

Letter of the President of the Management Board of mBank S.A. to the Shareholders

Dear Shareholders,

For the first time in history, we present the Report of the Management Board on the activity of mBank Group in a new format: as an integrated report. This is our first attempt to face the demanding task of outlining the process of value creation in our institution. The report covers both financial issues and non-financial areas of our activity. It reflects our conviction that the Bank's success and its financial and business performance depend on the trust of and collaboration with a multitude of stakeholders, mainly including our customers. This thinking underlies our new strategy, which is customer-centric. All that we do is guided by the customers' needs; customer satisfaction with our products and services is the main pillar of mBank's further growth.

Despite many challenges in the external environment, 2016 was a very successful year for our Bank, not least in terms of operating results. Net profit attributable to the shareholders of mBank reached PLN 1,219.3 million, representing a decrease of 6.3% year on year; however, the operating profit adjusted for one-off events in 2016 and 2015 improved by 15.6% year on year. This satisfying result was generated under strong pressures exerted on the revenue of financial institutions. Since the Monetary Policy Council cut the reference rate to a historical low of 1.5% in March 2015, the Polish banking sector has taken steps to rebuild the interest margin. Repricing affected mainly the cost of financing while credit margins improved mainly thanks to a shift in the structure of the loan portfolio. It was not easy to improve the net fee and commission income, which was adversely impacted by reduced interchange fees on cashless transactions with payment cards, slowdown in new lending, Recommendation U, and weak capital markets. However, driven by a dynamic growth of business, customer acquisition, as well as steadily rising transactionality, mBank Group generated a historically high core income of PLN 3,793.3 million, with the net interest income growing by 12.8% and the net fee and commission income rising by 1.0%.

An important factor which partly offset the tax on certain financial institutions introduced in February 2016 was a one-off gain on the Visa transaction, which was PLN 251.7 million at mBank. As a result, mBank Group's total income was close to PLN 4.3 billion, an increase of 4.9% year on year, despite the sale of BRE Ubezpieczenia TUIR to AXA Group and the sale of a stake in PZU in 2015, which translated into gains of PLN 319.3 million. Furthermore, it should be noted that the Polish banking sector paid significant one-off costs last year including an additional payment to the Banking Guarantee Fund at PLN 2.0 billion caused by the bankruptcy of Spółdzielczy Bank Rzemiosła i Rolnictwa w Wołominie, as required to cover guaranteed deposits, as well as a contribution to the Borrower Support Fund equal to PLN 600 million. The total contributions of mBank and mBank Hipoteczny to both funds were PLN 193.8 million. Another bankruptcy took place in the co-operative banking sector in Q4 2016, albeit on a smaller scale; mBank Group's resulting expense was PLN 10.9 million.

According to reported results, the cost/income ratio was 45.7%; net of positive and negative one-offs, the normalised C/I was 48.2% v. 49.2% a year earlier. High efficiency is a key attribute of our operating model while a structural cost advantage continues to set us apart from other financial institutions in Poland. Recurrent administrative costs including amortisation rose by 5.1% in 2016 to PLN 1,952.3 million. This was mainly driven by continued investments in future growth, development of facilitations for customers, as well as improved security of the Bank's systems; as a result, IT expenditures grew by close to 23% year on year. mBank Group's average headcount increased by 78 FTEs in 2016, resulting in an increase of employee expenses by 2.6%.

Prudent risk management, a conservative credit policy, and in-depth sector expertise preventing excessive exposure to any sector in a weaker condition ensure a high quality of our loan portfolio. The cost of risk was 45 basis points in 2016 while net loan loss provisions decreased by 13.3% year on year to PLN 365.4 million. The provisions additionally improved with the sale of corporate and retail impaired receivables. As a result, mBank Group's NPL ratio decreased to 5.4% at the end of 2016 while the coverage ratio was 57.1%. Furthermore, it should be noted that the strong Swiss franc prevailing since mid-January 2015 did not affect our retail customers' capacity to pay loan instalments while the continued repayment of the portfolio at ca. 7% per year resulted in a nominal and relative decrease of its share in the balance sheet.

Last but not least, mBank Group's profitability in 2016 was strongly affected by the tax on certain financial institutions, which reduced the profit by PLN 328.9 million, equivalent to 2.7 percentage

points of return on equity. ROE fell to 10.1% versus 11.8% in 2015. However, the ratio should be considered from the perspective of continued improvement of the Bank's capital base. This approach is grounded in measures taken by the regulator to reinforce the stability of the Polish banking sector and its resilience to shocks. The Polish Financial Supervision Authority (KNF) requires mBank to maintain the highest additional capital requirement for the risk related to FX retail mortgage loans. Following a revision in Autumn 2016, the consolidated additional capital requirement is 3.25 percentage points of TCR (total capital ratio) and 2.44 percentage points of Tier 1 capital ratio. Furthermore, an Other Systemically Important Institution (O-IIS) capital buffer of 0.5% of the total risk exposure was imposed on the Bank in early October 2016. As a result, mBank Group is required to maintain capital ratios of at least 13.19% (Tier 1) and 17.00% (TCR). Even in view of such high requirements imposed by KNF, our capital position is well above the regulatory minimum.

mBank Group's balance sheet structure improved in 2016. The volume of gross loans, net of the FX effect and reverse repo transactions, increased by 3.1% year to year to PLN 84.6 billion at the end of 2016. New production of non-mortgage loans increased by 26% year on year to a record-high PLN 6.1 billion. Meanwhile, as margins were raised to maintain product profitability, the volume of new mortgage loans decreased by 36%. It should be noted that we completed the transition of mBank Group's residential mortgages financing model. As of September 2016, after nearly three years of work, each new mortgage loan offered to mBank's retail customers is booked on the balance sheet of mBank Hipoteczny to build up a pool of collateral for issues of covered bonds. Tranches of these instruments placed on the market in the past years have maturities up to 15 years, largely improving the maturity match of assets and liabilities. Due to a certain slowdown and in the absence of demand in the corporate segment, and in view of the Bank's policy of non-engagement in unprofitable customer relations, we have partly moved from financing of large corporates to SMEs, where the volume of loans grew by 9.8%.

We continued to develop our deposit base, which stood at PLN 91.4 billion at the end of 2016, rising by 12.7% year on year. The balances of retail customers' current accounts continued to grow dynamically; combined with balances in savings accounts, they expanded by 17.2% year on year. Importantly, the growth rate was superior to that of customer acquisition; this implies that it was driven by enhanced transactionality, which has always been our goal as we offer the most convenient online and mobile banking systems. These growth rates helped to lower the loan-to-deposit ratio, which stood at 89.4% at the end of 2016 versus 96.7% a year earlier. We have not seen an LtD ratio of this order at mBank for more than 10 years. Speaking of the sources of funding, it is important to mention the EMTN issue of September 2016. After a pause of more than two years, the prices on the international debt market became so attractive for mBank that we issued EUR 500 million of unsecured Eurobonds with a maturity of 4 years and an attractive coupon of 1.398% p.a. We repaid CHF 800 million of borrowings to Commerzbank in 2016.

One of the key features which distinguish mBank from the consolidating Polish market is the ability of organic growth, which we have turned into a major competitive advantage. Our customer acquisition in 2016 was once again more than satisfactory. We added 1,378 companies to our corporate customer database, which stood at 20,940 at the end of 2016. The number of mBank's retail customers grew by 246 thousand in Poland and 73 thousand in the Czech Republic and Slovakia. We also added 81 thousand accounts to the Orange Finance database. mBank now serves 5,348 thousand customers in three markets. It should also be noted that we have the highest mobile customer penetration rate in the sector. The ratio of active mobile banking users to the number of personal accounts is now close to 40%. The campaign launched in early August targeting young clients (13-24 years) with an offering and communication style developed especially for the target group will certainly give a strong boost to the development of the channel.

On 10 June 2016, the Supervisory Board approved the new "mBank Group Strategy for 2016-2020" entitled "mobile Bank". The approval of the strategy completed many months of preparatory work including the drafting of the mission, the selection of the pillars of mBank's activity in the coming years, and the definition of the critical elements and resources necessary to attain the goals. By 2020, our business activity will focus on three strategic areas: empathy, mobility, efficiency. mBank wants to meet the authentic needs of clients in simple and user-friendly ways, generating positive emotions in line with the positioning of the brand. The aspiration is reflected in the new mission, which highlights the focus on providing customers with whatever they need at the right place and time: *To help. Not to annoy. To delight... Anywhere.*

In view of the dynamic evolution of the regulatory and operating environment of the banking sector, it is a great challenge to define reliable financial targets in a five-year time horizon. As we want to be responsible in defining our aspirations, while a precise indication of financial measures would, under the current circumstances, involve major risks of obsolescence in the coming years, mBank Group's financial targets are defined in relative terms instead of rigid numbers. We believe that our strengths allow us to generate better financial results than our peers, and we defined our target position along five dimensions. In terms of cost efficiency (Cost/Income ratio) and return on equity (net ROE), we want to be one of top three listed banks in Poland every year. By 2020, we want to reach the podium in terms of return on assets (ROA net). We will maintain a CET1 ratio at least 1.5 percentage points above mBank's capital requirement, as well as a capacity to pay out a dividend taking into account of the regulatory restrictions. Finally, our loan-to-deposit ratio may be only slightly more than 100%. The "mobile Bank" strategy outlines a vision of mBank Group's business growth; it is not a closed-ended list of initiatives to take in the next five years as the current pace of change requires us to maintain strategic agility in our approach and action.

The issue of FX mortgage loans remains unresolved. Debates about potential assistance to bank customers who are CHF borrowers have continued for more than two years. We are ready to discuss the economic and social rationale of further assistance measures, which would not endanger the interests of our deposit holders but could support families which repay their own housing at a disproportionate cost. mBank was quick to implement just such solutions: our customers may have the crediting period extended, some of the instalments suspended, the FX spread reduced, the loan converted into PLN at NBP's average exchange rate at no extra fee. I can assure you that the repayment rate of our FX loan portfolio remains very strong.

The composition of mBank Group changed in 2016. On 20 May 2016, we formally closed the integration of Dom Maklerski mBanku and mWealth Management into the organisation of mBank. The goal of the integration of the brokerage, private banking and wealth management services were to create a comprehensive investment offer under one brand, targeting the most demanding institutional and private clients, and to combine the competences and experience of our experts to better address customers' needs. mLeasing closed its product gap by adding innovative solutions and developing competences in retail customer service; mKsięgowość – the accounting service for micro-firms was integrated with the bank account service; and SMEs were offered fixed-rate loans.

In the non-financial part of the report, we describe our achievements, goals, risks and opportunities in the CSR area with regard to the five key areas identified in the CSR Strategy of mBank for 2016-2020. These are: building a stable and long-lasting relationships with clients, conducting socially responsible lending policies, creating a unique team, reducing the so-called environmental footprint of the bank and the improvement of the mechanisms of responsible management in the organization.

Among the CSR activities undertaken in 2016, I would like to pay special attention to the continuation of the first social campaign promoting online security, launched in 2015. We also conducted a process of simplifying credit agreements, and mBank Foundation carried out a number of educational activities. In addition, in 2016 we launched a deaf customer service, introducing into our transactional service an online video-chat with a bank expert who knows the Polish sign language or using translation services available in every bank's outlet.

To summarise, despite many adverse developments in the external environment which financial institutions still face in 2017, including the banking tax, more restrictive capital requirements, the impact of recommendations published by the Financial Stability Committee in January, amended rules of calculation of BFG contributions, as well as further proposals intended to limit the space for banks to charge fees and commissions, I am certain that mBank Group's business performance, which is a function of our relations with customers, will continue to improve. We have the qualities which ensure continued expansion in the strategic segments whatever the circumstances. Our competences, experience, professionalism, and state-of-the-art offer based on advanced technological solutions help us to efficiently acquire new customers and provide them with top quality service, resulting in a steady growth of revenue.

May I thank you, our Shareholders, for your unwavering trust, and assure you that we will continue to deliver satisfying returns based on the strong foundations of our business model.

I thank the Supervisory Board for their close co-operation and reliable support.

I also wish to thank our employees, whose continued engagement contributed to mBank Group's success last year. I do believe that we are well prepared to leverage our competitive advantages and successfully meet the challenging market situation in 2017.

Yours faithfully,

Cezary Stypułkowski