

**Management Board Report
on the performance of mBank Hipoteczny S.A.
in the first half of 2019**

Table of content

1. Activity of mBank Hipoteczny S.A. in the first half of 2019.....	3
1.1. Key projects.....	3
1.2. Financial credibility - ratings	4
1.3. Financial results	5
1.4. Lending	7
1.5. Issuing of covered bonds and refinancing	10
1.6. Legal environment.....	12
2. Risk management.....	13
2.1. Credit risk.....	13
2.2. Market risk	15
2.3. Liquidity risk	16
2.4. Operational risk.....	16
2.5. Covered bonds investment risk.....	18
2.6. Internal control system	18
2.7. Remuneration policy	19
3. Directions of development and key elements of the Bank strategy	20
4. Bank Authorities.....	21
5. Other information.....	24
6. Statements of the Management Board	25

1. Activity of mBank Hipoteczny S.A. in the first half of 2019

In July 2018, mBank Hipoteczny S.A. (hereinafter the "Bank") adopted new 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 transfer of commercial real estate transactions (CRE) from mBank (commercial pooling);
- 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 and CRE loans in close cooperation with mBank, i.e. assuming that the sales will be executed by the forces of mBank both in the retail area, within the already functioning cooperation model, and in the commercial area in the context of the changes to the model introduced from January 2019.

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.

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 awaiting final post-inspection observations.

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.

Implementation of the Anti-money Laundering Act

In the first half of 2019, works were carried out at the Bank in order to comply with the new requirements for reporting information on transactions to the General Inspector of Financial Information, as specified in

mBank Hipoteczny S.A.

Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2019

the Regulation of the Minister of Finance of 4 October 2018 on providing information on transactions and a form identifying an obligated institution. New rules for reporting information on transactions came into force on 13 July 2019.

EBA's guidelines

In connection with the required alignment of mBank Hipoteczny S.A. with the guidelines of the European Banking Authority (EBA) on outsourcing arrangements of 25 February 2019, a project team responsible for the implementation of the aforementioned guidelines was appointed and a work schedule prepared. The guidelines will be implemented in regulations, processes and outsourcing agreements with the assistance of an external legal advisor.

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.

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
Long-Term Issuer Default Ratings (IDR)	BBB	Stable	30-11-2018 <i>affirming</i>
Short-Term Issuer Default Ratings (IDR)	F2	-	30-11-2018 <i>affirming</i>
National Long-Term Rating	AA-(pol)	Stable	30-11-2018 <i>affirming</i>
National Short-Term Rating	F1+(pol)	-	30-11-2018 <i>affirming</i>
Support Rating	2	-	30-11-2018 <i>affirming</i>

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
Long-term Issuer Ratings	Baa2	Stable	27-05-2019 <i>assignment</i>
Short-term Issuer Ratings	Prime-2	-	27-05-2019 <i>assignment</i>
Long-term Counterparty Risk Ratings	A3	-	27-05-2019 <i>assignment</i>

mBank Hipoteczny S.A.Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2019

Short-term Counterparty Risk Ratings	Prime-2	-	27-05-2019 <i>assignment</i>
Long-term Counterparty Risk Assessment	A3(cr)	-	27-05-2019 <i>assignment</i>
Short-term Counterparty Risk Assessment	Prime-2(cr)	-	27-05-2019 <i>assignment</i>
Mortgage Covered Bonds	Aa3	-	27-05-2019 <i>assignment</i>

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.

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	30.06.2019	31.12.2018	Dynamics
ASSETS	13,602,817	12,385,908	9.82%
Including			
Loans and advances to customers (at amortised cost)	12,102,412	10,930,534	10.72%
Loans and advances to customers (at fair value through profit or loss)	179,477	208,181	-13.79%
LIABILITIES AND EQUITY	13,602,817	12,385,908	9.82%
Including			
Debt securities in issue	7,996,133	7,870,443	1.60%
Share capital	884,631	734,719	20.40%

mBank Hipoteczny S.A.Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2019

In the first half of 2019 the Bank achieved a positive gross result in the amount of PLN 26,833 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 2019 was greatly influenced by low interest rates and strong pressure on margins. Despite this, the Bank reported a growth in the net interest income compared to the first half of 2018 (by PLN 6,922 thousand or 8.16%).

The total value of administrative expenses increased by 14.52% compared to the first half of 2018. The cost to income ratio rose to 43.83% from 36.78% at the end of 2018.

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 42,967 thousand, as compared to 37,343 thousand in the first half of 2018, which represents an increase by 15.06%. After the tax, the gross result was higher than in the previous year by PLN 3,065 thousand (or 12.90%).

In 2018 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 174,862 thousand (in 2017: PLN 146,908 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 01.01.2019 to 30.06.2019	Period from 01.01.2018 to 30.06.2018	Dynamics
Net interest income	91,741	84 819	8.16%
Net fee and commission income	(3,425)	(1,000)	-
Net trading income	3,631	(1,006)	-
Net impairment write-downs on loans and advances	(8,341)	(8,564)	-2.60%
Overhead costs	(36,194)	(31,605)	14.52%
Amortisation and depreciation	(3,395)	(1,726)	96.70%
Operating result	42,967	37,343	15.06%
Tax on the Bank's balance sheet items	(16,134)	(13,575)	18.85%
Gross profit	26,833	23,768	12.90%
Income tax	(9,627)	(7,146)	34.72%
Net profit	17,206	16,622	3.51%
Weighted average number of ordinary shares / weighted average diluted number of ordinary shares	3,295,359	3,210,000	2.66%
Net profit per ordinary share / Diluted profit per ordinary share (in PLN)	5.22	5.18	0.77%

Table 3. Effectiveness ratios

PERFORMANCE INDICATORS	30.06.2019	31.12.2018
ROA net ¹⁾	0.26%	0.33%
ROA gross ¹⁾	0.41%	0.49%
ROE net ³⁾	2.99%	3.97%
ROE gross ⁴⁾	4.66%	5.85%
Cost to income ratio (C/I) ⁵⁾	43.83%	36.78%
Net interest margin ⁶⁾	1.38%	1.44%
Cost of risk ⁷⁾	0.13%	0.19%
Total Capital Ratio	17.43%	16.25%
OTHER		
Employment	141 employees/131 FTE's	170 employees/161 FTE's
Average employment	141 employees	170 employees

mBank Hipoteczny S.A.

Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2019

Facilities

Headquarters

Headquarters + 4 branches

- 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)
- 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

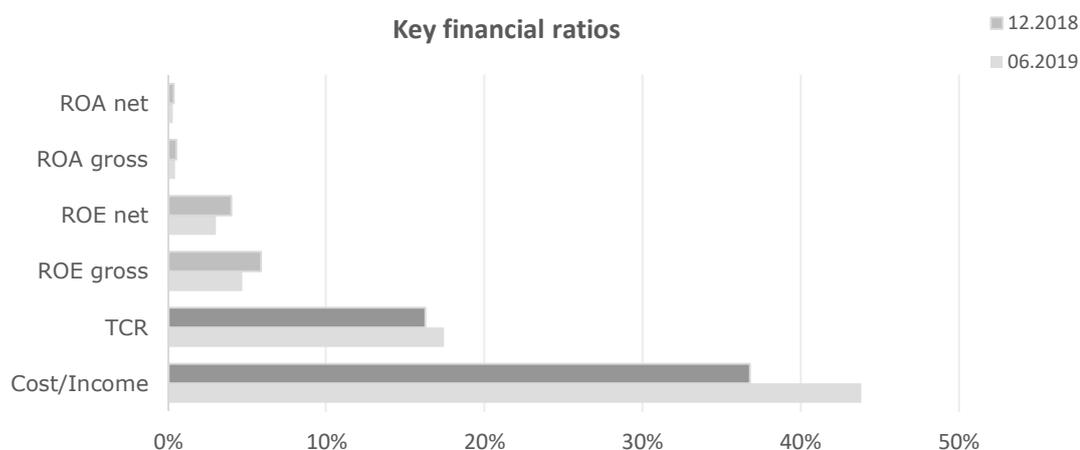
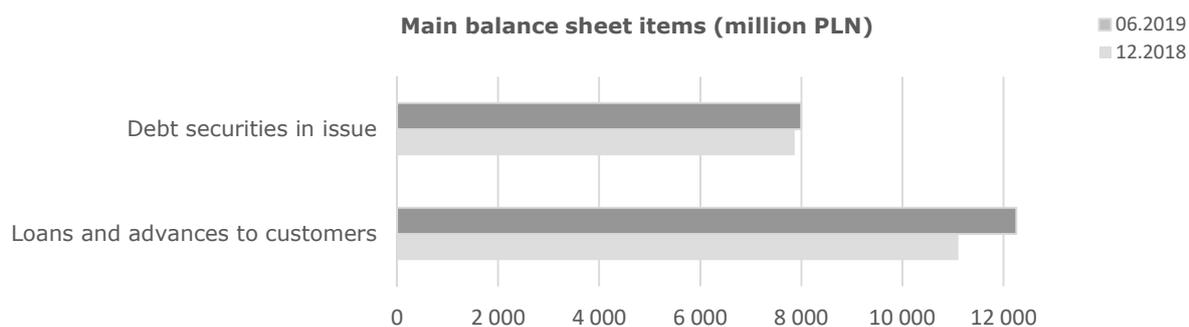


Chart 2. Main balance sheet items (in PLN million)



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 the first half of the year, no commercial pooling from mBank was carried out.

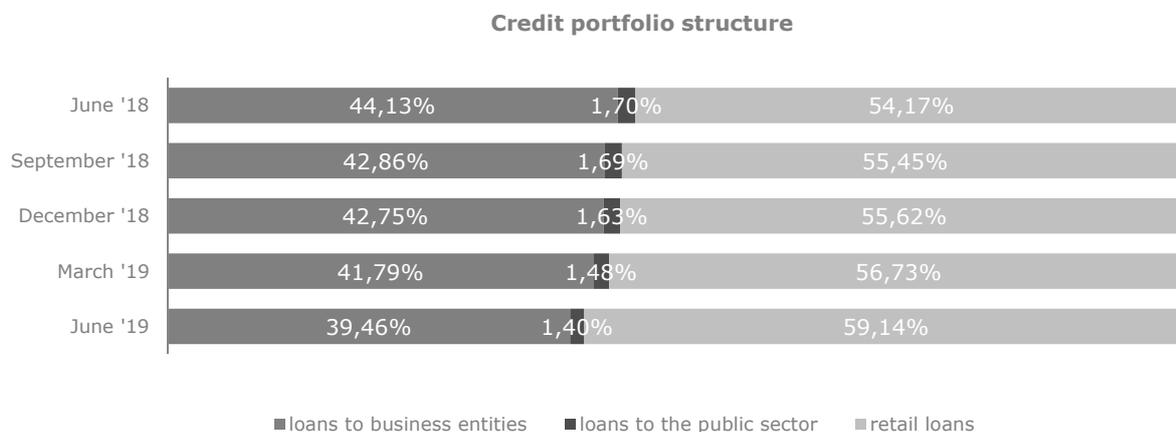
In the retail area, in line with the mBank Group's strategy, the Bank recorded an increase in the portfolio of mortgage loans for retail customers by PLN 1.067 million or 17.3%. In the first half of 2019, 5 pooling transactions were carried out.

mBank Hipoteczny S.A.

Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2019

The net value of the entire loan portfolio, including off-balance sheet exposure, increased at the end of first half of 2019 by 4.78% as compared to the end of 2018, reaching PLN 13.2 billion.

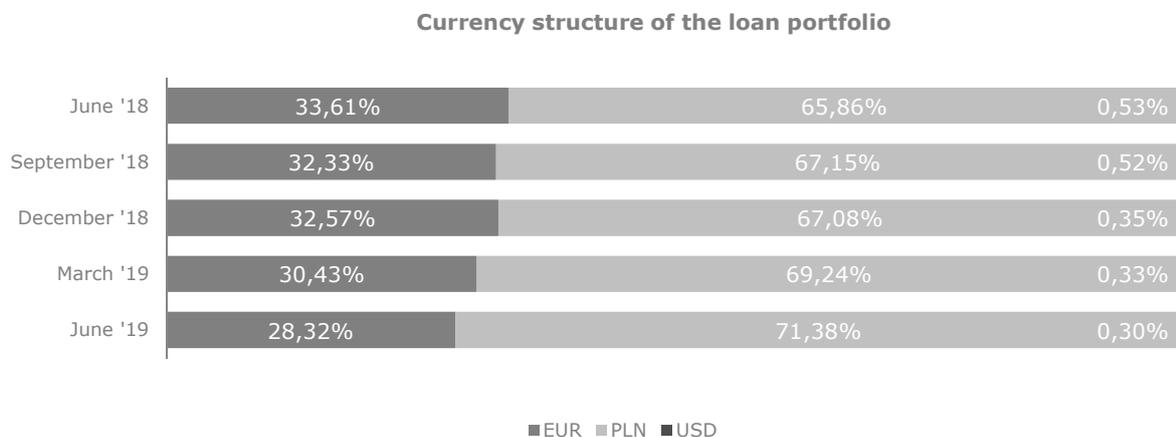
Chart 3. The structure of the loan portfolio



In 2019, the currency structure of the loan portfolio changed slightly. Compared to the end of 2018, the share of loans in PLN increased by 4.3 percentage points and as at the end of June 2019 they accounted for 71.38% of the loan portfolio. The share of loans in EUR amounted to 28.32%.

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

Chart 4. The currency structure of the loan portfolio



Corporate loans

Net balance sheet exposure to business entities amounted to PLN 4,835 million. The dominant part (84.29%) accounted for refinancing of completed commercial facilities, the exposure in housing projects constituted 5.53%, and credits for financing of construction of commercial objects 6.61%.

In the area of commercial real estates the Bank finances in particular office buildings and shopping centres. The Bank focuses on financing of the purchase or refinancing of completed facilities of appropriate standard and financing of the construction process upon the completion of which the construction loan is converted into a long-term mortgage.

Chart 5. Corporate loans by type of financed real estate

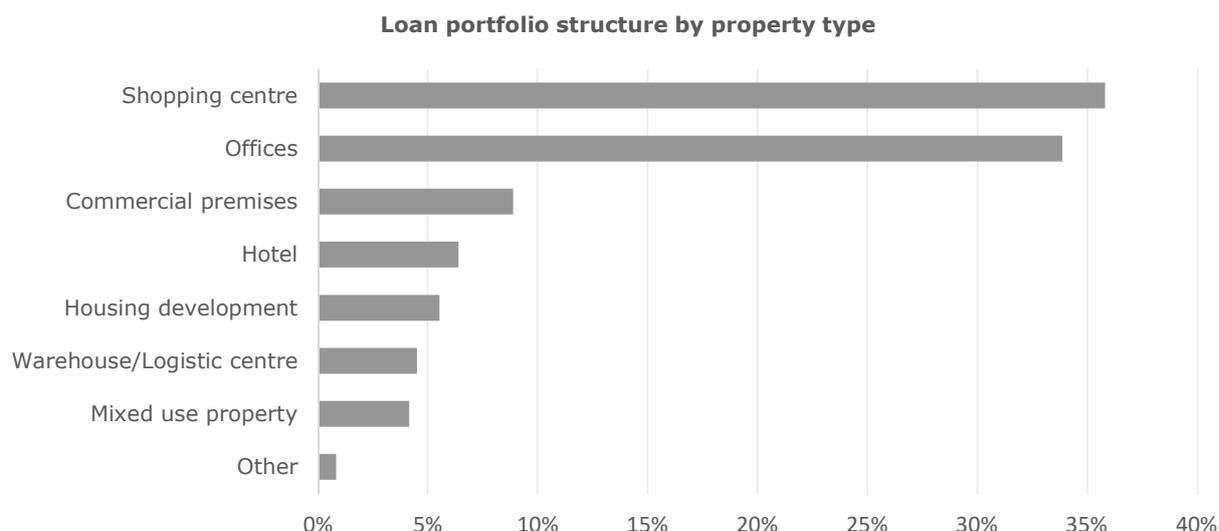
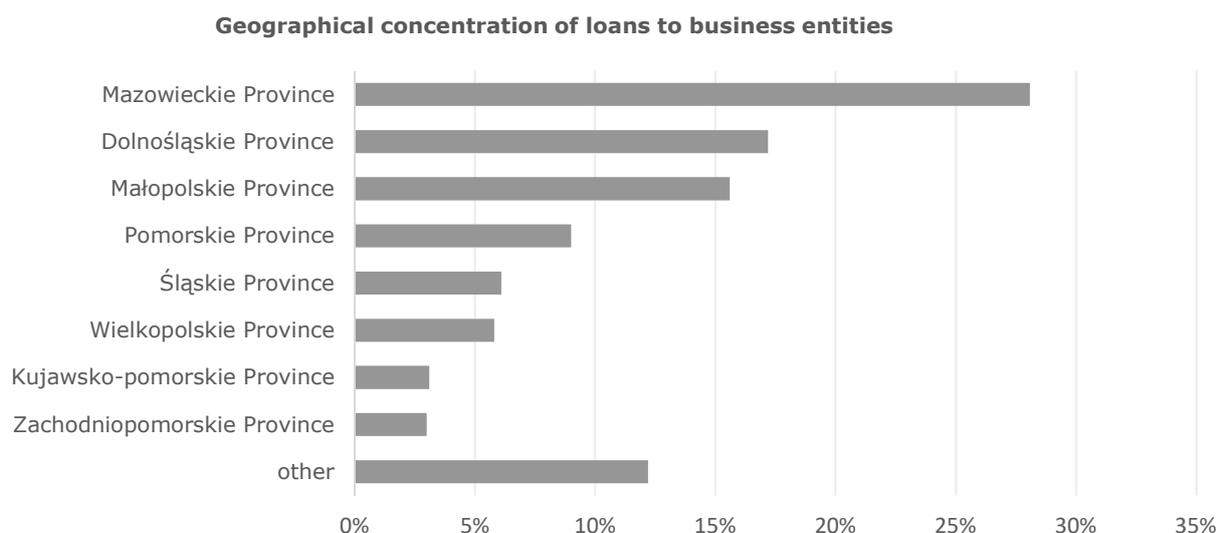


Chart 6. Geographical concentration of loan portfolio for business entities



The largest number of financed projects is concentrated in Mazowieckie province, where 28.1% of all credit resources is involved. In Dolnośląskie, Małopolskie and Pomorskie province the total balance sheet exposure accounts for 41.8%.

As of the reporting date loans granted in EUR (71.5%) and PLN (27.8%) dominated the corporate loans portfolio.

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 30 June 2018, balance sheet exposure to public sector. As at the reporting date the exposure was PLN 172 million (down by 10.0%).

Retail loans to natural persons

In 2019, the Bank's activities in the area of retail loans focused on the implementation of a new strategy in the mBank Group, connected with a change of the model of acquiring retail loans by the Bank. The existing so called "agency model" of cooperation with mBank was replaced by the „pooling model“. As of

mBank Hipoteczny S.A.

Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2019

22 July 2017, retail loans for to natural persons are offered only by mBank. In 2018 and 2019, 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. Actions were undertaken to build a new, innovative process ensuring 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 2019 was PLN 7.2 billion, which accounts for 30% of the total market, which already amounts to PLN 24.3 billion. The covered bond issue activities of the Bank is a significant element of the Strategy of the mBank Group in the area of financing. The scale of bond issue activities in the first half of 2019 and parameters of individual issues are a confirmation of the implementation of the Bank's financing strategy, which provides for fund raising and refinancing of long-term mortgage loans by the issues of covered bonds with the assumption of the reduction of mismatches between the maturity dates of liabilities and assets, currency mismatch and lower costs of funds raised.

In the first half of 2019, the Bank placed on the market one issue of mortgage covered bonds of the total nominal value of PLN 100 million.

The summary of bond issue activities of the Bank on the public market in 2019 is presented in the table below.

Volume	Currency	Issue date	Redemption date	Tenor (years)	Coupon	Stock exchange
100 M	PLN	22.02.2019	20.12.2028	10	WIBOR 3M +80bps	WSE and Bondspot

The PLN 100 million issue is the longest maturity series of PLN covered bonds in the 20-year history of mBank Hipoteczny and an issue with the longest maturity available on the Polish market. The Bank's previous record was set by the 8.5-year issue of 4 August 2014 with a nominal value of PLN 200 million.

The PLN 100 million issue was carried out on the basis of the National Covered Bonds Issue Programme in a public offering according to the standard procedure, i.e. without firm commitment underwriting. The Bank entrusted the book-building process to mBank, through which 8 investors submitted their purchase declarations concerning covered bonds.

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. This is confirmed by the ratings granted by Moody's Investors Service Ltd. to the mortgage covered bonds issued by the Bank. On 27 May 2019 the rating of mortgage covered bonds was confirmed at level Aa3.

Issues of mortgage bonds of mBank Hipoteczny S.A. 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
28.04.2016	28.04.2020	PLN	50,000,000	Aa3
11.05.2016	28.04.2020	PLN	100,000,000	Aa3
29.09.2017	10.09.2022	PLN	500,000,000	Aa3

mBank Hipoteczny S.A.

Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2019

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	4,065,000,000	
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
28.11.2014	15.10.2019	EUR	50,000,000	Aa3
25.02.2015	25.02.2022	EUR	20,000,000	Aa3
24.04.2015	24.04.2025	EUR	11,000,000	Aa3
24.06.2015	24.06.2020	EUR	50,000,000	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
26.04.2018	05.03.2025	EUR	300,000,000	Aa3
TOTAL		EUR	726,900,000	

The Bank continues to issue unsecured bonds. At the end of June 2019, the Bank held 6 issued series for the total amount of PLN 715 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 9,993.4 million from total number of 20,937 loans.

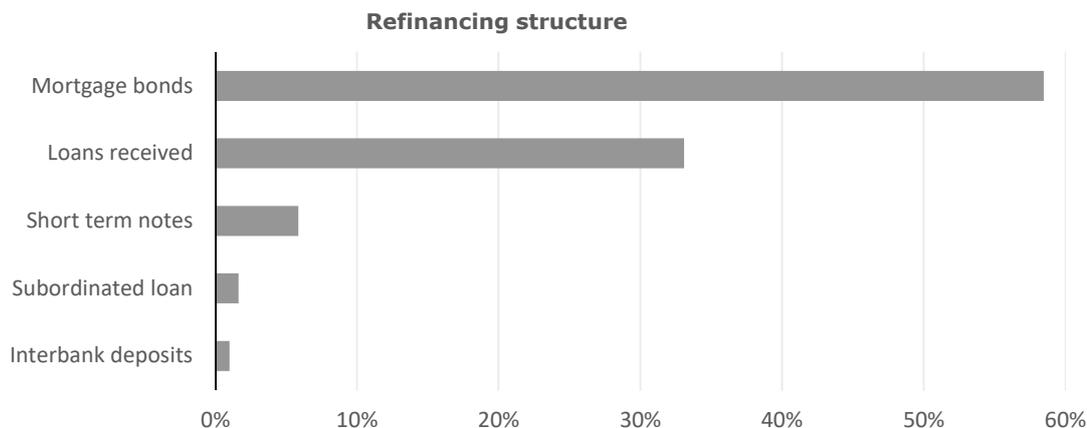
Loans for commercial clients constituted 42.52% and for retail clients 57.48% of the total amount of receivables entered into the mortgage cover register. Loans granted in PLN (67.59%) dominated, loans in EUR (32.15%) and USD (0.26%) constituted the remaining part.

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 41.63%.

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

Following the intensive work that took place at the Bank in 2018 to ensure that its operating procedures comply with the requirements of the Regulation (EU) 679/2016 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data (...), in the first half of 2019 the requirements resulting from the Act of 21 February 2019 on the amendment of certain acts in connection with ensuring the application of the Regulation (EU) 679/2016 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Processing Regulation) [Journal of Laws of 2019, item 730] were analysed. This means that the issue of personal data protection has continued to be a challenge from the point of view of the Bank's legal environment since 2017.

Following the work aimed and ensuring alignment of operating procedures with the Anti-Money Laundering and Anti-Terrorism Financing Act of 1 March 2018 (Journal of Laws of 723, as amended) which entered into force on 13 July 2018 to supersede the previous Act of 2000 and was the transposition of the AML IV Directive into the Polish legal framework, in the first half of 2019 the Bank continued intensive work on the implementation of tools enabling proper performance of reporting obligations.

In March 2019, the memorandum of understanding on the proposal for a directive of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and the proposal for a regulation of the European Parliament and of the Council amending Regulation No 575/2013 as regards exposures in the form of covered bonds – legal acts concerning the rules for issuing covered bonds and the rules for activities of their issuers (mortgage banks) was published. The Bank analysed successive versions of these draft acts on an ongoing basis and participated in public consultations on these drafts through the institutions set up for this purpose. In the opinion of the Bank, the measures proposed in the final version on 20 March 2019 do not pose a threat related to the need to fundamentally change the 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. Minor discrepancies are reported by the Bank on an ongoing basis in the consultation process through authorised institutions.

As of January 2019, the Bank is obliged to report tax schemes. Regulations concerning the so-called MDR contained in the amendments to the Tax Ordinance Act imposed on the Bank and its employees a number of obligations related to the implementation of internal regulations as well as identification and reporting of schemes when the Bank acts as a promoter, beneficiary or supporter. The Bank was also obliged to adapt its operating procedures to new obligations resulting from the function of the withholding tax (WHT) remitter resulting from the amendment to the Corporate Income Tax Act of 15 February 1992, the Personal Income Tax Act of 26 July 1991 and the Tax Ordinance Act of 29 August 1997.

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.

2. 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.

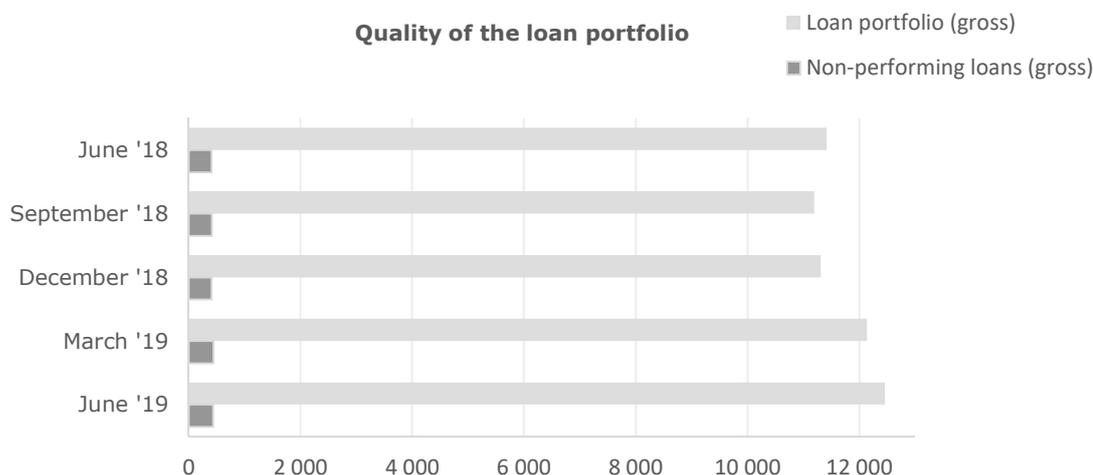
The share of non-performing loans in the loan portfolio decreased in the first half of 2019 from the level of 3.59% to 3.48%. Most of the loans are repaid in a timely manner, and the borrowers of higher risk profile are subjected to a more strict monitoring.

Impairment provisions (including the adjustment to the fair value and CEIR) reaching PLN 178 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 41%.

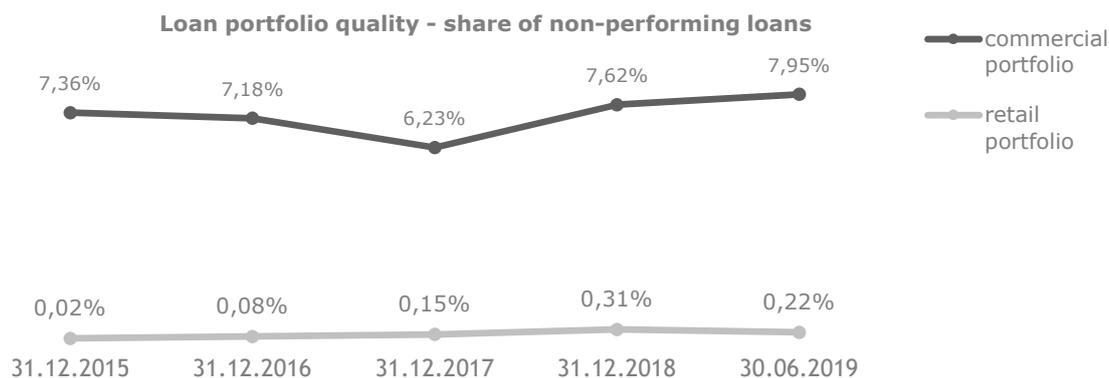
The retail portfolio is characterised by very high quality, which results from the applied credit policy (until the moment of transferring the whole process of selling retail mortgage loans to mBank S.A.) as well as the fact that this portfolio is young (the average age of contracts in this portfolio is 3.2 years). As of the reporting date there were only 60 cases with reported loss of value. Loans for natural persons are 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

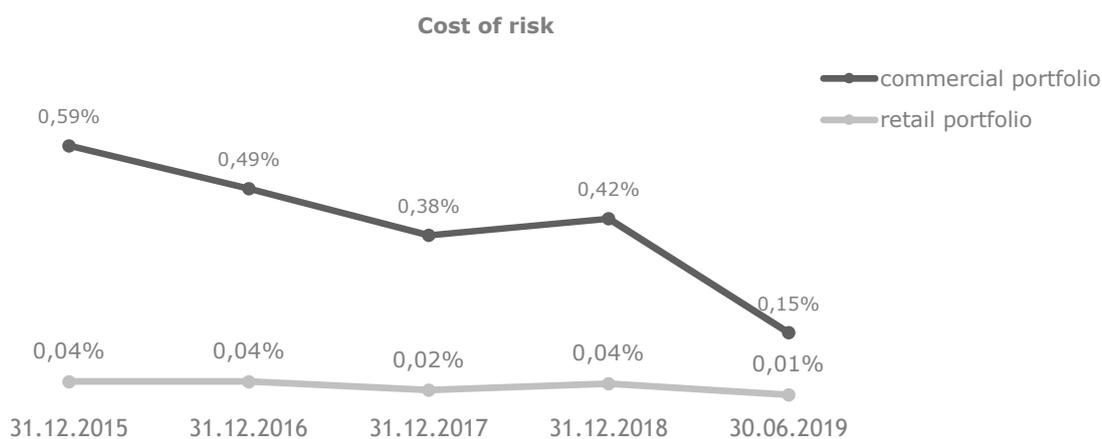
Chart 9. Share of non-performing loans by portfolio



*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)

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 as from 1 January 2019, the Bank continues cooperation with its existing customers. The establishment of cooperation with new customers having experience on the real estate market, companies with a strong market position is possible in the form of purchase of claims granted by mBank. These claims will be used to finance: the purchase of finished or refinancing of existing or new commercial real estates or completely renovated real estates, which are comprehensively utilised and remain economically competitive over a longer period of time.

In the area of retail loans, the loan portfolio will be built by transferring loans which meet the criteria specified by the Bank from mBank S.A. The criteria selected will ensure maintaining a portfolio with a low loss ratio, based on the foundation of customers with confirmed creditworthiness.

Lawsuits brought by the Bank, insolvency proceedings

In the second half of 2018 the Bank filed with courts three bankruptcy petitions with respect to commercial clients. The first petition was filed with a court on 23 July 2018. The petition concerned the claim, which was earlier asserted by the Bank by way of enforcement proceedings. In this case, on 28 January 2016 the Bank submitted a declaration of takeover of ownership of the real estate, after the second unsuccessful auction. However, due to the obstructive actions of the debtor and persons related to the borrower, until the date of preparing this report the real estate has not been successfully taken over by the Bank. On 16 January 2019, the court declared bankruptcy and appointed a receiver in the case in question. There are two parallel proceedings in this case – enforcement proceedings (currently suspended) and bankruptcy proceedings. As at 30 June 2019, the court had not decided to discontinue the enforcement proceedings and to continue the bankruptcy proceedings.

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. The cases are currently at an early stage of the 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. 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 Bank has not yet received confirmation of payment of the price 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. If the auctioneer pays the price, the amount collected will be added to the bankruptcy estate. The auctioneer's failure to pay the price will be the basis for the receiver to initiate actions aimed at selling the real estate pledged as collateral for the loan granted by the Bank.

In the second half of 2018, the real estate was sold in the auction in Lublin. The real estate was sold for the amount of PLN 4.8 million plus VAT 23%. By the order of 18 December 2018, the court partially approved the list of claims. After preparation of a partial plan of division of the sum obtained from the sale of the real estate concerned (the plan concerns indisputable claims) the Bank's claim should be satisfied in full.

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 case is currently at an early stage of the proceedings.

In the area of retail loans, in the second half of 2018, two lawsuits were brought in the total amount of PLN 615.3 thousand. The lawsuits concerned the new portfolio. As at the date of the report, enforcement proceedings have already been initiated in these cases. In 2019, 3 lawsuits (new portfolio) were brought in the total amount of PLN 371.5 thousand. At present, these cases are at the stage of court proceedings.

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 2019 VaR amounted to PLN 634.3 thousand. The currency risk was PLN 18.0 thousand, the interest rate risk was PLN 103.9 thousand and the credit spread risk was PLN 629.5 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. The interest rate risk is measured among others by using Earnings At Risk (EaR) ratio, which by the end of June 2019 reached a safe level of 3.79%. The banking books items that are 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

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.

Due to the mismatch between the maturity dates of long-term securities and assets, the higher security of liquidity is guaranteed through maintaining of liquid assets in case of unforeseen events.

At the end of June 2019, the excess of liquid assets amounted to approx. 8.1% 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 June 2019 was 1.062. M1 and M2 short-term liquidity standards were maintained at a safe level, PLN 1,599,975 thousand and 3.677 respectively. The M3 standard was 81.835.

Net outflows coverage ratio, determining the relation of the liquidity buffer to the net liquidity outflows under stressed conditions lasting 30 calendar days (LCR) at the end of June 2019 amounted to 1960%.

As at the end of June 2019 the liabilities limit, resulting from Art. 15.2 of the "Act on covered bonds and mortgage banks", was used in 71.41%. In 2019 this limit was not exceeded.

As at the end of June 2019 average maturity of issued mortgage covered bonds was 3.8 of a year while the average maturity of loans obtained from other banks was 2.9 of a year. The margin of mortgage covered bonds issued in 2019 on average amounted to 0.8%, with average maturity of 9.8 of a year.

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.

In 2018, the Bank developed a new business strategy, resulting in the next change of the Bank's business profile, after transferring the sale of retail loans to mBank in 2017.

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; transparent procedure of problem solving (Joint Committee and the Outsourcing Committee); 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.

2.5. Covered bonds investment risk

In the first half of 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.

The Bank's strategic objectives for 2019–2022 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 and commercial 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 – both types of collaterals will be acquired in cooperation with mBank.

mBank Hipoteczny S.A.

Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2019

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 – Resolution of the Supervisory Board No 19/2019 of 26 March 2019
- 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

mBank Hipoteczny S.A.

Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2019

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 Jabłowska-Luba - Supervisory Board Vice-Chairman
- Andreas Boeger – Supervisory Board Member
- Paweł Przybyłek – Supervisory Board Member - Resolution of the EGM No 3/2019 of 28 May 2019
- Paweł Graniewski – Independent Supervisory Board Member
- Cezary Kocik - Supervisory Board Member
- Michał Popiołek - Supervisory Board Member
- Mariusz Tokarski – Independent Supervisory Board Member

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 2019 the Audit Committee held meetings on 25 March and 29 May.

Remuneration Committee – appointed by Resolution of the Supervisory Board No 23/2019 of 18 April 2019

The Remuneration Committee included the following members:

- Frank Bock – Committee Chairman
- Andreas Boeger - Committee Vice-Chairman
- Lidia Jabłowska-Luba – Committee Member
- Cezary Kocik – Committee Member

In 2019 the Remuneration Committee held one meeting on 26 April.

Risk Committee

The Risk Committee included the following members:

- Lidia Jabłowska-Luba – Chairwoman of the Committee
- Frank Bock - Committee Member

- 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 2019 the Risk Committee held meetings on 16 April.

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,
- 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 2019, 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 2019.

Events after the balance sheet date

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

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.

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

mBank Hipoteczny S.A.

Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2019

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.

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

mBank Hipoteczny S.A.

Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2019

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.

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 2018 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 Compliance Department, the Accounting and Clearance Department and by way of meetings - three meetings 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

mBank Hipoteczny S.A.

Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2019

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.

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

mBank Hipoteczny S.A.

Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2019

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.

Piotr Cyburt	Krzysztof Dubejko	Andrzej Kulik	Marcin Wojtachnio
President of the Management Board	Member of the Management Board	Member of the Management Board	Member of the Management Board
<i>(signed electronically)</i>	<i>(signed electronically)</i>	<i>(signed electronically)</i>	<i>(signed electronically)</i>