (Tier 2).

On 7 September 2018 the Bank made an early repayment of the subordinated loan concluded on 16 October 2012, having obtained the consent from the Polish Financial Supervision Authority. The repayment was made pursuant to the Amendment 4 to the above agreement, signed on 6 September 2018.

29. Provisions

	31.12.2019	31.12.2018
Provision (due to)	**2 276**	**2 557**
- off-balance sheet contingent liabilities granted	1 568	2 313
- provisions for future liabilities	473	-
- provisions for retirement and disability benefits	147	155
- provisions for legal proceedings	88	89
Provision, in total	**2 276**	**2 557**
Short-term (up to 1 year)	290	2 430
Long-term (over 1 year)	1 986	127

CJEU ruled on 11 September 2019 that in case concerning consumer loans paid off prematurely the consumer has the right to a reduction in the total cost of the loan in the event of early repayment of the credit. In connection with the judgment, the Bank created a provision for the return of commissions in the case of early loan repayments in the amount of PLN 473 thousand. presented in the item "provision for future liabilities".

for 2019 (in PLN thousand)

Movements in provisions for post-employment employee benefits — retirement and disability pension provision

	2019			
	Off-balance sheet contingent liabilities granted	Provisions for future liabilities	Provisions for legal proceedings	Provisions for retirement and disability benefits
Provisions as at the beginning of the period	**2 313**	**-**	**89**	**155**
- increase on provisions	2 131	473		11
- release of provisions	(2 874)	-	(1)	5
- other changes	(2)	-		(24)
Provisions as at the end of the period	**1 568**	**473**	**88**	**147**
Expected settlement period of provisions:				
Short-term (up to 1 year)	5	248	3	34
Long-term (over 1 year)	1 563	225	85	113

	2018			
	Off-balance sheet contingent liabilities granted	Provisions for future liabilities	Provisions for legal proceedings	Provisions for retirement and disability benefits
Provisions as at the beginning of the period	**3 418**	**-**	**-**	**143**
- increase on provisions	5 109	-	89	10
- release of provisions	(6 214)	-		5
- other changes	-	-		(3)
Provisions as at the end of the period	**2 313**	**-**	**89**	**155**
Expected settlement period of provisions:				
Short-term (up to 1 year)	2 313	-	89	28
Long-term (over 1 year)	-	-	-	127

30. Other liabilities

	31.12.2019	31.12.2018
Other liabilities (due to)	**18 505**	**28 842**
- accrued expenses	12 872	21 652
- settlements due to tax from Bank balance sheet items	2 568	2 300
- provision for holiday equivalents	896	1 147
- deferred income	63	1 521
- settlements with insurers	1 151	1 241
- liabilities due to income tax on salaries, Social Security contributions and VAT	680	754
- other	275	227
Other liabilities, in total	**18 505**	**28 842**
Short-term (up to 1 year)	18 505	28 842

31. Deferred income tax assets and provision

Deferred income tax assets and provision are calculated for all temporary differences in accordance with the balance sheet method, using an effective income tax rate that will be applicable in the year of the tax obligation arising (19% both in 2019 and 2018).

Changes in deferred tax assets and provision are presented below:

for 2019 (in PLN thousand)

Deferred income tax assets	As at 01.01.2019	Recognised in the income statement	Recognised in other comprehensive income	As at 31.12.2019
Interest accrued	20 028	8 184	-	28 212
Valuation of derivative financial instruments	1 062	(1 030)	706	738
Valuation of debt financial instruments measured at fair value through other comprehensive income	-	-	44	44
Value of impairment losses on receivables and adjustment to fair values *	24 970	904	-	25 874
Provisions and other liabilities related to employment benefits	1 778	11	-	1 789
Impairment write-downs on inventories	-	-	-	-
Accruals	1 309	740	-	2 049
Revenues to be settled (commissions settled using the effective interest rate method)	8 264	(2 626)	-	5 638
Total deferred income tax assets	**57 411**	**6 183**	**750**	**64 344**

Settled within 12 months	48 171
To be settled after more than 12 months	16 172

* The item "Amount of valuation allowances on receivables and adjustment to the fair value" refers to valuation allowances on loans for which the Bank expects that their non-recoverability will be documented, and to adjustments to the fair value for loans mandatorily measured at fair value through profit or loss.

Deferred income tax liabilities	As at 01.01.2019	Recognised in the income statement	Recognised in other comprehensive income	As at 31.12.2019
Interest accrued	(11 894)	(1 821)	-	-13 715
Valuation of derivative financial instruments	(8 548)	(8 840)	-	-17 388
Valuation of debt financial instruments measured at fair value through other comprehensive income	(1 284)	-	527	-757
Provisions and other liabilities related to employment benefits	(1)	-	(5)	-6
Costs paid in advance	(22 447)	761	-	-21 686
Difference between tax and balance sheet depreciation/amortisation	(651)	(18)	-	-669
Other	-	-	-	-
Total deferred income tax liabilities	**(44 825)**	**(9 918)**	**522**	**(54 221)**

Settled within 12 months	(53 552)
To be settled after more than 12 months	(669)

Deferred income tax assets (net)	As at 01.01.2019	Recognised in the income statement	Recognised in other comprehensive income	As at 31.12.2019
Total deferred income tax assets (net)	**12 586**	**(3 735)**	**1 272**	**10 123**

Settled within 12 months	(5 381)
To be settled after more than 12 months	15 503

Deferred income tax assets	As at 01.01.2018	Impact of the implementation of IFRS 9	Adjusted condition at the beginning of the period	Recognised in the income statement	Recognised in other comprehensive income	Other changes	As at 31.12.2018
Interest accrued	12 664	-	12 664	7 152	-	-	19 816
Valuation of derivative financial instruments	2 461	-	2 461	(1 187)	-	-	1 274
Valuation of debt financial instruments measured at fair value through other comprehensive income	24	-	24	-	(24)	-	-
Value of impairment losses on receivables and adjustment to fair values *	17 857	4 997	22 854	2 116	-	-	24 970
Provisions and other liabilities related to employment benefits	1 666	-	1 666	112	-	-	1 778
Impairment write-downs on inventories	374	-	374	(374)	-	-	-
Accruals	1 593	-	1 593	(284)	-	-	1 309
Revenues to be settled (commissions settled using the effective interest rate method)	8 019	-	8 019	245	-	-	8 264
Total deferred income tax assets	**44 658**	**4 997**	**49 655**	**7 780**	**(24)**	**-**	**57 411**

Settled within 12 months	46 995
To be settled after more than 12 months	10 416

for 2019 (in PLN thousand)

* The item "Amount of valuation allowances on receivables" refers to valuation allowances on loans for which the Bank expects that their non-recoverability will be documented.

Deferred income tax liabilities	As at 01.01.2018	Impact of the implementation of IFRS 9	Adjusted condition at the beginning of the period	Recognised in the income statement	Recognised in other comprehensive income	Other changes	As at 31.12.2018
Interest accrued	(4 517)	-	(4 517)	(3 173)	-	-	-7 690
Valuation of derivative financial instruments	(4 891)	-	(4 891)	(7 861)	-	-	-12 752
Valuation of debt financial instruments measured at fair value through other comprehensive income	(914)	-	(914)	-	(370)	-	-1 284
Provisions and other liabilities related to employment benefits	-	-	-	-	(1)	-	-1
Costs paid in advance	(23 219)	-	(23 219)	772	-	-	-22 447
Difference between tax and balance sheet depreciation/amortisation	(523)	-	(523)	(128)	-	-	-651
Other	(22)	(1 861)	(1 883)	22	-	1 861	-
Total deferred income tax liabilities	**(34 086)**	**(1 861)**	**(35 947)**	**(10 368)**	**(371)**	**1 861**	**(44 825)**

Settled within 12 months	(44 174)
To be settled after more than 12 months	(651)

Deferred income tax assets (net)	As at 01.01.2018	Impact of the implementation of IFRS 9	Adjusted condition at the beginning of the period	Recognised in the income statement	Recognised in other comprehensive income	Other changes	As at 31.12.2018
Total deferred income tax assets (net)	**10 572**	**3 136**	**13 708**	**(2 588)**	**(395)**	**1 861**	**12 586**

Settled within 12 months	2 821
To be settled after more than 12 months	9 765

Deferred tax recognised in the income statement	Year ended 31 December	
	2019	2018
Interest accured	6 363	(13)
Valuation of derivative financial instruments	(9 870)	(5 056)
Amount of impairment write-downs on receivables and adjustment to fair value	904	2 116
Provisions and other liabilites related to employment benefits	11	112
Impairment write-downe on inventories	-	(374)
Accruals	740	(284)
Revenues to be settled (commissions settled using the effective interest rate method)	-2 626	245
Prepaid costs	761	772
Difference between tax sheet depreciation/amortisation	(18)	(128)
Other	0	22
Total, deferred tax recognised in the income statement	**(3 735)**	**(2 588)**

* The item "Amount of valuation allowances on receivables and adjustment to the fair value" refers to valuation allowances on loans for which the Bank expects that their non-recoverability will be documented, and to adjustments to the fair value for loans mandatorily measured at fair value through profit or loss.

The Bank capitalises impairment write-downs on loans in the event of estimating that the most likely scenario will entail documenting non-recoverability in accordance with applicable tax laws as a result of undertaken debt collection activities.

Deferred tax assets are recognised when it is probable that taxable income will be generated in the future.

32. Litigation pending before a court, an appropriate arbitration authority or public administration authority

In 2019, the Bank was not involved in any proceedings before a court, arbitration body, or public administration authority, where the value of such proceedings represented at least 10% of the Bank's equity. No significant actions were brought by the Bank or against the Bank within the presented reporting periods. The Bank made no provisions for ongoing disputes of that category.

for 2019 (in PLN thousand)

33. Off-balance sheet commitments

Off-balance-sheet commitments of the Bank include:

- lending commitments

  The amounts and the relevant dates on which the Bank must meet the off-balance-sheet financial liabilities by granting loans are presented in the table below.

- liabilities received,
- liabilities in respect of derivative financial instruments.

The tables below present the off-balance-sheet liabilities made and received by the Bank, and the nominal value of open derivative transactions of the Bank as at 31 December 2019.

	Nominal amount of off-balance sheet loan commitments				Provisions for off-balance sheet loan commitments			
	Stage 1	Stage 2	Stage 3	POCI	Stage 1	Stage 2	Stage 3	POCI
Lending commitments	441 997	7 615	-	-	1 418	150	-	-

31.12.2019	Up to 1 year	From 1 to 5 years	Over 5 years	Total
1. Off-balance sheet liabilities granted and received	**1 958**	**1 089 952**	**138 303**	**1 230 213**
Liabilities granted	**1 958**	**309 351**	**138 303**	**449 612**
1. Financial liabilities::	1 958	309 351	138 303	449 612
a) Lending commitments	1 958	309 351	138 303	449 612
b) Operating lease liabilities	-	-	-	-
Liabilities received:	**-**	**780 601**	**-**	**780 601**
a) Financial liabilities received	-	780 601	-	780 601
2. Derivative financial instruments (nominal value of contracts)	**3 320 628**	**1 234 114**	**5 980 314**	**10 535 056**
1. Interest rate derivatives	2 805 304	1 234 114	3 423 834	7 463 252
2. Foreign exchange derivatives	515 324	-	2 556 480	3 071 804
Total off-balance sheet items	**3 322 586**	**2 324 066**	**6 118 617**	**11 765 269**

The table below presents the off-balance-sheet liabilities made and received by the Bank, and the nominal value of open derivative transactions of the Bank as at 31 December 2018.

	Nominal amount of off-balance sheet loan commitments				Provisions for off-balance sheet loan commitments			
	Stage 1	Stage 2	Stage 3	POCI	Stage 1	Stage 2	Stage 3	POCI
Lending commitments	1 502 224	3 642	562	0	2 309	4	0	0

31.12.2018	Up to 1 year	From 1 to 5 years	Over 5 years	Total
1. Off-balance sheet liabilities granted and received	**5 384**	**1 945 487**	**645 456**	**2 596 327**
Liabilities granted	**5 384**	**864 797**	**645 456**	**1 515 637**
1. Financial liabilities::	5 384	864 797	645 456	1 515 637
a) Lending commitments	2 483	860 400	643 545	1 506 428
b) Operating lease liabilities	2 901	4 397	1 911	9 209
Liabilities received:	**-**	**1 080 690**	**-**	**1 080 690**
a) Financial liabilities received		1 080 690	-	1 080 690
2. Derivative financial instruments (nominal value of contracts)	**1 525 369**	**1 590 000**	**3 671 340**	**6 786 709**
1. Interest rate derivatives	-	1 590 000	3 671 340	5 261 340
2. Foreign exchange derivatives	1 525 369	-	-	1 525 369
Total off-balance sheet items	**1 530 753**	**3 535 487**	**4 316 796**	**9 383 036**

34. Pledged assets

In accordance with the Act on the Bank Guarantee Fund, as at 31 December 2019, the Bank not held treasury bonds but as at 31 December 2018, the Bank held treasury bonds in the amount of PLN 1,047 thousand which constituted collateral for the guaranteed deposits protection fund. These assets are presented on the balance sheet under the item "Financial assets measured at fair value through other comprehensive income."

for 2019 (in PLN thousand)

The Bank secured the mortgage covered bonds issued with receivables in respect of loans and advances granted, which are described in Note 28.

In addition, the Bank entered CIRS securing transactions in the covered bond collateral register.

The mortgage bank shall be obliged to maintain in the register of collateral created with the funds referred to in Article 18.3 of the Act, a surplus in the amount not lower than the total nominal value of interest on mortgage bonds in circulation, due for payment within the next 6 months. The funds allocated to the surplus may not constitute the basis for the issue of mortgage bonds.

The amount of the substitute collateral may be discharged from the register at any time (released) if the Trustee agrees. The amount of the surplus is variable over time and must remain in the register in accordance with Article 18(3a) of the Act until all covered bonds are redeemed.In addition, the Bank secured the mortgage covered bonds issued with treasury bonds with the carrying amount of PLN 202,070 thousand as at 31 December 2019 (PLN 201,877 thousand as at 31.12.2018).

35. Registered share capital

As at 31 December 2019, the total number of ordinary shares was 3,360,000 shares with the nominal value of PLN 100 per share (as at 31 December 2018: 3 210 000). All shares in issue are fully paid up.

REGISTERED SHARE CAPITAL (STRUCTURE) AS AT 31 DECEMBER 2019							
Share type	**Type of preference**	**Type of restrictions**	**Number of shares**	**Series / issue at par value (PLN)**	**Means of covering share capital**	**Registration date**	**Right to dividend**
registered	-	-	500 000	50 000 000	gotówka	16.04.1999	01.01.2000
registered	-	-	850 000	85 000 000	gotówka	20.09.2000	01.01.2001
registered	-	-	400 000	40 000 000	gotówka	24.04.2006	01.01.2006
registered	-	-	1 000 000	100 000 000	gotówka	08.01.2013	01.01.2013
registered	-	-	100 000	10 000 000	gotówka	30.12.2014	01.01.2015
registered	-	-	140 000	14 000 000	gotówka	19.08.2015	01.01.2016
registered	-	-	100 000	10 000 000	gotówka	01.08.2016	01.01.2017
registered	-	-	120 000	12 000 000	gotówka	03.04.2017	01.01.2017
registered	-	-	150 000	15 000 000	gotówka	09.05.2019	01.01.2019
Total number of shares			**3 360 000**				
Total registered share capital				**336 000 000**			

On March 7, 2019 the Extraordinary General Meeting of Shareholders adopted a resolution on increasing the share capital and depriving the shareholder of the pre-emptive right to shares, pursuant to which the share capital of mBank Hipoteczny S.A. was increased by PLN 15,000 thousand, i.e. up to PLN 336,000 thousand through the issue of 150,000 ordinary registered shares with a nominal value of PLN 100 each and an issue price of PLN 1,000 each. The new shares were offered to mBank S.A. by way of a private placement. The shares were fully paid up

March 20, 2019. On 9 May 2019, the registry court made an entry in the register of entrepreneurs of the increased share capital. On June 19, 2019, the Polish Financial Supervision Authority (KNF) gave its consent to classify new shares to Tier 1 share capital.

The shareholders of mBank Hipoteczny S.A. as at 31 December 2019 are presented in the table below:

Shareholder's name	**Equity (PLN)**	**Shares**		**Voting rights at the General Shareholders' Meeting**	
		Number of shares	**%**	**Number of votes**	**%**
mBank S.A.	336 000 000	3 360 000	100,00	3 360 000	100,00
Total	**336 000 000**	**3 360 000**	**100,00**	**3 360 000**	**100,00**

for 2019 (in PLN thousand)

36. Share premium

Share premium is formed from the share premium obtained from the issue of shares reduced by the direct costs incurred with that issue. This capital is intended to cover all balance sheet losses that may result from the business activity of the Bank.

37. Retained earnings

	31.12.2019	31.12.2018
Other supplementary capital	300 948	273 082
General banking risk reserve	44 800	44 800
Profit for the current year	38 897	41 237
The effect of implementing IFRS 9	*n/a*	(13 371)
Total retained earnings	**384 645**	**345 748**

Other supplementary capital and the General Risk Fund are created as a result of profit appropriation and are intended for the purposes specified in the Memorandum of Association or other legal regulations.

The Bank is obliged to transfer at least 8% of its net profit to its statutory supplementary capital until it has reached the level of one-third of the Bank's share capital. The Bank may also transfer a part of its net profit to the General Risk Fund to cover unforeseen losses.

According to Resolution No 2 passed by the General Shareholders' Meeting of mBank Hipoteczny S.A. on 21 March 2018, net profit for 2017 in the amount of PLN 27,829 thousand was allocated in full to the supplementary capital.

The Bank intends to allocate net profit for 2018 to the supplementary capital and to cover losses from previous years due to the effects to implementation of IFRS 9.

The effect of implementation of IFRS 9 is presented in detail in Note 2.25.

38. Other components of equity

	31.12.2019	31.12.2018
Financial assets at fair value through other comprehensive income	**3 041**	**5 476**
Unrealised gains on debt instruments	3 041	5 476
Actuarial gains and losses on post-employment benefits	**24**	**4**
Actuarial gains of the defined benefit pension plan	24	4
Zabezpieczenie przepływów pieniężnych	(3 008)	n/a
Other components of equity, total	**57**	**5 480**

39. Dividend per share

mBank Hipoteczny S.A. does not plan to pay a dividend for 2019, nor did it pay any for 2018.

40. Notes to the statement of cash flows

Cash and cash equivalents

For the purpose of the statement of cash flows, the balance of cash and cash equivalents includes the following balances with maturities of up to three months.

for 2019 (in PLN thousand)

	31.12.2019	31.12.2018
Cash and balances with the central bank (Note 20)	35 234	16 294
Amounts due from other banks (Note 24)	13 912	58 432
Money bills	219 982	89 989
Total cash and cash equivalents	**269 128**	**164 715**

upplementary information to the statement of cash flows

<u>Change in the status of items of operational activity</u>

The following table provides additional information to the statement of cash flows and presents differences between the balance-sheet changes in items and changes in such items recognised under operating activities in the statement of cash flows.

	Year ended 31 December 2019
Financial assets and liabilities held for trading and derivative hedging instruments - change in balance due to balance sheet balances	**(5 991)**
The difference between the interest accrued and paid in cash in the period	9 069
Financial assets and liabilities held for trading and derivative hedging instruments, total	**3 078**
Loans and advances to clients, change resulting from balance-sheet values	**(649 675)**
The difference between the interest accrued and paid in cash in the period	19 468
Change in loans and advances to clients, total	**(630 207)**
Financial assets at fair value through other comprehensive income - change resulting from balance-sheet values	**(152 343)**
Exclusion of change in cash and cash equivalents	129 993
Valuation recognised in other comprehensive income	(3 006)
The difference between the interest accrued and paid in cash in the period	5 441
Change in respect Financial assets at fair value through other comprehensive income, total	**(19 915)**
Debt securities issued at amortised cost - change resulting from balance-sheet values	**986 958**
The difference between the interest accrued and paid in cash in the period	(5 821)
Exclusion of change in cash from financing activities	(1 269 625)
Change in debt securities in issue at amortised cost, total	**(288 488)**
Amounts due to other banks, change resulting from balance-sheet values	**(363 056)**
The difference between the interest accrued and paid in cash in the period	498
Exclusion of change in cash from financing activities	2 291 096
Change in amounts due to banks, in total	**1 928 538**
Debt securities in issue - change resulting from balance-sheet values	**5 835**
The difference between the interest accrued and paid in cash in the period	(299)
Transfer to cash flows from financing activities - leasing	2 924
Change in amounts due to clients, in total	**8 459**

`000 PLN	Year ended 31 December 2018
Financial assets and liabilities held for trading and derivative hedging instruments - change in balance due to balance sheet balances	13 799
The difference between the interest accrued and paid in cash in the period	12 016
Financial assets and liabilities held for trading and derivative hedging instruments, total	**25 815**
Loans and advances to clients, change resulting from balance-sheet values	**(371 804)**
The difference between the interest accrued and paid in cash in the period	18 134
Impact of the implementation of IFRS 9	(13 154)
Change in loans and advances to clients, total	**(366 824)**
Financial assets at fair value through other comprehensive income - change resulting from balance-sheet values	**207 735**
Exclusion of change in cash and cash equivalents	(33 496)
Valuation recognised in other comprehensive income	2 072
Result on sale	149
The difference between the interest accrued and paid in cash in the period	347
Change in respect Financial assets at fair value through other comprehensive income, total	**176 807**
Debt securities issued at amortised cost - change resulting from balance-sheet values	**827 318**
The difference between the interest accrued and paid in cash in the period	(12 355)
Exclusion of change in cash from financing activities	(900 158)
Change in debt securities in issue at amortised cost, total	**(85 195)**
Amounts due to other banks, change resulting from balance-sheet values	**(650 148)**
The difference between the interest accrued and paid in cash in the period	1 046
Exclusion of change in cash from financing activities	1 244 612
Change in amounts due to other banks, in total	**595 510**
Amounts due to clients, change resulting from balance-sheet values	**(1 032)**
The difference between the interest accrued and paid in cash in the period	(7)
Change in amounts due to clients, in total	**(1 039)**
Debt securities in issue - change resulting from balance-sheet values	**827 318**
The difference between the interest accrued and paid in cash in the period	(12 355)
Exclusion of change in cash from financing activities	(900 158)
Change in debt securities in issue, in total	**(85 195)**
Change in provisions - change resulting from balance-sheet values	**2 353**
Actuarial valuation of provisions for post-employment benefits recognised in other comprehensive income	**3**
Impact of the implementation of IFRS 9	**(3 353)**
Change in other liabilities and provisions, in total	**(997)**

Interest received and paid with respect to the operational activity

	Year ended 31 December	
	2019	2018
Interest received from:		
Cash and balances with the Central Bank	25	28
Loans and advances to banks	700	615
Loans and advances to customers	385 175	355 793
Financial assets at fair value through other comprehensive income	15 070	21 351
Derivative instruments classified to the banking book	19 182	11 174
Income from interest received, total	**420 152**	**388 961**

	Year ended 31 December	
	2019	2018
Interest paid on account:		
Settlements with banks on account of received credits, security deposits with the original maturity below 1 year, liabilities on account of deferred payment	23 784	1 468
Settlements with banks on account of debt securities issued with an original maturity of less than one year	3 201	10 295
Total costs of interest received	**26 985**	**11 763**

for 2019 (in PLN thousand)

Cash flows from financing activities

The following tables present a change in liabilities in connection with the financing activities

	OB. 01.01.2019	Cash flow	Other changes	CB 31.12.2019
Debt securities in issue (long-term)	7 570 458	1 113 781	173 162	8 857 401
Amounts due to banks (long-term)	3 149 847	(476 742)	96 682	2 769 787
Leasing liabilities (Note 28)	8 994	(2 924)	997	7 067
Subordinate liabilities(Note 28)	200 406	-	26	200 432

	OB. 01.01.2018	Cash flow	Other changes	CB 31.12.2018
Debt securities in issue (long-term)	6 544 420	764 336	261 702	7 570 458
Amounts due to banks (long-term)	3 779 572	(1 325 666)	695 941	3 149 847
Subordinate liabilities(Nota 28)	200 484	(11 018)	10 940	200 406

Column "Other Changes" shows non-cash flows resulting from accrued interest, commissions accounted for with the effective interest rate method, exchange differences, changes in hedge accounting adjustments related to fair value of hedged items, financial liabilities with deferred maturity resulting from agreements concluded with mBank S.A. on the transfer of a portfolio of retail loans secured with a mortgage on real estate.

41. Incentive plan for the Bank's Management Board and employees having a material impact on the risk profile of the Bank

Principles of establishing variable remuneration components of persons holding managerial positions, who have significant influence on the risk profile of the Bank are specified by "Policy for remuneration of persons having significant influence on the risk profile of mBank Hipoteczny S.A.", hereinafter referred to as "Policy", was adopted for the first time by Resolution of the Supervisory Board No. 21/2012 as at 19 September 2012. Since then, the Remuneration Policy has been subject to annual verification and modification by the Management Board and the Supervisory Board of the Bank

Incentive plan for the Bank's Management Board and employees having a material impact on the risk profile of the Bank of 2014

On 17 December 2014, the Supervisory Board of the Bank adopted Regulations on variable remuneration of persons having a material impact on the risk profile of the Bank which superseded the provisions of the "Regulations on the variable remuneration of the Management Board Members of mBank Hipoteczny S.A." and the "Regulations on variable remuneration for employees having a material impact on the risk profile of the Bank" of 19 September 2012.

In accordance with the Regulations, the variable remuneration for 2014 was awarded in line with the following principles:

Variable remuneration for the Bank's Management Board Members:

1) 60% of the bonus shall be paid in the year following the financial year (non-deferred part), of which 50% in the form of cash payment and 50% in phantom shares,
2) 40% of the bonus shall be paid in three equal tranches in three consecutive years after the year in which the bonus granted (deferred part), of which 50% in the form of cash payment and 50% in phantom shares.

The Supervisory Board may decide to suspend as a whole or reduce the deferred tranche amount:

1) in view of the subsequent assessment of the Manager's work in a longer period than 1 financial year,

2) when at least one of the elements included in the scorecard has not been met.

Moreover, the Supervisory Board of the Bank may decide to suspend as a whole or reduce the bonus amount for a given financial year, and with regard to a deferred tranche, in a situation of balance-sheet loss or a threat of the same or of the Bank's insolvency. The suspension as a whole or reduction of the bonus and the deferred tranche may also apply to the bonus and deferred tranche paid to the Manager when the agreement has expired or has been terminated.

<u>Variable remuneration for employees with a material impact on the risk profile of the Bank, other than members of the Bank's Management Board:</u>

1) 50% of the bonus for a given period shall be granted in the cash form (non-deferred part),

2) 50% of the bonus for a given period shall be granted in the non-cash form (deferred part) in phantom shares, of which:
   - 20% is granted in the year following the appraisal period for which the bonus is granted, within 30 calendar days of approval by the General Meeting of Shareholders of the financial statements of the Bank,
   - 80% is realised in three equal annual tranches (deferred tranches).

The entitled person shall acquire the right to the first, second and third tranche in the second, third and fourth calendar year after the end of the appraisal period, respectively, if:

- the appraisal level they reached for the given year is 80%,
- they fulfilled the conditions of employment at the Bank; and
- the Bank's performance as at the end of the first, second and third calendar year after the end of the appraisal period is not lower than the result adopted for a given year in the financial plan, reduced by 10%.

Each of the above-mentioned deferred tranches shall be granted within 30 calendar days upon the approval by the General Meeting of Shareholders of the Bank of the Bank's financial statements for a given year.

The Supervisory Board may modify the level of the planned Bank performance appropriately to the market situation.

The last settlements under this programme were made in 2018.

ncentive plan for the Bank's Management Board and employees having a material impact on the risk profile of the Bank of 2015, 2016 and 2017

On 26 June 2015, the Supervisory Board of the Bank adopted the "Policy on remuneration for persons having a material impact on the risk profile of the Bank at mBank Hipoteczny S.A." The new policy came into force on 1 July 2015.

On 18 June 2016, the Supervisory Board adopted Resolution No 14/2016 to approve the amended "Policy on remuneration for persons having a material impact on the risk profile of the Bank Bank at mBank Hipoteczny S.A." which came into force on 1 July 2016 and superseded the previous policy in this scope. The change referred to the calculation of the average value of phantom shares for the purpose of payment of the non-deferred cash part and the deferred cash tranches. Before the change, the value of the shares was understood as the value at the end of the annual period preceding the payment date. Currently, the average value of a phantom share is calculated as the total amount of a phantom share value at the end of the annual period preceding the payment date and the phantom share value at the end of the first half of the year in which the payment is due, divided by 2.

On 27 March 2017, with Resolution No 13/2017, the Supervisory Board amended the Policy on remuneration for persons having a material impact on the risk profile of the Bank, by introducing a limit of PLN 200 thousand for the payment of the variable remuneration. If the amount is equal to or less than PLN 200 thousand, the Management Board of the Bank may decide not to defer the variable remuneration for the subsequent years, and may award the entire variable remuneration in the form of non-deferred cash payment. The above principle does not apply to the Members of the Management Board of the Bank.

According to the Policy, variable remuneration shall consist of a bonus granted for a given financial year to Management Board Members or other employees. Variable remuneration shall be determined in a transparent and verifiable manner which ensures efficient implementation of the

Policy. The maximum level of variable components of remuneration of persons covered by the Policy shall not exceed 100% of the amount of the basic remuneration paid to a Management Board Member or other employees for a given financial year. Variable remuneration shall constitute a part of total remuneration (annual basic remuneration and variable remuneration) granted to a Management Board Member or other employees. It shall be determined taking market practices into account, both in the banking sector and in general on the Polish market, verified on the basis of market salary reports and the remuneration policy of the mBank Group.

<u>Process of granting and deferring variable remuneration for the Bank's Management Board Members:</u>

The Supervisory Board shall determine the amounts of bonuses of individual Management Board Members, taking into account whether the Management Board Member has accomplished the agreed annual/long-term business and development objective — Management By Objective ("MBO"). The decision on granting the bonus and on the amount thereof shall be taken at the sole discretion of the Supervisory Board of the Bank which confirms the accomplishment of MBO on the basis of its own judgement and decision, taking into account the situation on financial markets in the last/previous financial period(s).

Variable remuneration shall be granted in accordance with the following principles:

- 60% of the bonus amount shall be paid in the year in which the bonus is granted (non-deferred part),in the following manner:
  - 50% in the form of cash payment; and
  - 50% in phantom shares.
- 40% of the bonus amount shall be paid in three equal tranches (deferred part) in three consecutive years after the year in which the bonus is granted, in the following manner:
  - 50% in the form of cash payment; and
  - 50% in the form of non-cash payment, in phantom shares.

Phantom shares shall be awarded both in the non-deferred part and deferred part, and they will be available for payment no earlier than 6 months after the month of awarding the phantom shares.

The Supervisory Board may decide to suspend in whole or reduce the deferred tranche amount if:

- it determines that in a longer time horizon (of at least 3 years) a Member of the Management Board has directly and adversely affected, through their actions or omissions, the financial performance and the market position of the Bank; or
- at least one of the elements included in the scorecard has not been met (i.e. if at least one "YES" answer is given to the questions posed therein); or
- the managerial contract expires or is terminated for reasons other than:
  - expiry of the term for which a contract was concluded,
  - recalling the Management Board Member from the Bank's Management Board during the term of the contract, excluding the reasons set out in detail in the contract,
  - assumption of new duties within the mBank Group,
  - retirement of a Management Board Member.

Under the programme referred to above, the Management Board Members were awarded bonuses for 2015, 2016 and 2017. The last settlements under this programme are to be made in 2021.

<u>Process of granting and deferring variable remuneration for other employees having a significant impact on the risk profile of the Bank</u>:

The Bank's Management Board shall determine the amounts of bonuses of employees having a material impacton the risk profile of the Bank, taking into account whether they have accomplished the agreed annual/long-term business and development objective — MBO. The decision on granting the bonus and on the amount thereof shall be taken at the sole discretion of the Bank's Management Board which confirms the accomplishment of MBO on the basis of its own judgement and decision, taking into account the situation on financial markets in the last/previous financial period(s).

Variable remuneration shall be granted in accordance with the following principles:

- 60% of the bonus amount shall be paid in the year in which the bonus is granted (non-deferred part), in the following manner:
  - 50% in the form of cash payment; and

- 50% in phantom shares,

- 40% of the bonus shall be paid in three equal tranches (deferred part) in three consecutive years after the year in which the bonus is granted, in the following manner:
  - 50% in the form of cash payment; and
  - 50% in phantom shares.

Phantom shares shall be awarded both in the non-deferred part and deferred part, and they will be available for payment no earlier than 6 months after the month of awarding the phantom shares.

If the amount of the variable remuneration is equal to or less than PLN 200 thousand, the Management Board of the Bank may decide not to defer the variable remuneration for the subsequent years, and may award the entire variable remuneration in the form of non-deferred cash payment (applicable to bonuses for 2017).

The Bank's Management Board may decide to suspend as a whole or reduce the deferred tranche amount:

- if it determines that in a longer time horizon (of at least 3 years) the employee directly and adversely affected, through their actions or omissions, the financial performance and the market position of the Bank. When evaluating the employee's actions or omissions, the Management Board of the Bank takes into account the MBO evaluation results for the particular employee,

- in the event of termination of employment contract, excluding the reasons set out in the employment contract/internal regulations of the Bank,

the Banks' Management Board may decide to suspend as a whole or reduce the Discretionary Bonus amount for a given financial year, and with regard to a Deferred Tranche which has not been paid yet, in a situation of balance-sheet loss or a threat of the same or a danger of the Bank's insolvency.

Under the programme referred to above, employees having material impact on the risk profile of the Bank were awarded bonuses for 2015, 2016 and 2017. The last settlements under this programme are to be made in 2021.

Incentive plan for the Bank's Management Board and employees having a material impact on the risk profile of the Bank of 2018

On 23 November 2018, with Resolution No 37/2018, the Supervisory Board amended the Policy on remuneration for persons having a material impact on the risk profile of the Bank at mBank Hipoteczny S.A., and cancelled the Policy of 27 March 2017. Provisions of the Policy apply to bonuses for 2018. Changes were made e.g. in the scope of:

- extension of the retention period from 6 to 12 months, phantom shares awarded both within the non-deferred part and the deferred part, and they will be available for payment no earlier than 12 months after the month of awarding the phantom shares,

- a change of the method of calculation of the equivalent for phantom shares – in order to calculate the average value of phantom shares, the sum of the value of phantom shares at the end of the last two annual periods preceding the payment date is taken into account,

- specification of provisions concerning the terms and conditions for receipt of bonus specified in the so-called scorecard,

- introduction of a clawback on the basis of which the Supervisory Board may request the Management Board Members, and the Management Board may request the employees having a material impact on the risk profile of the Bank, to return the bonus awarded and paid for the given calendar year (i.e. the non-deferred part and all deferred parts).

On 23 November 2018 the Supervisory Board adopted resolution No 39/2018 introducing regular adjustments of the content to the Policy adopted by resolution No 37/2018.

The amount of the bonus for the given calendar year shall be determined on the basis of evaluation of the achievement of MBO objectives in the last three calendar years, by the Supervisory Board – for the Management Board Members, by the Management Board of the Bank – for the employees having a material impact on the risk profile of the Bank (the so-called Risk Takers).

The bonus comprises a non-deferred part of 60% of the bonus, and a deferred part of 40% of the bonus.

for 2019 (in PLN thousand)

The deferred part and the non-deferred part is divided in half into a cash part (50%) and a non-cash part awarded in the form of phantom shares (50%). The non-deferred cash part is payable in the year of award of the bonus. The second half of the non-deferred part (50%) is payable in the form of equivalent for the phantom shares, no earlier than after 12 months of the date of the Ordinary General Meeting of Shareholders.

The deferred part, in the form of cash and in the form of phantom shares, shall be paid after the approval of the Bank's financial statements for the previous calendar year, and the part paid in the form of phantom shares shall be paid no earlier than after 12 months of the date of approval of the consolidated financial statements.

If the amount of bonus for a particular calendar year determined for an employee having a material impact on the risk profile of the Bank, who is not a Management Board Member, does not exceed PLN 200 thousand, the bonus may be paid in full, based on a decision of the Management Board of the Bank, in the form of cash, non-deferred.

The deferred part of the bonus, both to the Management Board Members and other Risk Takers, shall be evaluated in terms of its determination and payment.The Supervisory Board – in respect to the Management Board Members, and the Management Board of the Bank – in respect of employees identified as Risk Takers, may decide to withhold altogether or to reduce the amount of a deferred tranche, if it determines that in a longer period than 1 financial year, i.e. for a period of at least 3 years, the Risk Taker had a direct and negative impact on the financial result or market position of the Bank, violated the principles and standards adopted by the Group, directly caused significant financial losses, when at least one of the elements included in the scorecard is not complied with, or any of the conditions referred to in Article 142(2) of the Banking Law occurred.

In case of occurrence of the events referred to above, at the stage of determination of the amount of bonus for the Risk Takers, the Supervisory Board/Management Board of the Bank may decide not to award the bonus for the given calendar year in its entirety, or to reduce the bonus.

Furthermore, a Risk Taker can be compelled - on such terms and in such time limit as the Supervisory Board / Management Board, respectively, may decide - to return the bonus granted and paid for a given calendar year(i.e. undeferred portion and all deferred portions), when he/she violated principles and standards in place in mBank, committed a major violation of generally applicable provisions of law or directly brought to significant financial losses arising from an informed, adverse conduct to the detriment of the mBank Group or brought to the imposition of financial penalties on the Bank by supervisory authorities on the basis of a final decision.

The decision on the occurrence of the above-described events may be made until the end of the calendar year in which the final tranche of the deferred part of the bonus granted for the year in which the event occurred is paid.

The bonus under the above-described rules will be granted to Management Board Members and other Risk Takers for the first time in 2019 for 2018.

Appointment of the Remuneration Committee

On April 18, 2019 the Supervisory Board of mBank Hipoteczny S.A. adopted a resolution on appointing the Remuneration Committee in the following composition:

1.	Frank Bock	-	Chairman of the Remuneration Committee
2.	Andreas Boeger	-	Deputy Chairman of the Remuneration Committee
3.	Lidia Jabłonowska-Luba	-	Member of the Remuneration Committee
4.	Cezary Kocik	-	Member of the Remuneration Committee

Accounting approach to incentive plans

Remuneration plan benefits for the Bank's Management Board and employees having a material impact on the risk profile of the Bank are cleared in line with IAS 19 Employee Benefits. Both the cash part of the plan and the phantom share part settled in money add to the cost of a given period in correspondence with the liability. Costs are recognised in time throughout the vesting period and carried under the item "general administrative expenses". Liabilities due to incentive plans are presented "Other assets" in the statement of financial position.

for 2019 (in PLN thousand)

42. Related party transactions

mBank S.A. is the direct parent entity in relation to mBank Hipoteczny S.A. Commerzbank AG is the direct parent entity of mBank S.A.

All transactions between the Bank and the related entities were typical and routine transactions concluded on arm's length terms, and their nature and terms resulted from the current operating activities conducted by the Bank. Transactions with related entities concluded in the normal course of operating activities include loans, liabilities from debt securities in issue and derivative transactions.

The following table presents financial liabilities towards mBank S.A., broken down by contractual maturity dates.

31.12.2019	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
Loans received	-	-	-	360 433	2 108 615	**2 469 048**
Covered bonds and bonds in issue	-	-	-	480 508	16 069	**496 577**
Subordinated liabilities	-	-	-	-	200 432	**200 432**
Liabilities in respect of cash collateral	47 035	-	-	-	-	**47 035**
Other financial liabilities with deferred payment date	-	-	-	296 413	-	**296 413**
Derivative financial instruments	76	-	-	-	-	**76**

31.12.2018	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
Loans received	-	-	180 506	2 264 323	591 484	**3 036 313**
Covered bonds and bonds in issue	-	-	-	496 059	-	**496 059**
Subordinated liabilities	-	-	-	-	200 406	**200 406**
Liabilities in respect of cash collateral	30 032	-	-	-	-	**30 032**
Other financial liabilities with deferred payment date	-	-	-	113 533	-	**113 533**
Derivative financial instruments	1 974	54	-	-	-	**2 028**

Other financial liabilities with deferred payment term related to a liability resulting from agreements concluded with mBank S.A. on 30 November 2018 on the transfer of retail loans secured with a mortgage on real estate. This liability was repaid on 25 January 2019.

The table below presents the amounts of the Bank's transactions with related entities. The transaction value covers assets and liabilities' balances as at 31 December 2019 and 31 December 2018, and related costs and income for 2019 and 2018.

(PLN '000)	Supervisory and Management Board members of mBank Hipoteczny S.A./mBank S.A., management personnel of mBank Hipoteczny S.A.		Other persons and entities related*		mBank Group companies***		mBank S.A.		Commerzbank Group companies***	
As at the end of the period	**31.12.2019**	**31.12.2018**	**31.12.2019**	**31.12.2018**	**31.12.2019**	**31.12.2018**	**31.12.2019**	**31.12.2018**	**31.12.2019**	**31.12.2018**
Statement of finacial position										
Assets	454	2 074	-	642	472	-	65 088	94 756	-	-
Liabilities	-	-	-	-	475	-	3 513 907	3 880 031	674 627	933 822
Contingent liabilities										
Liabilities received	-	-	-	-	-	-	780 601	1 080 690	-	-
Commitment granted	-	-	-	-	-	394	-	4 321	-	-
Derivatives (purchase, sales)										
IRS contracts	-	-	-	-	-	-	1 185 768	1 194 400	-	-
FX SWAP contracts	-	-	-	-	-	-	508 083	1 498 271	-	-

*The item Liabilities presents, among others, lease payments in the amount of PLN 616 thousand.

(PLN '000)	Supervisory and Management Board members of mBank Hipoteczny S.A./mBank S.A., management personnel of mBank Hipoteczny S.A.		Other persons and entities related*		mBank Group companies***		mBank S.A.		Commerzbank Group companies***	
Year ended	**31.12.2019**	**31.12.2018**	**31.12.2019**	**31.12.2018**	**31.12.2019**	**31.12.2018**	**31.12.2019**	**31.12.2018**	**31.12.2019**	**31.12.2018**
Income statement										
Interest income	19	62	-	22	338	356	15 977	19 877	-	-
Interest expense	-	-	-	-	(6)	-	(111 801)	(105 020)	(4 475)	(5 987)
Fee and commission income	-	-	-	-	-	(2)	-	-	-	-
Fee and commission expenses	-	-	-	-	(10)	(126)	(6 150)	(3 693)	-	-
Net trading income	-	-	-	-	-	-	14 374	(13 221)	-	-
Other operating income	-	-	-	-	-	-	67	472	-	-
Other operating expenses	-	-	-	-	(29)	-	-	-	-	-
Overhead costs, amortisation and depreciation	-	-	-	-	(597)	(898)	(1 664)	(4 034)	-	-

* Other persons and related parties encompass the loan extended to the a close relative of a member of Supervisory Board of mBank S.A.

** The item "mBank Group companies" includes transactions with the following mBank Group companies: mFinanse S.A., mCentrum Operacji Sp. z o.o., mCorporate Finance S.A., mLeasing Sp. z o.o

*** The item "Commerzbank Group companies" includes transactions of acquisition of mortgage covered bonds on the secondary market by Commerzbank AG and Comdirect Bank AG.

for 2019 (in PLN thousand)

Composition and remuneration of Members of the Bank's Management Board

As at 31 December 2019, the composition of the Management Board was as follows:

Piotr Cyburt — President of the Management Board
Krzysztof Dubejko — Member of the Management Board
Andrzej Kulik — Member of the Management Board
Marcin Wojtachnio — Member of the Management Board

As at 31 December 2018, the composition of the Management Board was as follows:

Piotr Cyburt — President of the Management Board
Andrzej Kulik — Member of the Management Board
Grzegorz Trawiński — Member of the Management Board
Marcin Wojtachnio — Member of the Management Board

Information on the remuneration and bonuses paid to the Members of the Management Board of the Bank who were performing their functions at the end of 2019, as at 31 December 2019 and 31 December 2018, is presented below:

		Remuneration paid in 2019 (in PLN)		
		Gross remuneration	Other benefits*	Settlement of incentive programme in 2017
1.	Piotr Cyburt	756 000	16 773	270 728
2.	Krzysztof Dubejko	313 333	12 312	154 805
3.	Andrzej Kulik	510 000	34 190	75 489
4.	Marcin Wojtachnio	510 000	16 947	230 330
	Total	**2 089 333**	**80 221**	**731 351**

Remuneration of former Management Board Members paid in 2019

	Remuneration paid in 2019 (in PLN)		
	Gross remuneration	Other benefits*	Settlement of incentive programme in 2017
Grzegorz Trawiński	30 805	339	226 864

		Remuneration paid in 2018 (in PLN)		
		Gross remuneration	Other benefits*	Settlement of incentive programme in 2018
1.	Piotr Cyburt	756 000	16 710	381 400
2.	Andrzej Kulik	492 500	16 596	93 089
3.	Grzegorz Trawiński	510 000	12 633	271 589
4.	Marcin Wojtachnio	510 000	16 884	336 356
	Total	**2 268 500**	**62 822**	**1 082 434**

* "Other benefits" include co-financing of medical care, insurance, multisport cards, company car

As at 31 December 2019, the provision for employee and Management Board awards/bonuses amounted to PLN 7,729 thousand, which includes the provision for variable remuneration for Members of the Management Board and employees having a material impact on the Bank's risk profile amounting to PLN 4,854 thousand (as at 31.12.2018: PLN 7,968 thousand and PLN 4,381 thousand, respectively).

The Regulations on variable remuneration for the Members of the Management Board and employees having a material impact on the Bank's risk profile is discussed in more detail in Note 41.

for 2019 (in PLN thousand)

In accordance with the concluded contracts, when a Management Board Member is dismissed as Management Board Member before the end of his/her term of office or is not appointed for the next term of office, such Management Board Member is entitled to severance pay, the amount of which depends on the time of service as Management Board Member and is calculated as follows:

- 3-month remuneration, if the Management Board Member served as Management Board Member for less than 1 year,
- 6-month remuneration, if the Management Board Member served as Management Board Member for a period between 1 and 5 years,
- 9-month remuneration, if the Management Board Member served as Management Board Member for more than 5 years, 12-month remuneration of the Management Board Member served as Management Board Member for more than 5 years.

The Supervisory Board may decide to suspend as a whole or reduce the amount of the above-mentioned Severance Pay, in case of a balance-sheet loss or the threat of the same or a danger of the Company's insolvency.

Composition and remuneration of Members of the Bank's Supervisory Board

On 11 March 2019, Mr Jakub Fast resigned from the Supervisory Board of mBank Hipoteczny S.A., with effect from 31 March 2019.

By Resolution No. 3 of the Extraordinary General Meeting of Shareholders of mBank Hipoteczny S.A. of 28 May 2019, Mr. Paweł Przybyłek was appointed Member of the Supervisory Board of mBank Hipoteczny S.A.

The composition of the Supervisory Board of mBank Hipoteczny S.A. as at 31 December 2019:

1.	Frank Bock	-	Chairman of the Supervisory Boardj, Member of the Risk Committee
2.	Lidia Jabłonowska-Luba	-	Deputy Chairwoman of the Supervisory Board, Member of the Risk Committee
3.	Andreas Boeger	-	Member of the Supervisory Board, Member of the Audit Committee
4.	Paweł Graniewski	-	Independent Member of the Supervisory Board, Chairman of the Audit Committee
5.	Cezary Kocik	-	Member of the Supervisory Board
6.	Michał Popiołek	-	Member of the Supervisory Board, Member of the Risk Committee
7.	Paweł Przybyłek	-	Member of the Supervisory Board
8.	Mariusz Tokarski	-	Independent Member of the Supervisory Board, Member of the Audit Committee

In 2019 Members of the Supervisory Board did not receive any remuneration, except for Mr Paweł Graniewski and Mr Mariusz Tokarski, who received remuneration for 2019 as Supervisory Board Members in the amount of 108 tys. (PLN 54 thousand each).

The composition of the Supervisory Board of mBank Hipoteczny S.A. as at 31 December 2018:

1.	Frank Bock	-	Chairman of the Supervisory Boardj, Member of the Risk Committee
2.	Lidia Jabłonowska-Luba	-	Deputy Chairwoman of the Supervisory Board, Member of the Risk Committee
3.	Andreas Boeger	-	Member of the Supervisory Board, Member of the Audit Committee
4.	Jakub Fast	-	Member of the Supervisory Board
5.	Paweł Graniewski	-	Independent Member of the Supervisory Board, Chairman of the Audit Committee
6.	Cezary Kocik	-	Member of the Supervisory Board
7.	Michał Popiołek	-	Member of the Supervisory Board, Member of the Risk Committee
8.	Mariusz Tokarski	-	Independent Member of the Supervisory Board, Member of the Audit Committee

In 2018, Members of the Supervisory Board did not receive any remuneration, except for Mr Paweł Graniewski and Mr Mariusz Tokarski, who received remuneration for 2018 as Supervisory Board Members in the amount of PLN 108 thousand (PLN 54 thousand each).

In accordance with paragraph 14, section 1, item 5 of the Articles of Association of mBank Hipoteczny S.A.the General Shareholders' Meeting decides, by resolution, on appointing and recalling Membersof the Supervisory Board and establishing the terms of their remuneration.

In accordance with paragraph 3, section 1, item 9 of the Supervisory Board Regulations in mBank Hipoteczny S.A., determining the terms of contracts and remuneration of the Members of the Bank's Management Board lies with the competencies of the Supervisory Board.

43. Information on the registered audit company

With the Resolution No 19/2018 of 2 March 2018, the Supervisory Board of mBank Hipoteczny S.A., acting under paragraph 26 section 8 of the Bank's Articles of Association, appointed Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością spółka komandytowa (EY) as auditor of the financial statements of the Bank for 2018-2019.

On 22 June 2018, mBank Hipoteczny S.A. signed a contract with EY for the audit of the financial statements for 2018 and 2019.

Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością spółka komandytowa with its registered office in Warsaw at Rondo ONZ 1, 00-124 Warsaw, is a registered auditor No 130 authorised to audit financial statements.
The total amount of EY remuneration in 2019 was PLN 716,000 PLN gross (in 2018 it amounted to PLN 500,000 gross),included:

- due to of auditing the financial statements of mBank Hipoteczny S.A. and examination of reporting packages for 2019 amounted to 270 thousand. PLN gross (for 2018 amounted to PLN 252,000 gross),
- due to of the review of the financial statements of mBank Hipoteczny S.A. for the first half of 2019, reporting packages for the first half of 2019, a reporting package for mBank S.A. as at December 31, 2019, it amounted to 138 thousand. PLN gross, (respectively for 2018 amounted to PLN 156 thousand gross)
- for the service consisting in assessing the compliance of information disclosed by financial institutions and investment companies with the requirements for disclosure of information on capital adequacy and variable components of remuneration amounted to PLN 74 thousand. PLN gross for 2018, the service was not performed for 2019
- due to the services of performing agreed upon procedures in relation to the basic issue prospectus of mBank Hipoteczny S.A. on the establishment of a mortgage bond issue programme in the amount of EUR 3,000,000,000 amounted to PLN 308,000 (for 2018 it was PLN 18,000 gross).

44. Capital adequacy

One of the Bank's main tasks is to ensure an appropriate level of capital. Within the framework of the capital management policy, the Bank prepares the guidelines for the most effective planning and use of capital basis which:

- are compliant with external and internal regulations in force,
- guarantee a continuity of financial targets, which render an appropriate rate of return for shareholders,
- ensure the maintenance of a strong capital basis being a fundamental support for business development.

The Bank's capital management policy is based on two basic pillars:

- maintenance of an optimal level and structure of own funds with the application of available methods and means, like retention of net profit, subordinated loan or issue of shares,
- effective use of existing capital, among others through application of a set of measures of effective use of the capital, limitation of activities that do not provide an expected rate of return and development of products with lower capital absorption.

for 2019 (in PLN thousand)

Effective use of capital is an integral part of the capital management policy oriented at reaching an optimal rate of return on capital and as a result forming a stable foundation of reinforcement of the capital basis in future periods. This helps to maintain the Tier 1 common equity ratio (calculated as the quotient of Tier 1 common equity and total amount of risk exposure), Tier 1 capital ratio (calculated as the quotient of Tier 1 capital and total amount of risk exposure), and combined capital ratio (calculated as the quotient of own funds and total amount of risk exposure), at a level significantly higher than required by the regulatory authority.

The strategic capital objectives of the Bank are aimed at maintaining both the combined capital ratio and the Common Equity Tier 1 capital ratio at a level significantly higher than required by the regulatory authority. This permits a safe growth of the business while meeting supervision standards in long term.

Capital ratios

The measurement of own funds adequacy, including i.a. calculation of capital ratios and leverage ratio, own funds and the Bank's total exposure to risk, is performed on the basis of the following regulations:

- Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 as amended (hereinafter referred to as CRR Regulation) and other Commission (EU) implementing regulations to the CRR Regulation,
- Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council with further amendments (ITS Regulation),
- Act of 29 August 1997 — Banking Law (Journal of Laws of 2002 No 72, item 665) as amended,
- Act of 5 August 2015 (Journal of Laws 2015, item 1513) on the macro-prudential oversight of the financial system and crisis management in the financial system ("Macro Prudential Oversight Act"),
- Regulation of the Minister of Development and Finance of 25 May 2017 on the application of higher risk weights to credit exposures secured by mortgages on real estate property,
- Regulation of the Minister of Development and Finance of 1 September 2017 on the systemic risk buffer.

In connection with the Macro-Prudential Oversight Act coming into force as of 1 January 2016, which transposes CRD IV into the Polish legal regime, as at 31 December 2019 the Bank was compelled to maintain own funds as such a level as would permit covering the conservation buffer determined under the Act at 2.5% of the total exposure to risk.

In accordance with the decision of the Financial Stability Committee, the anti-cycle buffer imposed on the Bank as at 31 December 2019 was 0%.

On 1 January 2018, the Regulation of the Minister of Development and Finance of 1 January 2018 on the systemic risk buffer came into force. The systemic risk buffer applicable to the Bank as at 31 December 2019 was 3% of the total risk exposure.

Ultimately, the combined buffer requirement set for mBank Hipoteczny S.A. as at the end of 2019 was 5.5%.

Capital ratios, both as at the end of 2019 and the end of 2018, were below the minimum required values as presented in the following table. In 2019 and 2018, the Bank met internal capital requirements.

Capital ratio	31.12.2019	
	Minimum ratio	Presented ratio
Total capital ratio	13,50%	18,24%
Equiety Tier 1 capital ratio	11,50%	15,45%
Equiety Tier 1 core capital ratio	10,00%	15,45%

for 2019 (in PLN thousand)

Capital ratio	31.12.2018	
	Minimum ratio	Presented ratio
Total capital ratio	12,875%	16,25%
Equiety Tier 1 capital ratio	10,875%	13,38%
Equiety Tier 1 core capital ratio	9,375%	13,38%

The leverage ratio, calculated in line with the CRR Regulation and the Commission Delegated Regulation (EU) 2015/62 of 10 October 2014 to amend Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to leverage ratio at the end of 2018 was 7.56%.

The Bank decided that for the purposes of capital adequacy calculation, including the calculation of own funds, based on Article 1(9) of the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 12 December 2017 (Regulation) amending the CRR, it will not apply the transitional period, which permits to alleviate the impact on capital, connected with the implementation of IFRS 9.

The capital ratios, own funds, leverage ratio reported in this document fully reflect the impact of IFRS 9.

Own funds

In accordance with the CRR Regulation, own funds consist of Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital, however mBank Hipoteczny S.A. does not identify items that could be treated as Additional Tier 1 capital.

Common Equity Tier 1 capital of mBank Hipoteczny S.A. encompasses:

- paid-up equity instruments and the related share premium accounts,
- earnings retained in previous years,
- independently verified interim profits,
- other accumulated comprehensive income,
- other capital reserves,
- general risk funds,
- items reducing the Common Equity Tier 1 capital (value adjustments due to the requirements
  regarding prudent valuation, intangible assets, deficiency in credit risk adjustments in light of anticipated losses, regulatory adjustments concerning other accumulated comprehensive income, and net write-downs).

Tier 2 capital of mBank Hipoteczny S.A. encompasses subordinated liabilities.

As at 31 December 2019, the Bank's own funds amounted to PLN 1,308,385 thousand (as at 31 December 2018: PLN 1,133,394 thousand). At the same time, the Common Equity Tier 1 capital ratio of mBank Hipoteczny S.A. amounted to PLN 1 108,385 thousand (as at 31 December 2018: PLN 933,394).

Total risk exposure amount (TREA)

The total amount of risk exposure of the Bank consists of:

- risk-weighted exposure amount for credit risk, counterparty credit risk, calculated using the IRB slotting approach and a standardised approach for exposures permanently excluded from the IRB approach as well as exposures subject to temporary exclusion,
- operational risk exposure amount,

for 2019 (in PLN thousand)

There is no trading portfolio in the Bank, therefore, the Bank does not calculate risk-weighted exposure amounts in relation to other types of risks.

In calculation of the Bank's capital ratios, the total risk exposure amount is determined taking into account the credit risk exposure amount, applying the internal ratings based approach, with the use of the supervisory approach, in regard to assigning specialised lending exposures to risk categories (IRB slotting approach).

As at 31 December 2019, the Bank's total risk exposure amount was PLN 7,176,049 thousand, including the credit risk exposure amount at PLN 6,800,860 thousand (including other noncredit obligations assets – PLN 24,702 thousand).

The table below presents credit exposures for which the requirement was calculated using the IRB slotting approach broken down into supervisory categories of risk and standardised approach as at 31 December 2019.

IRB slotting approach

31.12.2019						
Regulatory categories	**Remaining maturity**	**On- balance-sheet amount**	**Off-Balance-sheet amount**	**Risk weight**	**Exposure amount**	**RWAs**
Category 1	Less than 2.5 years	-	-	50%	-	-
	Equal to or more than 2.5 years	3 090	-	70%	3 091	2 163
Category 2	Less than 2.5 years	236 969	121 308	70%	237 294	166 106
	Equal to or more than 2.5 years	3 372 906	268 030	90%	3 384 887	3 046 398
Category 3	Less than 2.5 years	2 272	-	115%	2 340	2 691
	Equal to or more than 2.5 years	225 742	52 113	115%	229 985	264 483
Category 4	Less than 2.5 years	-	-	250%	-	-
	Equal to or more than 2.5 years	16 453	-	250%	16 577	41 442
Category 5	Less than 2.5 years	46 000	-	-	80 799	-
	Equal to or more than 2.5 years	187 647	-	-	301 045	-
Total	**Less than 2.5 years**	**285 241**	**121 308**		**320 433**	**168 797**
	Equal to or more than 2.5 years	**3 805 838**	**320 143**		**3 935 585**	**3 354 486**

Standardised approach

31.12.2019	**Exposures before CCF and CRM**		**Exposures post CCF and CRM**		**RWAs**
Exposure classes	**On-balance-sheet amount**	**Off-balance-sheet amount**	**On-balance-sheet amount**	**Off-balance-sheet amount**	
Central governments or central banks	1 267 424	-	1 267 424	-	26 138
Regional government or local authorities	49 536	-	161 782	-	32 356
Public sector entities	47 890	-	-	-	-
Institutions	290 784	-	290 784	-	83 058
Corporates	64 356	-	-	-	-
Retail	1 108 293	1 436	1 108 293	718	831 760
Secured by mortgages on immovable property	6 373 694	5 157	6 373 694	2 579	2 256 066
Exposures in default	22 117	-	22 117	-	23 489
Equity	8	-	8	-	8
Total	**9 224 102**	**6 593**	**9 224 102**	**3 297**	**3 252 875**

As at 31 December 2018, the Bank's total risk exposure amount wasPLN 6,975,276 thousand, including the credit risk exposure amount at PLN 6,723,151 thousand (including other noncredit obligations assets – PLN 47,227 thousand).

The table below presents credit exposures for which the requirement was calculated using the IRB slotting approach broken down into supervisory categories of risk and standardised approach as at 31 December 2018.

for 2019 (in PLN thousand)

IRB slotting approach

31.12.2018							
Regulatory categories	**Remaining maturity**	**On- balance-sheet amount**	**Off-Balance-sheet amount**	**Risk weight**	**Exposure amount**	**RWAs**
Category 1	Less than 2.5 years	-	-	50%	-	-
	Equal to or more than 2.5 years	5 931	-	70%	5 932	4 153
Category 2	Less than 2.5 years	106 076	140 088	70%	106 212	74 348
	Equal to or more than 2.5 years	4 204 152	1 339 303	90%	4 213 835	3 792 452
Category 3	Less than 2.5 years	2 525	-	115%	2 538	2 919
	Equal to or more than 2.5 years	142 990	-	115%	145 503	167 327
Category 4	Less than 2.5 years	-	-	250%	-	-
	Equal to or more than 2.5 years	17 299	-	250%	17 308	43 271
Category 5	Less than 2.5 years	95 125	-	-	131 659	-
	Equal to or more than 2.5 years	153 592	-	-	252 660	-
Total	**Less than 2.5 years**	**203 726**	**140 088**		**240 409**	**77 267**
	Equal to or more than 2.5 years	**4 523 964**	**1 339 303**		**4 635 238**	**4 007 203**

Standardised approach

31.12.2018	**Exposures before CCF and CRM**		**Exposures post CCF and CRM**		**RWAs**
Exposure classes	**On-balance-sheet amount**	**Off-balance-sheet amount**	**On-balance-sheet amount**	**Off-balance-sheet amount**	
Central governments or central banks	1 085 686	-	1 085 686	-	-
Regional government or local authorities	57 003	-	180 329	-	36 066
Public sector entities	53 436	-	-	-	-
Institutions	130 335	-	130 335	-	28 002
Corporates	69 891	-	-	-	-
Retail	778 394	13 698	778 394	6 849	588 950
Secured by mortgages on immovable property	5 408 015	10 464	5 408 015	5 225	1 923 574
Exposures in default	13 465	563	13 465	281	14 854
Equity	8	-	8	-	8
Total	**7 596 233**	**24 725**	**7 596 232**	**12 355**	**2 591 454**

Internal capital

The purpose of the ICAAP process (Internal Capital Adequacy Assessment Process), implemented in the Bank, is to keep own funds at the level adequate to the risk profile and the risk level stemming from the Bank's operations.

Due to the fact that the total capital requirement of Bank calculated according to the CRR Regulation and internal capital assessed for the Bank according to the Regulation of the Minister of Development and Finance of 6 March 2017 on the risk management system and internal control system, remuneration policy and detailed method of estimation of internal capital in banks, are lower than the value of the Bank's own funds, as at 31 December 2018 the Bank maintained own funds at a level consistent with the CRR.
As at 31 December 2019, the Bank's internal capital amounted to PLN 428,976 thousand.

for 2019 (in PLN thousand)

Capital adequacy	31.12.2019	31.12.2018
Common Equity Tier 1 Capital	**1 108 385**	**933 394**
Own funds	**1 308 385**	**1 133 394**
Risk weighted exposure amounts for credit risk, counterparty credit risk, dilution risk and deliveries with deferred settlement date:	6 800 860	6 723 151
- using internal rating method	3 547 985	4 131 698
- using standard method	3 252 875	2 591 453
Total operational risk exposure amount	288 769	252 125
Total CVA exposure amount	86 420	-
The total amount of risk exposure	**7 176 049**	**6 975 276**
Common Equity Tier 1 capital ratio	**15,45%**	**13,38%**
Total capital ratio	**18,23%**	**16,25%**
Internal capital	**428 976**	**480 632**

Own funds	31.12.2019	31.12.2018
Own funds	**1 308 385**	**1 133 394**
TIER 1 CAPITAL	**1 108 385**	**933 394**
Common Equity Tier 1 Capital	**1 108 385**	**933 394**
Capital instruments eligible as CET1 Capital	884 631	734 719
Paid up capital instruments	336 000	321 000
Share premium	548 631	413 719
Retained earnings	-	16 622
Retained earnings from previous years	-	-
Profit or loss eligible	-	16 622
Other accumulated comprehensive income	3 065	5 481
Other reserves	300 948	273 082
General banking risks founds	44 800	44 800
(-) Value adjustments due to the requirements for prudent valuatio	(1 504)	(1 351)
(-) Intangible assets	(48 288)	(39 719)
(-) Other intangible assets gross amount	(48 620)	(40 021)
Deferred tax liabilities associated to other intangible assets	332	302
(-) IRB shortfall of credit risk adjustments to expected losses	(58 048)	(81 585)
Other transitional adjustments to CET1 Capital	-	-
CET1 capital elements or deductions - other	(17 219)	(5 284)
Impact of IFRS 9	-	(13 371)
Additional Tier 1 capital	-	-
TIER 2 CAPITAL	**200 000**	**200 000**
Capital instruments and subordinated loans eligible as T2 capital	200 000	200 000

45. Other information

Commerzbank AG announcement regarding the approval of the strategy including, among others, the potential sale of mBank S.A shares On 26 September 2019, Commerzbank AG published a communication according to which the new business strategy of Commerzbank was approved by the Management and Supervisory board of Commerzbank. The strategy provides for sale of the majority stake in mBank held by Commerzbank. The potential sale of the Bank's shares would depend on obtaining the required regulatory approvals.

46. Post balance-sheet date events

- Since 1 January 2020 nBank Hipoteczny S.A. joined the Tax Capital Group ("PGK") based on Corporate Income Tax Act. PGK consists of: mBank S.A. as a parent company and representing PGK to the extent provided for by tax law and other subsidiaries of the mBank Group: mFinance S.A. and mLeasing Sp. z o. o. In the year preceding the establishment of PGK, no tax losses occurred in the companies constituting it. The PGK agreement was concluded for 4 years.
- As at the publication date of the financial statements, the scale of the SARS-CoV-2 coronavirus epidemic and the pace of growth of new cases are still unknown, and even less so the period over which the virus will affect the bank's stakeholders.

In the Bank's view, the areas of adverse effect of the epidemic on business processes are as follows:

1. Credit risk.

We identify credit risk associated with deteriorated possibilities to generate commercial real estate revenues (CRE). In the Bank’s loan portfolio, the biggest risk is associated with exposures to shopping malls, hotels and housing developers. If the threat posed by SARS-CoV-2 continues, problems associated with handling loans may translate into other CRE exposures, and next — to retail housing loans. Credit risk in the portfolio of mortgage retail loans will also increase. Some retail borrowers, providing for themselves not from employment contracts, but from self-employment, may already experience financial problems and request grace period for repayment of their loans.

Some retail borrowers who do not depend on their work, but their own business, may experience financial problems and apply for a grace period. In connection with the above, write-offs may increase. An important mitigator of the impact of credit risk is the fact that, on average, the LTV ratio is at the level of 65% for the vast majority of loans in the bank's assets, does not pose a threat to collateral for the issue of covered bonds.

2. Liquidity risk.

Deterioration of the quality of loans will affect the value of the collateral register for covered bonds, which will translate into limitation or suspension of the issue capacities of the bank, i.e. refinancing of the conducted operations by issue of mortgage bonds. The liquidity risk is also influenced by credit holidays granted by the bank to its clients. Due to limited contact with investors working under the epidemic regime, there may be short-term disturbances on the primary market, however, in the long run, contingency procedures in individual institutions should eliminate these disturbances.

The Bank has a significant portfolio of liquid assets, in particular bills and treasury bonds, which are presented in Note 23. The Bank's liquidity ratios are above the required supervisory standards. The average M4 coefficient was 1.065, while the average LCR coefficient was 1395%.

3. Financial stability risk.

The above impacts on the quality of the loan portfolio will result in a decrease of the Bank's financial result and profitability arising from a decrease in the interest income and the dynamics of impairment. Concluding, in the event of aggravated and prolonged epidemic crisis, we identify the risk of financial stability.

4. Operational risk.

The Bank identifies also operational risk associated with:

- availability of staff resources. It is probable, especially in the scenario of epidemic evolution, that many employees will not work due to: sickness, child care or quarantine.

- availability of services provided by insourcers due to their staffing problems.

Operational risk has been minimized thanks to remote work.

As at the publication date of the financial statements, all critical processes of the bank are executed.

We expect that the effects of market disturbances will be mitigated by regulatory, as well as fiscal and monetary solutions. In particular, the operations of central banks for the liquidity of financial institutions (decreased reference rates, buyback programmes and liquidity boosting measures), as well as aid schemes for entrepreneurs, should significantly mitigate the risks defined above. However, today specific parameters of these actions remain unknown, rendering estimation of their impact on the Bank's balance sheet and the outturn account impossible.

Based on internal analyses of current liquidity and stress scenarios concerning the development of the Bank's regulatory indicators in the future, in the opinion of the Board of Executives, the Bank does not identify significant uncertainties related to the assumption of continuing operations in the foreseeable future.