Management Board Report
on the performance of mBank Hipoteczny S.A.
in 2016

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1. Activity of mBank Hipoteczny S.A. in 2016

In June 2016, mBank Hipoteczny S.A. (hereinafter the "Bank") reviewed and updated its business strategy assumptions for subsequent years (2016–2019), adopted in 2015. The aim of the update was to align the strategy to changes in legal environment and in the mBank Group's policy. The main directions of development and strategic objectives remain valid.

The Bank continued activities aimed at increasing Bank's effectiveness and dynamics of development, through the best possible use of its resources and market potential as well as determination of the role and competencies in the mBank Group, in which the Bank intends to strengthen its position as a strategic company and an issuing bank. The Bank's objective remains to achieve a secure growth through specialisation, which due to the nature of the Bank and its narrow scope of activities is the source of its competitive advantage and high market position. On the other hand, such characteristic of the Bank determines its sources of revenue and as a consequence its relatively low rate of return, wherein the revenue of the Bank is strongly linked with the applicable market interest rates.

The Bank has two business lines:

- retail, focused on mortgage lending to natural persons,
- commercial, which conducts financing of commercial real estate and residential real estate by development companies.

From the end of 2012 the Bank does not finance local government units or other entities with a guarantee of local government units, which results from the risk profile of this segment and inadequate credit margins. This approach has been maintained in the update of the strategy for years 2016-2019. Nevertheless, the Bank owns a historically developed portfolio of credit transactions for this segment.

In the retail line the Bank implemented a business model based on close cooperation with parent universal bank through the use of specialised expertise and market experience of a mortgage bank.

In 2016 the Bank focused its activities on the development of lending within the scope of retail mortgage loans through close cooperation with mBank in terms of product offer and distribution channels. The Bank continued the development of its portfolio in this area basing on both acquisition of new customers and systematic acquisition of existing retail loans portfolio from mBank. This applies only to the loans that may be a basis for issuing of covered bonds.

The following market trends were observed in the area of commercial projects:

- maintenance of increased investor activity in real property trading,
- investment growth in regional cities within the scope of offices,
- offering of low levels of credit spreads by banks, even below 2.0%.

In the area of commercial residential housing financing the following could be observed:

- increase of developers' activity in terms of project implementation,
- decrease in the level of the utilization of loans as a result of increasing the share of financing investments by purchasers of the apartments,
- liberal approach of banks to assessment of projects, in particular in terms of own contributions and pre-sales along with strong pressure on banks to lower the margins.

Within the Bank, in terms of commercial and residential facilities, the levels of margins were maintained at the cost of only partial participation in the growth of investors' activity, in particular in the housing developers sector.

1.1. Key projects of 2016

The "covered bonds" project

The project of rebuilding of the balance sheet of mBank Group on the basis of long-term source of financing in a form of covered bonds issued by mBank Hipoteczny continued to be the highest priority venture in the first half of 2016. Works on the project started in August 2012, and their purpose was preparation of a comprehensive model of cooperation between a mortgage and a universal bank in terms of sales, service and management of retail mortgage loans portfolio and then issuing of covered bonds on its basis. The division of tasks between mBank and mBank Hipoteczny, accordant with competencies and specialisation of both banks, allows for effective development and refinancing of retail portfolio on the basis of common credit policy and operational synergy effect. Within the scope of implementation of the project the banks cooperate on the basis of interbank outsourcing, based on the agency model which in the second part of 2014 was extended with a pooling model consisting in acquisition of already existing retail loan portfolio from mBank in order to refinance it. Additionally, one loan was transferred by the Bank in 2016 as part of the commercial pooling.

The implementation of the model aims at:

- improvement of banks financing stability within the mBank Group through application of long-term and at the same time innovative solutions in relation to mortgage portfolio in the mBank Group, taking into account the liquidity needs resulting from external (new regulations - Basel III) and internal (e.g. changes within the scope of financing of subsidiary banks in the Commerzbank group) factors,
- diversification of financing sources - increasing independence of the mBank Group in terms of financing of the current portfolio of retail mortgage loans,
- improvement of long-term liquidity in the mBank Group - adaptation to the requirements of Basel III through the increase of long-term financing.

The project is a pioneer solution in the Polish banking sector and the success of its implementation will indicate further developments in the market and searching for long-term sources of refinancing by banks.

The New Register of Covered Bonds Collateral

In connection with the execution of the Covered Bonds Project in the Bank, it was decided to implement a new IT solution dedicated for operating the register of collateral for covered bonds. The new solution ensures:

- an automated process of qualifying receivables eligible as collateral,
- an automated process of maintaining the covered bonds collateral register, including monitoring the receivables entered for statutory requirements,
- harmonizing the reporting associated with the register and the collateral account, including purposes of issuing covered bonds,
- forecasting the balance of the covered bonds collateral account.

The solution implemented enables the Bank to manage the qualification process from the inception of a receivable until its entry into the register by allowing the full measurement, auditability and automation of the entire qualification process.

Monitoring the data which affects compliance with the statutory requirements applicable to the collateral register and the proper running of the collateral account are critical for the correct functioning of the register and the collateral account. Based on the data gathered in the data warehouse and the experience and knowledge accumulated during other projects executed within the Bank, an innovative solution was developed to enable on-going monitoring of the changes in the key data.

Not only does the new system introduce solutions which make the receivables qualification process and the monitoring of the entries more efficient, but also enables preparing complex projections of the balance of the collateral account, calculating limits and conducting liquidity tests and coverage tests which take into consideration sales plans, loans in the process of verification (at various stages of the process), planned and simulated early repayments or changes in exchange and interest rates.

Implementation of IRB method

The Bank is working on the implementation of the internal ratings-based (IRB) approach. It is a task of high priority and long-term nature. In June 2016, the Bank received a final decision on the positive verification of the fulfillment of conditions for portfolios covered with the gradual implementation plan. Following that decision, all internal rating models in the commercial area for specialised lending within real estate financing received an approval of the supervision authority for the application of the IRB method (slotting approach) to calculate capital requirements with respect to credit risk on a consolidated (the Commerzbank Group), sub-consolidated (the mBank Group) and individual (mBank Hipoteczny S.A.) basis.

Intensive works are also aimed at covering the retail portfolio, acquired in cooperation with mBank S.A., with the A-IRB method, on the basis of adaptation of models applied in mBank S.A. Key areas that require major involvement within the project include the verification of proper operation of group models for the Bank’s exposures, approach to outsourcing of business services as well as issues from the area of data quality management. The Bank filed a pre-validation application in the second half of 2016 and intends, in the first quarter of 2017, to file the final Application for the use of statistical methods to calculate capital requirements for credit risk with respect to the retail portfolio acquired in cooperation with mBank S.A.

Implementation of Recommendation W

The Bank has completed all significant work related to the implementation of Recommendation W on managing model risk in banks, thereby ensuring compliance with the provisions of Recommendation W. In 2016, a gap analysis was carried out, Model Management Policy in mBank Hipoteczny S.A. and other key regulations in the model management area will be updated, the list of models was defined together with an allocation of the materiality level, risk exposure level and model risk level. On 12 July 2016, the Model Risk Committee was established, a body responsible for approving significant aspects of the functioning of models in accordance with delegation from the Bank’s Management Board. The Bank defined the tolerance to the aggregated level of model risk accepted by the Supervisory Board on 5 December 2016 by approving the Model Management Policy at Bank Hipoteczny S.A. The Bank also built a Model Register application in order to maintain the models register and log.

IFRS 9

Due to the fact that as of 1 January 2018, IFRS 9: “Financial Instruments” will come into effect to replace the existing International Accounting Standard 39: “Financial Instruments: Recognition and Measurement”, intensive work is pending in the Bank on drawing up and implementing the required changes.

The new standard introduces provisions which require significant changes in respect of the classification and evaluation of financial instruments (in particular financial assets), a new model of financial assets impairment, as well as new approach to hedge accounting.

In order to implement IFRS 9, in January 2016, the Bank began an implementation project, by defining the areas of design work and project leaders. The structure of the project comprises the Steering Committee which consists of a Management Board Member for Retail Sales, Accounting and IT, and a Management Board Member for Risk Management. Leaders of individual project areas are selected directors of the Bank in the areas of accounting, risk and treasury. The project also involves business, IT and support departments.

As part of the project for the implementation of IFRS 9, three areas have been distinguished: classification and measurement, impairment methodology and hedge accounting.

In the area of classification and measurement, IFRS 9 introduces new classification of financial assets, distinguishing the following categories of valuation:

- financial assets stated at amortized cost;
- financial assets stated at fair value through other comprehensive income;
- financial assets stated at fair value through profit or loss.

Due to the retroactive application of the standard, in order to ensure the possibility of making the classification decision in respect of fixed assets owned (in accordance with IFRS 9) as at 1 January 2018, as part of the IFRS 9 implementation project, the Bank reviews its financial assets which will be in the Bank's possession after 31 December 2017, by:

- determining and allocating groups of financial assets to respective business models;
- determining the characteristics of contractual cash flows of financial assets, aimed at verifying whether the terms and conditions of the agreements result in cash flows on specific dates, which are only a repayment of the principal amount and interest on the outstanding principal amount (i.e. the SPPI criterion – solely payments of principal and interest).

With regard to classification and measurement, the Bank is working on the implementation of a new asset classification methodology, implementation of the respective changes in the processes and changes in the IT systems.

In the impairment area, IFRS 9 replaces the impairment model applicable under IAS 39 based on the concept of an "incurred loss", with the new model based on the concept of "expected credit loss" (hereinafter: ECL). A direct consequence of this change will be the need to measure impairment write-downs based on expected loan losses and to take into account forecasts and expected future economic conditions in the context of evaluating the exposure to credit risk. The new impairment model will apply to the Bank's financial assets classified in accordance with IFRS 9 as financial assets stated at amortized cost or at fair value through other comprehensive income.

Pursuant to IFRS 9, instead of IBNR write-downs and non-performing exposure write-downs, the impairment write-downs will be determined in the following categories:

- Basket 1: 12-month expected loan loss – anticipated losses that may result from possible defaults within 12 months from the reporting day;
- Baskets 2 and 3: expected loan loss within the expected life of a given financial asset – anticipated losses which will result from all possible defaults in the period of life of a given financial asset.

Upon implementing IFRS 9, the one-off change resulting from the change in the classification of financial assets and adoption of new models will be recognized in the revaluation reserve.

Project of transferring bank accounts of commercial customers

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.

Implementation of a new ELIXIR application

In November 2016, the Bank successfully completed the production launch of a new user application for the ELIXIR system. It has been the largest technological change implemented in the Bank since the launch of the first version of the electronic settlement system. The changes in the inter-bank settlements system were aimed at optimizing the processing of orders and introducing several improvements, including:

- increasing the quality of settlement services, and increasing effectiveness;
- increasing safety of the processed payment data;
- meeting the bank requirements, among other things, in respect of mechanisms which prevent duplicating transactions, the possibility of withdrawing orders, and creating new methods of communicating with the Bank's IT system.

1.2. Financial credibility

Financial credibility of mBank Hipoteczny is assessed by an international rating agency - Fitch Ratings Ltd. As of 31 December 2016 the following ratings applied:

BBB/F2 - long- and short-term international rating

2 - support rating

A - for mortgage covered bonds

On 7 January 2016, Fitch Ratings Ltd. placed the rating of mortgage covered bonds issued by the Issuer on the "BBB" level (positive outlook), on a watch list with positive indication, following the entry into force of amendments to mortgage bond regulations on 1 January 2016.

On 7 March 2016, Fitch Ratings Ltd. upgraded mBank Hipoteczny's international long-term IDR rating ("Issuer Default Rating") from "BBB-" (positive outlook) to "BBB" (stable outlook), following the upgrade of the IDR rating for Commerzbank AG from "BBB" to "BBB+" and for mBank S.A. from "BBB-" to "BBB". As a consequence, the international short-term IDR rating of the Bank was also upgraded from "F3" to "F2", while the support rating was confirmed at level "2".

On 7 March 2016, Fitch Ratings Ltd. also upgraded the rating for, respectively, mortgage and public sector covered bonds issued by the Bank from "BBB" (stable outlook) to "BBB+" (positive outlook for mortgage covered bonds, stable outlook for public sector covered bonds). The change of the ratings for the Bank's covered bonds resulted from the upgrade of the international long-term IDR rating ("Issuer Default Rating") of the Issuer and from the fact that Fitch Ratings Ltd.'s assessment took account of the statutory requirement imposed on the Bank to maintain the over-collateralisation of covered bonds at the minimum level of 10%.

On 4 and 20 May 2016, the rating agency Fitch Ratings Ltd. confirmed the ratings for, respectively, public sector covered bonds issued by the Bank — at "BBB+" level (stable outlook) and mortgage covered bonds issued by the Bank — at "BBB+" level (positive outlook).

On 1 July 2016, the rating agency Fitch Ratings Ltd. published a decision on upgrading the rating for mortgage covered bonds issued by the Bank from "BBB+" to "A" (positive outlook). The rating was upgraded following the amendments to the Act on covered bonds, which entered into force on 1 January 2016. The positive outlook for the mortgage covered bond rating reflects the Fitch agency's expectations concerning the reduction, on a year-to-year basis, of credit and currency risk of credit receivables of the Bank from mortgage loans granted and acquired, entered in the register of mortgage covered bonds collateral.

On 28 September 2016, in connection with the expiry of the last series of public sector bonds, Fitch Ratings Ltd ceased providing ratings for public sector bonds.

On 18 January 2017, Fitch Ratings confirmed its rating of the Bank. Moreover, the agency assigned national ratings in PLN (corresponding to international ratings) at the level of AA-(pol) stable perspective/F1+(pol) – long-/short-term national ratings in PLN.

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

- long-term international/domestic ratings: AAA, AA, A, BBB, BB, B, CCC, CC, C, RD, D
- short-term international/domestic ratings: F1, F2, F3, B, C, RD, D

- support ratings: 1, 2, 3, 4, 5

The ratings obtained by the Bank are also affected by, beside its financial results, the rating of mBank S.A. and Commerzbank AG, including the support granted by those institutions.

1.3. Financial results

The financial statement of the Bank for 2016 was prepared according to the International Financial Reporting Standards binding in the European Union (IFRS). The data presented in the Management Board Report are presented in the management view and they do not have to be consistent with the data included in the Financial Statement.

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

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

Main balance sheet items	31.12.2016	31.12.2015	Dynamics
ASSETS	10 649 499	8 419 125	26,49%
including			
Loans granted to customers	9 411 505	7 391 743	27,32%
LIABILITIES AND EQUITY	10 649 499	8 419 125	26,49%
including			
Debt securities in issue	6 123 466	4 164 902	47,03%
Share capital	614 792	514 856	19,41%

In 2016 the Bank achieved a positive gross result in the amount of PLN 30,179 thousand. Due to a specialised activity profile in which the main source of the Bank's result is the interest income, the financial result in 2016 was greatly influenced by low interest rates and strong pressure on margins. Despite this, the Bank reported a growth in the net interest income compared to 2015 (by PLN 19,379 thousand or 17. 5%).

The net trading income, which includes the result on swaps, other net trading income and result on hedge accounting was above the line in 2016 (PLN 1,736 thousand) with important contribution to the gross result, while in 2015 a corresponding result was below the line (PLN - 434 thousand).

The total value of administrative expenses, amortization and depreciation were maintained at the level similar to that of 2015, due to which the cost to income ratio went down to 48.96%, from 54.82% in 2015.

Introduction of the bank tax on 1 February 2016 had a material impact on the results recorded by the Bank. Due to the specialization and narrow range of the products offered, the Bank was unable to compensate the effects of the bank tax. Before the tax, the Bank's operating result amounted to PLN 46,864 thousand, as compared to 26,797 thousand in 2015, which represents an increase by 74.89%. After the tax, the gross result was still significantly higher than in the previous year (by PLN 3,382 thousand or 12.62%).

In 2016 the income of the Bank, calculated as the sum of net interest income, net fee and commission income, net trading income, other operating income and other operating expenses, amounted to PLN 134,116 thousand (2015: PLN 114,147 thousand). This income pertains in whole to the activity conducted within the Republic of Poland.

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

Profit and loss account	Period from 01.01.2016 to 31.12.2016	Period from 01.01.2015 to 31.12.2015	Dynamics
Net interest income	130 141	110 762	17.50%
Net fee and commission income	1 526	6 529	-76.63%
Net trading income	1 736	(434)	-
Net impairment write-downs on loans and advances	(21 588)	(24 775)	-12.86%
Overhead costs	(62 472)	(57 876)	7.94%
Amortisation and depreciation	(3 197)	(4 699)	-31.96%
Operating result	**46 864**	**26 797**	**74.89%**
Tax on the Bank's balance sheet items	(16 685)	-	-
Gross profit	**30 179**	**26 797**	**12.62%**
Income tax	(6 757)	(8 006)	-15.60%
Net profit	**23 422**	**18 791**	**24.64%**
Weighted average number of ordinary shares / weighted average diluted number of ordinary shares	3 042 186	2 909 068	4.58%
Net profit per ordinary share / Diluted profit per ordinary share (in PLN)	7,70	6,46	19.19%

Table 3. Effectiveness ratios

PERFORMANCE INDICATORS	31.12.2016	31.12.2015
ROA net 1)	0.24%	0.26%
ROA gross 1)	0.31%	0.37%
ROE net 3)	2.81%	2.74%
ROE gross 4)	3.62%	3.91%
Cost to income ratio (C/I) 5)	48.96%	54.82%
Net interest margin 6)	1.37%	1.55%
Cost of risk 7)	0.26%	0.39%
Total Capital Ratio	14.54%	13.81%
RATINGS Fitch Ratings Ltd		
long-term international rating	BBB	BBB-
short-term international rating	F2	F3
support rating	2	2
mortgage covered bonds	A	BBB
OTHER		
Employment	227 employees / 218 FTE's	222 employees / 212 FTE's
Average employment	227 employees / 217 FTE's	218 employees / 207 FTE's
Facilities	Headquarters + 6 branches	Headquarters + 6 branches

1) net result / average assets

2) gross result / average assets

3) net result / average equity

4) gross result / average equity

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

6) interest income / average earning assets

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

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

Chart 1. Key financial ratios

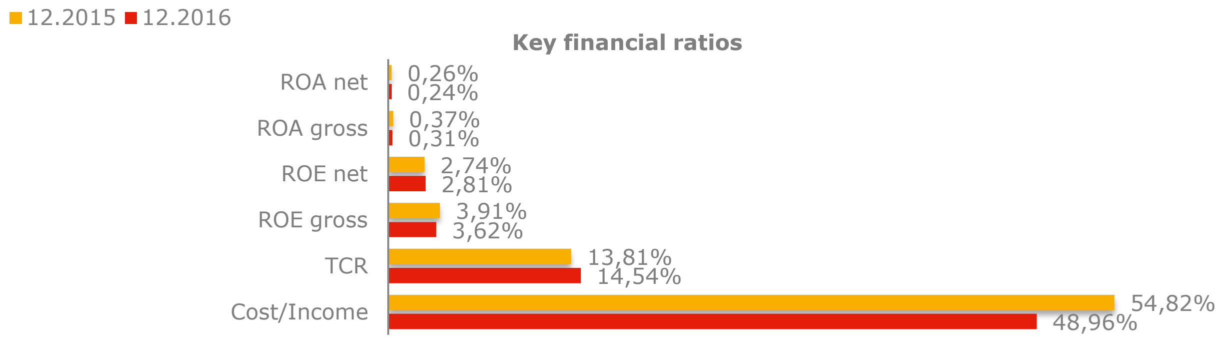
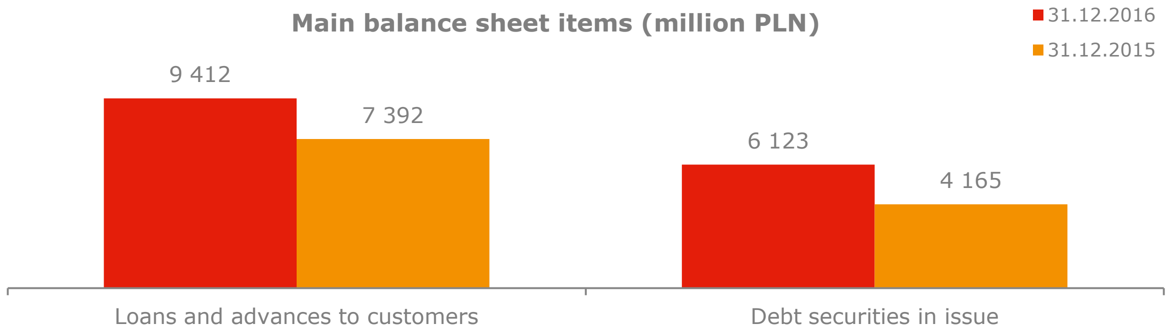


Chart 2. Main balance sheet items (in PLN million)



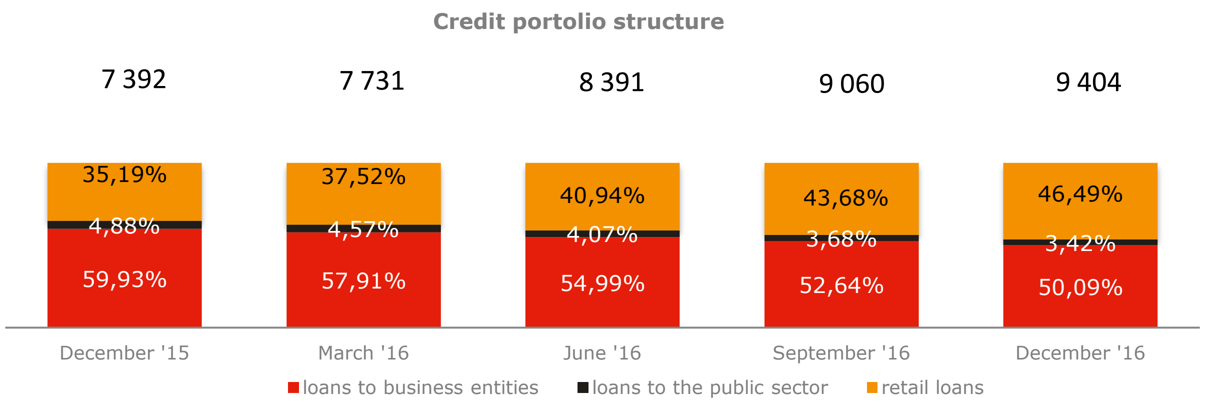
1.4. Lending

In 2016 the Bank developed its activity in both corporate and retail loan areas. The value of sales reached PLN 3.990 million and was higher by 12.6% than the value of agreements signed in 2015. The net value of the whole loans portfolio, taking into account "pooling" transactions and off-balance sheet liabilities, increased by the end of 2016 compared to the end of 2015 by 27.6%, reaching PLN 10.7 billion.

In 2016 sales of commercial loans amounted to PLN 1,871 million, which is a record high result in the sixteen years of the Bank's history. As regards the sales structure, 45% of financing accounted for the refinancing of completed commercial facilities, 25% accounted for construction of commercial facilities and the share of new financing for housing developers amounted to 29%. The housing developers market is a very dynamic market and the large number of apartments sold resulted in short periods for project financing,which is currently affecting the reduction of balance-sheet and off-balance sheet balances. One commercial pooling transaction was executed. This transaction will cover the shortfall resulting from the total repayment of three loans acquired from mBank as part of the commercial pooling arrangement in 2015.

In the retail area, within the scope of implementation of the strategy of the mBank Group, the Bank recorded an increase of PLN 2,118.9 million in the retail mortgage portfolio. Sales of credits in the agency model (newly signed agreements of total value of PLN 1,589.5 million) was supplemented with a pooling model, in the scope of which the Bank acquires mortgages granted by mBank that can constitute the basis for issuing of covered bonds (PLN 529.4 million in four tranches).

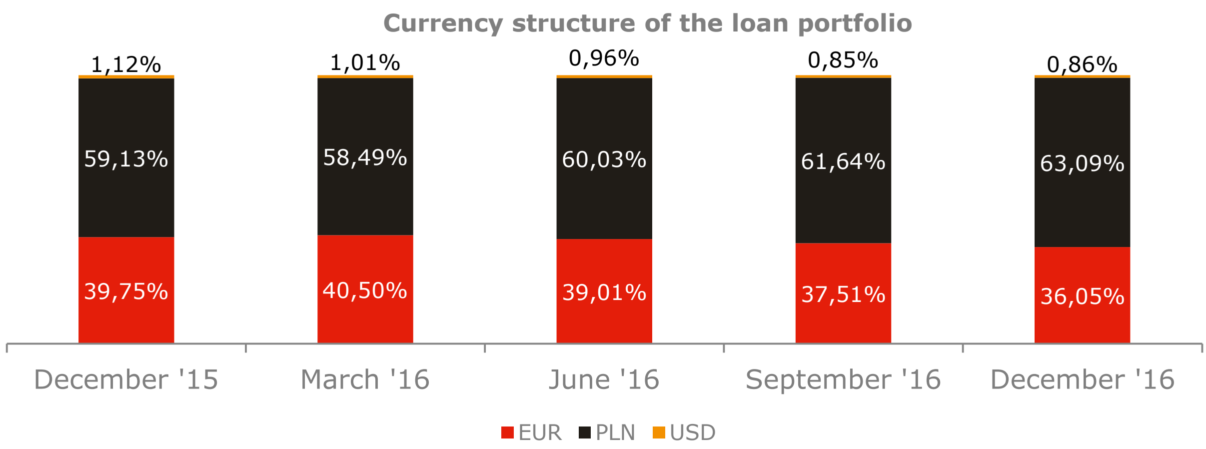
Chart 3. The structure of the loan portfolio in the period 31.12.2015 – 31.12.2016 (in PLN million)



The currency structure of the loan portfolio in 2016 was subject to change due to systematic growth of retail credit portfolio granted in PLN only. Compared to the end of December 2015, the share of PLN loans increased by 4 percentage points by the end of December 2016. They constituted 63% of the loan portfolio. The share of EUR loans decreased to the level of 36%.

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

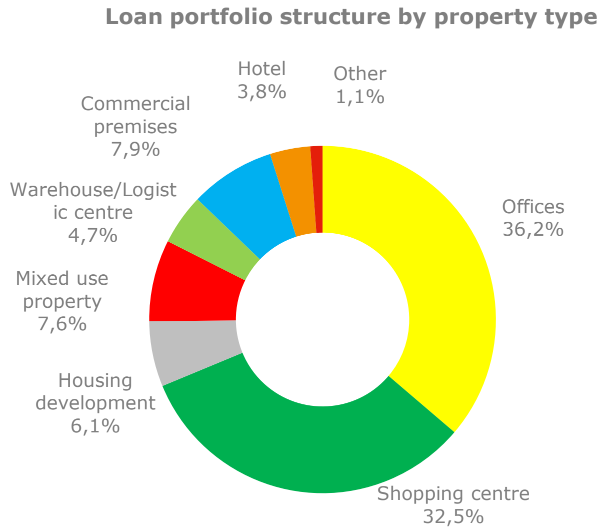
Chart 4. The currency structure of the loan portfolio in the period 31.12.2015 – 31.12.2016



Corporate loans

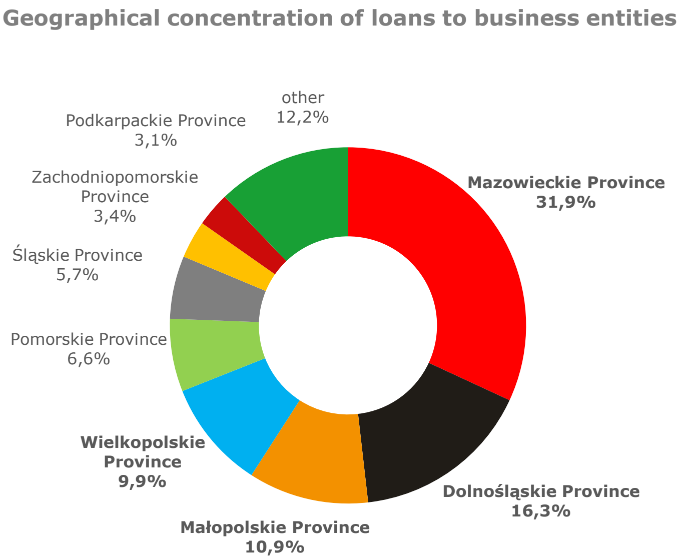
Net balance sheet exposure to business entities as of 31 December 2016 amounted to PLN 4,711 million. The dominant part (86.5%) accounted for refinancing of completed commercial facilities, the exposure in housing projects constituted 6.1%, and credits for financing of construction of commercial objects 7.4%.

Chart 5. Corporate loans by type of financed real estate as of 31 December 2016



As of the end of December 2016, in the area of commercial real estates the Bank financed in particular office buildings and shopping centres. The Bank focused on financing of the purchase or refinancing of completed facilities of appropriate standard and financing of the construction process upon the completion of which the construction loan is converted into a long-term mortgage.

Chart 6. Geographical concentration of loan portfolio for business entities as of 31 December 2016



The largest number of financed projects is concentrated in Mazowieckie province, where 31.9% of all credit resources is involved. In Dolnośląskie, Małopolskie and Wielkopolskie province the total balance sheet exposure accounts for 37.1%.

As of 31 December 2016 loans granted in EUR (71.6%) and PLN (26.8%) dominated the corporate loans portfolio.

Public sector loans

Due to the strategy of the Bank the portfolio does not contain new agreements, which in connection with significant prepayments is reflected in a lower, as compared to 31 December 2015, balance sheet exposure to public sector. As at 31 December 2016 the exposure was PLN 322 million (down by 10.8%)

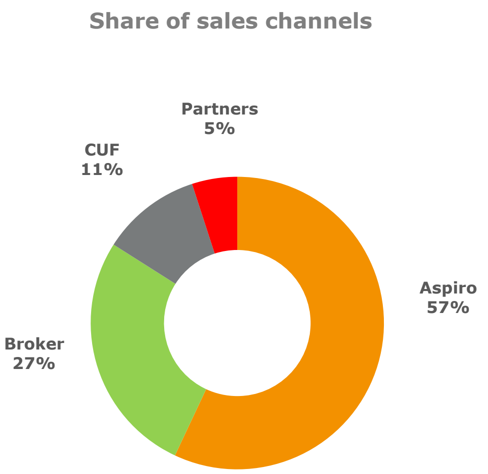
Retail loans to natural persons

The Bank continues the implementation of strategic objectives in the area of mortgage loans to natural persons in cooperation with mBank S.A. Following the amendment to the Act on Covered Bonds and Mortgage Banks, which enables less stringent lending by mortgage banks for the purchase of premises on the primary market, the Bank has consequently increased its activities in this area.

In the second half of 2016, an important change in the acquisition process of mortgage loans offered in the mBank Group took place. mBank S.A. withdrew from its offer of mortgage loan products – i.e. a mortgage borrowing for discretionary purpose, a consolidation loan secured with a mortgage, purchase of service premises and purchase of housing properties with co-operative ownership right. This means that currently, all mortgage loans for individuals (except the Private Banking area), granted in the mBank Group are processed by mBank Hipoteczny S.A.

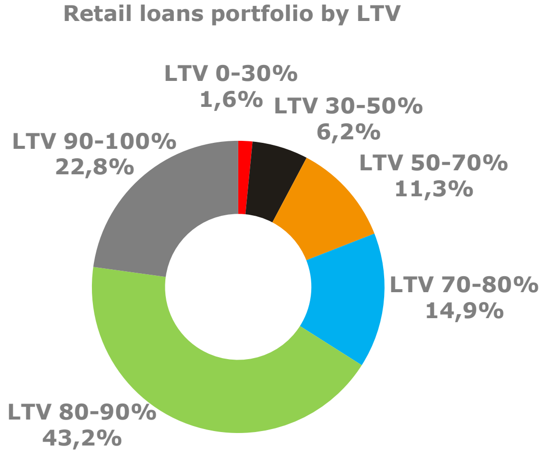
In the last quarter of 2016, the Bank provided its customers with solutions which are to support the participation of remote channels in soliciting applications. On the product webpages, which have been created from scratch, customers can also find a transparent instalment calculator, a tool for carrying out loan simulation on one's own, a list of the documents required, and in the future also a complete application form for a loan.

Chart 7. The share of sales channels in 2016.



The volume of loans disbursed in 2016 amounted to PLN 1.6 billion. The average loan amount was PLN 314 thousand. The volume-weighted average margin for the portfolio acquired in 2016 was 2.13%. The average commission weighted by the amount of credit agreement for loans disbursed in this period was 0.7%. Loans with LTV of 80-90% and clients' verified net income of PLN 9 thousand constituted the largest share in the sales.

Chart 8. Sales structure in 2016 divided by LTV bands.



1.5. Refinancing and issuing of covered bonds

In 2016, mBank Hipoteczny successfully placed on the market eight issues of mortgage covered bonds with a total nominal value of approx. PLN 1.59 billion as at 31 December 2016, including two issues in a private offer of approx. PLN 710 million. The value of four issues in domestic currency amounted to PLN 850 million. The value of four euro-denominated issues amounted to EUR 168 million. Two of the said issues in domestic currency were the first transactions characterised by fixed interest rate in the history of Polish mortgage banking.

The value of all mortgage covered bonds issued by the Bank and publicly traded as at the end of 2016 amounted to approximately PLN 4.6 billion, representing approximately 50.2% of the mortgage covered bonds market in Poland according to the Bank's estimates.

Covered bonds of mBank Hipoteczny are instruments characterised by a low level of investment risk as a result of the statutory requirement of multi-stage collateral for the issuing and trade. It is confirmed by the ratings assigned by Fitch Ratings Ltd. to mortgage covered bonds issued by the Bank. On 1 July 2016, the rating for mortgage covered bonds was upgraded from BBB+ to A.

Issues of mortgage bonds of mBank Hipoteczny S.A. in the public offering

Organisers of the offering: Bidder: Biuro Maklerskie mBanku S.A., Leading manager: mBank S.A.

Issue date	Redemption date	Currency	Value	Rating Fitch Ratings Ltd.
15.06.2011	16.06.2017	PLN	200 000 000	A
20.04.2012	20.04.2017	PLN	200 000 000	A
15.06.2012	15.06.2018	PLN	200 000 000	A
20.06.2013	21.06.2019	PLN	80 000 000	A
28.07.2014	28.07.2022	PLN	300 000 000	A
04.08.2014	20.02.2023	PLN	200 000 000	A
20.02.2015	28.04.2022	PLN	200 000 000	A
15.04.2015	16.10.2023	PLN	250 000 000	A
17.09.2015	10.09.2020	PLN	500 000 000	A
02.12.2015	20.09.2021	PLN	255 000 000	A
09.03.2016	05.03.2021	PLN	300 000 000	A
28.04.2016	28.04.2020	PLN	50 000 000	A
11.05.2016	28.04.2020	PLN	100 000 000	A
TOTAL		**PLN**	**2 835 000 000**	

Issue date	Redemption date	Currency	Value	Rating Fitch Ratings Ltd.
19.10.2012	19.10.2017	EUR	10 000 000	A
26.07.2013	28.07.2020	EUR	30 000 000	A
22.11.2013	22.10.2018	EUR	50 000 000	A
17.02.2014	15.02.2018	EUR	7 500 000	A
28.02.2014	28.02.2029	EUR	8 000 000	A
17.03.2014	15.03.2029	EUR	15 000 000	A
30.05.2014	30.05.2029	EUR	20 000 000	A
22.10.2014	22.10.2018	EUR	20 000 000	A
28.11.2014	15.10.2019	EUR	50 000 000	A
25.02.2015	25.02.2022	EUR	20 000 000	A
24.04.2015	24.04.2025	EUR	11 000 000	A
24.06.2015	24.06.2020	EUR	50 000 000	A
23.03.2016	21.06.2021	EUR	50 000 000	A
28.09.2016	20.09.2026	EUR	13 000000	A
26.10.2016	20.09.2026	EUR	35 000 000	A
TOTAL		**EUR**	**389 500 000**	

Issues of mortgage bonds of mBank Hipoteczny S.A. in the private offering

Organiser of the offering: mBank S.A.

Issue date	Redemption date	Currency	Value
19.08.2016	28.08.2019	EUR	70 000 000

Issue date	Redemption date	Currency	Value
15.12.2016	25.07.2018	PLN	400 000 000

The basis for issuing of covered bonds

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

As of 31 December 2016 the collateral of mortgage covered bonds consisted of receivables of value PLN 7,297.1 million from total number of 13,261 loans,

Loans for commercial clients constituted 56% and for retail clients 44% of the total amount of receivables entered into the mortgage cover register. Loans granted in PLN (57.2%) dominated, loans in EUR (41.7%) and USD (1.1%) constituted the remaining part.

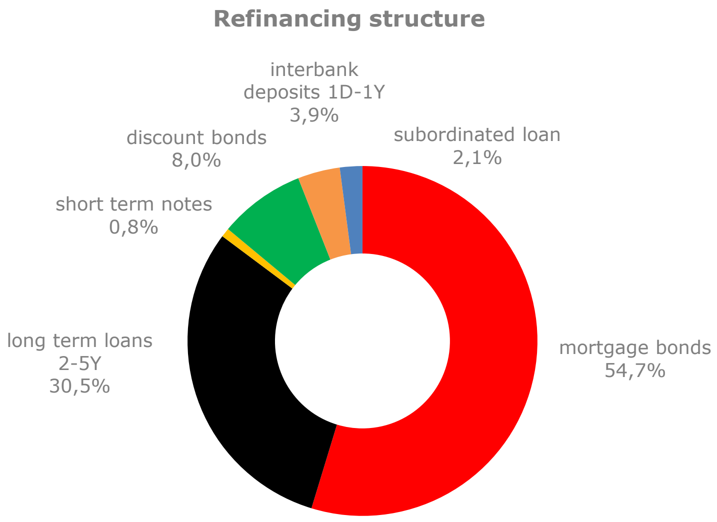
Additionally to the credit receivables, the additional collateral in a form of treasury bonds of nominal value of PLN 90 million was also entered into the mortgage cover register.

As of 31 December 2016 the level of over-collateralisation (including substitute cover) of mortgage covered bonds and public sector covered bonds amounted to 39.16%.

At the turn of 2016 and 2017, the process of entering loans in the register of mortgage bond security was modernized and restructured along with the implementation of a new IT system dedicated to this process.

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

Chart 9. The structure of refinancing of the Bank activity as of 31 December 2016



1.6. Legal environment

On 1 January 2016 new law amending the Act on Covered Bonds and Mortgage Banks as well as certain other acts, came into force. The legal framework of mortgage banking was significantly improved in particular through enhanced safety of mortgage banks' activity and improved rights of investors acquiring covered bonds.

Key changes include:

1) changes in principles of mortgage banks' activity, involving:

- statutory 10% over-collateralisation for covered bonds in the form of assets entered into cover register,
- statutory collateral for 6-month's interest payments on covered bonds in the form of assets entered into cover register which do not constitute the basis for covered bonds issue,
- banks' obligation to run coverage and liquidity tests to verify if the assets in the cover register for covered bonds are still sufficient for full satisfaction of the covered bond holders,
- cover pool monitor's obligation to notify KNF on negative test results to guarantee prompt reaction of the regulator,
- limitation to premature redemption of covered bonds to instances where it is necessary for ensuring compliance with existing limits but also to instances where issue conditions allow for such premature redemption,
- raised limit of refinancing of loans secured on residential real property with covered bonds, from 60% to 80% of the mortgage lending value of such property;

2) changes in the procedure and principles of mortgage banks' bankruptcy proceedings, involving:

- detailed regulations on bankruptcy proceedings, dedicated to mortgage banks as well as all stages of such proceedings and competences of participants,
- obligation imposed on an administrative receiver to run coverage tests and possible also liquidity tests the results of which would indicate the procedures to be adopted for the bankruptcy proceedings,
- initial delay of covered bonds' redemption date by 1 year relative to the original redemption date (basic procedure if both tests' results are positive),

- introduction of pass-through procedure in case of a negative outcome of any of the tests, meaning that the covered bonds' redemption date is delayed however interest payments and, if possible, early redemptions are to be made during that time,
- improved rights of investors in case of bankruptcy, through the right granted to covered bonds' holders to decide on specific bankruptcy procedure in each case, including a procedure for liquidation of a bankruptcy,
- regulation on calculation of interest on covered bonds,

3) necessary changes in tax legislation:

- covered bonds' investors exemption from withholding tax,
- equal tax treatment of loans acquired by a mortgage bank with loans granted by the bank (such as provisions being tax deductible costs for banks);

4) limit for investing in covered bonds by pension funds increased to 5%.

In 2016, secondary regulations issued on 30 December 2015 by the Minister of Finance were also in force in respect of the Act on mortgage bonds and mortgage banks, i.e. the Decree on the accounting of mortgage bonds security and the test of coverage balance, and liquidity test, and Recommendation K amended by the PFSA in February 2016 concerning the rules for mortgage banks maintaining the register of mortgage bond security, in order to adapt them to the new wording of the Act.

Another extremely important change in the legal environment was the passing by the Sejm of the Act of 20 May 2016 on the Bank Guarantee Fund, deposit-guarantee scheme and mandatory restructuring (Journal of Laws item 996, as amended) whose Art. 348 amended the Act of 29 August 1997 on mortgage bonds and mortgage banks, by repealing points 1) and 6) in Art. 15, clause 1. This entailed a significant change in the operations of mortgage banks which lost the right (which was due to them to a limited extent) to accept any deposits, by which the model of refinancing the bank must be changed. Therefore, the Bank will not be obliged to pay contributions for the mandatory deposit-guarantee scheme, and moreover, due to the fact that it meets the additional criteria stipulated in Art. 97 (4) of the Act on the Bank Guarantee Fund, the Bank expects positive decisions with regard to its obligation to maintain MREL and the amount of the contribution for the mandatory restructuring fund.

In 2016, the Bank was involved in social consultations on the draft Act on mortgage loans and on the supervision of mortgage loan intermediaries, which is expected to come into effect at the turn of the first and second quarters of 2017, and prepared itself for the implementation of the solutions contained in this Act. The Bank also participated in consultations on the draft new Recommendation S in respect of offering fixed interest rate loans, in connection with its work on the implementation of this product in the Bank.

2. Risk management

2.1. Credit risk

Loan portfolio

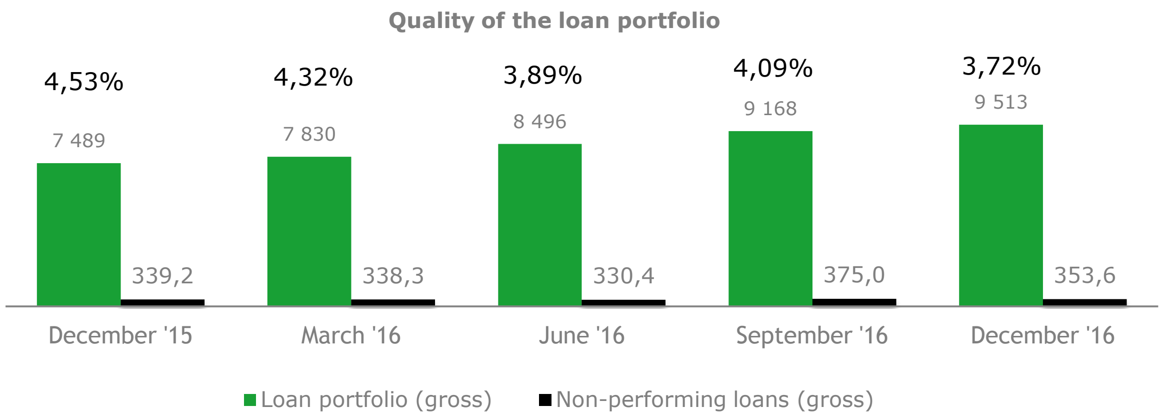
The principles for granting loans have been specified in the Bank's Credit Policy and the management of existing loan portfolio is done mainly through current monitoring of credit exposures.

Due to the actions undertaken by the Bank within the scope of problem loans management and as a result of increasing of the loan portfolio, the share of non-performing loans in the loan portfolio decreased to the level of 3.72%. Most of the loans are repaid in a timely manner, and the borrowers of higher risk profile are subjected to a more strict monitoring. The net value of the loan portfolio in 2016 increased in relation to the end of 2015 by PLN 2,012 million, which resulted mainly from the increase of the retail portfolio (agency loans and retail pooling).

Impairment provisions reaching PLN 101.4 million together with mortgages on the financed real estates constitute an appropriate security against potential losses resulting from credit risk.

The main area of activity of the Bank in 2016 was refinancing of commercial real estates, especially shopping centres and offices. This activity is based on a uniform for the whole mBank SA group commercial real estate financing policy, including key elements of acceptance policy for individual segments of the real estate market. Drawing on past experiences in housing investments financing, the Bank continued financing of residential construction projects focusing on selective financing of projects of the most favourable market parameters (e.g. adaptation of the offer to the needs of the market, positive history of the developer's activity, adequate level of own contribution and verified pre-sale).

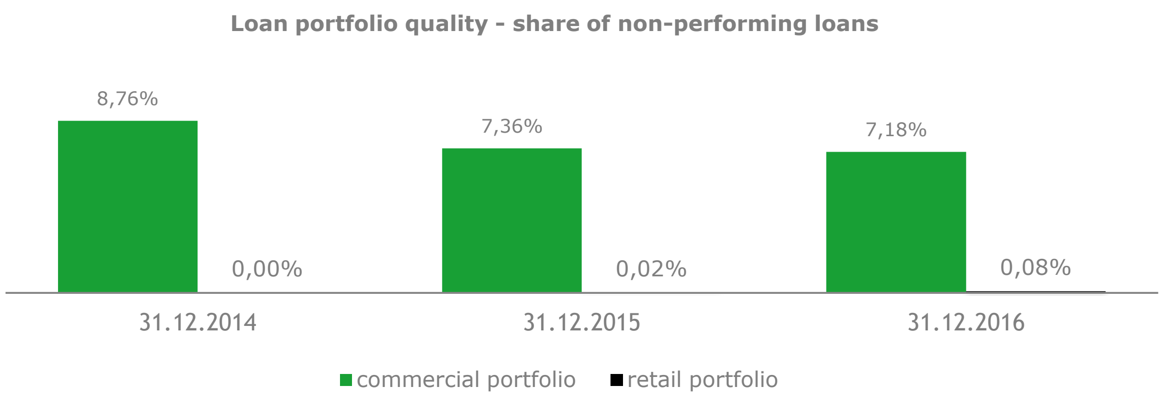
Chart 10. The share of non-performing loans* in the loan portfolio (gross value, in PLN million)



*non-performing loans - loans for which a loss event has been identified – in accordance with IAS 39

The retail portfolio, which is growing strongly, is characterised by very high quality, which is clearly affected by, apart from the applied credit policy, the fact that this portfolio is very young. As of 31 December 2016 there were only 11 cases with reported loss of value. Loans for natural persons are monitored monthly for timely repayments and correctness in terms of established effective mortgage collaterals. Realisation of all contractual obligations of the client is verified in the same monitoring period (including insuring of the real estate and assignment of the rights under insurance policies).

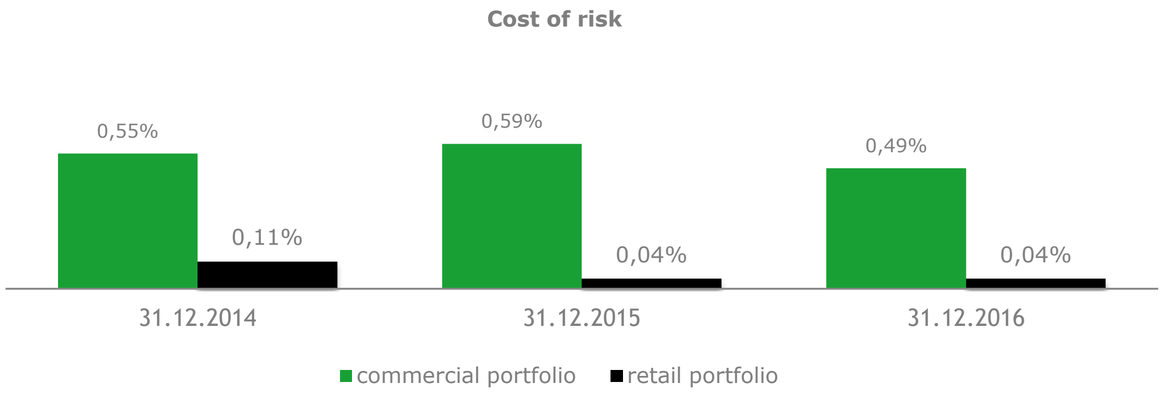
Chart 11. Share of non-performing loans by portfolio



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

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

Chart 12. Cost of risk by portfolio



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

Credit risk management

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

Within the corporate area the Bank plans to cooperate primarily with reliable customers, experienced in given segments of the real estate market (without delays in realisation of liabilities due to the Bank, borrowers who continue cooperation with the Bank on subsequent stages of project implementation, companies with recognised market position).

The priority is to increase the share of loans for purchase or refinancing of existing, new or extensively renovated commercial real estate which have universal purpose and may maintain economic value in a longer term in the total loan sales.

In the area of retail loans the Bank aims to acquire affluent customers from previously indicated target group with positively verified relationship with the banking system. The Bank intends to maximise the share of loans secured by typical residential real estates localised on markets characterised by high liquidity.

The Bank attempts to maintain alow level of loss ratio of the portfolio through application of conservative approach to the evaluation of creditworthiness and solvency of the clients. Within this area the Bank plans to base on the best market practices and take benefit from the experience of the parent company by building the foundations of credit policy and decision-making process on proven principles that function in mBank S.A.

The Bank's approach aims to eliminate the currency risk - in case of new transactions the Bank attempts to grant loans only in the currency of the customer's income.

On 30 June 2016, in connection with the annual review of internal concentration limits of the Bank's exposure, the Bank updated its internal limits of exposure which are one of the elements of the credit risk management process.

Lawsuits brought by the Bank

In the first half of 2016, the Bank filed 1 lawsuit for issuing a payment order for the amount of EUR 849.5 thousand, relating to a commercial loan. The court issued the payment order and the Bank waits for the order to become valid. In the second half of 2016, the Bank filed a motion for declaring bankruptcy in respect of commercial receivables of EUR 13 268.7 thousand. The Court has not yet issued any decision on the announcement or refusal to announce the bankruptcy. The Court has issued an injunction and appointed a court supervisor.

2.2. Market risk

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

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

The amount of market risk the Bank is exposed to in the day horizon is determined using Value at Risk (VaR) method at the confidence level of 97.5%. As of end of December 2016 VaR amounted to PLN 506.8 thousand. The currency risk was PLN 45.7 thousand, the interest rate risk was PLN 212.2 thousand and the credit spread risk was PLN 526.4 thousand [1].

The interest rate risk results from exposure of the financial result and the Bank's capital to adverse effect of interest rates changes. The Bank manages the interest rate gap through matching the repicing dates of assets and liabilities. The sensitivity of the Bank's portfolio to interest rates fluctuations is determined on the basis of results of stress tests and scenario analyses. The interest rate risk is measured among others by using Earnings At Risk (EaR) ratio, which by the end of December 2016 reached a safe level of 4.56%. The banking books items that are exposed to interest rate risk are hedged with linear interest rate derivatives.

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

2.3. Liquidity risk

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

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

At the end of December 2016, the excess of liquid assets amounted to approx. 10.5% of the balance sheet total.

In 2016 financing of Bank's lending was performed primarily through issuing covered bonds in PLN and EUR. The long-term situation of the Bank in terms of liquidity is stable. Loans obtained from mBank S.A. have significant share in financing of long-term receivables.

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

The share of stable financing sources and liquidity reserves adequate to the scale of the Bank's activity determines meeting of long-term liquidity standard M4 required by KNF. The M4 ratio at the end of December 2016 was 1.081. M1 and M2 short-term liquidity standards were maintained at a safe level, PLN 1,186,731 thousand and 2.599 respectively. The M3 standard was 86.577.

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[1] Starting 1 September 2016 an additional risk factor, credit spread, is included in the calculation of VaR.

As at the end of December 2016 the liabilities limit, resulting from Art. 15.2 of the "Act on covered bonds and mortgage banks", was used in 73.36%. In 2016 this limit was not exceeded.

As at the end of December 2016 average maturity of issued mortgage covered bonds was 4.0 of a year for mortgage covered bonds while the average maturity of contracted long-term deposits and loans obtained from other banks was 3.6 of a year. The margin of mortgage covered bonds issued in 2016 on average amounted to 1.04%, with average maturity of 3.7 of a year.

2.4. Operational risk

The main factor influencing the operational risk profile in the last period is the effect of changes in the operational activity profile (extension of the scope of activity of the Bank with retail mortgages) and significant scale of activity entrusted to third parties. The Bank adapted its internal procedures and practice in order to ensure a proper control of risk categories associated with those factors. In order to properly manage the risk associated with entrusting activities, a structure that covers business units and compliance unit was implemented. Risk assessments of ordered "outsourcing" processes and risk assessments of entities implementing activities on behalf of the Bank, performed both before establishing cooperation and periodically in the course of cooperation, constitute the primary tool for monitoring of risk level associated with entrusting activities. During risk assessment the Bank takes into account relative significance of entrusted activities and analyses the risk of failure to perform or improper performance of a service. Those analyses take into account business continuity plans of entities implementing ordered activities and potential possibility of limiting the risk through insurance.

With the introduction of retail lending, mechanisms of detection and operational risk management were launched in this area. The process of fraud detection, mechanisms of registration and analysing errors in transactions and customer complaints were launched. The Bank observes all changes that influence the operational risk profile. So far the collected data do not indicate an increase of operational risk level in the retail banking business line. As the portfolio of loans granted to natural persons develops, the increase of losses in this line may be anticipated, however, due to the nature of conducted activity it should not reach the distribution of the operational risk characteristic for commercial banks. This phenomenon is subjected to constant monitoring. Due to the nature of conducted business, despite increase of the value of retail mortgages portfolio, operational losses still burden mainly the commercial banking business line.

The Bank has a Business Continuity Plan that was implemented in 2014 in accordance with ISO 22301 standard and since then periodically tested. It is accordant with provisions of Recommendation D of KNF. The purpose of the Plan is to implement mechanisms that ensure maintenance of mBank Hipoteczny activity in the scope defined by a list of critical processes within a period of up to five days. This plan is tested at least two times a year and the list of critical processes is subjected to analyses and updates not less than every two years. Actions that improve the plan, in accordance with adopted internal regulations, are measured and the Management Board is informed about them. In order to comply with the postulate of accountability in IT systems, events monitoring and notifying systems were implemented together with internal safety procedures for individual IT systems for which the IT safety risk assessment is performed. Furthermore, the information security management system was supplemented with redesigned processes: the Bank's physical and environmental safety management as well as knowledge management of knowledge on information safety (raising users' awareness). The processes were incorporated into complete policy of IT service model of management. Considering the probability of occurring of critical situations in the areas of liquidity management, currency risk or interest rate risk the Bank has an "Emergency plan in case of liquidity crisis." Additionally, the Bank also has an "Emergency plan in case of unexpected, radical changes in prices on the real estate market."

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

- changes in the organisational structure,
- number of conducted undertakings and IT projects,

- turnover of employees,
- changes in the operational activities profile, associated with development of retail mortgages portfolio on the basis of concluded outsourcing agreements in both business area and IT technology.

With the expansion of activity with sales of retail loans the Bank may expect:

- increase of number of complaints and claims of natural persons against the Bank,
- higher number of loan frauds by natural persons.

The Bank will observe and analyse any changes that influence the risk profile.

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

- operational risk management system implemented in the Bank,
- simple organisational structure, no subsidiaries,
- small scale and the degree of complexity resulting from the specificity characteristic for mortgage banks,
- no electronic banking services,
- procedures governing the process of making decisions on entrusting of activities (analysis of benefits, risks and means of their limitation, business continuity plans and insourcer's financial situation as well as the ability to implement services in a timely and qualitative manner).
- Bank's business continuity plans,
- highly qualified staff,
- efficient internal control system.

2.5. Covered bonds investment risk

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

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

2.6. Internal control system

The Bank has an internal control system, which is divided into the following:

1) **control function** - aimed at ensuring compliance with mechanisms, in particular related to the Bank's risk management system. Internal control mechanisms constitute an integral part of the Bank's daily activities.
2) **Compliance Department** - a compliance department whose task is to identify, assess, control and monitor the risk of the Bank's non-compliance with the provisions of law, internal regulations and market standards as well as submission of reports in this regard.

   The Bank's aim in the scope of non-compliance risk management is avoiding of potential financial losses, legal sanctions, deterioration of the Bank's reputation as a result of non-compliance with law, recommendations and guidelines of supervisory authorities as well as adopted standards of conduct.

The scope of activities of the Compliance Department covers in particular:

- complex monitoring and coordination of non-compliance risk management of the Bank, including development and verification of non-compliance risk management mechanisms
- implementation of tasks regarding:
  - anti-money laundering and counter-terrorist financing
  - protection of personal data
  - banking outsourcing
  - preventing conflicts of interest, fraud and corruption
  - supervision over the process of handling of client's complaints
  - Inside information according to Market Abuse Regulation

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

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

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

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

2.7. Remuneration policy

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

3. Real estate market in Poland in 2016

Housing market[2]

- 2016 was a year of high activity both on the side of demand and supply on the housing properties market.
- In total, at the end of 2016, in the main cities in Poland there were approx. 52.7 thousand apartments in the offer (an increase of 8% y/y), of which only approx. 17.2% of the offer consisted of completed premises.
- The number of transactions calculated jointly for the main 6 markets, in the last four quarters reached an unprecedented level of 61.9 thousand apartments, which was approx. 20% more than in the record-breaking year 2015, in which approx. 52 thousand apartments were sold.
- The increase in the supply of apartments exceeded the high rate of demand. The number of apartments introduced for sale in 2016 went up by approx. 25.2% y/y and amounted to approx. 65 thousand apartments. The increase resulted from production decisions made by developers several quarters ago.
- The timing of the sale of apartments on the primary market in the 6 largest cities remained stable in the period in question. In their investment decisions, developers relied on the actual demand on the market and reasonably reacted to an increase in the number of unsold apartments. The dynamics of the number of apartments whose construction was started decreased y/y.
- The transactional prices on the primary and secondary markets in the largest cities showed slight fluctuations. In Gdynia, Kraków and Warsaw, a slight increase in average prices per 1 m^2 was noted, whereas a slight decrease was noted in Poznań. The average transaction prices per 1 m^2 of apartments on secondary markets in the analysed cities remained stable.
- The high estimated developer's profit margins as well as the return rate on housing projects and high demand contributed to an increase in the number of building permits issued for the construction of apartments and the number of apartments commissioned for use.

Commercial real estate market

- The volume of transactions concluded in 2016 on the commercial real property market amounted to approx. EUR 4.6 billion and the result was comparable with that recorded in 2015 (EUR 4.1 billion).
- The share of the markets was more or less equal in the case of office and trade space, and amounted to approx. 41%, whereas investments in the warehousing sector constitutes approx. 17% of the transaction volume.

Office real property[3]

- Warsaw remains the unchallenged largest office market in Poland. The total resources of modern space at the end of 2016 amounted to over 5 million m^2. In the analysed period, 407 thousand

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2 Analysis of the housing market relates to 6 main cities: Warsaw, Krakow, Lodz, Wroclaw, Poznań, Gdańsk.

3 Analysis of the office market relates to 7 main cities: Warsaw, Krakow, Lodz, Wroclaw, Poznań, Gdańsk, Katowice.

m^2 reached the market, of which 40% of the supply was in three buildings (Q22, Warsaw Spire A and Gdański Business Center 2).

- Taking into consideration projects under construction and developers' plans, the forecast annual sales in 2017 in the capital are at a level of approx. 300 thousand m^2.
- The demand for office space in Warsaw, despite a decrease of approx. 9% y/y was considerably higher than the average annual level of 2008-2015, and amounted to approx. 755 m^2 at the end of the year. The strong demand for office space in the capital was generated to a large extent by companies in the BPO sector. Assuming a stable GDP growth and further dynamic development of the sector of modern business services, the activities of tenants should remain at a high level.
- The high level of the new supply in Warsaw contributed to an increase in the vacancy ratio by approx. 2 pp which amounted to 14.2% at the end of 2016.
- Taking into consideration the forecasts for supply and demand for 2017, a further growth of the ratio by approx. 0.5-1 pp is possible.
- The base rents for the highest class of office space were adjusted to EUR 23.5 - 24 /m^2/month, and in locations outside the city centre, the rates remained at a level of EUR 13–16.5 /m^2/month.
- The total resources of office space in the main regional markets amounted to nearly 4 million m^2. In the analysed period, a record level of supply of space was introduced, of 491 thousand m^2 (an increase of approx. 34% y/y). The majority of the new space appeared on the most mature markets, such as Kraków and Warsaw, and as a result, total resources in these cities reached a level of approx. 916 thousand m^2 and approx. 848 thousand m^2. Taking into consideration the scale of the constructed space, the new supply in 2017 could reach a value comparable with last year.
- The record-breaking level of new supply contributed to an increase in the vacancy ratio to a level of 10.8% (an increase of 1.7 pp y/y). The most significant increase was recorded in Wrocław and in Kraków.
- The total volume of demand in the prior year reached a level of 585 thousand m^2, which constitutes an increase of approx. 50% compared with the average value in the years 2011-2015 (390 thousand m^2), and the highest number of transactions was concluded on the Kraków and Wrocław markets.
- The base rents for the highest-class office space on the main regional markets amounted to EUR 10–14.5 /m^2/month. Developers are demonstrating considerable flexibility while negotiating rental terms other than rent, such as participation in the costs of finishing the space, or grace periods.

Retail real property

- The total resources of retail space in Poland increased by a subsequent 460 thousand m^2 in 2016, to the level of 13.88 million m^2.
- Shopping centres remain the predominant trade format with a total rental area of 10.11 million m^2, which accounts for 73% of the total modern retail space in Poland.
- The largest retail space projects opened in 2016 include, among others, Galeria Posnania in Poznań (99 thousand m^2), Galeria Metropolia in Gdańsk (34.5 thousand m^2), and Galeria Navigator in Mielec (25 thousand m^2).
- In 2016, 22 new retail facilities were launched, including 15 shopping centres with a total rental area of 306 000 m^2, two shopping parks with a total rental area of 11 400 m^2, and five detached warehouses with a total area of 68 800 m^2.
- In 2016, the construction of 13 retail facilities was carried out and completed: 8 shopping centres, 3 shopping parks, one sales outlet and one detached warehouse. Extensions of the existing shopping facilities increased the resources of retail space by an additional 74 000 m^2, which accounted for 16% of the total annual supply.

- Currently, approx. 650 000 m^2 of retail space is under construction, of which 86%, i.e. 560 000 m^2 is scheduled for opening in 2017.
- The largest retail facilities planned for 2017 include: Galeria Północna in Warsaw (69.3 thousand m^2), Wroclavia in Wrocław – a shopping and entertainment centre integrated with a bus station (64.0 thousand m^2), Serenada in Kraków (42.0 thousand m^2), and Gemini Park in Tychy (36.0 thousand m^2).
- Nearly 300 thousand m^2 of retail space will be commissioned for use in the 8 largest agglomerations, both in new facilities and in the planned extensions of retail facilities, such as: Arkadia in Warsaw or Galaxy Centre in Szczecin.
- The total value of the investment transactions related to the retail sector in 2017 is estimated at approx. EUR 2 billion (a decrease of 11% y/y).
- In the past months, no significant changes in the level of rent rates for retail space were noted. Warsaw remains the most expensive location, where the "prime" rent for the best premises with an area up to 100 m^2 in the most prestigious shopping centres are at a level of EUR 120 /m^2/month.
- The vacancy ratio remains low.

Warehouse space

- The total resources of warehousing space in Poland increased by a subsequent 1.2 million m^2 in 2016, and amounted to 10.4 million m^2.
- Investors pursued new development projects, mainly in the Górny Śląsk (Upper Silesia) region (commissioning for use 240 thousand m^2), near Warsaw (210 thousand m^2), in Central Poland (190 thousand m^2) and in Poznań (180 thousand m^2).
- Despite the high volume of the new space commissioned for use in 2016, the vacancy ratio on the main warehousing markets remained at a stable level.
- At the end of 2016, approx. 1.45 million m^2 of modern warehousing space remained under construction. Nearly 75% of the constructed space was secured with lease agreements. The remaining part of the constructed space was of a speculative nature.
- The ownership structure is still concentrated in the hands of five main actors (Prologis, SEGRO, Logicor, Goodman, Panattoni and their partners) which at the end of 2016 controlled more than 56% of warehousing space in Poland.
- The increased share of logistics operators and chains of shops in the demand structure, which generate nearly 60% of the total demand for warehousing space in 2016.
- Stabilization of rent rates can be seen, however a slight increase is forecast on the markets with a low vacancy level.
- The constant extension of sections of express routes can result in increased interest of investors in other areas for potential warehouse investments.

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

The mission of mBank Hipoteczny is to develop effective real property market financing through issuing long-term debt securities - covered bonds.

The Bank's vision is safe, sustained, profitable and long-term growth that leads to maintaining strong leading position on the changing and increasingly demanding covered bonds market through the best use of 15-year experience, specialist expertise and potential of the mBank brand, as well as reinforcement of the Bank's position on the growing market of commercial and housing real property financing.

In June 2016, the Bank completed a review and update of the strategy for subsequent years (2016–2019) (adopted in 2015). Key directions of development and strategic objectives remain valid.

The business strategy formulates two main strategic objectives for the Bank in the years 2016-2019:

- building of the largest possible portfolio of real estate assets within the scope of applicable risk management strategy, which meet the collateral criteria of covered bonds,
- maximum use of covered bonds as a tool for refinancing of the portfolio of long-term mortgages.

Since 2013 the Bank has been implementing a strategic project based on cooperation with mBank in terms of development and refinancing of retail portfolio through issuing covered bonds (the agency model). In September 2013 the Bank launched mortgage lending to natural persons via mBank sales network. It applies to loans that meet the criteria of entering into the cover register for mortgage bonds and potentially constitute the basis for their issuing. In Q3 2014 the development of retail loan portfolio was additionally supported through implementation of the pooling model, which consists in acquisition of already existing retail mortgage portfolio of mBank. Two transactions of this type took place in 2014, followed by four transactions in 2015.

In 2016 the Bank continued actions consisting in development of the new retail mortgages portfolio acquired in cooperation with mBank, improvement of the loan process, acquisition of retail loans portfolio from mBank within the pooling model (four subsequent pooling transactions) and refinancing of this portfolio through issuing covered bonds.

Strategy of sales of loans for commercial real property

In the years 2016-2019 the Bank will gradually limit financing projects with value below PLN 10 million and will focus on financing projects with value exceeding PLN 10 million (including the limit on derivative transactions) and falling below the limit of credit concentration (currently EUR 40 million). The priority of the Bank will be financing of commercial real estate of low investment risk, characterised by a high standard, located in large and medium urban centres, while in the smaller ones only in case of prime locations. The Bank will be in particular financing real property from the following segments:

- office facilities,
- storage facilities,
- retail and service facilities.

Refinancing or financing of transactions of purchasing completed, commercialised objects will constitute the main sales objective.

Secondly, the Bank will focus on acquisition of clients from the area of commercial developers. After completion of construction phase those loans will be converted into long-term refinancing loans.

Additionally, in the years 2016-2019, drawing on past experiences in financing of housing investments, the Bank will continue crediting of housing developers' projects. Loans will be offered to successful and experienced developers with market knowledge, practice and well prepared projects adapted to the market needs. Above all the Bank will continue cooperation with developers with whom it successfully implemented housing projects in the past.

Retail lending strategy

Through implementation of the strategy for the years 2016-2019 mBank Hipoteczny will develop activity in the retail area in the scope of development of mortgage loans portfolio to natural persons, both through sales of new credits and transfer of existing loan portfolio from mBank and its refinancing with covered bonds.

The Bank will draw on its past experiences and experience of mBank Group on this market, following criteria that qualify loans for issuing of covered bonds. The mBank Group will aspire to increase the share in financing of market of mortgage loans for natural persons to approximately 10% in 2019.

In the second half of 2016, an important change in the process of selling mortgage loans offered in the mBank Group took place. Loan products secured with mortgage were withdrawn from the offer of mBank S.A. which means that currently, all mortgage loans for individuals (except Private Banking area), granted in the mBank Group are processed by mBank Hipoteczny S.A.

Due to the planned Act on mortgage loans, the Bank will consider changes in its strategy of selling retail loans, depending on the final wording of the Act.

Refinancing strategy of mBank Hipoteczny

The activity of mBank Hipoteczny in the years 2016-2019 will be financed from five main sources:

- covered bonds, including:
  - bonds secured with retail mortgages (in PLN),
  - bonds secured with commercial mortgages (in PLN, EUR),
- own bonds,
- long-term credit lines (in PLN, EUR),
- subordinated loan obtained from mBank S.A.,
- equity.

By increasing balance sheet total in the following years, mBank Hipoteczny will strive to build a structure of assets which within applicable law regulations will allow for issuing of the greatest possible volume of covered bonds.

Issues in PLN and denominated in EUR are planned. According to current practice the maturity dates of particular trenches will in particular be in the range of 5-10 years. Issues will be offered in public or private offerings, on the domestic market and for foreign investors. Issues in public offerings will be traded on regulated markets.

The Bank will not finance its activities from customer deposits. In 2016, the process of transferring deposits and corporate customers accounts to mBank was concluded.

5. Bank Authorities

Shareholders

As at 31 December 2016, the total number of ordinary shares was 3,090,000 shares with a nominal value of PLN 100 per share. On 2 June 2016, the Extraordinary General Meeting adopted resolution on the increase of the share capital and the exclusion of the shareholder from the pre-emptive right to shares, under which the share capital will be increased to the amount of PLN 309,000,000.00 by way of issuing 100,000 series G ordinary registered shares with a nominal value of PLN 100.00 each and the issue price of PLN 1,000.00 each. The new shares were offered for subscription to mBank S.A. through private placement. The shares were paid-up in full on 24 June 2016. On 1 August 2016, the registry court entered the increased share capital in the registry of entrepreneurs.

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

As of 31 December 2016 the ownership structure of registered share capital of the Bank is as follows:

Name of shareholder	Registered share capital in PLN thousand	Shares		Votes at the General Meeting of Shareholders	
		Amount in thousands	%	Amount in thousand 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 does not collaborate with international public institutions.

Management Board

As at 31 December 2016 the Management Board of mBank Hipoteczny included the following members:

- 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

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

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

The Management Board of the Bank manages the Bank's operations and represents it, including making decisions on issuing of covered bonds and bonds, deciding on the volume of issues in the scope of operational strategy and annual financial plans approved by the Supervisory Board. The scope of activities of the Management Board of the Bank covers all matters not reserved to the competence of other authorities of the Bank, under the articles of association or provisions of law.

Rules on amending articles of association

In accordance with Art. 430 § 1 of the CCC the change of articles of association requires resolution of the general meeting and entry into register.
Pursuant to art. 34 par. 1 Banking Law the change of bank's articles of association requires approval of the Financial Supervision Authority, if it relates to the matters specified below, i.e.:

- a company's name must include a separate word "bank" and differ from the names of other banks as well as indicate whether it is a national bank, bank in the form of a joint stock company or cooperative bank;
- registered office, business objectives and scope of activities of a bank including activities referred to in Art 69 para. 2 item 1-7 dated 29 July 2005 on trading in financial instruments which the bank intends to perform in accordance with Art. 70 para. 2 thereof;
- bodies and their competencies with particular emphasis on competencies of members of the management board referred to in Art. 22b para. 1 banking law, as well as principles of decision-making, basic organisational structure of the bank, rules for submission of statements in the scope of rights and financial obligations, procedures of issuing internal obligations and decision-making procedures regarding commitments or disposal of assets which total value in relation to one entity exceeds 5% of own funds;
- principles of operation of the internal audit system;
- own funds and financial management principles

as well as principles of share privilege and restrictions in relation to voting rights in the bank in the form of a joint stock company.

Supervisory Board

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

- Hans-Dieter Kemler – Supervisory Board Chairman
- Lidia Jabłonowska-Luba - Supervisory Board Vice-Chairman

- Christoph Heins
- Cezary Kocik – Supervisory Board Member
- Michał Popiołek - Supervisory Board Member
- Dariusz Solski – Supervisory Board Member
- Mariusz Tokarski – Supervisory Board Member

The Supervisory Board in the above composition, except Mr Christoph Heins, was appointed for the tenth term of office on 19 April 2016 by the Annual General Meeting of mBank Hipoteczny S.A. As of 30 June 2016, Mr Joerg Hessenmueller resigned as a Member of the Supervisory Board. The composition of the Supervisory Board was supplemented on 6 July 2016 by the Extraordinary General Meeting — Mr Christoph Heins was appointed a Member of the Supervisory Board.

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

According to the wording of paragraph 3 clause 1 point 9 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.

Two Committees operate within the Supervisory Board: Audit Committee and Risk Committee

Audit Committee

As at 31 December 2016 the Audit Committee included the following members:

- Christoph Heins - Committee Chairman
- Hans-Dieter Kemler - Committee Member
- Dariusz Solski - Committee Member
- Mariusz Tokarski - Committee Member

The tasks of the Audit Committee include:

- monitoring the financial reporting process,
- monitoring of the efficiency of the internal control, internal audit and risk management systems,
- monitoring the performance financial audits,
- monitoring of independence of the auditor and the entity authorised to audit financial statements.

In 2016 the Audit Committee debated three times - on 18 April, 9 November and 7 December.

Risk Committee

As at 31 December 2016 the Risk Committee included the following members:

- Lidia Jabłonowska-Luba – Chairwoman of the Committee
- Christoph Heins - Committee Member
- Hans-Dieter Kemler – Committee Member
- Michał Popiołek – Committee Member

The tasks of the Risk Committee include:

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

In 2016 the Risk Committee held two meetings - on 15 April and 23 September.

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

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

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

- review and approval of the Management Board's report on Bank's activities and financial statements for the previous financial year,
- acknowledgement of the fulfilment of duties by the Bank's authorities (vote of confidence),
- Bank's profit distribution or loss coverage,
- amendments to articles of association,
- appointment and dismissal of members of the Supervisory Board and determination of their remuneration,
- increasing or decreasing Bank's share capital,
- liquidation, disposal of the entire Bank's enterprise or merger (combination) with another bank,
- appointment of receivers and determination of their remuneration,
- any decisions relating to claims for rectification of damages caused during the establishment of the company or during its management or supervision,
- decision on dividend payment date,

- disposal or establishing lien on Bank's real property being the location of Bank's authorities,
- matters submitted by the Supervisory Board,
- matters submitted by shareholders under the procedure provided for by the articles of association,
- other matters reserved under the law or the provisions of the Articles of Association.

6. Other information

Loans, deposits and interest rates

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

Transactions with affiliated entities

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

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

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

On 19 April 2016, the Annual General Meeting of mBank Hipoteczny S.A. appointed the Supervisory Board for the tenth term of office, composed of the following Members: Hans-Dieter Kemler, Lidia Jabłonowska-Luba, Joerg Hessenmueller, Cezary Kocik, Michał Popiołek, Dariusz Solski, Mariusz Tokarski.

On 6 July 2016, another Member of the Supervisory Board was appointed — Christoph Heins — due to the resignation of Joerg Hessenmueller from his position as a Member of the Supervisory Board as of 30 June 2016.

The General Meeting conducted a verification and concluded that the candidates for Members of the Supervisory Board comply with the requirements set out in Article 22aa of the Banking Law.

On 18 April 2016, the Supervisory Board appointed the Management Board for the next term of office in the following composition: Piotr Cyburt, Marcin Romanowski, Grzegorz Trawiński, Marcin Wojtachnio. The Supervisory Board conducted a verification and concluded that the appointed Members of the Management Board comply with the requirements set out in Article 22aa of the Banking Law.

Proceedings before a court, arbitration body or public administration authority

Information on pending proceedings is provided in Note 33 to the Financial Statements.

Public aid

In 2016, the Bank did not receive any public subsidies, in particular on the basis of the Act on the Government support for the financial institutions dated February 12, 2009 (Journal of Laws of 2014 item 158).

Guarantees and sureties granted by the Bank

No guarantees or sureties were granted by the Bank in 2016.

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.

7. Statements of the Management Board

Corporate governance

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

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

True and fair picture in the presented reports

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

- the financial statements and the comparative figures were prepared in compliance with the binding accounting principles and present a true, fair and clear picture of the financial position and the condition of the assets of mBank Hipoteczny as well as its financial performance,
- The report of the Management Board on activities presents a true picture of the situation of mBank Hipoteczny, including a description of the main risks and threats.

The process of preparing financial data for reporting is automated and based on the General Ledger of the Bank. Preparation of data in source systems is subject to formalised operational and acceptance procedures. Creating the General Ledger of the Bank takes place within a process covering respective internal controls. Manual adjustments are subject to special controls.

The Department of Financial Reporting in the Department of Accounting and Settlement is responsible for preparation of financial statements in mBank Hipoteczny S.A. Financial accounting and management of standard chart of accounts lies within competencies of the Department of Accounting and Settlement.

Selection of authorised entity

The entity authorised to audit financial statements, who performs audit of annual financial statement of mBank Hipoteczny was selected in accordance with the law. This entity and auditors met the conditions of expressing an impartial and independent opinion about the audit, in accordance with appropriate provisions of the national law. Information on auditor's remuneration is provided in Note 44 to the Financial Statements.

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