

**Management Board Report
on the performance of mBank Hipoteczny S.A.
in the first half of 2017**

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1. Activity of mBank Hipoteczny S.A. in the first half of 2017

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

In the period May – June 2017, the Bank started preparing for another change in how the strategy is implemented. The key assumptions of the strategy remain unchanged. The Bank is performing the function of financing loans secured with mortgages based on its issuing capacity as part of a wider balance sheet management strategy of the mBank Group and is gradually expanding its share in the mortgage bond market. However, a condition appeared for changing the model for selling retail mortgage products within the mBank Group. It is now assumed that starting from the end of July 2017, all sales of such products will be executed solely by mBank S.A. as part of a uniform process of loan selling and post-selling activities. As a result, the sourcing of retail assets for the Bank will change. The approach based on purchasing receivables from mBank S.A., i.e. transaction pooling, will fully replace the current leading model in which retail mortgage loans are sold directly by the Bank.

There are two lines of business in the Bank:

- retail, focusing on granting mortgage loans to private individuals, which will be based on transaction pooling from mBank S.A. after the planned change has been implemented;
- commercial, focused on providing the financing of commercial real estate and residential real estate to developers.

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

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

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

In the area of commercial projects, one could note a reduction in the investors' activity in real estate trading which was due to changes in tax interpretations.

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

- maintaining a high level of developers' activity in project execution;
- maintaining a low level of loan utilization due to an increased share of construction projects financed by the buyers of apartments;
- liberal approach of banks to assessment of projects, in particular in terms of own contributions and pre-sales along with strong pressure on banks to lower the margins.

Within the Bank, in terms of commercial and residential facilities, the levels of margins were maintained.

1.1. Key projects in the first half of 2017

The "covered bonds" project

The project of rebuilding of the balance sheet of mBank Group on the basis of long-term source of financing in a form of covered bonds issued by mBank Hipoteczny continued to be the highest priority venture in the first half of 2017. Works on the project started in August 2012, and their purpose was preparation of a comprehensive model of cooperation between a mortgage and a universal bank in terms of sales, service and management of retail mortgage loans portfolio and then issuing of covered bonds on its basis.

The implementation of the model aims at:

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

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

Implementation of IRB method

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

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

Implementation of the Regulation on personal data protection

In connection with the entry into force of the general Regulation on personal data protection (RPDP), the RPDP Project Team was appointed by resolution of the Bank's Management Board. The Bank started cooperating with an external law firm DLA Piper specializing in information security. Currently, in cooperation with DLA Piper, an analysis of information systems used to process personal data administered by the Bank is being conducted. The analysis is aimed at verifying the compliance of the systems with the currently applicable Act on personal data protection and the provisions of the RPDP.

Common Reporting Standard (CRS) project

The Bank completed work on the implementation of the requirements set out in the Act of 9 March 2017 on exchanging tax information with other countries, which implements the related EU law in the Polish legal system and enables exchanging information with non-EU countries based on the Common Reporting Standard procedure.

Implementation of the Regulation of the Minister of Development and Finance on the risk management system and the internal control system, and of Recommendation H

In connection with the entry into force of the Regulation of the Minister of Development and Finance on the risk management system and the internal control system, remuneration policy and the detailed

manner of estimating the internal capital in banks of 6 March 2017 (hereinafter: the Regulation) and the publication by the Polish Financial Supervision Authority of Recommendation H relating to the internal control system in banks, work was started on the implementation of the Regulation and Recommendation H: a Project Team was appointed by resolution of the Management Board of the Bank and a gap analysis was prepared for the Regulation and Recommendation H. Currently, work is in progress on aligning internal procedures with the provisions of the Regulation and Recommendation H.

Implementation of Recommendation W

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

IFRS 9

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

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

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

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

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

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

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

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

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

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

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

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

1.2. Financial credibility

Financial credibility of mBank Hipoteczny is assessed by an international rating agency - Fitch Ratings Ltd. As of 30 June 2017 the following ratings applied:

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

2 - support rating

A - for mortgage covered bonds

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

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

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

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

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

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

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

On 23 June 2017, Fitch Ratings Ltd. confirmed the rating of mortgage bonds at "A" level with a positive outlook, indicating an improvement in the risk characteristics of the collateral register and an increase in over-collateralization.

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

- long-term international/domestic ratings: AAA, AA, A, BBB, BB, B, CCC, CC, C, RD, D
- short-term international/domestic ratings: F1, F2, F3, B, C, RD, D
- support ratings: 1, 2, 3, 4, 5

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

1.3. Financial results

The financial statement of the Bank for the first half of 2017 was prepared according to the International Financial Reporting Standards binding in the European Union (IFRS). The data presented in the Management Board Report are presented in the management view and they do not have to be consistent with the data included in the Financial Statement.

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

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

| Main balance sheet items | 30.06.2017 | 31.12.2016 | Dynamics |
|---------------------------------------|------------|------------|----------|
| ASSETS | 11,335,233 | 10,649,499 | 6.44% |
| Including | | | |
| Loans granted to customers | 10,173,290 | 9,411,505 | 8.09% |
| LIABILITIES AND EQUITY | 11,335,233 | 10,649,499 | 6.44% |
| Including | | | |
| Debt securities in issue ¹ | 6,158,931 | 6,152,771 | 0.10% |
| Share capital | 734,719 | 614,792 | 19.51% |

In the first half of 2017 the Bank achieved a positive gross result in the amount of PLN 16,999 thousand. Due to a specialised activity profile in which the main source of the Bank's result is the interest income, the financial result in the first half of 2017 was greatly influenced by low interest rates and strong pressure on margins. Despite this, the Bank reported a growth in the net interest income compared to the first half of 2016 (by PLN 12,135 thousand or 20.19%).

The total value of administrative expenses, amortization and depreciation increased compared to the first half of 2016. The cost to income ratio rose to 54.36% from 48.96% at the end of 2016.

¹ In the first half of 2017, the Bank changed the presentation of the hedge accounting difference relating to the fair value of hedged items in such a way that the adjustment is presented jointly with the hedged item in the line "Debt securities in issue", which is consistent with IAS 39. The presentation change was applied to all comparable periods presented in the financial statements.

mBank Hipoteczny S.A.Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2017

Introduction of the bank tax on 1 February 2016 had a material impact on the results recorded by the Bank. Due to the specialization and narrow range of the products offered, the Bank was unable to compensate the effects of the bank tax. Before the tax, the Bank's operating result amounted to PLN 28,219 thousand, as compared to 19,835 thousand in the first half of 2016, which represents an increase by 42.27%. After the tax, the gross result was still significantly higher than in the previous year (by PLN 3,612 thousand or 26.98%).

In the first half of 2017 the income of the Bank, calculated as the sum of net interest income, net fee and commission income, net trading income, other operating income and other operating expenses, amounted to PLN 65,642 thousand (the first half of 2016: PLN 63,022 thousand). This income pertains in whole to the activity conducted within the Republic of Poland.

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

| Profit and loss account | Period from 01.01.2017 to 30.06.2017 | Period from 01.01.2016 to 31.12.2016 | Dynamics |
|---|--|--|----------------|
| Net interest income | 72,225 | 60,090 | 20.19% |
| Net fee and commission income | (3,119) | 1,367 | - |
| Net trading income | (3,425) | 2,024 | - |
| Net impairment write-downs on loans and advances | (1,742) | (10,351) | -83.17% |
| Overhead costs | (34,118) | (31,191) | 9.38% |
| Amortisation and depreciation | (1,563) | (1,645) | -4.99% |
| Operating result | 28,219 | 19,835 | 42.27% |
| Tax on the Bank's balance sheet items | (11,220) | (6,448) | 74.01% |
| Gross profit | 16,999 | 13,387 | 26.98% |
| Income tax | (6,743) | 379 | - |
| Net profit | 10,256 | 13,766 | -25.50% |
| Weighted average number of ordinary shares / weighted average diluted number of ordinary shares | 3,172,210 | 2,993,846 | 5.96% |
| Net profit per ordinary share / Diluted profit per ordinary share (in PLN) | 3.23 | 4.60 | -29.78% |

Table 3. Effectiveness ratios

| PERFORMANCE INDICATORS | 30.06.2017 | 31.12.2016 |
|--|------------|------------|
| ROA net ¹⁾ | 0.19% | 0.24% |
| ROA gross ¹⁾ | 0.31% | 0.31% |
| ROE net ³⁾ | 2.10% | 2.81% |
| ROE gross ⁴⁾ | 3.47% | 3.62% |
| Cost to income ratio (C/I) ⁵⁾ | 54.36% | 48.96% |
| Net interest margin ⁶⁾ | 1.34% | 1.37% |
| Cost of risk ⁷⁾ | 0.04% | 0.26% |
| Total Capital Ratio | 15.82% | 14.54% |
| RATINGS Fitch Ratings Ltd | | |
| long-term international rating | BBB | BBB |
| short-term international rating | F2 | F2 |
| support rating | 2 | 2 |
| mortgage covered bonds | A | A |

| OTHER | | |
|------------|----------------------|-----------------------|
| Employment | 222 osoby/214 etatów | 227 osób / 218 etatów |

mBank Hipoteczny S.A.**Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2017**

| | | |
|--------------------|---------------------------|---------------------------|
| Average employment | 225 osób | 227 osób |
| Facilities | Headquarters + 6 branches | Headquarters + 6 branches |

1) net result / average assets

2) gross result / average assets

3) net result / average equity

4) gross result / average equity

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

6) interest income / average earning assets

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

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

Chart 1. Key financial ratios

■ 12.2016 ■ 06.2017

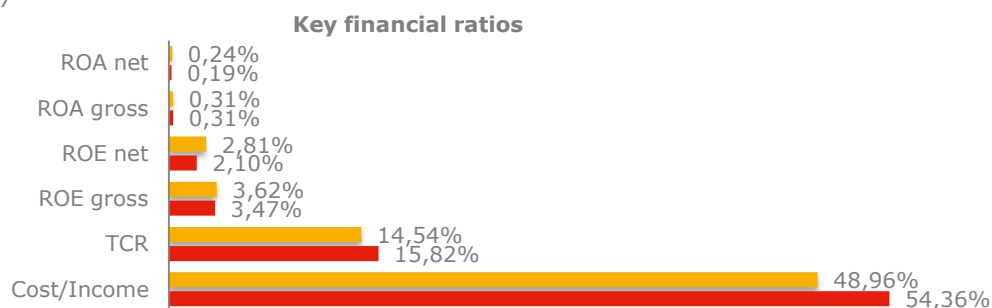
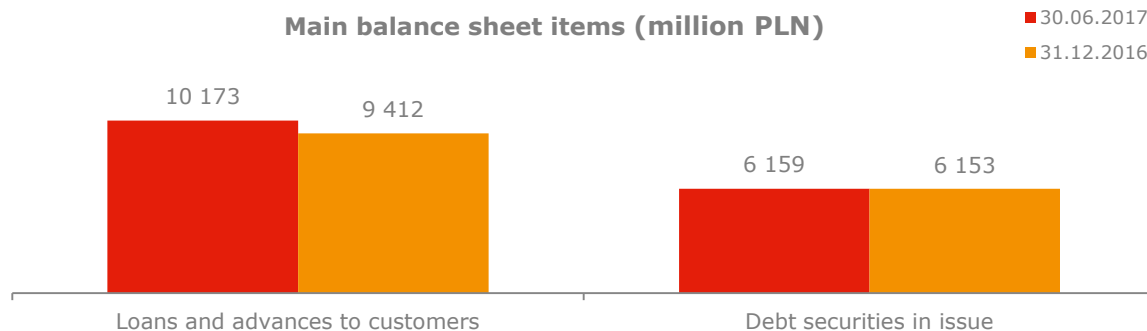


Chart 2. Main balance sheet items (in PLN million)



1.4. Lending

In the first half of 2017 the Bank developed its activity in both corporate and retail loan areas. The value of sales reached PLN 1.737 million and was lower by 22.9% than the value of agreements signed in the first half of 2016, due to lower sales in the commercial area. The net value of the whole loans portfolio, taking into account off-balance sheet liabilities, increased by the end of June 2017 compared to the end of 2016 by 8.6%, reaching PLN 11.6 billion.

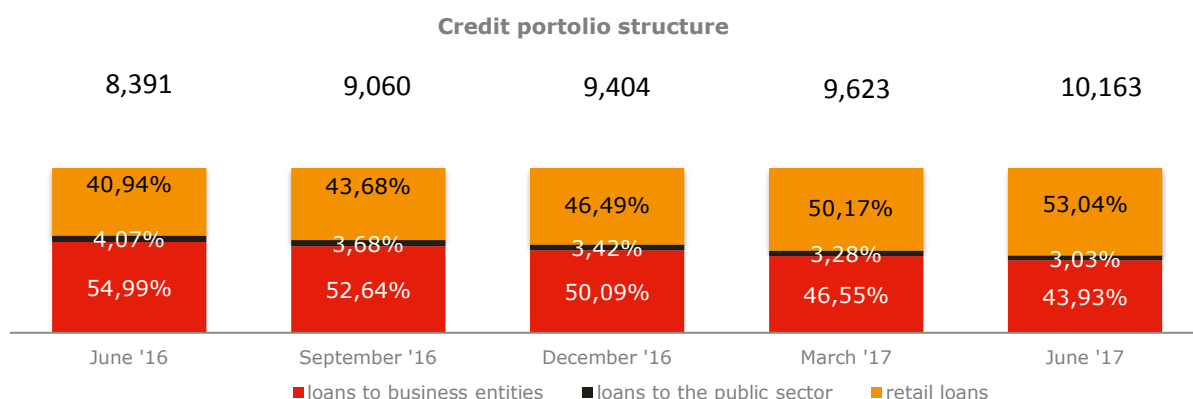
In the first half of 2017, sales of corporate loans amounted to PLN 409 million, of which PLN 283 million represented housing developers and PLN 126 million - the financing of commercial facilities. In the comparable period of 2012-15, the share of the first half of the year in annual sales ranged between 24-36%, with the exception of 2016, which saw record high sales, when the share was 68%.

mBank Hipoteczny S.A.Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2017

The lower sales to date were affected by seasonality, but mainly by a change in the tax interpretations relating to buying and selling commercial real estate. Investors delayed transactions waiting for clear new interpretations. In addition, in the second half of 2017, a "commercial pooling" from mBank for the minimum of PLN 200 million will be executed. The total amount of applications being processed at various stages amounting to PLN 1,877 million seems to confirm the expectation of higher sales in the second half of 2017.

In the retail area, within the scope of implementation of the strategy of the mBank Group, the Bank recorded an increase of PLN 1,018 million in the retail mortgage portfolio. Sales of credits in the agency model amounted to 1,327.2 million. There were no pooling transactions in the first half of 2017.

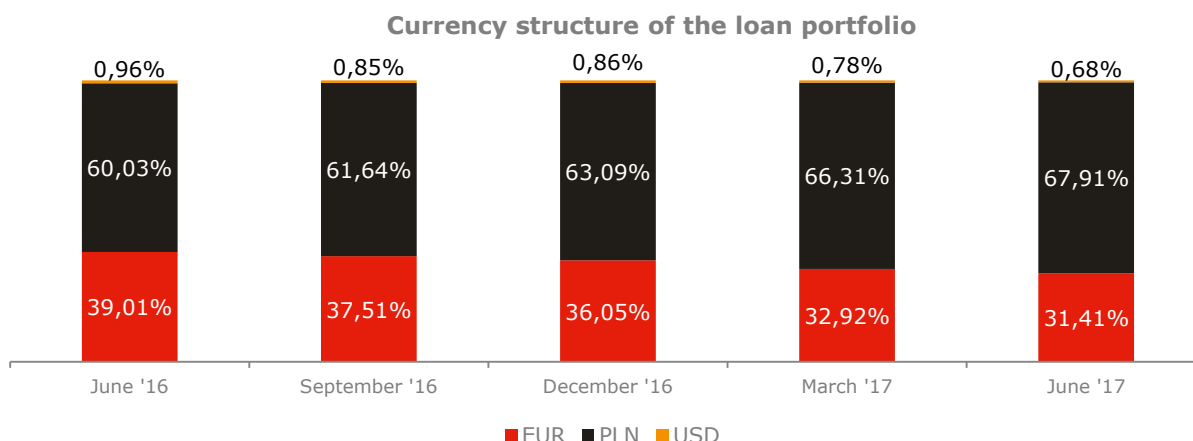
Chart 3. The structure of the loan portfolio in the period 30.06.2016 – 30.06.2017 (in PLN million)



The currency structure of the loan portfolio in 2017 was subject to change due to systematic growth of retail credit portfolio granted in PLN only. Compared to the end of June 2016, the share of PLN loans increased by 7.9 percentage points by the end of June 2017. They constituted 67.9% of the loan portfolio. The share of EUR loans decreased to the level of 31.4%.

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

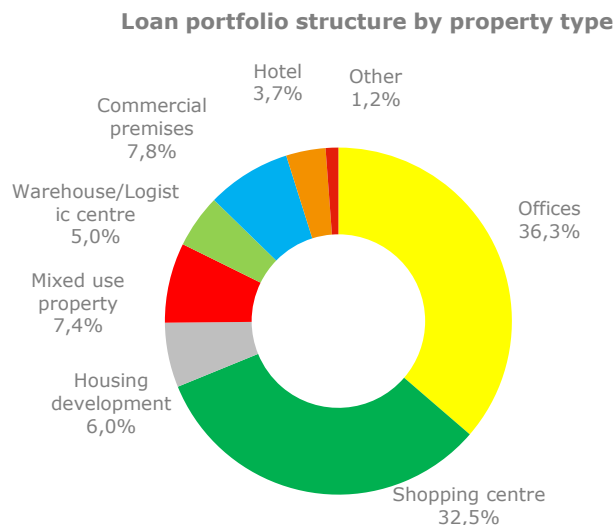
Chart 4. The currency structure of the loan portfolio in the period 30.06.2016 – 30.06.2017



Corporate loans

Net balance sheet exposure to business entities as of 30 June 2017 amounted to PLN 4,465 million. The dominant part (86.9%) accounted for refinancing of completed commercial facilities, the exposure in housing projects constituted 6.0%, and credits for financing of construction of commercial objects 7.1%.

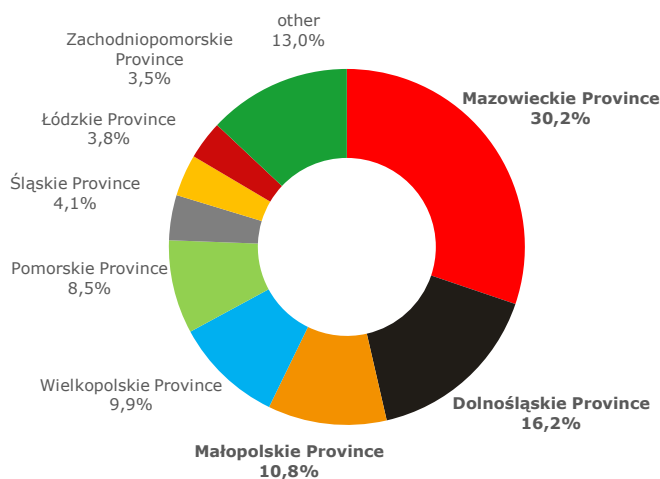
Chart 5. Corporate loans by type of financed real estate as of 30 June 2017



As of the end of June 2017, in the area of commercial real estates the Bank financed in particular office buildings and shopping centres. The Bank focused on financing of the purchase or refinancing of completed facilities of appropriate standard and financing of the construction process upon the completion of which the construction loan is converted into a long-term mortgage.

Chart 6. Geographical concentration of loan portfolio for business entities as of 30 June 2017

Geographical concentration of loans to business entities



The largest number of financed projects is concentrated in Mazowieckie province, where 30.2% of all credit resources is involved. In Dolnośląskie, Małopolskie and Wielkopolskie province the total balance sheet exposure accounts for 36.9%.

As of 30 June 2017 loans granted in EUR (71.2%) and PLN (27.4%) dominated the corporate loans portfolio.

Public sector loans

Due to the strategy of the Bank the portfolio does not contain new agreements, which in connection with significant prepayments is reflected in a lower, as compared to 30 June 2016, balance sheet exposure to public sector. As at 30 June 2017 the exposure was PLN 308 million (down by 9.8%)

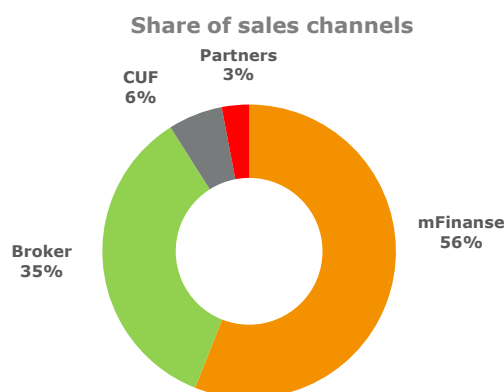
Retail loans to natural persons

The Bank continues the implementation of strategic objectives in the area of mortgage loans to natural persons in cooperation with mBank S.A.

In the second quarter of 2017, mBank S.A. decided to move sales of retail loans from mBank Hipoteczny to mBank S.A. Starting from 22 July 2017, all mortgage loans to natural persons will be processed and granted by mBank S.A.

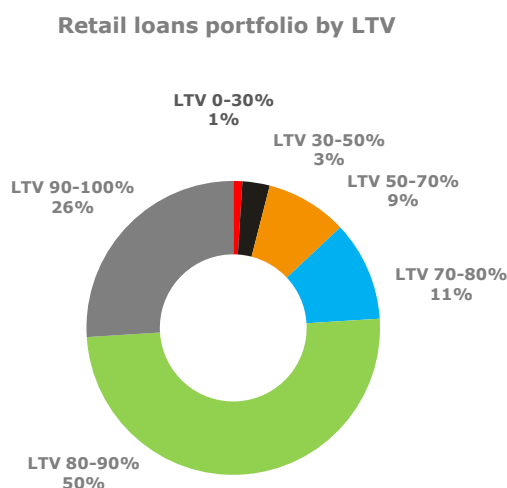
The acquisition by mBank Hipoteczny S.A. from mBank S.A. of the portfolio of receivables resulting from loans secured with a mortgage with a view to their refinancing by issuing mortgage bonds will continue to be a material component in the pursuit of strategic objectives.

Chart 7. The share of sales channels in 2017



The volume of loans disbursed in the first half of 2017 amounted to PLN 1.3 billion. The average loan amount was PLN 321 thousand. The volume-weighted average margin for the portfolio acquired in the first half of 2017 was 1.93%. The average commission weighted by the amount of credit agreement for loans disbursed in this period was 1.75%. Loans with LTV of 80-90% constituted the largest share in the sales.

Chart 8. Sales structure in 2017 divided by LTV bands.



1.5. Refinancing and issuing of covered bonds

In the first half of 2017, mBank Hipoteczny successfully placed on the market two issues of mortgage covered bonds. The first issue conducted in the form of a public offering and amounting to EUR 24.9 million was conducted in February, and another one of PLN 300 million was conducted in a private placement in May 2017.

The value of all mortgage covered bonds issued by the Bank and publicly traded as at the end of June 2017 amounted to approximately PLN 4.2 billion, representing approximately 36% of the mortgage covered bonds market in Poland according to the Bank's estimates.

Covered bonds of mBank Hipoteczny are instruments characterised by a low level of investment risk as a result of the statutory requirement of multi-stage collateral for the issuing and trade. It is confirmed by the ratings assigned by Fitch Ratings Ltd. to mortgage covered bonds issued by the Bank. On 23 June 2017, the rating for mortgage covered bonds was confirmed at A level.

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

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

| Issue date | Redemption date | Currency | Value | Rating Fitch Ratings Ltd. |
|--------------|-----------------|------------|----------------------|---------------------------|
| 15.06.2012 | 15.06.2018 | PLN | 200 000 000 | A |
| 20.06.2013 | 21.06.2019 | PLN | 80,000,000 | A |
| 28.07.2014 | 28.07.2022 | PLN | 300,000,000 | A |
| 04.08.2014 | 20.02.2023 | PLN | 200,000,000 | A |
| 20.02.2015 | 28.04.2022 | PLN | 200,000,000 | A |
| 15.04.2015 | 16.10.2023 | PLN | 250,000,000 | A |
| 17.09.2015 | 10.09.2020 | PLN | 500,000,000 | A |
| 02.12.2015 | 20.09.2021 | PLN | 255,000,000 | A |
| 09.03.2016 | 05.03.2021 | PLN | 300,000,000 | A |
| 28.04.2016 | 28.04.2020 | PLN | 50,000,000 | A |
| 11.05.2016 | 28.04.2020 | PLN | 100,000,000 | A |
| TOTAL | | PLN | 2,435,000,000 | |

| Issue date | Redemption date | Currency | Value | Rating Fitch Ratings Ltd. |
|--------------|-----------------|------------|--------------------|---------------------------|
| 19.10.2012 | 19.10.2017 | EUR | 10,000,000 | A |
| 26.07.2013 | 28.07.2020 | EUR | 30,000,000 | A |
| 22.11.2013 | 22.10.2018 | EUR | 50,000,000 | A |
| 17.02.2014 | 15.02.2018 | EUR | 7,500,000 | A |
| 28.02.2014 | 28.02.2029 | EUR | 8,000,000 | A |
| 17.03.2014 | 15.03.2029 | EUR | 15,000,000 | A |
| 30.05.2014 | 30.05.2029 | EUR | 20,000,000 | A |
| 22.10.2014 | 22.10.2018 | EUR | 20,000,000 | A |
| 28.11.2014 | 15.10.2019 | EUR | 50,000,000 | A |
| 25.02.2015 | 25.02.2022 | EUR | 20,000,000 | A |
| 24.04.2015 | 24.04.2025 | EUR | 11,000,000 | A |
| 24.06.2015 | 24.06.2020 | EUR | 50,000,000 | A |
| 23.03.2016 | 21.06.2021 | EUR | 50,000,000 | A |
| 28.09.2016 | 20.09.2026 | EUR | 13,000,000 | A |
| 26.10.2016 | 20.09.2026 | EUR | 35,000,000 | A |
| 01.02.2017 | 01.02.2014 | EUR | 24,900,000 | A |
| TOTAL | | EUR | 414,400,000 | |

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

Organiser of the offering: mBank S.A.

| Issue date | Redemption date | Currency | Value |
|------------|-----------------|----------|------------|
| 19.08.2016 | 28.08.2019 | EUR | 70,000,000 |

| Issue date | Redemption date | Currency | Value |
|------------|-----------------|----------|-------------|
| 15.12.2016 | 25.07.2018 | PLN | 400,000,000 |
| 12.05.2017 | 10.09.2019 | PLN | 300,000,000 |

The basis for issuing of covered bonds

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

As of 30 June 2017 the collateral of mortgage covered bonds consisted of receivables of value PLN 7,589.7 million from total number of 15,308 loans,

Loans for commercial clients constituted 50.73% and for retail clients 49.27% of the total amount of receivables entered into the mortgage cover register. Loans granted in PLN (61.7%) dominated, loans in EUR (37.58%) and USD (0.73%) constituted the remaining part.

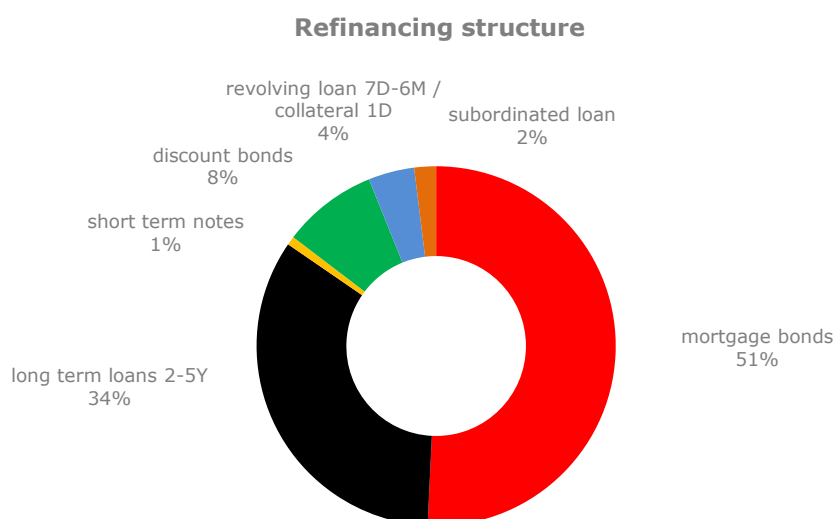
Additionally to the credit receivables, the additional collateral in a form of treasury bonds of nominal value of PLN 110 million was also entered into the mortgage cover register.

As of 30 June 2017 the level of over-collateralisation (including substitute cover) of mortgage covered bonds and public sector covered bonds amounted to 47.56%.

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

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

Chart 9. The structure of refinancing of the Bank activity as of 30 June 2017



1.6. Legal environment

On 23 March 2017, the Act on mortgage loans was passed. The Act on mortgage loans sets out the principles and procedures for concluding a mortgage loan agreement; rights and obligations of the lender, mortgage loan intermediary and agent in terms of information provided before concluding a mortgage loan agreements, and rights and obligations of a consumer, a lender, a mortgage loan intermediary and agent with regard to a mortgage loan agreement concluded, the results of a failure by the lender, mortgage loan intermediary or agent to fulfil their obligation, and the principles and procedures of supervision over mortgage loan intermediaries and agents. The Act implements the Directive of the European Parliament and of the Council 2014/17/UE of 4 February 2014 on credit agreements for consumers relating to residential immovable property (...). The Act on mortgage loans will substantially enter into force as of 22 July 2017, with the exception of a few provisions which have later effective dates. The said Act has a limited impact on the operations of mBank Hipoteczny S.A. due to the fact that the effective date of the Act (which applies to agreements concluded after its entry into force) coincides with the date of mBank S.A. taking over sales of mortgage loans to consumers and mBank Hipoteczny S.A.'s discontinuation of such activities. The Act required certain internal procedures to be amended and this was done. The Bank is ready for the Act's entry into force. In particular, until loan agreements are signed and loans are disbursed based on loan applications submitted before the date of discontinuing lending activities, the Bank will fulfil all the duties resulting from the Act on mortgage loans, including, in particular, the provision of the required information form.

Work is in progress in the Bank to adjust operating procedures and IT infrastructure to the requirements of Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data (...). The Regulation shall apply after 25 May 2018.

2. Risk management

2.1. Credit risk

Loan portfolio

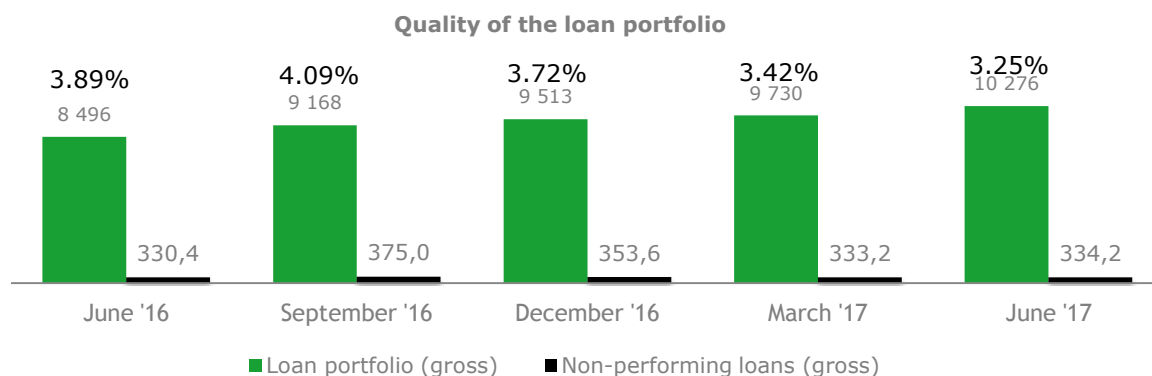
The principles for granting loans have been specified in the Bank's Credit Policy and the management of existing loan portfolio is done mainly through current monitoring of credit exposures.

Due to the actions undertaken by the Bank within the scope of problem loans management and as a result of increasing of the loan portfolio, the share of non-performing loans in the loan portfolio decreased to the level of 3.25%. Most of the loans are repaid in a timely manner, and the borrowers of higher risk profile are subjected to a more strict monitoring. The net value of the loan portfolio in the first half of 2017 increased in relation to the end of 2016 by PLN 759 million, which resulted mainly from the increase of the retail portfolio (agency loans).

Impairment provisions reaching PLN 102.8 million together with mortgages on the financed real estates constitute an appropriate security against potential losses resulting from credit risk.

The main area of activity of the Bank in the first half of 2017 was refinancing of commercial real estates, especially shopping centres and offices. This activity is based on a uniform for the whole mBank SA group commercial real estate financing policy, including key elements of acceptance policy for individual segments of the real estate market. Drawing on past experiences in housing investments financing, the Bank continued financing of residential construction projects focusing on selective financing of projects of the most favourable market parameters (e.g. adaptation of the offer to the needs of the market, positive history of the developer's activity, adequate level of own contribution and verified pre-sale).

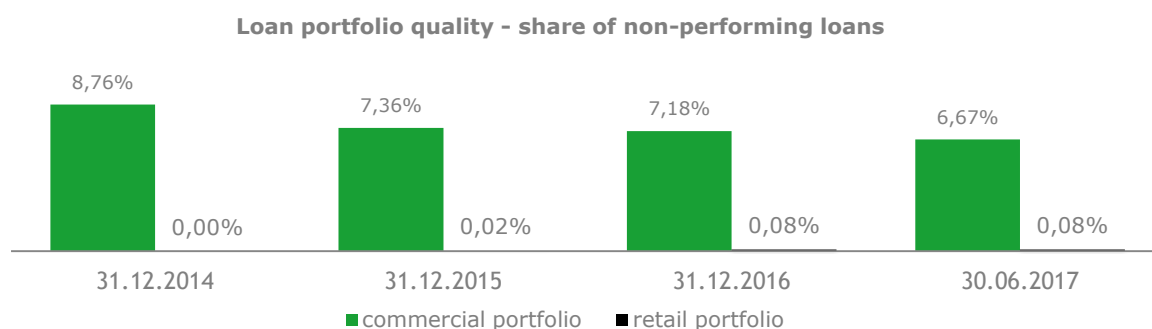
Chart 10. The share of non-performing loans* in the loan portfolio (gross value, in PLN million)



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

The retail portfolio, which is growing strongly, is characterised by very high quality, which is clearly affected by, apart from the applied credit policy, the fact that this portfolio is very young. As of 30 June 2017 there were only 16 cases with reported loss of value. Loans for natural persons are monitored monthly for timely repayments and correctness in terms of established effective mortgage collaterals. Realisation of all contractual obligations of the client is verified in the same monitoring period (including insuring of the real estate and assignment of the rights under insurance policies).

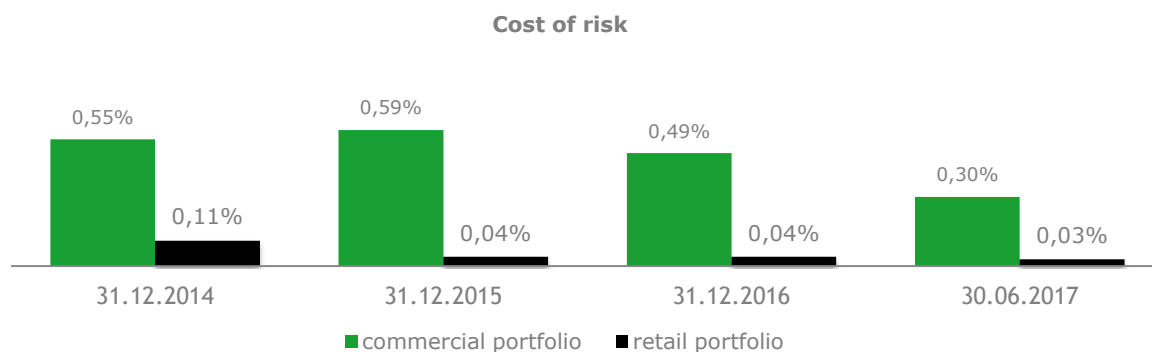
Chart 11. Share of non-performing loans by portfolio



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

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

Chart 12. Cost of risk by portfolio



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

Credit risk management

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

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

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

In the area of retail loans, the loan portfolio will be built by transferring loans which meet the criteria specified by the Bank from mBank. The criteria selected will ensure maintaining a portfolio with a low loss ratio, based on the foundation of customers with confirmed creditworthiness.

Lawsuits brought by the Bank

In the first half of 2016, the Bank filed a lawsuit for issuing a payment order for the amount of EUR 849.5 thousand, relating to a commercial loan. The court issued the payment order, which became valid on 24 April 2017. In the second half of 2016, the Bank filed a motion for declaring bankruptcy in respect of commercial receivables of EUR 13 268.7 thousand. The court announced bankruptcy of the client on 8 March 2017. In addition, on 19 April 2017, the Bank submitted to the court a motion to open recovery proceedings relating to a corporate client. The court has not yet issued a decision to open the recovery proceedings.

2.2. Market risk

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

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

The amount of market risk the Bank is exposed to in the day horizon is determined using Value at Risk (VaR) method at the confidence level of 97.5%. As of the end of June 2017 VaR amounted to PLN 392.8 thousand. The currency risk was PLN 19.0 thousand, the interest rate risk was PLN 98.7 thousand and the credit spread risk was PLN 399.0 thousand.

The interest rate risk results from exposure of the financial result and the Bank's capital to adverse effect of interest rates changes. The Bank manages the interest rate gap through matching the repricing dates of assets and liabilities. The sensitivity of the Bank's portfolio to interest rates fluctuations is determined on the basis of results of stress tests and scenario analyses. The interest rate risk is measured among others by using Earnings At Risk (EaR) ratio, which by the end of June 2017 reached a safe level of 3.50%. The banking books items that are exposed to interest rate risk are hedged with linear interest rate derivatives.

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

2.3. Liquidity risk

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

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

At the end of June 2017, the excess of liquid assets amounted to approx. 7.9% of the balance sheet total.

In 2017 financing of Bank's lending was performed primarily through issuing covered bonds in PLN and EUR. The long-term situation of the Bank in terms of liquidity is stable. Loans obtained from mBank S.A. have significant share in financing of long-term receivables.

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

The share of stable financing sources and liquidity reserves adequate to the scale of the Bank's activity determines meeting of long-term liquidity standard M4 required by KNF. The M4 ratio at the end of June 2017 was 1.046. M1 and M2 short-term liquidity standards were maintained at a safe level, PLN 1,106,270 thousand and 2.444 respectively. The M3 standard was 94.392.

As at the end of June 2017 the liabilities limit, resulting from Art. 15.2 of the "Act on covered bonds and mortgage banks", was used in 72.65%. In 2017 this limit was not exceeded.

As at the end of June 2017 average maturity of issued mortgage covered bonds was 3.8 of a year for mortgage covered bonds while the average maturity of contracted long-term deposits and loans obtained from other banks was 3.2 of a year. The margin of mortgage covered bonds issued in 2017 on average amounted to 1.04%, with average maturity of 2.3 of a year.

2.4. Operational risk

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

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

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

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

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

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

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

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

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

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

2.5. Covered bonds investment risk

In the first half of 2017 the investment risk profile associated with covered bonds issued by mBank Hipoteczny did not change. Those securities are a financial instrument of a low investment risk, resulting

from the requirements of multi-stage collateralisation of their issuing and trade by the issuer, accordant with the Act on covered bonds and mortgage banks. In addition to compliance with a number of statutory requirements during economic slowdown, high safety of investing in covered bonds is also a result of the Bank's conservative policy of valuation of real estates constitute their collateral, which has been applied for many years. According to the amended Act on covered bonds and mortgage banks, the minimum level of over-collateralisation of mortgage and public sector covered bonds since 1 January 2016 is 10%.

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

2.6. Internal control system

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

- 1) **control function** – whose task is to ensure compliance with controls relating, in particular, to risk management at the Bank, which comprises positions, groups of people or organizational units responsible for performing tasks assigned to this function. The Control function comprises all controls put in place in the processes executed in the Bank, independent monitoring of the compliance with these controls and reporting within the function.
- 2) **Compliance Department** - a compliance department whose task is to identify, assess, control and monitor the risk of the Bank's non-compliance with the provisions of law, internal regulations and market standards as well as submission of reports in this regard.

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

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

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

The Compliance Department is currently working on ensuring compliance with the Regulation of the Minister of Development and Finance on the risk management system and the internal control system, remuneration policy and the detailed manner of estimating the internal capital in banks, and to Recommendation H. Draft By-laws of the Internal Control System have been prepared, taking into account the requirements of Recommendation H. The draft By-laws will be submitted for approval to the Supervisory Board.

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

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

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

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

2.7. Remuneration policy

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

3. Real estate market in Poland

Housing market²

- The first quarter of 2017 was a period of strong activity both on the demand and supply side of the residential real estate market.
- In total the number of units on offer in the main Polish cities was approx.. 50.2 thousand (an increase of 3.9% q/q). The number of units completed but unsold decreased – at the end of March such apartments represented only 13% of the entire offer.
- During the first quarter, the total number of sale transactions for the 6 main markets reached a record high level of 18.6 thousand units, approx. 30% more than in the first quarter of 2016 when approx. 14.3 thousand units were sold.

² Analysis of the housing market relates to 6 main cities: Warsaw, Kraków, Wrocław, Poznań, Łódź, Gdańsk.

- Developers acted prudently with regard to the impact of Recommendation S which increased own contribution to 20%, and the exhaustion of the funds from the MDM programme. As a result, approximately 15.9 thousand units, i.e. 16.1% less than in the fourth quarter of 2016, were introduced for sale.
- Transaction prices of residential units on primary and secondary markets in the largest cities showed little fluctuation. On the primary market, there was a slight decrease in the average prices per sq m: in Warsaw (of approx. 1.61% q/q) and in Kraków (of approx. 1.46% q/q). On the secondary market, prices rose in Gdańsk (by approx. 3.15% q/q). In other cities, the prices remained at the levels noted in the fourth quarter of 2016. The largest share in the market (approx. 35%) and the highest average prices have been recorded in Warsaw, while the lowest, in Łódź.
- High estimated profit margins of the developers and a high demand contributed to increasing, by more than 18.1 thousand, the number of planning permits issued and by 3 thousand, the number of units commissioned, compared with the first quarter of 2016.

Commercial real estate market

- The volume of transactions concluded in the first quarter of 2017 on the commercial real estate market amounted to EUR 485 million, which means a decrease in value of approx. 11% y/y.
- The record high value of transaction of approx. EUR 218 million (approx. 45% of the volume) was concluded on the domestic hotel market. Investments in commercial space represented approx. 30% of the volume, and investments in office space, approx. 20%. Transactions in the market of warehouse space accounted for only approx. 6% of the value of all transactions concluded.

Office real property³

Warsaw

- Warsaw continues to remain the largest market for office space in Poland. The total stock of modern office space amounted to over 5.1 million sq m as at the end of March 2017. In the first quarter of 2017, 84.2 thousand sq m of new office space was commissioned. The largest facilities put into use include, among other things, Business Garden (Buildings III - VII - 54.8 thousand sq m), Equilibrium (9.8 thousand sq m) and Airtech Business Park III (9 thousand sq m).
- In the period analysed, approximately 193.9 thousand sq m of office space was leased out. The largest office space was leased out in the Central district (57.8 thousand sq m), Central Business Area – COB (39.2 thousand sq m) and in the Mokotów district (38.6 thousand sq m). The net absorption which amounted to approx. 86.6 thousand sq m and was approx. 60% higher than the quarterly average for the years 2012-2016 is evidence of strong activity among the tenants.
- New lease agreements represented approx. 54%, re-negotiated agreements approx. 37%, and pre-let transaction were approx. 8%. Companies in the manufacturing and service sectors were among the most active tenants.
- The vacancy rate was 14.0 % as at the end of March 2017 (↓ by approx. 0.1 p.p y/y), which translated into approx. 718 thousand sq m of free space. In the Central Business Area, the unleased space represented 14.8%, in the Central district 11.8%, and 14.7% outside the Central district.
- Base rents for the top class office space were revised to EUR 20.5 – 23.5 per sq m per month, and in non-Central locations they remained in the range of EUR 10.5 – 18.0 per sq m per month.

Regional cities

³ Analysis of the office market relates to Warsaw and regional markets: Kraków, Wrocław, Katowice, Poznań, Gdańsk, Łódź.

- The total stock of office space in the main regional markets amounted to nearly 3.7 million sq m. In the period analysed, only 67.2 thousand sq m of new space was introduced to the market. The largest new space was delivered to the Kraków and Wrocław markets, respectively, approx. 28.2 thousand sq m and 18 thousand sq m.
- Taking into account developer activity which the level never recorded before of approx. 826 thousand sq m of office space in the course of construction, the new supply in 2017 may reach a record high level of approx. 520 thousand sq m.
- The total volume of lease transactions reached 178 thousand sq m which represented y/y growth of approx. 41%. The strongest activity was recorded in Wrocław (approx. 59 thousand sq m) and Kraków (52.5 thousand sq m). The share of new agreements was approx. 52%, re-negotiated/extended agreements accounted for approx. 35% and pre-let agreements represented approx. 29%.
- The asking rates of rent in the majority of the large cities remain unchanged and range between EUR 10 – 16.5 per sq m per month. However, developers show significant flexibility when negotiating terms of the lease other than rent, such as the share in finishing costs or rent-free periods.
- Given the moderate level of new supply in the first three months of the year, vacancy rates decreased in most of the markets, both year-on-year and quarter-on-quarter. The lowest vacancy rate of approx. 5.8% was recorded in Łódź and approx. 6.8% in Kraków.

Retail real property⁴

- The total stock of retail area in Poland increased in the first quarter of 2017 by 38 thousand sq m to 13.92 million sq m.
- The two retail projects opened before March 2017 were the large-format retail facilities of Leroy Merlin in Bełchatów (7 thousand sq m) and Agata Meble in Rzeszów (18 thousand sq m). In addition, Auchan Hetmańska in Białystok (5.8 thousand sq m) and Galeria Wnętrz City Meble in Gdańsk (5.8 thousand sq m) were expanded. Moreover, Galeria Graffica in Rzeszów changed its format and is now operating as a clearance sale centre.
- Currently, approx. 591 thousand sq m of retail space is under construction, of which 86% is to be commissioned by the end of 2017.
- The largest retail facilities planned for 2017 include: Galeria Północna in Warsaw (69.3 thousand sq m), Wroclavia (a retail and entertainment centre integrated with a bus station) in Wrocław (64 thousand sq m), Serenada in Kraków (42 thousand sq m) and Gemini Park in Tychy (36 thousand sq m).
- The vast majority of new retail space planned to be commissioned in the current year is in the shopping centre format (approx. 76%).
- In the past months, no significant changes in the rates of rent for retail space were noted. Warsaw continued to be the most expensive location, where prime rents for the top retail units with a surface area of up to 100 sq m in the most prestigious shopping centres are at a level of EUR 130 per sq m per month. In other main cities, rates are in the range of EUR 45 – 60 per sq m per month.
- The vacancy rates in the main cities remained at a low level of approx. 3.3 %.

⁴ Analysis relates to: Warsaw, Poznań, Kraków, Wrocław, Trojmiasto, Aglomeracja śląska, Łódź.

Warehouse space⁵

- In the period from January to March 2017, the very strong activity of developers in the Polish warehouse space market continued. The stock of modern space increased by more than 600 thousand sq m and amounted to approx. 11.6 million sq m as at the end of March.
- The demand, which amounted to approx. 1 million sq m in the first three months of the year, also remained high. The most popular locations among the tenants included the Upper Silesia region (approx. 30% of the demand) and the Warsaw area (approx. 20%).
- The structure of the demand continued to be dominated by logistics operators with approx. 26% of the share in the volume of lease transactions. Among the other sectors, the most active ones included: e-commerce approx. 16% and retail networks approx. 12%.
- Currently, approx 1.4 million sq m of warehouse space is under construction, of which 75% is secured with pre-let agreements.
- The vacancy rate at the end of March 2017 was 6.3% which represented an increase of 0.4 p.p. y/y. The fact that a large proportion of the new warehouse space was built for speculative purposes contributed to the increase in the vacancy rate.
- Rate of rent remained stable on the majority of the markets. The highest rent rates were in the Warsaw City area: EUR 3.5 – 4.6 per sq m per month, and the lowest in Central Poland: EUR 1.9 – 2.9 per sq m per month.

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

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

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

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

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

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

Since 2013 the Bank has been implementing a strategic project based on cooperation with mBank in terms of development and refinancing of retail portfolio through issuing covered bonds (the agency model). In September 2013 the Bank launched mortgage lending to natural persons via mBank sales network. It applies to loans that meet the criteria of entering into the cover register for mortgage bonds and potentially constitute the basis for their issuing. In Q3 2014 the development of retail loan portfolio was additionally supported through implementation of the pooling model, which consists in acquisition of already existing retail mortgage portfolio of mBank. Two transactions of this type took place in 2014, followed by four transactions in 2015 and four transactions in 2016.

In 2017 the Bank continued actions consisting in development of the new retail mortgages portfolio acquired in cooperation with mBank, improvement of the loan process, acquisition of retail loans portfolio from mBank within the pooling model and refinancing of this portfolio through issuing covered bonds.

Strategy of sales of loans for commercial real property

⁵ The analysis covers: Warsaw City, Warsaw Area, Upper Silesia, Poznań, Wrocław, Central Poland, Tri-City, Kraków, Szczecin, Emerging Markets (Rzeszów, Lublin).

mBank Hipoteczny S.A.**Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2017**

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

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

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

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

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

Retail lending strategy

Starting from 22 July 2017, mBank Hipoteczny will develop its activity in the retail area to build the portfolio of mortgage loans for natural persons by transfers of the existing and newly-granted loan portfolios from mBank and re-financing of that portfolio with mortgage bonds.

Refinancing strategy of mBank Hipoteczny

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

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

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

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

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

5. Bank Authorities

Shareholders

As at 30 June 2017, the total number of ordinary shares was 3,210,000 shares with a nominal value of PLN 100 per share. On 8 February 2017, the Extraordinary General Meeting adopted resolution on the increase of the share capital and the exclusion of the shareholder from the pre-emptive right to shares, under which the share capital will be increased to the amount of PLN 321,000,000.00 by way of issuing 120,000 series H ordinary registered shares with a nominal value of PLN 100.00 each and the issue price of PLN 1,000.00 each. The new shares were offered for subscription to mBank S.A. through private placement. The shares were paid-up in full on 28 February 2017. On 3 April 2017, the registry court entered the increased share capital in the registry of entrepreneurs.

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

As of 30 June 2017 the ownership structure of registered share capital of the Bank is as follows:

| Name of shareholder | Registered share capital in PLN thousand | Shares | | Votes at the General Meeting of Shareholders | |
|---------------------|--|---------------------|---------------|--|---------------|
| | | Amount in thousands | % | Amount in thousand shares | % |
| mBank S.A. | 321,000,000 | 3,210,000 | 100.00 | 3,210,000 | 100.00 |
| Total | 321,000,000 | 3,210,000 | 100.00 | 3,210,000 | 100.00 |

The Bank does not collaborate with international public institutions.

Management Board

As at 30 June 2017 the Management Board of mBank Hipoteczny included the following members:

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

Marcin Romanowski resigned from the position of Management Board Member as of 20 September 2017.

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

The Supervisory Board appoints and dismisses members of the Management Board of the Bank, including the President of the Management Board.

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

The Management Board of the Bank manages the Bank's operations and represents it. The Management Board adopts annual financial plans and operating strategy which are approved by the Supervisory Board. In these plans, the Management Boards specifies the maximum volume of mortgage bond and bond issues for a given year. The scope of activities of the Bank's Management Board includes all matters not reserved for the competence of other Bank's bodies based on its Articles of Association or the provisions of the law.

Rules on amending articles of association

In accordance with Art. 430 § 1 of the CCC the change of articles of association requires resolution of the general meeting and entry into register.

Pursuant to art. 34 par. 1 Banking Law the change of bank's articles of association requires approval of the Financial Supervision Authority, if it relates to the matters specified below, i.e.:

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

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

Supervisory Board

Composition of mBank Hipoteczny S.A. Supervisory Board as at 30 June 2017:

- Cezary Kocik – Supervisory Board Chairman
- Lidia Jabłonowska-Luba - Supervisory Board Vice-Chairman
- Christoph Heins – Supervisory Board Member
- Frank Bock – Supervisory Board Member
- Michał Popiołek - Supervisory Board Member
- Jakub Fast – Supervisory Board Member
- Mariusz Tokarski – Supervisory Board Member

As of 7 February 2017, Dariusz Solski resigned from the position of Supervisory Board Member. The composition of the Supervisory Board was supplemented on 8 February 2017 by the Extraordinary Shareholders Meeting: Jakub Fast was appointed a Supervisory Board Member.

As of 31 March 2017, Hans Dieter Kemler resigned from the position of a Supervisory Board Member. As of 1 March 2017, the Supervisory Board appointed Cezary Kocik the Chairman of the Supervisory Board. On 29 May 2017, the Extraordinary Shareholders Meeting supplemented the composition of the Supervisory Board by appointing Frank Bock a Supervisory Board Member.

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

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

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

Audit Committee

As at 30 June 2017 the Audit Committee included the following members:

- Christoph Heins - Committee Chairman
- Jakub Fast - Committee Member
- Mariusz Tokarski - Committee Member

On 27 March 2017, the Supervisory Board appointed Jakub Fast a member of the Audit Committee.

The tasks of the Audit Committee include:

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

In 2017 the Audit Committee debated on 27 March.

Risk Committee

As at 30 June 2017 the Risk Committee included the following members:

- Lidia Jabłowska-Luba – Chairwoman of the Committee
- Christoph Heins - Committee Member
- Michał Popiołek – Committee Member

The tasks of the Risk Committee include:

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

- supporting the Bank's Supervisory Board in the task of supervision over cooperation of the Bank with the Commerzbank AG group with respect to consolidated supervision over risk and information exchange.

In 2017 the Risk Committee held one meeting - on 13 March.

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

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

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

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

6. Other information

Loans and interest rates

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

Transactions with affiliated entities

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

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

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

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

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

In the first half of 2017, the composition of the Supervisory Board was changed twice, due to resignations from the position of Supervisory Board Member submitted by Dariusz Solski and Hans Dieter Kemler. On 8 February 2017, Jakub Fast and on 29 May 2017, Frank Bock, were appointed members of the Supervisory Board.

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

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

Proceedings before a court, arbitration body or public administration authority

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

Public aid

In 2017, the Bank did not receive any public subsidies, in particular on the basis of the Act on the Government support for the financial institutions dated February 12, 2009 (Journal of Laws of 2014 item 158).

Guarantees and sureties granted by the Bank

No guarantees or sureties were granted by the Bank in 2017.

Events after the balance sheet date

■ Approval of the prospectus

On 6 July 2017, mBank Hipoteczny S.A. gained the acceptance of the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg for a new base prospectus and the approval of the International Mortgage Bonds Issuance Programme totalling EUR 3,000,000 thousand.

■ Agreements concluded with Commerzbank AG in connection with the planned issuance of mortgage bonds abroad

On 4 July 2017, mBank Hipoteczny S.A. signed an agreement with Commerzbank AG on the appointment of a process agent as part of the mortgage bonds issuance programme.

On 6 July 2017, mBank Hipoteczny S.A. signed a multilateral agreement on the mortgage bonds issuance programme with Commerzbank AG as the organizer and one of the five dealers of the programme

■ Acquisition of commercial loans granted by mBank S.A. by the Bank

On 6 July 2017, two agreements were concluded by and between mBank S.A. and mBank Hipoteczny S.A. on the transfer of commercial loans secured with a mortgage of EUR 8 488 thousand and EUR 12 791 thousand to mBank Hipoteczny S.A.

mBank Hipoteczny S.A.

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■ Change in amounts due to mBank S.A.

On 14 July and 20 July 2017, tranches of loans received from mBank S.A. of PLN 150,000 thousand repayable by 13 September 2024 and PLN 150,000 thousand repayable by 22 March 2023 respectively were drawn down.

■ Changes to the composition of the Supervisory Board

As of 12 July 2017, Christoph Heins resigned from the position of Supervisory Board Member.

On 14 July 2017, by resolution of the Extraordinary General Meeting of mBank Hipoteczny S.A., Mr Andreas Boeger and Mr Paweł Graniewski were appointed Members of the Supervisory Board.

The composition of the Supervisory Board of mBank Hipoteczny S.A. as at the date of publication of the Condensed Financial Statements for the first half of 2017:

1. Cezary Kocik – Chairman of the Supervisory Board
2. Lidia Jabłonowska-Luba - Deputy Chairman of the Supervisory Board
3. Frank Bock – Member of the Supervisory Board
4. Andreas Boeger – Member of the Supervisory Board
5. Jakub Fast – Member of the Supervisory Board
6. Paweł Graniewski – Member of the Supervisory Board
7. Michał Popiołek – Member of the Supervisory Board
8. Mariusz Tokarski – Member of the Supervisory Board

7. Statements of the Management Board

Corporate governance

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

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

True and fair picture in the presented reports

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

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

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

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

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