

**Management Board Report
on the performance of mBank Hipoteczny S.A.
in the first half of 2020**

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1. Activity of mBank Hipoteczny S.A. in the first half of 2020

In July 2018, mBank Hipoteczny S.A. (hereinafter the "Bank") adopted objectives for its operating strategy for 2019–2022.

The strategy for 2019–2022 responds mainly to challenges resulting from the current and expected intensive development of the covered bond market in Poland as well as the strong demand for Polish covered bonds in the European Union, supported by continued low interest rates. Simultaneously, the strategy continues the assumptions regarding the safe financial structure of mBank Group, and in the currently growing competitive pressure among mortgage banks, it stresses the importance of the cost-effectiveness of the Bank's business model.

The Bank's strategy assumes that the foundation of its operations will be to obtain long-term refinancing for mBank Capital Group (hereinafter referred to as "mBank Group"), i.e. to issue covered bonds in the most cost-effective business model possible. Such a direction requires primarily ensuring an appropriate scale of assets in the Bank's balance sheet that meet the criteria for securing covered bonds.

There are three business areas at the Bank:

- retail area, based on the transfer of mortgage loans for natural persons from mBank's portfolio (retail pooling);
- commercial area, based on the management of the existing portfolio of commercial real estate transactions (CRE);
- mortgage covered bonds issuance area, responsible for ensuring long-term financing of loans with covered bonds.

In the coming years, the Bank will develop the portfolio of retail mortgage loans in close cooperation with mBank, i.e. assuming that the sales will be executed by the forces of mBank, within the already functioning cooperation model.

From the end of 2012 the Bank does not finance local government units or other entities with a guarantee of local government units, which results from the risk profile of this segment and inadequate credit margins. This approach has been maintained in the update of the strategy for years 2019-2022. Nevertheless, the Bank owns a historically developed portfolio of credit transactions for this segment. In 2020 the Bank does not plan to increase the scale of transactions financing commercial real estate (CRE).

1.1. Key projects

Implementation of AIRB method

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

A substantial part of the recommendations identified during the inspection was addressed by the Bank, among others by redesigning the LGD model. In order to bring the LGD model in line with the applicable requirements, mBank redesigned the model in 2018. This significant change was concluded with an inspection carried out in December 2018. At present, mBank is still awaiting approval of the model by the PFSA.

At the same time, in order to meet the expectations of the supervisory authorities, work is underway to ensure alignment to the new definition of default, including, among others, redesign of group models for the retail portfolio based on which the Bank applies for permission to use the AIRB approach. The application to apply the A-IRB approach to the retail portfolio acquired within the framework of cooperation with mBank S.A. is planned to be submitted upon the models' alignment with the New Definition of Default.

EBA's guidelines on outsourcing

In the first half of 2020, works to ensure the Bank's alignment with the European Banking Authority's guidelines (EBA Guidelines) of 25 February 2019 on outsourcing arrangements were continued. The date of alignment of financial institutions to the Guidelines, anticipated by the PFSA Office, was extended until 28 December 2020. In the reported period, the Bank commenced an analysis of concluded agreements in order to meet the conditions resulting from the Guidelines. When implementing the Guidelines, the Bank is assisted by an external legal counsellor, it cooperates with mBank and a working group at the Polish Bank Association.

Definition of Default

The Bank has started preparations to implement changes related to the entry into force of the European Commission regulation EU No 2018/171 issued pursuant to Article 178 of the Regulation No 575/2013 (CRR) on changes in the definition of default applied by banks. The work are conducted by a dedicated project team in close cooperation with a respective team appointed at mBank S.A.

In June 2020, a request was submitted to the ECB for a permit for a significant change in the applied IRB method, involving a change of the definition of default. The submission of the request was preceded by preparation of changes in the procedures, processes and information systems.

Green Covered Bonds

The Bank has adopted the mBank Group Green Bond Framework, a significant part of which refers to green covered bonds. The Framework sets out the objectives of the mBank Group and the principles for supporting environmental objectives of the European Union, as well as the UN Sustainable Development Goals. The Framework of the mBank Group is in line with the principles concerning green bonds (Green Bond Principles – GBP), which was confirmed by the Sustainalytics agency in its Second Party Opinion document. The necessary methodology was also adopted for the selection of receivables of retail customers which may constitute a collateral for the issue of covered bonds, as well as necessary governance procedures and principles, while simultaneously obtaining the capability of issuing green covered bonds.

Project "Tokio"

The Bank, taking advantage of the experience related to remote work, gained during the pandemic, and preparing to move to the new premises, launched a project whose task is to adapt the organisation to the new mode of work. The works are carried out as part of the following streams:

- managerial – preparation of the management staff for managing a dispersed team,
- employee – preparing the employees for increased use of remote work, identification of employee needs, including within the scope of tools and training,
- IT tools – provision of IT solutions facilitating work within dispersed teams
- e-processes, i.e. paperless – optimisation of business processes in order to minimise paper flow of documents.

The purpose of the project is also to improve communication within the Bank. The project will be implemented until moving to the new premises.

1.2. Financial credibility - ratings

Financial credibility of mBank Hipoteczny S.A. and covered bonds issued by the Bank is assessed by an international rating agency – Fitch and from 27 May 2019 – Moody's Investors Service Ltd. As of the reporting date the following ratings applied:

	Rating by Fitch Agency	Outlook	Date of decision	Decision
Long-Term Issuer Default Ratings (IDR)	BBB-	Stable	14-04-2020	Removal of the issuer's rating from the watch list with positive indication

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Short-Term Issuer Default Ratings (IDR)	F3	-	15-10-2019	Downgrade
National Long-Term Rating	A+ (pol)	Positive	15-10-2019	Downgrade
National Short-Term Rating	F1 (pol)	-	15-10-2019	Downgrade
Support Rating	2	-	15-10-2019	Affirming

Fitch Ratings Ltd. assigns ratings according to the following scale (descending):

- long-term international/domestic ratings (pol): AAA, AA, A, BBB, BB, B, CCC, CC, C, RD, D
- short-term international/domestic ratings (pol): F1, F2, F3, B, C, RD, D
- support ratings: 1, 2, 3, 4, 5

	Rating by Moody's Agency	Outlook	Date of decision	Decision
Long-term Issuer Ratings	Baa2	Stable	20-05-2020	change of rating outlook
Short-term Issuer Ratings	Prime-2	-	20-05-2020	Affirming
Long-term Counterparty Risk Ratings	A3	-	20-05-2020	Affirming
Short-term Counterparty Risk Ratings	Prime-2 (cr)	-	20-05-2020	Affirming
Long-term Counterparty Risk Assessment	A3(cr)	-	20-05-2020	Affirming
Short-term Counterparty Risk Assessment	Prime-2	-	20-05-2020	Affirming
Mortgage Covered Bonds	Aa3	-	27-05-2019	Assignment

Moody's Investors Service Ltd. assigns ratings according to the following scale (descending):

- long-term international, covered bonds ratings: Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C
- short-term international: Prime-1, Prime-2, Prime-3, Not Prime
- numeric modifier: 1, 2, 3.

Moody's applies numerical modifiers 1, 2, and 3 in each global long-term rating classification from Aa through Caa. The modifier 1 indicates a ranking in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of that generic rating category.

The Aa3-level rating of mortgage covered bonds issued by mBank Hipoteczny, assigned by Moody's, is the highest available rating for financial instrument in Poland.

- On 28 May 2019, the Bank terminated the agreement with the Fitch Polska S.A. rating agency which concerned the covered bonds issued by the Bank. The remaining ratings assigned by Fitch remain valid.

Besides its financial results, ratings assigned to the Bank are influenced by the assessment of mBank S.A and Commerzbank AG, including the support granted by these institutions.

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The rating obtained by the Bank is a starting point for the rating assigned to the covered bonds issued by the Bank, which has an impact on the recognition of payments from covered bonds in case of the issuer's insolvency and the risk profile of the collateral of covered bonds.

1.3. Financial results

The financial statement of the Bank was prepared according to the International Financial Reporting Standards binding in the European Union (IFRS). The data presented in the Management Board Report are presented in the management view and they do not have to be consistent with the data included in the Financial Statement.

Due to the specific nature of the Bank, its assets primarily include loans secured by mortgage, and on the liabilities side - liabilities arising from the issue of covered bonds, as a main source of refinancing of credit operations.

Table 1. The dynamics of selected elements of the statement on financial situation (in PLN thousands)

Main balance sheet items	30.06.2020	31.12.2019	Dynamics
ASSETS	13,122,781	13,187,908	-0.49%
Including			
Loans and advances to customers (at amortised cost)	11,587,825	11,628,432	-0.35%
Loans and advances to customers (at fair value through profit or loss)	146,098	157,714	-7.37%
LIABILITIES AND EQUITY	13,122,781	13,187,908	-0.49%
Including			
Debt securities in issue	8,646,335	8,857,401	-2.38%
Share capital	884,631	884,631	0.00%

In the first half of 2020 the Bank achieved a positive gross result in the amount of PLN 4,398 thousand. Due to a specialised activity profile in which the main source of the Bank's result is the interest income, the financial result in 2020 was greatly influenced by low interest rates and decrease in the commercial portfolio. Consequently, the Bank reported a decline in the net interest income compared to the first half of 2019 (by PLN 8,455 thousand or 9.22%).

The total value of administrative expenses were lower by 8.13% compared to June 2019. Despite this, due to lower income, the cost to income ratio rose to 49.45% (36.81% at the end of 2019).

Due to the specialization and narrow range of the products offered, the Bank is unable to compensate the effects of the bank tax. Before the tax, the Bank's operating result amounted to PLN 19,931 thousand, as compared to 42,967 thousand in the first half of 2019.

In the first half of 2020 the income of the Bank, calculated as the sum of net interest income, net fee and commission income, net trading income, other operating income and other operating expenses, amounted to PLN 80,044 thousand (in the first half of 2019: PLN 92,381 thousand). This income pertains in whole to the activity conducted within the Republic of Poland.

Table 2. The dynamics of selected elements of profit and loss account (in PLN thousand)

Profit and loss account	Period from 01.01.2020 to 30.06.2020	Period from 01.01.2019 to 30.06.2019	Dynamics
Net interest income	83,286	91,741	-9.22%
Net fee and commission income	(3,508)	(3,425)	-
Net trading income	240	3,631	-93.39%
Net impairment write-downs on loans and advances	(17,571)	(8,341)	110.66%
Overhead costs	(33,251)	(36,194)	-8.13%

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Amortisation and depreciation	(4,270)	(3,395)	25.77%
Operating result	19,931	42,967	-53.61%
Tax on the Bank's balance sheet items	(15,533)	(16,134)	-3.73%
Gross profit	4,398	26,833	-83.61%
Income tax	(3,204)	(9,627)	-66.72%
Net profit	1,194	17,206	-93.06%
Weighted average number of ordinary shares / weighted average diluted number of ordinary shares	3,295,359	3,295,359	0.00%
Net profit per ordinary share / Diluted profit per ordinary share (in PLN)	0.36	5.22	-93.10%

Table 3. Effectiveness ratios

PERFORMANCE INDICATORS	31.12.2019	31.12.2019
ROA net ¹⁾	0.02%	0.28%
ROA gross ¹⁾	0.07%	0.44%
ROE net ³⁾	0.19%	3.11%
ROE gross ⁴⁾	0.70%	4.95%
Cost to income ratio (C/I) ⁵⁾	49.45%	36.81%
Net interest margin ⁶⁾	1.24%	1.40%
Cost of risk ⁷⁾	0.32%	0.19%
Total Capital Ratio	18.52%	18.23%
OTHER		
Employment	134 employees/125 FTE's	140 employees/129 FTE's
Average employment	140 employees	140 employees
Facilities	Headquarters	Headquarters

1) net result / average assets

2) gross result / average assets

3) net result / average equity

4) gross result / average equity

5) (overhead costs + amortisation and depreciation) / total income (defined as net interest income + net fee and commission income + net trading income + other operating income - other operating expenses + other income)

6) interest income / average earning assets

7) net write-downs for impairment of credit and loans / average balance of credits and loans granted to clients

Average balance sheet amounts were calculated based on monthly data considering the opening and closing balance of the reporting period.

Chart 1. Key financial ratios

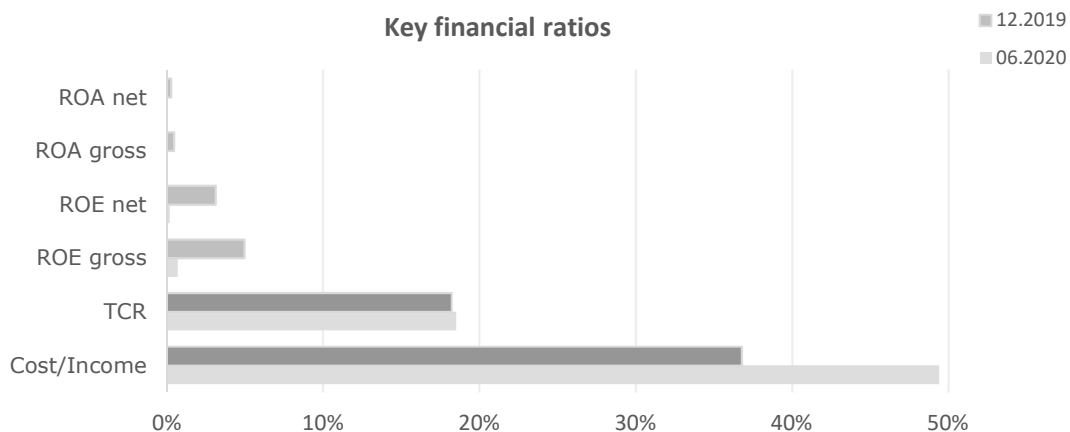
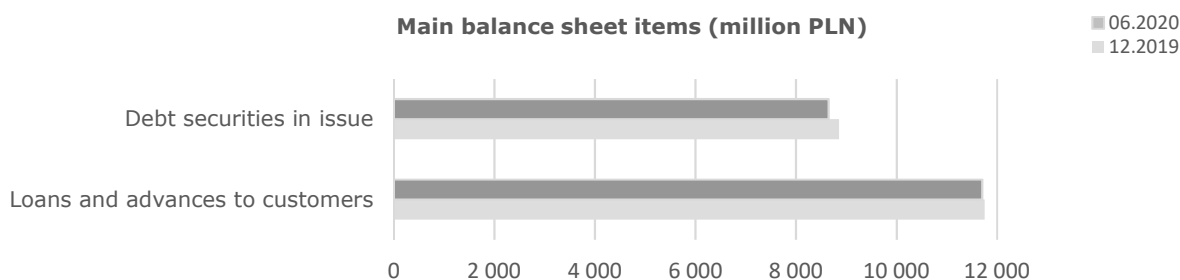


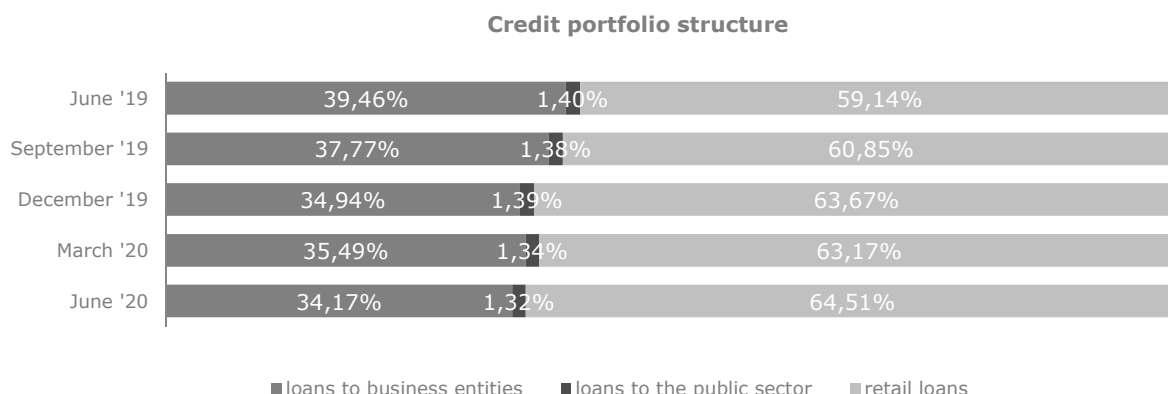
Chart 2. Main balance sheet items (in PLN million)



1.4. Lending

Following the transfer of the entire retail loan sales process to mBank on 22 July 2017, pooling transactions were the source of supply of retail assets to the Bank's loan portfolio. On 1 January 2019 also commercial loan sales process was transferred to mBank. In 2020 no commercial pooling from mBank was carried out. In the retail area, in line with the mBank Group's strategy, the Bank carried out 4 pooling transactions with a total amount of PLN 375 million.

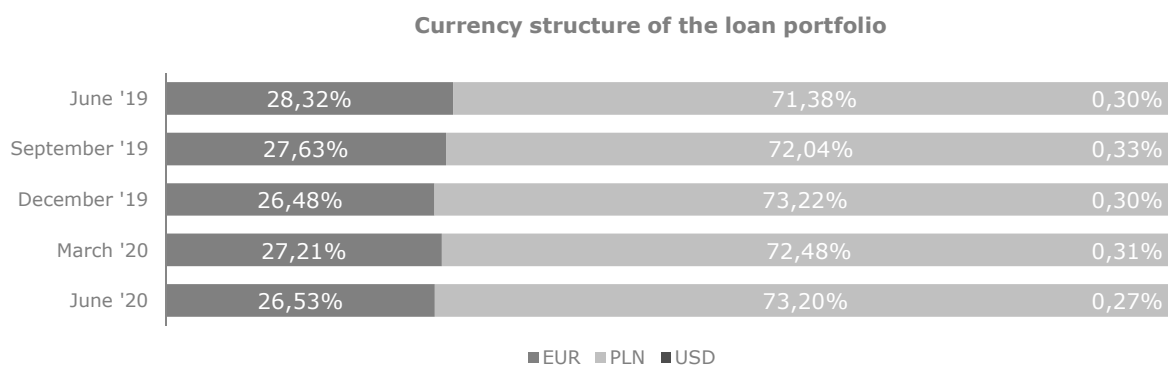
Chart 3. The structure of the loan portfolio



In 2020, the currency structure of the loan portfolio did not change. Compared to the end of 2019, the share of loans in PLN fell by 0.02 percentage points and as at the end of June 2020 they accounted for 73.20% of the loan portfolio. The share of loans in EUR amounted to 26.53%.

The Bank was not involved in any activity outside the Republic of Poland.

Chart 4. The currency structure of the loan portfolio



Corporate loans

The Bank focuses on managing the existing portfolio, which is subject to regular reduction in connection with scheduled and early repayments.

Net balance sheet exposure to business entities amounted to PLN 3,998 million. The dominant part (92.81%) accounted for refinancing of completed commercial facilities, the exposure in housing projects constituted 3.03%, and credits for financing of construction of commercial objects 4.16%.

In the area of commercial real estates the Bank's portfolio consists of loans financing in particular office buildings and shopping centres.

Chart 5. Corporate loans by type of financed real estate

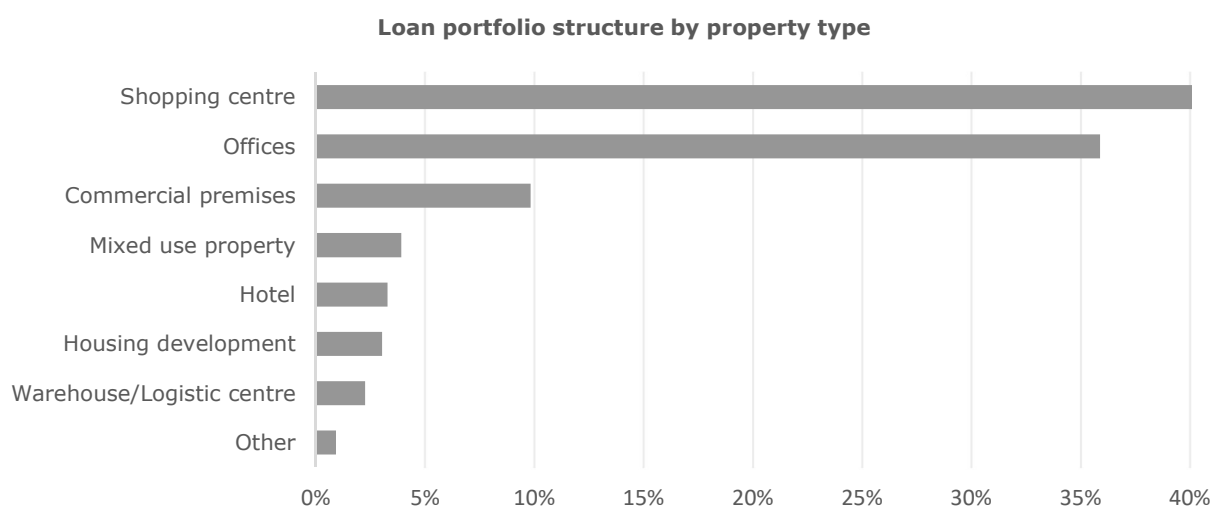
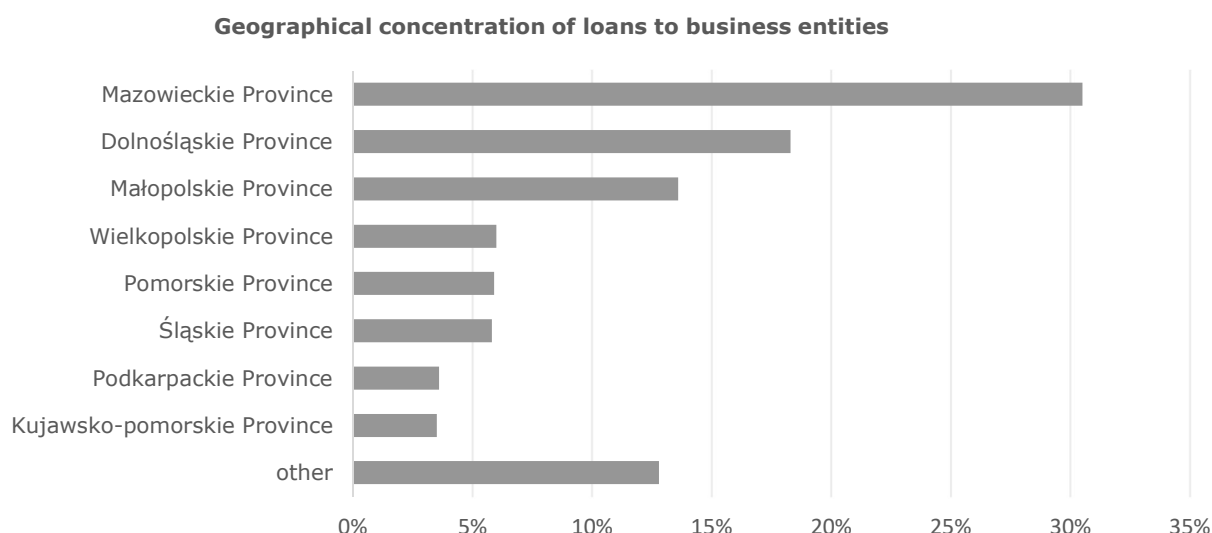


Chart 6. Geographical concentration of loan portfolio for business entities



The largest number of financed projects is concentrated in Mazowieckie province, where 30.5% of all credit resources is involved. In Dolnośląskie, Małopolskie and Wielkopolskie province the total balance sheet exposure accounts for 37.9%.

As of the reporting date loans granted in EUR (77.4%) and PLN (21.9%) dominated the corporate loans portfolio.

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Public sector loans

Due to the strategy of the Bank the portfolio does not contain new agreements, which in connection with significant prepayments is reflected in a lower, as compared to 31 December 2019, balance sheet exposure to public sector. As at the reporting date the exposure was PLN 154 million (down by 5.5%).

Retail loans to natural persons

In 2020, the Bank's activities in the area of retail loans focused on acquiring new retail assets via the pooling model. In 2020 the Bank actively cooperated with mBank with the aim to develop the product and maximise sales of newly granted retail loans at the side of mBank, meeting the requirements of transfer to the Bank. Also, a new innovative process was built, which enables the transfer of retail assets in monthly cycles.

1.5. Issuing of covered bonds and refinancing

mBank Hipoteczny is a mortgage bank with the longest history of issues of covered bonds on the Polish capital market. The value of outstanding mortgage covered bonds issued by the Bank as at 30 June 2020 was PLN 8.1 billion, which accounts for 30.4% of the total market, which already amounts to PLN 26.5 billion.

The funding and liquidity profile of the mBank Group in the first half of 2020 did not provide for the need for issuance of covered bonds by mBank Hipoteczny.

The Bank covered bonds are instruments that carry low investment risk, resulting from the statutory requirement of multi-tiered security of their issue and trade. Ratings for the Bank and mortgage covered bonds are presented in item 1.2.

Issues of mortgage bonds of the Bank in the public offering

Issue date	Redemption date	Currency	Value	Rating Moody's Investor Service Ltd.
28.07.2014	28.07.2022	PLN	300,000,000	Aa3
04.08.2014	20.02.2023	PLN	200,000,000	Aa3
20.02.2015	28.04.2022	PLN	200,000,000	Aa3
15.04.2015	16.10.2023	PLN	250,000,000	Aa3
17.09.2015	10.09.2020	PLN	500,000,000	Aa3
02.12.2015	20.09.2021	PLN	255,000,000	Aa3
09.03.2016	05.03.2021	PLN	300,000,000	Aa3
29.09.2017	10.09.2022	PLN	500,000,000	Aa3
11.10.2017	15.09.2023	PLN	1,000,000,000	Aa3
22.06.2018	10.06.2024	PLN	310,000,000	Aa3
22.02.2019	20.12.2028	PLN	100,000,000	Aa3
TOTAL		PLN	3,915,000,000	
Issue date	Redemption date	Currency	Value	Rating Moody's Investor Service Ltd.
26.07.2013	28.07.2020	EUR	30,000,000	Aa3
28.02.2014	28.02.2029	EUR	8,000,000	Aa3
17.03.2014	15.03.2029	EUR	15,000,000	Aa3
30.05.2014	30.05.2029	EUR	20,000,000	Aa3
25.02.2015	25.02.2022	EUR	20,000,000	Aa3
24.04.2015	24.04.2025	EUR	11,000,000	Aa3
23.03.2016	21.06.2021	EUR	50,000,000	Aa3
28.09.2016	20.09.2026	EUR	13,000,000	Aa3
26.10.2016	20.09.2026	EUR	35,000,000	Aa3
01.02.2017	01.02.2024	EUR	24,900,000	Aa3
30.10.2017	22.06.2022	EUR	100,000,000	Aa3

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26.04.2018	05.03.2025	EUR	300,000,000	Aa3
12.11.2019	15.09.2025	EUR	300,000,000	Aa3
TOTAL		EUR	926,900,000	

The Bank continues to issue unsecured bonds. In the first half of 2020, the Bank carried out two issues of coupon bonds for a total amount of PLN 95 million.

As of the reporting date, the Bank held 5 issued series for the total amount of PLN 460 million. The Bank's offer includes zero-coupon bonds and coupon bonds denominated in PLN with a maturity of over 1 year.

The basis for issuing of covered bonds

According to the Act on covered bonds and mortgage banks, the basis for the issuing of mortgage covered bonds are receivables entered into the cover register for mortgage bonds, secured by mortgages established on the right of perpetual usufruct or the right of ownership of the real estate entered into the land and mortgage registry as the first item.

As of the reporting date the collateral of mortgage covered bonds consisted of receivables of value PLN 10,144 million from total number of 26,795 loans.

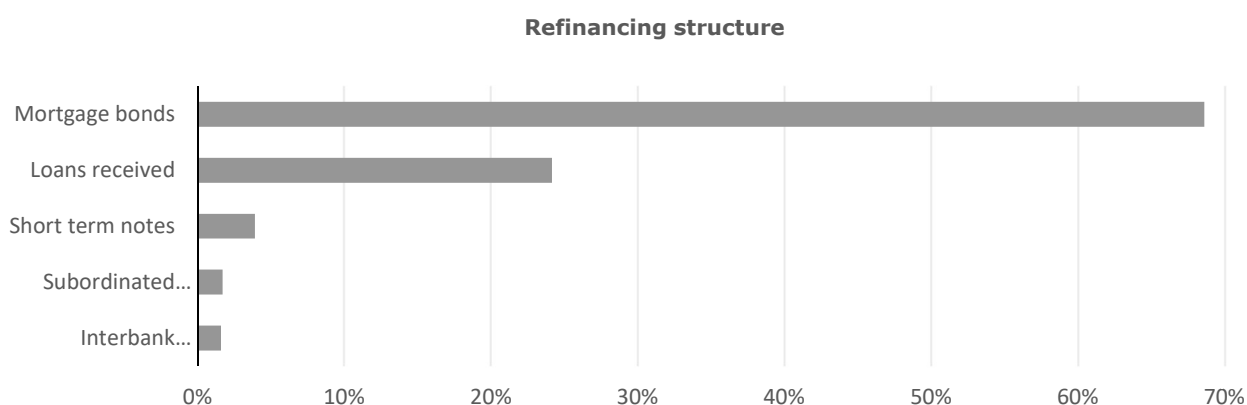
Loans for commercial clients constituted 34.19% and for retail clients 65.81% of the total amount of receivables entered into the mortgage cover register. Loans granted in PLN (73.01%) dominated, loans in EUR (26.74%) and USD (0.25%) constituted the remaining part.

Additionally to the credit receivables, the additional collateral in a form of treasury bonds of nominal value of PLN 200 million was also entered into the mortgage cover register.

The level of over-collateralisation (including substitute cover) of mortgage covered bonds and public sector covered bonds amounted to 28.0%.

The Bank raises funds for the lending activity predominantly through issuing of covered bonds and subsequently through issuing short-term bonds and received loans, mainly from the interbank market.

Chart 7. The structure of refinancing of the Bank activity



1.6. Legal environment

Since mid-March 2020, the legal environment of mBH's operations has been dominated by events related to the Covid-19 pandemic and the state of epidemic threat, as well as state of epidemic, introduced in Poland. The special statutory solutions introduced in Poland in the form of the so-called Shields 1.0-4.0. had a material impact on the Bank's operations. The so-called Shield 1.0., i.e. the Act of 2 March 2020 on specific solutions related to the prevention, counteracting and control of COVID-19, other infectious diseases and crisis situations caused by them, introduced the possibility for mBH, as an employer, to issue

an order that work be performed remotely, i.e. using means of electronic communication. In mid-March 2020, the Bank ordered remote work for all employees of the Bank, with exceptions for necessary duty hours at the registered office. The Bank has adopted its activities to remote working conditions by ensuring the necessary hardware for the employees, as well as acquired an appropriate number of qualified electronic signatures for persons authorised to represent it in order to ensure the possibility of making statements remotely in electronic form. This form was practiced by the Bank itself as well as proposed to customers and counterparties.

Announcement of the state of epidemic, most employers in Poland ordering remote work, including in the public sector, public administration and courts, as well as suspension of a wide range of court, procedural and administrative deadlines for a certain period of time under the aforementioned Act has led to a significant slowdown in many processes important for the bank. In particular, the process of changing the entries of mortgages securing loans acquired by mBH in land and mortgage registers — which is a condition for entering such loans in the register of collaterals for mortgage covered bonds and affects the final issue capabilities of the Bank — was significantly slowed down. At the end of June 2020, some acceleration of proceedings by courts was noted.

The Bank's activities were affected both by the statutory regulations contained in Shield 1.0 in Article 31 f, concerning contractual facilitations in the repayment of loans for entrepreneurs experiencing financial difficulties related to the epidemic, as well as the implementation of the EBA Guidelines concerning statutory and non-statutory moratoriums on the repayment of loans that the banks apply in connection with the COVID-19 crisis. They were further specified in the Position of banks notified by the PFSA to the EBA in terms of standardising the principles of offering assistance tools for banking sector customers (position developed by the Polish Bank Association). The efficient execution of arrangements with commercial customers of the Bank was of significant importance due to commercial customers (borrowers) representing the commercial sector (especially shopping malls) or the hotel sector, which were subject to the prohibition of conducting business activity in connection with Covid-19.

As regards the facilitations for consumers, related to the possibility of repayment of loans, the Bank implemented a programme of so-called "Covid annexes", which are voluntary facilities offered by the Bank to the borrowers, consisting in introduction of a grace period in repayment of principal instalments or credit vacation for up to 6 months. Under the so-called Shield 4.0, i.e. the Act of 19 June 2020 on subsidies for interest on bank loans granted to entrepreneurs affected by COVID-19 and simplified proceedings for approval of composition in connection with the occurrence of COVID-19 (Journal of Laws, item 1086), the so-called "statutory credit vacation" has been introduced, i.e. suspension of performance of the loan agreement granted to consumers for a maximum of 3 months from the date of submission of the request for suspension by the borrower. During the suspension period, neither principal and interest instalments are payable, nor are any fees or commissions charged. The Bank has adjusted the operating procedures to the requirements arising from the provisions of Articles 31f a) to 31fc) of the aforesaid Act ("statutory credit vacation").

On 18 December 2019, the text of Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019 on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU, concerning the rules for issuing covered bonds and the rules for activities of their issuers (mortgage banks), was published. The publication of the final text of this Directive has become the foundation for the works of the mortgage banks' environment within the framework of the Polish Bank Association on the development of postulates of amendments to the Polish law. In the opinion of the Bank, the final version of the proposed directive does not pose a threat related to the need to fundamentally change the mortgage banking business model in the future. Most of the proposed arrangements are in line with those currently in force in Poland, in particular the Act on Covered Bonds and Mortgage Banks or bankruptcy provisions for mortgage banks. Some inconsistencies or possible lack of arrangements at the level of generally applicable law (yet, implemented in practice, e.g. information obligations for investors, as envisaged by the Directive) will be supplemented in the directive implementation process, i.e. by way of legislative changes. The Directive came into force on 7 January 2020. It states that the member states shall adopt and publish legislative, regulatory and administrative provisions required to implement the Directive within 18 months, while these provisions shall be applied within 30 months from the Directive's date of entry into force. Therefore, the deadline for implementing the provisions of the Directive into the Polish legal order falls on 8 July 2021 and those provisions should start to apply as of 8 July 2022.

On 25 February 2019, the EBA issued its Guidelines on outsourcing arrangements which, pursuant to Article 16 of Regulation (EU) 1093/2010 of the European parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority, should be applied by the Bank in its activities. Given the nature of a mortgage bank and the significant scale of outsourcing used in the Bank's operations, as well as the new requirements set out in the Guidelines, this regulation will pose a significant challenge in the legal environment. On 16 September 2019, in its position on selected issues concerning the entry into force of the EBA Guidelines on outsourcing arrangements and their application by the banks in their activities, the PFSA clarified its expectations in this regard and set the date of 30 June 2020 to be the deadline for the banks to adjust to the Guidelines. According to the announcement included in the PFSA position, mortgage banks may expect a separate, slightly different approach. Mortgage banks still await the indicated document. As a result of the emergence of the Covid-19 pandemic in Europe and the introduction of the state of the Covid-19 epidemic in Poland, the Polish Financial Supervision Authority has postponed the deadline for implementation of the EBA guidelines until 31 December 2020. Due to the described circumstances, the works on implementation of the Guidelines have been slowed down, but meeting the deadline is not at risk.

In the first half of 2020, intensive works were ongoing in relation to the implementation of the solutions resulting from the Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts [...] in the Bank (in line with the mBank Group), in particular implementation of the so-called fallback clauses in contractual relationships with both commercial and retail customers. Adjustment of contingency plans for cessation of indicator quotations is also planned. The works will continue until the end of 2020.

The amendment of the Code of Commercial Companies, adopted on 19 July 2019, provides that all shares undergo a mandatory dematerialisation, i.e. they shall be entered in the register of shareholders maintained by an entity authorised to operate a securities account, e.g. a brokerage house. This applies both to registered shares and bearer shares. Entire trading in shares will be required to be executed by this entity. In connection with the announcement of the state of the Covid-19 epidemic in Poland pursuant to the Act of 30 April 2020, the expiry date of the binding share documents was postponed. So far, this deadline was set for 1 January 2021; pursuant to the amending act, it will be 31 March 2021. On the same date, entries into the register of shareholders kept in electronic form will become legally binding. On 20 May 2020, the GMS selected mBank S.A. as the entity which will maintain the register of the Bank's shareholders. The deadline for concluding an agreement on keeping the register of shareholders shall expire on 30 September 2020. The register of shareholders, i.e. all data concerning each shareholder, will be accessed not only by the company and the shareholders but also by state authorities, based on similar principles as in the case of banking or brokerage secrecy.

Amendment of the Bankruptcy Law. The Act of 30 August 2019 amending the Bankruptcy Law and certain other acts introduces changes for further simplification and acceleration of the process. Most of the changes shall enter into force on 24 March 2020; the situation of natural persons acting as business operators was brought into balance with the situation of a consumer, the requirement of court examination of the debtor's fault in leading to or aggravating the insolvency at the stage of bankruptcy proceedings was dropped. It is expected that the changes introduced by this Act will lead to a higher number of consumer bankruptcies. In the first half of 2020, the impact of new solutions on mBH's activity could not be observed yet, especially as it had been dominated by events related to the Covid-19 pandemic and the facilitations, introduced under the Act and sectoral arrangements, for customers who experienced difficulties in servicing the loan in connection with the loss of revenues due to the pandemic.

Recommendation S: In December 2019, the PFSA published a new version of Recommendation S. One of the main issues subject to implementation based on Recommendation S will be fixed-interest-rate loans or temporarily fixed-interest-rate loans, which will be obligatory items in the market offer of each bank. Banks which do not offer loans, such as mBH, will be required to provide to each customer with a mortgage loan with an option to switch into a fixed-interest-rate arrangement. Also, the PFSA expects the banks to specify the target parity of fixed-interest-rate loans in the bank's portfolio. As regards newly signed loan agreements, the supervisory authority expects the customers to provide information on their income and debts for the purposes of regular monitoring the DtI ratio throughout the lifetime of the agreement. The PFSA expects the Recommendation to be implemented by 31 December 2020. In the first half of 2020, further works related to the development of a common position of the banking sector in the law of

interpretation of the provisions of Recommendation S and their correct implementation by the banks were carried out at the Polish Bank Association. The Bank actively participates in these works.

2. Risk management

Risk management at the Bank is based in particular on the following principles:

- the risk management process is defined and regulated by strategies,
- policies and procedures adopted by the Management Board and approved by the Supervisory Board,

The Bank manages all identified types of banking risk and carries out ICAAP (Internal Capital Adequacy Assessment Process) and ILAAP (Internal Liquidity Adequacy Assessment Process) processes, whereby:

- the risk management process is appropriate to the scale of operations and the materiality, scale and complexity of a given risk and is constantly adapted to new factors and sources of risk,
- risk management methods, models, their assumptions and systems are adjusted to the scale and complexity of the risk and are periodically verified and validated,
- the organizational structure of risk management ensures the independence of the risk area,
- the risk management process is integrated with planning and controlling processes and supports the implementation of the Bank's strategy, while maintaining compliance with the risk management strategy, in particular with regard to the level of risk tolerance,
- the risk management process is consistent with the mBank Group's risk management principles, including the use of group risk models adapted to the specific nature of the Bank's operations.

The Bank's risk management system consists of:

- risk identification,
- risk measurement or assessment,
- risk control,
- risk forecasting and monitoring,
- risk reporting,
- management activities.

Risk management is supervised by the Bank's Supervisory Board, which regularly receives information about the risk profile and the most important activities undertaken in the area of risk management.

The Management Board of the Bank is responsible for risk management, including supervision and monitoring of activities undertaken by the Bank in the area of risk management. The Bank's Management Board takes the most important decisions affecting the Bank's risk level and adopts internal regulations regarding risk management.

2.1. Credit risk

Loan portfolio

The principles for granting loans have been specified in the Bank's Credit Policy and the management of existing loan portfolio is done mainly through current monitoring of credit exposures.

The share of non-performing loans in the loan portfolio decreased in the first half of 2020 from the level of 3.45% to 3.24%. Most of the loans are repaid in a timely manner, and the borrowers of higher risk profile are subjected to a more strict monitoring.

Impairment provisions (including the adjustment to the fair value and CEIR) reaching PLN 123 million together with mortgages on the financed real estates constitute an appropriate security against potential losses resulting from credit risk.

The level of NPL coverage with provisions amounted to 25.7%.

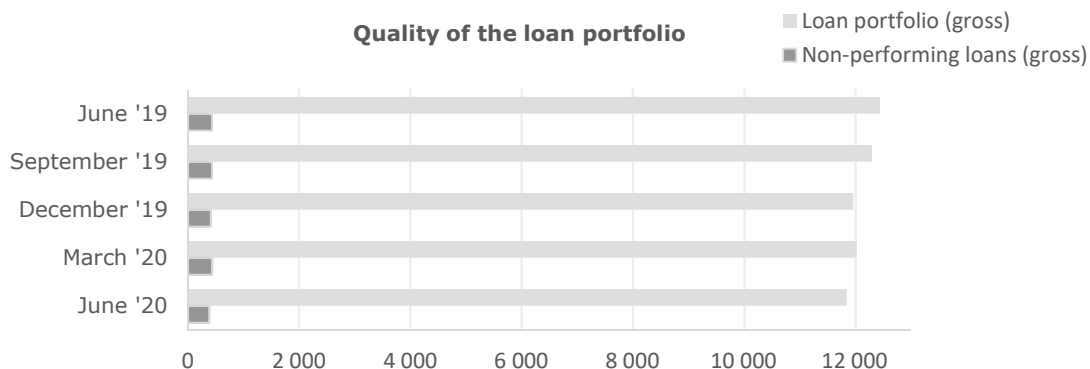
The retail portfolio is characterised by very high quality, which results from the applied credit policy (until the moment of transferring the whole process of selling retail mortgage loans to mBank S.A.) as well as the fact that this portfolio is young (the average age of contracts in this portfolio is 4.1 years). As of the reporting date there were only 101 loans with reported loss of value. Loans for natural persons are

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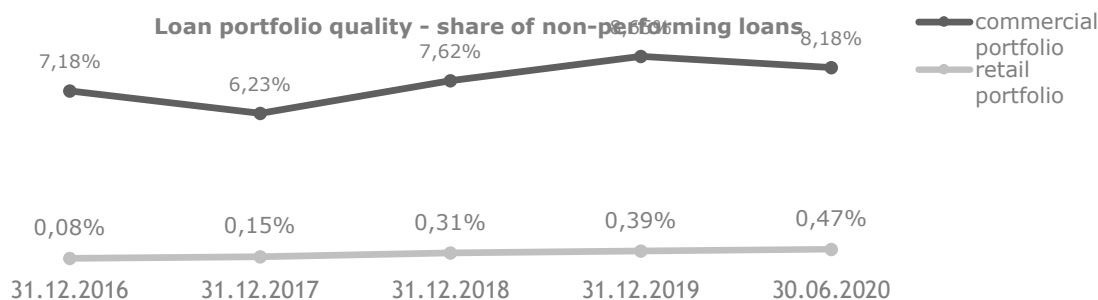
monitored monthly for timely repayments and correctness in terms of established effective mortgage collaterals. Realisation of all contractual obligations of the client is verified in the same monitoring period (including insuring of the real estate and assignment of the rights under insurance policies).

Chart 8. Non-performing loans* in the loan portfolio (gross value, in PLN million)



* non-performing loans – loans classified in basket 3 or POCI, in accordance with IFRS 9

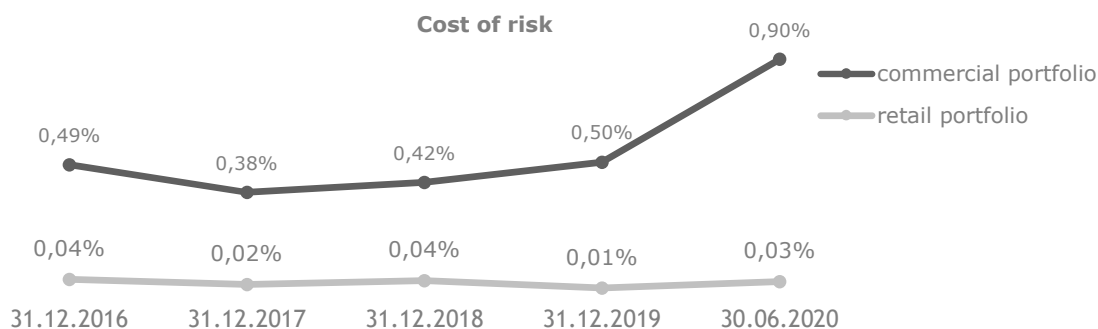
Chart 9. Share of non-performing loans by portfolio



*retail portfolio – the portfolio of loans granted in cooperation with mBank S.A. (agency portfolio) and the portfolio acquired from mBank S.A. (the pooling portfolio)

The cost of risk is an important indicator monitored by the Bank. The cost of risk is maintained at a very good level.

Chart 10. Cost of risk by portfolio



*retail portfolio – the portfolio of loans granted in cooperation with mBank S.A. (agency portfolio) and the portfolio acquired from mBank S.A. (the pooling portfolio)

Impact of the COVID-19 pandemic on the Bank's operations

Assistance measures taken by the Bank following the COVID-19 pandemic

In the context of the crisis triggered by the COVID-19 pandemic, the bank offers its customers a range of assistance tools to support them in the difficult situation following the outbreak. The aim of these tools is to help customers to maintain their liquidity by reducing their financial burden in the short term.

The tools used by the Bank are consistent with the position of the Banks regarding the unification of the rules of offering assistance tools to banking sector customers. This position is a non-statutory moratorium within the meaning of the guidelines of the European Banking Authority on statutory and non-statutory moratoriums on loan repayments, which the Banks apply in connection with the COVID-19 crisis. It was notified by the Polish Financial Supervision Authority to the European Banking Authority.

As regards the activity of the Retail Banking area, the Bank allowed its customers to apply for a deferral of capital or capital and interest payments of a part of instalments, for a period of up to 6 months indicated by them, with a possibility to extend the loan term by the moratorium's duration. Applications meeting the conditions set by the sector's position are considered in a simplified procedure, i.e. without the need to examine the customer's ability to repay the debt. The application process is supported by a mechanism of automatic verification of boundary conditions (inter alia, no arrears in repayment of more than one instalment, no grace period granted during the last 12 months, at least 6 months of repayment history). In case of a positive result of the verification, the customer's request is automatically accepted. Requests from customers who have not passed the automatic verification are considered by a credit analyst.

When granting a capital grace, the amount of capital outstanding after the grace period shall be divided, according to an algorithm (instalments equal to or decreasing - according to the agreement), over the outstanding period. In the case of an extension of the lending period, the outstanding period is longer, which results in lower instalments after the grace period than in the case of the capital grace without extending the lending period. In the case of granting a capital-interest grace for capital, the mechanism is identical to that of the capital grace, whereas the suspended interest is evenly distributed over the outstanding period after the grace period.

Assistance instruments under this moratorium shall be available to all retail clients whose delay in repayment of principal or interest does not exceed 30 days at the date of application for assistance and shall only apply to loans granted before 13 March 2020 which have not been reclassified as default.

The Bank also offers its customers support under the so-called "anti-crisis shield 4.0", in force since 23 June 2020, under which customers who lost their jobs or other main source of income after 13 March 2020 have the right to suspend for up to 3 months the loan repayment without charging interest during the suspension period. This facility is a statutory moratorium within the meaning of the European Banking Authority guidelines. The scale of applications for this form of assistance is insignificant at the moment. As of 30 June 2020, 23 applications for aid under this moratorium were submitted, of which aid was granted 19 borrowers. The gross carrying amount of their liabilities as at 30 June 2020 was PLN 2.3 million.

In the Commercial Banking business area in connection with COVID-19, the Bank allows all corporate clients to suspend the repayment of the capital part of instalments for a maximum period of 6 months. In addition, small and medium-sized enterprises, which are the Bank's customers, have the possibility to suspend the repayment of entire capital and interest instalments for up to 3 months.

Assistance instruments under these moratoria are available to all corporate customers who as at March 15, 2020, in accordance with the Bank's internal regulations, were not reclassified to the default category and only concern loans granted before 8 March 2020. In addition, when providing assistance, the Bank requires that collateral be maintained at least at the same level and distribution to the owner be limited.

In the face of an unprecedented situation caused by the COVID-19 pandemic, mBank Mortgage Bank, operating within the mBank Group, offered its clients a suspension of capital repayments. Each retail client of the Bank, regardless of their expected financial situation, could apply for assistance remotely, as part of an automatic application acceptance process.

The vast majority of clients who received support under the moratorium on suspension of payments only benefited from the suspension of the capital part of the instalment - about 94% of the total exposure covered by the moratorium. This means that clients are still required to pay their liabilities only with a lower instalment. Delay in payment of interest instalments is subject to standard overdue calculation.

Overdue of such payment over 30 days results in classification into basket 2 and over 90 days into stage 3. In the case of commercial loans, the Bank used an individual approach in its assessment.

Impact of the COVID-19 pandemic on the client's financial situation assessment process

In assessing the financial situation of corporate clients, the Bank uses only individual assessment as the most appropriate and precise (the Bank does not use a collective or sectorial approach).

The process of client and transaction risk monitoring takes into account the impact of the COVID-19 pandemic on the client's situation and the strength of the impact (i.e. temporary turbulence, long-term problem for the business model, etc.) as well as the plan to mitigate this impact implemented by the client. The Bank conducts sector analysis of clients that have applied for moratorium. Among those clients, the largest balance sheet exposure as at 30 June 2020 is held by clients operating in the following sectors: wholesale and retail trade and hotels.

The client is placed on the Watch List (LW - list of clients under observation) based on standard criteria defined in the Bank internal regulations. With regard to clients who have submitted an application for assistance to the Bank, the list of criteria classifying to Watch List has been extended by an additional, discretionary premise in respect of COVID-19. On the basis of this premise, a risk analyst may put the client on the Watch List if, according to his opinion, problems arising from a pandemic may have a long-term nature and after its termination the customer may not return to the financial situation allowing the settlement of his obligations. Other criteria of the placement on Watch List, defined in the Group's credit regulations, also apply to customers who have received support from the Group in connection with COVID-19. Placing a customer on Watch List results in customer classification to stage 2.

In the scope of retail customers risk assessment, the borrowers with granted assistance tools in the form of moratorium are still subject to scoring approach in accordance with the standard risk assessment process.

Description of the forbearance classification approach applied in the Group in relation to COVID-19

According to the statement of the European Banking Authority on the prudential framework regarding Default, Forbearance and IFRS 9 in light of COVID-19 measures published on 25 March 2020, saying that the use of COVID-19 aid tools in the form of repayment moratorium, meeting the EBA guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis published on 2 April 2020 does not automatically classify exposures to default and forbearance, as well as according to the UKNF (Polish Financial Supervision Authority) statement published as a part of the Supervisory Impulse Package for Security and Development that UKNF will apply a flexible approach to the application of EBA guidelines for unsupported and restructured exposures, the Group does not classify the granting of the moratoria due to the COVID-19 crisis as forbearance, with the exception of corporate clients, for whom there is applied an approach based on individual assessment whether classification of such client's exposure as forborne is required, in accordance with the Group's internal regulations.

Due to the deterioration of the economic situation in the country resulting from the COVID-19 epidemic, the Bank has taken additional actions aimed at including this information in the expected credit losses. Due to the uncertainty caused by dynamic situation changes, the Group's activities were spread over time and in particular covered:

1. Review of sectors and individual clients of the corporate portfolio, in particular clients under observation, in order to verify the potential increase in the probability of failure to implement the restructuring plans, which was already carried out in March as the first activity of the Group as part of taking into account the impact of the epidemic on clients' financial situation,
2. Updating models of the relationship between the long-term PD parameter and macroeconomic variables, based on historical data and the currently observed economic situation, in the second quarter of 2020,
3. Updating macroeconomic forecasts, taking into account the impact of COVID-19 and state aid actions, affecting long-term PD, EAD and LGD parameters, as well as the level of exposure allocation to stage 2, in the second quarter of 2020,

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4. Restoration of macroeconomic scenario weights of 60% for the baseline scenario, 20% for the optimistic and 20% for the pessimistic respectively, in the expected credit loss model, while taking into account the current macroeconomic forecasts implemented directly in the risk parameters, in the second quarter of 2020.

Deterioration of the economic situation in the country related to the COVID-19 epidemic resulted in recognition of additional write-offs for expected credit losses in the amount of PLN 21,268 thousand in the portfolio valued at amortised cost, of which PLN 20,568 thousand in the commercial portfolio and PLN 700 thousand in the retail portfolio.

Due to the fact that the changes in risk parameters following the outbreak of the COVID-19 pandemic were implemented over a period of several months in a very dynamically changing macroeconomic environment, the Bank decided to present the total value of their impact on the date of 30 June 2020 as shown in the table below.

	30.06.2020	
	Individual customers	Corporate customers
Assets measured at amortised cost	700	20 568
Stage 1	150	685
Stage 2	450	9 233
Stage 3	100	10 650
Assets measured at fair value through profit or loss	-	0

As at 30 June 2020, the Bank did not apply management adjustments (overlays).

The Bank will continue the analysis of the impact of COVID-19 and state aid programs on the result on the cost of credit risk in subsequent quarters.

The table below presents the projections of key macroeconomic indicators adopted as at 30 June 2020 and 31 December 2019:

Scenario 30.06.2020	Base		Optimistic		Pessimistic	
Probability	60%		20%		20%	
	2020	Average for the next two years	2020	Average for the next two years	2020	Average for the next two years
Unemployment rate / end of year	7,0%	5,5%	3,3%	2,9%	9,2%	11,9%

Scenario 31.12.2019	Base		Optimistic		Pessimistic	
Probability	60%		20%		20%	
	2020	Average for the next two years	2020	Average for the next two years	2020	Average for the next two years
Unemployment rate / end of year	3,9%	4,0%	3,0%	3,5%	6,5%	8,0%

The reason for changes in the key values in the Bank's risk models were changes in macroeconomic indicators in the wake of the COVID-19 pandemic. The Bank's predictions concerning the future macroeconomic situation were mainly influenced by the gradually introduced government support measures in the area of monetary, fiscal and labour markets policy aimed at counteracting the COVID-19 crisis.

Significant measures have been taken to protect revenues and reduce job losses and bankruptcies, and to manage the negative feedback loop between the real and financial sector. In the Bank's view, the liquidity support for businesses will halt the rise in unemployment at around 7% after the first wave of redundancies that occurred in March and April and will start to decline in the following years.

The Bank's macroeconomic forecasts were significantly influenced by the European Council's launch of negotiations with the Member States on the long-term EU budget for 2021-2027 and on a European recovery plan to support EU citizens, businesses and countries in recovering from the economic crisis caused by the COVID-19 pandemic. The EC's estimates for the allocation of funds for Poland influenced the estimated GDP growth from 2021 onwards.

Credit risk management

The Bank assumes that the level of credit risk will be maintained in line with the risk appetite defined by the target level of capital adequacy and exposure limits. At the same time the objective of the credit risk management is ensuring the quality required by the Act on covered bonds and mortgage banks for individual exposures in order to utilise them to the greatest extent as a basis for issuing of covered bonds.

Following a change in the model of the Bank's activity in the commercial area financing, the Bank concentrates exclusively on the management of the existing portfolio of commercial loans without developing it.

Rating system

Specialised financing portfolio

The Bank obtained permission to apply the IRB approach to the portfolio of specialised financing for commercial real estate (SPL). To analyse the credit portfolio, the Bank uses rating models that are annually updated and regularly reviewed by the validation unit and the internal audit. Currently, rating systems cover 99.05% of the total sum of the risk-weighted exposures in line with the standardised approach, taking into account portfolios covered by the phasing-in plan, and 56.68% without taking into account those portfolios. The difference results from the fact that 42.37% of the total sum of exposures weighted using the standardised approach are retail exposures acquired as part of the cooperation with mBank S.A., which are currently covered by the phasing-in plan for the IRB approach approved by the Polish Financial Supervision Authority (KNF), and in the future, the Bank intends to seek the consent of the competent supervisory authorities to use statistical methods to calculate regulatory capital requirements regarding this portfolio's credit risk.

In accordance with the classification adopted with the implementation of Recommendation W, the Bank uses one rating model to assess the credit quality of its customers within the mixed SPL portfolio. It includes:

- 11 expert questionnaires dedicated to particular segments of the commercial real estate market that provide for point scores from 0 to 54 points to be awarded and
- the statistical model of the transfer function to assign the supervisory categories in line with Article 153(5) CRR based on the point score awarded in the expert questionnaires.

The rating model for assessing the credit quality of customers within the SPL portfolio is used in the case of financing provided:

- using "project finance", where in principle, the borrower is a special purpose vehicle
- for various types of transactions related to financing or refinancing of construction/purchase of office, service and commercial buildings, commercial and service areas, warehouses, estates of single or multi-family houses for lease or sale, hotels and premises for commercial activities, offices or warehouses.

The rating model for assessing the credit quality of customers within the SPL portfolio takes into account various stages of transaction financing – construction financing or purchase financing/refinancing of finished real estate. The criteria include area related to:

- real estate: location, legal status, functional features of the facility;

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- characteristics of the local market: relation of demand to supply of a given type of real estate, the rate of economic activity in the region;
- analysis of the cash flows generated by the real estate: amount, stability, currency adjustment, stress tests;
- quality assessment of the project's sponsor as well as their financial potential and willingness to support the project.

With regard to the SPL portfolio, the Bank uses the slotting approach that assigns exposures to appropriate risk categories specifying supervisory values of expected loss (EL) in line with Article 158(6) of CRR and risk weights in line with Article 153(5) of CRR. The appropriate supervisory categories are assigned after the transaction risk assessment conducted using the developed by the Bank expert questionnaires and the transfer function model, transforming the point scores awarded in the above mentioned questionnaires into supervisory categories. This is done by combining two recommended transition functions determined using regression and surjection. The distribution of exposures by supervisory categories is presented in the table below.

KNF category	Gross exposure	Off-balance-sheet	Average CCF	EAD post-CRM and post-CCF	Number of contracts	RWA	Average RWA (%)	EL
1	3,112	0	0	3,112	2	2,178	70.0%	12
2	3,488,524	290,588	0	3,488,524	236	3,070,819	88.0%	26,531
3	232,549	0	0	232,549	27	267,431	115.0%	6,511
4	16,415	0	0	16,415	1	41,038	250.0%	1,313
5	346,876	0	0	346,876	30	0	0.0%	173,438
Razem	4,087,475	290,558		4,087,475	296	3,381,466	82.7%	207,806

With regard to the portfolios covered by the IRB approach, the rating model used in the SPL area is subject to a monitoring process conducted at least annually by model Owners who are independent of model Users. The monitoring includes analyses at the level of individual cases as well as portfolio analyses. More frequent verification of the rating system by model Owners depends on the occurrence of factors (internal and/or external) that may have a significant impact on the value of the model's component parameters. The efficiency of elements of the rating system is also assessed on a current basis by model Owners with regard to loans for which default has occurred.

The rating model for the SPL portfolio is also subject to annual validation that is executed by the Validation Unit, which is independent of the units responsible for creation, modification and use of rating models at the Bank. The validation of the rating system for the specialised lending area is qualitative and quantitative. The qualitative validation includes, among other things, assessment of principles of model creation, examination of theoretical correctness and appropriateness of implementation of rating models, analysis of the quality of the data used for model creation. Within the quantitative validation, the functioning of the model in terms of the discriminatory power of the model and the stability of the model are primarily assessed.

The rating system of the SPL area is also subject to annual reviews of the Bank's rating systems. As part of the review, the Internal Audit Department assesses corporate governance, the segmentation rules and the correctness of determining the capital requirement, the stress tests used in the capital adequacy assessment, the integrity of the rating process, the credit risk mitigation methods and the data quality management process.

Retail portfolio acquired in cooperation with mBank S.A.

For the purpose of assessing the credibility of a retail customer who has a mortgage-backed credit product as well as of monitoring/reporting credit risk for this portfolio, group credit risk models are used, of which the Bank is a local user. Detailed terms and conditions as well as the scope of cooperation between the Banks with regard to group risk models are stipulated in provisions of a separate agreement on risk management cooperation. The capital requirement for credit risk for this part of the portfolio is calculated using the standardised approach because as at 31 December 2019 it is included in the phasing-in plan.

The following models being part of the rating system are used in the retail banking area:

- the Loss Given Default (LGD) model. In this model, loss is defined as a function depending on the level of recovery from the customer's own repayments and the possible value of the collateral on the real estate, realised during the enforcement proceedings,
- the Credit Conversion Factor (CCF) model. This factor is an integral element of the EAD model (CCF as the degree to which off-balance-sheet liabilities have been met by the customer on the date of the default),
- the Probability of Default (PD) model, which is a model integrating the models functioning in the retail banking area – application, behavioural and models based on the external data from the Credit Information Bureau (BIK).

Description of the factors that influenced the losses incurred in the previous period.

In the commercial portfolio the amount of losses incurred in the first half of 2020 was higher than the amount of losses incurred in the first half of 2019. The main factor that resulted in the increase was the need to create a provision for the identified cases of default in the individual method.

As regards the retail portfolio acquired in cooperation with mBank S.A. in the first half of 2020, there were changes in the applied group models of credit risk (changes implemented by the Model Competence Centre). Changes which had a significant impact on the level of estimated write-downs are: the recalibration implemented in January this year, resulting in a decrease in the amount of write-downs in February this year by ca. PLN 580 thousand, implementation of a change in the NLF parameter in March this year, resulting in an increase in the amount of write-downs by ca. PLN 500 thousand and the implementation of a change in the NLF parameter together with the recalibration of the PD LT model and re-parameterisation of Transfer Logic, resulting in an increase in the amount of provisions in June this year by ca. PLN 300 thousand.

Lawsuits brought by the Bank, insolvency proceedings

The credit exposure covered by the bankruptcy proceedings on the basis of the petition dated 23 July 2018 was sold by the bank in the first half of 2020. The loan was closed.

Two bankruptcy petitions, concerning two loans of two companies related by the person of the partner and the president of the management board, were filed with the court on 20 December 2018. In both cases, the court declared bankruptcy on 26 April 2019. The court has appointed a different receiver for each case. In the course of bankruptcy, the Receivers sold the real property. In the first case, the receiver sold 4 residential units for PLN 12 million. An agreement with the buyer was signed and the price paid. The Bank awaits approval of the list of receivables and preparation of the division plan. In the second case, the receiver sold the real estate for PLN 6.308 million. An agreement with the buyer was signed and the price paid. The Bank awaits approval of the list of receivables and preparation of the division plan. In both cases, the Bank closely monitors the pending proceedings.

In the first half of 2018, an auction sale of one of the real estates subject to enforcement proceedings took place. The real estate was auctioned at the price of PLN 10 million. Initially the auctioneer did not fulfil the adjudication conditions (did not pay the price for the auctioned claim). Due to formal irregularities, the court set an additional deadline for the auctioneer to pay the price. As at the date of this report, the price was paid by the auctioneer. In the same case, on 24 May 2018 another entity filed a petition for declaration of bankruptcy of the company which was the owner of the auctioned real estate. On 25 July 2018, the Bankruptcy Court declared the company bankrupt. The Court's decision on the declaration of bankruptcy

became final and binding on 6 December 2018. The price paid by the auctioneer was added to the bankruptcy estate. The division plan has been prepared. The Bank awaits its approval by the court.

On 29 January 2019, the Bank filed a petition for bankruptcy in a commercial case where the collateral for the loan consists of residential units in Plewiska near Poznań. On 17 April 2019, the court declared bankruptcy in the case in question and appointed a receiver. The decision on declaring bankruptcy is final. The receiver performs all the acts possible to be performed at the present stage of the proceedings, i.e. the receiver filed the bankruptcy schedule, sells the real estate included in the bankruptcy estate. The death of the main shareholder of the bankrupt company may affect the bankruptcy proceedings in this case.

On 9 January 2020, the Bank filed a petition for bankruptcy in a case that was at the restructuring stage. The court declared bankruptcy on 21 April 2020. The decision is not final. The receiver performs activities that are possible at the current stage of the proceedings.

On 21 January 2020, the Bank was informed by the Administrator of the company under the restructuring proceedings about the filed simplified petition for bankruptcy of the restructured company. As at the date of submission of this report, the court did not issue any decision on the bankruptcy petition.

In the area of retail loans, 2 lawsuits (new retail) were filed in the first half of 2020 for the total amount of PLN 444,246.99. These cases are at the stage of court proceedings.

In the first half of 2020, 5 commercial cases and 6 retail cases operated by the Bad Loans Section in the Commercial Credit Risk Department were closed.

2.2. Market risk

The risk of loss resulting from adverse changes of market parameters from the point of view of the term structure of items in the portfolio of the Bank is maintained as low as possible, which results from the nature of the Bank's activity, properly functioning system of risk limitation and managing of the risk at the operational level.

In order to limit the market risk, the Bank adjusts the currency and term structure of acquired sources of financing to the structure of loans, uses linear plain vanilla derivatives and concludes spot or forward currency transactions and FX SWAP transactions.

The amount of market risk the Bank is exposed to in the day horizon is determined using Value at Risk (VaR) method at the confidence level of 97.5%. As of the end of June 2020 VaR amounted to PLN 2 616.4 thousand. The currency risk was PLN 11.2 thousand, the interest rate risk was PLN 2 361.0 thousand and the credit spread risk was PLN 2 300.0 thousand.

The interest rate risk results from exposure of the financial result and the Bank's capital to adverse effect of interest rates changes. The Bank manages the interest rate gap through matching the repricing dates of assets and liabilities. The sensitivity of the Bank's portfolio to interest rates fluctuations is determined on the basis of results of stress tests and scenario analyses. According to data as at the end of June 2020, the decrease in the economic value of the bank's equity (EVE) in relation to the bank's own funds was 1.42%. Interest rate risk is also measured in relation to the bank's net interest income. As at the end of June 2020, Earnings at Risk (EaR) and Net Interest Income (NII) ratios reached 4.40% (EaR) and 11.30% (NII), respectively. The bank portfolio items exposed to interest rate risk are hedged with linear interest rate derivatives.

The currency risk is limited through immediate closing the foreign exchange position. The measurement of scale and structure of currency risk is done on the basis of the current foreign exchange position taking into account anticipated repayments and disbursements of loans. The currency risk is limited using foreign exchange position limits for each currency.

2.3. Liquidity risk

When organising liquidity risk management processes, the Bank complies with legal requirements and includes supervisory recommendations, in particular PFSA Recommendations and EBA Guidelines on liquidity risk management.

The Bank has a set of procedures, adapted to the scale and profile of the Bank's operations, defining the process and setting a framework for managing the liquidity risk. The roles and responsibilities in the liquidity risk management process, the manner of measuring, monitoring, limiting, managing and controlling liquidity risk, and the principles of setting and updating the limits are all defined. In order to secure the Bank's liquidity, in the event of stress conditions of an internal, external nature or their combination, a surplus of high quality unencumbered liquid assets is maintained in case the negative scenarios materialise (Liquidity Surplus).

In the rules of conducting stress tests, the Bank took into account the rules for the development of liquidity stress tests scenarios. By conducting the stress tests, the Bank assesses the potential change in liquidity risk exposure in particular time frames of the liquidity gaps and the ability to cover the refinancing source demand for particular test scenarios.

In carrying out the stress tests, it takes into account the impact on the Bank's economic standing of unfavourable events or fluctuations in macroeconomic and financial parameters and takes into account the loan factor.

Based on the outcome of the stress tests, the Bank may revise its liquidity risk management policy. The outcome of the stress tests may be the basis for a decision of the Bank's Management Board to modify the liquidity management policies specified in the Contingency Plan in the event of a liquidity crisis.

The outcome of the stress tests is the basis for determining the required liquidity surplus and internal limits..

Liquidity risk management is conducted at the level of intraday, short-, medium- and long-term liquidity, the lack of which means inability to finance assets and timely settle liabilities in the normal course of business of the Bank.

At the end of June 2020, the excess of liquid assets amounted to approx. 6.89% of the balance sheet total. The long-term situation of the Bank in terms of liquidity is stable. Loans obtained from mBank S.A. have significant share in financing of long-term receivables.

Due to necessity to maintain liquidity indicators on an appropriate level, the needs to bridge the mismatch of the assets structure to the liabilities that finance them as well as increasing the stability of financing sources, mBank Hipoteczny S.A. will continue actions aimed at replacing short-term financing with financing in a form of new issues of covered bonds with maturity period of 5 years or more.

The share of stable financing sources and liquidity reserves adequate to the scale of the Bank's activity determines meeting of long-term liquidity standard M4 required by KNF. The M4 ratio at the end of December 2019 was 1.056. M1 and M2 short-term liquidity standards were maintained at a safe level, PLN 1,300,996 thousand and 3.067 respectively. The M3 standard was 82.637.

Net outflows coverage ratio, determining the relation of the liquidity buffer to the net liquidity outflows under stressed conditions lasting 30 calendar days (LCR) amounted to 480%.

As at the end of June 2020 the liabilities limit, resulting from Art. 15.2 of the "Act on covered bonds and mortgage banks", was used in 44.0%. In 2020 this limit was not exceeded.

As at the reporting date average maturity of issued mortgage covered bonds was 3.4 of a year while average maturity of loans obtained from other banks was 2.9 of a year.

The Bank has a management information system based on banking systems and applications supporting the measurement and monitoring of liquidity risk. This system ensures that information on liquidity risk is received, enables impact assessment as regards management decisions, and is used to monitor risk and control the limits. The Bank prepares reports on liquidity risk on a daily, monthly and quarterly basis. Liquidity risk reports, containing information on liquidity risk exposure and information on the use of limits for this risk, are presented to the ALCO committee at least once every two months and to the Management Board of the Bank and the Supervisory Board on a quarterly basis. In order to better manage liquidity risk and supervise this process, the Management Board of the Bank and persons responsible for liquidity risk management have on-going access to daily reports.

At least once a year, the Bank reviews the liquidity risk management system within the ILAAP process, including review and assessment of the individual elements of the liquidity risk management process in accordance with the Rules for internal liquidity adequacy assessment process (ILAAP) at mBank Hipoteczny S.A.

2.4. Operational risk

The Bank has a simplified organisational structure, and the products offered are consistent with the nature of the mortgage bank's activity.

Since January 2019, the Bank is planning to develop the commercial loans portfolio, similarly like the retail loans portfolio, in the formula of close cooperation with mBank, i.e. assuming that the sale will be executed by the forces of mBank.

The operational risk connected with the loan sale stage was transferred together with the sales process. It has an impact on reducing the level of the operational risk of the Bank, nevertheless increases the significance of the tasks entrusted in the outsourced processes, relating to the processes of loan acquisition by pooling and maintenance of the loan portfolio. The outsourcing processes are subject to continuous monitoring.

In the first half of 2019, work under the project of redesigning the Business Continuity Plan was carried out at the Bank. The first stage of the project was concluded with the drafting of the "Business Continuity Plan" document compliant with ISO 22301 standard, Commerzbank Group standards, Recommendation M and D of the Polish Financial Supervision Authority, tailored to the current organisational structure and business model of the Bank. The purpose of the Plan is to define the principles of the Bank's operation in case of a contingency. In addition, an internal regulation was drafted specifying the procedure for the performance of business continuity tasks of the Bank, as well as a new BIA Methodology. Following the BIA conducted in accordance with the new principles, the List of Critical Business Processes was compiled. Relevant emergency procedures and contact (notification) lists were updated. The new business continuity management rules set out the obligation to test the Business Continuity Plan in accordance with the agreed schedule, at least once a year. The list of critical processes is reviewed and updated at least once a year with each subsequent BIA. Actions that improve the plan, in accordance with adopted internal regulations, are measured and the Management Board is informed about them. In order to comply with the postulate of accountability in IT systems, events monitoring and notifying systems were implemented together with internal safety procedures for individual IT systems for which the IT safety risk assessment is performed. Furthermore, the information security management system was supplemented with redesigned processes: the Bank's physical and environmental safety management as well as knowledge management of knowledge on information safety (raising users' awareness). The processes were incorporated into complete policy of IT service model of management. Considering the probability of occurring of critical situations in the areas of liquidity management, currency risk or interest rate risk the Bank has an "Emergency plan in case of liquidity crisis." Additionally, the Bank also has an "Emergency plan in case of unexpected, radical changes in prices on the real estate market."

The factors influencing the increase of Bank's level of exposure to operational risk:

- changes in the organisational structure,
- number of conducted undertakings and IT projects,
- turnover of employees,
- changes in the profile of operational activity, related to the transfer of the sales process of retail and commercial loans to mBank S.A.
-

The factors that stabilise the Bank's level of exposure to operational risk:

- operational risk management system implemented in the Bank,
- simple organisational structure, no subsidiaries,
- small scale and the degree of complexity resulting from the specificity characteristic for mortgage banks,

- no electronic banking services,
- procedures governing the process of making decisions on entrusting of activities (analysis of benefits, risks and means of their limitation, business continuity plans and insourcer's financial situation as well as the ability to implement services in a timely and qualitative manner).
- Bank's Business Continuity Plan,
- highly qualified staff,
- efficient internal control system,
- monitoring of the quality of the outsourced tasks (periodic control of the insourcer with monitoring of post-control recommendations; monitoring of the quality and timeliness of service performance, also for the purpose of calculation of the remuneration level).

The Bank will monitor and analyse any changes affecting its operational risk profile.

In the first half of 2020, due to the threat of the COVID-19 spread, resulting in the announcement of the state of epidemic emergency in Poland, new policies were developed at the Bank in order to ensure safety while keeping the continuity of the executed processes. The Bank has introduced the mode of teleworking. Wherever it was not possible, office duty hours were introduced with all the safeguards. In addition to the new organisation of work, the Bank has also developed support measures addressed both to corporate and retail customers.

2.5. Covered bonds investment risk

In 2019 the investment risk profile associated with covered bonds issued by mBank Hipoteczny S.A. did not change. Those securities are a financial instrument of a low investment risk, resulting from the requirements of multi-stage collateralisation of their issuing and trade by the issuer, accordant with the Act on covered bonds and mortgage banks. In addition to compliance with a number of statutory requirements during economic slowdown, high safety of investing in covered bonds is also a result of the Bank's conservative policy of valuation of real estates constitute their collateral, which has been applied for many years. According to the amended Act on covered bonds and mortgage banks, the minimum level of over-collateralisation of mortgage and public sector covered bonds since 1 January 2016 is 10%.

The increase of investment attractiveness of such securities also results from the fact that covered bonds issued by mortgage banks may constitute a collateral for a lombard loan as well as repurchase transactions conducted with other banks.

2.6. Internal control system

An internal control system has been implemented at the Bank that takes into account the requirements of the law and supervisory recommendations as well as the profile and scale of operations.

The internal control system was defined in the Rules of the internal control system approved by the Supervisory Board.

The internal control system is organised at the Bank at three lines of defense, where:

- 1) the first line of defense comprises risk management in operating activities of the Bank, performed by organisational units of the Bank;
- 2) the second line of defense comprises:
 - a) risk management by designated organisational units/designated employees of organisational units, irrespectively of risk management at the first line of defense;
 - b) the operation of the compliance unit performed by the Compliance Department;
- 3) the third line of defense comprises the operation of the internal audit unit performed by the Internal Audit Department.

As part of its internal control system, the Bank has established the following functions:

- 1) **control function** – which comprises all controls put in place in the processes executed in the Bank, independent monitoring of the compliance with these controls and reporting within the function.

Internal controls are an integral part of the Bank's day-to-day operations and comprise:

- a) internal procedures on the Bank's operations,
- b) reviews of reports by the Management Board of the Bank,
- c) inspections conducted by the directors of departments and offices,
- d) physical security,
- e) a system of limits and rules for controlling them,
- f) rules for taking credit decisions and the system of authorisations,
- g) principles of verifying the transaction details and activities, and results of risk management models,
- h) activities aimed at controlling the quality and accuracy of the implemented tasks.

The control of accurate operation of the internal controls is made on an ongoing basis by each employee as part of their functions, and periodically, as part of horizontal and vertical testing, by heads of organisational units or their appointees.

2) **Compliance Department** - compliance cell with the following responsibilities:

- it manages compliance risk (construed as the risk of effects of non-compliance with legal regulations, internal regulations and market standards) through identification, assessment, controlling, monitoring and reporting on compliance risk regarding the law, internal regulations and market standards;
- it performs horizontal monitoring tasks of the compliance unit and vertical monitoring tasks within the so-called second line of defence, assigned to the compliance unit to assure compliance of the Bank's operations with legal regulations, internal regulations and market standards. CD performs other tasks, provided that it does not undermine its effectiveness and independence.

The Compliance Department is responsible for implementation of the standards of the mBank Group and, indirectly, of Commerzbank AG in areas regarded as "compliance areas" in accordance with the Group standards, which include in particular:

- anti-money laundering and counter-terrorist financing
- protection of personal data
- banking outsourcing
- preventing conflicts of interest, fraud and corruption
- supervision over the process of handling of client's complaints
- Inside information according to Market Abuse Regulation.

3) **Internal Audit Department** - independent internal audit department whose task is to independently and objectively examine and assess the adequacy of the risk management system and the internal audit system. Internal audit supports the Bank in achieving objectives through systematic and disciplined approach to examination, assessment and improvement of effectiveness of risk management, audit and organisational governance processes.

Within the scope of its activity the internal audit provides services:

- providing - covering objective assessment of evidence, performed by internal auditors in order to provide independent opinion and proposals related to a process, system or other issues,
- consulting - covering advisory and related service activities, which nature and scope are arranged in detail with principal, and which purpose is to add value to and improve organisational governance, risk management and internal audit processes.

Internal Audit Department, within the scope of implemented function, is subject to periodical assessment of independent competent entity from outside the Bank. The entity is selected by the Bank's Management Board and approved by the Audit Committee. The work assessment covers compliance of the internal audit with IIA Standards, Recommendation H and best market practices.

2.7. Remuneration policy

The Bank runs a remuneration scheme for the Bank's Management Board and employees with significant influence on Bank's risk profile, based on phantom shares settled in cash; the scheme is further referred to as the "Policy". These benefits are accounted for in accordance with IAS 19 "Employee benefits". Phantom share valuation is debited to relevant period expenses with a credit to liabilities. Costs are recognised over time during the period of the right to benefits and included in "General administrative expenses". Allocation of phantom shares results from their valuation for the assessment period. Phantom shares valuation is calculated always as at the end of a reporting period by dividing Bank's book value over the number of ordinary shares. The payout under phantom shares depends on the average valuation of these shares obtained on the basis of two values: the phantom share value at the end of the annual period preceding the payment date and the phantom share value at the end of the first half of the year in which the payment is due in a given reporting period. The aforementioned average value is multiplied by the number of phantom shares to be executed in a given period, and the outcome determines the amount of the cash payment resulting from phantom shares held. The final value of the premium, which is a product of the number of shares and their estimated value as at the balance sheet date preceding the realisation of each of the deferred tranches is subject to actuarial discounting. The discounted amount is reduced by amounts of allocations to the relevant provision, which are subject to annual actuarial discounting at the same date. The actuarial discount is the product of the financial discount and the probability of each of the participants individually reaching the moment of obtaining full entitlement to each of the deferred tranches. Annual allocations are calculated according to the Projected Unit Credit Method. The aforementioned probability was determined using the Multiple Decrement Model, where the following three risks were taken into account: the possibility of dismissal, the risk of total incapacity for work, the risk of death.

3. Directions of development and key elements of the Bank strategy

Mission statement

With regard to the real estate market, the mission of mBank Hipoteczny is to support the development of an effective mechanism for financing the real estate market in Poland by issuing long-term debt securities (covered bonds), which are an instrument that makes it possible to refinance attractive forms of real estate financing based on strong competences, the longest market experience and the highest standard of service.

With regard to mBank Group, the mission of mBank Hipoteczny is to provide stable, long-term and safe refinancing.

From the investors' point of view, the mission of mBank Hipoteczny is to ensure a high level of long-term covered bonds with a high level of security.

The vision

mBank Hipoteczny will be focused on issuing covered bonds in Poland and on the international market within the most cost-effective business model possible, i.e. aimed at maximising synergies within mBank Group, in particular on using the available resources of each bank, primarily mBank, in accordance with their economic purpose, as well as the knowledge and experience within mBank Group.

In view of the development of the covered bond market in Poland, and in particular in view of the expected establishment of new mortgage banks, the Bank's ambition is to maintain its current position among the leading issuers of such instruments in Poland.

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The Bank's strategic objectives for 2020–2022 are the following:

- Maximum utilisation of covered bonds as a tool for refinancing the portfolio of long-term mortgage loans.
- Dynamic development of the portfolio of real estate loan assets (housing loans) under the applicable risk management strategy, compliant with the covered bond collateral criteria.
- Optimal use of resources and competencies in both banks as well as other entities of mBank Group, making it possible to achieve synergy in order to ensure an effective issuance process while maintaining the principles of safe and prudent management of the Bank so that the Bank is a safe, efficient and effective issuer of covered bonds on the market.

Strengthening mBank Group's independence with regard to the financing of its operations and better matching the time horizon of financing with assets is a key element of the financing strategy. The issuance of covered bonds is a factor supporting the financing of operations on the real estate market.

mBank Group assumes a dynamic growth of the issuance operations of the Bank in the coming years. The issuance of covered bonds allows the Bank to generate stable and long-term financing on affordable terms.

The Bank assumes issuance of covered bonds secured by both residential and CRE mortgage loans – residential loans will be acquired in cooperation with mBank.

Housing mortgage loans will be the main driver of the increase in the covered pool for the issuance of covered bonds at the Bank. Covered bonds will be issued both in PLN and in EUR, and their maturity will vary between 5 and 10 years.

4. Bank Authorities

Shareholders

As at the reporting date, the total number of ordinary shares was 3,360,000 shares with a nominal value of PLN 100 per share. On 7 March 2019, the Extraordinary General Meeting adopted resolution on the increase of the share capital and the exclusion of the shareholder from the pre-emptive right to shares, under which the share capital will be increased to the amount of PLN 336,000,000.00 by way of issuing 150,000 series I ordinary registered shares with a nominal value of PLN 100.00 each and the issue price of PLN 1,000.00 each. The new shares were offered for subscription to mBank S.A. through private placement. The shares were paid-up in full. On 9 May 2019, the registry court entered the increased share capital in the registry of entrepreneurs.

The Bank did not issue preferred shares, there are no limitations of rights associated with shares. All shares participate equally in the dividend distribution. All issued shares are fully paid. The Bank does not possess own shares.

As of the reporting date the ownership structure of registered share capital of the Bank is as follows:

Name of shareholder	Registered share capital in PLN	Shares		Votes at the General Meeting of Shareholders	
		Amount	%	Amount	%
mBank S.A.	336,000,000	3,360,000	100.00	3,360,000	100.00
Total	336,000,000	3,360,000	100.00	3,360,000	100.00

The Bank does not collaborate with international public institutions.

Management Board

The Management Board of mBank Hipoteczny S.A. included the following members:

- Piotr Cyburt – President of the Management Board
- Krzysztof Dubejko – Member of the Management Board
- Andrzej Kulik – Member of the Management Board
- Marcin Wojtachnio – Member of the Management Board

Appointment and dismissal of members of the Management Board and their rights:

The Supervisory Board appoints and dismisses members of the Management Board of the Bank, including the President of the Management Board.

Appointing of two members of the Management Board, including the President of the Management Board and a member of the Management Board responsible for risk takes place upon Financial Supervision Authority approval. A request for approval is submitted by the Supervisory Board.

The Management Board of the Bank manages the Bank's operations and represents it. The Management Board adopts annual financial plans and operating strategy which are approved by the Supervisory Board. In these plans, the Management Boards specifies the maximum volume of mortgage bond and bond issues for a given year. The scope of activities of the Bank's Management Board includes all matters not reserved for the competence of other Bank's bodies based on its Articles of Association or the provisions of the law.

Rules on amending articles of association

In accordance with Art. 430 § 1 of the CCC the change of articles of association requires resolution of the general meeting and entry into register.

Pursuant to art. 34 par. 2 Banking Law the change of bank's articles of association requires approval of the Financial Supervision Authority.

Supervisory Board

Composition of mBank Hipoteczny S.A. Supervisory Board:

- Frank Bock – Supervisory Board Chairman
- Lidia Jabłonowska-Luba - Supervisory Board Vice-Chairman
- Andreas Boeger – Supervisory Board Member
- Paweł Przybyłek – resignation as of 19 May 2020
- Paweł Graniewski – Independent Supervisory Board Member
- Cezary Kocik - resignation as of 27 April 2020
- Michał Popiołek - Supervisory Board Member
- Mariusz Tokarski – Independent Supervisory Board Member
- Łukasz Witkowski – appointment as of 15 May 2020

According to the wording of paragraph 14 clause 1 point 5 of the Articles of Association of mBank Hipoteczny S.A., the General Meeting, in a form of resolution, makes a decision regarding appointment or dismissal of the Supervisory Board members and determination of principles of their remuneration.

According to the wording of paragraph 3 clause 1 point 9 and 10 of the Rules and Regulations of the Supervisory Board of mBank Hipoteczny S.A., powers of the Supervisory Board include appointing and removing from office the President and other members of the Management Board, as well as assigning the functions of Vice President of the Management Board and member of the Management Board responsible for oversight over the management of risks material to the Bank's operations, as well as determining the terms and conditions of the contracts and remuneration for the members of the Bank's Management Board and representing the Bank at the execution of contracts with the Management Board members.

Three Committees operate within the Supervisory Board: Audit Committee, Risk Committee and Remuneration Committee.

Audit Committee

The Audit Committee included the following members:

- Paweł Graniewski - Committee Chairman
- Andreas Boeger - Committee Member
- Mariusz Tokarski - Committee Member

In 2020 the Audit Committee held meetings on 26 March and 21 May.

Remuneration Committee

The Remuneration Committee included the following members:

- Frank Bock – Committee Chairman
- Andreas Boeger - Committee Vice-Chairman
- Lidia Jabłowska-Luba – Committee Member
- Cezary Kocik – rezygnacja z Rady Nadzorczej

In 2020 the Remuneration Committee did not hold meetings.

Risk Committee

The Risk Committee included the following members:

- Lidia Jabłowska-Luba – Chairwoman of the Committee
- Frank Bock - resignation
- Łukasz Witkowski – appointed by Resolution of the Supervisory Board No 26/2020 of 21 May 2020
- Michał Popiołek – Committee Member

The tasks of the Risk Committee include:

- expressing opinions about the comprehensive risk appetite of the Bank at present and in the future,
- expressing opinions about the strategy of risk management in Bank's activities developed by the Bank's Management Board and about the information on implementing this strategy submitted by the Management Board,
- supporting the Bank's Supervisory Board in monitoring the implementation of the strategy of risk management in Bank's activities by top management,
- verifying whether the prices of liabilities and assets offered to customers fully comply with the Bank's business model and its risk strategy, and if these prices do not reflect appropriately the types of risks in accordance with this model and this strategy, providing the Bank's Management Board with proposals aiming at ensuring the adequacy of liabilities and assets prices to these risks,
- recommending approval or rejection of the Bank's operational strategy and principles of prudent and stable management of the Bank to the Supervisory Board,
- supervision over risk management in the Bank,
- supporting the Bank's Supervisory Board in the task of supervision over risk management activities in the Bank,
- supporting the Supervisory Board in the task of supervision over the compliance of changes implemented in the credit policy with the strategy and financial plan of the Bank/mBank Group,
- verifying the quality of assets,
- supporting the Bank's Supervisory Board in the task of supervision over cooperation of the Bank with the Commerzbank AG group with respect to consolidated supervision over risk and information exchange.

In 2020 the Risk Committee held a meetings on 26 March.

The procedure for convening and powers of the General Meeting of Shareholders

General Meeting of Shareholders is convened as ordinary (annual) and extraordinary meeting, in accordance with the Bank's Articles of Association and the provisions of the commercial companies' code.

Key competencies of the General Meeting of Shareholders include decision making through resolutions on the following matters:

- review and approval of the Management Board's report on Bank's activities and financial statements for the previous financial year,
- acknowledgement of the fulfilment of duties by the Bank's authorities (vote of confidence),
- Bank's profit distribution or loss coverage,
- amendments to articles of association,

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- appointment and dismissal of members of the Supervisory Board and determination of their remuneration,
- increasing or decreasing Bank's share capital,
- liquidation, disposal of the entire Bank's enterprise or merger (combination) with another bank,
- appointment of receivers and determination of their remuneration,
- any decisions relating to claims for rectification of damages caused during the establishment of the company or during its management or supervision,
- decision on dividend payment date,
- disposal or establishing lien on Bank's real property being the location of Bank's authorities,
- matters submitted by the Supervisory Board,
- matters submitted by shareholders under the procedure provided for by the articles of association,
- granting consent for the Bank to purchase or sell shares or other equity interests, or to establish or join other business organisations; such consent not being required if the purchase of shares or equity interests in other companies takes place under enforcement, insolvency or restructuring proceedings or other arrangement with the Bank's debtors, or if the Bank sells shares or equity interests purchased in the manner just described; in such a case, the Bank's Management Board shall inform the Supervisory Board of the above actions,
- other matters reserved under the law or the provisions of the Articles of Association.

5. Other information

Loans and interest rates

Basic variable interest rates applied in the Bank are based on LIBOR or EURIBOR interest rates for foreign currency loans and WIBOR for loans in PLN. The loan interest rate in a given day is equal to the sum of margins of the Bank established in the agreement as well as the base rate.

Transactions with affiliated entities

The direct parent entity of mBank Hipoteczny S.A. is mBank S.A. The direct parent entity of mBank S.A. is Commerzbank AG.

All transactions between the Bank and affiliated entities were typical and routine transactions, according to the Management board concluded on conditions that did not vary from the market conditions, and their nature and conditions resulted from current operational activity conducted by the Bank. Transactions with affiliated entities concluded in the scope of ordinary operational activity cover loans, deposits, liabilities arising from the issue of debt securities and derivative transactions.

Information on meeting of requirements specified in Art. 22aa of the Banking Law Act by members of the Supervisory Board

On 21 March and 29 March 2018, the Annual General Meeting of mBank Hipoteczny S.A. appointed the Supervisory Board of the eleventh term of office, composed as above. Additionally, on 28 May 2019, in connection with the resignation of Jakub Fast from the position of Member of the Supervisory Board, Paweł Przybyłek was appointed to the Supervisory Board. The General Meeting verified the candidates for the Supervisory Board members and decided that they fulfilled the requirements set forth in Article 22a of the Banking Law.

When appointing the current Management Board, the Supervisory Board verified the persons being appointed as Members of the Management Board and decided that they fulfilled the requirements set forth in Article 22a of the Banking Law.

Proceedings before a court, arbitration body or public administration authority

Information on pending proceedings is provided in Note 25 to the Financial Statements.

Public aid

In 2020, the Bank did not receive any public subsidies, in particular on the basis of the Act on the Government support for the financial institutions dated February 12, 2009 (Journal of Laws of 2014 item 158).

Guarantees and sureties granted by the Bank

No guarantees or sureties were granted by the Bank in 2020.

Events after the balance sheet date

Events as indicated above did not occur in the Bank.

6. Statements of the Management Board

Corporate governance

In its activity the Bank is guided by the rules of corporate governance and best banking practices which set high standards based on transparency of operations, ethics in business and maintaining the balance between interests of all entities involved in the functioning of the Company.

On 16 December 2014 the Management Board, and on 19 January 2015 the Supervisory Board accepted the application of the Principles of Corporate Governance for Supervised Institutions ("Principles"), adopted by the Financial Supervision Authority on 22 July 2014, with the exclusion of Principles indicated in § 8 para. 4, §25 para.1, § 29 , §53-57. The principles addressed to shareholders were presented by the Management Board on the Annual General Meeting of mBank Hipoteczny S.A. on 22 April 2015. On the same day, the General Meeting adopted resolution No 15 on the application of Principles of Corporate Governance for Supervised Institutions, in which it adopted these Principles for application within the scope in which they relate to the general meeting, excluding the principle set forth in § 29 of the Principles (remuneration for holding the position of a Member of the Supervisory Board is awarded by the General Meeting only to an independent member). The resolution came into force on the date of adoption.

The Principles are available at:

https://www.knf.gov.pl/dla_rynku/regulacje_i_praktyka/zasady_ladu_korporacyjnego

Principles of Corporate Governance for Supervised Institutions is the only set of corporate governance rules followed by the Bank. The Bank did not adopt any other voluntary rules of corporate governance to be followed, nor does it apply any corporate governance practices which go beyond the requirements provided for in the national law.

The Bank has excluded the application of the Principles of Corporate Governance for Supervised Institutions as regards the rules set out in §8(4), §25(1), §29, §53-57. The justification of waiver of said Principles is presented in an Appendix to the Management Board's Resolution No 247 of 16.12.2014.

§8 (4): The Bank does not apply the following Principles: If it is justified by the number of shareholders, the supervised institution should strive to facilitate the participation of all shareholders in the meeting of the decision-making body of the supervised institution by, without limitation, enabling active participation in the meetings of the decision-making body using electronic means.

Shares of mBank Hipoteczny S.A. are acquired indirectly or directly by the sole shareholder i.e. mBank S.A. The General Meetings are held without a formal convocation, and 100% of the share capital shall always be represented at the General Meetings. Accordingly, the number of shareholders does not justify the need for organizing meetings by the use of electronic devices.

§25(1): The Bank does not follow the Principle: Supervision exercised by the supervisory body should be of permanent nature, and the supervisory body meetings should be held as needed. If an audit committee or other committees operate in the supervised institution, and they have been entrusted with specific matters of the supervised institution's activity, meetings of the supervisory body should be held at least four times a year, and otherwise at least every two months.

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Deviation from the above Principle is dictated by the close cooperation with the shareholder, in particular as regards consolidated supervision, large exposure risk management, application of statistical methods, risk area, compliance, internal audit, and elaborate regular reporting. The above cooperation results in particular from the obligation defined in Resolution of the Polish Financial Supervision Authority No 258/2011 on detailed principles of operation of the risk management system and the internal control system, and detailed conditions for estimation of internal capital by banks and for reviews of the internal capital retention and estimation process and the principles of determining the policy of variable components of the remunerations of persons in managerial positions at banks, concerning the obligation of risk management by the shareholder (mBank) in subsidiaries. In view of the above, the Supervisory Board's meetings held 3 times a year are sufficient to ensure security of the Bank.

§29: The Bank does not apply the Principle: 1. Remuneration of members of the supervisory body shall be established adequately to the function they hold and to the scale of operations of the supervised institution. Members of the supervisory body appointed to work on committees, including the audit committee, should be remunerated adequately to the additional tasks performed on the committee.

2. Remuneration of members of the supervisory body, unless payment of such remuneration is prohibited by the law, should be established by the decision-making body.

3. The rules for remunerating members of the supervisory body should be transparent and included in the relevant internal regulation of the supervised institution.

Remuneration for holding the position of a member of the Supervisory Board is awarded by the General Meeting to an independent member. The other Board Members do not receive remuneration.

The Bank does not apply the Principles:

§ 53.

The supervised institution which manages assets at a client's risk should efficiently manage the assets so as to provide the required protection of the clients' interests.

§ 54.

1. The supervised institution should employ the available corporate supervision measures over entities – issuers of securities under management, in particular when the level of involvement in the securities is considerable or when it is required for protection of the clients' interests.

2. The supervised institution which manages assets at the client's risk should introduce transparent rules of cooperation with other financial institutions when executing corporate supervision over entities – issuers of securities under management.

3. The supervised institution which manages assets at the client's risk shall create and communicate to clients the policy of corporate supervision measure used, which includes the procedures of participation and voting at meetings of the decision-making bodies.

§ 55. In its operations, the supervised institution which manages assets at the client's risk should avoid situations which might cause a conflict of interests, and if a conflict of interests arises, the institution should be guided by the client's interest, and notify the client thereof.

§ 56. The supervised institution which manages assets at the client's risk should introduce transparent rules for cooperation with other supervised institutions with respect to transactions executed at the client's risk.

§ 57. The supervised institution, when acquiring assets at the client's risk, should act in the client's interest. The decision-making process should be duly documented.

Deviation from the above Principles is dictated by the fact that the Bank, as a specialized institution, does not engage in the activity of asset management at the client's risk.

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The Bank does not use any restrictions concerning the exercise of the voting right afforded by the securities. As regards the transfer of ownership of the securities, the only restriction is that issuances of covered bonds in the primary market are not addressed to individual (retail) investors and in the case of issuances introduced abroad – not addressed to Polish residents.

Rules for appointment and dismissal of the management:

The Supervisory Board shall appoint and dismiss members of the Management Board of the Bank, including the President of the Management Board, taking into account the assessment of fulfilment of the requirements, referred to in Article 22aa of the Banking Law. The President of the Management Board and the Management Board Member supervising the management of material risk in the Bank's operations shall be appointed and the function of the member of the Management Board supervising the management of material risk in the Bank's operations shall be entrusted to the appointed member of the Management Board with the consent of the Polish Financial Supervision Authority. The application for such consent shall be submitted by the Supervisory Board. Promptly after appointing the Management Board and changing the composition thereof, the Supervisory Board shall notify the Polish Financial Supervision Authority of the composition of the Management Board and changes in the composition thereof, and shall provide the information resulting from the assessment referred to in (1) on fulfilment by the members of the Management Board of the requirements referred to in Article 22aa of the Banking Law. Additionally, the Supervisory Board shall notify the Polish Financial Supervision Authority of the approval of and changes in the internal division of competence in the Management Board of the Bank. The Management Board shall be composed of the President of the Management Board and other members of the Management Board. The internal division of competence in the Management Board of the Bank shall be established by the Management Board and approved by the Supervisory Board. The President and other members of the Management Board shall be appointed for a joint 3-year term of office. Mandates of the Management Board members shall expire on the day of the General Meeting that approves the financial statements for the last full financial year of the term of office of the Management Board members at the latest. Furthermore, the mandate of a Management Board member shall also expire in case of death, resignation or dismissal of the member from the Management Board, as of the date of the event which causes the expiry, unless the resolution on dismissal provides for a different expiry date. Members of the Bank's Management Board may be dismissed at any time before their term of office expires. The Management Board of the Bank shall manage the Bank's affairs and shall represent the Bank. The Management Board shall accept the annual financial plans and the business strategy, which shall be approved by the Supervisory Board. The Management Board defines the maximum size of covered bond and bond issues in a given year in annual financial plans and business strategies.

Audit Committee

The Bank complies with the regulations governing the appointment, composition and operation of the audit committee, including those which apply to fulfilment by the audit committee members of the independence criteria and the requirements of knowledge and skills in banking and in accounting and financial statements auditing.

The Audit Committee of the Supervisory Board of mBank Hipoteczny S.A. operates in accordance with the Rules of the Audit Committee introduced upon Resolution of the Supervisory Board No 36/2017 of 28 December 2017. In 2018 the Audit Committee's members were appointed upon Resolution of the Supervisory Board No 26/2017 of 17 August 2017. All members of the Audit Committee satisfy the requirements of knowledge and skills in banking and in accounting and financial statements auditing, which they acquired through education and professional experience.

The basic tasks of the Audit Committee result from the Act of 11 May 2017 on statutory auditors, audit firms and public supervision, the Bank's Articles of Association, the Regulations of the Supervisory Board, "Recommendations regarding the operation of the Audit Committee" adopted by the Polish Financial Supervision Authority.

In 2019 the Audit Committee performed the tasks of the audit committee provided for in the mandatory legal regulations by way of performing ongoing supervision, based on the information provided by the Management Board of mBank Hipoteczny, the certified auditor, the Internal Audit Department, the

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Compliance Department, the Accounting and Clearance Department and by way of meetings - four meeting of the Committee were held.

The Audit Committee with Resolution No. 6/2017 of December 14, 2017 adopted the "Policy regarding the selection of an audit firm and the audit company conducting the audit by entities related to this auditing company and by a member of the auditing company's network of permitted services that are not auditing the financial statements at mBank Hipoteczny SA together with the attachment " Procedure for selecting the Audit Company in mBank Hipoteczny SA". The policy meets the requirements of the Act on statutory auditors, auditing companies and public supervision as well as the Regulation of the European Parliament and the Council of the European Union of 16/04/2014 No. 537/2014.

mBank Hipoteczny's policy on the selection of an audit firm includes the principle of statutory auditor rotation. The duration of total uninterrupted statutory audit engagements referred to in Article 17 (1) paragraph 2 of Regulation (EU) No. 537/2014 carried out by the same audit firm or an audit firm related to this audit firm, or any member of the network operating within the European Union to which these audit firms belong, must not exceed five years. The key statutory auditor may carry out a statutory audit again in the bank after at least three years of the completion of the last statutory audit. In the case of a statutory audit, the first agreement on statutory audit is concluded with an audit firm for the period not shorter than two years with an option to extend it for another two-year period.

Pursuant to the policy on the performance of permitted non-audit services in mBank Hipoteczny S.A. by the audit firm carrying out the audit, by entities related to the audit firm and by a member of an audit firm network, a statutory auditor or an audit firm carrying out the audit, or any member of the network to which the statutory auditor or the audit firm belongs, must not directly or indirectly provide to the audited entity, to its parent undertaking or to its controlled undertakings within the Union:

- any prohibited non-audit services in the period between the beginning of the period audited and the issuing of the audit report;
- any services that consist in designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems.

Under Article 136 of the Act on Statutory Auditors, prohibited services do not include the following:

1. services that consist in:

- a. conducting due diligence procedures with regard to economic and financial condition,
 - b. issuing comfort letters in connection with prospectuses issued by the audited entity, in accordance with the national standard of related services and by means of agreed procedures,
2. assurance services with regard to pro forma financial information, forecasts of results or estimated results, published in the prospectus issued by the audited entity,
 3. examination of historical financial information of the prospectus,
 4. verification of consolidation packages,
 5. confirmation of fulfilment of conditions of the concluded loan contracts on the basis of the analysis of financial information coming from financial statements audited by a given audit firm,
 6. assurance services in reporting concerning corporate governance, risk management and corporate social responsibility,
 7. services consisting in the assessment of compliance of information revealed by financial institutions and investment companies with the requirements for disclosing information concerning capital adequacy and variable remuneration,
 8. certification concerning financial statements or other financial information for supervision bodies, the supervisory board or other supervisory authority of the company, or owners, exceeding the scope of the statutory audit, to help these authorities to perform their statutory duties.

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The audit firm auditing the financial statements of mBank and mBank Group provided the permitted non-audit services to mBank Hipoteczny S.A. Therefore, the Audit Committee each time assessed the independence of the audit firm and granted its consent to the provision of the services.

Diversity policy

When selecting and appointing Members of the Management Board and proposing candidates for Members of the Supervisory Board, mBank Hipoteczny S.A. takes into account the diversity issue. When deciding on the composition of the Management Board, the Supervisory Board makes every effort to ensure its diversity, especially in terms of age, education, professional experience and participation of women. The Supervisory Board pays attention to the diversity of educational background and professional experience of the Management Board Members. The age structure of the Supervisory Board Members should be diverse. Moreover, the Supervisory Board aims at ensuring that its members have diverse educational background and professional experience. The Supervisory Board also lays emphasis on the adequate participation of women. By 2028, the total participation of women in the Management Board and the Supervisory Board will have amounted to no less than 30% of all members. The recommended number of women in the Management Board is minimum one.

True and fair picture in the presented reports

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

- the financial statements 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 Hipoteczny S.A. as well as its financial performance,
- The report of the Management Board on activities presents a true picture of the situation of mBank Hipoteczny S.A., including a description of the main risks and threats.

The process of preparation of the financial data for the purpose of reporting is automated and based on the Bank's accounting data. Preparation of the data in the source systems is subject to formalized operational and acceptance procedures. The set of accounting balances based on the main ledger system of the Bank is created in a process which includes the relevant internal controls. Manual adjustments are subject to special control.

The Bank continuously monitors changes in legislation and internal bylaws governing the preparation of financial reports and updates the internal bylaws on an ongoing basis, adjusting the IT systems if necessary.

Preparation of the financial statements of mBank Hipoteczny S.A. is the responsibility of the Financial Reporting Unit of the Accounting and Clearance Department. Keeping of the financial books and administration of the model chart of accounts is the responsibility of the Accounting and Clearance Department.

The Bank prepares annual and semi-annual financial statements which are submitted to the Management Board of mBank Hipoteczny S.A. for approval. At the same time the statements are submitted to the members of the Audit Committee of the Supervisory Board. Following consultations with an external auditor and members of the Management Board, the Audit Committee recommends adoption or rejection of the annual financial statements to the Supervisory Board.

The annual and semi-annual financial statements of mBank Hipoteczny S.A. are subject to an independent audit and review by a certified auditor. The certified auditor for the Bank is selected upon a resolution of the Supervisory Board of mBank Hipoteczny S.A. The recommendation concerning the certified auditor selection is issued by the Audit Committee of the Supervisory Board.

mBank Hipoteczny S.A. complies with the rules of rotation of the certified auditor. On 2 March 2018 the Supervisory Board of mBank Hipoteczny S.A. selected Ernst & Young Audyt Polska sp. z o.o. spółka komandytowa to be the auditor and to audit the financial statements of mBank Hipoteczny S.A. for the years 2018-2019. Previously, this company was authorized to audit the financial statements of mBank Hipoteczny S.A. in the period 2013-2015. In the period of 2016-2017, the Bank's financial statements were audited by PricewaterhouseCoopers sp. z o.o.

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Piotr Cyburt

President of the
Management Board

(signed electronically)

Krzysztof Dubejko

Member of the
Management Board

(signed electronically)

Andrzej Kulik

Member of the
Management Board

(signed electronically)

Marcin Wojtachnio

Member of the
Management Board

(signed electronically)