Management Board Report
on the performance of Bank Hipoteczny S.A.
in the first half of 2023

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1. Introduction

As a specialist mortgage bank, in the first half of 2023 mBank Hipoteczny SA (Bank, mBH) focused on three business areas:

(1) retail, based on a strategic cooperation with mBank S.A. (mBank) and sourcing mortgages for individuals from it (Retail Loans, Retail Pooling),

(2) raising financing, in particular through the issuance of mortgage bonds, which provide the mBank Group with stable and long-term financing from the capital market,

(3) management of loan portfolios for which the Bank has discontinued new lending - on 17 May 2023, as part of the demerger of the Bank by spin-off of an organised part of the enterprise pursuant to Article 529 § 1 clause 4 of the CCC (Demerger), this business was transferred to mBank.

The Bank's total assets at the end of June 2023 amounted to PLN 10.2 billion, of which approximately 89% were high quality Retail Loans acquired from mBank.

mBH (as at the end of June 2023) issued mortgage bonds worth PLN 6.2 billion, which accounted for approximately 34% of the total value of mortgage bonds outstanding issued by Polish mortgage banks.

Financial credibility assessment - rating

The financial credibility of the Bank and the mortgage bonds it issues is assessed by the international rating agency Moody's Investors Service Ltd.

On 24 March 2023, Moody's Investors Service downgraded the long-term rating assigned to mBank Mortgage from Baa1 to Baa2. The rating downgrade is due to the downgrade of mBank's ratings and the methodology for assigning ratings to related companies in one group. The ratings assigned to mortgage bonds remained unchanged.

As at the reporting date, the following ratings were in force:

	rating	perspective	date	decision
Long-term Issuer Rating	Baa2	negative	24.03.2023	downgrading
Short-term Issuer Rating	Prime-2	-	24.03.2023	confirmation of rating
Long-term Counterparty Risk Rating	A2	-	13.07.2021	rating upgrade

Short-term Counterparty Risk Rating	Prime-1	-	13.07.2021	rating upgrade
Long-term Counterparty Risk Assessment Rating	A2 (cr)	-	13.07.2021	rating upgrade
Short-term Counterparty Risk Assessment Rating	Prime-1	-	13.07.2021	rating upgrade
Mortgage bonds	Aa1	-	13.07.2021	rating upgrade

Key projects

In H1 2023, the Bank began the process of implementing its multi-year strategy through the following projects:

1) Automation of the pooling process

In Q2 2023, together with mBank, mBH started work on the development of the pooling process. The new process is intended to respond to the growing demand for a more accurate portfolio selection in line with current business requirements (e.g. in the area of eco-credits and including loans with periodic fixed interest rates in pooling). At the same time, the bank is introducing clear and readable electronic communication with the customer. The assumptions made will minimise the paper circulation of documentation, which is in line with the ESG strategy. The process is scheduled for completion in the fourth quarter of 2023. This project is part of the implementation of one of the strategic objectives, i.e. a modern, automated pooling process.

2) Implementation of the AIRB method

The Bank has embarked on a joint project with mBank to secure supervisory approval for the AIRB approach for mBH's retail mortgage portfolio. Following the demerger by spin-off in May and the transfer of commercial loans to mBank, the retail portfolio is the core business of the Bank.

This project is a continuation of work that was initiated in 2016 and later temporarily halted. The submission of an application to the FSA on this matter is planned in 2024, once the Bank has met the formal conditions. The project fulfils a strategic objective from the area of risk management.

3) mBank Group's carbon footprint and decarbonisation strategy

As part of the mBank Group, mBH is participating in the preparation of a submission to the Science Based Targets initiative, which is planned for 2024. The submission is being prepared in cooperation with the Climate Strategies Poland Foundation.

4) Division by separation

On 17 May 2023, the demerger of the Bank was successfully completed pursuant to Article 529 § 1(4) of the Commercial Companies Code, through the transfer to mBank of a portion of the Bank's assets (assets and liabilities) and rights and obligations in the form of an organised part of the enterprise, being an organisationally and financially separate set of tangible and intangible assets in the existing mBH enterprise, related to the business of granting and servicing loans involving:

(1) loans secured by mortgages to finance commercial real estate (CRE Portfolio),
(2) loans granted to or guaranteed by local authorities (Loans to local authorities),
(3) loans secured by mortgages granted to individuals for non-business purposes for which the loan agreement with the customer was concluded by 25 July 2013, meeting the criteria set out in the Demerger Plan, available on the Bank's website (www.mhipoteczny.pl),

together with the IT systems dedicated to servicing the aforementioned loans and the staff necessary to carry out these activities, as well as the tangible assets, rights and obligations related to the conduct of this business and other assets and liabilities necessary for the performance of certain economic tasks remaining within the scope of these banking activities.

As a result of the Demerger, the Bank's share capital was reduced to PLN 220 million, while maintaining safe levels of the Bank's solvency ratios, corresponding to the new business profile.

There has been a significant improvement in the credit risk profile, with the NPL ratio as at 30.06.2023 decreasing by 3.84 percentage points compared to year-end 2022 and amounting to 0.97%. The risk of material defaults has also been eliminated (no singularly large exposures characteristic of the CRE Portfolio and the JST Portfolio).

The Bank has improved the risk profile of the asset pool securing the issuance of mortgage bonds, by eliminating the risk of concentration of large corporate exposures. New issuances will be carried out using a homogeneous portfolio of PLN mortgage retail loans. This will reduce the cost of issuing mortgage bonds, which will maintain a high rating with lower required overcollateralisation and more favourable collateral quality ratios (lower Collateral Score and Cover Pool Losses). Better utilisation of available collateral will reduce the cost of funding in the future.

The Bank's organisational structure has been simplified and the headcount at the end of June was reduced by 18 FTEs compared to the end of December 2022.

5) IBOR

In the first half of 2023, the Bank, as part of a joint project of the mBank Group, continued to implement solutions resulting from Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as reference indices in financial instruments and financial contracts [...] (BMR Regulation) by introducing so-called fallback clauses into contractual relations with customers. On the basis of the Bank's Business Continuity Plan and project schedule, the Bank sent communications to customers of almost the entire Retail Loan portfolio and signed annexes to contracts with customers who responded to the Bank's proposal. Bank representatives are participating in the National Working Group to ensure smooth implementation of the findings.

6) Implementation of the amendments to the Labour Code

In connection with the amendment to the Labour Code introduced on 7 April 2023, related to the implementation of two EU directives, the Bank enacted the relevant changes concerning the rules of remote working. Thus, the hybrid working model and the possibility to work from abroad have become a permanent element (not only during the pandemic period) of the Bank's operation. The continuous improvement of this working model is the implementation of one of the strategic objectives related to creating the best hybrid workplace.

7) Electronic circulation of powers of attorney

The Bank has implemented a proxy management application. It streamlines the circulation of powers of attorney and authorisations, purchases electronic signatures for the Bank's employees, enables efficient reporting and ensures transparency of the process. The assumptions adopted allow for the minimisation of paper documentation circulation, which fits in with the ESG strategy.

2. External Determinants of Business

2.1. Macroeconomic and legal environment

The global economy is in a phase of reduced activity, influenced by factors such as (1) high oil, food and energy commodity prices and (2) global interest rate rises.

The end of the COVID-19 outbreak worldwide has contributed to the consolidation of the hybrid working model in some economies, which until now had been a temporary solution for the duration of the pandemic. In Poland, relevant regulations allowing remote working and so-called hybrid working were introduced into the Labour Code in April 2023.

As a result of the ongoing war in Ukraine, a number of countries have introduced unprecedented sanctions against Russia and Belarus, including banning the export of certain goods and technology (including through intermediaries), cutting off the banking system from SWIFT, closing the airspace to Russian aircraft and introducing a maximum import price for Russian oil of $60 per barrel.

These factors translate into high levels of inflation, which in Poland peaked at 18.4% in March 2023. In recent months, consumer inflation in Poland has fallen to 11.5%, while the prospects for a further decline around the NBP's inflation target are uncertain and postponed. In the United States and the euro zone, inflation has also started to decelerate, which translated into consumer inflation readings of 4% and 6.1% respectively at the end of May.

In October 2021, the National Bank of Poland began a cycle of interest rate increases. The total scale of increases in the NBP reference rate until October 2022 was 6.8 p.p. (to 6.8%) and there were no further changes in its level in 2023. Throughout the first half of 2023, the reference rate remained stable. The first interest rate cuts are not ruled out at the end of 2023 in the event of a significant reduction in inflation.

In parallel, the two key central banks, the FED and the ECB, are in the midst of a cycle of interest rate rises. At the FED, the main rate has reached between 5% and 5.3%. Further interest rate rises are likely, provided the US labour market remains stable. At the ECB, the main rate has reached 4% and further increases are possible.

The slowdown exacerbated by high interest rate levels is lowering the outlook for Poland's GDP growth in 2023, although the minimum has probably already been reached in the first quarter of this year. The deceleration in economic growth may be reflected in an increase in the unemployment rate and a weakening labour market. On the other hand, the rating agencies S&P, Fitch and Moody's have in recent months maintained Poland's existing ratings with a stable outlook.

In its long-term analysis, mBank expects inflation in Poland to fall further in 2023, albeit at a slower pace than before and to around 10% by the end of the year.

The Polish currency will continue to be sensitive to the geopolitical situation in the region. In recent months, there has been a strengthening of the Polish currency, which has improved the prospects for lower inflation in the imported goods section. Increased state spending (e.g. compensation for energy price increases, defence sector spending, increased public debt costs) may contribute to increases in Polish government bond yields, which have however fallen recently due to potential interest rate cuts in Poland.

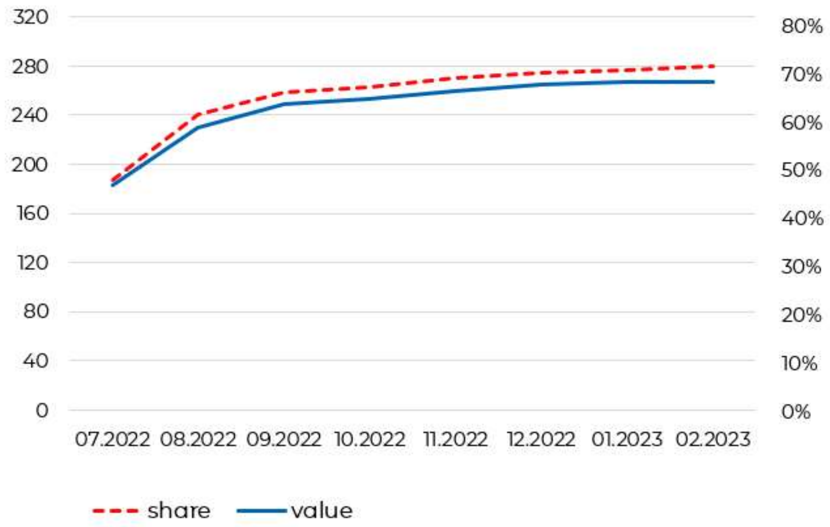
Key macroeconomic indicators 2023-2024

	GDP (% y/y)	Private consumption	Investments	Inflation (% y/y, end of period)	Unemployment rate (%, end of period)
2023 Q1	-0.3	-2.0	5.5	16.1	5.4
2023 Q2	0.3	-1.9	3.9	11.5	5.0
2023 Q3	1.4	0.4	5.9	9.5	5.2
2023 Q4	4.4	3.3	5.5	8.5	5.6
2024 Q1	3.9	5.3	3.9	6.3	5.7
2024 Q2	4.0	5.3	3.1	7.3	5.5
2024 Q3	2.3	4.4	1.6	7.4	4.9
2024 Q4	1.9	3.8	0.4	7.0	5.1

Source: https://makroekonomia.mbank.pl/252091-prognozy-dla-stop-procentowych-i-walut-z-komentarzem

Due to the increased risk of default among certain groups of borrowers in an environment of rising interest rates, concerns are being raised about the health of the banking sector. The sector's health has been impacted by the government's announcement of a universal borrower support scheme introduced by the Community Financing for Business Ventures and Borrower Assistance (Credit Vacation) Act of 7 July 2022. The Act introduced the possibility for consumers to benefit from what is known as a credit holiday, i.e. the suspension of four capital and interest instalments in 2022 and four instalments in 2023 in relation to a mortgage taken out to meet their own housing needs. In total, this means eight instalments over one and a half years. No interest accrues during the suspension period, which means a real loss for the bank, which loses the agreed remuneration and incurs refinancing costs.

According to the NBP's Financial System Stability Report, at the end of February 2023, around 70% of loans (by value) were covered by the Credit Vacation programme. According to the Polish Banks Association, 66-68% of those eligible benefited from mortgage repayment assistance, costing banks a total of around PLN 20 billion.



Source: June 2023 Financial System Stability Report

Rising interest rates entail an increase in the legal risk associated with the variable rate used in loan agreements. WIBOR has been adapted to the requirements of the BMR Regulation, and in future the WIRON index is to be used as a substitute. On the Polish market, the first banks have started selling mortgage loans based on the WIRON index. As part of the work of the National Working Group on Reference Index Reform, recommendations are being developed for the transition of individual product types to the WIRON index. Introduced into the banks' offerings in July 2021, loans with a periodically fixed interest rate are very popular with borrowers and, according to AMRON, for the fourth consecutive quarter accounted for more than half of mortgage sales (52% of sales in Q1 2023). It has also been possible to convert loans granted at a variable rate to a periodically fixed rate, making it easier for customers to consciously mitigate the risk of interest rate changes.

The FSA's position on the assessment of creditworthiness when granting loans was modified in February 2023. Previously, banks were obliged to take into account the scenario of a further 5 p.p. increase in interest rates when assessing creditworthiness, whereas after the change this buffer was reduced to 2.5 p.p.. This translated into an improvement in the availability of mortgages and an increase in the market volume of newly granted loans by around 21% compared to the previous quarter (AMRON data for 1Q2023) and an increase in the value of credit enquiries by around 26% year-on-year (BIK data from June 2023).

On 19 June 2023, the FSA also adopted an amendment to Recommendation S on good practices for the management of mortgage-backed credit exposures.

The changes introduced in Recommendation S relate to:

(1) the inclusion within the recommendation of a guaranteed housing loan covered by a government scheme and a housing loan covered by a government interest subsidy scheme;
(2) rules for calculating the interest rate rise buffer to be taken into account in determining a customer's creditworthiness;
(3) the introduction of new expectations on the inclusion of models estimating the risk of early repayment of loans;
(4) the introduction of new expectations regarding the information on mortgage risks that should be provided to customers.

The Financial Supervision Authority (FSA, Authority) expects banks and branches of credit institutions to align their operations with the amendments to Recommendation S by 1 July 2024.

Part of the banking sector in Poland has been adversely affected by a judgment of the Court of Justice of the European Union on 15 June 2023. The Court ruled that banks cannot claim capital usage fees from borrowers if a court declares a CHF loan agreement invalid.

On 24 March 2023, the FSA has adopted an amendment to Recommendation J concerning the rules for the collection and processing of real estate data by banks. The deadline for banks to comply with the new rules was indicated by the Authority by the end of 2023 and, with regard to categories identifying properties in real estate databases, no later than 31 March 2024.

On 1 July 2023, a comprehensive amendment to the Code of Civil Procedure also came into force. Among other things, it introduced new rules for proceedings involving consumers including:

(1) the possibility for the consumer to choose the court of his or her domicile;
(2) the possibility for a court to order a trader in dispute with a consumer to pay the trader's legal costs in the event of failure to settle;
(3) the introduction of stricter evidence preclusion for a trader in a dispute with a consumer (obligation to present all claims and evidence in the statement of claim or statement of defence under pain of losing the opportunity to raise them).
(4) On 1 July 2023, the Act of 26 May 2023 on State Aid to Housing Savings came into force, which, among other things, introduced the 2% Safe Loan (to the Family Housing Loan Act). This credit will be provided by banks that will sign an agreement with Bank Gospodarstwa Krajowego, under which interest rate subsidies on housing loans will be provided to eligible borrowers. These will be persons who are purchasing their first residential property and

meet the additional criteria defined in the Act. The subsidy will be implemented for the first 10 years of the contract. There is considerable interest in this product, but the Bank will not be able to offer it directly (it does not sell loans). The possibility of purchasing such subsidised loans from mBank under a pooling model is being analysed in cooperation with BGK. The Bank is seeking to develop an appropriate agreement and cooperation model.

On 16 May 2023, the FSA presented the concept of a new Long-Term Funding Ratio. The potential introduction of a mandatory indicator could prompt banks involved in mortgage lending to increase their issuance of covered bonds to meet the new requirements. The proposed facilitation of mortgage bond acquisitions would make this instrument more attractive to new groups of buyers in the Polish market and would contribute to a reduction of asset-liability management risk in the financial sector.

2.2 Mortgage bond market

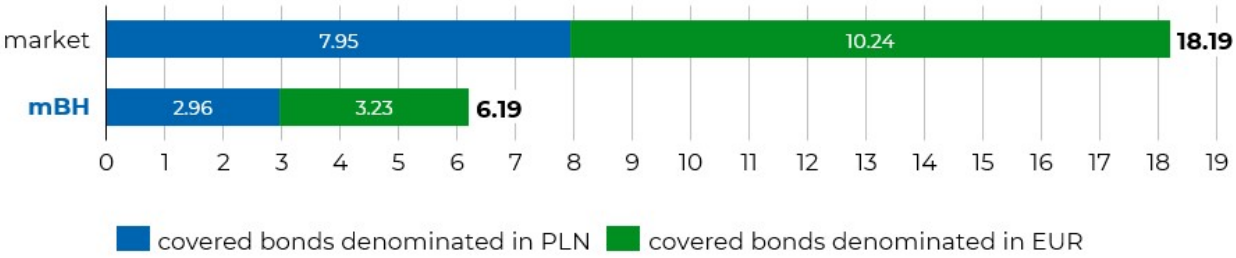
Mortgage bonds are issued in 30 different European countries. The increased popularity of this type of instrument has taken it beyond European borders. It has become a global product, with issuers in countries such as Australia, Canada, New Zealand, Singapore, South Korea and Brazil.

The mortgage bond market has been operating in Poland for more than 20 years. Polish mortgage banks have a reputation not only in the domestic market but also abroad. mBank Hipoteczny is one of the issuers whose mortgage bonds are listed, in addition to the Warsaw Stock Exchange, also on the Luxembourg Stock Exchange.

The volume of Polish mortgage bonds outstanding at the end of June 2023 was approximately PLN 18.2 billion (€4.2 billion). This represented 0.2% of the European mortgage covered bond market. On a macro level, the most significant issuers of mortgage bonds remain Denmark, Germany and France, whose issues, by comparison, account for 15.5%, 13.3% and 11.9% of the European market respectively (according to ECBC: European Covered Bond Fact Book 2022).

In the first half of 2023, five mortgage banks operated in Poland, four of which issued mortgage bonds, three of which, including mBank Hipoteczny, have mortgage bonds listed on the European market. These letters were mainly intended for foreign institutional investors.

Mortgage bonds traded domestically and abroad as at 30 June 2023 (in PLN billion)



Source: Financial statements of Polish mortgage banks and information on issues

On 30 June 2023, 6.2 billion mBH mortgage bonds were publicly traded (34.1% - market share).

The currently felt limited demand for mortgage bonds in Poland is due to the lack of systemic incentives for long-term savings:

(1) decline in assets under management of OFEs,
(2) low popularity of IKE, IKZE and PPK and PPE,
(3) MIFID restrictions in transactions with individuals,
(4) need for financial institutions to pay a bank tax, which significantly reduces the profitability of the investment,
(5) low profitability of using letters in repo or credit transactions with the NBP,
(6) lack of an NBP mortgage bond purchase programme,
(7) competition in the form of debt securities issued by banks to meet MREL/TLAC requirements (on a scale that is difficult to estimate at the present time).

The concept of long-term mortgage financing, presented by the PFSA in May 2023, described in section 2.1. is an opportunity to accelerate the development of the mortgage bond market in Poland.

Regardless of the proposals for systemic solutions, since the beginning of 2023 we can observe asset increases in domestic TFIs, where assets under management have increased by a total of PLN 18 billion, reaching PLN 285 billion in May 2023, the level before the outbreak of the war in Ukraine.

Positive investment performance combined with high inflows meant that assets in the debt fund segment increased by almost PLN 2.7 billion (3%) in May 2023 alone. With such a sustained upward trend, mortgage bonds issued by the Bank may attract much more interest from TFIs than before.

An alternative to the domestic market is the European market, where central banks are active in the context of covered bonds. The ECB, under the CBPP3 programme, has been buying covered bonds issued by European entities. The size of this portfolio in mid-2022 was €299 billion. This portfolio has been reduced since 2023 as part of quantitative tightening as one of the tools to fight inflation and at the end of June its size held by the ECB was around 296.5 billion euro.

It is also crucial that mortgage banks support the Sustainable Development Goals. This will positively translate into the development and well-being of society. On the other hand, it will enable banks to access investors for whom ESG objectives (E - environment, S - social responsibility, G - corporate governance) are one of the key criteria for cooperation.

Until 30 June 2023, two of the five mortgage banks have green mortgage bonds issued by them. mBank Hipoteczny, when setting out its objectives in its 2023-2026 strategy, also committed to issuing mortgage bonds that support ESG objectives.

2.3 Residential property market

The first quarter of 2023 saw an improvement in performance in terms of the number of flats sold on the primary market. In total, in the six main markets, Warsaw, Krakow, Wrocław, the Tri-City, Poznań and Łódź, developers sold more than 11,400 units. This was an improvement of around 34.0% compared to Q4 2022, which already saw a rebound in sales, but also an improvement of around 9.7% compared to last year's results.

On the new supply side, deceleration continued to be seen. The number of flats newly introduced to the offer was as low as in the last two quarters of 2022 and amounted to around 6,800 units between January and March 2023. The smallest number of new units appeared in the Tri-City and Kraków, below a thousand. In the other three markets, Wrocław, Poznań and Łódź, developers put on the market slightly more than a thousand units. In the case of Warsaw, the result was also exceptionally low - below 2,000 units.

In most markets, the difference between the number of flats sold and put on offer was very pronounced. In the case of Warsaw, Kraków and Wrocław, this resulted in a large shrinkage of the offer. At the end of March, clients had a choice of only ca. 12,000 flats in the capital city, and less than 7,000 in the other two cities. Developers slowed down the start of sales of units in new projects, which caused the offer in total on the six markets to fall to ca. 44,000 flats at the end of March.

On the back of a wave of development projects started in previous years, approximately 54.9 thousand residential units were completed in Q1 2023, approximately 0.3 per cent more than in the same period in 2022. The number of approximately 38.6 thousand dwellings with construction starts was approximately 27.6% lower year-on-year. Despite the persistence of reduced demand for housing, the still high estimated rates of return on housing projects compared to other industries contributed to investors' efforts to obtain more housing permits, albeit at a lower rate (the number of building permits in Q1 2023 fell by approximately 33.8% y/y).

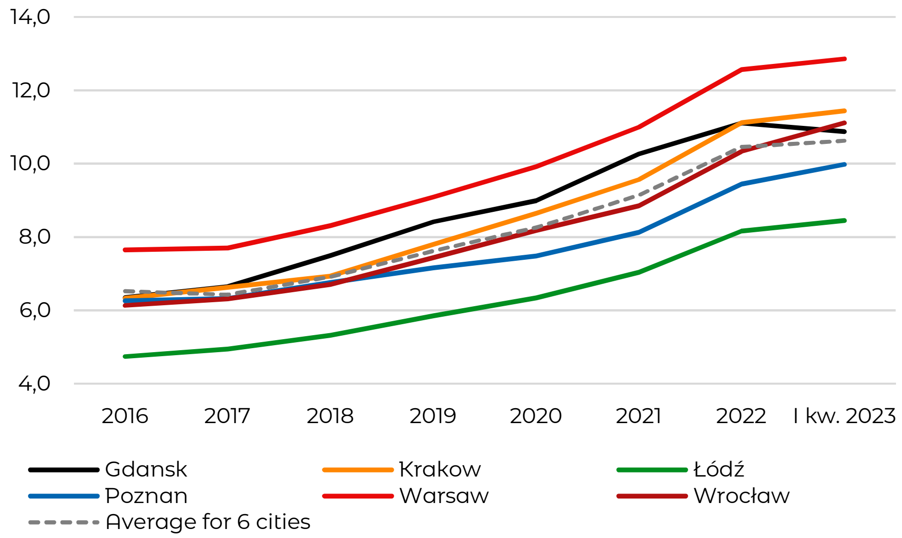
In the last two quarters of last year, the structure of new supply changed in terms of an increase in the share of more expensive, higher-standard flats. The previous proportions, in which there were fewer cash customers than credit customers, have reversed. In the second half of 2022, the demand was generated mainly by cash customers, and developers, adjusting their offer to them, started to put investment projects in attractive locations or offer a high standard, which resulted the maintenance of upward price trends in the market.

In Q1 2023, the housing offer was strongly influenced by the announcement of the launch of the new government housing programme[a], which is tailored to first-time buyers, and the amount of the loan combined with the limitation of the own contribution limits the purchase price. This group of buyers will primarily be looking for small 1-3 room flats of basic standard, so that the amount of the loan taken out is within the limit. Developers are therefore returning to the introduction of more units of basic standard. Units introduced for sale in the first three months of 2023 were considerably cheaper than in the previous two quarters, but year-on-year price increases for new flats were still observed.

The average transaction price per 1 m^2 , in the primary market in Q1 2023, for the six main cities amounted to approximately PLN 10.6 thousand/m^2 and increased by approximately 6.6% y/y. The highest average transaction price was recorded in Warsaw and amounted to ca. PLN 12,800/m^2, and the lowest in Łódź at ca. PLN 8,400/m^2 . The highest average increase in transaction prices per 1 m^2 was recorded in Poznań (by approx. 13.5% y/y) and the lowest in Warsaw (by approx. 3.9%).

[a] As of 1 July 2023, the government's programme - First Home - was launched. The programme provides for subsidies from the state budget for the instalments of a loan for the first home (Safe Credit 2%).

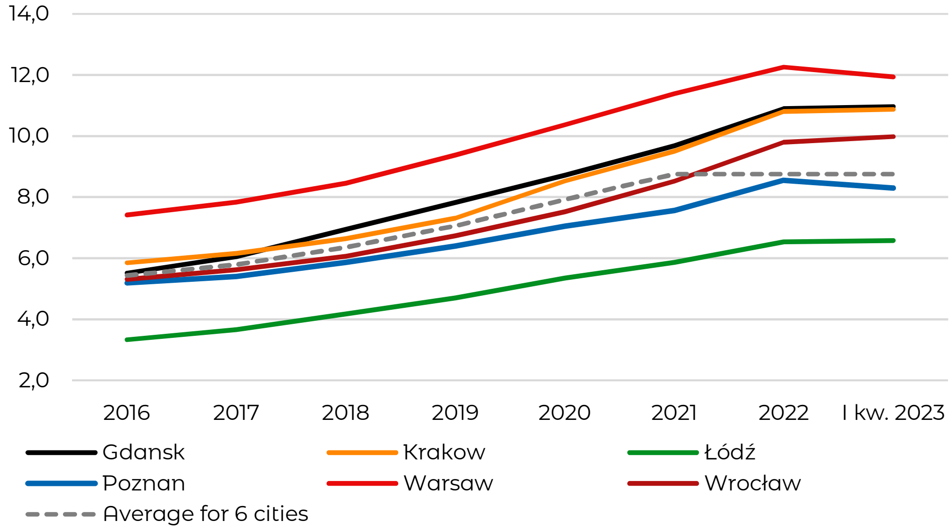
Change in the level of average transaction prices on the primary market in the six biggest Polish cities (in thousand PLN/m)[2]



Source: NBP, own elaboration

A study of average transaction prices per 1m² at the end of March 2023, for the six main cities in the secondary market showed an increase of approximately 3.8%, compared to the 2022 data. The highest dynamics were recorded in Wrocław (↑ by approximately 8.5% y/y), while the lowest price increase in the secondary market was recorded in Poznań (by approximately 2.1% y/y). A decrease in the average transaction price was recorded in Warsaw (by approx. 2.5%). The highest average transaction price on the secondary market occurred in Warsaw and amounted to approx. PLN 11,900/m², and the lowest in Łódź at approx. PLN 6,500/m².

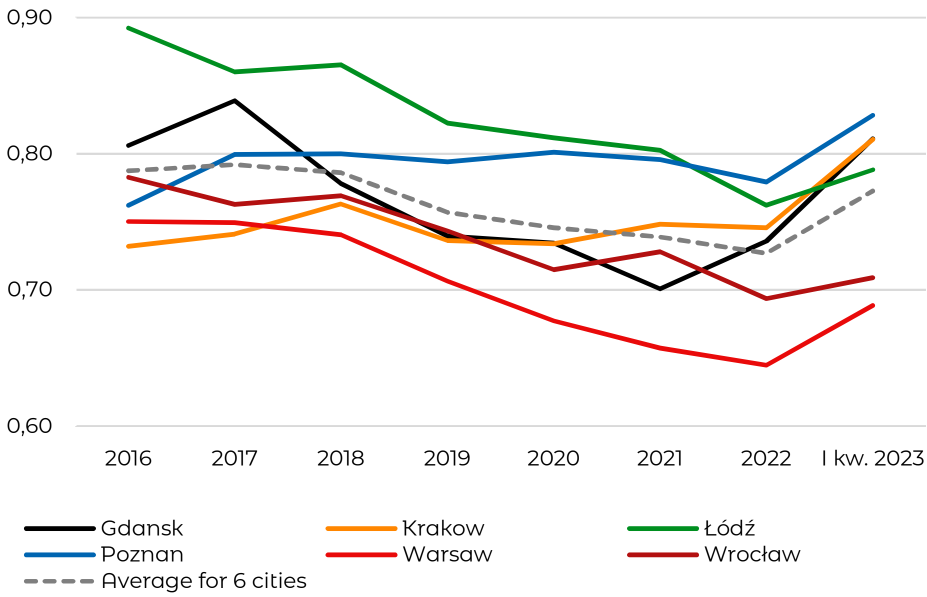
Change in the level of average transaction prices on the secondary market in the 6 biggest Polish cities (in thousand PLN/m)[2]



Source: NBP, own elaboration

The housing affordability index at the end of March 2023, in most of the analysed cities (based on the average monthly remuneration in the business sector) increased slightly in relation to the previous quarter mainly as a result of salary increases. The cities with the highest housing availability ratio were Poznań at approx. 0.83 m² and Kraków at approx. 0.81 m². The lowest housing availability rate was in Warsaw ca. 0.69 m². The average indicator for the 6 cities included in the analysis at the end of March 2023 was around 0.77 m².

Housing availability at average pay (in m²)



Source: NBP, own elaboration

The exposure period[b] needed to sell out all flats in the current offer, at the end of March 2023, decreased to 4.9 quarters from 5.8 quarters in Q4 2022. The shortest time to sell out the offer, occurred in Kraków (approximately 4 quarters) and the longest in Poznań (approximately 6.3 quarters). The most sought-after flats remained those from the popular segment (2- or 3-room units), in well-connected urban and suburban locations.

The annual result for residential sales in the six largest markets in 2022 was close to that of 2013, the period before the housing boom. After a year of turmoil due to the war in Ukraine, rising inflation, high rates and a reduction in mortgages, optimism returned to the market in Q1 2023 and sales achieved a good quarterly result. On the supply side, we continued to see a deceleration, but there was a definite improvement in the demand-supply relationship. The good sales performance, combined with a reduction in the number of launches, resulted in an offer sell-through rate, which fell and approached equilibrium.

[b] Exposure period - time to sell calculated as the number of dwellings on offer at the end of the quarter relative to the average sales over the last year.

The main factors bound to affect the residential property market in 2023 are:

(1) reduction by the FSA of the level of the interest rate variation buffer from a minimum of 5.0 p.p. to a minimum of 2.5 p.p. for loans with a periodically fixed interest rate, taken into account in the assessment of creditworthiness;
(2) introduction of the government's "First Home" programme in the second half of 2023, thereby stimulating the trend in housing sales;
(3) reduction of the supply of new dwellings and postponing their completion due to falling demand and high construction costs;
(4) increase in demand for housing on the outskirts of large cities and in counties that border larger conurbations;
(5) stabilisation of flat rents at high levels. The return of some refugees to Ukraine and the purchase of flats by some refugees are reducing pressure on the rental market;
(6) recovery in demand expected in the following years with the classic lag in the supply side response may lead to a return to an upward price trend.

2.4 Housing loan market

At the end of the first quarter of 2023, based on source data from a report prepared by AMRON-SARFiN, banks have PLN 485.529bn of housing loan receivables. According to data published by the BIK, the value of housing loans granted from January to the end of May 2023 is more than PLN 15 billion.

Compared to the same period last year, a decrease in lending of more than 46% is evident. In May, however, the banking sector recorded an increase in loans granted and granted the most loans in the last 12 months. This was 10,900 agreements worth PLN 3.9 billion. This represents a 14.3% increase in the value of loans granted compared to April. The results presented here are the result of growing demand for housing loans following an increase in creditworthiness. The liberalisation of the FSA's supervisory actions regarding the calculation of creditworthiness and the increase in salaries contributed to this.

The increase in the volume of housing loans in the second half of 2023 will be influenced by the launch of the government's “2% Secure Credit” programme. According to the law introducing the programme, PLN 8 million has been earmarked for subsidies this year and PLN 941 million the following year. Government projections indicate that 155,000 people will benefit from the '2% Safe Credit' by the end of 2027. In 2023, approximately 10,000 agreements are expected to be concluded, and in subsequent years this will be 30,000-40,000 agreements per year. The programme envisages granting loans with instalment subsidies until the end of 2027.

3 Financial results

3.1 Key financial indicators

	30.06.2023	31.12.2022
Net ROA[1)]	0.19%	-2.33%
Gross ROA[2)]	0.34%	-2.81%
Net ROE[3)]	2.29%	-23.52%
Gross ROE[4)]	4.13%	-28.35%
C/I (cost/income ratio)[5)]	49.18%	56.91%
Interest margin ratio[6)]	1.33%	1.04%
Cost of risk[7)]	0.13%	0.37%
Total capital ratio	22.35%	15.71%

1) net profit / average assets, 2) gross profit / average assets, 3) net profit / average equity, 4) gross profit / average equity, 5) (general administrative expenses + depreciation) / total income (understood as net interest income + net fee and commission income + trading profit + other operating income - other operating expenses + other income), 6) net interest income / average interest earning assets, 7) net impairment losses on loans and advances (excluding loan guarantee valuation) / average loans and advances to customers

3.2 Statement of financial position

in PLN '000	30.06.2023	31.12.2022	Dynamics
ASSETS	10 172 579	13 177 225	-22,80%
Loans and advances to customers measured at amortised cost	9 076 376	11 468 142	-20,86%
Loans and advances to customers measured at fair value through profit or loss	0	100 822	-100%
Financial assets at fair value through other comprehensive income	840 348	1 171 608	-28,27%
Other assets	255 855	436 653	-41,41%
LIABILITIES AND CAPITAL	10 172 579	13 177 225	-22,80%

Liabilities from the issue of debt securities	6 145 084	6 581 915	-6,64%
Liabilities to banks	3 049 462	5 544 817	-45,00%
Core capital	727 362	884 631	-17,78%
Other liabilities	250 671	165 862	51,13%

The balance sheet total of mBH at 30 June 2023 was PLN 10.2 billion, down 22.8% from the end of December. The net value of the loan portfolio at the end of June 2023 was PLN 9.1 billion compared to PLN 11.6 billion at the end of June 2022. The decrease in the value of the loan portfolio was mainly due to the transfer to mBank of the CRE and JST Portfolio with a net value of PLN 1.7 billion and prepayments. The second factor affecting the balance sheet total was the reduced inflow of retail assets in the Retail Pooling, which was related to the Credit Vacation.

On the liability side, the carrying amount of debt securities in issue at the end of June 2023 was 6.64% lower than in December 2022, this was due to the redemption of 1 series of mortgage bonds worth PLN 200 million and the redemption of 1 series of bonds worth PLN 60 million.

3.3 Profit and loss account

in PLN '000	Period from 01.01.2023 to 30.06.2023	Period from 01.01.2022 to 30.06.2022	Dynamics
Net interest income	77 092	54 904	40,41%
Net fee and commission income	(4 124)	(4 616)	-10,66%
Result from trading business	(1 160)	27 732	-104,18%
Result from non-substantive modification	106	1 923	-94,49%
Net impairment losses on loans and advances	(7 697)	(12 206)	-36,94%
General administrative costs	(32 349)	(32 120)	0,71%
Depreciation	(6 793)	(6 983)	-2,72%
Operating result	**33 831**	**26 641**	**26,99%**
Tax on the Bank's balance sheet items	(13 614)	(15 723)	-13,41%

Gross profit	**20 217**	**10 918**	**85,17%**
Income tax	(9 029)	(5 556)	62,51%
Net profit	**11 188**	**5 362**	**108,65%**
Weighted average number of ordinary shares / diluted weighted average number of ordinary shares	3 078 011	3 360 000	-8,39%
Net earnings per ordinary share / Diluted earnings per ordinary share (in PLN)	3,63	1,60	126,88%

In H1 2023, the Bank's results were mainly influenced by:

(1) Higher interest income compared to H1 2022 due to reduced prepaid retail loans and the release of part of the provision for reimbursement of commissions on prepaid TSUE loans,

(2) Increased average cost of financing as a result of the transfer in the organised part of the company to mBank of the liabilities related to the financing of Retail Pooling, which had a short maturity and therefore a lower interest rate,

(3) Compensation from reduced Retail Pooling, which credited the operating result with PLN 8 million,

(4) Lower loan write-downs -- down 37% (£4.5m) compared to H1 2022; H1 2023 includes loan provisions made for commercial loans for 4 months - until the Spin-off,

(5) Costs related to contributions to the Bank Guarantee Fund, which amounted to PLN 8.6 million (versus PLN 11.2 million in H1 2022).

The Spin-off transaction will have a positive impact on the Bank's financial performance in future years through:

(1) elimination of the risk of large commercial loan defaults and the associated high credit provisions,

(2) reduction in the overall administrative cost base, including staff costs and depreciation.

In H1 2023, the Bank's income, calculated as the sum of net interest income, net fee and commission income, trading income, other operating income and other operating expenses, amounted to PLN 79,491 thousand (H1 2022: PLN 77,593 thousand). This income is derived entirely from operations in the Republic of Poland.

Despite the significant level of inflation, the bank's operating costs and depreciation and amortisation were kept in line with the previous year, thanks to conservative control of budgets, which translated into a 7.73 p.p. improvement in the C/I ratio.

4 Business of mBH

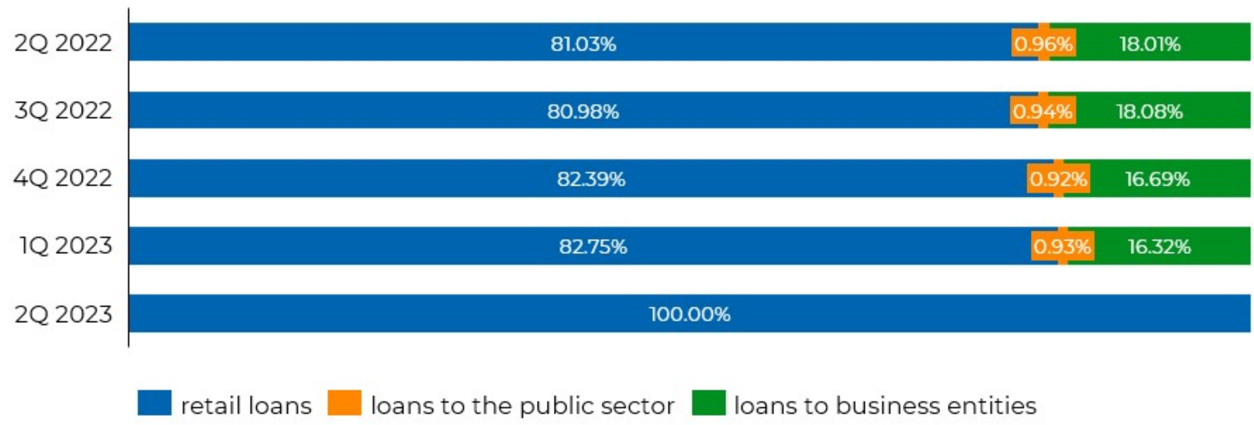
4.1 Lending business

As a result of the Demerger and the transfer of the CRE and JST Portfolios to mBank, the Bank's lending business will focus exclusively on the retail lending area. The business model of mBH, consistently implemented since 2013, is largely based on the outsourcing of a number of activities to external entities, mainly mBank, on the basis of outsourcing agreements.

The most important agreement relating to the Bank's core business segment, i.e. the Retail Loans portfolio, was concluded in 2014. It regulates the process of acquiring Retail Loans and the rules for after-sales service, support of the credit risk management process and provision of IT systems.

Based on this agreement, mBH carried out one pooling transaction of Retail Loans in 2023 for an amount of PLN 120 million. The reduced number of transactions carried out relative to the operations planned for this year is the result of customers taking advantage of the Credit Vacation, which affects the temporary tax inefficiency of acquiring these receivables in the Group.

The share of the CRE Portfolio and the JST Portfolio, in line with the strategy, declined steadily and, as a result of the Demerger, fell to zero.



CRE loans (for business entities)

In line with the provisions of the strategy, the Bank focused on managing the existing portfolio, which was being reduced on a regular basis due to schedule and early repayments.

On 17 May 2023, as a result of the Demerger, the portfolio was transferred in its entirety to mBank. The gross carrying amount of the transferred loans was PLN 1.9 billion.

Loans to the public sector (JST)

In line with the provisions of the Bank's strategy, there were no new contracts in this portfolio, which, combined with significant prepayments, was reflected in the decreasing balance sheet exposure of these loans.

On 17 May 2023, as part of the Demerger transaction, this portfolio was transferred in its entirety to mBank.

Retail loans to individuals

The bank has actively worked with mBank to shape the product and maximise sales of retail loans on the mBank side that meet the transfer requirements to mBH. The pooling process currently in place ensures that retail assets can be transferred on a monthly basis.

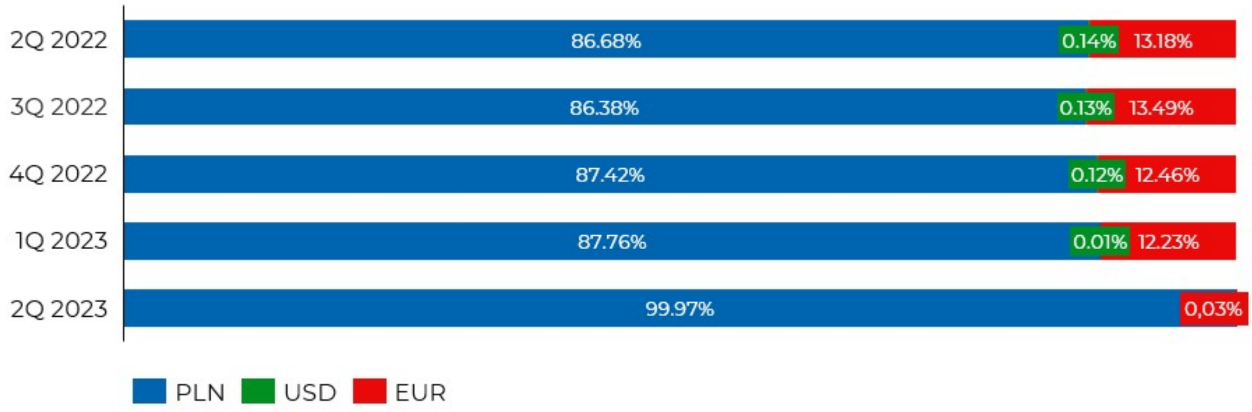
The reduction of the prudential buffer by the FSA from 5% to 2.5% has contributed to an increase in the creditworthiness of borrowers and, consequently, the number of loans granted at mBank has increased. Thus, the potential for mBH to acquire further loan portfolios in pooling transactions is growing.

The conversions of variable-rate home loans to periodically fixed-rate loans mean that, in the pooling area, mBH will expand its business to include the development of a model for the transfer of temporarily fixed-rate loans. Following the end of a series of interest rate rises in October 2022, mBH has seen a decline in the number of new applications for the conversion of variable-rate loans to periodically fixed-rate loans. Across the entire mBH portfolio, approximately 5.8 per cent of the total loan volume is made up of periodically fixed-rate loans.

Following the judgment of the Court of Justice of the European Union of 15 June 2023, it should be emphasised that there are no Swiss franc loans on mBH's balance sheet and therefore the Bank does not need to make provisions for this.

Currency structure of the loan portfolio

The currency structure of the loan portfolio changed significantly. As part of the Demerger, the CRE loan portfolio, which was largely denominated in euro, was transferred to mBank; as a result, at the end of June 2023, the share of loans in PLN amounted to 99.9%.



4.2 Issuance of covered bonds and refinancing

mBank Hipoteczny is the longest-established mortgage bank in Poland. It is the only entity in the Group with the authority to issue mortgage bonds, which it successfully places on both the domestic and foreign capital markets. As a result, it provides stable and long-term financing for loans secured by real estate.

The value, issued by the Bank, of mortgage bonds outstanding at the reporting date was PLN 6.2 billion, representing 34.1 per cent of the total market.

Bank mortgage bond issues outstanding

Date of issue	Redemption date	Currency	Value	Moody's rating
15.04.2015	16.10.2023	PLN	250 000 000	Aa1
11.10.2017	15.09.2023	PLN	1 000 000 000	Aa1
22.06.2018	10.06.2024	PLN	310 000 000	Aa1
22.02.2019	20.12.2028	PLN	100 000 000	Aa1
TOTAL		**PLN**	**1 660 000 000**	

Date of issue	Redemption date	Currency	Value	Moody's rating
28.02.2014	28.02.2029	EUR	8 000 000	Aa1
17.03.2014	15.03.2029	EUR	15 000 000	Aa1
30.05.2014	30.05.2029	EUR	20 000 000	Aa1
24.04.2015	24.04.2025	EUR	11 000 000	Aa1
28.09.2016	20.09.2026	EUR	13 000 000	Aa1
26.10.2016	20.09.2026	EUR	35 000 000	Aa1
01.02.2017	01.02.2024	EUR	24 900 000	Aa1
26.04.2018	05.03.2025	EUR	300 000 000	Aa1
12.11.2019	15.09.2025	EUR	300 000 000	Aa1
TOTAL		**EUR**	**726 900 000**	

Issuance of mortgage covered bonds of the Bank in a non-prospective offering

Date of issue	Redemption date	Currency	Value	Moody's rating
03.09.2021	03.09.2026	PLN	100 000 000	n/a
10.09.2021	10.12.2026	PLN	500 000 000	n/a
24.02.2022	10.09.2027	PLN	500 000 000	n/a
22.06.2022	22.06.2027	PLN	200 000 000	n/a
TOTAL		**PLN**	**1 300 000 000**	

As at the reporting date, the Bank had one issued series of unsecured bonds with a value of PLN 35 million.

In the first half of 2023, mBank Hipoteczny did not issue mortgage bonds or own bonds. This was a conscious policy of the Bank, resulting from the mBank Group's high over-liquidity and strategy focusing on intra-group financing.

Historically, the Bank has proven its ability to place covered bonds on the European market. The Bank's strategy continues to be to arrange issues of this type. However, the regulatory environment is unstable and there is temporarily a high level of over-liquidity in the Polish banking market. Therefore, there are periods when the Bank issues the majority of mortgage bonds through private placements.

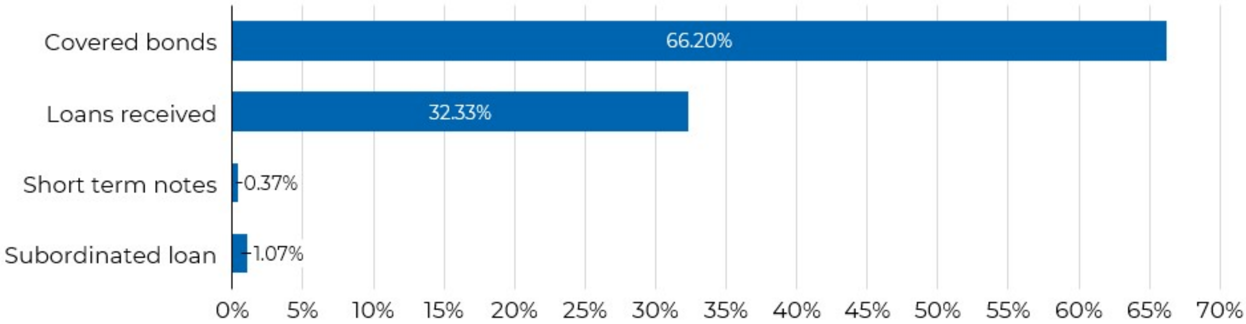
The Bank analyses changes in the legal and market environment and maintains issue readiness, therefore it:

(1) sustains relationships with institutional investors, relevant market players (rating agencies, dealers, exchanges), in particular thanks to the support and visibility of mBank and Commerzbank. We want to carry out issuances at all times, including in situations of economic stress and crisis,

(2) maintains the financial, organisational infrastructure,

(3) has an adequate level of collateral in the form of adequate credit quality.

Refinancing structure of the Bank's business



The loans and credits received relate to the territory of Poland, while the mortgage bonds issued are publicly traded and it is not possible to determine the territorial structure of the refinancing for them.

Agreements signed and repaid

On 16 February 2023, the Bank signed a loan agreement with mBank for PLN 900 million at a floating interest rate.

On 11 April 2023, the Bank signed an addendum to the loan agreement with mBank dated 6 May 2022 for PLN 400 million, adjusting the parameters for drawing tranches to the Bank's liquidity position.

On 18 May 2023, the Bank repaid two tranches totalling PLN 215 million under the PLN 500 million loan agreement with mBank of 18 December 2015, repaying the loan in full.

Basis for the issue of mortgage bonds

Pursuant to the Law on Mortgage Bills and Mortgage Banks, the basis for the issuance of mortgage covered bonds are claims registered in the mortgage bond collateral register, secured by mortgages established on the right of perpetual usufruct or the right of ownership of real estate, registered in the land and mortgage registers in the first place.

As at the reporting date, the collateral for the issue of mortgage covered bonds comprised receivables to the value of PLN 8.3 billion from a total of 33,556 mortgage loans in PLN. All loans forming the basis of the mortgage bond issue were Retail Loans, secured on real estate located in Poland, mainly in the Mazowieckie and Dolnośląskie voivodships.

In addition to the credit claims, government bonds with a nominal value of PLN 250 million and a CIRS hedging transaction with a nominal value of EUR 300 million were entered in the mortgage bond collateral register.

The level of overcollateralisation of mortgage bonds was 29.8% (including substitute collateral), which was sufficient to maintain the mortgage bond rating at Aa1, the highest available for Polish issuers.

5 Risk management

Risk management at mBH is defined and governed by the strategy, policies and procedures adopted by the Management Board and approved by the Bank's Supervisory Board.

The Bank manages all identified banking risks and carries out ICAAP (Internal Capital Adequacy Assessment Process) and ILAAP (Internal Liquidity Adequacy Assessment Process) with:

(1) risk management process is appropriate to the scale of the business and to the materiality, scale and complexity of the risks involved, and is continuously adapted to new risk factors and sources,

(2) risk management methods, models and their assumptions and systems are adapted to the scale and complexity of the risks and periodically reviewed and validated,
(3) organisational structure of risk management ensures the independence of the risk area,
(4) risk management process is integrated into the planning and controlling processes and supports the implementation of the Bank's strategy, while complying with the risk management strategy, in particular with regard to the level of risk tolerance,
(5) risk management process is consistent with the risk management principles of the mBank Group, including the use of group risk models adapted to the specifics of the Bank's operations.

The risk management system in consists of:

(1) risk identification,
(2) risk measurement or assessment,
(3) risk control,
(4) risk forecasting and monitoring,
(5) risk reporting,
(6) management activities.

Risk management is overseen by the Bank's Supervisory Board, which receives regular updates on the risk profile and key risk management actions taken.

The Management Board is responsible for risk management, including overseeing and monitoring the Bank's risk management activities. The Management Board of takes the most important decisions affecting the Bank's risk level and adopts internal regulations on risk management.

The Bank, on an individual basis, discloses in the Financial Statements and the Management Report information in accordance with the provisions of the CRR Regulation and Recommendation M, in particular concerning:

(1) own funds,
(2) compliance with capital requirements,
(3) credit risk mitigation techniques used,
(4) capital buffers,
(5) leverage,
(6) credit risk adjustments applied,
(7) existing remuneration policy for those with significant influence on the risk profile,
(8) operational risks,
(9) application of the IRB approach to credit risk.

(10) net outflow coverage ratio (LCR), liquidity buffers and net liquidity outflows.

For details on the scope of disclosures, how they are verified and how they are published, please refer to mBH's disclosure policy on capital adequacy and other information to be published, available on the Bank's website (https://www.mhipoteczny.pl).

5.1 Credit risk

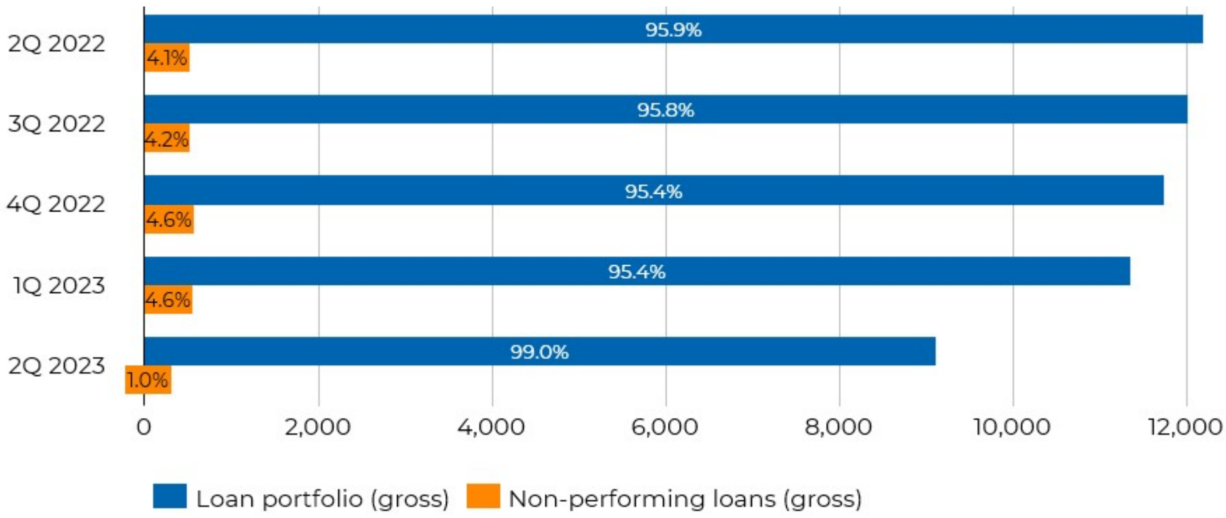
Credit portfolio

Lending rules are set out in the Bank's Credit Policy and the existing credit portfolio is managed mainly through the ongoing monitoring of credit exposures.

The share of non-performing loans in the Bank's loan portfolio decreased in H1 2023 from 4.8% to 4.6% as at 30 April 2023 before the Spin-off and to 0.97% at the end of H1 2023. The majority of liabilities are repaid on time and borrowers with a higher risk profile are subject to in-depth monitoring.

The allowances created, amounting to PLN 33.4 million, as well as the collateral for loans in the form of mortgages on financed properties, amounting to PLN 14,215 million, provide adequate security against possible losses due to credit risk. The level of provisioning coverage of non-working receivables was 24%.

Quality of the loan portfolio



* non-performing loans - loans classified as basket 3 or POCI under IFRS9

The Retail Loan portfolio is characterised by very good quality, which, in addition to the credit policy applied and the risk criteria that the Bank has defined for loans acquired through pooling from mBank, is clearly influenced by the fact that it is a maturing portfolio (the average age of the contracts in this portfolio is 5.8 years). As at the reporting date, there were 302 recorded impairments. Retail loans are monitored on a monthly basis in terms of the timeliness of repayments and the regularity of the effective mortgage collateral provided. The fulfilment of all the customer's contractual obligations (including property insurance and assignment of policy rights) is also monitored during the same period.

Share of non-performing loans by portfolio

* commercial portfolio - the last value presented relates to 30 April 2023.

For the CRE portfolio, the high level of the cost of write-downs was due to subsidies for loans in default due to changes in collateral values and developments in foreclosure/bankruptcy proceedings. For the Retail Loans portfolio, there was an increase in write-downs in 2023 due to the systematic increase in the portfolio balance with an impairment premise triggered by the natural maturation cycle of the portfolio and the update of macroeconomic forecasts in the risk models.

Currently, the Bank is not a participant in any proceedings in respect of the CRE Portfolio, since, as of the date of registration of the Demerger, mBank entered into all receivables covered by the portfolio and the rights, liabilities and proceedings relating to them. On 16 June 2023, after the date of the Demerger, the Bank received a lawsuit from a commercial borrower to declare the loan agreement invalid due to the currency clauses contained therein and to return the amounts paid to the Bank. On 17 July 2023, the Bank filed a statement of defence. The Bank acknowledges that after the Demerger it can no longer be a party to these proceedings. The value of the claim is PLN 75.7 million.

In H1 2023, the Bank filed 1 lawsuit against the in rem debtors in relation to the lack of satisfaction in the bankruptcy proceedings of a CRE borrower, and also filed two bankruptcy petitions for CRE borrowers.

In terms of consumer litigation in H1 2023, the Bank received only one lawsuit related to the settlement of commissions as a result of the early repayment of a mortgage loan. In addition, there are three pending cases from the previous period (two at first instance and one at second instance following the Bank's appeal against an unfavourable judgment). Two of them relate to an allegation of invalidity of the agreement due to a currency clause included in the original version of the loan agreement (the total value of the subject matter of the dispute is approximately PLN 874.2 thousand, and one allegation relating to the WIBOR index (the value of the subject matter of the dispute is PLN 183.9 thousand). The Bank estimates that the probability of losing on the currency clauses in dispute exceeds 50% and has made provisions for these cases. In the WIBOR index case, the Bank estimates that the probability of the court dismissing the action exceeds 50%.

5.2 Market risk

The risk of incurring a loss due to unfavourable changes in market parameters from the point of view of the term structure of the Bank's portfolio positions is kept as low as possible due to the nature of the Bank's business, the efficient risk mitigation and management system in place at the operational level.

In order to mitigate market risk, the Bank aligns the currency structure and repricing structure of its funding sources with the structure of its loan receivables, uses linear derivative instruments, makes FX buy/sell transactions with immediate or future dates and exchanges FX SWAP transactions.

The amount of market risk to which the Bank is exposed over a daily horizon is determined using the Value at Risk (VaR) method at a confidence level of 97.5%. As at the reporting date, VaR amounted to PLN 4,018.78 thousand. OtherOther risks calculated by this measure amounted to: currency risk PLN 76.7 thousand, interest rate risk PLN 3.5 million and credit spread risk PLN 2.3 million. The level of risk measures is slightly lower than in the previous period, mainly due to lower exposure to currency risk.

Interest rate risk arises from the exposure of the Bank's earnings and capital to the adverse impact of changes in interest rates. The Bank manages the interest rate gap by adjusting the repricing dates of assets and liabilities. The sensitivity of the Bank's portfolio to interest rate disruptions is determined by the results of stress tests and scenario analyses. The decrease in the economic value of the bank's capital (EVE) in relation to the bank's own funds, as at the reporting date, was 1.5 per cent. Interest rate risk is also measured in relation to the bank's net interest income. The Earnings at Risk (EaR) and Net Interest Income (NII) ratios were 3.7 per cent (EaR) and 12.5 per cent (NII) respectively, higher than in the previous period. The bank's portfolio positions exposed to interest rate risk are hedged with linear interest rate derivatives.

Foreign exchange risk is mitigated by closing the foreign exchange position on an ongoing basis. The scale and structure of foreign exchange risk is measured on the basis of the Bank's current foreign exchange position. The foreign exchange position, which takes into account expected loan repayments and disbursements, is also monitored. Currency risk is mitigated by currency position limits for each currency.

5.3 Liquidity risk

In organising its liquidity risk management processes, the Bank complies with regulatory requirements and takes into account supervisory recommendations, in particular the FSA Recommendations and the EBA Guidelines, which relate to liquidity risk management.

The Bank has a set of procedures, adapted to the scale and profile of the Bank's business, which defines the process and sets the framework for liquidity risk management. It defines the roles and responsibilities in the liquidity risk management process, and how liquidity risk is measured, monitored, capped, managed and controlled, and sets out the principles for setting and updating limits. In order to safeguard the Bank's liquidity, a surplus of unencumbered, high quality liquid assets is maintained as a buffer in the event of stress conditions of an internal or external nature, or a combination of the above, should negative scenarios materialise (liquidity reserve).

The Bank has included principles for developing liquidity stress scenarios in its stress testing (ST) rules. When conducting ST, the Bank assesses the potential change in liquidity risk exposure in the different time bands of the liquidity gap and the ability to cover the need for refinancing sources for each test scenario. In conducting stress tests, it takes into account the impact on the

Bank's economic situation of adverse events or fluctuations in macroeconomic and financial parameters and considers the credit factor. The results of the ST form the basis for determining the required liquidity reserve and internal limits.

Liquidity risk management is carried out at the level of intraday, short-, medium- and long-term payment liquidity, the lack of which implies the inability to finance assets and meet obligations in a timely manner in the course of the Bank's normal operations.

As at the reporting date, the liquidity provision represented approximately 6.6% of total assets.

The Bank's long-term liquidity position is stable. A significant share of the funding of long-term credit claims is made up of borrowings received from mBank.

Due to the need to maintain liquidity ratios at an appropriate level, the need to address the mismatch between the structure of assets and the liabilities that finance them and to increase the stability of funding sources, mBH will continue its efforts to convert short-term funding into funding in the form of new mortgage bond issues with a maturity of 5 years or more.

The net outflow coverage ratio, which measures the ratio of the liquidity buffer to its net liquidity outflows over a stress period of 30 calendar days (LCR), was 779.3%.

The ratio of the bank's own funds and stable liabilities that provide stable funding to non-liquid assets and receivables that require stable funding (NSFR) was 108.2%.

The utilisation level of the commitment limit under Article 15.2 of the Mortgage Bills and Mortgage Banks Act as at the date of the report was 34.6%. In 2023, this limit was not exceeded.

The average residual maturity of mortgage bonds issued was 2.1 years, while the average maturity of loans received from other banks was 4.4 years.

The Bank has a management information system based on banking systems and applications to support the measurement and monitoring of liquidity risk. This system ensures the receipt of information on liquidity risk, enables the assessment of the impact of management decisions and serves to monitor risks and control limits. Liquidity risk reports are prepared at the Bank on a daily, monthly and quarterly basis. The liquidity risk reports, which include information on liquidity risk exposure and information on the use of limits for this risk, are presented to the ALCO Committee at least once every two months and to the Bank's Management Board and Supervisory Board on a quarterly basis. In order to better manage and supervise liquidity risk, the Bank's Management Board and those responsible for liquidity risk management have ongoing access to daily reports.

At least once a year, the Bank conducts a review of the liquidity risk management system as part of the ILAAP process, which includes a review and assessment of the various elements of the liquidity risk management process in accordance with the Principles for Assessing the Adequacy of Liquidity Resources (ILAAP) at mBH.

5.4 Operational risk

The Bank has a simplified organisational structure and the products offered are in line with the specifics of a mortgage bank.

Since the date of the Demerger, the Bank has maintained a business model in which it bases the development of its portfolio exclusively on retail mortgage loans in a formula of close cooperation with mBank, which reduces the operational risk associated with the loan sales stage. This has the effect of reducing the level of the Bank's operational risk, but nevertheless increases the materiality of the activities outsourced in the outsourced processes related to the loan acquisition processes through pooling and the maintenance of the loan portfolio. Outsourced processes are subject to constant monitoring

Factors contributing to the Bank's increased exposure to operational risk:

(1) dynamic changes in the external environment, including legal,
(2) changes to the organisational structure,
(3) high risk of cyber attacks, related to the hybrid mode maintained and the conflict in Ukraine,
(4) ongoing IT projects and ventures,
(5) employee turnover,

Factors stabilising the Bank's exposure to operational risk:

(1) control and operational risk management system at each level of the organisational hierarchy,
(2) simple organisational structure, no subsidiaries,
(3) small scale and complexity of the business, due to the specific characteristics of mortgage banks,
(4) no e-banking services,
(5) procedures governing the decision-making process for outsourcing activities (analyses of benefits, risks and how to mitigate them, plans for business continuity and the insourcer's financial situation, and the ability to deliver services on time and with quality),

(6) Bank Business Continuity Plan,
(7) highly qualified staff,
(8) effective internal control system
(9) monitoring the quality of the performance of the outsourced activities (periodic inspections of the insourcer together with monitoring of post-inspection recommendations; monitoring of the quality and timeliness of the service provision, i.a. as part of the calculation of the remuneration level).

The Bank observes and analyses any changes that affect the operational risk profile.

The Bank focuses its efforts to deepen operational risk awareness and build an organisational culture to develop appropriate risk mitigation mechanisms.

5.5 Model risks

The Bank has a Model Management Policy (MMP), which is subject to periodic review to ensure that it is up to date with the current conditions and organisation of the Bank's processes. The unit responsible for organising the model management process at the Bank is responsible for carrying out periodic reviews of this Policy and for supervising the correctness of this Policy.

The Bank's Management Board is responsible for approving the MMP that introduces uniform rules for the Bank's model management process, as well as for setting out in the strategy and operational plans the intentions for the scope of the models, taking into account the risk of the models and the nature of the mechanisms used in risk management. The Management Board oversees the process of controlling the risk of models and the correctness of their operation, delegating decision-making powers on key aspects of the operation of models to the Models Risk Committee. This Committee functions as a dedicated body responsible for overseeing the models risk management process, the detailed responsibilities, composition and decision-making procedure of which are set out in the relevant internal documents.

The Bank also has other regulations in place to actively manage and effectively mitigate model risk so that the aggregate level of model risk does not exceed the applicable tolerance level.

Currently, all models in the Bank have a low risk exposure, which, combined with the materiality criterion of the models, means a low risk level of each model and a low aggregate risk level of the models. The risk tolerance of the models has been maintained. Compared to the previous year, there is no change in the aggregate risk level of the models.

5.6 Risks of investment in covered bonds

In the first half of 2023, the risk profile of the mortgage bond investments issued by mBH relative to previous reporting periods has changed significantly due to the Spin-off transaction. The mortgage bond security register consists exclusively of residential mortgage loans. The lack of euro-denominated commercial loans made it necessary to hedge the currency position in connection with euro mortgage bond issues.

In addition to the Bank's compliance with a number of statutory requirements, the Bank's conservative policy of valuing the properties used as collateral for mortgage bonds, which has been in place for many years, also contributes to the high security of investment in mortgage bonds. In accordance with the Mortgage Banks and Mortgage Bills Act, the minimum level of overcollateralisation of mortgage and public mortgage bonds as at the reporting date was 5%.

6 Internal control system

The Bank has implemented an internal control system to support the organisation in the effective and efficient operation of its business processes. It covers all the Bank's organisational units, defining the principles of cooperation between them, and the principles of information flow and monitoring of activities within the Bank. The principles and objectives of the internal control system derive from the Banking Law, the Regulation of the Minister of Finance, Funds and Regional Policy of 8 June 2021 on the risk management system and internal control system and remuneration policy in banks, and Recommendation H of the FSA, concerning the internal control system in banks. The internal control system is organised in the Bank in three lines of defence, where:

(1) The first line of defence consists of the risk management of the Bank's operational activities, carried out by the Bank's organisational units/independent work posts,

(2) The second line of defence consists of:
   a. risk management by designated organisational units/designated staff of organisational units, independent of frontline risk management,
   b. activities of the Security Unit carried out by the IT and Security Department,
   c. activities of the compliance function carried out by the Compliance Department,

(3) the third line of defence consists of the activities of the internal audit function carried out by the staff of the Internal Audit function.

As part of the internal control system, the Bank distinguishes:

(1) **control function** - the control function consists of all controls in the processes operating in the Bank, independent monitoring of compliance with these controls and reporting as part of this function.

Internal control mechanisms are an integral part of the Bank's daily operations and include:

a. internal procedures relating to the Bank's business,

b. reviews of the reports by the Bank's Management Board,

c. reviews by heads of departments/independent posts,

d. physical security,

e. system of limits and rules for controlling them,

f. credit decision rules and the proxy system,

g. rules for verifying the details of transactions and activities and the results of risk management models,

h. activities aimed at checking the quality and correctness of the execution of tasks.

Checking the correct operation of the controls is carried out on an ongoing basis by each employee as part of his or her functions and periodically as part of horizontal and vertical testing by heads of organisational units or their designated employees.

Compliance Department (CD) - the compliance cell, which performs the following tasks:

a. manages compliance risk (understood as the risk of the consequences of non-compliance with laws, internal regulations and market standards) by identifying, assessing, controlling, monitoring and reporting on the risk of non-compliance with laws, internal regulations and market standards;

b. performs horizontal monitoring within the compliance function and vertical monitoring within the so-called second line of defence assigned to the compliance function to ensure the Bank's compliance with laws, internal regulations and market standards. In addition, the DC performs other tasks insofar as this does not compromise the operational efficiency and independence of the DC.

The Compliance Department is responsible for the implementation of the mBank Group's and indirectly Commerzbank AG's standards in the areas recognised as "compliance areas" according to the Group's standards, which include in particular:

a. Anti-Money Laundering and Countering the Financing of Terrorism,

b. application of the sanctions policy,

c. protection of personal data,

d. outsourcing,

e. prevention of conflicts of interest, fraud and corruption,

f. overseeing the process of handling customer complaints and grievances,

g. confidential information within the meaning of Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse.

(2) **Internal Audit Position** - an independent internal audit function to examine and assess**,** in an independent and objective manner, the adequacy of the risk management and internal control system. Internal Audit supports the Bank in achieving its objectives through a systematic and disciplined approach to examining, evaluating and improving the effectiveness of its risk management, control and governance processes.

As part of its activities, internal audit provides the following services:

a. assurance - involving the objective evaluation of evidence by internal auditors to provide an independent opinion and conclusions on a process, system or other matter,

b. advisory - comprising consultancy and related service activities, the nature and scope of which are agreed in detail with the principal, and which are intended to add value and improve organisational governance, risk management and internal control processes.

The Internal Audit position, in respect of the functions performed, is subject to periodic evaluation by an independent competent entity from outside the Bank. The selection of the entity is made by the Bank's Management Board and approved by the Audit Committee. The assessment of the work includes internal audit's compliance with the IIA Standards, Recommendation H and best market practices.

An assessment of the adequacy and effectiveness of the internal control system is made on the basis of:

a. annual report on the activities of the Internal Audit function, including, inter alia, an assessment of the adequacy and effectiveness of the internal control and risk management system,

b. annual report of the Analysis and Risk Management Department, including an assessment of the effectiveness of the control function and taking into account the critical and significant deficiencies identified,

c. annual report of the Compliance Department on the management of compliance risk at the Bank,

d. information from the Bank's Management Board on the implementation of the tasks assigned to this body within the framework of the internal control system,

e. information obtained from the parent company, relevant from the point of view of the adequacy and effectiveness of the internal control system,

f. findings of the auditor,

g. FSA's annual examination and supervisory assessment (BION),

h. findings arising from the activities of the inspection bodies,

i. evaluations and opinions made by entities outside the Bank, relevant to the adequacy and effectiveness of the internal control system.

7 Remuneration policy

The Bank operates a remuneration programme for the Bank's Management Board and persons with a significant impact on the Bank's risk profile based on cash-settled phantom shares. These benefits are accounted for in accordance with IAS 19 "Employee benefits". The value from the valuation of the phantom shares is added to the costs of the period in correspondence with the liabilities. The costs are recognised over time throughout the vesting period and are included in "General administrative expenses".

Phantom shares are granted in the number resulting from the valuation of these shares for the assessment period. The valuation of phantom shares is calculated each time at the end of the reporting period as the quotient of the Bank's book value and the number of ordinary shares.

The payout of phantom shares depends on the average valuation of these shares obtained from two values: the value of the phantom share at the end of the annual period preceding the payout date and the value of the phantom share at the end of the first six months of the year in which the payout is to take place during the reporting period. The aforementioned average value is multiplied by the number of phantom shares due to be exercised in the relevant period, and the result of this exercise determines the amount of the cash payout resulting from the phantom shares held.

The final value of the bonus, being the product of the number of shares and their expected value at the balance sheet date preceding the realisation of each deferred tranche, is actuarially discounted. The discounted amount is reduced by the actuarially discounted amounts of the annual allowance for the provision as at the same date. The actuarial discount means the product of the financial discount and the probability of each participant individually surviving until each of the deferred tranches becomes fully vested. The annual allowance amounts are calculated in accordance with the projected unit credit method ("Projected Unit Credit Method"). The probabilities referred to above were determined using the method of competing risks ("Multiple Decrement Model"), where the following three risks were taken into account: the possibility of redundancy, the risk of total incapacity and the risk of death.

8 Development directions and key elements of the Bank's strategy

The Bank's mission

From the perspective of the real estate market, mBH's mission is to support the development of an effective mechanism for financing the real estate market in Poland by issuing long-term debt securities (mortgage bonds) as an instrument to refinance attractive forms of real estate lending based on strong competence, the longest market experience and the highest standard of service.

From the perspective of the mBank Group, mBH's mission is to provide stable, long-term and secure refinancing.

From the point of view of investors, mBH's mission focuses on providing long-term mortgage bonds with a high level of security.

The Bank's vision

mBH will focus on the issuance of mortgage bonds in Poland and on the international market in the most cost-effective business model possible, i.e. aimed at maximising synergies within the mBank Group, in particular using the free resources of each bank, primarily mBank, in accordance with their economic purpose, as well as the knowledge and experience within the mBank Group.

In view of the development of the mortgage bond market in Poland, the Bank's aspiration is to maintain its current position among the leading issuers of these instruments in the country.

Strategic initiatives at mBH are grouped around five pillars:

(1) sourcing retail mortgages from mBank;

(2) financing them with regular issues of primarily green covered bonds;

(3) improving the IT platform and data security;

(4) risk management;

(5) fostering an organisational culture based on shared values, ensuring respect for diversity, the professional development of employees and satisfactory working conditions.

Strengthening the mBank Group's self-reliance in financing its business and better matching the time horizon of financing to assets is a key element of the financing strategy. A factor supporting the financing of real estate business is the issuance of mortgage bonds.

The mBank Group assumes dynamic growth in the Bank's issuance business in the coming years. The issuance of mortgage bonds allows the Bank to generate stable and long-term financing on attractively priced terms.

The Bank envisages issuing mortgage bonds secured by residential mortgages raised in cooperation with mBank using a pooling model.

The mortgage bonds will be issued in both zloty and euro and will have maturities ranging from 4-7 years.

9 Bank authorities

Shareholders

The total number of ordinary shares at the reporting date was 2.2 million with a nominal value of PLN 100 per share.

The Bank has not issued any preference shares and there are no restrictions on the rights attached to the shares. All shares participate equally in the distribution of dividends. All issued shares are fully paid up. The Bank does not hold any treasury shares.

As at the reporting date, the ownership structure of the Bank's registered share capital was as follows:

Name of shareholder	Registered share capital in PLN	Shares		Votes at the General Assembly	
		Number	%	Number	%
mBank S.A.	220 000 000	2 220 000	100	2 220 000	100
Total	**220 000 000**	**2 220 000**	**100**	**2 220 000**	**100**

Management Board

In the first half of 2023, mBH's Management Board consisted of:

(1) Krzysztof Dubejko - President of the Management Board

(2) Andrzej Kulik - Member of the Management Board

(3) Katarzyna Dubaniewicz - Member of the Management Board

(4) Jolanta Pankiewicz - Member of the Management Board.

On 14 June 2023, Jolanta Pankiewicz resigned from her position with effect from 31 August 2023.

<u>Appointment and removal of board members and their powers:</u>

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

The appointment of two members of the Management Board, including the President of the Management Board and the member of the Management Board responsible for risk, shall be made with the approval of the FSA. The approval is requested by the Supervisory Board.

The Management Board manages the Bank's affairs and represents the Bank. The Management Board adopts annual financial plans and an operating strategy, which are approved by the Supervisory Board. In them, the Management Board determines the maximum volume of mortgage bonds and bonds issued in a given year. The scope of activities of the Bank's Management Board includes all matters not reserved for the competence of other bodies of the Bank, pursuant to the Articles of Association or legal regulations.

Supervisory Board

In H1 2023, the Bank's Supervisory Board consisted of:

<table>
<tr><th>From</th><th>01.01.2023</th><th>15.03.2023</th><th>01.05.2023</th><th>08.05.2023</th></tr>
<tr><th>To</th><th>14.03.2023</th><th>30.04.2023</th><th>07.05.2023</th><th></th></tr>
<tr><td>Frank Bock</td><td colspan="4">Member of the Supervisory Board</td></tr>
<tr><td>Andreas Boeger</td><td>Chairman of the RN</td><td>Vice-Chairman of the Supervisory Board</td><td colspan="2">---</td></tr>
<tr><td>Pawel Graniewski</td><td colspan="4">Independent Member of the Supervisory Board</td></tr>
<tr><td>Marek Lusztyn</td><td>Vice-Chairman of the Supervisory Board</td><td colspan="3">Chairman of the SB</td></tr>
<tr><td>Lukasz Maculewicz</td><td colspan="4">Member of the Supervisory Board</td></tr>
<tr><td>Grzegorz Ostrowski</td><td colspan="4">Member of the Supervisory Board</td></tr>
<tr><td>Michał Popiołek</td><td colspan="4">Member of the Supervisory Board</td></tr>
<tr><td>Pascal Ruhland</td><td colspan="2">---</td><td>Member of the Supervisory Board</td><td>Vice-Chairman of the Supervisory Board</td></tr>
<tr><td>Mikolaj Tatarkiewicz</td><td colspan="4">Member of the Supervisory Board</td></tr>
<tr><td>Mariusz Tokarski</td><td colspan="4">Independent member of the Supervisory Board</td></tr>
</table>

Pursuant to the wording of § 14 (1) (5) of mBH's Articles of Association, the General Assembly decides in the form of a resolution on the election and dismissal of members of the Supervisory Board and the determination of the principles of their remuneration. The members of the Supervisory Board meet the suitability requirements determined on the basis of the Bank's

Policy on the Assessment of the Qualifications (Suitability) of Members of the Supervisory, Management and Key Functional Bodies of mBH.

Pursuant to the wording of § 3(1)(9) and (10) of the Regulations of the Supervisory Board of mBH, the Supervisory Board has the power to appoint and dismiss the President of the Management Board, the members of the Management Board, as well as the power to entrust the function of the Vice-President of the Management Board and to entrust the function of the member of the Management Board who supervises the management of risks that are material to the Bank's operations, and to determine the terms and conditions of contracts and remuneration for the members of the Management Board of the Bank and to represent the Bank in concluding agreements with the members of the Management Board.

There were four Committees within the Supervisory Board: Audit Committee, Nominations Committee, Remuneration Committee and Risk Committee.

<u>Audit Committee:</u>

(1) Paweł Graniewski - Chairman of the Committee

(2) Pascal Ruhland - Member of the Committee (from 8 May 2023)

(3) Mariusz Tokarski - Member of the Committee

In H1 2023, the Audit Committee met on 3 March, 27 March, 28 June.

<u>Nominations Committee</u>

(1) Marek Lusztyn - Chairman of the Committee

(2) Paweł Graniewski - Member of the Committee

(3) Pascal Ruhland - Member of the Committee (from 8 May 2023)

<u>Remuneration Committee</u>

(1) Frank Bock - Vice-Chairman of the Committee

(2) Marek Lusztyn - Chairman of the Committee.

(3) Pascal Ruhland - Member of the Committee

In H1 2023, the Remuneration Committee met on 20 March and adopted one resolution by circulation.

Remuneration and Nominations Committee

This Committee was established by Supervisory Board Resolution No. 50/2023 with effect from 28 June 2023,thereby rendering the Remuneration Committee and the Nominations Committee redundant and abolished.

Remuneration and Nominations Committee consists of:

(1) Marek Lusztyn - Chairman of the Committee

(2) Pascal Ruhland - Member of the Committee

(3) Paweł Graniewski - Member of the Committee

(4) Frank Bock - Member of the Committee

Risk Committee

(1) Mikołaj Tatarkiewicz - Chairman of the Committee (from 15 March 2023)

(2) Marek Lusztyn - Member of the Committee (until 14 March 2023 Chairman)

(3) Michał Popiołek - Member of the Committee

In H1 2023, the Risk Committee met on 21 March, 29 June.

Procedure for convening and powers of the General Assembly of Shareholders

The General assembly of Shareholders shall be convened as an ordinary or extraordinary general assembly in accordance with the Bank's Articles of Association and the provisions of the Commercial Companies Code.

The core competences of the General Assembly include the adoption of resolutions on the following matters:

(1) considering and approving the annual report on the Bank's operations and the financial statements for the previous financial year,

(2) granting discharge to the members of the Bank's governing bodies for the performance of their duties,

(3) distributing net profit or covering losses of the Bank,

(4) amending the articles of association,

(5) electing and dismissing members of the Supervisory Board and determining the principles of their remuneration,

(6) increasing or reducing the Bank's share capital,

(7) liquidation, disposal of the whole of the Bank's undertaking or merger with another bank,

(8) selection of liquidators and determination of their remuneration,

(9) provisions concerning claims for compensation for damage caused in the formation of the company or in the exercise of management or supervision,

(10) setting a date for the payment of dividends,

(11) disposal or encumbrance of the Bank's real estate on which its head office is located,

(12) matters brought before the Supervisory Board for consideration,

(13) matters brought by for consideration shareholders under the procedure provided for in the Articles of Association,

(14) giving consent for the Bank to acquire or dispose of shares or stocks, or to establish or join other business organisations, whereby consent is not required if the acquisition of shares or stocks in companies has taken place as part of enforcement, bankruptcy, restructuring or other agreement with the Bank's debtor and in the event of the disposal of shares or stocks acquired in the above manner; in such a case, the Bank's Management Board is obliged to inform the Supervisory Board of the above actions,

(15) other matters reserved by law or the Articles of Association.

Rules for amending the articles of association

Pursuant to Article 430 § 1 of the CCC, an amendment to the articles of association requires a resolution of the general meeting and an entry in the register. Pursuant to Article 34(2) of the Banking Law, an amendment to a bank's articles of association requires a permit from the FSA.

10 Other information

Loans and their interest rates

The variable interest rates applied by the Bank are based on LIBOR or EURIBOR for foreign currency loans and WIBOR for PLN loans. The Bank's interest rate on a given day is equal to the sum of the Bank's margin set in the agreement and the base rate.

In accordance with Recommendation S, the Bank introduced the possibility of converting variable interest rates into periodically fixed interest rates for a period of 5 years. At the end of June 2023, the share of loans with periodically fixed interest rates in the loan portfolio was 5.82%.

Information on the Government's Credit Vacation

Under the government's Credit Vacation programme, which continues in 2023, retail customers may suspend repayment of loan instalments for one PLN loan agreement for one month in each quarter of 2023. As at 30 June 2023, 92.8% of Retail Loans met the conditions for inclusion in this programme, and 75.56% of total Retail Loans were covered by the holiday. This portfolio is subject to separate monitoring.

Related party transactions

The direct parent of mBH is mBank. The direct parent of mBank is Commerzbank AG.

On 17 May 2023, the Bank transferred some of its serviced mortgage loans to mBank. The majority of these were commercial property finance loans. The acquisition took place through the demerger of the Bank by spinning off part of its business and transferring it to mBank. Details of this transaction are described in Note 2 to the condensed financial statements.

The other transactions concluded in the first half of 2023 between the Bank and related parties were typical and routine transactions, concluded on terms that did not deviate from market conditions, and their nature and terms resulted from the day-to-day operational activities conducted by the Bank. Transactions with related parties carried out in the ordinary course of business include loans, deposits, obligations to issue debt securities and derivative transactions.

Information on amendments to the articles of association

The amendments to the Articles of Association adopted on 1 June 2023 by the GA after prior approval by the FSA included adaptation to the amendments to the Mortgage Bills and

Mortgage Banks Act (Izbh Act) and to the requirements of the amendments to the Commercial Companies Code.

In terms of alignment with the MBMB Act, the possibility of issuing public mortgage bonds on the basis of securities acquired by the Bank, issued by the State Treasury, local government units and Bank Gospodarstwa Krajowego, which have been secured entirely by a guarantee or surety of the State Treasury, has been extended.

In terms of alignment with the amended Commercial Companies Code:

(1) provisions on the term of office of the members of the Management Board and the Supervisory Board have been amended, stipulating that it shall be a joint term of office of 3 (three) years. The term of office shall be calculated in financial years (the first financial year of the term of office shall in each case be the financial year in which the office commenced, even if it would not have commenced at the beginning of that financial year. The term of office of a member of the Management Board/SB is to expire at the latest on the date of the General Meeting approving the financial statements for the last full financial year of his/her office.

(2) provisions on the procedure for meetings of the Supervisory Board have also been adapted, stipulating that the Supervisory Board may also adopt resolutions during a meeting on items not included in the proposed agenda if none of the Supervisory Board members participating in the meeting objects, and that the Supervisory Board may also meet without being formally convened if all members agree and do not object to the inclusion of individual items on the agenda. Meetings of the SB are to be convened as required, but at least four times per financial year, once in each quarter of the financial year, as required by the Companies Act.

(3) it has been clarified that a meeting of the SB shall be chaired by the Chairman of the Supervisory Board. In his absence, the Vice-Chairman of the SB (in their absence, a member elected at the meeting) shall act as chairman of the meeting.

(4) provisions were introduced to clarify the issue of notices of meetings. The notice of convening a meeting containing the date, time and place of the meeting and the

proposed agenda, as well as the manner of using means of direct remote communication during the meeting is to be sent to Supervisory Board Members by e-mail at least 14 days prior to the date of the meeting. In justified cases, if no Supervisory Board Member objects, this period may be shortened.

(5) the need to obtain the approval of the Supervisory Board for the Bank to enter into a transaction with a parent company, subsidiary or associated company, the value of which, when aggregated with the value of transactions entered into with the same company during the financial year, exceeds 10% of the Bank's total assets, was excluded.

(6) provisions on share redemption have also been clarified. Shares may be redeemed, which is done either by reducing the share capital or from net profit. The redemption of shares and/or their cancellation (reduction of CET1 share capital) requires the approval of the FSA.

Information on compliance by members of the Supervisory Board and the Management Board with the requirements set out in Article 22aa of the Banking Law Act

On 28 April 2023, the General Assembly reviewed and considered that the candidate and the existing Supervisory Board members met the requirements set out in Article 22aa of the Banking Law Act.

On 28 June 2023, the Supervisory Board reviewed and concluded that the members of the Management Board meet the requirements set out in Article 22aa of the Banking Law Act.

Proceedings pending before a court, an authority competent to conduct arbitration proceedings or a public administration body

Information on pending proceedings can be found in Note 25 of the Condensed Financial Statements for H1 2023.

Financial support from public funds

In H1 2023, the Bank did not receive financial support from public funds, in particular under the Act of 12 February 2009 on the granting of support to financial institutions by the State Treasury (Journal of Laws 2014, item 158).

Cooperation with international institutions

The Bank does not cooperate with international public institutions.

Guarantees and sureties granted by the Bank

The Bank did not issue any guarantees or sureties in H1 2023.

Events after the balance sheet date

There were no material events after the balance sheet date that would require additional disclosure in these condensed financial statements.

11 Statements by the Management Board

Corporate governance

In its operations, the Bank is guided by the principles of corporate governance and good banking practices, setting high standards based on transparency of operations, business ethics and a balance between the interests of all stakeholders involved in the Company.

On 16 December 2014, the Management Board and on 19 January 2015, the Supervisory Board adopted for application the Corporate Governance Principles for Supervised Institutions ("Rules"), adopted by the Financial Supervisory Authority on 22 July 2014, with the exception of the Rules indicated in § 8.4, § 29, §53-57.

The Rules addressed to shareholders were presented by the Management Board at the Annual General Assembly of shareholders of mBH on 22 April 2015, and the General Assembly on that date adopted Resolution 15 on the application of the Corporate Governance Rules for Supervised Institutions, in which it adopted the Rules for application insofar as they relate to the General Assembly, with the exception of para. 29 of the Principles (remuneration for serving as a member of the Supervisory Board is granted by the General Assembly only to an independent member). This resolution entered into force on the date of its adoption.

Based on and to the extent of the aforementioned decision, the Bank exempted the following provisions of the Corporate Governance Principles for Supervised Institutions from application:

§8(4) The supervised institution shall, where warranted by the number of shareholders, endeavour to facilitate the participation of all shareholders in the meeting of the governing body of the supervised institution, including by providing for the possibility of electronic active participation in meetings of the governing body.

The Bank does not apply the Principle. The Bank's shares are held directly and indirectly by its sole shareholder, mBank. General Assemblies are held without being formally convened and 100% of the capital is always represented at the General Assembly. Therefore, the number of shareholders does not justify the need for electronic meetings.

§29 : The Bank does not apply the Principle:

(1) The remuneration of members of the supervisory authority shall be determined in accordance with the function they perform and also in accordance with the scale of activity of the supervised institution. Members of the supervisory authority appointed to serve on committees, including the audit committee, should be remunerated commensurate with the additional tasks performed by the committee concerned.

(2) The remuneration of the members of the supervisory authority, unless such remuneration is prohibited by law, should be determined by the constituent body.

(3) The remuneration arrangements for members of the supervisory authority should be transparent and included in the relevant internal regulation of the supervised institution.

Remuneration for serving as a member of the Supervisory Board is granted by the General Assembly to the independent member. The other members of the Board do not receive remuneration.

In connection with the mandatory provision of Art.389 §7. of the Companies Act (*Meetings of the Supervisory Board should be convened as and when required, but at least once in each quarter of the financial year*), the Bank also applies the previously excluded rule § 25 (1) of the Corporate Governance Principles in its operations.

The Bank does not apply the principles of §53 -.§57 of the IAC, which relate to the activity of managing assets at the client's risk, as the Bank does not carry out this type of activity. The Bank does not apply any restrictions on the exercise of voting rights on securities. With regard to the transfer of ownership of securities, the only restriction is the indication in the prospectus that the issuance of mortgage bonds on the primary market is not addressed to individual (retail) investors and, in the case of mortgage bonds marketed abroad, additionally that they are not addressed to Polish residents.

As required by § 27 of the Corporate Governance Principles for Supervised Institutions, on 27 March 2022, the Bank's Supervisory Board assessed the application of the Principles at the Bank in 2022. The Supervisory Board concluded that internal governance at the Bank is organised in an adequate and effective manner, while identifying areas for further improvement.

These rules are available on the website:

https://www.knf.gov.pl/dla_rynku/regulacje_i_praktyka/zasady_ladu_korporacyjnego

In addition, the Bank has implemented and applies Recommendation Z on internal governance principles in banks in accordance with the principle of proportionality and adequacy arising from the scale, nature of its activities and the specific characteristics of the Bank.

The Bank declares that where the scope of Recommendation Z overlaps with the scope of the Corporate Governance Principles for Supervised Institutions, the provisions of Recommendation Z shall prevail. To the extent not covered by Recommendation Z, the Corporate Governance Principles for Supervised Institutions shall apply.

The text of Recommendation Z on the principles of internal governance in banks can be found on the website of the Financial Supervision Commission:

https://www.knf.gov.pl/knf/pl/komponenty/img/Rekomendacja_Z_70998.pdf

Rules for the appointment and removal of managers

The Supervisory Board appoints and dismisses members of the Bank's Management Board, including the President of the Management Board, taking into account the assessment of the fulfilment of the requirements referred to in Article 22aa of the Banking Law. The appointment of the President of the Management Board and the member of the Management Board supervising the management of the significant risk in the Bank's operations, as well as the assignment of the function of the member of the Management Board supervising the management of the significant risk in the Bank's operations to the appointed member of the Management Board shall be made with the consent of the FSA. The consent is requested by the Supervisory Board. The Supervisory Board, immediately after the appointment of the Management Board and after any change in its composition, shall submit to the FSA information on the composition of the Management Board and on any change in its composition, as well as information resulting from the assessment referred to in section 1 on the fulfilment by the members of the Management Board of the requirements referred to in Article 22aa of the Banking Law. The assessment in question is carried out on the basis of the Policy on the assessment of qualifications (suitability), appointment and dismissal of members of the Bank's Body in force at the Bank (Suitability Policy). In addition, the Supervisory Board informs the FSA of the approval and change of the internal division of competences in the Bank's

Management Board. The Bank's Management Board consists of President of the Bank's Management Board and other members of the Bank's Management Board. The internal division of competences in the Bank's Management Board is determined by the Management Board and approved by the Supervisory Board. The President and the other members of the Bank's Management Board are appointed for a joint term of office of 3 years. The terms of office of the members of the Management Board expire at the latest on the date of the General assembly of Shareholders approving the financial statements for the last full financial year of their function as members of the Management Board. In addition, the mandate of a member of the Management Board shall also expire due to death, resignation or dismissal from the Management Board. Members of the Bank's Management Board may be dismissed before the expiry of their term of office at any time. The Management Board manages the Bank's affairs and represents the Bank. The Management Board adopts annual financial plans and an operating strategy, which are approved by the Supervisory Board. The Management Board determines the maximum volume of mortgage bonds and bonds issued in a given year in its annual financial plans and operating strategy.

The Bank has also adopted a Policy on the Identification of Key Functions in the Bank, the Appointment and Removal of Employees Performing these Functions and the Assessment of their Qualifications (Suitability) in accordance with Recommendation Z.

Audit Committee

The Bank complies with the regulations on the appointment, composition and functioning of the audit committee, including that its members meet the independence criteria and the requirements for having knowledge and skills in banking and in accounting or auditing.

The Audit Committee of the Bank's Supervisory Board operates on the basis of the Audit Committee Regulations introduced by Supervisory Board Resolution No. 31/2023 of 27 March 2023 with the composition appointed by Supervisory Board Resolution No. 42/2023 of 8 May 2023. All members of the Audit Committee meet the requirements for having knowledge and skills in banking and finance and in accounting or auditing, which they have acquired through experience and education.

The basic tasks of the Audit Committee derive from the provisions of the Act of 11 May 2017 on Statutory Auditors, Audit Firms and Public Supervision, the Bank's Articles of Association, the Regulations of the Supervisory Board, the "Recommendations on the functioning of the Audit Committee" adopted by the FSA.

The Audit Committee performs the tasks of the Audit Committee provided for in the applicable legislation in the mode of day-to-day supervision on the basis of information provided by the Bank's Management Board, the Statutory Auditor, the Internal Audit Function, the Compliance Department, the Accounting and Settlement Department in the mode of meetings.

The Audit Committee, by Resolution No. 6/2017 of 14 December 2017, adopted the "Policy on the selection of the audit firm and on the provision by the audit firm conducting the audit, by entities related to the audit firm and by a member of the audit firm's network of permitted services that are not an audit of the financial statements at mBank Hipoteczny S.A." Together with the appendix "Procedure for the selection of the Audit Firm at mBank Hipoteczny S.A." The Policy fulfils the requirements of the Act on Statutory Auditors, Audit Firms and Public Supervision and the Regulation of the European Parliament and the Council of the European Union of 16.04.2014 No. 537/2014.

The policy on the selection of the audit firm takes into account the principle of auditor rotation. The maximum uninterrupted duration of the statutory audit engagements referred to in the second subparagraph of Article 17(1) of Regulation No. 537/2014 carried out by the same audit firm or an audit firm affiliated to that audit firm or any member of the network operating in countries of the European Union to which those audit firms belong shall not exceed 5 years. The key auditor may re-perform the statutory audit of a bank after a period of at least 3 years from the completion of the last statutory audit. In the case of a statutory audit, the first statutory audit contract shall be concluded with the audit firm for a period of not less than two years, renewable for a further period of at least two years.

The statutory auditor or audit firm carrying out the statutory audit, nor any member of the network to which the statutory auditor or audit firm belongs, shall not provide directly or indirectly to the audited entity, its parent undertaking or the entities controlled by it within the Union:

(1) any prohibited non-audit services during the period from the beginning of the audited period to the issuance of the audit report;

(2) services consisting of the development and implementation of internal control or risk management procedures relating to the preparation or control of financial information or the development and implementation of technological systems relating to financial information.

Services prohibited under section 136 of the Act on Statutory Auditors are not:

(1) services:

a. involving carrying out due diligence procedures on the economic and financial condition,

b. entailing issuance of assurance letters - performed in connection with the audited entity's prospectus, carried out in accordance with the national standard for related services and involving agreed procedures;

(2) assurance services on pro forma financial information, earnings forecasts or estimated results, included in the audited entity's prospectus;

(3) study of historical financial information for the prospectus;

(4) verification of consolidation packages;

(5) confirming the fulfilment of the terms and conditions of the concluded loan agreements on the basis of an analysis of financial information from the financial statements audited by the respective audit firm;

(6) assurance services on corporate governance, risk management and corporate social responsibility reporting;

(7) services to assess the compliance of financial institutions' and investment firms' disclosures with capital adequacy and variable remuneration disclosure requirements;

(8) certifications concerning reports or other financial information intended for the supervisory authorities, the supervisory board or any other supervisory body of the company or the owners, going beyond the scope of the statutory audit and intended to assist those bodies in fulfilling their statutory duties.

The audit firm reviewing the condensed financial statements did not provide mBH. with any prohibited services as well as permitted non-audit services.

Diversity policy at mBH

In its operations, the Bank applies the mBank Group SA requirements for ensuring diversity. When deciding on the composition of the Bank's Management Board, the Supervisory Board aims to ensure its diversity, in particular with regard to age, education, professional experience and the proportion of women.

The same criteria are applied by the Bank's shareholder when deciding on the composition of the Supervisory Board

By 2028, the total proportion of women on the Management Board and Supervisory Board will be at least 30%. The recommended number of women on the Board is a minimum of one. As at the reporting date, the proportion of women on the Bank's Management Board is 50%.

Truthfulness and reliability of the reports presented

The Management Board of mBH declares that, to the best of its knowledge:

(1) the financial statements and comparative data have been prepared in accordance with the applicable accounting principles and give a true, fair and clear view of the Bank's assets, financial position and profit or loss,

(2) the Management Board' report gives a true picture of the Bank's situation, including a description of the main risks and threats.

The process of preparing financial data for reporting purposes is automated and based on the Bank's accounting data. The preparation of data in the source systems is subject to formalised operational and acceptance procedures. The creation of a set of accounting balances based on the Bank's general ledger system follows a process that includes appropriate internal controls. Manual adjustments are subject to special controls.

The Bank continuously monitors changes in external laws and regulations related to the preparation of reports and updates internal regulations on an ongoing basis and adapts IT systems as necessary.

The preparation of financial statements at mBH is handled by the Financial Reporting Division in the Accounting and Settlement Department. The financial accounting and the administration of the model chart of accounts are the responsibility of the Accounting and Settlement Department.

The Bank prepares annual and abbreviated half-yearly financial statements, which are forwarded to mBH's Management Board for approval. At the same time, the reports are forwarded to the members of the Audit Committee of the Supervisory Board. The Audit Committee, after consultation with the external auditor and members of the Executive Board, recommends to the Supervisory Board the acceptance or rejection of the annual financial statements.

The annual and condensed half-yearly financial statements of mBH are subject to an independent audit and review by a statutory auditor, respectively. The selection of the Bank's auditor is made by resolution of the mBH Supervisory Board. A recommendation on the selection of the auditor is made by the Audit Committee of the Supervisory Board. In accordance with the Policy on the Selection of the Audit Firm, the Recommendation shall include a justification and at least two options for the selection of the audit firm together with a justified preference for one of them.