Financial Statements of mBank Hipoteczny S.A. according to the International Financial Reporting Standards (IFRS) for 2016

Selected financial data

The selected financial data presented below are supplementary information to the Financial Statements of mBank Hipoteczny S.A. for 2016.

Selected financial data		in PLN `000		in EUR `000	
		Year ended		Year ended	
		31.12.2016	31.12.2015	31.12.2016	31.12.2016
I.	Interest income	318 648	256 317	72 822	61 250
II.	Fee and commission income	6 722	12 636	1 536	3 019
III.	Net trading income	1 736	(434)	397	(104)
IV.	Operating result	46 864	26 797	10 710	6 403
V.	Profit before income tax	30 179	26 797	6 897	6 403
VI.	Net profit attributable to shareholders of mBank Hipotecznego S.A.	23 422	18 791	5 353	4 490
VII.	Net cash flows from operating activities	(1 824 043)	(1 270 880)	(416 857)	(303 690)
VIII.	Net cash flows from investment activities	(8 670)	(8 086)	(1 981)	(1 932)
IX.	Net cash flows from financing activities	1 403 403	1 442 916	320 727	344 799
X.	Total net cash flows	(429 310)	163 950	(98 112)	39 177
XI.	Basic earnings per ordinary share / Diluted earnings per ordinary share (in PLN/EUR)	7.70	6.46	1.76	1.54

Selected financial data		in PLN `000		in EUR`000	
		as at		as at	
		31.12.2016	31.12.2015	31.12.2016	31.12.2015
I.	Total assets	10 649 499	8 419 125	2 407 210	1 975 625
II.	Amounts due to other banks	3 316 817	2 959 741	749 733	694 530
III.	Amounts due to customers	36 394	265 509	8 226	62 304
IV.	Equity attributable to shareholders of mBank Hipoteczny S.A.	903 699	782 336	204 272	183 582
V.	Share capital	309 000	299 000	69 846	70 163
VI.	Number of shares	3 090 000	2 990 000	3 090 000	2 990 000
VII.	Book value per share / Diluted book value per share (in PLN/EUR)	292.46	261.65	66.11	61.40
VIII.	Total capital ratio (%)	14.54	13.81	14.54	13.81

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

- <u>for items of the statement of financial position</u> – exchange rate announced by the National Bank of Poland as at 31 December 2016: EUR 1 = 4.4240 and 31 December 2015: EUR 1 = PLN 4.2615.
- <u>for items of the income statement and statement of cash flow</u> – 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 2016 and 2015: 1 EUR = 4.3757 PLN and 1 EUR = 4.1848 PLN.

TABLE OF CONTENTS

for 2016 (in PLN thousand)

Income statement

		Year ended 31 December	
	Note	2016	2015
Interest income	7	318 648	256 317
Interest expense	7	(188 507)	(145 555)
Net interest income		**130 141**	**110 762**
Fee and commission income	8	6 722	12 636
Fee and commission expenses	8	(5 196)	(6 107)
Net fee and commission income		**1 526**	**6 529**
Net trading income, including:	9	1 736	(434)
Foreign exchange result		*4 240*	*2 036*
Other net trading income and result on hege accounting		*(2 504)*	*(2 470)*
Gains less losses from investment securities		5	-
Other operating income	10	3 116	763
Net impairment write-downs on loans and advances	11	(21 588)	(24 775)
Overhead costs	12	(62 472)	(57 876)
Amortisation and depreciation	23,24	(3 197)	(4 699)
Other operating expenses	13	(2 403)	(3 473)
Operating result		**46 864**	**26 797**
Taxes on the Bank balance sheet items		(16 685)	-
Profit before income tax		**30 179**	**26 797**
Income tax	14	(6 757)	(8 006)
Net profit		**23 422**	**18 791**
Net profit attributable to shareholders of the Bank	15	**23 422**	**18 791**
Weighted average number of ordinary shares / Diluted weighted average number of ordinary shares	15	**3 042 186**	**2 909 068**
Earnings per ordinary share / Diluted earnings per ordinary share (in PLN)	15	**7.70**	**6.46**

The entire profit of mBank Hipoteczny S.A. for the 2016 and 2015 pertains to the performance of continuing operations.

Notes presented on pages 7 to 101 constitute an integral part of these Financial Statements.

for 2016 (in PLN thousand)

Statement of comprehensive incomes

		Year ended 31 December	
	Note	2016	2015
Net profit		**23 422**	**18 791**
Other comprehensive income net of tax	16	**(1 995)**	**(914)**
Items that may be reclassified to the income statement		**(1 993)**	**(917)**
Available-for-sale financial assets (gross)		(2 461)	(1 132)
Deferred tax on valuation available for sale financial assets		468	215
Available-for-sale financial assets (net)		(1 993)	(917)
Items that will not be reclassified to the income statement	16	**(2)**	**3**
Actuarial gains and losses on post-employment benefits (gross)	30.2	(3)	4
Deferred tax on actuarial gains and losses on post-employment benefits		1	(1)
Actuarial gains and losses on post-employment benefits (net)		(2)	3
Total comprehensive income net of tax		**21 427**	**17 877**
Net comprehensive income attributable to shareholders of the Bank		**21 427**	**17 877**

Notes presented on pages 7 to 101 constitute an integral part of these Financial Statements.

for 2016 (in PLN thousand)

Statement of financial position

ASSETS	Note	31.12.2016	31.12.2015
Cash and balances with the central bank	17	5 530	7 521
Amounts due from other banks	18	16 262	205 180
Derivative financial instruments	19	45 160	32 212
Loans and advances to customers	21	9 411 505	7 391 743
Investment securities available for sale	22	1 134 049	748 505
Intangible assets	23	13 357	8 152
Tangible fixed assets	24	7 603	7 523
Current income tax assets		-	1 597
Deferred income tax assets	31	8 644	7 213
Other assets, including:	25	7 389	9 479
- inventories	3.1.4	3 432	6 768
Total assets		**10 649 499**	**8 419 125**
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to other banks	26	3 316 817	2 959 741
Derivative financial instruments	19	9 635	3 770
Amounts due to customers	27	36 394	265 509
Debt securities in issue	28	6 123 466	4 164 902
Hedge accounting adjustments related to fair value of hedged items	20	29 305	21 530
Subordinated liabilities	29	200 484	200 899
Current income tax liabilities		2 791	-
Other liabilities and provisions	30	26 908	20 438
Total liabilities		**9 745 800**	**7 636 789**
Equity			
Share capital:		**614 792**	**514 856**
- Registered share capital	36	309 000	299 000
- Share premium	37	305 792	215 856
Retained earnings	38	**290 053**	**266 631**
- Profit from the previous years		266 631	247 840
- Profit for the current period		23 422	18 791
Other components of equity	39	**(1 146)**	**849**
Total equity		**903 699**	**782 336**
TOTAL LIABILITIES AND EQUITY		**10 649 499**	**8 419 125**
Total capital ratio (%)	45	**14.54**	**13.81**

Notes presented on pages 7 to 101 constitute an integral part of these Financial Statements.

for 2016 (in PLN thousand)

Statement of changes in equity

Changes in equity from 1 January 2016 to 31 December 2016

	Note	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 available-for-sale financial assets	Actuarial gains and losses on post-employment benefits	
As at 1 January 2016		**299 000**	**215 856**	**211 340**	**36 500**	**18 791**	**-**	**825**	**24**	**782 336**
Net profit		-	-	-	-	-	23 422	-	-	23 422
Other comprehensive income (gross)		-	-	-	-	-	-	(2 461)	(3)	(2 464)
Deferred tax on other comprehensive income		-	-	-	-	-	-	468	1	469
Total comprehensive income	16	**-**	**-**	**-**	**-**	**-**	**23 422**	**(1 993)**	**(2)**	**21 427**
Transfer to general banking risk reserve	38	-	-	-	6 000	(6 000)	-	-	-	-
Transfer to supplementary capital	38	-	-	12 791	-	(12 791)	-	-	-	-
Issue of shares	36,37	10 000	90 000	-	-	-	-	-	-	100 000
Share issue costs		-	(64)	-	-	-	-	-	-	(64)
As at 31 December 2016		**309 000**	**305 792**	**224 131**	**42 500**	**-**	**23 422**	**(1 168)**	**22**	**903 699**

Changes in equity from 1 January 2015 to 31 December 2015

	Note	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 available-for-sale financial assets	Actuarial gains and losses on post-employment benefits	
As at 1 January 2015		**285 000**	**89 938**	**192 469**	**33 000**	**22 371**	**-**	**1 742**	**21**	**624 541**
Net profit		-	-	-	-	-	18 791	-	-	18 791
Other comprehensive income (gross)		-	-	-	-	-	-	(1 132)	4	(1 128)
Deferred tax on other comprehensive income		-	-	-	-	-	-	215	(1)	214
Total comprehensive income	16	**-**	**-**	**-**	**-**	**-**	**18 791**	**(917)**	**3**	**17 877**
Transfer to general banking risk reserve	38	-	-	-	3 500	(3 500)	-	-	-	-
Transfer to supplementary capital	38	-	-	18 871	-	(18 871)	-	-	-	-
Issue of shares		14 000	126 000	-	-	-	-	-	-	140 000
Share issue costs		-	(82)	-	-	-	-	-	-	(82)
As at 31 December 2015		**299 000**	**215 856**	**211 340**	**36 500**	**-**	**18 791**	**825**	**24**	**782 336**

Notes presented on pages 7 to 101 constitute an integral part of these Financial Statements.

for 2016 (in PLN thousand)

Statement of cash flow

		Year ended 31 December	
	Note	2016	2015
A. Cash flows from operating activities		**(1 824 043)**	**(1 270 880)**
Profit before income tax		**30 179**	**26 797**
Adjustments:		***(1 854 222)***	***(1 297 677)***
Income tax paid		(3 332)	(4 175)
Amortisation	23,24	3 197	4 699
Impairment of tangible fixed assets	13,24	-	12
Interest income (income statement)	7	(318 648)	(256 317)
Interest expenses (income statement)	7	188 507	145 555
Interest received		287 392	260 007
Interest paid		(16 708)	(13 852)
Change in balances with the central bank		-	-
Change in amounts due from other banks	32	(2)	7
Change in assets and liabilities on derivative financial instruments	32	(3 025)	(3 134)
Change in loans and advances to customers	32	(2 001 178)	(2 069 877)
Change in investment securities	32	(624 474)	(25 540)
Change in other assets		2 090	5 211
Change in amounts due to other banks	32	14 663	632 700
Change in amounts due to customers	32	(229 079)	15 592
Change in debt securities in issue	32	839 719	9 300
Change in other liabilities and provisions	32	6 468	6 353
Result on disposal of intangible assets and tangible fixed assets	10,13	(14)	15
Adjustments to intangible assets and property, plant and equipment		202	-
Net cash from operating activities		**(1 824 043)**	**(1 270 880)**
B. Cash flows from investing activities		**(8 670)**	**(8 086)**
Investing activity inflows		**207**	**17**
Disposal of intangible assets and tangible fixed assets		207	17
Investment activity outflows		**8 877**	**8 103**
Purchase of intangible assets and tangible fixed assets	23,24	8 877	8 103
Net cash from investing activities		**(8 670)**	**(8 086)**
C. Cash flow from financing activites		**1 403 403**	**1 442 916**
Financing activity inflows		**2 526 485**	**3 239 210**
Loans and advances from banks		850 096	1 454 847
Due to the issue of debt securities		1 569 769	1 540 713
Due to the issue of shares		99 937	139 918
Due to subordinated loans	29	-	100 000
Interest received from hedging derivative financial instruments		6 683	3 732
Financing activities outflows		**1 123 082**	**1 796 294**
Repayment of loans and advances from banks		508 728	1 105 726
Redemption of debt securities		450 000	550 000
Interest paid on loans received, debt securities in issue, subordinated loan		164 354	140 568
Net cash from financing activities		**1 403 403**	**1 442 916**
Net increase / decrease in cash and cash equivalents (A+B+C)		**(429 310)**	**163 950**
Cash and cash equivalents as at the beginning of the reporting period, including:		**682 564**	**518 614**
Cash and balances with the central bank		7 521	7 669
Amounts due from other banks		205 180	30 972
Investment securities with maturity of up to 3 months from the date of purchase		469 863	479 973
Cash and cash equivalents as at the end of the reporting period, including:	**41**	**253 254**	**682 564**
Cash and balances with the central bank	17	5 530	7 521
Amounts due from other banks	18	16 262	205 180
Investment securities with maturity of up to 3 months from the date of purchase		231 462	469 863

Notes presented on pages 7 to 101 constitute an integral part of these Financial Statements.

Explanatory notes to the condensed 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 Armii Ludowej av. No. 26.

The Bank was established for an indefinite period of time.

mBank Hipoteczny S.A. is a specialised mortgage bank that plays a leading role on the commercial real estate financing market and issuing of covered bonds - debt securities through which the Bank finances its loan activities.

There are two business lines in the Bank:

- retail line, focused on granting mortgage loans in cooperation with 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.

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.

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

As at December 31, 2016 the employment in the Bank was 218 FTEs and 227 persons (December 31, 2015: 212 FTEs; 222 persons).

Average employment in 2016 was 227 employees, in 2015 it was 218 employees.

These financial statements mBank Hipoteczny S.A. were approved by the Management Board on 3 March 2017.

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. These principles were applied consistently over all presented periods unless specified otherwise.

2.1. Accounting basis

Financial Statements of mBank Hipoteczny S.A. have been prepared for the 12-month period ended 31 December 2016. Comparative data presented in these financial statements relate to the period of 12 months ended on 31 December 2015. Presented financial statements are standalone financial statements.

As at 31 December 2016 and as at 31 December 2015 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 available for sale financial assets, 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 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 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. Material 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 and expenses on financial instruments carried at amortised cost is recognised in the income statement using the effective interest rate method as well as interest income from assets held for trading and available for sale.

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 at which the discounted future payments or future cash inflows are equal to the net present carrying value of the respective financial asset or liability. When calculating the effective interest rate, the Bank estimates the cash flows taking into account all the contractual terms of the financial instrument, but without taking into account possible future losses on account of non-recovered loans and advances. This calculation takes into account all the fees 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.

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

Interests accrued on receivables for which impairment was found are recognised in interest income on the basis of interest rates used to discount future cash flows when calculating allowances for impairment. Those interests are credited to the income statement from part of equity possible to be recovered, i.e. with consideration of adjustment of impairment of exposure.

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.

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 line 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 fair value hedge accounting.

Interest expenses include paid and accrued interests as well as commissions from deposits accepted from clients, interbank deposits, received loans, other financial liabilities with deferred payment term, subordinated loans, funds deposited in clients' bank accounts and own issued debt securities, which are recognized using the effective interest rate method.

2.3. Fee and commission income and expenses

Fee and commission income is recognised on the accrual basis, 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 financial instruments, in particular when insurance product is offered to the customer only with certain financial instrument, 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 financial instrument.

The Bank does not offer insurance products which are not bundled with financial instruments. Revenue and expenses 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: "Commercial loans", "Retail loans", "Other loans" and "Non-allocated assets items", described in detail in Note 6.

2.6. Financial assets/financial liabilities

2.6.1. Financial assets

The Bank classifies its financial assets to the following categories:

- financial assets valued at fair value through the income statement,
- loans and receivables,
- financial assets held to maturity,
- financial assets available for sale.

The classification of financial assets is determined by the Management at the time of their initial recognition. Financial assets at initial recognition are measured at fair value plus related transaction costs in case of a financial asset item not measured at fair value through profit or loss.

Standardised purchases and sales of financial assets at fair value through the income statement, held to maturity and available for sale 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. 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 assets valued at fair value through the income statement

This category comprises two subcategories: financial assets held for trading and financial assets designated at fair value through the income statement upon initial recognition. A financial asset is classified in this category if it was acquired principally for the purpose of short-term resale.

Derivative instruments are also classified as "held for trading", unless they were designated for hedging according to IAS 39.

The Bank classifies derivative instruments as financial assets valued at fair value through profit or loss. In the reporting periods presented in these financial statements, the Bank did not classify any financial instruments at their initial recognition as financial assets measured at fair value through profit or loss.

The measurement and the earnings or losses on the sales of financial assets measured at fair value through profit or loss are recognised in net trading income, except for the net interest income on derivatives, which is presented in the net interest income in the item Interest income/expense on derivatives classified into banking book or in the item Interest income/expense on derivatives concluded under the hedge accounting.

As at the end of the reporting period, financial assets measured at fair value through profit or loss are measured at fair value. Gains and losses arising from changes in the fair value of financial assets measured at fair value through profit or loss are demonstrated in the income statement, in the period in which they arose as net trading income.

<u>Loans and receivables</u>

Loans and receivables consist of financial assets not classified as derivative instruments, with payments either determined or possible to determine, not listed on an active market. They arise when the Bank supplies monetary assets, goods or services directly to the debtor without any intention of trading the receivable.

Loans and receivables are measured at adjusted cost of acquisition (amortised cost), applying the effective interest rate method.

<u>Investments held to maturity</u>

Investments held to maturity comprise listed on active markets financial assets, not classified as derivative instruments, where the payments are determined or possible to determine and with specified maturity dates, and which the Bank intends and is capable of holding until their maturity.

In the case of sale by the Bank before maturity of a part of assets held to maturity which cannot be deemed insignificant the held to maturity portfolio is tainted, and there with all the assets of this category are reclassified to the available for sale category.

In reporting periods presented in these financial statements, there were no assets held to maturity at the Bank.

<u>Financial assets available for sale</u>

Available for sale investments consist of investments which the Bank intends to hold for an undetermined period of time. They may be sold, e.g., in order to improve liquidity, in reaction to changes of interest rates, foreign exchange rates, or prices of equity instruments.

Interest income and expense from available for sale investments are presented in net interest income.

Available for sale financial assets and financial assets measured at fair value through the income statement are valued at the end of the reporting period according to their fair value. Loans and receivables, as well as investments held to maturity are measured at adjusted cost of acquisition (amortised cost), applying the effective interest rate method.

Gains and losses arising from changes in the fair value of available for sale financial assets are recognized in other comprehensive income until the derecognition of the respective financial asset 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 classified as available for sale 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 available for sale equity instruments are recognised 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 available for sale equity instruments at the Bank.

2.6.2. Financial liabilities

The Bank categorises its financial liabilities as follows:

- financial liabilities disclosed at the fair value through the income statement,
- other financial liabilities.

Financial liabilities measured at fair value through the income statement are:

- liabilities for held for trading incurred in order to achieve economic benefits resulting from short-term changes of prices and fluctuations of other market factors,
- other financial liabilities, regardless of intentions followed when concluding a contract, if they constitute one asset of portfolio of similar financial liabilities, in relation to which there is a high probability of realisation of expected economic benefits in a short-term,
- derivative financial instruments,
- financial liabilities disclosed at the fair value through the income statement by Bank's decision.

Apart from derivative instruments the Bank did not classify any other financial liability as measured at the fair value through the income statement.

Other financial liabilities include in particular:

- fund on current accounts,
- deposits from clients,
- subordinated loans received,
- loans received,
- other financial liabilities with deferred payment term,
- debt securities issued by the Bank (covered bonds and bonds),
- trade payables.

Other financial liabilities are valued at the depreciated cost using the effective interest rate method.

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

Assets carried at amortised cost

At the end of the reporting period the Bank estimates whether there is an objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is an objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The rules of impairment measurement and calculation of provisions for loans and advances are presented in Note 3.1.3.

Uncollectible loans are written off against the provision for loan impairment. Before a loan is written off all required procedures are conducted and the loss amount is determined.

Subsequent recoveries of amounts previously written off reduce (in accordance with IAS 39) the amount of the provision for loan impairment in the income statement. If in a subsequent period the impairment loss amount is decreasing and the decrease can be related objectively to an event occurring after the impairment was recognised (e.g., improvement of the debtor's credit rating), then the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recorded in the income statement.

Receivables written off and not accumulated are recorded on off-balance sheet accounts. In case of receivables written off without accumulation, the department providing administrative support of receivables conducts debt collection activities until complete recovery of the amount or its amortization. Those actions may be suspended when they are ineffective or unprofitable, or if all possibilities of recovering a receivable were exhausted. Write-offs are subject to de-recognition from off-balance sheet accounts, if:

- receivable is collected,
- receivable is redeemed.

Financial assets available for sale

At the end of the reporting period the Bank estimates whether there is an objective evidence that a financial asset or a group of financial assets is impaired. In the case of instruments classified as investments available for sale, a significant or prolonged decline in the fair value of the security below its cost resulting from higher credit risk is considered when determining whether the assets are impaired. If such kind of evidence concerning available for sale financial assets exists, the cumulative loss – determined as the difference between the cost of acquisition and the current fair value less impairment of relevant asset previously recognised in the income statement – is removed from other comprehensive income and recognised in the income statement. Impairment losses concerning equity instruments recorded in the income statement are not reversed through the income statement, but through other comprehensive income. If the fair value of a debt instrument classified as available for sale 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.

Renegotiated agreements

The Bank considers renegotiations on contractual terms of loans and advances as impairment indicator unless the renegotiation was not due to the situation of the debtor but had been carried out on normal business terms. In such a case the Bank makes an assessment whether the impairment should be recognised on either individual or group basis.

The general rule of the restructuring policy conducted by the Bank is recognition of the reasons of threat of failure to repay a loan granted according to conditions specified in the loan agreement as early as possible and diagnosis whether those threats are attributed to the market or the entrepreneur.

In case of threats resulting from the situation on the market, the Bank conducts a policy of restructuring of the granted loan towards implementation of the "stay" strategy which assumes maintenance of relationship with the borrower and consists in such change of the conditions of the granted loan which will allow the entrepreneur to continue business activity and its further development in case of beneficial change of market conditions.

In case of threats attributed to the entrepreneur, the Bank conducts a policy of restructuring of the granted loan towards implementation of the "exit" strategy assuming termination of relationship with a borrower as fast as possible and without losses.

The most important factor taken into account in restructuring of granted loans is assumed time of repayment of a loan, the Bank prioritises restructuring over debt collection, unless restructuring does not bring tangible effects.

In case of restructuring of conditions of repayment of loans, the Bank is flexible in terms of applied margins, commissions and fees, provided that the repayment of the entire current value of a loan is guaranteed.

Due to the specificity of the loan product (mortgage loan) offered by the Bank, the Bank prefers, in case of impairment calculation, taking assumptions of future cash inflows from the sale of assets on which the Bank established mortgages in time resulting from standard periods of liquidation of those assets, and not from inflows from the borrower's own contributions or implementation of other securities, unless such inflows are almost guaranteed.

A set of measures, defined by internal regulations and related to the renegotiation and restructuring of terms of loan agreements, defined as the Banks policy with respect to forbearance, was described in Note 3.1.5.

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 short term government securities. Cash and cash equivalents are valued to the amount of amortised cost.

2.10. Derivative financial instruments and hedge accounting

Derivative financial instruments are recognized 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 recognized 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) unless 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. If such a price is known, the Bank shows gains or losses on the first day.

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.

Fair value hedges

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.

Derivative instruments not fulfilling the criteria of hedge accounting

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.

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

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:

- Interest Rate Swap Contracts.

Foreign exchange risk instruments (which are forward liabilities to purchase a specified amount of foreign or local currency):

- 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

Intangible assets are recognised at their cost of acquisition adjusted by the costs of improvement (rearrangement, development, reconstruction 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. These 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 technical feasibility to complete and to use the intangible asset, the availability of adequate technical, financial and other resources to complete and to use the intangible asset and the ability to measure reliably the expenditure attributable to the intangible asset during its development.

“Development costs” useful lives are finite and the amortization period does not exceed 5 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

The balance sheet value is the purchase price or cost of production of a given asset decreased by the total value of amortisation write-offs and the total amount of impairment losses.

Cost is the amount of cash or cash equivalents paid and 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, reduced by the final value of this asset, should be amortised.

The amortisation 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 final 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).

Amortization and annual depreciation is determined considering the economic usability period of given tangible fixed assets. Correctness of the applied periods and rates for amortisation 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 amortisation 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 amortises tangible fixed assets using the straight-line method by distributing its initial value or revalued amount reduced by final value by estimated useful life. The final 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 amortisation 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 on 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 on financial situation.

Profits and losses resulting from the removal of a tangible fixed asset item from the statement on 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 on financial situation.

2.13. Deferred income tax

Such liabilities or 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. Temporary differences are differences arising between the carrying amount of an asset or liability and its tax base.

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.

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 deferred income tax assets and liabilities netted in the statement of financial position separately for each subsidiary undergoing consolidation.

Such assets and provisions may be Revaluation of non-financial assets available for sale 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.

This Regulation shall come into force on 1 January 2015.

2.14. Inventories

Assets repossessed for debt are classified by the Bank as inventories. At initial recognition assets repossessed for debt 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

The Bank recognises prepayments if the costs incurred relate to future reporting periods. Prepayments are presented in the statement of financial position under "Other assets".

Accrued expenses are liabilities payable for goods and services that were received/provided, but were not paid, invoiced or officially agreed with the supplier, including amounts due to employees. 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 and provisions".

2.16. Provisions

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. Retirement and other employee benefits

<u>Provision for retirement and similar benefits</u>

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.

<u>Phantom share-based benefits settled in cash</u>

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.

Pursuant to the Resolution of the Supervisory Board No 14/2016 of 18 April 2016, the amended Policy for remuneration of persons having a material impact on the risk profile in mBank Hipoteczny S.A. was approved. The amendment concerned the calculation of average value of the phantom shares for the execution of non-deferred non-cash portion and deferred non-cash tranches. Before the amendment, the value of shares was defined as the value as at the end of the annual period preceding the payment date. At present, the average phantom share value is calculated as the sum of phantom share values as 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 two. Details of the programme are provided in Note 42.

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 and deposits accepted are initially recognised at fair value reduced by the incurred transaction costs. After the initial recognition, loans and advances received and deposits accepted 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>Paid unregistered share capital</u>

Paid-up capital not entered into the 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.

- Share issue costs

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 created from profit appropriation,
- General Risk Fund created through the profit appropriation and intended for the purposes specified in the Articles of Association or in other legal regulations,
- retained earnings from the previous year,
- net result for the current year.

<u>Other components of equity</u>

Other equity items include amount from valuation of available for sale financial instruments and actuarial of employee benefits after the period of employment.

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.

The Bank determines whether an arrangement is, or contains, a lease based on the substance of the arrangement and assessment of whether fulfilment of the arrangement is dependent on the use of a specific asset and the arrangement conveys a right to use the asset.

2.22. Valuation of items denominated in foreign currencies

Functional currency and presentation currency

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

Transactions and balances

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.

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

The Bank presents the tax from the off-balance sheet positions 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 2016.

Published Standards and Interpretations which have been issued and binding for the Bank for annual periods starting on 1 January 2016

Standards and interpretations approved by the European Union:

- IAS 19 (Amended), Defined Benefit Plans: Employee Contributions, published by the International Accounting Standards Board on 21 November 2013, approved by European Union on 17 December 2014 and binding for annual periods starting on or after 1 July 2014, in EU effective at the latest for financial years beginning on or after 1 February 2015.

  The amendment relates only to contributions for defined benefit plans from employees or third parties. The amendment of the Standard is aimed at clarification and simplification the accounting requirements for contributions independent of the number of years of service, i.e. contributions that are a fixed percentage of the employee’s salary, a fixed amount throughout the service period or dependent on the employee’s age. In accordance with the amendment of the Standard such contributions should be recognized as a reduction in the service cost in the period in which the related service is rendered.

- Improvements to IFRSs 2010 – 2012 Cycle, published by the International Accounting Standards Board on 12 December 2013, approved by European Union on 17 December 2014, in majority binding for annual periods starting on or after 1 July 2014 and some effective prospectively for transactions occurring on or after 1 July 2014, in EU effective at latest for financial years beginning on or after 1 February 2015.

  The improvements to the following standards were implemented during the cycle: IFRS 2 in terms of changing definitions: "vesting condition", "market condition" and adding definitions: "service condition" and "performance condition", IFRS 3 in terms of clarification of classification a contingent consideration by an acquirer, IFRS 8 in terms of disclosure requirement of judgments made by management in applying the aggregation criteria for operating segments and disclosure of reconciliation of the total of the reportable segments' assets to the total assets, IFRS 13 in terms of clarification of doubts for the possibility of simplified measurement of short-term receivables and payables without discounting, when the effect of not discounting is immaterial, IAS 16 and IAS 38 in terms of proportionate restatement of accumulated depreciation or amortization, respectively, when an item of property, plant and equipment or intangible asset, respectively is revalued, IAS 24 in terms of identifying related party which provides key management personnel services to the reporting entity or to the parent of the reporting entity.

- Amendments to IAS 1, Disclosure initiative, published by the International Accounting Standards Board on 18 December 2014 approved by European Union on 18 December 2015 and binding for annual periods starting on or after 1 January 2016.

  The amendments to IAS 1 include the clarification of the material information with particular regard to the reduction of immaterial information in financial statements. Moreover, specific items in financial statements may be the subject to both aggregation and disaggregation depending on its materiality. IAS 1 was also completed with the requirements regarding the presentation of subtotals in financial statements. Additionally, the information presented in the notes of financial statements may be presented in a systematic manner, however in determining a systematic manner, the entity shall consider the effect on the understandability and comparability of its financial statements. The guidelines regarding the identification of significant accounting policies were deleted in the amendments to IAS 1.

- Amendments to IAS 16 and IAS 38, Clarification of acceptable methods of depreciation and amortization, published by the International Accounting Standards Board on 12 May 2014, approved by European Union on 2 December 2015, binding for annual periods beginning on or after 1 January 2016.

  The amended IAS 16 prohibits the use of a revenue-based method for depreciating a tangible fixed asset. A depreciation method that is based on revenue that is generated by an activity of the entity is not appropriate, because the revenue generated by an activity that includes the use of an asset reflects factors other than the consumption of the economic benefits of the asset.

  The amended IAS 38 includes a rebuttable presumption that a revenue-based method for amortization of an intangible asset is inappropriate for the same reasons as in the case of tangible fixed assets presented in amended IAS 16. However, the presumption in case of amended IAS 38 could be overcome in two circumstances: when it can be demonstrated that revenue is highly correlated with the consumption of the economic benefits embodied in an intangible asset and when the right embodied by an intangible asset is expressed as a total amount of revenue to be generated.

- Amendments to IAS 16 and IAS 41 Agriculture: Bearer Plants published by the International Accounting Standards Board on 30 June 2014, approved by European Union on 23 November 2015, binding for annual periods beginning on or after 1 January 2016.

  The amended IAS 16 and IAS 41 introduce the obligation of recognizing bearer plants in the same way as tangible fixed assets and of using the requirements of IAS 16 measuring them either at cost or at revaluated amount. IAS 41 still applies to the produce on those bearer plants, which should be measured at fair value less costs to sell. Bearer animals are not covered by the amendments.

- Amendments to IAS 27, Equity method in separate financial statements, published by the International Accounting Standards Board on 12 August 2014, approved by European

Union on 18 December 2015, binding for annual periods beginning on or after 1 January 2016.

The amended IAS 27 re-establish the possibility of equity method application for investments in subsidiaries, joint ventures and associates in separate financial statements. The entity preparing separate financial statements should account for investments in subsidiaries, joint ventures and associates at cost or according to IFRS 9 or using the equity method as described in IAS 28. The dividend from a subsidiary, a joint venture or an associate is recognized in profit and loss or as a reduction from the carrying amount of the investment if the equity method is used.

- Amendments to IFRS 11, Accounting for acquisitions of interests in joint operations, published by the International Accounting Standards Board on 6 May 2014, approved by European Union on 24 November 2015 and binding for annual periods beginning on or after 1 January 2016.

  The amended standard requires the acquirer of an interest in a joint operation in which the activity constitutes a business, as defined in IFRS 3 Business Combination, to apply all of the principles on business combinations accounting in IFRS 3 and other IFRSs except for those principles that conflict with the guidance in this IFRS. It applies to the acquisition of both the initial interest and additional interests in a joint operation in which the activity of the joint operation constitutes a business. Moreover, the acquirer shall disclose the information required by IFRS 3 and other IFRSs for business combinations

- Annual Improvements to IFRSs 2012-2014 Cycle, changing 4 standards, published by the International Accounting Standards Board on 25 September 2014, approved by European Union on 15 December 2015 and binding for annual periods beginning on or after 1 January 2016.

  The improvements to the following standards were implemented during the cycle: IFRS 5 in the situation when an asset is reclassified from being held for sale to being held for distribution to owners or from being held for distribution to owners to being held for sale, then the change in classification is considered a continuation of the original plan of disposal. Additionally, when assets no longer meet the criteria for held for distribution to owners (without meeting the held-for-sale criteria), the entity should cease to apply held-for-distribution accounting in the same way as it ceases to apply the held-for-sale accounting when they no longer meet the held-for-sale criteria; IFRS 7 when an entity transfers a financial asset retaining the right to service that financial asset for a fee that is included in a servicing contract, whether the entity has a continuing involvement as a result of the servicing contract for the purpose of disclosure requirements. Additionally, IFRS 7 clarifies that disclosures regarding offsetting financial assets and financial liabilities are not specifically required for all interim periods, unless it is required by IAS 34; IAS 19 in terms of clarification that high quality corporate bonds used to determine a discount rate of post-employment benefit obligations shall be in the same currency as the currency of the post-employment benefit obligations. Assessment whether there is a deep market in such high quality corporate bonds should be made for the currency, not for a country; IAS 34 in terms of clarifying the meaning of disclosure of information' elsewhere in the interim financial report' and additionally it introduces a requirement to incorporate disclosure in interim financial statement by cross-reference to information in another statement.

- Amendments to IFRS 10, IFRS 12 and IAS 28, Investment entities: applying the consolidation exception, published by the International Accounting Standards Board on 18 December 2014, approved by European Union on 22 September 2015 and binding for annual periods starting on or after 1 January 2016.

  The amendments to IFRS 10, IFRS 12 and IAS 28 exempt to the requirement of presenting consolidated financial statements by an entity that is a parent if its ultimate or any intermediate parent produces financial statements that are available for public use and comply with IFRSs, in which subsidiaries are consolidated or are measured at fair value through profit or loss. Additionally, the requirement to consolidation was limited to the situation when an investment entity has a subsidiary that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity's investment activities. Moreover, when applying the equity method in an associate or joint venture that is an investment entity, an investor retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries.

Above changes did not have a material impact on the information presented in the financial statements.

These financial statements do not include the following standards and interpretations 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.

Standards and interpretations not yet approved by the European Union:

- Amendments to IFRS 10 and IAS 28, Sale or contribution of assets between an investor and its associate or joint venture, published by the International Accounting Standards Board on 11 September 2014, binding for annual periods beginning on or after 1 January 2016, wherein the term has been initially postponed by the International Accounting Standards Board.

  The amendments to IFRS 10 and IAS 28 eliminate inconsistency between these standards and clarify the accounting approach in a situation when a parent loses control of a subsidiary as a result of transaction between a parent and its associate or joint venture. The accounting approach depends on whether contribution of assets to an associate or a joint venture constitute a business as defined in IFRS 3 Business Combinations. If assets constitute a business, the amendments introduce a requirement of full recognition gain or loss resulting from the transaction. If assets do not constitute a business, a gain or loss resulting from the transaction is recognized only to the extent of the unrelated investors' interests in that associate or joint venture.

  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 its initial application.

- IFRS 14, Regulatory Deferral Accounts, published by the International Accounting Standards Board on 30 January 2014, binding for annual periods starting on or after 1 January 2016.

  The Standard permits an entity that adopts IFRS to continue to use, in its first and subsequent IFRS financial statements, its previous accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances. The Standard requires to present regulatory deferral account balances as separate line items in the statement of financial position and to present movements in those account balances as separate line items in the statement of profit and loss and other comprehensive income. The disclosures to identify the nature of, and risks associated with, the rate regulation that has resulted in the recognition of regulatory deferral account balances are also required.

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

<u>Published Standards and Interpretations which have been issued but are not yet binding or have not been adopted early</u>

Standards and interpretations approved by the European Union:

- IFRS 9, Financial Instruments, published by the International Accounting Standards Board on 24 July 2014, approved by European Union on 22 November 2016, represents the final version of the standard, replaces earlier versions of IFRS 9 and completes the International Accounting Standards Board's project to replace IAS 39 Financial Instruments: Recognition and Measurement. The new standard addresses classification and measurement of financial assets and financial liabilities, impairment identification methodology and hedge accounting. IFRS 9 does not include macro hedge accounting, which is a separate project of International Accounting Standards Board. The Bank continues to apply IAS 39 accounting for macro hedges. The new standard is effective for annual periods beginning on or after 1 January 2018.

  The impact of the application of the standard on the presentation and measurement of these instruments in the financial statements is described at the end of this note.

- IFRS 15, Revenue from Contracts with Customers, published by the International Accounting Standards Board on 28 May 2014, binding for annual periods beginning on or after 1 January 2018.

  Amendments to IFRS 15 were published by International Accounting Standards Board on 11 September 2015 and are binding for annuals periods starting on or after 1 January 2018.

  IFRS 15 introduces new principles of revenue recognition. The core principle is that an entity recognizes revenue to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. According to a new IFRS 15 revenue is recognized when the customer obtains control of these goods or services. Depending on the fulfilment of certain conditions revenues are either recognized over time throughout the duration of the contract if a performance obligation is satisfied over time, or at a point in time when the customer obtains control of these goods or services.

  Amendments to IFRS 15, Clarifications to IFRS 15 Revenue from Contracts with Customers, were published by the International Accounting Standards Board on 12 April 2016 and are effective for annual periods beginning on or after 1 January 2018.

  Amendments to IFRS 15 clarify the guidance in respect of identifying performance obligations, accounting for licences relating to intellectual property, and "principal versus agent" considerations in the context of presenting revenue on a gross or net basis. Practical solutions facilitating the implementation of the new standard were also added.

  The Bank is of the opinion that the application of the 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:

- Amendments to IAS 12, Recognition of Deferred Tax Assets for Unrealised Losses, published by the International Accounting Standards Board on 19 January 2016, binding for annual periods beginning on or after 1 January 2017.

  Amendments to IAS 12 clarify the requirements on recognition of deferred tax assets for unrealized losses on debt instruments measured at fair value. The amendments introduce the guidance on the identification of deductible temporary differences. Especially the standard confirms that decreases below cost in the carrying amount of a fixed-rate debt instrument measured at fair value for which the tax base remains at cost give rise to a deductible temporary difference. This applies irrespective of whether the debt instrument's holder expects to use it or sale it.

  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.

- Amendments to IAS 7, Disclosure Initiative, published by the International Accounting Standards Board on 29 January 2016, binding for annual periods beginning on or after 1 January 2017.

  Amendments to IAS 7 introduce the requirements to disclose changes in liabilities arising from financing activities in statement of cash flows, including both changes arising from cash flows and non-cash changes. To fulfill the requirement the standard requires a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities in cash flow statement.

  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.

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

  IFRS 16 introduces new principles for the recognition of leases. The main amendment is the elimination of the classification of leases as either operating leases or finance leases and instead, the introduction of a single lessee 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 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 lease assets and corresponding liability in the financial statements of the Bank as lessee. The Bank is of the option that the application of the new standard will not have a significant effect on the recognition of the existing financial leases in the Bank's financial statements.

- Amendments to IFRS 2, Classification and measurement of share-based payment transactions, published by International Accounting Standards Board on 20 June 2016, binding for annuals periods starting on or after 1 January 2018

  Amendments to IFRS 2 introduce additional guidance in respect of the recognition of cash-settled share-based payments and add an exception which allows settlement in equity instruments if the settlement of a share-based payment was divided into equity instruments issued to the employee and the payment of cash to the tax authorities.

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

- Amendments to IFRS 4, Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts were published by the International Accounting Standards Board on 12 September 2016 and are effective for annual periods beginning on or after 1 January 2018.

  Amendments to IFRS 4 provide a temporary exemption from applying the IFRS 9 requirements for insurers only when an entity first applies IFRS 9 and when the entity's predominant activities are connected with insurance. Alternatively, an entity can implement IFRS 9 using the overlay approach which is aimed at eliminating some of the accounting mismatches and temporary volatility in profit or loss for the designated financial assets that could arise when applying IFRS 9, before the implementation of the new standard relating to insurance contracts.

  The Bank believes that the application of the amended standard will not have an effect on the financial statements at the initial stage of its application.

- Amendments to IAS 40, Transfers of Investment Property, were published by the International Accounting Standards Board on 8 December 2016 and are effective for annual periods beginning on or after 1 January 2018.

  Amendments to IAS 40 clarify that a change in management's intentions for the use of a property by itself does not constitute evidence of a change in use. The examples relating to a change in use were also expanded to include property that is being constructed or developed. Amendments to IAS 40 also allow an entity to use one of the two temporary solutions and require disclosing information about all reclassifications of property as at the date of application of a simplified temporary solution.

  The Bank believes that the application of the amended standard will not have an effect on the financial statements at the initial stage of its application.

- IFRIC Interpretation 22, Foreign Currency Transactions and Advance Consideration, was published by the International Accounting Standards Board on 8 December 2016 and is effective for annual periods beginning on or after 1 January 2018.

  IFRIC Interpretation 22 clarifies the moment of establishing a date of transaction for the purpose of determining the exchange rate to be used for translation upon initial recognition of an asset, expense or income, when an entity recognizes the payment or receipt of advance consideration in a foreign currency. The Interpretation relates to a situation in which a transaction is denominated in a foreign currency, and an entity recognizes the payment or receipt of advance consideration in a foreign currency before the recognition of the related asset, expense or income.

  The Bank believes that the application of the interpretation will not have a significant effect on the financial statements at the initial stage of its application.

- Annual improvements to IFRS 2014-2016, amending 3 standards (IFRS 1, IFRS 12, IAS 28), were published by the International Accounting Standards Board on 8 December 2016 and are effective for annual periods beginning on or after 1 January 2017 or 1 January 2018.

  During the cycle amendments were made to the following standards: IFRS 1 with regard to deleting the short-term exemptions for first-time adopters of IFRS, IFRS 12 with regard to clarifying the scope of financial information requirements for a subsidiary, an associate or a joint venture classified as held for sale or a discontinued operation under IFRS 5, IAS 28 with regard to specifying that an entity which is not itself an investment entity, but which has investments in an associate or a joint venture which is an investment entity can, when applying the equity method of accounting, retain the fair value measurement that is applied by that associate or joint venture to the shares (investments) of the associate or joint venture in its subsidiaries.

  The Bank believes that the application of the amended standards will not have a significant effect on the financial statements at the initial stage of their application.

IFRS 9, Financial instruments

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.

In June 2015 the Bank launched an IFRS 9 implementation project which actively engages the Bank's organizational units responsible for accounting, financial reporting and risk management as well as business, IT and organisation department.

The Bank is currently implementing necessary solutions for the particular IFRS 9 requirements based on the results of gap analysis and defined methodological assumptions. The Bank intends to complete the project by December 2017.

Summary of key IFRS 9 requirements

Classification and measurement

Financial assets

In accordance with IFRS 9, on initial recognition a financial asset may be classified as subsequently measured at:

- amortised cost,
- fair value through other comprehensive income,
- fair value through profit or loss.

A financial asset shall be classified as subsequently measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss on the basis of both:

- the entity's business model for managing the financial assets which is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective; and
- the contractual cash flow characteristics of the financial asset by verifying if the 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 (so called SPPI criterion).

A financial asset shall be reclassified if, and only if, the Bank changes its business model for managing financial assets. In such a case, all financial assets affected by the business model change are subject to reclassification.

Financial liabilities

IFRS 9 does not introduce significant changes with regard to classification and measurement of financial liabilities requirements existing in IAS 39.

Impairment

IFRS 9 replaces the „incurred loss" model in IAS 39 with a forward-looking „expected credit loss" (ECL) model. Because of the aforementioned change the Bank will be obliged to calculate loss allowances based on the expected credit loss, taking into consideration forecasts of future economic conditions with regard to the measurement of the credit risk of an exposure, which is not allowed under IAS 39.

The new impairment model will be applied to financial instruments measured, in accordance with IFRS 9, at amortised cost or at fair value through other comprehensive income, except for equity instruments.

Replacing the concept of „incurred loss" with the concept of „expected credit loss" will influence significantly the way of modelling credit risk parameters and the final amount of loss allowance. The currently applied loss identification period will not be used anymore, therefore the IBNR (incurred but not reported) category of loss allowance will be eliminated.

In accordance with IFRS 9, the loss allowance will be calculated in the following categories (instead of the IBNR loss allowance and the loss allowance for non-performing exposures):

- Stage 1 – credit losses expected within 12 months from the reporting date for the exposures without identified significant increase of credit risk,
- Stage 2 – lifetime expected credit losses for the exposures with significant increase of credit risk identified since the initial recognition but not defaulted,
- Stage 3 – lifetime expected credit losses for defaulted exposures.

The new approach to calculating the impairment of the financial assets will also have an impact on the interest income recognition. In particular, interest income on financial assets allocated to Stages 1 and 2 will be calculated based on the gross carrying amount of the exposure, whereas interest income on financial assets allocated to Stage 3 will be calculated based on the net carrying amount of the exposure (similarly to impaired financial assets under the requirements of IAS 39).

Hedge accounting

In accordance with standard, when initially applying IFRS 9 (and only on the day of initial application) the Bank may choose as its accounting policy element to continue to apply the IAS 39 hedge accounting requirements instead of the IFRS 9 requirements.

IFRS 9 requires the Bank to ensure that its hedging relationships are compliant with the risk management strategy applied by the Bank and its objectives. IFRS 9 introduces new requirements with regard to the assessment of hedge effectiveness, rebalancing of the hedge relationship as well as it prohibits voluntary discontinuation of hedge accounting.

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

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

As at 31st December 2016, it is not possible to estimate the overall impact of IFRS 9 implementation on the Bank's financial situation and own funds. In the Bank's opinion, disclosing quantitative data that would not reflect the potential impact of all aspects of IFRS 9 on the Bank's financial situation and own funds could have a negative impact on the informative value of the financial statement for its users. Nevertheless, taking into account the current regulations, changes in the requirements regarding classification and measurement and impairment of financial assets, would have moderately negative impact on the Bank's own funds. However, the impact of changes can be reliably estimated only in the consecutive periods.

Therefore, the Bank has chosen to disclose solely qualitative information on the Bank's approach to the IFRS 9 implementation, which in the Bank's opinion will enable the users of the financial statement to understand the impact of IFRS 9 on the financial situation and capital management of the Bank.

Qualitative data enabling the users of the financial statement to understand the impact of IFRS 9 on the Bank's financial situation

Classification and measurement

Financial assets

In order to be able to classify the financial assets in accordance with IFRS 9 on 1st January 2018, the Bank, in the course of the ongoing IFRS 9 implementation project, is reviewing the financial assets in the Bank's portfolio, which are going to be a part of the portfolio after 31st December 2017. The objectives of the review are:

1. allocation of financial assets to the appropriate business model on the basis of the assessment of the applied way of managing the financial asset portfolios by:
   a) reviewing and assessing relevant and objective qualitative data which may have an impact on allocating financial asset portfolios to the appropriate business model (such as, e.g.: how the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel; the risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way in which those risks are managed; how managers of the business are compensated and reasons of sales of the financial assets from certain portfolios that occurred in previous reporting periods,
   b) reviewing and assessing relevant and objective quantitative data which may have an impact on allocating financial asset portfolios to the appropriate business model (e.g. the value of sales of the financial assets from certain portfolios that occurred, if any, in previous reporting periods and the frequency of those sales),
   c) analysis of expectations regarding the value and frequency of sales from certain portfolios;
2. determination, through identifying and analysing the contractual terms of financial assets (held within a business model whose objective is to hold financial assets in order to collect contractual cash flows or held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets) whether these contractual terms are consistent with the SPPI criteria.

Based on the performed analysis, the Bank expects changes in classification of the certain part of corporate loans (e.g. Commercial Real Estate) measured at amortised cost under IAS 39, which will have to be measured at fair value through profit or loss due to the failure of the SPPI test.

Quantitative data, including impact on the Bank's financial result and own funds, will be available after the finalization of works on the methodology of fair value measurement for the part of loan portfolio.

As at 31st December 2016 the Bank does not identify financial assets which the Bank is going to designate as measured at fair value through profit or loss on 1st January 2018 to eliminate or significantly reduce "accounting mismatch" which would arise as a result of measuring these financial assets at amortised cost or at fair value through other comprehensive income.

Financial liabilities

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

Impairment

The Bank assumes that the implementation of the new impairment model based on the concept of ECL will result 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 will result in the earlier recognition of credit losses which will cause an increase in loss allowance and therefore it will also affect profit or loss. With regard to retail exposures classified to Stage 1 the Bank does not expect the change in the level of impairment allowances. In the corporate segment the Bank expects the increase of impairment allowances due to the cease of application of LIP parameter.

It needs to be emphasized that as of the date of implementation of IFRS 9, this one-off change in the level of loss allowance stemming from the adoption of new impairment model will be recognized in the profit of previous years, not in profit of the current year.

Within the scope of the IFRS 9 implementation project, the Bank is working on implementing a new methodology of loss allowance calculation as well as on implementing appropriate modifications in IT systems and processes used by the Bank, in particular on the foundations of the impairment model, acquiring appropriate data as well as designing the processes and tools and performing a detailed estimation of the impact of IFRS 9 on the level of loss allowances. Methodological tasks are focused on both development of currently applied solutions as well as implementation of the brand new solutions. In terms of the development of existing solutions, the Bank is currently adjusting PD, LGD, EAD and CCF models so that they may be used to estimate expected credit losses. In terms of brand new solutions, the scope of the IFRS 90020project is focused mainly on defining the Stage allocation criteria and including expectations regarding future macroeconomic outlook in the estimation of loss allowance levels.

The impact assessment of IFRS 9 on the financial position of the Bank and its capital management is currently difficult. The difficulties stem from the ongoing methodological works regarding adjustments of credit risk models to IFRS 9 requirements which are still in progress as well as from the lack of unambiguous interpretations of the new Standard and uniform market practice. From the legislative standpoint, the supervisory and regulatory authorities are working on updating prudential requirements which will be binding for the Bank. However, it needs to be noted that these works are not advanced enough to enable Bank to unambiguously determine the impact of the IFRS 9 on the financial position and capital ratios.

Hedge accounting

Currently the Bank assumes that based on the paragraph 7.2.21 of IFRS 9 it will continue to apply the hedge accounting requirements of IAS 39 instead of the requirements of IFRS 9.

Due to the aforementioned assumption, the adoption of IFRS 9 in the area of hedge accounting will probably not have any impact on the financial position of the Bank.

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 21.

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 Financial Supervision Authority), including Recommendation S and J as well as provisions of internal banking regulations.

The Bank hold and applies Rules and Regulations of Establishing of banking and mortgage real estate value approved by the Banking Supervision Commission (currently Financial Supervision Authority - KNF), 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 rules and regulations of establishing the 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 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 control 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) cash in banks,
g) power of attorney to account,
h) accession to a loan debt,
i) loan insurance,
j) 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 97.45% of total sum of risk-weighted exposures with standard method including portfolios covered with a plan of gradual implementation and 66.55% without including those portfolios. The difference results from the fact, that 30.9% 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 target 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 lease, hotels and business premises for commercial activity, offices and 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 glows 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.

Retail portfolio obtained in cooperation with mBank S.A.

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 2016 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.

Additional information

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 45.

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.

As presented in note 21, 94.47% of gross value of loans and advances granted to clients are not overdue loans, without identified impairment. Remaining 5.53% of the loan portfolio value are overdue loans without identified impairment (2.24%) and loans with identified impairment (3.29%).

3.1.3. Loss of value measurement

The Bank measures the loss of value of credit exposures in accordance with International Accounting Standard no. 39.

For the purposes of loss of value analysis four portfolios are distinguished in the Bank:

- commercial portfolio,
- retail portfolio obtained in cooperation with mBank S.A.,

- public sector portfolio, including those guaranteed by local government authorities, hereinafter called "the LGA portfolio",
- portfolio of other retail loans.

Commercial portfolio is divided into two sub-portfolios, distinguishing commercial loans (developer loans, commercial loans and loans to legal persons) and other loans to individual entrepreneurs.

A credit exposure is considered to be potentially impaired when the possibility of default has been identified for the debtor (contract owner). mBank Hipoteczny uses a uniform definition of default in all areas of credit risk management, including for the purpose of calculating allowances, provisions and capital requirements. The basis for the adopted definition of default is the definition of default contained in 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 (the CRR).

<u>Retail loan portfolio, JST and other retail loans</u>

The Bank assumes the occurrence of a default in relation to a given debtor, if at least one out of three following events took place:

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:

   - in case of retail exposures the overdue amount exceeds PLN 500,
   - in case of other exposures the overdue amount exceeds PLN 3 000,

c) qualification of an entity to a default situation by the Bank's parent entity.

For a default date the Bank assumes the date of decision on occurrence of a default - on the basis of obtaining of information about hard and soft evidence as well as on the basis of conducted exposure assessment analysis.

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 or subsidiary 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.

The Bank calculated loss impairments on the basis of individual analysis (commercial or public sector portfolio) and portfolio analysis (retail portfolio and exposures from the commercial or public sector portfolio for which no value loss was identified in the individual analysis).

The process of calculation of impairment losses in the individual analysis consists in:

a) determination of estimated future cash flows (repayments) both from collaterals and payments made by borrowers, including planned costs,

b) in the calculation of difference between balance sheet value of a given asset and current value of estimated profits and costs discounted with effective interest rate,

c) booking of impairment losses.

In case of evidence of loss of value and individual analysis of a given credit exposure, not stating the loss of value, impairment loss is calculated on the basis portfolio parameters analysis.

In case of lack of evidence of the loss of value against credit exposure, on the basis of probability of default, an impairment loss is calculated in the portfolio analysis for the incurred, but not identified losses.

The portfolio analysis covers all retail and commercial loans not covered by the individual analysis. The Bank applies estimated for the purposes of loss of value measurement parameters specifying the rate of healing (ZLGD), indicator of faulty collaterals (BD) and indicator of relationship between recovery and the value of collateral (CCR), as well as individual for each exposure indicator of relationship between a debt and the value of collateral (LTV) used for determination of LGD in the portfolio analysis and additionally parameters PD and LIP. The Bank assumes that LIP amounts to 8 months for the commercial loan portfolio and 12 months for retail loans. PD parameter is currently determined using 3 year time series. LGD parameter is estimated on the basis of data from 2009, selection of the scope of data is made in order to ensure adequacy of estimation of the amount of impairment losses to current economic conditions. Each of separated portfolios has its own set of ZLGD, BD, CRR and PD parameters.

In case of assets for which a loss of value was identified, the Bank executes stricter monitoring, e.g. revaluation of the mortgage lending value of the property constituting collateral of a loan.

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

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:

a) 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,

b) one of the client's transactions is subject to restructuring,

c) loan claim is sold with significant economic credit loss,

d) the Bank submits a motion to commence execution proceedings, bankruptcy or recovery proceedings (resulting with possible omission or delay in repayment) by the debtor,

e) loss impairment was made as a result of significant deterioration of the client's creditworthiness.

Calculation of impairment losses on balance sheet credit exposures and reserves on off-balance sheet credit exposures in parameters based on risk determined using methodology applied for the purposes of advanced method of external ratings (AIRB) after necessary elimination of differences between approach resulting from AIRB and MSR 39.

The factors analysed in recognition of loan impairment include all evidence of impairment recognized by the Bank, including, among other things, significant financial difficulties of the debtor and a violation of the contract, i.e. failure to pay interest or the principal amount of the liability.

for 2016 (in PLN thousand)

The main legal collateral for the loans granted to customers by the Bank is a mortgage established for the Bank in the first place in the land and mortgage register maintained for the property.

The value of the property which is collateral for a loan granted by the Bank is estimated on the basis of the so-called mortgage lending value which assumes that the property will maintain its value in the longer term.

In the event of adverse changes in the value of collateral, the Bank verifies it by revaluing the property. Depending on the results of the revaluation, as a rule the Bank negotiates with the borrower, pursuant to the concluded loan agreement:

a) establishing additional collateral;

b) changing the collateral;

c) making a one-time repayment of the debt to the LTV level accepted by the Bank;

d) renegotiating the terms of the agreement.

As a result of the analysis of the valuation, the Bank revalues the estimated amount recoverable from own payments and from the collateral and recognizes an impairment allowance.

Failure to reach an agreement may result in partial or full termination of the agreement if the borrower’s economic and financial position shows permanent deterioration.

The Bank has a contingency plan in the event of unexpected, radical changes in prices on the real estate market.

3.1.4. Repossessed collateral

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 2016 the Bank did not take over any collaterals. Reduction of value of inventories is associated with the sale of residential premises situated in the repossessed real estate in the previous years and impairment write-downs for the repossessed properties.

Change of status of repossessed collaterals

	Period from 01.01.2016 to 31.12.2016	Period from 01.01.2015 to 31.12.2015
As at the beginning of the period	**6 768**	**8 192**
Increase (due to)	382	166
- reversal of impairment write-downs	222	34
- other increase	160	132
Decrease (due to)	(3 718)	(1 590)
- sale of real estate	(1 779)	(1 302)
- establishment of impairment write-downs	(1 939)	(288)
As at the end of the period	**3 432**	**6 768**

for 2016 (in PLN thousand)

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

The Bank offers forbearance to assist customers, who are temporarily in financial distress and are unable to meet their original contractual repayment terms, through 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 receivables repayment and minimise the risk of 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 increase 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 offers, 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.

The risk of no repayment of the product portfolio subject to the forbearance policy is mitigated with the amount of PLN 505 299 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 in the forbearance category in mBank Hipoteczny S.A. as at 31 December 2016 is as follows:

Balance sheet data	Gross value	Of which defaulted	Write-downs created	Net value
Loans and advances to customers, including:	355 738	208 717	47 486	308 252
Corporate customers	348 583	208 381	47 422	301 161
Individual customers	7 155	336	64	7 091
Total balance sheet data	**355 738**	**208 717**	**47 486**	**308 252**

The structure of the loan portfolio in the forbearance category in mBank Hipoteczny S.A. as at 31 December 2015 is as follows:

Balance sheet data	Gross value	Of which defaulted	Write-downs created	Net value
Loans and advances to customers, including:	355 873	163 780	33 957	321 916
Corporate customers	353 913	163 780	33 954	319 959
Individual customers	1 960	-	3	1 957
Total balance sheet data	**355 873**	**163 780**	**33 957**	**321 916**

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 3.74% (4.75% as at 31.12.2015) of the entire portfolio. As at 31 December 2016, the forbearance exposure portfolio in the default category represented 58.67% of the forbearance portfolio (46.02% as at 31.12.2015). 22.63% of the portfolio of default exposures was covered with allowances (20.73% as at 31.12.2015). 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 505 299 thousand (PLN 612 697 thousand as at 31.12.2015), including PLN 287 772 thousand in the default category (PLN 250 404 thousand as at 31.12.2015).

for 2016 (in PLN thousand)

Changes in forbearance exposures carrying value in 2016 and 2015

	Gross value	Of which defaulted	Write-downs created	Net value
Balance as at 1 January 2016	**355 873**	**163 780**	**33 957**	**321 916**
Outputs	(47 758)	(4 906)	(523)	(47 235)
Change in exposure	(18 442)	(10 974)	9 356	(27 798)
New forbearance	66 065	60 817	4 696	61 369
Balance as at 31 December 2016	**355 738**	**208 717**	**47 486**	**308 252**

	Gross value	Of which defaulted	Write-downs created	Net value
Balance as at 1 January 2015	**336 133**	**197 029**	**35 453**	**300 680**
Outputs	(21 505)	(21 505)	(917)	(20 588)
Change in exposure	(22 739)	(11 744)	(773)	(21 966)
New forbearance	63 984	-	194	63 790
Balance as at 31 December 2015	**355 873**	**163 780**	**33 957**	**321 916**

Forbearance exposures by type of concession as at 31 December 2016

Type of concession (31.12.2016)	Gross value	Of which defaulted	Write-downs created	Net value
Refinancing	25 293	25 293	46	25 247
Modification of terms and conditions	330 445	183 424	47 440	283 005
Total	**355 738**	**208 717**	**47 486**	**308 252**

Forbearance exposures by type of concession as at 31 December 2015

Type of concession (31.12.2015)	Gross value	Of which defaulted	Write-downs created	Net value
Refinancing	25 267	25 267	78	25 189
Modification of terms and conditions	330 606	138 513	33 879	296 727
Total	**355 873**	**163 780**	**33 957**	**321 916**

Forbearance exposures without recognised loss impairment per length of overdue period as at 31 December 2016

Forborne exposures without impairment recognised (31.12.2016)	Gross value	Of which defaulted	Write-downs created	Net value
Not overdue	173 929	33 404	309	173 620
up to 30 days	6 496	-	13	6 483
31 to 90 days	616	616	1	615
more than 90 days	-	-	-	-
Total	**181 041**	**34 020**	**323**	**180 718**

Forbearance exposures without recognised loss impairment per length of overdue period as at 31 December 2015

Forborne exposures without impairment recognised (31.12.2015)	Gross value	Of which defaulted	Write-downs created	Net value
Not overdue	224 887	33 128	690	224 197
up to 30 days	334	-	1	333
31 to 90 days	3 377	3 377	10	3 367
more than 90 days	9 639	9 639	30	9 609
Total	**238 237**	**46 144**	**731**	**237 506**

for 2016 (in PLN thousand)

Forbearance exposures with recognised loss impairment per length of overdue period as at 31 December 2016

Forborne exposures with impairment recognised (31.12.2016)	Gross value	Of which defaulted	Write-downs created	Net value
Not overdue	60 817	60 817	4 688	56 129
up to 30 days	32 464	32 464	17	32 447
31 to 90 days	-	-	-	-
more than 90 days	81 416	81 416	42 458	38 958
Total	**174 697**	**174 697**	**47 163**	**127 534**

Forbearance exposures with recognised loss impairment per length of overdue period as at 31 December 2015

Forborne exposures with impairment recognised (31.12.2015)	Gross value	Of which defaulted	Write-downs created	Net value
Not overdue	35 188	35 188	-	35 188
up to 30 days	-	-	-	-
31 to 90 days	-	-	-	-
more than 90 days	82 448	82 448	33 226	49 222
Total	**117 636**	**117 636**	**33 226**	**84 410**

Forbearance exposures by industry as at 31 December 2016

As at 31 December 2016	Gross value	Of which defaulted	Write-downs created	Net value
Activity related to the real estate market	281 861	141 659	47 186	234 675
Building industry	66 722	66 722	236	66 486
Professional, scientific and technical activity	-	-	-	-
Natural persons	7 155	336	64	7 091
Total	**355 738**	**208 717**	**47 486**	**308 252**

Forbearance exposures by industry as at 31 December 2015

As at 31 December 2015	Gross value	Of which defaulted	Write-downs created	Net value
Activity related to the real estate market	238 809	91 528	33 708	205 101
Building industry	79 300	72 252	136	79 164
Professional, scientific and technical activity	35 804	-	110	35 694
Natural persons	1 960	-	3	1 957
Total	**355 873**	**163 780**	**33 957**	**321 916**

Interest income related to forbearance exposures at the end of 2016, amounted to PLN 11 871 thousand (for the period ended 31 December 2015: PLN 13 380 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, 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 transactions' 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,
- 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 2016 amounted to PLN 7 155 thousand (PLN 1 960 thousand as at 31.12.2015).

<u>Corporate banking</u>

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 negotiated 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,
- deferral 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,
- covenant waiver.

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 recognise that the client came back to normal category it is necessary that the debt is appropriately serviced and that there is no overdue at the end of the trial 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 Credit 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 2016 amounted to PLN 348 583 thousand (PLN 353 913 thousand as at 31.12.2015).

3.1.6. 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 and currency swaps. The Board of Directors approves the limits for the Bank's exposure in derivative transactions. The limits 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) and the central clearing houses in which the 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 2016 and 2015. As at 31 December 2016, 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.

3.1.7. Debt instruments: investment securities

The value of investment securities as at 31 December 2016 amounted to PLN 1 134 049 thousand, and as at 31 December 2015 amounted to PLN 748 505 thousand. Debt instruments on both 31 December 2016 and 31 December 2015 had A rating in the scale of Fitch Ratings.

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

- as at 31 December 2016 amounted to PLN 89 667 thousand,
- as at 31 December 2015 amounted to PLN 66 343 thousand.

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

- as at 31 December 2016 amounted to PLN 1 008 thousand,
- as at 31 December 2015 amounted to PLN 2 070 thousand.

Investment securities on which collateral was established are presented in Note 35.

Both as at 31 December 2016 and 31 December 2015 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.

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 KNF,
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 2016 no exceeding of exposure limit against an entity or a group of affiliated clients specified in Art. 395.1 of the CCR 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 cover 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 en expert approach.

Credit risk management in financing of commercial real estate also includes: creation of impairment losses 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 to updating of real estate value, applying conservative principles for determining the mortgage lending value of properties, using statistical models for revaluing properties.

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

No.	Industries	Net carrying amount (PLN '000)	Share in the portfolio (%)	Net carrying amount (PLN '000)	Share in the portfolio (%)
		31.12.2016		31.12.2015	
1.	Natural persons	4 371 412	46.45	2 601 184	35.19
2.	Activity related to the real estate market	3 249 144	34.52	2 581 345	34.92
3.	Building industry	1 363 935	14.49	1 749 932	23.67
4.	Activity related to culture, entertainment and leisure	183 279	1.95	191 123	2.59
5	Professional, scientific and technical activity	93 210	0.99	91 245	1.23
6	Public administration and defence; Compulsory social security	73 200	0.78	92 666	1.25
7.	Health protection and social welfare	51 994	0.55	55 481	0.75
8.	Activity related to accommodation and catering services	10 983	0.12	14 007	0.19
9	Water supply; Sewage and waste management and activity related to reclamation	4 671	0.05	6 367	0.09
10	Information and Communication	-	0.00	7 932	0.11
11.	Other	9 677	0.10	461	0.01
	Total	**9 411 505**	**100.00**	**7 391 743**	**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.

Derivative instruments

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.

Off-balance sheet liabilities of credit nature

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 variability of those risk factors and credit spread.

The risk profile results from the Bank's operational strategy. The Bank offers products based on variable 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[1]). 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 2016, VaR amounted to PLN 506.81 thousand compared with PLN 100.75 thousand as at 31 December 2015, with a confidence level of 97.5%.

[1] Since 1 September 2016 Bank introduced credit spread as additional risk factor in the measurement of value at risk

The list below presents the value of average VaR of the Bank during the period from 1 January 2016 until 31 December 2016 and from 1 January 2015 until 31 December 2015.

PLN '000	12 months until 31.12.2016 *		12 months until 31.12.2015	
	average	maximum	average	maximum
Credit spread risk	625	720	nie dotyczy	nie dotyczy
Interest rate risk	201	294	26	83
Currency risk	28	257	29	459
Total VaR	**624**	**821**	**55**	**455**

* for credit spread risk and total VaR, the statistics are calculated for a period of 84 working days

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 2016, the risk amount arising from an expanded scenario was PLN 18 573 thousand, whereas the average risk amount for this scenario in the period from 8 March 2016[2] to 31 December 2016 was PLN 19 212 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	31.12.2016				31.12.2015		
	Total	Interest rate risk	Currency risk	Credit spread risk	Total	Currency risk	Currency risk
Amount of risk in PLN '000	(18 573)	(3 948)	63	(14 688)	1 080	(3 079)	4 159

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 20). 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.

[2] On 8 March 2016 the Board of Directors adopted a resolution changing the Attachment 1 (Market limits) to the market risk management policy, which introduces new types of stress test and scenario analyses.

for 2016 (in PLN thousand)

The following table presents exposures of the Bank to currency risk as at 31 December 2016 and 31 December 2015. The tables bellow present assets and liabilities of the Bank according to balance sheet amount broken down by particular currencies of transactions.

31.12.2016	PLN	EUR	USD	Total
Assets				
Cash and balances with the central bank	5 530	-	-	**5 530**
Amounts due from other banks	138	15 862	262	**16 262**
Derivative financial instruments	3 775	41 385	-	**45 160**
Loans and advances to customers	5 932 185	3 398 031	81 289	**9 411 505**
Investment securities available for sale	1 134 049	-	-	**1 134 049**
Intangible assets	13 357	-	-	**13 357**
Tangible fixed assets	7 603	-	-	**7 603**
Deferred income tax assets	8 644	-	-	**8 644**
Current income tax assets	-	-	-	**-**
Other assets	7 210	179	-	**7 389**
TOTAL ASSETS	**7 112 491**	**3 455 457**	**81 551**	**10 649 499**
Liabilities				
Amounts due to other banks	2 693 714	623 103	-	**3 316 817**
Derivative financial instruments	9 459	176	-	**9 635**
Amounts due to customers	26 942	9 293	159	**36 394**
Debt securities in issue	4 089 448	2 034 018	-	**6 123 466**
Hedge accounting adjustments related to fair value of hedged items	-	29 305	-	**29 305**
Subordinated liabilities	200 484	-	-	**200 484**
Current income tax liabilities	2 791	-	-	**2 791**
Other liabilities and provisions	25 140	1 768	-	**26 908**
TOTAL LIABILITIES	**7 047 978**	**2 697 663**	**159**	**9 745 800**
Net balance sheet position	**64 513**	**757 794**	**81 392**	**903 699**
Loan commitments	**991 540**	**278 381**	**-**	**1 269 921**

31.12.2015	PLN	EUR	USD	Total
Assets				
Cash and balances with the central bank	7 521	-	-	**7 521**
Amounts due from other banks	151 612	53 558	10	**205 180**
Derivative financial instruments	2 747	29 465	-	**32 212**
Loans and advances to customers	4 370 961	2 938 032	82 750	**7 391 743**
Investment securities available for sale	748 505	-	-	**748 505**
Intangible assets	8 152	-	-	**8 152**
Tangible fixed assets	7 523	-	-	**7 523**
Deferred income tax assets	7 213	-	-	**7 213**
Current income tax assets	1 597	-	-	**1 597**
Other assets	9 424	55	-	**9 479**
TOTAL ASSETS	**5 315 255**	**3 021 110**	**82 760**	**8 419 125**
Liabilities				
Amounts due to other banks	1 767 064	1 109 762	82 915	**2 959 741**
Derivative financial instruments	1 401	2 369	-	**3 770**
Amounts due to customers	210 818	54 430	261	**265 509**
Debt securities in issue	2 922 239	1 242 663	-	**4 164 902**
Hedge accounting adjustments related to fair value of hedged items	-	21 530	-	**21 530**
Subordinated liabilities	200 899	-	-	**200 899**
Other liabilities and provisions	20 365	73	-	**20 438**
TOTAL LIABILITIES	**5 122 786**	**2 430 827**	**83 176**	**7 636 789**
Net balance sheet position	**192 469**	**590 283**	**(416)**	**782 336**
Loan commitments	**847 706**	**132 261**	**-**	**979 967**

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 if 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)	31.12.2016	31.12.2015
for items expressed in PLN	5 732	7 518
for items expressed in USD	3	5
for items expressed in EUR	772	312

When calculating those values it was assumed that the structure of assets and liabilities recognised in financial statements as at 31 December 2016 and as at 31 December 2015 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 2016 on similar level as in 2015 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.

31.12.2016	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	5 530	-	-	-	-	-	**5 530**
Amounts due from other banks	16 262	-	-	-	-	-	**16 262**
Derivative financial instruments	411	30 721	14 028	-	-	-	**45 160**
Loans and advances to customers	2 236 766	5 818 399	1 356 190	150	-	-	**9 411 505**
Investment securities available for sale	715 666		124 853	293 530	-	-	**1 134 049**
TOTAL ASSETS	**2 974 635**	**5 849 120**	**1 495 071**	**293 680**	**-**	**-**	**10 612 506**
Liabilities							
Amounts due to other banks	933 031	2 162 460	221 326	-	-	-	**3 316 817**
Derivative financial instruments	2 890	3 166	3 579	-	-	-	**9 635**
Amounts due to customers	3	-	-	-	-	36 391	**36 394**
Debt securities in issue	1 421 952	2 550 273	1 236 169	373 935	541 137	-	**6 123 466**
Subordinated liabilities	-	200 484	-	-	-	-	**200 484**
TOTAL LIABILITIES	**2 357 876**	**4 916 383**	**1 461 074**	**373 935**	**541 137**	**36 391**	**9 686 796**
Balance sheet gap	**616 759**	**932 737**	**33 997**	**(80 255)**	**(541 137)**	**(36 391)**	**925 710**

31.12.2015	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	7 521	-	-	-	-	-	**7 521**
Amounts due from other banks	205 180	-	-	-	-	-	**205 180**
Derivative financial instruments	10 450	13 260	8 502	-	-	-	**32 212**
Loans and advances to customers	2 179 467	3 405 846	1 806 284	-	146	-	**7 391 743**
Investment securities available for sale	647 159	-	101 346	-	-	-	**748 505**
TOTAL ASSETS	**3 049 777**	**3 419 106**	**1 916 132**	**-**	**146**	**-**	**8 385 161**
Liabilities							
Amounts due to other banks	969 575	1 663 142	327 024	-	-	-	**2 959 741**
Derivative financial instruments	211	495	3 064	-	-	-	**3 770**
Amounts due to customers	253 134	1 584	8 451	-	-	2 340	**265 509**
Debt securities in issue	809 068	1 350 802	1 475 793	212 747	316 492	-	**4 164 902**
Subordinated liabilities	-	200 899	-	-	-	-	**200 899**
TOTAL LIABILITIES	**2 031 988**	**3 216 922**	**1 814 332**	**212 747**	**316 492**	**2 340**	**7 594 821**
Balance sheet gap	**1 017 789**	**202 184**	**101 800**	**(212 747)**	**(316 346)**	**(2 340)**	**790 340**

for 2016 (in PLN thousand)

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 2016 and 2015, the Bank monitored all liquidity measures specified in the resolution of KNF 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 2016 and their average, minimum and maximum values:

liquidity norm*	value as at 31.12.2016	average	minimum	maximum
M1	PLN 1 186 731 thousand	PLN 670 120 thousand	PLN 173 855 thousand	PLN 1 464 323 thousand
M2	2.599	1.738	1.173	3.230
M3	86.577	72.880	51.753	91.472
M4	1.081	1.068	1.032	1.117
LCR	181%	198%	107%	1070%

*M2, M3 and M4 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 2016 the LCR measure remained on safe level.

for 2016 (in PLN thousand)

The table below presents values of liquidity measures M1- M4 as at 31 December 2015 and their average, minimum and maximum values:

liquidity norm*	value as at 31.12.2015	average	minimum	maximum
M1	PLN 789 930 thousand	PLN 427 569 thousand	PLN 12 101 thousand	PLN 838 726 thousand
M2	3.243	1.767	1.012	3.305
M3	51.754	41.694	37.205	51.754
M4	1.080	1.075	1.039	1.134
LCR	850%	696%	209%	4374%

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

In 2016 and 2015 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 inflows required to pay or received 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.

Liabilities (by contractual dates of maturity) as at 31 December 2016

	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	5 530	-	-	-	-	5 530
Amounts due from other banks	16 297	-	-	-	-	16 297
Loans and advances to customers	60 551	156 991	641 619	3 240 551	8 532 666	12 632 378
Investment securities available for sale	237 814	-	140 721	786 847	-	1 165 382
Total assets	**320 192**	**156 991**	**782 340**	**4 027 398**	**8 532 666**	**13 819 587**
Planned payments of the off-balance sheet liabilities to grant loans or guarantees	**34**	**251**	**17 269**	**844 755**	**405 703**	**1 268 012**
Total asstes and off-balance sheet	**320 226**	**157 242**	**799 609**	**4 872 153**	**8 938 369**	**15 087 599**
Liabilities (by contractual dates of maturity)						
Amounts due to other bank	27 488	113 006	640 325	1 832 471	941 885	3 555 175
Amounts due to customers	36 390	-	-	-	-	36 390
Debt securities in issue	198 745	532 346	589 476	3 715 057	1 589 222	6 624 846
Subordinated liabilities	-	2 579	7 881	41 869	226 222	278 551
Total liabilities	**262 623**	**647 931**	**1 237 682**	**5 589 397**	**2 757 329**	**10 494 962**
Off-balance sheet liabilities to grant loans or guarantees	**475 526**	**109 732**	**386 345**	**296 408**	**-**	**1 268 011**
Total liabilites and off-balance sheet	**738 149**	**757 663**	**1 624 027**	**5 885 805**	**2 757 329**	**11 762 973**
Net liquidity gap	**(417 923)**	**(600 421)**	**(824 418)**	**(1 013 652)**	**6 181 040**	**3 324 626**

for 2016 (in PLN thousand)

Liabilities (by contractual dates of maturity) as at 31 December 2015

	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	7 521	-	-	-	-	7 521
Amounts due from other banks	205 180	-	-	-	-	205 180
Loans and advances to customers	44 967	124 268	635 368	2 785 839	6 054 391	9 644 833
Investment securities available for sale	471 575	-	103 420	181 693	-	756 688
Total assets	**729 243**	**124 268**	**738 788**	**2 967 532**	**6 054 391**	**10 614 222**
Planned payments of the off-balance sheet liabilities to grant loans or guarantees	**28**	**3 681**	**6 945**	**767 904**	**201 409**	**979 967**
Total asstes and off-balance sheet	**729 271**	**127 949**	**745 733**	**3 735 436**	**6 255 800**	**11 594 189**
Liabilities (by contractual dates of maturity)						
Amounts due to other bank	266 355	149 726	218 054	1 703 762	828 275	3 166 172
Amounts due to customers	252 642	1 588	8 498	-	-	262 728
Debt securities in issue	5 958	15 659	529 447	2 461 120	1 644 095	4 656 279
Subordinated liabilities	-	3 021	7 873	41 829	236 662	289 385
Total liabilities	**524 955**	**169 994**	**763 872**	**4 206 711**	**2 709 032**	**8 374 564**
Off-balance sheet liabilities to grant loans or guarantees	**265 735**	**244 480**	**352 254**	**117 498**	**-**	**979 967**
Total liabilites and off-balance sheet	**790 690**	**414 474**	**1 116 126**	**4 324 209**	**2 709 032**	**9 354 531**
Net liquidity gap	**(61 419)**	**(286 525)**	**(370 393)**	**(588 773)**	**3 546 768**	**2 239 658**

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

3.7.2. Cash flows from transactions in non-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 NBP from balance sheet date. Amounts recognised in the table are not discounted contractual cash outflows.

31.12.2016

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)	-	2 384	5 635	23 250	1 391	**32 660**
Total net valuation	**-**	**2 384**	**5 635**	**23 250**	**1 391**	**32 660**

31.12.2015

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)	(304)	2 767	4 391	19 529	1 061	**27 444**
Total net valuation	**(304)**	**2 767**	**4 391**	**19 529**	**1 061**	**27 444**

Derivative financial instruments settled in gross amounts

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

for 2016 (in PLN thousand)

The table below presents derivative financial instruments of the Bank which will be settled on the net 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.

31.12.2016

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	152 882	413 898	295 552	**862 332**
- inflows	150 516	414 197	295 152	**859 865**

31.12.2015

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	102 276	117 191	387 797	**607 264**
- inflows	103 473	117 842	389 715	**611 030**

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.

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 margins for credit risk and real payment terms resulting from loan agreements. The level of credit margins has been determined on the basis of market quotations of credit margins median for Moody's rating system. Attribution of a credit margin to a given credit exposure took place as a result of mapping of the Moody's rating system with the internal rating system of the Bank. In order to reflect the fact that the majority of exposures of the Bank is secured while the median of market quotations is concentrated around unsecured issues, the Bank made adjustments in this respect.

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

for 2016 (in PLN thousand)

Investment securities available for sale

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:

- fund on current accounts,
- loans received,
- other financial liabilities with deferred payment term,
- subordinated loans received,
- deposits,
- liabilities due to issued by the Bank covered bonds and bonds.

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 funds on current accounts, received loans, other financial liabilities with deferred payment term, received subordinated loans, deposits of variable interest rate or fixed interest rate, but below 1 year is equal to their carrying value.

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.

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	31.12.2016		31.12.2015	
	Carrying value	Fair value	Carrying value	Fair value
Financial assets				
Cash and balances with the central bank	**5 530**	**5 530**	**7 521**	**7 521**
Amounts due from other banks	**16 262**	**16 262**	**205 180**	**205 180**
Loans and advances to customers, including:	**9 411 505**	**9 727 512**	**7 391 743**	**7 542 198**
Corporate customers	4 867 619	4 975 144	4 606 821	4 648 842
Individual customers	4 403 438	4 607 345	2 638 649	2 742 969
Public sector customers	140 448	145 023	146 273	150 387
Total financial assets	**9 433 297**	**9 749 304**	**7 604 444**	**7 754 899**
Financial liabilities				
Amounts due to other banks	**3 316 817**	**3 316 817**	**2 959 741**	**2 959 741**
Amounts due to customers, including:	**36 394**	**36 394**	**265 509**	**265 509**
Corporate customers	36 227	36 227	265 364	265 364
Individual customers	132	132	141	141
Public sector customers	35	35	4	4
Debt securities in issue	**6 123 466**	**6 185 089**	**4 164 902**	**4 186 469**
Subordinated liabilities	**200 484**	**200 484**	**200 899**	**200 899**
Total financial liabilities	**9 677 161**	**9 738 784**	**7 591 051**	**7 612 618**

for 2016 (in PLN thousand)

The table below presents the fair value hierarchy of financial assets and liabilities measured at fair value in accordance with the assumptions described above, exclusively for disclosure as at 31 December 2016 and 31 December 2015.

31.12.2016	including:	Level 1 Prices quoted in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
VALUATION ONLY FOR PURPOSES OF DISCLOSURE				
Financial assets				
Cash and balances with the central bank	5 530	-	-	5 530
Amounts due from other banks	16 262	-	-	16 262
Loans and advances to customers	9 727 512	-	-	9 727 512
Financial liabilities				
Amounts due to other banks	3 316 817	-	-	3 316 817
Amounts due to customers	36 394	-	-	36 394
Debt securities in issue	6 185 089	-	-	6 185 089
Subordinated liabilities	200 484	-	-	200 484
Total financial assets	**9 749 304**	**-**	**-**	**9 749 304**
Total financial liabilities	**9 738 784**	**-**	**-**	**9 738 784**

31.12.2015	including:	Level 1 Prices quoted in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
VALUATION ONLY FOR PURPOSES OF DISCLOSURE				
Financial assets				
Cash and balances with the central bank	7 521	-	-	7 521
Amounts due from other banks	205 180	-	-	205 180
Loans and advances to customers	7 542 198	-	-	7 542 198
Financial liabilities				
Amounts due to other banks	2 959 741	-	-	2 959 741
Amounts due to customers	265 509	-	-	265 509
Debt securities in issue	4 186 469	-	-	4 186 469
Subordinated liabilities	200 899	-	-	200 899
Total financial assets	**7 754 899**	**-**	**-**	**7 754 899**
Total financial liabilities	**7 612 618**	**-**	**-**	**7 612 618**

The following table presents the hierarchy of fair values of financial assets and liabilities recognised in the statement of financial position of the Bank according to their fair values. Valuation of the instruments in level 2 is conducted based on the model of discounted cash flows using the current interest rates.

31.12.2016	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:	**1 134 049**	**902 587**	**231 462**	**-**
- Treasury bonds	902 587	902 587	-	-
- Money bills	231 462	-	231 462	-
Derivative financial instruments, including:	**45 160**	**-**	**45 160**	**-**
-Interest-bearing instruments	41 997	-	41 997	-
- Foreign exchange instruments	3 163	-	3 163	-
TOTAL FINANCIAL ASSETS	**1 179 209**	**902 587**	**276 622**	**-**

for 2016 (in PLN thousand)

31.12.2016	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	**9 635**	**-**	**9 635**	**-**
- Interest-bearing instruments	176	-	176	-
- Foreign exchange instruments	9 459	-	9 459	-
TOTAL FINANCIAL LIABILITIES	**9 635**	**-**	**9 635**	**-**
RECURRING FAIR VALUE MEASUREMENTS				
TOTAL FINANCIAL ASSETS	**1 179 209**	**902 587**	**276 622**	-
TOTAL FINANCIAL LIABILITIES	**9 635**	**-**	**9 635**	-

31.12.2015	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:	**748 505**	**278 642**	**469 863**	**-**
- Treasury bonds	278 642	278 642	-	-
- Money bills	469 863	-	469 863	-
Derivative financial instruments, including:	**32 212**	**-**	**32 212**	**-**
- Interest-bearing instruments	29 995	-	29 995	-
- Foreign exchange instruments	2 217	-	2 217	-
TOTAL FINANCIAL ASSETS	**780 717**	**278 642**	**502 075**	**-**

31.12.2015	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	**3 770**	**-**	**3 770**	**-**
- Interest-bearing instruments	2 369	-	2 369	-
- Foreign exchange instruments	1 401	-	1 401	-
TOTAL FINANCIAL LIABILITIES	**3 770**	**-**	**3 770**	**-**
RECURRING FAIR VALUE MEASUREMENTS				
TOTAL FINANCIAL ASSETS	**780 717**	**278 642**	**502 075**	-
TOTAL FINANCIAL LIABILITIES	**3 770**	**-**	**3 770**	-

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 departments of the Bank on the basis of internal rules.

In the reporting period there were no changes of classification of elements of statement of financial position in the 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 (with exclusion of future impairments due to outstanding loans that were no incurred yet), 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%, the estimated amount of loan impairment would decrease by PLN 16 745 thousand or increase by PLN 21 592 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. The principles for measuring impairment are described in Note 3.1.3. The rules of impairment measurement are presented in Note 3.1.3.

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 activates accumulated impairment losses on loans in deferred tax in case of occurrence of events allowing for prima facie evidence of irrecoverability of loans in accordance with applicable tax regulations, including as an effect of debt collection activities.

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 42.

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 in mBank Hipoteczny S.A.

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 2016, the value of the provision for variable remuneration amounted to PLN 2 770 thousand; as at 31 December 2015, it amounted to PLN 2 008 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 3.1.5, the Bank classifies exposure / customers which are subject to the forbearance policy on the basis of professional judgment.

6. Operating segments

Following the management approach, segments are reported in accordance with the internal reporting provided to the Bank's Management Board (the chief operating decision-maker), which is responsible for allocating resources to the reportable segments and assesses their performance.

mBank Hipoteczny S.A. is a specialist mortgage bank and it plays a leading role in the market of commercial real estate financing and issuing covered bonds, debt securities which refinance its credit activities.

There are two business lines in the Bank:

- retail line, focused on granting mortgage loans in cooperation with 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.

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.

Taking into consideration the specialist business profile of the Bank, the following operating segments were separated:

- Commercial loans – including loans: for refinancing, to housing developers, to commercial developers,
- Retail loans – loans to natural persons acquired in cooperation with mBank S.A.,
- Other – including loans: to local government units (LGU), for the purchase of land, for natural persons, not financed in cooperation with mBank S.A.

The segments were identified taking into account specific customer and product groups on the basis of homogeneous transaction characteristics. The classification is consistent with sales management.

Commercial loans — 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.

Retail loans — is a segment of the Bank's business that includes the following loans:

- loans to natural persons granted for housing purposes in PLN, secured with a mortgage on a housing property, sold under an agency agreement with mBank S.A. – agency model,
- loans to natural persons in PLN, secured with a mortgage on a housing property, acquired from mBank S.A., that can form a basis for the issue of mortgage covered bonds – pooling.

Other loans – this segment of the Bank's business is in decline due to the discontinuation of sales in the segment. The Bank classifies the following loans into this segment:

- 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);
- for land purchase — loans for financing and refinancing the purchase of land for housing real estate development projects.
- to natural persons — loans to natural persons granted not in cooperation with mBank S.A. The Bank discontinued the sales in this segment in 2004**.**

Non–allocated items — this position comprises all assets other than credits and loans.

On the basis of the above product segmentation, the profit before tax, including all profit and loss positions, is determined for each individual operating segment separately.

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. 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.

Due to the fact that the Bank cannot assign its liabilities to appropriate operating segments at the transaction level, the interest costs as well as fee and commission costs are attributed using a scheme described below.

The Bank's refinancing costs are divided into three categories: costs of public sector covered bonds, costs of mortgage covered bonds and average cost of other refinancing sources (mostly loans and deposits obtained from mBank S.A.). For each category, an average refinancing cost is calculated on basis of margin of each liability in a given category.

The interest and fee and commission costs for loans to local government units is calculated on the basis of actual refinancing costs of public sector covered bonds and part of average cost of other refinancing sources that is attributable to this segment (proportionally to the liabilities refinancing the surplus of loans for local government units over the value of the covered bonds issued).

The interest and fee and commission expense for other groups is calculated on the basis of actual refinancing costs of mortgage covered bonds and average cost of other refinancing sources that are attributable to the segment, proportionally to the share of segment loans in all loans portfolio (excluding loans for local government units).

Remaining income statement items are divided either by the share of average credit exposure in the year, or share of risk-weighted assets in the case of depreciation and administrative expenses. 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 division into operating segments described above is the main and only segmentation of Bank's operations. Taking into consideration the fact that the Bank operates only within the territory of the Republic of Poland, the Bank does not use geographic segmentation.

There are no operations between the operating segments within the Bank.

The segmentation of assets and profit and loss has been made using the information that Bank uses for controlling and management purposes. Assets and income and costs attributable to these assets have been assigned to individual segments. The segment results include all profit and loss positions. Liabilities have not been allocated to individual segments, as it is not presented to the Bank's Management Board on a regular basis.

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 2016 (in PLN thousand)

Period from 01.01.2016 to 31.12.2016	Commercial loans	Retail loans	Other loans	Total
Interest income	177 782	126 089	14 777	318 648
Interest expense	(70 045)	(105 752)	(12 710)	(188 507)
Net interest income	**107 737**	**20 337**	**2 067**	**130 141**
Fee and commission income	4 331	2 162	229	6 722
Fee and commission expenses	(640)	(4 503)	(53)	(5 196)
Net impairment write-downs on loans and advances	(18 614)	(1 166)	(1 808)	(21 588)
Amortisation/depreciation and overhead costs, taxes on the Bank balance sheet items	(56 573)	(24 228)	(1 553)	(82 354)
Other income statement items	1 686	722	46	2 454
Segment result (before tax)	**37 927**	**(6 676)**	**(1 072)**	**30 179**

31.12.2016	Commercial loans	Retail loans	Other loans	Non-allocated assets items	Total
Loans and advances to customers	4 710 560	4 342 849	350 390	-	9 403 799
Other assets	-	-	-	1 245 700	1 245 700
Segment assets	4 710 560	4 342 849	350 390	1 245 700	10 649 499

Period from 01.01.2015 to 31.12.2015*	Commercial loans	Retail loans	Other loans	Total
Interest income	180 244	58 915	17 158	256 317
Interest expense	(77 762)	(51 461)	(16 332)	(145 555)
Net interest income	**102 482**	**7 454**	**826**	**110 762**
Fee and commission income	8 574	3 398	664	12 636
Fee and commission expenses	(938)	(5 070)	(99)	(6 107)
Net impairment write-downs on loans and advances	(24 261)	(656)	142	(24 775)
Amortisation/depreciation and overhead costs	(49 293)	(11 479)	(1 803)	(62 575)
Other income statement items	(2 476)	(577)	(91)	3 144
Segment result (before tax)	**34 088**	**(6 930)**	**(361)**	**26 797**

31.12.2015*	Commercial loans	Retail loans	Other loans	Non-allocated assets items	Total
Loans and advances to customers	4 408 134	2 569 136	414 378	96	7 391 744
Other assets	-	-	-	1 027 381	1 027 381
Segment assets	4 408 134	2 569 136	414 378	1 027 477	8 419 125

* The following segments were aggregated by the Bank in 2016:

- “Loans for refinancing”, “Loans to housing developers” “Loans to commercial real estate developers” into one “Commercial loans” segment due to near economic characteristics and similarity according to IFRS 8, especially: type of the product or service (mortgage credits for the commercial projects); type of the customer (corporate entities), similar margin and interests, risk assessment and collaterals;
- “Loans for LGU”, “Loans for land purchase”, “Loans to individual customers” into one “Other loans” segment.

Because of the change the comparative data has been amended as of 31.12.2015

The criteria for the operational segments is based on the current business activity. “Other loans” segment consists of the historical loan agreements, which are no longer in the Bank’s actual product portfolio.

Gross result for particular operational segments of the Bank is presented in agreement with items of income statement, prepared for the purposes of audited financial statements.

for 2016 (in PLN thousand)

7. Net interest income

	Year ended 31 December	
	2016	2015
Interest income		
Loans and advances, including the unwind of discount relating to impairment write-down:	278 632	227 009
Cash and short-term deposits	971	528
Investment securities	18 489	14 266
Cash collaterals	106	14
Deposits taken	28	-
Interest income on derivatives classified into banking book	12 942	8 967
Interest income on derivatives concluded under hedge accounting	7 480	5 533
Total interest income	**318 648**	**256 317**
Interest expense		
Due to settlements with banks	(51 124)	(41 226)
Due to settlements with customers	(869)	(914)
Due to the issue of debt securities	(126 076)	(97 491)
Due to subordinated loan	(10 421)	(5 924)
In respect of cash collaterals	(17)	-
Total interest expense	**(188 507)**	**(145 555)**
Total net interest income	**130 141**	**110 762**

Interest income related to impaired financial assets amounted to PLN 9 056 thousand (for the period ended 31 December 2015: PLN 5 866 thousand).

Net interest income per client groups is as follows:

	Year ended 31 December	
	2016	2015
Interest income		
From banking sector	26 383	23 892
From other entities, including:	292 265	232 425
- from corporate customers	162 378	168 499
- from individual customers	112 373	54 000
- from public sector	17 514	9 926
Total interest income	**318 648**	**256 317**

Income due to interests on money bills were presented in the item "Interest income from banking sector" while income due to interests on treasury bonds in the item "Interest income from public sector".

	Year ended 31 December	
	2016	2015
Interest expense		
From banking sector	(61 545)	(47 150)
From other entities, including:	(886)	(914)
- from corporate customers	(869)	(914)
From own issuances	(126 076)	(97 491)
Total interest expense	**(188 507)**	**(145 555)**

for 2016 (in PLN thousand)

8. Net fee and commission income

	Year ended 31 December	
	2016	2015
Fee and commission income		
Credit-related fees and commissions	6 365	12 163
Commissions from bank accounts	321	428
Commissions from money transfers	36	45
Total fee and commission income	**6 722**	**12 636**
Fee and commission expenses		
Costs of real estate analyses and valuations related to the lending activity	(1 620)	(4 126)
Cost of servicing loan products	(2 091)	(390)
Costs related to the debt securities issue program (covered bonds and bonds)	(726)	(929)
Commissions from money transfers and bank accounts	(109)	(94)
Commission expense from the stand-by credit line	(66)	(356)
Other	(584)	(212)
Total fee and commission expense	**(5 196)**	**(6 107)**
Total net fee and commission income	**1 526**	**6 529**

9. Net trading income

	Year ended 31 December	
	2016	2015
Foreign exchange result	**4 240**	**2 036**
Net exchange differences on translation	11 783	(8 542)
Valuation of foreign currency derivatives	(7 543)	10 578
Other net trading income and result on hedge accounting	**(2 504)**	**(2 470)**
Interest rate risk instruments	(2 181)	(78)
Hedge accounting, including:	(323)	(2 392)
- net profit on hedged items	(7 775)	4 233
- net profit on hedging instruments	7 452	(6 625)
Total net trading income	**1 736**	**(434)**

The result of the exchange item includes implemented and not implemented positive and negative exchange difference as well as profits and losses from the spot transaction and futures contracts. The result of interest instruments operations includes result of interest rates swap contracts that were not determined as securing instruments.

for 2016 (in PLN thousand)

10. Other operating income

	Year ended 31 December	
	2016	2015
Reversal of impairment write-downs on receivables (excluding loans)	899	-
Income from sales of services	849	432
The refund of VAT was recognized in prior year costs	559	-
Refund the overpayment to cover the cost of banking supervision	177	63
Income from the release of the provisions for future liabilities	55	180
Income from recovering receivables designated previously as prescribed, remitted or uncollectible	20	52
Income from sales or liquidation tangible fixed assets and intangible assets	14	-
Compensations, penalties and fines recived	7	-
Other	536	36
Total other operating income	**3 116**	**763**

11. Net impairment write-downs on loans and advances

	Year ended 31 December	
	2016	2015
Net write-downs on loans and advances to customers (Note 21)	(21 552)	(24 759)
Net write-downs for contingent liability towards customers	(36)	(16)
Net impairment write-downs on loans and advances	**(21 588)**	**(24 775)**

12. Overhead costs

	Year ended 31 December	
	2016	2015
Staff-related costs	(34 339)	(32 434)
Material costs, including:	(22 662)	(19 564)
- logistic cost	(8 331)	(7 238)
- IT cost	(5 430)	(4 487)
- marketing cost	(5 256)	(4 128)
- consulting services cost	(2 790)	(2 203)
- other cost	(855)	(1 508)
Contribution and payments to the Bank Guarantee Fund	(3 572)	(3 959)
Taxes and fees	(1 654)	(1 340)
Reserve on Borrowers Support Fund	(10)	(350)
Contributions to the Social Benefits Fund	(235)	(229)
Total overhead costs	**(62 472)**	**(57 876)**

The amount "Logistic cost" consists of the property rent costs and leasing of the cars and other means of transport equals to PLN 3 706 thousand (2015: PLN 3 144 thousand).

for 2016 (in PLN thousand)

Employment costs

	Year ended 31 December	
	2016	**2015**
Wages and salaries	(26 507)	(26 116)
Social security expenses	(4 279)	(3 821)
Costs of retirement benefits	(11)	(9)
Provision for holiday equivalents	(218)	(413)
Remuneration payment in the form of phantom shares settled in cash	(2 185)	(915)
Other employee benefits	(1 139)	(1 160)
Staff-related costs, total	**(34 339)**	**(32 434)**

In 2016 average level of employment in the Bank was 227 persons (2015: 218 persons).

Remuneration in the form of phantom shares settled in cash relates to the costs of variable remuneration programme for employees having significant influence on the risk profile of the Bank program. Cash-settled phantom share-based payment benefits are presented in Note 2.17. Description of variable remuneration programme for employees having significant influence on the risk profile of the Bank program is presented in Note 42.

13. Other operating expenses

	Year ended 31 December	
	2016	**2015**
Inventory write-downs	(1 717)	(254)
Loss on the sales of assets repossessed for debts (inventories) and costs of their maintenance	(411)	(384)
Costs of enforcement proceedings	(199)	(243)
Compensations, penalties and fines paid	(20)	(6)
Cost of real estate valuation	(9)	(763)
Costs arising from impairment write-downs created for other receivables (excluding loans)	-	(1 746)
Provisions for disputes	-	(18)
Loss on sales or liquidation of tangible fixed assets	-	(15)
Costs of creation of impairment charges on tangible fixed assets	-	(12)
Other	(47)	(32)
Total other operating expenses	**(2 403)**	**(3 473)**

for 2016 (in PLN thousand)

14. Income tax expense

	Year ended 31 December	
	2016	**2015**
Current income tax	(7 719)	(3 579)
Deferred income tax (Note 31)	962	(4 427)
Total income tax	**(6 757)**	**(8 006)**

Profit before tax	**30 179**	**26 797**
Income tax calculated at the rate applicable in a given fiscal year (19%)	(5 734)	(5 091)
Non-taxable income	5 908	1 420
- loan loss provisions from prior year recognised as tax assets	4 822	-
- unrecoverable receivables write-off	1 032	1 334
- other non-taxable income	54	86
Non-deductible tax costs, including:	(7 227)	(4 335)
- value of write-downs on receivables	(3 689)	(3 893)
- tax on the Bank's balance sheet items	(3 171)	-
- costs of the prudent fee to the Bank Guarantee Fund	(216)	(140)
- other	(151)	(302)
Adjustments in respect of current tax from prior years	296	-
Total income tax expense	**(6 757)**	**(8 006)**

Effective tax rate calculation		
Profit before income tax	30 179	26 797
Income tax	(6 757)	(8 006)
Effective tax rate	**22.39%**	**29.88%**
Nominal tax rate	**19.00%**	**19.00%**

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.

Tax authorities may audit the correct settlement of taxes in the period of 5 years from the end of the year in which the deadline for filing of tax return expired. Since the beginning of activity of the Bank no tax audit was performed by tax authorities in terms of income tax for legal persons.

for 2016 (in PLN thousand)

15. Earnings per share

	Year ended 31 December	
	2016	**2015**
Basic:		
Net profit from activities attributable to shareholders of mBank Hipoteczny S.A.	23 422	18 791
Weighted average number of ordinary shares	3 042 186	2 909 068
Basic net profit per share (in PLN per share)	**7.70**	**6.46**
Diluted:		
Net profit attributable to shareholders of mBank Hipoteczny S.A., applied during the estimation of diluted profit per share	23 422	18 791
Weighted average number of ordinary shares	3 042 186	2 909 068
Earnings per ordinary share / Diluted earnings per ordinary share (in PLN per share)	**7.70**	**6.46**

The basic earnings per share are computed as the quotient of the Bank stockholders' share of the profit and the weighted average number of ordinary shares during the year.

Diluted profit is equal to base profit per single share, since there are no elements causing dilution.

Weighted average of number of ordinary shares during a period is a number of ordinary shares at the beginning of a given period, adjusted by the number of ordinary shares purchased or issued during this period weighted with an indicator that reflects period of the occurrence of these shares. The indicator reflecting the period of occurrence of particular shares is a number of days for which specified shares occur to the total number of days in a given period.

16. Other comprehensive incomes

The table below presents detailed information concerning other comprehensive income for the years 2016 and 2015

	Year ended 31 December	
	2016	**2015**
Items that may be reclassified to the income statement, including:	**(1 993)**	**(917)**
Available-for-sale financial assets:	**(1 993)**	**(917)**
Unrealised losses on debt instruments recognised in the financial year (net)	(1 993)	(917)
Items that will not be reclassified to the income statement, including:	**(2)**	**3**
Actuarial gains and losses on post-employment benefits	**(2)**	**3**
Actuarial gains	-	3
Actuarial losses	(2)	-
Total other comprehensive income, net	**(1 995)**	**(914)**

17. Cash and balances with central bank

The Bank has a current account in the Polish National Bank (NBP) which balance as at 31 December 2016 amounted to PLN 5 530 thousand. As at 31 December 2015, the funds of the Bank on this current account amounted to PLN 7 521 thousand. On the basis of the Act on the National Bank of Poland of 29 August 1997, mBank Hipoteczny S.A. hold a mandatory reserve deposit. The arithmetic mean of daily balances of the mandatory reserve which the Bank was obliged to maintain during a given period in the current account with NBP amounted to:

- PLN 2 965 thousand for the period from 30 November 2016 to 1 January 2017,
- PLN 7 139 thousand for the period from 31 December 2015 to 1 February 2016.

The interest rate on the funds maintained as a mandatory reserve amounted to 1.35% both as at 31 December 2016 and as at 31 December 2015.

18. Loans and advances to banks

	31.12.2016	31.12.2015
Current accounts	16 258	55 172
Deposits in other banks (overnight deposits)	-	150 006
Other receivables	4	2
Recognised in cash equivalents	**16 262**	**205 180**
Amounts (gross) due from other banks, in total	**16 262**	**205 180**
Amounts (net) due from other banks, in total	**16 262**	**205 180**
Short-term amounts due from other banks (up to 1 year)	16 262	205 180

Amounts due from other banks	31.12.2016		31.12.2015	
	exposure (PLN '000)	share/coverage (%)	exposure (PLN '000)	share/coverage (%)
Not overdue, without impairment recognised	16 262	100.00	205 180	100.00
Total gross	**16 262**	**100.00**	**205 180**	**100.00**
Total net	**16 262**	**100.00**	**205 180**	**100.00**

All receivables were receivables from Polish banks.

19. Derivative financial instruments

	Nominal amount		Fair value	
	purchase	disposal	assets	liabilities
As at 31 December 2016				
Derivative financial instruments held for trading				
Foreign exchange derivatives				
- FX swap contracts	865 174	867 642	3 163	9 459
Total OTC derivatives	**865 174**	**867 642**	**3 163**	**9 459**
Total foreign exchange derivatives	**865 174**	**867 642**	**3 163**	**9 459**
Interest rate derivatives				
- IRS contracts	150 000	150 000	612	-
Total OTC interest rate derivatives	**150 000**	**150 000**	**612**	**-**
Total interest rate derivatives	**150 000**	**150 000**	**612**	**-**
Total assets / liabilities held for trading	**1 015 174**	**1 017 642**	**3 775**	**9 459**
Derivatives held for hedging				
Derivatives designated as fair value hedges	760 928	760 928	41 385	6 717
- IRS contracts	760 928	760 928	41 385	6 717
Total derivatives held for hedging	**760 928**	**760 928**	**41 385**	**6 717**
Total recognised derivative assets /liabilities	**1 776 102**	**1 778 570**	**45 160**	**16 176**
Net-off effect	**-**	**-**	**-**	**(6 541)**
Total recognised derivative assets /liabilities held for trading	**1 776 102**	**1 778 570**	**45 160**	**9 635**
Short-term (up to 1 year)	865 174	867 642	3 163	9 459
Long-term (over 1 year)	910 928	910 928	41 997	176

Net-off effect consists of PLN 6 541 thousand from the collateral in form of the Variation Margin on the derivative transactions subject to netting.

for 2016 (in PLN thousand)

	Nominal amount		Fair value	
	purchase	disposal	assets	liabilities
As at 31 December 2015				
Derivative financial instruments held for trading				
Foreign exchange derivatives				
- FX swap contracts	613 746	609 984	2 217	1 401
Total OTC derivatives	**613 746**	**609 984**	**2 217**	**1 401**
Total foreign exchange derivatives	**613 746**	**609 984**	**2 217**	**1 401**
Interest rate derivatives				
- IRS contracts	200 000	200 000	530	-
Total OTC interest rate derivatives	**200 000**	**200 000**	**530**	**-**
Total interest rate derivatives	**200 000**	**200 000**	**530**	**-**
Total assets / liabilities held for trading	**813 746**	**809 984**	**2 747**	**1 401**
Derivatives held for hedging				
Derivatives designated as fair value hedges	528 426	528 426	29 465	2 369
- IRS contracts	528 426	528 426	29 465	2 369
Total derivatives held for hedging	**528 426**	**528 426**	**29 465**	**2 369**
Total recognised derivative assets /liabilities	**1 342 172**	**1 338 410**	**32 212**	**3 770**
Net-off effect	**-**	**-**	**-**	**-**
Total recognised derivative assets /liabilities held for trading	**1 342 172**	**1 338 410**	**32 212**	**3 770**
Short-term (up to 1 year)	813 746	809 984	2 747	1 401
Long-term (over 1 year)	528 426	528 426	29 465	2 369

20. Hedge accounting

The Bank applies fair value hedge accounting. The only type of risk hedged in the scope of hedge accounting is the risk of change of interest rates. Result from valuation of hedged item and hedge instruments is presented in the following tables. Collateral is regularly assessed and its high efficiency can be stated. 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 relation

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

Hedged items

Mortgage covered bonds of nominal value of EUR 172 000 thousand with fixed interest rates are hedged items.

Hedging instruments

Interest Rate Swap transactions which change fixed interest rate into variable interest rate constitute hedging instruments.

Presentation of the result from hedged and hedging transactions

Fair value adjustment of hedged liabilities and valuation of hedging instruments is recognised in the income statement in the result of trade activity excluding profits and interest costs of the interest element of valuation of hedging instruments that are presented in the Interest incomes/costs on derivative instruments item included in the scope of hedging accounting.

The following table presents hedged items as at 31 December 2016. In the following table the nominal value is presented in EUR thousand, while the carrying amount and hedge accounting adjustments related to fair value of hedge items and changes to fair value due to hedging accounting in PLN thousand.

Debt financial instruments by type	Nominal value	Intrest on 31.12.2016	Maturity	The carrying amount	Hedge accounting adjustments related to fair value of hedged items	Change of fair value due to hedge acounting
Mortgage covered bonds (EUR)	30 000	2.75%	2020-07-28	132 936	5 220	(192)
Mortgage covered bonds (EUR)	8 000	3.50%	2029-02-28	35 816	5 059	(1 733)
Mortgage covered bonds (EUR)	15 000	3.50%	2029-03-15	67 198	9 516	(3 264)
Mortgage covered bonds (EUR)	20 000	3.20%	2029-05-30	88 700	12 453	(4 393)
Mortgage covered bonds (EUR)	20 000	1.12%	2018-10-22	88 459	732	(155)
Mortgage covered bonds (EUR)	20 000	1.14%	2022-02-25	88 653	1 749	(1 607)
Mortgage covered bonds (EUR)	11 000	1.29%	2025-04-24	48 756	2	(1 857)
Mortgage covered bonds (EUR)	13 000	1.18%	2026-09-20	57 444	(1 986)	3 440
Mortgage covered bonds (EUR)	35 000	1.18%	2026-09-20	154 570	(3 440)	1 986
Total hedge amount				**762 532**	**29 305**	**(7 775)**

The following table presents hedged items as at 31 December 2015. In the following table the nominal value is presented in EUR thousand, while the carrying amount and hedge accounting adjustments related to fair value of hedge items and changes to fair value due to hedging accounting in PLN thousand.

Debt financial instruments by type	Nominal value	Intrest on 31.12.2015	Maturity	The carrying amount	Hedge accounting adjustments related to fair value of hedged items	Change of fair value due to hedge acounting
Mortgage covered bonds (EUR)	30 000	2.75%	2020-07-28	127 653	5 028	(754)
Mortgage covered bonds (EUR)	8 000	3.50%	2029-02-28	34 432	3 325	651
Mortgage covered bonds (EUR)	15 000	3.50%	2029-03-15	64 621	6 252	1 225
Mortgage covered bonds (EUR)	20 000	3.20%	2029-05-30	85 281	8 059	1 650
Mortgage covered bonds (EUR)	20 000	1.12%	2018-10-22	85 094	577	(251)
Mortgage covered bonds (EUR)	11 000	1.29%	2025-04-24	46 917	(1 854)	1 855
Mortgage covered bonds (EUR)	20 000	1.14%	2022-02-25	85 241	143	(143)
Total hedge amount				**529 239**	**21 530**	**4 233**

The following table presents hedging items as at 31 December 2016. In the following table the nominal value is presented in EUR thousand, while the fair value and change of fair value due to hedge accounting in PLN thousand.

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	8 498	-	(315)
IRS (EUR)	8 000	2029-02-28	6 454	-	1 820
IRS (EUR)	15 000	2029-03-15	11 804	-	3 434
IRS (EUR)	20 000	2029-05-30	12 268	-	4 714
IRS (EUR)	20 000	2018-10-22	761	-	202
IRS (EUR)	20 000	2022-02-25	1 600	-	1 789
IRS (EUR)	11 000	2025-04-24	-	70	1 979
IRS (EUR)	13 000	2026-09-20	-	2 274	(2 135)
IRS (EUR)	35 000	2026-09-20	-	4 373	(4 036)
Total hedge amount			**41 385**	**6 717**	**7 452**

The following table presents hedging items as at 31 December 2015. In the following table the nominal value is presented in EUR thousand, while the fair value and change of fair value due to hedge accounting in PLN thousand.

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	8 646	-	(26)
IRS (EUR)	8 000	2029-02-28	4 566	-	(1 008)
IRS (EUR)	15 000	2029-03-15	8 259	-	(1 890)
IRS (EUR)	20 000	2029-05-30	7 477	-	(2 323)
IRS (EUR)	20 000	2018-10-22	517	-	442
IRS (EUR)	20 000	2022-02-25	-	285	201
IRS (EUR)	11 000	2025-04-24	-	2 084	(2 021)
Total hedge amount			**29 465**	**2 369**	**(6 625)**

The total results of fair value hedge accounting recognised in the income statement in 2016 and 2015

	Year ended 31 December	
	2016	2015
Interest income on derivatives concluded under hedge accounting of fair value (Note 7)	7 480	5 533
Net profit on hedged items (Note 9)	(7 775)	4 233
Net profit on hedging instruments (Note 9)	7 452	(6 625)
Total net profit on hedge accounting of fair value	**7 157**	**3 141**

The fair value (equal to the book value) of hedging derivative instruments is presented in Note 19 "Derivative financial instruments".

21. Loans and advances to customers

	31.12.2016	31.12.2015
Loans and advances to corporate customers	**4 957 222**	**4 701 272**
Loans and advances to individual ccustomers	**4 407 440**	**2 641 448**
Loans and advances to the public sector	**140 490**	**146 317**
Other receivables	**7 706**	**95**
Loans and advances from customers (gross)	**9 512 858**	**7 489 132**
Write-downs on receivables (negative amount)	(101 353)	(97 389)
Loans and advances from customers (net)	**9 411 505**	**7 391 743**
Short-term (up to 1 year)	683 724	678 031
Long-term (over 1 year)	8 727 781	6 713 712

As at 31 December 2016, the gross balance sheet value of loans granted to corporate and individual clients as well as for the public sector in the Bank's loan portfolio amounted to PLN 9 505 133 thousand on the basis of variable interest rate, and PLN 19 thousand on the basis of fixed interest rate. As at 31 December 2015, on the basis of variable interest rate the gross balance sheet value amounted to PLN 7 489 018 thousand, and PLN 19 thousand on the basis of fixed interest rate.

The item "Other receivables" comprises cash collateral provided by the Bank for derivative transactions with the central clearing chamber.

The gross carrying value of the retail portfolio obtained as part of the cooperation with mBank S.A. amounted to:

- as at 31 December 2016 – PLN 4 344 866 thousand,

- as at 31 December 2015 – PLN 2 569 974 thousand.

The gross carrying value of the commercial portfolio transferred as part of commercial pooling with mBank S.A. amounted to:

- as at 31 December 2016 – PLN 261 375 thousand,
- as at 31 December 2015 – PLN 251 982 thousand.

Impairment write-downs on loans and advances

	31.12.2016	31.12.2015
Incurred but not identified losses		
Gross balance sheet exposure	9 199 935	7 284 837
Impairment write-downs on exposures analysed on a portfolio basis	(9 775)	(14 338)
Net balance sheet exposure	**9 190 160**	**7 270 499**
Impaired receivables		
Loans to corporate customers	304 605	198 551
Loans to individual customers	8 318	5 744
Total gross balance sheet exposure	**312 923**	**204 295**
Impairment write-down on impaired exposures	(91 578)	(83 051)
Net balance sheet exposure	**221 345**	**121 244**

Movements in Impairment write-downs on loans and advances

	Impairment write-downs as at 01.01.2016	Write-downs created	Reversal of write-downs	Receivables written-off	Other changes	Impairment write-downs as at 31.12.2016
Corporate customers	(94 546)	(40 965)	20 784	17 413	5	(97 309)
Individual customers	(2 799)	(4 563)	3 185	175	-	(4 002)
Public sector customers	(44)	-	7	-	(5)	(42)
Total movements in impairment write-downs on loans and advances	(97 389)	(45 528)	23 976	17 588	-	(101 353)

	Impairment write-downs as at 01.01.2015	Write-downs created	Reversal of write-downs	Receivables written-off	Other changes	Impairment write-downs as at 31.12.2015
Corporate customers	(85 356)	(35 687)	11 428	15 069	-	(94 546)
Individual customers	(2 291)	(3 216)	2 708	-	-	(2 799)
Public sector customers	(52)	-	8	-	-	(44)
Total movements in impairment write-downs on loans and advances	(87 699)	(38 903)	14 144	15 069	-	(97 389)

Loans and advances to customers by portfolio quality

Loans and advances to customers	31.12.2016		31.12.2015	
	exposure (PLN '000)	share/coverage (%)	exposure (PLN '000)	share/coverage (%)
Not overdue, without impairment recognised	8 987 247	94.47	7 082 378	94.57
Overdue, without impairment recognised	212 688	2.24	202 459	2.70
Items with impairment recognised	312 923	3.29	204 295	2.73
Total gross	**9 512 858**	**100.00**	**7 489 132**	**100.00**
Impairment write-down on loans not overdue, without impairment recognised	(9 280)	(0.10)	(13 650)	(0.18)
Impairment write-down on loans overdue, without impairment recognised	(495)	(0.01)	(688)	(0.01)
Impairment write-down on loans with impairment recognised	(91 578)	(0.96)	(83 051)	(1.11)
Total impairment write-down	**(101 353)**	**(1.07)**	**(97 389)**	**(1.30)**
Total net	**9 411 505**	**98.93**	**7 391 743**	**98.70**

for 2016 (in PLN thousand)

Loans and advances past due but not impaired

Gross amounts of loans and advances not past due and not impaired according to the rating are presented below.

	score from internal models 31.12.2016		31.12.2016	score from internal models 31.12.2015		31.12.2015
	[SCOREmin	SCOREmax)		[SCOREmin	SCOREmax)	
Exposures permanently exempted from the IRB approach	no rating	no rating	437 400	no rating	no rating	498 212
Exposures temporarily exempted from the IRB approach — retail portfolio acquired in cooperation with mBank S.A.	-	-	4 302 793	-	-	2 550 076
Exposures subject to the IRB approach — specialised lending, including	-	-	4 247 054	-	-	4 034 090
- supervisory category 1	45	54	2 244	45	54	8 813
- supervisory category 2	23	45	4 071 392	24	45	3 562 921
- supervisory category 3	11	23	133 811	12	24	338 330
- supervisory category 4	1	11	1 328	1	12	7 957
- supervisory category 5	default	default	38 279	default	default	116 069
Total			**8 987 247**			**7 082 378**

For the calculation of capital requirement for credit risk the Bank applies method of internal ratings with application of supervisory approach in terms of assignment of risk categories to exposure for specialised lending. Assignment to appropriate supervisory category takes place after risk assessment of a transaction using developed by the Bank internal rating models and the transfer function model which transforms scoring assigned in the scope of given internal models to supervisory categories. Particular supervisory categories listed in the table above specify supervisory risk weights and expected losses.

On the basis of the annual review of the transfer function, on 1 March 2016 changes were made to the transfer map – the boundary between supervisory category 2 and supervisory category 3 was lowered from 24 to 23 points, and the boundary between supervisory category 3 and supervisory category 4 was lowered from 12 to 11 points. The review was conducted on the basis of an updated sample, and the change in the boundaries for mapping the transfer function did not have a significant effect on the capital requirement determined in accordance with the internal ratings-based approach – the effect of the change was estimated as a decrease in capital requirements representing 0.63% of the values calculated as at 31.12.2015.

According to the original version of the gradual implementation plan, the IRB approach was to be applied to exposures in respect of specialized financing in the business portfolio. However, as a result of executing its business strategy and an expected significant increase in the share of retail exposures in the Bank's total assets, on 10 December 2013, the Bank adopted an internal resolution amending the scope of implementation of the IRB approach, and on 12 December 2013, the Bank notified the PFSA that it would expand the plan of gradual implementation of the IRB approach to the retail portfolio acquired in cooperation with mBank S.A. The application of the permanent exemption from the IRB approach to that category of exposures was no longer justified and posed a risk in the context of the permanent exemption ratio. The Bank expects to start calculating the capital requirement for credit risk in respect of exposures which are currently temporarily exempted from the application of the IRB approach in the third quarter of 2017, after obtaining relevant approval from the regulator.

The retail portfolio acquired in cooperation with mBank S.A. and temporarily exempted from the application of the IRB approach is characterized by a very good quality, with the cost of risk at a very low level of 0.04% and only a few cases of default, with a PD of 0.31%.

Gross amounts of loans and advances not past due and not impaired divided into client class are presented below.

	31.12.2016	31.12.2015
Corporate customers	4 481 989	4 322 972
Individual customers	4 357 974	2 612 994
Public sector customers	139 578	146 317
Other receivables	7 706	95
Total	**8 987 247**	**7 082 378**

for 2016 (in PLN thousand)

Quality assessment of loans and advances not past due and not impaired

	31.12.2016	31.12.2015
Loans and advances with limited credit risk	256 407	361 058
Loans and advances with standard credit risk	8 692 383	6 605 066
Loans and advances with increased credit risk	38 457	116 254
Total	**8 987 247**	**7 082 378**

In the portfolio of loan and advances of limited credit risk the Bank includes loans and advances granted to public sector clients and corporate clients whose basic legal collateral is guarantee or guarantee of local government units. Additionally, the Bank in this category includes receivables submitted to the clearing house of deposits securing derivative instruments through a central counterparty. In the portfolio of loans and advances of standard credit risk the Bank includes loans and advances granted to individual and corporate clients whose basic collateral is a mortgage established on real estates for which no evidence of loss of value was found.

In the portfolio of loans and advances of increased credit risk the Bank includes loans and advances granted to corporate clients in case of whom there is evidence of loss of value, but the Bank does not recognise the loss of value due to expected recovery of credit exposure in the full amount.

Loans and advances past due but not impaired

The exposures against clients and banks, for whom at least one receivable is past due by one or more days, are assumed as past due exposures. Whereby, in case of portfolio granted in cooperation with mBank S.A., the past due exposure is an exposure on delayed contracts (by one or more days). No impairment is recognised in respect of loans and advances past due for less than 90 days, unless other available information indicates their impairment. In rare cases for loans and advances overdue by over 90 days, the Bank does not recognise impairment if there is particular evidence demonstrating lack of impairment of those loans and advances.

Gross amounts of loans and advances which were overdue, but for which no impairment was recognised, divided into client classes, are presented below.

Overdue loans and advances without impairment recognised (31.12.2016)	Corporate customers	Individual customers	Public sector customers	Total customers
up to 30 days	140 172	38 268	-	178 440
from 31 to 60 days	7 935	2 183	912	11 030
from 61 to 90 days	20 907	142	-	21 049
more than 90 days	1 614	555	-	2 169
Total	**170 628**	**41 148**	**912**	**212 688**

Overdue loans and advances without impairment recognised (31.12.2015)	Corporate customers	Individual customers	Public sector customers	Total customers
up to 30 days	148 326	19 996	-	168 322
from 31 to 60 days	-	1 861	-	1 861
from 61 to 90 days	16 240	708	-	16 948
more than 90 days	15 183	145	-	15 328
Total	**179 749**	**22 710**	**-**	**202 459**

for 2016 (in PLN thousand)

Loans and advances individually impaired

Gross amounts of loans and advances individually impaired (before taking into consideration the cash flows from collateral held) are presented below by classes of assets.

Loans and advances individually impaired	Corporate customers	Individual customers	Total customers
31.12.2016			
Impaired loans and advances (gross amount)	304 605	8 318	312 923
Estimated recovery from contributions and collaterals	**215 150**	**5 926**	**221 076**
Impairment write-downs	**89 185**	**2 393**	**91 578**
The mortgage lending value of the property constituting collateral for loans	**426 670**	**18 861**	**445 531**
31.12.2015			
Impaired loans and advances (gross amount)	198 551	5 744	204 295
Estimated recovery from contributions and collaterals	**117 167**	**3 969**	**121 136**
Impairment write-downs	**81 276**	**1 775**	**83 051**
The mortgage lending value of the property constituting collateral for loans	**265 800**	**16 196**	**281 996**

In the position 'The mortgage lending value of the property constituting collateral for loans' Bank presented the actual value of the collaterals, not adjusted to the deacreasing value of the credit exposure. The mortgage lending value of the property constituting collateral for loans granted by the Bank is higher than the exposure value, so in case of additional charges from the exposure, e.g. additional collection costs, the Bank will be able to cover its claims.

The mortgage lending value is determined for the internal purpose and reflects the level of risk related to the property as the loan collateral. The mortgage lending value of the property includes only the features and income from the property, which on the assumption of the rational utilization have the stable nature and can be obtained by every owner of the property.

Financial effect of collaterals

In the note below, the effect of the value of the collateral accepted by the Bank, relating to the loans and advances granted by the Bank, on the level of allowances recorded, is presented.

As at 31 December 2016	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	**16 262**	**-**	**-**	**-**
Loans and advances to customers, including:	**9 512 858**	**(101 353)**	**(252 123)**	**150 770**
Corporate customers	4 957 222	(97 309)	(240 481)	143 172
Individual customers	4 407 440	(4 002)	(11 600)	7 598
Public sector customers	140 490	(42)	(42)	-
Other receivables	**7 706**	**-**	**-**	**-**
Total balance sheet data	**9 529 120**	**(101 353)**	**(252 123)**	**150 770**
Off-balance sheet data				
Loan commitments	1 269 921	(54)	(67)	13
Total off-balance sheet data	**1 269 921**	**(54)**	**(67)**	**13**

for 2016 (in PLN thousand)

As at 31 December 2015	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	**205 180**	**-**	**-**	**-**
Loans and advances to customers, including:	**7 489 132**	**(97 389)**	**(182 824)**	**85 435**
Corporate customers	4 701 272	(94 546)	(173 827)	79 281
Individual customers	2 641 448	(2 799)	(8 953)	6 154
Public sector customers	146 317	(44)	(44)	-
Other receivables	**95**	**-**	**-**	**-**
Total balance sheet data	**7 694 312**	**(97 389)**	**(182 824)**	**85 435**
Off-balance sheet data				
Loan commitments	979 967	(18)	(35)	17
Total off-balance sheet data	**979 967**	**(18)**	**(35)**	**17**

22. Investment securities

	31.12.2016		
	Investment securities without pledge	Pledged investment securities	Total investment securities
Debt securities:	**1 043 374**	**90 675**	**1 134 049**
Issued by government	811 912	90 675	902 587
- government bonds	811 912	90 675	902 587
Issued by central bank	231 462	-	231 462
- central bank’s money bills	231 462	-	231 462
Total debt securities	**1 043 374**	**90 675**	**1 134 049**
Short-term (up to 1 year)	357 323	1 008	358 331
Long-term (over 1 year)	686 051	89 667	775 718
Based on fixed interest rate	649 846	-	649 846
Based on floating interest rate	393 528	90 675	484 203

	31.12.2015		
	Investment securities without pledge	Pledged investment securities	Total investment securities
Debt securities:	**680 092**	**68 413**	**748 505**
Issued by government	210 229	68 413	278 642
- government bonds	210 229	68 413	278 642
Issued by central bank	469 863	-	469 863
- central bank’s money bills	469 863	-	469 863
Total debt securities	**680 092**	**68 413**	**748 505**
Short-term (up to 1 year)	569 139	2 070	571 209
Long-term (over 1 year)	110 953	66 343	177 296
Based on fixed interest rate	569 140	2 070	571 210
Based on floating interest rate	110 952	66 343	177 295

for 2016 (in PLN thousand)

Movements in investment securities

	Year ended 31 December	
	2016	**2015**
Investment securities		
As at the beginning of the period	**748 505**	**735 220**
Additions	18 243 642	29 369 527
Disposals (sale, redemption and forfeiture)	(17 855 637)	(29 355 110)
Gains / losses from changes in fair value	(2 461)	(1 132)
As at the end of the period	**1 134 049**	**748 505**

23. Intangible assets

	31.12.2016	**31.12.2015**
Concessions, patents, licences and similar assets, including:	4 842	5 556
- computer software	4 842	5 556
Intangible assets under development	8 515	2 596
Intangible assets, total	**13 357**	**8 152**

Movements in intangible assets

Movements in the period from 01.01.2016 to 31.12.2016	Acquired computer software	Intangible assets under development	Total
Gross value of intangible assets as at the beginning of the period: 01.01.2016	**16 314**	**2 596**	**18 910**
Increase (due to)	**534**	**5 922**	**6 456**
- purchase	534	5 922	6 456
Decrease (due to)	**(109)**	**(3)**	**(112)**
- other increases	(109)	(3)	(112)
Gross value of intangible assets as at the end of the period 31.12.2016	**16 739**	**8 515**	**25 254**
Accumulated amortisation as at the beginning of the period: 01.01.2016	**(10 758)**	**-**	**(10 758)**
Amortisation for the period (due to):	**(1 139)**	**-**	**(1 139)**
- amortisation	(1 190)	-	(1 190)
- adjustments to allowances	51	-	51
Accumulated amortisation as at the end of the period : 31.12.2016	**(11 897)**	**-**	**(11 897)**
Net value of intangible assets as at the end of the period: 31.12.2016	**4 842**	**8 515**	**13 357**

for 2016 (in PLN thousand)

Movements in the period from 01.01.2015 to 31.12.2015	Acquired computer software	Intangible assets under development	Total
Gross value of intangible assets as at the beginning of the period: 01.01.2015	**13 632**	**1 349**	**14 981**
Increase (due to)	**3 539**	**3 002**	**6 541**
- purchase	1 784	3 002	4 786
- transfer from intangible assets under development	1 755	-	1 755
Decrease (due to)	**(857)**	**(1 755)**	**(2 612)**
- transfer from intangible assets under development	-	(1 755)	(1 755)
- liquidation	(857)	-	(857)
Gross value of intangible assets as at the end of the period 31.12.2015	**16 314**	**2 596**	**18 910**
Accumulated amortisation as at the beginning of the period: 01.01.2015	**(9 907)**	**-**	**(9 907)**
Amortisation for the period (due to):	**(851)**	**-**	**(851)**
- amortisation	(1 708)	-	(1 708)
- liquidation	857	-	857
Accumulated amortisation as at the end of the period: 31.12.2015	**(10 758)**	**-**	**(10 758)**
Net value of intangible assets as at the end of the period: 31.12.2015	**5 556**	**2 596**	**8 152**

24. Tangible fixed assets

	31.12.2016	31.12.2015
Technical equipment and machinery	5 653	5 608
Vehicles	116	392
Fixed assets under construction	679	237
Other fixed assets	1 155	1 286
Tangible fixed assets, total	**7 603**	**7 523**

Movements in tangible fixed assets

Movements in the period from 01.01.2016 to 31.12.2016	Equipment	Vehicles	Other fixed assets	Fixed assets under construction	Total
Gross value of tangible fixed assets as at the beginning of the period: 01.01.2016	**19 861**	**2 131**	**5 439**	**237**	**27 668**
Increase (due to)	**1 743**	**-**	**240**	**442**	**2 425**
- purchase	1 743	-	236	442	2 421
- other increases	-	-	4	-	4
Decrease (due to)	**(2 413)**	**(1 357)**	**(125)**	**-**	**(3 895)**
- sale	-	(1 357)	-	-	(1 357)
- liquidation	(2 328)	-	(116)	-	(2 444)
- other increases	(85)	-	(9)	-	(94)
Gross value of tangible fixed assets as at the end of the period: 31.12.2016	**19 191**	**774**	**5 554**	**679**	**26 198**
Accumulated amortisation as at the beginning of the period: 01.01.2016	**(14 253)**	**(1 706)**	**(4 153)**	**-**	**(20 112)**
Amortisation for the period (due to):	**715**	**1 048**	**(246)**	**-**	**1 517**
- amortisation	(1 658)	(85)	(367)	-	(2 110)
- adjustments to allowances	47		5		52
- sale	-	1 133	-	-	1 133
- liquidation	2 326	-	116	-	2 442
Accumulated amortisation as at the end of the period: 31.12.2016	**(13 538)**	**(658)**	**(4 399)**	**-**	**(18 595)**
Impairment charge as at the beginning of the period: 01.01.2016	**-**	**(33)**	**-**	**-**	**(33)**
- decrease	-	33	-	-	33
Impairment charge as at the end of the period: 31.12.2016	**-**	**-**	**-**	**-**	**-**
Net value of tangible fixed assets as at the end of the period: 31.12.2016	**5 653**	**116**	**1 155**	**679**	**7 603**

for 2016 (in PLN thousand)

Movements in the period from 01.01.2015 to 31.12.2015	Equipment	Vehicles	Other fixed assets	Fixed assets under construction	Total
Gross value of tangible fixed assets as at the beginning of the period: 01.01.2015	**19 043**	**2 211**	**4 982**	**-**	**26 236**
Increase (due to)	**2 203**	**-**	**877**	**1 199**	**4 279**
- purchase	1 704	-	414	1 199	3 317
- transfer from fixed assets under construction	499	-	463	-	962
Decrease (due to)	**(1 385)**	**(80)**	**(420)**	**(962)**	**(2 847)**
- sale	-	(80)	-	-	(80)
- liquidation	(1 385)	-	(420)	-	(1 805)
- transfer from fixed assets under construction	-	-	-	(962)	(962)
Gross value of tangible fixed assets as at the end of the period: 31.12.2015	**19 861**	**2 131**	**5 439**	**237**	**27 668**
Accumulated amortisation as at the beginning of the period: 01.01.2015	**(13 325)**	**(1 566)**	**(4 079)**	**-**	**(18 970)**
Amortisation for the period (due to):	**(928)**	**(140)**	**(74)**	**-**	**(1 142)**
- amortisation	(2 307)	(195)	(489)	-	(2 991)
- sale	-	55	-	-	55
- liquidation	1 379	-	415	-	1 794
Accumulated amortisation as at the end of the period: 31.12.2015	**(14 253)**	**(1 706)**	**(4 153)**	**-**	**(20 112)**
Impairment charge as at the beginning of the period: 01.01.2015	**-**	**(25)**	**-**	**-**	**(25)**
- increase	-	(12)	-	-	(12)
- decrease	-	4	-	-	4
Impairment charge as at the end of the period : 31.12.2015	**-**	**(33)**	**-**	**-**	**(33)**
Net value of tangible fixed assets as at the end of the period: 31.12.2015	**5 608**	**392**	**1 286**	**237**	**7 523**

25. Other assets

	31.12.2016	31.12.2015
Other, including:	**7 389**	**9 479**
- inventories	3 432	6 768
- other prepayments	1 255	1 149
- debtors	822	438
- income receivable	410	670
- receivables from agency model valuation	1 431	425
- other	39	29
Total other assets	**7 389**	**9 479**
Short-term (up to 1 year)	7 389	9 479
Long-term (over 1 year)	-	-

Inventories consists of assets repossessed for debts described in note 3.1.4.

for 2016 (in PLN thousand)

26. Amounts due to other banks

	31.12.2016	31.12.2015
Loans received	2 979 842	2 513 519
Other financial liabilities with deferred payment term	311 431	113 011
Liabilities in respect of cash collateral	25 544	19 807
Term deposits (including overnight deposits)	-	313 404
Total amounts due to other banks	**3 316 817**	**2 959 741**
Short-term (up to 1 year)	725 401	589 165
Long-term (over 1 year)	2 591 416	2 370 576
Fixed rate deposits	-	313 404

As at 31 December 2016 other financial liabilities with deferred payment term relate to liability resulting from agreements on transfer of retail loans portfolio secured with a mortgage concluded with mBank S.A. As at 31 December 2015 other financial liabilities with deferred payment term relate to liability resulting from agreements on transfer of retail loans portfolio secured with a mortgage and agreements on transfer of commercial loans secured with a mortgages concluded with mBank S.A. Other financial liabilities with deferred payment term were based on the variable interest rate. The transactions are described in Note 43.

All received loans are based on variable interest rate.

mBank Hipoteczny S.A. did not provide collaterals to its creditors. The Bank did not register any breaches of contractual conditions associated with liabilities due to received loans.

27. Amounts due to clients

	31.12.2016	31.12.2015
Corporate customers:	**36 227**	**265 364**
Cash in current accounts	-	242 011
Term deposits (including overnight deposits)	-	20 663
Other liabilities (in respect of):	36 227	2 690
- cash collateral	747	1 130
- other	35 480	1 560
Individual customers:	**132**	**141**
Other liabilities (in respect of):	132	141
- cash collateral	65	65
- other	67	76
Public sector clients:	**35**	**4**
Other liabilities (in respect of):	35	4
- other	35	4
Total amounts due to customers	**36 394**	**265 509**
Short-term (up to 1 year)	35 585	264 825
Long-term (over 1 year)	809	684

On October 9, 2016 came into force the law of 10 June 2016 on the Bank Guarantee Fund, the deposit guarantee system and a forced restructuring, which amended the law on mortgage bonds and mortgage banks in a way that results in the inability of mortgage banks to run bank accounts used for processing investment projects implemented using loans granted and accepting term deposits by mortgage banks.

Accordingly, the Bank's Management Board on 12 July 2016 with Resolution No. 85/2016 decided to transfer existing customer service bank in the conduct of accounts, proprietary and closed escrow accounts to mBank by common offering customers products of mBank S.A.

meet the requirements set functionality. In December 2016 on the basis of the decision of the Chairman of the Management Board remaining, not transferred to escrow accounts, have been closed.

In the above table under "other" as of December 31, 2016 have been presented main measures that have not yet been settled after the close of escrow accounts and remained in a suspense account until the submission by the owner of the account balances, appropriate disposal.

28. Debt securities in issue

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

Receivables in respect of loans granted to local government units and loans secured with warranties of local government units form the basis for the issue of public sector covered bonds.

Covered bonds may also be issued based on the Bank's funds invested in treasury securities, deposited with the National Bank of Poland or in cash, hereinafter referred to as the "Substitute collateral".

<u>Principles for the admissible amount of the substitute collateral</u>

The Bank is required to maintain, separately for mortgage covered bonds and public sector covered bonds, a surplus created from the funds forming the Substitute collateral, equal to or higher than the aggregate nominal value of interest on the outstanding mortgage covered bonds or public sector covered bonds, as applicable, due over the next 6 months (hereinafter referred to as the "Surplus"). Such surplus funds may not serve as a basis for issuing covered bonds.

With respect to comparative periods, i.e. 31 December 2015, the Substitute collateral could serve as a basis for issuing covered bonds up to 10% of the amount of the Bank's debt claims secured by a mortgage.

<u>Principles for the statutory over-collateralisation of covered bonds</u>

The sum of nominal amounts of the Bank's claims:

- from loans secured with a mortgage and the 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 outstanding mortgage covered bonds, and the sum of nominal amounts of claims of the Bank secured by mortgages, constituting the basis for issuing mortgage covered bonds, cannot be lower than 85% of the total amount of nominal values of the outstanding mortgage covered bonds,
- in respect of loans granted to local self-government entities or loans secured by local self-government sureties and substitute collaterals entered in the register of collaterals of covered bonds, constituting the basis for issuing public covered bonds, cannot be lower than 110% of the total amount of nominal values of the public covered bonds currently in trading, and the sum of nominal amounts of liabilities of the Bank in respect of loans granted to local self-government entities or loans secured by local self-government sureties, constituting the basis for issuing public covered bonds, cannot be lower than 85% of the total amount.

In relation to comparative period, i.e. 31 December 2015, the minimum level of collateral for covered bonds in trading required by law is specified as the equivalent of the nominal amount of the issued mortgage covered bonds.

<u>Principles for refinancing loans with means originating from issuance of covered bonds</u>

According to the Act on covered bonds and mortgage banks, the Bank can refinance loans secured by a mortgage and acquired liabilities of other banks resulting from mortgage-secured loans granted with means obtained from issuance of covered bonds; the refinancing in respect of a single loan or single liability cannot exceed the amount equivalent to 60% of the mortgage lending value of the real property, and in the case of residential real property - 80% of the mortgage lending value (as of 31 December 2015 the limit of refinancing of liabilities secured by a mortgage on a residential real property was 60% of the lending mortgage value of the real property).

for 2016 (in PLN thousand)

The tables below show data related to the issuance of covered bonds as of 31 December 2016 and as of 31 December 2015.

Data as at 31.12.2016	Mortgage covered bonds	Public sector covered bonds
1. Nominal value of covered bonds listed on the market	5 267 828	-
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)	7 297 062	322 753
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)	33 465	-
4. Level of collateral the covered bonds by receivables (2/1)	138.52%	-
5. Total covered bonds collateral level (2+3) / 1	139.16%	-
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	3 394 475	-
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	2 988 910	-

Permissible value of Substitute collateral as at 31.12.2016	Mortgage covered bonds
1. Cash invested in treasury bonds	90 000
2. Interests from covered bonds on the market which will be paid in the next 6 months (Surplus)	56 535
3. Permissible value of Substitute collateral (1-2)	33 465

Data as at 31.12.2015	Mortgage covered bonds	Public sector covered bonds
Nominal value of covered bonds on the market	3 927 227	150 000
The nominal value of receivables entered in the collateral register of covered bonds underlying the issue of covered bonds (The value of not matured capital)	5 403 757	361 911
Cash in Bank, as a treasury bonds, entered in the collateral register of covered bonds additionaly underlying the issue of covered bonds (Substitute collateral)	60 000	-
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	4 342 172	-

The total nominal amount of the covered bonds in trading, both as of 31 December 2016 and as of 31 December 2015 was listed on two markets under CATALYST: The Regulated Market of Securities maintained by BondSpot S.A. and the regulated parallel stock exchange market of GPW w Warszawie S.A. (Warsaw Stock Exchange).

for 2016 (in PLN thousand)

As at 31.12.2016

Debt financial instruments by type	Nominal value	Interest rate as at 31.12.2016	Guarantee / collateral	Redemption date	Amount of liability
Long-term issues (with original maturity of over 1 year)					
Mortgage covered bonds (PLN)	200 000	2.79%	Mortgage cover bonds register	2017-06-16	200 194
Mortgage covered bonds (PLN)	200 000	3.09%	Mortgage cover bonds register	2017-04-20	201 188
Mortgage covered bonds (PLN)	200 000	3.50%	Mortgage cover bonds register	2018-06-15	200 122
Mortgage covered bonds (EUR)	10 000	1.70%	Mortgage cover bonds register	2017-10-19	44 378
Mortgage covered bonds (PLN)	80 000	2.81%	Mortgage cover bonds register	2019-06-21	80 015
Mortgage covered bonds (EUR)	30 000	2.75%	Mortgage cover bonds register	2020-07-28	132 936
Mortgage covered bonds (EUR)	50 000	0.82%	Mortgage cover bonds register	2018-10-22	221 338
Mortgage covered bonds (EUR)	7 500	0.61%	Mortgage cover bonds register	2018-02-15	33 202
Mortgage covered bonds (EUR)	8 000	3.50%	Mortgage cover bonds register	2029-02-28	35 816
Mortgage covered bonds (EUR)	15 000	3.50%	Mortgage cover bonds register	2029-03-15	67 198
Mortgage covered bonds (EUR)	20 000	3.20%	Mortgage cover bonds register	2029-05-30	88 700
Mortgage covered bonds (PLN)	300 000	2.72%	Mortgage cover bonds register	2022-07-28	302 501
Mortgage covered bonds (PLN)	200 000	2.72%	Mortgage cover bonds register	2023-02-20	201 224
Mortgage covered bonds (EUR)	20 000	1.12%	Mortgage cover bonds register	2018-10-22	88 459
Mortgage covered bonds (EUR)	50 000	0.56%	Mortgage cover bonds register	2019-10-15	221 119
Mortgage covered bonds (PLN)	200 000	2.58%	Mortgage cover bonds register	2022-04-28	200 281
Mortgage covered bonds (EUR)	20 000	1.14%	Mortgage cover bonds register	2022-02-25	88 653
Mortgage covered bonds (PLN)	250 000	2.67%	Mortgage cover bonds register	2023-10-16	250 372
Mortgage covered bonds (EUR)	11 000	1.29%	Mortgage cover bonds register	2025-04-24	48 756
Mortgage covered bonds (EUR)	50 000	0.37%	Mortgage cover bonds register	2020-06-24	220 782
Mortgage covered bonds (PLN)	500 000	2.83%	Mortgage cover bonds register	2020-09-10	499 677
Mortgage covered bonds (PLN)	255 000	2.88%	Mortgage cover bonds register	2021-09-20	254 525
Mortgage covered bonds (PLN)	300 000	2.93%	Mortgage cover bonds register	2021-03-05	299 906
Mortgage covered bonds (EUR)	50 000	0.56%	Mortgage cover bonds register	2021-06-21	220 681
Mortgage covered bonds (PLN)	50 000	2.91%	Mortgage cover bonds register	2020-04-28	50 879
Mortgage covered bonds (PLN)	100 000	2.91%	Mortgage cover bonds register	2020-04-28	101 662
Mortgage covered bonds (EUR)	70 000	1.05%	Mortgage cover bonds register	2019-08-28	309 986
Mortgage covered bonds (EUR)	13 000	1.18%	Mortgage cover bonds register	2026-09-20	57 444
Mortgage covered bonds (EUR)	35 000	1.18%	Mortgage cover bonds register	2026-09-20	154 570
Mortgage covered bonds (PLN)	400 000	2.58%	Mortgage cover bonds register	2018-07-25	400 432
Bonds (PLN)	20 000	3.24%	no collateral	2019-01-16	20 275
Bonds (PLN)	60 000	3.17%	no collateral	2019-01-21	60 315
Short-term issues (with original maturity up to 1 year)					
Bonds (PLN)	40 000	2.20%	no collateral	2017-04-20	39 732
Bonds (PLN)	10 000	2.12%	no collateral	2017-01-10	9 995
Bonds (PLN)	86 000	2.09%	no collateral	2017-01-02	85 995
Bonds (PLN)	15 000	2.12%	no collateral	2017-02-03	14 971
Bonds (PLN)	80 000	2.13%	no collateral	2017-02-09	79 813
Bonds (PLN)	100 000	2.10%	no collateral	2017-01-04	99 982
Bonds (PLN)	17 000	2.13%	no collateral	2017-02-16	16 953
Bonds (PLN)	60 000	2.13%	no collateral	2017-03-02	59 784
Bonds (PLN)	200 000	2.13%	no collateral	2017-03-02	199 281
Bonds (PLN)	15 000	2.13%	no collateral	2017-03-13	14 936
Bonds (PLN)	15 000	2.13%	no collateral	2017-03-21	14 929
Bonds (PLN)	10 000	2.04%	no collateral	2017-02-17	9 973
Bonds (PLN)	30 000	2.13%	no collateral	2017-03-24	29 853
Bonds (PLN)	60 000	2.04%	no collateral	2017-02-21	59 824
Bonds (PLN)	20 000	2.15%	no collateral	2017-04-04	19 888
Bonds (PLN)	10 000	2.04%	no collateral	2017-02-21	9 971
Debt securities in issue (carrying value)					**6 123 466**

for 2016 (in PLN thousand)

As at 31.12.2015

Debt financial instruments by type	Nominal value	Interest rate as at 31.12.2015	Guarantee / collateral	Redemption date	Amount of liability
Long-term issues (with original maturity of over 1 year)u)					
Mortgage covered bonds (PLN)	255 000	2.87%	Mortgage cover bonds register	2021-09-20	254 365
Mortgage covered bonds (PLN)	500 000	2.82%	Mortgage cover bonds register	2020-09-10	499 473
Mortgage covered bonds (EUR)	50 000	0.56%	Mortgage cover bonds register	2020-06-24	212 540
Mortgage covered bonds (EUR)	11 000	1.29%	Mortgage cover bonds register	2025-04-24	46 917
Mortgage covered bonds (PLN)	250 000	2.68%	Mortgage cover bonds register	2023-10-16	250 279
Mortgage covered bonds (EUR)	20 000	1.14%	Mortgage cover bonds register	2022-02-25	85 241
Mortgage covered bonds (PLN)	200 000	2.59%	Mortgage cover bonds register	2022-04-28	200 175
Mortgage covered bonds (EUR)	50 000	0.82%	Mortgage cover bonds register	2019-10-15	212 991
Mortgage covered bonds (EUR)	20 000	1.12%	Mortgage cover bonds register	2018-10-22	85 094
Mortgage covered bonds (PLN)	200 000	2.73%	Mortgage cover bonds register	2023-02-20	201 153
Mortgage covered bonds (PLN)	300 000	2.72%	Mortgage cover bonds register	2022-07-28	302 336
Mortgage covered bonds (EUR)	20 000	3.20%	Mortgage cover bonds register	2029-05-30	85 281
Mortgage covered bonds (EUR)	15 000	3.50%	Mortgage cover bonds register	2029-03-15	64 621
Mortgage covered bonds (EUR)	8 000	3.50%	Mortgage cover bonds register	2029-02-28	34 432
Mortgage covered bonds (EUR)	7 500	0.85%	Mortgage cover bonds register	2018-02-15	31 958
Mortgage covered bonds (EUR)	50 000	1.08%	Mortgage cover bonds register	2018-10-22	213 187
Mortgage covered bonds (EUR)	30 000	2.75%	Mortgage cover bonds register	2020-07-28	127 653
Mortgage covered bonds (PLN)	80 000	2.77%	Mortgage cover bonds register	2019-06-21	79 985
Public sector covered bonds (PLN)	150 000	3.59%	Public sector cover bonds register	2016-09-28	151 314
Mortgage covered bonds (PLN)	100 000	3.50%	Mortgage cover bonds register	2016-11-15	100 384
Mortgage covered bonds (EUR)	10 000	1.93%	Mortgage cover bonds register	2017-10-19	42 747
Mortgage covered bonds (PLN)	200 000	3.46%	Mortgage cover bonds register	2018-06-15	199 984
Mortgage covered bonds (PLN)	200 000	3.10%	Mortgage cover bonds register	2017-04-20	201 054
Mortgage covered bonds (PLN)	200 000	2.75%	Mortgage cover bonds register	2017-06-16	200 052
Mortgage covered bonds (PLN)	200 000	2.95%	Mortgage cover bonds register	2016-04-20	201 132
Bonds (PLN)	60 000	3.18%	no collateral	2019-01-21	60 286
Bonds (PLN)	20 000	3.24%	no collateral	2019-01-16	20 268
Debt securities in issue (carrying value)					**4 164 902**

Movements in debt securities in issue

	Year ended 31 December	
	2016	**2015**
As at the beginning of the period	**4 164 902**	**3 171 588**
Increase (due to)	5 662 376	1 647 504
- issue	5 465 469	1 540 713
- accrued interest	126 076	97 491
- exchange differences	70 831	9 300
Decrease (due to)	(3 703 812)	(654 190)
- redemption	(3 577 700)	(550 000)
- interest repayment	(126 112)	(104 190)
As at the end of the period	**6 123 466**	**4 164 902**

Short-term (up to 1 year)	1 219 878	457 675
Long-term (over 1 year)	4 903 588	3 707 227

Fixed interest rate debt securities issued	1 680 952	529 239
Floating interest rate debt securities issued	4 442 514	3 635 663

29. Subordinated liabilities

SUBORDINATED LIABILITIES	Nominal value	Currency	Interest rate as at 31.12.2016	Maturity / redemption date	Balance of liability (PLN '000)
As at 31 December 2016					
mBANK S.A.	100 000	PLN	5.23%	19.12.2022	**100 242**
mBANK S.A.	100 000	PLN	5.23%	15.12.2025	**100 242**

SUBORDINATED LIABILITIES	Nominal value	Currency	Interest rate as at 31.12.2015	Maturity / redemption date	Balance of liability (PLN '000)
As at 31 December 2015					
mBANK S.A.	100 000	PLN	5.22%	19.12.2022	**100 242**
mBANK S.A.	100 000	PLN	5.23%	15.12.2025	**100 657**

Both as at 31.12.2016 and as at 31.12.2015, subordinated liabilities bore variable interest rates.

Movements in subordinated liabilities

	Year ended 31 December	
	2016	2015
As at the beginning of the period	**200 899**	**100 257**
Increase (due to)	10 421	105 924
- taking a loan	-	100 000
- interest on a loan	10 421	5 924
Decrease (due to)	(10 836)	(5 282)
- repayment of interest on a loan	(10 836)	(5 282)
Subordinated liabilities as at the end of the period	**200 484**	**200 899**
Short-term (up to 1 year)	484	899
Long-term (over 1 year)	200 000	200 000

30. Other liabilities and provisions

30.1. Other liabilities

	31.12.2016	31.12.2015
Other liabilities (due to)	**26 748**	**20 272**
- accrued expenses	20 423	16 924
- settlements due to tax from Bank's balance sheet positions	1 764	-
- creditors	1 763	-
- provision for holiday equivalents	1 137	971
- liabilities due to income tax on salaries, Social Security contributions and VAT	927	956
- settlements with insurers	446	1 353
- other	288	68
Other liabilities, in total	**26 748**	**20 272**
Short-term (up to 1 year)	26 748	20 272
Long-term (over 1 year)	-	-

for 2016 (in PLN thousand)

30.2. Provisions

	31.12.2016	31.12.2015
Provision (for)	**160**	**166**
- off-balance sheet contingent liabilities granted	54	18
- provisions for retirement and disability benefits	106	93
- provisions for legal proceedings	-	55
Provision, in total	**160**	**166**
Short-term (up to 1 year)	55	75
Long-term (over 1 year)	105	91

Change of the status of provisions to employee benefits after the period of employment - pension provisions

	Year ended 31 December	
	2016	2015
Provisions as at the beginning of the period	**93**	**88**
- write-down on the provision	8	6
- interest cost	2	3
- actuarial gains and losses are recognised in other comprehensive income	3	(4)
- benefits paid	-	-
Provisions as at the beginning of the period	**106**	**93**
Expected provision settlement period:		
Short-term (up to 1 year)	1	2
Long-term (over 1 year)	105	91

31. Deferred income tax

Assets and liabilities for deferred income tax 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 occurrence of tax obligation (in 2016 and 2015: 19%).

Changes in assets and liabilities for deferred income tax are presented below.

Deferred income tax assets	As at 01.01.2016	Recognised in the income statement	Recognised in other comprehensive income	As at 31.12.2016
Interest accrued	9 924	2 972	-	**12 896**
Valuation of derivative financial instruments	623	1 230	-	**1 853**
Valuation of available-for-sale financial instruments	-	-	424	**424**
Amount of impairment write-downs on receivables*	10 700	5 835	-	**16 535**
Provisions and other liabilities related to employment benefits	1 144	281	-	**1 425**
Impairment write-downs on inventories	48	326	-	**374**
Accruals	2 282	406	-	**2 688**
Revenues to be settled (commissions settled using the effective interest rate method)	7 606	935	-	**8 541**
Other	172	(172)	-	**-**
Total deferred income tax assets	**32 499**	**11 813**	**424**	**44 736**

Short-term (up to 1 year)	35 741
Long-term (over 1 year)	8 995

*Item "Value write-offs updating the value of receivables" relates to write-offs updating the value of loans for which the Bank expects that their irrecoverability will be documented.

for 2016 (in PLN thousand)

Deferred income tax liabilities	As at 01.01.2016	Recognised in the income statement	Recognised in other comprehensive income	As at 31.12.2016
Interest accrued	(7 825)	(1 906)	-	**(9 731)**
Valuation of derivative financial instruments	(4 702)	(2 052)	-	**(6 754)**
Valuation of available-for-sale financial instruments	(193)	-	44	**(149)**
Provisions and other liabilities related to employment benefits	(6)	-	1	**(5)**
Prepaid costs	(12 273)	(6 720)	-	**(18 993)**
Foreign exchange differences	-	-	-	**-**
Difference between tax and balance sheet depreciation/amortisation	(287)	(101)	-	**(388)**
Other	-	(72)	-	**(72)**
Total deferred income tax liabilities	**(25 286)**	**(10 851)**	**45**	**(36 092)**

Short-term (up to 1 year)	(36 092)
Long-term (over 1 year)	-

Deferred income tax assets (net)	As at 01.01.2016	Recognised in the income statement	Recognised in other comprehensive income	As at 31.12.2016
Total deferred income tax assets (net)	**7 213**	**962**	**469**	**8 644**

Short-term (up to 1 year)	(351)
Long-term (over 1 year)	8 995

Deferred income tax assets	As at 01.01.2015	Recognised in the income statement	Recognised in other comprehensive income	As at 31.12.2015
Interest accrued	12 066	(2 142)	-	**9 924**
Valuation of derivative financial instruments	2 208	(1 585)	-	**623**
Amount of impairment write-downs on receivables*	10 075	625	-	**10 700**
Provisions and other liabilities related to employment benefits	926	218	-	**1 144**
Impairment write-downs on inventories	-	48	-	**48**
Accruals	1 400	882	-	**2 282**
Revenues to be settled (commissions settled using the effective interest rate method)	7 869	(263)	-	**7 606**
Foreign exchange differences	-	172	-	**172**
Total deferred income tax assets	**34 544**	**(2 045)**	**-**	**32 499**

Short-term (up to 1 year)	27 754
Long-term (over 1 year)	4 745

*Item “Value write-offs updating the value of receivables” relates to write-offs updating the value of loans for which the Bank expects that their irrecoverability will be documented.

Deferred income tax liabilities	As at 01.01.2015	Recognised in the income statement	Recognised in other comprehensive income	As at 31.12.2015
Interest accrued	(9 677)	1 852	-	**(7 825)**
Valuation of derivative financial instruments	(5 647)	945	-	**(4 702)**
Valuation of available-for-sale financial instruments	(408)	-	215	**(193)**
Provisions and other liabilities related to employment benefits	(5)	-	(1)	**(6)**
Prepaid costs	(4 834)	(7 439)	-	**(12 273)**
Foreign exchange differences	(2 356)	2 356	-	**-**
Difference between tax and balance sheet depreciation/amortisation	(191)	(96)	-	**(287)**
Total deferred income tax liabilities	**(23 118)**	**(2 382)**	**214**	**(25 286)**

Short-term (up to 1 year)	(25 286)
Long-term (over 1 year)	-

for 2016 (in PLN thousand)

Deferred income tax assets (net)	As at 01.01.2015	Recognised in the income statement	Recognised in other comprehensive income	As at 31.12.2015
Total deferred income tax assets (net)	**11 426**	**(4 427)**	**214**	**7 213**

Short-term (up to 1 year)	2 468
Long-term (over 1 year)	4 745

Deferred tax recognised in the income statement	Year ended 31 December	
	2016	2015
Interest accrued	1 066	(290)
Valuation of derivative financial instruments	(822)	(640)
Amount of impairment write-downs on receivables*	5 835	625
Provisions and other liabilities related to employment benefits	281	218
Impairment write-downs on inventories	326	48
Accruals	406	882
Revenues to be settled (commissions settled using the effective interest rate method)	935	(263)
Prepaid costs	(6 720)	(7 439)
Difference between tax and balance sheet depreciation/amortisation	(101)	(96)
Exchange differences	-	2 356
Other	(244)	172
Total deferred tax recognised in the income statement	**962**	**(4 427)**

*Item "Value write-offs updating the value of receivables" relates to write-offs updating the value of loans for which the Bank expects that their irrecoverability will be documented.

The Bank activates impairment losses on loans in case of estimation that the most probable scenario will be documenting of irrecoverability in accordance with applicable tax regulations as a result of conducted debt collection activities.

Assets due to deferred tax are recognised in case when it is probable that there will be a taxable income in the future.

32. Differences between balance sheet changes of the state of an item and changes of those items recognised in operational activity in the statement of cash flows

The following table contains additional information for the statement of cash flows and presents differences between balance sheet changes of the state of an item and changes of the state of those items recognised in operational activity in the statement on cash flows.

`000 PLN	Year ended 31 December	
	2016	2015
Amounts due from other banks, change resulting from balance-sheet balances	188 918	(174 208)
The difference between the interest accrued and paid in cash in the period	(2)	7
Exclusion of change in cash and cash equivalents	(188 918)	174 208
Change in amounts due from other banks, in total	**(2)**	**7**
Derivative financial instruments, change resulting from balance-sheet values	(7 084)	(593)
The difference between the interest accrued and paid in cash in the period	4 059	(2 541)
Change in respect of derivative financial instruments, in total	**(3 025)**	**(3 134)**
Loans and advances to clients, change resulting from balance-sheet values	(2 019 762)	(2 066 002)
The difference between the interest accrued and paid in cash in the period	18 584	(3 875)
Change in loans and advances to clients	**(2 001 178)**	**(2 069 877)**
Investment securities available for sale, change resulting from balance-sheet values	(385 544)	(13 285)
The difference between the interest accrued and paid in cash in the period	1 931	(1 013)
Exclusion of change in cash and cash equivalents	(238 400)	(10 110)
Valuation recognised in other comprehensive income	(2 461)	(1 132)
Change in investment securities, in total	**(624 474)**	**(25 540)**
Amounts due to other banks, change resulting from balance-sheet values	357 076	979 107
The difference between the interest accrued and paid in cash in the period	(1 045)	2 714
Exclusion of change in cash from financing activities	(341 368)	(349 121)
Change in amounts due to other banks, in total	**14 663**	**632 700**
Amounts due to clients, change resulting from balance-sheet values	(229 116)	15 497
The difference between the interest accrued and paid in cash in the period	37	95
Change in amounts due to clients, in total	**(229 079)**	**15 592**
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	1 966 338	989 081
The difference between the interest accrued and paid in cash in the period	(6 850)	6 699
Exclusion of change in cash from financing activities	(1 119 769)	(990 713)
Change in debt securities in issue, in total	**839 719**	**5 067**
Subordinated liabilities, change resulting from balance-sheet values	(414)	100 642
The difference between the interest accrued and paid in cash in the period	414	(642)
Exclusion of change in cash from financing activities	-	(100 000)
Change in subordinated liabilities, in total	**-**	**-**
Other liabilities and provisions, change resulting from balance-sheet values	6 471	6 349
Actuarial valuation of provisions for post-employment benefits recognised in other comprehensive income	(3)	4
Change in other liabilities and provisions, in total	**6 468**	**6 353**

for 2016 (in PLN thousand)

33. Proceedings before a court, arbitration body or public administration authority

In both 2016 and 2015, the Bank did not conduct any proceedings before a court, arbitration body or public administration authority, which value consists at least 10% of the Bank's equity.

Information on proceedings before a court, arbitration body or public administration authority brought against the Bank

1. On 27 October 2016, the Bank received a claim lodged with the Regional Court in Warsaw, 20th Business Department, from a borrower for whom the Bank had terminated a loan agreement, requesting that the termination of the loan agreement be deemed invalid, and on 4 October 2016 the Bank received a claim from the same borrower, lodged with the Regional Court in Warsaw, 20th Business Department, requesting that the agreement on the registered pledge on the shares in the borrower's company be deemed invalid. In both cases the Bank submitted replies to the claims.
2. On 15 February 2016, a private individual who was not a customer of the Bank filed a claim with the Regional Court in Warsaw, 17th Department of Competition and Consumer Protection, to declare the provisions of a mortgage loan agreement unlawful. The Bank submitted a reply to the claim.
3. A lawsuit brought by City of Warsaw against the mBank Hipoteczny S.A. for the payment of 39 thousand of the annual fee for 2012 for the perpetual lease of real estate acquired by the Bank in the course of execution of real estate (adjudgement right of perpetual lease by the court) located in Warsaw at ul.Nałęczów 33/35 was completed on October 13, 2016. On 20 May 2015 the Regional Court in Warsaw issued the XXIV C 228/15 judgment in which it discontinued the proceedings on the main claim (it was previously satisfied by the Bank), dismissed the claim by the City of Warsaw for payment of statutory interest in the amount of 39 thousand and ordered the Bank to pay the process costs in the amount of 9 thousand. On June 23, 2015, the Bank filed a complaint against the decision contained in the judgment demanding change in the judgment that is not charging Bank with costs of the process. City of Warsaw made an appeal on time against the judgment that dismissed the claim for interest. On 13 October 2016 the Court of Appeal in Warsaw dismissed the appeal of the City of Warsaw on I ACa 1693/15 case and, at the same time on I ACz 1984/15 case, dismissed the Bank's complaint against decision on costs contained in the judgment of 20 May 2015, therefore, judgment of 20 May 2015 became final in its entirety. The Bank has paid the city of Warsaw costs of the process. The second case filed by the City of Warsaw against the mBank Hipoteczny S.A. for payment of the missing part of the annual fee for 2012 for perpetual lease of property located in Warsaw on ul.Nałęczów 33/35 in amount of PLN 3 thousand for statutory interest for the delay since 18 March 2016 was settled favorably for the Bank on February 24, 2017 (the action of the City of Warsaw was dismissed).

34. Off-balance sheet liabilities

31.12.2016	Up to 1 year	From 1 to 5 years	Over 5 years	Total
1. Off-balance sheet liabilities granted and received	**1 708 584**	**306 591**	**-**	**2 015 175**
Liabilities granted	**976 831**	**306 591**	**-**	**1 283 422**
1. Financial liabilities:	976 831	306 591	-	1 283 422
a) Lending commitments	973 512	296 409	-	1 269 921
b) Operating lease liabilities	3 319	10 182	-	13 501
Liabilities received:	**731 753**	**-**	**-**	**731 753**
a) Financial liabilities received	731 753	-	-	731 753
2. Derivative financial instruments	**1 732 817**	**742 400**	**1 079 456**	**3 554 673**
1. Interest rate derivatives		742 400	1 079 456	1 821 856
2. Foreign exchange derivatives	1 732 817	-	-	1 732 817
Total off-balance sheet items	**3 441 401**	**1 048 991**	**1 079 456**	**5 569 848**

for 2016 (in PLN thousand)

31.12.2015	Up to 1 year	From 1 to 5 years	Over 5 years	Total
1. Off-balance sheet liabilities granted and received	**1 036 620**	**125 079**	**-**	**1 161 699**
Liabilities granted	**865 853**	**125 079**	**-**	**990 932**
1. Financial liabilities:	865 853	125 079	-	990 932
a) Lending commitments	862 469	117 498	-	979 967
b) Operating lease liabilities	3 384	7 581	-	10 965
Liabilities received:	**170 767**	**-**	**-**	**170 767**
a) Financial liabilities received	170 767	-	-	170 767
2. Derivative financial instruments	**1 623 730**	**426 150**	**630 702**	**2 680 582**
1. Interest rate derivatives	400 000	426 150	630 702	1 456 852
2. Foreign exchange derivatives	1 223 730	-	-	1 223 730
Total off-balance sheet items	**2 660 350**	**551 229**	**630 702**	**3 842 281**

35. Pledge assets

The Bank, in accordance with the Act on the Bank Guarantee Fund as at 31 December 2016 held treasury bonds in the amount of PLN 1 008 thousand (of nominal value of PLN 1 000 thousand), while as at 31 December 2015 held treasury bonds in the amount of PLN 2 070 thousand (of nominal value of PLN 2 000 thousand) which constituted collateral of fund for the guaranteed deposits protection fund. Those assets are recognised in the balance sheet in the item "Investment securities available for sale".

The Bank secured issued mortgage and public sector covered bonds with receivables due to loans and advances that are described in Note 28.

The Bank additionally secured issued mortgage and public sector covered bonds with treasury bonds of total balance sheet value of PLN 89 667 thousand as at 31 December 2016 (PLN 66 343 thousand as at 31.12.2015).

36. Registered share capital

As at 31 December 2016, the total number of ordinary shares was 3 090 000 (2 990 000 as at 31 December 2015) with a nominal value of PLN 100 per share.

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

The increase in the number of shares in 2016 took place due to the fact that mBank Hipoteczny S.A. issued 100 000 ordinary registered shares with a nominal value of PLN 100 each and an issue price of PLN 1 000 each, based on Resolution No. 1 of the Extraordinary General Shareholders' Meeting of mBank Hipoteczny S.A. which was held on 2 June 2016. The new shares were offered for take up to mBank S.A. by way of a private subscription. The shares were paid up in full on 24 June 2016. On 1 August 2016, the registration court entered the increased share capital in the Register of Businesses.

The shareholder structure of mBank Hipoteczny S.A. as at 31 December 2016 is presented in the following table:

Shareholder's name	Equity (PLN)	Shares		Voting rights at the General Shareholders' Meeting	
		Number of shares	%	Number of shares	%
mBank S.A.	309 000 000	3 090 000	100.00	3 090 000	100.00
Total	**309 000 000**	**3 090 000**	**100.00**	**3 090 000**	**100.00**

The Bank is under no obligation due to approved payment of dividend.

for 2016 (in PLN thousand)

REGISTERED SHARE CAPITAL (STRUCTURE) AS AT 30 DECEMBER 2016							
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
Total number of shares			**3 090 000**				
Total registered share capital				**309 000 000**			

37. 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 losses that may result from the business activity of the Bank.

38. Retained earnings

	31.12.2016	**31.12.2015**
Other supplementary capital	224 131	211 340
General banking risk reserve	42 500	36 500
Profit for the current year	23 422	18 791
Total retained earnings	**290 053**	**266 631**

Remaining supplementary capital and the fund for general banking risk are created from profit deductions and are intended for the purposes specified in the articles of association and other provisions of law.

The Bank is not required to allocate minimum of 8% of net profit to supplementary capital created statutorily until it reaches the level of the one third of the share capital of the Bank. The Bank may also allocate part of the profit to the fund for general banking risk to cover unexpected losses.

In accordance with the Resolution no. 2 of Ordinary General Meeting of mBank Hipoteczny S.A. dated 19 April 2016 the net profit of 2015 was allocated to:

- supplementary capital in the amount of PLN 12 791 thousand,
- fund for general banking risk in the amount of PLN 6 000 thousand.

The Bank intends to allocate the net profit of 2016 to supplementary capital and partially to the fund for general banking risk.

39. Other components of equity

	31.12.2016	**31.12.2015**
Available-for-sale financial assets	**(1 168)**	**825**
Unrealised losses on debt instruments	**(1 168)**	**-**
Unrealised gains on debt instruments	-	825
Actuarial gains and losses on post-employment benefits	**22**	**24**
Actuarial gains of the defined benefit pension plan	22	24
Total comprehensive income, net	**(1 146)**	**849**

for 2016 (in PLN thousand)

40. Dividend per share

mBank Hipoteczny S.A. does not plan to pay dividend for 2016 and did not pay dividend for 2015.

41. Cash and cash equivalents

For the needs of the cash flow account, the balance of cash and cash equivalents contains the following balances of maturity date shorter than three months from the day of purchase.

	31.12.2016	31.12.2015
Cash and balances with the central bank (Note 17)	5 530	7 521
Amounts due from other banks (Note 18)	16 262	205 180
Money bills	231 462	469 863
Total cash and cash equivalents	**253 254**	**682 564**

42. Incentive programme for the Members of the Management Board and employees who have significant influence on the Bank's risk profile

2012 Incentive programme for the Members of the Management Board and employees who have significant influence on the Bank's risk profile (valid for 2012 and 2013)

On 19 September 2012 the Supervisory Board of the Bank accepted the regulation on variable remuneration for Management Board Members of BRE Bank Hipoteczny S.A. (currently mBank Hipoteczny S.A.) and the "Regulation variable remuneration for persons having significant influence on the Bank's risk profile".

According to the above rules the Management Board and the employees having significant influence on the Bank's risk profile receive part of their variable remuneration in the form of phantom shares - virtual, non-transferable shares, whose owner is not the owner of rights pertaining to the owner of ordinary shares. Phantom shares are awarded in the amount resulting from valuation of those shares for the assessment period. Valuation of phantom shares is calculated at the end of each reporting period as the quotient of the Bank' book value and the amount of ordinary shares.

<u>Variable remuneration for Management Board Members and the employees having significant influence on the Bank's risk profile is granted under the following rules:</u>

1) 50% of period bonus in cash,
2) 50% of period bonus in phantom shares instead of cash, of which:
   - 20% is granted in the year following the period of appraisal, to which the bonus relates, within 30 calendar days following the approval of the Bank's annual financial statements by the General Meeting of Shareholders,
   - 80% is provided in three equal tranches ("Deferred tranches").

The entitled person earns the right to the first, second and third deferred tranches respectively after the second, third and fourth calendar year following the end of the appraisal period, if:

- he or she was positively assessed on his or her duties by the Supervisory Board in case of Members of the Management Board or he or she achieved the level of appraisal for relevant year of at least 80% in case of other employees,
- he or she meets the conditions for employment with the Bank and
- Bank's result at the end of the first, second and third calendar year respectively following the end of the appraisal period is not lower than the result for that year assumed in the financial plan less 10%.

Each of the deferred tranches referred to above is granted within 30 calendar days following the approval of the Bank's annual financial statements for relevant year by the General Meeting of Shareholders.

Supervisory Board may modify the budgeted Bank's result depending on the market situation

The last settlements of this program are planned in 2017.

2014 Incentive programme for the Members of the Management Board and employees who have significant influence on the Bank's risk profile

Beginning in 2014 the incentive programme for Members of the Management Board was modified as follows.

<u>Variable remuneration for Management Board Members is granted under the following rules:</u>

1) 60% of the bonus is paid in the year in which the bonus is granted, of which 50% in cash and another 50% in the form of phantom shares.
2) 40% of the bonus will be paid in three equal tranches in the next three following years after the year in which the bonus is granted, of which 50% in cash and another 50% in the form of phantom shares.

The Supervisory Board may decide to suspend in whole or reduce the amount of deferred tranche:

1) due to subsequent appraisal of Management Board performance in time perspective exceeding 1 fiscal year,
2) if at least one of the elements included in the Scorecard is not be met

Furthermore, the Supervisory Board may decide to suspend in whole or to reduce the amount of discretionary bonus for relevant fiscal year, as well as in terms of a deferred tranche in case of a balance sheet loss or threat of its occurrence or losing of liquidity by the Bank. Suspending in whole or reduction of a bonus, as well as any deferred tranche may also relate to a bonus and a deferred tranche paid to a member of the Management Board after expiration or termination of agreement.

Incentive programme for employees who have significant influence on the Bank's risk profile was not changed from its original content of 2012. Variable remuneration for employees having significant influence on the Bank's risk profile is granted under the following rules:

1) 50% of period bonus in cash,
2) 50% of period bonus in phantom shares instead of cash, of which:
   - 20% is granted in the year following the period of appraisal, to which the bonus relates, within 30 calendar days following the approval of the Bank's annual financial statements by the General Meeting of Shareholders,
   - 80% is provided in three equal tranches ("Deferred tranches").

The entitled person earns the right to the first, second and third deferred tranches respectively after the second, third and fourth calendar year following the end of the appraisal period, if:

- he or she was positively assessed on his or her duties by the Supervisory Board in case of Members of the Management Board or he or she achieved the level of appraisal for relevant year of at least 80% in case of other employees,
- he or she meets the conditions for employment with the Bank and
- Bank's result at the end of the first, second and third calendar year respectively following the end of the appraisal period is not lower than the result for that year assumed in the financial plan less 10%.

Each of the deferred tranches referred to above is granted within 30 calendar days following the approval of the Bank's annual financial statements for relevant year by the General Meeting of Shareholders.

Supervisory Board may modify the budgeted Bank's result depending on the market situation

The last settlements of this program are planned in 2018.

2015 Incentive programme for the Members of the Management Board and employees who have significant influence on the Bank's risk profile

On 26 June 2015, the Bank's Supervisory Board accepted remuneration policy for persons having significant influence on the Bank's risk profile in mBank Hipoteczny S.A., which entered into force on 1 July 2015. On 18 April 2016 the Supervisory Board Resolution No. 14/2016 was approved revised remuneration Policy of people having a significant impact on the risk profile of the Bank in the mBank Hipoteczny S.A. hereinafter referred to as "Policy", which came into force on 1 May 2016 and repealed the previous policy in this regard. The change concerned the calculation of the average value of the phantom shares for the implementation of payment nieodroczonej part of the non-cash and non-cash deferred installment. Before the change, the value of the shares was understood as the value at the end of the annual period preceding the date of payment. At the moment, the average value of a phantom share is calculated as the sum of the value of a phantom share at the end of the annual period preceding the date of payment and the value of a phantom share at the end of the first half of the year in which the payment, divided by two.

In accordance with the Policy, variable remuneration includes bonus granted to member of the Management Board or remaining employees for a given financial year. Variable remuneration is established in a transparent manner, possible to verify, ensuring effective implementation of the Policy.

The maximum level of the amount of variable remuneration components of persons covered by the Policy may not exceed 100% of the basic remuneration paid to a member of the Management Board or other employees for a given financial year. Variable remuneration is part of total remuneration (annual basic remuneration and variable remuneration) for Management Board members or other employees. Variable remuneration is established taking into account market practices, in both banking sector and nationwide market, verified on the basis of market payroll reports and remuneration policy of the mBank Group.

<u>Process for awarding and deferring variable remuneration for members of the Bank's Management Board:</u>

The amount of bonus for particular members of the Bank's Management Board is established by the Supervisory Board, taking into account whether a member of the Management Board completed an established annual/multi-annual business and development objective - Management By Objective ("MBO"). The decision on granting of a bonus and its amount is the exclusive competence of the Supervisory Board which according to its own assessment and decision confirms achieving of MBO, taking into account situation on financial markets in the last/previous financial periods.

Variable remuneration is granted in accordance with the following rules:

- 60% of the bonus will be paid in the year of bonus determination ("non-deferred bonus") as follows:
  - 50% of non-deferred bonus in form of cash payment and
  - 50% of non-deferred bonus in phantom shares
- 40% of the bonus will be paid in three equal tranches ("deferred trenches") in the next three following years after the year of granting of the bonus in the following way:
  - 50% of each of the deferred tranches in form of cash payment and
  - 50% of each of the deferred tranches in form of non-cash payment in phantom shares.

The Supervisory Board may decide to suspend in whole or reduce the amount of deferred tranche, if:

- if it finds that in a longer-term (period of at least 3 years) an employee through its actions or omissions directly and negatively impacted financial result and market position of the Bank or
- at least one of the elements included in the Scorecard is not be met (i.e. in case of at least one "YES" answer to questions raised by it) or
- the management contract will expire or will be terminated for reasons other than:
  - expiry of the period for which it was concluded,
  - dismissal of the member of the Management Board of the Bank in the duration of the contract, excluding reasons specified in detail in the contract,
  - adoption of new responsibilities within mBank Group,
  - retirement of the member of the Management Board.

<u>Process for awarding and deferring variable remuneration for remaining employees who have significant influence of the Bank's risk profile:</u>

The Management Board of the Bank establishes the amount of bonuses of particular employees who have significant influence on the Bank's risk profile taking into account whether they completed annual/multi-annual business and development objective - MBO. The decision on granting of a bonus and its amount is the exclusive competence of the Management Board of the Bank which according to its own assessment and decision confirms achieving of MBO, taking into account situation on financial markets in the last/previous financial periods.

for 2016 (in PLN thousand)

Variable remuneration is granted in accordance with the following rules:

- 60% of the bonus will be paid in the year of bonus determination ("non-deferred bonus") as follows:
  - 50% of non-deferred bonus in form of cash payment and
  - 50% of non-deferred bonus in phantom shares,
- 40% of the bonus will be paid in three equal tranches ("deferred trenches") in the next three following years after the year of granting of the bonus in the following way:
  - 50% of each of the deferred tranches in form of cash payment and
  - 50% of each of the deferred tranches in form of phantom shares.

The Management Board of the Bank may decide to suspend in whole or reduce the amount of deferred trench:

- if it finds that in a longer-term (period of at least 3 years) an employee through its actions or omissions directly and negatively impacted financial result and market position of the Bank in the assessment period. In the assessment of actions or omissions of an employee the Management Board of the Bank takes into account e.g. results of the MBO assessment of the employee,
- in case of termination of an employment contract with the exclusion of reasons specified in the employment contract/internal regulations of the Bank,

The Management Board can decide to suspend in whole or reduce the amount of bonus for a given financial year, as well as in the scope of deferred tranche that has not been paid yet, in case of a balance sheet loss or threat of its occurrence or a risk of insolvency or losing of liquidity by the Bank.

The last settlements of this program are planned in 2019.

Accounting for incentive programmes

Payments of the remuneration programme for Management Board members and employees having a significant impact on the Bank's risk profile are accounted for in accordance with IAS 19 "Employee Benefits". Both the cash portion of the program as well as the phantom share portion settled in cash is recognised in expenses for the period with a corresponding credit to liabilities. Costs are recognised over time during the period of the right to benefits and included in "General administrative expenses".

43. Transactions with related entities

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

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

The following table presents financial liabilities against mBank S.A. according to contractual due dates of the capital

31.12.2016	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
Term deposits	-	-	-	-	-	**-**
Loans received	-	100 184	437 849	1 528 022	913 787	**2 979 842**
Other financial liabilities with deferred payment term	-	-	158 209	153 222	-	**311 431**
Subordinated liabilities	-	-	-	-	200 484	**200 484**
Covered bonds and bonds in issue	-	-	46 895	906 618	16 940	**970 453**
Derivative financial instruments	4 230	1 725	3 504	-	69	**9 528**
Liabilities in respect of cash collateral	25 544	-	-	-	-	**25 544**
Other liabilities	2 742	-	-	-	-	**2 742**

Other deferred financial liabilities are related to a liability arising from the agreements on the transfer of retail loans secured with a mortgage on property, concluded with mBank S.A. in 2016.

for 2016 (in PLN thousand)

31.12.2015	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
Term deposits	244 636	55 107	13 661	-	-	**313 404**
Loans received	-	85 283	170 671	1 458 325	799 240	**2 513 519**
Other financial liabilities with deferred payment term	-	-	-	113 011	-	**113 011**
Subordinated liabilities	-	-	-	-	200 899	**200 899**
Liabilities in respect of cash collateral	19 807	-	-	-	-	**19 807**
Covered bonds and bonds in issue	-	-	11 356	5 687	-	**17 043**
Derivative financial instruments	208	204	985	-	2 369	**3 766**
Other liabilities	1 430	-	-	-	-	**1 430**

Other financial liabilities with deferred payment term relate to liability resulting from agreements on transfer of commercial loans secured with a mortgage concluded with mBank S.A. in 2015.

<u>Major agreements concluded by and between the Bank and mBank S.A. in 2016:</u>

1. Under the framework agreement signed on 28 August 2014 on the purchase of portfolios of receivables in respect of loans secured with a mortgage in order to refinance them by issuing mortgage bonds and for mBank Hipoteczny S.A. to entrust the further servicing of the purchased portfolios with mBank S.A, in 2016 the following agreements were concluded:
   - on 29 February 2016, a portfolio transfer agreement was concluded by and between mBank S.A. and mBank Hipoteczny S.A., based on which mBank Hipoteczny S.A. purchased a portfolio of loans secured with a mortgage from mBank S.A., with a total fair value of PLN 120 078 thousand;
   - on 31 March 2016, a portfolio transfer agreement was concluded by and between mBank S.A. and mBank Hipoteczny S.A., based on which mBank Hipoteczny S.A. purchased a portfolio of loans secured with a mortgage from mBank S.A., with a total fair value of PLN 84 327 thousand;
   - on 31 May 2016, a portfolio transfer agreement was concluded by and between mBank S.A. and mBank Hipoteczny S.A., based on which mBank Hipoteczny S.A. purchased a portfolio of loans secured with a mortgage from mBank S.A., with a total fair value of PLN 157 895 thousand;
   - on 29 July 2016, a portfolio transfer agreement was concluded by and between mBank S.A. and mBank Hipoteczny S.A., based on which mBank Hipoteczny S.A. purchased a portfolio of loans secured with a mortgage from mBank S.A., with a total fair value of PLN 152 641 thousand;
2. On 21 March 2016, an agreement was signed by and between mBank S.A. and mBank Hipoteczny S.A. on the transfer of a commercial loan secured with a mortgage to mBank Hipoteczny S.A., amounting to EUR 32 000 thousand.
3. On 29 January 2016, a service agreement was concluded, on preparing and conducting an issue of mortgage bonds as part of an issue programme with a value of up to PLN 15 bn, by and between mBank S.A., Dom Maklerski mBanku S.A., mCorporate Finance S.A. as the issue organizers and mBank Hipoteczny S.A. as the issuer.
4. On 14 April 2016, an agreement was concluded on the programme of a public issue of mortgage bonds, by and between mBank S.A. and mBank Hipoteczny S.A., of up to PLN 15 bn.
5. On 20 May 2016, a renewable loan agreement was concluded by and between mBank S.A. and mBank Hipoteczny S.A., of up to PLN 250 000 thousand.
6. On 30 May 2016, an agreement was concluded on the programme of a private issue of mortgage bonds, by and between mBank S.A. and mBank Hipoteczny S.A., of up to PLN 2 bn.
7. On 19 September 2016, an agreement on a renewable loan in PLN/EUR/USD was concluded by and between mBank S.A. and mBank Hipoteczny S.A., of up to PLN 510 000 thousand.
8. On 10 October 2016, a renewable stand-by loan agreement was concluded by and between mBank S.A. and mBank Hipoteczny S.A., of up to PLN 300 000 thousand.
9. On 10 November 2016, a loan agreement was concluded by and between mBank S.A. and mBank Hipoteczny S.A., of up to PLN 600 000 thousand.

The following table presents values of transactions of the Bank with related entities. The amounts of transactions include balances of assets and liabilities as at 31 December 2016 and 31 December 2015 and associated with them incomes and costs for 2016 and 2015.

(PLN '000)	Management and Supervisory Board and key workers of mBank Hipoteczny S.A./mBank S.A.		Other persons and entities related*		mBank Group companies**		mBANK S.A.		Commerzbank Group companies***	
As at the end of the period	**31.12.2016**	**31.12.2015**	**31.12.2016**	**31.12.2015**	**31.12.2016**	**31.12.2015**	**31.12.2016**	**31.12.2015**	**31.12.2016**	**31.12.2015**
Statement of finacial position										
Assets	2 985	3 377	107	108	2 826	2 265	61 648	236 950	-	-
Liabilities	-	-	-	-	304 639	352 506	4 500 025	3 182 879	883 921	638 718
Contingent liability										
Liability recived	-	-	-	-	-	-	731 753	170 767	-	-
Derivatives (purchase, sales)										
IRS contracts	-	-	-	-	-	-	1 397 152	1 056 852	-	-
FX SWAP contracts	-	-	-	-	-	-	1 722 198	1 218 294	-	-

(PLN '000)	Management and Supervisory Board and key workers of mBank Hipoteczny S.A./mBank S.A.		Other persons and entities related*		mBank Group companies**		mBANK S.A.		Commerzbank Group companies***	
Year ended	**31.12.2016**	**31.12.2015**	**31.12.2016**	**31.12.2015**	**31.12.2016**	**31.12.2015**	**31.12.2016**	**31.12.2015**	**31.12.2016**	**31.12.2015**
Income statement										
Interest income	77	58	3	-	1 154	1 344	21 164	14 953	-	-
Interest expense	-	-	-	-	(3 139)	-	(51 564)	(57 169)	(5 434)	(4 993)
Fee and commission income	-	-	-	-	208	1 020	-	-	-	-
Fee and commission expenses	-	-	-	-	(1 083)	(38)	(1 381)	(850)	-	-
Net trading income	-	-	-	-	-	-	3 873	3 902	-	-
Other operating income	-	-	-	-	-	-	580	181	-	-
Other operating expenses	-	-	-	-	-	-	(9)	-	-	-
Overhead costs, amortisation and depreciation	-	-	-	-	(1 354)	(1 320)	(5 028)	(3 602)	-	-

* Other persons and related entities include loans granted to close family members of Members of the Supervisory Board of mBank S.A.

** item mBank Group Companies include transactions with the following companies of mBank Group: mFinanse S.A., mCentrum Operacji Sp. z o.o., mCorporate Finance S.A., mLeasing, mLocum S.A.

*** item Commerzbank Group Companies include purchase transactions on secondary market of mortgage covered bonds by Comdirect Bank AG.

for 2016 (in PLN thousand)

Management Board composition and remuneration

As at 31 December 2016, the composition of the Management Board is as follows:

Piotr Cyburt - President of the Management Board
Marcin Romanowski - Member of the Management Board
Grzegorz Trawiński - Member of the Management Board
Marcin Wojtachnio - Member of the Management Board

Information on the value of salaries and bonuses paid to the Members of the Management Board who were performing their functions at the end of 2016 as at 31 December 2016 and 31 December 2015 is presented below

		Remuneration paid in 2016 (in PLN)		
		Gross remuneration	Other benefits	Cash settlement of discretionary award
1.	Piotr Cyburt	756 000	17 227	245 915
2.	Marcin Romanowski	730 800	8 105	237 317
3.	Grzegorz Trawiński	510 000	12 614	184 816
4.	Marcin Wojtachnio	510 000	16 601	274 589
	Total	**2 506 800**	**54 547**	**942 637**

		Remuneration paid in 2015 (in PLN)		
		Gross remuneration	Other benefits	Cash settlement of discretionary award
1.	Piotr Cyburt	756 000	17 867	194 422
2.	Marcin Romanowski	730 800	8 105	187 221
3.	Grzegorz Trawiński	382 500	8 749	-
4.	Marcin Wojtachnio	502 500	15 647	218 438
	Total	**2 371 800**	**50 368**	**600 081**

As at 31 December 2016, the value of the provision for bonuses for the Bank's employees and Management Board amounted to PLN 6 229 thousand, including a provision for variable remuneration for the Members of the Bank's Management Board and employees who have a significant effect on the Bank's risk profile which amounted to PLN 2 770 thousand (PLN 4 929 thousand and PLN 2 008 thousand respectively as at 31.12.2015).

Variable remuneration program for the Members of the Management Board and employees who have significant influence on the Bank's risk profile is described in Note 42.

The Members of the Management Board, in accordance with concluded agreements and current period of performing the role of the Member of the Management board, in case of termination of management agreement, are entitled to severance in the amount of:

- 12 monthly remunerations - Chairman of the Management Board,
- 6 monthly remunerations - Members of the Management Board.

Composition and remuneration of the Supervisory Board

On 19 April 2016 the Annual General Meeting of mBank Hipoteczny S.A. appointed the following Supervisory Board members for the tenth term of office:

1. Hans-Dieter Kemler
2. Lidia Jabłonowska-Luba
3. Joerg Hessenmueller
4. Cezary Kocik
5. Michał Popiołek
6. Dariusz Solski
7. Mariusz Tokarski

for 2016 (in PLN thousand)

By Resolution 25 of the Supervisory Board of mBank Hipoteczny S.A. of 20 June 2016, Mr. Hans-Dieter Kemler was appointed the Chairman of the Supervisory Board. By Resolution 26 of the Supervisory Board of mBank Hipoteczny S.A. of 20 June 2016, Ms. Lidia Jabłonowska-Luba was appointed the Vice-Chairman of the Supervisory Board.

Mr. Joerg Hessenmueller resigned from his Supervisory Board Member position as of 30 June 2016.

On 6 July 2016, by resolution of the Extraordinary General Meeting of mBank Hipoteczny S.A., Mr Christoph Heins was appointed a Member of the Supervisory Board.

The composition of mBank Hipoteczny S.A. Supervisory Board as at 31 December 2016:

1.	Hans-Dieter Kemler	-	Chairman of the Supervisory Board, Member of the Audit Committee, Member of the Risk Committee
2.	Lidia Jabłonowska-Luba	-	Deputy Chairman of the Supervisory Board, Member of the Risk Committee
3.	Christoph Heins	-	Member of the Supervisory Board, Chairman of the Audit Committee, Member of the Risk Committee
4.	Cezary Kocik	-	Member of the Supervisory Board
5.	Michał Popiołek	-	Member of the Supervisory Board, Member of the Risk Committee
6.	Dariusz Solski	-	Member of the Supervisory Board, Member of the Audit Committee
7.	Mariusz Tokarski	-	Member of the Supervisory Board, Member of the Audit Committee

In 2016 the Supervisory Board worked without remuneration, excluding Mr Mariusz Tokarski, who as a Member of the Supervisory Board received remuneration for 2016 in the amount of PLN 36 thousand.

Composition of mBank Hipoteczny S.A. Supervisory Board as at 31 December 2015:

1.	Hans-Dieter Kemler	-	Chairman of the Supervisory Board, Member of the Audit Committee, Member of the Risk Committee
2.	Lidia Jabłonowska-Luba	-	Deputy Chairman of the Supervisory Board, Member of the Risk Committee
3.	Joerg Hessenmueller	-	Member of the Supervisory Board, Chairman of the Audit Committee, Member of the Risk Committee
4.	Cezary Kocik	-	Member of the Supervisory Board
5.	Michał Popiołek	-	Member of the Supervisory Board, Member of the Risk Committee
6.	Dariusz Solski	-	Member of the Supervisory Board, Member of the Audit Committee
7.	Mariusz Tokarski	-	Member of the Supervisory Board, Member of the Audit Committee

In 2015, the Supervisory Board worked without receiving any remuneration, except for Mr. Mariusz Tokarski who, as a Supervisory Board Member, received remuneration of PLN 36 thousand in 2015.

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

According to the wording of paragraph 3 section 1 point 9 of the Rules and Regulations of the Supervisory Board of mBank Hipoteczny S.A., establishing of terms and conditions of contracts and remuneration for members of the Management Board of the Bank lies within the competence of the Supervisory Board.

44. Information about the registered audit company

By Resolution no. 19/2016 dated 18 April 2016, the Supervisory Board of mBank Hipoteczny S.A., acting under paragraph 26 para. 8) of the Articles of Association of the Bank, appointed PricewaterhouseCoopers sp. z o.o. (PwC) as auditor for audit of financial statement of the Bank for 2016.

Further to the above decision, on 13 June 2016 the Bank concluded an agreement with PwC on the audit of the financial statements for 2016 and 2017, however, the arrangements relating to 2017 are dependent on the Supervisory Board appointing PwC registered auditor responsible for auditing the Bank's financial statements for 2017.

PwC with registered office in Warsaw, Al. Armii Ludowej 14, 00-638 Warszawa, entered into the list of auditors authorised to audit financial statements under number 144.

The Bank's Financial Statements for 2015 were audited by Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością s. k.

PwC's fees for 2016 totalled PLN 406 thousand gross, including:

- for the audit of the financial statements mBank Hipoteczny S.A. and research and review of reporting packages for 2016 amounted to 230 thousand gross,
- for other assurance services, ie. the review of financial statements mBank Hipoteczny S.A. for the first half of 2016, reporting packages for the first half of 2016, verification of disclosures regarding the capital adequacy of the Bank as at 31 December 2016 it amounted to 151 thousand gross
- for other services to the mBank Hipoteczny S.A. amounted to 25 thousand gross.

Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością s. k.'s fees for 2015 totalled PLN 300 thousand gross, including:

- for the audit of the financial statements mBank Hipoteczny S.A. and studies of reporting packages for 2015 amounted to 197 thousand gross
- for the review of financial statements mBank Hipoteczny S.A. and a review of reporting packages for the first half of 2015 amounted to 98 thousand gross
- for other services to the mBank Hipoteczny S.A. amounted to 5 thousand gross.

45. Capital ratio/capital adequacy

The guiding principle of managing of capital in the Bank is maintaining of the capital on the level ensuring stable development of the Bank and covering of both minimum capital requirement and remaining risk categories recognised by the Bank as significant. Capital management is based of principles specified in the Banking Law and good practices.

The main aim of capital management is ensuring capital resources to the Bank that will be sufficient to cover risk exposures, and in particular ensuring of implementation of required capitalisation within the limits of risk appetite.

The Bank manages the capital for risk covering using system of limits and early warning indicators, basing the core of the concept on principles formulated within consolidated supervision in the Capital Group, supporting implementation of strategic capital objectives. The Bank acts within Principles of capital management and planning policy which aim is to ensure effective use of available capital.

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 fundament of reinforcement of the capital basis in future periods. This enables to maintain the Common Equity Tier 1 capital ratio (calculated as a quotient of Common Equity Tier 1 capital to the total risk exposure amount) and the total capital ratio (calculated as a quotient of own funds to the total risk exposure amount) at least on the level required by the supervision authority.

Strategic capital objectives of the Bank are oriented towards maintaining of both total capital ratio and Tier 1 share capital ratio on the level appropriately higher than level required by the supervising institution. It allows to maintain safe business development meeting the supervisory requirements in the long perspective.

Capital ratios

The Bank's capital ratio and financial leverage ratio, own funds and total risk exposure are calculated on the basis of the following regulations:

- Regulations (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 (hereinafter called "the CRR") and on the basis of supplementing Commission Implementing Regulations (EU) to the CRR;

for 2016 (in PLN thousand)

- the Banking Act of 29 August 1997, as amended.
- The law of 5 August 2015 on the macroprudential oversight of the financial system and crisis management in the financial system (hereinafter referred to as the Act of macroprudential supervision).

In 2016, the following factors affected the levels of the Bank's capital ratios:

- classification of PLN 100 000 thousand, constituting the Bank's subordinated liability in respect of a subordinated loan raised of 12 November 2015 based on the permission of the Polish Financial Supervision Authority of 7 January 2016, in own funds;
- classification of PLN 99 936 thousand, which constitutes share capital of PLN 10 000 thousand and supplementary capital created from share premium of PLN 89 936 thousand, in respect of the issue of 100 000 ordinary registered shares conducted on 2 June 2016, with a nominal value of PLN 100 each and an issue price of PLN 1 000 each, based on the permission of the Polish Financial Supervision Authority of 21 September 2016, in Tier I core capital;
- classification of the Bank's net profit for 2015, less any expected charges of PLN 18 791 thousand, in Tier I core capital;
- classification of the Bank's verified net profit for the first half of 2016, less all possible charges of PLN 13 766 thousand, based on the permission of the Polish Financial Supervision Authority of 3 November 2016, in Tier I core capital;
- the development of the Company's business activities.

Since 1 January 2016 Act came into force on macroprudential supervision of capital buffers. As at 31 December 2016, the Bank was required to maintain additional own funds, which will cover the designated pursuant to the provisions of the Act on macroprudential oversight conservation buffer amounting to 1.25% of the total risk exposure.

According to the decision of the Committee of Financial Stability, applicable to Bank countercyclical buffer rate as of 31 December 2016 amounted to 0%.

Detailed information about the calculation of the total capital ratio, Tier I core capital ratio, own funds and the Bank's total risk exposure as at 31 December 2016 are described in the document titled "Disclosures" concerning the capital adequacy of mBank Hipoteczny S.A. as at 31 December 2016, published on the Bank's website.

Capital ratios both at the end of 2016 and 2015 were above the minimum required value of what has been presented in the following table. During 2016 and 2015, the Bank meet external capital requirements.

Capital ratio	31.12.2016		31.12.2015	
	Minimum ratio	Presented ratio	Minimum ratio	Presented ratio
Total capital ratio	13.25%	14.54%	12.00%	13.81%
Equiety Tier 1 capital ratio	10.25%	11.49%	9.00%	11.94%

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, wherein mBank Hipoteczny S.A. does not identify items which would qualify as Additional Tier 1 capital.

Common Equity Tier 1 capital of mBank Group contains:

- paid up capital instruments and the related share premium accounts,
- previous years retained earnings,
- independently reviewed interim profits,
- accumulated other comprehensive income,
- other reserves,
- funds for general banking risk,

- independently identified gains for the current period;
- items decreasing the Tier I core capital (value adjustments due to prudent valuation requirements, intangible assets, insufficient credit risk adjustments in view of expected losses, regulatory adjustments relating to other accumulated comprehensive income and net write-downs).

The Tier II capital of mBank Hipoteczny S.A. comprises subordinated liabilities.

As at 31 December 2016, the Bank's own funds amounted to PLN 954 070 thousand (as at 31 December 2015, they amounted to PLN 740 012 thousand).

Total risk exposure amount

The total Bank's risk exposure amount contains:

- risk weighted exposure amounts for credit risk, counterparty credit risk, dilution risk and free deliveries,
- total amount of exposures to risk due to operational risk.

In the calculation of capital ratios of the Bank, the total amount of exposures to risk is determined taking into account the amount of exposure to credit risk with application of internal ratings method using supervisory approach in terms of assignment of exposures due to specialist crediting to risk categories (IRB slotting approach method).

As at 31 December 2016, the Bank's total risk exposure amounted to PLN 6 562 489 thousand, including a credit risk exposure of PLN 6 372 126 thousand.

As at 31 December 2015, the Bank's total risk exposure amounted to PLN 5 358 363 thousand, including a credit risk exposure of PLN 5 188 556 thousand.

Internal capital

The Bank adjusts its own funds to the level and type of risk, the Bank is exposed to, and to the nature, the scale and the complexity of its operations. For this purpose the Bank developed and implemented the process of assessment of internal capital adequacy, so called ICAAP process (Internal Capital Adequacy Assessment Process), which is used to maintain own funds on the level adequate to the profile and level of risk of the Bank's business activity.

The internal capital is the amount of capital estimated for mBank Group to cover all material risks identified in the activity of the Bank. The internal capital is the total sum of the economic capital to cover risks included in the process of the economic capital calculation and the capital required to cover other risks (including hard to quantify risks).

Internal capital adequacy assessment process in the Bank is performed continuously and consists of five stages implemented by organisational units of the Bank.

The process consists of the following elements:

- risk inventory in the business activity of the Bank,
- calculation of internal capital for coverage of risk,
- stress tests,
- planning of economic capital,
- monitoring consisting in a permanent identification of risk involved in the Bank's operations and analysis of the level of capital for risk coverage.

Internal capital adequacy assessment process is subject to approval of the Supervisory Board of mBank Hipoteczny S.A. The entire internal capital adequacy assessment process of the Bank is subject to annual reviews. The Management Board of mBank Hipoteczny S.A. is responsible for internal capital adequacy assessment process.

for 2016 (in PLN thousand)

Capital adequacy	**31.12.2016**	**31.12.2015**
Common Equity Tier 1 Capital	**754 070**	**640 012**
Own funds	**954 070**	**740 012**
Risk weighted exposure amounts for credit risk, counterparty credit risk, dilution risk and deliveries with deferred settlement date:	6 372 126	5 188 556
- using internal rating method	3 995 905	3 715 701
- using standard method	2 376 221	1 472 855
Total operational risk exposure amount	190 363	169 807
Łączna kwota ekspozycji na ryzyko	**6 562 489**	**5 358 363**
Common Equity Tier 1 capital ratio	**11.49%**	**11.94%**
Total capital ratio	**14.54%**	**13.81%**
Internal capital	**418 965**	**444 893**

Own funds	**31.12.2016**	**31.12.2015**
Own funds	**954 070**	**740 013**
TIER 1 CAPITAL	**754 070**	**640 013**
Common Equity Tier 1 Capital	**754 070**	**640 013**
Capital instruments eligible as CET1 Capital	614 792	514 856
Paid up capital instruments	309 000	299 000
Share premium	305 792	215 855
Retained earnings	13 766	4 956
Retained earnings from previous years	-	-
Profit or loss eligible	13 766	4 956
Other accumulated comprehensive income	(1 146)	849
Other reserves	224 131	211 340
General banking risks founds	42 500	36 500
(-) Value adjustments due to the requirements for prudent valuation	(1 195)	-
(-) Intangible assets	(13 191)	(8 048)
(-) Other intangible assets gross amount	(13 357)	(8 152)
Deferred tax liabilities associated to other intangible assets	166	104
(-) IRB shortfall of credit risk adjustments to expected losses	(114 085)	(108 764)
Other transitional adjustments to CET1 Capital	(264)	(509)
CET1 capital elements or deductions - other	(11 238)	(11 167)
Additional Tier 1 capital	-	-
TIER 2 CAPITAL	**200 000**	**100 000**
Capital instruments and subordinated loans eligible as T2 capital	200 000	100 000

46. Events after the balance sheet date

- Issue of mortgage bonds

On 1 February 2017, mBank Hipoteczny S.A. conducted a public, seven-year issue of mortgage bonds with a nominal value of EUR 24 900 thousand, bearing a fixed interest rate.

- Hedging relationship

On 30 January 2017, the Bank concluded a new hedging relationship to hedge against interest rate risk. The item hedged is mortgage bonds issued on 1 February 2017, with a nominal value of EUR 24 900 thousand, bearing a fixed interest rate. The hedging item is an IRS with a nominal value of EUR 24 900 thousand, swapping the fixed interest rate for a variable one.

- An increase in the Bank's share capital

On 8 February 2017, Resolution No. 1 of the Extraordinary General Shareholders' Meeting of mBank Hipoteczny S.A. was adopted to increase the share capital and deprive the shareholders of pre-emptive rights to shares, according to which the share capital of mBank Hipoteczny S.A. was increased by PLN 12 000 thousand, i.e. to PLN 321 000 thousand by issuing 120 000 ordinary registered shares with a nominal value of PLN 100 each and an issue price of PLN 1 000 each. The new shares were offered for take up to mBank S.A. by way of a private subscription. The shares were paid up in full on 27 February 2017.

- Change in the composition of the Supervisory Board

On February 8, 2017, the Extraordinary General Shareholders' Meeting of mBank Hipoteczny S.A. elected Mr. Jakub Fast for a member of the Supervisory Board of the tenth term of office, with regard to the resignation from the Supervisory Board by Mr. Dariusz Solski with effect from 7 February 2017.

- Change in the Bank's liabilities

On 15 February 2015 financial liability with deferred payment was prematurely paid in the amount of 158 209 thousand, whose original maturity date was on December 1, 2017.

On 2 January 2017 and February 15, 2017, there was a drawing tranche of loans received from mBank S.A in the amount of 150 000 thousand with maturity on April 1, 2019 and 260 000 thousand with maturity on 15 December 2021.

Warsaw, 3 March 2017

Signatures:

President of the Management Board
Piotr Cyburt

Member of the Management Board
Marcin Romanowski

Member of the Management Board
Grzegorz Trawiński

Member of the Management Board
Marcin Wojtachnio

The person responsible for bookkeeping
Milena Zwolińska-Grabowicz