# Management Board Report on the Performance of mBank S.A. Group in H1 2015

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# 1. Key highlights of mBank Group in H1 2015

## 1.1. H1 2015 in numbers

| | |
|---|---|
| Sound profitability in a challenging environment | ■ PLN 857.2 million in profit before tax compared to PLN 849.1 million in H1 2014 (+1.0%)<br>■ PLN 672.3 million in net profit attributable to mBank shareholders, which represents an increase by 1.5% compared to H1 2014 |
| Revenues additionally supported by the bancassurance transaction with AXA | ■ PLN 2,003.0 million in total income, which represents an increase by 1.1% year on year<br>■ Sale of BRE Ubezpieczenia Towarzystwo Ubezpieczeń i Reasekuracji S.A. and conclusion of agreements related to the sales of shares and distribution agreements, guarantying an additional pre-tax gain of PLN 194.3 million |
| Cost increases reflecting additional regulatory changes and investments in future growth | ■ Operating costs (including amortization and depreciation) amounted to PLN 938.1 million (+5.9% year on year), driven by increased scale of operations and higher contribution paid to the Bank Guarantee Fund (BGF)<br>■ Cost to income ratio stood at 46.8% (compared to 44.7% a year before) |
| Cost of risk reflecting high quality of assets | ■ Loan loss provisions decreased to PLN 207.6 million compared to PLN 245.3 million in H1 2014<br>■ Cost of risk at 0.54% compared to 0.70% a year before |
| Growth in client base | ■ Number of individual clients: 4,924 thousand (+236 thousand clients in 2015 to date)<br>■ Corporate client base: 18,654 (+867 clients in 2015 to date). |
| Growing net loans and advances | ■ Net loans and advances reached PLN 77,241.6 million, which represents an increase by 3.6% from the beginning of 2015 (or +8.0% excluding reverse repo/ buy-sell-back transactions) |
| Increasing deposits | ■ Amounts due to customers stood at PLN 73,058.3 million, with an increase by 0.9% from the beginning of 2015 (or +4.9% excluding repo/ sell-buy-back transactions) |
| Sound return on equity | ■ Gross ROE: 15.7% (17.5% at the end of H1 2014)<br>■ Net ROE: 12.3% (13.6% at the end of H1 2014)<br>■ A decrease in ROE compared to H1 2014 was a result of an increase in average equity |
| Abundant capital and safe liquidity | ■ Total capital ratio at 16.4%<br>■ Common Equity Tier 1 ratio at 13.5%<br>■ Loan to deposit ratio at 105.7% |

## 1.2. Key projects of mBank Group in H1 2015

In H1 2015 a number of strategic projects were implemented. Among those most important were:

**Cooperation with AXA Group**

In March 2015 the sale of BRE Ubezpieczenia Towarzystwo Ubezpieczeń i Reasekuracji (BRE Ubezpieczenia TUiR) was completed. On March 27 and on March 30, mBank Group and AXA Group signed agreements accompanying the sale and distribution agreements, governing long-term cooperation between mBank Group and AXA Group on the distribution of insurance products.

The total consideration of mBank Group from the sale of shares in its insurance subsidiary and from the distribution agreements signed with AXA Group members amounted to PLN 579.5 million, while the one-off impact of the transaction on the pre-tax income of mBank Group recognised in Q1 2015 amounted to PLN 194.3 million.

The cooperation with AXA Group will widen the range of products and improve the quality of services provided to mBank Group clients, who gained access to the most innovative insurance products available via electronic and mobile platforms as well as in traditional branches. In July mBank and AXA Group launched their first joint advertising campaign, which aims at presenting how the cooperation of two experienced business partners translates into convenience and security of clients buying insurance policies.

**mBank's strategic cooperation with Allegro**

mBank signed a long-term agreement on strategic cooperation with Poland's on-line auction market leader, Allegro. The cooperation will consist in offering banking products to Allegro users.

mBank products, primarily current accounts or cash loans, are offered to individuals across different parts of the service in the form of banners with contextual ads, mailings and newsletters. It allows to enhance the cross-sell of loans.

The cooperation with Allegro, the largest on-line auction service in Poland, will provide mBank with access to an additional group of clients - 13 million users concluding about 160 million transactions per year.

**Strategic alliance with Orange**

The joint-venture of mBank and Orange, Poland's leading landline telephone, mobile, Internet and data transfer provider, called Orange Finanse, was launched on October 2, 2014.

The overall client acquisition from the start of Orange Finanse reached nearly 150 thousand. H1 2015 was marked by new implementations and changes in the offer of Orange Finanse, whose clients are currently offered personal accounts, loans (Express Cash Loan, Renewable Loan), debit cards, credit cards, NFC payments by mobile phones, savings accounts, 3, 6 and 12-month deposits, discount programmes covering approx. 3 thousand partner outlets (stores, service providers, hotels, restaurants) and additional benefits available to the clients of Orange mobile network. In 2015 Orange Finanse extended its offer to micro-enterprises.

### Intensified relations with small and medium-sized enterprises

mBank continues its efforts in intensifying its cooperation with the sector of small and medium-sized enterprises, using its market leading mobility and rapid and efficient banking processes. To achieve this goal, the following new solutions promoting mobility have been developed with SMEs in mind:

1) FX Platform (mPlatforma walutowa) in mBank's mobile application - this solution allows business clients to manage all their currency dealing via mobile: to execute transactions or contact a dedicated currency dealer.

2) Mobile mTransfer - this globally unique solution enables quick and easy payments for on-line purchases without the need to type in SMS passwords or log into the Bank's transactional system.

3) Automatic download of company data from the Central Register and Information on Business Activity (CEiDG), which considerably shortens the time needed to open a company account.

4) Credit analysis using both the data already in the Bank's possession and reports from the IT system of the Credit Information Bureau (BIK) dedicated to entrepreneurs.

5) Multi-person transfer authorisation - the number of transactions which may be executed simultaneously has been increased (from 20 to 200), an option was added to execute an overdue orders and to authorise transactions in the mobile application.

6) Authorised FX Transaction Balance - a tool enabling business customers to "lock" for the defined period the price of foreign currency. Clients from outside of mBank may also find this solution interesting, which may increase the target client group - also in the mobile channel.

7) MT 940 reports - enabling automatic download of account history to the most popular accounting systems.

### mBank's "One Network" project

FINOVATEEUROPE LONDON


In H1 2015 mBank continued the One Network project aimed at consolidating its sales network and further improving the service of retail and corporate clients. Ultimately, the separate retail and corporate branches will be replaced by advisory competence centres and so-called "light" branches located in shopping malls. The advisory competence centres will be located in every city which currently hosts an mBank branch.

In H1 2015 mBank opened two "light" branches and an advisory center. In total, at the end of June 2015, there were four "light" branches and two advisory centres. In addition, in July, the first "light" branch was opened in Slovakia (in Bratislava).

The concept of a light acquisition branch won the Best of Show award at FinovativeEurope 2015, the world's largest conference promoting cutting-edge financial technology.

### Changes in the Group's funding structure

### Issue of covered bonds

mBank, in cooperation with mBank Hipoteczny, continues its long-term project aiming at the issue of mortgage-backed covered bonds. In H1 2015 mBank Hipoteczny issued covered bonds worth in total PLN 450 million and EUR 81 million, with maturity dates ranging from 5 to 10 years.

The chart below presents the issues in H1 2015:

| Currency | Amount | Issue date | Maturity date | Maturity (years) |
|---|---|---|---|---|
| PLN | 200,000,000 | 20 Feb. 2015 | 28 Apr. 2022 | 7.2 |
| EUR | 20,000,000 | 25 Feb. 2015 | 25 Feb. 2022 | 7.0 |
| PLN | 250,000,000 | 15 Apr. 2015 | 16 Oct. 2023 | 8.5 |
| EUR | 11,000,000 | 24 Apr. 2015 | 24 Apr. 2025 | 10.0 |
| EUR | 50,000,000 | 24 Jun. 2015 | 24 Jun. 2020 | 5.0 |

**Euro Medium Term Notes programme**

In March 2015 mBank's Prospectus for the Euro Medium Term Notes (EMTN) programme was updated up to EUR 3 billion. The updated Prospectus was approved by Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg. The programme aims at issuing debt securities by mFinance France, a special purpose vehicle of mBank Group, in many tranches and currencies, with a diversified interest structure.

## 1.3. Awards and distinctions

Since the beginning of 2015, mBank Group received a number of awards and distinctions, in particular:

In the 6th edition of the **Golden Banker ranking** organised by Bankier.pl, a financial portal, and PayU, leader of Internet payments in Poland, mBank triumphed for the fifth time, winning awards for the best mobile banking, the best personal account and account for entrepreneurs. mBank also received the largest number of nominations in all categories (16% of votes) and hence **won the major award - the Golden Bank statuette.**

**mBank was named the best bank in Poland by the Global Finance magazine**.

The best banks in 21 countries were selected on the basis of data received from analysts, managers and banking consultants. The selection criteria included growth in assets, profitability, cooperation with strategic partners, customer service, prices and innovative products.

For the second time in a row mBank won the **title of the most innovative bank** in the **Leaders of Banking & Insurance World competition**. The jury appreciated the changes introduced in the area of mobile banking and stressed in the justification that the new, totally redesigned application offering solutions such as the 30-second loan, i.e. the fastest loan on the market, or mOkazje discount programme with the possibility of geolocation of available offers, made banking simpler and more attuned to the clients' lifestyles.

Experts of the consultancy and research institution **Celent Research**, which assists financial institutions in the development of comprehensive business and technology strategies, appreciated mBank's insurance sales model. For the second consecutive time mBank was among the winners of the international Model Bank Awards competition**. mBank won in the "Innovation and Emerging Technologies" category**, presenting a model comprising more than 30 complete products remotely through modern processes and in every available channel: the Internet, phone, mobile devices, video-calls and in branches.

mBank was once again among the winners and received the **Service Quality Star award in the "Banks" category in the Service Quality programme**. Brands with the highest Customer Satisfaction Index (CSI) that stand out against their competitors and compared with the Polish Customer Satisfaction Index (PCSI) were selected on the basis of assessments and opinions of consumers published on the website: jakoscobslugi.pl.

For the seventh time **Private Banking of mBank was ranked the best in Poland by Euromoney Magazine**, a British financial magazine. The assessment criteria included the quality of services, quality of customer service and product offer.

Every year, Euromoney Magazine conducts a survey among financial institutions offering specialist banking services to affluent clients. In Poland, mWealth Management has been the winner of this ranking every year since 2007.

mBank's loyalty programme mOkazje **won in the category "The best loyalty activities in services" in the first edition of the Loyalty Awards, a contest of the best loyalty programmes in Poland in 2014**.

The winners were determined in a two-stage poll by votes cast only by experts with hands-on experience in managing relationships and inspiring client loyalty. The awards went to the best projects in retail commerce, services, B2B (relationships with resellers), and the best new programme and innovation of the year.

In the fourth edition of the **"Quality you can bank on"** ranking organised by TNS Polska in cooperation with *Dziennik Gazeta Prawna* daily mBank **came second in terms of the quality of services offered in its branches**. The ranking is the most comprehensive survey on the quality of service provided in banks' branches on the Polish market. As part of this year's edition, the auditors of TNS Polska visited nearly 1.5 thousand branches of nineteen banks offering personal accounts.

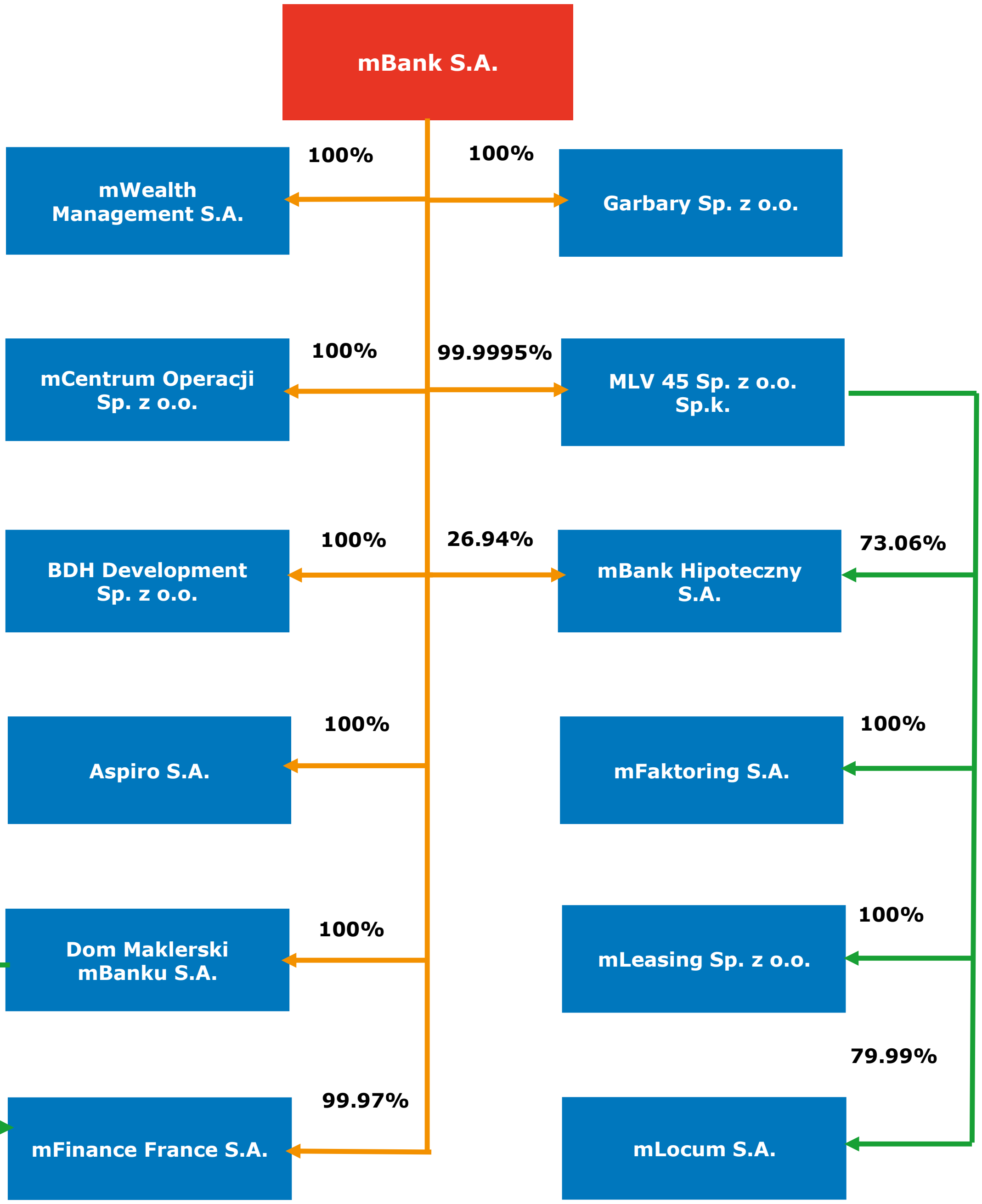
mBank triumphed in the innovation category of the first edition of **the Banking Stars competition organised by *Dziennik Gazeta Prawna*** daily and PwC, global leader in professional advisory services. mBank entered three projects in the competition: mobile banking, "light" branches located in shopping malls and cash loan available on line with credit decision taking only 30 seconds.


**mBank's team of economists was unrivalled in H1 2015 in forecasting** the key macroeconomic and market indicators among 21 participants of the **forecasting contest organised by *Parkiet* daily**. The economists working at mBank were appreciated in particular for their accurate forecasts of monthly current account balance.

## 2. Composition of mBank Group

The composition of mBank Group is presented in the chart below. In H1 2015, the most important subsidiaries of the Group were: mLeasing, mBank Hipoteczny, mFaktoring and Dom Maklerski mBanku.

The composition of mBank Group as of June 30, 2015 was as follows:




On January 20, 2015, the transaction of selling Transfinance a.s. was finalized. The sale of Transfinance was compliant with the One Bank Strategy for the years 2012-2016 and constituted the last stage of restructuring of the factoring activity abroad, i.e. after the sale of Magyar Factor zRt and Intermarket Bank AG in 2011.

The most significant change in the structure of mBank Group in H1 2015 was the sale of BRE Ubezpieczenia TUiR. On March 27, 2015, after meeting the conditions precedent, in particular: (i) obtaining the consent of the Office of Competition and Consumer Protection and (ii) having no objections raised by the Polish Financial Supervision Authority, Aspiro S.A. ("Aspiro") sold 100% of shares of BRE Ubezpieczenia TUiR to Avanssur S.A., a subsidiary of AXA Group.

The total remuneration of mBank Group arising from sales of shares of BRE Ubezpieczenia TUiR and signing linked agreements and distribution agreements with AXA Group entities amounted to PLN 579.5 million. One-off impact of the transaction on the consolidated pre-tax result of the Group amounted to PLN 194.3 million, and was book in Q1 2015. Additionally, as a result of the mentioned distribution agreements, within the next 10 years, the Group will recognize revenues of c. PLN 180 million in total.

On March 2, 2015, Aspiro conducted a merger by acquisition of BRE Ubezpieczenia Sp. z o.o. and BRE Agent Ubezpieczeniowy Sp. z o.o. The business activity of both companies was acquired and is continued within the same scope by Aspiro. The acquired companies were dissolved on the day of removing them from the registry on March 2, 2015, i.e. on the day when the merger was entered into the registry. The merger of the companies did not influence the stand-alone profit of mBank nor the consolidated profit of mBank Group.

From the beginning of 2015, there was a change in assigning segments of mLeasing Sp. z o.o. and mBank Hipoteczny S.A. From the so far assigned results of mLeasing Sp. z o.o., in accordance with the division of clients between the Corporate and Investment Banking segment and the Retail Banking segment, the fund raising activity was separated and included in the Financial Markets segment. Moreover, the results of mBank Hipoteczny S.A., so far assigned to the Retail Banking segment, were divided between Corporate and Investment Banking segment, Retail Banking segment (in accordance with the division into corporate and retail clients) and the Financial Markets segment, to which the operation of the company covering operations related to treasury was assigned, including funding through the issuance of covered bonds.

The comparative data concerning the segments of operation of the Group was restated to reflect the changes in presentation introduced in the current financial year.

In view of the above, at the end of H1 2015, the division of the operations of mBank Group into segments and business areas was as follows:

**mBank Group**

| Segment | Retail Banking | Corporates and Financial Markets | |
|---|---|---|---|
| | | Corporate and Investment Banking | Financial Markets |
| Bank | ■ Servicing retail clients and microenterprises<br>■ Servicing affluent clients<br>■ Servicing private banking clients | ■ Servicing corporations and non-banking financial institutions (K1)<br>■ Servicing large companies (K2)<br>■ Servicing small and medium-sized companies (K3) | ■ Servicing banks<br>■ Servicing corporate clients within the scope of trading and sales<br>■ Risk and liquidity management |
| Consolidated subsidiaries | ■ Retail part of Dom Maklerski mBanku S.A.<br>■ Retail part mLeasing Sp. z o.o.<br>■ Aspiro S.A.<br>■ Retail part of mBank Hipoteczny S.A.<br>■ mWealth Management S.A. | ■ Corporate part of Dom Maklerski mBanku S.A.<br>■ Corporate part of mLeasing Sp. z o.o.<br>■ Corporate part of mBank Hipoteczny S.A.<br>■ mFaktoring S.A.<br>■ Garbary Sp. z o.o.<br>■ MLV 45 Sp. z o.o. Sp. k. | ■ mFinance France S.A.<br>■ mLeasing Sp. z o.o. – within the scope related to fund raising<br>■ mBank Hipoteczny S.A. – within the scope related to fund raising |
| | **Other Companies** | ■ mLocum S.A. (property developer)<br>■ mCentrum Operacji Sp. z o.o. (outsourcing services provider)<br>■ BDH Development Sp. z o.o. (property management company) | |

The financial results of the Retail Banking segment include the results of the companies BRE Ubezpieczenia TUiR S.A. and AWL I Sp. z o.o. until the day of their sale, as well as the results of the companies BRE Ubezpieczenia TUiR S.A. and BRE Agent Ubezpieczeniowy Sp. z o.o. until the day of their merger with Aspiro. The Corporate and Investment Banking segment includes the results of Transfinance a.s., until the day of its sale.

Under the IFRS, all subsidiaries are consolidated using the full consolidation method. Activity of the most important companies is presented in chapter 10. Activity of selected mBank Group subsidiaries.

## 3. mBank Group Strategy for 2012-2016

Since July 2012, mBank Group has been pursuing its "One Bank" Strategy for 2012-2016. The vision of "One Bank" consists in the improvement of the long-term ability to generate income and profitability within a sound balance sheet structure, coupled with a strong technological support for client relationships and, simultaneously, enhanced integration within the Group, backed by a uniform brand and branch infrastructure.

The main areas of strategic focus for mBank Group in 2015 and in the following years include:

- Acquisition of new retail clients and activation of the existing Retail Banking clients with special attention to the segment of young customers.
- Increasing revenues generated by mBank's foreign branches in the Czech Republic and Slovakia through dynamic client base development and sale of high-margin products.
- Integration of products and services addressed to affluent clients, private banking and wealth management, with a view to improve reacting to the needs of this segment.
- Increased presence in the SME sector.
- Client acquisition in the K3 segment (firms with an annual turnover of up to PLN 30 million) focused on the most promising companies and improved segmentation of clients between retail and corporate customer service models.
- Cultivating relationships with K2 corporate clients by strengthening mBank's position in arranging debt issues and issues of shares, as well as on M&A market.
- More flexible cooperation with the largest K1 companies, drawing on the expertise of and relationship with Commerzbank.

In 2015 mBank's activities are first and foremost focused on strengthening the Bank's leading position in mobile and transactional banking.

mBank's strong position in transactional banking is reflected in, among others, the number and value of cashless payments. In H1 2015 the value of cashless payment by card transactions rose by 24.3% against the same period last year. At the same time, the number of such transactions went up by 41.3%.

mBank is a leader when it comes to the number of mobile banking users according to the peer group data published by PRnews.pl. The Bank works on enhancing its mobile applications in order to provide mobile banking users with the same functionalities as those offered on the Internet platform. mBank wants its mobile application to be always among the world's best solutions of this kind.

The development of transactional banking is of key importance as it counterbalances the decrease in the Group's income, driven by low interest rates and shrinking income from interchange fees. Other activities of the Group comprise, among others, a shift towards increasing sales of products generating other non-interest fees, including asset management and Treasury products (e.g. products for corporate clients wishing to hedge against interest rate risk), changes in loan structure, maintaining a high level of client acquisition and increasing client loyalty in order to reduce client acquisition/migration costs.

The end of migration of the former MultiBank clients to the new mBank platform in H2 2015 will mark another important stage in the implementation of the Strategy. This will enable a more precise segmentation of mBank Group clients, increased cost effectiveness and further technological development of mBank's transaction platform, as well as improved quality of marketing communication addressed to retail clients.

In 2015, mBank Group is continuing its efforts towards obtaining diversified, long-term and cheap funding for its business by means of, among others, issues of covered bonds by mBank Hipoteczny. The 2015 plan provides for issuing covered bonds worth a total of PLN 1.5 billion of which more than a half was placed in H1. Moreover, in H2 mBank plans to issue another tranche of bonds under the EMTN Programme.

The table below shows the financial objectives set in the 2012-2016 Strategy and their accomplishment as at 30 June 2015.

| Strategy for 2012-2016 | |
|---|---|
| **Financial objectives** | **Status as at 30 June 2015** |
| Loan-to-deposit ratio: c. 115% by 2016 | 105.7% |
| Net Stable Funding Ratio (NSFR): min. 110% | 107.0% |
| Core Tier 1 ratio: c. 11% | 13.5%* |
| Cost-to-income ratio (C/I): max. 48% | 46.8% |
| Gross ROE: min. 15% | 15.7% |
| Net ROA: min. 1.4% | 1.1% |

** Core Tier 1 ratio calculated in line with Basel III rules.*

# 4. Economy and the banking sector in H1 2015

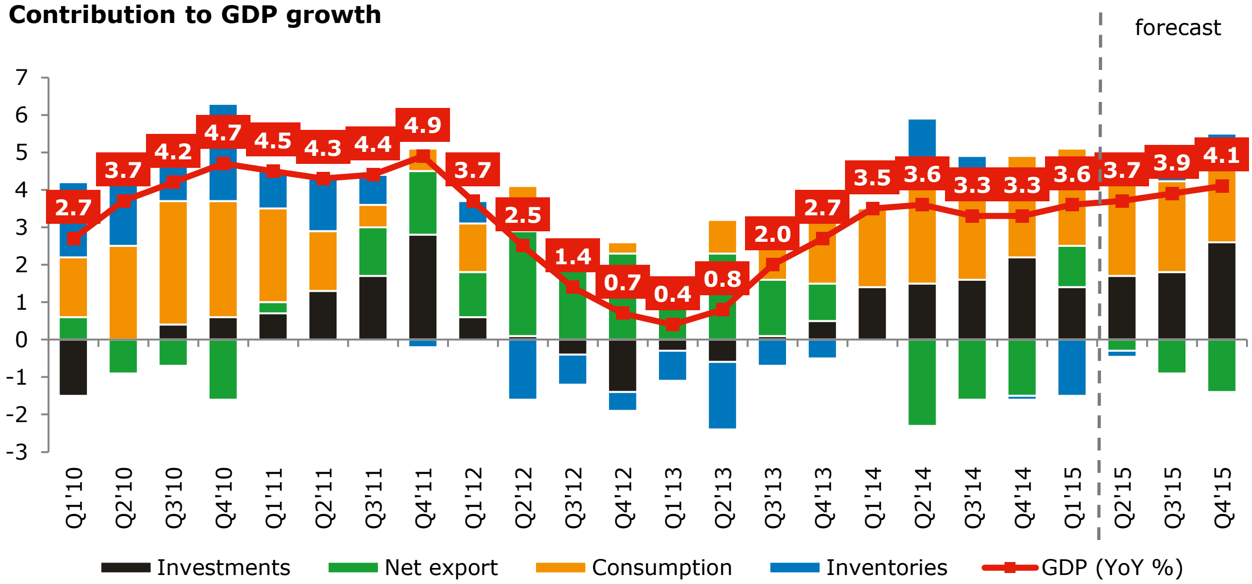
## 4.1. Questions about the Polish economy

### Stabilisation of economic growth in H1 2015

In H1 2015, the Polish economy grew at the fastest rate in four years: after a 3.6% growth in the first three months, the next quarter most likely (based only on high-frequency data) brought continuation of rapid economic growth. Growth in the early months of the year was balanced and based on three main pillars: investments, private consumption, and net exports.

Investments grew by 11.4% in Q1 2015 (well above the expectations), the biggest positive surprise in Polish economic statistics. Despite the concerns of some market participants, the growth of investments was driven both by solid construction activity, additionally bolstered by favourable weather conditions, and by enterprises investing in machinery and equipment (record-high growth in this category during the current phase of economic recovery). Although the spring brought some disappointment with the performance of the construction industry, the average growth of construction and assembly production rose from 1.3% to 2.4% YoY, which suggests that the positive contribution of such investments to growth continues. In the opinion of the Bank, this factor combined with consistently high investments in machinery and equipment should keep growth of investments at around 8% - 9% YoY.

**Contribution to GDP growth**



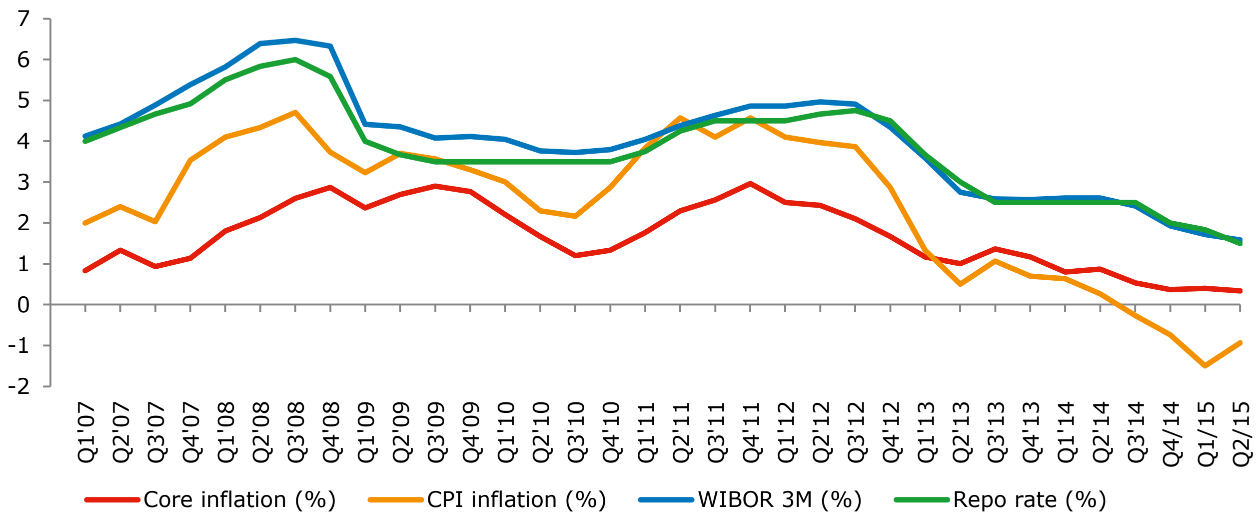

Private consumption grew at a stable pace in H1 2015 (3.1% YoY on average), steadily supported by a broad range of positive factors, i.e., consumer sentiment reaching new post-crisis highs, consistent improvement on the labour market (the unemployment rate was at a six-year low in Q2, while the widest employment measures steadily indicate that the number of jobs grows by more than 1.5% YoY), as well as low inflation which boosts real disposable incomes. The growth of retail sales reported in H1 2015 (4.3% in fixed prices) was close to the average of the last few years. The Bank expects the current growth rate of consumption to continue in the coming quarters. It may step up moderately in the following years, subject to the expected changes in the tax system (e.g., increase of the amount of personal income exempted from taxation).

In Q1, net exports contributed 1.1 percentage points to growth (and are expected to continue their positive contribution in the next three months as well); however, the strength of Polish exports was most evident in the record-high trade surplus in the last months. In May alone, according to NBP, it reached EUR 946 million, and the surplus of exports over imports was more than EUR 2.3 billion in the last 12 months; both figures are unprecedented. The excellent performance of net exports was driven both by moderate growth in imports (partly attributable to lower commodity prices) and very vibrant growth of exports (largely due to the recovery of demand in euro zone countries). In the opinion of the Bank, the trade surplus is likely to decrease in the coming months but the change will not be significant (however, the contribution of net exports to growth will decrease) as the Polish economy retains its internal balance.

### Very slow growth of inflation, the end of the rate cut cycle

Despite the acceleration of growth, Polish inflation was record-low in H1 2015. Inflation was down to 1.6% in February, driven mainly by low energy prices (especially prices of fuel). Inflation increased in the following months but the rebound was relatively slow and inflation measured at mid-year (-0.8% YoY) was far from normal. In addition to relatively low fuel and food prices, the strongly negative CPI was also driven by the core categories (core inflation net of food and energy process was only 0.2% YoY in June 2015), i.e., services and other consumer goods. The drivers of the low price index are fairly complex and result from both external and internal factors, including deflation in the environment of the Polish economy (falling commodity prices, concerns about the Chinese economy, very low inflation in the euro zone) and the appreciation of the zloty, which did not favour an increase in prices of imported goods. As a consequence, deflation took root in the Polish economy in H1, spilling into the majority of categories in the basket of consumer goods (ca. 50%).

**CPI inflation and NBP reference rate**




Under these conditions, the monetary policy steered a very relaxed course: the rates were cut (by 50 bps) in March, and the Monetary Policy Council in the following months emphasised the need to stabilise the rates at the record-low level and not to make any hasty hike decisions, more so than the optimistic statistics in the Polish economy. The prudent, relaxed monetary policy bias in H1 was also reflected in the central bank's forecasts. According to the forecasts, inflation will remain below the NBP target (2.5%) even at the end of 2017 while the demand gap in the Polish economy will gradually close. The Bank is generally in agreement with this assessment of the Polish economy and, notwithstanding the market consensus (which expects the monetary policy to normalise as of H2 2016), it expects the rates not to be cut before 2017. In addition to low inflation, as well as growth which has not significantly exceeded the potential, the relaxed monetary policy will be supported by political and organisational factors: a new Monetary Policy Council will be elected next year.

### Turbulences in financial markets

The main trend in Polish markets in H1 was the strong appreciation of the Polish zloty. After the early months of the year, which did not favour the Polish currency (the zloty fluctuated around PLN 4.30 against the euro), EUR/PLN fell sharply in the following weeks and reached a low below 4.00 in early April. The zloty depreciated in May and June due to both domestic factors (rising political uncertainty) and global drivers (sell-out on bonds, turbulences around the negotiations of a new assistance package for Greece). Eventually, however, the zloty closed the six months much stronger than it was at 2014 year-end.

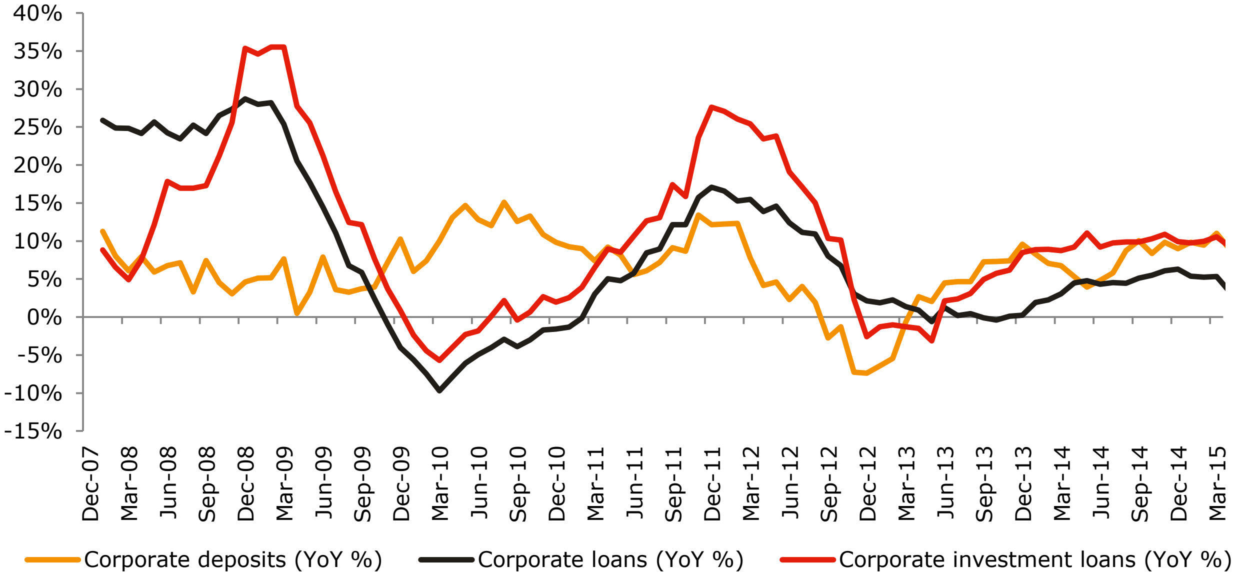
Polish Treasuries experienced a similar ride in H1. Their yields hit all-time lows in January (1.98% for 10Y bonds), right after the announcement of the extended asset purchase programme of the European Central Bank, and increased across the curve in the coming months. Initially sluggish, the increase stepped up in April as the sentiment around the European (and global) economy improved, oil prices regained ground, and a sell-out of bonds occurred across global markets. The yields of Polish 10Y T-bonds eventually stabilised at 2.8-3.2%.

## 4.2. Money supply and the banking sector mirroring the economy

Stable growth of banks' deposit base continued in H1 while lending to enterprises and households grew moderately.

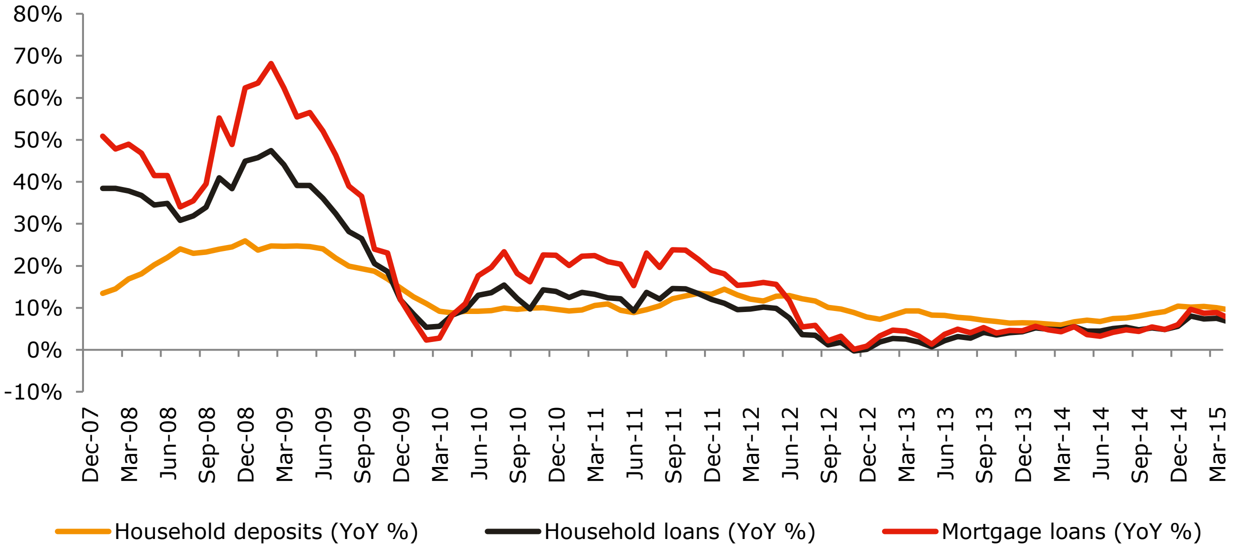
As for deposits, both retail (household) deposits and corporate deposits should be discussed. Retail deposits grew by 8.4% YoY on average, a much higher rate than reported in 2014 (6.4% annual average). Interestingly, the growth was accompanied by a record-high increase of cash in circulation, as well as positive cash flows of mutual funds; the former evidently shows that there was no significant flight of deposits from the banking sector as deposits remained insensitive to high nominal interest rates; the latter indirectly proves a high increase of disposable incomes of households.

**Corporate loans and deposits**




Corporate deposits rose by 10.3% YoY on average in H1. The growth rate was superior to that reported in 2014 (7.9% YoY on average). In the opinion of the Bank, this was due to a robust and stable financial position of Polish enterprises: taking advantage of low prices of commodities and imported goods and the still moderate growth of salaries, their financial performance steadily improved in the last quarters. The process should continue in the coming months, although in the opinion of the Bank the balance of risks suggests that the growth rate of corporate profits has slowed down and, consequently, the growth rate of corporate deposits is likely to drop modestly.

**Household loans and deposits**



Despite the relatively high growth, lending did not accelerate in a significant way. Quite the opposite: net of FX volatility, the growth rate of lending to enterprises fell from 7.9% YoY in December to 6.7% YoY at the end of June. The slow-down of the growth rate of household loans was even more pronounced at 3 percentage points (from 7.0% to 4.0% YoY, net of fx volatility). According to the Bank, the decrease was driven by a number of factors. The slow-down in corporate lending was illusory in the opinion of the Bank, caused exclusively by lower demand for overdraft (investment loans grew at a consistently high rate); however, the growth rate of household loans remained low for fundamental reasons (LTV cap imposed by the PFSA on household loans; low demand for consumer loans). In the opinion of the Bank, the lending landscape is unlikely to change in the coming quarters, but the growth of corporate loans has the biggest space to accelerate.

## 4.3. Changes in recommendations of the Polish Financial Supervision Authority (PFSA) and other regulations concerning banks

### Recommendation P of the Polish Financial Supervision Authority (PFSA)

On March 10, 2015 the KNF adopted Recommendation P concerning financial liquidity risk management at banks which replaced the document issued in 2002. The amended Recommendation P aims at updating the standards of liquidity risk management after the financial crisis experiences, and adjusting Polish regulations to international standards in this respect, including the guidelines of the Basel Committee on Banking Supervision and European regulators. The Recommendation covers issues such as setting liquidity risk tolerance, liquidity risk measurement, liquidity cost management and allocation together with conducting stress tests connected with liquidity contingency plans. The requirements stipulated in Recommendation P will take effect on December 31, 2015.

### Recommendation U of the Polish Financial Supervision Authority (PFSA)

Introduction of a reporting requirement whereby the bank clearly specifies its role in the offering of insurance services. In addition, under the recommendation, the selection of an insurer is at the client's discretion. Recommendation came into force on April 1, 2015.

### Act on Capital Market Supervision

In July 2015, the Polish parliament passed amendments to the Act on Capital Market Supervision. Among the most important amendments are: adding new entities to the list of institutions covering the costs of functioning of the PFSA, and more equal allocation of the costs among capital market participants. The fees paid by the entities specified in the Act comprise one-off fees and mandatory annual fees. The greater burdens imposed on banks following the amendments to the Act result from an increase in banks' participation in covering the costs of functioning of the PFSA (the share is specified in the budget act; it increases from 13.5% to 16.5%) and the need to pay additional fees such as fees imposed on public companies whose shares are traded on the regulated market, and fees imposed on issuers of securities other than shares. The manner of paying the fees imposed on banks will be specified in detail in a regulation of the Ministry of Finance. The Act will take effect on January 1, 2016.

### Ruling of the Constitutional Tribunal on banks' issuance of bank enforcement titles (BTE)

On April 14, 2015 the Constitutional Tribunal decided that banks' right to refer their receivables to enforcement proceedings without court examination proceedings violated Article 32 (1) of the Polish Constitution, i.e. it breached the principle of equality. Therefore, Article 96 (1) and Article 97 (1) of the Banking Law of August 29, 1997 which authorized banks to issue BTEs on the basis of their books or other documents connected with performing banking operations and to conduct civil-law enforcement after obtaining an enforcement clause from a court (after a formal examination, but not one focused on the subject matter of the case) will become null and void from August 1, 2016. By this date all pending cases must be closed in line with the existing regulations, and new regulations should be passed by the parliament.

### Act on amending the resolution on covered bonds and mortgage banks and other acts

On 9 July the lower chamber of the Polish parliament passed the government bill on amending the act on covered bonds and mortgage banks, as well as certain other acts.

The amendments aim at removing the obstacles to issuing covered bonds in Poland and trading in these instruments on the domestic and international market. To a larger scale banks will be able to refinance their lending activity through covered bonds issues thanks to the solutions provided in the bill. These include mechanisms strengthening the safety of covered bonds, improving the transparency of their issuers' bankruptcy process and making covered bonds more attractive to potential investors.

The new act offers greater statutory protection of the rights of creditors under covered bonds, by introducing detailed rules governing the process of satisfying claims of covered bond holders and describing the bankruptcy process of mortgage banks. Moreover, the act introduces new requirements designed to bolster the security of mortgage banks' operations (e.g. statutory requirement of over-collateralization, liquidity buffer) and changes to the existing limits on refinancing the loans granted by mortgage banks using funds raised through covered bonds issues.

In the legal and tax area the legislator decided to abolish the income tax on interest paid to foreign investors and to recognize as tax deductible expenses on the specific provisions (write-downs) for loans received by mortgage banks. This is expected to unleash the potential accumulated in the loans granted by universal banks, which are not authorized to issue covered bonds and have no equity relations with any mortgage bank. In addition, the new regulations offer institutional investors greater opportunity to invest in covered bonds on the domestic market.

The adopted solutions will contribute to improving the security of banks' operation by means of diversifying funding sources and narrowing the maturity gap between assets and liabilities. Furthermore, the changes will significantly improve the quality of Polish covered bonds, which will attract more investors, and consequently, reduce the funding costs of banks.

As part of the pending legislative proceedings, the bill will now go to the upper chamber of the Polish parliament, and if the senators propose no more changes, it will be submitted to the President for signing. The new law is expected to come into force on 1 January 2016.

In addition to the above-mentioned regulations, lawmakers are working on a number of bills which are going to have a major impact on banks' operations. The most important ones propose amendments to the following acts: the Banking Law Act, Act on Macroprudential Supervision, Act on the Bank Guarantee Fund, Deposit Guarantee Scheme and forced restructuring. In addition, the Polish Financial Supervision Authority continues works on Recommendation W on model risk management in banks whose draft was submitted for consultations in April 2015. The main aim of the Recommendation is to transpose the supervisory expectations regarding the process of model risk management which arise from CRD IV, set standards in the scope of model building principles and to assess the quality of model functioning by ensuring relevant corporate governance procedures. Recommendation W is planned to enter into force on 30 June 2016.

## 4.4. Factors impacting the banking sector until the end of 2015

The favourable trends in the economy concerning public sector and business investment, consumption, export, salaries and employment, are expected to continue in H2 2015. Sustained strong domestic demand (linked to the improvement in the labour market) is a good prognostic for the banking sector as it suggests continued high demand for loans, especially in the sector of consumer lending to households as well as corporate loans. Growth in this sector will be driven by relatively strong business investment and rising risk appetite on the part of borrowers and banks. Therefore, the increase in lending is expected to accelerate in H2. As a result, the poorer figures reported in Q2, when the sector experienced the full effects of interest rate cuts, are expected to be followed by a slight improvement in net interest income in H2. Accompanied by economic growth and low interest rates, risk costs in the banking industry are likely to remain relatively low.

On the other hand, banks continue to face regulatory risks including mandatory CHF mortgage loans conversion into PLN and the introduction of a bank levy on assets, which may adversely impact on their results in the coming years. These are driven by the proposals to solve the issue of CHF mortgage borrowers by passing a special bill which would make banks take financial responsibility for the problem and by the proposed introduction of a bank levy. Moreover, starting from 2016 the banking sector's contributions to the Bank Guarantee Fund (BFG) are likely to rise significantly. The actual magnitude of these risks will be known after the parliamentary election in October this year and when the final solutions are announced.

Those risk factors may result in banks changing the structure of their products and services and reviewing their tariffs. In addition, banks will put a greater emphasis on cost effectiveness and look for cost optimization opportunities. They will also keep working on improving quality and seeking for new revenue sources.

## 4.5. Proposed solutions to the FX mortgage loans problem

Several days after the Swiss franc's abrupt surge in mid-January 2015 the Association of Polish Banks (ZBP) proposed solutions to help CHF borrowers repay inflated credit instalments.

The package of solutions included:

- Taking into account the negative CHF LIBOR
- Narrowing the currency spread for 6 months
- Extending the repayment period at the client's request
- Not requesting new collateral or loan insurance from the borrowers who repay their instalments on time
- Converting the loans using the fixing rate of the National Bank of Poland (NBP)
- Introducing more flexible rules for restructuring mortgage loans applicable to clients.

In May 2015 the ZBP followed up with new measures. Banks declared financial and organisational involvement in the introduction of additional support for clients who took out housing loans, especially loans in foreign currencies. These measures include:

- Extending the applicability period of the first ZBP package by the end of 2015 with an option to extend the applicability of certain solutions even further
- Setting up internal stabilization funds dedicated solely to CHF borrowers
- Allocating PLN 125 million from banks' own resources to the Mortgage Loans Restructuring Support Fund whose creation by way of an act is requested by the banks declaring financial support
- Making it possible for the borrowers who took out mortgage loans in foreign currencies to meet their own housing needs to transfer mortgage collateral in order to facilitate the sale or exchange of flats.

The subsidies from internal stabilization funds would be granted if the exchange rate of the Swiss franc exceeded a pre-defined threshold. This solution would be available to the borrowers who are ready to undertake to convert their loans at a specified exchange rate and meet the specific income criteria. The support would be addressed to the borrowers whose income at the time of requesting for an amending annex is below the average monthly income in the national economy and whose flat or house is not bigger than 75 or 100 square metres respectively.  Another condition is regular repayment. In accordance with the declaration signed by banks, the subsidies would be granted when the CHF exchange rate exceeded PLN 5, yet the amount of the subsidy cannot be higher than PLN 0.33 per 1 CHF. According to ZBP's estimations, in 10 years the amount of subsidies paid by banks from the stabilization funds would reach approx. PLN 3.5 billion.

The Mortgage Loan Restructuring Support Fund aims at helping mortgage borrowers regardless of the loan currency who found themselves in financial straits due to an adverse event such as unemployment or illness. The support would account for up to 100% of the principal and interest instalment over 12 months, but no more than PLN 1,500 monthly. Except for special cases, the support would be returnable.

In July 2015 the Civic Platform (PO) party put forward a **bill on special principles for restructuring housing loans due to changes in foreign exchange rates.**

The bill provides for:

- Option to convert loans at the spot exchange rate of the National Bank of Poland prevailing on the day preceding the filing of the borrower's conversion request. The bill provides for calculating the difference between the value of the loan after conversion and the amount of debt the borrower would owe at the time of making the calculation if he had taken out the loan in the Polish zloty, not in a foreign currency.

- The conversion costs would be split between the bank and the borrower - half would be remitted by the bank and the other half would be divided into instalments bearing interest equal to the reference rate of the NBP.

- Exemption of banks from income tax on the remitted loans.

- Option to convert available by 2020. In the first year after the bill is passed the option to convert could be exercised by borrowers with loan to value ratio (LTV) of at least 120%. In the next year, the LTV would range from 100 to 120%, and in the following two years - from 80% up.

- Thresholds: the support would be available only to people with flats and homes not bigger than 75 and 100 square metres respectively. The last requirement would not be applicable to families with three or more children. In addition, the flat has to be the only flat owned by the borrower who uses it for his own housing purposes.

The estimated cost of introducing this solution to be borne by banks is PLN 9.0-9.5 billion.
The bill proposed by the PO party is similar to the assumptions on the restructuring of CHF loans presented by the Chairman of the Polish Financial Supervision Authority at a meeting of the parliamentary public finance committee on 3 February 2015. In accordance with the proposal outlined by the KNF Chairman, CHF loans could be converted into PLN at the current exchange rate and split in two parts: PLN loan secured by mortgage and non-secured loan reflecting the consequences of the PLN weakening. The debt in respect of the mortgage-backed loan would be equal to the hypothetical PLN loan granted at the same time as the CHF loan, whereas the non-secured loan would be equal to the difference between the total debt on the conversion date and the debt in respect of the mortgage-backed loan. One half of the non-secured loan would be repaid by the borrower (with 1% interest) and the other half would be remitted.

## 5. Rating of mBank and Group subsidiaries

### 5.1. Rating assigned by Fitch

On 19 May 2015, Fitch Ratings (Fitch) downgraded mBank's long-term IDR (Issuer Default Rating) from "A" to "BBB-" as a result of the downgrade of Commerzbank's IDR from "A+" to "BBB". Consequently, mBank's short-term rating was lowered from "F1" to "F3". The support rating was downgraded from "1" to "2". Similarly, ratings of the senior unsecured long-term debt were subject to downgrading: long-term senior unsecured debt rating to "BBB-" and short-term senior unsecured debt rating to "F3".

Since 27 March 2014, mBank's long-term IDR had a negative outlook. At present, the outlook for the long-term rating is positive.

Downgrading Commerzbank's rating, and in consequence mBank's rating by Fitch arises from the assessment of the impact of implementation of the Bank Resolution and Recovery Directive of the European Parliament and of the Council (BRRD), which radically restricted the state support for banks.

So far, Commerzbank's long-term IDR was higher than its individual viability rating because of a possibility of support from the German government. Following a verification of the support assessment arising from the implementation of the BRRD, Commerzbank's long-term rating was downgraded to the level of the individual viability rating. This, in turn, was reflected in the Fitch verification of Commerzbank's ability to provide mBank with support, if need arises.

mBank's viability rating assessing mBank's financial credibility based on such factors as business profile, management and strategy, risk profile, financial results and external environment has not changed and remained at "bbb-".

After the downgrade, mBank's long-term rating is assigned to the "BBB" investment category, which means good creditworthiness.

| **Fitch Ratings – ratings of mBank** | |
|---|---|
| Long–term IDR | BBB- (positive outlook) |
| Short-term IDR | F3 |
| Viability rating | bbb- |
| Support rating | 2 |
| Rating of the senior unsecured debt issued under the Euro Medium Term Note Programme (EMTN) | BBB- |

The rating action of 19 May 2015 covered also mBank Hipoteczny. The mBank Hipoteczny long-term rating was downgraded from "A" to "BBB-", the short-term rating from "F1" to "F3", and the support rating from "1" to "2". The rating of mBank Hipoteczny corresponds to the rating of mBank, which proves the meaning of this subsidiary to mBank.

| **Fitch Ratings – ratings of mBank Hipoteczny** | |
|---|---|
| Long–term IDR | BBB- (positive outlook) |
| Short-term IDR | F3 |
| Support rating | 2 |

As a result of downgrading the long-term rating, also the ratings of public and mortgage covered bonds issued by mBank Hipoteczny were downgraded from "A" (negative outlook) to "BBB" (positive outlook).

### 5.2. Rating assigned by the Standard & Poor's

On 9 June 2015 Standard & Poor's Ratings Services (S&P) lowered mBank's long-term counterparty credit rating from "BBB+" to "BBB" as a result of downgrading Commerzbank's rating from "A-" to "BBB+". Similarly, the rating of bonds issued by mFinance France under the Euro Medium Term Note Programme was downgraded to "BBB". mBank's short-term rating remained unchanged at "A2".

The downgrade of Commerzbank's long-term rating and the resulting downgrade of mBank's rating by S&P was driven by a verification of the likelihood of potential German government support for Commerzbank (in connection with the BRRD implementation) and the consideration of the criteria determining the additional loss-absorbing capacity (ALAC).

The long-term rating outlook for mBank is stable despite the negative outlook of the rating of Commerzbank. According to the agency, it reflects the gradual strengthening of the capital base of mBank thanks to its sound earnings capacity, supported by the Polish economy's positive growth prospects. This would likely counterbalance a potential weakening capacity of the parent Commerzbank to support mBank, in the case of a downgrade of Commerzbank's rating.

| **Standard & Poor's – ratings of mBank** | |
|---|---|
| Long-term counterparty credit rating | BBB (stable outlook) |
| Short-term counterparty credit rating | A-2 |
| Stand-alone credit profile (SACP) | bbb- |
| Rating of the senior unsecured debt issued under the Euro Medium Term Note Programme (EMTN) | BBB |

### 5.3. Rating assigned by the Moody's based on publicly available information

Moody's ratings for mBank are based solely on publicly available information, and mBank does not take part in the rating process, having the "non-participating issuer" status. On 21 May 2015, the Moody's agency upgraded the long-term deposit rating of mBank from "Baa3" to "Baa2", and the short-term rating from "Prime-3" to "Prime-2". The upgrade of the long-term rating of the Bank results from the implementation of an advanced LGF analysis (Loss Given Failure – loss in the case of default). The application of the LGF analysis compensated the effects of downgrading the assessment of state support, resulting from the implementation of legislation on recovery and resolution of credit institutions and allowed for increasing the adjusted baseline credit assessment (adjusted BCA) of the Bank ("ba1") by two notches.

In May 2015, Moody's introduced a new assessment for the banks – the Counterparty Risk (CR) Assessment. CR Assessment is an opinion on how counterparty obligations are likely to be treated if a bank fails and is distinct from debt and deposit ratings in that it (1) considers only the risk of default rather than the likelihood of default and the expected financial loss suffered in the event of default; and (2) applies to counterparty obligations and contractual commitments rather than debt or deposit instruments. The agency assigned to mBank the counterparty risk rating at the level of Baa1 (cr)/ P-2 (cr).

| Moody's – ratings of mBank based on publicly available information | |
|---|---|
| Long-term deposits rating | Baa2 (stable outlook)* |
| Short-term rating | Prime-2 |
| Rating for unsecured debt | Baa3 |
| Counterparty Risk (CR) Assessment | Baa1 (cr)/ P-2 (cr) |

** "Non-participating issuer", rating based solely on publicly available information.*

### 5.4. Ratings of Poland, mBank and Commerzbank – comparison

The table below compares the long-term ratings for Poland, mBank and Commerzbank as of 30 June 2015.

| Rating agency | Poland | mBank S.A. | Commerzbank AG |
|---|---|---|---|
| Fitch Ratings | A- (stab.) | BBB- (pos.) | BBB- (pos.) |
| Standard & Poor's | A- (pos.) | BBB (stab.) | BBB+ (neg.) |
| Moody's | A2 (stab.) | Baa2 (stab.)* | Baa1 (stab.) |

*Rating outlook in brackets: pos. – positive, stab. – stable, neg. – negative*

** "Non-participating issuer", rating based solely on publicly available information.*

## 6. mBank shareholders and share price on the WSE

### 6.1. mBank shares as of June 30, 2015

As at 30 June 2015, the following characteristics of mBank shares can be highlighted:

- Nominal value per share: PLN 4.00
- Registered share capital: PLN 168,841 thousand, paid up in full.
- mBank shares have been listed on the Warsaw Stock Exchange (WSE) since 1992.

- mBank shares are part of the following WSE indices: WIG, WIG-Poland, WIG20, WIG30 and WIG-Banks; the shares also participate in the derivative indices based on WIG20.

In H1 2015, the total number of shares increased by 100 shares issued as part of an incentive programme for the employees of mBank.

Commerzbank AG is the majority shareholder of mBank. Moreover, at the end of June 2015, ING Otwarty Fundusz Emerytalny exceeded the 5% threshold of shares and votes at the General Meeting. According to the notification of 18 March 2015, ING OFE held 5.05% of the total amount of shares and votes at the General Meeting.

In accordance with the recommendation of the Polish Financial Supervision Authority, the 28th Annual General Meeting of mBank S.A. adopted a resolution on distribution of profit, under which the dividend for 2014 will not be paid. The net profit of PLN 1,174,096,218 generated in 2014 was distributed as follows: PLN 50,000,000 to the general risk fund of mBank, PLN 406,523,549 to the supplementary capital, and the remaining part of the profit in the amount of PLN 717,572,669 has not been distributed.

### 6.2. mBank stock performance

The closing price per mBank share during the last session in H1 2015 (30 June) stood at PLN 412.65, which represents a drop by 17.1% compared with the price reported on the last business day of 2014 (30 December). At the same time, WIG-Banks index decreased by 7.1%. For comparison, EURO STOXX Banks Index gained 11.5%.

WIG20 remained basically unchanged (-0.1%), while the broad market index WIG rose by 3.1%.

The performance of listed companies was adversely affected by the Greek crisis and investors' uncertainty about the results and consequences of the Polish parliamentary elections due in October. Banks took the biggest hit, in particular those with a higher share of loans denominated in CHF in their portfolios, including mBank.

The slide in banks' share prices was driven by investors' fears about the proposed conversion of the CHF mortgage loans into the zloty at an exchange rate below the market rate (or at the historical exchange rate prevailing on the date of releasing the loans). Moreover, investors worry about the banking tax which may be imposed after the parliamentary elections and rising charges on the banking sector connected with a new bill on the Bank Guarantee Fund (BFG), which provides for a significant increase in the levies paid by banks.

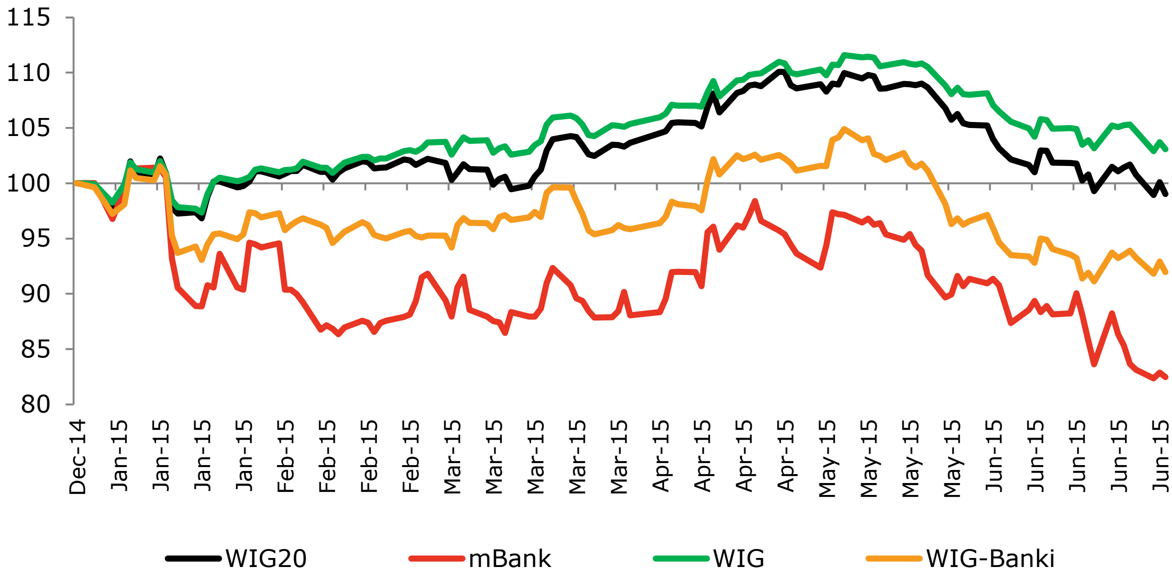
Although the financial results of mBank Group show potential for growth, the risk of introducing new solutions unfavourable to the banking sector affects the target price and analysts' recommendations for mBank shares. At the end of June "sell" (37%) and "hold" (37%) recommendations were prevailing, while "buy" recommendations accounted for 26% of all recommendations.

P/BV (price/book value) for mBank Group stood at 1.5 at the end of June 2015 compared with 2.1 a year before. P/E ratio (price/earnings per share) reached 12.9 after H1 2015, compared with 16.1 after H1 2014.

mBank's capitalisation amounted to PLN 17.4 billion (EUR 4.2 billion) as at 30 June 2015, compared with PLN 21.0 billion (EUR 4.9 billion) at the end of 2014.

The current consensus on the expected results of mBank Group is available at mBank's website http://www.mbank.pl/relacje-inwestorskie/akcje-mbank/konsensus.html.

**mBank share performance vs. main WSE indices**




## 7. Financial results of mBank Group in H1 2015

### 7.1. Profit and Loss Account

Profit before tax generated by mBank Group in H1 2015 stood at PLN 857.2 million, compared to PLN 849.1 million in H1 2014 (+PLN 8.1 million, i.e., 1.0%). Net profit attributable to Owners of mBank reached PLN 672.3 million, compared to PLN 662.6 million in H1 2014 (+PLN 9.7 million i.e., 1.5%).

Profit of mBank Group

| (PLN M) | H1 2014 | H1 2015 | Change in PLN M | Change in % |
|---|---|---|---|---|
| Profit before tax | 849.1 | 857.2 | 8.1 | 1.0% |
| Net profit attributable to Owners of mBank | 662.6 | 672.3 | 9.7 | 1.5% |

Main drivers of the financial results of mBank Group in H1 2015 included:

- **Increase of total income** by 1.1% year on year due to the booking of the gains on the sale of BRE Ubezpieczenia Towarzystwo Ubezpieczeń i Reasekuracji S.A. (BRE Ubezpieczenia TUiR) in Q1 2015, which offset a certain decrease in core income, i.e. net interest income and net fee and commission income;
- **Increase of operating expenses** (including depreciation and amortisation) by 5.9% year on year as a result of higher staff-related costs following an increase of employment, an increase of material costs (mainly IT and logistics costs), and higher contribution to the Bank Guarantee Fund;
- **Decrease in loan loss provisions** by 15.4% due to a stable quality of the loan portfolio, a prudent risk policies in the previous periods and improving economic conditions;
- **Continued organic growth and business expansion** as demonstrated by:
  - increase of the individual client base in Poland, the Czech Republic and Slovakia to 4,924 thousand (+236 thousand clients year to date);
  - increase of the number of corporate clients to 18,654 clients (+867 clients year to date).

Net loans and advances increased by 3.6% year to date in H1 2015 (by 8.0% net of reverse repos) while customer deposits increased by 0.9% (by 4.9% net of repos). Consequently, LtD ratio reached 105.7%, compared to 103.0% at the end of year 2014 and 110.8% as of June 30, 2014.

Changes in the Group's results translated into the following profitability ratios:

- Gross ROE of 15.7% (compared to 17.5% at the end of H1 2014).
- Net ROE of 12.3% (compared to 13.6% at the end of H1 2014).

An increase of own funds resulted in an improvement of capital ratios. The total capital ratio reached 16.38% as of 30 June 2015, compared to 14.66% at the end of 2014. The Common Equity Tier 1 capital ratio stood at 13.46%, compared to 12.24% at the end of 2014.

**Contribution of segments and business lines to the financial results**

The table below presents the contribution of the business areas to the Group's profit before tax:

| PLN M | H1 2014 | H1 2015 | Change in PLN M | Change in % |
|---|---|---|---|---|
| Retail Banking | 575.7 | 621.5 | 45.8 | 8.0% |
| Corporate and Investment Banking | 236.7 | 237.2 | 0.5 | 0.2% |
| Financial Markets | 57.0 | 1.8 | -55.2 | -96.8% |
| Other | -20.3 | -3.3 | 17.0 | -83.7% |
| **Profit before tax of mBank Group** | **849.1** | **857.2** | **8.1** | **1.0%** |

Retail Banking made the biggest contribution to the profit before tax of mBank Group at 72.5% in H1 2015. The profit before tax generated by Corporate and Investment Banking was 27.7% of the profit before tax of the Group, and the contribution of Financial Markets was 0.2%.

**Income of mBank Group**

Total income generated by mBank Group reached PLN 2,003.0 million in H1 2015, compared to PLN 1,980.4 million in H1 2014, representing an increase of nearly PLN 22.6 million, i.e., 1.1%. The increase in income was mainly driven by the recognition of the gains on the sale of the company BRE Ubezpieczenia TUiR to AXA Group and the execution of sales-related agreements. As a result of external conditions, including regulatory factors and low interest rate environment, core income decreased, including net interest income and net fee and commission income. Net trading income also declined in H1 2015 due to a negative result on interest rate instruments.

Income of mBank Group

| (PLN M) | H1 2014 | H1 2015 | Change in PLN M | Change in % |
|---|---|---|---|---|
| Interest income | 1,928.5 | 1,781.2 | -147.3 | -7.6% |
| Interest expense | -720.2 | -588.2 | 132.0 | -18.3% |
| **Net interest income** | **1,208.3** | **1,193.0** | **-15.3** | **-1.3%** |
| Fee and commission income | 722.9 | 680.0 | -42.9 | -5.9% |
| Fee and commission expense | -237.8 | -255.8 | -18.0 | 7.6% |
| **Net fee and commission income** | **485.1** | **424.2** | **-60.9** | **-12.6%** |
| Dividend income | 2.8 | 3.2 | 0.4 | 14.3% |
| Net trading income | 202.3 | 137.9 | -64.4 | -31.8% |
| Gains less losses from investment securities, investments in subsidiaries and associates | 13.9 | 196.4 | 182.5 | 1,312.9% |
| Other operating income | 199.1 | 134.3 | -64.8 | -32.5% |
| Other operating expenses | -131.1 | -86.0 | 45.1 | -34.4% |
| **Total income** | **1,980.4** | **2,003.0** | **22.6** | **1.1%** |

**Net interest income** was mBank Group's largest revenue source in H1 2015 (59.6% of total income). It stood at PLN 1,193.0 million, compared to PLN 1,208.2 million in H1 2014, representing a decrease of PLN 15.2 million. i.e., 1.3%. The cuts of interest rates by the Monetary Policy Council in October 2014 and in March 2015 resulted in a decrease of both interest income and interest expense.

**Interest income** decreased by PLN 147.3 million, i.e., 7.6% year on year in H1 2015 and stood at PLN 1,781.2 million. Income on loans and advances to customers remained the main source of interest income at 71.2% and stood at PLN 1,268.3 million, a decrease of PLN 123.4 million or 8.9% year on year. The decrease was driven by a reduction of PLN interest rates by 0.95 p.p. for WIBOR 1M and 0.96 p.p. for WIBOR 3M, the reduction of the Lombard rate which determines the maximum interest rate on loans, and the reduction of CHF and EUR LIBOR. An increase in the volumes of loans and changes in the structure of assets with a growing share of higher margin products only partly offset the adverse impact of the reduced interest rates. Interest income from investment securities decreased by PLN 27.0 million, i.e., 6.6% in H1 2015 while interest income on cash and short-term placements decreased by PLN 11.0 million, i.e., 29.3%. Interest income on derivatives concluded under the fair value and the cash flow hedge increased by PLN 23.7 million in aggregate, i.e., more than six-fold, due to the increase in the volumes of such transactions.

Interest income

| (PLN M) | H1 2014 | H1 2015 | Change in PLN M | Change in % |
|---|---|---|---|---|
| Loans and advances including the unwind of the impairment provision discount | 1,391.7 | 1,268.3 | -123.4 | -8.9% |
| Investment securities | 409.8 | 382.8 | -27.0 | -6.6% |
| Cash and short-term placements | 37.5 | 26.5 | -11.0 | -29.3% |
| Trading debt securities | 23.7 | 20.8 | -2.9 | -12.2% |
| Interest income on derivatives classified into banking book | 57.7 | 52.8 | -4.9 | -8.5% |
| Interest income on derivatives concluded under the fair value hedge | 3.9 | 21.4 | 17.5 | 448.7% |
| Interest income on derivatives concluded under the cash flow hedge | 0.0 | 6.2 | 6.2 | - |
| Other | 4.2 | 2.4 | -1.8 | -42.9% |
| **Total interest income** | **1,928.5** | **1,781.2** | **-147.3** | **-7.6%** |

**Interest expenses** decreased by PLN 132.0 million, i.e., 18.3% year on year in H1 2015. Expenses paid to customers decreased by PLN 87.7 million, i.e., 20.3% as a result of lower average interest rates on deposits following the reduction of the market interest rates and the alignment of the pricing of deposit products. Interest expenses paid to banks decreased by PLN 45.4 million, i.e., 45.0%, mainly due to the decrease of the average balances due to banks following the repayment of some of the borrowings from Commerzbank Group in H2 2014, as well as lower market interest rates, especially CHF LIBOR. Interest expenses on issued debt securities increased by PLN 33.2 million, i.e., 31.8% due to further diversification of the funding structure with the issuance of bonds under the EMTN programme (two tranches of EUR 500 million each, issued in March and November 2014), as well as covered bonds. Interest expenses on subordinated liabilities increased by PLN 4.7 million, i.e., 11.8% following the issuance of PLN 750 million subordinated bonds in December 2014.

Interest expenses

| (PLN M) | H1 2014 | H1 2015 | Change in PLN M | Change in % |
|---|---|---|---|---|
| Paid to banks | -101.0 | -55.6 | 45.4 | -45.0% |
| Paid to customers | -432.8 | -345.1 | 87.7 | -20.3% |
| Issued debt securities | -104.4 | -137.6 | -33.2 | 31.8% |
| Subordinated liabilities | -39.8 | -44.5 | -4.7 | 11.8% |
| Other | -42.2 | -5.4 | 36.8 | -87.2% |
| **Total interest expenses** | **-720.2** | **-588.2** | **132.0** | **-18.3%** |

Net interest margin stood at 2.08% in H1 2015, compared to 2.30% in H1 2014. The margin improved modestly quarter on quarter in Q2 2015 (it stood at 2.06% in Q1).

**Net fee and commission income** reached PLN 424.2 million in H1 2015, representing a decrease of PLN 60.9 million, i.e., 12.6% year on year. The decrease of the net fee and commission income was mainly driven by lower payment cards related fees.

Fee and commission income of mBank Group

| (PLN M) | H1 2014 | H1 2015 | Change in PLN M | Change in % |
|---|---|---|---|---|
| Payment cards related fees | 228.7 | 160.1 | -68.6 | -30.0% |
| Credit-related fees and commissions | 126.8 | 131.7 | 4.9 | 3.9% |
| Commissions for agency service regarding sale of insurance products of external financial entities | 60.1 | 66.2 | 6.1 | 10.1% |
| Fees from brokerage activity and debt origination | 54.1 | 63.8 | 9.7 | 17.9% |
| Commissions from bank accounts | 83.5 | 82.2 | -1.3 | -1.6% |
| Commissions from money transfers | 45.4 | 51.0 | 5.6 | 12.3% |
| Commissions due to guarantees granted and trade finance commissions | 22.4 | 23.7 | 1.3 | 5.8% |
| Commissions for agency service regarding sale of other products of external financial entities | 44.1 | 54.0 | 9.9 | 22.4% |
| Commissions on trust and fiduciary activities | 10.1 | 11.5 | 1.4 | 13.9% |
| Fees from portfolio management services and other management-related fees | 7.1 | 7.6 | 0.5 | 7.0% |
| Commissions on cash services | 16.8 | 18.7 | 1.9 | 11.3% |
| Other | 23.8 | 9.5 | -14.3 | -60.1% |
| **Total fee and commission income** | **722.9** | **680.0** | **-42.9** | **-5.9%** |

Commission income decreased by PLN 42.9 million, i.e., 5.9% year on year. Payment cards related fees, which make the biggest contribution to fee and commission income, decreased by PLN 68.6 million, i.e., 30.0% year on year in the period under review, despite an increase in the volume and value of non-cash transactions. This was mainly due to the mandatory reductions of the interchange fees introduced on July 1, 2014 and January 29, 2015.

Fees and commissions on loans increased by 3.9% year on year mainly due to bigger sales of retail non-mortgage loans and mortgage loans.

Commissions for agency service regarding sale of insurance products of external financial entities increased by 10.1% year on year in H1 2015.

Commissions for agency sales of other products of external entities increased by 22.4% year on year in H1 2015 following an increase in the number and value of sold financial products.

The increase in the customer base, the expansion of transactional banking and the increased transactional activity of customers improved commissions on money transfers, which increased by 12.3%.

One of the fastest growing item of fee and commission income were fees from brokerage activity and debt origination, which increased by PLN 9.7 million, i.e., by 17.9%. The increase was driven by higher commission income generated by Dom Maklerski mBanku, as well as mBank's strong activity in the origination of non-Treasury debt for corporate clients.

Fee and commission expenses increased by PLN 18.0 million, i.e., 7.6% year on year in H1 2015. The increase was mainly driven by expenses paid to external entities for sales of mBank's products (+PLN 9.6 million), as well as commissions for agency service regarding sale of other products of external financial entities (+PLN 3.8 million).

**Dividend income** amounted to PLN 3.2 million in H1 2015, compared to PLN 2.8 million in H1 2014. Similar to H1 2014, the income booked in H1 2015 included dividends received from Biuro Informacji Kredytowej (BIK) and Krajowa Izba Rozliczeniowa (KIR), in which the Bank holds minority interests.

**Net trading income** was PLN 137.9 million in H1 2015 and was lower by PLN 64.4 million, i.e., 31.8% compared to H1 2014. The decrease in net trading income was driven by negative other net trading income and result on hedge accounting (-PLN 6.8 million, compared to PLN 67.4 million in H1 2014) owing mainly to the valuation of interest rate derivatives. The FX result stood at PLN 144.7 million and increased by PLN 9.8 million, i.e., 7.3% year on year.

**Gains less losses on investment securities and investments in subsidiaries and associates** stood at PLN 196.4 million in H1 2015, compared to PLN 13.9 million in H1 2014. mBank Group recognised gains on the sale of the company BRE Ubezpieczenia TUiR and the execution of sales-related agreements with AXA Group companies at PLN 194.3 million in H1 2015. The gains in H1 2014 included the result on the sale of minority interests in two companies listed on the Warsaw Stock Exchange in the process of managing the Bank's non-core assets.

**Net other operating income** (other operating income net of other operating expenses and share of profit of associates) reached PLN 48.3 million, compared to PLN 68.0 million in H1 2014 (-29.9% year on year). Income from insurance activities, which was generated until the sale of the company BRE Ubezpieczenia TUiR (i.e., only in Q1 2015), decreased in H1 2015. In addition, income on the sale of apartments by mLocum decreased.

### Net impairment losses on loans and advances

Net impairment losses on loans and advances in mBank Group amounted to PLN 207.6 million in H1 2015, compared to PLN 245.3 million in H1 2014, representing a decrease of PLN 37.7 million, i.e., 15.4%.

Net impairment losses on loans and advances

| (PLN M) | H1 2014 | H1 2015 | Change in PLN M | Change in % |
|---|---|---|---|---|
| Retail Banking | 125.0 | 116.4 | -8.6 | -6.9% |
| Corporates and Financial Markets | 120.3 | 85.2 | -35.1 | -29.2% |
| Other | 0.0 | 6.0 | 6.0 | - |
| **Total net impairment losses on loans and advances** | **245.3** | **207.6** | **-37.7** | **-15.4%** |

In H1 2015, net impairment losses on loans and advances in Retail Banking decreased by PLN 8.6 million year on year. At the same time the coverage ratio increased.

Net impairment losses on loans and advances in Corporates and Financial Markets decreased by PLN 35.1 million in H1 2015. The decrease in H1 2015 was driven by released credit risk provisions in segments K1 and K2. On the other hand, provisions in segment K3, mBank Hipoteczny, mFaktoring and mLeasing increased.

### Costs of mBank Group

In the period under review, despite a much higher contribution to the Bank Guarantee Fund, mBank Group maintained a high cost efficiency while pursuing further investments in growth of the strategic areas which will help to improve income in the coming years.

Total overhead costs of mBank Group (including depreciation and amortisation) stood at PLN 938.1 million in H1 2015, representing an increase of PLN 52.2 million, i.e., 5.9% year on year.

Costs of mBank Group

| (PLN M) | H1 2014 | H1 2015 | Change in PLN M | Change in % |
|---|---|---|---|---|
| Staff-related expenses | 414.3 | 427.2 | 12.9 | 3.1% |
| Material costs, including: | 317.7 | 322.3 | 4.6 | 1.4% |
| - Logistics | 166.5 | 168.3 | 1.8 | 1.1% |
| - IT | 56.1 | 60.5 | 4.4 | 7.8% |
| - Marketing | 59.6 | 60.1 | 0.5 | 0.8% |
| - Consulting | 32.9 | 27.7 | -5.2 | -15.8% |
| - Other material costs | 2.6 | 5.6 | 3.0 | 115.4% |
| Amortisation | 94.4 | 96.3 | 1.9 | 2.0% |
| Other | 59.5 | 92.3 | 32.8 | 55.1% |
| **Total costs of mBank Group** | **885.9** | **938.1** | **52.2** | **5.9%** |
| Cost / Income ratio | 44.7% | 46.8% | - | - |
| Employment (FTEs) | 6,136 | 6,446 | 310 | 5.1% |

Staff-related costs increased by PLN 12.9 million, i.e., 3.1% year on year. The increase of the cost of salaries was driven by an increase in the employment of mBank Group. The number of FTEs increased from 6,136 at the end of June 2014 to 6,446 FTEs at the end of June 2015.

Material costs increased by PLN 4.6 million, i.e. 1.4% in the period under review. mBank Group reported higher IT and logistics costs in H1 2015 as a result of further investments in the strategic business areas.

Depreciation and amortisation charges increased by PLN 1.9 million, i.e., 2.0% year on year in H1 2015 due to higher depreciation of fixed assets while amortisation of intangible assets remained stable.

Other costs increased as the contributions to the Bank Guarantee Fund nearly doubled from PLN 35.4 million in H1 2014 to PLN 68.2 million in H1 2015. The increase of the BGF contribution resulted from an increase of the annual fee and the prudential fee, as well as an increase of risk-weighted assets of mBank Group, which are the basis for the calculation of the fees.

Changes to the income and costs of mBank Group resulted in a cost/income ratio of mBank Group at 46.8%, compared to PLN 44.7% in H1 2015. The ratio adjusted for the one-off gains on the sale of the company BRE Ubezpieczenia TUiR to AXA Group stood at 51.9%.

## 7.2. Changes in the consolidated statement of financial position

### Changes in the assets of mBank Group

In H1 2015, the assets of mBank Group rose by PLN 2,618.3 million, i.e. by 2.2%. As at 30 June 2015, the assets amounted to PLN 120,604.1 million.

The table below presents changes in the assets of mBank Group.

| PLN M | 30 June 2014 | 31 December 2014 | 30 June 2015 | YtD change | YoY change |
|---|---|---|---|---|---|
| Cash and balances with Central Bank | 1 418,0 | 3 054,5 | 3 187,5 | 4,4% | 124,8% |
| Loans and advances to banks | 4 933,2 | 3 751,4 | 2 072,0 | -44,8% | -58,0% |
| Trading securities | 2 812,5 | 1 163,9 | 2 597,3 | 123,2% | -7,7% |
| Derivative financial instruments | 3 017,9 | 4 865,5 | 3 345,9 | -31,2% | 10,9% |
| Net loans and advances to customers | 70 137,2 | 74 582,4 | 77 241,6 | 3,6% | 10,1% |
| Investment securities | 27 128,1 | 27 678,6 | 29 515,8 | 6,6% | 8,8% |
| Intangible assets | 460,1 | 465,6 | 469,9 | 0,9% | 2,1% |
| Tangible assets | 710,5 | 717,4 | 691,8 | -3,6% | -2,6% |
| Other assets | 1 329,9 | 1 706,5 | 1 482,3 | -13,1% | 11,5% |
| **Total assets** | **111 947,4** | **117 985,8** | **120 604,1** | **2,2%** | **7,7%** |

Loans and advances to customers retained the largest share in the balance sheet of mBank Group at the end of H1 2015. As at 30 June 2015 they accounted for 64.0% of total assets compared with 63.2% at the end of 2014. The net volume of loans and advances to customers increased by PLN 2,659.2 million or 3.6% against the end of 2014.

| PLN M | 30 June 2014 | 31 December 2014 | 30 June 2015 | change in PLN m | change in % |
|---|---|---|---|---|---|
| Loans and advances to individuals | 39 664,2 | 41 560,5 | 45 328,7 | 3 768,2 | 9,1% |
| Loans and advances to corporate entities | 30 564,5 | 32 841,0 | 32 226,5 | -614,5 | -1,9% |
| Loans and advances to public sector | 1 881,6 | 1 924,4 | 1 661,5 | -262,9 | -13,7% |
| Other receivables | 621,4 | 1 047,3 | 1 043,9 | -3,4 | -0,3% |
| **Total (gross) loans and advances to customers** | **72 731,7** | **77 373,2** | **80 260,6** | **2 887,4** | **3,7%** |
| Provisions for loans and advances to customers (negative amount) | -2 594,5 | -2 790,8 | -3 019,0 | -228,2 | 8,2% |
| **Total (net) loans and advances to customers** | **70 137,2** | **74 582,4** | **77 241,6** | **2 659,2** | **3,6%** |

In H1 2015 gross loans and advances to individuals rose by PLN 3,768.2 million or 9.1%. The amount of mortgage and housing loans increased by PLN 3,010.9 million or 9.9%, mainly due to growing sales which reached PLN 1,864.6 million in H1 2015 compared with PLN 1,434.1 million in H1 last year. The Group sold PLN 2,452.9 million worth of non-mortgage loans, which represents a 9.4% hike as compared with H1 2014. Net of the FX effect, loans and advances to individuals grew by ca. 3.0%.

At the same time, the volume of gross loans and advances to corporate entities went down by PLN 614.5 million or 1.9%. Excluding reverse repo/buy sell back transactions and FX effects, the value of loans to corporate entities increased by ca. 8.3% against the end of last year. The volume of gross loans and advances to public sector decreased by PLN 262.9 million or 13.7%.

Investment securities constituted mBank Group's second largest asset category (24.5% of total assets). In H1 2015, their value increased by PLN 1,837.2 million or 6.6%. The Treasury bonds portfolio increased by 8.1% year to date while the portfolio of debt instruments issued by the central bank decreased by 2.9%.

The balance of trading securities went up by PLN 1,433.3 million in H1 2015 as a result of extending the Treasury bonds portfolio.

**Changes in the liabilities and equity of mBank Group**

The table below presents changes in the liabilities and equity of mBank Group in H1 2015:

| PLN M | 30 June 2014 | 31 December 2014 | 30 June 2015 | QoQ change | YoY change |
|---|---|---|---|---|---|
| Amounts due to other banks | 22 297,0 | 13 383,8 | 15 675,9 | 17,1% | -29,7% |
| Derivative financial instruments | 2 915,0 | 4 719,1 | 3 302,2 | -30,0% | 13,3% |
| Amounts due to customers | 63 293,7 | 72 422,5 | 73 058,3 | 0,9% | 15,4% |
| Debt securities in issue | 7 696,2 | 10 341,7 | 11 013,9 | 6,5% | 43,1% |
| Subordinated liabilities | 3 278,9 | 4 127,7 | 3 896,6 | -5,6% | 18,8% |
| Other liabilities | 2 147,2 | 1 918,0 | 2 109,7 | 10,0% | -1,7% |
| **Total Liabilities** | **101 628,0** | **106 912,8** | **109 056,6** | **2,0%** | **7,3%** |
| **Total Equity** | **10 319,4** | **11 073,0** | **11 547,5** | **4,3%** | **11,9%** |
| **Total Liabilities and Equity** | **111 947,4** | **117 985,8** | **120 604,1** | **2,2%** | **7,7%** |

Amounts due to customers remained the dominant funding source of mBank Group. As at the end of June 2015 they accounted for 60.6% of total liabilities and equity as compared with 61.4% at the end of 2014.

| PLN M | 30 June 2014 | 31 December 2014 | 30 June 2015 | Change in PLN m | Change in % |
|---|---|---|---|---|---|
| Individual customers | 35 726,0 | 39 284,8 | 41 411,3 | 2 126,5 | 5,4% |
| Corporate customers | 26 595,1 | 32 237,1 | 29 661,2 | -2 575,9 | -8,0% |
| Public sector customers | 972,6 | 900,6 | 1 985,8 | 1 085,2 | 120,5% |
| **Total amounts due to customers** | **63 293,7** | **72 422,5** | **73 058,3** | **635,8** | **0,9%** |

Amounts due to customers increased by PLN 635.8 million or 0.9% and reached PLN 73,058.3 million in H1 2015.

The increase was observed mainly in amounts due to individuals which rose by PLN 2,126.5 million or 5.4%. The volume of customers' deposits in current accounts increased by 9.2% while term deposits went down by 5.1% against the end of 2014.

Amounts due to corporate clients decreased by PLN 2,575.9 million or 8.0%. The change resulted mainly from the shrinking volume of repo transactions. Excluding repo transactions, amounts due to corporate clients remained at a level similar to that reported at the end of 2014 (a 0.6% increase).

Amounts due to other banks grew by PLN 2,292.1 million or 13.0% against the end of last year and totalled PLN 15,675.9 million. This change is mainly a result of an increase in the value of loans extended by Commerzbank driven by the appreciation of the CHF in H1 2015.

The share of debt securities in mBank Group's funding structure went up from 8.8% at the end of 2014 to 9.1% at the end of June 2015. The amount of liabilities on account of debt securities in issue grew by PLN 672.2 million or 6.5% compared to H1 2014. This change is attributable mainly to the issue of covered bonds by mBank Hipoteczny worth PLN 450 million and EUR 81 million.

Subordinated liabilities decreased by PLN 231.1 million or 3.2% in H1 2015 mainly following the early repayment of certain subordinated liabilities to Commerzbank.

At the end of H1 2015, the share of equity in equity and liabilities of mBank Group reached 9.6% as compared with 9.4% at the end of December 2014.

## 7.3. Performance indicators

The table below presents mBank Group's key performance indicators:

| PLN M | H1 2014 | H1 2015 |
|---|---|---|
| ROA net | 1.2% | 1.1% |
| ROE gross | 17.5% | 15.7% |
| ROE net | 13.6% | 12.3% |
| C/I | 44.7% | 46.8% |
| Net Interest Margin | 2.3% | 2.1% |
| Tier 1 Capital Ratio | 13.2% | 13.5% |
| Total Capital Ratio | 15.8% | 16.4% |

*ROA net: Net profit attributable to owners of the Bank / Average total assets*

*ROE gross: Profit before income tax / Average total equity net of the year's result*

*ROE net: Net profit attributable to owners of the Bank / Average total equity net of the year's result*

*C/I ratio – Cost to Income; calculated as: (overhead costs + depreciation and amortisation) / net income (including net other operating income/costs)*

*Net interest margin: Net interest income / Average interest earning assets*

*Total Capital Ratio (TCR): Own funds expressed as a percentage of the Total Risk Exposure Amount (TREA)*

*Tier 1 Capital Ratio (T1 ratio): Tier 1 Capital expressed as a percentage of the Total Risk Exposure Amount (TREA)*

The decrease of gross and net return on equity in H1 2015 compared to H1 2014 despite an increase of the profit before tax and the net profit of the Group was due to an increase of the Group's average equity, which increased by 12.8% year on year. Likewise, return on assets decreased as a result of an increase in the average assets (+10.7% year on year). The capital ratios increased mainly as a result of the addition of the Group's 2014 net profit to Tier 1 capital and, for the total capital ratio, also due to the addition of PLN 750 million of subordinated debt issued in December 2014 to own funds.

## 7.4. Financial results of mBank Group in Q2 2014

In Q2 2015, mBank Group generated a profit before income tax of PLN 291.9 million, compared with PLN 565.3 million in Q1 2015. The net profit attributable to owners of mBank reached PLN 221.3 million, compared with PLN 450.9 million in Q1 2015 when the profit from the sale of BRE Ubezpieczenia Towarzystwo Ubezpieczeń i Reasekuracji S.A. was recognised.

| PLN M | Q2 2014 | Q1 2015 | Q2 2015 | QoQ | YoY |
|---|---|---|---|---|---|
| Interest income | 970.7 | 912.3 | 868.9 | -4.8% | -10.5% |
| Interest expense | -353.5 | -324.8 | -263.3 | -18.9% | -25.5% |
| **Net interest income** | **617.2** | **587.4** | **605.5** | **3.1%** | **-1.9%** |
| Fee and commission income | 369.2 | 314.5 | 365.5 | 16.2% | -1.0% |
| Fee and commission expense | -125.5 | -120.7 | -135.2 | 12.0% | 7.7% |
| **Net fee and commission income** | **243.7** | **193.9** | **230.3** | **18.8%** | **-5.5%** |
| Dividend income | 2.8 | 0.0 | 3.2 | - | 14.3% |
| Net trading income | 110.2 | 102.6 | 35.3 | -65.6% | -68.0% |
| Gains less losses from investment securities, investments in subsidiaries and associates | 4.0 | 195.0 | 1.3 | -99.3% | -67.5% |
| Other operating income | 125.8 | 88.7 | 45.6 | -48.6% | -63.8% |
| Other operating expenses | -80.0 | -49.5 | -36.5 | -26.3% | -54.4% |
| **Total income** | **1,023.8** | **1,118.1** | **884.9** | **-20.9%** | **-13.6%** |
| Net impairment losses on loans and advances | -155.9 | -100.0 | -107.7 | 7.7% | -30.9% |
| Overhead costs and amortization & depreciation | -455.3 | -452.8 | -485.3 | 7.2% | 6.6% |
| **Profit before income tax** | **412.6** | **565.3** | **291.9** | **-48.4%** | **-29.3%** |
| Income tax expense | -86.0 | -113.0 | -70.2 | -37.9% | -18.4% |
| **Net profit attributable to:** | **326.0** | **452.3** | **221.7** | **-51.0%** | **-32.0%** |
| **- Owners of mBank S.A.** | **325.0** | **450.9** | **221.3** | **-50.9%** | **-31.9%** |
| - Non-controlling interests | 1.0 | 1.4 | 0.4 | -71.4% | -60.0% |
| | | | | | |
| ROA net | 1.2% | 1.5% | 0.7% | | |
| ROE gross | 17.2% | 20.6% | 10.7% | | |
| ROE net | 13.6% | 16.4% | 8.1% | | |
| Cost / Income ratio | 44.5% | 40.5% | 54.8% | | |
| Net interest margin | 2.3% | 2.1% | 2.1% | | |
| Common Equity Tier 1 ratio | 13.2% | 16.3% | 13.5% | | |
| Total capital ratio | 15.8% | 12.9% | 16.4% | | |

The main drivers of mBank Group's financial results in Q2 2015 included:

- **increase in net interest income** by PLN 18.1 million or 3.1% driven mainly by an 18.9% decrease in interest expense;
- **increase in net fee and commission income** by PLN 36.4 million or 18.8% driven mainly by an increase in income from credit activity and fees for intermediation in the sale of insurance products;

- **decrease in net trading income** compared to the previous quarter by PLN 67.3 million or 65.6%, driven mainly by a weakening other net trading income. Q2 2015 was marked by a loss on the valuation of interest rate instruments.
- **increase in overhead costs (including amortization)** by PLN 32.5 million or 7.2% quarter on quarter driven by an increase in staff-related expenses, marketing and IT costs;
- **increase in net impairment losses on loans and advances** (by PLN 7.7 million) driven by an increase in provisions in Corporate Banking and Financial Markets, which stood at PLN 54.4 million against PLN 30.8 million in the previous quarter. In the analysed period, net impairment losses on loans and advances in the Retail Banking segment went down by PLN 10.0 million.

The balance sheet total of mBank Group stood at PLN 120,604.1 million as at 30 June 2015 compared with PLN 123,293.9 million at the end of March 2015.

Net loans and advances to customers dropped by PLN 1,735.5 million in Q2 2015 mainly due to an 8.8% decrease in gross loans and advances to corporate entities (net of the impact of FX changes and reverse repo / buy sell back transactions, loans and advances to corporate entities rose by ca. 4.8% in the analysed period). Gross loans and advances to individuals rose by 3.5% quarter on quarter, including an increase in mortgage loans by 3.4% (net of the impact of FX changes loans and advances to individuals rose by ca. 1.6% in the analysed period). In Q2 2015 mBank Group granted PLN 1,030.8 million of mortgage loans and PLN 1,248.8 million of non-mortgage loans.

At the same time, amounts due to customers went up by PLN 1,197.3 million or 1.7%, including a decrease in amounts due to corporate entities by 3.7%, however, net of repo transactions, amounts due to corporate entities rose by 11.3%. Amounts due to individuals continued to grow and went up by 4.3% quarter on quarter.

## 8. Retail Banking

### 8.1. Retail Banking in Poland

**Retail Banking segment financial results**

The Retail Banking segment generated a profit before tax of PLN 621.5 million in H1 2015, which represents an increase of PLN 45.8 million, i.e., 8.0% year on year.

| PLN M | H1 2014 | H1 2015 | Change in PLN M | Change in % |
|---|---|---|---|---|
| Net interest income | 801.5 | 765.2 | -36.3 | -4.5% |
| Net fee and commission income | 291.3 | 232.9 | -58.4 | -20.0% |
| Dividend income | 0.0 | 0.0 | 0.0 | - |
| Net trading income | 56.9 | 47.7 | -9.2 | -16.2% |
| Gains less losses from investment securities, investments in subsidiaries and associates | 0.0 | 194.3 | 194.3 | - |
| Net other operating income | 34.8 | 15.4 | -19.4 | -55.7% |
| Total income | 1 184.5 | 1 255.5 | 71.0 | 6.0% |
| Net impairment losses on loans and advances | -125.0 | -116.4 | 8.6 | -6.9% |
| Overhead costs and amortisation | -483.8 | -517.7 | -33.9 | 7.0% |
| **Profit before tax of Retail Banking** | **575.7** | **621.5** | **45.8** | **8.0%** |

The profit before tax of the Retail Banking segment in H1 2015 was driven by the following factors:

- **increase of total income** by PLN 71.0 million, i.e., 6.0% year on year to PLN 1,255.5 million. Recurrent income decreased, including net interest income by PLN 36.3 million (as a result of the reduction of market interest rates) and net fee and commission income by PLN 58.4 million (as a result of the reduction of the interchange fee). The decrease of recurrent income was more than offset by the gains on the sale of the company BRE Ubezpieczenia TUiR and the execution of sales-related agreements with AXA Group companies.
- **increase of operating expenses (including amortisation)** by PLN 33.9 million, i.e., 7.0% year on year including staff-related and material costs as well as an increase of the BFG fee.
- **decrease of net impairment losses on loans and advances** by PLN 8.6 million, i.e., 6.9% year on year following an improvement of the retail portfolio risk parameters.

**Activity of Retail Banking (mBank only) segment**

| thou. | 30.06.2014 | 31.12.2014 | 30.06.2015 | YtD change | YoY change |
|---|---|---|---|---|---|
| **Number of retail clients, including:** | **4,490.3** | **4,688.6** | **4,924.2** | **5.0%** | **9.7%** |
| Poland | 3,786.1 | 3,926.5 | 4,149.4 | 5.7% | 9.6% |
| Foreign branches | 704.2 | 762.1 | 774.8 | 1.7% | 10.0% |
| The Czech Republic | 503.4 | 534.2 | 541.9 | 1.4% | 7.6% |
| Slovakia | 200.9 | 227.9 | 232.9 | 2.2% | 16.0% |
| **PLN M** | | | | | |
| **Loans to retail clients, including:** | **39,382.5** | **40,615.0** | **43,571.2** | **7.3%** | **10.6%** |
| **Poland** | **36,952.8** | **37,666.1** | **40,274.6** | **6.9%** | **9.0%** |
| mortgage loans | 29,381.4 | 29,680.2 | 31,712.0 | 6.8% | 7.9% |
| non-mortgage loans | 7,571.5 | 7,985.9 | 8,562.6 | 7.2% | 13.1% |
| **Foreign branches** | **2,429.7** | **2,948.9** | **3,296.6** | **11.8%** | **35.7%** |
| The Czech Republic | 1,917.4 | 2,281.4 | 2,549.9 | 11.8% | 33.0% |
| Slovakia | 512.3 | 667.5 | 746.8 | 11.9% | 45.8% |
| **Deposits of retail clients, including:** | **35,338.5** | **38,999.4** | **40,901.6** | **4.9%** | **15.7%** |
| **Poland** | **30,082.9** | **33,381.0** | **34,933.7** | **4.7%** | **16.1%** |
| **Foreign branches** | **5,255.6** | **5,618.5** | **5,967.9** | **6.2%** | **13.6%** |
| The Czech Republic | 3,401.6 | 3,788.6 | 4,140.8 | 9.3% | 21.7% |
| Slovakia | 1,854.0 | 1,829.8 | 1,827.1 | -0.2% | -1.5% |
| **Investment funds (Poland)** | **4,874.4** | **5,252.1** | **6,098.0** | **16.1%** | **25.1%** |
| **thou.** | | | | | |
| **Credit cards, including** | **320.6** | **327.5** | **331.7** | **1.3%** | **3.5%** |
| Poland | 293.2 | 296.9 | 303.1 | 2.1% | 3.4% |
| Foreign branches | 27.4 | 30.6 | 28.6 | -6.6% | 4.4% |
| **Debit cards, including:** | **2,909.8** | **3,032.1** | **3,166.6** | **4.4%** | **8.8%** |
| Poland | 2,371.0 | 2,445.3 | 2,617.0 | 7.0% | 10.4% |
| Foreign branches | 538.8 | 586.8 | 549.6 | -6.3% | 2.0% |

| | 30.06.2014 | 31.12.2014 | 30.06.2015 |
|---|---|---|---|
| **Distribution network** | | | |
| Light branches within "One Network" Project | - | 2 | 4 |
| Advisory Centres | 1 | 1 | 2 |
| mBank (former Multibank) | 131 | 130 | 128 |
| mKiosks (incl. Partner Kiosks) | 67 | 67 | 76 |
| Aspiro Financial Centres | 24 | 23 | 23 |
| Czech Republic & Slovakia | 35 | 35 | 35 |

In H1 2015 the number or retail banking clients in Poland grew by 222.9 thousand, mainly due to increased marketing efforts, development of the product mix and effective cross-selling.

During the first six months of 2015 a range of new solutions improving the quality of retail banking offer were offered to clients, in particular:

- Introduction of a new account - **eKonto Mobilne Plus** - dedicated to active clients. The sales of this account have been rising since its launch in February 2015. After first half of 2015 one in ten new mBank clients holds eKonto mobilne plus.
- Implementation of **mobile payment** system BLIK in Q1 2015. The solution enables clients to make cash payments, cashless payments and on-line payments using mBank's mobile application.
- Launch in cooperation with Orange of **NFC sim centric mobile payments** in mBank's application in Q1 2015; a solution allows clients to download and activate mobile debit cards and use them to make transactions directly from mBank's application.
- Launch of two new cards in Q1 2015 - a proximity debit sticker and a USD card.

The sales of loans grew by 13.1% quarter on quarter amid stable deposit base.

In the six months to June 2015 in the Retail Banking area the Bank continued its cooperation with Orange and worked on developing its product offer as part of the Orange Finanse project. Consequently, by the end of June 2015 nearly 150 thousand accounts were opened in Orange Finanse, including almost 110 thousand in H1 2015 alone.

Furthermore, in March 2015 mBank finalized the sale of BRE Ubezpieczenia TUiR to AXA Group and signed 10-year accompanying agreements on distribution of insurance products. Also in March mBank signed an agreement on strategic cooperation with Allegro, a leading auction service, making the auction platform yet another channel for selling mBank accounts to individuals and companies.

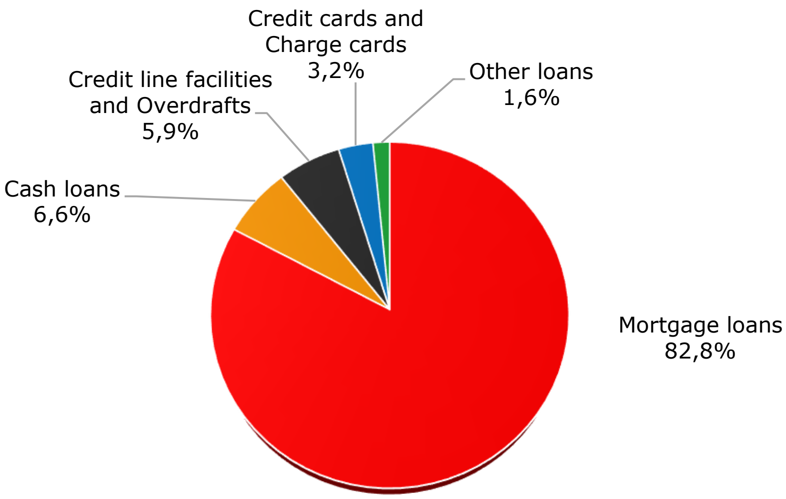
**Development of the retail banking offer in Poland**

**Loans**

The value of mortgage loans sold in H1 2015 stood at PLN 1,387.1 million, which represents a 29.4% increase compared to the same period last year. Sales of non-mortgage loans in H1 2015 increased by 10.9% compared with H1 2014, and totalled PLN 2,289.8 million at the end of June 2015. As a result, the carrying amount of Polish retail loans stood at PLN 40,274.6 million at the end of June 2015 as compared with PLN 39,515.9 million at the end of March 2015, which represents an increase by PLN 759.7 million or 1.9% or PLN 36,952.8 million at the end of June 2014 with an increase of 9.0% year on year.

The chart below presents the structure of the Retail Banking loan portfolio in Poland at the end of H1 2015:

**Retail loan portfolio in Poland (Household loans, mBank in Poland only)**




Sales of non-mortgage loans increased by 3.5% quarter on quarter and amounted to PLN 1,167.7 million in Q2 2015.

Q2 2015 was yet another quarter of dynamic growth in the portfolio of non-mortgage loans for households with an increase of PLN 291.3 million or 4.8% as compared with the end of March 2015. The main drivers of this growth were cash loans and credit cards. In addition, the Bank implemented and participated in customer acquisition projects aimed at attracting clients from outside the Bank's client base, such as the sale of Miles & More co-branded credit cards and special offer on loans for purchases on the Allegro auction platform.

An important event affecting the implementation of mBank's revenues in Retail Banking was the reduction of the maximum interest rate for customers to 10% (after the Polish Monetary Policy Council's decision to cut the Lombard rate to 2.5%). In order to prevent a decrease in income, starting from Q3 2014, the Bank has been introducing changes to its pricing policy for credit products.

Sales of mortgage loans amounted to PLN 786.9 million in Q2 2015, which represents an increase by 31.1% against Q1 2015.

The main parameters of the portfolio of mortgage loans for individuals were as follows:

| Mortgage loans for individuals (excl. Private Banking) | 30 June 2014 | 30 June 2015 |
|---|---|---|
| Carrying amount (PLN bn) | 26.7 | **30.3** |
| Average maturity (years) | 20.6 | **20.1** |
| Average value (PLN thousand) | 271.8 | **294.7** |
| Average LTV (%) | 80.1% | **85.0%** |
| NPL (%) | 4.6% | **4.3%** |

### Deposits and investment funds

At the end of June 2015, retail deposits amounted to PLN 34,933.7 million compared with PLN 33,780.6 million at the end of Q1 2014, which represents an increase by PLN 1,153.1 million or 3.4%. The deposits rose by PLN 4,850.8 million or 16.1% year on year.

The growth in the retail deposit base was accompanied by an increase in investment fund assets. These stood at PLN 5,903.4 million at the end of June 2015, an increase by PLN 1,029.0 million or 25.0% year on year.

mBank clients may purchase shares in domestic and foreign investment funds using the Bank's Investment Funds Supermarket.

### Cards

The value of card transactions executed by mBank retail banking clients was close to PLN 10 billion in H1 2015, marking a 24.4% rise year on year. The number of transactions made by mBank clients rose by approximately 14.1% year on year. mBank's credit cards are also characterised by a very high average number of transactions per client which is over two times higher than the market average.

## 8.2. Retail Banking in the Czech Republic and Slovakia

The activity of mBank in the Czech Republic and Slovakia in H1 2015 was focused on building the position of a mobile bank and intensifying its lending efforts, especially in the area of non-secured loans. At the turn of 2014 and 2015 mBank launched its new mobile application (Android, iOS) on the Czech and Slovak market, which was supported by a marketing campaign "Mobility icon". Moreover, the foreign branches extended their credit offer by adding cash loan refinancing. In Q2 2015 mBank launched campaigns advertising cash loans to support its position of a bank having the best credit offer.

Another major implementation from the viewpoint of building customer relations was the implementation of CRM tools allowing among others for real-time communication (real-time marketing).

The activity of mBank in the Czech Republic and Slovakia in H1 2015 was awarded in the Zlata Koruna contest: mBank's mobile application was ranked second in the innovation category, while its new Internet platform came third in the on-line banking category.  mBank's new offer of banking accounts launched in March 2015 was named the second best market offer for clients by bankovnipoplatky.com.

### Loans and deposits

As of June 30, 2015, the loan portfolio of mBank clients in the Czech Republic and Slovakia amounted to PLN 3,296.6 million, with an increase by PLN 866.9 million, i.e. 35.7% compared to the end of June 2014 or PLN 347.7 million, i.e. 11.8% compared to the end of 2014.

The sales of non-mortgage loans in H1 2015 decreased slightly year to date and year on year, and amounted to PLN 169.1 million.

The Bank also intensified its efforts aimed at increasing the sales of mortgage loans. The sales value of mortgage loans in H1 2015 amounted to PLN 477.5 million, which represents an increase of 31.9% compared to H1 2014.

The deposit base increased by PLN 349.4 million or 6.2%. compared to the end of 2014, and increased by PLN 712.3 million or 13.6% compared to the end of June 2014.

# 9. Corporates and Financial Markets

## 9.1. Corporate and Investment Banking (mBank)

### Corporate and Investment Banking segment financial results

### Corporate and Investment Banking

The Corporate and Investment Banking segment generated a profit before tax of PLN 237.2 million in H1 2015, which represents an increase of PLN 0.5 million, i.e., 0.2% year on year.

| PLN M | H1 2014 | H1 2015 | Change in PLN M | Change in % |
|---|---|---|---|---|
| Net interest income | 363.0 | 362.5 | -0.5 | -0.1% |
| Net fee and commission income | 188.8 | 183.9 | -4.9 | -2.6% |
| Dividend income | 0.2 | 0.0 | -0.2 | - |
| Net trading income | 90.7 | 107.7 | 17.0 | 18.7% |
| Gains less losses from investment securities, investments in subsidiaries and associates | 8.0 | 2.1 | -5.9 | - |
| Net other operating income | 39.9 | 15.3 | -24.6 | -61.7% |
| Total income | 690.6 | 671.5 | -19.1 | -2.8% |
| Net impairment losses on loans and advances | -120.3 | -84.8 | 35.5 | -29.5% |
| Overhead costs and amortisation | -333.6 | -349.5 | -15.9 | 4.8% |
| **Profit before tax of Corporate and Investment Banking** | **236.7** | **237.2** | **0.5** | **0.2%** |

Profit before tax of the Corporate and Investment Banking segment in H1 2015 was driven by the following factors:

- **decrease of total income** year on year. Net interest income was stable and net trading income increased (+PLN 17.0 million, +18.7%), while net fee and commission income decreased modestly (-PLN 4.9 million, -2.6%) and net other operating income decreased (-PLN 24.6 million, -61.7%) due to the high base of 2014 which included one-off events.
- **increase of operating costs (including amortisation)** by PLN 15.9 million, i.e., 4.8% in the period under review due to higher non-staff related costs.
- **decrease of net impairment losses on loans and advances** by PLN 35.5 million, i.e., 29.5% year on year as some provisions in customer segments K1 and K2 were released.

## Activity of Corporate and Investment Banking (mBank only) segment

| | 30.06.2014 | 31.12.2014 | 30.06.2015 | YtD change | YoY change |
|---|---|---|---|---|---|
| **Number of corporate clients** | **17,006** | **17,787** | **18,654** | **4.9%** | **9.7%** |
| K1 | 1,778 | 1,838 | 1,867 | **1.6%** | **5.0%** |
| K2 | 4,904 | 5,144 | 5,485 | **6.6%** | **11.8%** |
| K3 | 10,324 | 10,805 | 11,302 | **4.6%** | **9.5%** |
| **PLN M** | | | | | |
| **Loans to corporate clients, including** | **22,095.2** | **23,680.4** | **21,920.8** | **-7.4%** | **-7.4%** |
| K1 | 6,224.1 | 6,378.9 | 6,329.4 | **-0.8%** | **-0.8%** |
| K2 | 10,416.3 | 10,633.3 | 11,899.7 | **11.9%** | **11.9%** |
| K3 | 2,788.5 | 2,811.0 | 2,823.8 | **0.5%** | **0.5%** |
| Reverse repo/buy sell back transactions | 2,648.1 | 3,840.4 | 845.2 | **-78.0%** | **-78.0%** |
| Other | 18.2 | 16.9 | 22.6 | **34.0%** | **34.0%** |
| **Deposits of corporate clients, including** | **24,323.7** | **29,202.6** | **27,691.5** | **-5.2%** | **13.8%** |
| K1 | 10,045.2 | 12,111.3 | 13,488.1 | **11.4%** | **34.3%** |
| K2 | 7,683.5 | 9,455.2 | 9,214.6 | **-2.5%** | **19.9%** |
| K3 | 3,512.0 | 4,177.4 | 4,343.1 | **4.0%** | **23.7%** |
| Repo transactions | 3,050.8 | 3,395.3 | 593.5 | **-82.5%** | **-80.5%** |
| Other | 32.3 | 63.5 | 52.2 | **-17.7%** | **61.6%** |
| **Distribution network** | **47** | **47** | **47** | | |
| Corporate branches | 29 | 29 | 29 | | |
| Corporate offices | 18 | 18 | 18 | | |

*K1 is the segment of the largest corporations with annual sales over PLN 500 million, the largest public sector entities and non-bank financial institutions (including pension and investment funds and insurance companies); K2 is the segment of corporations with annual sales between PLN 30 and 500 million and medium-sized public sector enterprises; K3 is the segment of SMEs with annual sales of up to PLN 30 million.*

H1 2015 was a time of a moderate economic recovery translating into growing business activity of large enterprises. On the other hand, banks were forced to conduct their activity in an environment of record-low interest rates, lowered interchange fees and increased contributions to the Bank Guarantee Fund (BFG), while economic situation positively affected the development of credit and deposit volumes.

In H1 2015 the Bank intensified its sales efforts, which resulted in record-high acquisition of corporate clients - the corporate client base increased by 867 companies compared to the end of 2014. In H1 2015 the Bank continued to pursue the strategy of increasing its share in the sector of small and medium-sized enterprises (SME). The initiatives aimed at strengthening the Bank's position on the SME market translated into record-high acquisition of clients in this sector (client base in the K3 segment grew by 497 companies).

The acquisition of new clients positively impacted the value of funds deposited on current accounts, which at the end of June 2015 reached PLN 7,917.1 million (+43.4% YoY). The high volume of current deposits underpins continued development of transactional banking, which is of vital importance to the Bank due to its growth potential and closer cooperation with clients.

The consolidation of Corporate and Investment Banking services which took place in 2014 translated into an increase in the Bank's activity on the market of corporate debt securities issue. At the end of March 2015 the Bank held a 12.4% share in the corporate bonds market. Moreover, the activity of the segment focused on intensifying cooperation with non-banking financial institutions and clients from the agricultural and food industry.

**Products and services offer**

**Corporate client loans**

The value of loans granted by mBank to corporate clients (excluding reverse repo transactions) amounted to PLN 21,076.6 million at the end of H1 2015, which represents an increase by 6.2%, compared to the end of December 2014 (PLN 19,840.0 million) and by 8.4%, compared to the end of June 2014 (PLN 19,447.1 million).

The value of loans for enterprises at the end of June 2015 amounted to PLN 19,027.8 million and was by 6.5% higher than at the end of December 2014 (PLN 17,873.6 million) and by 10.4% higher compared to the end of H1 2014 (PLN 17,235.6 million).

At the same time, the market for loans to enterprises grew by 4.3% and 5.5% respectively. The market share of mBank's lending to enterprises stood at 6.4% at the end of June 2015, compared to 6.2% at the end of 2014 and 6.1% at the end of June 2014. Loan-to-deposit ratio for enterprises in the Bank reached 83.7% at the end of H1 2015 and was significantly lower than the market ratio of 127.8%.

The value of loans granted to local governments at the end of June 2015 amounted to PLN 1,092.6 million compared to PLN 1,324.1 million at the end of 2014 and PLN 1,277.3 million in H1 2014.

**Corporate client deposits**

The value of corporate deposits collected by the Bank (excluding repo transactions) amounted to PLN 27,098.0 million at the end of June 2015, which represents a rise by 5.0% compared to the end of December 2014 (PLN 25,807.3 million) and by 27.4% compared to the end of H1 2014 (PLN 21,272.9 million).

The value of mBank's current corporate deposits amounted to PLN 7,917.1 million at the end of H1 2015, which represents an increase by 18.0% compared to the end of December 2014 and by 43.4% compared to the end of H1 2014.

The value of deposits placed by enterprises at the end of June 2015 amounted to PLN 22,743.8 million and was by 9.8% higher than at the end of December 2014 (PLN 20,709.2 million) and by 35.0% higher compared to the end of H1 2014 (PLN 16,844.8 million).

The market of corporate deposits shrank by 0.8% compared with the end of 2014 and rose by 12.3% year on year. mBank's share in deposits placed by enterprises reached 9.7% at the end of June 2015 compared to 8.8% at the end of December 2014 or 8.1% at the end of June 2014.

The value of deposits of local governments as at the end of June 2015 amounted to PLN 1,309.3 million compared with PLN 212.4 million at the end of 2014 and PLN 396.6 million at the end of June 2014.

**European Union financing**

On 8 March 2015 the Bank signed a new agreement with the European Investment Bank (EIB) to open a EUR 100 million credit line dedicated to financing projects related to the production cycle of small and medium-sized enterprises (entities with headcount of up to 250 people) and mid-caps (entities with headcount ranging from over 250 to 3 thousand people).

**De minimis guarantees**

The Bank maintained its commitment to the "Supporting Entrepreneurship through BGK Sureties and Guarantees" program with an allocated limit of PLN 1,300 million (the limit was increased by PLN 400 million in 11 May 2015). The amount drawn under the limit reached PLN 922.9 million as at 30 June 2015.

**Corporate debt origination**

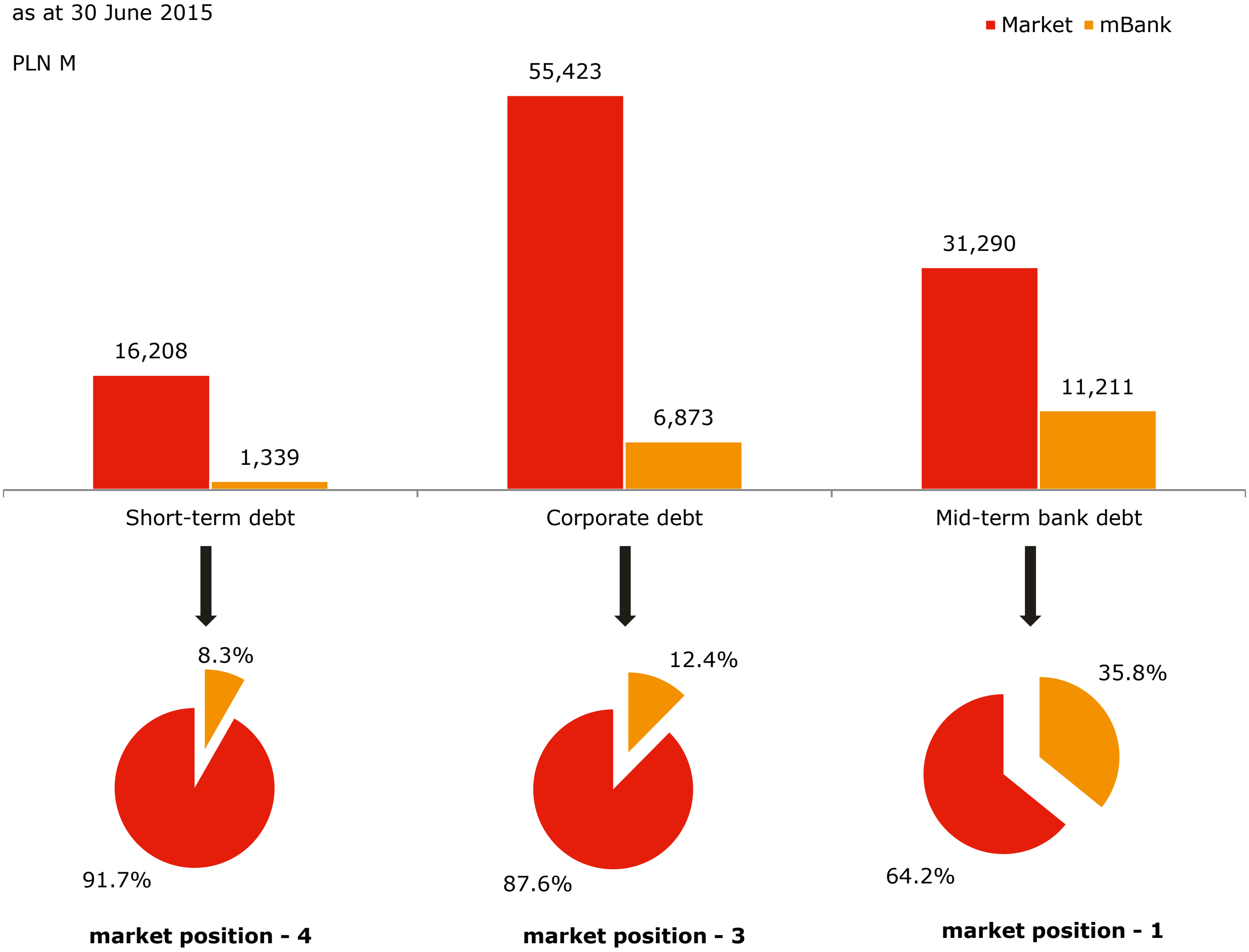
In H1 2015, mBank organised or co-organised a number of bond issue programs on the domestic market, both for corporate issuers and banks.

The share of mBank in the non-treasury debt market at the end of June 2015 is presented on the chart below.

**mBank in the Non-Treasury Debt Market**

as at 30 June 2015

PLN M




The value of debt securities issued by banks but not kept on primary books (excluding "road" bonds issued by Bank Gospodarstwa Krajowego) whose issue was arranged by mBank amounted to circa PLN 11.2 billion compared with PLN 9.9 billion at the end of 2014. For many years mBank has been the leader of the bank securities market. The largest issues arranged by mBank in H1 2015 included the issue of bonds worth PLN 696 million for Bank Gospodarstwa Krajowego and PLN 180 million for BOŚ Bank SA. Other large transactions in which the Bank participated included the issue of covered bonds of mBank Hipoteczny worth EUR 144 million and PLN 450 million.

The Bank ranked third on the growing market of corporate bonds, with a market share of 12.4%. A number of new large issues were arranged, including: Enea S.A. (PLN 250 million), Robyg S.A. (PLN 60 million), Magellan S.A. (PLN 60 million), BEST SA (PLN 55 million), Comp SA (PLN 50 million), EGB Investment (PLN 22 million) and Elzab SA (PLN 25 million). Outstanding corporate bonds stood at circa PLN 6.9 billion at the end of June 2015 compared with PLN 6.8 billion at the end of 2014.

**Development of transactional banking**

Cash management is an area of Corporate Banking which offers state-of-the-art solutions to facilitate planning, monitoring and management of the most liquid assets, cash processing, as well as electronic banking. The solutions facilitate daily financial operations, enhance effective cash flow management, and optimise interest costs and income.

mBank's comprehensive cash management offer, supporting long-term relationships with clients, is reflected in the following data:

- The number of domestic transfers made by corporate clients in H1 2015 increased by 9.6% YoY;
- The number of foreign transfers increased by 19.7% in H1 2015 YoY; the number of SEPA transfers (Single Euro Payments Area) grew by 18.1% in the reporting period;
- The total number of corporate cards issued amounted to 1,157.9 thousand at the end of H1 2015; the number of prepaid cards grew by 45.4% in the reporting period;
- As at the end of June 2015, over 964.9 thousand cards were issued as Electronic Money Instrument;
- The number of mBank CompanyNet system users rose by 12.9%. Currently, there are 82,825 active authorizations allowing the entitled employees of clients to cooperate with mBank.

**Development of the Corporate Banking offer**

**New functionalities of mBank CompanyMobile** In H1 2015, a new module was added to mBank CompanyMobile application, which enables the service of Housing Trust Accounts combined with identification of payments (collect service). The new module allows property developers to manage the collection of receivables related to particular investments (developer undertakings):

- Ensures quick access to data on investments,
- Presents information on payments made by individual buyers,
- Presents the history of virtual accounts assigned to individual buyers,
- Presents the overdue amounts that should have been paid to the property developer by the buyers (according to the works schedule of a given investment),
- Generates detailed reports and imports deposit-related data from external systems concerning individual investments.

## 9.2. Financial Markets

**Financial Markets segment financial results**

The Financial Markets segment generated a profit before tax of PLN 1.8 million in H1 2015, compared to PLN 57.0 million in H1 2014.

| PLN M | H1 2014 | H1 2015 | Change in PLN M | Change in % |
|---|---|---|---|---|
| Net interest income | 47.8 | 67.0 | 19.2 | 40.2% |
| Net fee and commission income | -3.1 | -0.8 | 2.3 | -74.2% |
| Dividend income | 0.1 | 0.1 | 0.0 | - |
| Net trading income | 54.8 | -16.9 | -71.7 | -130.8% |
| Gains less losses from investment securities, investments in subsidiaries and associates | 5.8 | 3.8 | -2.0 | - |
| Net other operating income | 0.3 | 0.1 | -0.2 | -66.7% |
| Total income | 105.7 | 53.3 | -52.4 | -49.6% |
| Net impairment losses on loans and advances | 0.0 | -0.5 | -0.5 | - |
| Overhead costs and amortisation | -48.8 | -51.0 | -2.2 | 4.5% |
| **Profit before tax of Financial Markets** | **57.0** | **1.8** | **-55.2** | **-96.8%** |

The profit before tax of the Financial Markets segment in H1 2015 was driven by the following factors:

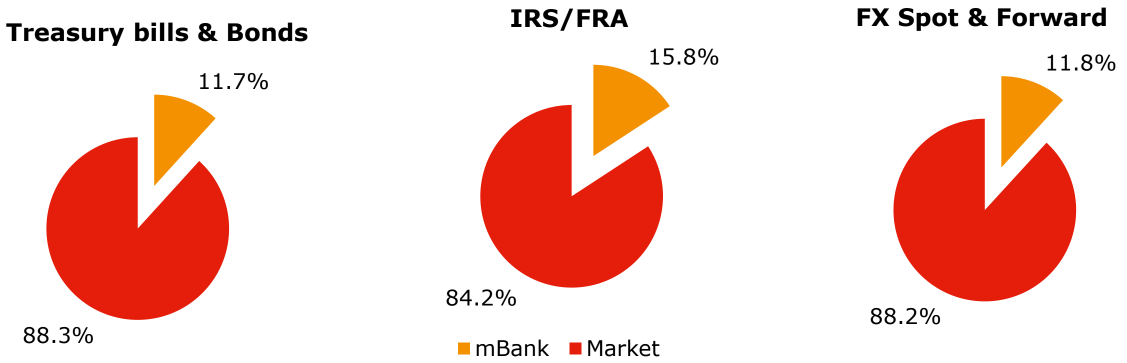
- **decrease of total income** by PLN 52.4 million, i.e., nearly 50% year on year to PLN 53.3 million. The lower income was driven by a negative net trading income in H1 2015 (-PLN 16.9 million, compared to PLN 54.8 million in H1 2014), mainly due to the negative result on interest rate derivatives.
- **increase of operating costs (including amortisation)** by PLN 2.2 million, i.e., 4.5% due to higher material costs.

**Activity of Financial Markets segment**

Since January 2015 the Financial Markets area covers:

- Direct sale of financial market products to Corporate Banking clients and non-banking financial institutions (such as insurance companies, pension and investment funds and asset management companies) as well as selected Private Banking clients;
- Management of mBank's liquidity as well as its assets and liabilities (including deposit and credit portfolio interest risk management). Liquidity management involves money market transactions, currency swaps, interest rate derivative transactions, T-bill, T-bond and NBP bill purchase transactions, repo transactions etc.;
- Management of mBank's interest rate and currency risk, trading in FX instruments on the interbank market (spot transactions and derivatives), trading in interest rate instruments (T-bills and T-bonds, interest rate derivatives), commodity derivatives, shares, equity and stock index derivatives, trading in non-Treasury securities;
- Offering the service of a depositary and a trustee in particular to non-banking financial institutions;
- Supervision over the operations of Dom Maklerski mBanku (brokerage house) with regard to its cooperation with financial institutions.

mBank's shares in particular financial instruments markets are presented on the charts below.




### Enhancement of sales of financial markets products

In H1 2015 the Financial Markets segment focused on enhancing or maintaining its position in particular product segments. The key initiatives which impacted on the volume of transactions and income generated from cooperation with clients included:

- Measures designed to boost income from currency exchange transactions with Corporate Banking clients. The main emphasis was put on increasing the volumes of transactions with both the existing and newly acquired clients. Consequently, the scale of currency exchange transactions with clients grew considerably despite a strong pressure on margins;
- Measures designed to increase the sales of and margins on Treasury transactions with K0 and K1 clients;
- Centralisation of the sales of commodity market products in one dedicated team;

- Intensive sales activities in the area of custody services and depositary function, which resulted in acquiring a large number of new investment funds to be served by the Bank. Furthermore, development activities aimed at further process automation have been continued.

**Financial Institutions**

The Financial Markets area covers relations with financial institutions focusing on, among others, obtaining funding and placing excess funds with other banks.

As of 30 June 2015 mBank had nineteen active loans in the total amount of PLN 23,815.6 million, of which the utilized value stood at PLN 16,625.1 million.

In H1 2015 two subordinated loans in CHF in the total amount of PLN 637.7 million were repaid on time. In addition, the Bank took out a new loan in EUR in the amount of PLN 419.4 million and a loan in USD in the amount of PLN 188.2 million. As a consequence, the debt resulting from the loans went up by PLN 1,123.6 million against the end of H1 2014.

At the end of June 2015, mBank's total exposure resulting from loans granted to other banks amounted to PLN 189.5 million. mBank's portfolio comprised twenty-seven short- and medium-term active loans granted to financial institutions from Poland and abroad.

In H1 2015 mBank actively supported trade transactions concluded by Polish exporters by providing short-term financing to financial institutions, and granted financing as part of syndicated loans. At the same time, the Bank continued providing services to banks from the Commonwealth of Independent States and offering them medium-term loans secured with KUKE insurance policies.

**mBank's custody services**

mBank's custody clients are mainly investment and pension funds, local and foreign financial institutions, banks offering custodian and investment services, insurance companies, asset management institutions and non-financial institutions.

mBank provides services including settlement of transactions in securities registered in local and foreign markets, safe-keeping of clients' assets, maintenance of securities accounts and registers of securities in non-public trading, maintenance of asset registers of pension funds and investment funds, monitoring the valuation of their assets, and processing corporate actions.

For mBank H1 2015 was another successful period in terms of custody operations. At the end of H1 2015 the number of serviced investment and pension funds rose by 39.0%, while the total value of their assets grew by 10.4% compared with the end of H1 2014.

# 10. Subsidiaries of mBank Group

## 10.1. Summary of financial results of mBank Group subsidiaries

mBank Group subsidiaries generated a profit before tax of PLN 122.2 million in H1 2015, compared to PLN 117.4 million in H1 2014 (net dividend paid by companies within mBank Group and the one-off gains on the sale of the company BRE Ubezpieczenia TUiR at Aspiro).

The profits of the subsidiaries mLeasing, Dom Maklerski mBanku, Aspiro and mWealth Management among others improved in the period under review.

The table below presents the profit before tax of the subsidiaries in H1 2015 compared to H1 2014.

| (PLN M) | H1 2014 | H1 2015 | Change in PLN M | Change in % |
|---|---|---|---|---|
| mLeasing | 23.0 | 27.8 | 4.8 | 20.9% |
| mBank Hipoteczny | 18.6 | 8.3 | -10.3 | -55.4% |
| mLocum | 15.2 | 11.1 | -4.1 | -26.8% |
| BRE Ubezpieczenia[1] | 30.9 | 7.1 | -23.8 | -77.1% |
| mWealth Management | 9.1 | 13.2 | 4.1 | 45.4% |
| mFaktoring | 8.7 | 2.8 | -5.9 | -67.9% |
| Dom Maklerski mBanku | 9.5 | 16.0 | 6.5 | 68.0% |
| Aspiro[2] | 3.5 | 37.5 | 34.0 | 965.8% |
| Other[3] | -1.0 | -1.5 | -0.5 | -50.0% |
| **Total** | **117.4** | **122.2** | **4.8** | **4.0%** |

[1] *the company was sold in March 2015*

[2] *in H1 2015 net of the one-off gains on the sale of the company BRE Ubezpieczenia TUiR; in H1 2014 net of the dividend paid within the Group*

[3] *incl. Transfinance (in H1 2014), mCentrum Operacji, mFinance France, MLV 45, BDH Development, Garbary*

## 10.1. Business activity of mBank Group subsidiaries

mDom Maklerski

| |
|---|
| **Comprehensive brokerage and capital market services for individuals and institutions as well as issues** |
| **The largest number of brokerage accounts on the Polish market, handling nearly 300 thou. customers** |
| **Equities trading market share – 5.6% and 7th position on the market** |
| **Futures trading market share – 17.6% and 2nd position on the market** |

At the end of H1 2015, the number of clients of Dom Maklerski mBanku (mDM) stood at 294.9 thousand and increased by 3.8 thousand compared to H1 2014.

In H1 2015, mDM conducted the IPO of Uniwheels AG worth PLN 504.0 million. Additionally, Dom Maklerski mBanku took part in two significant transactions conducted on WSE during H1 2015 – IPO of Wirtualna Polska Holding SA worth PLN 294.0 million, and the transaction of sale of 60% of shares of Prime Car Management SA worth PLN 300.0 million.

The company generated a profit before tax of PLN 16.0 million in H1 2015 compared to PLN 9.5 million in H1 2014 (+68% year on year). The improvement was mainly driven by high commission income in the ECM segment and growing client business on the forex market.

mBank Hipoteczny

| |
|---|
| **Poland's largest mortgage bank** |
| **Focusing on financing commercial and public sector projects and investments of individual clients, market analyses and advisory services for investors and operators of commercial real estate industry** |
| **The largest issuer of covered bonds with a 76% market share. Outstanding securities worth PLN 3.7 billion** |

The gross loan portfolio of mBank Hipoteczny (mBH) reached PLN 6.3 billion in H1 2015 (+19% year on year). The change was driven by a steady increase in the portfolio of new mortgage loans for retail clients of mBank Group. Throughout the year, in pursuit of its strategy, mBank Hipoteczny acquired from mBank retail loans with a total nominal value of over PLN 600 million, including three pooling transactions worth jointly PLN 315 million completed in H1 2015. In addition, the effective sales of commercial loans also deserve attention. In H1 2015, the total value of new contracts reached PLN 592.7 million, which represents an increase of 112% compared with H1 2014.

Consequently, profit before tax stood at PLN 8.3 million compared with PLN 18.6 million a year before (-55%).

Compared to the same period of 2014, due to increase of its loan portfolio mBank Hipoteczny reported an increase of 23% in net commission income, together with a considerable decrease in net trading income.

In the analysed period the Bank wrote down the value of other receivables taking into account the expected lack of refund of the adjusted VAT settlement (PLN 1.7 million). Moreover, compared with H1 2014, in H1 2015 loan loss provisions rose by PLN 4.5 million, while administrative cost increased by PLN 5.0 million.

In the six months to June 2015 mBank Hipoteczny was very active on the debt issuance market, which was reflected in five issues of mortgage bonds worth a total of PLN 789.7 million (including PLN 450.0 million and PLN 81.0 million). Mortgage bonds were taken up by domestic and foreign institutional investors. The Bank persistently pursues its goal to issue covered bonds worth PLN 1.5 billion in 2015 backed by the growing pool of retail mortgage loans (a share of over 22% in the collateral register). For more information about mBank Hipoteczny issuance of covered bonds see chapter 1.2. Key projects of mBank Group in H1 2015.

Aspiro

| |
|---|
| **An open platform for financial services sale on the intermediaries market** |
| **The offer comprises loans, deposits, insurance products, investments and savings for both individual customers and companies** |
| **Nearly 600 experienced client advisors** |

In H1 2015 Aspiro offered products of 25 financial service providers including mBank. The offer comprised 49 products, including mortgage loans, cash loans, insurance products, investment products, leasing and factoring.

In view of the revival observed on the housing market and a shift in mBank's policy on selling mortgage loans, Aspiro's sales of mortgage loans grew by nearly 32% in H1 2015 compared with H1 2014. Intensified sales of products offered by mBank Hipoteczny were reflected in the rising sales volumes of mortgage loans, which rose from PLN 84 million at the end of H1 2014 to PLN 366 million at the end of H1 2015.

On March 2, 2015, Aspiro merged with BRE Ubezpieczenia Sp. z o.o. and BRE Agent Ubezpieczeniowy Sp. z o.o. The business activity of both insurance companies was taken over and has been continued in the same scope by Aspiro S.A. Additionally, in March 2015 Aspiro concluded sale of BRE Ubezpieczenia TUiR to the AXA Group. For more information on the transaction see chapter 1.2. Key projects of mBank Group in H1 2015.

In H1 2015 Aspiro generated a profit before tax amounting to PLN 110.0 million compared with PLN 117.3 million (including also intra-Group dividends) in H1 2014. To a large extent the result was influenced by the completion of the sale of BRE Ubezpieczenia TUiR worth PLN 72.5 million (excluding this one-off transaction, Aspiro genetated a profit before tax amounting to PLN 37.5 million).

m Wealth Management

| |
|---|
| **Private Banking & Wealth Management services** |
| **Comprehensive asset management by the company's experts and specialists from cooperating companies** |

In H1 2015, the company continued the development of its comprehensive wealth management services, including investment advisory and asset management. The assets managed by the company increased by 10.2% year on year to record PLN 5.6 billion at the end of June 2015.

In H1 2015, the company's revenues stood at PLN 22.1 million, i.e. increased by 24.8% year on year. The company's profit before tax reached PLN 13.2 million compared to PLN 9.1 million in H1 2014.

## mLeasing

| |
|---|
| **Financing offer in the form of leasing or rent, and car fleet management** |
| **1st position on the real estate leasing market** *(at the end of H1 2015)* |
| **3th position on the overall leasing market in Poland** *(at the end of H1 2015)* |

The value of contracts concluded by mLeasing in H1 2015 stood at PLN 1.9 billion compared to PLN 1.5 billion a year earlier (+26.7%). The value of chattel contracts concluded by mLeasing in H1 2015 increased by 13.7% (PLN 1.6 billion in H1 2015 compared to PLN 1.4 billion a year earlier).

In H1 2015, within the One Bank Strategy, in order to create a comprehensive offer for customers, mLeasing continued a "Leasing in Retail" programme, dedicated to micro-, small- and medium- enterprises, which may enter into a lease contract for vehicles of up to 3.5 tonnes.

The company's profit before tax reported in H1 2015 reached PLN 27.8 million, compared to PLN 23.0 million a year before, which represents an increase by 20.9% year on year.

## mFaktoring

| |
|---|
| **Domestic and export factoring with recourse, non-recourse factoring, import guarantees** |
| **7th position on the factoring market in Poland, with 8.0% market share** |

mFaktoring generated turnover of PLN 5.0 billion in H1 2015 (+24.8% year on year), which enabled the company to maintain its 7th position on the factoring market.

In H1 2015, the profit before income tax reported by mFactoring reached PLN 2.8 million compared to PLN 8.7 million a year earlier (-67.9%), which was caused mainly due to higher volume of loan loss provisions booked in H1 2015.

## mCentrum Operacji

| |
|---|
| **Back-office processes for mBank Group** |
| **Settlements servicing and database administration** |
| **Documentation storage in electronic and paper form, confidential data protection** |

In H1 2015 mCentrum Operacji (mCO) extended scope of services for clients of Orange Finanse and continued cooperation with mBank Hipoteczny in handling mortgage loans to retail clients.

In H1 2015, the company generated a profit before tax of PLN 1.1 million compared to PLN 0.8 million a year earlier. The improved result was mainly driven by increasing volume of new accounts and lower operating expenses resulting from optimisation of operating processes.

| |
|---|
| **A leading real estate developer** |
| **Development projects in Kraków, Łódź, Wrocław, Warszawa, Poznań and Sopot** |
| **Member of Polish Developers Association** |

In H1 2015, the company sold 141 apartments, compared to 175 apartments a year earlier.

In H1 2014, mLocum reported a profit before tax of PLN 11.1 million, compared to PLN 15.2 million a year earlier.

**mFinance France S.A. (mFF)**

mFinance France is a special purpose vehicle set up for the purpose of acquiring funds on the international markets through the issue of Eurobonds. In April 2012, the Euro Medium Term Note Programme was renewed.

In H1 2015, the company reported a loss before tax of PLN 7.6 thousand compared to PLN 25 thousand loss a year earlier.

**BDH Development Sp. z o.o**

The company's core business is carrying out and completing construction projects connected with the residential real estate taken over by mBank Group subsidiaries in the process of restructuring and investment debt collection with the aim of the most effective value recovery of the estate taken over. In H1 2015 the company sold 19 apartments and generated a loss before tax of PLN 1.4 million.

**MLV 45 Sp. z o.o. Sp. k.**

MLV 45 is a company established as a result of the transformation of BRE Holding Sp. z o.o. into a limited partnership company in Q3 2013. The assets of the company comprise shares in mBank Hipoteczny S.A., mFaktoring S.A., mLeasing S.A. and mLocum S.A.

In H1 2015, the company generated a pre-tax loss of PLN 139.8 thousand compared to a loss before tax of PLN 53.0 thousand a year earlier.

## 11. Main directions of change and types of risk of the Group's activities

### 11.1. Risk management foundations and challenges of H1 2015

mBank Group manages risks on the basis of regulatory requirements and best market practice, by developing risk management strategies, policies and guidelines.

mBank Group consistently implements a risk management model based on three lines of defence:

1. The first line of defence are business segments (**Business**), responsible for considering risks in their business decisions.
2. The second line of defence, the risk area (**Risk**), provides the methodology framework and is responsible for making risk decisions at the request of Business segments and for measuring, limiting, monitoring and reporting risks accepted by the Group. Risk exercises independent supervision over the first line of defence.
3. The third line of defence is **Internal Audit** which provides independent assessment of Business and Risk.

Risk responsibilities are based on the following pillars of organisational management:

- **Client-Centric Approach** – understanding the needs of the Risk area clients.
- **One Risk** – integrated approach to risk management.
- **Risk v. Return Rate** – supporting Business segments in the decision-making process and defining the Bank's risk appetite on the basis of the long-term relationship between risk and rate of return.

Risk is the key partner to Business segments and the Management Board in creating lasting value of the Bank and ensuring a long-term balance between the expected rate of return for investors and the safety of the Bank. These strategic objectives require an integrated approach to risk, capital, financing and profitability management.

As a consequence of the foregoing, the Risk Management Strategy was updated at the end of 2014 to accommodate new challenges faced by Risk in 2015.

**Key changes in the risk management area in H1 2015:**

- The Bank worked on defining its risk appetite in the next planning horizon with a special emphasis on the year 2016.
- The Bank reviewed and updated the limits defined in mBank Group Limit Book.
- The Bank performed a regular update of the retail and corporate credit risk management strategy, the market risk management strategy, and the liquidity risk management strategy.
- In 2014 work was underway to implement a comprehensive reputation risk management strategy, which was approved by the Bank's Management Board in December. The Bank is steadily developing its approach to reputation risk management. In H1 2015, the rules of financing trade were added to the process. The Bank is currently developing its approach to other economic sectors which are sensitive to reputation risk in order to address the Bank's corporate social responsibility.
- In 2014, the Bank implemented the Internal Control System Self-assessment (ICS) process aimed to identify the key operational risks embedded in processes executed at the Bank and to assess their effective management. Self-assessment results are used to take measures necessary to optimise and facilitate the Bank's operational risk management system. The implementation of the Self-assessment was divided into two stages. The first stage was implemented in H1 2014 and its results were approved by the Bank's Management Board in September 2014. The second stage was finalised in June 2015 and its results will be presented for approval to the Bank's Management Board in Q3 2015.

**Basel III regulatory standards**

New regulations on macroprudential requirements for banks came into force in the European Union on January 1, 2014: the Capital Requirement Regulation (CRR) and the Capital Requirement Directive IV (CRD IV) on access to the activity of banks and prudential supervision, implementing Basel III. The changes imposed by Basel III include:

- Stricter capital requirements: a universal definition and structure of Banks' capital and implementation of a capital ratio set in relation to highest quality own funds;
- Introduction of own funds requirement for risk associated with credit valuation adjustment;
- Implementation of financial leverage ratio;
- Introduction of additional capital buffers including a capital conservation buffer, a counter-cyclical buffer, a buffer for global systemically important institutions, and a systemic risk buffer;
- Liquidity requirements measured as LCR (Liquidity Coverage Ratio) and NSFR (Net Stable Funding Ratio).

The regulatory amendments are designed mainly to protect the Banks' capital system against the adverse effect of a financial cycle of crises and depressions.

The new regulatory provisions of CRD IV must be implemented in national legislation while CRR applies directly as of January 1, 2014 without the need to harmonise national legislation.

## 11.2. Main risks of mBank Group's business

The Management Board of the Bank takes measures necessary to ensure that the Bank manages all significant risks arising from the implementation of the adopted business strategy.

Within the Group's risk inventory process implemented under the principles of the Internal Capital Adequacy Assessment Process (ICAAP), the following significant risks were identified in the operations of the Group in 2015:

1. Credit risk
2. Operational risk
3. Market risk
4. Business risk (including strategic risk)
5. Liquidity risk
6. Reputation risk
7. Model risk
8. Capital risk (including risk of excessive leverage)

mBank monitors all the aforementioned risks within ICAAP. Due to the specificity and characteristics of the portfolio, the section presents the rules of monitoring credit risk, operational risk, liquidity risk, market risk of the trading book, as well as interest rate risk of the banking book in mBank Group using risk measures applied by mBank and taking into account differences in the profile and scale of business of the Group.

Furthermore, in its risk review and risk appetite definition process for 2015 and 2016, the Bank reviewed a range of other risks, taking into account the results of the analysis in the planning horizon for 2016 and beyond.

In particular, the Bank analysed a package of non-financial risks including: cyber risk, strategic risk, city failure risk, miss-selling risk, conduct risk, physical security risk, long-term PR crisis risk, illicit transactions risk, model risk, social communication risk.

The non-financial risk package was assessed by the Bank's Management Board in terms of the probability of risk events and a potential impact on the organisation; subsequently, mitigating factors were defined for selected risks. Findings from the analysis were used as input in the update of the strategic assumptions for 2016.

### Business and Risk Forum of mBank Group

In its risk management process, the Bank attaches great importance to communication between Risk and Business. mBank Group Business and Risk Forum was established in 2014 as an official decision-making and information exchange platform for Risk and Business in the Group.

The Business and Risk Forum is comprised of the following bodies:

1. Retail Banking Risk Committee;

2. Corporate and Investment Banking Risk Committee;
3. Financial Markets Risk Committee.

The Committees are composed of representatives of Business and relevant Risk Departments.

Each Committee is responsible for all risks arising in the relevant Business and performs the following functions:

- **discussing and passing decisions** on:
    - launch of new products/instruments;
    - risk management rules for products/instruments offered or to be offered by Business;
    - Business risk appetite including risk limits set for Business;
    - approving risk policies for different client segments;
    - client segments preferred in order to achieve the target structure of the risk portfolio;
    - priorities and directions of change in the organisation of risk assessment tools and processes;
- **mutual exchange of information** on current and planned initiatives and projects including sales plans and their implementation, sales campaigns, changes to risk models, etc.;
- **monitoring of the following based on provided reports and information:**
    - quality and effectiveness of risk-bearing portfolios of business lines;
    - operational risk and other non-financial risks;
    - quality of data used in risk management processes;
    - early risk symptoms; and
    - arranging preventive or corrective measures.

### 11.2.1. Credit risk

The Bank organises credit risk management processes in line with the principles and requirements set out in the resolutions and recommendations of the Polish Financial Supervision Authority (in particular Recommendation S) and CRR/CRDIV, which address issues related to credit risk management.

**Tools and measures**

Credit risk inherent in financing of mBank Group clients is assessed based on shared statistical models developed for the AIRB (Advanced Internal Rating-Based) approach and uniform tools, and is based on common definitions of terms and parameters used in the credit risk management and rating process. The Bank ensures their cohesion at Group level.

The Group uses different models for particular client segments. The rules governing the clear assignment of clients to a system are defined in the Group's internal regulations.

The Bank and Group subsidiaries in their credit risk management process use the core risk measures defined under the AIRB approach:

- PD – Probability of Default (%)
- LGD – Loss Given Default (%)
- EAD – Exposure at Default (amount)
- EL – Expected Loss (amount)

as well as related measures including:

- RD – Risk Density, which is defined as EL to EAD (%)

- LAD - Loss at Default (amount of LGD).

In the decision-making process, for reporting and communication with business units, PD and EL are expressed in the language of rating classes whose definitions (Masterscale) are uniform across the Commerzbank Group.

In its credit risk management process, the Bank also attaches great importance to the assessment of unexpected loss risk. Capital required to cover unexpected loss is estimated at a confidence level of 99.91%. For this purpose, the Bank uses the following measure:

- RWA – Risk Weighted Assets used under the AIRB approach to calculate regulatory capital required to cover credit risk (unexpected loss).

In managing mortgage-secured credit exposures for different types of real estate and also for different products, the Group uses the LtV ratio (Loan to Value), i.e., the value of the loan to the market value (or mortgage banking calculated value) of the real estate which secures the loan.

Thanks to its simplicity, this measure is broadly used in communication with clients and in the construction of price matrices for credit products.

Stress testing is an additional tool of credit risk assessment which supplements CVaR (Credit Value at Risk) measurement of unexpected loss. Stress testing of the economic capital required to cover credit risk is measured quarterly.

Stress tests of credit risk are two-dimensional, analysed separately and jointly:

- The analysis of sensitivity of ECVaR model indications to assumptions concerning credit exposures (e.g., correlation) – i.e., parametric tests.

- The analysis of extreme credit losses on the assumption of an unfavourable macroeconomic situation – i.e., macroeconomic tests in which an econometrical model forecasts values of input parameters for the economic capital model (PD, LGD) based on assumptions of the Chief Economist about macro parameters in the case of the negative economic scenario. The risk parameters developed according to the above scenario form the basis for calculating economic capital both before and after the assumptions of parametric tests are taken into account.

In addition to the tools listed above, which are applied both in corporate and in retail credit risk measurement, the Group uses tools specific to these areas.

For corporate credit risk, the Group estimates maximum exposure to a client/group of related clients using the following credit risk mitigating measures:

- MBPZO – Maximum Safe Total Exposure, which defines the maximum level of financial debt of an entity from financial institutions calculated under the Bank’s methodology, approved by the Bank’s competent decision-making body.

- LG – General Limit, which defines the level of credit risk financial exposure to a client/group of related clients acceptable to the Group, approved by the Bank’s competent decision-making body. LG includes a structured limit and products granted outside the structured limit, including exposures of both mBank and the Group’s companies.

To minimise credit risk, the Group uses a broad range of collateral for credit products, also necessary to actively manage the capital requirement. In their assessment of the quality of risk products, mBank and mLeasing use the MRV ratio (Most Realistic Value), which reflects the worst-case scenario of debt enforcement through forced sale of collateral.

In addition, the decision-making process and the assessment of profitability per client in the CRM system use the RAROC ratio (Return on Risk Adjusted Capital), or return on the capital invested in risk products.

Retail credit risk measures are constructed to reflect the characteristics of this customer segment and, in the case of portfolio measures, the high granularity of the loan portfolio:

- DtI – Debt-to-Income, i.e. monthly credit payments to the net income of a household, used for individual customers.

- DPD – Days-Past-Due, a family of portfolio risk measures based on the number of days past due date (e.g. share of contracts which are from 31 to 90 days past due date in the total portfolio by number or by value).

- Vintage ratios, which represent the quality of cohorts of loans disbursed within a certain time bracket (e.g. each quarter) at a different phase of their lifetime, based on DPD.

- RC LLP – Risk Cost LLP, the cost of risk for a loan portfolio (segment), i.e. increment in loan loss provisions to the performing loan portfolio balance.

- Roll-rates, which measure the migration of contracts between days-past-due brackets (1-30, 31-60, 61-90 DPD, etc.).

**Strategy**

Corporate and Investment Banking

The Strategy of the corporate credit risk management closely correlated with the One Bank Strategy was updated in H1 2015. The main goal of mBank Group in corporate credit risk management is to unlock potential synergies in the Group by integrating the offer of the Bank and Group subsidiaries in sales of risk-bearing products to mBank Group clients, ensuring closer co-operation in credit risk measurement and management, defining a safe level of integrated risk appetite. According to ICAAP assumptions, the Strategy is complemented by detailed sector policies, the limit book, the credit process rules, decision-making powers, banking procedures both in mBank and the Group subsidiaries which generate credit risk and impact the quality of corporate credit risk management. The implementation of uniform risk measures and risk controlling processes at Group level takes into account the specificities of the Group entities. The Bank makes sure that the process does not affect client relations.

In order to structure and unify mBank Group's approach to financing commercial real estate (CRE), the mBank Group Credit Policy of Financing Commercial Real Estate was drafted and approved in H1 2015. A uniform approach to CRE finance was adopted in mBank and mBank Group subsidiaries including client service standards and CRE finance risk assessment. CRE finance competence centres were established in mBank Group, ensuring a clear scope of responsibilities. A framework was set up to safely build a CRE finance exposures portfolio by defining the preferred acquisition market and outlining the recommended terms of financing. Uniform definitions of commercial real estate and conditions of CRE finance transactions were put in place.

In May 2015, KRK approved the mBank Food & Agribusiness (F&A) Client Finance Policy which defines the F&A risks and the outlook of F&A segments that determines the F&A finance risk appetite. The finance rules will ensure the development of mBank's safe food and agribusiness loan portfolio with a special emphasis on agricultural production and processing.

The diversified approach to corporate clients is tied to the client's risk level as measured by PD and credit risk concentration measured with LAD of a client or group of related clients, taking into account the exposure of the Group subsidiaries.

The credit decision-making system is consistent with the Corporate Credit Risk Management Strategy and the approved principles of the Credit Risk Policy. The competent decision-making levels are defined in a decision-making matrix. On that basis, depending on the EL rating and the aggregate exposure of a client or group of related clients, the appropriate decision-making level responsible for the credit decision is assigned.

mBank follows a simplified credit decision-making procedure for a defined group of clients and transactions, in particular transactions under fast credit procedures (FCP), which enhances effectiveness while ensuring compliance with all legal and supervisory requirements and good practice of credit risk management.

A credit process supporting small and medium-sized enterprises is being built from scratch, ensuring its full adequacy with the AIRB approach requirements. The restructuring of the process includes the implementation of anti-fraud controls in several stages. The new strategy has enabled not only the development of a new workflow platform but also simplified documentation. Client-centricity in practice entails optimisation of documentation received from and delivered to clients and its digitisation in the credit process.

The Group actively manages credit risk aiming to optimise profitability in relation to return on risk. Analyses of the Group's risks are performed on an on-going basis. Risk management is supported by analyses of the Group's credit portfolio structure and the resulting formal limits, guidelines and recommendations on the Group's exposure to selected companies, sectors and geographic markets. In its current credit risk management and determination of concentration risk, the Bank performs quarterly portfolio analyses using a Steering Matrix which incorporates PD rating and LAD.

In order to mitigate the risk of lending and guarantees, the Bank classifies and monitors credit risk products. The Group uses write-offs and provisions under the International Financial Reporting Standards (IFRS). The Bank also monitors the credit portfolio on a quarterly basis including an analysis of the dynamics of change in the size and (sector) segmentation of the credit portfolio, client risk (PD rating), the quality of collateral against credit exposures, the scale of change in EL, Risk Density, and default exposures.

In Corporate Banking, the Group avoids concentration in industries and sectors whose credit risk is considered excessively high. The acceptable risk level is defined taking into account market segmentation and sector concentration limits. In compliance with Recommendation S of the Polish Financial Supervision Authority, the Bank has identified a mortgage-secured credit exposure portfolio, not only in Retail Banking but also in Corporate Banking. The Bank manages the mortgage-secured credit exposure portfolio risk with a focus on defining an optimised portfolio structure in terms of quality (rating), currencies, country regions, tenors, and types of properties. The main principles of mortgage-secured credit exposure risk management in Corporate and Investment Banking, the risk profile, the division of responsibilities, the rules of determining internal limits, and the rules of reporting are set out in the mBank Mortgage-Secured Credit Exposure Risk Management Policy.

mBank Group strives to unlock synergies with Commerzbank more broadly in syndicated finance of selected Group clients. For K1 segment clients, mBank Group promotes innovative products which are low in capital consumption, in particular products of Investment Banking (ECM, DCM, M&A), Transactional Banking and Financial Markets, as well as arrangement of syndicated finance for selected big ticket clients to ensure satisfactory profitability and mitigate the risk of high concentration of individual clients/groups of related companies.

For corporate clients, in particular K2 segment clients, mBank promotes financing alternative to banking loans by arranging public and private programmes and club deals for bonds issued by clients with a stable financial position.

In addition, the bank acts as an arranger of private placements of bonds with investors selected by the issuer.

Retail Banking

Lending in Retail Banking is a key segment of the Group's business model, both in terms of the share in total assets and the contribution to its profits.

The Bank's retail credit offer covers a broad range of products financing the needs of individual customers (OF) and small companies (MF). The scope and construction of the offer derive from the One Bank Strategy, whereby credit products in combination with the state-of-the-art transactional platform, savings and insurance products address all financial needs of clients within the Group.

Apart from the Polish market, Retail Banking credit products are offered (since 2007) through the foreign branches (OZ) of the Bank in the Czech Republic and Slovakia in an online banking model similar to that operating in Poland since 2000. The share of the foreign branches' exposure portfolio was around 7% of the aggregate retail portfolio at the end of June 2015 (by value). The Bank ensures the coherence of the credit risk management policy on all markets; any differences in specific rules or parameter values derive from the specificities of local markets or different goals of business strategies and are at each time subject to approval by the Retail Banking Risk Committee.

As credit exposures are highly granular (more than 2 million active loans), the Retail Banking credit risk management process is based on a portfolio approach. This is reflected in the statistical profile of risk rating models including the models which fulfil the regulatory requirements of the Advanced Internal Ratings-Based approach (AIRB). The AIRB parameters (PD, LGD and EL) are used widely in order to estimate credit requirements, to determine acceptance criteria and terms of transactions, and to report risks.

Furthermore, Retail Banking credit risk management has the following characteristics:

- high standardisation and automation of the credit process, including decision-making, both in acquisition, post-sale services, and debt collection;
- little (as compared to Corporate Banking) discretionary competences in the decision-making process (e.g. no discretionary adjustment of clients' ratings);
- alignment of decision-making endowment with mass acquisition, including automation of decision-making for selected transactions;
- extensive risk reporting system based on portfolio analysis of credit exposure quality, including vintage analysis and days-past-due analysis.

Under the portfolio approach, exposures are classified (separately for each market) as ML (mortgage-secured products) or NML (unsecured products or products with collateral other than mortgage). Furthermore, the segmentation includes products for individuals (ML OF, NML OF) and products for business clients (ML MF, NML MF). The segmentation serves two main functions:

- ensuring correct alignment of risk rating methods (models, procedures, required documentation) with the client's risk profile, exposure and business requirements,
- defining homogeneous transaction sub-portfolios to enable assessment of their quality in the context of the generated income margin.

The main point of reference in the Retail Banking credit risk management process is risk appetite defined in correlation with the One Bank Strategy which provides for:

- optimisation of the balance-sheet structure in terms of profitability and financing by reducing the growth rate of credit portfolios with long tenors (and low margins) while supporting growth of short-term loans (with high margins),
- developing long-term financing of the Group's lending with mortgage bonds issued against retail mortgage loans.

Taking into account the above assumptions, the general principle underlying the lending strategy of the Group is to address the offer to clients who have an established relationship with the Bank or to address it to new clients for whom the loan is a product initiating a long-term relationship of highly transactional nature. Consequently, the Bank continues to focus its NML policies on lending to existing clients with a high creditworthiness while systematically growing the acquisition of external clients.

These initiatives include lending to clients under a joint project of mBank and one of the biggest telecom operators (Orange Finance Project). Furthermore, the Bank increasingly provides financing to clients who are shop online. To reduce operational risks of accepting new clients, the Bank develops its credit policy using, among others, credit testing and is actively developing its fraud prevention system.

For long-term loans (ML segment - mortgage loans), the Bank maintains a conservative policy of borrower creditworthiness and credit rating to offset the higher probability of systematic risk materialising within the lifetime of a loan. In view of the current historically low interest rate environment, in its creditworthiness rating the Bank focuses among others on long-term interest rate estimates.

In retail mortgage lending, in order to mitigate the risk of impairment of mortgage collateral in relation to the value of credit exposure, the Bank addresses its credit offer mainly to clients who buy properties within large urban areas.

As of 2015, the Bank implemented yet another reduction of maximum LtV under Recommendation S.

The modifications facilitate a programme of co-operation between mBank and mBank Hipoteczny which started in Q4 2013 and aims at sales of mortgage loans to retail clients. According to the assumptions, the retail mortgage loan portfolio of mBank Hipoteczny is financed with new issues of mortgage bonds.

In its credit risk management process, the Bank attaches great importance to communication between Risk and Retail Banking. The Retail Banking Risk Committee, established in 2010, is a platform of decision-making and dialogue between the two areas. As of 2014, the Committee covers both credit risk and all secondary risks derived from accepted credit risk (reputation risk, legal risk, operational risk, data quality risk, etc.).

**Quality of the loan portfolio**

As at 30 June 2015, the share of impaired exposures in the total (gross) amount of loans and advances granted to clients decreased from 6.4% at the end of H1 and H2 2014 to 6.0%.

Provisions for loans and advances to customers increased from PLN 2,790.8 million at the end of 2014 to PLN 3,019.0 million at the end of June 2015. The IBNI (Incurred But Not Identified) loss provision increased from PLN 242.4 million to PLN 261.9 million in that period.

The ratio of provisions to non-performing loans increased from 51.9% at the end of 2014 to 56.9% at the end of H1 2015.

To assess impairment, the Bank applies credit risk parameters based on those derived from the A-IRB methodology.

The manner of identifying evidence of default is based on all available credit data of a given client and encompasses all of the client’s liabilities towards the Bank.

In H1 2015, the Group’s loans and advances (net) to customers rose by almost 4%, where the increase was mainly driven by the rising exposure under retail mortgage and housing loans caused by changes to FX rates.

The table below presents the quality of mBank Group’s credit portfolio as at the end of June 2015 compared to the end of December 2014 and the end of June 2014.

| Quality of mBank Group’s Loan Portfolio | 30.06.2015 (PLN’000) | 31.12.2014 (PLN’000) | 30.06.2014 (PLN’000) |
|---|---|---|---|
| **Loans and advances to retail customers:** | **45 328 730** | **41 560 477** | **39 664 158** |
| - short-term | 5 800 143 | 5 442 653 | 5 343 170 |
| - term facilities, including: | 39 528 587 | 36 117 824 | 34 320 988 |
| - mortgage and housing loans | 33 521 442 | 30 510 513 | 29 169 136 |
| - other | - | - | - |
| **Loans and advances to corporate customers:** | **32 226 547** | **32 841 046** | **30 564 478** |
| - short-term | 4 218 458 | 3 701 490 | 4 203 981 |
| - term facilities: | 25 752 358 | 23 977 679 | 22 283 841 |
| - to large customers | 5 843 425 | 5 751 583 | 5 396 534 |
| - to mid-sized and small customers | 19 908 933 | 18 226 096 | 16 887 307 |
| - reverse repo / buy sell back | 842 093 | 3 838 553 | 2 652 320 |
| - other | 1 413 638 | 1 323 324 | 1 424 336 |
| **Loans and advances to the public sector** | **1 661 475** | **1 924 395** | **1 881 573** |
| **Other amounts due** | **1 043 880** | **1 047 273** | **621 462** |
| **Loans and advances (gross) to customers** | **80 260 632** | **77 373 191** | **72 731 671** |
| Provisions against loans and advances to customers (negative amount) | (3 019 034) | (2 790 841) | (2 594 494) |
| **Loans and advances (net) to customers** | **77 241 598** | **74 582 350** | **70 137 177** |
| | | | |
| Short-term (up to 1 year) | 23 188 113 | 26 964 700 | 25 740 229 |
| Long-term (over 1 year) | 54 053 485 | 47 617 650 | 44 396 948 |

| **Incurred but not identified losses** | | | |
|---|---|---|---|
| Gross balance-sheet exposure | 75 411 743 | 72 458 578 | 68 095 603 |
| Impairment provisions of exposures analysed on a portfolio basis | (261 858) | (242 401) | (269 765) |
| **Net balance-sheet exposure** | **75 149 885** | **72 216 177** | **67 825 838** |

| **Impaired receivables** | | | |
|---|---|---|---|
| Gross balance-sheet exposure | 4 848 889 | 4 914 613 | 4 636 068 |
| Provisions against impaired receivables | (2 757 176) | (2 548 440) | (2 324 729) |
| **Net balance-sheet exposure** | **2 091 713** | **2 366 173** | **2 311 339** |

### 11.2.2. Market risk

mBank organises market risk management processes in line with the principles and requirements set out in the resolutions and recommendations of the PFSA which address issues related to market risk management, in particular Recommendations A and I.

#### Tools and measures

In its business, mBank is exposed to market risk, i.e., the risk of unfavourable changes in the present value of financial instruments in the Bank's portfolios due to changes in market risk factors: interest rates, FX rates, prices of securities, the implied volatility of options, and credit spreads. The Bank identifies market risk related with positions of the trading book measured at fair value (using the direct measurement method or the model measurement method) which may materialise in the form of losses reflected in mBank's financial performance. Moreover, the Bank attributes market risk to the banking book positions, regardless of the methods for calculating earnings generated from those positions used for the purpose of accounting reporting. In particular, in order to measure the interest rate risk of Retail and Corporate Banking products without a fixed interest revaluation date or with rates administered by the Bank, the Bank uses replicating portfolio models. Since 2013, the Bank uses the capital modelling concept, which is reflected in market risk measurement at the level of the Bank's internal organisational structures. Market risk measures of the interest positions of the banking book are calculated with the use of net present value (NPV) models. Market risk exposure is quantified by measurement of Value at Risk (VaR) and by use of stress tests.

Stress testing reflects the hypothetical change in the present valuation of mBank's portfolios that would occur as a result of stress-test scenarios, i.e., specific stressed values of risk factors in a one-day time horizon.

Stress testing includes a standard stress test defined for standard risk factors: FX rates, interest rates, stock prices and their volatility, as well as a stress test including change of credit spreads. This addresses among others the requirement for stress tests to cover independent impact of underlying risk (spread between T-bond yields and IRS rates) to which the Bank is exposed by holding a portfolio of T-bonds.

Value at Risk measures the potential loss of market value (of a financial instrument, a portfolio, an institution) such that the probability of generating or exceeding it within a set time horizon is equal to the set tolerance (confidence) level assuming an unchanged portfolio structure within a defined period of time. mBank calculates and limits one-day Value at Risk at a 97.5% confidence level. In addition, VaR is calculated for the following risk factors: interest rates, FX rates and their volatility, stock prices and their volatility, and credit spreads.

Market risk, in particular interest rate risk of the banking book, is also quantified by measurement of Earnings at Risk (EaR) of the banking book.

#### Strategy

The implementation of market risk management strategy involves managing the Bank's positions in a way enabling to maintain market risk profile within the risk appetite defined by the Bank. The Bank is focused on meeting customers' business needs, while reducing trade in derivatives in terms of currency, currency pairs, nominal values and tenors of transactions, as well as applying the principle of lack of commodity open positions.

The market risk profile is derived from the strategic goals of business units, the policy of Committee (ALCO) in charge of shaping the structure of the Group's assets and liabilities and the limits on market risk exposure established by the Financial Markets Risk Committee (KRF) at the Bank level, and by the Management Board and Supervisory Board at the Group level. The system of limits reflects in a quantitative manner the defined risk appetite.

In accordance with the previously described general principles of risk management, market risk management is organized under so-called three lines of defence. The main principle of organisation of the market risk management process stipulates separation between the market risk monitoring and control function and the functions related with opening and maintaining open market risk positions. The market risk monitoring and control functions (assigned to the second line of defence) are performed by the Financial Markets Risk Department (DRR) in the Risk Area of the Bank supervised by the Vicepresident of the Management Board, Chief Risk Officer, whereas operational management of market risk positions (assigned to the first line of defence) takes place in the Financial Markets Department (DFM), the Brokerage Bureau (BM) and the Treasury Department (DS) supervised by the Vicepresident of the Management Board, Head of Financial Markets, as well as in the Debt Securities Issue Department (DCM) and Structured and Mezzanine Finance Department supervised by the Vicepresident of the Management Board, Head of Corporate and Investment Banking. BM is an organisational unit of mBank which was separated from the DFM structure and carries out its operations focusing on financial instruments traded on the Warsaw Stock Exchange (WSE). The Debt Securities Issue Department (DCM) is responsible for debt origination and management of positions in non-Treasury securities on the banking book. Investment positions sensitive to market risk factors are managed by the Structured and Mezzanine Finance Department (DFS). In addition, the Bank applies the rule of organizational separation between managing banking book operations (including portfolios of Treasury Department, Debt Securities Issue Department and Structured and Mezzanine Finance Department) and trading book operations (including portfolios of Financial Markets Department and Brokerage Bureau).

In order to limit the level of exposure to market risk, the Bank's Management Board (for the Bank portfolio) and the Financial Markets Risk Committee operating as part of the Risk and Business Forum (for portfolios of business units) set VaR limits, stress test limits, as well as maturity gap limits which are warning thresholds. These limits are cascaded to lower levels in accordance with the principles of the management of specific types of market risk and the internal procedures of the front-office units, which are dedicated to individual portfolios or risk positions. This is aimed at conscious development of the required market risk structure and acceptable level of exposure to individual type of market risk.

In Q1 2015, the Bank finalised a review of the mBank Group Market Risk Management Strategy. The modified Strategy was approved by the Bank's Management Board on 10 March 2015, received a positive opinion of the Risk Committee of the Supervisory Board, and was finally approved by the Supervisory Board on 30 March 2015.

**Measuring mBank's risk**

**Value at Risk**

In H1 2015, the Bank's market risk exposure, measured by Value at Risk (VaR, for one day holding period, at 97.5% confidence level), was moderate in relation to the VaR limits. The average utilisation of VaR limits for the portfolio of the Financial Markets Department (DFM), whose positions consist primarily of trading book portfolios, amounted to 50% (PLN 2.8 million), for the Brokerage Bureau (BM) 13% (PLN 0.17 million), and for the Treasury Department (DS), whose positions are classified solely in the banking book, 70% (PLN 29.3 million) for the positions without capital modelling, and 58% (PLN 24.4 million) for the positions with capital modelling. The average utilisation of the VaR limit for the positions of the Debt Securities Issue Department (DCM) was 16% (PLN 0.4 million). The average utilisation of the VaR limit for the positions of the Structured and Mezzanine Finance Department (DFS) in shares listed on the Warsaw Stock Exchange was 62% (PLN 5.6 million). In H1 2015, the VaR figures for the Bank's portfolio were driven mainly by portfolios of instruments sensitive to interest rates and to selected credit spread – T-bonds portfolios managed by DS in the banking book and managed by DFM in the trading book including interest rate swap positions. The second major factor impacting the Bank's risk profile was the DFS equities portfolio, where the PZU share price is a significant risk due to the maintained material position in the company by the Bank. The DFM portfolios of instruments sensitive to changes in exchange rates, such as

FX futures and options, and the exposure of the BM portfolios to equity price risk and the risk of implied variability of options traded on the WSE had a relatively low impact on the Bank's risk profile.

The table below presents VaR statistics of mBank's portfolio in H1 2015:

| PLN'000 | H1 2015 | | | | 2014 | | | |
|---|---|---|---|---|---|---|---|---|
| | 30.06.15 | average | max | min | 31.12.2014 | average | max | min |
| VaR IR | 17 899 | 18 087 | 23 329 | 13 421 | 16 457 | 14 693 | 19 081 | 8 122 |
| VaR FX | 605 | 791 | 1 096 | 524 | 937 | 348 | 1 162 | 95 |
| VaR EQ | 5 701 | 5 655 | 6 588 | 4 779 | 6 243 | 6 507 | 7 647 | 5 836 |
| VaR CS | 24 457 | 24 899 | 25 791 | 23 970 | 25 142 | 27 245 | 31 279 | 25 049 |
| VaR | **26 740** | **31 317** | **34 881** | **26 549** | **33 393** | **29 448** | **36 453** | **15 968** |

*VaR IR – interest rate risk*

*VaR FX - FX risk*

*VaR EQ – stock price risk*

*VaR CS – credit spread risk*

**Stress testing**

The utilisation of stress tests in H1 2015 is presented in the table below:

| PLN M | H1 2015 | | | | 2014 | | | |
|---|---|---|---|---|---|---|---|---|
| | 30.06.2015 | average | max | min | 31.12.2014 | average | max | min |
| Base stress test | 94 | 113 | 134 | 83 | 93 | 85 | 130 | 44 |
| CS stress test | 750 | 743 | 770 | 684 | 705 | 699 | 760 | 634 |
| **Total stress test** | **844** | **856** | **900** | **768** | **798** | **784** | **888** | **684** |

*Base stress test – standard stress test*

*CS stress test – stress test with scenarios including credit spread changes*

*Total stress test – total stress test (sum of the standard stress test and the stress test with scenarios including credit spread changes)*

In H1 2015, the average utilisation of the stress test limits in mBank was 65% (PLN 856.3 million). The average utilisation of the stress test limits in H1 2015 was 70% (PLN 666.2 million) for the portfolio held by DS without capital modelling and 66% (PLN 629.8 million) with capital modelling. The average utilisation of the limit was 48% (PLN 120.8 million) for the DFM portfolio, 12% (PLN 0.9 million) for the BM portfolio, 63% (PLN 38.7 million) for the DCM portfolio, and 67% (PLN 33.7 million) for the DFS portfolio. The main part of the presented stress test results is the value of stress tests for change of the credit spread of T-bond portfolios because the stress test scenarios assume on average a 100 bps increase of interest rates.

**Interest rate risk of the banking book**

In H1 2015, the interest rate risk of the banking book as measured by EaR, i.e., potential decrease of interest income within 12 months assuming an unfavourable 100 bps change of market interest rates (parallel shift of the curve by 100 basis points) and based on a stable value of the portfolio over the period, was as presented in the table below:

| PLN M | H1 2015 | | | | 2014 | | | |
|---|---|---|---|---|---|---|---|---|
| | 30.06.15 | average | max | min | 31.12.14 | average | max | min |
| PLN | 59.4 | 44.4 | 86.8 | 8.4 | 32.8 | 28.4 | 69.8 | 4.2 |
| USD | 2.4 | 2.0 | 2.8 | 0.8 | 1.0 | 1.4 | 4.0 | 0.2 |
| EUR | 38.4 | 20.4 | 59.8 | 0.03 | 4.5 | 6.6 | 12.6 | 1.4 |
| CHF | 17.8 | 11.9 | 38.8 | 0.0 | 13.3 | 0.8 | 15.7 | 0.0 |
| CZK | 2.4 | 2.3 | 4.7 | 1.3 | 2.3 | 4.2 | 8.5 | 2.2 |

**Measuring mBank Group's market risk**

The main sources of market risk of the Group are mBank's positions. The table below shows VaR statistics (VaR at a 97.5% confidence level for a one-day holding period) for mBank Group in H1 2015 for individual members of the Group in which market risk positions were identified (i.e., portfolios of mBank, mBank Hipoteczny, mLeasing, Dom Maklerski mBanku) and their decomposition to the VaRs corresponding to the main risk factor types – interest rate risk (VaR IR), foreign exchange risk (VaR FX), stock prices/index value risk (VaR EQ), and credit spread risk (VaR CS). The table below presents VaR statistics at the end of H1 2015.

| PLN'000 | mBank Group | mBank | mBH | mLeasing | DM mBanku |
|---|---|---|---|---|---|
| VaR IR average | 18 486 | 18 087 | 31 | 389 | 7 |
| VaR FX average | 788 | 791 | 16 | 20 | 21 |
| VaR EQ average | 5 668 | 5 655 | 0 | 0 | 108 |
| VaR CS average | 24 899 | 24 899 | 0 | 0 | 0 |
| VaR average | 31 703 | 31 317 | 37 | 388 | 110 |
| VaR max | 35 005 | 34 881 | 105 | 462 | 124 |
| VaR min | 26 870 | 26 549 | 17 | 338 | 96 |
| VaR 30.06.2015 | **27 297** | **26 740** | **53** | **355** | **114** |

For comparison, at the end of 2014, VaR for mBank Group was PLN 33,513 thousand, including VaR of mBank at PLN 33,393 thousand, mBank Hipoteczny – PLN 53 thousand, mLeasing – PLN 424 thousand, Dom Maklerski mBanku – PLN 112 thousand.

### 11.2.3. Liquidity risk

mBank organises liquidity risk management processes in line with the principles and requirements defined in PFSA Resolution No. 258/2011 of 4 October 2011, PFSA Resolution No. 386/2008 of 17 December 2008 on establishing liquidity measures binding on banks, and best practice, in particular PFSA recommendations on liquidity risk management (Recommendation P).

**Tools and measures**

In its operations, mBank is exposed to liquidity risk, i.e., the risk of being unable to honour its payment obligations, arising from the Bank's balance-sheet and off-balance-sheet positions, on terms advantageous to the Bank and at a reasonable price.

In terms of its sources, liquidity risk may result from internal factors (reputation risk resulting for instance in excessive withdrawal of cash by Bank clients, materialisation of credit risk) and external factors (turbulences and crises on the financial markets, country risk, turbulences in the operation of clearing systems).

For this purpose, the Bank has defined a set of liquidity risk measures and a system of limits and warning thresholds which protect the Bank's liquidity in the event of unfavourable internal or external conditions. Independent measurement, monitoring and controlling of liquidity risk is performed daily by the Financial Markets Risk Department. The main measures used in liquidity risk management of the Bank include ANL (Available Net Liquidity), the regulatory measures (M1, M2, M3, M4), and LCR and NSFR for analysis only. ANL reflects the projected future cash flow gap of assets, liabilities and off-balance-sheet commitments of the Bank, which represents potential risk of being unable to meet liabilities within a specific time horizon and under a certain scenario. ANL cash flow projections are based on crisis scenarios which include excessive withdrawal of cash by the Bank's clients and being unable to liquidate some assets due to an external crisis.

In H1 2015, mBank continued to harmonise with the CRR requirements for LCR and NSFR liquidity measures. In October 2014, the European Parliament approved a delegated act which defines modifications to the LCR calculation and now the Bank is engaged in harmonisation efforts which are scheduled to close by October 2015.

**Strategy**

The liquidity strategy is pursued by active management of the balance sheet structure and future cash flows as well as maintenance of liquidity reserves adequate to liquidity needs depending on the activity of the Bank and the current market situation as well as funding needs of the Group subsidiaries.

The Bank manages liquidity risk at two levels: strategic (within committees of the Bank) and operational (Treasury Department).

Liquidity risk limiting covers supervisory and internal measures.

The first category includes four liquidity measures determined by the Polish Financial Supervision Authority: M1, M2, M3 and M4. Liquidity measures required by the CRD IV/CRR: LCR (Liquidity Coverage Ratio) and NSFR (Net Stable Funding Ratio) are monitored, and LCR is additionally reported to the National Bank of Poland.

The liquidity risk internal limit system is based mainly on defining acceptable gaps for ANL tenors in specific time horizons and for different liquidity risk profiles (for all currencies in aggregate converted to PLN) and for specific foreign currencies.

The Bank has introduced a centralised approach to the Group's funding management in order to increase the efficiency of liquidity resources used. According to its principles, mBank Hipoteczny raises additional funding on the market by issuance of covered bonds and from mBank, while mLeasing and other subsidiaries raise almost all of their funding from mBank. Financing of subsidiaries is done via the Treasury Department.

The centralised approach to the financing of the Group subsidiaries enables to ensure better matching of the tenors of funding and a uniform treatment of particular subsidiaries within the unified system of transactional rates.

In Q1 2015, the Bank finalised a review of the mBank Group Liquidity Risk Management Strategy. The modified Strategy was approved by the Bank's Management Board on 10 March 2015, received a positive opinion of the Risk Committee of the Supervisory Board, and was finally approved by the Supervisory Board on 30 March 2015.

Since early March 2015, a limit of the volume of foreign currency funding of mBank with FX-swaps and CIRS is set in order to determine the relevant risk appetite accepted by the Bank. In addition, the limit is decomposed into individual limits for CIRS and FX-swaps as well as limits for funding in EUR and CHF. The limit structure reflects the Bank's preference for currency funding with long tenors.

**Measuring mBank's liquidity risk**

The liquidity of mBank remained safe in H1 2015, as reflected in the high surplus of liquid assets over short-term liabilities in the ANL tenors and in the regulatory measures.

The table below presents the ANL gap for tenors up to 1M and 1Y in H1 2015 as well as the regulatory measures M1, M2, M3, M4 and LCR:

| Measure* | 2015 | | | |
|---|---|---|---|---|
| | 30.06.2015 | average | max | min |
| ANL 1M | 6 323 | 8 449 | 13 968 | 4 352 |
| ANL 1Y | 8 298 | 8 680 | 13 886 | 4 551 |
| M1 | 6 015 | 9 205 | 14 789 | 4 657 |
| M2 | 1.19 | 1.34 | 1.59 | 1.15 |
| M3 | 5.83 | 5.48 | 6.08 | 4.86 |
| M4 | 1.29 | 1.29 | 1.33 | 1.27 |
| LCR | 129% | 139% | 154% | 129% |

** ANL and M1 are shown in PLN million, M2 is a relative measure presented as a decimal.*

**Measuring the Group's liquidity risk**

The Group's liquidity risk measurement includes mBank Hipoteczny, mLeasing and, as of 1 August 2014, also Dom Maklerski mBanku. mBank monitors liquidity risk of the subsidiaries in the ANL tenors so as to protect liquidity also at Group level in the event of adverse events (crises).

The Group's liquidity was safe in H1 2015, as reflected in the high surplus of liquid assets over short-term liabilities in the ANL tenors calculated at Group level.

The table below presents the ANL gap for tenors up to 1M and 1Y at mBank Group level:

| PLN M | H1 2015 | | | |
|---|---|---|---|---|
| | 30.06.2015 | average | max | min |
| ANL 1M | 7 958 | 9 980 | 15 446 | 5 977 |
| ANL 1Y | 10 830 | 10 433 | 15 445 | 6 963 |

### 11.2.4. Operational risk

mBank organises the operational risk management process taking into account the rules and requirements set out in the Resolution No. 76/2010 of the Polish Financial Supervision Authority of 10 March 2010 as well as in the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013. The abovementioned regulations as well as recommendations of the Polish Financial Supervision Authority (including Recommendations M, H and D, in particular) constitute a starting point for developing the framework of the operational risk control and management system in mBank Group.

**Tools and measures**

The Bank understands operational risk as the possibility of incurring a loss arising from inadequate or defective internal processes, systems, errors or actions taken by the Bank's employee or from external events. In particular, operational risk includes legal risk.

Operational risk accompanies all processes at banks (inadequate or defective internal processes, systems, human errors or external events) and its consequences can be often very harmful. It is characterized by an asymmetric distribution of losses; overwhelmingly, these are small value losses. Large losses are rare but the size of such a loss may exceed the sum of all the remaining operational losses in a given reporting period.

In order to effectively manage operational risk (identification, monitoring, measurement, assessment, reporting as well as reduction, avoidance, transfer or acceptance of operational risk), the bank applies quantitative and qualitative methods and tools. The tools applied by the Bank intend to cause-oriented operational risk management and focus on bottom-up approach to identify risk.

The basic qualitative tool is the self-assessment of internal control system carried out by the Bank's organizational units. The Bank has just completed implementing the Internal Control System Self-assessment, which replaced formerly existing Risk Self-assessment Surveys and the functional control process. The Internal Control System Self-assessment includes assessment of key operational risks and control mechanisms applied for mitigating those risks, and then to develop corrective action plans for identified weaknesses. The process will be repeated periodically, once a year, and its results are accepted by the Management Board, and then presented to the Risk Committee of the Supervisory Board and the Audit Committee of the Supervisory Board.

Another tool - the key risk indicators (KRI) - enables identification and evaluation in particular areas of the Bank's operations, of operational risk factors that have an ongoing impact on that risk level in those areas and, therefore, also in the entire Bank.

The Bank prepares also scenario analyses describing risks associated with rare operational risk events with potentially very serious consequences. Quantitative tools of the operational risk methodology include mainly collection of data on operational incidents and effects. With the use of the database available at the mBank Group, data on operational risk losses are recorded with an emphasis on the cause. Recorded data are analysed by the Integrated Risk and Capital Department and at organizational units, which allows organizational units to carry out ongoing monitoring of their current risk profile.

The implementation of qualitative elements and comprehensive collection of operational loss data is required for both the standard and the advanced measurement method (AMA) for the calculation of regulatory capital in accordance with the requirements of the New Capital Accord and in order to fulfil the relevant Pillar II requirements.

**Strategy**

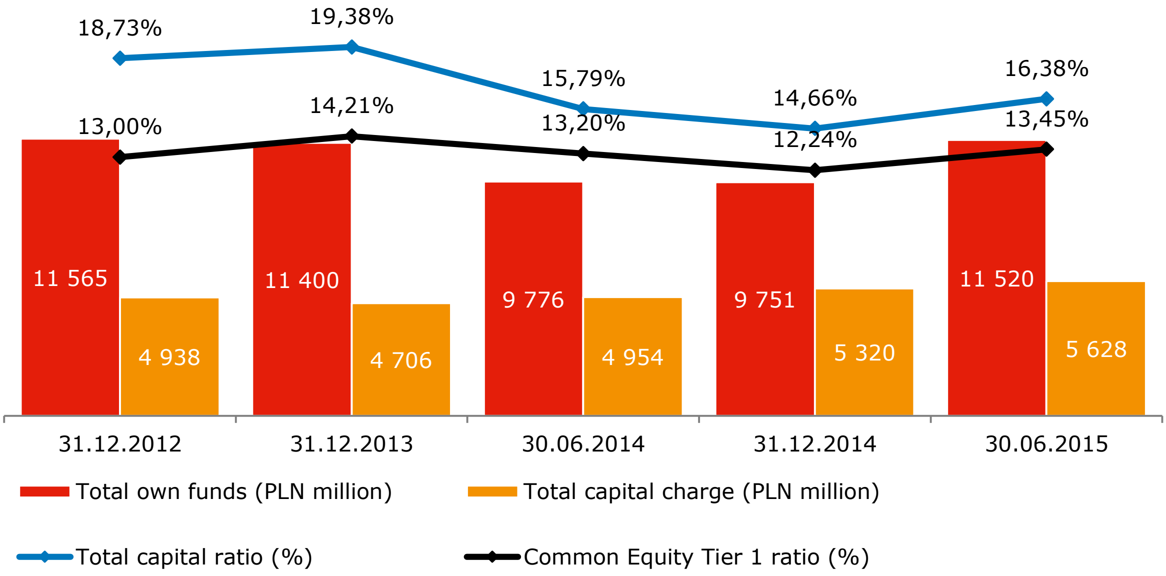
The operational risk control and management system, with its classification of roles and responsibilities, forms an organisational basis in order to enable effective control and management of operational risk at every level of mBank's organisational hierarchy. The structure of operational risk control and management covers in particular the role of the Management Board of the Bank, the Business and Risk Forum, the Chief Risk Officer, the Integrated Risk and Capital Management Department, and the tasks assigned to persons managing operational risk in particular organisational units and business areas of the Bank. The operational risk control and management process at mBank is developed and co-ordinated by the central operational risk control function while operational risk management takes place in every organisational unit of the Bank and in every subsidiary of mBank Group. It consists in identifying and monitoring operational risk and taking actions aimed to avoid, mitigate or transfer operational risk.

The entire operational risk control process is supervised by the Supervisory Board of the Bank through its Risk Committee.

## 11.3. Capital adequacy

Maintaining an adequate level of capital is one of the main tasks of managing the balance sheet of the Bank. The Management Board of mBank ensures consistency of the capital and risk management process by means of a system of strategies, policies, procedures and limits for the management of particular risks which constitute the ICAAP architecture. Furthermore, in line with the Capital Management Policy applicable at mBank, mBank maintains an optimum level and structure of own funds, guaranteeing maintenance of the capital adequacy ratio at a level higher than the statutory minimum, at the same time covering all significant risks identified in the Bank's operations. mBank's capital targets are being set based on the regulatory requirements and simulated capital needs to cover unfavourable changes in the external environment and within the Bank.

**Capital Adequacy of mBank Group**




The Capital Management Policy at mBank is based on two main pillars:

- Maintenance of an optimal level and structure of own funds, with the use of available methods and means (retained net profit, issue of shares, subordinated bonds, etc.).
- Effective use of the existing capital among others by applying a system of capital utilisation measures resulting in reduction of the activity that is not generating the expected return and development of products with lower capital absorption.

The capital ratios of mBank Group in H1 2015 were driven by the following factors:

- addition of PLN 750 million to the own funds: it is the Group's subordinated liability following the issuance on 17 December 2014 of subordinated bonds (face value PLN 750 million, maturing in 2025), approved by the PFSA on 8 January 2015;
- early repayment of a subordinated loan of CHF 90 million (face value), approved by the PFSA on 8 January 2015, previously included in the own funds;
- increase of the consolidated own funds of mBank Group following the 2014 profit distribution decision of the General Meeting;
- inclusion of the company Aspiro Sp. z o.o. in prudential consolidation;
- expansion of the application of the internal rating approach to cover the calculation of the credit risk and counterparty credit risk requirements following the approvals of the PFSA and BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht, the Federal Financial Supervisory Authority) of the Bank's exposure to commercial banks and retail mortgage-secured exposures (micro-companies) received in H1 2015;
- recalibration of the LGD model in Corporate Banking.

**Capital buffers**

In mBank, risk appetite covers all significant risks and key risk concentrations embedded in its business strategy by setting appropriate capital buffers for risk resulting from potential materialisation of selected risk factors related to existing portfolios and planned business, and it addresses expected new regulatory requirements and potential negative macroeconomic changes.

### Stress tests

The integrated stress tests are conducted assuming a scenario of unfavourable economic conditions that may adversely affect the Bank's financial position in at least a full two-year time horizon (for liquidity risk, in a one-year horizon). The risk scenario, i.e., the most plausible (in at least a full two-year time horizon) scenario of negative deviations from the base scenario, expressed in terms of macroeconomic and financial ratios, is common for all risk types, applied at Group level and aligned with the corresponding scenario accepted by the consolidating entity.

Additionally, once a year, the Bank carries out supplementary stress tests using much more severe risk scenarios and/or selected risk concentrations. The Group and the Bank carry out reverse stress tests, the goal of which is to identify events potentially leading to unviability of the Group and the Bank.

The Group and the Bank take part in regulatory stress tests conducted by the PFSA in order to determine the impact of assumed macroeconomic stress scenarios on the Group's balance sheet and P&L as well as on external supervisory norms.

## 12. mBank's Authorities

### Supervisory Board of mBank S.A.

In H1 2015, no changes to the composition of the Supervisory Board of mBank have been made. Composition of the Supervisory Board:

1. Maciej Leśny – Chairman of the Supervisory Board
2. Martin Zielke – Deputy Chairman of the Supervisory Board
3. Martin Blessing – Member of the Supervisory Board
4. Andre Carls – Member of the Supervisory Board
5. Stephan Engels – Member of the Supervisory Board
6. Thorsten Kanzler – Member of the Supervisory Board
7. Teresa Mokrysz – Member of the Supervisory Board
8. Stefan Schmittmann – Member of the Supervisory Board
9. Agnieszka Słomka-Gołębiowska – Member of the Supervisory Board
10. Waldemar Stawski – Member of the Supervisory Board
11. Wiesław Thor – Member of the Supervisory Board
12. Marek Wierzbowski – Member of the Supervisory Board

There are four independent members in the Supervisory Board: Maciej Leśny, Agnieszka Słomka-Gołębiowska, Waldemar Stawski and Marek Wierzbowski.

Résumés of all members of mBank authorities are available on www.mBank.pl

The Supervisory Board has got 4 committees: the Executive Committee, the Risk Committee, the Audit Committee, and the Remuneration Committee. Members of individual committees are presented below (first – chairmen of the committees).

| Executive Committee | Risk Committee | Audit Committee | Remuneration Committee |
|---|---|---|---|
| Maciej Leśny | Stefan Schmittmann | Stephan Engels | Andre Carls |
| Martin Blessing | Thorsten Kanzler | Andre Carls | Maciej Leśny |
| Andre Carls | Maciej Leśny | Maciej Leśny | Marek Wierzbowski |
| Teresa Mokrysz | Agnieszka Słomka-Gołębiowska | Waldemar Stawski | Martin Zielke |

### Management Board of mBank S.A.

In H1 2015, the composition of the Management Board of mBank remained unchanged and as at 30 June 2015 it was as follows:

1. Cezary Stypułkowski – President of the Management Board, Chief Executive Officer
2. Przemysław Gdański – Vice-President of the Management Board, Head of Corporate and Investment Banking
3. Jörg Hessenmüller – Vice-President of the Management Board, Chief Financial Officer
4. Lidia Jabłonowska-Luba – Vice-President of the Management Board, Chief Risk Officer
5. Hans-Dieter Kemler – Vice-President of the Management Board, Head of Financial Markets
6. Cezary Kocik – Vice-President of the Management Board, Head of Retail Banking
7. Jarosław Mastalerz – Vice-President of the Management Board, Head of Operations and Information Technology.

Résumés of all members of mBank authorities are available on www.mBank.pl

## 13. Statements of the Management Board

### True and fair picture in the presented reports

The Management Board of mBank S.A. declares that according to their best knowledge:

- IFRS Condensed Consolidated Financial Statements for the first half of 2015 and the comparative figures were prepared in compliance with the binding accounting principles and present a true, fair and clear picture of the financial position and the condition of the assets of mBank S.A. Group as well as its financial performance;
- Management Board Report on the Performance of mBank S.A. Group in the first half of 2015 presents a true picture of the developments, achievements, and situation of the mBank S.A. Group, including a description of the main risks and threats.

### Appointment of the auditor

The Auditor authorised to audit financial statements and performing the review of the IFRS Condensed Consolidated Financial Statements of mBank S.A. Group for the first half of 2015 and IFRS Condensed Stand-alone Financial Statements of mBank S.A. for the first half of 2015 – Ernst & Young Audyt Polska Spółka z ograniczoną odpowiedzialnością Sp. k. - was appointed in compliance with legal regulations. The audit company and its auditors fulfilled the conditions necessary for issue of a review report of these financial statements, in compliance with respective provisions of Polish law and professional standards.

### Signatures of the Management Board of mBank S.A.

| Date | First and last name | Position | Signature |
|---|---|---|---|
| 30.07.2015 | Cezary Stypułkowski | President of the Management Board,<br>General Director of the Bank | |
| 30.07.2015 | Lidia Jabłonowska-Luba | Deputy President of the Management Board, Chief Risk Officer | |
| 30.07.2015 | Przemysław Gdański | Deputy President of the Management Board, Head of Corporate and Investment Banking | |
| 30.07.2015 | Jörg Hessenmüller | Deputy President of the Management Board, Chief Financial Officer | |
| 30.07.2015 | Hans-Dieter Kemler | Deputy President of the Management Board, Head of Financial Markets | |
| 30.07.2015 | Cezary Kocik | Deputy President of the Management Board, Head of Retail Banking | |
| 30.07.2015 | Jarosław Mastalerz | Deputy President of the Management Board, Head of Operations and Information Technology | |