

**Management Board Report  
on the performance of mBank Hipoteczny S.A.  
in the first half of 2018**

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## **1. Activity of mBank Hipoteczny S.A. in the first half of 2018**

In July 2018, mBank Hipoteczny S.A. (hereinafter the "Bank") adopted new objectives for its operating strategy for 2019–2022.

The strategy for 2019–2022 responds mainly to challenges resulting from the current and expected intensive development of the covered bond market in Poland as well as the strong demand for Polish covered bonds in the European Union, supported by continued low interest rates. Simultaneously, the strategy continues the assumptions regarding the safe financial structure of mBank Group, and in the currently growing competitive pressure among mortgage banks, it stresses the importance of the cost-effectiveness of the Bank's business model.

The Bank's strategy assumes that the foundation of its operations will be to obtain long-term refinancing for mBank Capital Group (hereinafter referred to as "mBank Group"), i.e. to issue covered bonds in the most cost-effective business model possible. Such a direction requires primarily ensuring an appropriate scale of assets in the Bank's balance sheet that meet the criteria for securing covered bonds.

Currently, there are two business areas at the Bank:

- the retail area focusing on acquiring mortgage loans for natural persons;
- the commercial area financing transactions regarding commercial real estate (CRE) and lending to residential real estate projects.

In the coming years, the Bank is planning to develop the portfolio of retail mortgage loans and CRE loans in close cooperation with mBank, i.e. assuming that the sale will be executed by the forces of mBank both in the retail area, within the already functioning cooperation model, and in the commercial area in the context of the planned changes to the model.

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 2019-2022. Nevertheless, the Bank owns a historically developed portfolio of credit transactions for this segment.

The commercial projects area has experienced changes in development projects due to rising material and, above all, labour costs. The investor activity in the market can be described as stable.

Projects in the area of residential financing are still sold at a very early stage of construction, which results in a low level of utilisation of construction loans. As is the case with commercial projects, there is an increase in contracting costs.

### **1.1. Key projects in the first half of 2018**

#### **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 S.A. continued to be the highest priority venture in 2018. 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.

### **Implementation of AIRB method**

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

A substantial part of the recommendations identified during the inspection was addressed by the Bank, however the mBank Group intends to fulfill all the expectations of the Supervision in 2018, which shall result in the submission of the final Request for the application of the statistical methods for calculating the capital requirements for credit risk for the retail portfolio acquired within the scope of the cooperation with mBank S.A. For the purpose of submitting the final request, a project team was appointed in June 2018. The Bank intends to submit the final request after the Supervision authority has approved changes in group models applied by the Bank.

### **Implementation of the general Regulation on personal data protection**

In the first half of 2018, work initiated in January 2017, aimed at adjusting the Bank to the General Data Protection Regulation (GDPR), was continued. In particular, these included the preparation of a number of documents (GDPR packages and information clauses), in cooperation with an external law firm, aimed at informing individuals (in particular customers, employees, counterparties) about their rights and the manner of exercising those rights by the Bank. The key GDPR packages were published on the website.

A template agreement for entrusting personal data was also prepared and the process of executing annexes to agreements on the delegation of personal data processing signed by the Bank was carried out. Under a resolution of the Management Board, an employee was appointed to perform the function of a Data Protection Officer at the Bank.

In addition, employees were provided with e-learning training on personal data protection. In the second half of 2018, in cooperation with mBank S.A., work aimed at automating the process of exercising the rights of data subjects will be continued.

### **Implementation of the Anti-money Laundering Act**

The Bank continued works for the adaptation to the requirements of the Anti-Money Laundering and Anti-Terrorism Financing Act of 1 March 2018, which implements to Polish law Directive 2015/849 of the EU Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (the "AML IV Directive").

As part of the implementation work, the Bank carried out necessary analyses and initiated changes in its internal regulations and processes. Work was also carried out in order to introduce relevant changes in the IT systems supporting the performance of obligations in the area of counteracting money laundering and terrorist financing. The Bank also provided its employees with training on the provisions of the new Act.

### **Implementation of Recommendation H issued by the Polish Financial Supervision Authority**

The Bank continued works aimed at implementing Recommendation H on internal control systems at banks, issued on 25 April 2017 by the Polish Financial Supervision Authority. The Bank's efforts focused on introducing new regulations required by Recommendation H or making appropriate changes to the Bank's internal procedures.

### **Anonymous whistleblowing system**

In 2017, in order to implement 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

assessing internal capital at banks of 6 March 2017, a dedicated internal procedure has been introduced to regulate the manner of receiving and processing anonymous whistleblowing with respect to violations of provisions of law and of applicable procedures and ethical standards. In June 2018, an IT system was launched to enable anonymous reporting of violations, including actual or potential violations of laws on counteracting money laundering and terrorist financing, which constitutes the implementation of requirements set forth in the Anti-Money Laundering and Anti-Terrorism Financing Act of 1 March 2018.

## **IFRS 9**

Due to the fact that as of 1 January 2018, IFRS 9: "Financial Instruments" came into effect to replace the existing International Accounting Standard 39: "Financial Instruments: Recognition and Measurement", works on the implementation of the required changes in the processes and IT systems are finalised at the Bank.

## **Definition of Default**

The Bank has started preparations to implement changes related to the entry into force of the European Commission regulation EU No 2018/171 issued pursuant to Article 178 of the Regulation No 575/2013 (CRR) on changes in the definition of default applied by banks. The works will be carried out in close cooperation with the relevant project team appointed for this purpose at mBank S.A.

### **1.2. Financial credibility**

Financial credibility of mBank Hipoteczny S.A. is assessed by an international rating agency - Fitch Ratings Ltd. As of 30 June 2018 the following ratings applied:

**BBB/F2 (stable perspective)** - long- and short-term international rating

**AA-(pol)(stable perspective)/F1+(pol)** - long-/short-term issuer rating (in the domestic currency)

**2** - support rating

**A** - for mortgage covered 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.

On 8 December 2017, rating agency Fitch Ratings Ltd. confirmed the long-term rating for the Bank at the BBB level with a stable perspective.

On 22 June 2018, Fitch Ratings Ltd. confirmed the rating of mortgage covered bonds at A, with a positive outlook.

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 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	30.06.2018	31.12.2017	Dynamics
<b>ASSETS</b>	12,704,967	12,168,169	4.41%
Including			
Loans and advances to customers	n/a	10,766,911	n/a
Loans and advances to customers (at amortised cost)	11,037,313	n/a	n/a
Loans and advances to customers (at fair value through profit or loss)	217,700	n/a	n/a
<b>LIABILITIES AND EQUITY</b>	12,704,967	12,168,169	4.41%
Including			
Debt securities in issue	8,041,306	7,043,125	14.17%
Share capital	734,719	734,719	0.0%

In the first half of 2018 the Bank achieved a positive gross result in the amount of PLN 23,768 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 2018 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 2017 (by PLN 11,079 thousand or 15.34%).

The total value of administrative expenses decreased by 7.37% compared to the first half of 2017. The cost to income ratio fell to 41.13% from 45.99% at the end of 2017.

Due to the specialization and narrow range of the products offered, the Bank is unable to compensate the effects of the bank tax. Before the tax, the Bank's operating result amounted to PLN 37,343 thousand, as compared to 28,219 thousand in the first half of 2017, which represents an increase by 32.33%. After the tax, the gross result was still significantly higher than in the previous year (by PLN 6,769 thousand or 39.82%).

In the first half of 2018 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 80,896 thousand (in the first half of 2017: PLN 65,642 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 01.01.2018 to 30.06.2018	Period from 01.01.2017 to 30.06.2017	Dynamics
Net interest income	83,304	72,225	15.34%
Net fee and commission income	(1,000)	(3,119)	-
Net trading income	(1,006)	(3,425)	-
Net impairment write-downs on loans and advances	(8,410)	(1,742)	-
Overhead costs	(31,605)	(34,118)	-7.37%
Amortisation and depreciation	(1,726)	(1,563)	10.43%

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<b>Operating result</b>	<b>37,343</b>	<b>28,219</b>	32.33%
Tax on the Bank's balance sheet items	(13,575)	(11,220)	20.99%
<b>Gross profit</b>	<b>23,768</b>	<b>16,999</b>	39.82%
Income tax	(7,146)	(6,743)	5.98%
<b>Net profit</b>	<b>16,622</b>	<b>10,256</b>	62.07%
Weighted average number of ordinary shares / weighted average diluted number of ordinary shares	3,210,000	3,172,210	1.19%
Net profit per ordinary share / Diluted profit per ordinary share (in PLN)	5.18	3.23	60.16%

Table 3. Effectiveness ratios

PERFORMANCE INDICATORS	30.06.2018	31.12.2017
ROA net <sup>1)</sup>	0.27%	0.24%
ROA gross <sup>1)</sup>	0.39%	0.30%
ROE net <sup>3)</sup>	3.23%	2.77%
ROE gross <sup>4)</sup>	4.62%	3.46%
Cost to income ratio (C/I) <sup>5)</sup>	41.13%	45.99%
Net interest margin <sup>6)</sup>	1.38%	1.36%
Cost of risk <sup>7)</sup>	0.16%	0.20%
Total Capital Ratio	15.22%	15.79%
<b>RATINGS Fitch Ratings Ltd</b>		
long-term international rating	BBB	BBB
short-term international rating	F2	F2
support rating	2	2
mortgage covered bonds	A	A
<b>OTHER</b>		
Employment	169 employees/162 FTE's	178 employees/169 FTE's
Average employment	172 employees	208 employees
Facilities	Headquarters + 4 branches	Headquarters + 4 branches

1) net result / average assets

2) gross result / average assets

3) net result / average equity

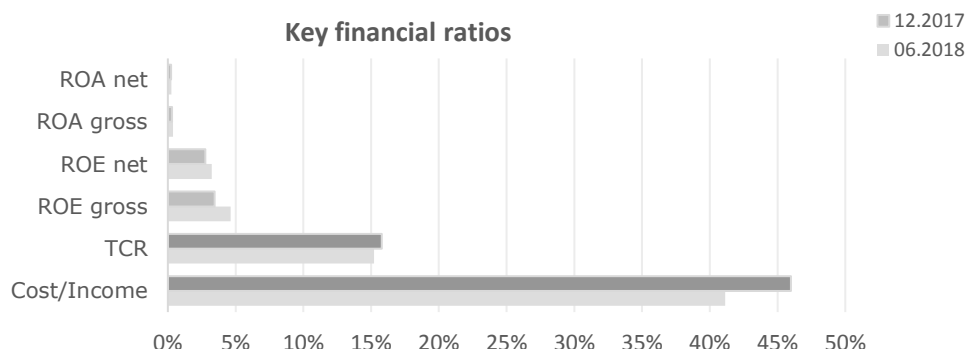
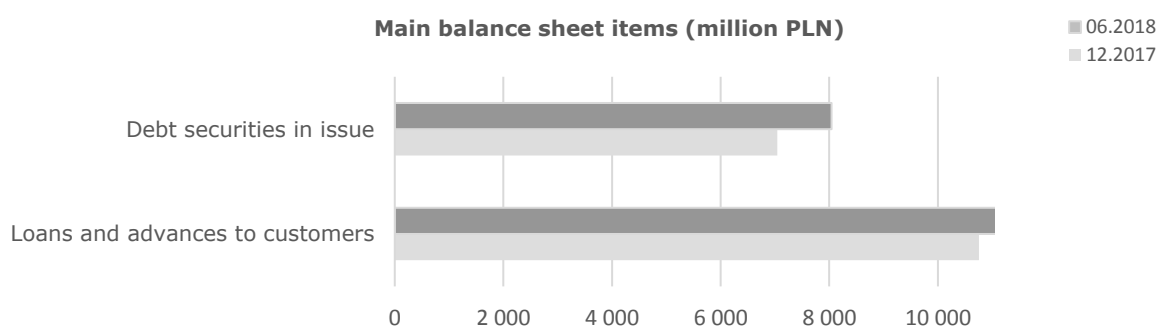
4) gross result / average equity

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

6) interest income / average earning assets

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

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

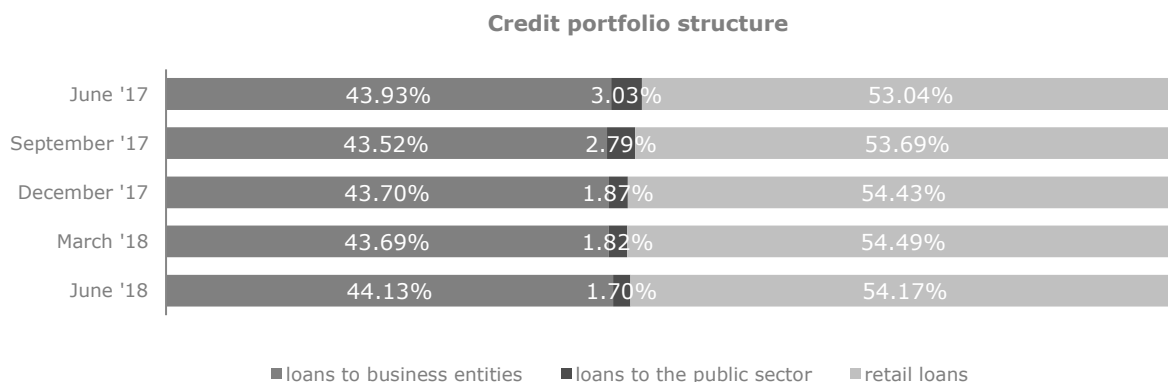
**Chart 1. Key financial ratios**

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


#### 1.4. Lending

In the first half of 2018, the Bank expanded its activities in the area of sales of loans to business entities. Following the transfer of the entire retail loan sales process to mBank on 22 July 2017, pooling transactions were the source of supply of retail assets to the Bank's loan portfolio. The net value of the entire loan portfolio, including off-balance sheet exposure, increased at the end of June 2018 by 3.06% as compared to the end of 2017, reaching PLN 12.7 billion.

In the first half of 2018, the Bank reported very good sales of commercial loans at the level of PLN 912 million, including PLN 286 million attributable to residential developers. In the discussed period, due to the ongoing implementation of IFRS 9, no commercial pooling from mBank S.A. was carried out.

In the retail area, in line with the mBank Group's strategy, the Bank recorded an increase in the portfolio of mortgage loans for retail customers by PLN 220 million or 3.76%. In the first half of 2018, 2 pooling transactions were carried out.

**Chart 3. The structure of the loan portfolio**




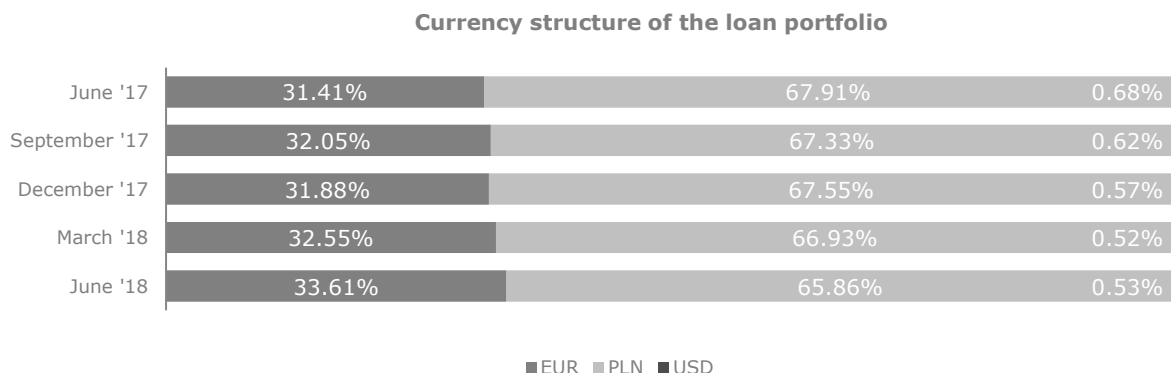
## mBank Hipoteczny S.A.

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In 2018, the currency structure of the loan portfolio changed slightly. Compared to the end of 2017, the share of loans in PLN decreased by 1.69 percentage points and as at the end of the first half of 2018 it accounted for 65.86% of the loan portfolio. The share of loans in EUR increased to 33.61%.

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

Chart 4. The currency structure of the loan portfolio



## Corporate loans

Net balance sheet exposure to business entities as of 30 June 2018 amounted to PLN 4,949 million. The dominant part (91.64%) accounted for refinancing of completed commercial facilities, the exposure in housing projects constituted 3.23%, and credits for financing of construction of commercial objects 5.13%.

As of the end of June 2018, 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 5. Corporate loans by type of financed real estate

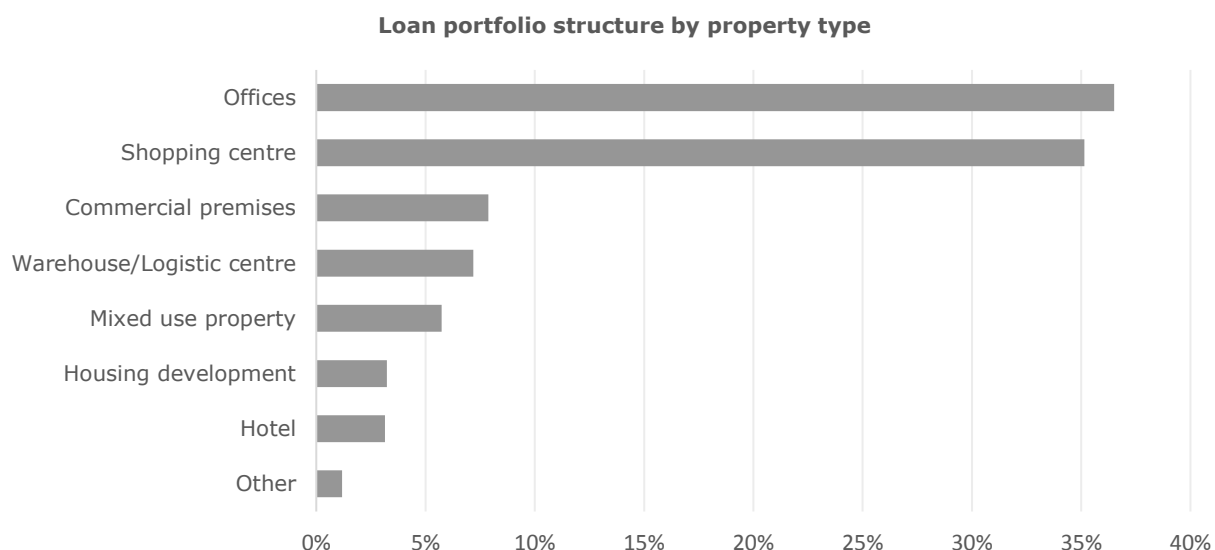
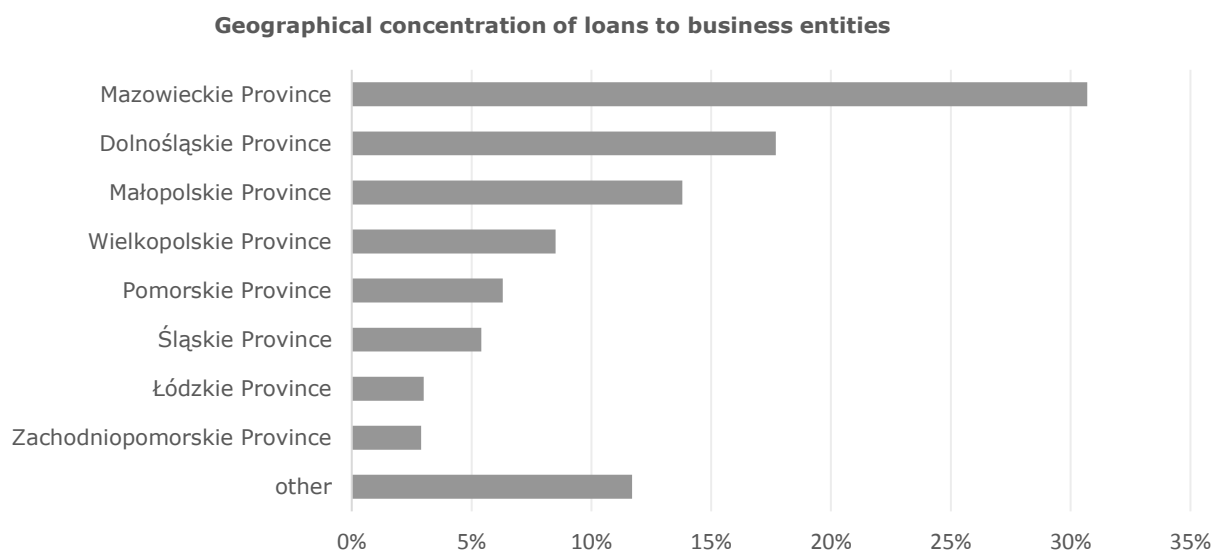


Chart 6. Geographical concentration of loan portfolio for business entities



The largest number of financed projects is concentrated in Mazowieckie province, where 30.7% of all credit resources is involved. In Dolnośląskie, Małopolskie and Wielkopolskie province the total balance sheet exposure accounts for 40.0%.

As of 30 June 2018 loans granted in EUR (75.9%) and PLN (23.0%) dominated the corporate loans portfolio.

#### **Public sector loans**

Due to the strategy of the Bank the portfolio does not contain new agreements, which in connection with significant prepayments is reflected in a lower, as compared to 31 December 2017, balance sheet exposure to public sector. As at 30 June 2018 the exposure was PLN 191 million (down by 5.0%).

#### **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 S.A. to mBank S.A. Starting from 22 July 2017, all mortgage loans to natural persons are processed and granted by mBank S.A. As a consequence of this change, the strategic objectives in this area will be implemented through the purchase by mBank Hipoteczny S.A. of a portfolio of mortgage loan receivables from mBank S.A.

### **1.5. Refinancing and issuing of covered bonds**

In the first half of 2018, mBank Hipoteczny S.A. placed on the market two big issues of mortgage covered bonds of a total nominal value of about PLN 1.61 billion as at 30 June 2018. In April, for the first time in 20 years of the Bank's history, a foreign issue of covered bonds with the tenor of 7 years and with the size of EUR 300 million, constituting the so-called sub-benchmark, was carried out. A second series of mortgage covered bonds with the size of PLN 300 million was issued in June – this time with the tenor of 6 years.

Moreover, as part of the debt restructuring, in the first half of 2018 the Bank repurchased one series of mortgage covered bonds from a private placement in the secondary market, with the total value of PLN 400 million.

The value of all mortgage covered bonds issued by the Bank and placed in organised trading as at the end of June 2018 amounted to approximately PLN 7.51 billion, representing approximately 36.0% of the mortgage covered bonds market in Poland according to the Bank's estimates.

At the end of June 2018, the Bank did not have any liabilities by virtue of issuing public covered bonds.

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Covered bonds of mBank Hipoteczny S.A. 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 22 June 2018, 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.
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
29.09.2017	10.09.2022	PLN	500,000,000	A
11.10.2017	15.09.2023	PLN	1,000,000,000	A
22.06.2018	10.06.2024	PLN	300 000 000	A
<b>TOTAL</b>		<b>PLN</b>	<b>4,035,000,000</b>	

Issue date	Redemption date	Currency	Value	Rating Fitch Ratings Ltd.
26.07.2013	28.07.2020	EUR	30,000,000	A
22.11.2013	22.10.2018	EUR	50,000,000	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	01.02.2024	EUR	24,900,000	A
30.10.2017	22.06.2022	EUR	100,000,000	A
26.04.2018	05.03.2025	EUR	300,000,000	A
<b>TOTAL</b>		<b>EUR</b>	<b>796,900,000</b>	

**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 2018 the collateral of mortgage covered bonds consisted of receivables of value PLN 9,124.7 million from total number of 19,700 loans.

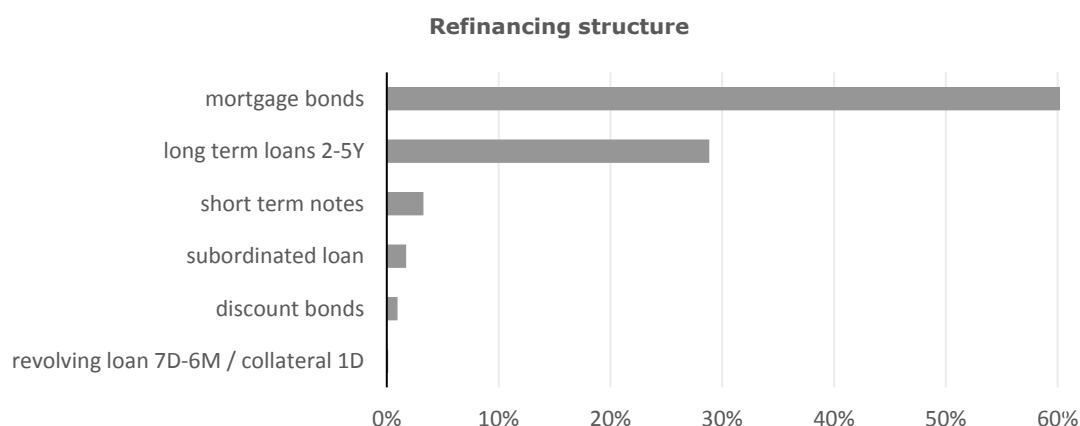
Loans for commercial clients constituted 45.39% and for retail clients 54.61% of the total amount of receivables entered into the mortgage cover register. Loans granted in PLN (64.34%) dominated, loans in EUR (35.14%) and USD (0.52%) constituted the remaining part.

Additionally to the credit receivables, the additional collateral in a form of treasury bonds of nominal value of PLN 340 million was also entered into the mortgage cover register.

As of 30 June 2018 the level of over-collateralisation (including substitute cover) of mortgage covered bonds and public sector covered bonds amounted to 25.21%.

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 7. The structure of refinancing of the Bank activity



## **1.6. Legal environment**

In the first half of 2018 intensive works were carried out 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 (...). Particular emphasis was placed on fulfilling obligations towards individuals who are customers and counterparties of the Bank and ensuring the exercise of their rights under the Regulation. These efforts were a continuation of works carried out already in 2017. The Regulation entered into force on 25 May 2018.

A legal challenge for the first half of 2018 was the alignment of operating procedures and technical infrastructure with the Anti-Money Laundering and Anti-Terrorism Financing Act of 1 March 2018 (Journal of Laws of 723, as amended) which superseded the previous Act of 2000 and was the transposition of the AML IV Directive into the Polish legal framework.

The end of the first half of the year also marked a change in the statute of limitation periods for claims. The statute of limitation period for business claims is still 3 years, but the period for claims established by court judgements has been shortened from 10 to 6 years. The rules of calculating the statute of limitation period were also changed. The Bank is adapting its procedures to these changes.

Following the announcement by the European Commission of the proposal for a directive of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and the proposal for a regulation of the European Parliament and of the Council amending Regulation No 575/2013 as regards exposures in the form of covered bonds – legal acts concerning the rules for issuing covered bonds and the rules for activities of their issuers (mortgage banks), the bank analyses these draft acts on an ongoing basis. The Bank participates in public consultations on these drafts through the institutions set up for this purpose. In the opinion of the bank, the proposed measures do not pose a threat related to the need to fundamentally change the business model in the future. Most of the proposed arrangements are in line with those currently in force in Poland, in particular the Act on Covered Bonds and Mortgage Banks. Minor discrepancies are reported by the bank on an ongoing basis in the consultation process through authorised institutions.

## 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.

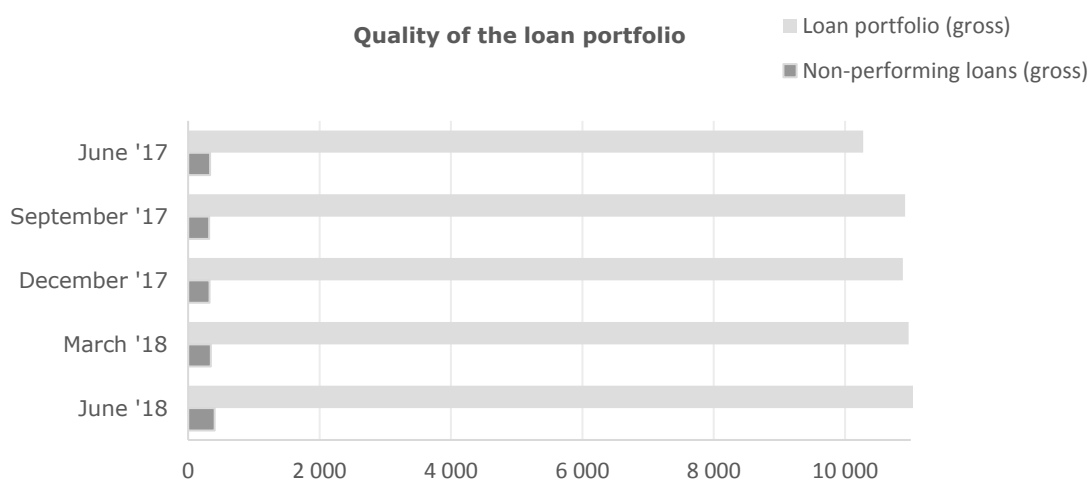
The share of non-performing loans in the loan portfolio increased from the level of 2.99% to 3.54%, as a result of reclassifying two commercial exposures to the default category. Most of the loans are repaid in a timely manner, and the borrowers of higher risk profile are subjected to a more strict monitoring.

Impairment provisions reaching PLN 167 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 2018 was refinancing of commercial real estates, especially shopping centres and offices. This activity is based on a uniform for the whole mBank S.A. 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).

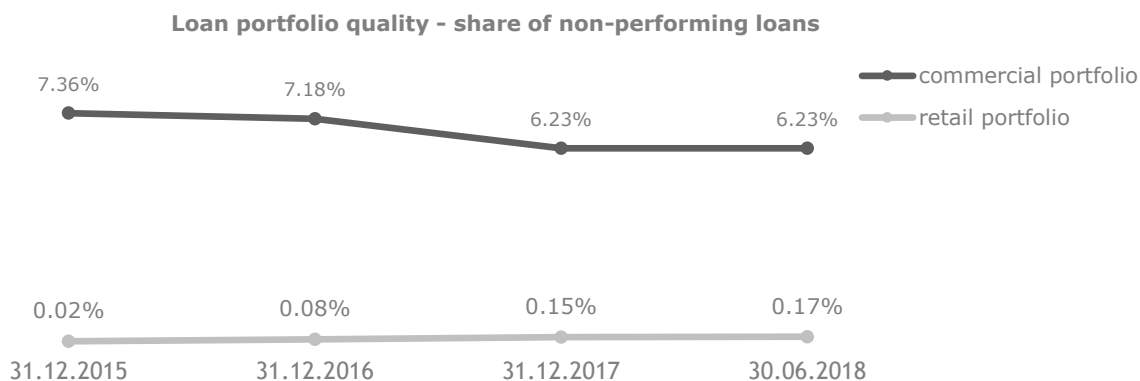
The retail portfolio is characterised by very high quality, which results from the applied credit policy (until the moment of transferring the whole process of selling retail mortgage loans to mBank S.A.) as well as the fact that this portfolio is very young. As of 30 June 2018 there were only 30 cases 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 8. Non-performing loans\* in the loan portfolio (gross value, in PLN million)



\* non-performing loans – loans classified in basket 3 or POCI, in accordance with IFRS 9

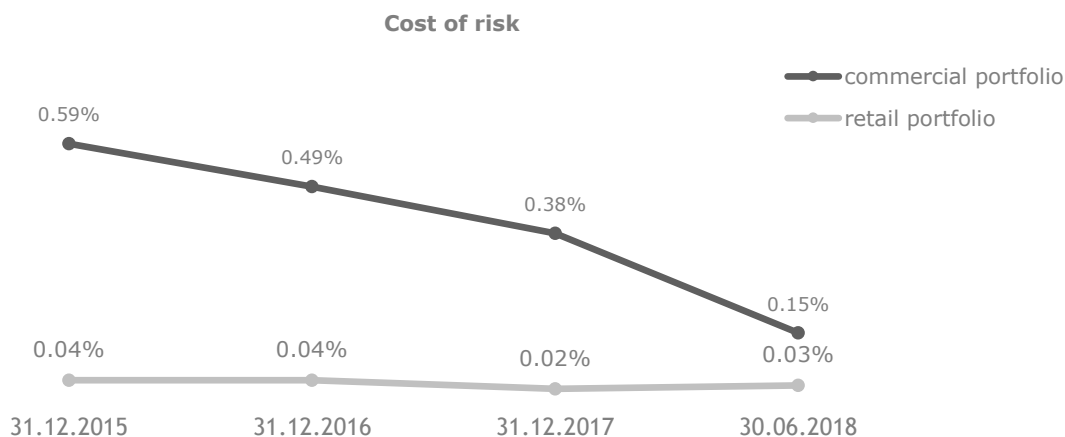
Chart 9. Share of non-performing loans by portfolio



\*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 10. 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 S.A. 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, insolvency proceedings**

In the first half of 2018, the Bank did not bring any lawsuits or file any motions for bankruptcy with respect to commercial clients.

On 25 May 2018, an auction sale of one of the real properties subject to enforcement proceedings took place. The real estate was auctioned at the price of PLN 10 million. As at the date of preparation of this report, the adjudication order has become final and binding. Additionally, the Bank was informed that on 24 May 2018 another entity filed a motion for bankruptcy of the company who was the owner of the auctioned real property. On 21 June 2018, the Court issued a decision on appointment of a Temporary Court Supervisor for the company in question. On 25 July 2018, the Bankruptcy Court declared the company bankrupt. The Court's decision on the declaration of bankruptcy is not final and binding.

In the area of retail loans, in the first half of 2018, 5 lawsuits were brought in the total amount of PLN 926.9 thousand. Two lawsuits concern clients of the legacy retail portfolio (loans granted without cooperation with mBank), while three lawsuits concern a new portfolio (1 pooling loan and 2 agency loans). As at the date of this report, the Bank had already obtained an enforcement title in one of the aforementioned cases.

## **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 2018 VaR amounted to PLN 581.8 thousand. The currency risk was PLN 23.2 thousand, the interest rate risk was PLN 251.7 thousand and the credit spread risk was PLN 540.8 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 2018 reached a safe level of 3.36%. 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 2018, the excess of liquid assets amounted to approx. 6.5% of the balance sheet total.

In 2018 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 S.A. 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 2018 was 1.072. M1 and M2 short-term liquidity standards were maintained at a safe level, PLN 1,577,387 thousand and 3.840 respectively. The M3 standard was 101.041.

As at the end of June 2018 the liabilities limit, resulting from Art. 15.2 of the "Act on covered bonds and mortgage banks", was used in 58.49%. In 2018 this limit was not exceeded.

As at the end of June 2018 average maturity of issued mortgage covered bonds was 4.5 of a year while the average maturity of loans obtained from other banks was 3.8 of a year. The margin of mortgage covered bonds issued in 2018 on average amounted to 0.58%, with average maturity of 6.0 of a year.

## **2.4. Operational risk**

The Bank has a simplified organisational structure, and the products offered are consistent with the nature of the mortgage bank's activity. In 2017, the profile of the Bank's activity was changed. As of 22 July 2017, the sales process for retail loans was transferred to mBank S.A. This involved the transfer of operational risk related to entrusting a substantial part of the activities to external entities and the transfer of risk identified at the stage of verifying loan applications and concluding loan agreements. The indicated factors contribute to decreasing the Bank's operational risk, yet, operations related to the maintained retail portfolio and the acquisition of loans by pooling are continuously monitored. So far, the data collected does not indicate any increase of operational risk in the retail banking 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 S.A. 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 profile of operational activity, related to the transfer of the sales process of retail loans to mBank S.A.

### **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.

The Bank will monitor and analyse any changes affecting its operational risk profile.

## **2.5. Covered bonds investment risk**

In 2018 the investment risk profile associated with covered bonds issued by mBank Hipoteczny S.A. 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** - compliance cell with the following responsibilities:
  - it manages compliance risk (construed as the risk of effects of non-compliance with legal regulations, internal regulations and market standards) through identification, assessment, controlling, monitoring and reporting on compliance risk regarding the law, internal regulations and market standards;
  - it performs horizontal monitoring tasks of the compliance unit and vertical monitoring tasks within the so-called second line of defence, assigned to the compliance unit to assure compliance of the Bank's operations with legal regulations, internal regulations and market standards. CD performs other tasks, provided that it does not undermine its effectiveness and independence.

The Compliance Department is responsible for implementation of the standards of the mBank Group and, indirectly, of Commerzbank AG in areas regarded as "compliance areas" in accordance with the Group standards, which include in particular:

- anti-money laundering and counter-terrorist financing
- protection of personal data
- banking outsourcing

- preventing conflicts of interest, fraud and corruption
- supervision over the process of handling of client's complaints
- Inside information according to Market Abuse Regulation.

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

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

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

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

## **2.7. Remuneration policy**

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

### **3. Directions of development and key elements of the Bank strategy**

#### Mission statement

With regard to the real estate market, the mission of mBank Hipoteczny is to support the development of an effective mechanism for financing the real estate market in Poland by issuing long-term debt securities (covered bonds), which are an instrument that makes it possible to refinance attractive forms of real estate financing based on strong competences, the longest market experience and the highest standard of service.

With regard to mBank Group, the mission of mBank Hipoteczny is to provide stable, long-term and safe refinancing.

From the investors' point of view, the mission of mBank Hipoteczny is to ensure a high level of long-term covered bonds with a high level of security.

#### The vision

mBank Hipoteczny will be focused on issuing covered bonds in Poland and on the international market within the most cost-effective business model possible, i.e. aimed at maximising synergies within mBank Group, in particular on using the available resources of each bank, primarily mBank, in accordance with their economic purpose, as well as the knowledge and experience within mBank Group.

In view of the development of the covered bond market in Poland, and in particular in view of the expected establishment of new mortgage banks, the Bank's ambition is to maintain its current position among the leading issuers of such instruments in Poland.

mBank Hipoteczny will use the experience gained and the unique knowledge of the market in the area of commercial mortgage loans aimed at securing issued covered bonds. The Bank's goal is to maintain its leading position on the Polish market in the refinancing of commercial real estate loans.

The Bank's strategic objectives for 2019–2022 are the following:

- Maximum utilisation of covered bonds as a tool for refinancing the portfolio of long-term mortgage loans.
- Dynamic development of the portfolio of real estate loan assets (housing and commercial loans) under the applicable risk management strategy, compliant with the covered bond collateral criteria.
- Optimal use of resources and competencies in both banks as well as other entities of mBank Group, making it possible to achieve synergy in order to ensure an effective issuance process while maintaining the principles of safe and prudent management of the Bank so that the Bank is a safe, efficient and effective issuer of covered bonds on the market.

Strengthening mBank Group's independence with regard to the financing of its operations and better matching the time horizon of financing with assets is a key element of the financing strategy. The issuance of covered bonds is a factor supporting the financing of operations on the real estate market.

mBank Group assumes a dynamic growth of the issuance operations of the Bank in the coming years. The issuance of covered bonds allows the Bank to generate stable and long-term financing on affordable terms.

The Bank assumes issuance of covered bonds secured by both residential and CRE mortgage loans – both types of collaterals will be acquired in cooperation with mBank, including with the use of the pooling model with regard to housing loans. In the case of commercial assets, one of the options considered for their acquisition in the coming years is a syndicated model with the participation of mBank.

Housing mortgage loans will be the main driver of the increase in the covered pool for the issuance of covered bonds at the Bank. Covered bonds will be issued both in PLN and in EUR, and their maturity will vary between 5 and 10 years.

#### **4. Bank Authorities**

##### **Shareholders**

As at 30 June 2018, 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 the reporting date the ownership structure of registered share capital of the Bank is as follows:

Name of shareholder	Registered share capital in PLN	Shares		Votes at the General Meeting of Shareholders	
		Amount	%	Amount	%
mBank S.A.	321,000,000	3,210,000	100.00	3,210,000	100.00
<b>Total</b>	<b>321,000,000</b>	<b>3,210,000</b>	<b>100.00</b>	<b>3,210,000</b>	<b>100.00</b>

The Bank does not collaborate with international public institutions.

##### **Management Board**

The Management Board of mBank Hipoteczny S.A. included the following members:

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

##### **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.:

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### Management Board Report on the Performance of mBank Hipoteczny S.A. in the first half of 2018

- 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:

- Frank Bock – Supervisory Board Chairman
- Lidia Jabłonowska-Luba - Supervisory Board Vice-Chairman
- Andreas Boeger – Supervisory Board Member
- Jakub Fast – Supervisory Board Member
- Paweł Graniewski – Independent Supervisory Board Member
- Cezary Kocik - Supervisory Board Member
- Michał Popiołek - Supervisory Board Member
- Mariusz Tokarski – Independent 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**

The Audit Committee included the following members:

- Paweł Graniewski - Committee Chairman
- Andreas Boeger - Committee Member
- Mariusz Tokarski - Committee Member

In 2018 the Audit Committee held a meeting on 2 March.

## **Risk Committee**

The Risk Committee included the following members:

- Lidia Jabłonowska-Luba – Chairwoman of the Committee
- Frank Bock - 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 2018 the Risk Committee held one meeting on 11 January.

### **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.

## **5. 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 21 March and 29 March 2018, the Annual General Meeting of mBank Hipoteczny S.A. appointed the Supervisory Board of the eleventh term of office, composed as above. The General Meeting verified the candidates for the Supervisory Board members and decided that they fulfilled the requirements set forth in Article 22a of the Banking Law.

When appointing the current Management Board, the Supervisory Board verified the persons being appointed as Members of the Management Board and decided that they fulfilled the requirements set forth in Article 22a of the Banking Law.

### **Proceedings before a court, arbitration body or public administration authority**

Information on pending proceedings is provided in Note 24 to the Financial Statements.

### **Public aid**

In 2018, 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 2018.

### **Events after the balance sheet date**

On 12 July 2018, the Bank concluded a new subordinated loan agreement in the amount of PLN 100 million. The loan in question was granted by mBank S.A. Funds acquired with the loan will be allocated and used to increase Bank's own funds (Tier II). On 17 July 2018, the Bank applied to the Polish Financial Supervision Authority for approval to include the new loan in Tier II. Having obtained the PFSA's consent for the inclusion of the loan in Tier II, the Bank intends to repay the subordinated loan granted by mBank S.A. under the agreement of 16 October 2012 in the amount of PLN 100 million. On 17 July 2018, the Bank applied to the Polish Financial Supervision Authority for permission to early repay the loan, which currently consists own funds (Tier II).

## **6. 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



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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 S.A. as well as its financial performance,
- The report of the Management Board on activities presents a true picture of the situation of mBank Hipoteczny S.A., including a description of the main risks and threats.

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

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

.....  
Piotr Cyburt  
President of the  
Management Board

.....  
Andrzej Kulik  
Member of the  
Management Board

.....  
Grzegorz Trawiński  
Member of the  
Management Board

.....  
Marcin Wojtachnio  
Member of the  
Management Board