Financial Statements of mBank Hipoteczny S.A. according to the International Financial Reporting Standards (IFRS) for 2017

Selected financial data

The selected financial data presented below are supplementary information to the Financial Statements of mBank Hipoteczny S.A. for 2017.

Selected financial data		in PLN `000		in EUR `000	
		Year ended		Year ended	
		31.12.2017	31.12.2016	31.12.2017	31.12.2016
I.	Interest income	390 074	318 648	91 897	72 822
II.	Fee and commission income	1 822	6 722	429	1 536
III.	Net trading income	(3 385)	1 736	(797)	397
IV.	Operating result	59 199	46 864	13 947	10 710
V.	Profit before income tax	34 773	30 179	8 192	6 897
VI.	Net profit attributable to shareholders of mBank Hipotecznego S.A.	27 829	23 422	6 556	5 353
VII.	Net cash flows from operating activities	(2 335 986)	(1 824 043)	(550 330)	(416 857)
VIII.	Net cash flows from investing activities	(16 538)	(8 670)	(3 896)	(1 981)
IX.	Net cash flows from financing activities	2 242 843	1 403 403	528 387	320 727
X.	Total net cash flows	(109 681)	(429 310)	(25 840)	(98 111)
XI.	Basic earnings per ordinary share / Diluted earnings per ordinary share (in PLN/EUR)	8.72	7.70	2.05	1.76

Selected financial data		in PLN `000		in EUR`000	
		as at		as at	
		31.12.2017	31.12.2016	31.12.2017	31.12.2016
I.	Total assets	12 168 169	10 649 499	2 917 396	2 407 210
II.	Amounts due to other banks	3 830 026	3 316 817	918 273	749 733
III.	Amounts due to customers	4 131	36 394	990	8 226
IV.	Equity attributable to shareholders of mBank Hipoteczny S.A.	1 056 401	903 699	253 279	204 272
V.	Share capital	321 000	309 000	76 962	69 846
VI.	Number of shares	3 210 000	3 090 000	3 210 000	3 090 000
VII.	Book value per share / Diluted book value per share (in PLN/EUR)	329.10	292.46	78.90	66.11
VIII.	Total capital ratio (%)	15.79	14.54	15.79	14.54

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

- for items of the statement of financial position – exchange rate announced by the National Bank of Poland as at 31 December 2017: EUR 1 = PLN 4.1709 and 31 December 2016: EUR 1 = PLN 4.4240.
- for items of the income statement and statement of cash flow – exchange rate calculated as the arithmetic mean of exchange rates announced by the National Bank of Poland as at the end of each month of 2017 and 2016: EUR 1 = PLN 4.2447 and EUR 1 = PLN 4.3757.

TABLE OF CONTENTS

for 2017 (in PLN thousand)

Income statement

	Note	Year ended 31 December	
		2017	**2016**
Interest income	7	390 074	318 648
Interest expense	7	(234 065)	(188 507)
Net interest income		**156 009**	**130 141**
Fee and commission income	8	1 822	6 722
Fee and commission expenses	8	(7 581)	(5 196)
Net fee and commission income		**(5 759)**	**1 526**
Net trading income, including:	9	(3 385)	1 736
Foreign exchange result		*(3 332)*	*4 240*
Other net trading income and result on hege accounting		*(53)*	*(2 504)*
Gains less losses from investment securities		73	5
Other operating income	10	1 132	3 116
Net impairment write-downs on loans and advances	11	(20 225)	(21 588)
Overhead costs	12	(64 361)	(62 472)
Amortisation and depreciation	23.24	(3 196)	(3 197)
Other operating expenses	13	(1 089)	(2 403)
Operating result		**59 199**	**46 864**
Taxes on the Bank balance sheet items		(24 426)	(16 685)
Profit before income tax		**34 773**	**30 179**
Income tax	14	(6 944)	(6 757)
Net profit		**27 829**	**23 422**
Net profit attributable to shareholders of the Bank	15	**27 829**	**23 422**
Weighted average number of ordinary shares / Diluted weighted average number of ordinary shares	15	**3 191 260**	**3 042 186**
Earnings per ordinary share / Diluted earnings per ordinary share (in PLN)	15	**8.72**	**7.70**

The entire profit of mBank Hipoteczny S.A. for the 2017 and 2016 pertains to the performance of continuing operations.

Notes presented on pages 7 to 100 constitute an integral part of these Financial Statements.

for 2017 (in PLN thousand)

Statement of comprehensive incomes

		Year ended 31 December	
	Note	2017	2016
Net profit		**27 829**	**23 422**
Other comprehensive income net of tax including:	16	**4 946**	**(1 995)**
Items that may be reclassified to the income statement		**4 966**	**(1 993)**
Change in valuation of available for sale financial assets (gross)		6 131	(2 461)
Deferred tax on available for sale financial assets		(1 165)	468
Change in valuation of available for sale financial assets (net)		4 966	(1 993)
Items that will not be reclassified to the income statement	16	**(20)**	**(2)**
Actuarial gains and losses on post-employment benefits (gross)	30.2	(25)	(3)
Deferred tax on actuarial gains and losses on post-employment benefits		5	1
Actuarial gains and losses on post-employment benefits (net)		(20)	(2)
Total comprehensive income net of tax		**32 775**	**21 427**
Net total comprehensive income attributable to shareholders of the Bank		**32 775**	**21 427**

Notes presented on pages 7 to 100 constitute an integral part of these Financial Statements.

for 2017 (in PLN thousand)

Statement of financial position

ASSETS	Note	31.12.2017	31.12.2016
Cash and balances with the central bank	17	1 351	5 530
Amounts due from other banks	18	18 737	16 262
Derivative financial instruments	19	48 973	45 160
Loans and advances to customers	21	10 766 911	9 411 505
Investment securities available for sale	22	1 277 127	1 134 049
Intangible assets	23	25 527	13 357
Tangible fixed assets	24	8 295	7 603
Deferred income tax assets	31	10 572	8 644
Other assets, including:	25	10 676	7 389
- inventories	3.1.4	3 432	3 432
TOTAL ASSETS		**12 168 169**	**10 649 499**

LIABILITIES AND EQUITY			
L i a b i l i t i e s			
Amounts due to other banks	26	3 830 026	3 316 817
Derivative financial instruments	19	548	9 635
Amounts due to customers	27	4 131	36 394
Debt securities in issue	28	7 043 125	6 152 771
Subordinated liabilities	29	200 484	200 484
Current income tax liabilities		7 682	2 791
Other liabilities and provisions	30	25 772	26 908
TOTAL LIABILITIES		**11 111 768**	**9 745 800**
E q u i t y			
Share capital:		**734 719**	**614 792**
- Registered share capital	36	321 000	309 000
- Share premium	37	413 719	305 792
Retained earnings	38	**317 882**	**290 053**
- Profit from the previous years		290 053	266 631
- Profit for the current period		27 829	23 422
Other components of equity	39	**3 800**	**(1 146)**
TOTAL EQUITY		**1 056 401**	**903 699**
TOTAL LIABILITIES AND EQUITY		**12 168 169**	**10 649 499**
Total capital ratio (%)	45	**15.79**	**14.54**

Notes presented on pages 7 to 100 constitute an integral part of these Financial Statements.

for 2017 (in PLN thousand)

Statement of changes in equity

Changes in equity from 1 January 2017 to 31 December 2017

	Note	Share capital		Retained earnings				Other components of equity		Total
		Registered share capital	Share premium	Other supplementary capital	General banking risk reserve	Retained profit from the previous years	Profit for the current period	Valuation of available-for-sale financial assets	Actuarial gains and losses on post-employment benefits	
As at 1 January 2017		**309 000**	**305 792**	**224 131**	**42 500**	**23 422**	**-**	**(1 168)**	**22**	**903 699**
Net profit		-	-	-	-	-	27 829			27 829
Other comprehensive income (gross)		-	-	-		-		6 131	(25)	6 106
Deferred tax on other comprehensive income		-	-	-	-	-		(1 165)	5	(1 160)
Total comprehensive income	16	**-**	**-**	**-**	**-**	**-**	**27 829**	**4 966**	**(20)**	**32 775**
Transfer to general banking risk reserve	38	-	-	-	2 300	(2 300)	-	-	-	-
Transfer to supplementary capital	38	-	-	21 122	-	(21 122)	-	-	-	-
Issue of shares	36,37	12 000	108 000	-	-	-	-	-	-	120 000
Share issue costs		-	(73)	-	-	-	-	-	-	(73)
As at 31 December 2017		**321 000**	**413 719**	**245 253**	**44 800**	**-**	**27 829**	**3 798**	**2**	**1 056 401**

Changes in equity from 1 January 2016 to 31 December 2016

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

Notes presented on pages 7 to 100 constitute an integral part of these Financial Statements.

for 2017 (in PLN thousand)

Statement of cash flows

		Year ended 31 December	
	Note	2017	2016
A. Cash flows from operating activities		**(2 335 986)**	**(1 824 043)**
Profit before income tax		**34 773**	**30 179**
Adjustments:		***(2 370 759)***	***(1 854 222)***
Income tax paid		(5 142)	(3 332)
Amortisation and depreciation	23,24	3 196	3 197
Interest income (income statement)	7	(390 074)	(318 648)
Interest expenses (income statement)	7	234 065	188 507
Interest received		370 846	287 392
Interest paid		(24 352)	(16 708)
Change in amounts due from other banks	32	(4)	(2)
Change in assets and liabilities on derivative financial instruments	32	(12 192)	(3 025)
Change in loans and advances to customers	32	(1 343 764)	(2 001 178)
Change in investment securities	32	(245 995)	(624 474)
Change in other assets		(3 287)	2 090
Change in amounts due to other banks	32	(512 685)	14 663
Change in amounts due to customers	32	(32 264)	(229 079)
Change in debt securities in issue	32	(408 426)	839 719
Change in other liabilities and provisions	32	(1 161)	6 468
Result on disposal of intangible assets and tangible fixed assets	10,13	152	(14)
Adjustments to intangible assets and property, plant and equipment		328	202
Net cash from operating activities		**(2 335 986)**	**(1 824 043)**
B. Cash flows from investing activities		**(16 538)**	**(8 670)**
Investing activity inflows		**24**	**207**
Due to the disposal of intangible assets and tangible fixed assets		24	207
Investing activity outflows		**16 562**	**8 877**
Due to the purchase of intangible assets and tangible fixed assets	23,24	16 562	8 877
Net cash from investing activities		**(16 538)**	**(8 670)**
C. Cash flow from financing activites			**1 403 403**
Financing activity inflows		**4 459 530**	**2 526 485**
Due to the loans and advances from banks		1 600 000	850 096
Due to the issue of debt securities		2 731 650	1 569 769
Due to the issue of shares		119 926	99 937
Interest received from hedging derivative financial instruments		7 954	6 683
Financing activities outflows		**2 216 687**	**1 123 082**
Due to the repayment of loans and advances from banks		578 432	508 728
Due to the issue of debt securities		1 439 202	450 000
Interest paid on loans received, debt securities in issue, subordinated loan		199 053	164 354
Net cash from financing activities		**2 242 843**	**1 403 403**
Net increase / decrease in cash and cash equivalents, total (A+B+C)		**(109 681)**	**(429 310)**
Cash and cash equivalents as at the beginning of the reporting period, including:		**253 254**	**682 564**
Cash and balances with the central bank		5 530	7 521
Amounts due from other banks		16 262	205 180
Investment securities with maturity of up to 3 months from the date of purchase		231 462	469 863
Cash and cash equivalents as at the end of the reporting period, including:	**41**	**143 573**	**253 254**
Cash and balances with the central bank	17	1 351	5 530
Amounts due from other banks	18	18 737	16 262
Investment securities with maturity of up to 3 months from the date of purchase		123 485	231 462

Explanatory notes to the standalone financial statements

1. Information on mBank Hipoteczny S.A.

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

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

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

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

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

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

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

The Bank was established for an indefinite period of time.

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

There are two business lines in the Bank:

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

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

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

As at December 31, 2017 the employment in the mBank Hipoteczny S.A. was 169 FTEs and 178 persons (December 31, 2016: 218 FTEs; 227 persons).

Average employment in 2017 was 208 employees, in 2016 it was 227 employees.

These financial statements were approved by the Management Board of mBank Hipoteczny S.A. on March 2, 2018.

2. Description of the relevant accounting policies

The most important accounting policies applied by the Bank to the drafting of these Financial Statements are presented below. These principles were applied consistently over all presented periods unless specified otherwise.

2.1. Accounting basis

Financial Statements of mBank Hipoteczny S.A. have been prepared for the 12-month period ended 31 December 2017. Comparative data presented in these financial statements relate to the period of 12 months ended on 31 December 2016. Presented financial statements are standalone financial statements.

As at 31 December 2017 and as at 31 December 2016 mBank Hipoteczny S.A. had no subsidiaries.

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

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

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

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

2.2. Interest income and expenses

All interest income and expenses on financial instruments carried at amortised cost is recognised in the income statement using the effective interest rate method as well as interest income from assets held for trading and available for sale.

The effective interest rate method is a method of calculation of the amortised initial value of financial assets or financial liabilities and allocation of interest income or interest expense to the proper periods. The effective interest rate is the interest rate at which the discounted future payments or future cash inflows are equal to the net present carrying value of the respective financial asset or liability. When calculating the effective interest rate, the Bank estimates the cash flows taking into account all the contractual terms of the financial instrument, but without taking into account possible future losses on account of non-recovered loans. This calculation takes into account all the fees paid or received between the parties to the contract, which constitute an integral component of the effective interest rate, as well as transaction expenses and any other premiums or discounts.

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

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

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

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

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

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

2.3. Fee and commission income and expenses

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

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

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

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

The Bank treats insurance products as bundled with financial instruments, in particular when insurance product is offered to the customer only with certain financial instrument, i.e. it is not possible to purchase from the Bank the insurance product which is identical in a legal form, conditions and commercial substance without purchasing the financial instrument.

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

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

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

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

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

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

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

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

2.5. Segment reporting

An operating segment is a component of the entity:

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

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

In accordance with IFRS 8, the Bank distinguished the following operating segments: "Commercial loans", "Retail loans", "Other loans" and "Non-allocated assets items", described in detail in Note 6.

2.6. Financial assets/financial liabilities

2.6.1. Financial assets

The Bank classifies its financial assets to the following categories:

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

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

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

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

Financial assets valued at fair value through the income statement

This category comprises two subcategories: financial assets held for trading and financial assets designated at fair value through the income statement upon initial recognition. A financial asset is classified in this category if it was acquired principally for the purpose of short-term resale. Derivative instruments are also classified as "held for trading", unless they were designated for hedging according to IAS 39.

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

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

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

Loans and receivables

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

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

Financial assets held to maturity

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

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

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

Financial assets available for sale

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

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

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

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

Dividends on available for sale equity instruments are recognised in the income statement when the entity's right to receive payment is established. The fair value of quoted investments in active markets is based on current market prices.

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

2.6.2. Financial liabilities

The Bank categorises its financial liabilities as follows:

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

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

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

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

Other financial liabilities include in particular:

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

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

2.7. Offsetting financial instruments

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

2.8. Impairment of financial assets

<u>Assets carried at amortised cost</u>

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

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

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

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

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

- receivable is collected,
- receivable is redeemed.

Financial assets available for sale

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

Renegotiated agreements

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

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

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

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

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

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

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

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

2.9. Cash and cash equivalents

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

2.10. Derivative financial instruments and hedge accounting

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

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

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

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

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

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

Fair value hedges

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

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

Derivative instruments not fulfilling the criteria of hedge accounting

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

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

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

The Bank holds the following derivative instruments in its portfolio:

Interest rate risk instruments:

- Interest Rate Swap (IRS) Contracts.

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

- FX SWAP contracts.

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

2.11. Intangible assets

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

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

Computer software

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

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

Development costs

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

"Development costs" useful lives are finite and the amortization period does not exceed 5 years. Amortization rates are adjusted to the period of economic utilisation.

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

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

2.12. Tangible fixed assets

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2.13. Current and deferred income tax

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

Deferred income tax liabilities or assets are determined by application of the tax rates in force by virtue of law or of actual obligations at the end of the reporting period. According to expectations such tax rates applied will be in force at the time of realisation of the assets or settlement of the liabilities for deferred corporate income tax. Temporary differences are differences arising between the carrying amount of an asset or liability and its tax base.

Liabilities or assets for deferred corporate income tax are recognised in their full amount according to the balance sheet method in connection with the existence of temporary differences between the tax value of assets and liabilities and their carrying value.

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

The Bank presents the deferred income tax assets and liabilities netted in the statement of financial position if the Bank has legal rights to recognize them simultaneously when calculating tax liability.

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

To determing exchange differences, the Bank uses accounting method on 1 January 2015.

2.14. Inventories

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

2.15. Prepayments, accruals and deferred income

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

Accrued expenses are liabilities payable for goods and services that were received/provided, but were not paid, invoiced or officially agreed with the supplier, including amounts due to employees. Deferred income includes received amounts of future benefits. Accruals and deferred income are presented in the statement of financial position under the item "Other liabilities and provisions".

2.16. Provisions

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

2.17. Retirement and other employee benefits

Provision for retirement and similar benefits

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

Phantom share-based benefits settled in cash

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

Pursuant to the Resolution of the Supervisory Board No 13/2017 of 27 March 2017, the amended Policy for remuneration of persons having a material impact on the risk profile in mBank Hipoteczny S.A. was approved. Details of the programme are provided in Note 42.

2.18. Issue of securities

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

2.19. Loans and advances received and deposits accepted

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

2.20. Equity

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

<u>Registered share capital</u>

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

<u>Share premium</u>

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

- Share issue costs

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

<u>Retained earnings</u>

Retained earnings include:

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

<u>Other components of equity</u>

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

2.21. Leasing

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

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

2.22. Valuation of items denominated in foreign currencies

Functional currency and presentation currency

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

Transactions and balances

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

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

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

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

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

2.24. New standards, interpretations and amendments to published standards

These financial statements include the requirements of all the International Accounting Standards and the International Financial Reporting Standards endorsed by the European Union, and the related with them interpretations which have been endorsed and binding for annual periods starting on 1 January 2017.

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

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

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

Standards and interpretations approved by the European Union:

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

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

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

- IFRS 15, Revenue from Contracts with Customers, published by the International Accounting Standards Board on 28 May 2014, approved by European Union on 22 September 2016, binding for annual periods beginning on or after 1 January 2018.

  Amendments to IFRS 15 were published by International Accounting Standards Board on 11 September 2015, approved by European Union on 22 September 2016, binding for annuals periods starting on or after 1 January 2018.

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

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

- Amendments to IFRS 15, *Clarifications to IFRS 15 Revenue from Contracts with Customers*, published by International Accounting Standards Board on 12 April 2016, approved by European Union on 31 October 2017, binding for annuals periods starting on or after 1 January 2018.

  Amendments to IFRS 15 clarify the guidance on the identification of performance obligation, the accounting of licensing of intellectual property and principal versus agent considerations in the context of presenting income on gross or net basis. The practical expedients on transition were also added when applying a new standard.

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

- Amendments to IFRS 4, *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*, published by International Accounting Standards Board on 12 September 2016, binding for annuals periods starting on or after 1 January 2018.

  Amendments to IFRS 4 provide a temporary exemption that permits the insurer not to apply IFRS 9 if, and only if the entity has not previously applied IFRS 9 requirements and if entity's activities are predominantly connected with insurance. Alternatively, the entity may implement IFRS 9 applying the overlay approach, which is intended to address the additional accounting mismatches and volatility in profit or loss for the designated financial assets that may arise from applying IFRS 9 before applying the forthcoming insurance contracts standard

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

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

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

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

The Bank is of the opinion that the application of a new standard will have an impact on the recognition, presentation, measurement and disclosure of operating lease assets and corresponding liability in the financial statements of the Bank as lessor. The Bank is of the opinion that the application of a new standard will have no significant impact on recognition of previous finance lease in the financial statements of the Bank.

- Annual Improvements to IFRS Standards 2014-2016 Cycle, changing 3 standards (IFRS 1, IFRS 12, IAS 28), published by International Accounting Standards Board on 8 December 2016, approved by European Union on 7 February 2018, binding for annuals periods starting on or after 1 January 2017 or on or after 1 January 2018.

  Annual Improvements to the following standards were implemented during the cycle: IFRS 1 deleted some short-term exemptions for first-time adopters, IFRS 12 clarifies the scope of disclosure of financial information for the subsidiary, joint venture or associate that is classified as held for sale or discontinued operation in accordance with IFRS 5, IAS 28 in the scope of clarifying that if an entity that is not itself an investment entity has an interest in an associate or joint venture that is an investment entity, the entity may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries.

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

Standards and interpretations not yet approved by the European Union:

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

  Amendments to IFRS 2 introduce additional guidelines for recognition cash-settled share-based payment transactions and add the exception allowing the recognition of settlement in a form of equity instruments, if the settlement of share-based payment transactions was divided into two components equity-settled instruments issued to the employee and cash-settled payments to the tax authority.

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

- Amendments to IAS 40, *Transfers of Investment Property*, published by International Accounting Standards Board on 8 December 2016, binding for annuals periods starting on or after 1 January 2018.

  Amendments to IAS 40 clarify that in isolation, a change in management's intentions for the use of a property does not provide evidence of a change in use. The examples for a change in use were modified to refer also to properties under construction or development. Amendments to IAS 40 allows also the entity to apply one of the two transition methods and require disclosure of any reclassification of property at the date of simplified transition method.

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

- IFRIC Interpretation 22, *Foreign Currency Transactions and Advance Consideration*, published by International Accounting Standards Board on 8 December 2016, binding for annuals periods starting on or after 1 January 2018.

  IFRIC Interpretation 22 clarify the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income when an entity has received or paid advance consideration in a foreign currency. The Interpretation relates to the situation when the transaction is in foreign currency and the entity pays or receives consideration in advance in a foreign currency before the recognition of the related asset, expense or income

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

IFRS 9, Financial instruments

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

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

In June 2015 the Bank launched an IFRS 9 implementation project which actively engages the Bank's organizational units responsible for accounting, financial reporting and risk management as well as business, IT and organisation department. For the retail portfolio, the Bank carried out work as part of a project conducted at mBank S.A.

From January 1, 2018 the Bank has implemented the necessary solutions for the particular requirements based on the results of gap analysis and the defined methodological assumptions.

Summary of key IFRS 9 requirements

Classification and measurement

Financial assets

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

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

A financial asset shall be classified to the above mentioned valuation categories on initial recognition on the basis of both:

- the Bank's business model for managing the financial assets which is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective; and
- the contractual cash flow characteristics of the financial asset by verifying if the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (so called SPPI criterion).

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

Financial liabilities

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

Impairment

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

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

Replacing the concept of „incurred loss" (IAS 39) with the concept of „expected credit loss" will influence significantly the way of modelling credit risk parameters and the final amount of loss allowance. The currently applied loss identification period will not be used anymore, therefore the IBNR (incurred but not reported) category of loss allowance will be eliminated.

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

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

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

Hedge accounting

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

IFRS 9 requires the Bank to ensure that its hedging relationships are compliant with the risk management strategy applied by the Bank and its objectives. IFRS 9 introduces new requirements with regard to the assessment of hedge effectiveness, rebalancing of the hedge relationship as well as it prohibits voluntary discontinuation of hedge accounting (i.e. in the absence of premises to cease to apply hedge accounting, specified in Standard).

for 2017 (in PLN thousand)

Bank, as at the day of implementing the standard, chose to continue to apply the hedge accounting requirements and hedging relationships arising from IAS 39.

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

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

Impact of IFRS 9 on financial position

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

The table below, the Bank presents the estimated negative impact of the implementation of IFRS 9 on capitals on January 1, 2018 due to changes in the classification and measurement of financial assets.

Assets	IAS 39 measurement category	IFRS 9 measurement category	IAS 39 carrying amount	IFRS 9 implementation impact* Classification and measurement impact	IFRS 9 implementation impact * Impairment impact	IFRS 9 carrying amount
Loans and advances to customers	amortized cost	amortized cost	10 544 526	-	(10 896)	10 533 630
Loans and advances to customers	amortized cost	fair value through profit or loss	222 385	(2 258)	-	220 127
Total assets			**10 766 911**	**(2 258)**	**(10 896)**	**10 753 757**

*without deffered tax effect

The value of other financial assets presented in the statement of financial position did not change significantly as a result of implementation of IFRS 9.

The table below, the Bank presents the estimated negative impact of the implementation of IFRS 9 on capitals on January 1, 2018 due to a change in the value of liabilities.

Liabilities	Measurement category	Measurement category	IAS 37 carrying amount	IFRS 9 implementation impact* Classification and measurement	IFRS 9 implementation impact* Impairment impact	IFRS 9 carrying amount
Provisions	IAS 37	IFRS 9	204	-	3 353	3 557
Total liabilities			**204**	**-**	**3 353**	**3 557**

* without deffered tax effect

The value of other liabilities presented in the statement of financial position did not change as a result of implementation of IFRS 9.

As at 1 January 2018, the total value of the impact of IFRS 9 implementation PLN (16 507) thousand and the deferred tax effect in the form of deferred net tax asset increase PLN 3 136 thousand decreased the balance of retained earnings by the amount of PLN 13 371 thousand.

Impact of IFRS 9 implementation on capital adequacy

The total fully-loaded impact of IFRS 9 calculated as on 1 January 2018 is insignificant of the Bank TCR and Tier1 ratio therefore due to the fact that in the calculation of capital ratios of the Bank, the total amount of exposures to risk is determined taking into account the amount of exposure to credit risk with using the Internal Ratings Based Approach using supervisory approach in terms of assignment of exposures due to specialist crediting to risk categories (IRB slotting approach method) and the impact of the application of IFRS 9 is offset by reducing the deficit of credit risk adjustments against expected losses.

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

for 2017 (in PLN thousand)

The table below presents the impact of IFRS 9 on the capital adequacy of the Bank as at 1 January 2018

Capital adequacy	31.12.2017	Impact of the implementation of IFRS 9	01.01.2018
Own funds	**1 104 182**	**313**	**1 104 495**
Common Equity Tier 1 Capital	904 182	313	904 495
(-) Impact of the implementation of IFRS 9 on capitals	-	(13 371)	(13 371)
(-) IRB shortfall of credit risk adjustments to expected losses	(88 720)	13 904	(74 816)
(-) Value adjustments due to the requirements for prudent valuation	(1 339)	(220)	(1 559)
The total amount of risk exposure	**6 993 562**	**2 757**	**6 996 319**
Common Equity Tier 1 capital ratio	**12.9288%**	**-0.0006%**	**12.9282%**
Total capital ratio	**15.7885%**	**-0.0017%**	**15.7868%**

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

Below the Bank disclosed the qualitative information about the Bank's approach to the implementation of IFRS 9, which in the Bank's opinion, will allow the recipients of the financial statements to understand the impact of IFRS 9 on the Bank's financial position and capital management.

Classification and measurement of financial instruments

Financial assets

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

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

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

As at December 31, 2017 the Bank does not identify financial assets which the Bank is going to designate as measured at fair value through profit or loss on 1st January 2018 to eliminate or significantly reduce "accounting mismatch" which would arise as a result of measuring these financial assets at amortised cost or at fair value through other comprehensive income.

Financial liabilities

Financial liabilities will continue to be measured in accordance with the existing rules laid down in IAS 39, i.e. at amortised cost or at fair value through profit or loss. Bank has not chosen the option of measuring financial liabilities at fair value. Should this option be chosen, changes in the fair value arising from changes in Bank credit risk will be taken to other comprehensive income, and once a financial liability is derecognised, the value previously recognised in other comprehensive income will not be recycled to profit or loss.

Impairment

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

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

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

Hedge accounting

Currently the Bank assumes that based on the paragraph 9.7.2.21 of IFRS 9 it will continue to apply the hedge accounting requirements of IAS 39 instead of the requirements of IFRS 9.

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

Comparative data

Bank elected to use the IFRS 9 provisions which provide for exemption of the obligation to restate comparative information for prior periods in relation to the changes arising from classification, measurement and impairment. Differences in the carrying amount of financial assets and liabilities resulting from the application of IFRS 9 are reported in retained earnings in equity as at 1 January 2018.

2.25. Change of presentation in the condensed statement of financial position

Beginning from the financial statements for the first half of 2017, in statement of financial position the Bank changed the presentation of a hedge accounting difference concerning the fair value of hedged items so that the said adjustment was presented along with the hedged item in the line "Debt securities in issue", which is consistent with the provisions of IAS 39. The change of presentation was also applied to the comparative period.

3. Financial risk management

3.1. Credit risk

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

The maximum exposure to credit risk equals to the amount of positions presented in the statement of financial position and off-balance sheet data presented in the note 21.

3.1.1. Collaterals

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

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

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

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

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

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

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

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

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

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

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

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

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

3.1.2. Description of the rating system and credit risk management

For the analysis of the loan portfolio the Bank uses rating models which are updated annually. Rating systems currently cover 98.13% of total sum of risk-weighted exposures with standard method including portfolios covered with a plan of gradual implementation and 63.2% without including those portfolios. The difference results from the fact, that 34.93% of the total sum of risk-weighted exposures with standard method are retail exposures gained from the cooperation with mBank S.A., which are part of gradual implementation of the IRB method, accepted by the Polish Financial Supervision Authority. The Bank intends to apply in the future for the acceptance to use the statistical methods to measure regulatory capital requirements for the credit risk of these exposures.

The Bank applies rating models:

- for the purposes of credit risk management, including making credit decisions, assessment of credit risk of a transaction and capital adequacy - in case of commercial portfolio;

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

Commercial portfolio including commercial receivables purchased from mBank S.A.

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

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

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

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

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

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

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

Retail portfolio obtained in cooperation with mBank S.A.

For the purposes of assessment of reliability of a client applying for a retail loan product secured with mortgage and monitoring/reporting of credit risk for this portfolio, group credit risk models, which the Bank is a local user, are applied. Detailed rules and scope of cooperation between Banks in terms of group risk models are specified by provisions of a separate agreement on cooperation in the scope of risk management. The capital requirement for credit risk for this part of the portfolio is calculated using the standard method, since as at 31 December 2017 it is covered by a plan of gradual implementation.

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

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

Additional information

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

Risk weighted exposure amounts for credit risk calculated using internal ratings method are presented in Note 45.

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

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

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

As presented in note 21, 94.51% of gross value of loans and advances granted to clients are not overdue loans, without identified impairment. Remaining 5.49% of the loan portfolio value are overdue loans without identified impairment (2.91%) and loans with identified impairment (2.58%).

3.1.3. Loss of value measurement

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

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

- commercial portfolio,
- retail portfolio obtained in cooperation with mBank S.A.,
- loan portfolio for local government authorities, including those guaranteed by local government authorities, hereinafter called "the LGA portfolio",
- portfolio of other retail loans.

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

A credit exposure is considered to be potentially impaired when the possibility of default has been identified for the debtor (contract owner). mBank Hipoteczny S.A. uses a uniform definition of default in all areas of credit risk management, including for the purpose of calculating allowances, provisions and capital requirements. The basis for the adopted definition of default is the definition of default contained in Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (the CRR).

<u>Commercial loan portfolio, LGA and other retail loans</u>

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

a) deterioration of counterparty/transaction loan quality. The Bank recognises that the debtor probably will not fully fulfil its loan obligations against the Bank, parent entity of the Bank without actions of the Bank, such as implementation of collateral, if such exists,
b) delay in payments for over 90 days. Any of the exposures of a nature of debtor loan obligation against the Bank, parent entity of the Bank is overdue for more than 90 days, provided that:
    - in case of retail exposures the overdue amount exceeds PLN 500,
    - in case of other exposures the overdue amount exceeds PLN 3 000,
c) qualification of an entity to a default situation by the Bank's parent entity.

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

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

a) preparation of a loss impairment as a result of significant deterioration of debtor's creditworthiness,

b) sale by the Bank of an exposure with significant economic loss associated with changes in its creditworthiness,

c) the Bank's permission for forced restructuring of loan liability, if it may cause reduction of financial liabilities through amortisation of significant part of the liability or deferring of payment of the principal amount, interests or - if applicable - commission,

d) filing by the Bank a bankruptcy motion against debtor or filing similar motion in respect of loan obligations of the debtor towards the Bank, the parent of the Bank.

e) bankruptcy of debtor or acquiring by him a similar legal protection resulting in his evasion of or delay in repayment of loan obligations towards the Bank, the parent or subsidiary entity of the Bank,

f) fraud of the client (provision of false data at the time of granting of a loan or during its monitoring, credit extortion etc.),

g) termination of an agreement (in whole or in part) and/or initiation of debt collection activities.

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

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

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

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

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

c) booking of impairment losses.

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

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

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

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

Retail portfolio obtained in cooperation with mBank S.A.

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

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

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

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

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

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

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

a) establishing additional collateral;
b) changing the collateral;
c) making a one-time repayment of the debt to the LTV level accepted by the Bank;
d) renegotiating the terms of the agreement.

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

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

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

3.1.4. Repossessed collateral

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

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

for 2017 (in PLN thousand)

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

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

In both 2017 and 2016, the Bank did not take over any collaterals. Reduction of value of inventories in 2016 is associated with the sale of residential premises situated in the repossessed real estate in the previous years and impairment write-downs for the repossessed properties.

Change of status of repossessed collaterals

	Period from 01.01.2017 to 31.12.2017	Period from 01.01.2016 to 31.12.2016
As at the beginning of the period	**3 432**	**6 768**
Increase (due to)	-	382
- reversal of impairment write-downs	-	222
- other increase	-	160
Decrease (due to)	-	(3 718)
- sale of real estate	-	(1 779)
- establishment of impairment write-downs	-	(1 939)
As at the end of the period	**3 432**	**3 432**

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

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

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

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

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

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

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

The risk of no repayment of the product portfolio subject to the forbearance policy is mitigated with the amount of PLN 381 755 thousand of accepted collaterals (the mortgage lending value of the property that constitute the collateral of the loan), therefore, the possible influence of this portfolio on deterioration of the entire portfolio of the Bank is significantly limited.

for 2017 (in PLN thousand)

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

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

The structure of the loan portfolio in the forbearance category in mBank Hipoteczny S.A. as at 31 December 2016 is as follows:

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

The size of the portfolio of the customers to whom the Bank has granted relief is still small compared with the total size of the Bank's loan portfolio. The forbearance portfolio represents 2.31% (3.74% as at 31.12.2016) of the entire portfolio. As at 31 December 2017, the forbearance exposure portfolio in the default category represented 71.66% of the forbearance portfolio (58.67% as at 31.12.2016). 30.54% of the portfolio of default exposures was covered with allowances (22.63% as at 31.12.2016). The risk of default on the forbearance portfolio is mitigated with the accepted collateral in the form of a mortgage on a property with a mortgage lending value of PLN 381 755 thousand (PLN 505 299 thousand as at 31.12.2016), including PLN 261 893 thousand in the default category (PLN 287 772 thousand as at 31.12.2016).

Changes in forbearance exposures carrying value in 2017 and 2016

	Gross value	Of which defaulted	Write-downs created	Net value
Balance as at 1 January 2017	**355 738**	**208 717**	**47 486**	**308 252**
Outputs from forbearance	(117 470)	-	(212)	(117 258)
Change in exposure	(33 317)	(29 598)	7 678	(40 995)
New forbearance	45 912	645	100	45 812
Balance as at 31 December 2017	**250 863**	**179 764**	**55 052**	**195 811**

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

Forbearance exposures by type of concession as at 31 December 2017

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

Forbearance exposures by type of concession as at 31 December 2016

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

for 2017 (in PLN thousand)

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

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

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

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

Forbearance exposures with recognised loss impairment per length of overdue period as at 31 December 2017

Forbearance exposures with impairment recognised (31.12.2017)	Gross value	Of which defaulted	Write-downs created	Net value
Not overdue	54 306	54 306	4 411	49 895
up to 30 days	-	-	-	-
31 to 90 days	-	-	-	-
more than 90 days	106 897	106 897	50 454	56 443
Total	**161 203**	**161 203**	**54 865**	**106 338**

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

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

Forbearance exposures by industry as at 31 December 2017

As at 31 December 2017	Gross value	Of which defaulted	Write-downs created	Net value
Activity related to the real estate market	172 511	131 742	45 222	127 289
Building industry	62 620	47 032	9 706	52 914
Natural persons	15 732	990	124	15 608
Total	**250 863**	**179 764**	**55 052**	**195 811**

Forbearance exposures by industry as at 31 December 2016

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

Interest income related to forbearance exposures at the end of 2017, amounted to PLN 9 671 thousand (for the period ended 31 December 2016: PLN 11 871 thousand).

<u>Retail Banking</u>

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

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

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

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

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

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

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

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

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

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

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

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

The portfolio of products of forbearance status in the retail part as at 31 December 2017 amounted to PLN 15 732 thousand (PLN 7 155 thousand as at 31.12.2016).

<u>Corporate banking</u>

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

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

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

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

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

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

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

The portfolio of loans classified to the forbearance category in the Bank is subject to particular monitoring by all units participating in the lending process and constant assessment whether any evidence of permanent impairment of the Bank's receivable occurred. Transactions qualified to this category remain in this portfolio and are reported as forbearance for minimum 24 months from the day of granting of a concession (so called trial period). In order to recognise that the client came back to normal category it is necessary that the debt is appropriately serviced and that there is no overdue at the end of the trial period. A client may be removed from the forbearance portfolio before the end of the trial period only in case of complete repayment of the debt.

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

The portfolio of products of forbearance status in the corporate part as at 31 December 2017 amounted to PLN 235 131 thousand (PLN 348 583 thousand as at 31.12.2016).

3.1.6. Counterparty risk arising from transactions in derivatives

The Bank makes derivative transactions only to hedge against the currency risk and interest rates risk. The Bank does not run trading activities, all derivative transactions are classified to the banking portfolio. The Bank has in its derivative portfolio interest rate swaps (IRS) and currency swaps (FX SWAP contracts). The Management Board of the Bank approves the limits for the Bank's exposure in derivative transactions. The limits of exposure for particular banks are monitored and verified at least once a year. The Bank determines the limits only for the banks with the signed ISDA (International Swaps and Derivatives Association) agreement with CSA annex (Credit Support Annex) for the banks with which it plans to conclude ISDA agreements with CSA annex and the central clearing houses in which the derivative transactions will be settled. The counterparty risk is limited by the choice of the individual segregated account structure in the clearing house. The use of the exposure limits is monitored on the daily basis. The limits were not exceeded in both 2017 and 2016. As at 31 December 2017, all transactions in derivative financial instruments were transactions concluded originally with mBank S.A., Bank Zachodni WBK S.A. and the central clearing house. Therefore, in the Bank's opinion the credit risk associated with the derivative instruments is limited.

3.1.7. Debt instruments: investment securities

The value of investment securities as at 31 December 2017 amounted to PLN 1 277 127 thousand, and as at 31 December 2016 amounted to PLN 1 134 049 thousand. Debt instruments on both 31 December 2017 and 31 December 2016 had A rating in the scale of Fitch Ratings.

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

- as at 31 December 2017 amounted to PLN 180 314 thousand,
- as at 31 December 2016 amounted to PLN 89 667 thousand.

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

- as at 31 December 2017 amounted to PLN 1 033 thousand,
- as at 31 December 2016 amounted to PLN 1 008 thousand.

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

Both as at 31 December 2017 and 31 December 2016 all investment securities were not past due instruments, without impairment.

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

Risk of geographical concentration

Assets, liabilities and off-balance sheet items are not presented according to geographical areas in the Bank due to insignificance of geographical differentiation of risks. The Bank operates only in the territory of the Republic of Poland.

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

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

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

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

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

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

i) stress test results.

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

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

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

Sector concentration risk

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

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

As at 31 December 2017 no exceeding of exposure limit against an entity or a group of affiliated clients specified in Art. 395.1 of the CRR Regulation occurred in the Bank.

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

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

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

No.	Industries	Net carrying amount (PLN '000)	Share in the portfolio (%)	Net carrying amount (PLN '000)	Share in the portfolio (%)
		31.12.2017		31.12.2016	
1.	Natural persons	5 853 656	54.37	4 371 412	46.45
2.	Activity related to the real estate market	3 263 008	30.31	3 249 144	34.52
3.	Building industry	1 338 771	12.43	1 363 935	14.49
4.	Activity related to culture, entertainment and leisure	78 759	0.73	183 279	1.95
5.	Public administration and defence; Compulsory social security	63 510	0.59	73 200	0.78
6.	Professional, scientific and technical activity	84 109	0.78	93 210	0.99
7.	Health protection and social welfare	48 606	0.45	51 994	0.55
8.	Activity related to accommodation and catering services	18 970	0.18	10 983	0.12
9	Financial activities	13 010	0.12	7 706	0.08
10	Water supply; Sewage and waste management and activity related to reclamation	2 973	0.03	4 671	0.05
11	Other	1 539	0.01	1 971	0.02
	Total	**10 766 911**	**100.00**	**9 411 505**	**100.00**

3.3. Strategy for use of financial instruments

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

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

Derivative instruments

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

Off-balance sheet liabilities of credit nature

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

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

3.4. Market risk

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

The risk profile results from the Bank's operational strategy. The Bank offers products based on variable and fixed interest rate, wherein the products based on variable interest rate are preferred.
The Bank offers products in foreign currencies EUR and USD. The Bank does not perform operations at its own account for trade purposes, it only has the bank portfolio. The main method of market risk management in the Bank is application of natural security, that is obtaining of funds for financing in currencies and of interest rates directly adjusted to corresponding assets. Due to the nature of the Bank's activity, the exposure to market risk

should be maintained at the lowest possible level. The Bank aims to limit the exposure to market risk resulting from the structure of assets and liabilities through concluding hedging transactions, the catalogue of which is approved by the Management Board of the Bank. Identification of market risks and liquidity takes into account internal and external factors. Internal factors include factors such as: the specificity of lending activity and the specificity of refinancing structure. External factors include factors constituting the surroundings of the Bank: interbank market, behaviour of financial markets, strategy and policy of shareholder against the Bank. The market risk is identified in all types of products and types of activities. Widely recognised methods are applied in the process of identification. The Bank specified the level of risk through measurement of the value exposed to risk (Value at Risk - VaR) and through stress tests.

VaR is a statistical measurement of the market risk level which expresses a potential loss to which a portfolio is exposed during specified period of time, for a given level of confidence, in normal market conditions, due to changes of risk factors (foreign exchange rates, interest rates, credit spreads[1]). The potentiality of a loss means that with previously established large probability (confidence level), at which fair value is determined, within a specified time period a loss lower than determined VaR value may be expected.

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

As at 31 December 2017, VaR amounted to PLN 508.9 thousand compared with PLN 506.81 thousand as at 31 December 2016, with a confidence level of 97.5%.

The list below presents the value of average and maximum VaR of the Bank during the period from 1 January 2017 until 31 December 2017 and from 1 January 2016 until 31 December 2016.

PLN '000	12 months until 31.12.2017		12 months until 31.12.2016*	
	average	maximum	average	maximum
Credit spread risk	441	576	625	720
Interest rate risk	120	236	201	294
Currency risk	20	211	28	257
Total VaR	**444**	**564**	**624**	**821**

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

Stress test and scenario analyses

An additional measure of market risk, supplementing the measurement of value at risk, is a stress test which shows a hypothetical change in the current valuation of the Bank's portfolio, that would take place as a result of risk factors (foreign exchange rates, interest rates, credit spreads) assuming the defined extreme values within a one-day time horizon. The Bank makes use of standard and expanded scenarios of big changes in the values of risk factors. As at 31 December 2017, the risk amount arising from an expanded scenario was PLN 22 298 thousand, whereas the average risk amount for this scenario in the period from 1 January 2017 to 31 December 2017 was PLN 17 379 thousand.

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

Stress test	31.12.2017				31.12.2016			
	Total	Interest rate risk	Currency risk	Credit spread risk	Total	Interest rate risk	Currency risk	Credit spread risk
Amount of risk in PLN '000	(22 298)	(3 993)	(198)	(18 107)	(18 573)	(3 948)	63	(14 688)

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

for 2017 (in PLN thousand)

3.5. Currency risk

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

The Bank is exposed to currency risk to a small degree, as it does not maintain significant currency mismatch of assets and liabilities (currency positions) through adaptation of currency structure of conducted lending action and sources of refinancing as well as closing of open currency positions with derivative contracts (Note 20). The risk of influence of changes of exchange rates to the financial result of the Bank is limited, and existing in the Bank procedures for control and reporting significantly eliminate possibility of its arising. In the scope of currency risk management, the Bank assesses the scale and structure of currency risk only on the basis of current currency position of the Bank. Monitoring also covers currency position including expected repayments and payment of loans that influence currency risk. The Bank manages currency position by performing currency purchase/sale transactions with immediate or future terms and by concluding transaction of the SWAP type.

The following table presents exposures of the Bank to currency risk as at 31 December 2017 and 31 December 2016. The table presents assets and liabilities of the Bank according to balance sheet amount broken down by particular currencies of transactions.

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

31.12.2016	PLN	EUR	USD	Total
Assets				
Cash and balances with the central bank	5 530	-	-	**5 530**
Amounts due from other banks	138	15 862	262	**16 262**
Derivative financial instruments	3 775	41 385	-	**45 160**
Loans and advances to customers	5 932 185	3 398 031	81 289	**9 411 505**
Investment securities available for sale	1 134 049	-	-	**1 134 049**
Intangible assets	13 357	-	-	**13 357**
Tangible fixed assets	7 603	-	-	**7 603**
Deferred income tax assets	8 644	-	-	**8 644**
Other assets	7 210	179	-	**7 389**
TOTAL ASSETS	**7 112 491**	**3 455 457**	**81 551**	**10 649 499**
Liabilities				
Amounts due to other banks	2 693 714	623 103	-	**3 316 817**
Derivative financial instruments	9 459	176	-	**9 635**
Amounts due to customers	26 942	9 293	159	**36 394**
Debt securities in issue	4 089 448	2 063 323	-	**6 152 771**
Subordinated liabilities	200 484	-	-	**200 484**
Current income tax liabilities	2 791	-	-	**2 791**
Other liabilities and provisions	25 140	1 768	-	**26 908**
TOTAL LIABILITIES	**7 047 978**	**2 697 663**	**159**	**9 745 800**
Net balance sheet position	**64 513**	**757 794**	**81 392**	**903 699**
Loan commitments	**991 540**	**278 381**	**-**	**1 269 921**

3.6. Interest rate risk

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

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

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

EaR (in PLN '000)	31.12.2017	31.12.2016
for items expressed in PLN	7 061	5 732
for items expressed in USD	8	3
for items expressed in EUR	99	772

When calculating those values it was assumed that the structure of assets and liabilities recognised in financial statements as at 31 December 2017 and as at 31 December 2016 will not change in the course of next year and that the Bank will not take any action in order to change exposure at risk.

Maintaining of interest rate risk level in 2017 on similar level as in 2016 is a result of current adjustment of revaluation terms of granted loans and corresponding financing sources. Additionally, the Bank concludes hedging transaction of IRS type in order to limit interest rate risk.

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

for 2017 (in PLN thousand)

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

31.12.2016	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Non-interest rate items	Total
Assets							
Cash and balances with the central bank	5 530	-	-	-	-	-	**5 530**
Amounts due from other banks	16 262	-	-	-	-	-	**16 262**
Derivative financial instruments	411	30 721	14 028	-	-	-	**45 160**
Loans and advances to customers	2 236 766	5 818 399	1 356 190	150	-	-	**9 411 505**
Investment securities available for sale	715 666		124 853	293 530	-	-	**1 134 049**
TOTAL ASSETS	**2 974 635**	**5 849 120**	**1 495 071**	**293 680**	**-**	**-**	**10 612 506**
Liabilities							
Amounts due to other banks	933 031	2 162 460	221 326	-	-	-	**3 316 817**
Derivative financial instruments	2 890	3 166	3 579	-	-	-	**9 635**
Amounts due to customers	3	-	-	-	-	36 391	**36 394**
Debt securities in issue	1 451 257	2 550 273	1 236 169	373 935	541 137	-	**6 152 771**
Subordinated liabilities	-	200 484	-	-	-	-	**200 484**
TOTAL LIABILITIES	**2 387 181**	**4 916 383**	**1 461 074**	**373 935**	**541 137**	**36 391**	**9 716 101**
Balance sheet gap	**587 454**	**932 737**	**33 997**	**(80 255)**	**(541 137)**	**(36 391)**	**896 405**

3.7. Liquidity risk

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

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

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

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

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

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

In 2017 and 2016, the Bank monitored all liquidity measures specified in the resolution of PFSA 386/2008 dated 17 December 2008:

- M1 - short-term liquidity gap,

for 2017 (in PLN thousand)

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

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

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

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

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

In 2017 the LCR measure remained on safe level.

The table below presents values of liquidity measures M1- M4 as at 31 December 2016 and their average, minimum and maximum values:

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

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

In 2017 and 2016 no exceeding of liabilities limit and any form of liquidity took place.

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

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

for 2017 (in PLN thousand)

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

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

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

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

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

3.7.2. Cash flows from transactions in derivative financial instruments

Derivative financial instruments settled in net amounts

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

The following table presents derivative financial liabilities of the Bank which will be settled on the net basis, broken down by particular maturity dates as at balance sheet date. The amount in foreign currencies has been converted to PLN according to average exchange rate of NBP from balance sheet date. Amounts recognised in the table are not discounted contractual cash outflows.

31.12.2017

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

for 2017 (in PLN thousand)

31.12.2016

Derivative financial instruments to be settled on a net basis	within 1 month	from 1 to 3 months	from 3 months to 1 year	from 1 to 5 years	over 5 years	Total
Interest rates swaps (IRS)	-	2 384	5 635	23 250	1 391	**32 660**
Total net valuation	**-**	**2 384**	**5 635**	**23 250**	**1 391**	**32 660**

Derivative financial instruments settled in gross amounts

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

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

31.12.2017

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

31.12.2016

Derivative financial instruments to be settled on a gross basis	within 1 month	from 1 to 3 months	from 3 months to 1 year	Total
Currency SWAP contracts:				
- outflows	152 882	413 898	295 552	**862 332**
- inflows	150 516	414 197	295 152	**859 865**

4. Fair value of financial assets and liabilities

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

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

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

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

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

Loans and advances to banks

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

Receivables due to loans and advances granted to clients

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

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

Investment securities available for sale

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

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

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

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

Financial instruments representing liabilities are:

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

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

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

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

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

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

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

for 2017 (in PLN thousand)

Financial assets and liabilities	31.12.2017		31.12.2016	
	Carrying value	Fair value	Carrying value	Fair value
Financial assets				
Cash and balances with the central bank	**1 351**	**1 351**	**5 530**	**5 530**
Amounts due from other banks	**18 737**	**18 737**	**16 262**	**16 262**
Loans and advances to customers, including:	**10 766 911**	**11 198 379**	**9 411 505**	**9 727 512**
Corporate customers	4 763 831	4 858 893	4 867 619	4 975 144
Individual customers	5 878 253	6 210 737	4 403 438	4 607 345
Public sector customers	124 827	128 749	140 448	145 023
Total financial assets	**10 786 999**	**11 218 467**	**9 433 297**	**9 749 304**
Financial liabilities				
Amounts due to other banks	**3 830 026**	**3 830 026**	**3 316 817**	**3 316 817**
Amounts due to customers, including:	**4 131**	**4 131**	**36 394**	**36 394**
Corporate customers	3 950	3 950	36 227	36 227
Individual customers	145	145	132	132
Public sector customers	36	36	35	35
Debt securities in issue	**7 043 125**	**7 090 832**	**6 152 771**	**6 185 089**
Subordinated liabilities	**200 484**	**200 484**	**200 484**	**200 484**
Total financial liabilities	**11 077 766**	**11 125 473**	**9 706 466**	**9 738 784**

The table below presents the fair value hierarchy of financial assets and liabilities measured at fair value in accordance with the assumptions described above, exclusively for purposes of disclosure as at 31 December 2017 and 31 December 2016.

31.12.2017	including:	Level 1 Prices quoted in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
VALUATION ONLY FOR PURPOSES OF DISCLOSURE				
Financial assets				
Cash and balances with the central bank	1 351	-	-	1 351
Amounts due from other banks	18 737	-	-	18 737
Loans and advances to customers	11 198 379	-	-	11 198 379
Financial liabilities				
Amounts due to other banks	3 830 026	-	-	3 830 026
Amounts due to customers	4 131	-	-	4 131
Debt securities in issue	7 090 832	-	-	7 090 832
Subordinated liabilities	200 484	-	-	200 484
Total financial assets	**11 218 467**	**-**	**-**	**11 218 467**
Total financial liabilities	**11 125 473**	**-**	**-**	**11 125 473**

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

The following table presents the hierarchy of fair values of financial assets and liabilities recognised in the statement of financial position of the Bank according to their fair values.

for 2017 (in PLN thousand)

Valuation of the instruments in level 2 is conducted based on the model of discounted cash flows using the current interest rates.

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

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

31.12.2016	including:	Level 1 Prices quoted in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS				
Investment securities available for sale, including:	**1 134 049**	**902 587**	**231 462**	**-**
- Treasury bonds	902 587	902 587	-	-
- Money bills	231 462	-	231 462	-
Derivative financial instruments, including:	**45 160**	**-**	**45 160**	**-**
- Interest-bearing instruments	41 997	-	41 997	-
- Foreign exchange instruments	3 163	-	3 163	-
TOTAL FINANCIAL ASSETS	**1 179 209**	**902 587**	**276 622**	**-**

31.12.2016	including:	Level 1 Prices quoted in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
FINANCIAL LIABILITIES				
Derivative financial instruments	**9 635**	**-**	**9 635**	**-**
- Interest-bearing instruments	176	-	176	-
- Foreign exchange instruments	9 459	-	9 459	-
TOTAL FINANCIAL LIABILITIES	**9 635**	**-**	**9 635**	**-**
RECURRING FAIR VALUE MEASUREMENTS				
TOTAL FINANCIAL ASSETS	**1 179 209**	**902 587**	**276 622**	-
TOTAL FINANCIAL LIABILITIES	**9 635**	**-**	**9 635**	-

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

In the reporting period there were no changes of classification of elements of statement of financial position in the fair value hierarchy.

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

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

Impairment of loans and advances

The Bank reviews its loan portfolio in terms of possible impairments at least once per quarter. In order to establish whether the impairment should be reported in the income statement, the Bank assesses whether there are any evidence indicating possible to measure decrease of estimated future cash flows arising from granted loans and advances. If there is objective evidence of impairment of loan, the amount of impairment is calculated as a difference between balance sheet value for a given element of asset and current value of estimated future cash flows (with exclusion of future impairments due to outstanding loans that were no incurred yet), discounted according to original effective interest rate of a given element of financial assets. If the current value of estimated cash flows for the portfolio of loans with recognized individual impairment changed by +/- 10%, the estimated amount of loan impairment would decrease by PLN 16 387 thousand or increase by PLN 17 408 thousand respectively. This estimate was made for a portfolio of loans in the case of which impairment is recognized on the basis of an individual analysis of future cash flows from recoveries from collateral. The principles for measuring impairment are described in Note 3.1.3.

Impairment of non-financial assets - inventories

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

Deferred tax assets

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

Phantom share-based benefits

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

The description of the structure of the Program is presented in Note 42.

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

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

As at 31 December 2017, the value of the provision for variable remuneration amounted to PLN 4 329 thousand; as at 31 December 2016, it amounted to PLN 2 770 thousand.

Fair value of derivatives and other financial instruments

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

Classification for forbearance exposures

In accordance with the Bank's forbearance policy presented under Note 3.1.5, the Bank classifies exposure / customers which are subject to the forbearance policy on the basis of professional judgment.

6. Operating segments

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

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

There are two business lines in the Bank:

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

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

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

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

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

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

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

- for refinancing — loans for refinancing or purchase of existing commercial properties (office buildings, warehouses, shopping centres and malls, logistics centres, hotels, guest houses, commercial premises, etc.), including commercial loans acquired from mBank S.A.,
- to housing developers — loans for the financing of housing development projects (estates with single/multi-family houses for sale or rent),
- loans to commercial developers — loans for the financing of commercial real estate projects that are consistent with the Bank's credit policy.

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

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

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

- to local government units — loans to local government units (municipalities, districts, provinces) as well as loans secured by local government units (commercial companies established by local governments, public health care institutions);
- to natural persons — loans to natural persons granted not in cooperation with mBank S.A. The Bank discontinued the sales in this segment in 2004**.**

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

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

The main purpose of profit and loss segmentation is to present the profitability of each individual segment of Bank's operations as closely as possible. In order to achieve this, the Bank assigns all direct income such as interest income, fee and commission income as well as impairment write-downs at the loan agreement level.

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

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

The Bank calculates the interest and commission expense for loans to local government authorities on the basis of the portion of the average costs of other financing sources, attributable to that segment.

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

Remaining income statement items are divided either by the share of average credit exposure in the year, or share of risk-weighted assets in the case of depreciation and administrative expenses. The Bank does not allocate the income tax charge to individual segments, accordingly the operating segments profit/loss data is presented on profit before income tax level. Data concerning operating segments is measured according to the same principles as those disclosed in the accounting policy.

The division into operating segments is the main and only segmentation of Bank's operations. Taking into consideration the fact that the Bank operates only within the territory of the Republic of Poland, the Bank does not use geographic segmentation.

for 2017 (in PLN thousand)

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

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

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

31.12.2017	Commercial loans	Retail loans	Other loans	Non-allocated assets items	Total
Loans and advances to customers	4 698 808	5 831 507	223 586	13 010	10 766 911
Other assets	-	-	-	1 401 258	1 401 258
Segment assets	4 698 808	5 831 507	223 586	1 414 268	12 168 169

Period from 01.01.2017 to 31.12.2017	Commercial loans	Retail loans	Other loans	Total
Interest income	170 733	207 312	12 029	390 074
Interest expense	(68 244)	(157 017)	(8 804)	(234 065)
Net interest income	**102 489**	**50 295**	**3 225**	**156 009**
Fee and commission income	1 669	144	9	1 822
Fee and commission expenses	(1 541)	(5 931)	(109)	(7 581)
Net impairment write-downs on loans and advances	(17 338)	(1 504)	(1 383)	(20 225)
Amortisation/depreciation and overhead costs, taxes on the Bank balance sheet items	(53 790)	(37 052)	(1 141)	(91 983)
Other income statement items	(1 912)	(1 317)	(40)	(3 269)
Segment result (before tax)	**29 577**	**4 635**	**561**	**34 773**

31.12.2016	Commercial loans	Retail loans	Other loans	Non-allocated assets items	Total
Loans and advances to customers	4 710 560	4 342 849	350 390	7 706	9 411 505
Other assets	-	-	-	1 237 994	1 237 994
Segment assets	4 710 560	4 342 849	350 390	1 245 700	10 649 499

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

for 2017 (in PLN thousand)

7. Net interest income

	Year ended 31 December	
	2017	2016
Interest income		
Loans and advances, including the unwind of discount relating to impairment write-down	343 337	278 632
Investment securities	21 168	18 489
Cash and short-term deposits	990	971
Cash collaterals	78	106
Deposits taken	-	28
Interest income on derivatives classified into banking book	15 328	12 942
Interest income on derivatives concluded under hedge accounting	9 173	7 480
Total interest income	**390 074**	**318 648**
Interest expense		
Due to settlements with banks	(79 564)	(51 124)
Due to the issue of debt securities	(143 761)	(126 076)
Due to subordinated loan	(10 459)	(10 421)
In respect of cash collaterals	(281)	(17)
Due to settlements with customers	-	(869)
Total interest expense	**(234 065)**	**(188 507)**
Total net interest income	**156 009**	**130 141**

Interest income related to impaired financial assets amounted to PLN 7 729 thousand (for the period ended 31 December 2016: PLN 9 056 thousand).

Net interest income by sectors is as follows:

	Year ended 31 December	
	2017	2016
Interest income		
From banking sector	26 473	26 383
From other entities, including:	363 601	292 265
- from corporate customers	156 667	162 378
- from individual customers	185 393	112 373
- from public sector	21 541	17 514
Total interest income	**390 074**	**318 648**

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

	Year ended 31 December	
	2017	2016
Interest expense		
From banking sector	(90 239)	(61 545)
From other entities, including:	(65)	(886)
- from corporate customers	(65)	(869)
From own issuances	(143 761)	(126 076)
Total interest expense	**(234 065)**	**(188 507)**

for 2017 (in PLN thousand)

8. Net fee and commission income

	Year ended 31 December	
	2017	**2016**
Fee and commission income		
Credit-related fees and commissions	1 822	6 365
Commissions from bank accounts	-	321
Commissions from money transfers	-	36
Total fee and commission income	**1 822**	**6 722**
Fee and commission expenses		
Cost of servicing loan products	(3 177)	(2 091)
Costs related to the debt securities issue program (covered bonds and bonds)	(1 899)	(726)
Commission expense from loan received and stand-by credit line	(1 330)	(310)
Costs of real estate analyses and valuations related to the lending activity	(369)	(1 620)
Commissions from money transfers and bank accounts	(115)	(109)
Other	(691)	(340)
Total fee and commission expense	**(7 581)**	**(5 196)**
Total net fee and commission income	**(5 759)**	**1 526**

9. Net trading income

	Year ended 31 December	
	2017	**2016**
Foreign exchange result	**(3 332)**	**4 240**
Net exchange differences on translation	(25 891)	11 783
Valuation of foreign currency derivatives	22 559	(7 543)
Other net trading income and result on hedge accounting	**(53)**	**(2 504)**
Interest rate risk instruments	1 263	(2 181)
Hedge accounting, including:	(1 316)	(323)
- net profit on hedged items	11 496	(7 775)
- net profit on hedging instruments	(12 812)	7 452
Total net trading income	**(3 385)**	**1 736**

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

for 2017 (in PLN thousand)

10. Other operating income

	Year ended 31 December	
	2017	**2016**
Income from sales of services	613	849
Income from release of prior year provisions	225	337
Income from recovering receivables designated previously as prescribed, remitted or uncollectible	23	20
Impairment write-downs on receivables (excluding loans)	7	899
The refund of VAT recognized in prior year costs	5	559
Refund the overpayment to cover the cost of banking supervision	-	177
Income from the release of the provisions for future liabilities	-	55
Income from sales or liquidation of tangible fixed assets and intangible assets	-	14
Compensations, penalties and fines recived	-	7
Other	259	199
Total other operating income	**1 132**	**3 116**

11. Net impairment write-downs on loans and advances

	Year ended 31 December	
	2017	**2016**
Net write-downs on loans and advances to customers (Note 21)	(20 218)	(21 552)
Net write-downs for contingent liabilities towards customers	(7)	(36)
Net impairment write-downs on loans and advances	**(20 225)**	**(21 588)**

12. Overhead costs

	2017	**2016**
Staff-related costs	(34 009)	(34 339)
Material costs, including:	(23 306)	(22 662)
- logistic cost	(8 997)	(8 331)
- IT cost	(6 789)	(5 430)
- marketing cost	(4 423)	(5 256)
- consulting services cost	(2 437)	(2 790)
- other material cost	(660)	(855)
Contribution and payments to the Bank Guarantee Fund	(5 152)	(3 572)
Taxes and fees	(1 643)	(1 654)
Reserve on Borrowers Support Fund	-	(10)
Contributions to the Social Benefits Fund	(251)	(235)
Total overhead costs	**(64 361)**	**(62 472)**

The amount "Logistic cost" consists of the property rent costs and leasing of the means of transport equals to PLN 4 003 thousand (2016: PLN 3 706 thousand).

for 2017 (in PLN thousand)

Staff costs

	Year ended 31 December	
	2017	2016
Wages and salaries	(27 400)	(26 507)
Social security expenses	(4 395)	(4 279)
Costs of retirement benefits	(12)	(11)
Provision for holiday equivalents	(22)	(218)
Provisions for payment in the form of phantom shares settled in cash	(1 003)	(2 185)
Other employee benefits	(1 177)	(1 139)
Staff-related costs, total	**(34 009)**	**(34 339)**

In 2017 average level of employment in the Bank was 208 persons (2016: 227 persons).

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

13. Other operating expenses

	Year ended 31 December	
	2017	2016
Write off of intangible assets under development	(308)	-
Costs of enforcement proceedings	(515)	(199)
Loss on sales or liquidation of tangible fixed assets	(152)	-
Loss on the sales of assets repossessed for debts (inventories) and costs of their maintenance	(5)	(411)
Donations	(4)	-
Compensations, penalties and fines paid	(3)	(20)
Cost of real estate valuation	(3)	(9)
Inventory write-downs	-	(1 717)
Other	(99)	(47)
Total other operating expenses	**(1 089)**	**(2 403)**

Financial Statements According to the International Financial Reporting Standards for 2017 (in PLN thousand)

14. Income tax expense

	Year ended 31 December	
	2017	**2016**
Current income tax	(10 032)	(7 719)
Deferred income tax (Note 31)	3 088	962
Total income tax	**(6 944)**	**(6 757)**

Profit before tax	**34 773**	**30 179**
Income tax calculated at the rate applicable in a given fiscal year (19%)	(6 607)	(5 734)
Non-taxable income	7 422	5 908
- reclassification of qualified income to impairment interest (change in PAS reporting regulations)	6 353	-
- unrecoverable receivables write-off	498	1 032
- loan loss provisions from prior year recognised as tax assets	476	4 822
- other non-taxable income	95	54
Non-deductible tax costs, including:	(8 481)	(7 227)
- tax on the Bank's balance sheet items	(4 643)	(3 171)
- value of write-downs on receivables	(2 726)	(3 689)
- contribution and payments to the Bank Guarantee Fund	(979)	(216)
- other	(133)	(151)
Adjustments in respect of current tax from prior years	722	296
Total income tax expense	**(6 944)**	**(6 757)**

Effective tax rate calculation		
Profit before income tax	34 773	30 179
Income tax	(6 944)	(6 757)
Effective tax rate	**19.97%**	**22.39%**
Nominal tax rate	**19.00%**	**19.00%**

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

15. Earnings per share

	Year ended 31 December	
	2017	**2016**
Basic:		
Net profit from activities attributable to shareholders of mBank Hipoteczny S.A.	27 829	23 422
Weighted average number of ordinary shares	3 191 260	3 042 186
Basic net profit per share (in PLN per share)	**8.72**	**7.70**
Diluted:		
Net profit attributable to shareholders of mBank Hipoteczny S.A., applied during the estimation of diluted earnings per share	27 829	23 422
Weighted average number of ordinary shares	3 191 260	3 042 186
Diluted earnings per share (in PLN per share)	**8.72**	**7.70**

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

for 2017 (in PLN thousand)

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

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

16. Other comprehensive incomes

The table below presents detailed information concerning other comprehensive income for the years 2017 and 2016

	Year ended 31 December	
	2017	**2016**
Items that may be reclassified to the income statement, including:	**4 966**	**(1 993)**
Available-for-sale financial assets:	**4 966**	**(1 993)**
Unrealised gains on debt instruments recognised in the financial year (net)	4 966	-
Unrealised losses on debt instruments recognised in the financial year (net)	-	(1 993)
Items that will not be reclassified to the income statement, including:	**(20)**	**(2)**
Actuarial gains and losses on post-employment benefits	**(20)**	**(2)**
Actuarial losses	(20)	(2)
Total other comprehensive income, net	**4 946**	**(1 995)**

17. Cash and balances with central bank

The Bank has a current account in the Polish National Bank (NBP) which balance as at 31 December 2017 amounted to PLN 1 351 thousand. As at 31 December 2016, the funds of the Bank on this current account amounted to PLN 5 530 thousand. On the basis of the Act on the National Bank of Poland of 29 August 1997, mBank Hipoteczny S.A. hold a mandatory reserve deposit. The arithmetic mean of daily balances of the mandatory reserve which the Bank was obliged to maintain during a given period in the current account with NBP amounted to:

- PLN 0 thousand for the period from 30 November 2017 to 1 January 2018,
- PLN 2 965 thousand for the period from 30 November 2016 to 1 January 2017.

The interest rate on the funds maintained as a mandatory reserve amounted to 1.35% both as at 31 December 2017 and as at 31 December 2016.

18. Amounts due from other banks

	31.12.2017	**31.12.2016**
Current accounts	18 737	16 258
Other receivables	-	4
Recognised in cash equivalents	**18 737**	**16 262**
Amounts (gross) due from other banks, in total	**18 737**	**16 262**
Amounts (net) due from other banks, in total	**18 737**	**16 262**
Short-term amounts due from other banks (up to 1 year)	18 737	16 262

Amounts due from other banks	31.12.2017		31.12.2016	
	exposure (PLN '000)	share/coverage (%)	exposure (PLN '000)	share/coverage (%)
Not overdue, without impairment recognised	18 737	100.00	16 262	100.00
Total gross	**18 737**	**100.00**	**16 262**	**100.00**
Total net	**18 737**	**100.00**	**16 262**	**100.00**

All receivables were receivables from Polish banks.

19. Derivative financial instruments

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

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

for 2017 (in PLN thousand)

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

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

20. Hedge accounting

The Bank applies fair value hedge accounting. The only type of risk hedged in the scope of hedge accounting is the risk of change of interest rates. Result from valuation of hedged item and hedge instruments is presented in the following tables. Collateral is regularly assessed and its high efficiency can be stated. The Bank documents its own assessment of the effectiveness of fair value hedging transactions, measured both prospectively and retrospectively from the time of their designation and throughout the period of duration of the hedging relationship between the hedging instrument and the hedged item.

Description of the hedging relation

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

Hedged items

Mortgage covered bonds of nominal value of EUR 296 900 thousand with fixed interest rates are hedged items.

Hedging instruments

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

Presentation of the result from hedged and hedging transactions

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

The following table presents hedged items as at 31 December 2017. In the following table the nominal value is presented in EUR thousand, while the carrying amount and hedge accounting adjustments related to fair value of hedge items and changes to fair value due to hedging accounting in PLN thousand.

Debt financial instruments by type	Nominal value	Interest rate as at 31.12.2017	Redemption date	Liability amount measured at amortised cost	Hedge accounting adjustments related to fair value of hedged items	Change of fair value due to hedge acounting
Mortgage covered bonds (EUR)	30 000	2.75%	2020-07-28	125 615	3 556	1 664
Mortgage covered bonds (EUR)	8 000	3.50%	2029-02-28	33 773	3 940	1 118
Mortgage covered bonds (EUR)	15 000	3.50%	2029-03-15	63 363	7 416	2 100
Mortgage covered bonds (EUR)	20 000	3.20%	2029-05-30	83 638	9 716	2 737
Mortgage covered bonds (EUR)	20 000	1.12%	2018-10-22	83 503	374	358
Mortgage covered bonds (EUR)	20 000	1.14%	2022-02-25	83 663	996	754
Mortgage covered bonds (EUR)	11 000	1.29%	2025-04-24	45 988	(409)	411
Mortgage covered bonds (EUR)	35 000	1.18%	2026-09-20	145 920	(5 006)	1 566
Mortgage covered bonds (EUR)	13 000	1.18%	2026-09-20	54 179	(2 468)	482
Mortgage covered bonds (EUR)	24 900	0.94%	2024-02-01	104 470	139	(139)
Mortgage covered bonds (EUR)	100 000	0.61%	2022-06-22	416 505	(445)	445
Total hedged items				**1 240 617**	**17 809**	**11 496**

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

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

The following table presents hedging items as at 31 December 2017. In the following table the nominal value is presented in EUR thousand, while the fair value and change of fair value due to hedge accounting in PLN thousand.

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

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

Derivatives	Nominal value	End of transaction	Fair value of asset	Fair value of liabilities	Change of fair value due to hedge acounting
IRS (EUR)	30 000	2020-07-28	8 498	-	(315)
IRS (EUR)	8 000	2029-02-28	6 454	-	1 820
IRS (EUR)	15 000	2029-03-15	11 804	-	3 434
IRS (EUR)	20 000	2029-05-30	12 268	-	4 714
IRS (EUR)	20 000	2018-10-22	761	-	202
IRS (EUR)	20 000	2022-02-25	1 600	-	1 789
IRS (EUR)	11 000	2025-04-24	-	70	1 979
IRS (EUR)	13 000	2026-09-20	-	2 274	(2 135)
IRS (EUR)	35 000	2026-09-20	-	4 373	(4 036)
Total hedging items			**41 385**	**6 717**	**7 452**

The total results of fair value hedge accounting recognised in the income statement in 2017 and 2016

	Year ended 31 December	
	2017	2016
Interest income on derivatives concluded under hedge accounting of fair value (Note 7)	9 173	7 480
Net profit on hedged items (Note 9)	11 496	(7 775)
Net profit on hedging instruments (Note 9)	(12 812)	7 452
Total net profit on hedge accounting of fair value	**7 857**	**7 157**

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

21. Loans and advances to customers

	31.12.2017	31.12.2016
Loans and advances to corporate customers	**4 857 610**	**4 957 222**
Loans and advances to individual ccustomers	**5 885 170**	**4 407 440**
Loans and advances to the public sector	**124 865**	**140 490**
Other receivables	**13 010**	**7 706**
Loans and advances from customers (gross)	**10 880 655**	**9 512 858**
Write-downs on receivables (negative amount)	(113 744)	(101 353)
Loans and advances from customers (net)	**10 766 911**	**9 411 505**
Short-term (up to 1 year)	708 128	683 724
Long-term (over 1 year)	10 058 783	8 727 781

As at 31 December 2017, the gross balance sheet value of loans granted to corporate and individual clients as well as for the public sector in the Bank’s loan portfolio amounted to PLN 10 867 627 thousand on the basis of variable interest rate, and PLN 18 thousand on the basis of fixed interest rate. As at 31 December 2016, on the basis of variable interest rate the gross balance sheet value amounted to PLN 9 505 133 thousand, and PLN 19 thousand on the basis of fixed interest rate.

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

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

- as at 31 December 2017 – PLN 4 768 415 thousand,

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

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

- as at 31 December 2017 – PLN 1 066 556 thousand,
- as at 31 December 2016 – PLN 261 375 thousand.

Impairment write-downs on loans and advances

	31.12.2017	31.12.2016
Incurred but not identified losses		
Gross balance sheet exposure	10 599 531	9 199 935
Impairment write-downs on exposures analysed on a portfolio basis	(12 521)	(9 775)
Net balance sheet exposure	**10 587 010**	**9 190 160**
Impaired receivables		
Loans to corporate customers	270 587	304 605
Loans to individual customers	10 537	8 318
Total gross balance sheet exposure	**281 124**	**312 923**
Impairment write-down on impaired exposures	(101 223)	(91 578)
Net balance sheet exposure	**179 901**	**221 345**

Movements in impairment write-downs on loans and advances

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

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

Loans and advances to customers by portfolio quality

Loans and advances to customers	31.12.2017		31.12.2016	
	exposure (PLN '000)	share/coverage (%)	exposure (PLN '000)	share/coverage (%)
Not overdue, without impairment recognised	10 282 981	94.51	8 987 247	94.47
Overdue, without impairment recognised	316 550	2.91	212 688	2.24
Items with impairment recognised	281 124	2.58	312 923	3.29
Total gross	**10 880 655**	**100.00**	**9 512 858**	**100.00**
Impairment write-down on loans not overdue, without impairment recognised	(11 462)	0.11	(9 280)	0.10
Impairment write-down on loans overdue, without impairment recognised	(1 059)	0.01	(495)	0.01
Impairment write-down on loans with impairment recognised	(101 223)	0.93	(91 578)	0.96
Total impairment write-down	**(113 744)**	**1.05**	**(101 353)**	**1.07**
Total net	**10 766 911**	**98.95**	**9 411 505**	**98.93**

for 2017 (in PLN thousand)

Loans and advances not past due and not impaired

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

	score from internal models		31.12.2017	31.12.2016
	[SCOREmin	SCOREmax)		
Exposures permanently exempted from the IRB approach	no rating	no rating	292 053	437 400
Exposures temporarily exempted from the IRB approach — retail portfolio acquired in cooperation with mBank S.A.	-	-	5 748 533	4 302 793
Exposures subject to the IRB approach — specialised lending, including	-	-	4 242 395	4 247 054
- supervisory category 1	45	54	2 666	2 244
- supervisory category 2	23	45	4 031 208	4 071 392
- supervisory category 3	11	23	191 068	133 811
- supervisory category 4	1	11	-	1 328
- supervisory category 5	default	default	17 453	38 279
Total			**10 282 981**	**8 987 247**

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

On the basis of the annual review of the transfer function, on 25 May 2017, the Bank decided not to introduce any changes to the current transfer map. The review was conducted on the basis of an updated sample and analyses carried out as part of the transfer function review showed stability and no necessity to change the transfer map.

According to the original version of the gradual implementation plan, the IRB approach was to be applied to exposures in respect of specialized financing in the business portfolio. However, as a result of executing its business strategy and an expected significant increase in the share of retail exposures in the Bank's total assets, on 10 December 2013, the Bank adopted an internal resolution amending the scope of implementation of the IRB approach, and on 12 December 2013, the Bank notified the PFSA that it would expand the plan of gradual implementation of the IRB approach to the retail portfolio acquired in cooperation with mBank S.A.

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

A substantial part of the recommendations identified during the inspection was addressed by the Bank in 2017, however the mBank Group intends to fulfil all the expectations of the supervision authority in 2018, which shall result in the submission in 2018 of the final Request for the application of the statistical methods for calculating the capital requirements for the credit risk for the retail portfolio acquired within the scope of the cooperation with mBank S.A.

for 2017 (in PLN thousand)

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

	31.12.2017	31.12.2016
Corporate customers	4 355 114	4 481 989
Individual customers	5 790 936	4 357 974
Public sector customers	123 921	139 578
Other receivables	13 010	7 706
Total	**10 282 981**	**8 987 247**

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

	31.12.2017	31.12.2016
Loans and advances with limited credit risk	213 513	256 407
Loans and advances with standard credit risk	10 049 699	8 692 383
Loans and advances with increased credit risk	19 769	38 457
Total	**10 282 981**	**8 987 247**

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

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

Loans and advances past due but not impaired

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

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

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

for 2017 (in PLN thousand)

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

Loans and advances impaired

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

Loans and advances impaired	Corporate customers	Individual customers	Total customers
31.12.2017			
Impaired loans and advances (gross amount)	270 587	10 537	281 124
Estimated recovery from contributions and collaterals	**174 075**	**6 072**	**180 147**
Impairment write-downs	**(96 758)**	**(4 465)**	**(101 223)**
The mortgage lending value of the property constituting collateral for loans	**381 436**	**20 954**	**402 390**
31.12.2016			
Impaired loans and advances (gross amount)	304 605	8 318	312 923
Estimated recovery from contributions and collaterals	**215 150**	**5 926**	**221 076**
Impairment write-downs	**(89 185)**	**(2 393)**	**(91 578)**
The mortgage lending value of the property constituting collateral for loans	**426 670**	**18 861**	**445 531**

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

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

Financial effect of collaterals

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

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

for 2017 (in PLN thousand)

As at 31 December 2016	Gross amount	Established impairment write-downs	Impairment write-downs without the collateral cash flows	Financial effect of collaterals
Balance sheet data				
Amounts due from other banks	**16 262**	**-**	**-**	**-**
Loans and advances to customers, including:	**9 512 858**	**(101 353)**	**(252 123)**	**150 770**
Corporate customers	4 957 222	(97 309)	(240 481)	143 172
Individual customers	4 407 440	(4 002)	(11 600)	7 598
Public sector customers	140 490	(42)	(42)	-
Other receivables	7 706	-	-	-
Total balance sheet data	**9 529 120**	**(101 353)**	**(252 123)**	**150 770**
Off-balance sheet data				
Loan commitments	1 269 921	(54)	(67)	13
Total off-balance sheet data	**1 269 921**	**(54)**	**(67)**	**13**

22. Investment securities

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

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

for 2017 (in PLN thousand)

Movements in investment securities

	31.12.2017	31.12.2016
As at the beginning of the period	**1 134 049**	**748 505**
Additions	10 486 331	18 243 642
Disposals (sale, redemption and forfeiture)	(10 349 384)	(17 855 637)
Gains / losses from changes in fair value	6 131	(2 461)
As at the end of the period	**1 277 127**	**1 134 049**

23. Intangible assets

	31.12.2017	31.12.2016
Concessions, patents, licences and similar assets, including:	5 882	4 842
- computer software	5 882	4 842
Intangible assets under development	19 645	8 515
Intangible assets, total	**25 527**	**13 357**

Movements in intangible assets

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

for 2017 (in PLN thousand)

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

24. Tangible fixed assets

	31.12.2017	31.12.2016
Technical equipment and machinery	5 714	5 653
Vehicles	8	116
Fixed assets under construction	501	679
Other fixed assets	2 072	1 155
Tangible fixed assets, total	**8 295**	**7 603**

Movements in tangible fixed assets

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

for 2017 (in PLN thousand)

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

25. Other assets

	31.12.2017	31.12.2016
Other, including:	**10 676**	**7 389**
- inventories	3 432	3 432
- receivables from agency model valuation	3 210	1 431
- other prepayments	3 150	1 255
- debtors	448	822
- income receivable	410	410
- other	26	39
Total other assets	**10 676**	**7 389**
Short-term (up to 1 year)	10 676	7 389

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

26. Amounts due to other banks

	31.12.2017	31.12.2016
Loans received	3 779 572	2 979 842
Liabilities in respect of cash collateral	50 454	25 544
Other financial liabilities with deferred payment term	-	311 431
Total amounts due to other banks	**3 830 026**	**3 316 817**
Short-term (up to 1 year)	350 931	725 401
Long-term (over 1 year)	3 479 095	2 591 416

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

for 2017 (in PLN thousand)

All received loans are based on variable interest rate.

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

27. Amounts due to customers

	31.12.2017	31.12.2016
Corporate customers:	**3 950**	**36 227**
Other liabilities (in respect of):	3 950	36 227
- cash collateral	446	747
- other	3 504	35 480
Individual customers:	**145**	**132**
Other liabilities (in respect of):	145	132
- cash collateral	65	65
- other	80	67
Public sector clients:	**36**	**35**
Other liabilities (in respect of):	36	35
- other	36	35
Total amounts due to customers	**4 131**	**36 394**
Short-term (up to 1 year)	3 696	35 585
Long-term (over 1 year)	435	809

On October 9, 2016 came into force the law of 10 June 2016 on the Bank Guarantee Fund, the deposit guarantee system and a forced restructuring, which amended the law on mortgage bonds and mortgage banks in a way that results in the inability of mortgage banks to run bank accounts used for processing investment projects implemented using loans granted and accepting term deposits by mortgage banks. Accordingly, the Bank's Management Board on 12 July 2016 with Resolution No. 85/2016 decided to transfer existing customer service bank in the conduct of accounts, proprietary and closed escrow accounts to mBank by common offering customers products of mBank S.A. meet the requirements set functionality. In December 2016 on the basis of the decision of the Chairman of the Management Board remaining, not transferred to escrow accounts, have been closed.

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

28. Debt securities in issue

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

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

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

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

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

for 2017 (in PLN thousand)

Principles for the statutory over-collateralisation of covered bonds

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

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

Principles for refinancing loans with means originating from issuance of covered bonds

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

The tables below show data related to the issuance of covered bonds as of 31 December 2017 and as of 31 December 2016.

	31.12.2017	31.12.2016	
	Mortgage covered bonds	Mortgage covered bonds	Public sector covered bonds
1. Nominal value of covered bonds listed on the market	6 438 802	5 267 828	-
2. The nominal value of receivables entered in the collateral register of covered bonds underlying the issue of covered bonds (value on not matured capital)	8 591 745	7 297 062	322 753
3. Cash in Bank, as a treasury bonds, entered in the collateral register of covered bonds additionaly underlying the issue of covered bonds (Substitute collateral)	106 620	33 465	-
4. Level of collateral the covered bonds by receivables (2/1)	133.44%	138.52%	-
5. Total covered bonds collateral level (2+3) / 1	135.09%	139.16%	-
6. The value of receivables as collateral issue of mortgage covered bonds to the part which not exceeding 60% of the mortgage lending value of real estate for commercial real estate	3 355 035	3 394 475	-
7. The value of receivables as collateral issue of mortgage covered bonds to the part which not exceeding 80% of the mortgage lending value of real estate for residential property	4 385 960	2 988 910	-

Permissible value of Substitute collateral	31.12.2017	31.12.2016
	Mortgage covered bonds	
1. Cash invested in treasury bonds	180 000	90 000
2. Interests from covered bonds on the market which will be paid in the next 6 months (Surplus)	73 380	56 535
3. Permissible value of Substitute collateral (1-2)	106 620	33 465

The total nominal amount of the covered bonds in trading, both as of 31 December 2017 and as of 31 December 2016 was listed on two markets under CATALYST: The Regulated Market of Securities maintained by BondSpot S.A. and the regulated parallel stock exchange market of Warsaw Stock Exchange.

for 2017 (in PLN thousand)

As at 31.12.2017

Debt financial instruments by type	Nominal value	Interest rate as at 31.12.2017	Guarantee / collateral	Redemption date	Liability amount measured at amortised cost	Hedge accounting adjustments related to fair value of hedged items	Carrying amount of liability
Long-term issues (with original maturity of over 1 year)							
Mortgage covered bonds (PLN)	200 000	3.50%	Mortgage covered bonds register	2018-06-15	200 260	-	200 260
Mortgage covered bonds (PLN)	80 000	2.81%	Mortgage covered bonds register	2019-06-21	80 038	-	80 038
Mortgage covered bonds (EUR)	30 000	2.75%	Mortgage covered bonds register	2020-07-28	125 615	3 556	129 171
Mortgage covered bonds (EUR)	50 000	0.80%	Mortgage covered bonds register	2018-10-22	208 768	-	208 768
Mortgage covered bonds (EUR)	7 500	0.53%	Mortgage covered bonds register	2018-02-15	31 339	-	31 339
Mortgage covered bonds (EUR)	8 000	3.50%	Mortgage covered bonds register	2029-02-28	33 773	3 940	37 713
Mortgage covered bonds (EUR)	15 000	3.50%	Mortgage covered bonds register	2029-03-15	63 363	7 416	70 779
Mortgage covered bonds (EUR)	20 000	3.20%	Mortgage covered bonds register	2029-05-30	83 638	9 716	93 354
Mortgage covered bonds (PLN)	300 000	2.74%	Mortgage covered bonds register	2022-07-28	302 696	-	302 696
Mortgage covered bonds (PLN)	200 000	2.74%	Mortgage covered bonds register	2023-02-20	201 366	-	201 366
Mortgage covered bonds (EUR)	20 000	1.12%	Mortgage covered bonds register	2018-10-22	83 503	374	83 877
Mortgage covered bonds (EUR)	50 000	0.54%	Mortgage covered bonds register	2019-10-15	208 566	-	208 566
Mortgage covered bonds (PLN)	200 000	2.59%	Mortgage covered bonds register	2022-04-28	200 369	-	200 369
Mortgage covered bonds (EUR)	20 000	1.14%	Mortgage covered bonds register	2022-02-25	83 663	996	84 659
Mortgage covered bonds (PLN)	250 000	2.68%	Mortgage covered bonds register	2023-10-16	250 533	-	250 533
Mortgage covered bonds (EUR)	11 000	1.29%	Mortgage covered bonds register	2025-04-24	45 988	(409)	45 579
Mortgage covered bonds (EUR)	50 000	0.36%	Mortgage covered bonds register	2020-06-24	208 248	-	208 248
Mortgage covered bonds (PLN)	500 000	2.83%	Mortgage covered bonds register	2020-09-10	499 997	-	499 997
Mortgage covered bonds (PLN)	255 000	2.87%	Mortgage covered bonds register	2021-09-20	254 668	-	254 668
Mortgage covered bonds (PLN)	300 000	2.93%	Mortgage covered bonds register	2021-03-05	300 076	-	300 076
Mortgage covered bonds (EUR)	50 000	0.54%	Mortgage covered bonds register	2021-06-21	208 147	-	208 147
Mortgage covered bonds (PLN)	50 000	2.91%	Mortgage covered bonds register	2020-04-28	50 909	-	50 909
Mortgage covered bonds (PLN)	100 000	2.91%	Mortgage covered bonds register	2020-04-28	101 824	-	101 824
Mortgage covered bonds (EUR)	35 000	1.18%	Mortgage covered bonds register	2026-09-20	145 920	(5 006)	140 914
Mortgage covered bonds (EUR)	13 000	1.18%	Mortgage covered bonds register	2026-09-20	54 179	(2 468)	51 711
Mortgage covered bonds (EUR)	24 900	0.94%	Mortgage covered bonds register	2024-02-01	104 470	139	104 609
Mortgage covered bonds (PLN)	400 000	2.51%	Mortgage covered bonds register	2019-12-16	400 427	-	400 427
Mortgage covered bonds (PLN)	500 000	2.48%	Mortgage covered bonds register	2022-09-10	499 315	-	499 315
Mortgage covered bonds (PLN)	1 000 000	2.54%	Mortgage covered bonds register	2023-09-15	997 814	-	997 814
Mortgage covered bonds (EUR)	100 000	0.61%	Mortgage covered bonds register	2022-06-22	416 505	(445)	416 060
Bonds (PLN)	20 000	3.26%	no collateral	2019-01-16	20 289	-	20 289
Bonds (PLN)	60 000	3.18%	no collateral	2019-01-21	60 347	-	60 347
Short-term issues (with original maturity up to 1 year)							
Bonds (PLN)	81 000	2.28%	no collateral	2018-01-11	80 948	-	80 948
Bonds (PLN)	20 000	2.26%	no collateral	2018-01-10	19 988	-	19 988
Bonds (PLN)	10 000	2.26%	no collateral	2018-01-12	9 993	-	9 993
Bonds (PLN)	15 000	2.26%	no collateral	2018-02-05	14 966	-	14 966
Bonds (PLN)	20 000	2.30%	no collateral	2018-09-04	19 685	-	19 685
Bonds (PLN)	30 000	2.26%	no collateral	2018-03-05	29 880	-	29 880
Bonds (PLN)	88 500	2.15%	no collateral	2018-01-08	88 462	-	88 462
Bonds (PLN)	32 000	2.26%	no collateral	2018-03-08	31 865	-	31 865
Bonds (PLN)	10 000	2.03%	no collateral	2018-01-05	9 998	-	9 998
Bonds (PLN)	20 000	2.11%	no collateral	2018-04-27	19 862	-	19 862
Bonds (PLN)	20 000	2.03%	no collateral	2018-02-09	19 955	-	19 955
Bonds (PLN)	25 000	2.11%	no collateral	2018-05-17	24 798	-	24 798
Bonds (PLN)	50 000	2.11%	no collateral	2018-06-13	49 516	-	49 516
Bonds (PLN)	10 000	2.11%	no collateral	2018-06-13	9 903	-	9 903
Bonds (PLN)	20 000	2.02%	no collateral	2018-03-19	19 912	-	19 912
Bonds (PLN)	40 000	2.02%	no collateral	2018-03-21	39 819	-	39 819
Bonds (PLN)	9 200	2.02%	no collateral	2018-03-28	9 155	-	9 155
Debt securities in issue (carrying value)					**7 025 316**	**17 809**	**7 043 125**

for 2017 (in PLN thousand)

As at 31.12.2016

Debt financial instruments by type	Nominal value	Interest rate as at 31.12.2017	Guarantee / collateral	Redemption date	Liability amount measured at amortised cost	Hedge accounting adjustments related to fair value of hedged items	Carrying amount of liability
Long-term issues (with original maturity of over 1 year)							
Mortgage covered bonds (PLN)	200 000	2.79%	Mortgage covered bonds register	2017-06-16	200 194	-	200 194
Mortgage covered bonds (PLN)	200 000	3.09%	Mortgage covered bonds register	2017-04-20	201 188	-	201 188
Mortgage covered bonds (PLN)	200 000	3.50%	Mortgage covered bonds register	2018-06-15	200 122	-	200 122
Mortgage covered bonds (EUR)	10 000	1.70%	Mortgage covered bonds register	2017-10-19	44 378	-	44 378
Mortgage covered bonds (PLN)	80 000	2.81%	Mortgage covered bonds register	2019-06-21	80 015	-	80 015
Mortgage covered bonds (EUR)	30 000	2.75%	Mortgage covered bonds register	2020-07-28	132 936	5 220	138 156
Mortgage covered bonds (EUR)	50 000	0.82%	Mortgage covered bonds register	2018-10-22	221 338	-	221 338
Mortgage covered bonds (EUR)	7 500	0.61%	Mortgage covered bonds register	2018-02-15	33 202	-	33 202
Mortgage covered bonds (EUR)	8 000	3.50%	Mortgage covered bonds register	2029-02-28	35 816	5 059	40 875
Mortgage covered bonds (EUR)	15 000	3.50%	Mortgage covered bonds register	2029-03-15	67 198	9 516	76 714
Mortgage covered bonds (EUR)	20 000	3.20%	Mortgage covered bonds register	2029-05-30	88 700	12 453	101 153
Mortgage covered bonds (PLN)	300 000	2.72%	Mortgage covered bonds register	2022-07-28	302 501	-	302 501
Mortgage covered bonds (PLN)	200 000	2.72%	Mortgage covered bonds register	2023-02-20	201 224	-	201 224
Mortgage covered bonds (EUR)	20 000	1.12%	Mortgage covered bonds register	2018-10-22	88 459	732	89 191
Mortgage covered bonds (EUR)	50 000	0.56%	Mortgage covered bonds register	2019-10-15	221 119	-	221 119
Mortgage covered bonds (PLN)	200 000	2.58%	Mortgage covered bonds register	2022-04-28	200 281	-	200 281
Mortgage covered bonds (EUR)	20 000	1.14%	Mortgage covered bonds register	2022-02-25	88 653	1 749	90 402
Mortgage covered bonds (PLN)	250 000	2.67%	Mortgage covered bonds register	2023-10-16	250 372	-	250 372
Mortgage covered bonds (EUR)	11 000	1.29%	Mortgage covered bonds register	2025-04-24	48 756	2	48 758
Mortgage covered bonds (EUR)	50 000	0.37%	Mortgage covered bonds register	2020-06-24	220 782	-	220 782
Mortgage covered bonds (PLN)	500 000	2.83%	Mortgage covered bonds register	2020-09-10	499 677	-	499 677
Mortgage covered bonds (PLN)	255 000	2.88%	Mortgage covered bonds register	2021-09-20	254 525	-	254 525
Mortgage covered bonds (PLN)	300 000	2.93%	Mortgage covered bonds register	2021-03-05	299 906	-	299 906
Mortgage covered bonds (EUR)	50 000	0.56%	Mortgage covered bonds register	2021-06-21	220 681	-	220 681
Mortgage covered bonds (PLN)	50 000	2.91%	Mortgage covered bonds register	2020-04-28	50 879	-	50 879
Mortgage covered bonds (PLN)	100 000	2.91%	Mortgage covered bonds register	2020-04-28	101 662	-	101 662
Mortgage covered bonds (EUR)	70 000	1.05%	Mortgage covered bonds register	2019-08-28	309 986	-	309 986
Mortgage covered bonds (EUR)	13 000	1.18%	Mortgage covered bonds register	2026-09-20	57 444	(1 986)	55 458
Mortgage covered bonds (EUR)	35 000	1.18%	Mortgage covered bonds register	2026-09-20	154 570	(3 440)	151 130
Mortgage covered bonds (PLN)	400 000	2.58%	Mortgage covered bonds register	2018-07-25	400 432	-	400 432
Bonds (PLN)	20 000	3.24%	no collateral	2019-01-16	20 275	-	20 275
Bonds (PLN)	60 000	3.17%	no collateral	2019-01-21	60 315	-	60 315
Short-term issues (with original maturity up to 1 year)							
Bonds (PLN)	40 000	2.20%	no collateral	2017-04-20	39 732	-	39 732
Bonds (PLN)	10 000	2.12%	no collateral	2017-01-10	9 995	-	9 995
Bonds (PLN)	86 000	2.09%	no collateral	2017-01-02	85 995	-	85 995
Bonds (PLN)	15 000	2.12%	no collateral	2017-02-03	14 971	-	14 971
Bonds (PLN)	80 000	2.13%	no collateral	2017-02-09	79 813	-	79 813
Bonds (PLN)	100 000	2.10%	no collateral	2017-01-04	99 982	-	99 982
Bonds (PLN)	17 000	2.13%	no collateral	2017-02-16	16 953	-	16 953
Bonds (PLN)	60 000	2.13%	no collateral	2017-03-02	59 784	-	59 784
Bonds (PLN)	200 000	2.13%	no collateral	2017-03-02	199 281	-	199 281
Bonds (PLN)	15 000	2.13%	no collateral	2017-03-13	14 936	-	14 936
Bonds (PLN)	15 000	2.13%	no collateral	2017-03-21	14 929	-	14 929
Bonds (PLN)	10 000	2.04%	no collateral	2017-02-17	9 973	-	9 973
Bonds (PLN)	30 000	2.13%	no collateral	2017-03-24	29 853	-	29 853
Bonds (PLN)	60 000	2.04%	no collateral	2017-02-21	59 824	-	59 824
Bonds (PLN)	20 000	2.15%	no collateral	2017-04-04	19 888	-	19 888
Bonds (PLN)	10 000	2.04%	no collateral	2017-02-21	9 971	-	9 971
Debt securities in issue (carrying value)					**6 123 466**	**29 305**	**6 152 771**

Movements in debt securities in issue

	2017	2016
As at the beginning of the period	**6 152 771**	**4 186 432**
Increase (due to)	5 631 747	5 675 672
- issue	5 487 841	5 465 469
- accured interest, interest non-linearity adjustments, EIR commission	143 768	126 076
- exchange differences	-	70 831
- hedge accounting adjustments related to fair value of hedged items	138	13 296
Decrease (due to)	(4 741 393)	(3 709 333)
- redemption	(4 464 026)	(3 577 700)
- interest repayment, interest non-linearity adjustments, EIR commission,	(144 257)	(126 112)
- exchange differences	(121 476)	-
- hedge accounting adjustments related to fair value of hedged items	(11 634)	(5 521)
As at the end of the period	**7 043 125**	**6 152 771**

Short-term (up to 1 year)	1 047 568	1 249 183
Long-term (over 1 year)	5 995 557	4 903 588

Fixed interest rate debt securities issued	1 909 862	1 710 257
Floating interest rate debt securities issued	5 133 263	4 442 514

29. Subordinated liabilities

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

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

Both as at 31.12.2017 and as at 31.12.2016, subordinated liabilities bore variable interest rates.

for 2017 (in PLN thousand)

Movements in subordinated liabilities

	Year ended 31 December	
	2017	2016
As at the beginning of the period	**200 484**	**200 899**
Increase (due to)	10 459	10 421
- interest on a loan	10 459	10 421
Decrease (due to)	(10 459)	(10 836)
- repayment of interest on a loan	(10 459)	(10 836)
Subordinated liabilities as at the end of the period	**200 484**	**200 484**
Short-term (up to 1 year)	484	484
Long-term (over 1 year)	200 000	200 000

30. Other liabilities and provisions

30.1. Other liabilities

	31.12.2017	31.12.2016
Other liabilities (due to)	**25 568**	**26 748**
- accrued expenses	19 295	20 423
- settlements due to tax from Bank balance sheet items	2 179	1 764
- deferred income	1 252	-
- settlements with insurers	1 050	446
- provision for holiday equivalents	990	1 137
- liabilities due to income tax on salaries, Social Security contributions and VAT	752	927
- creditors	-	1 763
- other	50	288
Other liabilities, in total	**25 568**	**26 748**
Short-term (up to 1 year)	25 568	26 748

30.2. Provisions

	31.12.2017	31.12.2016
Provision (due to)	**204**	**160**
- off-balance sheet contingent liabilities granted	61	54
- provisions for retirement and disability benefits	143	106
Provision, in total	**204**	**160**
Short-term (up to 1 year)	80	55
Long-term (over 1 year)	124	105

for 2017 (in PLN thousand)

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

	Year ended 31 December	
	2017	2016
Provisions as at the beginning of the period	**106**	**93**
- write-down on the provision	8	8
- interest cost	4	2
- actuarial gains and losses are recognised in other comprehensive income	25	3
Provisions as at the end of the period	**143**	**106**
Expected provision settlement period:		
Short-term (up to 1 year)	19	1
Long-term (over 1 year)	124	105

31. Deferred income tax

Assets and liabilities for deferred income tax are calculated for all temporary differences in accordance with the balance sheet method, using an effective income tax rate that will be applicable in the year of occurrence of tax obligation (in 2017 and 2016: 19%).

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

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

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

*Item "Amount of impairment write down on receivables" relates to write-offs adjusting the value of loans for which the Bank expects that their irrecoverability will be documented.

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

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

for 2017 (in PLN thousand)

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

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

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

Settled within 12 months	35 741
To be settled after more than 12 months	8 995

* Item "Amount of impairment write down on receivables" relates to write-offs adjusting the value of loans for which the Bank expects that their irrecoverability will be documented.

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

Settled within 12 months	(36 092)
To be settled after more than 12 months	-

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

Settled within 12 months	(351)
To be settled after more than 12 months	8 995

for 2017 (in PLN thousand)

Deferred tax recognised in the income statement	Year ended 31 December	
	2017	2016
Interest accrued	4 982	1 066
Valuation of derivative financial instruments	2 471	(822)
Amount of impairment write-downs on receivables*	1 322	5 835
Provisions and other liabilities related to employment benefits	241	281
Impairment write-downs on inventories	-	326
Accruals	(1 095)	406
Revenues to be settled (commissions settled using the effective interest rate method)	(522)	935
Prepaid costs	(4 226)	(6 720)
Difference between tax and balance sheet depreciation/amortisation	(135)	(101)
Other	50	(244)
Total deferred tax recognised in the income statement	**3 088**	**962**

* Item “Amount of impairment write down on receivables” relates to write-offs adjusting the value of loans for which the Bank expects that their irrecoverability will be documented.

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

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

32. Explanatory note to the statement of cash flows

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

`000 PLN	Year ended 31 December	
	2017	2016
Amounts due from other banks, change resulting from balance-sheet balances	(2 475)	188 918
The difference between the interest accrued and paid in cash in the period	(4)	(2)
Exclusion of change in cash and cash equivalents	2 475	(188 918)
Change in amounts due from other banks, in total	**(4)**	**(2)**
Derivative financial instruments, change resulting from balance-sheet values	(12 900)	(7 084)
The difference between the interest accrued and paid in cash in the period	708	4 059
Change in respect of derivative financial instruments, in total	**(12 192)**	**(3 025)**
Loans and advances to clients, change resulting from balance-sheet values	(1 355 406)	(2 019 762)
The difference between the interest accrued and paid in cash in the period	11 642	18 584
Change in loans and advances to clients	**(1 343 764)**	**(2 001 178)**
Investment securities available for sale, change resulting from balance-sheet values	(143 078)	(385 544)
The difference between the interest accrued and paid in cash in the period	(1 071)	1 931
Exclusion of change in cash and cash equivalents	(107 977)	(238 400)
Valuation recognised in other comprehensive income	6 131	(2 461)
Change in investment securities, in total	**(245 995)**	**(624 474)**
Amounts due to other banks, change resulting from balance-sheet values	513 209	357 076
The difference between the interest accrued and paid in cash in the period	(4 326)	(1 045)
Exclusion of change in cash from financing activities	(1 021 568)	(341 368)
Change in amounts due to other banks, in total	**(512 685)**	**14 663**
Amounts due to clients, change resulting from balance-sheet values	(32 263)	(229 116)
The difference between the interest accrued and paid in cash in the period	(1)	37
Change in amounts due to clients, in total	**(32 264)**	**(229 079)**
Debt securities in issue (including hedge accounting adjustments related to fair value of hedged items) - change in the balance of the statement of financial position	890 354	1 966 338
The difference between the interest accrued and paid in cash in the period	(6 334)	(6 850)
Exclusion of change in cash from financing activities	(1 292 446)	(1 119 769)
Change in debt securities in issue, in total	**(408 426)**	**839 719**
Subordinated liabilities, change resulting from balance-sheet values	-	(414)
The difference between the interest accrued and paid in cash in the period	-	414
Change in subordinated liabilities, in total	**-**	**-**
Other liabilities and provisions, change resulting from balance-sheet values	(1 136)	6 471
Actuarial valuation of provisions for post-employment benefits recognised in other comprehensive income	(25)	(3)
Change in other liabilities and provisions, in total	**(1 161)**	**6 468**

for 2017 (in PLN thousand)

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

	Balance 01.01.2017	Cash flow	Other changes	Balance 31.12.2017
Debt securities in issue	5 386 891	1 171 198	(13 669)	6 544 420
Amounts due to banks	2 782 230	954 225	43 117	3 779 572
Subordinated liabilities	200 485	(10 460)	10 459	200 484

The "Other changes" column shows non-cash flows from accrued interest, commissions settled ESP, foreign exchange differences, differences from hedge accounting regarding the fair value of hedged items.

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

In both 2017 and 2016, the Bank did not conduct any proceedings before a court, arbitration body or public administration authority, which value consists at least 10% of the Bank's equity.

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

1. On 27 October 2016, the Bank received a claim lodged with the Regional Court in Warsaw, 20th Business Department, from a borrower for whom the Bank had terminated a loan agreement, requesting that the termination of the loan agreement be deemed invalid, and on 4 October 2016 the Bank received a claim from the same borrower, lodged with the Regional Court in Warsaw, 20th Business Department, requesting that the agreement on the registered pledge on the shares in the borrower's company be deemed invalid. In both cases the Bank submitted replies to the claims. Due to the fact that the District Court for the Capital City of Warsaw in Warsaw declared the borrower bankrupt, the Regional Court suspended both sets of proceedings. Currently, the Regional Court scheduled the hearing in the case for invalidation of the agreement on the registered pledge on the shares in the borrower's company for 15 May 2018.
2. On 15 February 2016, a private individual who was not a customer of the Bank filed a claim with the Regional Court in Warsaw, 17th Department of Competition and Consumer Protection, to declare the provisions of a mortgage loan agreement unlawful. The Bank submitted a reply to the claim. The hearing took place on 18 January 2018. On 23 January 2018, a decision of the Regional Court in Warsaw – Court of Competition and Consumer Protection – on case No XVII AmC 195/16 (not final) was announced, in which the claim was partially accepted, and partially dismissed and rejected. The Bank requested the reasoning of the decision and the service of the decision together with the reasoning. After studying the aforementioned documents, the Bank will file an appeal. Regardless of the final outcome of the proceedings — any legally binding resolution will not have, apart from the legal costs, any financial effects for the Bank.
3. A claim lodged by the Capital City of Warsaw against mBank Hipoteczny S.A. for the payment of (after the scope of the claim had been reduced) PLN 3 057 representing capitalised interest on a portion of the annual fee for 2012 for the perpetual usufruct of a property taken over by the Bank in the course of enforcement proceedings against the property (adjudication of the right of perpetual usufruct by the court) located in Warsaw at 33/35 Nałęczowska St. is currently pending before a court of second instance – the Regional Court in Warsaw, 5th Appeals Department. In the court of first instance, the case was resolved in favour of the Bank. On 24 February 2017, the District Court for Warsaw Mokotów dismissed the claim of the Capital City of Warsaw. The City of Warsaw has filed an appeal. The Bank has filed a reply to the appeal, and the case is currently awaiting a date for an appeal hearing to be set.

for 2017 (in PLN thousand)

34. Off-balance sheet liabilities

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

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

35. Pledge assets

The Bank, in accordance with the Act on the Bank Guarantee Fund as at 31 December 2017 held treasury bonds in the amount of PLN 1 033 thousand (of nominal value of PLN 1 000 thousand), while as at 31 December 2016 held treasury bonds in the amount of PLN 1 008 thousand (of nominal value of PLN 1 000 thousand) which constituted collateral of fund for the guaranteed deposits protection fund. Those assets are recognised in the balance sheet in the item "Investment securities available for sale".

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

The Bank additionally secured issued mortgage and public sector covered bonds with treasury bonds of total balance sheet value of PLN 180 314 thousand as at 31 December 2016 (PLN 89 667 thousand as at 31.12.2016).

36. Registered share capital

As at 31 December 2017, the total number of ordinary shares was 3 210 000 (3 090 000 as at 31 December 2016) with a nominal value of PLN 100 per share.

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

The increase in the number of shares in 2017 took place due to the fact that mBank Hipoteczny S.A. issued 120 000 ordinary registered shares with a nominal value of PLN 100 each and an issue price of PLN 1 000 each, based on Resolution No. 1 of the Extraordinary General Shareholders' Meeting of mBank Hipoteczny S.A. which was held on 8 February 2017. 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. On 3 April 2017, the registration court entered the increased share capital in the Register of Businesses.

The shareholder structure of mBank Hipoteczny S.A. as at 31 December 2017 is presented in the following table:

for 2017 (in PLN thousand)

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

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

REGISTERED SHARE CAPITAL (STRUCTURE) AS AT 30 DECEMBER 2017							
Share type	Type of preference	Type of restrictions	Number of shares	Series / issue at par value (PLN)	Means of covering share capital	Registration date	Right to dividend
registered	-	-	500 000	50 000 000	cash	16.04.1999	01.01.2000
registered	-	-	850 000	85 000 000	cash	20.09.2000	01.01.2001
registered	-	-	400 000	40 000 000	cash	24.04.2006	01.01.2006
registered	-	-	1 000 000	100 000 000	cash	08.01.2013	01.01.2013
registered	-	-	100 000	10 000 000	cash	30.12.2014	01.01.2015
registered	-	-	140 000	14 000 000	cash	19.08.2015	01.01.2016
registered	-	-	100 000	10 000 000	cash	01.08.2016	01.01.2017
registered	-	-	120 000	12 000 000	cash	03.04.2017	01.01.2017
Total number of shares			**3 210 000**				
Total registered share capital				**321 000 000**			

37. Share premium

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

38. Retained earnings

	31.12.2017	31.12.2016
Other supplementary capital	245 253	224 131
General banking risk reserve	44 800	42 500
Profit for the current year	27 829	23 422
Total retained earnings	**317 882**	**290 053**

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

The Bank is required to allocate minimum of 8% of net profit to supplementary capital created statutorily until it reaches the level of the one third of the share capital of the Bank. The Bank may also allocate part of the profit to the general banking risk reserve to cover unexpected losses.

In accordance with the Resolution no. 2 of Ordinary General Meeting of mBank Hipoteczny S.A. dated 27 March 2017 the net profit of 2016 was allocated to:

- supplementary capital in the amount of PLN 21 122 thousand,
- general banking risk reserve in the amount of PLN 2 300 thousand.

The Bank intends to allocate the net profit of 2017 to supplementary capital.

for 2017 (in PLN thousand)

39. Other components of equity

	31.12.2017	31.12.2016
Available-for-sale financial assets	**3 798**	**(1 168)**
Unrealised losses on debt instruments	3 798	-
Unrealised gains on debt instruments	-	(1 168)
Actuarial gains and losses on post-employment benefits	**2**	**22**
Actuarial gains of the defined benefit pension plan	2	22
Other components of equity, total	**3 800**	**(1 146)**

40. Dividend per share

mBank Hipoteczny S.A. does not plan to pay dividend for 2017 and did not pay dividend for 2016.

41. Cash and cash equivalents

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

	31.12.2017	31.12.2016
Cash and balances with the central bank (Note 17)	1 351	5 530
Amounts due from other banks (Note 18)	18 737	16 262
Money bills	123 485	231 462
Total cash and cash equivalents	**143 573**	**253 254**

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

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

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

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

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

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

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

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

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

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

The last settlements of this program were in 2017.

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

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

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

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

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

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

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

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

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

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

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

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

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

The last settlements of this program are planned in 2018.

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

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

By Resolution No. 13/2017 of the Supervisory Board dated 27 March 2017 an amended Policy of remuneration of persons who have a significant effect on the Bank's risk profile was approved. This change consisted of setting a limit on the payment of variable remuneration so that if the amount of variable remuneration is equal to or lower than PLN 200 thousand, the Bank's Management Board may decide not to defer the variable remuneration for the following years and award the entire variable remuneration in the form of undeferred cash. The above rule does not apply to members of the Bank's Management Board.

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

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

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

Variable remuneration is granted in accordance with the following rules:

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

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

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

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

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

Variable remuneration is granted in accordance with the following rules:

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

If the amount of variable remuneration is equal to or lower than PLN 200 thousand, the Bank's Management Board may decide not to defer the variable remuneration for the following years and award the entire variable remuneration in the form of undeferred cash.

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

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

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

Accounting for incentive programmes

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

for 2017 (in PLN thousand)

43. Transactions with related parties

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

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

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

31.12.2017	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
Loans received	-	83 425	208 696	2 279 606	1 207 845	**3 779 572**
Subordinated liabilities	-	-	-	100 242	100 242	**200 484**
Covered bonds and bonds in issue	-	-	-	579 267	263 559	**842 826**
Liabilities in respect of cash collateral	48 080	-	-	-	-	**48 080**
Derivative financial instruments	-	-	-	-	421	**421**
Other liabilities	1 748	-	-	-	-	**1 748**
31.12.2016	**Up to 1 month**	**From 1 to 3 months**	**From 3 to 12 months**	**From 1 to 5 years**	**Over 5 years**	**Total**
Loans received	-	100 184	437 849	1 528 022	913 787	**2 979 842**
Other financial liabilities with deferred payment term	-	-	158 209	153 222	-	**311 431**
Subordinated liabilities	-	-	-	-	200 484	**200 484**
Covered bonds and bonds in issue	-	-	46 895	906 618	16 940	**970 453**
Liabilities in respect of cash collateral	25 544	-	-	-	-	**25 544**
Derivative financial instruments	4 230	1 725	3 504	-	69	**9 528**
Other liabilities	2 742	-	-	-	-	**2 742**

Other financial liabilities with deferred payment term relate to liability resulting from agreements on transfer of retail loans secured with a mortgage concluded with mBank S.A. in 2016.

<u>Major agreements concluded by and between the Bank and mBank S.A. in 2017:</u>

1. On 29 May 2017, a loan agreement was concluded by and between mBank S.A. and mBank Hipoteczny S.A., for a loan of up to PLN 1 100 000 thousand. The loan is to be disbursed in tranches.
2. On 6 July 2017, two agreements were concluded by and between mBank S.A. and mBank Hipoteczny S.A. on the transfer of commercial loans secured with a mortgage of EUR 8 488 thousand and EUR 12 791 thousand to mBank Hipoteczny S.A.

<u>Major agreements concluded in 2017 between the Bank and Commerzbank:</u>

In connection with the international programme of issuance of mortgage bonds of up to EUR 3 billion in total, the following agreements were signed:

1. On 28 February 2017, mBank Hipoteczny S.A. signed a Mandate letter with Commerzbank AG concerning the organization of a mortgage bonds issuance programme.
2. On 28 February 2017, mBank Hipoteczny S.A. signed a Mandate letter with Commerzbank AG concerning the Commerzbank’s participation in the mortgage bonds issuance programme as one of the dealers.
3. On 4 July 2017, mBank Hipoteczny S.A. signed an agreement with Commerzbank AG on the appointment of a process agent as part of the mortgage bonds issuance programme.
4. On 6 July 2017, mBank Hipoteczny S.A. signed a multilateral agreement on the mortgage bonds issuance programme with Commerzbank AG as the organizer and one of the five dealers of the programme.

The following table presents values of transactions of the Bank with related parties. The amounts of transactions include balances of assets and liabilities as at 31 December 2017 and 31 December 2016 and associated with them incomes and costs for 2017 and 2016.

(PLN '000)	Supervisory and Management Board members of mBank Hipoteczny S.A./mBank S.A., management personnel of mBank Hipoteczny S.A.		Other persons and entities related*		mBank Group companies**		mBank S.A.		Commerzbank Group companies***	
As at the end of the period	**31.12.2017**	**31.12.2016**	**31.12.2017**	**31.12.2016**	**31.12.2017**	**31.12.2016**	**31.12.2017**	**31.12.2016**	**31.12.2017**	**31.12.2016**
Statement of finacial position										
Assets	2 355	2 985	105	107	54	2 826	65 010	61 648	-	-
Liabilities	-	-	-	-	169 606	304 639	4 873 131	4 500 025	1 041 983	883 921
Contingent liabilities										
Liabilities received	-	-	-	-	-	-	1 079 820	731 753	-	-
Derivatives (purchase, sales)										
IRS contracts	-	-	-	-	-	-	1 334 383	1 397 152	-	-
FX SWAP contracts	-	-	-	-	-	-	2 067 594	1 722 198	-	-

(PLN '000)	Supervisory and Management Board members of mBank Hipoteczny S.A./mBank S.A., management personnel of mBank Hipoteczny S.A.		Other persons and entities related*		Other persons and entities related*		mBank S.A.		Commerzbank Group companies***	
Year ended	**31.12.2017**	**31.12.2016**	**31.12.2017**	**31.12.2016**	**31.12.2017**	**31.12.2016**	**31.12.2017**	**31.12.2016**	**31.12.2017**	**31.12.2016**
Income statement										
Interest income	72	77	3	3	398	1 154	22 597	21 164	-	-
Interest expense	-	-	-	-	(2 044)	(3 139)	(113 496)	(51 564)	(5 258)	(5 434)
Fee and commission income	-	-	-	-	4	208	-	-	-	-
Fee and commission expenses	-	-	-	-	(1 530)	(1 083)	(3 125)	(1 381)	-	-
Net trading income	-	-	-	-	-	-	11 319	3 873	-	-
Other operating income	-	-	-	-	-	-	414	580	-	-
Other operating expenses	-	-	-	-	-	-	(3)	(9)	-	-
Overhead costs, amortisation and depreciation	-	-	-	-	(1 220)	(1 354)	(3 907)	(5 028)	-	-

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

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

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

for 2017 (in PLN thousand)

Management Board composition and remuneration

As at 31 December 2017, the composition of the Management Board is as follows:

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

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

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

On 19 June 2017, Mr Marcin Romanowski resigned as Member of the Management Board. The resignation took place as of 20 September 2017.

Mr Andrzej Kulik was appointed Member of the Management Board of mBank Hipoteczny S.A. as of 21 September 2017 by way of resolution No 24/2017 of the Supervisory Board of mBank Hipoteczny S.A. of 17 August 2017.

Information on the value of salaries and bonuses paid to the Members of the Management Board who were performing their functions at the end of 2017 as at 31 December 2017 and 31 December 2016 is presented below

		Remuneration paid in 2017 (in PLN)		
		Gross remuneration	Other benefits	Settlement of incentive programme in 2017
1.	Piotr Cyburt	756 000	16 691	290 654
2.	Andrzej Kulik	133 333	3 659	-
3.	Grzegorz Trawiński	510 000	12 614	244 091
4.	Marcin Wojtachnio	510 000	16 865	322 550
	Total	**1 909 333**	**49 829**	**857 295**

		Remuneration paid in 2016 (in PLN)		
		Gross remuneration	Other benefits	Settlement of incentive programme in 2016
1.	Piotr Cyburt	756 000	17 227	245 915
2.	Grzegorz Trawiński	510 000	12 614	184 816
3.	Marcin Wojtachnio	510 000	16 601	274 589
	Total	**1 776 000**	**46 442**	**705 320**

Remuneration of Members of the Management Board who ceased to perform their functions in 2017:

	Remuneration paid in 2017 (in PLN)			Remuneration paid in 2016 (in PLN)		
	Gross remuneration	Other benefits	Settlement of incentive programme in 2017	Gross remuneration	Other benefits	Settlement of incentive programme in 2016
Marcin Romanowski	555 590	6 305	267 136	730 800	8 105	237 317
Total	**555 590**	**6 305**	**267 136**	**730 800**	**8 105**	**237 317**

As at 31 December 2017, the value of the provision for bonuses and awards for the Bank’s employees and Management Board amounted to PLN 7 637 thousand, including a provision for variable remuneration for the Members of the Bank’s Management Board and employees who have a significant effect on the Bank’s risk profile which amounted to PLN 4 329 thousand (PLN 6 229 thousand and PLN 2 770 thousand respectively as at 31.12.2016).

for 2017 (in PLN thousand)

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

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

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

Composition and remuneration of the Supervisory Board

As from 7 February 2017, Mr Dariusz Solski resigned as Member of the Supervisory Board. The vacant position on the Supervisory Board was filled on 8 February 2017 by the Extraordinary General Meeting by Resolution No. 4 – Mr Jakub Fast was appointed Member of the Supervisory Board. As from 31 March 2017, Mr Hans Dieter Kemler resigned as Member of the Supervisory Board. Supervisory Board appointed Mr Cezary Kocik Chairperson as of 1 April 2017 by way of resolution No 20/2017 of 27 March 2017. On 29 May 2017, the Extraordinary General Meeting completed the Supervisory Board by appointing Mr Frank Bock by way of resolution No 2. On 12 July 2017, Mr Christoph Heins resigned from the position of the Member of the Supervisory Board. On 14 July 2017, the Extraordinary General Meeting of mBank Hipoteczny S.A. appointed Mr Paweł Graniewski and Mr Andreas Boeger Members of the Supervisory Board during its tenth term of office by way of resolution No 2 and resolution No 3.

The composition of mBank Hipoteczny S.A. Supervisory Board as at 31 December 2017:

1.	Cezary Kocik	-	Chairman of the Supervisory Board
2.	Lidia Jabłonowska-Luba	-	Deputy Chairwoman of the Supervisory Board, Member of the Risk Committee
3.	Frank Bock	-	Member of the Supervisory Board, Member of the Risk Committee
4.	Andreas Boeger	-	Member of the Supervisory Board, Member of the Audit Committee
5.	Jakub Fast	-	Member of the Supervisory Board
6.	Paweł Graniewski	-	Independent Member of the Supervisory Board, Chairman of the Audit Committee
7.	Michał Popiołek	-	Member of the Supervisory Board, Member of the Risk Committee
8.	Mariusz Tokarski	-	Independent Member of the Supervisory Board, Member of the Audit Committee

In 2017 the Supervisory Board worked without remuneration, excluding Mr Paweł Graniewski and Mr Mariusz Tokarski, who as Members of the Supervisory Board received remuneration for 2017 in the amount of PLN 18 and 36 thousand respectively.

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

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

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

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

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

44. Information about the registered audit company

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

By Resolution no. 15/2017 dated 27 March 2017, the Supervisory Board of mBank Hipoteczny S.A., acting under paragraph 26 para. 8 of the Articles of Association of the Bank, appointed PricewaterhouseCoopers Sp. z o.o. (PwC) as auditor for audit of financial statement of the Bank for 2017.

PwC with registered office in Warsaw, at 14 Lecha Kaczyńskiego St.,(previously at 14 Armii Ludowej Av.), 00-638 Warszawa, entered into the list of auditors authorised to audit financial statements under number 144.

PwC's fees for 2017 totalled PLN 724 thousand gross, including:

- for the audit of the financial statements mBank Hipoteczny S.A. and audit and review of reporting packages for 2017 amounted to PLN 279 thousand gross,
- for other assurance services, ie. the review of financial statements mBank Hipoteczny S.A. for the first half of 2017, reporting packages for the first half of 2017, verification of disclosures regarding the capital adequacy of the Bank as at 31 December 2017 amounted to PLN 151 thousand gross,
- for the attestation service related to the foreign prospectus amounted to PLN 272 thousand gross,
- for other services to the mBank Hipoteczny S.A. amounted to PLN 22 thousand gross.

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

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

45. Capital adequacy

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

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

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

for 2017 (in PLN thousand)

Effective use of capital is an integral part of the capital management policy oriented at reaching an optimal rate of return on capital and as a result forming a stable fundament of reinforcement of the capital basis in future periods. This enables to maintain the Common Equity Tier 1 capital ratio (calculated as a quotient of Common Equity Tier 1 capital to the total risk exposure amount) and the total capital ratio (calculated as a quotient of own funds to the total risk exposure amount) at least on the level required by the supervision authority.

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

Capital ratios

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

- Regulations (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 as amended (hereinafter called "the CRR") and on the basis of supplementing Commission Implementing Regulations (EU) to the CRR;
- the Banking Act of 29 August 1997, as amended;
- The law of 5 August 2015 on the macroprudential oversight of the financial system and crisis management in the financial system (hereinafter referred to as the Act of macroprudential supervision).

In 2017, the following factors affected the levels of the Bank's capital ratios:

- classification of PLN 119 926 thousand, which constitutes share capital of PLN 12 000 thousand and supplementary capital created from share premium of PLN 107 927 thousand, in respect of the issue of 120 000 ordinary registered shares conducted on 8 February 2017, with a nominal value of PLN 100 each and an issue price of PLN 1 000 each, based on the permission of the Polish Financial Supervision Authority of 10 May 2017, in Tier I core capital;
- classification of the Bank's net profit for 2016, less any expected charges of PLN 23 422 thousand, in Tier I core capital;
- classification of the Bank's verified net profit for the first half of 2017, less all possible charges of PLN 10 256 thousand, based on the permission of the Polish Financial Supervision Authority of 11 September 2017, in Tier I core capital;
- the development of the Bank's business activities.

Since 1 January 2016 Act came into force on macroprudential supervision of capital buffers. As at 31 December 2017, the Bank was required to maintain additional own funds at the level, which will cover the designated pursuant to the provisions of the Act on macroprudential oversight conservation buffer amounting to 1.25% of the total risk exposure.

According to the decision of the Committee of Financial Stability, applicable to Bank countercyclical buffer rate as at 31 December 2017 amounted to 0%.

Detailed information about the calculation of the total capital ratio, Tier I core capital ratio, own funds and the Bank's total risk exposure as at 31 December 2017 are described in the document "Disclosures" concerning the capital adequacy and variable elements of renumeration of mBank Hipoteczny S.A. as at 31 December 2017, published on the Bank's website.

Capital ratios both at the end of 2017 and 2016 were above the minimum required value of what has been presented in the following table. During 2017 and 2016, the Bank meet external capital requirements.

Capital ratio	31.12.2017		31.12.2016	
	Minimum ratio	Presented ratio	Minimum ratio	Presented ratio
Total capital ratio	13.25%	15.79%	13.25%	14.54%
Equiety Tier 1 capital ratio	10.25%	12.93%	10.25%	11.49%

Own Funds

In accordance with the CRR Regulation, own funds consist of Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital, wherein mBank Hipoteczny S.A. does not identify items which would qualify as Additional Tier 1 capital.

Common Equity Tier 1 capital of mBank Hipoteczny S.A. contains:

- paid up capital instruments and the related share premium accounts,
- previous years retained earnings,
- independently reviewed interim profits,
- other accumulated comprehensive income,
- other reserves,
- general banking risk reserve,
- independently identified gains for the current period;
- items decreasing the Tier I core capital (value adjustments due to prudent valuation requirements, intangible assets, insufficient credit risk adjustments in view of expected losses, regulatory adjustments relating to other accumulated comprehensive income and net write-downs).

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

As at 31 December 2017, the Bank's own funds amounted to PLN 1 104 182 thousand (as at 31 December 2016, they amounted to PLN 954 070 thousand).

Total risk exposure amount

The total Bank's risk exposure amount contains:

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

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

As at 31 December 2017, the Bank's total risk exposure amounted to PLN 6 993 562 thousand, including a credit risk exposure of PLN 6 769 934 thousand.

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

Internal capital

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

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

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

The process consists of the following elements:

- risk inventory in the business activity of the Bank,
- calculation of internal capital for coverage of risk,

for 2017 (in PLN thousand)

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

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

Capital adequacy	31.12.2017	31.12.2016
Common Equity Tier 1 Capital	**904 182**	**754 070**
Own funds	**1 104 182**	**954 070**
Risk weighted exposure amounts for credit risk, counterparty credit risk, dilution risk and deliveries with deferred settlement date:	6 769 934	6 372 126
- using internal rating method	4 026 640	3 995 905
- using standard method	2 743 294	2 376 221
Total operational risk exposure amount	223 628	190 363
The total amount of risk exposure	**6 993 562**	**6 562 489**
Common Equity Tier 1 capital ratio	**12.93%**	**11.49%**
Total capital ratio	**15.79%**	**14.54%**
Internal capital	**429 129**	**418 965**

Own funds	31.12.2017	31.12.2016
Own funds	**1 104 182**	**954 070**
TIER 1 CAPITAL	**904 182**	**754 070**
Common Equity Tier 1 Capital	**904 182**	**754 070**
Capital instruments eligible as CET1 Capital	734 719	614 792
Paid up capital instruments	321 000	309 000
Share premium	413 719	305 792
Retained earnings	10 256	13 766
Retained earnings from previous years	-	-
Profit or loss eligible	10 256	13 766
Other accumulated comprehensive income	3 800	(1 146)
Other reserves	245 253	224 131
General banking risks founds	44 800	42 500
(-) Value adjustments due to the requirements for prudent valuation	(1 339)	(1 195)
(-) Intangible assets	(25 324)	(13 191)
(-) Other intangible assets gross amount	(25 527)	(13 357)
Deferred tax liabilities associated to other intangible assets	203	166
(-) IRB shortfall of credit risk adjustments to expected losses	(88 720)	(114 085)
Other transitional adjustments to CET1 Capital	(781)	(264)
CET1 capital elements or deductions - other	(18 482)	(11 238)
Additional Tier 1 capital	-	-
TIER 2 CAPITAL	**200 000**	**200 000**
Capital instruments and subordinated loans eligible as T2 capital	200 000	200 000

46. Events after the balance sheet date

There were no significant events after the balance sheet date.

Warsaw, 2 March 2018

Signatures:

President of the Management Board
Piotr Cyburt

Member of the Management Board
Andrzej Kulik

Member of the Management Board
Grzegorz Trawiński

Member of the Management Board
Marcin Wojtachnio

The person responsible for bookkeeping
Milena Zwolińska-Grabowicz