# Financial Statements of mBank Hipoteczny S.A. according to the International Financial Reporting Standards (IFRS) for 2020

Official Financial Statements of mBank Hipoteczny SA for 2020 was prepared in accordance with the requirements of the ESEF. This document is not the official version of the Financial Statements of mBank Hipoteczny SA for 2020, but was prepared on the basis of the original prepared in the ESEF format and is a copy of it.
This document is a translation from the original Polish version. In case of any discrepancies between the Polish and English versions, the Polish version shall prevail.

## Selected financial data

The selected financial data presented below are supplementary information to the Financial Statements of mBank Hipoteczny S.A. for 2020.

| Selected financial data | | in PLN `000 | | in PLN `000 | |
|---|---|---|---|---|---|
| | | Year ended 31.12.2020 | Year ended 31.12.2019 | Year ended 31.12.2020 | Year ended 31.12.2019 |
| I. | Interest income | 363 027 | 454 195 | 81 138 | 105 583 |
| II. | Fee and commission income | 1 183 | 2 203 | 264 | 512 |
| III. | Net trading income | 327 | 5 096 | 73 | 1 185 |
| IV. | Operating result | 53 704 | 91 294 | 12 003 | 21 222 |
| V. | Profit before income tax | 22 355 | 59 068 | 4 996 | 13 731 |
| VI. | Net profit attributable to shareholders of mBank Hipoteczny S.A. | 4 878 | 37 084 | 1 090 | 8 621 |
| VII. | Net cash flows from operating activities | 2 934 255 | 1 233 982 | 655 817 | 286 852 |
| VIII. | Net cash flows from investing activities | (13 399) | (19 485) | (2 995) | (4 529) |
| IX. | Net cash flows from financing activities | (2 802 459) | (1 110 084) | (626 360) | (258 051) |
| X. | Total net cash flows | 118 397 | 104 413 | 26 462 | 24 272 |
| XI. | Basic earnings per ordinary share / Diluted earnings per ordinary share (in PLN/EUR) | 1,45 | 11,14 | 0,32 | 2,59 |

| Selected financial data | | in PLN `000 | | in EUR `000 | |
|---|---|---|---|---|---|
| | | as at | | as at | |
| | | 31.12.2020 | 31.12.2019 | 31.12.2020 | 31.12.2019 |
| I. | Total assets | 12 869 308 | 13 187 908 | 2 788 703 | 3 096 843 |
| II. | Amounts due to other banks | 3 500 673 | 2 816 822 | 758 575 | 661 459 |
| III. | Amounts due to customers | 3 477 | 8 934 | 753 | 2 098 |
| IV. | Equity attributable to shareholders of mBank Hipoteczny S.A. | 1 290 240 | 1 267 520 | 279 587 | 297 645 |
| V. | Share capital | 336 000 | 336 000 | 72 809 | 78 901 |
| VI. | Number of shares | 3 360 000 | 3 360 000 | 3 360 000 | 3 360 000 |
| VII. | Book value per share / Diluted book value per share (in PLN/EUR) | 384,00 | 377,24 | 83,21 | 88,58 |
| VIII. | Total capital ratio (%) | 19,22 | 18,23 | 19,22 | 18,23 |

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 2020: EUR 1 = PLN 4.6148 and obligated for 31 December 2019: EUR 1 = PLN 4.2585,
- 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 2020 and 2019: 1 EUR = 4.4742 PLN i 1 EUR = 4.3018 PLN.

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for 2020 (in PLN thousand)

# Income statement

| | Note | Year ended 31 December | |
|---|---|---|---|
| | | 2020 | 2019 |
| Interest income, including: | 7 | 363 027 | 454 195 |
| *Interest income calculated using the effective interest rate method* | | *330 863* | *417 477* |
| *Income similar to interest - financial assets measured at fair value through profit or loss* | | *32 164* | *36 718* |
| Interest expense | 7 | (195 447) | (268 126) |
| **Net interest income** | | **167 580** | **186 069** |
| Fee and commission income | 8 | 1 183 | 2 203 |
| Fee and commission expenses | 8 | (7 595) | (10 404) |
| **Net fee and commission income** | | **(6 412)** | **(8 201)** |
| Net trading income | 9 | 327 | 5 096 |
| Net income on modification | 10 | (2 793) | (1 776) |
| Net income on derecognition of financial instruments not measured at fair value through pı | 11 | 3 226 | (185) |
| Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss | 12 | (2 168) | (2 844) |
| Other operating income | 13 | 813 | 1 030 |
| Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss | 16 | (42 320) | (20 003) |
| Overhead costs | 14 | (52 852) | (59 586) |
| Amortisation and depreciation | 25, 26 | (9 770) | (6 915) |
| Other operating expenses | 15 | (1 927) | (1 391) |
| **Operating result** | | **53 704** | **91 294** |
| Taxes on the Bank balance sheet items | | (31 349) | (32 226) |
| **Profit before income tax** | | **22 355** | **59 068** |
| Income tax | 17 | (17 477) | (21 984) |
| **Net profit** | | **4 878** | **37 084** |
| | | | |
| **Net profit attributable to shareholders of the mBank Hipoteczny S.A.** | | **4 878** | **37 084** |
| **Weighted average number of ordinary shares / Diluted weighted average number of ordinary shares** | 18 | **3 360 000** | **3 327 945** |
| **Earnings per ordinary share / Diluted earnings per ordinary share (in PLN)** | 18 | **1,45** | **11,14** |

The entire profit of mBank Hipoteczny S.A. for the 2020 and 2019 pertains to the performance of continuing operations.

Notes presented on pages 7 to 123 constitute an integral part of these Financial Statements.

for 2020 (in PLN thousand)

## Statement of comprehensive incomes

| | | Year ended 31 December | |
|---|---|---|---|
| | **Note** | **2020** | **2019** |
| **Net profit** | | **4 878** | **37 084** |
| **Other comprehensive income net of tax including:** | 19 | **17 842** | **(5 423)** |
| **Items that may be reclassified to the income statement** | | **17 840** | **(5 443)** |
| Change in the valuation of debt financial instruments measured at fair value through other comprehensive income (net) | | 1 382 | (2 435) |
| Net cash flow hedge | | 16 458 | (3 008) |
| **Items that will not be reclassified to the income statement** | | **2** | **20** |
| Actuarial gains and losses on post-employment benefits (net) | | 2 | 20 |
| **Total comprehensive income net of tax** | | **22 720** | **31 661** |
| **Net total comprehensive income attributable to shareholders of the mBank Hipoteczny S.A.** | | **22 720** | **31 661** |

Notes presented on pages 7 to 123 constitute an integral part of these Financial Statements.

for 2020 (in PLN thousand)

## Statement of financial position

| ASSETS | Note | 31.12.2020 | 31.12.2019 |
|---|---|---|---|
| Cash and balances with the Central Bank | 20 | 29 393 | 35 234 |
| Financial assets held for trading and derivatives held for hedges | 21 | 196 917 | 48 217 |
| Non-trading financial assets mandatorily at fair value through profit or loss, including: | 22 | 133 838 | 157 714 |
| *Loans and advances to customers* | | 133 838 | 157 714 |
| Financial assets at fair value through other comprehensive income | 23 | 791 045 | 1 221 735 |
| Financial assets at amortised cost, including: | 24 | 11 640 889 | 11 642 344 |
| *Loans and advances to banks* | | *323 133* | *13 912* |
| *Loans and advances to customers* | | *11 317 756* | *11 628 432* |
| Intangible assets | 25 | 53 936 | 48 620 |
| Tangible assets | 26 | 13 818 | 16 301 |
| Current income tax assets | | 112 | - |
| Deferred income tax assets | 31 | 4 011 | 10 123 |
| Other assets | 27 | 5 349 | 7 620 |
| **TOTAL ASSETS** | | **12 869 308** | **13 187 908** |
| **LIABILITIES AND EQUITY** | | | |
| **Liabilities** | | | |
| Financial liabilities held for trading and derivatives held for hedges | 21 | 4 719 | 7 600 |
| Financial liabilities measured at amortised cost, including: | 28 | 11 555 229 | 11 883 589 |
| *Amounts due to banks* | | *3 500 673* | *2 816 822* |
| *Amounts due to customers* | | *3 477* | *8 934* |
| *Debt securities issued* | | *7 950 930* | *8 857 401* |
| *Subordinated liabilities* | | *100 149* | *200 432* |
| Provisions | 29 | 3 392 | 2 276 |
| Current income tax liabilities | | - | 8 418 |
| Other liabilities | 30 | 15 728 | 18 505 |
| **TOTAL LIABILITIES** | | **11 579 068** | **11 920 388** |
| **Equity** | | | |
| **Share capital:** | | **884 631** | **884 631** |
| - Registered share capital | 31 | 336 000 | 336 000 |
| - Share premium | 36 | 548 631 | 548 631 |
| **Retained earnings:** | 37 | **387 710** | **382 832** |
| - Profit from the previous years | | 382 832 | 345 748 |
| - Profit for the current period | | 4 878 | 37 084 |
| **Other components of equity** | **38** | **17 899** | **57** |
| | | | |
| **TOTAL EQUITY** | | **1 290 240** | **1 267 520** |
| **TOTAL LIABILITIES AND EQUITY** | | **12 869 308** | **13 187 908** |

Notes presented on pages 7 to 123 constitute an integral part of these Financial Statements.

for 2020 (in PLN thousand)

# Statement of changes in equity

Changes in equity from 1 January 2020 to 31 December 2020

| | Share capital | | Retained earnings | | | | Total comprehensive income net of tax | | | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| | Registered share capital | Share premium | Other supplementary capital | General banking risk reserve | Retained profit from the previous years | Profit for the current period | Valuation of financial assets at fair value through other comprehensive income | Cash flow hedge | Actuarial gains and losses relating to post-employment benefits | |
| **As at 1 January 2020** | **336 000** | **548 631** | **300 948** | **44 800** | **37 084** | **-** | **3 041** | **(3 008)** | **24** | **1 267 520** |
| Net profit | - | - | - | - | - | 4 878 | - | - | - | 4 878 |
| Other comprehensive income (gross) | - | - | - | - | - | - | 1 707 | 20 319 | 2 | 22 028 |
| Deferred tax on other comprehensive income | - | - | - | - | - | - | (325) | (3 861) | - | (4 186) |
| **Total comprehensive income** | **-** | **-** | **-** | **-** | **-** | **4 878** | **1 382** | **16 458** | **2** | **22 720** |
| Transfer to supplementary capital | - | - | 37 084 | - | (37 084) | - | - | - | - | - |
| **As at 31 December 2020** | **336 000** | **548 631** | **338 032** | **44 800** | **-** | **4 878** | **4 423** | **13 450** | **26** | **1 290 240** |

Changes in equity from 1 January 2019 to 31 December 2019

| | 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 | Zabezpieczenie przepływów pieniężnych | Valuation of financial assets at fair value through other comprehensive income | Actuarial gains and losses relating to post-employment benefits | |
| **As at 1 January 2019** | **321 000** | **413 719** | **273 082** | **44 800** | **27 866** | **-** | **-** | **5 476** | **4** | **1 085 947** |
| Net profit | - | - | - | - | - | 37 084 | - | - | - | 37 084 |
| Other comprehensive income (gross) | - | - | - | - | - | - | (3 714) | (3 006) | 24 | (6 696) |
| Deferred tax on other comprehensive income | - | - | - | - | - | - | 706 | 571 | (4) | 1 273 |
| **Total comprehensive income** | **-** | **-** | **-** | **-** | **-** | **37 084** | **(3 008)** | **(2 435)** | **20** | **31 661** |
| Transfer to general banking risk reserve | - | - | - | - | - | - | - | - | - | - |
| Transfer to supplementary capital | - | - | 27 866 | - | (27 866) | - | - | - | - | - |
| Issue of shares | 15 000 | 135 000 | - | - | - | - | - | - | - | 150 000 |
| Share issue costs | - | (88) | - | - | - | - | - | - | - | (88) |
| **As at 31 December 2019** | **336 000** | **548 631** | **300 948** | **44 800** | **-** | **37 084** | **(3 008)** | **3 041** | **24** | **1 267 520** |

for 2020 (in PLN thousand)

## Statement of cash flows

| | Note | Year ended 31 December | |
|---|---|---|---|
| | | 2020 | 2019 |
| **A. Cash flows from operating activities** | | **2 934 255** | **1 233 982** |
| **Profit before income tax** | | **22 355** | **59 068** |
| ***Adjustments:*** | | **2 911 900** | **1 174 914** |
| Income tax paid | | (24 081) | (23 806) |
| Amortisation and depreciation | 25, 26 | 9 770 | 6 915 |
| Foreign exchange (gains) losses related to financing activities | | 319 565 | - |
| (Profits) losses on investing activities | 11 | (4 243) | - |
| Interest income (income statement) | 7 | (363 027) | (454 195) |
| Interest expenses (income statement) | 7 | 195 447 | 268 126 |
| Interest received | | 359 527 | 420 152 |
| Interest paid | | (25 895) | (26 985) |
| Change in assets and liabilities on derivative financial instruments | | (109 838) | 3 078 |
| Change in loans and advances to customers | | 315 072 | (630 207) |
| Change in the balance of financial assets at fair value through other comprehensive income | | 249 530 | (19 915) |
| Adjustments to intangible assets and property, plant and equipment | 25, 26 | 797 | (3 652) |
| Change in other assets | 27 | 2 271 | (2 488) |
| Change in amounts due to banks | | 1 990 984 | 1 928 538 |
| Change in amounts due to customers | | (2 821) | 8 459 |
| Change in debt securities in issue | | 937 | (288 488) |
| Change in subordinated liabilities | | (434) | - |
| Change in provisions | 29 | 1 116 | (281) |
| Change in other liabilities | 30 | (2 777) | (10 337) |
| **Net cash from operating activities** | | **2 934 255** | **1 233 982** |
| **B. Cash flows from investing activities** | | **(13 399)** | **(19 485)** |
| **Investing activity inflows** | | **36** | **42** |
| Due to the disposal of intangible assets and tangible fixed assets | | 36 | 42 |
| **Investing activity outflows** | | **13 435** | **19 527** |
| Due to the purchase of intangible assets and tangible fixed assets | 25, 26 | 13 435 | 19 527 |
| **Net cash from investing activities** | | **(13 399)** | **(19 485)** |
| **C. Cash flow from financing activites** | | **(2 802 459)** | **(1 110 084)** |
| **Financing activity inflows** | | **723 759** | **1 992 462** |
| Due to the loans and advances from banks | | 625 000 | - |
| Due to the issue of debt securities | | 95 000 | 1 842 550 |
| Due to the issue of shares | | - | 149 912 |
| Interest received from hedging derivative financial instruments | | 3 759 | - |
| **Financing activities outflows** | | **3 526 218** | **3 102 546** |
| Due to the repayment of loans and advances from banks | | 1 935 240 | 2 291 096 |
| Due to the issue of debt securities | 28 | 1 354 621 | 572 925 |
| Due to repayment a subordinated loan | 28 | 100 000 | - |
| Payments of leasing liabilities | 40 | 3 151 | 2 924 |
| Interest paid on loans received, debt securities in issue, subordinated loan | | 133 206 | 234 268 |
| Interest paid on derivative hedging instruments | | - | 1 333 |
| **Net cash from financing activities** | | **(2 802 459)** | **(1 110 084)** |
| **Net increase / decrease in cash and cash equivalents, total (A+B+C)** | | **118 397** | **104 413** |
| Cash and cash equivalents as at the beginning of the reporting period | 40 | 269 128 | 164 715 |
| **Cash and cash equivalents as at the end of the reporting period** | 40 | **387 525** | **269 128** |

Notes presented on pages 7 to 123 constitute an integral part of these Financial Statements.

# Explanatory notes to the standalone financial statements

## 1. Information on mBank Hipoteczny S.A.

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

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

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

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

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

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

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

The Bank was established for an indefinite period of time.

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

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

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

mBank Hipoteczny S.A. is not a parent company and a significant investor for associates and jointly controlled entities, both as at December 31, 2020 and December 31, 2019 mBank Hipoteczny S.A. did not have any subsidiary.

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

As at December 31, 2020 the employment in the mBank Hipoteczny S.A. was 124 FTEs and 133 persons (December 31, 2019: 130 FTEs; 140 persons).

Average employment in 2020 was 133 employees, in 2019 it was 140 employees.

These financial statements were approved by the Management Board of mBank Hipoteczny S.A. on March 4, 2021.

## 2. Description of the relevant accounting policies

The he most important accounting principles applied by the Bank in the preparation of these financial statements are presented below. The accounting principles adopted by the Bank were applied in a continuous manner to all the periods presented in the financial statements.

## 2.1. Accounting basis

Financial Statements of mBank Hipoteczny S.A. have been prepared for the 12-month period ended 31 December 2020. Comparative data presented in these financial statements relate to the period of 12 months ended on 31 December 2019. Presented financial statements are standalone financial statements.
As at 31 December 2020 and as at 31 December 2019 mBank Hipoteczny S.A. had no subsidiaries.
The Financial Financial statements of mBank Hipoteczny S.A. has been prepared in accordance with the International Financial Reporting Standards adopted for use in the European Union (IFRS EU), according to the historical cost principle, except for derivative contracts and financial instruments held for trading, financial assets that do not meet the SPPI test, financial assets assigned to a business model that does not assumes holding them in order to obtain contractual cash flows, equity instruments and liabilities related to cash-settled share-based payments that are carried at fair value through profit or loss, and except for financial instruments at fair value through other comprehensive income and equity instruments with the fair value through other comprehensive income option.

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.

Due to the current situation with regard to COVID-19, on the basis of the analyzes performed at that moment, no significant uncertainty for the continuation of operations has been identified. In the Bank's opinion, the following areas of the epidemic's negative impact on business processes can be identified: credit risk, liquidity risk, financial stability risk and operational risk. In the opinion of the Management Board, the Bank, based on internal analyzes of current liquidity and stress scenarios related to the future development of the Bank's regulatory ratios, does not identify any significant uncertainties related to the going concern assumption in the foreseeable future. In 2020, due to the reduction in interest rates and the economic situation in the country, the Bank decided not to issue covered bonds due to the favorable financing provided by the parent company. The Bank's business model consisting in the transfer of retail mortgage loans from mBank's portfolio to mBank Hipoteczny and financing them with issued long-term covered bonds does not indicate a threat to the going concern.
The Bank's business model consisting in the transfer of retail mortgage loans from mBank's portfolio to mBH and financing them with the use of issued long-term covered bonds does not indicate a threat to the going concern.
The Bank carried out an impairment test in relation to the Bank's net asset value.
Based on ten-year forecasts of financial results, the recoverable amount of the Bank's net assets was estimated. As a result of its comparison to the carrying amount of net assets, no impairment was found. In the test, a discount rate was adopted based on the cost of capital of comparable entities - the rate was set at 7%. A 1% change in the projected result in the test in 2030 (and in the residual period) would cause a change in the recoverable amount by PLN 4.1 million.
The financial statements are prepared in accordance with the principle of materiality. Omissions or distortions of items in the financial statements are material if they could, individually or collectively, affect the economic decisions made by users of the Bank's financial statements. Materiality depends on the size and nature of the omission or misstatement of items in the financial statements, and a combination of both. Each material category of similar items is presented separately by the Bank. Items different in terms of their nature or function are presented by the Bank separately, unless they are immaterial.

## 2.2. Interest income and expenses

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

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

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

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

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

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

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

Interest expenses include paid and accrued interests as well as commissions settled over time using effective interest rate from received loans, other financial liabilities with deferred payment term, subordinated loans, debt securities issued (legal costs, rating costs and audit costs) and cash collateral and leasing and commissions in connection with the judgment of the CJEU C / 383/18.

## 2.3. Fee and commission income and expenses

Fee and commission income is recognised in accordance with IFRS 15 using a 5-step model for revenue recognition, which consists of:

Step 1: Identifying the contract's with a customer

Step 2: Identifying performance obligations in the contract

Step 3: Determining the transaction price

Step 4: Allocating the transaction price to the preformance obligation

Step 5: Recognition of revenue when (or as) the Group satisfies a performance obligation

Revenues recognized in accordance with mssf 15 do not constitute a significant part of the revenues generated by the bank

Loans and commissions are recognized in the effective interest rate account and classified as interest income. Commissions for contracts that have not been disbursed as at the date of collection or payment of the commission, adjust the value of the effective interest rate on the date of disbursement of funds. Commissions for loan agreements that have not been started

are recognized once in the profit and loss account on the expiry date of the loan agreement. Commissions for the loan tranches made available to the customer (for commitment) are calculated evenly over the period of service provision. The commission amount is settled over the period of the commission transaction on a straight-line basis.

Commission income also includes fees and commissions settled over time using the straight-line method, received on loans and advances granted with undetermined schedules of future cash flows, for which the effective interest rate cannot be determined. The linear method for this type of service provides a fair picture of the transfer of goods and services as these services are provided evenly over time.

Accounting policies regarding the recognition of commission income from the sale of insurance products related to loans and borrowings are described in Note 2.4

Commission costs related to amounts paid on loans taken, securities issued, adjust the value of the effective interest rate on the date of disbursement of funds or on the date of payment, if it occurred after the date of disbursement of funds, and are presented in the line of interest expense. Commission costs on other operations, including costs related to the after-sale service of portfolios under outsourcing agreements, as well as costs related to the issue of covered bonds, among others legal costs, costs of ratings and audit costs are charged to the profit and loss account once.

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

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

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

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

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

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

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

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

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

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

## 2.5. Segment reporting

An operating segment is a component of the entity:

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

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

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

## 2.6. Financial assets/financial liabilities

The Bank classifies its financial assets to the following categories:

- financial assets measured at fair value through profit or loss, financial assets measured at fair value through other comprehensive income with the option of reclassifying gains and losses on the instrument to the profit and loss account when the asset is derecognised,
- financial assets measured at fair value through other comprehensive income without the possibility of reclassifying gains and losses on the instrument to profit or loss when the asset is derecognised, and
- financial assets measured at amortized cost. A debt financial asset is classified into one of the categories upon its initial recognition based on the Bank's business model for financial asset management and the contractual cash flow characteristics of the financial asset. An equity financial asset is classified as a financial asset measured at fair value through profit or loss unless, upon initial recognition, the Bank made an irrevocable choice with respect to certain investments in equity instruments to recognize subsequent changes in fair value through other comprehensive income.

Standardized purchase and sale transactions of financial assets measured at fair value through profit or loss and measured at fair value through other comprehensive income are recognized on the transaction settlement date - the date on which the Bank delivers or receives a given asset. Changes in the fair value between the trade date and the settlement date in the case of assets measured at fair value are recognized in the profit and loss account or in other items of equity. Loans are recognized when funds are withdrawn or made available to the borrower's account. Derivative financial instruments are recognized starting from the transaction date.

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

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

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

A financial liability other than a derivative is classified into one of the categories at the time of its acquisition, in line with the Bank's intention as to its destination. As financial assets measured at fair value through profit or loss, the Bank classifies derivative financial instruments and financial assets (loans and advances granted by the Bank) whose contractual terms give rise to cash flows on a specified date that are not only repayments of the principal and interest on the principal amount. outstanding (loans that do not meet the SPPI criterion in the category of non-recourse assets. These assets are presented in the statement of financial position under "Financial assets not held for trading, which are obligatorily measured at fair value through profit or loss".

<u>Financial instruments valued at fair value through profit or loss</u>

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

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

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

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

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

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

Gains and losses resulting from changes in the fair value of financial assets measured at fair value through profit or loss are recognized in the income statement in the period in which they arise.

<u>Financial assets measured at amortized cost</u>

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

Financial assets measured at amortized cost are recognized at adjusted purchase price (amortized cost) using the effective interest rate.

<u>Financial assets measured at fair value through other comprehensive income</u>

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

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

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

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

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

<u>Capital instrument</u>

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

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

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

Modification of contractual terms for financial assets

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

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

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

Purchased or originated credit impaired financial assets (POCI assets)

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

Reclassification of financial assets

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

Reclassification of financial liabilities

Financial liabilities are not subject to reclassification by the Bank.

## 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. The only assets and liabilities that the Bank compensates for are those related to hedge accounting.

## 2.8. Impairment of financial assets

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

<u>Financial assets measured at amortized cost - how exposures are classified to stagesale teaz nam nie</u>

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

In the case of the retail portfolio acquired in cooperation with mBank S.A., there is no grace period and the exposure leaves basket 3 to basket 1 or 2 after the impairment premise ceases. There is also no grace period when switching from basket 2 to basket 1.

In the case of the commercial portfolio, the transfer from Cart 3 is preceded by a minimum 90-day quarantine period.
The transfer from Cart 2 to Cart 1 is possible after the appropriate period:

- for the Forborne flag (customer's status indicating his difficulties in paying off the credit obligation in accordance with the Forborne definition used in the Bank) - after a minimum of two years;
- for the Watch flag (the Bank's internal process indicating corporate customers subject to special observation with respect to changes in their credit quality, in accordance with the rules of classification into the Watch List adopted by the Bank) - after meeting the conditions for exit from the WL;
- for overdue receivables by more than 30 days - immediately after the condition is fulfilled.

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

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

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

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

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

A credit exposure provides indication of impairment where:

- recovery actions are taken at the court stage or the contract is prepared for write-off,
- a payment of a benefit on account of low own contribution insurance was made by the insurance company,

- the transaction was deemed fraudulent (there was a case of falsification or of providing false data in documents establishing the identity of the debtor or in documents relating to collateral accepted).

Significant deterioration of credit quality

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

Qualitative criteria

Qualitative criteria are:

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

Quantitative criteria

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

Estimating expected credit losses (ECL)

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

The long-term PD parameter is generated based on the customer's rating derived from the AIRB PD model, in line with the customer's belonging to a given class determined in the rating cross-section and product. In order to estimate the long-term PD parameter, estimation was used based on the Weibull function with exponential adjustment, in which the dependent variable is the cumulative DR value (cDR). Additionally, the obtained estimates are converted in the above manner to the values corresponding to the expected macroeconomic conditions (PIT). The curves obtained on the basis of the Weibull distribution allow to obtain estimates that correspond to the frequency of default events in each of the annual periods from the reporting date to the maturity date.
The long-term LGD parameter is determined at the exposure level and defined as the quotient of the economic loss and the EAD value, where the economic loss is defined as the difference between the outstanding amount at default (EAD) plus all direct costs related to the recovery process discounted as at default and all recoveries made during the default period, discounted at the default.
The long-term EAD parameter for mortgage contracts is calculated on the basis of future scheduled cash flows corrected by the prepayment ratios observed in the portfolio history in a given portfolio to which the loan product belongs.

Use of macroeconomics scenarios in ECL estimation

The bank is required to calculate the expected credit loss in a way that reflects the expectations regarding various scenarios for the future macroeconomic situation. In the case of portfolio ECL estimation, the Bank determines the NLF (non-linearity factor) parameter, which is to adjust the value of the expected credit loss (determined every month). The value of the NLF is determined at least annually, separately for each segment of the retail portfolio. The values of the NLF ratio are used as scaling factors for individual ECL values determined at the level of individual exposures in individual segments on the basis of the results of 3 simulation conversions of the expected credit loss value to the identical reporting date, resulting from the adopted macroeconomic scenarios. In particular, the NLF parameter for a given segment is defined as the quotient of:

1. weighted by the probability of the scenario realization, the average value of the expected loss from 3 macroeconomic scenarios (the so-called average estimate), which includes: the baseline, optimistic, pessimistic scenario. The weights of these scenarios correspond to the probability of realization of each of them and are respectively 60% for the base one, 20% for the optimistic one and 20% for the pessimistic one.

2. the expected loss value determined in the baseline scenario (reference estimate). Simulation processing, the results of which are used to calculate the NLF, are performed on the basis of the same input data for exposure characteristics, but with different risk parameter vectors, where the macroeconomic expectations defined in the scenarios influence the values of these parameters.

Additionally, the inclusion of forward-looking information takes place in the models of all three credit risk parameters estimated in the lifetime horizon (LtPD, LtEAD, LtLGD). The data relating to the future is used to determine the values of parameters over a period from 12 months to 6 years. In its estimates, the Bank uses, inter alia, generally available macroeconomic indicators (employment in the enterprise sector, unemployment rate, export / import level, wages, bond profitability, monetary receivables of financial institutions from households), expectations regarding the development of interest rates and exchange rates, as well as changes in real estate prices. In the case of individual ECL estimation, the assumed recovery scenarios take into account different conditions of the macroeconomic environment.

Impairment corporate portfolio

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

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

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

a) The bank stopped charging interest on the credit exposure to the profit and loss account
b) The bank determines the expected credit losses (ECL) as a result of a significant deterioration of creditworthiness after the liability to the Bank arises
c) disposal by the Bank of an exposure with a significant economic loss related to a change in its creditworthiness,
d) the Bank's authorization for a forced restructuring of the credit obligation provided that it may result in a reduction of financial liabilities by writing off a significant part of the liability or deferring the repayment of the principal amount, interest or - if applicable - commission

e) the Bank submits a petition to declare the debtor bankrupt or a similar petition with regard to the debtor's credit obligations towards the Bank, the parent entity of the Bank or a subsidiary of the Bank,

f) bankruptcy of the debtor or obtaining by him similar legal protection, resulting in the avoidance or delay of repayment of credit obligations towards the Bank, the parent entity of the Bank or a subsidiary of the Bank.

Moreover, the Bank defined additional hard premises for the occurrence of a default event for individual sub-portfolios within the corporate portfolio, allowing for a better reflection of the specificity of a given sub-portfolio.

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.

Significant deterrioration

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

Qualitative criteria are:

- where an amount is more than 30 days past due and exceeds PLN 3 000 (days past due, with an activation threshold – the number of days for which the longest overdue amount of the exposure concerned is greater than or equal to 31 days),
- occurrence of the Forborne flag (the client status shows that he or she is experiencing difficulties in repaying the loan commitment, as defined by the Bank).
- occurrence of the Watch flag (the Bank's internal process designed to identify corporate clients who are subject to increased monitoring in terms of changes in credit quality, in accordance with the Watch List classification rules adopted by the Bank).

The Transfer Logic quantitative criterion uses a measure of significant credit deterioration based on the absolute change in the PD value determined for the exposure at the reporting date compared to the PD measure of the exposure determined at the initial recognition date.
If, during the life of the exposure, the value of the PD change exceeds the so-called the transition threshold, then the exposure is transferred to Basket 2. Another initial recognition date is determined for the exposures for which the contractual terms have been significantly modified.

Estimating expected credit losses (ECL)

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

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

assume a significant share of recoveries from the customer's own payments. In case of vindication strategy, the scenarios are based on collateral recoveries.
Determining the long-term PD parameter for the majority of the corporate portfolio (94%) is made on the basis of generating income from the lease of various areas, taking into account 5 models of risk factor dynamics (exchange rate model, interest rate, rental prices, occupancy level, level of the price index on the market) real estate) affecting the amount of these revenues.
As part of the modeling, both specific market data (exchange rates, interest rates) and specific real estate data (forecasts of expected revenues, schedule liabilities) are subjected to stress in order to determine the value of revenues, liabilities, property value, LTV ratios in the horizon until the loan maturity.

Based on a set of default conditions (independent of the regulatory definition of default), the Monte Carlo simulation determines the probability of an unfavorable economic situation that may lead to or contribute to default, which allows the mPD curve to be determined.

For a part of the portfolio, i.e. for exposures without individual estimates of risk parameters, the estimation based on the Weibull function with exponential adjustment was used, in which the cumulative DR (cDR) is the dependent variable.

For the purpose of determining the long-term LGD parameter, the bank determines the components of this parameter, ie ZLGD, RR and BD. ZLGD (Zero Loss Given Default) determines the share of loans that have entered the default state and left this state without taking any debt collection measures in relation to the total defaults. The indicator is quantified based on historical observations as well as for unfinished default cases based on expected recovery scenarios. RR (Recovery Rate) determines the expected recovery rate that the Bank is able to recover. The indicator is quantified based on the weighted average of the number of historical observations as well as for unfinished default cases based on the expected recovery scenarios.

BD (Bad Debt) defines the share of contracts in relation to which the realization of the security turned out to be impossible, ended with a total loss. Due to the fact that there are no such cases, the ratio is determined by experts, taking into account the impact of the expected changes in the legal and economic environment on the possibility of selling the real estate being the subject of collateral.

With regard to the long-term EAD parameter, due to the fact that all credit exposures are exposures with a repayment schedule, the bank, for the purposes of estimating the LtEAD value, uses the information on the gross carrying amount of the exposure, future principal and interest installments from the schedule available as at the reporting date and the effective amount interest rate. For the purpose of estimating the LtEAD value, the bank also uses information on the observed prepayment ratio in a given portfolio to which the loan product belongs.

<u>Use of macroeconomics scenarios in ECL estimation</u>

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

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

Determination of the LGD level for a corporate client in the horizon up to the loan maturity is made on the basis of forecasted LtV levels, which in turn are affected by forecasted rental price levels, vacancy levels and exchange rates.

<u>Loan receivable write-off</u>

Loan receivable write-off can be partial or total. In case of retail banking, writing off receivables can be done in the case of:

1. Debt recovery is not possible e.g.:
a. the claim limitation,

b. fraud – inability to identify the debtor,
c. limitation of inheritors' liability,
d. the claim was questioned by the debtor in court.

2. The lack or exhaustion of recovery capacity, in particular:
a. the discontinuance of enforcement proceedings due to its ineffectiveness,
b. rejection of the application for bankruptcy or closure of bankruptcy proceedings on the grounds that the debtor's assets are insufficient to cover the costs of the proceedings,
c. the recognition of the claim as irrecoverable - the costs of recovery exceed the potential recovery.

## 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, amounts due from other banks and government securities acquired for the purpose of short-term resale.

## 2.10. Derivative financial instruments and hedge accounting

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

The best fair value indicator for a derivative instrument at the time of its initial recognition is the price of the transaction (i.e., the fair value of the paid or received consideration). If the fair value of the particular instrument may be determined by comparison with other current market transactions concerning the same instrument (not modified) or relying on valuation techniques based exclusively on market data that are available for observation, then the Bank recognises the respective gains or losses from the first day in accordance with the principles described in note 2.11.

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

The method of recognising the resulting fair value gain or loss depends on whether the given derivative instrument is designated as a hedging instrument, and if it is, it also depends on the nature of the hedged item. The Group designates some derivative instruments either as (1) fair value hedges against a recognised asset or liability or against a binding contractual obligation (fair value hedge), or as (2) hedges against highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (cash flow hedge)

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 or cash flows attributable to the hedged risk**;**
- The hedge is expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship;
- for cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect profit or loss;

- The effectiveness of the hedge can be reliably measured, i.e. the fair value hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured;
- The hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.

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

Fair value hedges

Changes in the fair value of derivative instruments designated and qualifying as fair value hedges are recognized in the income statement together with any changes in the fair value of the hedged liability that are attributable to the hedged risk. The Bank presents the adjustment of balance sheet value of the hedged instrument as the separate line of the statement of financial position. The gain or loss on hedging a hedged item adjusts the carrying amount of the hedged item.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.
The forecast transaction being the subject of the hedge must be highly probable and must be subject to the threat of changes in cash flows, which could affect the profit and loss account;

Cash flow hedges

The effective part of the fair value changes of derivative instruments designated and qualifying as cash flow hedges is recognised in other comprehensive income. The gain or loss concerning the ineffective part is recognised in the income statement of the current period. The amounts recognised in other comprehensive income are transferred to the income statement and recognised as income or cost of the same period in which the hedged item will affect the income statement (e.g., at the time when the forecast sale that is hedged takes place). In case the hedging instrument has expired or has been sold, or the hedge has ceased to fulfil the criteria of hedge accounting, any aggregate gains or losses recognised at such time in other comprehensive income remain in other comprehensive income until the time of recognition in the income statement of the forecast transaction. When a forecast transaction is no longer expected to occur, the aggregate gains or losses recorded in other comprehensive income are immediately transferred to the income statement.

### 2.11. Gains and losses on initial recognition

The best evidence of fair value of a financial instrument at initial recognition is the transaction price (i.e., the fair value of the payment given or received), unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.

If the Bank determines that the fair value on initial recognition differs from the transaction price, it recognises the difference between the two values on that date as follows:

- as a gain or loss if the fair value is evidenced by the price quoted in an active market for an identical or identical asset or is based on a valuation technique that uses only data from observable markets,

- in other cases, including for CIRS transactions, is deferred.

The transaction for which the fair value determined using a valuation model (where inputs are both observable and non-observable data) and the transaction price differ, the initial recognition is at the transaction price. The Group assumes that the transaction price is the best indicator of fair value, although the value obtained from the valuation model may differ. The difference between the transaction price and the model value, commonly referred to as "day one profit and loss", is amortised over the period of time

The timing of recognition of deferred day one profit and loss is determined individually. It is either amortised over the life of the transaction, deferred until the instrument's fair value can be determined using market observable data, or realised through settlement. The financial instrument is subsequently measured at fair value, adjusted for the deferred day one profit and loss. Subsequent changes in fair value are recognised immediately in the income statement without reversal of deferred day one profits and losses.

## 2.12. Financial liabilities measured at amortised cost

Financial liabilities measured at amortized cost include borrowings, deposits taken, debt securities issued and subordinated liabilities. These liabilities are initially recognized at fair value reduced by the incurred transaction costs. After the initial recognition, these liabilities are recorded at adjusted cost of acquisition (amortised cost using the effective interest method). Any differences between the amount received (reduced by transaction costs) and the redemption value are recognized in the income statement over the period of duration of the respective agreements according to the effective interest rate method.

## 2.13. 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. Expenditures on an intangible asset are included in costs as they are incurred, unless they constitute an element of the purchase price or cost of creation of an intangible asset that meets the criteria of recognition.

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

Computer software

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

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

Development costs

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

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

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

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

## 2.14. Tangible fixed assets

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

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

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

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

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

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

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

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

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

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

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

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

Depreciable fixed assets are tested for impairment always whenever events or changes in circumstances indicate that the carrying value may not be recoverable and at the end of each reporting period. The value of a fixed asset carried in the statement of financial position is reduced to the level of its recoverable value if the carrying value in the statement of financial position exceeds the estimated recoverable amount. The recoverable value is the higher of two amounts: the fair value of the fixed asset reduced by its selling costs and the value in use. If it is not possible to estimate the recoverable amount of an individual asset, the Bank determines the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).

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.

## 2.15. Current and deferred income tax

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

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

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

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

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

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

## 2.16. Inventories

Assets repossessed for debt are classified by the Bank as inventories. At initial recognition assets repossessed for debt are valued at their fair value and then are stated at the lower of: purchase price or net sales price. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling costs. The amount of any inventory write-downs to the net realisable value and any inventory losses are recorded as costs of the period in which a write-down or a loss occurred. Reversals of inventory write-downs resulting from increases in their net realisable value are recorded as other operating income. As at December 31, 2020 and December 31, 2019, the Bank had no inventories.

## 2.17. Prepayments, accruals and deferred income

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

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

## 2.18. Provisions

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

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

## 2.19. Post-employment employee benefits and other employee benefits

Provision for retirement and similar benefits

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

Phantom share-based benefits settled in cash
The Bank runs a remuneration program for the Bank's Management Board and employees who have a significant impact on the Bank's risk profile, based on phantom shares settled in cash.
Pursuant to the provisions of IAS 19, the projected unit credit method was applied to determine the present value of employee benefit obligations. The basis for calculating the provision for the deferred part of the variable remuneration for eligible employees of the Bank is the amount of the bonus that the Bank undertakes to pay on the basis of the Employee Remuneration Policy that has a significant impact on the Bank's risk profile.
Phantom shares are awarded in the number resulting from the valuation of these shares for the assessment period. The valuation of phantom shares is calculated each time at the end of the reporting period as the quotient of the Bank's book value (estimated by the Bank's internal experts) and the number of ordinary shares. The payment of phantom shares depends on the average valuation of these shares derived from two values: the value of the phantom share at the end of the annual period preceding the payment date and the value of the phantom share at the end of the first half of the year in which the payment is to take place in a given reporting period. The final value of the bonus, being the product of the number of shares and their expected value as at the balance sheet date preceding the realization of each of the deferred tranches, is actuarial discounted. The actuarial discount is the product of the financial discount (the time value of money) and the probability that each participant will survive individually until the moment of full vesting of each of the deferred tranches. Probability, the aforementioned was determined by the competing risk method, where the following three risks were taken into account: the possibility of dismissal from work, the risk of complete incapacity for work, and the risk of death. The possibility of an employee quitting work has been assessed using a probability distribution, taking into account the Bank's statistical data. For the purposes of the valuation, it was assumed that the average probability of an employee's dismissal in each subsequent year of work is 11%. The risk of death was expressed in the form of the latest statistical data from Polish life expectancy tables for men and women, published by the Central Statistical Office, as at the date of the valuation. A detailed description of the program is presented
in note 41.

## 2.20. 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".

## 2.21. Loans and advances received

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

## 2.22. Equity

Equity consists of capital and own funds attributable to owners of the Bank, and non-controlling interest created in compliance with the respective provisions of the law, i.e., the appropriate legislative acts, the Bank by-laws.

Registered share capital

Share capital is presented at its nominal value, in accordance with the by-laws and with the entry in the business register.

Share premium

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

Costs directly connected with the issue of new shares and options reduce the proceeds from the issue recognized in equity.

Moreover, share premium takes into account the settlements related to incentive programs based on Bank's shares.

Retained earnings

Retained earnings include

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

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

Inne pozycje kapitałów

Inne pozycje kapitałów tworzone są w wyniku:

- valuation of financial assets at fair value through other comprehensive income,
- actuarial gains and losses relating to post-employment benefits,
- applying cash flow hedge accounting

## 2.23. Leasing

The Bank acts as the lessee. Leases are recognized as the right to use an asset together with the corresponding lease liability determined at the amount of discounted future payments over the lease term, except for short-term leases of up to 12 months and leases involving insignificant assets.

Expenses related to the use of leased assets are classified as amortization costs and interest costs.

Assets by virtue of the right of use are depreciated on a straight-line basis, while liabilities by virtue of leasing contracts are settled taking into account the effective interest rate.

mBankHipoteczny S.A. as a lessee

If the definition of a lease is met, the right to use an asset is recognized in the group of property, plant and equipment together with the appropriate lease liability, ie under financial liabilities measured at amortized cost.The Bank as a lessee applies simplified approach and it does not apply the requirements in terms of recognition, measurement and presentation for short-term lease contracts lasting no longer than 12 months for each class of underlying asset as well as for lease contracts for which the underlying asset is of low value, i.e. less than PLN 20 000 for separate leases. Lease payments are recognized as costs using straight-line method throughout the lease period for lease contracts for which the Group applies simplified approach. Perpetual usufruct right is classified as a lease according to IFRS 16 due to the occurrence of future fees for the use of this right. The Group assumed that the lease period for this type of contracts is the remaining period of the right granted since the transition to IFRS 16.

Group shall determine the lease term as the non-cancellable period of a lease, together with both:

- periods covered by an option to extend the lease if the Bank as a lessee is reasonable certain to exercise that option, and
- periods covered by an option to terminate the lease if the Bank as a lessee is reasonable certain not to exercise that option.

The Bank shall reassess whether it is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease. The Bank shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise an option to extend a lease, or not to exercise an option to terminate a lease. The Bank shall reassess whether it is reasonably certain to exercise an extension option, or not to exercise a termination option, upon the occurrence of either a significant event or a significant change in circumstances that is within the control of the Bank as a lessee, and that affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term. The Bank shall revise the lease term if there is a change in the non-cancellable period of a lease.

- the amount of the initial measurement of the lease liability
- any lease payments made at or before the commencement date, less any lease incentives received,
- initial direct costs incurred by the Group as a lessee in connection with the conclusion of the leasing contract and
- an estimate of the costs to be incurred by the Group as a lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories.

After the commencement date, the Group as a lessee shall measure the right-of-use asset at cost:

- less any accumulated depreciation and any accumulated impairment losses and,
- adjusted for any remeasurement of the lease liability.

The Bank applies the depreciation requirements in IAS 16 Property, Plant and Equipment in depreciating the right-of-use asset and requirements in IAS 36 Impairment of Assets to determine whether the rightof-use asset is impaired. At the commencement date, the Group shall measure the lease liability at the present value of the lease payments that are not paid at that date. At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments:

- fixed lease payments less any lease incentives,
- variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date,
- amounts expected to be payable by the lessee under residual value guarantees,
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option and,
- payment of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Variable lease payments that depend on an index or a rate include, for example, payments linked to a customer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates. After the commencement date, the Group shall measure the lease liability by:

- increasing the carrying amount to reflect interest on the lease liability,
- reducing the carrying amount to reflect the lease payments made and,
- remeasuring the carrying amount to reflect any reassessment or lease modifications or to reflect revised in-substance fixed lease payments

The Bank discounts lease payments using the interest rate of lease if this rate can be easily determined. Otherwise, the Group applies the marginal interest rate of lessee. As the lessee the Group estimates the discount rate taking into account the duration and the currency of the contract. Cash payments of lease liabilities are classified in statement of cash flows within financial activities. Short term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability are classified in statement of cash flows within operating activites. Total lease expenses recognized in accordance with IFRS 16 and other types of lease, i.e. short-term lease fees, lease fees for low-value assets and variable lease payments as at December 31, 2020 amounted to PLN 3,831 thousand. PLN, while as at December 31, 2019 they amounted to PLN 3 848 thousand. PLN.

Before the implementation of IFRS 16, the Bank, as a lessee, classified lease agreements existing in the Bank as operating lease agreements. All lease payments made under operating lease were charged to costs on a straight-line basis over the lease term. There were no financial lease agreements in the Bank.

## 2.24. 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. Foreign exchange gains and losses on such transactions as well as balance sheet revaluation of monetary assets and liabilities denominated in foreign currency are recognised in the income statement.

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

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

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

## 2.25. Tax from the off-balance sheet positions of the Bank

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

## 2.26. Received financial guarantees

Guarantees received during the life of the loan are not an integral part of the loan and should not be considered as collateral for the loan. They are accounted for as a separate financial instrument and the cash flows from which are not included in the measurement of ECL for a loan that is guaranteed.

Where the cash flows under the financial guarantee contract are not included in the expected credit losses on the guaranteed loan, the guarantee return is treated as a separate expected return asset (Other assets). As at the date of granting the guarantee, no asset to be reimbursed is recognized in the amount of the present value of the write-down for expected credit losses, and the impact on the financial result is neutral. This is due to the fact that the mechanism of this instrument is designed to cover the potential increases in the write-off for expected credit losses on the guaranteed portfolio. The change in the value of the asset to be returned, which is referred to the income statement in the same line as the costs of expected credit losses (impairment or reversal of impairment on financial assets not measured at fair value through profit or loss), is conditional on the recognition of an increase in credit risk on a given exposure.

## 2.27. New standards, interpretations and amendments to published standards

### Standards and interpretations endorsed by the European Union

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

- Amendments to IFRS 16 COVID-19-Related Rent Concessions, published by International Accounting Standards Board on 28 May 2020, approved by the European Union on 10 October 2020, binding for annuals periods starting on or after 1 June 2020.

  Amendments to IFRS 16 provides practical expedient that permits lessees not to assess whether rent concessions that occur as a direct consequence of the COVID-19 pandemic and meet specified conditions are lease modifications and, instead, to account for those rent concessions as if they were not lease modifications.

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

- Amendments to IFRS 4 Extension of the Temporary Exemption from Applying IFRS 9, published by International Accounting Standards Board on 25 June 2020, approved by the European Union on 15 December 2020, binding for annuals periods starting on or after 1 June 2023.

  Amendments to IFRS 4 provides a temporary exemption that permits the insurer to apply IAS 39 rather than IFRS 9 Financial Instruments. The extension maintains the alignment between the expiry date of the temporary exemption and the effective date of IFRS 17, which replaces IFRS 4.

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

- Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 Interest Rate Benchmark Reform – Phase 2, published by International Accounting Standards Board on 27 August 2020, approved by the European Union on 13 January 2021, binding for annuals periods starting on or after 1 January 2021.

  Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 Interest Rate Benchmark Reform – Phase 2 relate to the modification of financial assets, financial liabilities and lease liabilities, specific hedge accounting requirements, and disclosure requirements applying IFRS 7 to accompany the amendments regarding modifications and hedge accounting.

  Regarding modification of financial assets, financial liabilities and lease liabilities a practical expedient for modifications required by the reform (modifications required as a direct consequence of the IBOR reform and made on an economically equivalent basis) has been introduced. These modifications are accounted for by updating the effective interest rate. All other modifications are accounted for using the current IFRS requirements. A similar practical expedient is proposed for lessee accounting applying IFRS 16.

  Regarding hedge accounting amendments, hedge accounting is not discontinued solely because of the IBOR reform. Hedging relationships (and related documentation) must be amended to reflect modifications to the hedged item, hedging instrument and hedged risk. Amended hedging relationships should meet all qualifying criteria to apply hedge accounting, including effectiveness requirements.

  Specific disclosures are also required in order to allow users to understand the nature and extent of risks arising from the IBOR reform to which the entity is exposed to and how the entity manages those risks as well as the entity's progress in transitioning from IBORs to alternative benchmark rates, and how the entity is managing this transition.

IFRS 4 was also amended to require insurers that apply the temporary exemption from IFRS 9 to apply the amendments in accounting for modifications directly required by IBOR reform.

The Bank is currently analysing the impact of applying the amendments to the standards on the financial statements in the period of their initial application.

**Standards and interpretations not yet endorsed by the European Union**

These financial statements do not include standards and interpretations listed below which await endorsement of the European Union.

- IFRS 17, *Insurance contracts*, published by the International Accounting Standards Board ("IASB") on 18 May 2017, binding for annual periods starting on or after 1 January 2023.

  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 within the scope of IFRS 17 have on the financial position, financial performance and cash flows of the entity. IFRS 17 introduces a number of significant changes in relation to the existing requirements of IFRS 4. They concern, among others: aggregation levels at which the calculations are made, methods for the valuation of insurance liabilities, recognition a profit or loss over the period the entity provides insurance coverage, reassurance recognition, separation of the investment component and presentation of particular items of the balance sheet and profit and loss account of reporting units including the separate presentation of insurance revenues, insurance service expenses and insurance finance income or expenses.

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

- Amendments to IFRS 17, published by International Accounting Standards Board on 25 June 2020, binding for annuals periods starting on or after 1 June 2023.

  Amendments to IFRS 17 include a two-year deferral of the effective date and the fixed expiry date of the temporary exemption from applying IFRS 9 granted to insurers meeting certain criteria. Preparers of financial statements are no longer required to apply IFRS 17 to certain credit cards and similar arrangements, and loans that provide insurance coverage. The profit recognition pattern for insurance contracts under IFRS 17 has been amended to reflect insurance coverage and any investment services provided. Insurance contracts are now required to be presented on the balance sheet at the portfolio level. The amendment addresses also accounting mismatches that arise when an entity reinsures onerous contracts and recognizes losses on the underlying contracts on initial recognition.

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

- Amendments to IAS 1, Classification of liabilities as current or non-current, published by IASB on 23 January 2020. On 15 July 2020 the IASB published an amendment that provides entities with operating relief by postponing the effective date of the amendments to the Standard by one year for annual reporting periods beginning on or after 1 January 2023.

  Amendments to IAS 1 affect the requirements for the presentation of liabilities in the financial statements. In particular, they explain one of the criteria for classifying liabilities as non-current.

  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.

- Annual Improvements to IFRS Standards 2018-2020, published by International Accounting Standards Board on 14 May 2020, binding for annuals periods starting on or after 1 January 2022.

  Annual Improvements include changes to IFRS 1 First-time Adoption of International Financial Reporting Standards, IFRS 9 Financial Instruments, Illustrative Examples accompanying IFRS 16 Leases and IAS 41 Agriculture.

  The amendment to IFRS 1 permits a subsidiary that applies paragraph D16(a) of IFRS 1 to measure cumulative translation differences using the amounts reported by its parent, based on the parent's date of transition to IFRSs.

The amendment to IFRS 9 clarifies which fees the entity includes when it applies the '10 per cent test' in assessing whether to derecognize a financial liability. An entity includes only the fees paid or received between the entity (the borrower) and the lender, including fees paid or received by either the entity or lender on the other's behalf.

The amendment to IFRS 16 removes the illustration of payments from the lessor relating to leasehold improvements in order to resolve any potential confusion regarding the treatment of lease incentives.

The amendment to IAS 41 removes the requirement to exclude cash flows for taxation when measuring fair value of a biological asset using a parent value technique. This will ensure consistency with the requirements in IFRS 13 Fair Value Measurement.

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

- Amendments to IAS 16 Property, Plant and Equipment: Proceeds before Intended Use, published by International Accounting Standards Board on 14 May 2020, binding for annuals periods starting on or after 1 January 2022.

  Amendments to IAS 16 prohibit a company from deducting from the cost of property, plant and equipment amounts received from selling items produced while the company is preparing the asset for its intended use. Instead, a company will recognize such sales proceeds and related cost in profit or loss.

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

- Amendments to IAS 37 Onerous contracts – Cost of Fulfilling the Contract, published by International Accounting Standards Board on 14 May 2020, binding for annuals periods starting on or after 1 January 2022.

  Amendments to IAS 37 specifies which costs to include in estimating the cost of fulfilling a contract for the purpose of assessing whether the contract is onerous.

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

- Amendments to IFRS 3 Reference to the Conceptual Framework, published by International Accounting Standards Board on 14 May 2020, binding for annuals periods starting on or after 1 January 2022.

  Amendments to IFRS 3 replaced references to the Framework with references to the 2018 Conceptual Framework. They also added a requirement that, for transactions and other events within the scope of IAS 37 or IFRIC 21, an acquirer applies IAS 37 or IFRIC 21 (instead of conceptual framework) to identify the liabilities it has assumed in business combination. Moreover, the standard added an explicit statement that an acquirer does not recognize contingent asset acquired in a business combination.

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

- Amendment to IAS 8, Definition of Accounting Estimates, published by International Accounting Standards Board on 12 February 2021, binding for annuals periods starting on or after 1 January 2023.

  In amendment to IAS 8 Definition of Accounting Estimates, the definition of a change in accounting estimates was replaced with a definition of accounting estimates. Under the new definition, accounting estimates are monetary amounts in financial statements that are subject to measurement uncertainty. The IASB also clarified a new definition through additional guidance and examples, how accounting policies and accounting estimates relate to each other and how a change in valuation technique is a change in accounting estimates. The introduction of a definition of accounting estimates and other amendments to IAS 8 was aimed to help entities distinguish changes in accounting policies from changes in accounting estimates.

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

- Amendments to IAS 1 and IFRS Practice Statement 2 Disclosure of Accounting Policies, published by International Accounting Standards Board on 12 February 2021, binding for annuals periods starting on or after 1 January 2023.

for 2020 (in PLN thousand)

Amendments to IAS 1 and IFRS Practice Statement 2 are intended to help preparers in deciding which accounting policies to disclose in their financial statements. The amendments introduce the requirement to disclose material accounting policy information instead of significant accounting policies. Some clarifications and examples were added how an entity can identify material accounting policy information. The amendments clarify that accounting policy information may be material because of its nature, even if the related amounts are immaterial and if users of financial statements would need it to understand other material information in the financial statements.

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

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

### Reform of interest rate indicators

mBank Hipoteczny provides services in the field of servicing mortgage loan portfolios, issuing securities and concluding derivative transactions (only for its own account). Therefore, it is an entity exposed to the risk related to the evolution of rates and the migration of the market to rates consistent with the BMR Regulation. The greatest impact of the reform of benchmark interest rates (IBOR reform) is observed in the field of financial instruments, in particular loans and securities whose interest rates are based on the WIBOR, EURIBOR and LIBOR USD benchmarks. Among these three indicators, mBank Hipoteczny identifies the highest risk of an event on the indicator (i.e. the situation in which the indicator will not be published, will cease to be published, will not be able to be used, will change), mBank Hipoteczny identifies on the USD LIBOR indicator. The legal risk resulting from the method of replacing this ratio is limited due to the low value of loans bearing interest based on this ratio (approx. USD 9.6 million, which is approx. 0.3% of the entire portfolio). The bank identifies the greatest impact of the IBOR reform on older loan agreements (granted before 2018) that do not take into account the principles of rate changes due to liquidation or a significant change of the ratio used in the agreement. The bank sees the changes introduced to the WMD regulation as a risk mitigator. These changes were adopted by the European Parliament on January 19, 2021. In terms of instruments based on WIBOR and EURIBOR, mBH does not identify significant risks in the next few years. This is due to the fact that the Polish Financial Supervision Authority issued a decision on granting GPW Benchmark S.A. on December 16, 2020. authorization to conduct business as an administrator of interest rate benchmarks, including the key WIBOR indicator, the method of quoting of which has been adjusted to the requirements of the BMR Regulation. This event resulted in the elimination of a significant regulatory risk in relation to this indicator. In the case of the EURIBOR rate, the process of adjusting the rate to the requirements of the WMD Regulation was completed in June 2019. The bank has 80.3% of the loan portfolio with interest based on WIBOR and 19.4% for the EURIBOR rate. It also has 15 issues of securities with an interest rate based on the WIBOR index, the longest of which matures in 2028 and one issue, the interest rate of which is based on the EURIBOR rate maturing in 2021. Additionally, the Bank has a portfolio of derivatives hedging the issue of fixed-rate securities that convert a fixed rate to a variable. The table below shows the notional values and the weighted average maturity of the derivatives in hedging relationships that will be affected by the IBOR reform, analyzed at the interest rate. Derivative hedging instruments ensure a close approximation of the scope of risk exposure managed by the Bank through hedging relationships.

| 31.12.2020 | Nominal value | Weighted average maturity (in years) |
|---|---|---|
| **Interest Rate Swap (IRS)** | | |
| EURIBOR (3 months) | 2 067 430 | 3,7 |
| EURIBOR (6 months) | 456 404 | 5,1 |
| **Interest rate swaps (IRS), total** | **2 523 834** | |
| | | |
| **Contract CIRS (Cross-Currency Interest Rate Swap)** | | |
| WIBOR (3 months) | 1 278 930 | 4,7 |
| **Contract CIRS (Cross-Currency Interest Rate Swap), total** | **1 278 930** | |
| **Total** | **3 802 764** | |

As a result of the ongoing reform of the interest rate benchmark and its replacement with a risk-free alternative interest rate, the Bank has launched a project to manage a change for any of its contracts that may be affected. An important issue minimizing the risk is the fact that the Bank concludes new contracts only on the basis of rates consistent with the BMR Regulation. It should also be emphasized that mBank Hipoteczny has a reliable plan, prepared in writing, specifying the course of action in the event of significant changes or discontinuation of the benchmark.

## 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 24.

#### 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 99.01% of total sum of risk-weighted exposures with standard method including portfolios covered with a plan of gradual implementation and 45.69% without including those portfolios. The difference results from the fact, that 53.32% 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.

The amount of losses incurred in 2020 was higher than the amount of losses incurred in the corresponding period of the previous year - an increase from PLN 20,315 thousand. PLN up to 43 890 thousand. PLN. The main driver of the increase was the need to create credit write-offs for identified defaults under the stand-alone approach and for exposures covered by the portfolio approach due to the impact of the COVID-19 pandemic.
The Bank, using an individual approach, made judgments on the reclassification of credit exposures to individual baskets, in particular with regard to identifying a significant increase in credit risk and identifying premises for default in an individual approach.

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

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

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

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

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

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

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

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

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

For the purposes of assessment of reliability of a client applying for a retail loan product secured with mortgage and monitoring/reporting of credit risk for this portfolio, group credit risk models, which the Bank is a local user, are applied. Detailed rules and scope of cooperation between Banks in terms of group risk models are specified by provisions of a separate agreement on cooperation in the scope of risk management. The capital requirement for credit risk for this part of the portfolio is calculated using the standard method, since as on 31 December 2019 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.

The risk-weighted exposure amounts to credit risk calculated using the internal ratings method using the supervisory approach for assigning specialized lending exposures to risk categories (IRB slotting approach) are presented in note 44

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

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

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

### 3.1.3. EBA guidelines on the application of the definition of default (EBA/GL2016/07)

On 1 January 2021, EBA's guidelines on the application of the definition of default set out in Art. 178 of the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26/06/2013.

Key changes include:

- change in the method of calculating days past due;

- determination of the materiality threshold (relative and absolute) in accordance with the Regulation of the Minister of Finance, Investment and Development of October 3, 2019 (paragraph 2), it will be exceeded when:

1.the sum of all overdue credit obligations of the debtor towards the bank exceeds:

a. PLN 400 - in the case of retail exposures,

b. PLN 2,000 - for exposures other than retail exposures,

2. the amount of overdue credit obligations of the debtor in relation to the total amount of all the bank's balance sheet exposures to this debtor exceeds 1%;

- guidelines on forced restructuring. The materiality threshold from which the Bank considers a diminished financial liability to be defaulted is 1%;

- introducing a quarantine (trial period), the time during which the Bank assesses the behavior and financial situation of the debtor. The quarantine period is calculated from the moment when the event giving rise to the premise of default ceased to apply. The duration of the quarantine is 12 months in the case of a forced restructuring condition, and 3 months in the case of other premises. Proper handling of obligations by the debtor during the trial period is the basis for reclassifying him to the status of non-default;

- consistent application of the definition of default - the EBA guidelines require institutions to implement appropriate processes ensuring that the default of one obligor is consistently identified throughout the Group;

- detailed rules for the treatment of joint credit obligations - the Bank applies the definition of default at the level of the obligor in the retail area, therefore it is obliged to apply the provisions of par. 95-105 of the Guidelines on the basis of which the Authority should define in its internal rules and procedures the rules for the treatment of joint credit obligations and for the transfer of default status between exposures.

The implementation of changes in the definition of default under the EBA guidelines unifies the approach on the European market, thus ensuring comparability of the levels of non-performing loans presented by institutions.

The impact of the implementation of the EBA guidelines for credit risk as at January 1, 2021 is a decrease in the level of write-offs for the commercial portfolio by approximately PLN 0.44 million and for the retail portfolio by approximately PLN 2.13 million.

### 3.1.4. Repossessed collateral

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

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

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

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

In both 2019 and 2018, the Bank did not take over any collaterals.

### 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.

for 2020 (in PLN thousand)

The risk of no repayment of the product portfolio subject to the forbearance policy is mitigated with the amount of PLN 462 200 thousand of accepted collaterals (the mortgage lending value of the property that constitute the collateral of the loan), therefore, the possible influence of this portfolio on deterioration of the entire portfolio of the Bank is significantly limited.

The analysis conducted for the above reporting periods showed a negligible share of exposures that leave and return to forbearance status within one year.

The structure of the loan portfolio measured at amortized cost in the forbearance category in mBank Hipoteczny S.A. as at 31 December 2020 is as follows:

| 31.12.2020 | Gross value | Of which defaulted | Write-downs created | Net value |
|---|---|---|---|---|
| Loans and advances to customers, including: | 275 228 | 161 279 | 61 306 | 213 922 |
| Corporate customers | 238 782 | 156 829 | 59 159 | 179 623 |
| Individual customers | 36 446 | 4 450 | 2 147 | 34 299 |
| **Total balance sheet data** | **275 228** | **161 279** | **61 306** | **213 922** |

The structure of the loan portfolio measured mandatorily at fair value through profit or loss in the forbearance category in mBank Hipoteczny S.A. as at 31 December 2020 is as follows:

| 31.12.2020 | Fair value | Of which defaulted |
|---|---|---|
| Non-trading financial assets mandatorily at fair value through profit or loss - loans and advances to customers, including: | 7 698 | 5 921 |
| Corporate customers | 7 698 | 5 921 |
| **Total** | **7 698** | **5 921** |

The structure of the loan portfolio measured at amortized cost in the forbearance category in mBank Hipoteczny S.A. as at 31 December 2019 is as follows:

| 31.12.2019 | Gross value | Of which defaulted | Write-downs created | Net value |
|---|---|---|---|---|
| Loans and advances to customers, including: | 227 959 | 164 578 | 53 463 | 174 496 |
| Corporate customers | 194 993 | 159 407 | 51 657 | 143 336 |
| Individual customers | 32 966 | 5 171 | 1 806 | 31 160 |
| **Total balance sheet data** | **227 959** | **164 578** | **53 463** | **174 496** |

The structure of the loan portfolio measured mandatorily at fair value through profit or loss in the forbearance category in mBank Hipoteczny S.A. as at 31 December 2019 is as follows:

| 31.12.2019 | Fair value | Of which defaulted |
|---|---|---|
| Non-trading financial assets mandatorily at fair value through profit or loss - loans and advances to customers, including: | 26 210 | 24 056 |
| Corporate customers | 26 210 | 24 056 |
| **Total** | **26 210** | **24 056** |

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 2.45% (2.14% as at 31.12.2019) of the entire portfolio. As at 31 December 2020, the forbearance exposure portfolio in the default category represented 59.09% of the forbearance portfolio (74.22% as at 31.12.2019). 38.01% of the portfolio of default exposures was covered with allowances (18.14% as at 31.12.2019).

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 478 951 thousand (PLN 462 200 thousand as at 31.12.2019), including PLN 375 377 thousand in the default category (PLN 347 971 thousand as at 31.12.2019).

for 2020 (in PLN thousand)

Changes in the carrying amount of the forbearance exposures measured at amortized cost in 2020:

| | Gross value | Of which defaulted | Write-downs created | Net value |
|---|---|---|---|---|
| **Saldo 01.01.2020** | **227 959** | **164 578** | **53 463** | **174 496** |
| Outputs from forbearance | (9 049) | - | (51) | (8 998) |
| Change in exposure | (43 774) | (73 129) | (20 559) | (23 215) |
| New forbearance | 100 092 | 69 830 | 28 454 | 71 638 |
| **Saldo 31.12.2020** | **275 228** | **161 279** | **61 307** | **213 921** |

In 2020, 48 new exposures in the forbearance category were added, of which 8 were corporate clients for a total gross amount of PLN 87,530 thousand. PLN. In 2019, 42 new exposures entered the forbearance category, of which only 3 related to corporate clients for a total gross amount of PLN 41 803 thousand PLN.

Changes in the fair value of the forbearance exposures which is mandatorily at fair value through profit or loss in 2020:

| | Fair value | Of which defaulted |
|---|---|---|
| **Saldo 01.01.2020** | **26 210** | **24 056** |
| Outputs from forbearance | - | - |
| Change in exposure | (18 512) | (18 135) |
| New forbearance | - | - |
| **Saldo 31.12.2020** | **7 698** | **5 921** |

Changes in the carrying amount of the forbearance exposures measured at amortized cost in 2019:

| | Gross value | Of which defaulted | Write-downs created | Net value |
|---|---|---|---|---|
| **Saldo 01.01.2019** | **219 547** | **180 210** | **33 362** | **186 185** |
| Outputs from forbearance | (11 496) | (8 317) | 7 504 | (19 000) |
| Change in exposure | (33 120) | (31 768) | 3 646 | (36 766) |
| New forbearance | 53 028 | 24 453 | 8 951 | 44 077 |
| **Saldo 31.12.2019** | **227 959** | **164 578** | **53 463** | **174 496** |

Changes in the fair value of the forbearance exposures which is mandatorily at fair value through profit or loss in 2019:

| | Fair value | Of which defaulted |
|---|---|---|
| **Saldo 01.01.2019** | **31 982** | **24 190** |
| Outputs from forbearance | - | - |
| Change in exposure | (5 772) | (134) |
| New forbearance | - | - |
| **Saldo 31.12.2019** | **26 210** | **24 056** |

Forbearance exposures measured at amortized cost by type of concession as at 31 December 2020

| Type of concession 31.12.2020 | Gross value | Of which defaulted | Write-downs created | Net value |
|---|---|---|---|---|
| Refinancing | 12 812 | 11 303 | 1 508 | 11 304 |
| Modification of terms and conditions | 262 416 | 149 976 | 59 798 | 202 618 |
| **Total** | **275 228** | **161 279** | **61 306** | **213 922** |

Forbearance exposures measured mandatorily at fair value through profit or loss by type of concession as at 31 December 2020

| Type of concession 31.12.2020 | Fair value | Of which defaulted |
|---|---|---|
| Refinancing | - | - |
| Modification of terms and conditions | 7 698 | 5 921 |
| **Total** | **7 698** | **5 921** |

for 2020 (in PLN thousand)

Forbearance exposures measured at amortized cost by type of concession as at 31 December 2019

| Type of concession (31.12.2019r.) | Gross value | Of which defaulted | Write-downs created | Net value |
|---|---|---|---|---|
| Refinancing | 11 964 | 11 964 | 1 037 | 10 927 |
| Modification of terms and conditions | 215 995 | 152 614 | 52 426 | 163 569 |
| **Total** | **227 959** | **164 578** | **53 463** | **174 496** |

Forbearance exposures measured mandatorily at fair value through profit or loss by type of concession as at 31 December 2019

| Type of concession (31.12.2019r.) | Fair value | Of which defaulted |
|---|---|---|
| Refinancing | - | - |
| Modification of terms and conditions | 26 210 | 24 056 |
| **Total** | **26 210** | **24 056** |

Forbearance exposures measured mandatorily at fair value through profit or loss per length of overdue period as at 31 December 2020

| 31.12.2020<br>Past due period | Fair value | Of which defaulted |
|---|---|---|
| Not overdue | 5 921 | 5 921 |
| over 90 days | 1 777 | - |
| **Total** | **7 698** | **5 921** |

Forbearance exposures measured mandatorily at fair value through profit or loss per length of overdue period as at 31 December 2019

| 31.12.2019<br>Past due period | Fair value | Of which defaulted |
|---|---|---|
| Not overdue | 2 154 | - |
| up to 30 days | - | - |
| 31 to 90 days | 5 162 | 5 162 |
| over 90 days | 18 894 | 18 894 |
| **Total** | **26 210** | **24 056** |

Forbearance exposures measured at amortized cost without recognised loss impairment per length of overdue period as at 31 December 2020

| Forbearance exposures without impairment recognised (31.12.2020r.) | Gross value | Of which defaulted | Write-downs created | Net value |
|---|---|---|---|---|
| Not overdue | 46 817 | - | 2 704 | 44 113 |
| up to 30 days | 6 443 | - | 148 | 6 295 |
| 31 to 90 days | 2 351 | - | 117 | 2 234 |
| **Total** | **55 611** | **-** | **2 969** | **52 642** |

Forbearance exposures measured at amortized cost without recognised loss impairment per length of overdue period as at 31 December 2019

| Forbearance exposures without impairment recognised (31.12.2019r.) | Gross value | Of which defaulted | Write-downs created | Net value |
|---|---|---|---|---|
| Not overdue | 58 481 | - | 1 428 | 57 053 |
| up to 30 days | 1 821 | - | 41 | 1 780 |
| 31 to 90 days | 2 974 | - | 151 | 2 823 |
| over 90 days | 328 | 328 | 8 | 320 |
| **Total** | **63 604** | **328** | **1 628** | **61 976** |

for 2020 (in PLN thousand)

Forbearance exposures measured at amortized cost with recognised loss impairment per length of overdue period as at 31 December 2020

| Forbearance exposures without impairment recognised (31.12.2020r.) | Gross value | Of which defaulted | Write-downs created | Net value |
|---|---|---|---|---|
| Not overdue | 102 953 | 102 953 | 10 536 | 92 417 |
| up to 30 days | 1 891 | 1 891 | 356 | 1 535 |
| 31 to 90 days | 12 304 | 12 304 | 3 053 | 9 251 |
| more than 90 days | 102 467 | - | 44 393 | 58 074 |
| **Total** | **219 615** | **117 148** | **58 338** | **161 277** |

Forbearance exposures measured at amortized cost with recognised loss impairment per length of overdue period as at 31 December 2019

| Forbearance exposures with impairment recognised (31.12.2019r.) | Gross value | Of which defaulted | Write-downs created | Net value |
|---|---|---|---|---|
| Not overdue | 76 875 | 76 770 | 20 863 | 56 012 |
| up to 30 days | 7 856 | 7 856 | 247 | 7 609 |
| 31 to 90 days | 821 | 821 | (6) | 827 |
| over 90 days | 78 803 | 78 803 | 30 731 | 48 072 |
| **Total** | **164 355** | **164 250** | **51 835** | **112 520** |

Forbearance exposures measured mandatorily at fair value through profit or loss by industry as at 31 December 2020

| As at 31 December 2020 | Fair value | Of which defaulted |
|---|---|---|
| Activity related to the real estate market | 7 698 | 5 921 |
| Building industry | - | - |
| **Total** | **7 698** | **5 921** |

Forbearance exposures measured at amortized cost by industry as at 31 December 2020

| As at 31 December 2020 | Gross value | Of which defaulted | Write-downs created | Net value |
|---|---|---|---|---|
| Activity related to the real estate market | 121 525 | 103 004 | 9 478 | 112 047 |
| Building industry | 117 257 | 53 825 | 49 681 | 67 576 |
| Natural persons | 36 446 | 4 450 | 2 147 | 34 299 |
| **Total** | **275 228** | **161 279** | **61 306** | **213 922** |

Forbearance exposures measured mandatorily at fair value through profit or loss by industry as at 31 December 2019

| As at 31 December 2019 | Fair value | Of which defaulted |
|---|---|---|
| Activity related to the real estate market | 17 937 | 15 783 |
| Building industry | 8 273 | 8 273 |
| **Total** | **26 210** | **24 056** |

Forbearance exposures measured at amortized cost by industry as at 31 December 2019

| As at 31 December 2019 | Gross value | Of which defaulted | Write-downs created | Net value |
|---|---|---|---|---|
| Activity related to the real estate market | 124 085 | 88 499 | 23 961 | 100 124 |
| Building industry | 70 908 | 70 908 | 27 696 | 43 212 |
| Natural persons | 32 966 | 5 171 | 1 806 | 31 160 |
| **Total** | **227 959** | **164 578** | **53 463** | **174 496** |

Interest income related to forbearance exposures at the end of 2020, amounted to PLN 5 897 thousand (for the period ended 31 December 2019: PLN 7 440 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 198product 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 2020 amounted to PLN 36 446 thousand (PLN 32 966 thousand as at 31.12.2019).

<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 conclude that the customer has returned to the regular category the debt and interest must be serviced in a proper manner (delays in payment not exceeding 31 DPD) at least until the mid trial period and there must be no amount overdue at the end of the trial period. None of the debtor's exposures above PLN 3,000 is past due for more than 30 days at the end of the reporting period.

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

All loan products granted to a client serviced in the area of restructuring in the scope of the Bad Loans Section in the Commercial Loans Risk Department have the forbearance status and are subject to disclosure.
The portfolio of products of forbearance status in the corporate part as at 31 December 2020 amounted to PLN 275 228 thousand for assets measured at amortized cost and PLN 7 698 thousand for the portfolio measured mandatorily at fair value through profit or loss (PLN 194 993 thousand as at 31.12.2019 and PLN 26 210 thousand for the portfolio measured mandatorily at fair value through profit or loss). 30.27% of forbearance loans as at the end of December 2020 received aid in the form of a moratorium, including 1% for credit holidays.

### 3.1.6. Counterparty risk arising from transactions in derivatives

The Bank enters into derivative transactions only to hedge against currency risk and interest rate risk. The bank does not conduct trading activities, all derivative transactions are included in the banking book. The Bank's portfolio includes interest rate risk (IRS), exchange rate risk (FX SWAP contracts) and CIRS derivatives. The Bank has credit exposure limits for derivative transactions, approved by the Bank's Management Board. The amounts of the applicable credit exposure limits for individual banks are subject to review and verification at least once a year. The bank sets limits for banks with which an ISDA (International Swaps and Derivatives Association) agreement has been signed with a CSA (Credit Support Annex), for banks with which it plans to sign ISDA agreements with a CSA annex, and for central clearing houses, by which the Bank will settle derivative transactions. The counterparty risk is limited by selecting the individual segregated account structure in the clearing house. The utilization of credit exposure limits is controlled on a daily basis. Both in 2020 and 2019, there were no cases of exceeding the limits. As of December 31, 2020 and on On December 31, 2019, derivative transactions were concluded with mBank S.A. and with the central clearing house. Therefore, it is assumed that derivative transactions at the Bank have a limited credit risk profile.

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

The value of debt securities (financial assets at fair value through other comprehensive income) as at 31 December 2020 amounted to PLN 791 045 thousand, and as at 31 December 2019 amounted to PLN 1 221 735 thousand. Debt securities on both 31 December 2020 and 31 December 2019 had A- rating in the scale of Standard & Poor's (S&P) Ratings.

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

- as at 31 December 2020 amounted to PLN 151 009 thousand,
- as at 31 December 2019 amounted to PLN 239 815 thousand.

Investment securities on which collateral was established are presented in Note 34.

Both as at 31 December 2020 and 31 December 2019 all investment securities were not past due instruments, without impairment.

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

Risk of geographical concentration

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

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

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

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

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

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

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

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

i) stress test results.

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

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

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

<u>Sector concentration risk</u>

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 2020 and 31 December 2019 no exceeding of exposure limit against an entity or a group of affiliated clients specified in Art. 395.1 of the CRR Regulation occurred in the Bank.

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

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

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

| No. | Trade | 31.12.2020 | | 31.12.2019 | |
|---|---|---|---|---|---|
| | | Net carrying amount (PLN '000) | Share in the portfolio (%) | Net carrying amount (PLN '000) | Share in the portfolio (%) |
| 1. | Natural persons | 8 346 280 | 72,88 | 7 484 793 | 63,49 |
| 2. | Activity related to the real estate market | 1 989 425 | 17,37 | 2 644 120 | 22,44 |
| 3. | Building industry | 851 337 | 7,43 | 1 283 594 | 10,89 |
| 4. | Professional, scientific and technical activity | 82 577 | 0,72 | 171 967 | 1,46 |
| 5 | Activity related to culture, entertainment and leisure | 62 468 | 0,55 | 66 678 | 0,57 |
| 6 | Public administration and defence; Compulsory social security | 42 668 | 0,37 | 50 517 | 0,43 |
| 7. | Health protection and social welfare | 37 254 | 0,33 | 40 264 | 0,34 |
| 8. | Financial activities | 29 242 | 0,26 | 32 622 | 0,28 |
| 9. | Activity related to accommodation and catering services | 10 343 | 0,09 | 10 734 | 0,09 |
| 10. | Other | - | 0,00 | 857 | 0,01 |
| | **Razem** | **11 451 594** | **100,00** | **11 786 146** | **100,00** |

## 3.3. Strategy for use of financial instruments

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

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

<u>Derivative instruments</u>

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

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

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

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

## 3.4. Market risk

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

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

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

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

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

As at 31 December 2020, VaR amounted to PLN 2 411.1 thousand compared with PLN 2 531.9 thousand as at 31 December 2019, with a confidence level of 97.5%. The increase in VAR was influenced by the CIRS transaction securing the issue of mortgage bonds in EUR.

The list below presents the value of average and maximum VaR of the Bank during the period from 1 January 2020 until 31 December 2020 and from 1 January 2019 until 31 December 2019.

| PLN ‘000 | 12 months until 31.12.2020 | | 12 months until.31.12.2019 | |
|---|---|---|---|---|
| | average | maximum | average | maximum |
| Credit spread risk | 1 941 | 2 510 | 748 | 962 |
| Interest rate risk | 2 346 | 2 719 | 470 | 2 549 |
| Currency risk | 37 | 374 | 24 | 72 |
| **Total VaR** | **2 676** | **3 100** | **957** | **2 775** |

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 2020, the risk amount arising from an expanded scenario was PLN 45 466 thousand, whereas the average risk amount for this scenario in the period from 1 January 2020 to 31 December 2020 was PLN 53 236 thousand. The increase in risk vale resulting from stress tests was significantly influenced by the CIRS transaction securing the issue of mortgage bonds in EUR.

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 | 31.12.2020 | | | | 31.12.2019 | | | |
|---|---|---|---|---|---|---|---|---|
| | Total | Interest rate risk | Currency risk | Credit spread risk | Total | Interest rate risk | Currency risk | Credit spread risk |
| Amount of risk in PLN '000 | (45 466) | (30 724) | (303) | (14 439) | (53 509) | (33 761) | (642) | (19 105) |

## 3.5. Currency risk

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

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

The table below presents an analysis of the sensitivity of assets, liabilities and off-balance sheet items to changes in exchange rates to which the Bank was exposed as at 31/12/2020 and as at 31/12/2019. The analysis shows the impact of a 10% increase in the currency exchange rate against the PLN profit and loss. A 10% drop in odds causes the same change, but with the opposite sign. A negative amount in the table reflects a potential decline in the income statement, while a positive amount reflects a potential growth.

**Impact on the income statement due to changes in exchange rates**

| currency | scenaio | 31.12.2020 | 31.12.2019 |
|---|---|---|---|
| **EUR** | +10% | (233 684) | (611 131) |
| **USD** | +10% | (69 388) | (30 474) |

for 2020 (in PLN thousand)

The following table presents exposures of the Bank to currency risk as at 31 December 2020 and 31 December 2019. The table presents assets and liabilities of the Bank according to balance sheet amount broken down by particular currencies of transactions.

| 31.12.2020 | PLN | EUR | USD | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and balances with the central bank | 29 393 | - | - | **29 393** |
| **Financial assets held for trading and derivatives held for hedges** | - | 195 982 | 935 | **196 917** |
| **Non-trading financial assets mandatorily at fair value through profit or loss, including:** | 76 203 | 57 635 | - | **133 838** |
| Loans and advances to customers | 76 203 | 57 635 | - | **133 838** |
| **Financial assets at fair value through other comprehensive income** | 791 045 | - | - | **791 045** |
| **Financial assets at amortised cost:** | 9 103 318 | 2 501 771 | 35 800 | **11 640 889** |
| Loans and advances to banks | 659 | 322 276 | 198 | **323 133** |
| Loans and advances to customers | 9 102 659 | 2 179 495 | 35 603 | **11 317 756** |
| **Intangible assets** | 53 936 | - | - | **53 936** |
| **Tangible fixed assets** | 13 818 | - | - | **13 818** |
| **Deferred income tax assets** | 4 123 | - | - | **4 123** |
| **Other assets** | 5 349 | - | - | **5 349** |
| **TOTAL ASSETS** | **10 077 185** | **2 755 388** | **36 736** | **12 869 308** |
| **Liabilities** | | | | |
| **Financial liabilities held for trading and derivatives held for hedges** | 216 | 4 503 | - | **4 719** |
| **Financial liabilities measured at amortised cost, including:** | 6 699 008 | 4 856 221 | - | **11 555 229** |
| *Amounts due to banks* | 2 915 394 | 585 279 | - | **3 500 673** |
| *Amounts due to customers* | 1 687 | 1 790 | - | **3 477** |
| *Debt securities issued* | 3 681 778 | 4 269 152 | - | **7 950 930** |
| Subordinated liabilities | 100 149 | - | - | **100 149** |
| **Provisions** | 3 392 | - | - | **3 392** |
| **Current income tax liabilities** | - | - | - | **-** |
| **Other liabilities** | 15 728 | - | - | **15 728** |
| **TOTAL LIABILITIES** | **6 718 345** | **4 860 723** | **-** | **11 579 068** |
| | | | | |
| **Net balance sheet position** | **3 358 840** | **(2 105 336)** | **36 736** | **1 290 240** |
| | | | | |
| **Loan commitments** | **66 576** | **-** | **-** | **66 576** |

| 31.12.2019 | PLN | EUR | USD | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and balances with the central bank | 35 233 | - | - | **35 233** |
| **Financial assets held for trading and derivatives held for hedges** | 3 144 | 44 736 | 336 | **48 217** |
| **Non-trading financial assets mandatorily at fair value through profit or loss, including:** | 83 219 | 122 998 | - | **206 217** |
| Loans and advances to customers | 83 219 | 122 998 | - | **206 217** |
| **Financial assets at fair value through other comprehensive income** | 1 221 735 | - | - | **1 221 735** |
| **Financial assets at amortised cost:** | 8 441 349 | 3 114 698 | 37 795 | **11 593 842** |
| Loans and advances to banks | 794 | 13 021 | 98 | **13 913** |
| Loans and advances to customers | 8 440 555 | 3 101 676 | 37 697 | **11 579 928** |
| **Intangible assets** | 48 620 | - | - | **48 620** |
| **Tangible fixed assets** | 16 301 | - | - | **16 301** |
| **Deferred income tax assets** | 10 123 | - | - | **10 123** |
| **Other assets** | 7 620 | - | - | **7 620** |
| **TOTAL ASSETS** | **9 867 345** | **3 282 432** | **38 131** | **13 187 908** |
| **Liabilities** | | | | |
| **Financial liabilities held for trading and derivatives held for hedges** | - | 7 525 | 75 | **7 600** |
| **Financial liabilities measured at amortised cost, including:** | 7 665 146 | 4 218 442 | 1 | **11 883 589** |
| *Amounts due to banks* | 2 816 822 | - | - | **2 816 822** |
| *Amounts due to customers* | 6 443 | 2 491 | 1 | **8 935** |
| *Debt securities issued* | 4 641 449 | 4 215 951 | - | **8 857 400** |
| Subordinated liabilities | 200 432 | - | - | **200 432** |
| **Provisions** | - | - | - | **-** |
| **Current income tax liabilities** | 7 482 | - | - | **7 482** |
| **Other liabilities** | 20 781 | - | - | **20 781** |
| **TOTAL LIABILITIES** | **7 693 409** | **4 225 967** | **76** | **11 919 452** |
| | | | | |
| **Net balance sheet position** | **2 173 936** | **(943 535)** | **38 055** | **1 268 455** |
| | | | | |
| **Loan commitments** | **338 242** | **111 397** | **-** | **449 639** |

## 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, CIRS). 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) | 31.12.2020 | 31.12.2019 |
|---|---|---|
| for items expressed in PLN | 8 965 | 8 002 |
| for items expressed in USD | 42 | 20 |
| for items expressed in EUR | 546 | 510 |

When calculating those values it was assumed that the structure of assets and liabilities recognised in financial statements as at 31 December 2020 and as at 31 December 2019 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 2020 on similar level as in 2019 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 and CIRS.

for 2020 (in PLN thousand)

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.no tak

| 31.12.2020 | 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 | 29 393 | - | - | - | - | - | **29 393** |
| Financial assets held for trading and derivatives held for hedges | 12 777 | 162 895 | 21 245 | - | - | - | **196 917** |
| Non-trading financial assets mandatorily at fair value through profit or loss | 19 475 | 107 511 | 6 852 | - | - | - | **133 838** |
| Financial assets at fair value through other comprehensive income | 488 735 | - | 302 310 | - | - | - | **791 045** |
| Financial assets at amortised cost - loans and advances to banks | 323 133 | - | - | - | - | - | **323 133** |
| Financial assets at amortised cost - loans and advances to customers | 1 646 852 | 9 091 507 | 579 397 | - | - | - | **11 317 756** |
| **TOTAL ASSETS** | **2 520 365** | **9 361 913** | **909 804** | **-** | **-** | **-** | **12 792 082** |
| **Liabilities** | | | | | | | |
| Financial liabilities held for trading and derivatives held for hedges | 4 495 | 224 | - | - | - | - | **4 719** |
| Financial liabilities measured at amortised cost - amounts due to banks | 832 368 | 2 668 305 | - | - | - | - | **3 500 673** |
| Financial liabilities measured at amortised cost - amounts due to customers | - | - | - | - | - | 3 477 | **3 477** |
| Zobowiązania finansowe wyceniane w zamortyzowanym koszcie - zobowiązania z tytułu emisji dłużnych papierów wartościowych | 468 060 | 3 048 231 | 457 885 | 3 549 449 | 427 305 | - | **7 950 930** |
| Subordinated liabilities | - | 100 149 | - | - | - | - | **100 149** |
| **TOTAL LIABILITIES** | **1 304 923** | **5 816 909** | **457 885** | **3 549 449** | **427 305** | **3 477** | **11 559 948** |
| | | | | | | | |
| **Balance sheet gap** | **1 215 442** | **3 545 004** | **451 919** | **(3 549 449)** | **(427 305)** | **(3 477)** | **1 232 134** |

| 31.12.2019 | 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 | 35 233 | - | - | - | - | - | **35 233** |
| Financial assets held for trading and derivatives held for hedges | 7 285 | 23 046 | 17 886 | - | - | - | **48 217** |
| Non-trading financial assets mandatorily at fair value through profit or loss | 35 456 | 160 416 | 10 344 | - | - | - | **206 216** |
| Financial assets at fair value through other comprehensive income | 827 953 | - | 151 455 | 242 328 | - | - | **1 221 736** |
| Financial assets at amortised cost - loans and advances to banks | 13 912 | - | - | - | - | - | **13 912** |
| Financial assets at amortised cost - loans and advances to customers | 1 991 409 | 9 009 786 | 580 977 | - | - | - | **11 582 172** |
| **TOTAL ASSETS** | **2 911 248** | **9 193 248** | **760 662** | **242 328** | **-** | **-** | **13 107 486** |
| **Liabilities** | | | | | | | |
| Financial liabilities held for trading and derivatives held for hedges | 77 | 7 523 | - | - | - | - | **7 600** |
| Financial liabilities measured at amortised cost - amounts due to banks | 710 338 | 2 106 484 | - | - | - | - | **2 816 822** |
| Financial liabilities measured at amortised cost - amounts due to customers | - | - | - | - | - | 8 934 | **8 934** |
| Zobowiązania finansowe wyceniane w zamortyzowanym koszcie - zobowiązania z tytułu emisji dłużnych papierów wartościowych | 420 568 | 4 044 398 | 737 520 | 625 336 | 3 029 579 | - | **8 857 401** |
| Subordinated liabilities | - | 200 432 | - | - | - | - | **200 432** |
| **TOTAL LIABILITIES** | **1 130 983** | **6 358 837** | **737 520** | **625 336** | **3 029 579** | **8 934** | **11 891 189** |
| | | | | | | | |
| **Balance sheet gap** | **1 780 265** | **2 834 411** | **23 142** | **(383 008)** | **(3 029 579)** | **(8 934)** | **1 216 297** |

## 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.

for 2020 (in PLN thousand)

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 2020 and 2019, the Bank monitored all liquidity measures specified in the resolution of PFSA 386/2008 dated 17 December 2008:

- 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 The tables below present the values of the M3 - M4 liquidity standards and the LCR measure as at December 31, 2020 and December 31, 2019, their average and minimum values and maximum:

| liquidity norm* | value as at 31.12.2020 | average | minimum | maximum |
|---|---|---|---|---|
| M3 | 93,281 | 84,217 | 79,315 | 93,281 |
| M4 | 1,047 | 1,059 | 1,031 | 1,099 |
| LCR | 848% | 901% | 262% | 1554% |

| liquidity norm* | value as at 31.12.2019 | average | minimum | maximum |
|---|---|---|---|---|
| M3 | 80.225 | 80.871 | 63.890 | 130.480 |
| M4 | 1.075 | 1.065 | 1.047 | 1.085 |
| LCR | 1366% | 1395% | 628% | 2683% |

* 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 2020 and 2019 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 2020 (in PLN thousand)

| | 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 | 29 393 | - | - | - | - | 29 393 |
| Non-trading financial assets mandatorily at fair value through profit or loss | 611 | 1 356 | 6 410 | 35 667 | 89 794 | 133 838 |
| Financial assets at fair value through other comprehensive income | 155 630 | - | 153 837 | 403 710 | 80 112 | 793 289 |
| Financial assets at amortised cost - loans and advances to banks | 323 307 | - | - | - | - | 323 307 |
| Financial assets at amortised cost - loans and advances to customers | 63 085 | 140 026 | 661 850 | 3 682 923 | 9 271 841 | 13 819 725 |
| **Total assets** | **572 026** | **141 382** | **822 097** | **4 122 300** | **9 441 747** | **15 099 552** |
| **Planned payments of the off-balance sheet liabilities to grant loans or guarantees** | **25** | **49** | **35 454** | **26 035** | **5 014** | **66 577** |
| **Total asstes and off-balance sheet** | **572 051** | **141 431** | **857 551** | **4 148 335** | **9 446 761** | **15 166 129** |
| **Liabilities (by contractual dates of maturity)** | | | | | | |
| Financial liabilities measured at amortised cost - amounts due to banks | 248 902 | 6 338 | 220 453 | 2 240 340 | 996 480 | 3 712 513 |
| Financial liabilities measured at amortised cost - amounts due to customers | 3 477 | - | - | - | - | 3 477 |
| Financial liabilities measured at amortised cost - debt securities issued | 2 307 | 329 013 | 622 885 | 6 574 971 | 552 268 | 8 081 444 |
| Financial liabilities measured at amortised cost - subordinated liabilities | - | 794 | 2 426 | 12 889 | 109 669 | 125 778 |
| **Total liabilities** | **254 686** | **336 145** | **845 764** | **8 828 200** | **1 658 417** | **11 923 212** |
| **Off-balance sheet liabilities to grant loans or guarantees** | **26 170** | **12 516** | **27 134** | **756** | **-** | **66 576** |
| **Total liabilites and off-balance sheet** | **280 856** | **348 661** | **872 898** | **8 828 956** | **1 658 417** | **11 989 788** |
| **Net liquidity gap** | **291 195** | **(207 230)** | **(15 347)** | **(4 680 621)** | **7 788 344** | **3 176 341** |

**Liabilities (by contractual dates of maturity) as at 31 December 2019**

| | 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 | 35 233 | - | - | - | - | 35 233 |
| Non-trading financial assets mandatorily at fair value through profit or loss | 1 023 | 2 907 | 10 026 | 58 724 | 148 527 | 221 207 |
| Financial assets at fair value through other comprehensive income | 375 370 | - | 122 419 | 680 775 | 82 148 | 1 260 712 |
| Financial assets at amortised cost - loans and advances to banks | 14 050 | - | - | - | - | 14 050 |
| Financial assets at amortised cost - loans and advances to customers | 72 576 | 206 312 | 711 610 | 4 167 916 | 10 541 639 | 15 700 053 |
| **Total assets** | **498 252** | **209 219** | **844 055** | **4 907 415** | **10 772 314** | **17 231 255** |
| **Planned payments of the off-balance sheet liabilities to grant loans or guarantees** | **56** | **141** | **3 285** | **358 976** | **87 178** | **449 636** |
| **Total asstes and off-balance sheet** | **498 308** | **209 360** | **847 340** | **5 266 391** | **10 859 492** | **17 680 891** |
| **Liabilities (by contractual dates of maturity)** | | | | | | |
| Financial liabilities measured at amortised cost - amounts due to banks | 121 716 | 12 582 | 48 897 | 2 899 541 | - | 3 082 736 |
| Financial liabilities measured at amortised cost - amounts due to customers | 8 934 | - | - | - | - | 8 934 |
| Financial liabilities measured at amortised cost - debt securities issued | 55 144 | 143 646 | 1 287 530 | 4 619 730 | 3 152 488 | 9 258 538 |
| Financial liabilities measured at amortised cost - subordinated liabilities | - | 2 468 | 7 432 | 39 654 | 223 986 | 273 540 |
| **Total liabilities** | **185 794** | **158 696** | **1 343 859** | **7 558 925** | **3 376 474** | **12 623 748** |
| **Off-balance sheet liabilities to grant loans or guarantees** | **139 171** | **78 144** | **127 883** | **104 442** | **-** | **449 640** |
| **Total liabilites and off-balance sheet** | **324 965** | **236 840** | **1 471 742** | **7 663 367** | **3 376 474** | **13 073 388** |
| **Net liquidity gap** | **173 343** | **(27 480)** | **(624 402)** | **(2 396 976)** | **7 483 018** | **4 607 503** |

The amounts disclosed in maturity dates analysis are undiscounted contractual cash flows. Liabilities due to leases fall under the item: financial liabilities valued at the motorized cost cost - payable to clients and banks. Maturity structure of liabilities due to leasing was presented in note 28.

for 2020 (in PLN thousand)

### 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.

**31.12.2020**

| 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)** | - | 19 568 | 6 520 | 90 140 | 19 709 | 135 937 |
| **Total net valuation** | - | 19 568 | 6 520 | 90 140 | 19 709 | 135 937 |

**31.12.2019**

| 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)** | (878) | 17 386 | 9 337 | 76 946 | 38 495 | **141 286** |
| **Total net valuation** | **(878)** | **17 386** | **9 337** | **76 946** | **38 495** | **141 286** |

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 and CIRS.

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.

**31.12.2020**

| Derivative financial instruments to be settled on a gross basis | within 1 month | from 1 to 3 months | from 3 months to 1 year | from 1 to 5 years | over 5 years | Total |
|---|---|---|---|---|---|---|
| **Currency SWAP contracts:** | | | | | | |
| **- outflows** | **610 002** | **597 114** | **-** | **-** | **-** | **1 207 116** |
| **- inflows** | **618 302** | **611 646** | **-** | **-** | **-** | **1 229 947** |
| **Interest-rate contracts CIRS:** | **-** | **-** | **-** | **-** | **-** | **-** |
| **- outflows** | **-** | **3 489** | **9 809** | **1 350 455** | **-** | **1 363 754** |
| **- inflows** | **-** | **-** | **3 350** | **1 397 841** | **-** | **1 401 192** |

**31.12.2019**

| Derivative financial instruments to be settled on a gross basis | within 1 month | from 1 to 3 months | from 3 months to 1 year | from 1 to 5 years | over 5 years | Total |
|---|---|---|---|---|---|---|
| **Currency SWAP contracts:** | | | | | | |
| **- outflows** | **113 544** | **11 013** | **127 755** | **-** | **-** | **252 312** |
| **- inflows** | 115 130 | 11 152 | 129 489 | - | - | **255 771** |
| **Interest-rate contracts CIRS:** | **-** | **-** | **-** | **-** | **-** | **-** |
| **- outflows** | - | 8 249 | 24 933 | 133 037 | 1 303 772 | **1 469 991** |
| **- inflows** | **-** | **-** | **2 602** | **12 367** | **1 280 642** | **1 295 611** |

## 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:

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- 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.

In line with IFRS 9, for accounting purposes, the Bank measures financial assets and liabilities at amortized cost or at fair value. Moreover, for items measured at amortized cost accounting for the needs of disclosures in the financial statements - in accordance with the requirements of IFRS 7 - measurement at fair value.

In line with market practices, the Bank measures financial instruments in which it maintains open positions using market prices (valuation to the market) or valuation models recognized in market practice (valuation from the model) fed with prices or market parameters, and in few cases with parameters estimated internally by the Bank. All material open positions in derivative instruments are valued using market models that are fed with prices or parameters observable by the market.

For the purposes of disclosures, the Bank assumed that the fair value of short-term financial liabilities (less than 1 year) was equal to their book value. For financial liabilities over 1 year, the fair value is estimated on the basis of discounted cash flows using appropriate interest rates.

**Items valued at amortized cost**

The table below summarizes the book values and fair values for each group of financial assets and liabilities not measured in the statement. from the financial position of the Bank at fair value.

| Financial assets and liabilities | 31.12.2020 | | 31.12.2019 | |
|---|---|---|---|---|
| | Carrying value | Fair value | Carrying value | Fair value |
| **Aktywa finansowe wyceniane w zamortyzowanym koszcie** | | | | |
| **Cash and balances with the central bank** | **29 393** | **29 393** | **35 234** | **35 234** |
| **Amounts due from other banks** | **323 133** | **323 133** | **13 912** | **13 912** |
| **Loans and advances to customers, including:** | **11 317 756** | **11 972 924** | **11 628 432** | **12 163 792** |
| Individual customers | 8 346 281 | 8 933 414 | 7 500 053 | 7 951 968 |
| Corporate customers | 2 856 501 | 2 921 918 | 3 997 350 | 4 078 548 |
| Public sector customers | 85 731 | 88 349 | 98 407 | 100 654 |
| Other financial institutes | 29 243 | 29 243 | 32 622 | 32 622 |
| **Total financial assets** | **11 670 282** | **12 325 450** | **11 677 578** | **12 212 938** |
| **Financial liabilities at amortised cost** | | | | |
| **Amounts due to other banks** | **3 500 673** | **3 500 673** | **2 816 822** | **2 816 822** |
| **Amounts due to customers, including:** | **3 477** | **3 477** | **8 934** | **8 934** |
| Corporate customers | 3 353 | 3 353 | 8 752 | 8 752 |
| Individual customers | 114 | 114 | 139 | 139 |
| Public sector customers | 10 | 10 | 43 | 43 |
| **Debt securities in issue** | **7 950 930** | **7 956 838** | **8 857 401** | **8 850 860** |
| **Subordinated liabilities** | **100 149** | **100 149** | **200 432** | **200 432** |
| **Total financial liabilities** | **11 555 229** | **11 561 137** | **11 883 589** | **11 877 048** |

The main assumptions and methods used by the Bank when estimating the fair value of financial instruments are presented below:

<u>Receivables due to loans and advances granted to clients</u>

The fair value of receivables from banks and loans and advances to customers was calculated as the value of estimated future cash flows (taking into account the effect of prepayments) using current interest rates, taking into account the amount of the credit spread, liquidity cost and cost of capital. The credit spread level was determined based on the market quotation of the median credit spreads for Moody's rating system. The credit spread was assigned to a given credit exposure by mapping Moody's rating system with the Bank's internal rating system. In order to reflect the fact that a large part of the Bank's exposure is secured, while the median of market quotes is concentrated around unsecured issues, the Bank made an adjustment on this account.
The value of expected future cash flows takes into account potential losses resulting from credit risk. Input data for the model are principal installments schedules, forward rate curves, PD and LGD parameter curves and components of the discount rate related to the financing cost margin, fixed costs and capital, as well as the calibration margin.

for 2020 (in PLN thousand)

Financial instruments representing liabilities include the following:

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

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

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

The Bank estimated the fair value of the issued covered bonds and unsecured high-rated corporate bonds using the credit spread. For the so far issued tranches subject to secondary trading, the assumption was made that that the value of the credit spread is the same as for primary market issues with the same maturity. The clean price of individual tranches of outstanding covered bonds was estimated taking into account the remaining maturity, the value of the expected credit spread for issues on the secondary market and quotations from the swap curve.

Liabilities from the issue of debt securities are presented at level 3 in the fair value hierarchy.

Based on the methods used by the Bank to determine the fair value, financial assets and liabilities are classified into the following categories:

- Level 1: quoted prices in active markets for the same instrument (without modification);
- Level 2: quoted prices in active markets for similar instruments, or other valuation methods for which all relevant inputs are based on observable market data;
- Level 3: valuation methods for which at least one significant input is not based on observable market data.

The table below presents the fair value hierarchy for financial assets and liabilities measured at fair value in accordance with the assumptions and methods described above, solely for the purpose of disclosure, as at December 31, 2020 and December 31, 2019.

| 31.12.2020 | including: | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| | | Quoted prices in active markets | Valuation techniques based on observable market data | Other valuation techniques |
| **VALUATION FOR DISCLOSURE ONLY** | | | | |
| **FINANCIAL ASSETS** | | | | |
| **Cash and balances with the central bank** | 29 393 | - | - | 29 393 |
| **Amounts due from other banks** | 323 133 | - | - | 323 133 |
| **Loans and advances to customers, including:** | 11 972 924 | - | - | 11 972 924 |
| Individual customers | 8 933 414 | - | - | 8 933 414 |
| Corporate customers | 2 921 918 | - | - | 2 921 918 |
| Public sector customers | 88 349 | - | - | 88 349 |
| Other financial institutes | 29 243 | - | - | 29 243 |
| **FINANCIAL LIABILITIES** | | | | |
| **Amounts due to other banks** | 3 500 673 | - | - | 3 500 673 |
| **Amounts due to customers, including:** | 3 477 | - | - | 3 477 |
| Corporate customers | 3 353 | - | - | 3 353 |
| Individual customers | 114 | - | - | 114 |
| Public sector customers | 10 | - | - | 10 |
| Debt securities in issue | 7 956 838 | - | - | 7 956 838 |
| **Subordinated liabilities** | 100 149 | - | - | 100 149 |
| **Total financial assets** | **12 325 450** | **-** | **-** | **12 325 450** |
| **Total financial liabilities** | **11 561 137** | **-** | **-** | **11 561 137** |

for 2020 (in PLN thousand)

| 31.12.2019 | including: | Level 1<br>Quoted prices in active markets | Level 2<br>Valuation techniques based on observable market data | Level 3<br>Other valuation techniques |
|---|---|---|---|---|
| **VALUATION FOR DISCLOSURE ONLY** | | | | |
| **FINANCIAL ASSETS** | | | | |
| **Cash and balances with the central bank** | 35 234 | - | - | 35 234 |
| **Amounts due from other banks** | 13 912 | - | - | 13 912 |
| **Loans and advances to customers, including:** | 12 163 792 | - | - | 12 163 792 |
| Individual customers | 7 951 968 | - | - | 7 951 968 |
| Corporate customers | 4 078 548 | - | - | 4 078 548 |
| Public sector customers | 100 654 | - | - | 100 654 |
| Other financial institutes | 32 622 | - | - | 32 622 |
| **FINANCIAL LIABILITIES** | | | | |
| **Amounts due to other banks** | 2 816 822 | - | - | 2 816 822 |
| **Amounts due to customers, including:** | 8 934 | - | - | 8 934 |
| Corporate customers | 8 752 | - | - | 8 752 |
| Individual customers | 139 | - | - | 139 |
| Public sector customers | 43 | - | - | 43 |
| Debt securities in issue | 8 850 860 | - | - | 8 850 860 |
| **Subordinated liabilities** | 200 432 | - | - | 200 432 |
| **Total financial assets** | **12 212 938** | **-** | **-** | **12 212 938** |
| **Total financial liabilities** | **11 877 048** | **-** | **-** | **11 877 048** |

## Items valued at fair value

The tables below present the fair value hierarchy for financial assets and liabilities that were disclosed in the Bank's statement of financial position at fair value as at December 31, 2020.

The tables below present the fair value hierarchy of financial assets and liabilities recognised in the statement of financial position of the Bank at their fair values as of 31 December 2019.

| 31.12.2020 | including: | Level 1<br>Prices quoted in active markets | Level 2<br>Valuation techniques based on observable market data | Level 3<br>Other valuation techniques |
|---|---|---|---|---|
| **RECURRING FAIR VALUE MEASUREMENTS** | | | | |
| **FINANCIAL ASSETS** | | | | |
| **Financial assets held for trading and derivatives held for hedges** | **196 917** | **-** | **75 888** | **-** |
| **Derivative financial instruments, including:** | **196 917** | **-** | **75 888** | **-** |
| **Derivative financial instruments held for trading:** | **28 323** | **-** | **28 323** | **-** |
| - Interest rate derivatives | - | - | - | - |
| - Foreign exchange derivatives | 28 323 | - | 28 323 | - |
| **Derivative financial instruments held for hedging:** | **168 594** | **-** | **47 565** | **121 029** |
| Derivatives designated as fair value hedges | 47 565 | - | 47 565 | - |
| - Derivatives designated as cash flow hedges | 121 029 | - | - | 121 029 |
| **Non-trading financial assets mandatorily at fair value through profit or loss** | **133 838** | **-** | **-** | **133 838** |
| **Loans and advances to custumers** | **133 838** | **-** | **-** | **133 838** |
| Corporate customers | 133 838 | - | - | 133 838 |
| **Financial assets at fair value through other comprehensive income** | **791 045** | **756 046** | **34 999** | **-** |
| - Treasury bonds | 756 046 | 756 046 | - | - |
| - Money bills | 34 999 | - | 34 999 | - |
| **TOTAL FINANCIAL ASSETS** | **1 121 800** | **756 046** | **110 887** | **133 838** |

| 31.12.2020 | including: | Level 1<br>Prices quoted in active markets | Level 2<br>Valuation techniques based on observable market data | Level 3<br>Other valuation techniques |
|---|---|---|---|---|
| **FINANCIAL LIABILITIES** | | | | |
| **Derivative financial instruments, including:** | **4 719** | **-** | **4 719** | **-** |
| **Derivative financial instruments held for trading:** | **4 674** | **-** | **4 674** | **-** |
| - Interest rate derivatives | - | - | - | - |
| - Foreign exchange derivatives | 4 674 | - | 4 674 | - |
| **Derivative financial instruments held for hedging:** | **45** | **-** | **45** | **-** |
| -Derivatives designated as fair value hedges | **45** | **-** | **45** | **-** |
| **TOTAL FINANCIAL LIABILITIES** | **4 719** | **-** | **4 719** | **-** |
| | | | | |
| **RECURRING FAIR VALUE MEASUREMENTS** | | | | |
| **TOTAL FINANCIAL ASSETS** | **1 121 800** | **791 045** | **75 888** | **133 838** |
| **TOTAL FINANCIAL LIABILITIES** | **4 719** | **-** | **4 719** | **-** |

for 2020 (in PLN thousand)

| Level 3 financial assets measured at fair value | Non-trading loans and advances at mandatory fair value through profit or loss - change in 2020 |
|---|---|
| **Opening balance sheet** | **157 714** |
| **Gains or losses recognised in the profit and loss account** | **(2 168)** |
| Gains or losses on non-trading financial assets required to be measured at fair value through profit or loss | (2 168) |
| Changes due to modifications that do not result in derecognition (net) | (9 100) |
| Write-offs | (12 608) |
| Decreases due to derecognition | - |
| **Closing balance sheet** | **133 838** |

The tables below present the fair value hierarchy for financial assets and liabilities that were disclosed in the Bank's statement of financial position at fair value as at December 31, 2019.

| 31.12.2019 | including: | Level 1<br>Prices quoted in active markets | Level 2<br>Valuation techniques based on observable market data | Level 3<br>Other valuation techniques |
|---|---|---|---|---|
| **RECURRING FAIR VALUE MEASUREMENTS** | | | | |
| **FINANCIAL ASSETS** | | | | |
| **Financial assets held for trading and derivatives held for hedges** | **48 217** | **-** | **48 217** | **-** |
| **Derivative financial instruments, including:** | **48 217** | **-** | **48 217** | **-** |
| **Derivative financial instruments held for trading:** | **5 756** | **-** | **5 756** | **-** |
| - Interest rate derivatives | 3 299 | - | 3 299 | - |
| - Foreign exchange derivatives | 2 457 | - | 2 457 | - |
| **Derivative financial instruments held for hedging:** | **42 461** | **-** | **42 461** | **-** |
| Derivatives designated as fair value hedges | 42 461 | - | 42 461 | - |
| **Non-trading financial assets mandatorily at fair value through profit or loss** | **157 714** | **-** | **-** | **157 714** |
| **Loans and advances to custumers** | **157 714** | **-** | **-** | **157 714** |
| Corporate customers | 157 714 | - | - | 157 714 |
| **Financial assets at fair value through other comprehensive income** | **1 221 735** | **1 221 735** | **-** | **-** |
| - Treasury bonds | 1 001 753 | 1 001 753 | - | - |
| - Money bills | 219 982 | 219 982 | - | - |
| **TOTAL FINANCIAL ASSETS** | **1 427 666** | **1 221 735** | **48 217** | **157 714** |

| 31.12.2019 | including: | Level 1<br>Prices quoted in active markets | Level 2<br>Valuation techniques based on observable market data | Level 3<br>Other valuation techniques |
|---|---|---|---|---|
| **FINANCIAL LIABILITIES** | | | | |
| **Derivative financial instruments, including:** | **7 600** | **-** | **76** | **7 524** |
| **Derivative financial instruments held for trading:** | **253** | **-** | **253** | **-** |
| - Interest rate derivatives | 177 | - | 177 | - |
| - Foreign exchange derivatives | 76 | - | 76 | - |
| **Derivative financial instruments held for hedging:** | **7 347** | **-** | **(177)** | **7 524** |
| -Derivatives designated as fair value hedges | **(177)** | **-** | **(177)** | **-** |
| - Derivatives designated as cash flow hedges | 7 524 | - | - | 7 524 |
| **TOTAL FINANCIAL LIABILITIES** | **7 600** | **-** | **76** | **7 524** |
| | | | | |
| **RECURRING FAIR VALUE MEASUREMENTS** | | | | |
| **TOTAL FINANCIAL ASSETS** | **1 427 666** | **1 221 735** | **48 217** | **157 714** |
| **TOTAL FINANCIAL LIABILITIES** | **7 600** | **-** | **76** | **7 524** |

for 2020 (in PLN thousand)

| Level 3 financial assets measured at fair value | Non-trading loans and advances at mandatory fair value through profit or loss - change in 2019 |
|---|---|
| **Opening balance sheet** | **208 181** |
| **Gains or losses recognised in the profit and loss account** | **(2 844)** |
| Gains or losses on non-trading financial assets required to be measured at fair value through profit or loss | (2 844) |
| Changes due to modifications that do not result in derecognition (net) | (10 454) |
| Write-offs | - |
| Decreases due to derecognition | (37 169) |
| **Closing balance sheet** | **157 714** |

With regard to financial instruments repeatedly measured at fair value, classified at levels 1 and 2 of the fair value hierarchy, any potential transfer between these levels is monitored by the relevant departments of the Bank based on internal rules.
In 2020 and 2019, there were no transfers of financial instruments between individual levels of the fair value hierarchy.
With respect to financial instruments repeatedly measured at fair value, classified at levels 1 and 2 of the fair value hierarchy, any potential transfer between these levels is monitored by the Risk Management Department based on internal policies. If there is no market price for direct valuation, the valuation method for this instrument is changed for a period of more than 5 business days, i.e. the transition from direct valuation to model valuation, if an approved valuation method from the model for this instrument is available. The return to the direct valuation method takes place after a period of at least 10 business days in which the market price has been continuously available. In the absence of a market price for Treasury debt securities, the above periods are 2 and 5 business days, respectively.

**Level 1**
As at 31 December 2019, at level 1 of the hierarchy of values, the Bank presents the fair value of government bonds measured at fair value through other comprehensive income in the amount of PLN 45 548 thousand. PLN (31 December 2019: PLN 1,221,753 thousand).
These instruments were classified to level 1 because their valuation consists in direct use of the current market prices of these instruments from active and liquid financial markets.

**Level 2**
Level 2 of the hierarchy mainly covers the fair value of money bills issued by NBP in the amount of PLN 744 649 thousand. PLN (December 31, 2019: PLN 219,982 thousand), the valuation of which is based on the NPV model (discounting future cash flows), which is fed with interest rate curves determined by transformation of quotations derived directly from active and liquid financial markets.
In addition, to level 2, the Group includes the valuation of derivative financial instruments for which models are used, in accordance with market standards and practices in this respect, which are supplied with parameters directly from the markets (e.g. exchange rates, implied volatilities of currency options, stocks) or parameters that transform quotes directly from active and liquid financial markets (e.g. interest rate curves).

**Level 3**
At level 3 of the hierarchy, the fair value of Loans and advances to customers is disclosed, which are obligatorily measured at fair value through profit or loss in the amount of PLN 133 838 thousand. PLN (December 31, 2019 - PLN 157 714 thousand). The valuation model uses credit risk parameters (e.g. PD, LGD) and information obtained from the market (including spreads implied from transactions). The PD and LGD parameters are not observed in active markets and therefore have been derived from statistical analyzes. The credit spread model has been built internally in risk units, has been approved by the Model Risk Committee and is subject to periodic monitoring and validation carried out by a unit independent of the units responsible for model building and maintenance.
The table below presents the sensitivity of the fair value measurement to the change in unobservable parameters used in models for loans and advances to customers measured at fair value at level 3.

for 2020 (in PLN thousand)

| Portfolio | Fair value 31.12.2020 | Sensitivity to the change of the unobservable parameterego | | Description |
|---|---|---|---|---|
| | | (-) | (+) | |
| Loans and advances to customers are obligatorily measured at fair value through profit or loss in a non-default situation | 118 460 | 753 | (348) | The valuation model uses the PD credit risk parameters Sensitivity calculated assuming a PD change of +/- 10% |
| Loans and advances to customers obligatorily measured at fair value through profit or loss in the def | 15 378 | (1 538) | 946 | The valuation model uses individual estimates of expected cash flows. Sensitivity calculated assuming a change in flows of +/- 10% |

| Portfolio | Fair value 31.12.2019 | Sensitivity to the change of the unobservable parameterego | | Description |
|---|---|---|---|---|
| | | (-) | (+) | |
| Loans and advances to customers are obligatorily measured at fair value through profit or loss in a non-default situation | 124 540 | 208 | (201) | The valuation model uses the PD credit risk parameters Sensitivity calculated assuming a PD change of +/- 10% |
| Loans and advances to customers obligatorily measured at fair value through profit or loss in the def | 33 391 | (3 339) | 2 801 | The valuation model uses individual estimates of expected cash flows. Sensitivity calculated assuming a change in flows of +/- 10% |

Derivatives designated as cash flow hedges

The derivative designated as a cash flow hedge is a CIRS (Cross-Currency Interest Rate Swap), which was classified at level 3 of the fair value hierarchy, where the Bank pays a variable rate based on WIBOR and receives a fixed rate in EUR. In the case of announced bankruptcy of mBank Hipoteczny S.A., the CIRS transaction is not completed and continues until the date of completion of the transaction in accordance with the parameters set on the transaction date. Moreover, the transaction in question is characterised by a high denomination and a unilateral obligation to make a security deposit, where mBank Hipoteczny S.A. is exempt from the obligation to make it.

For the purposes of cash flow hedge accounting, the Bank enters into two hedging relationships simultaneously:

- by decomposition of the actual part of a CIRS transaction securing a PLN loan portfolio with a variable interest rate (hedging against interest rate risk), and

- by decomposing the part of the actual CIRS transaction securing the obligation

in EUR (hedging against currency risk).

For the purpose of calculating changes in the fair value of future cash flows of items being hedged, the Bank applies the "hypothetical derivative" method, which assumes the possibility of reflecting the hedged item and the characteristics of the hedged risk.
in the form of a derivative. The rules of valuation are analogous to those of interest rate derivatives. Due to the properties of a CIRS transaction concluded by the Bank, containing non-standard and non-quoted price components, the margin on the leg paid by the Bank was higher than the margin of a standard, analogous CIRS transaction, which is resolved in the case of bankruptcy of a counterparty with a bilateral exchange of margin. This fact was confirmed by an independent quotation of CIRS transactions obtained by the Bank. At the same time, before concluding the transaction, the Bank checked other market quotations of high-rated counterparties and they showed convergence with the finally obtained transaction quotation. Thus the transaction was classified as a transaction concluded on market conditions, not having an option character, free of additional fees at the time of its conclusion and was considered a transaction in which there are parameters unobservable on an active market influencing its valuation.

Due to the non-standard character of the CIRS transaction concluded by the Bank, the valuation of this transaction consists of three elements - the value of discounted expected flows from the CIRS transaction, CVA/DVA adjustments and linear depreciation over time until the maturity date of the difference between the valuation of a non-standard CIRS transaction (including CVA/DVA adjustments corresponding to the nature of this transaction) and the valuation of a standard CIRS transaction (including CVA/DVA adjustments resulting from the profile of this transaction) determined on the transaction date. The amount depreciated on a straight-line basis, taken into account in the valuation of IRS transactions, determined at the time of concluding the transaction is PLN 7,216 thousand. Due to the fact that at the moment of establishing the NPV relation of the original CIRS transaction was transferred to the IRS transaction, therefore DVA as a significant valuation component was included in its valuation, and CVA due to its insignificant value was included in the valuation of the CIRS transaction.

for 2020 (in PLN thousand)

The components of the CIRS transaction valuation are presented in the table below

| | | Date of the transaction | 31.12.2020 |
|---|---|---|---|
| **Fair value measurement of CIRS transactions** | | **(1 402)** | **121 029** |
| including: | CVA of the CIRS transaction | (60) | (76) |
| | DVA of the CIRS transaction | 3 555 | 468 |
| | Value of the valuation of the CIRS transaction to be settled over time | 7 216 | 5 794 |

For the CIRS transaction concluded by the Bank for the purposes of cash flow hedge accounting, there is no active market that would reflect the valuation of transactions with similar characteristics. Publicly available CIRS quotes refer to contracts that are settled upon bankruptcy of the counterparty, include bilateral margin collateral and have a face value that is actively traded in the market. In the opinion of the Bank, these are the arguments that there are no prices available on an actively available market that could adequately reflect the fair value of the CIRS transaction concluded by the Bank.

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

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

Impairment of loans and advances

The Bank reviews its loan portfolio in terms of possible impairments at least once per quarter. In order to establish whether the impairment should be reported in the income statement, the Bank assesses whether there are any evidence indicating possible to measure decrease of estimated future cash flows arising from granted loans and advances. If there is objective evidence of impairment of loan, the amount of impairment is calculated as a difference between balance sheet value for a given element of asset and current value of estimated future cash flows, discounted according to original effective interest rate of a given element of financial assets. If the current value of estimated cash flows for the portfolio of loans with recognized individual impairment changed by +/- 10%, as at 31 December 2020 the estimated amount of loan impairment would decrease by PLN 16 624 thousand or increase by PLN 21 461 thousand respectively (as at 31 December 2019, the amount of estimated cash flows would decrease by PLN 13 601 thousand or increase by PLN 20 242 thousand respectively). This estimate was made for a portfolio of loans in the case of which impairment is recognized on the basis of an individual analysis of future cash flows from recoveries from collateral (stage 3). The principles for measuring impairment are described in Note 2.8.

### The impact of the COVID-19 pandemic on the Bank's operations

Aid measures taken at the Bank as a result of the COVID-19 pandemic

In connection with the crisis caused by the COVID-19 pandemic, the Bank offered its clients a number of assistance tools aimed at supporting them in a difficult situation resulting from the outbreak of the epidemic. The purpose of these tools was to help maintain the financial liquidity of clients by reducing the financial burden in the short term.

The tools used at the Bank until the end of September 2020 were in line with the Banks' position regarding the unification of the rules for offering assistance tools to clients of the banking sector. This position was a non-statutory moratorium within the meaning of the European Banking Authority's guidelines on statutory and non-statutory loan repayment moratoria that were applied by the Banks in connection with the COVID-19 crisis. They were notified by the Polish Financial Supervision Authority to the European Banking Authority.

The moratorium covered aid instruments granted from March 13 to September 30, 2020.

In the scope of the Retail Banking area, the Bank made it possible for clients to apply for deferment of principal or principal and interest repayments of installments for a specified period of up to 6 months, with the simultaneous extension of the loan period by the duration of the moratorium. Examination of applications that met the conditions set by the sectoral position was carried out in a simplified manner, i.e. without the need to test the client's ability to pay the liability. The application examination process was supported by the mechanism of automatic verification of boundary conditions (among others, no arrears in repayment of more than one installment, no grace period in repayment in the last 12 months, at least 6-month repayment history). In the event of a positive verification result, the client's request was automatically accepted. Customer requests that did not pass the automatic verification were processed by a credit analyst.

When granting a capital grace, the sum of capital outstanding after the grace period was divided according to the algorithm (equal or decreasing installments - according to the contract) for the remaining period. In the case of extending the loan period, the period to be repaid is longer, which means that the installments after the grace period will be lower than in the case of a capital grace without extending the loan period. When granting the capital and interest grace period for the capital, the mechanism was identical to that for the capital grace, while the interest suspended was evenly distributed over the period to be repaid after the grace period.

Aid instruments under this moratorium were available to all retail clients whose delay in repayment of principal or interest did not exceed 30 days as of the date of submitting the application for support and concerned only loans granted before March 13, 2020, which were not reclassified to the default category.

The bank also offers clients support under the so-called anti-crisis shield 4.0, effective from June 24, 2020, under which customers who have lost their job or other main source of income after March 13, 2020 have the right to suspend loan repayment for up to 3 months without charging interest during the suspension period. This improvement is a statutory moratorium within the meaning of the guidelines of the European Banking Authority. The scale of applications for this form of aid is currently insignificant. As of December 31, 2020, 15 applications for aid under this moratorium have been submitted, of which aid has been granted 14 borrowers. The gross carrying amount of their liabilities as at December 31, 2020 was PLN 7.30 million.

As regards the activities of the Commercial Banking area in connection with COVID-19, the Bank made it possible for its corporate clients to suspend the repayment of principal installments for a period of up to 6 months. In addition, small and medium-sized entrepreneurs who are the Bank's customers had the option to suspend the repayment of entire principal and interest installments for up to 3 months. In the case of transactions in the area of Corporate Banking, the repayment terms were defined individually.

Aid instruments under these moratoria were available to all corporate clients who, as at March 15, 2020, in accordance with the Bank's internal regulations, had not been reclassified to the default category and concerned only loans granted before March 8, 2020. Moreover, when granting assistance measures, the Bank required the maintenance of collateral at least at the same level and the restriction of distribution to the owner.

Corporate clients' applications for assistance in connection with the crisis caused by the COVID-19 pandemic submitted after September 30, 2020 were considered by the Bank using the Bank's standard internal regulations and on the basis of the standard credit decision-making process.

In connection with the reactivation on December 2, 2020 by the European Banking Authority (EBA) of the Guidelines on statutory and non-statutory moratoria for the repayment of loans to entrepreneurs, applied in the face of the crisis caused by COVID-19 and the resumption of the non-statutory moratorium, i.e. the common position of banks on the harmonization of the rules of offering assistance tools to clients of the banking sector (non-statutory moratorium within the meaning of the EBA Guidelines), the Bank offers its corporate clients assistance instruments under the renewed non-statutory moratorium from January 18, 2021 to March 31, 2021.

for 2020 (in PLN thousand)

The tables below present information on the scope of COVID-19 moratoria applied by the Bank.

| | 31.12.2020 | |
|---|---|---|
| | Number of obligors | Number of obligors |
| **Moratoriums** | 2 526 | 2 519 |
| **BGK government guarantees** | - | - |

| | 31.12.2020 | | | | |
|---|---|---|---|---|---|
| | Gross value of contracts with awarded moratoria | Including: gross value of contracts with expired moratoria | Including: gross value of contracts with active moratoria | Cumulative impairment of contracts with active moratoria | Net value/fair value of contracts with active moratoria |
| **Moratoriums** | **2 109 167** | **2 097 392** | **11 775** | **(38)** | **11 737** |
| Individual customers | 795 427 | 783 652 | 11 775 | (38) | 11 737 |
| Corporate customers | 1 313 740 | 1 313 740 | - | - | - |

The table presents contracts with active moratoria as of December 31, 2020.

| 31.12.2020 | Performing | | | | |
|---|---|---|---|---|---|
| | Gross carrying amount | Of which: exposures with forbearance measures | Of which: grace period of capital and interest | Of which: instruments with significant increase in credit risk since initial recognition but not credit-impaired (Stage 2) | Accumulated impairment |
| **Moratoriums** | **11 775** | **-** | **10 075** | **9 304** | **(38)** |
| Individual customers | 11 775 | - | 10 075 | 9 304 | (38) |
| Corporate customers | - | - | - | - | - |

At the end of December 31, 2020, there are no unsupported moratoria.

The vast majority of clients who received support under the payment suspension moratoria only benefited from the suspension of the principal of the installment - approximately 97.35% of the total exposure subject to the moratoria. This means that customers still had to pay their liabilities only with a lower installment. The delay in the payment of interest installments was subject to the standard overdue calculation. If such payment was overdue by more than 30 days, it was classified into basket 2 and over 90 days into basket 3. In the case of commercial loans, the Bank applied an individual approach in its assessment.

The tables below provide information on the expired moratoria that were applied within the Group under COVID-19 from March 13 to September 30, 2020.

| Expired assistance provided between March 13 and September 30, 2020 | Performing | | | | |
|---|---|---|---|---|---|
| | Gross carrying amount | Of which: exposures with forbearance measures | Of which: grace period of capital and interest | Of which: instruments with significant increase in credit risk since initial recognition but not credit-impaired (Stage 2) | Accumulated impairment |
| **Moratoriums** | **2 033 126** | **24 598** | **43 975** | **814 536** | **15 572** |
| Individual customers | 779 154 | 6 622 | 43 975 | 396 932 | 1 999 |
| Corporate customers | 1 253 972 | 17 976 | - | 417 604 | 13 573 |

for 2020 (in PLN thousand)

| Expired assistance provided between March 13 and September 30, 2020 | Non-performing | | | | |
|---|---|---|---|---|---|
| | Non-performing | Of which: exposures with forbearance measures | Of which: unlikely to pay that are not past-due or past-due <= 90 days | Accumulated impairment | Inflows to non-performing exposures |
| **Moratoriums** | **64 266** | **61 067** | **64 267** | **(13 139)** | **2 114** |
| Individual customers | 4 498 | 1 298 | 4 498 | 533 | 2 114 |
| Corporate customers | 59 768 | 59 769 | 59 769 | (13 672) | - |

<u>The impact of the COVID-19 pandemic on the process of assessing the client's financial situation</u>

In assessing the financial condition of corporate clients, the Bank used only the individual assessment as the most appropriate and precise (the Bank did not use a collective or sectoral approach).

During the monitoring of customer and transaction risk, the impact of the COVID-19 pandemic on the customer's situation and the strength of this impact (i.e. temporary turbulence, long-term problem for the business model, etc.) as well as the plan to reduce this impact implemented by the customer were assessed. Among corporate clients applying for moratoria, CRE clients in the retail and hotel industries had the largest balance sheet exposure.

The customer was entered on the Watch List (LW - list of customers under the watch) based on standard criteria defined in the Bank's internal regulations. With regard to customers who submitted an application for an aid measure to the Bank, the list of criteria for entry on the Watch List has been extended with an additional, discretionary COVID-19 premise. A customer may have been included on the Watch List if, in the credit analyst's opinion, the customer's problems resulting from the pandemic are of a long-term nature and after the pandemic is over, the customer may not return to a financial situation sufficient to settle liabilities. In addition, other criteria for inclusion on the Watch List, contained in the Bank's internal regulations, also applied to the clients whom the Bank provided support in connection with COVID-19. Placing a client on the Watch List results in the classification of the client into the basket 2.

With regard to the retail client risk assessment, clients covered by the moratorium aid tools continue to be scoring according to the standard client evaluation process.

<u>Description of the Bank's approach to forbearance classification in relation to aid activities under COVID-19</u>

According to the statement of the European Banking Authority on the application of the prudential default, forbearance and IFRS9 framework in the light of COVID-19 measures, published on March 25, 2020, stating that the use of COVID-19 aid tools in the form of repayment moratoria meeting the guidelines defined in the guidelines The EBA regarding the treatment of public and private moratoria in the light of COVID-19 measures does not automatically classify exposures to default and forbearance, and in line with the statement of the KNF Office published under the Supervisory Impulses for Security and Development Package that it will apply a flexible approach to the application of EBA guidelines on of non-performing and restructured exposures, the Bank does not classify the granting of aid instruments used due to the COVID-19 crisis under the moratoria as a forbearance measure.

The exception are corporate clients, for which the approach was used based on an individual assessment of whether it is required to classify such client's exposure as forborne, in accordance with the applicable internal regulations of the Bank.

Due to the deterioration of the economic situation in the country related to the COVID-19 epidemic, the Bank took additional steps to include this information in the expected credit risk losses. Due to the dynamically changing situation and the related uncertainty, the Bank's activities were spread over time and included in particular:

1. review of sectors and individual clients of the corporate portfolio, in particular clients under observation, in order to verify the potential increase in the probability of non-implementation of restructuring plans, which was started in March as the first action of the Bank to take into account the impact of the epidemic on the clients' financial situation.

2.modification of the weight of macroeconomic scenarios, consisting in assigning a weight of 100% to the pessimistic scenario, in the model for the expected loss, at the end of 2020,

for 2020 (in PLN thousand)

3. Updating the models of dependence of the long-term PD parameter on macroeconomic variables, based on historical data and the currently observed economic situation, at the end of 2020,

4. Update of macroeconomic forecasts, taking into account the impact of COVID-19 and state aid actions, affecting the models of long-term PD, EAD and LGD parameters, as well as the level of allocation of exposures to basket 2, at the end of 2020,

5. Restoring the weights of macroeconomic scenarios, respectively: 60% for the baseline scenario, 20% for the optimistic and 20% for the pessimistic, in the expected loss model, while taking into account the current macroeconomic forecasts directly in the risk parameters, at the end of 2020,

6. monitoring of macroeconomic forecasts in order to verify the macroeconomic data used in the models in terms of their adequacy to the actual development of the economic situation in Poland. No grounds were found for changes to the macroeconomic forecasts within the risk parameters in the third and fourth quarter of 2020.

Due to the uncertainty related to the hindered observation of the timeliness of repayment of loans covered by moratoria, the Bank also decided to reclassify, as at December 31, 2020, some of the retail clients covered by this form of support, selected on the basis of behavioral characteristics, into basket 2 despite the lack of evidence of a significant increase in risk which resulted in the recognition of additional allowances for expected credit losses in the amount of PLN 0.77 million. The change had an impact on the basket share structure. The share of basket 2 in the total exposure of the loan portfolio increased with a simultaneous decrease in its coverage with provisions, which is a natural consequence of allocating exposures with a lower probability of impairment (lower PD) to the basket.

Additionally, the Group made a decision to reclassify as of December 31, 2020 into basket 3, or, in justified cases, into basket of 2 exposures with an improvement in the form of a statutory moratorium. The final allocation of the exposure to basket 2 was possible after additional analyzes were carried out, taking into account quantitative and qualitative factors, such as, among others: the presence of a co-borrower in the contract, the credit quality of all customer exposures, the occurrence and amount of cash flows after the date of submitting the moratorium application. These actions resulted in the recognition of additional allowances for expected credit losses in the amount of PLN 0.2 million.

The deterioration of the economic situation in the country related to the COVID-19 epidemic resulted in the recognition of additional allowances for expected credit losses in the amount of PLN 38,536 thousand. PLN in the portfolio measured at amortized cost, of which 36 836 thousand. PLN in the commercial portfolio and 1 700 thous. PLN in the retail portfolio.

Due to the fact that changes in risk parameters following the outbreak of the COVID-19 pandemic were implemented over a period of several months in a very dynamically changing macroeconomic environment, the Bank decided to present the total value of their impact on the date December 31, 2020 as presented in the table below:

| | 31.12.2020 | | |
|---|---|---|---|
| | **Individual customers** | **Corporate customers** | **Total** |
| **Financial assets at amortised** | **1 700** | **36 836** | **38 536** |
| Stage 1 | 150 | 1 196 | 1 346 |
| Stage 2 | 1 250 | 12 943 | 14 193 |
| Stage 3 | 300 | 22 697 | 22 997 |
| **Assets measured at fair value through profit or loss** | **nd** | **838** | **838** |
| **Total** | **1 700** | **37 674** | **39 374** |

On 17 December 2020, mBank Hipoteczny SA (acting as the Beneficiary) concluded a Framework Guarantee Agreement with mBank SA (acting as the Guarantor) and 23 Detailed Guarantee Agreements (in total: Guarantee Agreements) concerning 23 commercial credit exposures mainly in stage 2 granted by mBank Hipoteczny SA (Beneficiary) to its borrowers (ECL at the time of granting was PLN 16.2 million). The total value of guarantee instruments as at the date of signing the Guarantee Agreements, i.e. December 17, 2020, amounted to PLN 121.52 million and EUR 105.83 million. Under the Guarantee Agreements, mBank SA (Guarantor) is a provider of unfunded credit protection within the meaning of Art. 194 paragraph. 6 CRR.

for 2020 (in PLN thousand)

As at December 31, 2020, the Bank did not apply management overlays.
In the period from the last interim report, i.e. from June 30, 2020, the Bank did not modify the forecasts of future macroeconomic conditions, therefore, no significant changes in the expectations of future economic conditions were identified that could materially affect the estimates of expected credit losses.
The bank will continue to analyze the impact of COVID-19 and state aid programs on the result on the cost of credit risk in the coming quarters.
In order to assess the sensitivity of the ECL to future macroeconomic conditions, the Bank determined the value of the ECL separately for each of the applied scenarios. The impact of each scenario is presented in the table below.

| Scenario MYP 31.12.2020 | Base | | Optimistic | | Pessimistic | |
|---|---|---|---|---|---|---|
| Probability | 60% | | 20% | | 20% | |
| | 2020 | Average for the next two years | 2020 | Average for the next two years | 2020 | Average for the next two years |
| Unemployment rate/end of year | 7,00% | 5,50% | 3,30% | 2,90% | 9,20% | 11,90% |

| Scenario MYP 31.12.2019 | Base | | Optimistic | | Pessimistic | |
|---|---|---|---|---|---|---|
| Probability | 60% | | 20% | | 20% | |
| | 2020 | Average for the next two years | 2020 | Average for the next two years | 2020 | Average for the next two years |
| Unemployment rate/end of year | 3,90% | 4,00% | 3,00% | 3,50% | 6,50% | 8,00% |

The above result was estimated taking into account the equal allocation to the second basket based on the weighted average of all 3 macroeconomic scenarios, without taking into account additional potential migrations between baskets. The ECL sensitivity analysis was carried out on 85% of the assets of the portfolio of loans and advances to customers and off-balance sheet liabilities granted to them.

The reason for changes in the key values in the Bank's risk models were changes in macroeconomic indicators following the outbreak of the COVID-19 pandemic.

Apart from the activities related to the updating of the credit risk models mentioned above, the Bank did not introduce any other dedicated changes to the models used for the calculation of the expected credit risk losses. In conjunction with:

• no significant impact of the current economic situation (resulting in large part from the aid measures applied) on parameters such as the loss ratio or the level of portfolio losses,

• results of consultations with other units of the Bank's risk division indicating that there is no need to take into account additional effects due to the impact of COVID-19 on the models,

The bank limited the model management process to cyclical activities such as:

• cyclical recalibration of short-term PD models reflecting the current level of the portfolio's loss ratio,

• cyclical recalibration of long-term PD models and quantitative model of allocation to baskets,

• cyclical recalibration of the long-term LAG model in the corporate area.

<u>A significant modification</u>

Material modification - a change in the contractual terms of a financial instrument, which leads to the removal of a modified asset from the balance sheet and recognition of a new one. Modified assets are written off in the net amount, ie taking into account previously recognized expected credit losses for credit risk (in the case of impaired assets). The new asset is recognized at fair value (possibly adjusted for new commissions on the newly created asset) and a new effective interest rate is calculated for it. The assessment of whether a given modification of financial assets is a material or a minor modification depends on the fulfillment of the qualitative and quantitative criteria described in Note 2.6.

Description of the assumptions made regarding the calculation of the effective interest rate and significant modification

The solutions applied so far under the aid programs did not meet the criteria of significant modification applied by the Bank in relation to financial assets.
In particular, there were no situations where the Bank used aid programs as a beneficiary that would change the terms of the Bank's financial liabilities.
A change in the loan repayment schedule as a result of credit holidays means, from the point of view of the accounting principles applied by the Bank, an insignificant modification that results in the following effects:

- if the credit holiday period is not part of the contract, then the introduction of the holiday changes the contractual cash flows and the Bank recalculates the gross carrying amount of the financial asset and recognizes the gain or loss on the modification in the income statement;
- if the credit vacation period is a feature of an existing contract (the existing contract allows an equivalent grace period), there is a change in expected cash flows and a cumulative adjustment to the gross carrying amount of the financial asset must be recognized on the other side of the income statement, net interest income.

The Bank identifies a negative result on an insignificant modification in the amount of PLN 2,793 thousand. PLN (Note 10), including a positive result of PLN 973 thousand. PLN in connection with the application of aid programs due to the COVID-19 pandemic.

Deferred tax assets

The Bank recognizes a deferred tax asset if there is sufficient certainty that tax profit will be generated in the future allowing for its use.
The carrying amount of a deferred tax asset is verified at each balance sheet date and is reduced accordingly by the amount that it is no longer probable that the taxable income will be sufficient for partial or full realization of the deferred tax asset.
The Bank activates in deferred tax write-offs for credit losses not recognized as tax costs, in the part attributable to capital, which, in accordance with tax regulations, may become tax-deductible in the future in the form of a write-off for credit losses, after meeting the statutory conditions for overdue or making it plausible. or as the cost of irrecoverable capital after documenting the uncollectibility of the debt. Write-offs for credit losses which, in accordance with the CIT Act, will never become a tax expense, have been excluded from the income tax calculation.

Benefits based on phantom shares

The Bank runs a remuneration program for the Bank's Management Board and employees who have a significant impact on the Bank's risk profile, based on phantom shares settled in cash.
Pursuant to the provisions of IAS 19, the projected unit credit method was applied to determine the present value of employee benefit obligations. The basis for calculating the provision for deferred part of the variable remuneration for eligible employees of the Bank is the amount of the bonus that the Bank undertakes to pay on the basis of the Employee Remuneration Policy that has a significant impact on the Bank's risk profile.
Phantom shares are awarded in the number resulting from the valuation of these shares for the assessment period. The valuation of phantom shares is calculated each time at the end of the reporting period as the quotient of the Bank's book value and the number of ordinary shares. The payment of phantom shares depends on the average valuation of these shares derived from two values: the value of the phantom share at the end of the annual period preceding the payment date and the value of the phantom share at the end of the first half of the year in which the payment is to take place in a given reporting period. This average value is multiplied by the number of phantom shares to be exercised in a given period, and the result of this action determines the amount of the cash payout resulting from the phantom shares held. The final value of the bonus, which is the product of the number of shares and their expected value as at the balance sheet date preceding the realization of each of the deferred tranches, is actuarial discounted. The discounted amount is reduced by the amounts of annual write-downs for the provision, discounted actuarially for the same day. The actuarial discount is the product of the financial discount and the probability that each participant will survive individually until the moment of full vesting of rights to each of the deferred tranches. The amounts of the annual write-offs are calculated according to the Projected Unit Credit Method. The above-mentioned probability was determined using the competitive risk method ("Multiple Decrement Model"), where the following three risks were taken into account: possibility of dismissal, risk of complete incapacity to work, risk of death.

<u>The fair value of derivatives and other financial instruments</u>

The fair value of financial instruments not listed on active markets is determined using valuation techniques. All models are approved before use and also calibrated to ensure that the results obtained reflect the actual data and comparable market prices. As far as possible, only observable data from an active market are used in the models. The methods of determining the fair value of financial instruments are described in Note 4.

<u>Early repayment of retail loans</u>

In the judgment of September 11, 2019, in a case concerning a consumer loan fully repaid early, the CJEU ruled that "the consumer's right to a reduction in the total cost of the loan in the event of early loan repayment covers all costs that have been imposed on the consumer". Due to the change in estimates of the expected future cash flows, a provision in the amount of PLN 2,594 thousand was created as at December 31, 2020. PLN. As at December 31, 2020, the provision recognized under provisions for future liabilities (Note 29) relating to costs for potential commission reimbursements due to early repayment of loans made before the date of the judgment by the CJEU amounted to PLN 2,900 thousand. PLN, (as at December 31, 2019: PLN 473 thousand). Originally, the group model referred to the entire loan portfolio, which resulted in an overestimation, therefore, in the first quarter of 2020, an adjustment of the group model was made taking into account only a part of the portfolio that will be prepaid in the future. The total negative impact of early repayment of retail loans on the Bank's gross profit in 2020 amounted to PLN 2,861 thousand. PLN, of which 2 891 thousand. PLN decreased interest income and 30 thousand. PLN. increased other operating income. The above estimates are subject to significant uncertainty as to the number of clients who will apply to the Bank for the reimbursement of commissions related to early repayments made before the judgment of the CJEU, as well as the expected rate of prepayment of loans in the future.

## 6. Operating segments

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

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

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

From January 2019, the sale of commercial loans was transferred to mBank S.A.
The introduced method of data presentation is consistent with the Bank's business profile and facilitates the receipt of management information by report users. Moreover, the dynamic development of the retail mortgage loan portfolio, as the second significant area of the Bank's lending activity, resulted in the need to allocate internal interest costs, to set business goals and to account for segment results.
The Bank segmented the result into three business segments, which were distinguished from the point of view of specific customer groups and products according to the homogeneous characteristics of the transaction:

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

for 2020 (in PLN thousand)

- historically to local government units — loans to local government units (municipalities, districts, provinces) as well as loans secured by local government units (commercial companies established by local governments, public health care institutions).

2. The Retail Banking Segment – is a segment of the Bank's business that includes the loans to natural persons, those that may form a basis for the issue of mortgage bonds:
   - loans granted for housing purposes in PLN, the sale of which was under an agency agreement with mBank S.A. – agency model,
   - loans in PLN, secured with a mortgage on a housing property, acquired from mBank S.A. – pooling,
   - loans to natural persons granted not in cooperation with mBank S.A. The Bank discontinued the sales in this segment in 2004.
3. Treasury Segment – a segment of Bank's activities, comprising financing acquisition, in particular issuance of mortgage bonds, liquidity management, and Bank's interest rate and currency risk management. Revenues of the segment result from the maintenance of the liquidity portfolio and reclassification of internal interest costs from retail banking and corporate banking segments. Costs of the segment pertain to acquiring financing and, as of 2018, include a part of administrative expenses too.

The main assumption of the segment division within the profit and loss account is the most accurate presentation of the profitability of a given segment in the Bank's operations (with the exception of the Treasury Segment, which finances the activities of other segments in a mortgage bank and by definition does not generate a positive financial result). For this purpose, the Bank assigns at the level of each loan agreement all direct income, such as interest income, commission income and determines the level of expected credit losses.

The bank does not allocate to individual income tax segments, therefore information in terms of profit / loss, they are disclosed at the level of profit before tax. Information on segments is measured according to the same principles as those presented in the accounting policy.

The separation of the segment's assets and liabilities as well as revenues and costs was made on the basis of internal information prepared at the Bank for management purposes. The individual segments of the Bank have been assigned assets and liabilities and related to these assets and liabilities, income and expenses. There are related assets and liabilities in the Treasury segment with hedging derivatives and liabilities due to external financing. The segment result takes into account all revenue items that can be allocated and costs.

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

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.

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

| **Period from 01.01.2020 to 31.12.2020** | **Corporate Banking** | **Retail Banking** | **Treasure Segment** | **Total** |
|---|---|---|---|---|
| **Net interest income** | **79 526** | **93 414** | **(5 360)** | **167 580** |
| **Net fee and commission income** | **(2 161)** | **(1 608)** | **(2 643)** | **(6 412)** |
| Other operating income/expenses | (881) | (246) | 13 | (1 114) |
| Net trading income | - | - | 327 | 327 |
| Result from non-substantial modificationj | (2 652) | (141) | - | (2 793) |
| Wynik z tytułu zaprzestania ujmowania instrumentów finansowych niewycenianych do wartości godziwej przez rachunek zysków i strat | (1 018) | - | 4 244 | 3 226 |
| Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss | (2 168) | - | - | (2 168) |
| Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss | (39 504) | (2 816) | - | (42 320) |
| Overhead costs | (22 969) | (23 057) | (6 826) | (52 852) |
| Depreciation | (1 941) | (7 142) | (687) | (9 770) |
| Tax on the Bank's balance sheet items | (11 013) | (20 336) | - | (31 349) |
| **Segment result (gross)** | **(4 781)** | **38 068** | **(10 932)** | **22 355** |

for 2020 (in PLN thousand)

| Period from 01.01.2019 to 31.12.2019 | Corporate Banking | Retail Banking | Treasure Segment | Total |
|---|---|---|---|---|
| **Net interest income** | **103 313** | **83 785** | **(1 029)** | **186 069** |
| **Net fee and commission income** | **(1 453)** | **(1 051)** | **(5 697)** | **(8 201)** |
| Other operating income/expenses | (360) | 35 | (36) | (361) |
| Net trading income | - | - | 5 096 | 5 096 |
| Result from non-substantial modificationj | (1 767) | (9) | - | (1 776) |
| Wynik z tytułu zaprzestania ujmowania instrumentów finansowych niewycenianych do wartości godziwej przez rachunek zysków i strat | (185) | - | - | (185) |
| Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss | (2 844) | - | - | (2 844) |
| Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss | (19 669) | (334) | - | (20 003) |
| Overhead costs | (26 183) | (25 941) | (7 462) | (59 586) |
| Depreciation | (1 374) | (5 055) | (486) | (6 915) |
| Tax on the Bank's balance sheet items | (13 390) | (18 836) | - | (32 226) |
| **Segment result (gross)** | **36 088** | **32 594** | **(9 614)** | **59 068** |

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

| 31.12.2020 | Corporate Banking | Retail Banking | Treasure Segment | Other assets | Total |
|---|---|---|---|---|---|
| Segment Assets | 3 089 600 | 8 332 751 | 1 369 731 | 77 226 | 12 869 308 |
| Segment Liabilities | 8 050 | 14 547 | 11 556 471 | - | 11 579 068 |

| 31.12.2019 | Corporate Banking | Retail Banking | Treasure Segment | Other assets | Total |
|---|---|---|---|---|---|
| Segment Assets | 4 268 893 | 7 485 063 | 1 351 720 | 82 232 | 13 187 908 |
| Segment Liabilities | 20 510 | 17 624 | 11 882 254 | - | 11 920 388 |

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

for 2020 (in PLN thousand)

## 7. Net interest income

| | Year ended 31 December | |
|---|---|---|
| | **2020** | **2019** |
| **Interest income** | | |
| **Interest income calculated using the effective interest rate method** | **330 936** | **417 477** |
| Interest income of financial assets at amortised cost, including: | **316 784** | **396 372** |
| - Loans and advances | 316 009 | 395 377 |
| - Cash and short-term placements | 122 | 725 |
| - Interest income on liabilities | 653 | 270 |
| Interest income on financial assets at fair value through other comprehensive income | 14 152 | 21 105 |
| - *Debt securities* | 14 152 | 21 105 |
| **Income similar to interest on financial assets at fair value through profit or loss, including:** | **32 091** | **36 718** |
| Non-trading financial assets mandatorily measured at fair value through profit or loss, including: | 4 098 | 7 064 |
| - *Loans and advances* | 4 098 | 7 064 |
| Interest income on derivatives classified into banking book | 3 272 | 7 901 |
| Interest income on derivatives concluded under hedge accounting | 24 721 | 21 753 |
| **Total interest income** | **363 027** | **454 195** |

| | Year ended 31 December | |
|---|---|---|
| | **2020** | **2019** |
| **Interest expense** | | |
| Financial liabilities valued at amortized cost, including: | (175 791) | (264 064) |
| -Due to the issue of debt securities | (118 088) | (161 039) |
| -Loans received | (42 462) | (71 589) |
| -Due to subordinated loan | (8 159) | (9 938) |
| -Other financial liabilities | (7 082) | (21 498) |
| Interest expenses on derivatives condluded under the cash flow hedge | (19 618) | (4 033) |
| Interest expense on leasing | (38) | (29) |
| **Total interest expense** | **(195 447)** | **(268 126)** |

In 2020, interest income related to impaired financial assets measured at amortised cost, stood at PLN 6,430 thousand (for the period ended on 31 December 2019: PLN 8,497 thousand).

for 2020 (in PLN thousand)

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

| | Year ended 31 December | |
|---|---|---|
| | 2020 | 2019 |
| **Interest income** | | |
| From banking sector | 22 028 | 37 139 |
| From other entities, including: | 340 999 | 417 056 |
| - from corporate customers | 134 081 | 172 802 |
| - from individual customers | 205 387 | 241 659 |
| - from public sector | 1 531 | 2 595 |
| **Total interest income** | **363 027** | **454 195** |
| **Interest expense** | | |
| From banking sector | (69 038) | (92 978) |
| From other entities, including: | (162) | (138) |
| - from corporate customers | (162) | (138) |
| From own issuances | (118 088) | (161 039) |
| Subordinated capital | (8 159) | (9 938) |
| Interest expenses on derivatives condluded under the cash flow hedge | - | (4 033) |
| **Total interest expense** | **(195 447)** | **(268 126)** |

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

## 8. Net fee and commission income

| | Year ended 31 December | |
|---|---|---|
| | 2020 | 2019 |
| **Fee and commission income** | | |
| Credit-related fees and commissions | 1 183 | 2 203 |
| **Total fee and commission income** | **1 183** | **2 203** |
| **Fee and commission expenses** | | |
| Fee and commission expenses | (4 419) | (4 541) |
| Commission expense from loan received and stand-by credit line | (770) | (1 330) |
| Costs related to the debt securities issue program (covered bonds and bonds) | (1 762) | (4 274) |
| Costs of real estate analyses and valuations related to the lending activity | (66) | (3) |
| Commission for transfers for billing | (110) | (92) |
| Other | (468) | (164) |
| **Total fee and commission expense** | **(7 595)** | **(10 404)** |
| **Total net fee and commission income** | **(6 412)** | **(8 201)** |

All fees and commission income and expenses presented in the table above relate to items not measured at fair value through profit or loss. The costs of fees and commissions for the issue of debt securities decreased due to the lack of issues in 2020. The decrease in commission income was the result of a decrease in balance sheet and off-balance sheet exposures.

Costs of servicing credit products related to the outsourcing agreement with mBank S.A. for after-sale service of the commercial portfolio amount to PLN 3 159 thousand. PLN.

for 2020 (in PLN thousand)

## 9. Net trading income

| | Year ended 31 December | |
|---|---|---|
| | **2020** | **2019** |
| **Foreign exchange result** | **(168)** | **287** |
| Net exchange differences on translation | (21 914) | (4 961) |
| Valuation of foreign currency derivatives | 21 746 | 5 248 |
| **Other net trading income and result on hedge accounting** | **495** | **4 809** |
| Interest rate risk instruments | (220) | 243 |
| Hedge accounting, including: | 715 | 4 566 |
| - net profit on hedged items | (24 995) | (45 734) |
| - net profit on hedging instruments | 25 726 | 51 702 |
| - net profit on hedging instruments of CF | (16) | (1 402) |
| **Total net trading income** | **327** | **5 096** |

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

The Bank applies fair value hedge accounting. The interest rate risk is the only type of risk hedged for which hedge accounting is applied. The result on hedged item and hedging instruments is presented in the Note 21. The hedge is assessed on an ongoing basis and determined to have been highly effective. The Bank documents its own assessment of the effectiveness of fair value hedging transactions, measured both prospectively and retrospectively from the time of their designation and throughout the period of duration of the hedging relationship between the hedging instrument and the hedged item.

## 10. Net income on modification

In 2020 and 2019, the result on modifications was calculated only for assets measured at amortized cost, as the Bank did not have instruments measured at fair value through other comprehensive income.
The matters related to recognition of the net income on insubstantial modification are described in note 2.6.

| 31.12.2020 | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **Financial assets modified during the period** | | | | |
| Amortized cost of financial assets before modification | 1 891 200 | 672 282 | 173 036 | 2 736 518 |
| Net income on modification | (1 802) | 545 | (1 536) | (2 793) |

| 31.12.2019 | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| **Financial assets modified during the period** | | | | |
| Amortized cost of financial assets before modification | 633 177 | 78 690 | 69 850 | 781 717 |
| Net income on modification | (2 591) | 47 | 768 | (1 776) |

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

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

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

for 2020 (in PLN thousand)

In 2020, the result was PLN 4,243 thousand. PLN on the sale of treasury bonds.

| | Year ended 31 December 2020 | |
|---|---|---|
| | Gains | Losses |
| Debt securities | 4 243 | - |
| Loans and advances | 562 | (1 577) |
| **Gains of losses on derecognistion of financial assets and liabilities not measured at fair value through profit or loss** | **4 805** | **(1 577)** |

| | Year ended 31 December 2019 | |
|---|---|---|
| | Gains | Losses |
| Loans and advances | 28 601 | (28 786) |
| **Gains of losses on derecognistion of financial assets and liabilities not measured at fair value through profit or loss** | **28 601** | **(28 786)** |

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

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

| | Year ended 31 December | |
|---|---|---|
| | 2020 | 2019 |
| Loans and advances | (2 168) | (2 844) |
| - Corporate customers | (2 168) | (2 844) |
| **Gains or losses from non-trading financial assets mandatorily at fair value through profit or loss** | **(2 168)** | **(2 844)** |

## 13. Other operating income

| | Year ended 31 December | |
|---|---|---|
| | 2020 | 2019 |
| Income from release of prior year provisions | 34 | 745 |
| Income from sales of services | 67 | 63 |
| Income from recovering receivables designated previously as prescribed, remitted or uncollectible | 22 | 157 |
| Other | 690 | 65 |
| **Total other operating income** | **813** | **1 030** |

for 2020 (in PLN thousand)

## 14. General administrative expenses

| | Year ended 31 December | |
|---|---|---|
| | 2020 | 2019 |
| Staff-related costs | (22 643) | (25 786) |
| Material costs, including: | (16 579) | (16 901) |
| - logistic cost | (5 314) | (5 892) |
| - IT cost | (8 740) | (8 100) |
| - marketing cost | (437) | (785) |
| - consulting services cost | (1 649) | (1 542) |
| - other overheads cost | (439) | (582) |
| Contributions and transfers to the Bank Guarantee Fund | (10 902) | (13 315) |
| Taxes and fees | (2 510) | (3 388) |
| Contributions to the Social Benefits Fund | (218) | (196) |
| **Total overhead costs** | **(52 852)** | **(59 586)** |

The "logistics costs" item includes costs related to short-term lease contracts, costs related to low-value asset lease contracts and costs related to variable remuneration components (not included in the lease obligation). The total cost of leasing recognized in general administrative expenses as at December 31, 2020 amounted to PLN 333 thousand. PLN (as at December 31, 2019, PLN 924 thousand).

In accordance with the Resolution of the Bank Guarantee Fund Council of April 6, 2020 on determining the amount of contributions to the bank restructuring fund for 2020, in the current reporting period, the Bank recognized the contribution in the profit and loss account in the amount of PLN 10 902 thousand PLN (for 2019 in the amount of PLN 13 315 thousand.

### Staff-related expenses

| | Year ended 31 December | |
|---|---|---|
| | 2020 | 2019 |
| Wages and salaries | (19 072) | (20 866) |
| Social security expenses | (2 898) | (3 353) |
| Costs of retirement benefits | (14) | (16) |
| Provision for unused holidays | - | - |
| Remuneration payment in the form of phantom shares settled in cash | (161) | (753) |
| Other employee benefits | (498) | (798) |
| **Staff-related costs, total** | **(22 643)** | **(25 786)** |

## 15. Other operating expenses

| | Year ended 31 December | |
|---|---|---|
| | 2020 | 2019 |
| Costs of enforcement proceedings | (792) | (517) |
| Provision for disputes | (25) | - |
| Writing down investments | (901) | (266) |
| Loss on sales or liquidation of tangible fixed assets and intangible assets | (151) | (253) |
| Provisions for future liabilities | - | (248) |
| Other | (58) | (107) |
| **Total other operating expenses** | **(1 927)** | **(1 391)** |

for 2020 (in PLN thousand)

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

| | Year ended 31 December | |
|---|---|---|
| | **2020** | **2019** |
| **Financial assets at amortised cost, including:** | **(43 698)** | **(20 746)** |
| - Loans and advances | **(43 698)** | **(20 746)** |
| *Stage 1* | 9 720 | (2 720) |
| *Stage 2* | (15 588) | (1 931) |
| *Stage 3* | (38 373) | (22 704) |
| *POCI* | 543 | 6 609 |
| **Commitments and guarantees given** | **1 378** | **743** |
| *Stage 1* | 1 228 | 888 |
| *Stage 2* | 150 | (145) |
| **Net impairment losses on financial assets not measured at fair value through profit or loss** | **(42 320)** | **(20 003)** |

In 2020, there was a significant increase in basket 2 through the transfer of exposures from basket 1 to basket 2 in connection with entries on the LL, assigning the forborne tag, mainly as a result of the COVID-19 pandemic, and the introduction of quantitative SICR. Additionally, in Q4 2020, mBank refinanced several of mBank Hipoteczny's largest credit exposures. The vast majority of these were exposures from basket 1, which resulted in a further relative increase in the share of basket 2 and basket 3 in the portfolio.

As regards the increase in write-offs for basket 2 and basket 3, it should be emphasized that the Bank reacted to any symptoms of deterioration in the financial situation of its clients on an ongoing basis and applied appropriate reclassifications to basket 2 (significant increase in basket 2 in 2020) or basket 3, respectively. of the provisioning level, the current conversion of PD ratings for basket 2 was applied, and the recovery scenarios for basket 3 were adjusted on an ongoing basis. The above elements contributed to a significant increase in the level of write-offs observed in baskets 2 and 3.

The Bank applies an individual approach to all exposures under CRE financing. Each renewal of PD is associated with a reassessment of the borrower's current situation, location and technical advantages of the financed property, the current lease status, etc. exhibition, incl. due to the increase in the level of rented space, renewal of lease agreements, extension of lease periods, improvement of financial data and the economic and financial situation of the Borrower and / or the project sponsor.

for 2020 (in PLN thousand)

## 17. Income tax

| | Year ended 31 December | |
|---|---|---|
| | **2020** | **2019** |
| Current income tax | (15 285) | (18 249) |
| Deferred income tax (Note 29) | (2 192) | (3 735) |
| **Total income tax** | **(17 477)** | **(21 984)** |

| | | |
|---|---|---|
| **Profit before tax** | **22 355** | **59 068** |
| Income tax calculated at the rate applicable in a given fiscal year (19%) | (4 248) | (11 223) |
| - other non-taxable income | (13 154) | (10 738) |
| - tax on the Bank's balance sheet items | (5 956) | (6 123) |
| - value of write-downs on receivables | (633) | (1 736) |
| - contribution and payments to the Bank Guarantee Fund | (2 071) | (2 530) |
| - receivables written off against the write-offs | (2 877) | - |
| - NKUP on purchased receivables | (1 409) | (202) |
| - other | (208) | (147) |
| Adjustments in respect of current tax from prior years | (75) | (23) |
| **Total income tax expense** | **(17 477)** | **(21 984)** |

| **Effective tax rate calculation** | | |
|---|---|---|
| Profit before income tax | 22 355 | 59 068 |
| Income tax | (17 477) | (21 984) |
| **Effective tax rate** | **78,18%** | **37,22%** |
| **Nominal tax rate** | **19,00%** | **19,00%** |

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

## 18. Profit per share

| | Year ended 31 December | |
|---|---|---|
| | **2020** | **2019** |
| **Basic:** | | |
| Net profit from activities attributable to shareholders of mBank Hipoteczny S.A. | 4 878 | 37 084 |
| Weighted average number of ordinary shares | 3 360 000 | 3 327 945 |
| **Basic net profit per share (in PLN per share)** | **1,45** | **11,14** |
| **Diluted:** | | |
| Net profit attributable to shareholders of mBank Hipoteczny S.A., applied during the estimation of diluted earnings per share | 4 878 | 37 084 |
| Weighted average number of ordinary shares | 3 360 000 | 3 327 945 |
| **Diluted net profit per share (in PLN per share)** | **1,45** | **11,14** |

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

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

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

for 2020 (in PLN thousand)

## 19. Other comprehensive income

| Disclosure of tax effects relating to each component of other comprehensive income | Year ended 31 December | |
|---|---|---|
| | **2020** | **2019** |
| **Net profit** | **4 878** | **37 084** |
| **Other comprehensive income net of tax including:** | **17 842** | **(5 423)** |
| **Items that may be reclassified to the income statement** | **17 840** | **(5 443)** |
| *Change in the valuation of debt financial instruments valued at fair value through other comprehensive income (gross)* | *1 707* | *(3 006)* |
| *Deferred tax on debt financial instruments measured at fair value through other comprehensive income* | *(325)* | *571* |
| Change in the valuation of debt financial instruments measured at fair value through other comprehensive income (net) | 1 382 | (2 435) |
| *Change in valuation due to cash flow hedge (gross)* | *20 319* | *(3 714)* |
| *Deferred tax due to cash flow hedges* | *(3 861)* | *706* |
| Net cash flow hedge (net) | 16 458 | (3 008) |
| **Items that will not be reclassified to the income statement** | **2** | **20** |
| Actuarial gains and losses on post-employment benefits (gross) | 2 | 24 |
| Deferred tax on actuarial gains and losses on post-employment benefits | - | (4) |
| Actuarial gains and losses on post-employment benefits (net) | 2 | 20 |
| **Total comprehensive income net of tax** | **22 720** | **31 661** |

## 20. Cash and balances with the central bank

As at December 31, 2020, the Bank has a current account with the National Bank of Poland, the balance of which was PLN 29,393 thousand. PLN (as at December 31, 2019: PLN 1,034 thousand). As at December 31, 2020, the Bank did not have ON deposits (as at December 31, 2019, the Bank had an ON deposit in the amount of PLN 34,200 thousand).

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

- PLN 0 thousand for the period from 31 December 2020 to 30 January 2021,
- PLN 605 thousand in the period from 31 December 2019 to 30 January 2020.

As at 31 December 2020, the interest rate on the cash maintained as a mandatory reserve was 0.50% (31 December 2019).

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

The Bank has the following derivative instruments in its portfolio:

Interest rate risk instruments:

- Interest Rate Swap (IRS),

Currency risk instruments

- FX SWAP contracts,

Instrument for interest rate risk and exchange rate risk

- Cross Currency Interest Rate Swap (CIRS)

for 2020 (in PLN thousand)

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

As at December 31, 2020, the offsetting effect, apart from the valuation of derivative transactions, includes 90 294 thous. PLN of collaterals accepted in connection with concluded transactions on derivative instruments subject to compensation.

| | Nominal amount | | Fair value | |
|---|---|---|---|---|
| | purchase | disposal | assets | liabilities |
| **As at 31 December 2020** | | | | |
| **Derivative financial instruments held for trading** | | | | |
| - Foreign exchange derivatives | 2 968 | 3 000 | - | 32 |
| - FX swap contracts | 1 229 947 | 1 207 116 | 28 323 | 4 642 |
| **Total OTC derivatives** | **1 232 915** | **1 210 116** | **28 323** | **4 674** |
| **Total foreign exchange derivatives** | **1 232 915** | **1 210 116** | **28 323** | **4 674** |
| | - | - | - | - |
| **Total assets / liabilities held for trading** | **1 232 915** | **1 210 116** | **28 323** | **4 674** |
| **Interest rate derivatives** | | | | |
| Derivatives designated as fair value hedges | 2 523 834 | 2 523 834 | 137 814 | - |
| - IRS contracts | 2 523 834 | 2 523 834 | 137 814 | - |
| Derivatives designated as cash flow hedges | | | | |
| - CIRS | 1 384 440 | 1 278 930 | 121 029 | - |
| **Total derivatives held for hedging** | **3 908 274** | **3 802 764** | **258 843** | **-** |
| **Total recognised derivative assets / liabilities** | **5 141 189** | **5 012 880** | **287 166** | **4 674** |
| **Net-off effect** | **-** | **-** | **(90 249)** | **45** |
| **Total recognised derivative assets / liabilities held for trading** | **5 141 189** | **5 012 880** | **196 917** | **4 719** |
| Short-term (up to 1 year) | 1 232 915 | 1 210 116 | 28 323 | 4 674 |
| Long-term (over 1 year) | 3 908 274 | 3 802 764 | 168 594 | 45 |

As at December 31, 2019 except of valuation of derivatives, the netting effect includes PLN 68,613 thousand of collaterals received in connection with the derivative transactions subject to netting.

| | Nominal amount | | Fair value | |
|---|---|---|---|---|
| | purchase | disposal | assets | liabilities |
| **As at 31 December 2019** | | | | |
| **Derivative financial instruments held for trading** | | | | |
| Foreign exchange derivatives | 3 621 | 3 620 | 1 | - |
| - FX swap contracts | 255 771 | 252 312 | 2 456 | 76 |
| **Total OTC derivatives** | **259 392** | **255 932** | **2 457** | **76** |
| **Total foreign exchange derivatives** | **259 392** | **255 932** | **2 457** | **76** |
| **Interest rate derivatives** | | | | |
| - IRS contracts | 1 274 897 | 1 274 897 | 3 299 | 177 |
| **Total OTC interest rate derivatives** | **1 274 897** | **1 274 897** | **3 299** | **177** |
| **Total interest rate derivatives** | **1 274 897** | **1 274 897** | **3 299** | **177** |
| | - | - | - | - |
| **Total assets / liabilities held for trading** | **1 534 289** | **1 530 829** | **5 756** | **253** |
| **Interest rate derivatives** | | | | |
| Derivatives designated as fair value hedges | 2 456 729 | 2 456 729 | 111 251 | - |
| - IRS contracts | 2 456 729 | 2 456 729 | 111 251 | - |
| Derivatives designated as cash flow hedges | | | | |
| - CIRS | 1 277 550 | 1 278 930 | - | 7 524 |
| **Total derivatives held for hedging** | **3 734 279** | **3 735 659** | **111 251** | **7 524** |
| **Total recognised derivative assets / liabilities** | **5 268 568** | **5 266 488** | **117 007** | **7 777** |
| **Net-off effect** | **-** | **-** | **(68 790)** | **(177)** |
| **Total recognised derivative assets / liabilities held for trading** | **5 268 568** | **5 266 488** | **48 217** | **7 600** |
| Short-term (up to 1 year) | 1 662 044 | 1 658 584 | 8 159 | 253 |
| Long-term (over 1 year) | 3 606 524 | 3 607 904 | 40 058 | 7 347 |

## Hedge accounting

### a) *Fair value hedge accounting*

The Bank applies fair value hedge accounting where the only type of hedged risk is the interest rate risk. At the end of each month, the Bank assesses the effectiveness of the applied hedge by analyzing the changes in the fair value of the hedged instrument and the hedging instrument due to the hedged risk in order to confirm that the hedging relationships are effective in line with the accounting policy described in Note 2.10.

Description of the hedging relationship

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

Hedged items

The hedged items are fixed-interest rate mortgage covered bonds with the nominal value of EUR 546,900 thousand.

The hedged item and the hedging item have exactly the same nominal amounts, start and end dates. As at the reporting dates, the Bank performs retrospective and prospective tests using a linear regression model that describes changes in the fair value of the hedging instrument and the hedged item.

Sources of ineffectiveness for hedging relationships for which ineffectiveness occurs are cash flow mismatches, credit risk of the hedged instrument, and mismatch due to the initial measurement of derivatives, if a derivative that was entered into before the relationship was included in the hedging relationship.

Hedging instruments

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

Presentation of the result from hedged and hedging transactions

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

Pledged letters being a hedged instrument are presented in the statement of financial position under Liabilities arising from the issue of debt securities.

The following table presents hedged items as at 31 December 2020. In the following table, the nominal value is presented in EUR thousands, while the value of liability measured at amortised cost, hedge accounting adjustments related to fair value, carrying amount of a liability and the change of fair value resulting from hedge accounting, in PLN thousands.

As at 31.12.2020

| Debt financial instruments by type | Nominal value | Interest rate as at 31.12.2020 | Redemption date | Liability amount measured at amortised cost | Hedge accounting adjustments related to fair value of hedged items | Carrying amount of liability | The change in the value of the hedged item from the date of designation used as the basis for recognizing the hedge ineffectiveness in a given period |
|---|---|---|---|---|---|---|---|
| Mortgage covered bonds (EUR) | 20 000 | 1.14% | 25.02.2022 | 93 031 | 1 083 | 94 114 | 329 |
| Mortgage covered bonds (EUR) | 100 000 | 0.61% | 22.06.2022 | 462 630 | 4 381 | 467 011 | 143 |
| Mortgage covered bonds (EUR) | 24 900 | 0.94% | 01.02.2024 | 115 751 | 3 484 | 119 235 | (698) |
| Mortgage covered bonds (EUR) | 300 000 | 1.07% | 05.03.2025 | 1 394 280 | 63 148 | 1 457 428 | (12 888) |
| Mortgage covered bonds (EUR) | 11 000 | 1.29% | 24.04.2025 | 51 033 | 2 077 | 53 110 | (662) |
| Mortgage covered bonds (EUR) | 13 000 | 1.18% | 20.09.2026 | 60 040 | 2 031 | 62 071 | (1 247) |
| Mortgage covered bonds (EUR) | 35 000 | 1.18% | 20.09.2026 | 161 684 | 6 675 | 168 359 | (3 263) |
| Mortgage covered bonds (EUR) | 8 000 | 3.5% | 28.02.2029 | 37 564 | 7 279 | 44 843 | (1 399) |
| Mortgage covered bonds (EUR) | 15 000 | 3.5% | 15.03.2029 | 70 417 | 13 720 | 84 137 | (2 648) |
| Mortgage covered bonds (EUR) | 20 000 | 3.2% | 30.05.2029 | 92 974 | 18 400 | 111 374 | (3 679) |
| Mortgage covered bonds (EUR) | - | - | - | - | - | - | 1 017 |
| **Total hedged items** | | | | **2 539 404** | **122 278** | **2 661 682** | **(24 995)** |

**As at 31.12.2019**

| Debt financial instruments by type | Nominal value | Interest rate as at 31.12.2019 | Redemption date | Liability amount measured at amortised cost | Hedge accounting adjustments related to fair value of hedged items | Carrying amount of liability | The change in the value of the hedged item from the date of designation used as the basis for recognizing the hedge ineffectiveness in a given period |
|---|---|---|---|---|---|---|---|
| Mortgage covered bonds (EUR) | 30 000 | 2,75% | 28.07.2020 | 129 018 | 1 018 | 130 036 | 1 524 |
| Mortgage covered bonds (EUR) | 8 000 | 3,50% | 28.02.2029 | 34 581 | 5 879 | 40 460 | (1 587) |
| Mortgage covered bonds (EUR) | 15 000 | 3,50% | 15.03.2029 | 64 855 | 11 072 | 75 927 | (2 990) |
| Mortgage covered bonds (EUR) | 20 000 | 3,20% | 30.05.2029 | 85 624 | 14 721 | 100 345 | (4 081) |
| Mortgage covered bonds (EUR) | 20 000 | 1,135% | 25.02.2022 | 85 700 | 1 412 | 87 112 | 28 |
| Mortgage covered bonds (EUR) | 11 000 | 1,285% | 24.04.2025 | 47 038 | 1 415 | 48 453 | (1 133) |
| Mortgage covered bonds (EUR) | 13 000 | 1,180% | 20.09.2026 | 55 370 | 784 | 56 154 | (2 345) |
| Mortgage covered bonds (EUR) | 35 000 | 1,183% | 20.09.2026 | 149 116 | 3 411 | 152 527 | (6 106) |
| Mortgage covered bonds (EUR) | 24 900 | 0,94% | 01.02.2024 | 106 759 | 2 787 | 109 546 | (1 371) |
| Mortgage covered bonds (EUR) | 100 000 | 0,61% | 22.06.2022 | 426 641 | 4 524 | 431 165 | (1 188) |
| Mortgage covered bonds (EUR) | 300 000 | 1,073% | 05.03.2025 | 1 285 875 | 50 260 | 1 336 135 | (26 485) |
| Mortgage covered bonds (EUR) | 300 000 | 0,242% | 15.09.2025 | 1 274 659 | - | 1 274 659 | - |
| **Total hedged items** | | | | **3 745 236** | **97 283** | **3 842 519** | **(45 734)** |

The following table presents hedged items as at 31 December 2020. In the following table, the nominal value is presented in EUR thousands, while the fair value and the change of fair value resulting from hedge accounting, in PLN thousands.

**As at 31.12.2020**

| Derivatives | Nominal value | End of transaction | Fair value of asset | The change in the value of the hedging item since designation used as the basis for recognizing the hedge ineffectiveness in a given period |
|---|---|---|---|---|
| IRS (EUR) | 20 000 | 44 617 | 1 639 | (218) |
| IRS (EUR) | 100 000 | 44 734 | 5 643 | (43) |
| IRS (EUR) | 24 900 | 45 323 | 4 254 | 715 |
| IRS (EUR) | 300 000 | 45 721 | 71 577 | 13 457 |
| IRS (EUR) | 11 000 | 45 771 | 2 292 | 690 |
| IRS (EUR) | 13 000 | 46 285 | 2 054 | 1 291 |
| IRS (EUR) | 35 000 | 46 285 | 6 722 | 3 387 |
| IRS (EUR) | 8 000 | 47 177 | 8 653 | 1 399 |
| IRS (EUR) | 15 000 | 47 192 | 16 026 | 2 652 |
| IRS (EUR) | 20 000 | 47 268 | 18 954 | 3 763 |
| IRS (EUR) | - | - | - | (1 367) |
| **Total hedging items** | | | **137 814** | **25 726** |

for 2020 (in PLN thousand)

**As at 31.12.2019**

| Derivatives | Nominal value | End of transaction | Fair value of asset | The change in the value of the hedging item since designation used as the basis for recognizing the hedge ineffectiveness in a given period |
|---|---|---|---|---|
| IRS (EUR) | 30 000 | 28.07.2020 | 2 403 | (2 154) |
| IRS (EUR) | 8 000 | 28.02.2029 | 7 172 | 1 727 |
| IRS (EUR) | 15 000 | 15.03.2029 | 13 238 | 3 278 |
| IRS (EUR) | 20 000 | 30.05.2029 | 15 044 | 4 711 |
| IRS (EUR) | 20 000 | 25.02.2022 | 1 791 | 123 |
| IRS (EUR) | 11 000 | 24.04.2025 | 1 556 | 1 212 |
| IRS (EUR) | 13 000 | 20.09.2026 | 745 | 2 467 |
| IRS (EUR) | 35 000 | 20.09.2026 | 3 286 | 6 459 |
| IRS (EUR) | 24 900 | 01.02.2024 | 3 446 | 1 439 |
| IRS (EUR) | 100 000 | 22.06.2022 | 5 551 | 2 201 |
| IRS (EUR) | 300 000 | 05.03.2025 | 57 019 | 30 239 |
| **Total hedging items** | | | **111 251** | **51 702** |

Total result on fair value hedge accounting recognised in the income statement in 2020 and 2019

| | Year ended 31 December | |
|---|---|---|
| | 2020 | 2019 |
| Interest income on derivatives as part of fair value hedge accounting | 3 272 | 21 753 |
| Result from the valuation of the hedged | (24 995) | (45 734) |
| Result on the valuation of hedging instruments | 25 726 | 51 702 |
| **Total result on fair value hedge accounting** | **4 003** | **27 721** |

### *b) Cash flow hegde accounting*

The Bank uses hedge accounting with respect to the cash flows of the portfolio of mortgage loans denominated in PLN and the mortgage bonds denominated in EUR issued by the Bank. The purpose of the hedging strategy is to eliminate the risk of volatility of cash flows generated by PLN mortgage loans due to changes in reference interest rates and mortgage bonds denominated in a convertible currency due to changes in the exchange rate using currency interest rate swaps (CIRS).

As part of hedge accounting, the Bank designates a hedged item consisting of:

- parts of the portfolio of housing loans for retail customers entered in the collateral register for mortgage covered bonds, denominated in PLN with an interest rate indexed to 3M WIBOR, the loan margin is excluded from collateral**;**
- mortgage bonds issued by the Bank in EUR with a fixed interest rate.

As hedging instruments, the Bank uses CIRS derivative transactions in which, as a party to the transaction, it pays variable interest flows in PLN increased by a margin,and receives fixed interest rates in EUR and the denominations are exchanged at the beginning and at the end of the transaction. As transactions concluded by a mortgage bank, CIRS transactions are subject to entry in the Register of covered bond collateral. In addition, if the bank's bankruptcy is announced by the court, it will not be immediately terminated, it will last until the end of the original maturity on the conditions specified on the date of the transaction (they will not be extended beyond the original maturity).

In accordance with the adopted methodology, the Bank hedges the interest rate risk and currency risk within one economic relationship between the concluded CIRS transactions and part of the loan portfolio in PLN and mortgage bonds financing them in EUR. For the purposes of cash flow hedge accounting, the Bank simultaneously establishes two hedging relationships:

- by decomposing the real part of the CIRS transaction hedging the portfolio of loans in PLN with variable interest (hedging against interest rate risk) - relation A and
- by decomposing the actual portion of the CIRS transaction securing the liability in EUR (protection against currency risk) – relation B.

For the purpose of calculating changes in the fair value of future cash flows of items being hedged, the Bank uses the "hypothetical derivative" method, which assumes the possibility of reflecting the hedged item and the characteristics of the risk being hedged
in the form of a derivative. The valuation principles are analogous to the principles for the valuation of interest rate derivatives.

Hedged items - cash flow hedge

| | The nominal value of the hedged items | | Change in fair value due to hedge accounting since the designation of the hedged instrument | |
|---|---|---|---|---|
| | 31.12.2020 | 31.12.2019 | 31.12.2020 | 31.12.2019 |
| Loans in PLN with variable interest | 1 278 930 | 1 278 930 | (70 742) | 455 |
| Covered bonds issued in a convertible currency with a fixed interest rate | 1 384 440 | 1 277 550 | (53 921) | 4 772 |

Hedging items - cash flow hedge

| | The notional value of the hedging items | | Change in fair value due to hedge accounting from the date of designation of the hedging instrument | | Other equity items Effective part of CIRS valuation | |
|---|---|---|---|---|---|---|
| | 31.12.2020 | 31.12.2019 | 31.12.2020 | 31.12.2019 | 31.12.2020 | 31.12.2019 |
| IRS decomp FV | 1 278 930 | 1 278 930 | 69 185 | 85 | 68 194 | (338) |
| CIRS decomp FV | 1 384 440 | 1 277 550 | 53 246 | (6 207) | (51 589) | (3 377) |

The average constant rate weighted by denomination for a fixed leg was 0.24%.
The average constant rate weighted by the nominal value of the variable leg in PLN was 2.42%.

| 31.12.2020 | Up to 1 month | From 1 to 3 months | From 3 to 12 months | From 1 to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| **INTEREST RATE RISK** | | | | | | |
| **Interest rate swap (CIRS) transaktions hedging the cash flows available from loans with variable interest rates denominated in PLN** | | | | | | |
| Nominal value (in thousand PLN) | - | - | - | 1 384 440 | - | **1 384 440** |
| Average interest rate on a fixed leg | - | - | - | 0,242% | - | |

| 31.12.2019 | Up to 1 month | From 1 to 3 months | From 3 to 12 months | From 1 to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| **INTEREST RATE RISK** | | | | | | |
| **Interest rate swap (CIRS) transaktions hedging the cash flows available from loans with variable interest rates denominated in PLN** | | | | | | |
| Nominal value (in thousand PLN) | - | - | - | - | 1 277 550 | **1 277 550** |
| Average interest rate on a fixed leg | - | - | - | - | 0,242% | |

In the case of established relationships, the period in which cash flows are expected and when they should be expected to influence the results is the period from January 2021 to September 2025. Efficiency tests include the valuation of hedging transactions after deducting accrued interest and exchange differences on the nominal value of hedging transactions. Hedge effectiveness is verified by applying prospective and retrospective effectiveness tests. The tests are performed on a monthly basis.
The main sources of hedge ineffectiveness can be:

- taking into account the CVA / DVA correction only on the hedging instrument side,
- minimal differences in the construction method and basic parameters of hedging transactions and hedged items

Changes in the fair value of a derivative hedging instrument designated as a cash flow hedge are recognized directly in other comprehensive income in the portion that forms the effective portion of the hedge. The ineffective portion of the hedge is recognized in the income statement in the position 'Result on financial instruments measured at fair value' or 'Result on exchange position'. In addition, amounts charged directly to other comprehensive income are transferred to the profit and loss account respectively of the item 'Net interest income' and 'Net foreign exchange gains' in the same period or periods in which the inflow of the hedged transaction is referred to the profit and loss account and precipitate.

for 2020 (in PLN thousand)

The table below presents other comprehensive income from the cash flow hedge and the ineffective part of the cash flow hedge for the period from January 1 to December 31, 2020 and in the period from January 1 to December 31, 2019.

| CUMULATED OTHER TOTAL REVENUE FOR PROTECTION OF CASH FLOWS AND IMPACT ON OTHER TOTAL INCOME | the period | |
|---|---|---|
| | from 01.01.2020 to 31.12.2020 | from 01.01.2019 to 31.12.2019 |
| **Accumulated other comprehensive income from cash flow hedges at the beginning of the gross period** | **(3 714)** | **-** |
| **Profits / (Losses) recognized in other comprehensive income in the period** | **107 591** | **(9 127)** |
| **The amount transferred during the period from other comprehensive income to the profit and loss account** | **(87 272)** | **5 413** |
| - Net interest income | 19 618 | 4 033 |
| - Result on exchange position | (106 890) | 1 380 |
| **Accumulated other comprehensive income from cash flow hedges at the end of the gross period** | **16 605** | **(3 714)** |
| Tax effect | (3 155) | 706 |
| **Accumulated other comprehensive income from cash flow hedges at the end of the net period** | **13 450** | **(3 008)** |
| | | |
| **Ineffective portion of cash flow hedges recognized in the income statement** | (16) | - |
| | | |
| **Impact during the period on other gross comprehensive income** | **20 319** | **(3 714)** |
| Deferred tax due to cash flow hedges | (3 861) | 706 |
| **Impact during the period on other net comprehensive income** | **16 458** | **(3 008)** |

| | the period | |
|---|---|---|
| | from 01.01.2020 to 31.12.2020 | from 01.01.2019 to 31.12.2019 |
| **Gains/losses recognised in comprehensive income (gross) during the reporting period, including:** | | |
| **Unrealised gains/losses included in other comprehensive income (gross)** | **20 319** | **(3 714)** |
| **Results of cash flow hedge accounting recognised in the income statement** | **87 256** | **(5 413)** |
| - amount included as interest income in income statement during the reporting period (Note 5) | (19 618) | (4 033) |
| - foreign exchange result | 106 890 | (1 380) |
| - ineffective portion of hedge recognised included in other net trading income in income statement (Note 7) | (16) | - |
| **Impact on other comprehensive income in the reporting period (gross)** | **107 575** | **(9 127)** |

| BALANCE SHEET / FAIR VALUE OF DERIVATIVE INSTRUMENTS FOR PROTECTING CASH FLOWS | Asets |
|---|---|
| **31.12.2020** | |
| **IRS** (decomposed part of the actual CIRS transaction hedging against interest rate risk - Relation A) | 67 843 |
| **CIRS** (decomposed part of the actual CIRS transaction as hedging against currency risk - Relation B) | 53 186 |
| **Total** | **121 029** |

| BALANCE SHEET / FAIR VALUE OF DERIVATIVE INSTRUMENTS FOR PROTECTING CASH FLOWS | Liabilities |
|---|---|
| **31.12.2019** | |
| **IRS** (decomposed part of the actual CIRS transaction hedging against interest rate risk - Relation A) | 1 265 |
| **CIRS** (decomposed part of the actual CIRS transaction as hedging against currency risk - Relation B) | 6 259 |
| **Total** | **7 524** |

| NOMINAL VALUE OF SECURITY INSTRUMENTS BY DURATION FOR IMPLEMENTATION | up to 1 month | over 1 month to 3 months | over 1 year to 5 years | over 5 years Total | Total |
|---|---|---|---|---|---|
| **31.12.2020** | | | | | |
| **CIRS** | | | | | |
| PLN float sale | - | - | 1 278 930 | - | **1 278 930** |
| Fixed EUR purchase (original currency) | - | - | 300 000 | - | **300 000** |

for 2020 (in PLN thousand)

| NOMINAL VALUE OF SECURITY INSTRUMENTS BY DURATION FOR IMPLEMENTATION | up to 1 month | over 1 month to 3 months | over 1 year to 5 years | over 5 years Total | Total |
|---|---|---|---|---|---|
| **31.12.2019** | | | | | |
| **CIRS** | | | | | |
| PLN float sale | - | - | - | 1 278 930 | **1 278 930** |
| Fixed EUR purchase (original currency) | - | - | - | 300 000 | **300 000** |

Estimates and assessments
The fair value of derivatives is determined using valuation models based on discounted future cash flows from a given financial instrument. The variables in the model and the assumptions used for valuation include, if available, data from observable markets (e.g. deposit rates on the interbank market, currency exchange rates, IRS and CCBS transaction quotes). The fair value of derivatives includes DVA's own credit risk (debit value adjustment) as well as the credit risk of the counterparty CVA (credit value adjustment). The process of calculating CVA and DVA adjustments involves choosing a method to determine the spread on the counterparty or Bank's credit risk as well as estimating the probability of the contractor or Bank's insolvency and the recovery rate. In addition, to reflect the impact of non-standard transaction parameters on the valuation level, the model uses historical prices used in CIRS transactions with similar parameters for which quotes can be obtained from active markets.
Estimate calculation
The Bank conducted a simulation to determine the possible impact of changes in yield curves on the transaction valuation.

| ESTIMATED CHANGE IN VALUATION WITH A PARALLEL INCOME SHIFT | Scenario + 50 bp. | Scenario -50 bp. |
|---|---|---|
| **31.12.2020** | | |
| **CIRS** | (32 774) | 32 790 |

For the purpose of calculating the valuation of CIRS transactions classified under level 3 of the fair value hierarchy, the Bank determines the value of the CVA and DVA adjustments using: - available market data in the form of spread curves necessary to determine the probability of default, the input data range of which is summarized in the table below:

| RANGE OF SPREAD CURVES USED FOR CVA AND DVA CALCULATIONS | Min | Max |
|---|---|---|
| **31.12.2020** | | |
| Credit spread | 0,0019% | 3,4868% |

- and unobserved LGD levels, for which, in the case of determining CVA and DVA, the Bank assumes the levels of 60% and 100%, respectively. The asymmetric LGD levels for CIRS transactions result from the specific nature of this transaction, described in detail in the section "Derivatives designated as cash flow hedges".
The tables below present the estimated impact of the applied input parameters on the valuation of CIRS transactions - a parallel shift of the spread curves by 50 basis points and the impact of different levels of the LGD parameter on the amount of CVA and DVA adjustments.

| ESTIMATED CHANGE IN THE VALUATION OF A CIRS TRANSFER WITH A PARALLEL SHIFT OF THE SPREAD CURVE | Scenario +50pb. |
|---|---|
| CIRS transaction CVA change | (112) |
| CIRS transaction DVA change | 245 |
| **Total impact on the valuation of CIRS transactions** | **133** |

| ESTIMATED VALUES OF THE VALUATION OF THE CVA AND DVA APPLYING DIFFERENT LAG LEVELS | 40% | 60% | 80% | 100% |
|---|---|---|---|---|
| CVA | (50) | (76) | (101) | (126) |
| DVA | 187 | 281 | 374 | 468 |

for 2020 (in PLN thousand)

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

| | 31.12.2020 | 31.12.2019 |
|---|---|---|
| **Loans** | **133 838** | **157 714** |
| - corporate customers | 133 838 | 157 714 |
| **Financial assets not held for trading mandatorily measured at fair value through net financial income** | **133 838** | **157 714** |

The credit quality non-trading financial assets mandatorily at fair value through profit or loss according to an internal rating as at December 31, 2020 and December 31, 2019.

| | score z modeli wewnętrznych | | 31.12.2020 |
|---|---|---|---|
| | [SCOREmin | SCOREmax) | |
| Exposures subject to the IRB approach — specialised lending, including | - | - | 133 838 |
| - supervisory category 2 | 23 | 45 | 99 768 |
| - supervisory category 3 | 11 | 23 | 13 716 |
| - supervisory category 4 | 1 | 11 | 4 976 |
| - supervisory category 5 | default | default | 15 378 |
| **Total** | | | **133 838** |

| | score z modeli wewnętrznych | | 31.12.2019 |
|---|---|---|---|
| | [SCOREmin | SCOREmax) | |
| Exposures subject to the IRB approach — specialised lending, including | - | - | 157 714 |
| - supervisory category 2 | 23 | 45 | 97 303 |
| - supervisory category 3 | 11 | 23 | 27 238 |
| - supervisory category 5 | default | default | 33 173 |
| **Total** | | | **157 714** |

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

| 31.12.2020 | Wartość bilansowa |
|---|---|
| **Debt securities** | **791 045** |
| - Central banks | 34 999 |
| - General governments, including:: | 756 046 |
| *pledged securities* | *151 009* |
| **Total financial assets at fair value through comprehensive income** | **791 045** |
| | |
| Short-term (up to 1 year) | 308 177 |
| Long-term (over 1 year) | 482 868 |
| | |
| Based on fixed interest rate | 188 047 |
| Based on floating interest rate | 602 998 |

All debt securities have been classified into basket 1. Financial assets in the form of money bills and treasury bonds, the Bank considers financial assets with low credit risk due to the fact that these assets are characterized by a low risk of default.

As at 31.12.2020 and 31.12.2019, all debt securities were classified in basket 1.

Change in financial assets at fair value through other comprehensive income

for 2020 (in PLN thousand)

| | 31.12.2020 |
|---|---|
| **As at the beginning of the period** | **1 221 735** |
| Additions | 5 277 038 |
| Disposals (sale, redemption and forfeiture) | (5 712 213) |
| Gains / losses from changes in fair value | 4 485 |
| **As at the end of the period** | **791 045** |

| 31.12.2019 | Carrying value |
|---|---|
| **Debt securities** | **1 221 735** |
| - Central banks | 219 982 |
| - General governments, including:: | 1 001 753 |
| *pledged securities* | *202 070* |
| **Total financial assets at fair value through comprehensive income** | **1 221 735** |
| | |
| Short-term (up to 1 year) | 483 414 |
| Long-term (over 1 year) | 738 321 |
| | |
| Based on fixed interest rate | 577 846 |
| Based on floating interest rate | 643 889 |

Change in financial assets at fair value through other comprehensive income

| | 31.12.2019 |
|---|---|
| **As at the beginning of the period** | **1 069 392** |
| Additions | 11 430 323 |
| Disposals (sale, redemption and forfeiture) | (11 274 940) |
| Gains / losses from changes in fair value | (3 040) |
| **As at the end of the period** | **1 221 735** |

Both as at 31 December 2020 and as at 31 December 2019, debt instruments had a rating of AAA on the scale of Standard & Poor’s (S&P) rating agency.

Pledged assets are not subject to resale or further pledging.

## 24. Financial assets measured at amortised cost

| 31.12.2020 | Carrying value | Gross carrying amount | | | | Accumulated impairment | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Stage 1 | Stage 2 | Stage 3 | POCI | Stage 1 | Stage 2 | Stage 3 | POCI |
| **Loans and advances to banks** | 323 133 | 323 133 | - | - | - | - | - | - | - |
| **Loans and advances to customers** | **11 317 756** | **9 480 090** | **1 627 930** | **314 440** | **3 224** | **(4 369)** | **(29 841)** | **(95 531)** | **21 813** |
| Individual customers | 8 346 281 | 7 524 397 | 798 837 | 43 381 | 1 043 | (1 594) | (4 991) | (14 673) | (119) |
| Corporate customers | 2 856 501 | 1 841 181 | 829 093 | 269 991 | 2 181 | (2 749) | (24 850) | (80 278) | 21 932 |
| Public sector customers | 85 731 | 85 269 | - | 1 068 | - | (26) | - | (580) | - |
| Financial institutions | 29 243 | 29 243 | - | - | - | - | - | - | - |
| **Financial assets at amortised cost, total** | **11 640 889** | **9 803 223** | **1 627 930** | **314 440** | **3 224** | **(4 369)** | **(29 841)** | **(95 531)** | **21 813** |

| | |
|---|---|
| Short-term (up to 1 year) | 433 522 |
| Long-term (over 1 year) | 11 207 367 |

In 2020, the Bank sold loan receivables with a total gross carrying amount of PLN 53,989 thousand. PLN qualified to the basket 3. Prices obtained in the amount 11 700 thousand PLN were credited towards the repayment of principal and interest, in accordance with the provisions of the sale agreements. Unpaid principal and interest in the amount of PLN 42 289 thousand PLN was written off against previously created provisions for individual debts. In 2019, the Bank did not sell any receivables.

for 2020 (in PLN thousand)

## Loan structure by past due days

| Loan structure by past due days 31.12.2020 | Loans and advances to banks | Financial istitutions | Corporate customers | Individual customers | Public sector customers | Total |
|---|---|---|---|---|---|---|
| Not overdue or up to 30 days | 323 133 | 29 243 | 2 732 795 | 8 322 661 | 85 244 | 11 493 076 |
| 31 to 60 days | - | - | 1 867 | 8 727 | - | 10 594 |
| 61 to 90 days | - | - | 8 354 | 4 438 | - | 12 792 |
| over 90 days | - | - | 113 486 | 10 454 | 488 | 124 428 |
| **Total** | **323 133** | **29 243** | **2 856 502** | **8 346 280** | **85 732** | **11 640 890** |

| 31.12.2019 | Carrying value | Gross carrying amount | | | | Accumulated impairment | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Stage 1 | Stage 2 | Stage 3 | POCI | Stage 1 | Stage 2 | Stage 3 | POCI |
| **Loans and advances to banks** | 13 912 | 13 912 | - | - | - | - | - | - | - |
| **Loans and advances to customers** | **11 628 432** | **10 491 496** | **940 227** | **940 227** | **24 404** | **(12 093)** | **(13 394)** | **(92 527)** | **53** |
| Individual customers | 7 500 054 | 6 957 216 | 529 232 | 529 232 | 434 | (1 976) | (5 159) | (10 975) | - |
| Corporate customers | 3 997 349 | 3 404 203 | 410 995 | 410 995 | 23 970 | (10 088) | (8 235) | (81 487) | 53 |
| Public sector customers | 98 407 | 97 455 | - | - | - | (29) | - | (65) | - |
| Financial institutions | 32 622 | 32 622 | - | - | - | - | - | - | - |
| **Financial assets at amortised cost, total** | **11 642 344** | **10 505 408** | **940 227** | **940 227** | **24 404** | **(12 093)** | **(13 394)** | **(92 527)** | **53** |

| | |
|---|---|
| Short-term (up to 1 year) | 724 009 |
| Long-term (over 1 year) | 10 918 335 |

## Loan structure by past due days

| Loan structure by past due days (31.12.2019r.) | Loans and advances to banks | Financial istitutions | Corporate customers | Individual customers | Public sector customers | Total |
|---|---|---|---|---|---|---|
| Not overdue or up to 30 days | 13 912 | 32 622 | 3 894 471 | 7 473 086 | 97 426 | 11 511 517 |
| 31 to 60 days | - | - | 40 595 | 13 024 | - | 53 619 |
| 61 to 90 days | - | - | 11 560 | 3 934 | - | 15 494 |
| over 90 days | - | - | 50 724 | 10 009 | 981 | 61 714 |
| **Total** | **13 912** | **32 622** | **3 997 350** | **7 500 053** | **98 407** | **11 642 344** |

As at 31 December 2020, in the Bank's credit portfolio measured at amortised cost, the gross value of loans to corporate customers, individual customers and the public sector in the Bank's loan portfolio, carrying floating interest rates, amounted to PLN 11,396,441 thousand (2019: 11,713,719 TPLN), and the gross value of loans carrying fixed-to-floating interest rates amounted to PLN 0 thousand (0 TPLN), (2019: 52 TPLN).

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

Gross carrying amount of the retail portfolio acquired in cooperation with mBank S.A. as at December 31, 2020, it amounted to PLN 8,333,218 thousand PLN (in 2019: PLN 7,480,886 thousand), including agency sales of PLN 4,442,500 thousand. PLN (in 2019: PLN 4,256,423 thousand) and as part of retail pooling PLN 3,890,718 thousand. PLN (in 2019: PLN 3,224,463 thousand).

Gross carrying amount of the commercial portfolio transferred as part of commercial pooling from mBank S.A. as at December 31, 2020, it amounted to PLN 47,000 thousand. PLN (in 2019: 166 874 thou. PLN). In connection with the SARS-CoV-2 coronavirus epidemic, the Bank identifies the negative impact of the epidemic on credit risk in future periods. The impact of the epidemic has been described in Note 6.

for 2020 (in PLN thousand)

Credit quality of financial assets measured at amortized cost according to internal rating as at December 31, 2020 and December 31, 2019

| 31.12.2020 | score from internal models | | Stage 1 | Stage 2 | Stage 3 | POCI | Total |
|---|---|---|---|---|---|---|---|
| | [SCOREmin | SCOREmax) | | | | | |
| Exposures permanently exempted from the IRB approach | no rating | no rating | 198 812 | 6 537 | 1 407 | 390 | 207 146 |
| Exposures temporarily exempted from the IRB approach — retail portfolio acquired in cooperation with mBank S.A. | - | - | 7 500 305 | 787 803 | 27 789 | 534 | 8 316 431 |
| Exposures subject to the IRB approach — specialised lending, including | - | - | 1 776 604 | 803 749 | 189 713 | 24 113 | 2 794 179 |
| - supervisory category 1 | 45 | 54 | 1 713 | - | - | - | 1 713 |
| - supervisory category 2 | 23 | 45 | 1 749 023 | 524 522 | - | - | 2 273 545 |
| - supervisory category 3 | 11 | 23 | 25 868 | 272 483 | - | - | 298 351 |
| - supervisory category 4 | 1 | 11 | - | - | - | - | - |
| - supervisory category 5 | default | default | - | 6 744 | 189 713 | 24 113 | 220 570 |
| **Total** | | | **9 475 721** | **1 598 089** | **218 909** | **25 037** | **11 317 756** |

| | score from internal models | | Stage 1 | Stage 2 | Stage 3 | POCI | 31.12.2019 |
|---|---|---|---|---|---|---|---|
| | [SCOREmin | SCOREmax) | | | | | |
| Exposures permanently exempted from the IRB approach | no rating | no rating | 221 967 | 4 318 | 3 047 | 434 | 229 766 |
| Exposures temporarily exempted from the IRB approach — retail portfolio acquired in cooperation with mBank S.A. | - | - | 6 928 969 | 520 335 | 18 240 | - | 7 467 544 |
| Exposures subject to the IRB approach — specialised lending, including | - | - | 3 523 516 | 207 131 | 176 452 | 24 023 | 3 931 122 |
| - supervisory category 1 | 45 | 54 | 3 090 | - | - | - | 3 090 |
| - supervisory category 2 | 23 | 45 | 3 430 260 | 80 068 | - | - | 3 510 328 |
| - supervisory category 3 | 11 | 23 | 90 166 | 110 610 | - | - | 200 776 |
| - supervisory category 4 | 1 | 11 | - | 16 453 | - | - | 16 453 |
| - supervisory category 5 | default | default | - | - | 176 452 | 24 023 | 200 475 |
| **Total** | | | **10 674 452** | **731 784** | **197 739** | **24 457** | **11 628 432** |

To calculate the capital requirement for credit risk, the Bank uses the Internal Ratings-Based Approach (IRB) with the supervisory approach to assign risk categories to exposures under specialized lending. The assignment to the appropriate supervisory category takes place after the transaction risk is assessed with the use of internal rating models developed by the Bank and the transition function model, which transforms the score assigned to the given internal models into supervisory categories. The different supervisory categories listed in the table above determine the supervisory risk weights and expected losses.

Movements in the balance of loss allowances and provisions (31.12.2020)

| | Opening balance | Transfered to stage 1 | Transfered to stage 2 | Transfered to stage 3 | Increase due to given and repossess | Decreases caused by deletion from the balance sheet | Change due to modyfications that do not result in removal from the balance sheet (net) | Decreases due to amounts taken against allowances | Closing balance |
|---|---|---|---|---|---|---|---|---|---|
| **Loans** | **(117 961)** | **-** | **-** | **-** | **(977)** | **1 595** | **(29 179)** | **38 594** | **(107 928)** |
| Stage 1 | (12 093) | (1 885) | 2 442 | 14 | (370) | 2 671 | 4 853 | - | (4 368) |
| Stage 2 | (13 394) | 1 487 | (2 849) | 2 995 | (254) | 2 122 | (19 949) | - | (29 842) |
| Stage 3 | (92 527) | 398 | 407 | (2 989) | (353) | (3 198) | (35 863) | 38 594 | (95 531) |
| POCI | 53 | - | - | (20) | - | - | 21 780 | - | 21 813 |
| **Provision related to financial assets, total** | **(117 961)** | **-** | **-** | **-** | **(977)** | **1 595** | **(29 179)** | **38 594** | **(107 928)** |

Changes in the gross carrying amount of financial instruments as at December 31, 2020

| | Opening balance | Transfered to stage 1 | Transfered to stage 2 | Transfered to stage 3 | Increase due to given and repossess | Decreases caused by deletion from the balance sheet | Change due to modyfications that do not result in removal from the balance sheet (net) | Decreases due to amounts taken against allowances | other adjustments | Closing balance |
|---|---|---|---|---|---|---|---|---|---|---|
| **Receivables from banks** | **13 912** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **309 221** | **323 133** |
| Stage 1 | 13 912 | - | - | - | - | - | - | - | 309 221 | 323 133 |
| **Loans** | **11 746 393** | **-** | **-** | **-** | **1 535 980** | **(1 438 745)** | **-** | **(38 594)** | **(379 350)** | **11 425 684** |
| Stage 1 | 10 491 496 | 201 529 | (1 077 602) | (8 792) | 1 484 238 | (1 273 506) | - | - | (337 273) | 9 480 090 |
| Stage 2 | 940 227 | (199 945) | 1 087 213 | (70 196) | 50 457 | (153 486) | - | - | (26 339) | 1 627 931 |
| Stage 3 | 290 266 | (1 584) | (9 611) | 78 406 | 1 285 | (11 753) | - | (38 594) | 6 025 | 314 440 |
| POCI | 24 404 | - | - | 582 | - | - | - | - | (21 763) | 3 223 |
| **Gross carrying amount of financial assets at amortized cost** | **11 760 305** | **-** | **-** | **-** | **1 535 980** | **(1 438 745)** | **-** | **(38 594)** | **(70 129)** | **11 748 817** |

Movements in the balance of loss allowances and provisions (31.12.2019)

for 2020 (in PLN thousand)

| | Opening balance | Transfered to stage 1 | Transfered to stage 2 | Transfered to stage 3 | Increase due to given and repossess | Decreases caused by deletion from the balance sheet | Change due to modyfications that do not result in removal from the balance sheet (net) | Decreases due to amounts taken against allowances | other adjustments | Closing balance |
|---|---|---|---|---|---|---|---|---|---|---|
| **Loans** | **(90 052)** | **-** | **-** | **-** | **(1 300)** | **4 734** | **(24 522)** | **(7 060)** | **239** | **(117 961)** |
| Stage 1 | (9 393) | (3 775) | 761 | 3 | (711) | 1 076 | (48) | - | (6) | (12 093) |
| Stage 2 | (11 340) | 3 768 | (926) | 1 437 | (527) | 1 051 | (6 866) | - | 9 | (13 394) |
| Stage 3 | (76 870) | 7 | 165 | (1 440) | (62) | 2 607 | (24 217) | 7 047 | 236 | (92 527) |
| POCI | 7 551 | - | - | - | | | 6 609 | (14 107) | | 53 |
| **Provision related to financial assets, total** | **(90 052)** | **-** | **-** | **-** | **(1 300)** | **4 734** | **(24 522)** | **(7 060)** | **239** | **(117 961)** |

The positive valuation of the accumulated impairment results from the presentation of the accrued interest in this item

Explanation of substantial changes in the gross carrying amount of financial instruments during the period impacting changes in expected credit loss allowance (31.12.2019)

| | Opening balance | Transfered to stage 1 | Transfered to stage 2 | Transfered to stage 3 | Increase due to given and repossess | Decreases caused by deletion from the balance sheet | Change due to modyfications that do not result in removal from the balance sheet (net) | Decreases due to amounts taken against allowances | other adjustments | Closing balance |
|---|---|---|---|---|---|---|---|---|---|---|
| **Receivables from banks** | **58 432** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **(44 520)** | **13 912** |
| Stage 1 | 58 432 | - | - | - | - | - | - | - | (44 520) | 13 912 |
| **Loans** | **11 020 586** | **-** | **-** | **-** | **1 878 522** | **(899 557)** | **-** | **(12 830)** | **(240 329)** | **11 746 393** |
| Stage 1 | 9 641 442 | 515 380 | (473 815) | (3 396) | 1 799 077 | (816 269) | - | - | (170 923) | 10 491 496 |
| Stage 2 | 1 083 596 | (515 380) | 473 815 | (68 537) | 79 149 | (77 700) | - | - | (34 716) | 940 227 |
| Stage 3 | 287 028 | - | - | 17 749 | 296 | (5 588) | - | (5 129) | (4 090) | 290 266 |
| POCI | 8 521 | - | - | 54 184 | - | - | - | (7 701) | (30 600) | 24 404 |
| **Gross carrying amount of financial assets at amortized cost** | **11 079 018** | **-** | **-** | **-** | **1 878 522** | **(899 557)** | **-** | **(12 830)** | **(284 849)** | **11 760 305** |

## Financial effect of collaterals

| As at 31 December 2020 | 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** | **323 133** | **-** | **-** | **-** |
| **Loans and advances to customers, including:** | **11 425 684** | **(107 928)** | **(144 179)** | **36 251** |
| Corporate customers | 2 942 446 | (85 945) | (110 129) | 24 184 |
| Individual customers | 8 367 658 | (21 377) | (33 444) | 12 067 |
| Public sector customers | 86 337 | (606) | (606) | - |
| Other receivables | 29 243 | - | - | - |
| **Total balance sheet data** | **11 748 817** | **(107 928)** | **(144 179)** | **36 251** |
| **Off-balance sheet data** | | | | |
| Loan commitments | 66 576 | (223) | - | (223) |
| **Total off-balance sheet data** | **66 576** | **(223)** | **-** | **(223)** |

| As at 31 December 2018 | Gross amount | Established impairment write-downs | Impairment write-downs without the collateral cash flows | Financial effect of collaterals |
|---|---|---|---|---|
| **Balance sheet data** | | | | |
| **Amounts due from other banks** | **13 912** | **-** | **-** | **-** |
| **Loans and advances to customers, including:** | **11 746 393** | **(115 717)** | **(192 614)** | **76 897** |
| Corporate customers | 4 097 108 | (97 513) | (164 357) | 34 603 |
| Individual customers | 7 518 162 | (18 110) | (28 163) | 10 053 |
| Public sector customers | 98 501 | (94) | (94) | (29) |
| Other receivables | 32 622 | - | - | - |
| **Total balance sheet data** | **11 760 305** | **(115 717)** | **(192 614)** | **76 897** |
| **Off-balance sheet data** | | | | |
| Loan commitments | 449 612 | (1 568) | - | (1 568) |
| **Total off-balance sheet data** | **449 612** | **(1 568)** | **-** | **(1 568)** |

The table below presents information on financial assets that were modified without derecognition from the balance sheet and for which expected credit losses were calculated as credit losses over the life of the exposure.

for 2020 (in PLN thousand)

| | 31.12.2020 | 31.12.2019 |
|---|---|---|
| **Financial assets that were subject to modification in the period** | | |
| Gross carrying amount of financial assets at amortized cost before modification, for which the write-down for expected credit losses was calculated in the lifetime horizon | 302 709 | 98 637 |
| Net profit / loss due to modification | (1 449) | 829 |
| **Financial assets modified from the moment of initial recognition** | | |
| Gross carrying amount of financial assets whose valuation horizon of the write-off for expected credit losses during the period changed from lifetime to 12-month | - | - |

## 25. Intangible assets

| | 31.12.2020 | 31.12.2019 |
|---|---|---|
| Concessions, patents, licences and similar assets, including: | 45 431 | 11 972 |
| - computer software | 45 431 | 11 972 |
| Intangible assets under development | 8 505 | 36 648 |
| **Intangible assets, total** | **53 936** | **48 620** |

### Movements in intangible assets

| Movements in the period from 01.01.2020 to 31.12.2020 | Acquired computer software | Intangible assets under development | Total |
|---|---|---|---|
| **Gross value of intangible assets as at the beginning of the period: 01.01.2020** | **28 747** | **36 648** | **65 395** |
| **Increase (due to)** | **37 703** | **8 490** | **46 193** |
| - purchase | 1 840 | 8 490 | 10 330 |
| - transfer from intangible assets under development | 35 863 | - | 35 863 |
| **Decrease (due to)** | **-** | **(36 633)** | **(36 633)** |
| - transfer from intangible assets under development | - | (36 066) | (36 066) |
| - other decreases | - | (567) | (567) |
| **Gross value of intangible assets as at the end of the period 31.12.2020** | **66 450** | **8 505** | **74 955** |
| **Accumulated amortisation as at the beginning of the period: 01.01.2020** | **(16 775)** | **-** | **(16 775)** |
| **Amortisation for the period (due to):** | **(4 244)** | **-** | **(4 244)** |
| - amortisation | (4 244) | - | (4 244) |
| **Accumulated amortisation as at the end of the period : 31.12.2020** | **(21 019)** | **-** | **(21 019)** |
| **Net value of intangible assets as at the end of the period: 31.12.2020** | **45 431** | **8 505** | **53 936** |

for 2020 (in PLN thousand)

| Movements in the period from 01.01.2019 to 31.12.2019 | Acquired computer software | Intangible assets under development | Total |
|---|---|---|---|
| **Gross value of intangible assets as at the beginning of the period: 01.01.2019** | **23 404** | **31 351** | **54 755** |
| **Increase (due to)** | **5 539** | **10 368** | **15 907** |
| - purchase | 1 463 | 10 368 | 11 831 |
| - transfer from intangible assets under development | 4 076 | - | 4 076 |
| **Decrease (due to)** | **(196)** | **(5 071)** | **(5 267)** |
| - transfer from intangible assets under development | - | (4 076) | (4 076) |
| - liquidation | (196) | - | (196) |
| - other decreases | - | (995) | (995) |
| **Gross value of intangible assets as at the end of the period 31.12.2019** | **28 747** | **36 648** | **65 395** |
| **Accumulated amortisation as at the beginning of the period: 01.01.2019** | **(14 734)** | **-** | **(14 734)** |
| **Amortisation for the period (due to):** | **(2 041)** | **-** | **(2 041)** |
| - amortisation | (2 069) | - | (2 069) |
| - likwidacji | 28 | - | 28 |
| **Accumulated amortisation as at the end of the period : 31.12.2018** | **(16 775)** | **-** | **(16 775)** |
| **Net value of intangible assets as at the end of the period: 31.12.2018** | **11 972** | **36 648** | **48 620** |

## 26. Property, plant and equipment

| | 31.12.2020 | 31.12.2019 |
|---|---|---|
| Technical equipment and machinery | 6 014 | 6 338 |
| Other fixed assets | 982 | 1 613 |
| Fixed assets under construction | 1 403 | 1 711 |
| **Prawo do użytkowania z tytułu umów leasingu:** | **5 419** | **6 639** |
| budynki | 4 938 | 6 166 |
| środki transportu | 481 | 473 |
| **Tangible fixed assets, total** | **13 818** | **16 301** |

for 2020 (in PLN thousand)

## Movements in tangible fixed assets

| Movements in the period from 01.01.2020 to 31.12.2020 | Equipment | Vehicles | Other fixed assets | Fixed assets under construction | Right to use | | Total |
|---|---|---|---|---|---|---|---|
| | | | | | Building | Vehicles | |
| **Gross value of tangible fixed assets as at the beginning of the period: 01.01.2020** | **22 980** | **-** | **6 706** | **1 711** | **8 413** | **635** | **40 445** |
| **Increase (due to)** | **1 750** | **-** | **267** | **584** | **1 251** | **333** | **4 185** |
| - purchase | 1 169 | - | 64 | 584 | - | - | 1 817 |
| - przeniesienia ze środków trwałych w budowie | 556 | - | - | - | - | - | 556 |
| - other increase | 25 | - | 203 | - | 1 251 | 333 | 1 812 |
| **Decrease (due to)** | **(67)** | **-** | **(424)** | **(892)** | **-** | **(103)** | **(1 486)** |
| - sale | (31) | - | (4) | - | - | - | (35) |
| - liquidation | (36) | - | (420) | - | - | - | (456) |
| - przeniesienia ze środków trwałych w budowie | - | - | - | (556) | - | - | (556) |
| - other decrease | - | - | - | (336) | - | (103) | (439) |
| **Gross value of tangible fixed assets as at the end of the period: 31.12.2020** | **24 663** | **-** | **6 549** | **1 403** | **9 664** | **865** | **43 144** |
| **Accumulated amortisation as at the beginning of the period: 01.01.2020** | **(16 642)** | **-** | **(5 093)** | **-** | **(2 247)** | **(162)** | **(24 144)** |
| **Amortisation for the period (due to):** | **(2 007)** | **-** | **(474)** | **-** | **(2 479)** | **(222)** | **(5 182)** |
| - amortisation | (2 074) | - | (721) | - | (2 479) | (252) | (5 526) |
| - sale | 31 | - | 3 | - | - | - | 34 |
| - likwidacji | 36 | - | 244 | - | - | - | 280 |
| - other changes | - | - | - | - | - | 30 | 30 |
| **Accumulated amortisation as at the end of the period: 31.12.2020** | **(18 649)** | **-** | **(5 567)** | **-** | **(4 726)** | **(384)** | **(29 326)** |
| **Impairment charge as at the beginning of the period: 01.01.2020** | **-** | - | **-** | **-** | **-** | **-** | **(10 708)** |
| - decrease | - | - | - | - | - | - | - |
| **Impairment charge as at the end of the period: 31.12.2020** | **-** | **-** | **-** | **-** | **-** | **-** | **(10 708)** |
| **Net value of tangible fixed assets as at the end of the period: 31.12.2020** | **6 014** | **-** | **982** | **1 403** | **4 938** | **481** | **13 818** |

| Movements in the period from 01.01.2019 to 31.12.2019 | Equipment | Vehicles | Other fixed assets | Fixed assets under construction | Right to use | | Total |
|---|---|---|---|---|---|---|---|
| | | | | | Building | Vehicles | |
| **Gross value of tangible fixed assets as at the beginning of the period: 01.01.2019** | **22 122** | **76** | **6 794** | **720** | **7 777** | **293** | **37 782** |
| **Increase (due to)** | **2 252** | **-** | **302** | **991** | **636** | **361** | **4 542** |
| - purchase | 2 252 | - | 302 | 991 | - | - | 3 545 |
| - other increase | - | - | - | - | 636 | 361 | 997 |
| **Decrease (due to)** | **(1 394)** | **(76)** | **(390)** | **-** | **-** | **(19)** | **(1 879)** |
| - sale | (66) | (76) | (222) | - | - | - | (364) |
| - liquidation | (1 328) | - | (168) | - | - | - | (1 496) |
| - other decrease | - | - | - | - | - | (19) | (19) |
| **Gross value of tangible fixed assets as at the end of the period: 31.12.2019** | **22 980** | **-** | **6 706** | **1 711** | **8 413** | **635** | **40 445** |
| **Accumulated amortisation as at the beginning of the period: 01.01.2019** | **(16 120)** | **(68)** | **(4 846)** | **-** | **-** | **-** | **(21 034)** |
| **Amortisation for the period (due to):** | **(522)** | **68** | **(247)** | **-** | **(2 247)** | **(162)** | **(3 110)** |
| - amortisation | (1 802) | - | (632) | - | (2 247) | (165) | (4 846) |
| - sale | 66 | 68 | 217 | - | - | - | 351 |
| - likwidacji | 1 214 | - | 168 | - | - | - | 1 382 |
| - other changes | - | - | - | - | - | 3 | 3 |
| **Accumulated amortisation as at the end of the period: 31.12.2019** | **(16 642)** | **-** | **(5 093)** | **-** | **(2 247)** | **(162)** | **(24 144)** |
| **Impairment charge as at the beginning of the period: 01.01.2019** | **-** | - | **-** | **-** | **-** | **-** | **-** |
| - decrease | - | - | - | - | - | - | - |
| **Impairment charge as at the end of the period: 31.12.2019** | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| **Net value of tangible fixed assets as at the end of the period: 31.12.2019** | **6 338** | **-** | **1 613** | **1 711** | **6 166** | **473** | **16 301** |

for 2020 (in PLN thousand)

## 27. Other assets

| | 31.12.2020 | 31.12.2019 |
|---|---|---|
| **Other, including:** | **5 349** | **7 620** |
| - other prepayments | 2 794 | 3 354 |
| - receivables from the portfolio of retail loans acquired as part of cooperation with mBank S.A. | 1 959 | 3 160 |
| - income receivable | 116 | 120 |
| - debtors | 466 | 972 |
| - other | 14 | 14 |
| **Total other assets** | **5 349** | **7 620** |
| | | |
| Short-term (up to 1 year) | 3 422 | 7 620 |
| Long-term (over 1 year) | 1 927 | - |

As at December 31, 2020 and December 31, 2019, the bank did not have any assets taken over for debts.

## 28. Financial liabilities measured at amortised cost

### Amounts due to other banks and customers

| 31.12.2020 | Amount due to banks | Amount due to customers | Individual customers | Corporate customers | Public sector customers |
|---|---|---|---|---|---|
| **Loans received** | **2 455 117** | **-** | **-** | **-** | **-** |
| **Other financial liabilities:** | **1 045 556** | **3 477** | **114** | **3 353** | **10** |
| Liabilities with deferred payment term | 275 907 | - | - | - | - |
| Liabilities in respect of cash collateral | 765 503 | 973 | 11 | 962 | - |
| Leasing liabilities | 4 146 | 1 733 | - | 1 733 | - |
| Other liabilitie | - | 771 | 103 | 658 | 10 |
| **Total** | **3 500 673** | **3 477** | **114** | **3 353** | **10** |
| Short-term (up to 1 year) | 973 093 | 2 581 | | | |
| Long-term (over 1 year) | 2 527 580 | 896 | | | |

The increase in liabilities due to cash collateral concerns the deposit, which is a security for the guarantee granted by mBank.

| 31.12.2019 | Amount due to banks | Amount due to customers | Individual customers | Corporate customers | Public sector customers |
|---|---|---|---|---|---|
| **Loans received** | **2 469 049** | **-** | **-** | **-** | **-** |
| **Other financial liabilities:** | **347 773** | **8 934** | **139** | **8 752** | **43** |
| Liabilities with deferred payment term | 296 413 | - | - | - | - |
| Liabilities in respect of cash collateral | 47 035 | - | 49 | 443 | - |
| Leasing liabilities | 4 325 | - | - | 2 742 | - |
| Other liabilitie | - | - | 90 | 5 567 | 43 |
| **Total** | **2 816 822** | **8 934** | **139** | **8 752** | **43** |
| Short-term (up to 1 year) | 58 710 | | | | |
| Long-term (over 1 year) | 2 758 112 | | | | |

Deferred liabilities act as a bridge financing for the portfolio of credit receivables taken over from mBank S.A. The value of this category of liabilities will increase after taking over subsequent tranches of pooling and decrease after issuance of mortgage covered bonds or in the case of repayment of tranches from excess liquidity. The original maturity of the deferred liability is 24 months until the date of transfer of the pooling.

In 2020, the Bank took over tranches of pooling, which resulted in a deferred liability for the total amount of PLN 1,554,708 thousand. PLN. At the same time, the Bank repaid tranches of liabilities

for 2020 (in PLN thousand)

for the total amount 1 279 708 thousand PLN from excess liquidity and the Bank repaid 2 tranches of liabilities from 2019 for a total amount of PLN 296 million from excess liquidity.
In the item other financial liabilities with deferred payment dates, they relate to the liabilities resulting from the agreement concluded with mBank S.A. on November 30, 2018, an agreement to transfer the retail mortgage-backed loan portfolio. Other financial liabilities with deferred payment terms were subject to a floating interest rate. The transactions are described in note 42.
Cash collateral liabilities relate to the value of the variable margin securing derivative instruments.

All loans received were based on a variable interest rate. mBank Hipoteczny S.A. it failed to provide collateral to its creditors.

The Bank did not register any breaches of contractual terms related to liabilities under contracted loans.

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

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

<u>Leasing liabilities</u>

Below are the liabilities due to leasing by maturity dates

| | 31.12.2020 | 31.12.2019 |
|---|---|---|
| **Leasimg liabilities by maturity day (undiscointed)** | | |
| Up to 3 months | 798 | 737 |
| 3-12 months | 1 137 | 2 191 |
| 1-5 years | 2 196 | 2 197 |
| Over 5 years | 1 748 | 2 081 |
| **Total** | **5 879** | **7 206** |

## Liabilities from debt securities in issue

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

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

<u>Rules of admissible amount of the Substitute Collateral</u>

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

<u>Rules of statutory overcollateralisation for covered bonds</u>

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

for 2020 (in PLN thousand)

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

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

The tables below present data related to the issue of covered bonds as at 31 December 2020 and as at 31 December 2019.

| Mortgage covered bonds | 31.12.2020 | 31.12.2019 |
|---|---|---|
| 1. Nominal value of covered bonds listed on the market | 7 554 014 | 8 225 129 |
| 2. The nominal value of receivables entered in the collateral register of covered bonds underlying the issue of covered bonds (value on not matured capital) | 9 329 195 | 10 232 614 |
| 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) | 104 889 | 118 409 |
| 4. Level of collateral the covered bonds by receivables (2/1) | 123,50% | 124,41% |
| 5. Total covered bonds collateral level (2+3) / 1 | 124,89% | 125,85% |
| 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 | 2 117 009 | 3 301 729 |
| 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 | 6 580 040 | 6 098 962 |

| Permissible value of Substitute collateral as at 31.12.2018 | 31.12.2020 | 31.12.2019 |
|---|---|---|
| 1. Cash invested in treasury bonds | 150 000 | 200 000 |
| 2. Interests from covered bonds on the market which will be paid in the next 6 months (Surplus) | 45 111 | 81 591 |
| 3. Permissible value of Substitute collateral (1-2) | 104 889 | 118 409 |

The total nominal value of covered bonds currently traded on, both as at 31 December 2020 and as at 31 December 2019 was listed on two markets as part of CATALYST: regulated market operated by BondSpot S.A. and regulated parallel market operated by Warsaw Stock Exchange.
On 11 July 2019, the Financial Supervision Authority in Luxembourg approved a new foreign base prospectus of mBank Hipoteczny S.A. establishing a mortgage bond issue programme of EUR 3,000,000,000.

for 2020 (in PLN thousand)

**As at 31.12.2020**

| Debt financial instruments by type | Nominal value | Interest rate as at 31.12.2020 | 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 (EUR) | 8 000 | 3,50% | Mortgage covered bonds register | 28.02.2029 | 37 564 | 7 279 | 44 843 |
| Mortgage covered bonds (EUR) | 15 000 | 3,50% | Mortgage covered bonds register | 15.03.2029 | 70 417 | 13 720 | 84 137 |
| Mortgage covered bonds (EUR) | 20 000 | 3,20% | Mortgage covered bonds register | 30.05.2029 | 92 974 | 18 400 | 111 374 |
| Mortgage covered bonds (PLN) | 300 000 | 1,21% | Mortgage covered bonds register | 28.07.2022 | 301 262 | - | 301 262 |
| Mortgage covered bonds (PLN) | 200 000 | 1,20% | Mortgage covered bonds register | 20.02.2023 | 200 609 | - | 200 609 |
| Mortgage covered bonds (PLN) | 200 000 | 1,03% | Mortgage covered bonds register | 28.04.2022 | 200 201 | - | 200 201 |
| Mortgage covered bonds (EUR) | 20 000 | 1.14% | Mortgage covered bonds register | 25.02.2022 | 93 031 | 1 083 | 94 114 |
| Mortgage covered bonds (PLN) | 250 000 | 1,120% | Mortgage covered bonds register | 16.10.2023 | 250 161 | - | 250 161 |
| Mortgage covered bonds (EUR) | 11 000 | 1,29% | Mortgage covered bonds register | 24.04.2025 | 51 033 | 2 077 | 53 110 |
| Mortgage covered bonds (PLN) | 255 000 | 1,360% | Mortgage covered bonds register | 20.09.2021 | 254 989 | - | 254 989 |
| Mortgage covered bonds (PLN) | 300 000 | 1,42% | Mortgage covered bonds register | 05.03.2021 | 300 259 | - | 300 259 |
| Mortgage covered bonds (EUR) | 50 000 | 0,330% | Mortgage covered bonds register | 21.06.2021 | 230 704 | - | 230 704 |
| Mortgage covered bonds (EUR) | 35 000 | 1,180% | Mortgage covered bonds register | 20.09.2026 | 161 684 | 6 675 | 168 359 |
| Mortgage covered bonds (EUR) | 13 000 | 1,18% | Mortgage covered bonds register | 20.09.2026 | 60 040 | 2 031 | 62 071 |
| Mortgage covered bonds (EUR) | 24 900 | 0,94% | Mortgage covered bonds register | 01.02.2024 | 115 751 | 3 484 | 119 235 |
| Mortgage covered bonds (PLN) | 500 000 | 0,97% | Mortgage covered bonds register | 10.09.2022 | 499 773 | - | 499 773 |
| Mortgage covered bonds (PLN) | 1 000 000 | 1,040% | Mortgage covered bonds register | 15.09.2023 | 998 833 | - | 998 833 |
| Mortgage covered bonds (EUR) | 100 000 | 0,61% | Mortgage covered bonds register | 22.06.2022 | 462 630 | 4 381 | 467 011 |
| Mortgage covered bonds (EUR) | 300 000 | 1,07% | Mortgage covered bonds register | 05.03.2025 | 1 394 280 | 63 148 | 1 457 428 |
| Mortgage covered bonds (PLN) | 208 000 | 0,800% | Mortgage covered bonds register | 10.06.2024 | 207 864 | - | 207 864 |
| Mortgage covered bonds (PLN) | 51 100 | 0,80% | Mortgage covered bonds register | 10.06.2024 | 50 978 | - | 50 978 |
| Mortgage covered bonds (PLN) | 40 000 | 0,80% | Mortgage covered bonds register | 10.06.2024 | 39 974 | - | 39 974 |
| Mortgage covered bonds (PLN) | 900 | 0,80% | Mortgage covered bonds register | 10.06.2024 | 899 | - | 899 |
| Mortgage covered bonds (PLN) | 10 000 | 0,80% | Mortgage covered bonds register | 10.06.2024 | 9 968 | - | 9 968 |
| Mortgage covered bonds (PLN) | 100 000 | 1,010% | Mortgage covered bonds register | 20.12.2028 | 99 784 | - | 99 784 |
| Mortgage covered bonds (EUR) | 300 000 | 0,240% | Mortgage covered bonds register | 15.09.2025 | 1 382 685 | - | 1 382 685 |
| Bonds (PLN) | 65 000 | 0,88% | Mortgage covered bonds register | 21.01.2022 | 65 222 | - | 65 222 |
| Bonds (PLN) | 100 000 | 0,81% | Mortgage covered bonds register | 28.06.2021 | 99 984 | - | 99 984 |
| Bonds (PLN) | 35 000 | 0,67% | Mortgage covered bonds register | 03.01.2022 | 35 038 | - | 35 038 |
| Bonds (PLN) | 60 000 | 0,82% | Mortgage covered bonds register | 03.01.2023 | 60 059 | - | 60 059 |
| **Debt securities in issue (carrying value)** | | | | | **7 828 652** | **122 278** | **7 950 930** |

for 2020 (in PLN thousand)

**As at 31.12.2019**

| Debt financial instruments by type | Nominal value | Interest rate as at 31.12.2019 | 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) | 50 000 | 2,91% | Mortgage covered bonds register | 28.04.2020 | 50 969 | - | 50 969 |
| Mortgage covered bonds (PLN) | 100 000 | 2,91% | Mortgage covered bonds register | 28.04.2020 | 101 938 | - | 101 938 |
| Mortgage covered bonds (EUR) | 50 000 | 0,29% | Mortgage covered bonds register | 24.06.2020 | 212 869 | 0 | 212 869 |
| Mortgage covered bonds (EUR) | 30 000 | 2,75% | Mortgage covered bonds register | 28.07.2020 | 129 019 | 1 017 | 130 036 |
| Mortgage covered bonds (PLN) | 500 000 | 2,80% | Mortgage covered bonds register | 10.09.2020 | 500 627 | - | 500 627 |
| Mortgage covered bonds (PLN) | 300 000 | 2,91% | Mortgage covered bonds register | 05.03.2021 | 300 426 | - | 300 426 |
| Mortgage covered bonds (EUR) | 50 000 | 0,47% | Mortgage covered bonds register | 21.06.2021 | 212 772 | - | 212 772 |
| Mortgage covered bonds (PLN) | 255 000 | 2,850% | Mortgage covered bonds register | 20.09.2021 | 254 966 | - | 254 966 |
| Mortgage covered bonds (EUR) | 20 000 | 1,14% | Mortgage covered bonds register | 25.02.2022 | 85 700 | 1 412 | 87 112 |
| Mortgage covered bonds (PLN) | 200 000 | 2,570% | Mortgage covered bonds register | 28.04.2022 | 200 624 | - | 200 624 |
| Mortgage covered bonds (EUR) | 100 000 | 0,61% | Mortgage covered bonds register | 22.06.2022 | 426 641 | 4 524 | 431 165 |
| Mortgage covered bonds (PLN) | 300 000 | 2,720% | Mortgage covered bonds register | 28.07.2022 | 303 000 | - | 303 000 |
| Mortgage covered bonds (PLN) | 500 000 | 2,450% | Mortgage covered bonds register | 10.09.2022 | 499 917 | - | 499 917 |
| Mortgage covered bonds (PLN) | 200 000 | 2,72% | Mortgage covered bonds register | 20.02.2023 | 201 600 | - | 201 600 |
| Mortgage covered bonds (PLN) | 1 000 000 | 2,52% | Mortgage covered bonds register | 15.09.2023 | 998 859 | - | 998 859 |
| Mortgage covered bonds (PLN) | 250 000 | 2,66% | Mortgage covered bonds register | 16.10.2023 | 250 827 | - | 250 827 |
| Mortgage covered bonds (EUR) | 24 900 | 0,940% | Mortgage covered bonds register | 01.02.2024 | 106 759 | 2 787 | 109 546 |
| Mortgage covered bonds (PLN) | 208 000 | 2,28% | Mortgage covered bonds register | 10.06.2024 | 207 983 | - | 207 983 |
| Mortgage covered bonds (PLN) | 51 100 | 2,28% | Mortgage covered bonds register | 10.06.2024 | 50 983 | - | 50 983 |
| Mortgage covered bonds (PLN) | 40 000 | 2,280% | Mortgage covered bonds register | 10.06.2024 | 39 997 | - | 39 997 |
| Mortgage covered bonds (PLN) | 900 | 2,28% | Mortgage covered bonds register | 10.06.2024 | 900 | - | 900 |
| Mortgage covered bonds (PLN) | 10 000 | 2,28% | Mortgage covered bonds register | 10.06.2024 | 9 967 | - | 9 967 |
| Mortgage covered bonds (EUR) | 300 000 | 1,07% | Mortgage covered bonds register | 05.03.2025 | 1 285 874 | 50 261 | 1 336 135 |
| Mortgage covered bonds (EUR) | 11 000 | 1,29% | Mortgage covered bonds register | 24.04.2025 | 47 038 | 1 415 | 48 453 |
| Mortgage covered bonds (EUR) | 300 000 | 0,242% | Mortgage covered bonds register | 15.09.2025 | 1 274 659 | - | 1 274 659 |
| Mortgage covered bonds (EUR) | 13 000 | 1,180% | Mortgage covered bonds register | 20.09.2026 | 55 370 | 784 | 56 154 |
| Mortgage covered bonds (EUR) | 35 000 | 1,18% | Mortgage covered bonds register | 20.09.2026 | 149 116 | 3 411 | 152 527 |
| Mortgage covered bonds (PLN) | 100 000 | 2,50% | Mortgage covered bonds register | 20.12.2028 | 99 807 | - | 99 807 |
| Mortgage covered bonds (EUR) | 8 000 | 3,50% | Mortgage covered bonds register | 28.02.2029 | 34 581 | 5 879 | 40 460 |
| Mortgage covered bonds (EUR) | 15 000 | 3,50% | Mortgage covered bonds register | 15.03.2029 | 64 855 | 11 072 | 75 927 |
| Mortgage covered bonds (EUR) | 20 000 | 3,20% | Mortgage covered bonds register | 30.05.2029 | 85 624 | 14 721 | 100 345 |
| Bonds (PLN) | 50 000 | 2,17% | Mortgage covered bonds register | 09.01.2020 | 50 249 | - | 50 249 |
| Bonds (PLN) | 100 000 | 2,16% | Mortgage covered bonds register | 25.03.2020 | 100 018 | - | 100 018 |
| Bonds (PLN) | 200 000 | 2,16% | Mortgage covered bonds register | 27.07.2020 | 200 002 | - | 200 002 |
| Bonds (PLN) | 100 000 | 2,31% | Mortgage covered bonds register | 28.06.2021 | 99 956 | - | 99 956 |
| Bonds (PLN) | 65 000 | 2,39% | Mortgage covered bonds register | 21.01.2022 | 65 626 | - | 65 626 |
| **Debt securities in issue (carrying value)** | | | | | **8 760 118** | **97 283** | **8 857 401** |

### Movements in the balance of debt securities issued

| | Year ended 31 December | |
|---|---|---|
| | **2020** | **2019** |
| **As at the beginning of the period** | **8 857 401** | **7 870 443** |
| Increase (due to) | 573 181 | 2 056 985 |
| - issue | 95 000 | 1 848 640 |
| - accured interest, interest non-linearity adjustments, EIR commission | 118 190 | 161 059 |
| - exchange differences | 333 506 | - |
| - hedge accounting adjustments related to fair value of hedged items | 26 485 | 47 286 |
| Decrease (due to) | (1 479 652) | (1 070 027) |
| - redemption | (1 354 621) | (874 745) |
| - interest repayment, interest non-linearity adjustments, EIR commission, | (123 542) | (159 294) |
| - exchange differences | - | (34 436) |
| - hedge accounting adjustments related to fair value of hedged items | (1 489) | (1 552) |
| **As at the end of the period** | **7 950 930** | **8 857 401** |

| | | |
|---|---|---|
| Short-term (up to 1 year) | 1 022 656 | 1 457 952 |
| Long-term (over 1 year) | 6 928 274 | 7 399 449 |

| | | |
|---|---|---|
| Fixed interest rate debt securities issued | 4 044 366 | 3 995 427 |
| Floating interest rate debt securities issued | 3 906 564 | 4 861 974 |

## Subordinated financial liabilities

| Subordinated liabilities | Nominal value | Currency | Interest rate as at 31.12. | Maturity / redemption date | Balance of liability (PLN '000) |
|---|---|---|---|---|---|
| **As at 31 December 2020** | | | | | |
| mBank S.A. | 100 000 | PLN | 3.26% | 15.12.2028 | **100 149** |

| Subordinated liabilities | Nominal value | Currency | Interest rate as at 31.12. | Maturity / redemption date | Balance of liability (PLN '000) |
|---|---|---|---|---|---|
| **As at 31 December 2019** | | | | | |
| mBank S.A. | 100 000 | PLN | 5.20% | 15.12.2025 | **100 227** |
| mBank S.A. | 100 000 | PLN | 4,70% | 15.12.2028 | **100 205** |

Both as at 31 December 2020 and as at 31 December 2019, subordinated liabilities were variable interest rate liabilities.

for 2020 (in PLN thousand)

### Movements in the balance of subordinated liabilities

| | 2020 | 2019 |
|---|---|---|
| **As at the beginning of the period** | **200 432** | **200 406** |
| Increase (due to) | 150 | 26 |
| - interest on a loan | 150 | 26 |
| Decrease (due to) | (100 433) | - |
| - repayment of interest on a loan | (433) | - |
| - repayment of a loan | (100 000) | - |
| Subordinated liabilities as at the end of the period | **100 149** | **200 432** |
| | | |
| Short-term (up to 1 year) | 149 | 432 |
| Long-term (over 1 year) | 100 000 | 200 000 |

## 29. Provisions

| | 31.12.2020 | 31.12.2019 |
|---|---|---|
| **Provision (due to)** | **3 392** | **2 276** |
| - off-balance sheet contingent liabilities granted | 224 | 1 568 |
| - provisions for future liabilities | 2 900 | 473 |
| - provisions for retirement and disability benefits | 158 | 147 |
| - provisions for legal proceedings | 110 | 88 |
| | | |
| **Provision, in total** | **3 392** | **2 276** |
| | 0 | |
| Short-term (up to 1 year) | 410 | 290 |
| Long-term (over 1 year) | 2 982 | 1 986 |

In the judgment of 11 September 2019 in the case of a consumer loan fully repaid early C / 383/18, the CJEU ruled that "the consumer's right to a reduction in the total cost of the loan in the event of early repayment of the loan covers all costs that have been imposed on the consumer". In connection with the judgment, the Bank created a provision for the reimbursement of commission in the case of early loan repayments, which as at 31 December 2020 was in the amount 2 900 thousand PLN, (as at December 31, 2019: PLN 473 thousand). The above provision is presented in the item "provision for future liabilities".

for 2020 (in PLN thousand)

| | 2020 | | | |
|---|---|---|---|---|
| | Off-balance sheet contingent liabilities granted | Provisions for future liabilities | Provisions for legal proceedings | Provisions for retirement and |
| **Provisions as at the beginning of the period** | **1 568** | **473** | **88** | **147** |
| - increase on provisions | 702 | 2 427 | 25 | 11 |
| - release of provisions | (2 080) | - | (3) | 3 |
| - other changes | 34 | - | - | (3) |
| **Provisions as at the end of the period** | **224** | **2 900** | **110** | **158** |
| **Expected settlement period of provisions:** | - | - | - | - |
| Short-term (up to 1 year) | 71 | 186 | 110 | 43 |
| Long-term (over 1 year) | 153 | 2 714 | - | 115 |

0

| | 2019 | | | |
|---|---|---|---|---|
| | Off-balance sheet contingent liabilities granted | Provisions for future liabilities | Provisions for legal proceedings | Provisions for retirement and |
| **Provisions as at the beginning of the period** | **2 313** | **-** | **89** | 155 |
| - increase on provisions | 2 131 | 473 | - | 11 |
| - release of provisions | (2 874) | - | (1) | 5 |
| - other changes | (2) | - | - | (24) |
| **Provisions as at the end of the period** | **1 568** | **473** | **88** | **147** |
| **Expected settlement period of provisions:** | - | - | - | - |
| Short-term (up to 1 year) | 5 | 248 | 3 | 34 |
| Long-term (over 1 year) | 1 563 | 225 | 85 | 113 |

## 30. Other liabilities

| | 31.12.2020 | 31.12.2019 |
|---|---|---|
| **Other liabilities (due to)** | **15 728** | **18 505** |
| - accrued expenses | 9 918 | 12 872 |
| - settlements due to tax from Bank balance sheet items | 2 500 | 2 568 |
| - provision for holiday equivalents | 983 | 896 |
| - deferred income | 80 | 63 |
| - settlements with insurers | 979 | 1 151 |
| - liabilities due to income tax on salaries, Social Security contributions and VAT | 73 | 680 |
| - other | 1 195 | 275 |
| **Other liabilities, in total** | **15 728** | **18 505** |
| | | |
| Short-term (up to 1 year) | 15 728 | 18 505 |

## 31. Deferred income tax assets and provision

Deferred income tax assets and provision are calculated for all temporary differences in accordance with the balance sheet method, using an effective income tax rate that will be applicable in the year of the tax obligation arising (19% both in 2020 and 2019).

Changes in deferred tax assets and liabilities in the period from January 1, 2020 to December 31, 2020 are presented below.

for 2020 (in PLN thousand)

| Deferred tax assets | As at 01.01.2020 | impact MSSF 16 | Through the profit and loss account | Through other total income | Other changes | As at 31.12.2020 |
|---|---|---|---|---|---|---|
| Accrued interest | 28 212 | | 1 468 | - | - | 29 680 |
| Valuation of derivative financial instruments | 738 | | (29) | 9 096 | 266 | 10 071 |
| Measurement of debt financial instruments measured at fair value through other comprehensive incomeody | 44 | | - | (38) | - | 6 |
| Value of write-downs on receivables and adjustment to fair value * | 25 874 | | (1 669) | - | - | 24 205 |
| Provisions and other benefit obligations employees | 1 789 | | (576) | - | - | 1 213 |
| Write-offs due to permanent loss of value of inventories | - | | - | - | - | 0 |
| Accruals of costs | 2 049 | (1 343) | 572 | - | - | 1 278 |
| The difference between the depreciation of the right to use and the cost of financing the lease (IFRS 16) | - | 1 343 | (226) | | | 1 117 |
| Income to be settled (commissions settled using the effective interest method) | 5 638 | | (2 183) | - | - | 3 455 |
| **Total deferred tax assets** | **64 344** | **-** | **(2 643)** | **9 058** | **266** | **71 025** |

| | |
|---|---|
| Realized within 12 months | 3 427 |
| To be completed over 12 months | 67 598 |

* The item "Value of write-downs on receivables and adjustment to fair value" refers to expected credit losses value of loans measured at amortized cost for which the Bank expects that their uncollectibility will be documented and adjustments to fair value for loans that are obligatorily measured at fair value through profit or loss financial.

| Deferred income tax | As at 01.01.2020 | impact MSSF 16 | Through the profit and loss account | Through other total income | Other changes | As at 31.12.2020 |
|---|---|---|---|---|---|---|
| Accrued interest | (13 715) | | 3 275 | | | -10 440 |
| Valuation of derivative financial instruments | (17 388) | | (4 814) | (12 957) | | -35 159 |
| Measurement of debt financial instruments measured at fair value through other comprehensive income | (757) | | | (287) | | -1 044 |
| Provisions and other benefit obligations employees | (6) | | | | | -6 |
| Up-front costs | (21 686) | 1 261 | 1 883 | | | -18 542 |
| The difference between the property's carrying amount and tax amount fixed assets and intangible assets | (669) | (1 261) | 107 | | | -1 823 |
| Other | - | | | | | 0 |
| **Total provision for deferred income taxdowego** | **(54 221)** | **-** | **451** | **(13 244)** | **-** | **(67 014)** |

| | |
|---|---|
| Realized within 12 months | (65 191) |
| To be completed over 12 months | (1 823) |

| Deferred tax assets (net) | As at 01.01.2020 | impact MSSF 16 | Through the profit and loss account | Through other total income | Other changes | As at 31.12.2020 |
|---|---|---|---|---|---|---|
| **Total deferred tax assets (net)** | **10 123** | **-** | **(2 192)** | **(4 186)** | **266** | **4 011** |

| | |
|---|---|
| Realized within 12 months | (61 764) |
| To be completed over 12 months | 66 141 |

Changes in the deferred tax assets and liabilities in the period from January 1, 2019 to December 31, 2019 are presented below.

for 2020 (in PLN thousand)

| Deferred income tax assets | As at 01.01.2019 | Recognised in the income statement | Recognised in other comprehensive income | As at 31.12.2019 |
|---|---|---|---|---|
| Interest accrued | 20 028 | 8 184 | - | 28 212 |
| Valuation of derivative financial instruments | 1 062 | (1 030) | 706 | 738 |
| Valuation of debt financial instruments measured at fair value through other comprehensive income | - | - | 44 | 44 |
| Value of impairment losses on receivables and adjustment to fair values * | 24 970 | 904 | - | 25 874 |
| Provisions and other liabilities related to employment benefits | 1 778 | 11 | - | 1 789 |
| Impairment write-downs on inventories | - | - | - | - |
| Accruals | 1 309 | 740 | - | 2 049 |
| Revenues to be settled (commissions settled using the effective interest rate method) | 8 264 | (2 626) | - | 5 638 |
| **Total deferred income tax assets** | **57 411** | **6 183** | **750** | **64 344** |

| | |
|---|---|
| Settled within 12 months | 48 171 |
| To be settled after more than 12 months | 16 172 |

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

| Deferred income tax liabilities | As at 01.01.2019 | Recognised in the income statement | Recognised in other comprehensive income | As at 31.12.2019 |
|---|---|---|---|---|
| Interest accrued | (11 894) | (1 821) | - | -13 715 |
| Valuation of derivative financial instruments | (8 548) | (8 840) | - | -17 388 |
| Valuation of debt financial instruments measured at fair value through other comprehensive income | (1 284) | - | 527 | -757 |
| Provisions and other liabilities related to employment benefits | (1) | - | (5) | -6 |
| Costs paid in advance | (22 447) | 761 | - | -21 686 |
| Difference between tax and balance sheet depreciation/amortisation | (651) | (18) | - | -669 |
| Other | - | - | - | - |
| **Total deferred income tax liabilities** | **(44 825)** | **(9 918)** | **522** | **(54 221)** |

| | |
|---|---|
| Settled within 12 months | (53 552) |
| To be settled after more than 12 months | (669) |

| Deferred income tax assets (net) | As at 01.01.2019 | Recognised in the income statement | Recognised in other comprehensive income | As at 31.12.2019 |
|---|---|---|---|---|
| **Total deferred income tax assets (net)** | **12 586** | **(3 735)** | **1 272** | **10 123** |

| | |
|---|---|
| Settled within 12 months | (5 381) |
| To be settled after more than 12 months | 15 503 |

for 2020 (in PLN thousand)

| Deferred tax recognised in the income statement | Year ended 31 December | |
|---|---|---|
| | 2020 | 2019 |
| Interest accured | 4 743 | 6 363 |
| Valuation of derivative financial instruments | (4 843) | (9 870) |
| Amount of impairment write-downs on receivables and adjustment to fair value | (1 669) | 904 |
| Provisions and other liabilites related to employment benefits | (576) | 11 |
| Accruals | 572 | 740 |
| Revenues to be settled (commissions settled using the effective interest rate method) | (2 183) | -2 626 |
| Prepaid costs | 1 883 | 761 |
| Difference between tax sheet depreciation/amortisation | (119) | (18) |
| **Total, deferred tax recognised in the income statement** | **(2 192)** | **(3 735)** |

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

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

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

## 32. Administration authority

In 2020, the Bank was not involved in any proceedings before a court, arbitration body, or public administration authority, where the value of such proceedings represented at least 10% of the Bank's equity. No significant actions were brought by the Bank or against the Bank within the presented reporting periods. The Bank made no provisions for ongoing disputes of that category.

## 33. Off-balance sheet commitments

Off-balance-sheet commitments of the Bank include:

- lending commitments

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

The tables below present the off-balance-sheet liabilities made and received by the Bank, and the nominal value of open derivative transactions of the Bank as at 31 December 2020.

| 31.12.2020 | Up to 1 year | From 1 to 5 years | Over 5 years | Total |
|---|---|---|---|---|
| **Off-balance sheet liabilities granted and received** | **816 963** | **24 301** | **617 010** | **1 458 274** |
| **Liabilities granted** | **35 174** | **24 301** | **7 101** | **66 576** |
| 1. Financial liabilities:: | 35 174 | 24 301 | 7 101 | 66 576 |
| a) Lending commitments | 35 174 | 24 301 | 7 101 | 66 576 |
| **Liabilities received:** | **781 789** | **-** | **609 909** | **1 391 698** |
| a) Financial liabilities received | 781 789 | - | - | 781 789 |
| b) guarantee | - | - | 609 909 | 609 909 |
| **Derivative financial instruments (nominal value of contracts)** | **2 443 031** | **6 871 144** | **839 894** | **10 154 069** |
| 1. Interest rate derivatives | - | 4 207 774 | 839 894 | 5 047 668 |
| 2. Foreign exchange derivatives | 2 443 031 | 2 663 370 | - | 5 106 401 |
| **Total off-balance sheet items** | **3 259 994** | **6 895 445** | **1 456 904** | **11 612 343** |

On December 17, 2020, the Bank concluded with mBank S.A. a bank guarantee agreement for selected commercial credit exposures of the Bank with a total amount of over PLN 590 million. The purpose of entering into the guarantee is to improve the risk profile of exposures with the highest risk of deteriorating the economic situation of debtors.

for 2020 (in PLN thousand)

| | Nominal amount of off-balance sheet loan commitments | | | | Provisions for off-balance sheet loan commitments | | | |
|---|---|---|---|---|---|---|---|---|
| | Stage 1 | Stage 2 | Stage 3 | POCI | Stage 1 | Stage 2 | Stage 3 | POCI |
| Lending commitments | 65 940 | 636 | 0 | 0 | 221 | 2 | 0 | 0 |

| Off-balance sheet exposures: credit commitments. Change in reserves | | | | | |
|---|---|---|---|---|---|
| **31.12.2020** | **Opening balance** | **Increases due to the grant and takeover** | **Decreases due to derecognition** | **Changes due to change in credit risk (net)** | **Closing balance** |
| **Loan commitments** | **1 568** | **194** | **(1 098)** | **(441)** | **223** |
| Stage 1 | 1 418 | 194 | (952) | (437) | 223 |
| Stage 2 | 150 | - | (146) | (4) | - |
| Stage 3 | - | - | - | - | - |
| POCI | - | - | - | - | - |
| **Total** | **1 568** | **194** | **(1 098)** | **(441)** | **223** |

The tables below show off-balance sheet commitments to grant credit and provisions for off-balance sheet commitments granted by the levels of the internal rating system on December 31, 2020.

| Nominal amount of off-balance sheet loan commitments | Stage 1 | Stage 2 | Stage 3 | POCI | TOTAL |
|---|---|---|---|---|---|
| 1 | 2 398 | - | - | - | 2 398 |
| 2 | 1 938 | 339 | - | - | 2 277 |
| 3 | 129 | - | - | - | 129 |
| 4 | 61 475 | - | - | - | 61 475 |
| 5 | - | 297 | - | - | 297 |
| 6 | - | - | - | - | - |
| 7 | - | - | - | - | - |
| 8 | - | - | - | - | - |
| default | - | - | - | - | - |
| **Total** | **65 940** | **636** | **-** | **-** | **66 576** |

| Provisions for off-balance sheet loan commitments | Stage 1 | Stage 2 | Stage 3 | POCI | TOTAL |
|---|---|---|---|---|---|
| 1 | - | - | - | - | - |
| 2 | - | - | - | - | - |
| 3 | - | - | - | - | - |
| 4 | 223 | - | - | - | 223 |
| 5 | - | - | - | - | - |
| 6 | - | - | - | - | - |
| 7 | - | - | - | - | - |
| 8 | - | - | - | - | - |
| default | - | - | - | - | - |
| **Total** | **223** | **-** | **-** | **-** | **223** |

The tables below present the off-balance sheet commitments granted and received by the Bank, the nominal value of the Bank's open derivative transactions and the change in provisions for loan commitments as at December 31, 2019.

| | Nominal amount of off-balance sheet loan commitments | | | | Provisions for off-balance sheet loan commitments | | | |
|---|---|---|---|---|---|---|---|---|
| | Stage 1 | Stage 2 | Stage 3 | POCI | Stage 1 | Stage 2 | Stage 3 | POCI |
| Lending commitments | 441 997 | 7 615 | - | - | 1 418 | 150 | - | - |

for 2020 (in PLN thousand)

| 31.12.2019 | Up to 1 year | From 1 to 5 years | Over 5 years | Total |
|---|---|---|---|---|
| **1. Off-balance sheet liabilities granted and received** | **1 958** | **1 089 952** | **138 303** | **1 230 213** |
| **Liabilities granted** | **1 958** | **309 351** | **138 303** | **449 612** |
| 1. Financial liabilities:: | 1 958 | 309 351 | 138 303 | 449 612 |
| a) Lending commitments | 1 958 | 309 351 | 138 303 | 449 612 |
| b) Operating lease liabilities | - | - | - | - |
| **Liabilities received:** | **-** | **780 601** | **-** | **780 601** |
| a) Financial liabilities received | - | 780 601 | - | 780 601 |
| **2. Derivative financial instruments (nominal value of contracts)** | **3 320 628** | **1 234 114** | **5 980 314** | **10 535 056** |
| 1. Interest rate derivatives | 2 805 304 | 1 234 114 | 3 423 834 | 7 463 252 |
| 2. Foreign exchange derivatives | 515 324 | - | 2 556 480 | 3 071 804 |
| **Total off-balance sheet items** | **3 322 586** | **2 324 066** | **6 118 617** | **11 765 269** |

| Off-balance sheet exposures: credit commitments. Change in reserves | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 31.12.2019 | Opening balance | Transfer to stage 1 | Transfer to stage 2 | Transfer to stage 3 | Increases due to the grant and takeover | Decreases due to derecognition | Changes due to change in credit risk (net) | Changes resulting from the update of the methodology for estimating write-offs (net) | Decreases in write-offs | Closing balance |
| **Loan commitments** | **2 313** | **-** | **-** | **-** | **2 094** | **(884)** | **(1 950)** | **-** | **(5)** | **1 568** |
| Stage 1 | 2 309 | - | (32) | - | 1 980 | (884) | (1 950) | - | (5) | 1 418 |
| Stage 2 | 4 | - | 32 | - | 114 | - | - | - | - | 150 |
| Stage 3 | - | - | - | - | - | - | - | - | - | - |
| POCI | - | - | - | - | - | - | - | - | - | - |
| **Total** | **2 313** | **-** | **-** | **-** | **2 094** | **(884)** | **(1 950)** | **-** | **(5)** | **1 568** |

The tables below show off-balance sheet commitments to grant credit and provisions for off-balance sheet commitments granted by the levels of the internal rating system on December 31, 2019.

| Nominal amount of off-balance sheet loan commitments | Stage 1 | Stage 2 | Stage 3 | POCI | TOTAL |
|---|---|---|---|---|---|
| 1 | 3 008 | 4 | - | - | 3 012 |
| 2 | 3 616 | 794 | - | - | 4 410 |
| 3 | 106 | - | - | - | 106 |
| 4 | 435 267 | 6 520 | - | - | 441 787 |
| 5 | - | 80 | - | - | 80 |
| 6 | - | - | - | - | - |
| 7 | - | 217 | - | - | 217 |
| 8 | - | - | - | - | - |
| default | - | - | - | - | - |
| **Total** | **441 997** | **7 615** | **-** | **-** | **449 612** |

| Provisions for off-balance sheet loan commitments | Stage 1 | Stage 2 | Stage 3 | POCI | TOTAL |
|---|---|---|---|---|---|
| 1 | - | - | - | - | - |
| 2 | - | - | - | - | - |
| 3 | - | - | - | - | - |
| 4 | 1 418 | 150 | - | - | 1 568 |
| 5 | - | - | - | - | - |
| 6 | - | - | - | - | - |
| 7 | - | - | - | - | - |
| 8 | - | - | - | - | - |
| default | - | - | - | - | - |
| **Total** | **1 418** | **150** | **-** | **-** | **1 568** |

## 34. Pledged assets

As at December 31, 2020 and as at December 31, 2019, the Bank had no pledged assets. The Bank secured the issued mortgage bonds with receivables from credits and loans granted, which are described in note 28. Moreover, the Bank entered the CIRS hedging transaction in the covered bond collateral register. The mortgage bank is obliged to keep in the collateral register created with the funds referred to in Art. 18 (3) of the Act, a surplus in the amount not lower than the total amount of the nominal value of interest on traded mortgage covered bonds to be paid within the next 6 months. The funds allocated to the surplus may not constitute the basis for the issue of mortgage bonds. The amount of the substitute security may be withdrawn from the register at any time (released), provided that the trustee agrees. The amount of the excess varies over time and must remain in the register in accordance with Art. 18 sec. 3a of the Act, until all mortgage bonds are purchased. The Bank secured the issued mortgage covered bonds with Treasury bonds with a carrying amount as at December 31, 2020, PLN 151,009 thousand PLN (as at December 31, 2019: PLN 202,070 thousand).

for 2020 (in PLN thousand)

## 35. Registered share capital

As at 31 December 2020, the total number of ordinary shares was 3,360,000 shares with the nominal value of PLN 100 per share (as at 31 December 2018: 3 210 000). All shares in issue are fully paid up.

| REGISTERED SHARE CAPITAL (STRUCTURE) AS AT 31 DECEMBER 2020 | | | | | | | |
|---|---|---|---|---|---|---|---|
| **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 | gotówka | 16.04.1999 | 01.01.2000 |
| registered | - | - | 850 000 | 85 000 000 | gotówka | 20.09.2000 | 01.01.2001 |
| registered | - | - | 400 000 | 40 000 000 | gotówka | 24.04.2006 | 01.01.2006 |
| registered | - | - | 1 000 000 | 100 000 000 | gotówka | 08.01.2013 | 01.01.2013 |
| registered | - | - | 100 000 | 10 000 000 | gotówka | 30.12.2014 | 01.01.2015 |
| registered | - | - | 140 000 | 14 000 000 | gotówka | 19.08.2015 | 01.01.2016 |
| registered | - | - | 100 000 | 10 000 000 | gotówka | 01.08.2016 | 01.01.2017 |
| registered | - | - | 120 000 | 12 000 000 | gotówka | 03.04.2017 | 01.01.2017 |
| registered | - | - | 150 000 | 15 000 000 | gotówka | 09.05.2019 | 01.01.2019 |
| **Total number of shares** | | | **3 360 000** | | | | |
| **Total registered share capital** | | | | **336 000 000** | | | |

On March 7, 2019 the Extraordinary General Meeting of Shareholders adopted a resolution on increasing the share capital and depriving the shareholder of the pre-emptive right to shares, pursuant to which the share capital of mBank Hipoteczny S.A. was increased by PLN 15,000 thousand, i.e. up to PLN 336,000 thousand through the issue of 150,000 ordinary registered shares with a nominal value of PLN 100 each and an issue price of PLN 1,000 each. The new shares were offered to mBank S.A. by way of a private placement. The shares were fully paid up March 20, 2019. On 9 May 2019, the registry court made an entry in the register of entrepreneurs of the increased share capital. On June 19, 2019, the Polish Financial Supervision Authority (KNF) gave its consent to classify new shares to Tier 1 share capital.

The shareholders of mBank Hipoteczny S.A. as at 31 December 2020 are presented in the table below:

| **Shareholder's name** | **Equity (PLN)** | **Shares** | | **Voting rights at the General Shareholders' Meeting** | |
|---|---|---|---|---|---|
| | | **Number of shares** | **%** | **Number of votes** | **%** |
| mBank S.A. | 336 000 000 | 3 360 000 | 100,00 | 3 360 000 | 100,00 |
| **Total** | **336 000 000** | **3 360 000** | **100,00** | **3 360 000** | **100,00** |

## 36. Share premium

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

## 37. Retained earnings

| | **31.12.2020** | **31.12.2019** |
|---|---|---|
| Other supplementary capital | 338 032 | 300 948 |
| General banking risk reserve | 44 800 | 44 800 |
| Profit for the current year | 4 878 | 37 084 |
| **Total retained earnings** | **387 710** | **382 832** |

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

for 2020 (in PLN thousand)

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

- Distribution of profit for 2019

On March 27, 2020, the Ordinary General Meeting of mBank Hipoteczny S.A. adopted a resolution on the distribution of the net profit for 2019. The Bank's net profit for 2019 in the amount of PLN 37,084 thousand PLN was allocated entirely to the supplementary capital of the Bank.

## 38. Other components of equity

| | 31.12.2020 | 31.12.2019 |
|---|---|---|
| **Financial assets at fair value through other comprehensive income** | **4 423** | **3 041** |
| Unrealised gains on debt instruments | 4 423 | 3 041 |
| **Actuarial gains and losses on post-employment benefits** | **26** | **24** |
| Actuarial gains of the defined benefit pension plan | 26 | 24 |
| Zabezpieczenie przepływów pieniężnych | 13 450 | (3 008) |
| **Other components of equity, total** | **17 899** | **57** |

## 39. Dividend per share

mBank Hipoteczny S.A. does not plan to pay a dividend for 2020, nor did it pay any for 2019.

## 40. Notes to the statement of cash flows

### Cash and cash equivalents

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

| | 31.12.2020 | 31.12.2019 |
|---|---|---|
| Cash and balances with the central bank (Note 20) | 29 393 | 35 234 |
| Amounts due from other banks (Note 24) | 323 133 | 13 912 |
| Money bills | 34 999 | 219 982 |
| **Total cash and cash equivalents** | **387 525** | **269 128** |

### Supplementary information to the statement of cash flows

Change in the status of items of operational activity

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

for 2020 (in PLN thousand)

| | Year ended 31 December 2020 | Year ended 31 December 2019 |
|---|---|---|
| **Financial assets and liabilities held for trading and derivative hedging instruments - change in balance due to balance sheet balances** | **(151 581)** | **(5 991)** |
| The difference between the interest accrued and paid in cash in the period | 21 424 | 12 783 |
| Valuation recognised in other comprehensive income | 20 319 | (3 714) |
| **Financial assets and liabilities held for trading and derivative hedging instruments, total** | **(109 838)** | **3 078** |
| **Loans and advances to clients, change resulting from balance-sheet values** | **334 552** | **(649 675)** |
| The difference between the interest accrued and paid in cash in the period | (19 480) | 19 468 |
| **Change in loans and advances to clients, total** | **315 072** | **(630 207)** |
| **Financial assets at fair value through other comprehensive income - change resulting from balance-sheet values** | **430 690** | **(152 343)** |
| Exclusion of change in cash and cash equivalents | (184 983) | 129 993 |
| Valuation recognised in other comprehensive income | 1 707 | (3 006) |
| Result on disposal | 4 243 | - |
| The difference between the interest accrued and paid in cash in the period | (2 127) | 5 441 |
| **Change in respect Financial assets at fair value through other comprehensive income, total** | **249 530** | **(19 915)** |
| **Debt securities issued at amortised cost - change resulting from balance-sheet values** | **(906 471)** | **986 958** |
| The difference between the interest accrued and paid in cash in the period | (32 648) | (5 821) |
| Exclusion of change in cash from financing activities | 1 259 621 | (1 269 625) |
| | (319 565) | |
| **Change in debt securities in issue at amortised cost, total** | **937** | **(288 488)** |
| **Amounts due to other banks, change resulting from balance-sheet values** | **683 851** | **(363 056)** |
| The difference between the interest accrued and paid in cash in the period | (3 108) | 498 |
| Exclusion of change in cash from financing activities | 1 310 240 | 2 291 096 |
| **Change in amounts due to banks, in total** | **1 990 983** | **1 928 538** |
| **Debt securities in issue - change resulting from balance-sheet values** | **(5 457)** | **5 835** |
| The difference between the interest accrued and paid in cash in the period | (514) | (299) |
| Transfer to cash flows from financing activities - leasing | 3 151 | 2 924 |
| **Change in amounts due to clients, in total** | **(2 821)** | **8 459** |

## Interest received and paid with respect to the operational activity

| | Year ended 31 December | |
|---|---|---|
| | 2020 | 2019 |
| **Interest received from:** | | |
| Cash and balances with the Central Bank | 15 | 25 |
| Loans and advances to banks | 107 | 700 |
| Loans and advances to customers | 339 774 | 385 175 |
| Financial assets at fair value through other comprehensive income | 16 280 | 15 070 |
| Derivative instruments classified to the banking book | 3 142 | 19 182 |
| **Income from interest received, total** | **359 318** | **420 152** |

| | Year ended 31 December | |
|---|---|---|
| | 2020 | 2019 |
| **Interest paid on account:** | | |
| Settlements with banks on account of received credits, security deposits with the original maturity below 1 year, liabilities on account of deferred payment | 25 895 | 23 784 |
| Settlements with banks on account of debt securities issued with an original maturity of less than one year | - | 3 201 |
| **Total costs of interest received** | **25 895** | **26 985** |

for 2020 (in PLN thousand)

Cash flows from financing activities

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

| | OB. 01.01.2020 | Cash flow | Other changes | CB 31.12.2020 |
|---|---|---|---|---|
| Debt securities in issue (long-term) | 8 857 401 | (1 264 972) | 358 501 | 7 950 930 |
| Amounts due to banks (long-term) | 2 769 787 | (83 562) | 44 799 | 2 731 024 |
| Leasing liabilities (Note 28) | 7 067 | (3 151) | 1 963 | 5 879 |
| Subordinate liabilities(Note 28) | 200 432 | (100 432) | 149 | 100 149 |

| | OB. 01.01.2019 | Cash flow | Other changes | CB 31.12.2019 |
|---|---|---|---|---|
| Debt securities in issue (long-term) | 7 570 458 | 1 113 781 | 173 162 | 8 857 401 |
| Amounts due to banks (long-term) | 3 149 847 | (476 742) | 96 682 | 2 769 787 |
| Leasing liabilities (Note 28) | 8 994 | (2 924) | 997 | 7 067 |
| Subordinate liabilities(Note 28) | 200 406 | - | 26 | 200 432 |

Column "Other Changes" shows non-cash flows resulting from accrued interest, commissions accounted for with the effective interest rate method, exchange differences, changes in hedge accounting adjustments related to fair value of hedged items, financial liabilities with deferred maturity resulting from agreements concluded with mBank S.A. on the transfer of a portfolio of retail loans secured with a mortgage on real estate.

## 41. Incentive plan for the Bank's Management Board and employees having a material impact on the risk profile of the Bank

The rules for determining the variable remuneration components of persons holding positions that have a significant impact on the Bank's risk profile are set out in the "Remuneration policy for persons having a significant impact on the risk profile at mBank Hipoteczny S.A." hereinafter referred to as the "Policy", adopted for the first time by the Resolution of the Supervisory Board no. 21/2012 of 19 September 2012. Since then, the Policy has been subject to annual verification and modification by the Management Board and Supervisory Board of the Bank.

**2015, 2016 and 2017 incentive program for members of the Bank's Management Board and employees who have a significant impact on the Bank's risk profile**

On June 26, 2015, the Supervisory Board of the Bank adopted the "Policy of remuneration of persons having a significant impact on the Bank's risk profile at mBank Hipoteczny S.A.", which entered into force on July 1, 2015.
On April 18, 2016, by Resolution No. 14/2016 of the Supervisory Board, the amended "Remuneration policy for persons having a significant impact on the Bank's risk profile at mBank Hipoteczny S.A." was approved, which entered into force on May 1, 2016 and repealed the previous policy in this regard. The change concerned the calculation of the average value of phantom shares for the payment of the non-deferred non-cash part and the deferred non-cash tranches. Before the change, the value of the shares was understood as the value at the end of the annual period preceding the payment date. After the change, the average value of the phantom share is calculated as the sum of the value of the phantom share at the end of the annual period preceding the payment date and the value of the phantom share at the end of the first half of the year in which the payment is to take place, divided by two.
On March 27, 2017, the Supervisory Board, by Resolution No. 13/2017, changed the Remuneration Policy for persons having a significant impact on the Bank's risk profile by introducing a limit of PLN

200 thousand PLN for the payment of variable remuneration. If the amount is equal to or less than PLN 200,000 The Bank's Management Board may decide not to postpone the variable remuneration for subsequent years and grant the entire variable remuneration in the form of non-deferred cash. The above rule does not apply to members of the Bank's Management Board.
Pursuant to the Policy, the variable remuneration includes a bonus granted to a member of the Management Board or other employees for a given financial year. Variable remuneration is determined in a transparent, verifiable manner, ensuring effective implementation of the Policy. The maximum level of the variable remuneration components of persons covered by the Policy may not exceed 100% of the value of the base remuneration paid to a member of the Management Board or other employees for a given financial year. Variable remuneration is part of the total remuneration (annual base salary and variable remuneration) awarded to a member of the Management Board or other employees. It is fixed taking into account market practices, both in the banking sector and on the Polish market, verified on the basis of market salary reports and the remuneration policy of mBank Group.

<u>The process of granting and deferring variable remuneration for members of the Bank's Management Board:</u>

The Supervisory Board determines the amount of bonuses for individual members of the Bank's Management Board, taking into account whether the Management Board member has achieved the agreed annual / long-term business and development goal - Management By Objective ("MBO"). The decision on granting the bonus and its amount is at the sole discretion of the Bank's Supervisory Board, which, according to its own assessment and decision, confirms the achievement of MBO, taking into account the situation on financial markets in the last / previous financial periods.

<u>Variable remuneration is awarded in accordance with the following principles:</u>

- 60% of the bonus amount will be paid in the year it was granted (non-deferred part), in the following way: - 50% in the form of a cash withdrawal and - 50% in phantom shares.
- 40% of the bonus amount will be paid, in three equal installments (deferred part)
  in the three years following the granting of the premium, as follows:
  - 50% in the form of a cash withdrawal and
  - 50% in the form of a cashless payment in phantom shares.

Phantom shares granted both in the non-deferred and deferred part may be paid out at the earliest in the 6th month after the month of granting the phantom shares.
The Supervisory Board may decide to suspend in whole or reduce the amount of the deferred tranche, if:

- states that in a longer time horizon (at least 3 years), the Management Board member, through his actions or omissions, had a direct and negative impact on the financial result and market position of the Bank, or
- at least one of the elements included in the scorecard is not met (ie if there is at least one "YES" answer to the questions posed in it) or
- the management contract will expire or be terminated for reasons other than: - expiry of the term for which the contract was concluded, - dismissal of a Management Board member from the Bank's Management Board during the term of the contract, except for the reasons specified in detail in the contract, - taking on new responsibilities within the mBank Group, - retirement of the Management Board member.

As part of the program described above, Members of the Management Board were awarded a bonus for 2015, 2016 and 2017. The last settlements of this program are in 2021.

<u>The process of granting and deferring variable remuneration for other employees having an impact on the Bank's risk profile:</u>
The Bank's Management Board determines the amount of bonuses for individual employees who have significant influence on the Bank's risk profile, taking into account whether they have achieved the agreed annual / long-term business and development goal - MBO. The decision on granting the bonus and its amount is at the sole discretion of the Management Board of the Bank, which, according to its own assessment and decision, confirms the achievement of MBO, taking into account the situation on financial markets in the last / previous financial periods.

Variable remuneration is awarded in accordance with the following principles:

- 60% of the bonus amount will be paid in the year it was granted (the non-deferred part), in the following way:
  - 50% in the form of a cash withdrawal and
  - 50% in phantom shares,
- 40% of the bonus will be paid, in three equal installments (deferred portion) in the three following years following the bonus year, as follows:
  - 50% in the form of a cash withdrawal and
  - 50% in phantom shares.

Phantom shares granted both in the non-deferred and deferred part may be paid out at the earliest in the 6th month after the month of granting the phantom shares. If the amount of the variable remuneration is equal to or lower than PLN 200,000, The Bank's Management Board may decide not to postpone the variable remuneration for subsequent years and grant the entire variable remuneration in the form of non-deferred cash.
The Bank's Management Board may decide to suspend in whole or reduce the amount of the deferred tranche:

- if it finds that in the long term (at least 3 years) the employee, through his actions or omissions, had a direct and negative impact on the financial result and market position of the Bank during the assessment period. When assessing the actions or omissions of an employee, the Bank's Management Board takes into account, inter alia, the results of the MBO assessment of a given employee,
- in the event of termination of the employment contract, except for the reasons specified in the contract for employment / internal regulations of the Bank,

The Management Board of the Bank may decide to suspend in whole or reduce the amount of the discretionary bonus for a given financial year, as well as in the case of the deferred tranche still unpaid, in the event of a balance sheet loss or a threat of its occurrence or a threat of insolvency or loss of liquidity of the Bank.
As part of the program described above, employees who had an impact on the Bank's risk profile were awarded a bonus for 2015, 2016 and 2017. The last settlements for the bonus granted under this program were made in 2020.

**2018 and 2019 incentive program for members of the Bank's Management Board and employees who have a significant impact on the Bank's risk profile**

On November 23, 2018, the Supervisory Board, by Resolution No. 37/2018, approved the amended Remuneration Policy for people who have a significant impact on the Bank's risk profile at mBank Hipoteczny S.A. and repealed the Policy of March 2017. The provisions of the adopted Policy apply from the bonus for 2018. The changes concerned, among others:

- Extension of the retention period from 6 to 12 months, phantom shares awarded to both as part of the non-deferred and deferred part, they can be paid at the earliest 12 months after the month of granting phantom shares,
- changes in the rules for calculating the equivalent for phantom shares - to calculate the average value of phantom shares, the sum of the value of the phantom shares at the end of the last two annual periods preceding the payment date is taken into account,
- detailing the provisions regarding the conditions for receiving a bonus in the so-called scorecard,
- introducing clawback, on the basis of which the Supervisory Board in relation to members of the Management Board, the Management Board in relation to employees who have a significant impact on the Bank's risk profile may request the return of the bonus granted and paid for a given calendar year (i.e. deferred).

On December 14, 2018, the Supervisory Board adopted Resolution No. 39/2018 introducing order corrections to the content of the Policy adopted with Resolution No. 37/2018.
The amount of the bonus for a given calendar year is determined based on the assessment of the achievement of the set MBO goals for the last three calendar years, the Supervisory Board for members of the Management Board, the Bank's Management Board for employees who have a significant impact on the Bank's risk profile, the so-called Risk Taker.
The bonus consists of a non-deferred portion representing 60% of the bonus and a deferred portion representing 40% of the bonus.

The deferred and non-deferred part is divided into the cash part (50%) and the non-cash part allocated in phantom shares (50%). The non-deferred cash portion is payable in the year of granting the bonus. The other half of the non-deferred portion (50%) is paid in the form of an equivalent for phantom shares not earlier than 12 months after the date of the Ordinary General Meeting of Shareholders.
The deferred part, both in cash and in the form of phantom shares, is paid after approval of the Bank's financial statements for the previous calendar year, and the part is paid in the form of phantom shares not earlier than 12 months after the approval of the Bank's financial statements.
If the amount of the bonus for a given calendar year, determined for an employee having a significant impact on the risk profile of the Bank who is not a member of the Management Board, does not exceed PLN 200 thousand. on the basis of a decision made by the Bank's Management Board, the bonus may be paid in full in cash in a non-deferred form.
The deferred part of the bonus of both the Management Board members and other Risk Takers in terms of determination and payment is subject to assessment. Accordingly, the Supervisory Board in relation to members of the Management Board, the Management Board of the Bank in relation to employees identified as Risk Takers, may decide to suspend in whole or reduce the amount of the deferred tranche if it finds that in a longer time horizon than 1 financial / financial year, i.e. for a period of at least 3 years, Risk Taker had a direct and negative impact on the financial result or market position of the Bank, violated the rules and standards adopted in mBank Group, directly led to significant financial losses, when at least one of the elements included in the scorecard failed has been met or any of the conditions referred to in art. 142 sec. 2 of the Banking Law.

If the above-mentioned events occur at the stage of determining the amount of the bonus for Risk Takers, the Supervisory Board / Management Board of the Bank may decide not to grant the bonus in full or to reduce the bonus for a given calendar year. In addition, Risk Taker may be required, on the terms and within the time specified by a decision of the Supervisory Board / Management Board of the Bank, respectively, to return the bonus granted and paid for a given calendar year (i.e. the non-deferred part and all deferred parts) if it breached the rules adopted in mBank Group. and standards, has committed a material breach of generally applicable provisions of law or has directly led to significant financial losses as a result of deliberate, negative action to the detriment of mBank Group or led to the imposition of financial sanctions on the Bank by supervisory authorities based on a legally valid decision.
The decision on the occurrence of the above-mentioned events may be made by the end of the calendar year in which the payment of the last tranche of the detrimental part of the premium for the year in which the event occurred.

The bonus under the rules described above was awarded for the first time to members of the Management Board and other Risk Takers for 2018 and 2019.

**2020 incentive program for members of the Bank's Management Board and employees having a significant impact on the Bank's risk profile**

On February 3, 2020, the Supervisory Board, by Resolution No. 5/2020, approved the amended Remuneration Policy for people with a significant impact on the Bank's risk profile at mBank Hipoteczny S.A. and repealed the Policy of December 2018. The most important changes in the Policy result from the recommendations of the Polish Financial Supervision Authority:

- the previous limit of 200,000 PLN. has been replaced with a relative value for Risk Takers (not applicable to Management Board Members), for whom their annual variable remuneration does not exceed one third of the annual total remuneration. As a result, such employees may receive variable remuneration for a given calendar year, based on a decision made by the Management Board, in full in cash and in a non-deferred form. The provision is directly and explicitly confirmed in the content of the relevant provisions of Directive 2019/878 / EU (CRD V Directive).

The Bank introduced a change to the Remuneration Policy for Persons having a significant impact on the Bank's risk profile in force in 2020. The change is related to the Recommendation of the Polish Financial Supervision Authority on the expected actions of banks regarding the payment of variable remuneration components in order to effectively respond to the economic effects of the COVID-19 pandemic.
The Policy introduces provisions that will enable the Supervisory Board to decide on granting the Management Board Members the entire bonus for 2020 only in the form of phantom shares. This change is aimed at minimizing the risk associated with maintaining a solid capital base of the Bank in order to be able to effectively respond to the economic situation of the country related to the COVID-19 pandemic.

for 2020 (in PLN thousand)

### Appointment of the Remuneration Committee

On April 18, 2019, the Supervisory Board of mBank Hipoteczny S.A. passed a resolution on the appointment of the Remuneration Committee with the following composition:
As at 31 December 2020, the composition of the Remuneration Committee is as follows:

| | | | |
|---|---|---|---|
| 1. | Frank Bock | - | Chairman |
| 2. | Andreas Boeger | - | Vice-chairman |
| 3. | Marek Lusztyn | - | Member of the Remuneration Committee |

As at December 31, 2019, the composition of the Remuneration Committee was as follows:

| | | | |
|---|---|---|---|
| 1. | Frank Bock | - | Chairman |
| 2. | Andreas Boeger | - | Vice-chairman |
| 3. | Lidia Jabłonowska-Luba | - | Member of the Remuneration Committee |
| 3. | Cezary Kocik | - | Member of the Remuneration Committeeeń |

### Accounting for incentive programs

The benefits of the remuneration program for members of the Management Board and employees who have a significant impact on the Bank's risk profile are accounted for in accordance with IAS 19 Employee Benefits. Both the cash part of the program and the part in phantom shares settled in cash increase the cost of a given period in correspondence with liabilities. Costs are recognized over time throughout the vesting period and are recorded under 'General administrative expenses'. Liabilities due to incentive programs are presented in the statement of financial position under "Other liabilities".

## 42. Related party transactions

All transactions between the Bank and related entities were typical transactions and routine, concluded in the opinion of the Management Board on conditions not deviating from market ja terzby the Bank. Transactions with related entities carried out in the ordinary course of business include loans, debt securities issued and derivative transactions.

The following table presents financial liabilities towards mBank S.A., broken down by contractual maturity dates.

| 31.12.2020 | 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 | - | - | - | 100 039 | 2 355 078 | **2 455 117** |
| Covered bonds and bonds in issue | - | 21 018 | - | 527 979 | 100 | **549 097** |
| Subordinated liabilities | - | - | - | - | 100 149 | **100 149** |
| Liabilities in respect of cash collateral | 672 126 | - | - | - | - | **672 126** |
| Other financial liabilities with deferred payment date | - | - | - | 275 907 | - | **275 907** |
| Derivative financial instruments | 4 421 | 221 | - | - | - | **4 642** |

| 31.12.2019 | 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 | - | - | - | 360 433 | 2 108 615 | **2 469 048** |
| Covered bonds and bonds in issue | - | - | - | 480 508 | 16 069 | **496 577** |
| Subordinated liabilities | - | - | - | - | 200 432 | **200 432** |
| Liabilities in respect of cash collateral | 47 035 | - | - | - | - | **47 035** |
| Other financial liabilities with deferred payment date | - | - | - | 296 413 | - | **296 413** |
| Derivative financial instruments | 76 | - | - | - | - | **76** |

Other financial liabilities with deferred payment term related to a liability resulting from agreements concluded with mBank S.A. on 30 November 2018 on the transfer of retail loans secured with a mortgage on real estate. This liability was repaid on 25 January 2019.

The table below presents the amounts of the Bank's transactions with related entities. The transaction value covers assets and liabilities' balances as at 31 December 2020 and 31 December 2019, and related costs and income for 2020 and 2019.

| (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** | **31.12.2020** | **31.12.2019** | **31.12.2020** | **31.12.2019** | **31.12.2020** | **31.12.2019** | **31.12.2020** | **31.12.2019** | **31.12.2020** | **31.12.2019** |
| **Statement of finacial position** | | | | | | | | | | |
| **Total assets** | **-** | **-** | **251** | **454** | **481** | **472** | **402 994** | **65 088** | **-** | **-** |
| Receivables from Banks | | | | | | | 323 133 | 13 913 | | |
| Derivative financial instruments held for trading | | | | | | | 28 323 | 5 566 | | |
| Receivables from credits | | | 251 | 454 | | | | | | |
| Derivative hedging instruments | | | | | | | 47 564 | 41 204 | | |
| Intangible assets | | | | | | | 49 | 49 | | |
| Other assets | | | | | | | 7 | 17 | | |
| Fixed assets | | | | | 481 | 472 | 3 918 | 4 339 | | |
| **Total liabilities** | **-** | **-** | **-** | **-** | **487** | **475** | **4 061 185** | **3 513 907** | **535 683** | **674 627** |
| Derivative financial instruments held for trading | | | | | | | 4 642 | 76 | | |
| Liabilities due to loans received from the financial sector | | | | | | | 2 455 117 | 2 469 049 | | |
| Cash collateral liabilities | | | | | | | 672 126 | 47 035 | | |
| Liabilities due to deferred payment (retail pooling) | | | | | | | 275 907 | 296 413 | | |
| Subordinated loan | | | | | | | 100 150 | 200 432 | | |
| Covered bonds and bonds | | | | | | | 549 097 | 496 577 | 535 683 | 674 627 |
| Liabilities for the right of use - buildings | | | | | | | 4 146 | 4 325 | | |
| Liabilities due to the right to use - means of transport | | | | | 487 | 475 | | | | |
| **Contingent liabilities** | | | | | | | | | | |
| Liabilities received | - | - | - | - | - | - | 781 789 | 780 601 | - | - |
| Commitment granted | - | - | - | - | - | - | - | - | - | - |
| Guarantee received | | | | | | | 609 909 | | | |
| **Derivatives (purchase, sales)** | | | | | | | | | | |
| IRS contracts | - | - | - | - | - | - | 682 990 | 1 185 768 | - | - |
| FX SWAP contracts | - | - | - | - | - | - | 2 437 063 | 508 083 | - | - |

Property, plant and equipment include lease contracts classified in accordance with IFRS 16, relating to buildings, i.e. rental of office space in Warsaw and Łódź and redemption of the above-mentioned asset components.
The item "Off-balance sheet liabilities granted and received - Guarantee received" relates to a bank guarantee agreement concluded on December 17, 2020 with mBank S.A. on selected commercial credit exposures. Detailed information on the guarantee is described in Note 5.

| (PLN '000) | Supervisory and Management Board members of mBank Hipoteczny S.A./mBank S.A., management personnel of mBank Hipoteczny S.A. | | Other persons and entities related* | | mBank Group companies*** | | mBank S.A. | | Commerzbank Group companies*** | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Year ended** | **31.12.2020** | **31.12.2019** | **31.12.2020** | **31.12.2019** | **31.12.2020** | **31.12.2019** | **31.12.2020** | **31.12.2019** | **31.12.2020** | **31.12.2019** |
| **Income statement** | | | | | | | | | | |
| Interest income | - | - | 10 | 19 | 315 | 338 | 9 930 | 15 977 | - | - |
| Interest expense | - | - | - | - | (12) | (6) | (67 480) | (111 801) | (3 471) | (4 475) |
| Fee and commission income | - | - | - | - | - | - | - | - | - | - |
| Fee and commission expenses | - | - | - | - | (5) | (10) | (5 449) | (6 150) | - | - |
| Net trading income | - | - | - | - | - | - | 28 498 | 14 374 | - | - |
| Other operating income | - | - | - | - | - | - | 65 | 67 | - | - |
| Other operating expenses | - | - | - | - | - | (29) | - | - | - | - |
| Overhead costs, amortisation and depreciation | - | - | - | - | (487) | (597) | (1 620) | (1 664) | - | - |

* Other persons and related parties encompass the loan extended to the a close relative of a member of Supervisory Board of mBank S.A.

** The item "mBank Group companies" includes transactions with the following mBank Group companies: mFinanse S.A., mCentrum Operacji Sp. z o.o., mCorporate Finance S.A., mLeasing Sp. z o.o

*** The item "Commerzbank Group companies" includes transactions of acquisition of mortgage covered bonds on the secondary market by Commerzbank AG and Comdirect Bank AG.

for 2020 (in PLN thousand)

Composition and remuneration of Members of the Bank's Management Board

As at 31 December 2020, the composition of the Management Board was as follows:

Piotr Cyburt — President of the Management Board
Krzysztof Dubejko — Member of the Management Board
Andrzej Kulik — Member of the Management Board

As at 31 December 2019, the composition of the Management Board was as follows:

Piotr Cyburt — President of the Management Board
Andrzej Kulik — Member of the Management Board
Krzysztof Dubejko — Member of the Management Board
Marcin Wojtachnio — Member of the Management Board

As of September 30, 2020, Marcin Wojtachnio resigned from the position of a member of the Management Board.
By Resolution of the Supervisory Board of mBank Hipoteczny S.A. No. 19/2019 of March 26, 2019, to the position of a Member of the Management Board of mBank Hipoteczny S.A. Mr. Krzysztof Dubejko was appointed, who took up the position of a Member of the Management Board for Financial Markets.

Information on the value of remuneration and bonuses paid to the Management Board Members who held their positions at the end of 2020 as at December 31, 2020 is presented below.
and December 31, 2019.

| | | Remuneration paid in 2020 (in PLN) | | |
|---|---|---|---|---|
| | | Gross remuneration | Other benefits* | Settlement of incentive programme in 2020 |
| 1. | Piotr Cyburt | 756 000 | 24 224 | 350 940 |
| 2. | Krzysztof Dubejko | 418 000 | 24 582 | 66 364 |
| 3. | Andrzej Kulik | 510 000 | 48 457 | 136 363 |
| | **Total** | **1 684 000** | **97 263** | **553 667** |

Remuneration of former Management Board members paid in 2020

| | | Wynagrodzenie wypłacone w 2020 roku | | |
|---|---|---|---|---|
| | | Wynagrodzenie zasadnicze brutto | Pozostałe korzyści | Rozliczenie programu motywacyjnego w 2020 roku |
| 1. | Marcin Wojtachnio | 382 500 | 12 732 | 271 778 |
| 2. | Grzegorz Trawiński | 0 | 0 | 208 188 |

| | | Remuneration paid in 2019 (in PLN) | | |
|---|---|---|---|---|
| | | Gross remuneration | Other benefits* | Settlement of incentive programme in 2017 |
| 1. | Piotr Cyburt | 756 000 | 16 773 | 270 728 |
| 2. | Krzysztof Dubejko | 313 333 | 12 312 | 154 805 |
| 3. | Andrzej Kulik | 510 000 | 34 190 | 75 489 |
| 4. | Marcin Wojtachnio | 510 000 | 16 947 | 230 330 |
| | **Total** | **2 089 333** | **80 221** | **731 351** |

* "Other benefits" include co-financing of medical care, insurance, multisport cards, company car

As at 31 December 2020, the amount of the provision for bonuses / bonuses for employees and the Bank's Management Board was PLN 5,243 thousand. PLN, including the amount of the provision for variable remuneration for Members of the Bank's Management Board and employees who have a significant impact on the Bank's risk profile, 3 654 thous. PLN (as at December 31, 2019, PLN 7,729 thousand; PLN 4,854 thousand, respectively). The variable remuneration program for Members of the Management Board and employees who have a significant impact on the Bank's risk profile is described in Note 41.

for 2020 (in PLN thousand)

Composition and remuneration of Members of the Bank's Supervisory Board

On 11 March 2019, Mr Jakub Fast resigned from the Supervisory Board of mBank Hipoteczny S.A., with effect from 31 March 2019.

On April 24, 2020, Mr. Cezary Kocik resigned from the function of a Member of the Supervisory Board of mBank Hipoteczny S.A., with effect from May 15, 2020.

By Resolution No. 1 of the Extraordinary General Meeting of Shareholders of May 15, 2020 as a member of the Supervisory Board of mBank Hipoteczny S.A. Mr. Łukasz Witkowski was appointed.

By Resolution No. 2 of the Extraordinary General Meeting of Shareholders of November 13, 2020 as a member of the Supervisory Board of mBank Hipoteczny S.A. Mr. Marek Lusztyn was appointed in connection with the resignation of Ms. Lidia Jabłonowska-Luba on October 22, 2020.

The composition of the Supervisory Board of mBank Hipoteczny S.A. as at 31 December 2020:

| | | | |
|---|---|---|---|
| 1. | Frank Bock | - | Chairman of the Supervisory Boar |
| 2. | Marek Lusztyn | - | Vice-chairman of the Supervisory Board |
| 3. | Aleksandra Buczkowska | - | Member of the Supervisory Board |
| 4. | Andreas Boeger | - | Member of the Supervisory Board |
| 5. | Paweł Graniewski | - | Independent Member of the Supervisory Board |
| 6. | Michał Popiołek | - | Member of the Supervisory Board |
| 7. | Mariusz Tokarski | - | Independent Member of the Supervisory Board |
| 8. | Łukasz Witkowski | - | Member of the Supervisory Board |

In 2020, the Supervisory Board worked without remuneration, except for Mr. Paweł Graniewski and Mr. Mariusz Tokarski, who, as Supervisory Board Members, received remuneration for 2019 in the amount of PLN 120 thousand. (respectively PLN 60 thousand).

The composition of the Supervisory Board of mBank Hipoteczny S.A. as at 31 December 2019:

| | | | |
|---|---|---|---|
| 1. | Frank Bock | - | Chairman of the Supervisory Board, Member of the Risk Committee |
| 2. | Lidia Jabłonowska-Luba | - | Deputy Chairwoman of the Supervisory Board, Member of the Risk Committee |
| 3. | Andreas Boeger | - | Member of the Supervisory Board, Member of the Audit Committee |
| 4. | Paweł Graniewski | - | Independent Member of the Supervisory Board, Chairman of the Audit Committee |
| 5. | Cezary Kocik | - | Member of the Supervisory Board |
| 6. | Michał Popiołek | - | Member of the Supervisory Board, Member of the Risk Committee |
| 7. | Mariusz Tokarski | - | Independent Member of the Supervisory Board, Member of the Audit Committee |
| 8. | Paweł Przybyłek | - | Member of the Supervisory Board |

In 2019, the Supervisory Board worked without remuneration, with the exception of Mr. Paweł Graniewski and Mr. Mariusz Tokarski, who, as Supervisory Board Members, received remuneration for 2019 in the amount of PLN 120 thousand. (respectively PLN 60 thousand).

On March 11, 2019, Mr. Jakub Fast resigned from the function of a Member of the Supervisory Board of mBank Hipoteczny S.A., with effect from March 31, 2019.

By Resolution No. 3 of the Extraordinary General Meeting of Shareholders of May 28, 2019, as a member of the Supervisory Board of mBank Hipoteczny S.A. Mr. Paweł Przybyłek was appointed. Pursuant to the wording of paragraph 14 section 1 point 5 of the By-laws of mBank Hipoteczny S.A., In the form of a resolution, the General Meeting decides on the election and dismissal of members Of the Supervisory Board and determining the principles of their remuneration.

Pursuant to the wording of paragraph 3 section 1 point 9 of the Regulations of the Supervisory Board mBank Hipoteczny S.A. determining the terms of contracts and remuneration for members of the Bank's Management Board is within the competence of the Supervisory Board.

## 43. Information on the registered audit company

By Resolution No. 20/2020 of March 26, 2020, the Supervisory Board of mBank Hipoteczny S.A., acting on the basis of paragraph 26 sec. 8 of the Bank's Articles of Association, selected Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością spółka komandytowa (EY) as the auditor to audit the Bank's financial statements for the years 2020-2022.

On June 29, 2020, mBank Hipoteczny S.A. concluded an agreement with EY to audit the financial statements for 2020-2022.

Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością spółka komandytowa

with its seat in Warsaw, Rondo ONZ 1, 00-124 Warsaw, is entered on the list of auditors authorized to audit financial statements under number 130.

The total amount of EY's remuneration in 2020 was PLN 295 thousand. gross PLN (in 2019 it was PLN 716 thousand gross), including:

- due to the audit of the financial statements of mBank Hipoteczny S.A. and the examination of reporting packages for 2020 amounted to 189 thousand. gross PLN (for 2019 it was 270 thousand PLN gross),

- due to the review of the financial statements of mBank Hipoteczny S.A. for the first half of 2020, reporting packages for the first half of 2020, reporting packages for mBank S.A. as at December 31, 2020, it amounted to 106 thousand gross PLN (respectively for 2019 it amounted to PLN 138 thousand gross),

## 44. Capital adequacy

One of the Bank's main tasks is to ensure an appropriate level of capital. Within the framework of the capital management policy, the Bank prepares the guidelines for the most effective planning and use of capital basis which:

- are compliant with external and internal regulations in force,
- guarantee a continuity of financial targets, which render an appropriate rate of return for shareholders,
- ensure the maintenance of a strong capital basis being a fundamental support for business development.

The Bank's capital management policy is based on two basic pillars:

- maintenance of an optimal level and structure of own funds with the application of available methods and means, like retention of net profit, subordinated loan or issue of shares,
- effective use of existing capital, among others through application of a set of measures of effective use of the capital, limitation of activities that do not provide an expected rate of return and development of products with lower capital absorption.

Effective use of capital is an integral part of the capital management policy oriented at reaching an optimal rate of return on capital and as a result forming a stable foundation of reinforcement of the capital basis in future periods. This helps to maintain the Tier 1 common equity ratio (calculated as the quotient of Tier 1 common equity and total amount of risk exposure), Tier 1 capital ratio (calculated as the quotient of Tier 1 capital and total amount of risk exposure), and combined capital ratio (calculated as the quotient of own funds and total amount of risk exposure), at a level significantly higher than required by the regulatory authority.

The strategic capital objectives of the Bank are aimed at maintaining both the combined capital ratio and the Common Equity Tier 1 capital ratio at a level significantly higher than required by the regulatory authority. This permits a safe growth of the business while meeting supervision standards in long term.

for 2020 (in PLN thousand)

## Capital ratios

The measurement of own funds adequacy, including i.a. calculation of capital ratios and leverage ratio, own funds and the Bank's total exposure to risk, is performed on the basis of the following regulations:

- Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 as amended (hereinafter referred to as CRR Regulation) and other Commission (EU) implementing regulations to the CRR Regulation,
- Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council with further amendments (ITS Regulation),
- Act of 29 August 1997 — Banking Law (Journal of Laws of 2002 No 72, item 665) as amended,
- Act of 5 August 2015 (Journal of Laws 2015, item 1513) on the macro-prudential oversight of the financial system and crisis management in the financial system ("Macro Prudential Oversight Act"),
- Regulation of the Minister of Development and Finance of 25 May 2017 on the application of higher risk weights to credit exposures secured by mortgages on real estate property,
- Regulation of the Minister of Development and Finance of 1 September 2017 on the systemic risk buffer.

In connection with the Macro-Prudential Oversight Act coming into force as of 1 January 2016, which transposes CRD IV into the Polish legal regime, as at 31 December 2019 the Bank was compelled to maintain own funds as such a level as would permit covering the conservation buffer determined under the Act at 2.5% of the total exposure to risk.

In accordance with the decision of the Financial Stability Committee, the anti-cycle buffer imposed on the Bank as at 31 December 2019 was 0%.

On March 19, 2020, the repeal of the regulation on the systemic risk buffer entered into force. The value of the systemic buffer as at 31 December 2020 is 0% of the total risk exposure amount. Ultimately, the combined buffer requirement for mBank Hipoteczny S.A. at the end of 2020 it was 2.5%

Capital ratios both as at the end of 2020 and at the end of 2019 were above the minimum required values, which was presented in the table below. In 2020 and 2019, the Bank met external capital requirements.

| Capital ratio | 31.12.2020 | |
|---|---|---|
| | Minimum ratio | Presented ratio |
| Total capital ratio | 10,50% | 19,22% |
| Equiety Tier 1 capital ratio | 8,50% | 17,73% |
| Equiety Tier 1 core capital ratio | 7,00% | 17,73% |

| Capital ratio | 31.12.2019 | |
|---|---|---|
| | Minimum ratio | Presented ratio |
| Total capital ratio | 13,50% | 18,24% |
| Equiety Tier 1 capital ratio | 11,50% | 15,45% |
| Equiety Tier 1 core capital ratio | 10,00% | 15,45% |

The Bank decided that for the purposes of capital adequacy calculation, including the calculation of own funds, based on Article 1(9) of the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 12 December 2017 (Regulation) amending the CRR, it will not apply the transitional period, which permits to alleviate the impact on capital, connected with the implementation of IFRS 9.

The capital ratios, own funds, leverage ratio reported in this document fully reflect the impact of IFRS 9.

## Own funds

In accordance with the CRR Regulation, own funds consist of Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital, however mBank Hipoteczny S.A. does not identify items that could be treated as Additional Tier 1 capital.

Common Equity Tier 1 capital of mBank Hipoteczny S.A. encompasses:

- paid-up equity instruments and the related share premium accounts,
- earnings retained in previous years,
- independently verified interim profits,
- other accumulated comprehensive income,
- other capital reserves,
- general risk funds,
- items reducing the Common Equity Tier 1 capital (value adjustments due to the requirements regarding prudent valuation, intangible assets, deficiency in credit risk adjustments in light of anticipated losses, regulatory adjustments concerning other accumulated comprehensive income, and net write-downs).

Tier 2 capital of mBank Hipoteczny S.A. encompasses subordinated liabilities.

The Bank's own funds as at December 31, 2020 amounted to PLN 1,289,735 thousand. PLN (as at December 31, 2019, they amounted to PLN 1,308,385 thousand). At the same time, the Common Equity Tier I capital amounted to PLN 1,189,735 thousand. PLN (as at December 31, 2019 it was PLN 1 108 385 thousand).

## Leverage ratio

The regulatory leverage ratio as at 31 December 2018 was calculated on the basis of the provisions of Commission Delegated Regulation (EU) 2015/62 of 10 October 2014 amending Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to the leverage ratio (hereinafter: "Regulation 2015/62").

The leverage ratio is calculated as a measure of Tier 1 capital divided by the total exposure measure and is expressed as a percentage. The total exposure measure is the sum of the exposure values specified in accordance with Regulation 2015/62 in respect of all assets and off-balance sheet items not deducted when determining the measure of Tier 1 capital.

Tier 1 capital to the leverage ratio was calculated in accordance with Regulation 575/2013 using national options defined in the Banking Law, Art. 171a. The financial leverage ratio at the end of 2020 was 9.46%, at the end of 2019 it was 8.37%.

## Total risk exposure amount (TREA)

The total amount of risk exposure of the Bank consists of:

- risk-weighted exposure amount for credit risk, counterparty credit risk, calculated using the IRB slotting approach and a standardised approach for exposures permanently excluded from the IRB approach as well as exposures subject to temporary exclusion,
- operational risk exposure amount,

There is no trading portfolio in the Bank, therefore, the Bank does not calculate risk-weighted exposure amounts in relation to other types of risks.

In calculation of the Bank's capital ratios, the total risk exposure amount is determined taking into account the credit risk exposure amount, applying the internal ratings based approach, with the use of the supervisory approach, in regard to assigning specialised lending exposures to risk categories (IRB slotting approach).

for 2020 (in PLN thousand)

As at 31 December 2020, the Bank's total risk exposure amount was PLN 6,711,021 thousand, including the credit risk exposure amount at PLN 6,229,822 thousand (including other noncredit obligations assets – PLN 56,540 thousand).

The table below presents credit exposures for which the requirement was calculated using the IRB slotting approach broken down into supervisory categories of risk and standardised approach as at 31 December 2020.

IRB slotting approach

| 31.12.2020 | | | | | | |
|---|---|---|---|---|---|---|
| **Regulatory categories** | **Remaining maturity** | **On-Balance - shet amount** | **Off-Balance - shet amount** | **Risk weight** | **Exposure amount** | **RWAs** |
| Category 1 | Equal to or more than 2.5 years | 1 713 | - | 70% | 1 715 | 1 200 |
| Category 2 | Less than 2.5 years | 279 897 | 37 589 | 70% | 281 081 | 196 757 |
| | Equal to or more than 2.5 years | 2 100 160 | 23 662 | 90% | 2 118 003 | 1 906 203 |
| Category 3 | Less than 2.5 years | 82 655 | - | 115% | 84 417 | 97 079 |
| | Equal to or more than 2.5 years | 229 412 | - | 115% | 236 819 | 272 341 |
| Category 4 | Equal to or more than 2.5 years | 4 976 | - | 250% | 5 027 | 12 569 |
| Category 5 | Less than 2.5 years | 42 819 | - | - | 52 394 | - |
| | Equal to or more than 2.5 years | 186 385 | - | - | 274 920 | - |
| **Total** | **Less than 2.5 years** | **405 371** | **37 589** | | **417 892** | **293 836** |
| | **Equal to or more than 2.5 years** | **2 522 646** | **23 662** | | **2 636 484** | **2 192 313** |

Standardised approach

| **31.12.2020** | **Exposures before CCF and CRM** | | **Exposures post CCF and CRM** | | **RWAs** |
|---|---|---|---|---|---|
| **Kategorie ekspozycji** | **On-Balance -shet amount** | **Off-Balance - shet amount** | **On-Balance - shet amount** | **Off-Balance - shet amount** | |
| Central governments or central banks | 825 079 | - | 825 079 | - | 11 320 |
| Regional goverrment or local authorities | 42 180 | - | 145 987 | - | 29 197 |
| Public sector entities | 43 064 | - | - | - | - |
| Institutions | 737 928 | - | 737 928 | - | 104 360 |
| Corporates | 60 743 | - | - | - | - |
| Retail | 1 443 302 | 618 | 1 443 302 | 309 | 1 082 708 |
| Secured by mortgages on immovable property | 6 878 804 | 4 484 | 6 878 804 | 2 242 | 2 431 610 |
| Exposures in default | 27 537 | 0 | 27 537 | - | 27 929 |
| Equity | 9 | 0 | 9 | - | 9 |
| **Total** | **10 058 646** | **5 102** | **10 058 646** | **2 551** | **3 687 133** |

The total amount of exposure to the Bank's risk as at December 31, 2019 was PLN 7,176,049 thousand. PLN, of which the amount of exposure to risk due to credit risk was PLN 6 800 860 thousand. PLN (including other assets that do not generate a credit obligation PLN 24 702 thousand).

The tables below present the credit exposures for which the requirement was calculated using the standard method and the IRB slotting approach, broken down by supervisory risk categories as at December 31, 2019.

for 2020 (in PLN thousand)

IRB slotting approach

| 31.12.2019 | | | | | | | |
|---|---|---|---|---|---|---|---|
| Regulatory categories | Remaining maturity | On-Balance - shet amount | Off-Balance - shet amount | Risk weight | Exposure amount | RWAs |
| Category 1 | Equal to or more than 2.5 years | 3 090 | - | 70% | 3 091 | 2 163 |
| Category 2 | Less than 2.5 years | 236 969 | 121 308 | 70% | 237 294 | 166 106 |
| | Equal to or more than 2.5 years | 3 370 662 | 268 030 | 90% | 3 384 887 | 3 046 398 |
| Category 3 | Less than 2.5 years | 2 272 | - | 115% | 2 340 | 2 691 |
| | Equal to or more than 2.5 years | 225 742 | 52 113 | 115% | 229 985 | 264 483 |
| Category 4 | Equal to or more than 2.5 years | 16 453 | - | 250% | 16 577 | 41 442 |
| Category 5 | Less than 2.5 years | 46 000 | - | - | 80 799 | - |
| | Equal to or more than 2.5 years | 187 647 | - | - | 301 045 | - |
| **Total** | **Less than 2.5 years** | **285 241** | **121 308** | | **320 433** | **168 797** |
| | **Equal to or more than 2.5 years** | **3 803 594** | **320 143** | | **3 935 585** | **3 354 486** |

Standardised approach

| 31.12.2019 | Exposures before CCF and CRM | | Exposures post CCF and CRM | | RWAs |
|---|---|---|---|---|---|
| Exposure classes | On-balance-sheet amount | Off-balance-sheet amount | On-balance-sheet amount | Off-balance-sheet amount | |
| Central governments or central banks | 1 267 424 | - | 1 267 424 | - | 26 138 |
| Regional government or local authorities | 49 536 | - | 161 782 | - | 32 356 |
| Public sector entities | 47 890 | - | - | - | - |
| Institutions | 290 784 | - | 290 784 | - | 83 058 |
| Corporates | 64 356 | - | - | - | - |
| Retail | 1 108 293 | 1 436 | 1 108 293 | 718 | 831 760 |
| Secured by mortgages on immovable property | 6 373 694 | 5 157 | 6 373 694 | 2 579 | 2 256 066 |
| Exposures in default | 22 117 | - | 22 117 | - | 23 489 |
| Equity | 8 | - | 8 | - | 8 |
| **Total** | **9 224 102** | **6 593** | **9 224 102** | **3 297** | **3 252 875** |

## Internal capital

The purpose of the ICAAP process (Internal Capital Adequacy Assessment Process), implemented in the Bank, is to keep own funds at the level adequate to the risk profile and the risk level stemming from the Bank's operations.

Due to the fact that the total capital requirement of Bank calculated according to the CRR Regulation and internal capital assessed for the Bank according to the Regulation of the Minister of Development and Finance of 6 March 2017 on the risk management system and internal control system, remuneration policy and detailed method of estimation of internal capital in banks, are lower than the value of the Bank's own funds, as at 31 December 2019 the Bank maintained own funds at a level consistent with the CRR.
The internal capital of the Bank as at 31 December 2020 amounted to PLN 376,123 thousand. PLN, (per day On December 31, 2019, it amounted to PLN 428,976 thousand. PLN.

for 2020 (in PLN thousand)

| Capital adequacy | 31.12.2020 | 31.12.2019 |
|---|---|---|
| **Common Equity Tier 1 Capital** | **1 189 735** | **1 108 385** |
| **Own funds** | **1 289 735** | **1 308 385** |
| Risk weighted exposure amounts for credit risk, counterparty credit risk, dilution risk and deliveries with deferred settlement date: | 6 229 822 | 6 800 860 |
| - using internal rating method | 2 542 689 | 3 547 985 |
| - using standard method | 3 687 133 | 3 252 875 |
| Total operational risk exposure amount | 318 441 | 288 769 |
| Total CVA exposure amount | 162 758 | 86 420 |
| **The total amount of risk exposure** | **6 711 021** | **7 176 049** |
| **Common Equity Tier 1 capital ratio** | **17,73%** | **15,45%** |
| **Total capital ratio** | **19,22%** | **18,23%** |
| **Internal capital** | **376 123** | **428 976** |

| Own funds | 31.12.2020 | 31.12.2019 |
|---|---|---|
| **Own funds** | **1 289 735** | **1 308 385** |
| **TIER 1 CAPITAL** | **1 189 735** | **1 108 385** |
| **Common Equity Tier 1 Capital** | **1 189 735** | **1 108 385** |
| Capital instruments eligible as CET1 Capital | 884 631 | 884 631 |
| Paid up capital instruments | 336 000 | 336 000 |
| Share premium | 548 631 | 548 631 |
| Retained earnings | - | - |
| Retained earnings from previous years | - | - |
| Profit or loss eligible | - | - |
| Other accumulated comprehensive income | 4 450 | 3 065 |
| Other reserves | 338 032 | 300 948 |
| General banking risks founds | 44 800 | 44 800 |
| (-) Value adjustments due to the requirements for prudent valuatio | (1 217) | (1 504) |
| (-) Intangible assets | (16 415) | (48 288) |
| (-) Other intangible assets gross amount | (16 931) | (48 620) |
| Deferred tax liabilities associated to other intangible assets | 516 | 332 |
| (-) IRB shortfall of credit risk adjustments to expected losses | (64 546) | (58 048) |
| Other transitional adjustments to CET1 Capital | - | - |
| CET1 capital elements or deductions - other | - | (17 219) |
| Impact of IFRS 9 | - | - |
| **Additional Tier 1 capital** | - | - |
| **TIER 2 CAPITAL** | **100 000** | **200 000** |
| Capital instruments and subordinated loans eligible as T2 capital | 100 000 | 200 000 |

## 45. Other information

As of January 1, 2020, mBank Hipoteczny S.A. joined the Tax Capital Group ("PGK"), established pursuant to the provisions of the Corporate Income Tax Act. The PGK consists of: mBank S.A. as the parent entity and representing the PGK within the scope provided for by tax law and other subsidiaries of mBank Group: mFinanse S.A. and mLeasing Sp. z o. o. In the year preceding the establishment of the PGK there were no tax losses in the companies forming it. The PGK agreement was concluded for 4 years.

## 46. Post balance-sheet date events

From December 31, 2020 until the approval of these financial statements, there were no events that would require additional disclosure in these financial statements.