Financial Statements of mBank Hipoteczny S.A. according to the International Financial Reporting Standards (IFRS) for 2018

Selected financial data

The selected financial data presented below are supplementary information to the Financial Statements of mBank Hipoteczny S.A. for 2018.

Selected financial data		in PLN `000		in EUR `000	
		Year ended		Year ended	
		31.12.2018	31.12.2017	31.12.2018	31.12.2017
I.	Interest income	427 181	390 074	100 115	91 897
II.	Fee and commission income	3 038	1 822	712	429
III.	Net trading income	1 210	(3 385)	284	(797)
IV.	Operating result	88 262	59 199	20 685	13 947
V.	Profit before income tax	60 694	34 773	14 224	8 192
VI.	Net profit attributable to shareholders of mBank Hipoteczny S.A.	41 237	27 829	9 664	6 556
VII.	Net cash flows from operating activities	608 159	(2 335 986)	142 529	(550 330)
VIII.	Net cash flows from investing activities	(22 383)	(16 538)	(5 246)	(3 896)
IX.	Net cash flows from financing activities	(564 634)	2 242 843	(132 329)	528 387
X.	Total net cash flows	21 142	(109 681)	4 955	(25 840)
XI.	Basic earnings per ordinary share / Diluted earnings per ordinary share (in PLN/EUR)	12,85	8,72	3,01	2,05

Selected financial data		in PLN `000		in EUR `000	
		as at		as at	
		31.12.2018	31.12.2017	31.12.2018	31.12.2017
I.	Total assets	12 385 908	12 168 169	2 880 444	2 917 396
II.	Amounts due to other banks	3 179 878	3 830 026	739 507	918 273
III.	Amounts due to customers	3 099	4 131	721	990
IV.	Equity attributable to shareholders of mBank Hipoteczny S.A.	1 085 947	1 056 401	252 546	253 279
V.	Share capital	321 000	321 000	74 651	76 962
VI.	Number of shares	3 210 000	3 210 000	3 210 000	3 210 000
VII.	Book value per share / Diluted book value per share (in PLN/EUR)	338.30	329.10	78.67	78.90
VIII.	Total capital ratio (%)	16.25	15.79	16.25	15.79

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

- for items of the statement of financial position – exchange rate announced by the National Bank of Poland as at 31 December 2018: EUR 1 = PLN 4.3000 and obligated for 31 December 2017: EUR 1 = PLN 4.1709,
- for items of the income statement and statement of cash flow – exchange rate calculated as the arithmetic mean of exchange rates announced by the National Bank of Poland as at the end of each month of 2018 and 2017: EUR 1 = PLN 4.2669 and EUR 1 = PLN 4.2447.

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for 2018 (in PLN thousand)

Income statement

		Year ended 31 December	
	Note	2018	2017
Interest income, including:	7	427 181	390 074
Interest income calculated using the effective interest rate method		*387 812*	*365 573*
Income similar to interest - financial assets measured at fair value through profit or loss		*39 369*	*24 501*
Interest expense	7	(250 904)	(234 065)
Net interest income		**176 277**	**156 009**
Fee and commission income	8	3 038	1 822
Fee and commission expenses	8	(5 540)	(7 581)
Net fee and commission income		**(2 502)**	**(5 759)**
Net trading income, including:	9	1 210	(3 385)
Foreign exchange result		*2 286*	*(3 332)*
Gains or losses on financial assets and liabilities held for trading		*916*	*1 263*
Gains or losses from hedge accounting		*(1 992)*	*(1 316)*
Net income on modification	*10*	*(3 312)*	*n/a*
Net income on derecognition of financial instruments not measured at fair value through proft and loss	*11*	*1 627*	*73*
Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss	12	(4 556)	*n/a*
Other operating income	13	1 202	1 132
Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss	16	(16 712)	(20 225)
Overhead costs	14	(59 849)	(64 361)
Amortisation and depreciation	25, 26	(3 798)	(3 196)
Other operating expenses	15	(1 325)	(1 089)
Operating result		**88 262**	**59 199**
Taxes on the Bank balance sheet items		(27 568)	(24 426)
Profit before income tax		**60 694**	**34 773**
Income tax	17	(19 457)	(6 944)
Net profit		**41 237**	**27 829**

Net profit attributable to shareholders of the mBank Hipoteczny S.A.		**41 237**	**27 829**
Weighted average number of ordinary shares / Diluted weighted average number of ordinary shares	18	**3 210 000**	**3 191 260**
Earnings per ordinary share / Diluted earnings per ordinary share (in PLN)	18	**12,85**	**8,72**

The entire profit of mBank Hipoteczny S.A. for the 2018 and 2017 pertains to the performance of continuing operations.

Notes presented on pages 7 to 112 constitute an integral part of these Financial Statements.

for 2018 (in PLN thousand)

Statement of comprehensive incomes

		Year ended 31 December	
	Note	2018	2017
Net profit		**41 237**	**27 829**
Other comprehensive income net of tax including:	19	**1 680**	**4 946**
Items that may be reclassified to the income statement		***1 678***	**4 966**
Change in valuation of available for sale financial assets (gross)		*n/a*	6 131
Deferred tax on available for sale financial assets	31	*n/a*	(1 165)
Change in valuation of available for sale financial assets (net)		*n/a*	4 966
Change in the valuation of debt financial instruments valued at fair value through other comprehensive income (gross)		*2 072*	*n/a*
Deferred tax on debt financial instruments measured at fair value through other comprehensive income	31	*(394)*	*n/a*
Change in the valuation of debt financial instruments measured at fair value through other comprehensive income (net)		*1 678*	*n/a*
Items that will not be reclassified to the income statement	19	**2**	**(20)**
Actuarial gains and losses on post-employment benefits (gross)	30	3	(25)
Deferred tax on actuarial gains and losses on post-employment benefits	31	(1)	5
Actuarial gains and losses on post-employment benefits (net)		2	(20)
Total comprehensive income net of tax		**42 917**	**32 775**

Net total comprehensive income attributable to shareholders of the mBank Hipoteczny S.A.		**42 917**	**32 775**

Notes presented on pages 7 to 112 constitute an integral part of these Financial Statements.

for 2018 (in PLN thousand)

Statement of financial position

ASSETS	**Nota**	**31.12.2018**	**31.12.2017**
Cash and balances with the Central Bank	20	16 294	1 351
Loans and advances to banks		*n/a*	18 737
Financial assets held for trading and derivatives held for hedges	21	36 658	48 973
Loans and advances to customers		*n/a*	10 766 911
Non-trading financial assets mandatorily at fair value through profit or loss, including:	22	208 181	*n/a*
Loans and advances to customers		208 181	*n/a*
Investment securities available for sale		*n/a*	1 277 127
Financial assets at fair value through other comprehensive income	23	1 069 392	*n/a*
Financial assets at amortised cost, including:	24	10 988 966	*n/a*
Loans and advances to banks		*58 432*	*n/a*
Loans and advances to customers		*10 930 534*	*n/a*
Intangible assets	25	40 021	25 527
Tangible assets	26	8 678	8 295
Deferred income tax assets	31	12 586	10 572
Other assets, including:	27	5 132	10 676
- inventories	3.1.3	-	3 432
TOTAL ASSETS		**12 385 908**	**12 168 169**
LIABILITIES AND EQUITY			
L i a b i l i t i e s			
Financial liabilities held for trading and derivatives held for hedges	21	2 032	548
Financial liabilities measured at amortised cost, including:	28	11 253 826	11 077 766
Amounts due to banks		*3 179 878*	*3 830 026*
Amounts due to customers		*3 099*	*4 131*
Debt securities issued		*7 870 443*	*7 043 125*
Subordinated liabilities		*200 406*	*200 484*
Provisions	29	2 557	204
Current income tax liabilities		12 704	7 682
Other liabilities	30	28 842	25 568
TOTAL LIABILITIES		**11 299 961**	**11 111 768**
E q u i t y			
Share capital:		**734 719**	**734 719**
- Registered share capital	31	321 000	321 000
- Share premium	36	413 719	413 719
Retained earnings:	37	**345 748**	**317 882**
- Profit from the previous years		304 511	290 053
- Profit for the current period		41 237	27 829
Other components of equity	**38**	**5 480**	**3 800**
TOTAL EQUITY		**1 085 947**	**1 056 401**
TOTAL LIABILITIES AND EQUITY		**12 385 908**	**12 168 169**

Notes presented on pages 7 to 112 constitute an integral part of these Financial Statements.

for 2018 (in PLN thousand)

Statement of changes in equity

Changes in equity from 1 January 2017 to 31 December 2018

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

Changes in equity from 1 January 2017 to 31 December 2017

	Share capital		Retained earnings				Other components of equity		Total
	Registered share capital	Share premium	Other supplementary capital	General banking risk reserve	Retained profit from the previous years	Profit for the current period	Valuation of financial assets at fair value through other comprehensive income	Actuarial gains and losses relating to post-employment benefits	
As at 1 January 2017	**309 000**	**305 792**	**224 131**	**42 500**	**23 422**	**-**	**(1 168)**	**22**	**903 699**
Net profit	-	-	-	-	-	27 829	-	-	27 829
Other comprehensive income (gross)	-	-	-	-	-	-	6 131	(25)	6 106
Deferred tax on other comprehensive income	-	-	-	-	-	-	(1 165)	5	(1 160)
Total comprehensive income	**-**	**-**	**-**	**-**	**-**	**27 829**	**4 966**	**(20)**	**32 775**
Transfer to general banking risk reserve	-	-	-	2 300	(2 300)	-	-	-	-
Transfer to supplementary capital	-	-	21 122	-	(21 122)	-	-	-	-
Issue of shares	12 000	108 000	-	-	-	-	-	-	120 000
Share issue costs	-	(73)	-	-	-	-	-	-	(73)
As at 31 December 2017	**321 000**	**413 719**	**245 253**	**44 800**	**-**	**27 829**	**3 798**	**2**	**1 056 401**

Notes presented on pages 7 to 112 constitute an integral part of these Financial Statements.

for 2018 (in PLN thousand)

Statement of cash flows

	Note	Year ended 31 December	
		2018	2017
A. Cash flows from operating activities		**608 159**	**(2 335 986)**
Profit before income tax		**60 694**	**34 773**
Adjustments:		**547 465**	**(2 370 759)**
Income tax paid		(13 708)	(5 142)
Amortisation and depreciation	25, 26	3 798	3 196
(Profits) losses on investing activities	11	(149)	(74)
Interest income (income statement)	7	(427 181)	(390 074)
Interest expenses (income statement)	7	250 904	234 065
Interest received		388 961	370 846
Interest paid		(11 763)	(24 352)
Change in amounts due from other banks		-	(4)
Change in assets and liabilities on derivative financial instruments		25 815	(12 192)
Change in loans and advances to customers		(366 824)	(1 343 764)
Change in investment securities		*n/a*	(245 921)
Change in the balance of financial assets at fair value through other comprehensive income		176 807	*n/a*
Change in other assets	27	5 544	(3 287)
Change in amounts due to other banks		595 510	(512 685)
Change in amounts due to customers		(1 039)	(32 264)
Change in debt securities in issue		(85 195)	(408 426)
Change in provisions		(997)	19
Change in other liabilities	29	3 274	(1 180)
Result on disposal of intangible assets and tangible fixed assets	15	1	152
Adjustments to intangible assets and property, plant and equipment	25, 26	3 707	328
Net cash from operating activities		**608 159**	**(2 335 986)**
B. Cash flows from investing activities		**(22 383)**	**(16 538)**
Investing activity inflows		**2**	**24**
Due to the disposal of intangible assets and tangible fixed assets		2	24
Investing activity outflows		**22 385**	**16 562**
Due to the purchase of intangible assets and tangible fixed assets	25, 26	22 385	16 562
Net cash from investing activities		**(22 383)**	**(16 538)**
C. Cash flow from financing activites		**(564 634)**	**2 242 843**
Financing activity inflows		**2 189 482**	**4 459 530**
Due to the loans and advances from banks		250 000	1 600 000
Due to the issue of debt securities		1 831 760	2 731 650
Due to take a subordinated loan	28	100 000	-
Due to the issue of shares		-	119 926
Interest received from hedging derivative financial instruments		7 722	7 954
Financing activities outflows		**2 754 116**	**2 216 687**
Due to the repayment of loans and advances from banks		1 494 612	578 432
Due to the issue of debt securities		931 602	1 439 202
Due to repayment a subordinated loan	28	100 000	
Interest paid on loans received, debt securities in issue, subordinated loan		227 902	199 053
Net cash from financing activities		**(564 634)**	**2 242 843**
Net increase / decrease in cash and cash equivalents, total (A+B+C)		**21 142**	**(109 681)**
Cash and cash equivalents as at the beginning of the reporting period, including:	**40**	**143 573**	**253 254**
Cash and balances with the central bank		1 351	5 530
Amounts due from other banks		18 737	16 262
Investment securities with maturity of up to 3 months from the date of purchase		123 485	231 462
Cash and cash equivalents as at the end of the reporting period, including:	**40**	**164 715**	**143 573**
Cash and balances with the central bank		16 294	1 351
Amounts due from other banks		58 432	18 737
Investment securities with maturity of up to 3 months from the date of purchase		89 989	123 485

Notes presented on pages 7 to 112 constitute an integral part of these Financial Statements.

Explanatory notes to the standalone financial statements

1. Information on mBank Hipoteczny S.A.

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

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

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

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

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

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

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

The Bank was established for an indefinite period of time.

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

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

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

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

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

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

As at December 31, 2018 the employment in the mBank Hipoteczny S.A. was 161 FTEs and 170 persons (December 31, 2017: 169 FTEs; 178 persons).

Average employment in 2018 was 170 employees, in 2017 it was 208 employees.

These financial statements were approved by the Management Board of mBank Hipoteczny S.A. on March 26, 2019.

2. Description of the relevant accounting policies

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

2.1. Accounting basis

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

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

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

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

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

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

2.2. Interest income and expenses

All interest income on financial instruments carried at amortised cost using the effective interest rate method is recognized in the income statement as well as interest income from financial assets measured at fair value through other comprehensive income and measured at fair value through profit or loss.

The effective interest rate method is a method of calculation of the amortised initial value of financial assets or financial liabilities and allocation of interest income or interest expense to the proper periods. The effective interest rate is the interest rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial assets or financial liability to the gross carrying amount of a financial asset or to the amortized cost of a financial liability. When calculating the effective interest rate, the Bank estimates the expected cash flows taking into account all the contractual terms of the financial instrument, but without taking into account the expected credit losses. This calculation takes into account all the fees and points paid or received between the parties to the contract, which constitute an integral component of the effective interest rate, as well as transaction expenses and any other premiums or discounts.

In case of reclassification to the stage 3 of a financial asset or a group of similar financial assets, the interest income is calculated on the net value of financial assets and recognized using the interest rate at which the future cash flows were discounted for the purpose of valuation of impairment.

Interest income reported by the Bank also include commission on early repayment of loans granted, recognized in the income statement on a one-off basis.

Interest income includes interest and commissions received or due on account of loans, inter-bank deposits or investment securities recognized in the calculation of the effective interest rate.

Interest income, including interest on loans, is recognized in the income statement and on the other side in the statement of financial position as part of receivables from banks or from other customers.

Income and expenses related to the interest component of the result on interest rate derivatives and resulting from current calculation of swap points on currency derivatives classified into banking book are presented in the interest results in the position Interest income/expense on derivatives classified into banking book. The Bank does not conduct commercial activity, all transactions on derivatives are classified in the banking book.

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

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

2.3. Fee and commission income and expenses

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

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

Commissions on other operations are included in the income statement as one-off items.

2.4. Revenue and expenses from sale of insurance products bundled with loans

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

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

Revenue from sale of insurance products bundled with loans are split into interest income and fee and commission income based on the relative fair value analysis of each of these products.

The remuneration included in interest income is recognised over time as part of effective interest rate calculation for the bundled loan. The remuneration included in commission income is recognised partly as upfront income and partly including deferring over time based on the analysis of the stage of completion of the service.

Expenses directly linked to the sale of insurance products are recognised using the same pattern as in case of income observing the matching concept. A part of expenses is treated as an element adjusting the calculation of effective interest rate for interest income and the remaining part of expenses is recognised in fee and commission expenses as upfront cost or as cost accrued over time.

For insurance products considered as bundled with loans the Bank estimates also the part of remuneration which in the future will be returned due to early termination of insurance contract and appropriately decreases interest income or fee and commission income to be recognised.

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

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

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

2.5. Segment reporting

An operating segment is a component of the entity:

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

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

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

2.6. Financial assets/financial liabilities

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

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

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

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

Standardised purchases and sales of financial assets at fair value through profit or loss and measured at fair value through other comprehensive income are recognized on the settlement date – the date on which the Bank delivers or receives the asset. Changes in fair value in the period between trade and settlement date with respect to assets carried at fair value is recognized in profit or loss or in other components of equity. Loans are recognized when cash is advanced to the borrowers / on the date of transaction. Derivative financial instruments are recognized beginning from the date of transaction.

A financial asset is de-recognized if Bank loses control over any contractual rights attached to that asset, which usually takes place if the financial instrument is disposed of or if all cash flows attached to the instrument are transferred to an independent third party.

Financial instruments valued at fair value through profit or loss

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

The Bank, at the initial recognition, irrevocably designate a the financial assets/financial liabilities at fair value through profit or loss when doing so results in more relevant information, because either:

- it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as "an accounting mismatch") that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel.

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

Financial assets and financial liabilities classified to this category are valued at fair value upon initial recognition.

Interest income/expense on financial assets/financial liabilities designated at fair value, of which interest profit or loss on derivatives, is recognized in net interest income. The valuation and result on disposal of financial assets/financial liabilities valued at fair value through profit or loss are included as follows:

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

Financial assets measured at amortized cost

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

Financial assets measured at fair value through other comprehensive income

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

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

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

Financial assets measured at fair value through other comprehensive income and financial assets measured at fair value through profit or loss are valued at the end of the reporting period according to their fair value. Financial assets measured at amortized cost, are measured at adjusted cost of acquisition (amortised cost), applying the effective interest rate method. Gains and losses resulting from changes in the fair value of financial assets measured at fair value through profit or loss are recognized in the income statement in the period in which they arise.

Gains and losses arising from changes in the fair value of financial assets measured at fair value through other comprehensive income are recognized in other comprehensive income until the derecognition of the respective debt instrument in the statement of financial position or until its impairment: at such time the aggregate net gain or loss previously recognized in other comprehensive income is now recognized in the income statement. However, interest calculated using the effective interest rate is recognized in the income statement. If the fair value of a debt instrument measured at fair value through other comprehensive income increases in a subsequent period, and such increase can be objectively related to an event occurring after the recording of the impairment loss in the income statement, then the respective impairment loss is reversed in the income statement.

Dividends on equity instruments are recognized in the income statement when the entity's right to receive payment is established.

The fair value of quoted investments in active markets is based on current market prices.

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

Modification of contractual terms for financial assets

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

- substantial increase of the credit amount of more than 10%,
- substantial prolongation of the contractual maturity of more than 12 months,
- change of the currency – when the original contract does not provide for an unconditional conversion option,
- change of the borrower – only if the current borrower is exempted from the debt (not applicable if another borrower participates in the contract),
- change of the cash flow criterion from 'SPPI compliance',
- change of the financed asset.

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

Purchased or originated credit impaired financial assets (POCI assets)

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

Reclassification of financial assets

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

Financial liabilities are not subject to reclassification by the Bank.

The accounting principles applied by the Bank until 31 December 2017 in the scope of classification and measurement of financial instruments are described in Note 2 of the IFRS Financial Statements of the mBank Hipoteczny S.A. for 2017, published on 2 March 2018.

2.7. Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

2.8. Impairment of financial assets

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

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

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

Retail portfolio obtained in cooperation with mBank S.A.

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

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

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

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

A credit exposure provides indication of impairment where:

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

Significant deterrioration

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

Qualitative criteria

Qualitative criteria are:

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

Quantitative criteria

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

Estimating expected credit losses (ECL)

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

Use of macroeconomics scenarios in ECL estimation

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

In particular, NLF is calculated as:

1. the probability-weighted average of the expected loss from 3 macroeconomic scenarios ('average estimation') comprising:
    a. baseline scenario,

   b. optimistic scenario,
   c. pessimistic scenario,

2. divided by the expected loss determined under baseline scenario (reference estimate).

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

<u>Impairment corporate portfolio</u>

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

a) deterioration of counterparty/transaction loan quality. The Bank recognises that the debtor probably will not fully fulfil its loan obligations against the Bank, parent entity of the Bank without actions of the Bank, such as implementation of collateral, if such exists,
b) delay in payments for over 90 days. Any of the exposures of a nature of debtor loan obligation against the Bank, parent entity of the Bank is overdue for more than 90 days, provided that the overdue amount exceeds PLN 3 000,
c) qualification of an entity to a default situation by the Bank's parent entity.

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

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

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

<u>Significant deterrioration</u>

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

Qualitative criteria are:

- where an amount is more than 30 days past due and exceeds PLN 3 000 (days past due, with an activation threshold – the number of days for which the longest overdue amount of the exposure concerned is greater than or equal to 31 days),

- occurrence of the Forborne flag (the client status shows that he or she is experiencing difficulties in repaying the loan commitment, as defined by the Bank).
- occurrence of the Watch flag (the Bank's internal process designed to identify corporate clients who are subject to increased monitoring in terms of changes in credit quality, in accordance with the Watch List classification rules adopted by the Bank).

Estimating expected credit losses (ECL)

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

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

Use of macroeconomics scenarios in ECL estimation

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

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

The accounting principles applied by the Bank until 31 December 2017 regarding the impairment of financial assets are described under Note 2.8 of the IFRS Financial Statements of the mBank Hipoteczny S.A. for 2017.

2.9. Cash and cash equivalents

Cash and cash equivalents comprise items with maturities of up to three months from the date of their acquisition, including: cash in hand and cash held at the Central Bank with unlimited availability for disposal, treasury bills and other eligible bills, loans and advances to banks, amounts due from other banks and government securities acquired for the purpose of short-term resale.

2.10. Derivative financial instruments and hedge accounting

Derivative financial instruments are recognised at fair value from the date of transaction. Fair value is determined based on prices of instruments listed on active markets, including recent market transactions, and on the basis of valuation techniques, including models based on discounted cash flows and options pricing models, depending on which method is appropriate in the particular case. All derivative instruments with a positive fair value are recognised in the statement of financial position as assets, those with a negative value as liabilities.

The best fair value indicator for a derivative instrument at the time of its initial recognition is the price of the transaction (i.e., the fair value of the paid or received consideration). If the fair value of the particular instrument may be determined by comparison with other current market transactions concerning the same instrument (not modified) or relying on valuation techniques based exclusively on market data that are available for observation, then the Bank recognises the respective gains or losses from the first day.

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

The method of recognising the resulting fair value gain or loss depends on whether the given derivative instrument is designated as a hedging instrument, and if it is, it also depends on the nature of the hedged item. The Bank designates some derivative instruments as fair value hedges against a recognized liability (issued mortgage covered bonds at a fixed rate).

Derivative instruments designated as hedges against positions maintained by the Bank are recorded by means of hedge accounting, subject to the fulfillment of the criteria specified in IAS 39:

- At the inception of the hedge there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instruments effectiveness in offsetting the exposure to changes in the hedged item's fair value;
- The hedge is expected to be highly effective in offsetting changes in fair value attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship;
- The effectiveness of the hedge can be reliably measured, i.e. the fair value hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured;
- The hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.

The Bank documents the objectives of risk management and the strategy of concluding hedging transactions, as well as at the time of concluding the respective transactions, the relationship between the hedging instrument and the hedged item. The Bank also documents its own assessment of the effectiveness of fair value hedging transactions, measured both prospectively and retrospectively from the time of their designation and throughout the period of duration of the hedging relationship between the hedging instrument and the hedged item.

<u>Fair value hedges</u>

Changes in the fair value of derivative instruments designated and qualifying as fair value hedges are recognized in the income statement together with any changes in the fair value of the hedged liability that are attributable to the hedged risk. The Bank presents the adjustment of balance sheet value of the hedged instrument as the separate line of the statement of financial position.

In case a hedge has ceased to fulfil the criteria of hedge accounting, the adjustment to the carrying value of the hedged item for which the effective interest method is used is amortised to the income statement over the period to maturity.

<u>Derivative instruments not fulfilling the criteria of hedge accounting</u>

Changes of the fair value of derivative instruments that do not meet the criteria of hedge accounting are recognized in the income statement of the current period.

<u>Rules of calculation of impairments (valuation adjustment) on credit risk of the counterparty from valuation of derivative instruments of the market risk.</u>

Impairment loss due to credit risk (valuation adjustment) for derivative instruments is created for customers in the financial sector, who were not classified to the default category or technical default which means a default resulting from the breach of provisions of agreement (e.g. failure to cover costs arising from a transaction despite the fact that the main receivable was settled in a timely manner). The amount of impairment constitutes the sum of expected on particular transactions concluded with a given counterparty credit losses for a default of this counterparty, which will become apparent until the maturity date of particular derivative instruments. Expected loss due to counterparty risk is estimated per counterparty - cumulatively for all transactions of the counterparty on the basis of indicated term structure of expected future positive exposure (EPE) and curves of credit spreads for individual sectors and ratings.

The Bank holds the following derivative instruments in its portfolio:

Interest rate risk instruments:

a) Interest Rate Swap (IRS) Contracts.

Foreign exchange risk instruments:

b) FX SWAP contracts.

All transactions on derivative instruments are concluded with the objective to secure currency risk and interest rate risk. The Bank does not conduct commercial activity, all transactions on derivatives are classified in the banking portfolio.

2.11. Intangible assets

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

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

Computer software

Purchased computer software licences are capitalised in the amount of costs incurred for the purchase and adaptation for use of specific computer software. Capitalised costs are amortised on the basis of the expected useful life of the software (2-10 years). Expenses attached to the development or maintenance of computer software are expensed when incurred. Expenses directly linked to the development of identifiable unique proprietary computer programmes controlled by the Bank, which are likely to generate economic benefits in excess of such costs expected to be gained over a period exceeding one year, are recognised as intangible assets.

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

Development costs

The Bank identifies development costs as intangible asset as the asset will generate probable future economic benefits and fulfil the following requirements described in IAS 38, i.e., the Bank has the intention and ability to complete and to use the generated intangible asset, the availability of adequate technical and financial resources to complete and to use the generated intangible asset and the ability to measure reliably the expenditure attributable to the generated intangible asset during its development.

"Development costs" useful lives are finite and the amortization period does not exceed 3 years. Amortization rates are adjusted to the period of economic utilisation.

Development expenditure comprises all expenditure that is directly attributable to research and development activities.

Intangible assets are tested in terms of possible impairment always after the occurrence of events or change of circumstances indicating that their carrying value in the statement of financial position might not be possible to be recovered.

2.12. Tangible fixed assets

Tangible fixed assets are carried at historical cost reduced by accumulated depreciation and accumulated impairment losses. Historical cost takes into account the expenses directly attached to the acquisition of the respective assets.

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

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

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

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

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

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

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

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

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

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

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

Depreciable fixed assets are tested for impairment always whenever events or changes in circumstances indicate that the carrying value may not be recoverable and at the end of each reporting period. The value of a fixed asset carried in the statement of financial position is reduced to the level of its recoverable value if the carrying value in the statement of financial position exceeds the estimated recoverable amount. The recoverable value is the higher of two amounts: the fair value of the fixed asset reduced by its selling costs and the value in use.

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

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

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

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

2.13. Current and deferred income tax

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

Deferred tax liabilities and assets are determined by application of the tax rates in force by virtue of law or of actual obligations at the end of the reporting period. According to expectations such tax rates applied will be in force at the time of realisation of the assets or settlement of the liabilities for deferred corporate income tax. Liabilities or assets for deferred corporate income tax are recognised in their full amount according to the balance sheet method in connection with the existence of temporary differences between the tax value of assets and liabilities and their carrying value. Temporary differences are differences between the carrying amount of an asset or liability and its tax value. Positive net differences are shown in liabilities as "Deferred income tax provision". Negative net differences are recognized as "Deferred income tax assets". Changes in the deferred income tax provision and deferred income tax assets in relation to the previous financial period are included in the item "Income tax".

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

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

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

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

2.14. Inventories

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

2.15. Prepayments, accruals and deferred income

Prepayments are recorded if the respective expenses concern the months succeeding the month in which they were incurred. Prepayments are presented in the statement of financial position under "Other assets".

Accruals include costs of supplies delivered to the Bank but not yet resulting in its payable liabilities. Deferred income includes received amounts of future benefits. Accruals and deferred income are presented in the statement of financial position under the item "Other liabilities".

2.16. Provisions

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

According to IAS 37, provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, it is more likely that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated.

2.17. Post-employment employee benefits and other employee benefits

Provision for retirement and similar benefits

The Bank forms provisions against future liabilities on account of post-employment benefits determined on the basis of an estimation of liabilities of that type, using an actuarial model. Current employment costs and net interest are recognized in the income statement under "Overhead costs". Actuarial profits and losses are recognised in other comprehensive incomes which will not be reclassified to the income statement.

Phantom share-based benefits settled in cash

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

2.18. Issue of securities

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

2.19. Loans and advances received

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

2.20. Equity

Equities consist of capitals and funds produced by the Bank in accordance with specified provisions of law, i.e. appropriate acts, the Articles of Association.

<u>Registered share capital</u>

Share capital is presented at its nominal value, in accordance with the Articles of Association and with the entry in the National Court Register.

<u>Share premium</u>

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

Costs directly connected with the issue of new shares reduce the proceeds from the issue recognised in equity.

<u>Retained earnings</u>

Retained earnings include:

- other supplementary capital,
- general risk reserve,
- undistributed profit for the previous years,
- net profit (loss) for the current period.

Other supplementary capital, general risk reserve are formed from allocations of profit and they are assigned to purposes specified in the By-laws or other regulations of the law.

<u>Other components of equity</u>

Other components of equity result from:

- valuation of financial assets at fair value through other comprehensive income,
- actuarial gains and losses relating to post-employment benefits.

2.21. Leasing

The Bank acts as the lessee. Leasing agreements in the Bank are operational leasing agreements. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease. No financial lease agreements were concluded by the Bank.

2.22. Valuation of items denominated in foreign currencies

<u>Functional currency and presentation currency</u>

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

<u>Transactions and balances</u>

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

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

At the end of each reporting period non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction, and non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was measured.

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

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

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

2.24. New standards, interpretations and amendments to published standards

These financial statements include the requirements of all the International Accounting Standards and the International Financial Reporting Standards endorsed by the European Union, and the related with them interpretations which have been endorsed and binding for annual periods starting on 1 January 2018.

These financial statements do not include standards and interpretations listed below which await endorsement of the European Union or which have been endorsed by the European Union but entered or will enter into force after the balance sheet date.

In relation to standards and interpretations that have been approved by the European Union, but entered or will enter into force after the balance sheet date, the Bank did not use the possibility of early application.

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

Standards and interpretations approved by the European Union

- IFRS 16, Leases, published by the International Accounting Standards Board on 13 January 2016, approved by European Union on 31 October 2017, binding for annual periods starting on or after 1 January 2019.

  IFRS 16 introduces new principles for the recognition of leases. The main amendment involves the elimination of the classification of leases as either operating leases or finance leases and instead, the introduction of a single lease accounting model. Applying a single accounting model, a lessee is required to recognize lease assets and corresponding liability in the statement of financial position, except for short-term leases with a term of less than 12 months and leases with underlying asset of low value. A lessee is also required to recognize depreciation costs of lease asset separately from interest costs on lease liabilities in the income statement.

  IFRS 16 substantially carries forward the lessor accounting approach. It means that lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

  The Bank is of the opinion that the application of a new standard will have an impact on the recognition, presentation, measurement and disclosure of operating lease assets and corresponding liability in the financial statements of the Bank as lessee.

  The Bank is of the opinion that the application of a new standard will have an impact on the recognition, presentation, measurement and disclosure of operating lease assets and corresponding liability in the financial statements of the Bank as lessee.

  Quantitative and qualitative information, including the analysis of main changes resulting from adoption of the standard on the financial statements for the annual periods starting from 1 January 2019 has been presented under the end of these note.

- Amendments to IFRS 9, Prepayment Features with Negative Compensation, published by the International Accounting Standards Board on 12 October 2017, approved by European Union on 22 March 2018, binding for annual periods starting on or after 1 January 2019.

  Amendments to IFRS 9 introduce the statements with reference to contractual prepayment feature, when the lender could be forced to accept the prepayment amount that is substantially less than unpaid amounts of principal and interest. Such a prepayment amount would be a payment to the borrower from the lender, instead of compensation from the borrower to the lender. Such a financial asset would be eligible to be measured at amortized cost or fair value through other comprehensive income (subject to an assessment of the business model in which they are held), however, the negative compensation must be reasonable compensation for early termination of the contract.

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

- IFRIC Interpretation 23 Uncertainty over Income Tax Treatments, published by International Accounting Standards Board on 7 June 2017, approved by European Union on 23 October 2018, binding for annuals periods starting on or after 1 January 2019.

  IFRIC Interpretation 23 addresses, in particular, when there is uncertainty over income tax treatments, whether an entity considers uncertain tax treatments separately, what assumptions an entity makes about the examination of tax treatments by taxation authorities, how an entity determines taxable profit (tax loss), tax bases, unused tax losses, tax rates and how an entity considers changes in facts and circumstances.

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

- Amendments to IAS 28, Long-term Interests in Associates and Joint Ventures, published by the International Accounting Standards Board on 12 October 2017, approved by European Union on 8 February 2019, binding for annual periods starting on or after 1 January 2019.

  Amendments to IAS 28 clarify that an entity applies IFRS 9 'Financial Instruments' to other financial instruments in an associate or joint venture to which the equity method is not applied. These instruments include long-term interests that, in substance, form part of the entity's net investment in an associate or joint venture. In amendments to IAS 28 it has been clarified that the requirements of IFRS 9 apply to long-term interests before an entity applies share of losses requirements from IAS 28 and in applying IFRS 9, the entity does not take account of any adjustments to the carrying amount of long-term interests that arise from applying IAS 28.

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

Standards and interpretations not yet approved by the European Union

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

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

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

- Annual Improvements to IFRS Standards 2015-2017 Cycle, published by the International Accounting Standards Board on 12 December 2017, binding for annual periods starting on or after 1 January 2019.

  The improvements to the following standards were implemented during the cycle: IFRS 3 in terms of clarifying that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business, IFRS 11 in terms of clarifying that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business, IAS 12 in terms of clarifying that all income tax consequences of dividends (i.e. distribution of profits) should be recognized in profit or loss, regardless of how the tax arises, IAS 23 in terms of clarifying that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalization rate on general borrowings.

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

- Amendments to IAS 19, Plan Amendment, Curtailment or Settlement, published by the International Accounting Standards Board on 7 February 2018, binding for annual periods starting on or after 1 January 2019.

  Amendments to IAS 19 specifies how an entity determines pension expenses when changes to a defined benefit pension plan occur. IAS 19 'Employee Benefits' specifies how an entity accounts for a defined benefit plan. When a change to a plan – an amendment, curtailment or settlement – takes place, IAS 19 requires an entity to remeasure its net defined benefit liability or
  asset. The amendments require an entity to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. By requiring the use of updated assumptions, the amendments are expected to provide useful information to users of financial statements.

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

- Amendments to References to the Conceptual Framework in International Financial Reporting Standards, issued on 29 March 2018, effective for financial years beginning on or after 1 January 2020.

  Amendments to References to the Conceptual Framework in International Financial Reporting Standards is a document that sets out the objective of the financial reporting, the qualitative characteristics of useful financial information, a description of the reporting entity, definitions of an asset, a liability, equity, income and expenses, criteria of recognition assets and liabilities in financial statements and guidance on when to derecognize them, measurement bases and guidance on when to use them, as well as concepts and guidance
  on presentation and disclosure.

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

- Amendments to IFRS 3, Definition of a Business, published by the International Accounting Standards Board on 22 October 2018, binding for annual periods starting on or after 1 January 2020.

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

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

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

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

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

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

IFRS 16 Leases

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

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

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

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

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

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

Impact of IFRS 16 on financial statements

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

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

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

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

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

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

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

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

Description of adjustments

(a) Recognition of lease liabilities

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

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

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

- for contracts in PLN: 1.95%;

- for contracts in EUR: 0.02%.

(b) Recognition of right-of-use assets

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

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

(c) Application of estimates

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

(d) The use of practical simplifications

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

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

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

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

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

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

<u>Impact on the statement of financial position</u>

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

for 2018 (in PLN thousand)

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

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

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

Impact on the income statement

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

Impact on equity

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

Impact on capital ratios

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

2.25. Implementation of IFRS 9

On 24 July 2014 the International Accounting Standards Board (IASB) issued a new International Financial Reporting Standard – IFRS 9, Financial instruments effective for annual periods beginning on or after 1 January 2018, which replaces the existing International Accounting Standard 39 „Financial instruments recognition and measurement”. The European Commission adopted IFRS 9 as published by the IASB on 24 July 2014 in the Resolution No. 2016/2067 issued on 22 November 2016.

IFRS 9 introduces a new impairment model based on the concept of „expected credit losses”, changes to the rules of classification and measurement of financial instruments (particularly of financial assets) as well as a new approach towards hedge accounting.

The Bank decided to use the provisions of IFRS 9 allowing exemption from the obligation to transform comparative data for prior periods in relation to changes resulting from classification and measurement and impairment. At the same time the Bank introduced changes to the financial statements to adjust the presentation of financial data to the new categories introduced by IFRS 9.

for 2018 (in PLN thousand)

As at 1 January 2018, differences in the carrying amount of financial assets and liabilities resulting from the application of IFRS 9 were recognized as a part of undistributed financial result from previous years in the Bank's equity.

Impact of IFRS 9 on the Bank's financial situation and own funds

Quantitative impact of IFRS 9 on the Bank's financial situation and own funds

As at 1 January 2018, changes in the requirements regarding classification and measurement and impairment of financial assets, had moderately negative impact on the Bank's financial position and own funds.

In the tables below has been presented the impact resulting from changes in the classification and measurement of financial assets in connection with the implementation of IFRS9 as at 1 January 2018.

Restatement of statement of financial position of mBank Hipoteczny S.A. as at 31 December 2017 in connection with the implementation of IFRS 9

ASSETS	31.12.2017 in accordance with IAS 39	ASSETS	Reclassification	IFRS 9 implementation	01.01.2018 in accordance with IFRS 9
Cash and balances with the Central Bank	1 351	Cash and balances with the Central Bank	1 351	-	1 351
Loans and advances to banks	18 737	Financial assets at amortised cost - loans and advances to banks	18 737	-	18 737
Derivative financial instruments	48 973	Financial assets held for trading and derivatives held for hedges	48 973	-	48 973
Loans and advances to customers	10 766 911	Financial assets at amortised cost - loans and advances to customers	10 544 526	(10 896)	10 533 630
		Non-trading financial assets mandatorily at fair value through profit or loss	222 385	(2 258)	220 127
Investment securities available for sale	1 277 127	Financial assets at fair value through other comprehensive income	1 277 127	-	1 277 127
Intangible assets	25 527	Intangible assets	25 527	-	25 527
Tangible fixed assets	8 295	Tangible fixed assets	8 295	-	8 295
Deferred income tax assets	10 572	Deferred income tax assets	10 572	3 136	13 708
Other assets	10 676	Other assets	10 676	-	10 676
TOTAL ASSETS	**12 168 169**	**TOTAL ASSETS**	**12 168 169**	**(10 018)**	**12 158 151**
LIABILITIES AND EQUITY					
Liabilities					
Amounts due to other banks	3 830 026	Financial liabilities measured at amortised cost - Amounts due to banks	3 830 026	-	3 830 026
Derivative financial instruments	548	Financial liabilities held for trading and derivatives held for hedges	548	-	548
Amounts due to customers	4 131	Financial liabilities measured at amortised cost - amounts due to customers	4 131	-	4 131
Debt securities in issue	7 043 125	Financial liabilities measured at amortised cost - debt securities issued	7 043 125	-	7 043 125
Subordinated liabilities	200 484	Subordinated liabilities	200 484	-	200 484
Current income tax liabilities	7 682	Current income tax liabilities	7 682	-	7 682
Provisions	204	Provisions	204	3 353	3 557
Other liabilities	25 568	Other liabilities	25 568	-	25 568
TOTAL LIABILITIES	**11 111 768**	**TOTAL LIABILITIES**	**11 111 768**	**3 353**	**11 115 121**
Equity					
Share capital:	**734 719**	**Share capital:**	**734 719**	-	**734 719**
- Registered share capital	321 000	- Registered share capital	321 000	-	321 000
- Share premium	413 719	- Share premium	413 719	-	413 719
Retained earnings:	**317 882**	**Retained earnings:**	**317 882**	**(13 371)**	**304 511**
- Profit from the previous years	290 053	- Profit from the previous years	290 053	(13 371)	276 682
- Profit for the current period	27 829	- Profit for the current period	27 829	-	27 829
Other components of equity	**3 800**	**Other components of equity**	**3 800**	-	**3 800**
TOTAL EQUITY	**1 056 401**	**TOTAL EQUITY**	**1 056 401**	**(13 371)**	**1 043 030**
TOTAL LIABILITIES AND EQUITY	**12 168 169**	**TOTAL LIABILITIES AND EQUITY**	**12 168 169**	**(10 018)**	**12 158 151**

for 2018 (in PLN thousand)

Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

Measurement category	Loss allowance under IAS 39 /Provisions IAS 37	Impairment	Loss allowance under IFRS 9
Loans and receivables (IAS 39)/Financial assets at amortized cost (IFRS 9)			
Loans and advances to customers	69 004	23 940	92 944
Loans and receivables (IAS 39)/Financial assets at amortized cost (IFRS 9) - TOTAL	69 004	23 940	92 944
Loans and receivables (IAS 39)/Non-trading financial assets mandatorily at fair value through profit or loss (IFRS 9)			
Loans and advances to customers	44 740	(44 740)	-
Loans and receivables (IAS 39)/Non-trading financial assets mandatorily at fair value through profit or loss - TOTAL	44 740	(44 740)	-
Provisions for off-balance sheet credit facilities (IAS 37)/Loss allowance for expected credit losses (IFRS 9)			
Provisions for off-balance sheet credit facilities (IAS 37)/Loss allowance for expected credit losses (IFRS 9)	61	3 353	3 414
Provisions (IAS 37)/Loss allowance for expected credit losses (IFRS 9) - TOTAL	61	3 353	3 414
TOTAL	**113 805**	**(17 447)**	**96 358**

Classification and measurement of financial instruments

The comparison of the category of valuation and balance sheet value of financial assets and liabilities as at January 1, 2018 in accordance with IAS 39 and IFRS 9 is as follows:

The item of the financial report for 2017 Assets	Valuation category according to IAS 39	01.01.2018	Valuation category according to IFRS 9	01.01.2018
Cash and balances with the Central Bank	Amortised cost (loans and advances)	1 351	Amortised cost	1 351
Loans and advances to banks	Amortised cost (loans and advances)	18 737	Amortised cost	18 737
Derivative financial instruments	Fair value through profit or loss	48 973	Fair value through profit or loss	48 973
Loans and advances to customers	Amortised cost (loans and advances)	10 753 757	Amortised cost	10 533 630
Loans and advances to customers	Amortised cost (loans and advances)		Fair value through profit or loss	220 127
Investment securities available for sale	Fair value through other comprehensive income	1 277 127	Fair value through other comprehensive income	1 277 127
TOTAL ASSETS		**12 099 945**	**TOTAL ASSETS**	**12 099 945**

The item of the financial report for 2017 Liabilities	Valuation category according to IAS 39	01.01.2018	Valuation category according to IFRS 9	01.01.2018
Amounts due to other banks	Amortised cost	3 830 026	Amortised cost	3 830 026
Derivative financial instruments	Fair value through profit or loss	548	Fair value through profit or loss	548
Amounts due to customers	Amortised cost	4 131	Amortised cost	4 131
Debt securities in issue	Amortised cost	7 043 125	Amortised cost	7 043 125
Subordinated liabilities	Amortised cost	200 484	Amortised cost	200 484
Provisions for off balance sheet credit facilities	IAS 37	3 414	IFRS 9	3 414
TOTAL LIABILITIES		**11 081 728**	**TOTAL LIABILITIES**	**11 081 728**

Restatement of statement of financial position of mBank Hipoteczny S.A. as at 31 December 2017 in connection with the implementation of IFRS 9 - Assets

ASSETS	01.01.2018	31.12.2017	Change
Cash and balances with the Central Bank	1 351	1 351	-
Financial assets held for trading and derivatives held for hedges	48 973	48 973	-
Loans and advances to banks	*n/a*	18 737	(18 737)
Non-trading financial assets mandatorily at fair value through profit or loss, including:	220 127	*n/a*	220 127
Loans and advances to customers	*220 127*	*n/a*	*220 127*
Investment securities	*n/a*	1 277 127	(1 277 127)
Financial assets at fair value through other comprehensive income	1 277 127	*n/a*	1 277 127
Financial assets at amortised cost, including:	10 552 367	*n/a*	10 552 367
Loans and advances to banks	*18 737*	*n/a*	*18 737*
Loans and advances to customers	*10 533 630*	*n/a*	*10 533 630*
Loans and advances to customers	*n/a*	10 766 911	(10 766 911)
Intangible assets	25 527	25 527	-
Tangible assets	8 295	8 295	-
Deferred income tax assets	13 708	10 572	3 136
Other assets	10 676	10 676	-
TOTAL ASSETS	**12 158 151**	**12 168 169**	**(10 018)**

for 2018 (in PLN thousand)

Restatement of statement of financial position of mBank Hipoteczny S.A. as at 31 December 2017 in connection with the implementation of IFRS 9 – Liabilities and equity

LIABILITIES AND EQUITY			
Liabilities			
Financial liabilities held for trading and derivatives held for hedges	548	548	-
Financial liabilities measured at amortised cost, including:	11 077 766	*n/a*	11 077 766
Amounts due to banks	*3 830 026*	*n/a*	*3 830 026*
Amounts due to customers	*4 131*	*n/a*	*4 131*
Debt securities issued	*7 043 125*	*n/a*	*7 043 125*
Subordinated liabilities	*200 484*	*n/a*	*200 484*
Amounts due to the other banks	*n/a*	3 830 026	(3 830 026)
Amounts due to customers	*n/a*	4 131	(4 131)
Debt securities in issue	*n/a*	7 043 125	(7 043 125)
Subordinated liabilities	*n/a*	200 484	(200 484)
Current income tax liabilities	7 682	7 682	-
Provisions	3 557	204	3 353
Other liabilities	25 568	25 568	-
TOTAL LIABILITIES	**11 115 121**	**11 111 768**	**3 353**
Equity			
Share capital:	**734 719**	**734 719**	**-**
- Registered share capital	321 000	321 000	-
- Share premium	413 719	413 719	-
Retained earnings:	**304 511**	**317 882**	**(13 371)**
- Profit from the previous years	276 682	290 053	(13 371)
- Profit for the current period	27 829	27 829	-
Other components of equity	**3 800**	**3 800**	**-**
TOTAL EQUITY	**1 043 030**	**1 056 401**	**(13 371)**
TOTAL LIABILITIES AND EQUITY	**12 158 151**	**12 168 169**	**(10 018)**

Financial assets

As at 1 January 2018, as a result of the implementation of IFRS 9, the Bank changed the classification and measurement method for 25 corporate loans measured at amortized cost in accordance with IAS 39 at fair value through profit or loss in accordance with IFRS 9 in connection with non-compliance the SPPI criteria in category non-recourse assets.

The impact of the valuation method change of the above loans from amortized cost to the fair value was negative and amounted to PLN 2 258 thousand excluding deferred tax effect.

As at 1 January 2018 Bank did not identify financial assets which were designated as measured at fair value through profit or loss in order to eliminate "accounting mismatch".

Financial liabilities

As a result of implementing IFRS 9, the Bank did not change the classification of financial liabilities in comparison to the requirements in IAS 39, which could have a significant impact on the financial position and profit or loss of the Bank.

Impairment

The implementation of the new impairment model based on the concept of ECL resulted in the moderate increase of the Bank's loss allowance, particularly with regard to exposures allocated to Stage 2. Contrary to IAS 39, IFRS 9 does not require the entities to identify the impairment trigger in order to estimate lifetime credit losses in Stage 2. Instead, the Bank is obliged to constantly estimate the level of credit losses since the initial recognition of a given asset until its derecognition. In the event of significant increase in credit risk since the initial recognition of the asset, the Bank will be obliged to calculate lifetime expected credit losses – Stage 2. Such an approach resulted in the earlier recognition of credit losses which causes an increase in loss allowance and therefore also affect profit or loss. With regard to exposures classified to Stage 1 the Bank did not identify the change in the level of impairment allowances. With regard to exposures classified to Stage 3, the increase in the level of impairment allowances is related to taking into the designated level of impairment allowances, in accordance with the requirements of the IFRS 9, additional scenarios regarding expected recoveries.

The total effect of the above changes on the category "Financial assets at amortized cost" was negative and amounted to PLN 10 896 thousand. In addition, these changes also influenced the increase in provisions for off-balance sheet liabilities presented in the category "Provisions" in the amount of PLN 3 353 thousand.

As a result, the total negative impact of the implementation of IFRS 9 in the amount of PLN 16 507 thousand and the tax effect resulting from the implementation of IFRS 9 in the form of an increase in net deferred tax asset in the amount of PLN 3 136 thousand caused a decrease in the retained earnings by PLN 13 371 thousand.

Impact of IFRS 9 on capital adequacy

The total fully-loaded impact of IFRS 9 calculated as on 1 January 2018 is insignificant of the Bank TCR and Tier1 ratio and was below 1 base point.

The Bank decided, for the purpose of capital adequacy calculation, including calculation of own funds, based on the Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017 (Regulation) amending Regulation (EU) No 575/2013 in light of Article 1 paragraph 9 of the Regulation, not to apply the transitional arrangements that would mitigate the impact on capital resulting from the introduction of IFRS9.

The data as at 31 December 2017 is presented in unchanged amounts.

Hedge accounting

In accordance with IFRS 9, only on the date of implementation of IFRS 9 the Bank could make a decision consisting a part of its accounting policy to continue to apply hedge accounting requirements under IAS 39, in place of the requirements of IFRS 9.

IFRS 9 requires the Bank to ensure consistency of relevant hedging relationships with Bank's risk management strategy and objectives. IFRS 9 introduces new provisions regarding, among others, the assessment of the effectiveness of hedging relationship and the mechanism of restoring the balance of hedging relationship (hedging relationship rebalancing), as well as abolishes the possibility to discontinue using hedge accounting through Bank's subjective decision (i.e. in the absence of premises for discontinuing the use of hedge accounting, as specified in the Standard).

As at the date of implementation of the standard, the Bank decided to continue to apply hedge accounting requirements in accordance with IAS 39.

2.26. Change of presentation in the income statement

In 2018, the Bank changed the method of presentation of foreign exchange differences of impairment write-downs on loans and advances in the income statement. Starting from January 2018, the Bank presents them under profit or loss from exchange item "Net exchange differences on translation", which is consistent with mBank Group's policy. In previous reporting periods, foreign exchange differences on account of allowances on loans and advances were presented under "Net impairment write-downs on loans and advances". Due to the lack of technical possibility to separate foreign exchange differences from allowances on loans and advances granted for previous periods, the Bank did not apply retrospective restatement of data for comparable periods presented in these financial statements. The amount of exchange differences as at 31 December 2018 due to write-downs and adjustment to fair value for granted loans and advances amounted to PLN (2 530) thousand.

3. Financial risk management

3.1. Credit risk

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

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

3.1.1. Collaterals

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

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

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

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

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

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

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

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

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

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

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

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

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

3.1.2. Description of the rating system and credit risk management

For the analysis of the loan portfolio the Bank uses rating models which are updated annually. Rating systems currently cover 98.90% of total sum of risk-weighted exposures with standard method including portfolios covered with a plan of gradual implementation and 65.23% without including those portfolios. The difference results from the fact, that 33.67% of the total sum of risk-weighted exposures with standard method are retail exposures gained from the cooperation with mBank S.A., which are part of gradual implementation of the IRB method, accepted by the Polish Financial Supervision Authority. The Bank intends to apply in the future for the acceptance to use the statistical methods to measure regulatory capital requirements for the credit risk of these exposures.

The Bank applies rating models:

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

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

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

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

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

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

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

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

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

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

For the purposes of assessment of reliability of a client applying for a retail loan product secured with mortgage and monitoring/reporting of credit risk for this portfolio, group credit risk models, which the Bank is a local user, are applied. Detailed rules and scope of cooperation between Banks in terms of group risk models are specified by provisions of a separate agreement on cooperation in the scope of risk management. The capital requirement for credit risk for this part of the portfolio is calculated using the standard method, since as at 31 December 2018 it is covered by a plan of gradual implementation.

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

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

<u>Additional information</u>

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

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

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

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

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

3.1.3. Repossessed collateral

for 2018 (in PLN thousand)

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

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

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

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

In both 2018 and 2017, the Bank did not take over any collaterals.

On 30 November 2018, the Bank sold the debtor's real property located in Stegna, recognized in 2013 as inventories. In the result for 2018, the revenue equivalent to the value of the sale price of the real property received and the cost of writing off the inventories in the amount not covered by write-downs created previously were recognized. Finally, the Bank recorded a loss equal to the difference between the sale price and the value at which the real property was taken over. The total result of sale of inventories was PLN (382) thousand and is disclosed in Note 11 and Note 13.

Change of status of repossessed collaterals

	Period from 01.01.2018 to 31.12.2018	Period from 01.01.2017 to 31.12.2017
As at the beginning of the period	**3 432**	**3 432**
Decrease	(3 432)	-
- real estate sales	(2 995)	-
- creation of impairment losses	(437)	-
As at the beginning of the period	**-**	**3 432**

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

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

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

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

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

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

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

for 2018 (in PLN thousand)

The risk of no repayment of the product portfolio subject to the forbearance policy is mitigated with the amount of PLN 467 013 thousand of accepted collaterals (the mortgage lending value of the property that constitute the collateral of the loan), therefore, the possible influence of this portfolio on deterioration of the entire portfolio of the Bank is significantly limited.

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

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

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

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

The structure of the loan portfolio in the forbearance category in mBank Hipoteczny S.A. as at 31 December 2017 is as follows:

31.12.2017	Gross value	Of which defaulted	Write-downs created	Net value
Loans and advances to customers, including:	250 863	179 764	55 052	195 811
Corporate customers	235 131	178 774	54 928	180 203
Individual customers	15 732	990	124	15 608
Total balance sheet data	**250 863**	**179 764**	**55 052**	**195 811**

The size of the portfolio of the customers to whom the Bank has granted relief is still small compared with the total size of the Bank's loan portfolio. The forbearance portfolio represents 2.24% (2.31% as at 31.12.2017) of the entire portfolio. As at 31 December 2018, the forbearance exposure portfolio in the default category represented 81.26% of the forbearance portfolio (71.66% as at 31.12.2017). 18.14% of the portfolio of default exposures was covered with allowances (30.54% as at 31.12.2017).

The risk of default on the forbearance portfolio is mitigated with the accepted collateral in the form of a mortgage on a property with a mortgage lending value of PLN 467 013 thousand (PLN 381 755 thousand as at 31.12.2017), including PLN 390 345 thousand in the default category (PLN 261 893 thousand as at 31.12.2017).

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

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

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

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

for 2018 (in PLN thousand)

Changes in forbearance exposures carrying value in 2017:

	Gross value	Of which defaulted	Write-downs created	Net value
Saldo 01.01.2017	**355 738**	**208 717**	**47 486**	**308 252**
Outputs from forbearance	(117 470)	-	(212)	(117 258)
Change in exposure	(33 317)	(29 598)	7 678	(40 995)
New forbearance	45 912	645	100	45 812
Saldo 31.12.2017	**250 863**	**179 764**	**55 052**	**195 811**

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

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

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

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

Forbearance exposures by type of concession as at 31 December 2017

Type of concession (31.12.2017r.)	Gross value	Of which defaulted	Write-downs created	Net value
Refinancing	10 292	10 292	23	10 269
Modification of terms and conditions	240 571	169 472	55 029	185 542
Total	**250 863**	**179 764**	**55 052**	**195 811**

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

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

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

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

Forbearance exposures without recognised loss impairment per length of overdue period as at 31 December 2017

Forbearance exposures without impairment recognised (31.12.2017r.)	Gross value	Of which defaulted	Write-downs created	Net value
Not overdue	74 562	18 098	143	74 419
up to 30 days	15 039	463	44	14 995
31 to 90 days	59	-	-	59
Total	**89 660**	**18 561**	**187**	**89 473**

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

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

Forbearance exposures without recognised loss impairment per length of overdue period as at 31 December 2017

Forbearance exposures with impairment recognised (31.12.2017r.)	Gross value	Of which defaulted	Write-downs created	Net value
Not overdue	54 306	54 306	4 411	49 895
more than 90 days	106 897	106 897	50 454	56 443
Total	**161 203**	**161 203**	**54 865**	**106 338**

for 2018 (in PLN thousand)

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

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

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

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

Forbearance exposures by industry as at 31 December 2017

As at 31 December 31.12.2017 r.	Gross value	Of which defaulted	Write-downs created	Net value
Activity related to the real estate market	172 511	131 742	45 222	127 289
Building industry	62 620	47 032	9 706	52 914
Natural persons	15 732	990	124	15 608
Total	**250 863**	**179 764**	**55 052**	**195 811**

Interest income related to forbearance exposures at the end of 2018, amounted to PLN 8 488 thousand (for the period ended 31 December 2017: PLN 9 671 thousand).

Retail Banking

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

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

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

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

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

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

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

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

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

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

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

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

The portfolio of products of forbearance status in the retail part as at 31 December 2018 amounted to PLN 24 982 thousand (PLN 15 732 thousand as at 31.12.2017).

Corporate banking

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

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

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

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

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

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

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

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

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

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

The portfolio of products of forbearance status in the corporate part as at 31 December 2018 amounted to PLN 194 565 thousand for assets measured at amortized cost and PLN 31 982 thousand for the portfolio measured mandatorily at fair value through profit or loss (PLN 235 131 thousand as at 31.12.2017).

3.1.5. Counterparty risk arising from transactions in derivatives

The Bank makes derivative transactions only to hedge against the currency risk and interest rates risk. The Bank does not run trading activities, all derivative transactions are classified to the banking portfolio. The Bank has in its derivative portfolio interest rate swaps (IRS) and currency swaps (FX SWAP contracts). The Management Board of the Bank approves the limits for the Bank's exposure in derivative transactions. The limits of exposure for particular banks are monitored and verified at least once a year. The Bank determines the limits only for the banks with the signed ISDA (International Swaps and Derivatives Association) agreement with CSA annex (Credit Support Annex) for the banks with which it plans to conclude ISDA agreements with CSA annex and the central clearing houses in which the derivative transactions will be settled. The counterparty risk is limited by the choice of the individual segregated account structure in the clearing house. The use of the exposure limits is monitored on the daily basis. The limits were not exceeded in both 2018 and 2017. As at 31 December 2018, all transactions in derivative financial instruments were transactions concluded originally with mBank S.A. and the central clearing house. Therefore, in the Bank's opinion the credit risk associated with the derivative instruments is limited.

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

The value of debt securities (financial assets at fair value through other comprehensive income) as at 31 December 2018 amounted to PLN 1 069 392 thousand, and as at 31 December 2017 amounted to PLN 1 277 127 thousand. Debt securities on both 31 December 2018 and 31 December 2017 had AAA rating in the scale of Standard & Poor's (S&P) Ratings.

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

- as at 31 December 2018 amounted to PLN 201 877 thousand,
- as at 31 December 2017 amounted to PLN 180 314 thousand.

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

- as at 31 December 2018 amounted to PLN 1 047 thousand,
- as at 31 December 2017 amounted to PLN 1 033 thousand.

Investment securities on which collateral was established are presented in Note 32.

Both as at 31 December 2018 and 31 December 2017 all investment securities were not past due instruments, without impairment.

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

Risk of geographical concentration

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

The risk of concentration of large exposures, the risk of concentration of exposures

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

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

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

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

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

a) the macroeconomic situation in the country,
b) situation on the real estate market in the country,
c) situation on financial markets in the country,
d) implementation of credit policy of the Bank in previous years,
e) results of restructuring and debt collection actions of the Bank,
f) information from reliable sources (academic centres) on economic situation of entities, branches, industry sectors, according to the recommendations of Resolution No. 384/2008 PFSA,
g) economic and quality information regarding the process of management in entities against which it holds exposure from which the concentration risk results,
h) factors resulting from other types of risk associated with identified exposures from which the risk of concentration arises (e.g. of interest rate, liquidity, operational and political) that may negatively influence an increase of concentration risk,
i) stress test results.

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

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

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

Sector concentration risk

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

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

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

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

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

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

No.	Industries	2018.12.31		2017.12.31	
		Net carrying amount (PLN '000)	Share in the portfolio (%)	Net carrying amount (PLN '000)	Share in the portfolio (%)
1.	Natural persons	6 177 906	55.46	5 853 656	54.37
2.	Activity related to the real estate market	3 127 446	28.08	3 263 008	30.31
3.	Building industry	1 429 931	12.84	1 338 771	12.43
4.	Professional, scientific and technical activity	180 446	1.62	84 109	0.78
5	Activity related to culture, entertainment and leisure	72 371	0.65	78 759	0.73
6	Public administration and defence; Compulsory social security	57 936	0.52	63 510	0.59
7.	Health protection and social welfare	43 267	0.39	48 606	0.45
8.	Financial activities	31 943	0.28	13 010	0.12
9.	Activity related to accommodation and catering services	15 205	0.14	18 970	0.18
10.	Water supply; Sewage and waste management and activity related to reclamation	1 275	0.01	2 973	0.03
11.	Other	989	0.01	1 539	0.01
	Total	**11 138 715**	**100.00**	**10 766 911**	**100.00**

3.3. Strategy for use of financial instruments

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

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

<u>Derivative instruments</u>

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

<u>Off-balance sheet liabilities of credit nature</u>

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

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

3.4. Market risk

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

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

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

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

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

As at 31 December 2018, VaR amounted to PLN 498.1 thousand compared with PLN 508.9 thousand as at 31 December 2017, with a confidence level of 97.5%.

The list below presents the value of average and maximum VaR of the Bank during the period from 1 January 2018 until 31 December 2018 and from 1 January 2017 until 31 December 2017.

PLN '000	12 months until 31.12.2018		12 months until 31.12.2017	
	average	maximum	average	maximum
Credit spread risk	492	570	441	576
Interest rate risk	192	273	120	236
Currency risk	21	123	20	211
Total VaR	**518**	**625**	**444**	**564**

Stress test and scenario analyses

An additional measure of market risk, supplementing the measurement of value at risk, is a stress test which shows a hypothetical change in the current valuation of the Bank's portfolio, that would take place as a result of risk factors (foreign exchange rates, interest rates, credit spreads) assuming the defined extreme values within a one-day time horizon. The Bank makes use of standard and expanded scenarios of big changes in the values of risk factors. As at 31 December 2018, the risk amount arising from an expanded scenario was

for 2018 (in PLN thousand)

PLN 23 253 thousand, whereas the average risk amount for this scenario in the period from 1 January 2018 to 31 December 2018 was PLN 25 175 thousand.

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

Stress test	31.12.2018				31.12.2017			
	Total	Interest rate risk	Currency risk	Credit spread risk	Total	Interest rate risk	Currency risk	Credit spread risk
Amount of risk in PLN '00	(23 253)	(5 858)	(1 509)	(15 886)	(22 298)	(3 993)	(198)	(18 107)

3.5. Currency risk

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

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

The following table presents exposures of the Bank to currency risk as at 31 December 2018 and 31 December 2017. The table presents assets and liabilities of the Bank according to balance sheet amount broken down by particular currencies of transactions.

for 2018 (in PLN thousand)

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

31.12.2017	PLN	EUR	USD	Total
Assets				
Cash and balances with the central bank	1 351	-	-	**1 351**
Amounts due from other banks	117	18 449	171	**18 737**
Derivative financial instruments	17 625	31 348	-	**48 973**
Loans and advances to customers	7 263 936	3 441 477	61 498	**10 766 911**
Investment securities available for sale	1 277 127	-	-	**1 277 127**
Intangible assets	25 527	-	-	**25 527**
Tangible fixed assets	8 295	-	-	**8 295**
Deferred income tax assets	10 572	-	-	**10 572**
Other assets	10 453	223	-	**10 676**
TOTAL ASSETS	**8 615 003**	**3 491 497**	**61 669**	**12 168 169**
Liabilities				
Amounts due to other banks	3 537 905	292 121	-	**3 830 026**
Derivative financial instruments	-	548	-	**548**
Amounts due to customers	2 441	1 557	133	**4 131**
Debt securities in issue	4 919 632	2 123 493	-	**7 043 125**
Subordinated liabilities	200 484	-	-	**200 484**
Current income tax liabilities	7 682	-	-	**7 682**
Other liabilities and provisions	25 767	5	-	**25 772**
TOTAL LIABILITIES	**8 693 911**	**2 417 724**	**133**	**11 111 768**
Net balance sheet position	**(78 908)**	**1 073 773**	**61 536**	**1 056 401**
Loan commitments	**1 194 709**	**366 816**	**-**	**1 561 525**

3.6. Interest rate risk

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

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

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

EaR (in PLN '000)	31.12.2018	31.12.2017
for items expressed in PLN	6 487	7 061
for items expressed in USD	2	8
for items expressed in EUR	705	99

When calculating those values it was assumed that the structure of assets and liabilities recognised in financial statements as at 31 December 2018 and as at 31 December 2017 will not change in the course of next year and that the Bank will not take any action in order to change exposure at risk.

Maintaining of interest rate risk level in 2018 on similar level as in 2017 is a result of current adjustment of revaluation terms of granted loans and corresponding financing sources. Additionally, the Bank concludes hedging transaction of IRS type in order to limit interest rate risk.

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

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

for 2018 (in PLN thousand)

31.12.2017	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Non-interest rate items	Total
Assets							
Cash and balances with the central bank	1 351	-	-	-	-	-	**1 351**
Amounts due from other banks	18 737	-	-	-	-	-	**18 737**
Derivative financial instruments	2 274	31 797	14 902	-	-	-	**48 973**
Loans and advances to customers	1 840 217	7 724 651	1 201 901	142			**10 766 911**
Investment securities available for sale	817 993	-	286 068	173 066	-	-	**1 277 127**
TOTAL ASSETS	**2 680 572**	**7 756 448**	**1 502 871**	**173 208**	**-**	**-**	**12 113 099**
Liabilities							
Amounts due to other banks	1 128 907	2 596 613	104 506	-	-	-	**3 830 026**
Derivative financial instruments	-	355	193	-	-	-	**548**
Amounts due to customers	-	-	-	-	-	4 131	**4 131**
Debt securities in issue	724 983	4 072 943	939 195	776 278	529 726	-	**7 043 125**
Subordinated liabilities	-	200 484	-	-	-	-	**200 484**
TOTAL LIABILITIES	**1 853 890**	**6 870 395**	**1 043 894**	**776 278**	**529 726**	**4 131**	**11 078 314**
Balance sheet gap	**826 682**	**886 053**	**458 977**	**(603 070)**	**(529 726)**	**(4 131)**	**1 034 785**

3.7. Liquidity risk

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

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

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

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

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

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

In 2018 and 2017, the Bank monitored all liquidity measures specified in the resolution of PFSA 386/2008 dated 17 December 2008:

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

The table below presents values of liquidity measures M1 - M4 and the LCR measure as at 31 December 2018 and their average, minimum and maximum values:

liquidity norm*	value as at 31.12.2018	average	minimum	maximum
M1	PLN 1 631 031 thousand	PLN 1 544 510 thousand	PLN 825 886 thousand	PLN 2 098 602 thousand
M2	3.507	3.105	1.557	5.778
M3	130.479	101.957	94.062	141.287
M4	1.067	1.078	1.045	1.170
LCR	1081%	1063%	567%	1812%

* M1 measure is given in thousand PLN; M2, M3 and M4 measures are relative measures expressed as decimal fraction

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

In 2018 the LCR measure remained on safe level.

The table below presents values of liquidity measures M1 - M4 as at 31 December 2017 and their average, minimum and maximum values:

liquidity norm*	value as at 31.12.2017	average	minimum	maximum
M1	PLN 1 482 059 thousand	PLN 1 380 805 thousand	PLN 708 421 thousand	PLN 2 173 949 thousand
M2	2.719	2.584	1.611	4.760
M3	94.223	89.389	80.422	94.392
M4	1.068	1.075	1.042	1.140
LCR	888%	533%	135%	1384%

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

In 2018 and 2017 no exceeding of liabilities limit and any form of liquidity took place.

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

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

for 2018 (in PLN thousand)

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

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

Liabilities (by contractual dates of maturity) as at 31 December 2017

	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Assets (by expected dates of maturity)						
Cash and balances with the central bank	1 351	-	-	-	-	1 351
Amounts due from other banks	18 825	-	-	-	-	18 825
Loans and advances to customers	72 154	151 090	693 050	3 856 204	9 974 339	14 746 837
Investment securities available for sale	259 654	-	302 240	647 987	102 715	1 312 596
Total assets	**351 984**	**151 090**	**995 290**	**4 504 191**	**10 077 054**	**16 079 609**
Planned payments of the off-balance sheet liabilities to grant loans or guarantees	**84**	**1 326**	**18 831**	**969 751**	**573 925**	**1 563 917**
Total asstes and off-balance sheet	**352 068**	**152 416**	**1 014 121**	**5 473 942**	**10 650 979**	**17 643 526**
Liabilities (by contractual dates of maturity)						
Amounts due to other bank	57 030	99 374	271 241	2 521 481	1 237 990	4 187 116
Amounts due to customers	4 131	-	-	-	-	4 131
Debt securities in issue	211 025	229 488	721 585	4 415 544	2 063 162	7 640 804
Subordinated liabilities	-	2 574	7 923	141 789	115 674	267 960
Total liabilities	**272 186**	**331 436**	**1 000 749**	**7 078 814**	**3 416 826**	**12 100 011**
Off-balance sheet liabilities to grant loans or guarantees	**409 692**	**184 855**	**519 199**	**450 171**	**-**	**1 563 917**
Total liabilites and off-balance sheet	**681 878**	**516 291**	**1 519 948**	**7 528 985**	**3 416 826**	**13 663 928**
Net liquidity gap	**(329 810)**	**(363 875)**	**(505 827)**	**(2 055 044)**	**7 234 153**	**3 979 598**

The amounts disclosed in maturity dates analysis are undiscounted contractual cash flows.

3.7.2. Cash flows from transactions in derivative financial instruments

Derivative financial instruments settled in net amounts

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

The following table presents derivative financial liabilities of the Bank which will be settled on the net basis, broken down by particular maturity dates as at balance sheet date. The amount in foreign currencies has been converted to PLN according to average exchange rate of

for 2018 (in PLN thousand)

NBP from balance sheet date. Amounts recognised in the table are not discounted contractual cash outflows.

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

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Derivative financial instruments to be settled on a net basis	within 1 month	from 1 to 3 months	from 3 months to 1 year	from 1 to 5 years	over 5 years	Total
Interest rates swaps (IRS)	-	3 127	6 691	14 199	(513)	**23 504**
Total net valuation	**-**	**3 127**	**6 691**	**14 199**	**(513)**	**23 504**

Derivative financial instruments settled in gross amounts

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

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

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

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Derivative financial instruments to be settled on a gross basis	within 1 month	from 1 to 3 months	from 3 months to 1 year	Total
Currency SWAP contracts:				
- outflows	155 060	755 686	252 339	**1 163 085**
- inflows	157 544	766 560	259 330	**1 183 434**

4. Fair value of financial assets and liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement assumes that the transaction of selling the asset or transferring a liability occurs either:

- on the main market of a given element of assets or liability,
- in the absence of a main market, for the most advantageous market for the asset or liability.

The main and the most advantageous markets must be both available to the Bank.

Following market practices the Bank values open positions in financial instruments using either the mark-to-market approach or is applying pricing models well established in market practice (mark-to- model method) which use as inputs market prices or market parameters, and in few cases parameters estimated internally by the Bank. All significant open positions in derivatives (currency or interest rates) are valued by marked-to-model using prices or parameters observable in the market.

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

The Bank assumed that the fair value of short-term financial liabilities (less than 1 year) is equal to the balance sheet values of such items.

In addition, the Bank assumes that the estimated fair value of financial assets and financial liabilities longer than 1 year is based on discounted cash flows using appropriate interest rates.

Loans and advances to banks

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

Receivables due to loans and advances granted to clients

The fair value for loans and advances to customers is disclosed as the present value of future cash flows using current interest rates including appropriate credit spreads and is based on the expected maturity of the respective loan agreements. The level of credit spread was determined based on market quotation of median credit spreads for Moody's rating grade. Attribution of a credit spread to a given credit exposure is based on a mapping between Moody's rating grade and internal rating grades of the Bank. To reflect the fact that the majority of the Bank's exposures is collateralised whereas the median of market quotation is centred around unsecured issues, the Bank applied appropriate adjustments.

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

Financial assets at fair value through other comprehensive income.

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

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

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

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

Financial instruments representing liabilities include the following:

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

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

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

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

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

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

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

Financial assets and liabilities	31.12.2018		31.12.2017	
	Carrying value	Fair value	Carrying value	Fair value
Aktywa finansowe wyceniane w zamortyzowanym koszcie				
Cash and balances with the central bank	**16 294**	**16 294**	**1 351**	**1 351**
Amounts due from other banks	**58 432**	**58 432**	**18 737**	**18 737**
Loans and advances to customers, including:	**10 930 534**	**11 373 116**	**10 766 911**	**11 198 379**
Individual customers	6 194 760	6 520 829	5 878 253	6 210 737
Corporate customers	4 592 460	4 705 467	4 750 821	4 845 883
Public sector customers	111 371	114 877	124 827	128 749
Other financial institutes	31 943	31 943	13 010	13 010
Total financial assets	**11 005 260**	**11 447 842**	**10 786 999**	**11 218 467**
Financial liabilities at amortised cost				
Amounts due to other banks	**3 179 878**	**3 179 878**	**3 830 026**	**3 830 026**
Amounts due to customers, including:	**3 099**	**3 099**	**4 131**	**4 131**
Corporate customers	2 918	2 918	3 950	3 950
Individual customers	138	138	145	145
Public sector customers	43	43	36	36
Debt securities in issue	**7 870 443**	**7 890 107**	**7 043 125**	**7 090 832**
Subordinated liabilities	**200 406**	**200 406**	**200 484**	**200 484**
Total financial liabilities	**11 253 826**	**11 273 490**	**11 077 766**	**11 125 473**

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

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

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

The tables below present the fair value hierarchy of financial assets and liabilities recognised in the statement of financial position of the Bank at their fair values as of 31 December 2017.

31.12.2017	including:	Level 1 Prices quoted in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS				
Investment securities available for sale, including:	**1 277 127**	**1 153 642**	**123 485**	**-**
- Treasury bonds	1 153 642	1 153 642	-	-
- Money bills	123 485	-	123 485	-
Derivative financial instruments, including:	**48 973**	**-**	**48 973**	**-**
- Interest-bearing instruments	33 326	-	33 326	-
- Foreign exchange instruments	15 647	-	15 647	-
TOTAL FINANCIAL ASSETS	**1 326 100**	**1 153 642**	**172 458**	**-**

31.12.2017	including:	Level 1 Prices quoted in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
FINANCIAL LIABILITIES				
Derivative financial instruments	**548**	**-**	**548**	**-**
- Interest-bearing instruments	548	-	548	-
- Foreign exchange instruments	-	-	-	-
TOTAL FINANCIAL LIABILITIES	**548**	**-**	**548**	**-**
RECURRING FAIR VALUE MEASUREMENTS				
TOTAL FINANCIAL ASSETS	**1 326 100**	**1 153 642**	**172 458**	**-**
TOTAL FINANCIAL LIABILITIES	**548**	**-**	**548**	**-**

With regard to financial instruments valuated in repetitive way to the fair value classified as level 1 and 2 in hierarchy of fair value, any cases in which transfer between these levels may occur, are monitored by appropriate department on the basis of internal rules.

In the reporting period, there were no changes in the classification of components of the statement of financial position with respect to fair value hierarchy.

5. Major estimates and assessments made in connection with the application of accounting principles

The Bank applies estimates and adopts assumptions which impact the values of assets and liabilities presented in the subsequent period. Estimates and assumptions, which are continuously subject to assessment, rely on historical experience and other factors, including expectations concerning future events, which seem justified under the given circumstances.

Impairment of loans and advances

The Bank reviews its loan portfolio in terms of possible impairments at least once per quarter. In order to establish whether the impairment should be reported in the income statement, the Bank assesses whether there are any evidence indicating possible to measure decrease of estimated future cash flows arising from granted loans and advances. If there is objective evidence of impairment of loan, the amount of impairment is calculated as a difference between balance sheet value for a given element of asset and current value of estimated future cash flows, discounted according to original effective interest rate of a given element of financial assets. If the current value of estimated cash flows for the portfolio of loans with recognized individual impairment changed by +/- 10%, as at 31 December 2018 the estimated amount of loan impairment would decrease by PLN 17 557 thousand or increase by PLN 21 540 thousand respectively (as at 31 December 2017, the amount of estimated cash flows would decrease by PLN 16,387 thousand or increase by PLN 17,408 thousand respectively). This estimate was made for a portfolio of loans in the case of which impairment is recognized on the basis of an individual analysis of future cash flows from recoveries from collateral (stage 3). The principles for measuring impairment are described in Note 2.8.

Impairment of non-financial assets - inventories

Impairment losses of acquired real estates are calculated in semi-annual and annual periods. Calculation of an impairment loss in comparison to sale prices of real estates (apartments) of comparable market in the last half-year/year to the purchase prices of concerned real estates (apartments). Loss on sale is an evidence for estimation of loss impairment of the value of unsold real estate properties for relevant location / relevant project.

Deferred tax assets

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

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

Phantom share-based benefits

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

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

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

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

As at 31 December 2018, the value of the provision for variable remuneration amounted to PLN 4 381 thousand; as at 31 December 2017, it amounted to PLN 4 329 thousand.

Fair value of derivatives and other financial instruments

The fair value of financial instruments not listed on active markets is determined by applying valuation techniques. All the models are approved prior to being applied and they are also calibrated in order to assure that the obtained results indeed reflect the actual data and comparable market prices. As far as possible, observable market data originating from an active market are used in the models. The methods used to determine the fair value of the financial instruments are described in the Note 4.

Classification for forbearance exposures

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

Lease classification

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

Significant modification

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

6. Operating segments

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

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

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

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

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

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

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

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

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

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

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

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

for 2018 (in PLN thousand)

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

Period from 01.01.2018 to 31.12.2018	Corporate Banking	Retail Banking	Treasure Segment	Total
Net interest income	**105 880**	**75 535**	**(5 138)**	**176 277**
Net fee and commission income	**2 497**	**(2 348)**	**(2 651)**	**(2 502)**
Other operating income/expenses	(208)	374	(289)	(123)
Net trading income	-	-	1 210	1 210
Result from non-substantial modificationj	(3 308)	(4)	-	(3 312)
Wynik z tytułu zaprzestania ujmowania instrumentów finansowych niewycenianych do wartości godziwej przez rachunek zysków i strat	1 475	3	149	1 627
Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss	(4 556)	-	-	(4 556)
Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss	(14 590)	(2 122)	-	(16 712)
Overhead costs	(26 622)	(24 607)	(8 620)	(59 849)
Depreciation	(1 718)	(1 719)	(361)	(3 798)
Tax on the Bank's balance sheet items	(13 391)	(14 177)	-	(27 568)
Segment result (gross)	**45 459**	**30 935**	**(15 700)**	**60 694**

Period from 01.01.2017 to 31.12.2017	Corporate Banking	Retail Banking	Treasure Segment	Total
Net interest income	**97 251**	**64 768**	**(6 010)**	**156 009**
Net fee and commission income	**1 655**	**(4 070)**	**(3 344)**	**(5 759)**
Other operating income/expenses	(264)	306	1	43
Net trading income	-	-	(3 385)	(3 385)
Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss	-	-	73	73
Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss	(17 302)	(2 923)	-	(20 225)
Overhead costs	(35 839)	(28 522)	-	(64 361)
Depreciation	(1 790)	(1 406)	-	(3 196)
Tax on the Bank's balance sheet items	(12 775)	(11 651)	-	(24 426)
Segment result (gross)	**30 936**	**16 502**	**(12 665)**	**34 773**

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

	Corporate Banking	
	31.12.2018	31.12.2017
Segment Assets	**4 928 865**	**4 900 195**
Segment Liabilities	**44 008**	**33 393**

	Retail Banking	
	31.12.2018	31.12.2017
Segment Assets	**6 177 906**	**5 853 706**
Segment Liabilities	**95**	**61**

	Treasure Segment	
	31.12.2018	31.12.2017
Segment Assets	**1 212 719**	**1 359 198**
Segment Liabilities	**11 255 858**	**11 078 314**

	31.12.2018	31.12.2017
Other assets not allocated to segments	**66 417**	**55 070**

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

for 2018 (in PLN thousand)

7. Net interest income

	Year ended 31 December	
	2018	**2017**
Interest income		
Interest income of financial assets at amortised cost, including:	**366 114**	***344 405***
- Loans and advances	365 460	*343 337*
- Cash and short-term placements	643	990
- Cash collateral	*11*	78
Interest income on financial assets at fair value through other comprehensive income	**21 698**	***21 168***
- Debt securities	21 698	*n/a*
Investment securities	*n/a*	*21 168*
Income similar to interest on financial assets at fair value through profit or loss, including:	***39 369***	*n/a*
Non-trading financial assets mandatorily measured at fair value through profit or loss, including:	8 456	***n/a***
- Loans and advances	8 456	*n/a*
Interest income on derivatives classified into banking book	12 329	15 328
Interest income on derivatives concluded under hedge accounting	18 584	9 173
Total interest income	**427 181**	**390 074**

Interest expense		
Financial liabilities valued at amortized cost, including:	(250 904)	(234 065)
-Due to the issue of debt securities	(158 481)	(143 761)
-Loans received	(79 807)	(76 201)
-Due to subordinated loan	(10 941)	(10 459)
-Other financial liabilities	(1 675)	(3 644)
Total interest expense	**(250 904)**	**(234 065)**

In 2018, interest income related to impaired financial assets measured at amortised cost, stood at PLN 8,603 thousand (for the period ended on 31 December 2017: PLN 7,729 thousand).

for 2018 (in PLN thousand)

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

	Year ended 31 December	
	2018	2017
Interest income		
From banking sector	23 096	26 473
From other entities, including:	404 085	363 601
- from corporate customers	172 046	156 667
- from individual customers	209 467	185 393
- from public sector	22 572	21 541
Total interest income	**427 181**	**390 074**

	Year ended 31 December	
	2018	2017
Interest expense		
From banking sector	(81 350)	(79 780)
From other entities, including:	(132)	(65)
- from corporate customers	(132)	(65)
From own issuances	(158 481)	(143 761)
Subordinated capital	(10 941)	(10 459)
Total interest expense	**(250 904)**	**(234 065)**

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

8. Net fee and commission income

	Year ended 31 December	
	2018	2017
Fee and commission income		
Credit-related fees and commissions	3 038	1 822
Total fee and commission income	**3 038**	**1 822**
Fee and commission expenses		
Cost of servicing loan products	(2 331)	(3 177)
Commission expense from loan received and stand-by credit line	(1 429)	(1 330)
Costs related to the debt securities issue program (covered bonds and bonds)	(1 116)	(1 899)
Costs of real estate analyses and valuations related to the lending activity	(405)	(369)
Commission for transfers for billing	(96)	(115)
Other	(163)	(691)
Total fee and commission expense	**(5 540)**	**(7 581)**
Total net fee and commission income	**(2 502)**	**(5 759)**

for 2018 (in PLN thousand)

9. Net trading income

	Year ended 31 December	
	2018	**2017**
Foreign exchange result	**2 286**	**(3 332)**
Net exchange differences on translation	19 975	(25 891)
Valuation of foreign currency derivatives	(17 689)	22 559
Other net trading income and result on hedge accounting	**(1 076)**	**(53)**
Interest rate risk instruments	916	1 263
Hedge accounting, including:	(1 992)	(1 316)
- net profit on hedged items	(33 740)	11 496
- net profit on hedging instruments	31 748	(12 812)
Total net trading income	**1 210**	**(3 385)**

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

The Bank applies fair value hedge accounting. The interest rate risk is the only type of risk hedged for which hedge accounting is applied. The result on hedged item and hedging instruments is presented in the Note 19. The hedge is assessed on an ongoing basis and determined to have been highly effective. The Bank documents its own assessment of the effectiveness of fair value hedging transactions, measured both prospectively and retrospectively from the time of their designation and throughout the period of duration of the hedging relationship between the hedging instrument and the hedged item.

10. Net income on modification

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

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

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

	Year ended 31 December	
	2018	**2017**
Result from non-substantial modification for financial assets at amortised cost	(3 313)	n/a
Result from non-substantial modification non-trading financial assets mandatorily at fair value through profit or loss	1	*n/a*
Result from non-substantial modification	**(3 312)**	***n/a***

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

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

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

for 2018 (in PLN thousand)

	Year ended 31 December	
	2018	2017
Result on sales financial assets at fair value through other comprehensive income	149	73
Result from significant modification for financial assets at amortised cost	1 478	*n/a*
Gains or losses on derecognition of financial instruments not measured at fair value through profit or loss	**1 627**	**73**

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

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

	Year ended 31 December	
	2018	2017
Loans and advances	(4 556)	*n/a*
- Corporate customers	(4 556)	*n/a*
Gains or losses from non-trading financial assets mandatorily at fair value through profit or loss	**(4 556)**	***n/a***

13. Other operating income

	Year ended 31 December	
	2018	2017
Income from release of prior year provisions	587	225
Income from sales of services	514	613
Income from sales of inventories	55	-
Income from recovering receivables designated previously as prescribed, remitted or uncollectible	17	23
Reversal of impairment write-downs on receivables (excluding loans)	-	7
Other	29	264
Total other operating income	**1 202**	**1 132**

The income from the sale of inventories of PLN 55 thousand consists of the selling price of PLN 3,050 thousand and (2,995) on write-down of the amount receivable from inventories.

for 2018 (in PLN thousand)

14. General administrative expenses

	Year ended 31 December	
	2018	**2017**
Staff-related costs	(30 448)	(34 009)
Material costs, including:	(22 410)	(23 306)
- logistic cost	(9 198)	(8 997)
- IT cost	(7 402)	(6 789)
- marketing cost	(3 550)	(4 423)
- consulting services cost	(1 685)	(2 437)
- other overheads cost	(575)	(660)
Contributions and transfers to the Bank Guarantee Fund	(5 274)	(5 152)
Taxes and fees	(1 508)	(1 643)
Contributions to the Social Benefits Fund	(209)	(251)
Total overhead costs	**(59 849)**	**(64 361)**

The item Logistics Costs includes costs of real property rental and costs of leasing means of transport of PLN 4,033 thousand (2017: PLN 4,003 thousand).

Staff-related expenses

	Year ended 31 December	
	2018	**2017**
Wages and salaries	(24 990)	(27 400)
Social security expenses	(3 748)	(4 395)
Costs of retirement benefits	(15)	(12)
Provision for unused holidays	(249)	(22)
Remuneration payment in the form of phantom shares settled in cash	(479)	(1 003)
Other employee benefits	(967)	(1 177)
Staff-related costs, total	**(30 448)**	**(34 009)**

In the first half of June 2018 an inspection by Social Insurance Institution (ZUS) started at the Bank for 2015, 2016 and 2017, with respect to:

- accuracy and fairness of the calculation of social insurance premiums and other premiums ZUS is obliged to collect, as well as that of registration for social insurance purposes, and
- of the determination of social insurance entitlements and disbursement of social insurance benefits,
- accuracy and timeliness of preparing applications for retirement and disability benefits,
- and of issuing certificates or reporting data for social insurance purposes.

On 31 July 2018, the Bank received a report of the inspection conducted. The report contains no recommendations and reservations.

for 2018 (in PLN thousand)

15. Other operating expenses

	Year ended 31 December	
	2018	2017
Inventory write-downs	(437)	-
Costs of enforcement proceedings	(330)	(515)
Provision for disputes	(88)	-
Writing down investments	(43)	(308)
Compensations, penalties and fines paid	(29)	(3)
Donations	(16)	(4)
Loss on sales or liquidation of tangible fixed assets and intangible assets	(1)	(152)
Other	(381)	(107)
Total other operating expenses	**(1 325)**	**(1 089)**

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

	Year ended 31 December	
	2018	2017
Financial assets at amortised cost, including:	**(17 829)**	**(20 218)**
- Loans and advances	**(17 829)**	**(20 218)**
Stage 1	(2 267)	*n/a*
Stage 2	2 332	*n/a*
Stage 3	(18 306)	*n/a*
POCI	412	*n/a*
Commitments and guarantees given	**1 117**	**(7)**
Stage 1	447	*n/a*
Stage 2	670	*n/a*
Stage 3	-	*n/a*
POCI	-	*n/a*
Net impairment losses on financial assets not measured at fair value through profit or loss	**(16 712)**	**(20 225)**

for 2018 (in PLN thousand)

17. Income tax

	Year ended 31 December	
	2018	**2017**
Current income tax	(16 869)	(10 032)
Deferred income tax (Note 29)	(2 588)	3 088
Total income tax	**(19 457)**	**(6 944)**

Profit before tax	**60 694**	**34 773**
Income tax calculated at the rate applicable in a given fiscal year (19%)	(11 532)	(6 607)
Non-taxable income	1	7 422
- reclassification of qualified income to impairment interest (change in PAS reporting regulations)	-	6 353
- unrecoverable receivables write-off	-	498
- loan loss provisions from prior year recognised as tax assets	-	476
- other non-taxable income	1	95
Non-deductible tax costs, including:	(8 082)	(8 481)
- tax on the Bank's balance sheet items	(5 238)	(4 643)
- value of write-downs on receivables	(1 665)	(2 726)
- contribution and payments to the Bank Guarantee Fund	(1 002)	(979)
- other	(177)	(133)
Adjustments in respect of current tax from prior years	717	722
Other permanent differences	(561)	-
Total income tax expense	**(19 457)**	**(6 944)**

Effective tax rate calculation		
Profit before income tax	60 694	34 773
Income tax	(19 457)	(6 944)
Effective tax rate	**32.06%**	**19.97%**
Nominal tax rate	**19.00%**	**19.00%**

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

18. Profit per share

	Year ended 31 December	
	2018	**2017**
Basic:		
Net profit from activities attributable to shareholders of mBank Hipoteczny S.A.	41 237	27 829
Weighted average number of ordinary shares	3 210 000	3 191 260
Basic net profit per share (in PLN per share)	**12.85**	**8.72**
Diluted:		
Net profit attributable to shareholders of mBank Hipoteczny S.A., applied during the estimation of diluted earnings per share	41 237	27 829
Weighted average number of ordinary shares	3 210 000	3 191 260
Diluted net profit per share (in PLN per share)	**12.85**	**8.72**

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

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

for 2018 (in PLN thousand)

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

19. Other comprehensive income

Presented below is detailed information on other net comprehensive income for 2018 and 2017

	Year ended 31 December	
	2018	**2017**
Items that may be reclassified to the income statement, including:	**1 678**	**4 966**
Change in valuation of available for sale financial assets (net)	*nd*	4 966
Change in the valuation of debt financial instruments valued at fair value through other comprehensive income (net)	1 678	*nd*
Items that will not be reclassified to the income statement, including:	**2**	**(20)**
Actuarial gains and losses on post-employment benefits	2	(20)
Total other comprehensive income, net	**1 680**	**4 946**

20. Cash and balances with the central bank

As at 31 December 2018, the Bank has a current account with the National Bank of Poland, with a balance amounting to PLN 93 thousand and an O/N deposit of PLN 16,200 thousand. As at 31 December 2017, the Bank maintained PLN 1,351 thousand in the current account.

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

- PLN 0 thousand for the period from 31 December 2018 to 30 January 2019,
- PLN 0 thousand in the period from 30 November 2017 to 1 January 2018.

As at 31 December 2018, the interest rate on the cash maintained as a mandatory reserve was 0.50%, as compared to 1.35% as at 31 December 2017.

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

The Bank has the following derivative instruments in its portfolio:

- Interest rate risk instruments: Interest Rate Swap (IRS),
- Currency risk instruments: FX SWAP contracts.

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

for 2018 (in PLN thousand)

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

Except of valuation of derivatives, the netting effect includes PLN 24,902 thousand of collaterals received in connection with the derivative transactions subject to netting.

	Nominal amount		Fair value	
	purchase	disposal	assets	liabilities
As at 31 December 2017				
Derivative financial instruments held for trading				
Foreign exchange derivatives	11 265	11 263	3	-
- FX swap contracts	1 183 434	1 163 085	15 644	-
Total OTC derivatives	**1 194 699**	**1 174 348**	**15 647**	**-**
Total foreign exchange derivatives	**1 194 699**	**1 174 348**	**15 647**	**-**
Interest rate derivatives				
- IRS contracts	150 000	150 000	1 979	-
Total OTC interest rate derivatives	**150 000**	**150 000**	**1 979**	**-**
Total interest rate derivatives	**150 000**	**150 000**	**1 979**	**-**
Total assets / liabilities held for trading	**1 344 699**	**1 324 348**	**17 626**	**-**
Derivatives held for hedging				
Derivatives designated as fair value hedges	1 238 340	1 238 340	31 950	10 438
- IRS contracts	1 238 340	1 238 340	31 950	10 438
Total derivatives held for hedging	**1 238 340**	**1 238 340**	**31 950**	**10 438**
Total recognised derivative assets /liabilities	**2 583 039**	**2 562 688**	**49 576**	**10 438**
Net-off effect	**-**	**-**	**(603)**	**(9 890)**
Total recognised derivative assets /liabilities held for trading	**2 583 039**	**2 562 688**	**48 973**	**548**
Short-term (up to 1 year)	1 278 117	1 257 766	16 088	-
Long-term (over 1 year)	1 304 922	1 304 922	32 885	548

Except of valuation of derivatives, the netting effect includes PLN 9,287 thousand of collaterals placed in connection with the derivative transactions subject to netting.

Hedge accounting

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

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

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

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

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

Fair value hedge accounting

The Bank applies fair value hedge accounting. The interest rate risk is the only type of risk hedged for which hedge accounting is applied. The result on hedged items and hedging instruments is presented in the following tables. The hedge is assessed on an ongoing basis and determined to have been highly effective. The Bank documents its own assessment of the effectiveness of fair value hedging transactions, measured both prospectively and retrospectively from the time of their designation and throughout the period of duration of the hedging relationship between the hedging instrument and the hedged item.

Description of the hedging relationship

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

Hedged items

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

Hedging instruments

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

Presentation of the result from hedged and hedging transactions

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

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

As at 31.12.2018

Debt financial instruments by type	Nominal value	Interest rate as at 31.12.2018	Redemption date	Liability amount measured at amortised cost	Hedge accounting adjustments related to fair value of hedged items	Carrying amount of liability	Change of fair value due to hedge acounting
Mortgage covered bonds (EUR)	30 000	2,75%	2020-07-28	129 886	2 541	132 427	1 015
Mortgage covered bonds (EUR)	8 000	3,50%	2029-02-28	34 879	4 292	39 171	(352)
Mortgage covered bonds (EUR)	15 000	3,50%	2029-03-15	65 423	8 081	73 504	(665)
Mortgage covered bonds (EUR)	20 000	3,20%	2029-05-30	86 367	10 640	97 008	(924)
Mortgage covered bonds (EUR)	20 000	1,135%	2022-02-25	86 402	1 441	87 843	(445)
Mortgage covered bonds (EUR)	11 000	1,285%	2025-04-24	47 459	282	47 742	(691)
Mortgage covered bonds (EUR)	35 000	1,183%	2026-09-20	150 513	(2 695)	147 818	(2 311)
Mortgage covered bonds (EUR)	13 000	1,180%	2026-09-20	55 887	(1 561)	54 326	(907)
Mortgage covered bonds (EUR)	24 900	0,94%	2024-02-01	107 757	1 416	109 172	(1 277)
Mortgage covered bonds (EUR)	100 000	0,61%	2022-06-22	430 591	3 336	433 927	(3 781)
Mortgage covered bonds (EUR)	300 000	1,073%	2025-03-05	1 295 900	23 775	1 319 676	(23 775)
Total hedged items				**2 491 064**	**51 549**	**2 542 613**	**(34 113)**

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

The change of fair value resulting from hedge accounting for the transaction ended as at 31 December 2018 is PLN 373 thousand.

The following table presents hedged items as at 31 December 2017. In the following table, the nominal value is presented in EUR thousands, while the value of liability measured at amortised cost, hedge accounting adjustments related to fair value, carrying amount of a liability and the change of fair value resulting from hedge accounting, in PLN thousands.

As at 31.12.2017

Debt financial instruments by type	Nominal value	Interest rate as at 31.12.2017	Redemption date	Liability amount measured at amortised cost	Hedge accounting adjustments related to fair value of hedged items	Carrying amount of liability	Change of fair value due to hedge acounting
Mortgage covered bonds (EUR)	30 000	2,75%	2020-07-28	125 615	3 556	129 171	1 664
Mortgage covered bonds (EUR)	8 000	3,50%	2029-02-28	33 773	3 940	37 713	1 118
Mortgage covered bonds (EUR)	15 000	3,50%	2029-03-15	63 363	7 416	70 779	2 100
Mortgage covered bonds (EUR)	20 000	3,20%	2029-05-30	83 638	9 716	93 354	2 737
Mortgage covered bonds (EUR)	20 000	1,115%	2018-10-22	83 503	374	83 877	358
Mortgage covered bonds (EUR)	20 000	1,135%	2022-02-25	83 663	996	84 659	754
Mortgage covered bonds (EUR)	11 000	1,285%	2025-04-24	45 988	(409)	45 579	411
Mortgage covered bonds (EUR)	35 000	1,183%	2026-09-20	145 920	(5 006)	140 914	1 566
Mortgage covered bonds (EUR)	13 000	1,18%	2026-09-20	54 179	(2 468)	51 711	482
Mortgage covered bonds (EUR)	24 900	0,94%	2024-02-01	104 470	139	104 609	(139)
Mortgage covered bonds (EUR)	100 000	0,612%	2022-06-22	416 505	(445)	416 060	445
Total hedged items				**1 240 617**	**17 809**	**1 258 426**	**11 496**

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

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

As at 31.12.2018

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

The change in the fair value due to hedge accounting for the transaction ended as at 31 December 2018 is PLN (353) thousand.

The following table presents hedged items as at 31 December 2017. In the following table, the nominal value is presented in EUR thousands, while the fair value and the change of fair value resulting from hedge accounting, in PLN thousands.

As at 31.12.2017

Derivatives	Nominal value	End of transaction	Fair value of asset	Fair value of liabilities	Change of fair value due to hedge acounting
IRS (EUR)	30 000	2020-07-28	6 074	-	(2 415)
IRS (EUR)	8 000	2029-02-28	5 114	-	(1 298)
IRS (EUR)	15 000	2029-03-15	9 325	-	(2 399)
IRS (EUR)	20 000	2029-05-30	9 372	-	(2 809)
IRS (EUR)	20 000	2018-10-22	441	-	(324)
IRS (EUR)	20 000	2022-02-25	1 021	-	(565)
IRS (EUR)	11 000	2025-04-24	-	(421)	(336)
IRS (EUR)	13 000	2026-09-20	-	(2 690)	(421)
IRS (EUR)	35 000	2026-09-20	-	(5 653)	(1 433)
IRS (EUR)	24 900	2024-02-01	603	-	148
IRS (EUR)	100 000	2022-06-22	-	(1 674)	(960)
Total hedging items			**31 950**	**(10 438)**	**(12 812)**

Total result on fair value hedge accounting recognised in the income statement in 2018 and 2017

	Year ended 31 December	
	2018	**2017**
Interest income on derivatives as part of fair value hedge accounting	18 584	9 173
Result from the valuation of the hedged	(33 740)	11 496
Result on the valuation of hedging instruments	31 748	(12 812)
Total result on fair value hedge accounting	**16 592**	**7 857**

for 2018 (in PLN thousand)

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

	31.12.2018	31.12.2017
Loans and advances	**208 181**	***n/a***
- Corporate customers	208 181	*n/a*
Total non-trading financial assets mandatorily at fair value through profit or loss	**208 181**	***n/a***

Credit quality of non-trading financial assets mandatorily at fair value through profit or loss according to internal rating system

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

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

31.12.2018	Carrying value
Debt securities	1 069 392
- Central banks	89 989
- General governments, including::	979 403
pledged securities	1 047
Total financial assets at fair value through comprehensive income	**1 069 392**
Short-term (up to 1 year)	377 879
Long-term (over 1 year)	691 513
Based on fixed interest rate	483 725
Based on floating interest rate	585 667

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

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

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

Credit quality of financial assets measured at fair value through other comprehensive income broken down by internal rating system levels

Both as at 31 December 2018 and as at 31 December 2017, debt instruments had a rating of AAA on the scale of Standard & Poor's (S&P) rating agency.

for 2018 (in PLN thousand)

The note below presents the carrying value of investment securities according to IAS 39 as at 31 December 2017.

31.12.2017	Investment securities without pledge	Pledged investment securities	Total investment securities
Debt securities:	**1 095 780**	**181 347**	**1 277 127**
Issued by government	972 295	181 347	1 153 642
- government bond	972 295	181 347	1 153 642
Issued by central bank	123 485	-	123 485
- central bank's money bills	123 485	-	123 485
Total debt securities	**1 095 780**	**181 347**	**1 277 127**
Short-term (up to 1 year)	541 596	1 033	542 629
Long-term (over 1 year)	554 184	180 314	734 498
Based on fixed interest rate	591 251	-	591 251
Based on floating interest rate	504 529	181 347	685 876

Pledged assets are not subject to resale or further pledging.

Movements in the balance of investment securities

	31.12.2017
As at the beginning of the period	**1 134 049**
Additions	10 486 331
Disposals (sale, redemption and forfeiture)	(10 349 384)
Gains / losses from changes in fair value	6 131
As at the end of the period	**1 277 127**

24. Financial assets measured at amortised cost

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

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

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

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

The gross carrying amount of the portfolio of retail loans acquired as part of cooperation with mBank S.A, as at 31 December 2018, was PLN 6,170,484 thousand, including as part of agency sales PLN 4 613 484 thousand and w as par of retail pooling PLN 1 557 000 thousand.

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

for 2018 (in PLN thousand)

Credit quality of financial assets measured at amortised cost measurement and financial assets not held for trading mandatorily measured at fair value through financial income broken down by rating

	score from internal models		31.12.2018
	[SCOREmin	SCOREmax)	
Exposures permanently exempted from the IRB approach	no rating	no rating	253 262
Exposures temporarily exempted from the IRB approach — retail portfolio acquired in cooperation with mBank S.A.	-	-	6 157 763
Exposures subject to the IRB approach — specialised lending, including	-	-	4 519 509
- supervisory category 1	45	54	5 931
- supervisory category 2	23	45	4 166 253
- supervisory category 3	11	23	115 983
- supervisory category 4	1	11	17 299
- supervisory category 5	default	default	214 043
Total			**10 930 534**

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

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

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

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

for 2018 (in PLN thousand)

Movements in the balance of loss allowances and provisions

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

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

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

Financial effect of collaterals

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

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

for 2018 (in PLN thousand)

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

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

The notes below present the loans and advances to banks, and loans and advances to customers according to IAS 39 as at 31 December 2017.

Loans and advances to banks

	31.12.2017
Current accounts	18 737
Included in cash equivalents	**18 737**
Claims (gross) on banks, total	**18 737**
Claims (net) on banks, total	**18 737**

Claims on banks short-term (up to 1 year)	18 737

Loans and advances to customers

	31.12.2017
Loans and advances to corporate customers	**4 857 610**
Loans and advances to individual customers	**5 885 170**
Loans and advances to the public sector	**124 865**
Other receivables	**13 010**
Loans and advances from customers (gross)	**10 880 655**
Write-downs on receivables (negative amount)	(113 744)
Loans and advances from customers (net)	**10 766 911**

Short-term (up to 1 year)	708 128
Long-term (over 1 year)	10 058 783

As at 31 December 2017, the gross value of loans to corporate customers, individual customers and the public sector in the Bank's loan portfolio, carrying floating interest rates, amounted to PLN 10,867,627 thousand, and the gross value of loans carrying fixed-to-floating interest rates amounted to PLN 18 thousand.

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

The gross carrying amount of the portfolio of retail loans acquired as part of cooperation with mBank S.A, as at 31 December 2017, was PLN 5,834,971 thousand, including as part of agency sales PLN 4,768,415 thousand and as part of retail pooling PLN 1,066,556 thousand.

The gross carrying amount of the portfolio of commercial loans transferred as part of commercial pooling from mBank S.A, as at 31 December 2018, was PLN 392,058 thousand.

Impairment write-downs on loans and advances

	31.12.2017
Incurred but not identified losses	
Gross balance sheet exposure	10 599 531
Impairment write-downs on exposures analysed on a portfolio basis	(12 521)
Net balance sheet exposure	**10 587 010**
Impaired receivables	
Loans to corporate customers	270 587
Loans to individual customers	10 537
Total gross balance sheet exposure	**281 124**
Impairment write-down on impaired exposures	(101 223)
Net balance sheet exposure	**179 901**

Movements in impairment write-downs on loans and advances

	Impairment write-downe as at 01.01.2017	Write-downs created	Reversal of write-downs	Receivables written-off	Impairment write-downs 31.12.2017
Corporate customers	(97 309)	(31 584)	14 277	7 827	(106 789)
Individual customers	(4 002)	(8 115)	5 200	-	(6 917)
Public sector customers	(42)	-	4	-	(38)
Total movements in impairment write-downs on loans and advances	(101 353)	(39 699)	19 481	7 827	(113 744)

Loans and advances granted to customers, broken down by portfolio quality

Loans and advances to customers	31.12.2017	
	exposure (PLN '000)	share/coverage (%)
Not overdue, without impairment recognised	10 282 981	94,51
Overdue, without impairment recognised	316 550	2,91
Items with impairment recognised	281 124	2,58
Total gross	**10 880 655**	**100,00**
Impairment write-down on loans not overdue, without impairment recognised	(11 462)	0,11
Impairment write-down on loans overdue, without impairment recognised	(1 059)	0,01
Impairment write-down on loans with impairment recognised	(101 223)	0,93
Total impairment write-down	**(113 744)**	**1,05**
Total net	**10 766 911**	**98,95**

Loans and advances neither past due nor impaired

Gross amounts of loans and advances neither past due nor impaired, broken down by rating score, are presented below according to the rating as at 31 December 2017.

for 2018 (in PLN thousand)

	score from internal models		31.12.2017
	[SCOREmin	SCOREmax)	
Exposures permanently exempted from the IRB approach	no rating	no rating	292 053
Exposures temporarily exempted from the IRB approach — retail portfolio acquired in cooperation with mBank S.A.	-	-	5 748 533
Exposures subject to the IRB approach — specialised lending, including	-	-	4 242 395
- supervisory category 1	45	54	2 666
- supervisory category 2	23	45	4 031 208
- supervisory category 3	11	23	191 068
- supervisory category 4	1	11	-
- supervisory category 5	default	default	17 453
Total			**10 282 981**

Gross amounts of loans and advances neither past due nor impaired, broken down by customer category, are presented below.

	31.12.2017
Corporate customers	4 355 114
Individual customers	5 790 936
Public sector customers	123 921
Other receivables	13 010
Total	**10 282 981**

Evaluation of the credit quality of loans and advances neither past due nor impaired

	31.12.2017
Loans and advances with limited credit risk	213 513
Loans and advances with standard credit risk	10 049 699
Loans and advances with increased credit risk	19 769
Total	**10 282 981**

The portfolio of loans and advances with limited credit risk includes loans and advances granted to customers from the public sector and to corporate customers, with a guarantee or a pledge from a local government unit constituting the basic legal security. In addition, the Bank includes in this category receivables from derivative hedging instruments deposited at the clearing house and cleared through CCP. The portfolio of loans and advances with standard credit risk includes loans and advances granted to individuals and corporate customers, with mortgage set up on real estate constituting the basic collateral, and in their case there is no evidence of impairment.

The portfolio of loans and advances with increased credit risk includes loans and advances granted to corporate customers in the case of which there was evidence of impairment but impairment did not occur due to the expected full recovery of the credit exposures.

Overdue loans and advances without impairment recognised

Overdue exposures are exposures to customers or banks for which at least one receivable is overdue by one or more days. In the case of the portfolio granted in cooperation with mBank S.A., overdue exposure means exposure associated with delayed contracts (by one day or more). For loans and advances overdue by less than 90 days, no impairment is recognised, unless other available information shows that impairment has taken place. In rare cases, for loans and advances overdue by more than 90 days, the Bank may decide not to recognise impairment if there is specific evidence that the said loans and advances have not been impaired.

Gross amounts of loans and advances which were overdue but not recognised as impaired, broken down by customer category, are presented below:

for 2018 (in PLN thousand)

Overdue loans and advances without impairment recognised (31.12.2017)	Corporate customers	Individual customers	Public sector customers	Total customers
up to 30 days	206 479	72 725	-	279 204
from 31 to 60 days	4 236	7 471	-	11 707
from 61 to 90 days	20 197	3 359	-	23 556
more than 90 days	997	142	944	2 083
Razem	**231 909**	**83 697**	**944**	**316 550**

Loans and advances with impairment recognised

Gross amounts of loans and advances with impairment recognised (before taking account of cash flows in respect of the collateral held), broken down by asset category, are presented below.

Overdue loans and advances without impairment recognised (31.12.2017)	Corporate customers	Individual customers	Public sector customers
Impaired loans and advances (gross amount)	270 587	10 537	281 124
Estimated recovery from contributions and collaterals	**174 075**	**6 072**	**180 147**
Impairment write-downs	**(96 758)**	**(4 465)**	**(101 223)**
The mortgage lending value of the property constituting collateral for loans	**381 436**	**20 954**	**402 390**

In item "Bank mortgage value of the real estate constituting collateral for loans", the Bank showed the present value of the collateral accepted, not adjusted to the decreasing value of the credit exposure. The bank and mortgage value of real estate constituting collateral for the loans granted by the Bank exceeds the value of the exposure. Therefore, in the event of any additional amounts due from exposure, e.g. additional enforcement costs, etc., the Bank will be able to satisfy its claims.

The bank and mortgage value of real estate is established for the purposes of the Bank and, in the Bank's opinion, reflects the level of the risk related to the real estate as a collateral for the loans granted. The bank and mortgage value of real estate takes particular account of only those characteristics of the real estate and the related revenues that, with the assumption of the rational use, are of permanent nature and may be obtained by any of the real estate holders.

Financial effect of collaterals

The note below presents the impact of the value of collaterals accepted by the Bank in relation to loans and advances granted by the Bank on the level of write-downs.

As at 31 December 2017	Gross amount	Established impairment write-downs	Impairment write-downs without the collateral cash flows	Financial effect of collaterals
Balance sheet data				
Amounts due from other banks	**18 737**	**-**	**-**	**-**
Loans and advances to customers, including:	**10 880 655**	**(113 744)**	**(252 690)**	**138 946**
Corporate customers	4 857 610	(106 789)	(236 432)	129 643
Individual customers	5 885 170	(6 917)	(16 220)	9 303
Public sector customers	124 865	(38)	(38)	-
Other receivables	13 010	-	-	-
Total balance sheet data	**10 899 392**	**(113 744)**	**(252 690)**	**138 946**
Off-balance sheet data				
Loan commitments	1 561 525	(61)	(73)	12
Total off-balance sheet data	**1 561 525**	**(61)**	**(73)**	**12**

for 2018 (in PLN thousand)

25. Intangible assets

	31.12.2018	31.12.2017
Concessions, patents, licences and similar assets, including:	8 670	5 882
- computer software	8 670	5 882
Intangible assets under development	31 351	19 645
Intangible assets, total	**40 021**	**25 527**

for 2018 (in PLN thousand)

Movements in intangible assets

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

Movements in the period from 01.01.2017 to 31.12.2017	Acquired computer software	Intangible assets under development	Total
Gross value of intangible assets as at the beginning of the period: 01.01.2017	**16 739**	**8 515**	**25 254**
Increase (due to)	**2 304**	**12 966**	**15 270**
- purchase	796	12 966	13 762
- transfer from intangible assets under development	1 508	-	1 508
Decrease (due to)	**-**	**(1 836)**	**(1 836)**
- transfer from intangible assets under development	-	(1 508)	(1 508)
- other decreases	-	(328)	(328)
Gross value of intangible assets as at the end of the period 31.12.2017	**19 043**	**19 645**	**38 688**
Accumulated amortisation as at the beginning of the period: 01.01.2017	**(11 897)**	**-**	**(11 897)**
Amortisation for the period (due to):	**(1 264)**	**-**	**(1 264)**
- amortisation	(1 264)	-	(1 264)
Accumulated amortisation as at the end of the period : 31.12.2017	**(13 161)**	**-**	**(13 161)**
Net value of intangible assets as at the end of the period: 31.12.2017	**5 882**	**19 645**	**25 527**

26. Property, plant and equipment

	31.12.2018	31.12.2017
Technical equipment and machinery	6 002	5 714
Vehicles	8	8
Fixed assets under construction	720	501
Other fixed assets	1 948	2 072
Tangible fixed assets, total	**8 678**	**8 295**

for 2018 (in PLN thousand)

Movements in tangible fixed assets

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

Movements in the period from 01.01.2017 to 31.12.2017	Equipment	Vehicles	Other fixed assets	Fixed assets under construction	Total
Gross value of tangible fixed assets as at the beginning of the period: 01.01.2017	**19 191**	**774**	**5 554**	**679**	**26 198**
Increase (due to)	**1 619**	**-**	**1 359**	**966**	**3 944**
- purchase	1 619	-	215	966	2 800
- transfer from tangible assets under construction	-	-	1 144	-	1 144
Decrease (due to)	**(330)**	**(698)**	**(132)**	**(1 144)**	**(2 304)**
- sale	-	(698)	-	-	(698)
- liquidation	(330)	-	(132)	-	(462)
- transfer from tangible assets under construction	-	-	-	(1 144)	(1 144)
Gross value of tangible fixed assets as at the end of the period: 31.12.2017	**20 480**	**76**	**6 781**	**501**	**27 838**
Accumulated amortisation as at the beginning of the period: 01.01.2017	**(13 538)**	**(658)**	**(4 399)**	**-**	**(18 595)**
Amortisation for the period (due to):	**(1 228)**	**590**	**(310)**	**-**	**(948)**
- amortisation	(1 506)	(18)	(408)	-	(1 932)
- sale	-	608	17	-	625
- liquidation	278	-	81	-	359
Accumulated amortisation as at the end of the period: 31.12.2017	**(14 766)**	**(68)**	**(4 709)**	**-**	**(19 543)**
Impairment charge as at the beginning of the period: 01.01.2017	**-**	**-**	**-**	**-**	**-**
- decrease	-	-	-	-	-
Impairment charge as at the end of the period: 31.12.2017	**-**	**-**	**-**	**-**	**-**
Net value of tangible fixed assets as at the end of the period: 31.12.2017	**5 714**	**8**	**2 072**	**501**	**8 295**

for 2018 (in PLN thousand)

27. Other assets

	31.12.2018	31.12.2017
Other, including:	**5 132**	**10 676**
- inventories	-	3 432
- other prepayments	2 597	3 150
- receivables from the portfolio of retail loans acquired as part of cooperation with mBank S.A.	1 733	3 210
- income receivable	246	410
- debtors	535	448
- other	21	26
Total other assets	**5 132**	**10 676**
Short-term (up to 1 year)	5 132	10 676

Inventories as at 31 December 2017 include repossessed assets which were sold in 2018. Detailed information is presented in note 3.1.3.

28. Financial liabilities measured at amortised cost

Amounts due to other banks

	31.12.2018	31.12.2017
Loans received	3 036 313	3 779 572
Liabilities in respect of cash collateral	30 032	50 454
Other financial liabilities with deferred payment term	113 533	-
Total amounts due to other banks	**3 179 878**	**3 830 026**
Short-term (up to 1 year)	210 537	350 931
Long-term (over 1 year)	2 969 341	3 479 095

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

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

All loans received were based on floating interest rates.

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

for 2018 (in PLN thousand)

Amounts due to customers

	31.12.2018	31.12.2017
Corporate customers:	**2 918**	**3 950**
Other liabilities (in respect of):	2 918	3 950
- cash collateral	449	446
- other	2 469	3 504
Individual customers:	**138**	**145**
Other liabilities (in respect of):	138	145
- cash collateral	49	65
- other	89	80
Public sector clients:	**43**	**36**
Other liabilities (in respect of):	43	36
- other	43	36
Total amounts due to customers	**3 099**	**4 131**

Short-term (up to 1 year)	2 677	3 696
Long-term (over 1 year)	422	435

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

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

Liabilities from debt securities in issue

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

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

Rules of admissible amount of the Substitute Collateral

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

Rules of statutory overcollateralisation for covered bonds

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

for 2018 (in PLN thousand)

Rules of loan refinancing from funds obtained from the issue of covered bonds

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

The tables below present data related to the issue of covered bonds as at 31 December 2018 and as at 31 December 2017.

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

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

Data as at 31.12.2017	Mortgage covered bonds
1. Nominal value of covered bonds listed on the market	6 438 802
2. The nominal value of receivables entered in the collateral register of covered bonds underlying the issue of covered bonds (value on not matured capital)	8 591 745
3. Cash in Bank, as a treasury bonds, entered in the collateral register of covered bonds additionaly underlying the issue of covered bonds (Substitute collateral)	106 620
4. Level of collateral the covered bonds by receivables (2/1)	133,44%
5. Total covered bonds collateral level (2+3) / 1	135,09%
6. The value of receivables as collateral issue of mortgage covered bonds to the part which not exceeding 60% of the mortgage lending value of real estate for commercial real estate	3 355 035
7. The value of receivables as collateral issue of mortgage covered bonds to the part which not exceeding 80% of the mortgage lending value of real estate for residential property	4 385 960

Permissible value of Substitute collateral as at 31.12.2017	Mortgage covered bonds
1. Cash invested in treasury bonds	180 000
2. Interests from covered bonds on the market which will be paid in the next 6 months (Surplus)	73 380
3. Permissible value of Substitute collateral (1-2)	106 620

The total nominal value of covered bonds currently traded on, both as at 31 December 2018 and as at 31 December 2017 was listed on two markets as part of CATALYST: regulated market operated by BondSpot S.A. and regulated parallel market operated by Warsaw Stock Exchange.

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

for 2018 (in PLN thousand)

As at 31.12.2018

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

for 2018 (in PLN thousand)

As at 31.12.2017

Debt financial instruments by type	Nominal value	Interest rate as at 31.12.2017	Guarantee / collateral	Redemption date	Liability amount measured at amortised cost	Hedge accounting adjustments related to fair value of hedged items	Carrying amount of liability
Long-term issues (with original maturity of over 1 year)							
Mortgage covered bonds (PLN)	200 000	3,50%	Mortgage covered bonds register	2018-06-15	200 260	-	200 260
Mortgage covered bonds (PLN)	80 000	2,81%	Mortgage covered bonds register	2019-06-21	80 038	-	80 038
Mortgage covered bonds (EUR)	30 000	2,75%	Mortgage covered bonds register	2020-07-28	125 615	3 556	129 171
Mortgage covered bonds (EUR)	50 000	0,802%	Mortgage covered bonds register	2018-10-22	208 768	-	208 768
Mortgage covered bonds (EUR)	7 500	0,53%	Mortgage covered bonds register	2018-02-15	31 339	-	31 339
Mortgage covered bonds (EUR)	8 000	3,50%	Mortgage covered bonds register	2029-02-28	33 773	3 940	37 713
Mortgage covered bonds (EUR)	15 000	3,50%	Mortgage covered bonds register	2029-03-15	63 363	7 416	70 779
Mortgage covered bonds (EUR)	20 000	3,20%	Mortgage covered bonds register	2029-05-30	83 638	9 716	93 354
Mortgage covered bonds (PLN)	300 000	2,74%	Mortgage covered bonds register	2022-07-28	302 696	-	302 696
Mortgage covered bonds (PLN)	200 000	2,74%	Mortgage covered bonds register	2023-02-20	201 366	-	201 366
Mortgage covered bonds (EUR)	20 000	1,115%	Mortgage covered bonds register	2018-10-22	83 503	374	83 877
Mortgage covered bonds (EUR)	50 000	0,54%	Mortgage covered bonds register	2019-10-15	208 566	-	208 566
Mortgage covered bonds (PLN)	200 000	2,59%	Mortgage covered bonds register	2022-04-28	200 369	-	200 369
Mortgage covered bonds (EUR)	20 000	1,135%	Mortgage covered bonds register	2022-02-25	83 663	996	84 659
Mortgage covered bonds (PLN)	250 000	2,68%	Mortgage covered bonds register	2023-10-16	250 533	-	250 533
Mortgage covered bonds (EUR)	11 000	1,285%	Mortgage covered bonds register	2025-04-24	45 988	(409)	45 579
Mortgage covered bonds (EUR)	50 000	0,361%	Mortgage covered bonds register	2020-06-24	208 248	-	208 248
Mortgage covered bonds (PLN)	500 000	2,83%	Mortgage covered bonds register	2020-09-10	499 997	-	499 997
Mortgage covered bonds (PLN)	255 000	2,87%	Mortgage covered bonds register	2021-09-20	254 668	-	254 668
Mortgage covered bonds (PLN)	300 000	2,93%	Mortgage covered bonds register	2021-03-05	300 076	-	300 076
Mortgage covered bonds (EUR)	50 000	0,541%	Mortgage covered bonds register	2021-06-21	208 147	-	208 147
Mortgage covered bonds (PLN)	50 000	2,91%	Mortgage covered bonds register	2020-04-28	50 909	-	50 909
Mortgage covered bonds (PLN)	100 000	2,91%	Mortgage covered bonds register	2020-04-28	101 824	-	101 824
Mortgage covered bonds (EUR)	35 000	1,183%	Mortgage covered bonds register	2026-09-20	145 920	(5 006)	140 914
Mortgage covered bonds (EUR)	13 000	1,18%	Mortgage covered bonds register	2026-09-20	54 179	(2 468)	51 711
Mortgage covered bonds (EUR)	24 900	0,94%	Mortgage covered bonds register	2024-02-01	104 470	139	104 609
Mortgage covered bonds (PLN)	400 000	2,51%	Mortgage covered bonds register	2019-12-16	400 427	-	400 427
Mortgage covered bonds (PLN)	500 000	2,48%	Mortgage covered bonds register	2022-09-10	499 315	-	499 315
Mortgage covered bonds (PLN)	1 000 000	2,54%	Mortgage covered bonds register	2023-09-15	997 814	-	997 814
Mortgage covered bonds (EUR)	100 000	0,612%	Mortgage covered bonds register	2022-06-22	416 505	(445)	416 060
Mortgage covered bonds (PLN)	20 000	3,26%	no collateral	2019-01-16	20 289	-	20 289
Mortgage covered bonds (PLN)	60 000	3,18%	no collateral	2019-01-21	60 347	-	60 347
Short-term issues (with original maturity up to 1 year)							
Bonds (PLN)	81 000	2,28%	no collateral	2018-01-11	80 948	-	80 948
Bonds (PLN)	20 000	2,26%	no collateral	2018-01-10	19 988	-	19 988
Bonds (PLN)	10 000	2,26%	no collateral	2018-01-12	9 993	-	9 993
Bonds (PLN)	15 000	2,26%	no collateral	2018-02-05	14 966	-	14 966
Bonds (PLN)	20 000	2,30%	no collateral	2018-09-04	19 685	-	19 685
Bonds (PLN)	30 000	2,26%	no collateral	2018-03-05	29 880	-	29 880
Bonds (PLN)	88 500	2,15%	no collateral	2018-01-08	88 462	-	88 462
Bonds (PLN)	32 000	2,26%	no collateral	2018-03-08	31 865	-	31 865
Bonds (PLN)	10 000	2,03%	no collateral	2018-01-05	9 998	-	9 998
Bonds (PLN)	20 000	2,11%	no collateral	2018-04-27	19 862	-	19 862
Bonds (PLN)	20 000	2,03%	no collateral	2018-02-09	19 955	-	19 955
Bonds (PLN)	25 000	2,11%	no collateral	2018-05-17	24 798	-	24 798
Bonds (PLN)	50 000	2,11%	no collateral	2018-06-13	49 516	-	49 516
Bonds (PLN)	10 000	2,11%	no collateral	2018-06-13	9 903	-	9 903
Bonds (PLN)	20 000	2,02%	no collateral	2018-03-19	19 912	-	19 912
Bonds (PLN)	40 000	2,02%	no collateral	2018-03-21	39 819	-	39 819
Bonds (PLN)	9 200	2,02%	no collateral	2018-03-28	9 155	-	9 155
Debt securities in issue (carrying value)					**7 025 316**	**17 809**	**7 043 125**

Movements in the balance of debt securities issued

	Year ended 31 December	
	2018	2017
As at the beginning of the period	**7 043 125**	**6 152 771**
Increase (due to)	2 705 462	5 631 747
- issue	2 453 760	5 487 841
- accured interest, interest non-linearity adjustments, EIR commission	134 729	143 768
- exchange differences	81 844	-
- hedge accounting adjustments related to fair value of hedged items	35 129	138
Decrease (due to)	(1 878 144)	(4 741 393)
- redemption	(1 754 301)	(4 464 026)
- interest repayment, interest non-linearity adjustments, EIR commission,	(122 320)	(144 257)
- exchange differences	(134)	(121 476)
- hedge accounting adjustments related to fair value of hedged items	(1 389)	(11 634)
As at the end of the period	**7 870 443**	**7 043 125**
Short-term (up to 1 year)	944 773	1 047 568
Long-term (over 1 year)	6 925 670	5 995 557
Fixed interest rate debt securities issued	2 695 414	1 909 862
Floating interest rate debt securities issued	5 175 029	5 133 263

Subordinated financial liabilities

Subordinated liabilities	Nominal value	Currency	Interest rate as at 31.12.2018	Maturity / redemption date	Balance of liability (PLN '000)
As at 31 December 2018					
mBank S.A.	100 000	PLN	5.22%	15.12.2025	**100 213**
mBank S.A.	100 000	PLN	4.72%	15.12.2028	**100 193**

Subordinated liabilities	Nominal value	Currency	Interest rate as at 31.12.2017	Maturity / redemption date	Balance of liability (PLN '000)
As at 31 December 2017					
mBank S.A.	100 000	PLN	5.22%	19.12.2022	**100 242**
mBank S.A.	100 000	PLN	5.22%	15.12.2025	**100 242**

Both as at 31 December 2018 and as at 31 December 2017, subordinated liabilities were variable interest rate liabilities.

for 2018 (in PLN thousand)

Movements in the balance of subordinated liabilities

	2018	2017
As at the beginning of the period	**200 484**	**200 484**
Increase (due to)	110 940	10 459
- interest on a loan	10 940	10 459
- taking out a loan	100 000	-
Decrease (due to)	(111 018)	(10 459)
- repayment of interest on a loan	(11 018)	(10 459)
- repayment of a loan	(100 000)	-
Subordinated liabilities as at the end of the period	**200 406**	**200 484**
Short-term (up to 1 year)	406	484
Long-term (over 1 year)	200 000	200 000

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

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

29. Provisions

	31.12.2018	31.12.2017
Provision (due to)	**2 557**	**204**
- off-balance sheet contingent liabilities granted	2 313	61
- provisions for retirement and disability benefits	155	143
- provisions for legal proceedings	89	-
Provision, in total	**2 557**	**204**
Short-term (up to 1 year)	2 430	80
Long-term (over 1 year)	127	124

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

	Year ended 31 December	
	2018	2017
Provisions as at the beginning of the period	**143**	**106**
- write-down on the provision	10	8
- interest cost	5	4
- actuarial gains and losses are recognised in other comprehensive income	(3)	25
Provisions as at the end of the period	**155**	**143**
Expected provision settlement period:		
Short-term (up to 1 year)	28	19
Long-term (over 1 year)	127	124

for 2018 (in PLN thousand)

30. Other liabilities

	31.12.2018	31.12.2017
Other liabilities (due to)	**28 842**	**25 568**
- accrued expenses	21 652	19 295
- settlements due to tax from Bank balance sheet items	2 300	2 179
- provision for holiday equivalents	1 147	990
- deferred income	1 521	1 252
- settlements with insurers	1 241	1 050
- liabilities due to income tax on salaries, Social Security contributions and VAT	754	752
- other	227	50
Other liabilities, in total	**28 842**	**25 568**
Short-term (up to 1 year)	28 842	25 568

31. Deferred income tax assets and provision

Deferred income tax assets and provision are calculated for all temporary differences in accordance with the balance sheet method, using an effective income tax rate that will be applicable in the year of the tax obligation arising (19% both in 2018 and 2017).

Changes in deferred tax assets and provision are presented below:

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

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

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

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

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

for 2018 (in PLN thousand)

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

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

Deferred income tax assets	As at 01.01.2017	Recognised in the income statement	Recognised in other comprehensive income	As at 31.12.2017
Interest accrued	12 896	(232)	-	**12 664**
Valuation of derivative financial instruments	1 853	608	-	**2 461**
Valuation of available-for-sale financial instruments	424	-	(400)	**24**
Amount of impairment write-downs on receivables*	16 535	1 322	-	**17 857**
Provisions and other liabilities related to employment benefits	1 425	241	-	**1 666**
Impairment write-downs on inventories	374	-	-	**374**
Accruals	2 688	(1 095)	-	**1 593**
Revenues to be settled (commissions settled using the effective interest rate method)	8 541	(522)	-	**8 019**
Total deferred income tax assets	**44 736**	**322**	**(400)**	**44 658**

Settled within 12 months	37 899
To be settled after more than 12 months	6 759

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

Deferred income tax liabilities	As at 01.01.2017	Recognised in the income statement	Recognised in other comprehensive income	As at 31.12.2017
Interest accrued	(9 731)	5 214	-	**(4 517)**
Valuation of derivative financial instruments	(6 754)	1 863	-	**(4 891)**
Valuation of available-for-sale financial instruments	(149)	-	(765)	**(914)**
Provisions and other liabilities related to employment benefits	(5)	-	5	**-**
Prepaid costs	(18 993)	(4 226)	-	**(23 219)**
Difference between tax and balance sheet depreciation/amortisation	(388)	(135)	-	**(523)**
Other	(72)	50	-	**(22)**
Total deferred income tax liabilities	**(36 092)**	**2 766**	**(760)**	**(34 086)**

Settled within 12 months	(32 647)
To be settled after more than 12 months	(1 439)

Deferred income tax assets (net)	As at 01.01.2017	Recognised in the income statement	Recognised in other comprehensive income	As at 31.12.2017
Total deferred income tax assets (net)	**8 644**	**3 088**	**(1 160)**	**10 572**

Settled within 12 months	5 252
To be settled after more than 12 months	5 320

for 2018 (in PLN thousand)

Deferred tax recognised in the income statement	Year ended 31 December	
	2018	2017
Interest accrued	(13)	4 982
Valuation of derivative financial instruments	(5 056)	2 471
Amount of impairment write-downs on receivables and adjustment to fair value*	2 116	1 322
Provisions and other liabilities related to employment benefits	112	241
Impairment write-downs on inventories	(374)	-
Accruals	(284)	(1 095)
Revenues to be settled (commissions settled using the effective interest rate method)	245	(522)
Prepaid costs	772	(4 226)
Difference between tax and balance sheet depreciation/amortisation	(128)	(135)
Other	22	50
Total, deferred tax recognised in the income statement	**(2 588)**	**3 088**

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

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

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

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

In 2018, the Bank was not involved in any proceedings before a court, arbitration body, or public administration authority, where the value of such proceedings represented at least 10% of the Bank's equity. No significant actions were brought by the Bank or against the Bank within the presented reporting periods. The Bank made no provisions for ongoing disputes of that category.

33. Off-balance sheet commitments

Off-balance-sheet commitments of the Bank include:

- lending commitments

  The amounts and the relevant dates on which the Bank must meet the off-balance-sheet financial liabilities by granting loans are presented in the table below.
- operating lease liabilities,
- liabilities received,
- liabilities in respect of derivative financial instruments.

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

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

for 2018 (in PLN thousand)

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

The table below presents the off-balance-sheet liabilities made and received by the Bank, and the nominal value of open derivative transactions of the Bank as at 31 December 2017.

31.12.2017		Up to 1 year	From 1 to 5 years	Over 5 years	Total
1.	**Off-balance sheet liabilities granted and received**	**2 208 784**	**442 572**	**-**	**2 651 356**
	Liabilities granted	**1 128 964**	**442 572**	**-**	**1 571 536**
	1. Financial liabilities::	1 128 964	442 572	-	1 571 536
	a) Lending commitments	1 125 421	436 104	-	1 561 525
	b) Operating lease liabilities	3 543	6 468	-	10 011
	Liabilities received:	**1 079 820**	**-**	**-**	**1 079 820**
	a) Financial liabilities received	1 079 820	-	-	1 079 820
2.	**Derivative financial instruments (nominal value of contracts)**	**2 535 883**	**1 551 270**	**1 058 574**	**5 145 727**
	1. Interest rate derivatives	166 836	1 551 270	1 058 574	2 776 680
	2. Foreign exchange derivatives	2 369 047	-	-	2 369 047
	Total off-balance sheet items	**4 744 667**	**1 993 842**	**1 058 574**	**7 797 083**

34. Pledged assets

In accordance with the Act on the Bank Guarantee Fund, as at 31 December 2018, the Bank held treasury bonds in the amount of PLN 1,047 thousand (with the nominal value of PLN 1,000 thousand),
and as at 31 December 2017, the Bank held treasury bonds in the amount of PLN 1,033 thousand (with the nominal value of PLN 1,000 thousand) which constituted collateral for the guaranteed deposits protection fund. These assets are presented on the balance sheet under the item "Financial assets measured at fair value through other comprehensive income."

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

In addition, the Bank secured the mortgage covered bonds issued with treasury bonds with the carrying amount of PLN 201,877 thousand as at 31 December 2018 (PLN 180,314 thousand as at 31.12.2017).

35. Registered share capital

As at 31 December 2018 and as at 31 December 2017, the total number of ordinary shares was 3,210,000 shares with the nominal value of PLN 100 per share. All shares in issue are fully paid up.

for 2018 (in PLN thousand)

REGISTERED SHARE CAPITAL (STRUCTURE) AS AT 30 DECEMBER 2018							
Share type	**Type of preference**	**Type of restrictions**	**Number of shares**	**Series / issue at par value (PLN)**	**Means of covering share capital**	**Registration date**	**Right to dividend**
registered	-	-	500 000	50 000 000	cash	16.04.1999	01.01.2000
registered	-	-	850 000	85 000 000	cash	20.09.2000	01.01.2001
registered	-	-	400 000	40 000 000	cash	24.04.2006	01.01.2006
registered	-	-	1 000 000	100 000 000	cash	08.01.2013	01.01.2013
registered	-	-	100 000	10 000 000	cash	30.12.2014	01.01.2015
registered	-	-	140 000	14 000 000	cash	19.08.2015	01.01.2016
registered	-	-	100 000	10 000 000	cash	01.08.2016	01.01.2017
registered	-	-	120 000	12 000 000	cash	03.04.2017	01.01.2017
Total number of shares			**3 210 000**				
Total registered share capital				**321 000 000**			

The shareholders of mBank Hipoteczny S.A. as at 31 December 2018 are presented in the table below:

Shareholder's name	**Equity (PLN)**	**Shares**		**Voting rights at the General Shareholders' Meeting**	
		Number of shares	**%**	**Number of votes**	**%**
mBank S.A.	321 000 000	3 210 000	100.00	3 210 000	100.00
Total	**321 000 000**	**3 210 000**	**100.00**	**3 210 000**	**100.00**

36. Share premium

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

37. Retained earnings

	31.12.2018	**31.12.2017**
Other supplementary capital	273 082	245 253
General banking risk reserve	44 800	44 800
Profit for the current year	41 237	27 829
The effect of implementing IFRS 9	(13 371)	-
Total retained earnings	**345 748**	**317 882**

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

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

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

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

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

for 2018 (in PLN thousand)

38. Other components of equity

	31.12.2018	31.12.2017
Financial assets at fair value through other comprehensive income	**5 476**	***n/a***
Unrealised gains on debt instruments	*5 476*	*n/a*
Financial assets available for sale	***n/a***	**3 798**
Unrealised gains on debt instruments	*n/a*	**3 798**
Actuarial gains and losses on post-employment benefits	**4**	**2**
Actuarial gains of the defined benefit pension plan	4	2
Other components of equity, total	**5 480**	**3 800**

39. Dividend per share

mBank Hipoteczny S.A. does not plan to pay a dividend for 2018, nor did it pay any for 2017.

40. Notes to the statement of cash flows

Cash and cash equivalents

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

	31.12.2018	31.12.2017
Cash and balances with the central bank (Note 20)	16 294	1 351
Amounts due from other banks (Note 24)	58 432	18 737
Money bills	89 989	123 485
Total cash and cash equivalents	**164 715**	**143 573**

Supplementary information to the statement of cash flows

Change in the status of items of operational activity

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

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

`000 PLN	Year ended 31 December 2017
Amounts due from other banks, change resulting from balance-sheet balances	(2 475)
The difference between the interest accrued and paid in cash in the period	(4)
Exclusion of change in cash and cash equivalents	2 475
Change in amounts due from other banks, in total	**(4)**
Derivative financial instruments, change resulting from balance-sheet values	(12 900)
The difference between the interest accrued and paid in cash in the period	708
Change in respect of derivative financial instruments, in total	**(12 192)**
Loans and advances to clients, change resulting from balance-sheet values	(1 355 406)
The difference between the interest accrued and paid in cash in the period	11 642
Change in loans and advances to clients	**(1 343 764)**
Investment securities available for sale, change resulting from balance-sheet values	(143 078)
The difference between the interest accrued and paid in cash in the period	(1 071)
Exclusion of change in cash and cash equivalents	(107 977)
Valuation recognised in other comprehensive income	6 131
Change in investment securities, in total	**(245 995)**
Amounts due to other banks, change resulting from balance-sheet values	513 209
The difference between the interest accrued and paid in cash in the period	(4 326)
Exclusion of change in cash from financing activities	(1 021 568)
Change in amounts due to other banks, in total	**(512 685)**
Amounts due to clients, change resulting from balance-sheet values	(32 263)
The difference between the interest accrued and paid in cash in the period	(1)
Change in amounts due to clients, in total	**(32 264)**
Debt securities in issue (including hedge accounting adjustments related to fair value of hedged items) - change in the balance of the statement of financial position	890 354
The difference between the interest accrued and paid in cash in the period	(6 334)
Exclusion of change in cash from financing activities	(1 292 446)
Change in debt securities in issue, in total	**(408 426)**
Subordinated liabilities, change resulting from balance-sheet values	-
The difference between the interest accrued and paid in cash in the period	-
Change in subordinated liabilities, in total	**-**
Other liabilities and provisions, change resulting from balance-sheet values	(1 136)
Actuarial valuation of provisions for post-employment benefits recognised in other comprehensive income	(25)
Change in other liabilities and provisions, in total	**(1 161)**

for 2018 (in PLN thousand)

Interest received and paid with respect to the operational activity

	Year ended 31 December	
	2018	2017
Interest received from:		
Cash and balances with the Central Bank	28	37
Loans and advances to banks	615	1 035
Loans and advances to customers	355 793	331 694
Financial assets at fair value through other comprehensive income	21 351	22 240
Derivative instruments classified to the banking book	11 174	15 840
Income from interest received, total	**388 961**	**370 846**

Cash flows from financing activities

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

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

	OB. 01.01.2017	Cash flow	Other changes	CB 31.12.2017
Debt securities in issue (long-term)	5 386 891	1 171 198	(13 669)	6 544 420
Amounts due to banks (long-term) (Note 28)	2 782 230	954 225	43 117	3 779 572
Subordinated liabilities (Note 28)	200 485	(10 460)	10 459	200 484

Column "Other Changes" shows non-cash flows resulting from accrued interest, commissions accounted for with the effective interest rate method, exchange differences, changes in hedge accounting adjustments related to fair value of hedged items, financial liabilities with deferred maturity resulting from agreements concluded with mBank S.A. on the transfer of a portfolio of retail loans secured with a mortgage on real estate in 2018 in the total nominal amount of PLN 612,642 thousand, and interest in the amount of PLN 929 thousand paid in 2018 on those liabilities.

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

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

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

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

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

Variable remuneration for the Bank's Management Board Members:

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

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

1) in view of the subsequent assessment of the Manager's work in a longer period than 1 financial year,
2) when at least one of the elements included in the scorecard has not been met.

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

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

1) 50% of the bonus for a given period shall be granted in the cash form (non-deferred part),
2) 50% of the bonus for a given period shall be granted in the non-cash form (deferred part) in phantom shares, of which:
   - 20% is granted in the year following the appraisal period for which the bonus is granted, within 30 calendar days of approval by the General Meeting of Shareholders of the financial statements of the Bank,
   - 80% is realised in three equal annual tranches (deferred tranches).

The entitled person shall acquire the right to the first, second and third tranche in the second, third and fourth calendar year after the end of the appraisal period, respectively, if:

- the appraisal level they reached for the given year is 80%,
- they fulfilled the conditions of employment at the Bank; and
- the Bank's performance as at the end of the first, second and third calendar year after the end of the appraisal period is not lower than the result adopted for a given year in the financial plan, reduced by 10%.

Each of the above-mentioned deferred tranches shall be granted within 30 calendar days upon the approval by the General Meeting of Shareholders of the Bank of the Bank's financial statements for a given year.

The Supervisory Board may modify the level of the planned Bank performance appropriately to the market situation.

The last settlements under this programme were made in 2018.

ncentive plan for the Bank's Management Board and employees having a material impact on the risk profile of the Bank of 2015, 2016 and 2017

On 26 June 2015, the Supervisory Board of the Bank adopted the "Policy on remuneration for persons having a material impact on the risk profile of the Bank at mBank Hipoteczny S.A." The new policy came into force on 1 July 2015.

On 18 June 2016, the Supervisory Board adopted Resolution No 14/2016 to approve the amended "Policy on remuneration for persons having a material impact on the risk profile of the Bank Bank at mBank Hipoteczny S.A." which came into force on 1 July 2016 and superseded the previous policy in this scope. The change referred to the calculation of the average value of phantom shares for the purpose of payment of the non-deferred cash part and the deferred cash tranches. Before the change, the value of the shares was understood as the value at the end of the annual period preceding the payment date. Currently, the average value of a phantom share is calculated as the total amount of a phantom share value at the end of the annual period preceding the payment date and the phantom share value at the end of the first half of the year in which the payment is due, divided by 2.

On 27 March 2017, with Resolution No 13/2017, the Supervisory Board amended the Policy on remuneration for persons having a material impact on the risk profile of the Bank, by introducing a limit of PLN 200 thousand for the payment of the variable remuneration. If the amount is equal to or less than PLN 200 thousand, the Management Board of the Bank may decide not to defer the variable remuneration for the subsequent years, and may award the entire variable remuneration in the form of non-deferred cash payment. The above principle does not apply to the Members of the Management Board of the Bank.

According to the Policy, variable remuneration shall consist of a bonus granted for a given financial year to Management Board Members or other employees. Variable remuneration shall be determined in a transparent and verifiable manner which ensures efficient implementation of the Policy. The maximum level of variable components of remuneration of persons covered by the Policy shall not exceed 100% of the amount of the basic remuneration paid to a Management Board Member or other employees for a given financial year. Variable remuneration shall constitute a part of total remuneration (annual basic remuneration and variable remuneration) granted to a Management Board Member or other employees. It shall be determined taking market practices into account, both in the banking sector and in general on the Polish market, verified on the basis of market salary reports and the remuneration policy of the mBank Group.

Process of granting and deferring variable remuneration for the Bank’s Management Board Members:

The Supervisory Board shall determine the amounts of bonuses of individual Management Board Members, taking into account whether the Management Board Member has accomplished the agreed annual/long-term business and development objective — Management By Objective (“MBO”). The decision on granting the bonus and on the amount thereof shall be taken at the sole discretion of the Supervisory Board of the Bank which confirms the accomplishment of MBO on the basis of its own judgement and decision, taking into account the situation on financial markets in the last/previous financial period(s).

Variable remuneration shall be granted in accordance with the following principles:

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

Phantom shares shall be awarded both in the non-deferred part and deferred part, and they will be available for payment no earlier than 6 months after the month of awarding the phantom shares.

The Supervisory Board may decide to suspend in whole or reduce the deferred tranche amount if:

- it determines that in a longer time horizon (of at least 3 years) a Member of the Management Board has directly and adversely affected, through their actions or omissions, the financial performance and the market position of the Bank; or
- at least one of the elements included in the scorecard has not been met (i.e. if at least one “YES” answer is given to the questions posed therein); or
- the managerial contract expires or is terminated for reasons other than:
  - expiry of the term for which a contract was concluded,
  - recalling the Management Board Member from the Bank’s Management Board during the term of the contract, excluding the reasons set out in detail in the contract,
  - assumption of new duties within the mBank Group,
  - retirement of a Management Board Member.

Under the programme referred to above, the Management Board Members were awarded bonuses for 2015, 2016 and 2017. The last settlements under this programme are to be made in 2021.

Process of granting and deferring variable remuneration for other employees having a significant impact on the risk profile of the Bank:

The Bank's Management Board shall determine the amounts of bonuses of employees having a material impact on the risk profile of the Bank, taking into account whether they have accomplished the agreed annual/long-term business and development objective — MBO. The decision on granting the bonus and on the amount thereof shall be taken at the sole discretion of the Bank's Management Board which confirms the accomplishment of MBO on the basis of its own judgement and decision, taking into account the situation on financial markets in the last/previous financial period(s).

Variable remuneration shall be granted in accordance with the following principles:

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

Phantom shares shall be awarded both in the non-deferred part and deferred part, and they will be available for payment no earlier than 6 months after the month of awarding the phantom shares.

If the amount of the variable remuneration is equal to or less than PLN 200 thousand, the Management Board of the Bank may decide not to defer the variable remuneration for the subsequent years, and may award the entire variable remuneration in the form of non-deferred cash payment (applicable to bonuses for 2017).

The Bank's Management Board may decide to suspend as a whole or reduce the deferred tranche amount:

- if it determines that in a longer time horizon (of at least 3 years) the employee directly and adversely affected, through their actions or omissions, the financial performance and the market position of the Bank. When evaluating the employee's actions or omissions, the Management Board of the Bank takes into account the MBO evaluation results for the particular employee,
- in the event of termination of employment contract, excluding the reasons set out in the employment contract/internal regulations of the Bank,

the Banks' Management Board may decide to suspend as a whole or reduce the Discretionary Bonus amount for a given financial year, and with regard to a Deferred Tranche which has not been paid yet, in a situation of balance-sheet loss or a threat of the same or a danger of the Bank's insolvency.

Under the programme referred to above, employees having material impact on the risk profile of the Bank were awarded bonuses for 2015, 2016 and 2017. The last settlements under this programme are to be made in 2021.

Incentive plan for the Bank's Management Board and employees having a material impact on the risk profile of the Bank of 2018

On 23 November 2018, with Resolution No 37/2018, the Supervisory Board amended the Policy on remuneration for persons having a material impact on the risk profile of the Bank at mBank Hipoteczny S.A., and cancelled the Policy of 27 March 2017. Provisions of the Policy apply to bonuses for 2018. Changes were made e.g. in the scope of:

- extension of the retention period from 6 to 12 months, phantom shares awarded both within the non-deferred part and the deferred part, and they will be available for payment no earlier than 12 months after the month of awarding the phantom shares,
- a change of the method of calculation of the equivalent for phantom shares – in order to calculate the average value of phantom shares, the sum of the value of phantom shares at the end of the last two annual periods preceding the payment date is taken into account,
- specification of provisions concerning the terms and conditions for receipt of bonus specified in the so-called scorecard,

- introduction of a clawback on the basis of which the Supervisory Board may request the Management Board Members, and the Management Board may request the employees having a material impact on the risk profile of the Bank, to return the bonus awarded and paid for the given calendar year (i.e. the non-deferred part and all deferred parts).

On 23 November 2018 the Supervisory Board adopted resolution No 39/2018 introducing regular adjustments of the content to the Policy adopted by resolution No 37/2018.

The amount of the bonus for the given calendar year shall be determined on the basis of evaluation of the achievement of MBO objectives in the last three calendar years, by the Supervisory Board – for the Management Board Members, by the Management Board of the Bank – for the employees having a material impact on the risk profile of the Bank (the so-called Risk Takers).

The bonus comprises a non-deferred part of 60% of the bonus, and a deferred part of 40% of the bonus.

The deferred part and the non-deferred part is divided in half into a cash part (50%) and a non-cash part awarded in the form of phantom shares (50%). The non-deferred cash part is payable in the year of award of the bonus. The second half of the non-deferred part (50%) is payable in the form of equivalent for the phantom shares, no earlier than after 12 months of the date of the Ordinary General Meeting of Shareholders.

The deferred part, in the form of cash and in the form of phantom shares, shall be paid after the approval of the Bank's financial statements for the previous calendar year, and the part paid in the form of phantom shares shall be paid no earlier than after 12 months of the date of approval of the consolidated financial statements.

If the amount of bonus for a particular calendar year determined for an employee having a material impact on the risk profile of the Bank, who is not a Management Board Member, does not exceed PLN 200 thousand, the bonus may be paid in full, based on a decision of the Management Board of the Bank, in the form of cash, non-deferred.

The deferred part of the bonus, both to the Management Board Members and other Risk Takers, shall be evaluated in terms of its determination and payment.The Supervisory Board – in respect to the Management Board Members, and the Management Board of the Bank – in respect of employees identified as Risk Takers, may decide to withhold altogether or to reduce the amount of a deferred tranche, if it determines that in a longer period than 1 financial year, i.e. for a period of at least 3 years, the Risk Taker had a direct and negative impact on the financial result or market position of the Bank, violated the principles and standards adopted by the Group, directly caused significant financial losses, when at least one of the elements included in the scorecard is not complied with, or any of the conditions referred to in Article 142(2) of the Banking Law occurred.

In case of occurrence of the events referred to above, at the stage of determination of the amount of bonus for the Risk Takers, the Supervisory Board/Management Board of the Bank may decide not to award the bonus for the given calendar year in its entirety, or to reduce the bonus.

Furthermore, a Risk Taker can be compelled - on such terms and in such time limit as the Supervisory Board / Management Board, respectively, may decide - to return the bonus granted and paid for a given calendar year(i.e. undeferred portion and all deferred portions), when he/she violated principles and standards in place in mBank, committed a major violation of generally applicable provisions of law or directly brought to significant financial losses arising from an informed, adverse conduct to the detriment of the mBank Group or brought to the imposition of financial penalties on the Bank by supervisory authorities on the basis of a final decision.

The decision on the occurrence of the above-described events may be made until the end of the calendar year in which the final tranche of the deferred part of the bonus granted for the year in which the event occurred is paid.

The bonus under the above-described rules will be granted to Management Board Members and other Risk Takers for the first time in 2019 for 2018.

Accounting approach to incentive plans

Remuneration plan benefits for the Bank's Management Board and employees having a material impact on the risk profile of the Bank are cleared in line with IAS 19 Employee Benefits. Both the cash part of the plan and the phantom share part settled in money add to the cost of a given period in correspondence with the liability. Costs are recognised in time throughout the vesting period and carried under the item "general administrative expenses". Liabilities due to incentive plans are presented "Other assets" in the statement of financial position.

for 2018 (in PLN thousand)

42. Related party transactions

mBank S.A. is the direct parent entity in relation to mBank Hipoteczny S.A. Commerzbank AG is the direct parent entity of mBank S.A.

All transactions between the Bank and the related entities were typical and routine transactions concluded on arm's length terms, and their nature and terms resulted from the current operating activities conducted by the Bank. Transactions with related entities concluded in the normal course of operating activities include loans, liabilities from debt securities in issue and derivative transactions.

The following table presents financial liabilities towards mBank S.A., broken down by contractual maturity dates.

31.12.2018	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
Loans received	-	-	180 506	2 264 323	591 484	**3 036 313**
Covered bonds and bonds in issue	-	-	-	496 059	-	**496 059**
Subordinated liabilities	-	-	-	-	200 406	**200 406**
Liabilities in respect of cash collateral	30 032	-	-	-	-	**30 032**
Other financial liabilities with deferred payment date	-	-	-	113 533	-	**113 533**
Derivative financial instruments	1 974	54	-	-	-	**2 028**

31.12.2017	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
Loans received	-	83 425	208 696	2 279 606	1 207 845	**3 779 572**
Subordinated liabilities	-	-	-	100 242	100 242	**200 484**
Covered bonds and bonds in issue	-	-	-	579 267	263 559	**842 826**
Liabilities in respect of cash collateral	48 080	-	-	-	-	**48 080**
Derivative financial instruments	-	-	-	-	421	**421**
Other liabilities	1 748	-	-	-	-	**1 748**

Other financial liabilities with deferred payment term related to a liability resulting from agreements concluded with mBank S.A. on 30 November 2018 on the transfer of retail loans secured with a mortgage on real estate. This liability was repaid on 25 January 2019.

<u>Major agreements concluded between the Bank and mBank S.A. in 2018:</u>

1. On 12 July 2018, a subordinated loan agreement was concluded between mBank S.A. and mBank Hipoteczny S.A. for the amount of PLN 100,000 thousand to increase the Bank's equity (Tier 2).
2. Under the framework agreement on the acquisition of portfolios of receivables in respect of mortgage-backed loans in order to refinance them through the issue of mortgage covered bonds and on entrusting mBank S.A. with further servicing of the acquired portfolios by mBank Hipoteczny S.A, signed on 28 August 2014, the following agreements were signed:.
   - on 28 February 2018, a portfolio transfer agreement was concluded between mBank S.A. and mBank Hipoteczny S.A., whereby mBank Hipoteczny S.A. acquired from mBank S.A. a retail portfolio of mortgage-backed loans with the fair value of PLN 83,529 thousand;
   - on 30 May 2018, a portfolio transfer agreement was concluded between mBank S.A. and mBank Hipoteczny S.A., whereby mBank Hipoteczny S.A. acquired from mBank S.A. a retail portfolio of mortgage-backed loans with the fair value of PLN 226,990 thousand;
   - on 31 July 2018, a portfolio transfer agreement was concluded between mBank S.A. and mBank Hipoteczny S.A., whereby mBank Hipoteczny S.A. acquired from mBank S.A. a retail portfolio of mortgage-backed loans with the fair value of PLN 74,241 thousand;
   - on 31 August 2018, a portfolio transfer agreement was concluded between mBank S.A. and mBank Hipoteczny S.A., whereby mBank Hipoteczny S.A. acquired from mBank S.A. a retail portfolio of mortgage-backed loans with the fair value of PLN 43,092 thousand;
   - on 28 September 2018, a portfolio transfer agreement was concluded between mBank S.A. and mBank Hipoteczny S.A., whereby mBank Hipoteczny S.A. acquired from

mBank S.A. a retail portfolio of mortgage-backed loans with the fair value of PLN 71,474 thousand;

- on 30 November 2018, a portfolio transfer agreement was concluded between mBank S.A. and mBank Hipoteczny S.A., whereby mBank Hipoteczny S.A. acquired from mBank S.A. a retail portfolio of mortgage-backed loans with the fair value of PLN 113,315 thousand;

The table below presents the amounts of the Bank's transactions with related entities. The transaction value covers assets and liabilities' balances as at 31 December 2018 and 31 December 2017, and related costs and income for 2018 and 2017.

(PLN '000)	Supervisory and Management Board members of mBank Hipoteczny S.A./mBank S.A., management personnel of mBank Hipoteczny S.A.		Other persons and entities related*		mBank Group companies***		mBank S.A.		Commerzbank Group companies***	
As at the end of the period	**31.12.2018**	**31.12.2017**	**31.12.2018**	**31.12.2017**	**31.12.2018**	**31.12.2017**	**31.12.2018**	**31.12.2017**	**31.12.2018**	**31.12.2017**
Statement of finacial position										
Assets	2 074	2 355	642	105	-	54	94 756	65 010	-	-
Liabilities	-	-	-	-	-	169 606	3 880 031	4 873 131	933 822	1 041 983
Contingent liabilities										
Liabilities received	-	-	-	-	-	-	1 080 690	1 079 820	-	-
Commitment granted	-	-	-	-	394	-	4 321	271	-	-
Derivatives (purchase, sales)										
IRS contracts	-	-	-	-	-	-	1 194 400	1 334 383	-	-
FX SWAP contracts	-	-	-	-	-	-	1 498 271	2 067 594	-	-

(PLN '000)	Supervisory and Management Board members of mBank Hipoteczny S.A./mBank S.A., management personnel of mBank Hipoteczny S.A.		Other persons and entities related*		mBank Group companies***		mBank S.A.		Commerzbank Group companies***	
Year ended	**31.12.2018**	**31.12.2017**	**31.12.2018**	**31.12.2017**	**31.12.2018**	**31.12.2017**	**31.12.2018**	**31.12.2017**	**31.12.2018**	**31.12.2017**
Income statement										
Interest income	62	72	22	3	356	398	19 877	22 597	-	-
Interest expense	-	-	-	-	-	(2 044)	(105 020)	(113 496)	(5 987)	(5 258)
Fee and commission income	-	-	-	-	(2)	4	-	-	-	-
Fee and commission expenses	-	-	-	-	(126)	(1 530)	(3 693)	(3 125)	-	-
Net trading income	-	-	-	-	-	-	(13 221)	11 319	-	-
Other operating income	-	-	-	-	-	-	472	414	-	-
Other operating expenses	-	-	-	-	-	-	-	(3)	-	-
Overhead costs, amortisation and depreciation	-	-	-	-	(898)	(1 220)	(4 034)	(3 907)	-	-

* Other persons and related parties encompass the loan extended to the a close relative of a member of Supervisory Board of mBank S.A.

** The item "mBank Group companies" includes transactions with the following mBank Group companies: mFinanse S.A., mCentrum Operacji Sp. z o.o., mCorporate Finance S.A., mLeasing Sp. z o.o.

*** The item “Commerzbank Group companies” includes transactions of acquisition of mortgage covered bonds on the secondary market by Commerzbank AG and Comdirect Bank AG.

for 2018 (in PLN thousand)

Composition and remuneration of Members of the Bank's Management Board

Both as at 31 December 2018 and as at 31 December 2017, the composition of the Management Board was as follows:

Piotr Cyburt — President of the Management Board
Andrzej Kulik — Member of the Management Board
Grzegorz Trawiński — Member of the Management Board
Marcin Wojtachnio — Member of the Management Board

Information on the remuneration and bonuses paid to the Members of the Management Board of the Bank who were performing their functions at the end of 2018, as at 31 December 2018 and 31 December 2017, is presented below:

		Remuneration paid in 2018 (in PLN)		
		Gross remuneration	Other benefits*	Settlement of incentive programme in 2018
1.	Piotr Cyburt	756 000	16 710	381 400
2.	Andrzej Kulik	492 500	16 596	93 089
3.	Grzegorz Trawiński	510 000	12 633	271 589
4.	Marcin Wojtachnio	510 000	16 884	336 356
	Total	**2 268 500**	**62 822**	**1 082 434**

		Remuneration paid in 2017 (in PLN)		
		Gross remuneration	Other benefits*	Settlement of incentive programme in 2017
1.	Piotr Cyburt	756 000	16 691	290 654
2.	Andrzej Kulik	133 333	3 659	-
3.	Grzegorz Trawiński	510 000	12 614	244 091
4.	Marcin Wojtachnio	510 000	16 865	322 550
	Total	**1 909 333**	**49 829**	**857 295**

* "Other benefits" include co-financing of medical care, insurance, multisport cards, company car

As at 31 December 2018, the provision for employee and Management Board awards/bonuses amounted to PLN 7,968 thousand, which includes the provision for variable remuneration for Members of the Management Board and employees having a material impact on the Bank's risk profile amounting to PLN 4,381 thousand (as at 31.12.2017: PLN 7,637 thousand and PLN 4,329 thousand, respectively).

The Regulations on variable remuneration for the Members of the Management Board and employees having a material impact on the Bank's risk profile is discussed in more detail in Note 41.

In accordance with the concluded contracts, when a Management Board Member is dismissed as Management Board Member before the end of his/her term of office or is not appointed for the next term of office, such Management Board Member is entitled to severance pay, the amount of which depends on the time of service as Management Board Member and is calculated as follows:

- 3-month remuneration, if the Management Board Member served as Management Board Member for less than 1 year,
- 6-month remuneration, if the Management Board Member served as Management Board Member for a period between 1 and 5 years,
- 9-month remuneration, if the Management Board Member served as Management Board Member for more than 5 years, 12-month remuneration of the Management Board Member served as Management Board Member for more than 5 years.

The Supervisory Board may decide to suspend as a whole or reduce the amount of the above-mentioned Severance Pay, in case of a balance-sheet loss or the threat of the same or a danger of the Company's insolvency.

for 2018 (in PLN thousand)

Composition and remuneration of Members of the Bank's Supervisory Board

With the Resolution No 21/2018 of the Supervisory Board of 21 March 2018, Mr Frank Bock was appointed as the Chairman of the Supervisory Board of mBank Hipoteczny S.A.

The composition of the Supervisory Board of mBank Hipoteczny S.A. as at 31 December 2018:

1.	Frank Bock	-	Chairman of the Supervisory Boardj, Member of the Risk Committee
2.	Lidia Jabłonowska-Luba	-	Deputy Chairwoman of the Supervisory Board, Member of the Risk Committee
3.	Andreas Boeger	-	Member of the Supervisory Board, Member of the Audit Committee
4.	Jakub Fast	-	Member of the Supervisory Board
5.	Paweł Graniewski	-	Independent Member of the Supervisory Board, Chairman of the Audit Committee
6.	Cezary Kocik	-	Member of the Supervisory Board
7.	Michał Popiołek	-	Member of the Supervisory Board, Member of the Risk Committee
8.	Mariusz Tokarski	-	Independent Member of the Supervisory Board, Member of the Audit Committee

In 2018, Members of the Supervisory Board did not receive any remuneration, except for Mr Paweł Graniewski and Mr Mariusz Tokarski, who received remuneration for 2018 as Supervisory Board Members in the amount of PLN 108 thousand (PLN 54 thousand each).

The composition of the Supervisory Board of mBank Hipoteczny S.A. as at 31 December 2017:

1.	Cezary Kocik	-	Chairman of the Supervisory Board
2.	Lidia Jabłonowska-Luba	-	Deputy Chairwoman of the Supervisory Board, Member of the Risk Committee
3.	Frank Bock	-	Member of the Supervisory Board, Member of the Risk Committee
4.	Andreas Boeger	-	Member of the Supervisory Board, Member of the Audit Committee
5.	Jakub Fast	-	Member of the Supervisory Board
6.	Paweł Graniewski	-	Independent Member of the Supervisory Board, Chairman of the Audit Committee
7.	Michał Popiołek	-	Member of the Supervisory Board, Member of the Risk Committee
8.	Mariusz Tokarski	-	Independent Member of the Supervisory Board, Member of the Audit Committee

In 2017, Members of the Supervisory Board did not receive any remuneration, except for Mr Paweł Graniewski and Mr Mariusz Tokarski, who received remuneration for 2017 as Supervisory Board Members in the amount of PLN 18 thousand and PLN 36 thousand, respectively.

In accordance with paragraph 14, section 1, item 5 of the Articles of Association of mBank Hipoteczny S.A., the General Shareholders' Meeting decides, by resolution, on appointing and recalling Members of the Supervisory Board and establishing the terms of their remuneration.

In accordance with paragraph 3, section 1, item 9 of the Supervisory Board Regulations in mBank Hipoteczny S.A., determining the terms of contracts and remuneration of the Members of the Bank's Management Board lies with the competencies of the Supervisory Board.

43. Information on the registered audit company

With the Resolution No 19/2018 of 2 March 2018, the Supervisory Board of mBank Hipoteczny S.A., acting under paragraph 26 section 8 of the Bank's Articles of Association, appointed Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością spółka komandytowa (EY) as auditor of the financial statements of the Bank for 2018-2019.

On 22 June 2018, mBank Hipoteczny S.A. signed a contract with EY for the audit of the financial statements for 2018 and 2019.

Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością spółka komandytowa with its registered office in Warsaw at Rondo ONZ 1, 00-124 Warsaw, is a registered auditor No 130 authorised to audit financial statements.

EY's total fee in 2018 amounted to PLN 500 thousand gross, which included:

- for the audit of the financial statements of mBank Hipoteczny S.A. and audit of the Statement Packages for 2018 - PLN 252 thousand gross,
- for the review of financial statements of mBank Hipoteczny S.A. for H1 2018, Statement Packages for H1 2018, Statement Package for mBank S.A. for the 0-month period ending on 30 September 2018, as at 31 December 2018 - PLN 156 thousand gross,
- for other attestation services i.e. verification of disclosures concerning the Bank's capital adequacy, and financial data reconciliation contained in the annex to the prospectus - PLN 92 thousand gross.

The entity authorised to audit financial statements for 2016 and 2017, with whom the Bank signed the contract, was PricewaterhouseCoopers Sp. z o.o. (PwC). The contract for the audit of the financial statements of mBank Hipoteczny S.A. was concluded on 13 June 2016.

PwC's total fee in 2018 was PLN 114 thousand gross, and involved the attestation service related to the foreign prospectus.

PwC's total fee in 2017 amounted to PLN 724 thousand gross, which included:

- for the audit of the financial statements of mBank Hipoteczny S.A. and audit review of Statement Packages for 2017 - PLN 279 thousand gross,
- for other attestation services i.e. review of financial statements of mBank Hipoteczny S.A. for H1 2017, Statement Packages for H1 2017, verification of disclosures concerning the Bank's capital adequacy as at 31 December 2017 - PLN 151 thousand gross,
- for the attestation service related to the foreign prospectus - PLN 272 thousand gross,
- for other services provided to mBank Hipoteczny S.A. - PLN 22 thousand gross.

44. Capital adequacy

One of the Bank's main tasks is to ensure an appropriate level of capital. Within the framework of the capital management policy, the Bank prepares the guidelines for the most effective planning and use of capital basis which:

- are compliant with external and internal regulations in force,
- guarantee a continuity of financial targets, which render an appropriate rate of return for shareholders,
- ensure the maintenance of a strong capital basis being a fundamental support for business development.

The Bank's capital management policy is based on two basic pillars:

- maintenance of an optimal level and structure of own funds with the application of available methods and means, like retention of net profit, subordinated loan or issue of shares,
- effective use of existing capital, among others through application of a set of measures of effective use of the capital, limitation of activities that do not provide an expected rate of return and development of products with lower capital absorption.

Effective use of capital is an integral part of the capital management policy oriented at reaching an optimal rate of return on capital and as a result forming a stable foundation of reinforcement of the capital basis in future periods. This helps to maintain the Tier 1 common equity ratio (calculated as the quotient of Tier 1 common equity and total amount of risk exposure), Tier 1 capital ratio (calculated as the quotient of Tier 1 capital and total amount of risk exposure), and combined capital ratio (calculated as the quotient of own funds and total amount of risk exposure), at a level significantly higher than required by the regulatory authority.

The strategic capital objectives of the Bank are aimed at maintaining both the combined capital ratio and the Common Equity Tier 1 capital ratio at a level significantly higher than required by the regulatory authority. This permits a safe growth of the business while meeting supervision standards in long term.

for 2018 (in PLN thousand)

Capital ratios

The measurement of own funds adequacy, including i.a. calculation of capital ratios and leverage ratio, own funds and the Bank's total exposure to risk, is performed on the basis of the following regulations:

- Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 as amended (hereinafter referred to as CRR Regulation) and other Commission (EU) implementing regulations to the CRR Regulation,
- Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council with further amendments (ITS Regulation),
- Act of 29 August 1997 — Banking Law (Journal of Laws of 2002 No 72, item 665) as amended,
- Act of 5 August 2015 (Journal of Laws 2015, item 1513) on the macro-prudential oversight of the financial system and crisis management in the financial system ("Macro Prudential Oversight Act"),
- Regulation of the Minister of Development and Finance of 25 May 2017 on the application of higher risk weights to credit exposures secured by mortgages on real estate property,
- Regulation of the Minister of Development and Finance of 1 September 2017 on the systemic risk buffer.

In connection with the Macro-Prudential Oversight Act coming into force as of 1 January 2016, which transposes CRD IV into the Polish legal regime, as at 31 December 2018 the Bank was compelled to maintain own funds as such a level as would permit covering the conservation buffer determined under the Act at 1.875% of the total exposure to risk.

In accordance with the decision of the Financial Stability Committee, the anti-cycle buffer imposed on the Bank as at 31 December 2018 was 0%.

On 1 January 2018, the Regulation of the Minister of Development and Finance of 1 January 2018 on the systemic risk buffer came into force. The systemic risk buffer applicable to the Bank as at 31 December 2018 was 3% of the total risk exposure.

Ultimately, the combined buffer requirement set for mBank Hipoteczny S.A. as at the end of 2018 was 4.875%.

Capital ratios, both as at the end of 2018 and the end of 2017, were below the minimum required values as presented in the following table. In 2018 and 2017, the Bank met internal capital requirements.

Capital ratio	31.12.2018	
	Minimum ratio	Presented ratio
Total capital ratio	12,875%	16,25%
Equiety Tier 1 capital ratio	10,875%	13,38%
Equiety Tier 1 core capital ratio	9,375%	13,38%

Capital ratio	31.12.2017	
	Minimum ratio	Presented ratio
Total capital ratio	13,25%	15,79%
Equiety Tier 1 capital ratio	10,25%	12,93%

The leverage ratio, calculated in line with the CRR Regulation and the Commission Delegated Regulation (EU) 2015/62 of 10 October 2014 to amend Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to leverage ratio at the end of 2018 was 7.56%.

The Bank decided that for the purposes of capital adequacy calculation, including the calculation of own funds, based on Article 1(9) of the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 12 December 2017 (Regulation) amending the CRR, it will not apply the transitional period, which permits to alleviate the impact on capital, connected with the implementation of IFRS 9.

The capital ratios, own funds, leverage ratio reported in this document fully reflect the impact of IFRS 9.

Own funds

In accordance with the CRR Regulation, own funds consist of Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital, however mBank Hipoteczny S.A. does not identify items that could be treated as Additional Tier 1 capital.

Common Equity Tier 1 capital of mBank Hipoteczny S.A. encompasses:

- paid-up equity instruments and the related share premium accounts,
- earnings retained in previous years,
- independently verified interim profits,
- other accumulated comprehensive income,
- other capital reserves,
- general risk funds,
- items reducing the Common Equity Tier 1 capital (value adjustments due to the requirements
  regarding prudent valuation, intangible assets, deficiency in credit risk adjustments in light of anticipated losses, regulatory adjustments concerning other accumulated comprehensive income, and net write-downs).

Tier 2 capital of mBank Hipoteczny S.A. encompasses subordinated liabilities.

As at 31 December 2018, the Bank's own funds amounted to PLN 1,133,394 thousand (as at 31 December 2017: PLN 1,104,182 thousand). At the same time, the Common Equity Tier 1 capital ratio of mBank Hipoteczny S.A. amounted to PLN 933,394 thousand (as at 31 December 2017: PLN 904,182).

Total risk exposure amount (TREA)

The Bank's total risk exposure amount encompasses:

- risk weighted exposure amounts for credit risk, counterparty credit risk and dilution risk and free deliveries,
- operational risk exposure amount.

In calculation of the Bank's capital ratios, the total risk exposure amount is determined taking into account the credit risk exposure amount, applying the internal ratings based approach, with the use of the supervisory approach, in regard to assigning specialised lending exposures to risk categories (IRB slotting approach).

As at 31 December 2018, the Bank's total risk exposure amount was PLN 6,975,276 thousand, including the credit risk exposure amount at PLN 6,723,151 thousand.

As at 31 December 2017, the Bank's total risk exposure amount was PLN 6,993,562 thousand, including the credit risk exposure amount at PLN 6,769,934 thousand.

Internal capital

The purpose of the ICAAP process (Internal Capital Adequacy Assessment Process), implemented in the Bank, is to keep own funds at the level adequate to the risk profile and the risk level stemming from the Bank's operations.

Due to the fact that the total capital requirement of Bank calculated according to the CRR Regulation and internal capital assessed for the Bank according to the Regulation of the Minister of Development and Finance of 6 March 2017 on the risk management system and internal control system, remuneration policy and detailed method of estimation of internal capital in banks, are lower than the value of the Bank's own funds, as at 31 December 2018 the Bank maintained own funds at a level consistent with the CRR.

for 2018 (in PLN thousand)

As at 31 December 2018, the Bank's internal capital amounted to PLN 480,632 thousand.

Capital adequacy	31.12.2018	31.12.2017
Common Equity Tier 1 Capital	**933 394**	**904 182**
Own funds	**1 133 394**	**1 104 182**
Risk weighted exposure amounts for credit risk, counterparty credit risk, dilution risk and deliveries with deferred settlement date:	6 723 151	6 769 934
- using internal rating method	4 131 698	4 026 640
- using standard method	2 591 453	2 743 294
Total operational risk exposure amount	252 125	223 628
The total amount of risk exposure	**6 975 276**	**6 993 562**
Common Equity Tier 1 capital ratio	**13,38%**	**12,93%**
Total capital ratio	**16,25%**	**15,79%**
Internal capital	**480 632**	**429 129**

Own funds	31.12.2018	31.12.2017
Own funds	**1 133 394**	**1 104 182**
TIER 1 CAPITAL	**933 394**	**904 182**
Common Equity Tier 1 Capital	**933 394**	**904 182**
Capital instruments eligible as CET1 Capital	734 719	734 719
Paid up capital instruments	321 000	321 000
Share premium	413 719	413 719
Retained earnings	16 622	10 256
Retained earnings from previous years		-
Profit or loss eligible	16 622	10 256
Other accumulated comprehensive income	5 481	3 800
Other reserves	273 082	245 253
General banking risks founds	44 800	44 800
(-) Value adjustments due to the requirements for prudent valuation	(1 351)	(1 339)
(-) Intangible assets	(39 719)	(25 324)
(-) Other intangible assets gross amount	(40 021)	(25 527)
Deferred tax liabilities associated to other intangible assets	302	203
(-) IRB shortfall of credit risk adjustments to expected losses	(81 585)	(88 720)
Other transitional adjustments to CET1 Capital	-	(781)
CET1 capital elements or deductions - other	(5 284)	(18 482)
Impact of IFRS 9	(13 371)	-
Additional Tier 1 capital	-	-
TIER 2 CAPITAL	**200 000**	**200 000**
Capital instruments and subordinated loans eligible as T2 capital	200 000	200 000

45. Post balance-sheet date events

1. As of 31 December 2018, Grzegorz Trawiński resigned from the function of the member of the Management Board (due to his appointment as a director of the Real Estate Financing Department of mBank S.A.). As from 1 January 2019, the composition of the Management Board of mBank Hipoteczny S.A. is as follows: Piotr Cyburt - President of the Management Board, Andrzej Kulik – Member of the Management Board and Marcin Wojtachnio – Member of the Management Board.
2. On 1 February 2019, a portfolio transfer agreement was concluded between mBank S.A. and mBank Hipoteczny S.A., whereby mBank Hipoteczny S.A. acquired from mBank S.A. a retail portfolio of mortgage-backed loans with the total fair value of PLN 716,225 thousand.
3. On 11 February 2019, the Fitch agency maintained the rating for mortgage covered bonds issued by the Bank at the „A" level and revised the rating outlook from „Positive" to „Stable".
4. On 22 February 2019, the Bank issued covered bonds in the total amount of PLN 100,000 thousand, as part of its Polish mortgage covered bonds issuance program.
5. Between 28 January and 26 February 2019, the PFSA Office held a comprehensive inspection in the Bank, on the basis of the notification

of 10 January 2019. At the date of signing of the financial statements, the Bank did not receive the record of the inspection.

6. On 7 March 2019, the Extraordinary General Meeting of mBank Hipoteczny S.A. adopted the Resolution No 1 on the increase of the share capital of mBank Hipoteczny S.A. and the exclusion of shareholder from the pre-emptive right to shares. The share capital will be increased by PLN 15,000 thousand, i.e. up to PLN 336,000 thousand, by way of issuing 150,000 ordinary registered shares of series I with a nominal value of PLN 100 each and issue price of PLN 1,000 each. The shares will be offered for subscription to mBank S.A. through private placement. The share subscription agreement should be signed by 28 March 2019.