mBank S.A.

IFRS Financial Statements 2016

Selected financial data

The selected financial data are supplementary information to these financial statements of mBank S.A. for 2016.

		in PLN '000		in EUR '000	
		Year ended 31.12.2016	Year ended 31.12.2015	Year ended 31.12.2016	Year ended 31.12.2015
I.	Interest income	3 394 096	3 274 494	775 669	782 473
II.	Fee and commission income	1 259 269	1 091 508	287 787	260 827
III.	Net trading income	249 545	294 010	57 030	70 257
IV.	Operating profit	1 789 234	1 538 826	408 902	367 718
V.	Profit before income tax	1 570 154	1 553 030	358 835	371 112
VI.	Net profit	1 219 339	1 301 233	278 661	310 943
VII.	Net cash flows from operating activities	8 348 347	8 084 953	1 907 888	1 931 981
VIII.	Net cash flows from investing activities	122 765	347 388	28 056	83 012
IX.	Net cash flows from financing activities	(363 482)	(6 281 212)	(83 068)	(1 500 959)
X.	Net increase / decrease in cash and cash equivalents	8 107 630	2 151 129	1 852 876	514 034
XI.	Basic earnings per share (in PLN/EUR)	28.86	30.82	6.60	7.36
XII.	Diluted earnings per share (in PLN/EUR)	28.84	30.80	6.59	7.36
XIII.	Declared or paid dividend per share (in PLN/EUR)	-	-	-	-

		in PLN '000		in EUR '000	
		As at		As at	
		31.12.2016	31.12.2015	31.12.2016	31.12.2015
I.	Total assets	128 215 265	119 115 370	28 981 751	27 951 512
II.	Amounts due to the Central Bank	-	-	-	-
III.	Amounts due to other banks	8 503 014	12 183 191	1 922 019	2 858 897
IV.	Amounts due to customers	98 960 320	85 924 151	22 368 969	20 162 889
V.	Equity	13 023 803	12 242 347	2 943 898	2 872 779
VI.	Share capital	169 121	168 956	38 228	39 647
VII.	Number of shares	42 280 127	42 238 924	42 280 127	42 238 924
VIII.	Book value per share (in PLN/EUR)	308.04	289.84	69.63	68.01
IX.	Total capital ratio	24.07	20.18	24.07	20.18

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

- for items of the consolidated statement of financial position – exchange rate announced by the National Bank of Poland as at 31 December 2016: EUR 1 = 4.4240 and 31 December 2015: EUR 1 = PLN 4.2615.
- for items of the consolidated income statement – exchange rate calculated as the arithmetic mean of exchange rates announced by the National Bank of Poland as at the end of each month of 2016 and 2015: EUR 1 = PLN 4.3757 and EUR 1 = PLN 4.1848 respectively.

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Income statement

	Note	Year ended 31 December	
		2016	2015 - restated
Interest income	5	3 394 096	3 274 494
Interest expense	5	(927 910)	(1 066 135)
Net interest income		**2 466 186**	**2 208 359**
Fee and commission income	6	1 259 269	1 091 508
Fee and commission expense	6	(576 047)	(468 653)
Net fee and commission income		**683 222**	**622 855**
Dividend income	7	166 833	197 872
Net trading income, including:	8	249 545	294 010
Foreign exchange result		*265 741*	*285 786*
Other net trading income and result on hedge accounting		*(16 196)*	*8 224*
Gains less losses from investment securities, investments in subsidiaries and associates	22	261 213	289 253
Gains less losses from investment securities		*261 652*	*133 645*
Gains less losses from investments in subsidiaries and associates		*(439)*	*155 608*
Other operating income	9	68 750	56 381
Net impairment losses on loans and advances	12	(312 195)	(325 325)
Overhead costs	10	(1 491 553)	(1 571 995)
Amortisation	24,25	(199 826)	(171 888)
Other operating expenses	11	(102 941)	(60 696)
Operating profit		**1 789 234**	**1 538 826**
Taxes on the Bank's balance sheet items		(312 254)	(3 650)
Share in profits (losses) of entities under the equity method	23	93 174	17 854
Profit before income tax		**1 570 154**	**1 553 030**
Income tax expense	13	(350 815)	(251 797)
Net profit		**1 219 339**	**1 301 233**

Net profit		**1 219 339**	**1 301 233**
Weighted average number of ordinary shares	14	**42 252 790**	**42 221 351**
Basic earnings per share (in PLN)	14	**28.86**	**30.82**
Weighted average number of ordinary shares for diluted earnings	14	**42 280 286**	**42 247 160**
Diluted earnings per share (in PLN)	14	**28.84**	**30.80**

Notes presented on pages 10–149 constitute an integral part of these Financial Statements.

IFRS Financial Statements 2016 PLN (000's)

Statement of comprehensive income

	Note	Year ended 31 December	
		2016	2015 - restated
Net profit		**1 219 339**	**1 301 233**
Other comprehensive income net of tax, including:	15	**(447 125)**	**(116 706)**
Items that may be reclassified subsequently to the income statement			
Exchange differences on translation of foreign operations (net)		337	684
Change in valuation of available for sale financial assets (net)		(444 189)	(112 192)
Cash flows hedges (net)		(2 404)	(3 197)
Share of other comprehensive income of entities under the equity method		(1 202)	(483)
Items that will not be reclassified to the income statement			
Actuarial gains and losses relating to post-employment benefits (net)		333	(1 518)
Total comprehensive income net of tax, total		**772 214**	**1 184 527**

Notes presented on pages 10–149 constitute an integral part of these Financial Statements.

IFRS Financial Statements 2016 PLN (000's)

Statement of financial position

ASSETS	Note	31.12.2016	31.12.2015 - restated	01.01.2015 - restated
Cash and balances with the Central Bank	16	9 158 751	5 930 611	3 046 817
Loans and advances to banks	17	7 308 769	4 981 321	5 648 047
Trading securities	18	3 837 606	558 590	1 251 064
Derivative financial instruments	19	1 818 306	3 350 746	4 874 882
Loans and advances to customers	21	72 304 131	71 284 102	69 529 868
Hedge accounting adjustments related to fair value of hedged items	20	-	130	461
Investment securities	22	30 467 780	29 982 642	27 246 034
Investments in subsidiaries	23	1 782 219	1 758 247	1 580 226
Non-current assets held for sale		-	-	31 063
Intangible assets	24	540 452	473 816	425 078
Tangible assets	25	481 695	484 867	468 822
Current income tax assets		1 067	-	60 211
Deferred income tax assets	33	146 693	31 279	15 144
Other assets	26	367 796	279 019	199 405
Total assets		**128 215 265**	**119 115 370**	**114 377 122**

LIABILITIES AND EQUITY				
Liabilities				
Amounts due to the Central Bank		-	-	-
Amounts due to other banks	27	8 503 014	12 183 191	13 384 224
Derivative financial instruments	19	1 644 250	3 203 918	4 755 856
Amounts due to customers	28	98 960 320	85 924 151	79 312 266
Hedge accounting adjustments related to fair value of hedged items	20	87 566	78 568	77 619
Debt securities in issue	29	-	-	386 423
Other liabilities	31	1 792 740	1 386 264	1 112 805
Current income tax liabilities		77 475	44 190	-
Deferred income tax liabilities	33	100	82	82
Provisions	32	182 648	225 344	176 878
Subordinated liabilities	30	3 943 349	3 827 315	4 127 724
Total liabilities		**115 191 462**	**106 873 023**	**103 333 877**

Equity				
Share capital:		**3 551 096**	**3 535 758**	**3 523 903**
- Registered share capital	38	169 121	168 956	168 840
- Share premium	39	3 381 975	3 366 802	3 355 063
Retained earnings:	**40**	**9 486 890**	**8 273 647**	**6 969 694**
- Profit from the previous years		8 267 551	6 972 414	6 969 694
- Profit for the current year		1 219 339	1 301 233	-
Other components of equity	**41**	**(14 183)**	**432 942**	**549 648**

Total equity		**13 023 803**	**12 242 347**	**11 043 245**
Total liabilities and equity		**128 215 265**	**119 115 370**	**114 377 122**

Total capital ratio	**48**	**24.07**	**20.18**	**16.95**
Common Equity Tier 1 capital ratio	**48**	**20.59**	**16.70**	**14.06**
Book value		**13 023 803**	**12 242 347**	**11 043 245**
Number of shares		**42 280 127**	**42 238 924**	**42 210 057**
Book value per share (in PLN)		**308.04**	**289.84**	**261.63**

Notes presented on pages 10–149 constitute an integral part of these Financial Statements.

IFRS Financial Statements 2016 PLN (000's)

Statement of changes in equity

Changes from 1 January to 31 December 2016

	Note	Share capital		Retained earnings					Other components of equity					Total equity
		Registered share capital	Share premium	Other supplementary capital	Other reserve capital	General banking risk reserve	Profit from the previous years	Profit for the current year	Exchange differences on translation of foreign operations	Valuation of available for sale financial assets	Cash flows hedges	Actuarial gains and losses relating to post-employment benefits	Share in profits (losses) of entities under the equity method	
Equity as at 1 January 2016		**168 956**	**3 366 802**	**4 384 011**	**32 976**	**1 065 143**	**2 791 517**	**-**	**(6 290)**	**441 758**	**859**	**(3 850)**	**465**	**12 242 347**
Total comprehensive income	15							**1 219 339**	**337**	**(444 189)**	**(2 404)**	**333**	**(1 202)**	**772 214**
Transfer to General Risk Fund		-	-	-	-	30 000	(30 000)	-	-	-	-	-	-	-
Issue of shares	38	165	-	-	-	-	-	-	-	-	-	-	-	165
Other changes		-	-	-	-	-	(11)	-	-	-	-	-	-	(11)
Stock option program for employees	39, 44	-	15 173	-	(6 085)	-	-	-	-	-	-	-	-	9 088
- value of services provided by the employees		-	-	-	*9 088*	-	-	-	-	-	-	-	-	*9 088*
- settlement of exercised options		-	*15 173*	-	*(15 173)*	-	-	-	-	-	-	-	-	-
Equity as at 31 December 2016		**169 121**	**3 381 975**	**4 384 011**	**26 891**	**1 095 143**	**2 761 506**	**1 219 339**	**(5 953)**	**(2 431)**	**(1 545)**	**(3 517)**	**(737)**	**13 023 803**

Changes from 1 January to 31 December 2015

	Note	Share capital		Retained earnings					Other components of equity					Total equity
		Registered share capital	Share premium	Other supplementary capital	Other reserve capital	General banking risk reserve	Profit from the previous years	Profit for the current year	Exchange differences on translation of foreign operations	Valuation of available for sale financial assets	Cash flows hedges	Actuarial gains and losses relating to post-employment benefits	Share of other comprehensive income of associates	
Equity as at 1 January 2015		**168 840**	**3 355 063**	**3 977 488**	**30 256**	**1 015 143**	**1 174 096**	**-**	**(6 974)**	**553 950**	**4 056**	**(2 332)**	**-**	**10 269 586**
- changes to accounting policies		-	-	-	-	-	772 711	-	-	-	-	-	948	773 659
Adjusted equity as at 1 January 2015		**168 840**	**3 355 063**	**3 977 488**	**30 256**	**1 015 143**	**1 946 807**	**-**	**(6 974)**	**553 950**	**4 056**	**(2 332)**	**948**	**11 043 245**
Total comprehensive income	15							**1 301 233**	**684**	**(112 192)**	**(3 197)**	**(1 518)**	**(483)**	**1 184 527**
Transfer to General Risk Fund		-	-	-	-	50 000	(50 000)	-	-	-	-	-	-	-
Transfer to supplementary capital		-	-	406 523	-	-	(406 523)	-	-	-	-	-	-	-
Issue of shares	38	116	-	-	-	-	-	-	-	-	-	-	-	116
Stock option program for employees	39, 44	-	11 739	-	2 720	-	-	-	-	-	-	-	-	14 459
- value of services provided by the employees		-	-	-	*14 459*	-	-	-	-	-	-	-	-	*14 459*
- settlement of exercised options		-	*11 739*	-	*(11 739)*	-	-	-	-	-	-	-	-	-
Equity as at 31 December 2015 - restated		**168 956**	**3 366 802**	**4 384 011**	**32 976**	**1 065 143**	**1 490 284**	**1 301 233**	**(6 290)**	**441 758**	**859**	**(3 850)**	**465**	**12 242 347**

Notes presented on pages 10–149 constitute an integral part of these Financial Statements.

IFRS Financial Statements 2016 PLN (000's)

Statement of cash flows

	Note	Year ended 31 December	
		2016	2015 - restated
A. Cash flows from operating activities		**8 348 347**	**8 084 953**
Profit before income tax		**1 570 154**	**1 553 030**
Adjustments:		***6 778 193***	***6 531 923***
Income taxes paid		(325 315)	(108 825)
Amortisation	24, 25	199 826	171 888
Foreign exchange (gains) losses on financing activities		584 298	1 617 302
(Gains) losses on investing activities		(362 429)	(314 689)
Impairment of investment securities and investments in subsidiaries	23	8 119	8 096
Dividends received	7	(166 833)	(197 872)
Interest income (income statement)	5	(3 394 096)	(3 274 494)
Interest expenses (income statement)	5	927 910	1 066 135
Interest received		3 648 385	3 482 616
Interest paid		(792 003)	(1 011 989)
Changes in loans and advances to banks		(855 233)	291 758
Changes in trading securities		45 521	253 060
Changes in assets and liabilities on derivative financial instruments		51 799	60 237
Changes in loans and advances to customers		(1 079 885)	(1 748 095)
Changes in investment securities		(866 124)	(3 230 924)
Changes in other assets		(93 071)	(31 052)
Changes in amounts due to other banks		(1 359 349)	659 837
Changes in amounts due to customers		10 183 114	8 450 347
Changes in debt securities in issue		-	(1 423)
Changes in provisions		(42 696)	48 466
Changes in other liabilities		466 255	341 544
Net cash generated from/(used in) operating activities		**8 348 347**	**8 084 953**
B.Cash flows from investing activities		**122 765**	**347 388**
Investing activity inflows		***371 906***	***587 108***
Disposal of shares in subsidiaries		2 000	28 036
Disposal of intangible assets and tangible fixed assets		4 041	148
Dividends received	7	166 833	197 872
Other investing inflows		199 032	361 052
Investing activity outflows		**249 141**	**239 720**
Purchase of intangible assets and tangible fixed assets		249 141	229 659
Other investing outflows		-	10 061
Net cash generated from/(used in) investing activities		**122 765**	**347 388**
C. Cash flows from financing activities		**(363 482)**	**(6 281 212)**
Financing activity inflows		***3 165 800***	***596 011***
Proceeds from loans and advances from other banks		570 635	180 475
Proceeds from other loans and advances		439 000	415 420
Issue of ordinary shares		165	116
Security deposit due to issue of Eurobonds		2 156 000	-
Financing activity outflows		**3 529 282**	**6 877 223**
Repayments of loans and advances from other banks		3 266 045	3 378 322
Repayments of other loans and advances		12 844	12 655
Redemption of debt securities		-	385 000
Acquisition of shares in subsidiaries - increase of involvement		102 200	144 168
Decrease of subordinated liabilities	30	-	637 661
Payments of financial lease liabilities		9 517	9 037
Repayment of security deposit due to issue of Eurobonds		-	2 113 650
Interest paid from loans and advances received from other banks and subordinated liabilities		138 676	196 730
Net cash generated from/(used in) financing activities		**(363 482)**	**(6 281 212)**
Net increase / decrease in cash and cash equivalents (A+B+C)		**8 107 630**	**2 151 129**
Effects of exchange rate changes on cash and cash equivalents		(12 377)	(21 303)
Cash and cash equivalents at the beginning of the reporting period		6 892 431	4 762 605
Cash and cash equivalents at the end of the reporting period	**43**	**14 987 684**	**6 892 431**

Notes presented on pages 10–149 constitute an integral part of these Financial Statements.

Explanatory notes to the financial statements

1. Information regarding mBank S.A.

mBank S.A. ("Bank", "mBank") was established under the name of Bank Rozwoju Eksportu SA by Resolution of the Council of Ministers N° 99 of 20 June 1986. The Bank was registered pursuant to the legally valid decision of the District Court for the Capital City of Warsaw, 16th Economic Registration Division on 23 December 1986 in the Business Register under the number RHB 14036. The 9th Extraordinary Meeting of Shareholders held on 4 March 1999 adopted the resolution changing the Bank's name to BRE Bank S.A. The new name of the Bank was entered in the Business Register on 23 March 1999. On 11 July 2001, the District Court in Warsaw issued the decision on the entry of the Bank in the National Court Register (KRS) under number KRS 0000025237.

On 22 November 2013, the District Court for the Capital City of Warsaw, 12th Commercial Division of the National Court Register, registered the amendments to the Bank's By-lows arising from Resolutions N° 26 and Resolutions N° 27 of the 26th Annual General Meeting of mBank S.A, which was held on 11 April 2013. With the registration of changes in By-lows, the name of the Bank has changed from the current BRE Bank Spółka Akcyjna on mBank Spółka Akcyjna (abbreviated mBank S.A.).

According to the Polish Classification of Business Activities, the business of the Bank was classified as "Other monetary intermediation" under number 6419Z. According to the Stock Exchange Quotation, the Bank is classified as "Banks" sector as part of the "Finance" macro-sector.

According to the By-laws of the Bank, the scope of its business consists of providing banking services and consulting and advisory services in financial matters, as well as of conducting business activities within the scope described in its By-laws. The Bank operates within the scope of corporate, institutional and retail banking (including private banking) throughout the whole country and operates trade and investment activities as well as brokerage activities.

The Bank provides services to Polish and international corporations and individuals, both in the local currency (Polish Zloty, PLN) and in foreign currencies.

The Bank may open and maintain accounts in Polish and foreign banks, and can possess foreign exchange assets and trade in them.

The Bank conducts retail banking business in Czech Republic and Slovakia through its foreign mBank branches in these countries.

As at 31 December 2016, the headcount of mBank S.A. amounted to 5 364 FTEs (Full Time Equivalents) - 6 313 persons (31 December 2015: 5 151 FTEs - 6 336 persons).

The Management Board of mBank S.A. approved these financial statements for issue on 1 March 2017.

2. Description of relevant accounting policies

The most important accounting policies applied to the drafting of these financial statements are presented below. These principles were applied consistently over all of the presented periods.

2.1. Accounting basis

The financial statements of mBank S.A. have been prepared for the 12-month period ended 31 December 2016. Comparative data presented in these financial statements relate to the period of 12 months ended on 31 December 2015.

These financial statements of mBank S.A. have been prepared in compliance with the International Financial Reporting Standards (IFRS) as adopted for use in the European Union, according to the historical cost method, as modified by the revaluation of available for sale financial assets, financial assets and financial liabilities measured at fair value through the income statement, all derivative contracts, liabilities related to cash-settled share-based payment transactions measured at fair value as well as financial assets and liabilities under hedge accounting. Non-current assets held for sale or group of these assets classified as held for sale are stated at the lower of the carrying value and fair value less costs to sell. Shares in subsidiaries, associates and joint ventures are settled using the equity method of accounting.

The preparation of the financial statements in compliance with IFRS requires the application of specific accounting estimates. It also requires the Management Board to use its own judgment when applying the accounting policies adopted by the Bank. The issues in relation to which a significant professional judgement is required, more complex issues, or such issues where estimates or judgments are material to the consolidated financial statements are disclosed in Note 4.

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

These financial statements were prepared under the assumption that the Bank continues as a going concern in the foreseeable future, i.e. in the period of at least 12 months following the reporting date. As of the date of approving these statements, the Bank Management Board has not identified any events that could indicate that the continuation of the operations by the Bank is endangered.

The Bank also prepares consolidated financial statements in accordance with IFRS. mBank S.A. Group Consolidated Financial Statements for the year 2016 were published on 1 March 2017.

2.2. Interest income and expenses

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

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

Following the recognition of an impairment loss on a financial asset or a group of similar financial assets, the interest income is calculated on the net value of financial assets and recognized using the interest rate at which the future cash flows were discounted for the purpose of valuation of impairment.

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

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

The calculation of the effective interest rate takes into account the cash flows resulting from only those embedded derivatives, which are strictly linked to the underlying contract.

Income and expenses related to the interest component of the result on interest rate derivatives and resulting from current calculation of swap points on currency derivatives classified into banking book are presented in the interest results in the position Interest income/expense on derivatives classified into banking book. The banking book includes transactions, which are not concluded for trading purposes i.e. not aimed at generating a profit in a short-term period (up to 6 months) and those that do not constitute hedging a risk arising from the operations assigned into trading book.

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

Interest income related to the interest measurement component of derivatives concluded as hedging instruments under cash flow hedge are presented in the interest result in the position interest income on derivatives under the cash flow hedge accounting.

2.3. Fee and commission income

Income on account of fees and commissions is recognized on the accrual basis, at the time of performance of the respective services. Fees charged for the granting of loans which are likely to be drawn down are deferred (together with the related direct costs) and recognized as adjustments of the effective interest rate charge on the loan. Fees on account of syndicated loans are recognized as income at the time of closing of the process of organisation of the respective syndicate, if the Bank has not retained any part of the credit risk on its own account or has retained a part of the risk of a similar level as other participants. Commissions and fees on account of negotiation or participation in the negotiation of a transaction on behalf of a third party, such as the acquisition of shares or other securities, or the acquisition or disposal of an enterprise, are recognized at the time of realisation of the transaction. The same principle is applied in the case of management of client assets, financial planning and custody services, which are continuously provided over an extended period of time.

Fee and commissions collected by the Bank on account of issuance, renewal and change in the limit of credit and payment cards, guarantees granted as well as opening, extension and increase of letters of credit are accounted for a straight-line basis.

Fee and commissions collected by the Bank on account of cash management operations, keeping of customer accounts, money transfers and brokerage business activities are recognized directly in the income statement.

The Bank's fee and commission income comprises also income from offering insurance products of third parties. In case of selling insurance products that are not bundled with loans, the revenues are recognized as upfront income or in majority of cases settled on a monthly basis.

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

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

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

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

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

The Bank estimates also the part of remuneration which in the future will be returned due to early termination of insurance contract and appropriately decreases interest income or fee and commission income to be recognized.

In connection with entry into force of Recommendation U concerning best practices in the area of bancassurance, starting from 31 March 2015 the Bank does not receive remuneration from the sale of insurance products which would have been treated as boundled with loans.

2.5. Financial assets

The Bank classifies its financial assets to the following categories: financial assets valued at fair value through the income statement; loans and receivables; financial assets held to maturity; financial assets available for sale. The classification of financial assets is determined by the Management at the time of their initial recognition.

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

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

<u>Financial assets valued at fair value through the income statement</u>

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

Disposals of debt and equity securities held for trading are accounted according to the weighted average method.

The Bank classifies financial assets/financial liabilities as measured at fair value through the income statement if they meet either of the following conditions:

- assets/liabilities are classified as held for trading i.e. they are acquired or incurred principally for the purpose of selling or repurchasing them in the near term, they are a part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit making or they are derivatives (except for derivatives that are designated as and being effective hedging instruments and financial guarantee contracts),

- upon initial recognition, assets/liabilities are designated by the entity at fair value through the income statement according to IAS 39.

If a contract contains one or more embedded derivatives, the Bank designates the entire hybrid (combined) contract as a financial asset or financial liability at fair value through the income statement unless:

- the embedded derivative(s) does not significantly modify the cash flows that otherwise would be required by the contract; or
- it is clear with little or no analysis when a similar hybrid instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortised cost.

The Bank also designates the financial assets/financial liabilities at fair value through the income statement when doing so results in more relevant information, because either:

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

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

Interest income/expense on financial assets/financial liabilities designated at fair value (Note 2.2), except for derivatives the recognition of which is discussed in Note 2.11, is recognized in net interest income. The valuation and result on disposal of financial assets/financial liabilities designated at fair value is recognized in trading income.

As presented in this financial statements reporting periods, the Bank did not designate any financial instrument on initial recognition as financial assets at fair value through the income statement.

<u>Loans and receivables</u>

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

<u>Investments held to maturity</u>

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

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

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

<u>Financial assets available for sale</u>

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

Interest income and expense from available for sale investments are presented in net interest income. Gains and losses from sale of available for sale investments are presented in gains and losses from investment securities.

Available for sale financial assets and financial assets measured at fair value through the income statement are valued at the end of the reporting period according to their fair value. Loans and receivables, as well as investments held to maturity are measured at adjusted cost of acquisition (amortised cost), applying the effective interest rate method. Gains and losses resulting from changes in the fair value of "financial assets measured at fair value through the income statement" are recognized in the income statement in the period in which they arise.

Gains and losses arising from changes in the fair value of available for sale financial assets are recognized in other comprehensive income until the derecognition of the respective financial asset in the statement of financial position or until its impairment: at such time the aggregate net gain or loss previously recognized in other comprehensive income is now recognized in the income statement. However, interest calculated using the effective interest rate is recognized in the income statement. Dividends on available for sale equity instruments are recognized in the income statement when the entity's right to receive payment is established.

The fair value of quoted investments in active markets is based on current market prices. If the market for a given financial asset is not an active one, the Bank determines the fair value by applying valuation techniques. These comprise recently conducted transactions concluded according to normal market principles, reference to other instruments, discounted cash flow analysis, as well as valuation models for options and other valuation methods generally applied by market participants (Note 19).

If the application of valuation techniques does not ensure obtaining a reliable fair value of investments in equity instruments not quoted on an active market, they are stated at cost.

2.6. Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. The conditions mentioned above are not satisfied and offsetting is inappropriate when: different financial instruments are used to emulate the features of a single financial instrument, financial assets and liabilities arise from financial instruments having the same primary risk exposure but involve different counterparties, financial or other assets are pledged as collaterals for non-recourse financial liabilities, financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in the settlement of the obligation, or obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance contract.

2.7. Impairment of financial assets

Assets carried at amortised cost

At the end of the reporting period, the Bank estimates whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the future cash flows of the financial asset or group of financial assets that can be reliably estimated. Loss events were divided into definite ("hard") loss events of which occurrence requires that there is a need to classify the client into the default category, and indefinite ("soft") loss events of which occurrence may imply that there is a need to classify the client into the default category.

In case of specific situation, when the future cash flows are clearly dependent on individual events (based on discrete metric), the Bank estimates the probability of such events as the basis for calculating the impairment charge.

The Bank first assesses whether objective indications exist individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines that for the given financial asset assessed individually there are no objective indications of its impairment (regardless of whether that particular item is material or not), the given asset is included in a group of financial assets featuring similar credit risk characteristics, which is subsequently collectively assessed in terms of its possible impairment. Financial assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

Recognition of default in respect of one exposure to a customer leads to recognision of the default status for all exposures to that customer.

If there is impairment indicator for impairment of loans and receivables or investments held to maturity and recognized at amortised cost, the impairment amount is calculated as the difference between the carrying value in the statement of financial position of the respective asset and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying value of the asset is reduced through the use of an allowance account, and the resulting impairment loss is charged to the income statement. If a loan or held to maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

The calculation of the present value of estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

In order to assess if the impairment loss has occurred, identification of credit exposures with premises for impairment is carried out. Subsequently the comparison of the gross balance sheet credit exposure with the value of estimated future cash flows discounted at the original effective interest rate is carried out, which leads to the conclusion whether the impairment loss has occurred. If the discounted value of future cash flow is higher than the gross balance sheet value, the impairment charge is not recognized.

For the purpose of collective evaluation of impairment, the credit exposures are grouped in order to ensure the uniformity of credit risk attached to the given portfolio. Many different parameters may be applied to the grouping into homogeneous portfolios, e.g., the type of counterparty, the type of exposure, estimated probability of default, the type of collateral provided, overdue status outstanding, maturities, and their combinations. Such features influence the estimation of the future cash flows attached to specific groups of assets as they indicate the capabilities of repayment on the part of debtors of their total liabilities in conformity with the terms and conditions of the contracts concerning the assessed assets.

Future cash flows concerning groups of financial assets assessed collectively in terms of their possible impairment are estimated on the basis of contractual cash flows and historical loss experience for assets with credit risk characteristics similar to those in the group.

Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

For the purpose of calculation of the amount to be provisioned against balance sheet exposures analysed collectively, the probability of default (PD) method has been applied. By calibration of PD values, taking into account characteristics of specific products and emerging periods for losses on those products, such PD values allow already arisen losses to be identified and cover only the period in which the losses arising at the date of establishment of impairment should crystallise.

When a loan is uncollectible, it is written off against the related provision for impairment. Before any loan is written off, it is necessary to conduct all the procedures required by the Bank and sets the amount of the loss. Subsequent recoveries of amounts previously written off reduce the amount of the provision for loan impairment in the income statement.

If in a subsequent period the impairment loss amount is decreasing and the decrease can be related objectively to an event occurring after the impairment was recognized (e.g., improvement of the debtor's credit rating), then the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recorded in the income statement under the item "Net impairment losses on loans and advances".

<u>Assets measured at fair value available for sale</u>

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

<u>Renegotiated agreements</u>

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

2.8. Financial guarantee contracts

The financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

When a financial guarantee contract is recognized initially, it is measured at the fair value. After initial recognition, an issuer of such a contract measures it at the higher of:

- the amount determined in accordance with IAS 37 "*Provisions, Contingent Liabilities and Contingent Assets*", and
- the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with IAS 18 "*Revenue*".

2.9. Cash and cash equivalents

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

2.10. Sell-buy-back, buy-sell-back, reverse repo and repo contracts

Repo and reverse-repo transactions are defined as selling and purchasing securities for which a commitment has been made to repurchase or resell them at a contractual date and for a specified contractual price and are recognized when the money is transferred.

Securities sold with a repurchase clause (repos/sell buy back) are reclassified in the financial statements as pledged assets if the entity receiving them has the contractual or customary right to sell or pledge them as collateral security. The liability towards the counterparty is recognized as amounts due to other banks, deposits from other banks, other deposits or amounts due to customers, depending on its nature. Securities purchased together with a resale clause (reverse repos/buy sell back) are recognized as loans and advances to other banks or other customers, depending on their nature.

When concluding a repo or reverse repo transaction, mBank sells or buys securities with a repurchase or resale clause specifying a contractual date and price. Such transactions are presented in the statement of financial position as financial assets held for trading or as investment financial assets, and also as liabilities in the case of "sell-buy-back" transactions and as receivables in the case of "buy-sell-back" transactions.

Securities borrowed by the Bank are not recognized in the financial statements, unless they are sold to third parties. In such case the purchase and sale transactions are recorded with a gain or a loss included in trading income. The obligation to return them is recorded at fair value as amounts due to customers. Securities borrowed under "buy-sell-back" transactions and then lent under "sell-buy-back" transactions are not recognized as financial assets.

As a result of "sell-buy-back" transactions concluded on securities held by the Bank, financial assets are transferred in such way that they do not qualify for derecognition. Thus, the Bank retains substantially all risks and rewards of ownership of the financial assets.

2.11. Derivative financial instruments and hedge accounting

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

The best fair value indicator for a derivative instrument at the time of its initial recognition is the price of the transaction (i.e., the fair value of the paid or received consideration). If the fair value of the particular instrument may be determined by comparison with other current market transactions concerning the same instrument (not modified) or relying on valuation techniques based exclusively on market data that are available for observation, then the Bank recognises the respective gains or losses from the first day in accordance with the principles described under Note 2.12.

Embedded derivative instruments are treated as separate derivative instruments if the risks attached to them and their characteristics are not strictly linked to the risks and characteristics of the underlying contract and the underlying contract is not measured at fair value through the income statement.

Embedded derivative instruments of this kind are measured at fair value and the changes in fair value are recognized in the income statement.

In accordance with IAS 39 AG 30: (i), there is no need to separate the prepayment option from the host debt instrument for the needs of financial statements, if the option's exercise price is approximately equal on each exercise date to the amortised cost of the host debt instrument. If the value of prepayment option was not to be closely related to the underlying debt instrument, the option should be separated and fair valued in the financial statements of the Bank; (ii), exercise price of a prepayment option reimburses the lender for an amount up to the approximate present value of lost interest for the remaining term of the host contract. Lost interest is the product of the principal amount prepaid multiplied by the interest rate differential. The interest rate differential is the excess of the effective interest rate of the host contract over the effective interest rate the entity would receive at the prepayment date if it reinvested the principal amount prepaid in a similar contract for the remaining term of the host contract.

The assessment of whether the call or put option is closely related to the host debt contract is made before separating the equity element of a host debt instrument in accordance with IAS 32.

The method of recognising the resulting fair value gain or loss depends on whether the given derivative instrument is designated as a hedging instrument, and if it is, it also depends on the nature of the hedged item. The Bank designates some derivative instruments either as (1) fair value hedges against a recognized asset or liability or against a binding contractual obligation (fair value hedge), or as (2) hedges against highly probable future cash flows attributable to a recognized asset or liability, or a forecasted transaction (cash flow hedge). Derivative instruments designated as hedges against positions maintained by the Bank are recorded by means of hedge accounting, subject to the fulfilment of the criteria specified in IAS 39:

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

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

Due to the split of derivatives classified into banking book and into trading book, the Bank applies a different approach to the presentation of interest income/expense for each of these groups of derivatives that is described in Note 2.2 "Interest income and expenses". The remaining result from fair value measurement of derivatives is recognized in Net trading income.

<u>Fair value hedges</u>

Changes in the fair value of derivative instruments designated and qualifying as fair value hedges are recognized in the income statement together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

In case a hedge has ceased to fulfil the criteria of hedge accounting, the adjustment to the carrying value of the hedged item for which the effective interest method is used is amortised to the income statement over the period to maturity. The adjustment to the carrying amount of the hedged equity security remains in other comprehensive income until the disposal of the equity security.

Cash flow hedges

The effective part of the fair value changes of derivative instruments designated and qualifying as cash flow hedges is recognized in other comprehensive income. The gain or loss concerning the ineffective part is recognized in the income statement of the current period.

The amounts recognized in other comprehensive income are transferred to the income statement and recognized as income or cost of the same period in which the hedged item will affect the income statement (e.g., at the time when the forecast sale that is hedged takes place).

In case the hedging instrument has expired or has been sold, or the hedge has ceased to fulfil the criteria of hedge accounting, any aggregate gains or losses recognized at such time in other comprehensive income remain in other comprehensive income until the time of recognition in the income statement of the forecast transaction. When a forecast transaction is no longer expected to occur, the aggregate gains or losses recorded in other comprehensive income are immediately transferred to the income statement.

Derivative instruments not fulfilling the criteria of hedge accounting

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

The Bank holds the following derivative instruments in its portfolio:

Market risk instruments:

- Futures contracts for bonds, index futures
- Options for securities and for stock-market indices
- Options for futures contracts
- Forward transactions for securities
- Commodity swaps

Interest rate risk instruments:

- Forward Rate Agreement (FRA)
- Interest Rate Swap (IRS), Overnight Index Swap (OIS)
- Interest Rate Options

Foreign exchange risk instruments:

- Currency forwards, fx swap, fx forward
- Cross Currency Interest Rate Swap (CIRS)
- Currency options.

2.12. Gains and losses on initial recognition

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

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

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

2.13. Borrowings and deposits taken

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

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2.14. Intangible assets

The Bank measures intangible assets initially at cost. After initaial recognition, intangible assets are recognized at their cost of acquisition adjusted by the costs of improvement (rearrangement, development, reconstruction or modernisation) less any accumulated amortization and any accumulated impairment losses. Accumulated amortization is accrued by the straight line method taking into account the expected period of economic useful life of the respective intangible assets.

Computer software

Purchased computer software licences are capitalised in the amount of costs incurred for the purchase and adaptation for use of specific computer software. These costs are amortised on the basis of the expected useful life of the software (2-11 years). Expenses attached to the maintenance of computer software are expensed when incurred. Expenses directly linked to the development of identifiable and unique proprietary computer programmes controlled by the Bank, which are likely to generate economic benefits in excess of such costs expected to be gained over a period exceeding one year, are recognized as intangible assets. Direct costs comprise personnel expenses directly related to the software.

Capitalised costs attached to the development of software are amortised over the period of their estimated useful life (2-11 years).

Computer software directly connected with the functioning of specific information technology hardware is recognized as "Tangible fixed assets".

Development costs

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

"Development costs" useful lives are finite and the amortization period does not exceed 3 years. Amortization rates are adjusted to the period of economic utilisation. The Bank shows separately additions from internal development and separately those acquired through business combinations.

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

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

2.15. Tangible fixed assets

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

Subsequent costs are included in the asset's carrying amount or are recognized as a separate asset, as appropriate, only where it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. Any other expenses incurred on repairs and maintenance are expensed to the income statement in the reporting period in which they were incurred.

Land is not depreciated. Depreciation of other fixed assets is accounted for according to the straight line method in order to spread their initial value reduced by the residual value over the period of their useful life which is estimated as follows for the particular categories of fixed assets:

Buildings and structures	25-40 years,
Equipment	2-10 years,
Vehicles	5 years,
Information technology hardware	2-5 years,
Investments in third party fixed assets	10-40 years, no longer when the period of the lease contract,
Office equipment, furniture	5-10 years.

Land and buildings consist mainly of branch outlets and offices. Residual values, estimated useful life periods and depreciation method are verified at the end of the reporting period and adjusted accordingly as the need arises prospectively.

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

If it is not possible to estimate the recoverable amount of the individual asset, the Bank shall determine the recoverable amount of the cash-generating unit to which the asset belongs (cash-generating unit of the asset).

Gains and losses on account of the disposal of fixed assets are determined by comparing the proceeds from their sale against their carrying value in the statement of financial position and they are recognized in the income statement.

The carrying amount of tangible fixed assets is derecognized on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from the derecognition of tangible fixed assets are included in profit or loss when the item is derecognized. Gains are not classified as revenue.

2.16. Non-current assets held for sale and discontinued operations

The Bank classifies a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sale of such assets (or disposal groups) and its sale must be highly probable, i.e., the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Non-current assets held for sale are priced at the lower of: carrying value and fair value less costs to sell. Assets classified in this category are not depreciated.

When criteria for classification to non-current assets held for sale are not met, the Bank ceases to classify the assets as held for sale and reclassifies them into appropriate category of assets. The Bank measures a non-current asset that ceases to be classified as held for sale (or ceases to be included in a disposal group classified as held for sale) at the lower of:

- its carrying amount at a date before the asset (or disposal group) was classified as held for sale, adjusted for any depreciation, amortization or revaluations that would have been recognized had the asset (or disposal group) not been classified as held for sale, and
- its recoverable amount at the date of the subsequent decision not to sell.

Discontinued operations are a component of the Bank that either has been disposed of or is classified as held for sale and represents a separate major line of business or geographical area of operation or is a subsidiary acquired exclusively with a view to resale.

The classification to this category takes places at the moment of sale or when the operation meets criteria of the operation classified as held for sale, if this moment took place previously. Disposal group which is to be taken out of usage may also be classified as discontinued operation.

2.17. Deferred income tax

The Bank creates a deferred income tax on the temporary difference arising between the carrying amount of an asset or liability in the statement of financial position and its tax base. A taxable net difference is recognized in liabilities as "Provisions for deferred income tax". A deductible net difference is recognized under 'Deferred income tax assets'. Any change in the balance of the deferred tax assets and liabilities in relation to the previous accounting period is recorded under the item "Income Tax". The balance sheet method is applied for the calculation of the deferred corporate income tax.

Liabilities or assets for deferred corporate income tax are recognized in their full amount according to the balance sheet method in connection with the existence of temporary differences between the tax value of assets and liabilities and their carrying value. Such liabilities or assets are determined by application of the tax rates in force by virtue of law or of actual obligations at the end of the reporting period. According to expectations such tax rates applied will be in force at the time of realisation of the assets or settlement of the liabilities for deferred corporate income tax.

The main temporary differences arise on account of impairment write-offs recognized in relation to the loss of value of credits and granted guarantees of repayment of loans, amortization of fixed assets and intangible assets, finance leases treated as operating leases for tax purposes, revaluation of certain financial assets and liabilities, including contracts concerning derivative instruments and forward transactions, provisions for retirement benefits and other benefits following the period of employment, and also deductible tax losses.

The Bank reviews the carrying amount of a deferred tax assets at the end of each reporting period. The Bank reduces the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Deferred income tax assets are recognized to the extent it is probable that there will be sufficient taxable profits to allow them to recover. If the forecast amount of income determined for tax purposes does not allow the realisation of the asset for deferred income tax in full or in part, such an asset is recognized to the respective amount, accordingly. The above described principle also applies to tax losses recorded as part of the deferred tax asset.

The Bank presents the deferred income tax assets and liabilities netted against each other for each country separately where the Bank conducts its business and are obliged to settle corporate income tax. Such assets and provisions may be netted against each other if the Bank possesses the legal rights allowing it to simultaneously account for them when calculating the amount of the tax liability.

The Bank discloses separately the amount of negative temporary differences (mainly on account of unused tax losses or unutilised tax allowances) in connection with which the deferred income tax asset was not recognized in the statement of financial position, and also the amount of temporary differences attached to investments in subsidiaries and associates for which no deferred income tax provision has been formed.

Deferred income tax for the Bank is provided on assets or liabilities due to temporary differences arising from investments in subsidiaries and associates, except where, on the basis of any probable evidence, the timing of the reversal of the temporary difference is controlled by the Bank and it is possible that the difference will not reverse in the foreseeable future.

Deferred income tax on account of revaluation of available for sale investments and of revaluation of cash flow hedging transactions is accounted for in the same way as any revaluation, directly in other comprehensive income, and it is subsequently transferred to the income statement when the respective investment or hedged item affects the income statement.

2.18. Assets repossessed for debt

Repossessed collateral represents financial and non-financial assets acquired by the Bank in settlement of overdue loans. The assets are initially recognized at fair value when acquired and included in premises and equipment, financial assets or other assets depending on their nature and the Bank's intention in respect of recovery of these assets. In case the fair value of repossessed collateral exceeds the receivable from the debtor, the difference constitutes a liability toward the debtor.

Repossessed assets are subsequently measured and accounted for in accordance with the accounting policies relevant for these categories of assets.

2.19. Prepayments, accruals and deferred income

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

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

2.20. Leasing

<u>mBank S.A. as a Lessee</u>

The leases entered into by the Bank are primarily operating leases. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. Title may or may not eventually be transferred.

A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

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

2.21. Provisions

The value of provisions for contingent liabilities such as unutilised guarantees and (import) letters of credit, as well as for unutilised irreversible unconditionally granted credit limits, is measured in compliance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

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

2.22. Post-employment employee benefits and other employee benefits

Post-employment employee benefits

The Bank forms provisions against future liabilities on account of post-employment benefits determined on the basis of an estimation of liabilities of that type, using an actuarial model. The Bank uses a principle of recognition of actuarial gains or losses from the measurement of post-employment benefits related to changes in actuarial assumptions in other comprehensive income that will not be reclassified to the income statement. The Bank recognizes service cost and net interest on the net defined benefit liability in the "Overhead cost" and in other interest expenses, respectively.

Equity-settled share-based payment transactions

The Bank runs programmes of remuneration based on and settled in own shares as well as based on shares of the ultimate parent of the Bank and settled in cash. Equity-settled share-based payment transactions are accounted for in compliance with IFRS 2 Share-based Payment. In case of the part of the programme settled in shares, the fair value of the service rendered by employees in return for options and shares granted increases the costs of the respective period corresponding to own equity. The total amount which needs to be expensed over the period when the outstanding rights of the employees for their options and shares to become exercisable are vested is determined on the basis of the fair value of the granted options and shares. There are no market vesting conditions that shall be taken into account when estimating the fair value of share options and shares at the measurement date. Non-market vesting conditions are not taken into account when estimating the fair value of share options and shares but they are taken into account through adjustment on the number of equity instruments. At the end of each reporting period, the Bank revises its estimates of the number of options and shares that are expected to become exercised. In accordance with IFRS 2 it is not necessary to recognise the change in fair value of the share-based payment over the term of the programmes.

Cash-settled share-based payment transactions

In case of the part of the programme based on cash-settled share-based payments based on shares of the ultimate parent of the Bank, the fair value of the service rendered by employees in return for right to options/share appreciation rights increases the costs of the respective period, corresponding to liabilities. Until the liability related to the cash-settled share-based payments transactions is settled, the Bank measures the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognized in profit or loss for the period.

2.23. Equity

Equity consists of capital and own funds created in compliance with the respective provisions of the law, i.e., the appropriate legislative acts, the By-laws or the Company Articles of Association.

Registered share capital

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

- Own shares

In the case of acquisition of shares in the Bank by the Bank the amount paid reduces the value of equity as own shares until the time when they are cancelled. In the case of sale or reallocation of such shares, the payment received in return is recognized in equity.

Share premium

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

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

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

Retained earnings

Retained earnings include:

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

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

Moreover, other reserve capital comprises valuation of incentive programs based on Bank's shares.

Dividends for a given year, which have been approved by the General Meeting but not distributed at the end of the reporting period, are shown under the liabilities on account of dividends payable under the item "Other liabilities".

Other components of equity

Other components of equity result from:

- valuation of available for sale financial instruments,
- exchange differences on translation of foreign operations.
- actuarial gains and losses relating to post-employment employee benefits,
- valuation of derivative financial instruments held for cash flow hedging in relation to the effective portion of the hedge.

2.24. Valuation of items denominated in foreign currencies

Functional currency and presentation currency

The items contained in financial reports of particular entities of the Bank, including foreign branches of the Bank, are valued in the currency of the basic economic environment in which the given entity conducts its business activities ('functional currency'). The financial statements are presented in the Polish zloty, which is the functional currency of the Bank.

Transactions and balances

Transactions denominated in foreign currencies are converted to the functional currency at the exchange rate in force at the transaction date. Foreign exchange gains and losses on such transactions as well as balance sheet revaluation of monetary assets and liabilities denominated in foreign currency are recognized in the income statement.

Foreign exchange differences arising on account of such monetary items as financial assets measured at fair value through the income statement are recognized under gains or losses arising in connection with changes of fair value. Foreign exchange differences on account of such non-monetary assets as equity instruments classified as available for sale financial assets are recognized under other comprehensive income.

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

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

Changes in fair value of monetary items available for sale cover foreign exchange differences arising from valuation at amortised cost, which are recognized in the income statement.

Items of the statement of financial position of foreign branches are converted from functional currency to the presentation currency with the application of the average exchange rate as at the end of the reporting period. Income statement items of these entities are converted to presentation currency with the application of the arithmetical mean of average exchange rates quoted by the National Bank of

Poland on the last day of each month of the reporting period. Foreign exchange differences so arisen are recognized in other comprehensive income.

2.25. Trust and fiduciary activities

mBank S.A. operates trust and fiduciary activities including domestic and foreign securities and services provided to investment and pension funds.

These assets have not been presented in these financial statements as they do not belong to the Bank.

2.26. New standards, interpretations and amendments to published standards

These financial statements include the requirements of all the International Accounting Standards and the International Financial Reporting Standards endorsed by the European Union, and the related with them interpretations which have been endorsed and binding for annual periods starting on 1 January 2016.

Published Standards and Interpretations which have been issued and binding for the Bank for annual periods starting on 1 January 2016

Standards and interpretations approved by the European Union:

- IAS 19 (Amended), *Defined Benefit Plans: Employee Contributions*, published by the International Accounting Standards Board on 21 November 2013, approved by European Union on 17 December 2014 and binding for annual periods starting on or after 1 July 2014, in EU effective at the latest for financial years beginning on or after 1 February 2015.

  The amendment relates only to contributions for defined benefit plans from employees or third parties. The amendment of the Standard is aimed at clarification and simplification the accounting requirements for contributions independent of the number of years of service, i.e. contributions that are a fixed percentage of the employee's salary, a fixed amount throughout the service period or dependent on the employee's age. In accordance with the amendment of the Standard such contributions should be recognized as a reduction in the service cost in the period in which the related service is rendered.

- *Improvements to IFRSs 2010 – 2012 Cycle*, published by the International Accounting Standards Board on 12 December 2013, approved by European Union on 17 December 2014, in majority binding for annual periods starting on or after 1 July 2014 and some effective prospectively for transactions occurring on or after 1 July 2014, in EU effective at latest for financial years beginning on or after 1 February 2015.

  The improvements to the following standards were implemented during the cycle: IFRS 2 in terms of changing definitions: "vesting condition", "market condition" and adding definitions: "service condition" and "performance condition", IFRS 3 in terms of clarification of classification a contingent consideration by an acquirer, IFRS 8 in terms of disclosure requirement of judgments made by management in applying the aggregation criteria for operating segments and disclosure of reconciliation of the total of the reportable segments' assets to the total assets, IFRS 13 in terms of clarification of doubts for the possibility of simplified measurement of short-term receivables and payables without discounting, when the effect of not discounting is immaterial, IAS 16 and IAS 38 in terms of proportionate restatement of accumulated depreciation or amortization, respectively, when an item of property, plant and equipment or intangible asset, respectively is revalued, IAS 24 in terms of identifying related party which provides key management personnel services to the reporting entity or to the parent of the reporting entity.

- Amendments to IAS 1, *Disclosure initiative*, published by the International Accounting Standards Board on 18 December 2014, approved by European Union on 18 December 2015 and binding for annual periods starting on or after 1 January 2016.

  The amendments to IAS 1 include the clarification of the material information with particular regard to the reduction of immaterial information in financial statements. Moreover, specific items in financial statements may be the subject to both aggregation and disaggregation depending on its materiality. IAS 1 was also completed with the requirements regarding the presentation of subtotals in financial statements. Additionally, the information presented in the notes of financial statements may be presented in a systematic manner, however in determining a systematic manner, the entity shall consider the effect on the understandability and comparability of its financial statements. The guidelines regarding the identification of significant accounting policies were deleted in the amendments to IAS 1.

- Amendments to IAS 16 and IAS 38, *Clarification of acceptable methods of depreciation and amortization*, published by the International Accounting Standards Board on 12 May 2014, approved by European Union on 2 December 2015 and binding for annual periods beginning on or after 1 January 2016.

The amended IAS 16 prohibits the use of a revenue-based method for depreciating a tangible fixed asset. A depreciation method that is based on revenue that is generated by an activity of the entity is not appropriate, because the revenue generated by an activity that includes the use of an asset reflects factors other than the consumption of the economic benefits of the asset.

The amended IAS 38 includes a rebuttable presumption that a revenue-based method for amortization of an intangible asset is inappropriate for the same reasons as in the case of tangible fixed assets presented in amended IAS 16. However, the presumption in case of amended IAS 38 could be overcome in two circumstances: when it can be demonstrated that revenue is highly correlated with the consumption of the economic benefits embodied in an intangible asset and when the right embodied by an intangible asset is expressed as a total amount of revenue to be generated.

- Amendments to IAS 16 and IAS 41 *Agriculture: Bearer Plants* published by the International Accounting Standards Board on 30 June 2014, approved by European Union on 23 November 2015 and binding for annual periods beginning on or after 1 January 2016.

  The amended IAS 16 and IAS 41 introduce the obligation of recognizing bearer plants in the same way as tangible assets and of using the requirements of IAS 16 measuring them either at cost or at revaluated amount. IAS 41 still applies to the produce on those bearer plants, which should be measured at fair value less costs to sell. Bearer animals are not covered by the amendments.

- Amendments to IAS 27, *Equity method in separate financial statements*, published by the International Accounting Standards Board on 12 August 2014, approved by European Union on 18 December 2015, binding for annual periods beginning on or after 1 January 2016. The impact of the amended IAS 27 on the separate comparative data presented in this financial statements are described under Note 2.27 "Comparative data".

  The amended IAS 27 re-establish the possibility of equity method application for investments in subsidiaries, joint ventures and associates in separate financial statements. The entity preparing separate financial statements should account for investments in subsidiaries, joint ventures and associates at cost or according to IFRS 9 or using the equity method as described in IAS 28. The dividend from a subsidiary, a joint venture or an associate is recognized in profit and loss or as a reduction from the carrying amount of the investment if the equity method is used.

- IFRS 11 (Amended), *Accounting for acquisitions of interests in joint operations*, published by the International Accounting Standards Board on 6 May 2014, approved by European Union on 24 November 2015 and binding for annual periods beginning on or after 1 January 2016.

  The amended standard requires the acquirer of an interest in a joint operation in which the activity constitutes a business, as defined in IFRS 3 Business Combination, to apply all of the principles on business combinations accounting in IFRS 3 and other IFRSs except for those principles that conflict with the guidance in this IFRS. It applies to the acquisition of both the initial interest and additional interests in a joint operation in which the activity of the joint operation constitutes a business. Moreover, the acquirer shall disclose the information required by IFRS 3 and other IFRSs for business combinations.

- Annual Improvements to IFRSs 2012-2014 Cycle, changing 4 standards, published by the International Accounting Standards Board on 25 September 2014, approved by European Union on 15 December 2015 and binding for annual periods beginning on or after 1 January 2016.

  The improvements to the following standards were implemented during the cycle: IFRS 5 in the situation when an asset is reclassified from being held for sale to being held for distribution to owners or from being held for distribution to owners to being held for sale, then the change in classification is considered a continuation of the original plan of disposal. Additionally, when assets no longer meet the criteria for held for distribution to owners (without meeting the held-for-sale criteria), the entity should cease to apply held-for-distribution accounting in the same way as it ceases to apply the held-for-sale accounting when they no longer meet the held-for-sale criteria; IFRS 7 when an entity transfers a financial asset retaining the right to service that financial asset for a fee that is included in a servicing contract, whether the entity has a continuing involvement as a result of the servicing contract for the purpose of disclosure requirements. Additionally, IFRS 7 clarifies that disclosures regarding offsetting financial assets and financial liabilities are not specifically required for all interim periods, unless it is required by IAS 34; IAS 19 in terms of clarification that high quality corporate bonds used to determine a discount rate of post-employment benefit obligations shall be in the same currency as the currency of the post-employment benefit obligations. Assessment whether there is a deep market in such high quality corporate bonds should be made for the currency, not for a country; IAS 34 in terms of clarifying the meaning of disclosure of information' elsewhere in the interim financial report' and additionally it introduces a requirement to incorporate disclosure in interim financial statement by cross-reference to information in another statement.

- Amendments to IFRS 10, IFRS 12 and IAS 28, *Investment entities: applying the consolidation exception*, published by the International Accounting Standards Board on 18 December 2014, approved by European Union on 22 September 2016, binding for annual periods starting on or after 1 January 2016.

  The amendments to IFRS 10, IFRS 12 and IAS 28 exempt to the requirement of presenting consolidated financial statements by an entity that is a parent if its ultimate or any intermediate parent produces financial statements that are available for public use and comply with IFRSs, in which subsidiaries are consolidated or are measured at fair value through profit or loss. Additionally, the requirement to consolidation was limited to the situation when an investment entity has a subsidiary that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity's investment activities. Moreover, when applying the equity method in an associate or joint venture that is an investment entity, an investor retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries.

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

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

Standards and interpretations not yet approved by the European Union:

- Amendments to IFRS 10 and IAS 28, *Sale or contribution of assets between an investor and its associate or joint venture*, published by the International Accounting Standards Board on 11 September 2014, binding for annual periods starting on or after 1 January 2016, while the date of entry into force has been postponed initially by International Accounting Standards Board.

  The amendments to IFRS 10 and IAS 28 eliminate inconsistency between these standards and clarify the accounting approach in a situation when a parent loses control of a subsidiary as a result of transaction between a parent and its associate or joint venture. The accounting approach depends on whether contribution of assets to an associate or a joint venture constitute a business as defined in IFRS 3 Business Combinations. If assets constitute a business, the amendments introduce a requirement of full recognition gain or loss resulting from the transaction. If assets do not constitute a business, a gain or loss resulting from the transaction is recognized only to the extent of the unrelated investors' interests in that associate or joint venture.

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

- IFRS 14, *Regulatory Deferral Accounts*, published by the International Accounting Standards Board on 30 January 2014, binding for annual periods starting on or after 1 January 2016.

  The Standard permits an entity that adopts IFRS to continue to use, in its first and subsequent IFRS financial statements, its previous accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances. The Standard requires to present regulatory deferral account balances as separate line items in the statement of financial position and to present movements in those account balances as separate line items in the statement of profit and loss and other comprehensive income. The disclosures to identify the nature of, and risks associated with, the rate regulation that has resulted in the recognition of regulatory deferral account balances are also required.

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

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

Standards and interpretations approved by the European Union:

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

Information about the impact of adopting the standard on the presentation and valuation of these instruments in the financial statements is presented at the end of this note.

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

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

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

Standards and interpretations not yet approved by the European Union:

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

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

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

- Amendments to IAS 12, *Recognition of Deferred Tax Assets for Unrealised Losses*, published by the International Accounting Standards Board on 19 January 2016, binding for annual periods starting on or after 1 January 2017.

  Amendments to IAS 12 clarify the requirements on recognition of deferred tax assets for unrealized losses on debt instruments measured at fair value. The amendments introduce the guidance on the identification of deductible temporary differences. Especially the standard confirms that decreases below cost in the carrying amount of a fixed-rate debt instrument measured at fair value for which the tax base remains at cost give rise to a deductible temporary difference. This applies irrespective of whether the debt instrument's holder expects to use it or sale it.

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

- Amendments to IAS 7, *Disclosure Initiative*, published by the International Accounting Standards Board on 29 January 2016, binding for annual periods starting on or after 1 January 2017.

  Amendments to IAS 7 introduce the requirements to disclose changes in liabilities arising from financing activities in statement of cash flows, including both changes arising from cash flows and non-cash changes. To fulfill the requirement the standard requires a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities in cash flow statement.

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

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

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

A lessee is also required to recognize depreciation costs of lease asset separately from interest costs on lease liabilities in the income statement.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- Annual Improvements to IFRS Standards 2014-2016 Cycle, changing 3 standards (IFRS 1, IFRS12, IAS 28), published by International Accounting Standards Board on 8 December 2016, binding for annuals periods starting on or after 1 January 2017 or on or after 1 January 2018.

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

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

IFRS 9, Financial instruments

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

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

In June 2015 the Bank launched an IFRS 9 implementation project which actively engages the Bank's organizational units responsible for accounting, financial reporting and risk management as well as business, IT and organisation department.

The Bank is currently implementing necessary solutions for the particular IFRS 9 requirements based on the results of gap analysis and defined methodological assumptions. The Bank intends to complete the project by December 2017.

Summary of key IFRS 9 requirements

Classification and measurement

Financial assets

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

1. amortised cost,
2. fair value through other comprehensive income,
3. fair value through profit or loss.

A financial asset shall be classified as subsequently measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss on the basis of both:

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

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

Financial liabilities

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

Impairment

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

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

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

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

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

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

Hedge accounting

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

IFRS 9 requires the Bank to ensure that its hedging relationships are compliant with the risk management strategy applied by the Bank and its objectives. IFRS 9 introduces new requirements with regard to the assessment of hedge effectiveness, rebalancing of the hedge relationship as well as it prohibits voluntary discontinuation of hedge accounting.

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

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

As at 31 December 2016, it is not possible to estimate the overall impact of IFRS 9 implementation on the Bank's financial situation and own funds. In the Bank's opinion, disclosing quantitative data that would not reflect the potential impact of all aspects of IFRS 9 on the Bank's financial situation and own funds could have a negative impact on the informative value of the financial statement for its users. Nevertheless, taking into account the current regulations, changes in the requirements regarding classification and measurement and impairment of financial assets, would have moderately negative impact on the Bank's own funds. However, the impact of changes can be reliably estimated only in the consecutive periods.

Therefore, the Bank has chosen to disclose solely qualitative information on the Bank's approach to the IFRS 9 implementation, which in the Bank's opinion will enable the users of the financial statement to understand the impact of IFRS 9 on the financial situation and capital management of the Bank.

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

Classification and measurement

Financial assets

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

1. allocation of financial assets to the appropriate business model on the basis of the assessment of the applied way of managing the financial asset portfolios by:
   a) reviewing and assessing relevant and objective qualitative data which may have an impact on allocating financial asset portfolios to the appropriate business model (such as, e.g.: how the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel; the risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way in which those risks are managed; how managers of the business

are compensated and reasons of sales of the financial assets from certain portfolios that occurred in previous reporting periods;

b) reviewing and assessing relevant and objective quantitative data which may have an impact on allocating financial asset portfolios to the appropriate business model (e.g. the value of sales of the financial assets from certain portfolios that occurred, if any, in previous reporting periods and the frequency of those sales);

c) analysis of expectations regarding the value and frequency of sales from certain portfolios.

2. determination, through identifying and analysing the contractual terms of financial assets (held within a business model whose objective is to hold financial assets in order to collect contractual cash flows or held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets) whether these contractual terms are consistent with the SPPI criteria.

Based on the performed analysis, the Bank expects changes in classification of the certain part of retail portfolio (cash loans, renewable loans and credit cards) and small number of corporate loans (e.g. syndicated loans) measured at amortised cost under IAS 39, which will have to be measured at fair value through profit or loss due to the failure of the SPPI test.

In addition, for the certain part of the securities portfolio classified as "Available-for-Sale" under IAS 39 the Bank considers application of the "Held-to-Collect" business model, which would result in the reclassification of these securities from the fair value through other comprehensive income into amortised cost measurement category.

Quantitative data, including impact on the Bank's financial result and own funds, will be available after the finalization of works on the methodology of fair value measurement for the part of loan portfolio and final decisions with regard to the part of securities portfolio assigned to the "Held-to-Collect" business model.

As at 31 December 2016 the Bank does not identify financial assets which the Bank is going to designate as measured at fair value through profit or loss on 1 January 2018 to eliminate or significantly reduce "accounting mismatch" which would arise as a result of measuring these financial assets at amortised cost or at fair value through other comprehensive income.

As at 31 December 2016 the Bank holds equity instruments (stocks and shares) which, in accordance with IAS 39, are categorized as financial assets "available for sale". In accordance with IFRS 9, the Bank will be able to classify them as financial assets measured at fair value through profit or loss (provided that they do not constitute a strategic investment in the view of the entities which manage them) or irrevocably choose to measure them at fair value through other comprehensive income. If the Bank chooses to measure the equity instruments at fair value through other comprehensive income, the fair value gains and losses would be reported in other comprehensive income, no impairment losses would be recognised in profit or loss and no gains or losses would be reclassified to profit or loss on disposal. At the moment of preparation of these financial statement the Bank has not yet made a decision in this regard.

Financial liabilities

As a result of implementing IFRS 9, the Bank does not expects changes in classification of financial liabilities in comparison to existing requirements in IAS 39, which could have a significant impact on the financial position and profit or loss of the Bank.

Impairment

The Bank assumes that the implementation of the new impairment model based on the concept of ECL will result in the moderate increase of the Bank's loss allowance, particularly with regard to exposures allocated to Stage 2. Contrary to IAS 39, IFRS 9 does not require the entities to identify the impairment trigger in order to estimate lifetime credit losses in Stage 2. Instead, the Bank is obliged to constantly estimate the level of credit losses since the initial recognition of a given asset until its derecognition. In the event of significant increase in credit risk since the initial recognition of the asset, the Bank will be obliged to calculate lifetime expected credit losses – Stage 2. Such an approach will result in the earlier recognition of credit losses which will cause an increase in loss allowance and therefore it will also affect profit or loss. With regard to retail exposures classified to Stage 1 the Bank does not expect the change in the level of impairment allowances. In the corporate segment the Bank expects the increase of impairment allowances due to the cease of application of LIP parameter.

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

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

The impact assessment of IFRS 9 on the financial position of the Bank and its capital management is currently difficult. The difficulties stem from the ongoing methodological works regarding adjustments of credit risk models to IFRS 9 requirements which are still in progress as well as from the lack of unambiguous interpretations of the new Standard and uniform market practice. From the legislative standpoint, the supervisory and regulatory authorities are working on updating prudential requirements which will be binding for the Bank. However, it needs to be noted that these works are not advanced enough to enable Bank to unambiguously determine the impact of the IFRS 9 on the financial position and capital ratios.

Hedge accounting

Currently the Bank assumes that based on the paragraph 7.2.21 of IFRS 9 it will continue to apply the hedge accounting requirements of IAS 39 instead of the requirements of IFRS 9.

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

2.27. Comparative data

In connection with the entry into force on 1 February 2016 of the Act on tax on certain financial institutions in the comparative data of the income statement for the period from 1 January to 31 December 2015, the Bank reclassified the amount of PLN 3 650 thousand of the tax paid by the mBank's branch in Slovakia on its total amount of liabilities, from overhead costs (from "Taxes and fees") to the new position "Taxes on the Bank's balance sheet items", resulting from the adoption by the Bank of the approach to present this position outside the operating profit. This change had no impact on the net income and equity of the Bank.

Due to the change in accounting policy regarding to the valuation method of investments in subsidiaries, associates and joint ventures, the Bank made restatement of the stand-alone comparative data as at 1 January 2015 and as at 31 December 2015. Until 31 December 2015, shares in subsidiaries, associates and joint ventures were recognised at cost method. Starting from 1 January 2016 the Bank applies the equity method to the valuation of such assets following the entry into force of IAS 27 Separate financial statements amendments allowing usage of such a valuation method (IAS 27.10 (c)).

The impact of changes in the accounting policies on the stand-alone comparative data of mBank S.A. presented in these condensed consolidated financial statements are shown in the following tables.

IFRS Financial Statements 2016 PLN (000's)

Restatement of the mBank S.A. statement of financial position as at 31 December 2015.

ASSETS	31.12.2015 before restatement	Restatement	31.12.2015 after restatement
Investments in subsidiaries	1 438 183	320 064	1 758 247
Other items of assets	117 357 123	-	117 357 123
Total assets	**118 795 306**	**320 064**	**119 115 370**

LIABILITIES AND EQUITY			
Liabilities			
Other liabilities	1 363 428	22 836	1 386 264
Other items of liabilities	105 486 759	-	105 486 759
Total liabilities	**106 850 187**	**22 836**	**106 873 023**
Equity			
Share capital	**3 535 758**	**-**	**3 535 758**
Retained earnings:	**7 976 884**	**296 763**	**8 273 647**
- Profit for the previous year	6 705 435	266 979	6 972 414
- Net profit for the current year	1 271 449	29 784	1 301 233
Other components of equity	**432 477**	**465**	**432 942**
Total equity	**11 945 119**	**297 228**	**12 242 347**
Total liabilities and equity	**118 795 306**	**320 064**	**119 115 370**

Restatement of the mBank S.A. income statement for the period from 1 January 2015 to 31 December 2015.

	Period from 01.01.2015 to 31.12.2015 before restatement	Restatement	Period from 01.01.2015 to 31.12.2015 after restatement
Interest income	3 274 494	-	3 274 494
Interest expense	(1 066 135)	-	(1 066 135)
Net interest income	**2 208 359**	**-**	**2 208 359**
Fee and commission income	1 091 508	-	1 091 508
Fee and commission expense	(468 653)	-	(468 653)
Net fee and commission income	**622 855**	**-**	**622 855**
Dividend income	197 872	-	197 872
Net trading income, including:	294 010	-	294 010
Foreign exchange result	*285 786*	-	*285 786*
Other net trading income and result on hedge accounting	*8 224*	-	*8 224*
Gains less losses from investment securities, investments in subsidiaries and associates, including:	277 323	11 930	289 253
Gains less losses from investment securities	*133 645*	-	*133 645*
Gains less losses from investments in subsidiaries and associates	*143 678*	*11 930*	*155 608*
Other operating income	56 381	-	56 381
Net impairment losses on loans and advances	(325 325)	-	(325 325)
Overhead costs	(1 575 645)	3 650	(1 571 995)
Amortisation	(171 888)	-	(171 888)
Other operating expenses	(60 696)	-	(60 696)
Operating profit	**1 523 246**	**15 580**	**1 538 826**
Taxes on the Bank's balance sheet items	-	(3 650)	(3 650)
Share in profits (losses) of entities under the equity method	-	17 854	17 854
Profit before income tax	**1 523 246**	**29 784**	**1 553 030**
Income tax expense	**(251 797)**	**-**	**(251 797)**
Net profit	**1 271 449**	**29 784**	**1 301 233**
Earnings per share (in PLN)	**30.11**		**30.82**
Diluted earnings per share (in PLN)	**30.10**		**30.80**

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Restatement of the mBank S.A. statement of comprehensive income for the period from 1 January 2015 to 31 December 2015.

	Period from 01.01.2015 to 31.12.2015 before restatement	Restatement	Period from 01.01.2015 to 31.12.2015 after restatement
Net profit	**1 271 449**	**29 784**	**1 301 233**
Other comprehensive income net of tax, including:	**(116 223)**	**(483)**	**(116 706)**
Items that may be reclassified subsequently to the income statement			
Exchange differences on translation of foreign operations (net)	684	-	684
Change in valuation of available for sale financial assets (net)	(112 192)	-	(112 192)
Cash flow hedges (net)	(3 197)	-	(3 197)
Share in other comprehensive income of entities under the equity method	-	(483)	(483)
Items that will not be reclassified to the income statement			
Actuarial gains and losses relating to post-employment benefits (net)	(1 518)	-	(1 518)
Total comprehensive income net of tax, total	**1 155 226**	**29 301**	**1 184 527**

Restatement of the mBank S.A. statement of cash flows for the period from 1 January 2015 to 31 December 2015.

	Period from 01.01.2015 to 31.12.2015 before restatement	Restatement	Period from 01.01.2015 to 31.12.2015 after restatement
A. Cash flows from operating activities	**8 084 953**	**-**	**8 084 953**
Profit before income tax	**1 523 246**	**29 784**	***1 553 030***
Adjustments:	***6 561 707***	***(29 784)***	***6 531 923***
Income taxes paid	(108 825)	-	(108 825)
Amortisation	171 888	-	171 888
Foreign exchange (gains) losses related to financing activities	1 617 302	-	1 617 302
(Gains) losses on investing activities	(296 835)	(17 854)	(314 689)
Impairment of investments in subsidiaries	20 026	(11 930)	8 096
Dividends received	(197 872)	-	(197 872)
Interest income (income statement)	(3 274 494)	-	(3 274 494)
Interest expense (income statement)	1 066 135	-	1 066 135
Interest received	3 482 616	-	3 482 616
Interest paid	(1 011 989)	-	(1 011 989)
Changes in loans and advances to banks	291 758	-	291 758
Changes in trading securities	253 060	-	253 060
Changes in assets and liabilities on derivative financial instruments	60 237	-	60 237
Changes in loans and advances to customers	(1 748 095)	-	(1 748 095)
Changes in investment securities	(3 208 088)	(22 836)	(3 230 924)
Changes in other assets	(31 052)	-	(31 052)
Changes in amounts due to other banks	659 837	-	659 837
Changes in amounts due to customers	8 450 347	-	8 450 347
Changes in debt securities in issue	(1 423)	-	(1 423)
Changes in provisions	48 466	-	48 466
Changes in other liabilities	318 708	22 836	341 544
Net cash generated from/(used in) operating activities	**8 084 953**	**-**	**8 084 953**
B.Cash flows from investing activities	**347 388**	**-**	**347 388**
C. Cash flows from financing activities	**(6 281 212)**	**-**	**(6 281 212)**
Net increase / decrease in cash and cash equivalents (A+B+C)	**2 151 129**	**-**	**2 151 129**
Effects of exchange rate changes on cash and cash equivalents	(21 303)	-	(21 303)
Cash and cash equivalents at the beginning of the reporting period	4 762 605	-	4 762 605
Cash and cash equivalents at the end of the reporting period	**6 892 431**	**-**	**6 892 431**

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Restatement of the mBank S.A. statement of financial position as at 1 January 2015 (opening balance).

ASSETS	01.01.2015 before restatement	Restatement	01.01.2015 after restatement
Investments in subsidiaries	806 567	773 659	1 580 226
Other items of assets	112 796 896	-	112 796 896
Total assets	**113 603 463**	**773 659**	**114 377 122**
LIABILITIES AND EQUITY			
Liabilities			
Total liabilities	**103 333 877**	**-**	**103 333 877**
Equity			
Share capital	**3 523 903**	**-**	**3 523 903**
Retained earnings:	**6 196 983**	**772 711**	**6 969 694**
- Profit for the previous year	6 196 983	772 711	6 969 694
- Net profit for the current year	-	-	-
Other components of equity	**548 700**	**948**	**549 648**
Total equity	**10 269 586**	**773 659**	**11 043 245**
Total liabilities and equity	**113 603 463**	**773 659**	**114 377 122**

2.28. Business segments

Data concerning business segments was presented in the Consolidated Financial Statements of mBank S.A. Group for the year 2016, prepared in compliance with the International Financial Reporting Standards and published on 1 March 2017.

3. Risk Management

mBank manages risks on the basis of regulatory requirements and best market practice, by developing risk management strategies, policies and guidelines. The risk management functions and roles are released on all of the levels of the organizational structure, starting at the level of the Supervisory Board down to each business unit of the Bank. Risk management is streamlined in unified process run by specialized organizational units, and analyses are carried out at the level of mBank Group.

3.1. General information

Location of risk management disclosures

mBank's risk management disclosures for 2016 are included in the Annual Report of the Bank and in the Disclosures regarding capital adequacy.

The table below presents reference to disclosures regarding various aspects of risk management within the abovementioned documents.

Disclosures regarding capital adequacy of mBank S.A. Group as at 31 December 2016 and Management Board Report are not the part of mBank S.A. Financial Statements.

Type of risk	Information	Location of information for 2016		
		Annual Report of mBank		Disclosures regarding capital adequacy
		Management Board Report	Financial Statements	
General information	Location of risk management disclosures	-	p. 35	p. 3
	Glossary of terms	-	p. 36	-
	External environment – regulatory standards	-	p. 38	-
Principles of risk management	Division of responsibilities in the risk management process	-	p. 39	-
	Risk culture	-	p. 43	-
	The risk management process documentation	-	p. 45	-

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	Internal capital adequacy assessment process (ICAAP)	-	p. 46	p. 27
	Risk appetite	-	p. 48	-
	Stress tests within ICAAP	-	p. 49	p. 29
	Capital planning	-	p. 50	p. 9
Credit risk	Organization of risk management	p. 43	p. 51	-
	Credit policy	p. 47	p. 52	-
	Collaterals accepted	-	p. 52	p. 63, 66
	Rating system	-	p. 54	-
	Monitoring and validation of models	-	p. 54	-
	Calculating impairment charges and provisions	p. 49	p. 55	p. 69
	mBank forbearance policy	-	p. 58	-
	Counterparty risk that arises from derivative transactions	-	p. 63	-
	Concentration risk	-	p. 64	p. 68
Market risk	Organization of risk management	-	p. 66	-
	Tools and measures	p. 53	p. 67	-
	Risk measurement	p. 54	p. 68	-
	Interest rate risk in the banking book	p. 56	p. 70	-
	Currency risk	-	p. 70	-
Liquidity risk and funding	Strategy of liquidity risk	p. 57	p. 72	-
	The measurement, limiting and reporting the liquidity risk	p. 58	p. 75	-
	Funding sources	-	p. 77	-
Operational risk	Tools and measures	p. 58	p. 80	p. 80
	Operational losses	-	p. 80	-
	Compliance risk	-	p. 80	-
Other risks	Business risk	-	p. 81	-
	Model risk	-	p. 82	-
	Reputational risk	-	p. 83	-
	Capital risk	-	p. 83	-
Capital adequacy		p. 59	p. 142	p. 9
Leverage ratio		p. 25, 62	p. 37, 38, 142	p. 58

Glossary of terms

Add-on - estimated future potential exposure

Collateral - asset that is to be paid or received depending on the current valuation of the derivatives portfolio to mitigate potential credit risk in the future. Currently the main collateral asset is cash.

CCF (Credit Conversion Factor) – estimated level of off-balance sheet items converted to balance sheet items at the date of default.

Common Equity Tier 1 Capital Ratio (CET1 ratio) – shall mean the Common Equity Tier 1 Capital expressed as a percentage of the Total Risk Exposure Amount (TREA).

Coverage ratio of non-liquid assets and limited liquidity assets with own funds and stable external funds (measure M4) - the ratio defined in KNF Resolution No. 386/2008 of 17 December 2008 on establishing liquidity measures binding on banks, calculated as a ratio of own funds diminished by sum of capital requirement on market risk, sum of capital requirement on delivery settlement, counterparty risk and stable external funds to sum of limited liquidity assets and non-liquidity assets.

CRD IV - Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC with further amendments (Capital Requirements Directive IV).

CRR - Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 with further amendments (Capital Requirements Regulation).

EAD (Exposure at Default) – estimated value of exposure in case of default.

Earnings at risk (EaR) - a potential decrease in the annual interest income within 12 months assuming defined change of market interest rates scenarios, fixed volume and structure of balance and off-balance portfolio and unchanged interest rate structure of particular position, therein interest margin.

Economic capital (EC) – the amount of capital required to cover unexpected loss (estimated by the Bank at the assumed confidence level over a one-year time horizon) arising from:

- credit risk,
- market risk,
- operational risk,
- business risk.

EL – statistically **Expected Loss** in case of default.

ICAAP – Internal Capital Adequacy Assessment Process.

Internal capital (IC) – the amount of capital estimated by the Bank required to cover unexpected loss arising from all material risks identified in the Bank's activity within the risk inventory process. Internal capital is the sum of economic capital and capital necessary to cover other risks (including hard to quantify risks).

KNF - Polish Financial Supervision Authority

LCR (Liquidity Coverage Ratio) - a relation of liquid assets of the liquidity buffer to the expected net outflows within 30 calendar days.

Leverage ratio – shall mean the relation of Tier 1 Capital to the institution's total exposure measure, understood as the sum of the exposure values of all assets and off-balance sheet items not deducted, when determining the Tier 1 capital.

LGD (Loss Given Default) – estimated loss resulting from the default.

LtV (Loan to Value) – the ratio of the loan value to the property market value.

NSFR (Net Stable Funding Ratio) – a relation of own funds and stable liabilities ensuring stable financing to illiquid assets and receivables requiring stable financing.

PD – Probability of Default.

Ratio of coverage of non-liquidity assets with own funds (measure M3) - the ratio defined in KNF Resolution No. 386/2008 of 17 December 2008 on establishing liquidity measures binding on banks, calculated as a ratio of own funds diminished by sum of capital requirement on market risk to sum of non-liquidity assets.

RBC (**Risk Bearing Capacity)** – shall mean the relations of Risk Coverage Potential (RCP) to the internal capital – internal measure.

RCP (Risk Coverage Potential) - shall mean the amount of own funds adjusted by specific correcting items, in accordance with respective internal regulations in mBank – internal measure.

Short-term liquidity factor (measure M2) - the ratio defined in KNF Resolution No. 386/2008 of 17 December 2008 on establishing liquidity measures binding on banks, calculated as a ratio of primary and supplementary liquidity reserves to unstable external funds.

Short-term liquidity gap (measure M1) – the ratio defined in KNF Resolution No. 386/2008 of 17 December 2008 on establishing liquidity measures binding on banks, calculated as a sum of primary and supplementary liquidity reserves diminished by unstable external funds.

Tier 1 Capital Ratio (T1 ratio) – shall mean the Tier 1 Capital expressed as a percentage of the Total Risk Exposure Amount (TREA).

Total Capital Ratio (TCR) – shall mean the own funds expressed as a percentage of the Total Risk Exposure Amount (TREA).

Total Risk Exposure Amount (TREA) – shall mean the total of risk-weighted exposure amount for credit risk, counterparty credit risk and (multiplied by 12.5) own funds requirements for:

- market risk,
- operational risk,
- other risks, eg. credit valuation adjustment risk, large exposures in the trading book, etc.

Value at risk (VaR) – a measure of potential loss of market value (of financial instrument, portfolio, institution) to which the financial instrument, portfolio, institution is exposed over defined period of time at a given confidence level under normal market conditions.

3.2. mBank risk management in 2016 – external environment

Basel III regulatory standards

The rules on prudential requirements for banks set out in the Capital Requirements Regulation on prudential requirements for credit institutions and investment firms (CRR) and the Capital Requirements Directive (CRD IV) on access to the activity of banks and the prudential supervision, implementing provisions of Basel III, are effective in the European Union as of January 1, 2014. The amendments introduced under Basel III included:

- a universal definition and components of the bank's capital as well as implementation of capital ratio specified for the funds of the highest quality,
- introduction of own funds requirement associated with credit valuation adjustment,
- implementation of financial leverage ratio,
- introduction of additional capital buffers, including a capital conservation buffer, a countercyclical buffer, a global systemically important financial institutions buffer and systemic risk buffer,
- liquidity requirements, measured by the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR).

The provisions of CRD IV were transposed into a national legislation, which took place in 2015 with the endorsement of the Act on Macro-prudential Supervision over the Financial System and Crisis Management in the Financial System and with an update of the Banking Law. Whereas CRR took effect as of January 1, 2014 without harmonisation with national laws.

Leverage ratio

In October 2014, the European Parliament approved the delegated act, in force since 2015, introducing modifications to the calculation of the leverage ratio. Bank implemented necessary changes regarding calculation of the leverage ratio. However in light of the guidelines from European and Polish regulator prudential reporting with regard to leverage ratio based on provisions of the delegated act was implemented in Poland beginning from September 2016. Before that date reporting was carried out based on CRR provisions and Bank calculated leverage ratio both under CRR provisions and under updated provisions of the delegated act.

Liquidity measures

In October 2015, came into force the Commission Delegated Regulation (EU) No 2015/61 of 10.10.2014 to supplement Regulation (EU) 575/2013. Bank reports to KNF calculations of LCR with implemented changes according to mentioned delegated regulation starting from reporting date as 31st October 2015 using special forms designed by KNF. However, the Bank reported to the NBP until 30.09.2016 according to standards set in 2014. Since the September 2016 report Bank reports according to the standard compliant to Commission Delegated Regulation (EU) No. 2015/61 of 10.10.2014.

In terms of the NSFR Bank reports to NBP according to standards set by EBA in 2014, as well as to the KNF in a form of a dedicated questionnaire.

Recommendations of the KNF

In 2016, Recommendation W of the KNF concerning model risk management in banks was implemented. The recommendation sets standards for the process of model risk management, including the principles for building models and assessing their performance, while ensuring proper solutions within corporate governance. The aim of the recommendation is to establish supervisory expectations in terms of efficient process of model risk management, in particular the determination of the bank's tolerance for this type of risk as well as limiting the banking sector's exposure to model risk.

In May 2016, the KNF issued the updated Recommendation C concerning concentration risk management (which replaced the Recommendation C on exposure concentration risk management issued by the banking supervision in 2002). The updated recommendation defines the principles of identification, measurement, monitoring and limiting concentration risk and applies to banks since 1 January 2017.

3.3. Principles of risk management

3.3.1 Division of responsibilities in the risk management process

1. **Supervisory Board,** through its **Risk Committee,** exercises constant supervision of the Bank's operations in the risk taking area, which includes among others approving the Risk Management Strategy of the Group and supervising its execution.
2. **Management Board of the Bank** accepts the Risk Management Strategy of the Group and is responsible for establishing and implementing the principles of managing individual risk types and for their coherence with the Strategy. Moreover, the Management Board defines the organisational structure of the Bank, ensuring the separation of roles, and allocates the tasks and responsibility to individual units.

   The Management Board undertakes activities aiming at assuring that the Bank conducts a policy enabling a management of all types of risks essential for the Bank's operations and has procedures to this extent, in particular including responsibility for preparing and introducing written strategies and procedures to the extent of: internal control system, risk management system, internal capital assessment, capital management and capital planning.
3. **Chief Risk Officer** is responsible for integrated management of the risk and capital of the Bank and the Group in the scope of: defining strategies and policies, measuring, controlling and independent reporting on all risk types (in particular credit risk, market risk, liquidity risk, non-financial risk including operational risk), approving (according to internal regulations) risks models and limits, and for processes of managing the risk of the retail credit portfolio and corporate portfolio.
4. **Committees:**

   a/ **Business and Risk Forum** is a formal decision and communication platform for the risk management area and organizational units in particular business lines of the Group.

   The Business and Risk Forum is constituted by the following bodies:

   - Retail Banking Risk Committee (KRD),
   - Corporate and Investment Banking Risk Committee (KRK), and
   - Financial Markets Risk Committee (KRF).

   The committees are composed of the representatives of business lines and respective risk management departments.

   Each committee is responsible for the all types of risk generated by business activity of the given business line.

   The main function of the above mentioned committees is to develop the principles of credit risk, market risk and liquidity risk management and risk appetite, by taking decisions and making recommendations concerning in particular:

   - credit risk policies,
   - processes and tools for risk assessment,
   - credit risk limitation system,
   - assessing the quality and profitability of portfolio of exposures,
   - liquidity risk issues such as methodology and limits.

   The Bank's internal rules define specific competencies and tasks of the committees constituting the Business and Risk Forum.

   b/ **Model Risk Committee**, responsible for supervising model risk management process, and performing information, discussion, decision and legislation functions. In particular, the Committee:

   - approves new and modified models as well as changes thereto and makes decision about resignation from using a model,
   - decides about the scope of using group models and external models, including central models, in banking processes,
   - recommends model risk tolerance level to the Management Board and the Supervisory Board,

- makes final decision about confirming significance assigned to the model,
- approves precautionary and remedial measures indicated in the results of monitoring,
- approves the validation timetable and the outcome of individual model validations.

Model Risk Committee ensures an adequate level of independence of individual participants of the model risk management process and allows for avoiding conflicts of interest among them. Moreover, it ensures possibility for the Validating Unit to issue binding recommendations of an adequate priority.

c/ **Assets and Liabilities Committee** of the mBank Group (ALCO) is responsible, in particular, for developing, monitoring and managing the structure of assets and liabilities, obligations and off-balance sheet items, with the aim of optimizing funds allocation.

d/ **Capital Management Committee** is responsible, in particular, for managing capital. Based on the decisions made, the Committee issues recommendations for the Management Board of the Bank on:

- measures in respect of capital management as well as capital level and structure,
- increasing the effectiveness of capital utilization,
- the internal procedures related to capital management and capital planning.

e/ **Credit Committee of the mBank Group** is responsible, in particular, for the supervision of concentration risk and large exposures at the Group level by taken decisions and made recommendations. The Committee shall also take decisions on debt conversion into shares, stocks, etc. as well as decisions on taking over properties in return for debts (applies to the bank).

f/ **Credit Committee of the Retail Banking** is responsible, in particular, for:

- making individual credit decisions concerning retail clients in the case when the total exposure to such a client, the value of the transaction or the values of AIRB risk parameters (PD/LGD/EL) set for the client/transaction achieve a specified threshold set for this decision-making level,
- granting/changing/revoking decision-making powers to individual employees of the Bank.

g/ **Data Quality and IT Systems Development Committee** is responsible for the tasks and decision making process in scope of principles and structure of operation of the data quality management system, approving operational standards of data management, assessing the effectiveness of the data quality management system, initiating actions aimed at improving data quality at the Bank, in particular, taking into account the needs related with calculating the regulatory capital requirements of the Bank under the AIRB approach.

h/ **Foreign Branch Supervision Committee of mBank S.A.** is responsible, among others, for issuing recommendations for the Management Board of the Bank on approval of the operational strategy and the rules for stable and prudent management of a particular foreign branch of the Bank, especially with reference to credit risk.

Other units:

1. Organisational units of the Risk Area

The function of management at the strategic level and the function of control of credit, market, liquidity and operational risks and risk of models used to quantify the aforesaid risk types are performed in the Risk Area supervised by the Vice-President of the Management Board, Chief Risk Officer.

The chart below presents the organisational structure of this area:

***organisational unit developing integral structures of foreign branches at mBank S.A.*

The roles played by particular units in the process of identifying, measuring, monitoring and controlling risk, which also includes assessing individual credit risk posed by clients and establishing the client selection rules, have been strictly defined. Within the scope of their powers, the units develop methodologies and systems supporting the aforesaid areas. Furthermore, the risk control units also report the risk and support the major authorities of the Bank.

Credit Processes and Retail Risk Assessment Department:

- making credit decisions concerning retail banking products,
- monitoring credit agreements and performing administrative activities,
- developing and effectively using anti-fraud systems and tools,
- preventing credit fraud and exercising control over operational risk in the credit process for retail and corporate banking products, as well as developing the methodology of these processes,
- identifying gaps in processes, products and systems that impact an increase in fraud exposure and applying measures to eliminate such gaps.

Retail Risk Management Department:

- development of risk management principles and processes,
- acceptance of retail banking products, including the impact on the different types of risk and capital requirements,
- development of reports for monitoring of risk management policies,
- development and management of systems supporting the risk assessment and decision-making process.

Retail Debt Restructuring and Collection Department

- handling the processes of debt restructuring and collection of receivables arising from retail loans granted on the Polish market,

- debt sale transaction of NPL for receivables arising from retail loans granted on the Polish market.

Corporate Risk Processes Department:

- developing and implementation of corporate credit process and supervision over its effectiveness,
- preparing corporate credit risk management strategy of mBank Group as well as credit policies including policies regarding industrial risk appetite,
- preparing portfolio analysis and reports for the purpose of management of corporate credit risk,
- developing and monitoring the quality of rating models for retail and corporate clients and financial institutions (credit risk modelling),
- settlement and accounting of structured finance and mezzanine transactions and collection operations,
- verification of value, liquidity and attractiveness of real estate and movables provided for collateral of loans, and analysis of investments financed by the Bank.

Corporate Risk Assessment Department:

- implementation of the Bank's credit policy regarding corporate customers, countries and financial institutions,
- credit risk management in the Bank and the Group subsidiaries in the abovementioned areas.

Financial Markets Risk Department:

- identifying, measuring controlling and monitoring of market risk, interest rate risk of the banking book, liquidity risk and counterparty risk,
- developing methods for measuring market risk, interest rate risk of the banking book, liquidity risk and counterparty risk,
- developing methods for valuations of financial instruments,
- valuation and control of transactions and analysis of P&L of front-office units,
- content management of front-office systems and risk measure system,
- controlling of Bank's contributions to WIBID/WIBOR fixing.

Integrated Risk and Capital Management Department:

- integration of risk and capital management within the ICAAP,
- control of capital adequacy and risk bearing capacity as well as planning and limiting risk capital,
- formulation of risk appetite and coordination of the process of determining strategic risk limits,
- integration of risk valuation (economic capital, reserves, stress tests),
- integration of control of non-financial risks (including operational risk) and Internal Control System Self-assessment (ICS),
- integration of model management and validation of quantitative models.

Projects and Risk Architecture Management Department:

- Risk Projects Portfolio Management,
- performing the function of competence centre in the area of process management,
- development and optimization of the architecture of IT processes and applications of Risk,
- management of the IT applications of Risk (maintenance and development),
- risk data management and cooperation with the Finance Division within the scope of centralized management information system.

Foreign Branches Risk Department:

- supporting the credit risk assessment process and taking part in the decision making process regarding credits in the Bank's foreign branches,
- credits managing/settling in the Bank's foreign branches,
- handling the vindication process in the Bank's foreign branches.

2. Organizational units outside the risk management area are in charge of the management and control of other risks identified in mBank Group's operations (business risk, capital risk, reputational risk, legal risk, IT systems risk, personnel and organisational risk, security risk and compliance risk).

3. Business units take part in managing particular risk types by means of taking risk into account in business decisions, in preparing the product offer and in the client acquisition process. The units assume the ultimate responsibility for taking risk within the set limits and for developing the Bank's results.

4. Control units:

- **Internal Audit Department (DAW)** carries out independent review of the process of identifying, taking, measuring, monitoring and controlling risk as part of its internal control and audit function.
- **Compliance Department (DC)** is responsible for establishing standards of managing the risk of non-compliance of internal regulations and standards of the Bank's operation with applicable law.

3.3.2 Risk culture

Lines of defence

Risk management roles and responsibilities in the Group are organised around the three lines of defence scheme:

- The first line of defence consists of **Business** (business lines) responsible for risk and capital management. The task of the Business is to take risk and capital into account in all its decisions and within the boundaries of risk appetite defined for the Group.
- The second line of defence where **Risk** (risk management area), **IT**, **Security and Compliance** are major players, assists the Business by creating risk management strategy for each risk and appropriate policies that give guidance to the Business while taking risk minded decisions. The main goal for the second line functions is to support the Business with the implementation of the strategies and policies and to create oversight over the Group's control environment and risk exposure.
- The third line of defence is **Internal Audit**, ensuring independent assessment of the first and the second lines of defence.

Pillars of risk management

Risk management framework in mBank Group rests on **three pillars concept**:

- **Customer Focus** – striving to understand and balance specific needs of the Risk's diverse stakeholders (Business, Management Board, Supervisory Board, shareholders, regulators).
- **One Risk** understood as an integrated approach to risk management and responsibility to the clients for all risks (defined in Risk Catalogue of mBank Group).
- **Risk vs Rate of Return** perspective – supporting business decision-making process on the basis of long-term relationship between risk and rate of return avoiding tail risks.

Vision of Risk

We take advantage of the opportunities in a dynamically changing environment, using innovative methods of risk management.

Bearing in mind the bank's efficiency and safety, we create value for the customer in a partner dialogue with the business.

Mission of Risk

The risk management area is actively involved in the implementation of initiatives and actions undertaken while realization of the new strategy of the mBank Group. This support is organized around five challenges facing the risk management area in the coming years:

- **Empathy** understood at the risk area as active adaptation of risk management to the changing needs of different groups of customers.
- Promoting the experience of **mobility**.
- **Efficiency** understood as: measuring, improving and automating Risk processes in the Lean culture; shaping - through a partner dialogue - risk appetite ensuring safe and profitable balance sheet of the bank.

- **Engaged employees**. This pillar will be developed by building a work environment which fosters innovation; attracts, maintains and develops employees with knowledge of business and risk management, curious to find solutions and openly communicating.
- **Technological advantage**, which means the implementation of risk management based on a common integrated data platform (CDL) and the search for technological solutions enabling innovative risk management.

Key changes in the risk area in 2016

The risk control and management process in the mBank Group is subject to continuous improvement with emphasis on the improvement of customer-oriented integrated risk management.

Selected projects being implemented in 2016 are described below:

- **Internal Control System Self-assessment (ICS)**

  Implementation of the Internal Control System Self-assessment was completed in mBank Group subsidiaries. In the Bank, the Self-assessment was implemented in 2015. Thus, the process covers the whole activity of the Group. Self-assessment process is carried out on an annual basis. It aims at a comprehensive assessment of operational risk through: identification of material operational risks, inventory of control mechanisms dedicated to mitigate those risks, assessment of adequacy and effectiveness of control mechanisms, and assessment of the risk level and the development and implementation of the necessary plans of remedial measures.

- **Adaptation works to the requirements of Recommendation W** concerning model risk management in banks (published in July 2015 by the KNF were completed. The works aimed at:
  - development of principles of models' classification and model risk measurement and monitoring in line with regulatory requirements,
  - implementation of the required reporting system concerning model risk at different levels of the organization,
  - supplementing the existing models' management process, particularly in the field of documentation, with elements indicated in the Recommendation.

  The abovementioned works resulted, among others, in the update of Model Management Policy, which was supplemented with provisions addressing requirements of the Recommendation W and in the defining of model risk tolerance level. The updated Policy, as well as the model risk tolerance level, was approved by the Management Board and the Supervisory Board of the Bank. In addition, the Model Risk Committee, the recipient, among others, of management information concerning model risk was appointed.

- **Policy regarding developers** – "Credit policy of financing residential developers projects by mBank Group" was adopted. It is another common policy at the Group level; the first common policy was the policy regarding financing commercial real estate. In the course of the dialogue with the Business, a framework for the risk appetite and development of acquisition in this market was determined, particularly definition of residential developer's project was developed, risks were identified and their mitigants were introduced, as well as the limit for the portfolio of residential developers' projects.

- Continuation of the program – launched in 2015 - of continuous increase of effectiveness of work in the risk management area based on the principles of **Lean Management** with an emphasis on implementing a culture of responsibility and mechanisms for continuous improvement of processes. The aim of the program is to enable the absorption of the increasing number of tasks resulting from the growth of business and increasing regulatory requirements, without necessity to enlarge significantly the available resources.

- The Bank carried out **IFRS 9 implementation project**, including, among others, analytical work in assessing the impact of IFRS 9 on the methodology for calculation of provisions in the Group; implementation of the necessary changes was also started. More information about the project were included under Note 2.26.

3.3.3 The risk management process documentation

The risk management process implemented in mBank and mBank Group is documented. The key documents are described below.

Strategies and policies:

- **Risk Management Strategy of the mBank Group**

  The document, developed in connection with the development strategy and the multi-year plan of the mBank Group, defines the risk appetite within the Group, including key quantitative and qualitative risk guidelines, as well as existential threats lying beyond its scope.

- **Corporate Credit Risk Management Strategy in mBank Group**

  The document describes issues connected with credit risk in the corporate and investment banking area: defines risk appetite level and general principles of corporate credit risk management and limitation in the Group.

- **Retail Credit Risk Management Strategy in mBank Group**

  The document defines general, directional guidelines regarding credit risk management in the retail banking area, including such issues as: formal organization and responsibility for credit risk management, risk appetite, general guidelines for the functioning credit processes, decision-making models and reporting systems.

- **Operational Risk Management Strategy in mBank Group**

  The document describes the principles and components of operational risk management in mBank Group, including the following issues: organization and responsibility for operational risk management, operational risk profile and appetite, methods and tools for operational risk control.

- **Market Risk Management Strategy of mBank Group**

  The document describes key issues concerning market risk management in the Group: specifies conditions influencing market risk profile, defines market risk appetite and provides framework of market risk management in the Group by determining organisation, roles and responsibilities, defining market risk management process as well as attitude to the market risk management in the Group subsidiaries.

- **Liquidity Risk Management Strategy of mBank Group**

  The document describes key issues concerning liquidity risk management in the Group: specifies conditions influencing liquidity risk profile, defines liquidity risk appetite and provides framework of liquidity risk management in the Group by determining organisation, roles and responsibilities, defining liquidity risk management process as well as attitude to the liquidity risk management in the Group subsidiaries.

- **Reputational Risk Management Strategy in mBank Group**

  The document specifies the principles and components of reputational risk management, including, in particular, the issues of reputational risk profile as well as organization and methods of reputational risk management.

- **Capital Management Policy of mBank Group**

  The Policy specifies organization of capital management, including the main aims, principles and methods of capital management process as well as the Group's strategic objectives in the capital area.

- **Compliance Policy in mBank SA**

  The document stipulates a set of procedures and organisational rules that the Bank fulfils to comply with the requirements of Polish law and compliance rules of the Commerzbank Group, without prejudice to the provisions of Polish law, as well as a set of the basic rules of conduct for the Bank's employees and main processes of compliance risk identification that allows to manage compliance risk on all levels of the Bank's organisation.

- **Model Management Policy**

  The document determines the participants and the framework for model management process, including issues related to the development of models in mBank Group, their approval, implementation, validation, monitoring, implementation of changes and the associated reporting process.

Limit system:

- **Limit Book. Rules for limitation of risk in mBank Group**

  The document contains a description of the system of limits, which are widely used in managing and controlling risk all over the mBank Group and ensures fine application of the risk appetite to the certain risk limiting in the particular areas, and guarantees fulfilling the regulatory requirements.

Stress tests:

- **Book of stress tests. Rules for stress testing in mBank Group**

  The document defines participants and the framework for stress testing, including aspects concerning: the creation of stress scenarios and their approval, carrying out stress tests and the use of their results as well as their integration into the risk management process.

ICAAP documentation:

- **Internal Capital Adequacy Assessment Process (ICAAP) in the mBank Group – Governing Principles**

  The document describes the internal capital adequacy assessment process (including the Risk Bearing Capacity concept) and the course of its individual components.

- **Document describing the rules for estimating capital for hard to quantify risks**

- **The concept of Risk Coverage Potential (RCP)**

3.3.4 Internal capital adequacy assessment process (ICAAP)

The mBank Group adjusts the own funds to the level and type of risk, the mBank Group is exposed to, and to the nature, the scale and the complexity of its operations. For that purpose, the ICAAP (Internal Capital Adequacy Assessment Process) is implemented in the mBank Group. The aim of this process is to maintain own funds at the level adequate to the profile and the level of risk in the mBank Group's operations.

The internal capital adequacy assessment process is composed of six stages implemented by organizational units of mBank and the mBank Group subsidiaries.

The process includes:

- risk inventory in the Group,
- estimation of internal capital for coverage of risk,
- capital aggregation,
- stress tests,
- planning and allocation of economic capital to business lines and the Group subsidiaries,
- monitoring consisting in a permanent identification of risk involved in mBank Group operations and analysis of the level of capital for risk coverage.

The process is reviewed by the Management Board of the Bank and supervised by the Supervisory Board of the Bank on a regular basis.

Material risks in mBank Group's operations

The Management Board is taking activities for ensuring that the Group manages all material risks arising from the implementation of adopted business strategy.

Material risks identified in the Group's operations as a result of the risk inventory process based on rules stipulated within ICAAP are classified to one of the two groups:

- the first group consists of risks included in the process of calculating economic capital;
- the second group comprises other risks (including hard to quantify risks) which are managed through adequate processes. In addition, in accordance with the ICAAP rules in force in the Group, capital buffer to cover other risks may be estimated.

The following risks were recognized as material for the Group as at 31 December 2016:

Risks included in calculating economic capital

Credit risk | **Market risk** | **Operational risk** | **Business risk**

Other risks (including hard to quantify risks)

Liquidity risk | **Reputational risk** | **Model risk** | **Capital risk**

Internal capital

Internal capital is the amount of capital estimated by the Bank and required to cover material risks identified in the mBank Group's operations. Internal capital is the total of:

- the economic capital to cover risks included in economic capital calculation,
- capital necessary to cover other risks (including hard to quantify risks).

The economic capital is measured by means of quantitative methods which make it possible to adequately reflect the risk level.

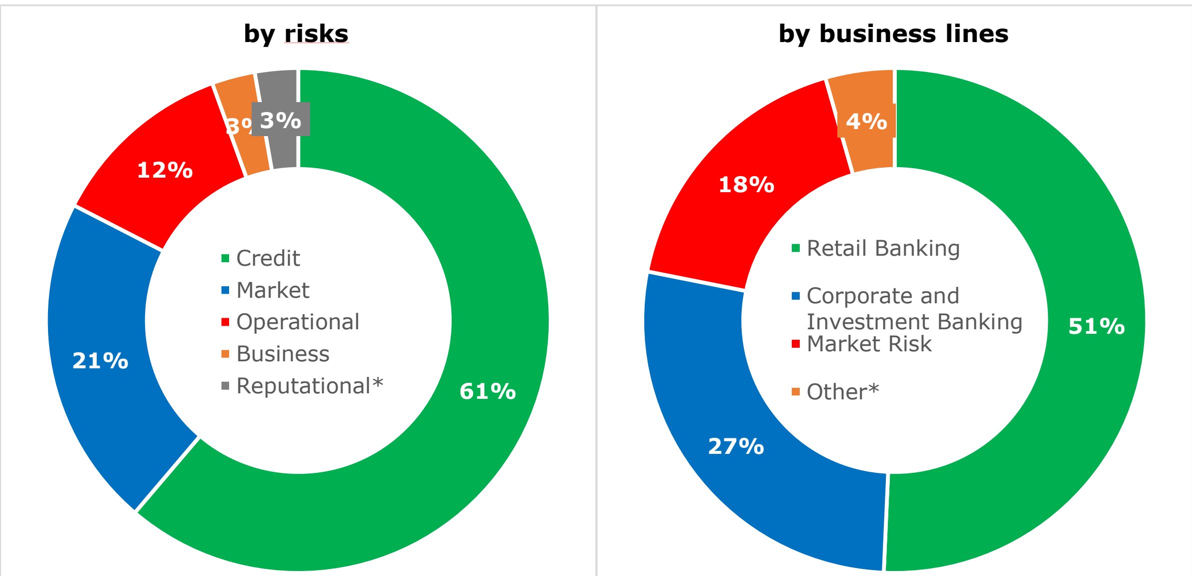
In 2016 (similarly as in 2015), the mBank calculated the economic capital at the 99.91% confidence level over a one-year time horizon, for all risk types. Diversification between different risks was not included while calculating the total of economic capital.

In accordance with internal regulations, the decision concerning the amount of capital for coverage of hard to quantify risks is taken by the Capital Management Committee. In 2016 the Bank maintained capital to cover reputational risk.

Structure of internal capital and total capital requirement

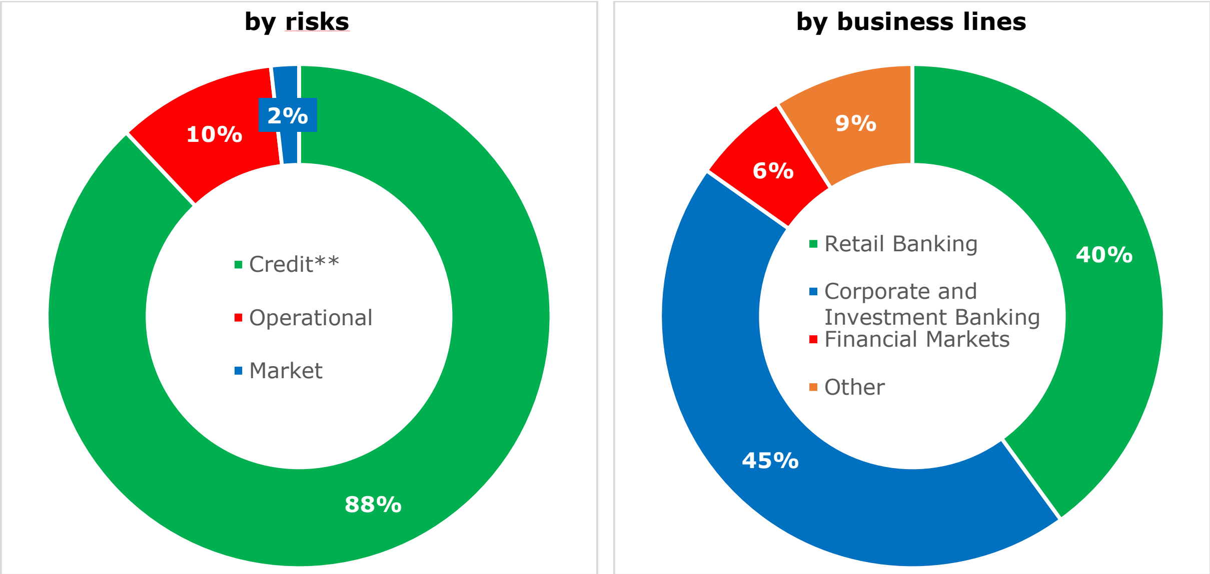
The charts below present the structure of internal capital and the total capital requirements of mBank as of 31.12.2016 by risks and business lines.

Structure of internal capital of mBank as of 31.12.2016



**Capital for coverage of hard to quantify risks (reputational risk) is not allocated to business lines. Reputational risk is included in „Other" on the chart presenting internal capital structure by business lines.*

Structure of total capital requirement of mBank as of 31.12.2016



***The item presenting "Credit" risk includes also supervisory floor for AIRB portfolios of banks exposures and mBank retail microenterprises mortgage loan portfolio*

Higher share of market risk in the structure of internal capital (compared to the share in the structure of total capital requirement) results from the fact that the model of economic capital for market risk includes additional risk factors, which (in accordance with the current methodology) do not generate capital requirement (primarily interest rate risk of the banking book and credit spread on the portfolio of Treasury securities in the banking book).

Significantly lower share of internal capital assigned to the Corporate and Investment Banking (compared to the share of this business line in the structure of total capital requirement) results from the diversification effect recognized in the model of economic capital for credit risk. The opposite effect in the case of the Retail Banking stems from taking into account the horizon of mortgage products' maturity (particularly housing loans) in the model of economic capital for credit risk (versus lack of maturity adjustment in regulatory risk weight).

3.3.5 Risk appetite

Risk appetite is defined within the mBank Group as the maximum risk, in terms of both amount and structure, which the Group is willing and able to incur in pursuing its business objectives under going concern scenario. Risk appetite resulting from the available capital and funding base is the starting point in the Group's risk management, and thus impacts the budgeting process and the capital allocation process.

Risk appetite management framework

The process of risk appetite management embedded within the Group is presented on the diagram below.

Risk appetite is based on assessment of the Group risk profile and risk capacity in the perspective of:

- capital,
- funding,
- non-financial risks,
- Risk Adjusted Performance Measures.

Risk appetite is the starting point for an ongoing dialogue about the risk profile within the organization. During the strategic discussions, the Management Board outlines directions for the development of the Group and particular business lines. The formulated general statements assure the foundation for ongoing dialogue between management and the Board, which materializes in the form of portfolio-specific statements. Risk appetite statements undergo further decomposition into key metrics and targets via the integrated strategic planning process, which are then cascaded down into the organization in operational phase of planning. Documentation of risk appetite and its monitoring activates appropriate control mechanism for protecting the Group's goals.

Capital buffers

Risk appetite is determined below the risk capacity set by the minimum standards on capital adequacy and liquidity set in European and Polish regulations in order to ensure that the Group survives in the case of negative changes in the Group or in its environment thereby providing the ability to assure risk bearing capacity. Level of funding sources and capital position of the Group, both regulatory and internal capital is taken into consideration while defining the risk capacity and risk appetite. The Bank maintains capital and liquid assets on the levels ensuring to meet regulatory requirements under normal and realistic stress conditions.

mBank Group's Risk appetite covers all significant risks and key risk concentrations embedded in its business strategy by setting appropriate capital buffers necessary in case of materialization of selected risk factors related to existing portfolios and planned business and addressing new regulatory requirements as well as potential negative macroeconomic changes.

Risk Bearing Capacity

Risk bearing capacity is expressed in terms of capital and funding resources available for allocation so as to ensure safety in normal scenario and risk scenario. The maximum risk that mBank Group is willing and able to incur, while accepting existential threats resulting from mBank Group business strategy, is subject to the following conditions:

- adequate economic risk-bearing capacity must be ensured (limits must be ensured in normal conditions),
- the internal floor set for regulatory capital ratios must be observed,
- financial liquidity and adequate structural liquidity must be ensured.

The approach of mBank Group to the assessment and control of mBank Group risk bearing capacity covers internal and regulatory requirements.

Risk limit system

To ensure effective allocation of the risk appetite the mBank Group applies a risk limit system. The structure of limits translates the risk appetite into specific constraints on risks incurred in the Group's activity. The concept of limit structure and limit management process is described in the document "Limit book. Rules for limitation of risk in mBank S.A. Group" accepted by the Supervisory Board. Accepted limit values are presented in the document "Limit Book - limit register".

3.3.6 Stress tests within ICAAP

Stress tests are an essential component of the ICAAP used for managing the Bank and the Group and for capital planning. Stress tests allow an assessment of the Group's resistance in the context of extreme, yet plausible scenarios of external and internal events.

The **integrated stress tests** are conducted assuming scenario of unfavourable economic conditions that may adversely affect the Bank's financial situation in at least a full two-year time horizon (for liquidity risk - in one-year horizon). The risk scenario, ie. the most plausible (in at least a full two-year time horizon) scenario of negative deviations from the base scenario, expressed in terms of macroeconomic and financial ratios is common for all risk types and is aligned with the scenario accepted at the group level of the parent entity of the Bank. The scenario may include idiosyncratic events.

The integrated macroeconomic scenario allows for a comprehensive analysis of all the risk types covered by internal capital and analysis of its impact on the capital adequacy and liquidity of the Bank and the Group.

The stress test results include the following measures:

1/ stressed economic capital (includes capital for credit risk, market risk, operational risk and business risk),

2/ stressed potential risk coverage (RCP),

3/ the liquidity norms under stress conditions.

The internal capital under stress scenario is defined as a product of calculation performed in line with the current methodology of internal capital calculation but on the basis of input parameters typical for stress conditions.

Macroeconomic stress scenarios are updated on quarterly basis or ad hoc, if needed. Based on the stress scenarios the resulting internal capital demand as well as negative financial effects of the adverse economic scenario are simulated.

Additionally, once a year, the Bank carries out **supplementary stress tests** using much more severe risk scenarios and/or events. The Bank and the Group carry out so called **reverse stress tests**, the goal of which is to identify events potentially leading to unviability of the Bank and the Group. Reverse stress tests are used for the verification of capital and liquidity contingency plans of the Group and are applied for making strategic decisions concerning the acceptable risk profile of the Group. Reverse stress tests are conducted in inverse mode to classic stress tests (from effect to causes) and serve as their complement. Reverse stress tests are carried out for material risks (internal capital) and are an additional element of the analysis of the Bank's and the Group's robustness to negative macroeconomic and idiosyncratic factors.

The Bank and the Group take part in **regulatory stress tests** conducted annually by the KNF, in order to determine the impact of assumed macroeconomic stress scenarios on the Group's balance sheet and P&L as well as on external supervisory norms.

3.3.7 Capital planning

Required capital planning – strategic phase

The strategic phase of capital planning takes the form of the strategic dialogue between the Management Board, risk management area, finance area and business lines, resulting in the determination of the desired directions of business development to support the realization of the business goals of the mBank Group.

The Group plans business activities and related risk appetite within its risk bearing capacity and constraints imposed by regulatory requirements which have to be satisfied under both normal and stress conditions.

In view of the above, the planned changes in the size and structure of the Group's business activities, as well as anticipated regulatory changes are taken into account in estimating the required capital during the planning process. The required capital is estimated using risk parameters reflecting macroeconomic expectations assumed in planning process and taking into consideration intended changes in the methodology.

Should the capital required to achieve business goals of the Group be greater than the capital available for allocation, then the said business goals need to be revised.

Following the establishment of strategic directions, the key risk concentrations arising from the current and planned risk profile are examined with the Management Board setting an acceptable level of the associated risk factors. Key risk concentrations are identified based on the reverse stress test analysis. Capital targets are set taking into account the capital needs arising from the potential materialization of key risk factors recognized in reverse stress test procedure and fixed at the levels accepted as corresponding with targeted risk tolerance. Impact of the risk factors on capital is determined through stress test calculations.

The process of setting strategic financial targets is accompanied by strategic allocation of capital resources to individual business areas taking into account longer-term return on capital.

Required capital planning – operational stage

Based on the strategic directions, general balance sheets targets are elaborated upon during operational phase of capital planning (bottom-up). At this stage the capital available is compared with the capital needed (resulting from business growth and stress test results) in order to determine an efficient capital allocation to lower levels.

Business units work out their partial plans based on accepted macroeconomic assumptions, financial targets and the assessment of business growth potential.

In order to determine an acceptable risk profile from the capital consumption perspective, the forecasted volumes (partial plans) and resulting demand for regulatory and economic capital are compared, in an iterative process, with available resources and strategic guidelines.

Limits supporting capital plan

Annually updated limits are set to ensure adequate use of available resources in order to achieve business targets. Multilevel limit structure aims to ensure that risk appetite is translated into specific constraints put on risks of the Group's activities in different business areas.

Available capital base

The final effect of the planning process is determination of target level of regulatory (own funds) and economic (RCP) capital base needed to cover risk concentrations of the current and planned activities, expressed by total regulatory capital requirement and total internal capital.

3.4. Credit risk

3.4.1 Organization of risk management

The mBank Group actively manages credit risk in order to optimise the level of profit in terms of return on risk. Analysis of the risk in the Group operations is continuous. For the purpose of identification and monitoring of credit risk, uniform credit risk management rules are applied across the Bank's structure and its subsidiaries; they are based, among others, on separation of the credit risk assessment function and the sales function at all levels up to the Management Board. A similar approach is applied to administration of credit risk exposures as this function is performed in the risk area and the operating area and is independent from sales functions. The model of Group-wide risk management assumes participation in the process of the Bank's risk management area organizational units as well as the Credit Committee of the mBank Group (KKG). The segregation of responsibilities in the process of credit risk management is as follows:

- **Credit Processes and Retail Risk Assessment Department (DPK)** is responsible for ensuring effectiveness and security of lending and post-sale service, including monitoring in respect of retail products on the Polish market and preventing extortion and fraud in the area of retail and corporate banking, as well as developing the methodology in this respect.
- **Retail Risk Management Department (DZR)** is responsible for management of credit risk and other risk types in mBank's retail banking. The main operational responsibility of DZR (in the domestic market) is supervision over the automated credit process. Furthermore, DZR develops rules of credit risk rating, calculating creditworthiness of retail clients and other components of credit policy submitted for the approval by the Retail Banking Risk Committee. Solutions applied on the Polish market are also adapted in foreign branches (in the Czech Republic and Slovakia. Moreover, the Department is responsible for implementing the assessment principles in the tools supporting the credit decision-making process, reports on the quality of the credit portfolio, and monitors the quality of data used in the risk rating process. To the extent permitted by external regulations DZR participates in the risk management process of the subsidiaries having credit risk bearing retail products in the offer.
- **Retail Debt Restructuring and Collection Department (DWD)** is responsible for ensuring the execution of processes of recovering the Bank's receivables arising from granted retail loans, cohesion and completeness of internal regulations and the reporting environment in debt collection related with credit products. Activity of the area is focused on handling soft collection processes, restructuring process, collection after termination of the credit agreement, including judicial and enforcement proceedings and debt sale transaction of NPL.
- **The Corporate Risk Assessment Department (DOR)** is responsible for management of the quality of the corporate loans portfolio of the Bank and subsidiaries of mBank Group including exposures under restructuring. DOR's key functions include: decision-making or participation in decision-making concerning performing and non-performing loans, including their impact on operational risk, reputational risk, liquidity risk and for capital requirements and return on invested capital; analysis, evaluation and control of credit risk of countries, banks, international financial institutions and non-financial clients of the Bank and the Group subsidiaries in the corporate and investment banking area; control of credit risk limits imposed on countries, banks, international financial institutions; the management of the credit risk provisions in the Bank's corporate and investment banking area.
- **Corporate Risk Processes Department (DPR)** responsible for: compiling the corporate credit risk strategy, shaping the credit policy within the corporate banking area, creating through

portfolio analyses, including industry-based division, products and concentration; compiling reports and statements for financial supervision bodies, the Bank's governing bodies and the Bank's organisational units, from the scope of credit portfolio of Bank and mBank Group entities. DPR compiles and introduces rules governing corporate risk process, monitors its efficiency, manages applications supporting credit process and provides support for their users. Within the area of DPR responsibilities lies development and quality control of the rating models for retail, corporate and financial clients of mBank and mBank Group entities. DPR manages the reserves for credit risk in the area of corporate banking, conducts settlement and accounting service of credits and guarantees issued by Structured and Mezzanine Finance Department and collected debts from Restructuring and Debt Collection Department portfolio. Within DPR also takes place verification of real estate and movables provided by customers for collateral of loans for their value, liquidity and attractiveness, as well as verification of the investments financed by the Bank.

- **Integrated Risk and Capital Management Department (DKR)** is responsible for: developing methodology and calculating capital requirement for credit risk; calculating portfolio credit provisions of the Bank and economic capital for credit risk; conducting stress tests in the area of credit risk (provisions, capital requirement, economic capital); organizing the process of managing models applied for credit risk management and evaluation as well as validating such models; coordinating and participating in the process of determining credit risk appetite; preparation of reports and information on credit risk (provisions, capital requirement, economic capital, stress tests) for the Bank's authorities and for the purposes of the consolidated supervision.

Decision-making for credit exposures in the corporate area. Credit decisions are consistent with the accepted rules set in the Corporate Risk Policy. Levels of decision-making competences are determined by a decision-making matrix. The determination of level of decision-making authority for credit decision is based on EL-rating and total exposure on client/group of affiliated entities. The total exposure includes also exposures on the client/group of affiliated entities in the mBank Group subsidiaries.

Decision-making for credit exposures in the retail banking area. Due to a profile of retail banking clients, the accepted amount of exposure per client and standardisation of products offered to those clients, the credit decision-making process differs from that applied to corporate clients. The decision-making process is automated to a large extent, both in terms of acquiring data on the borrower from internal and external data sources, and in terms of risk assessment by means of scoring techniques and standardised decision-making criteria. The tasks, which are not automated concern mainly the verification of credit documentation and potential derogations when a decision is made with the escalation to the decision-making level in accordance with the applicable rules. In addition, in case of mortgage loans for SMEs, the value of the collateral is established (internally or with the use of external appraisal report) and its compliance with the binding credit policy including acceptable LtV is assessed. These functions are performed by operating units located within the Credit Processes and Retail Risk Assessment Department and the Corporate Risk Processes Department in complete separation from sales functions.

3.4.2 Credit Policy

mBank manages credit risk based on supervisory requirements and market best practices. Credit policies, established separately for retail banking and corporate banking, play the key role in the credit risk management process. Credit policies include e.g.:

- target customer groups,
- minimum acceptable ratings' levels defined by the expected loss value,
- criteria for acceptance of financed subjects and collaterals,
- rules for mitigating concentration risk,
- rules for selected industries and customers segments.

3.4.3 Collateral accepted

Collateral accepted for granted credit products. The collateral policy is an important part of the credit policy. It provides that, in making a decision about granting a credit risk bearing product, the Bank strives to obtain collateral that would be adequate to the accepted risk. The quality of the proposed tangible collateral is assessed according to its liquidity and market value (or the mortgage lending value – in case of mBank Hipoteczny), and the quality of personal collateral is assessed according to the financial situation of the guarantor. Moreover, the impact of collateral on limitation of the impairment of the loan portfolio is a significant factor in the assessment of the collateral's quality. The quality of accepted collateral is linked to the amount of the credit risk bearing product and the level of risk related to granting such a product. The most common forms of accepted collateral include:

- mortgage on real estate,
- cession of receivables (cession of rights),
- registered pledge,
- transfer of ownership to collateral (partial or conditional),
- monetary deposit,
- guarantee deposit or cash blocked,
- bill of exchange,
- guarantees and warranties,
- a letter of comfort issued by a company whose reliability and fairness is known on the international financial markets.

In the case of personal collateral (e.g. warranty, guarantee), the situation and reliability of the entity issuing such collateral is evaluated against the same standards as those applicable to the assessment of borrowers.

Tangible collaterals are evaluated in accordance with the internal rules of the Group. The value of fixed assets (other than vehicles) taken as collateral is determined in most cases on the basis of an estimate prepared by a certified expert. These estimates submitted to the Bank is verified by a team of specialists situated in the Risk Area, who verify the correctness of the market value assumptions and assess the liquidity of the collateral from the Bank's point of view. The following factors are taken, among others, into account in the verification process:

a) for collateral on real estate:

- type of real estate,
- legal status,
- designation in the local land development plan,
- technical description of buildings and structures,
- description of land,
- situation on the local market,
- other price-making factors,

b) for collateral on plant and machinery:

- general application and function in the technological process/possibilities of alternative use,
- technical description and parameters,
- exploitation and maintenance conditions,
- compliance with applicable standards,
- availability of similar devices and machinery,
- current market situation,
- forecasts of demand for specific machinery in connection with the situation in the industrial sectors applying such machinery.

c) for collateral on inventories:

- formal and legal requirements related to specific products,
- saleability,
- warehousing conditions required,
- security and insurance of both the warehouse and the goods stored therein.

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Collateral accepted for transactions in derivative instruments. The Bank manages the risk of derivative instruments. Credit exposures arising from concluded derivative transactions are managed as a part of clients' general credit limits, taking into account potential impact of changes in market parameters on the value of the exposure. Existing master agreements with contractors obligate the Bank to monitor the value of exposure to the client on a daily basis and provide for additional collateral against the exposure to be contributed by the client if the exposure value increases or the limit is exceeded. In case of default, the master agreements provide for early settlement of the transaction with the client. mBank applies an Early Warning Process in order to monitor the usage of limits on derivatives and enables the Bank's quick reaction if client's open transaction nears the maximum limit. Moreover, taking into consideration credit risk related to a derivative limit granted to a specific client, the Bank may apply additional collaterals from standard catalogue of collaterals of credit risk-bearing products.

Collateral on securities resulting from buy-sell-back transactions. The Bank accepts collateral in the form of securities in connection with the buy-sell-back transactions concluded. Depending on the agreement such collateral may be sold or repledged.

3.4.4 Rating system

The rating system is a key element of the credit risk management process in the corporate banking area. It consists of two main elements:

- customer rating (PD-rating) – describing the probability of default (PD),
- credit rating (EL-rating) – describing expected loss (EL) and taking into consideration both customer risk (PD) and transaction risk (LGD, Loss Given Default – loss resulting from default). EL can be described as PD*LGD. EL indicator is used mainly at the credit decision-making stage.

The rating produces relative credit risk measures, both as percentages (PD%, EL%) and on a conventional scale from 1.0 to 6.5 (PD-rating, EL-rating) for corporations (sales over PLN 50 million) and SMEs (sales below PLN 50 million). PD rating calculation is a strictly defined process, which comprises seven steps including: financial analysis of annual reports, financial analysis of interim figures, assessment of timeliness of presenting financial statements, analysis of qualitative risks, warning indicators, level of integration of the debtor's group, and additional discretionary criteria. Credit rating based on expected loss (EL) is created by combining customer risk rating and transaction risk rating, which results from the value of exposure (EAD, Exposure at Default) and the character and coverage with collateral for transactions concluded with the client (LGD). LGD, described as % of EAD, is a function of possibly executed value of tangible and financial collateral and depends on the type and the value of the collateral, the type of transaction and the ratio of recovery from sources other than collateral.

The rating system generates the borrower's probability of default directly in the form of a PD ratio, expressed as a percentage (continuous scale). Rating classes are calculated on the basis of procedures of dividing percentage PD into groups based on geometric stepladder. In external reporting, the Bank maps the internal PD rating scale onto external ratings. The table below presents the mapping system.

Sub-portfolio	1				2			3		4			5			6	7		8	
PD-Rating	1.0 - 1.2	1.4	1.6	1.8	2	2.2	2.4 - 2.6	2.8	3	3.2 - 3.4	3.6	3.8	4	4.2 - 4.6	4.8	5	5.2 - 5.4	5.6 - 5.8	No rating	6.1 - 6.5
S&P	AAA	AA+	AA, AA-	A+, A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B+	B	B-	B-	CCC+	CCC down to CC-	n/a	C, D-I, D-II
	Investment Grade								Non-Investment Grade											Default

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

- Loss Given Default (LGD) model, which covers the entire retail portfolio. In the model, loss is defined as a function dependent on the level of recovery from clients' own payments and possible value of collateral using real estate collected in enforcement procedures,
- Credit Conversion Factor (CCF) model, which covers the entire retail banking portfolio. The model is based on historical data. The Credit Conversion Factor is an integral part of,
- PD model with a modular structure, which integrates application and behavioural models in the retail banking area as well as models which use Credit Information Bureau (BIK) data.

3.4.5 Monitoring and validation of models

All models of risk parameters applied in mBank and in the Group subsidiaries, including, i.a., scoring models, PD models, LGD models and CCF models are subject to detailed and annual monitoring by modelling units and are validated by the mBank's independent validation unit.

The monitoring includes tests to check discriminatory power of individual models or their components, stability over time, the materiality of individual deviations of empirical values from theoretical values and the impact on portfolio parameters. In case of identification of some mismatches, the modelling unit recalibrates the respective models.

Reports on the performed monitoring/backtests are presented to the model users and the independent validation unit.

Validation

Validation is an internal, complex process of independent and objective assessment of model operation, which is consistent with the Recommendation W requirements and - in case of the AIRB method - meets the supervisory guidelines set out in the CRR. The validation rules are set out in general in the Model Management Policy and described in details in other mBank's internal regulations. The validation covers models directly and indirectly used in the assessment of capital adequacy under the AIRB approach and other models indicated in the Model Register maintained in mBank.

In case of AIRB models there is assured an independence of validation unit in the organizational structures of the Bank or the Group's subsidiary in relation to the units involved in the model's construction/maintenance, ie. the model owner and users. The Validation Division of the Integrated Risk and Capital Management Department (Validation Unit) is responsible for the validation in mBank.

The scope of validation performed by the Validation Unit covers the assessment of:

- models,
- model implementation,
- their application process.

Depending on the materiality and complexity of the model, as well as the type of validation task to be performed, the validation may be advanced (covers both quantitative and qualitative elements) or basic (mainly focused on the quantitative analyses and selected qualitative elements). The validation results are documented in the validation report containing, in particular, an assessment used for the purpose of approving the model, and recommendations, if any, in the form of precautionary and remedial actions, about the irregularities found.

Validation tasks are performed in accordance with the annual validation plan. Both validation plan and the results of performed validation tasks are approved by the Model Risk Committee.

IRB Method Change Policy

The Bank implemented the IRB Method Change Policy approved by the Management Board. The Policy contains internal rules for the change management within the IRB approach, based on the supervisory guidelines and taking into account the organizational specifics of the Bank. The Policy specifies the stages of the change management process, defines roles and responsibilities, describes in details the rules of classification of changes, in particular classification criteria based on the guidelines published by the European Central Bank.

3.4.6 Calculating impairment charges and provisions

The method of calculating impairment charges and provisions is consistent with the International Financial Reporting Standards.

In order to assess if the impairment loss has occurred, identification of credit exposures with premises for impairment is carried out.

3.4.6.1 Impairment triggers - corporate portfolio

Loss events were divided into definite ('hard') loss events of which occurrence requires the client to be classified into the default category, and indefinite ('soft') loss events of which occurrence may imply that there is a need to classify the client into the default category. Credit analyst assesses additionally whether the event impacted adversely the obligor's creditworthiness. Indefinite loss events have been introduced in order to signal situations that may increase the credit risk of the debtor, which may result in the loss of the debtor's ability to repay loan to the Bank.

<u>The list of definite loss events:</u>

1. The number of days past due is above 90 days (14 days in the case of banks) and the overdue amount exceeds PLN 3,000.
2. The Bank has sold exposures with a significant economic loss related to the decrease of the debtor creditworthiness.

3. The Bank performed enforced restructuring of the exposure, which resulted in the change of the loan/transaction service schedule due to the lack of possibility of the obligor to meet his obligations under loan/transaction agreement, as initially stipulated, which resulted in:
   a) remitting part of these obligations, or
   b) postponing the repayment of the substantial part of the principal, interest or (if it refers to) commission; provided that the lack of approval for restructuring would cause more than 90 calendar days delay in repayment of substantial part of the obligation.
4. Filing by the Bank, the parent or subsidiary entity of the Bank a bankruptcy motion against debtor or filing similar motion in respect of credit obligations of the debtor towards the Bank, the parent or subsidiary entity of the Bank.
5. Bankruptcy of debtor or acquiring by him a similar legal protection resulting in his evasion of or delay in repayment of credit obligations towards the Bank, the parent or subsidiary entity of the Bank.
6. Termination of part or whole credit agreement by the Bank and the beginning of restructuring/collection procedures.
7. Client's fraud.

<u>The list of required conditions for indefinite loss events is prepared separately for each following entity type:</u>

a) governments and central banks,
b) banks,
c) corporations, including specialised lending,
d) local government units,
e) insurers,
f) pension fund managing companies, investment fund managing companies.

Defining separately the conditions for indefinite loss events for particular types of entities aims at reflecting specificity of particular types of entities in identification of loss events.

In order to assess if the impairment loss has occurred, identification of credit exposures with premises for impairment is carried out. Subsequently the comparison of the gross balance sheet credit exposure with the value of estimated future cash flows discounted at the original effective interest rate is carried out, which leads to the conclusion whether the impairment loss has occurred. If the discounted value of future cash flow is higher than the gross balance sheet value, the impairment charge is not recognised.

In case of specific situation, when the future cash flows are clearly dependent on individual events (based on discrete metric), the Bank estimates the probability of such events as the basis for calculating the impairment charge.

3.4.6.2 Impairment triggers - retail portfolio

In the Bank's retail banking in Poland, a debtor-oriented approach, including all exposures of the customers, is applied for identification of impairment triggers. Transactional approach, in which each exposure is analyzed independently, is applied in the foreign branches.

The main impairment trigger is delay in repayment, which is identified in different ways depending on the abovementioned approach. In the retail banking in Poland, impairment trigger is identified, when the total of all customer's exposures past due more than 30 days exceeds PLN 500 and the eldest delay exceeds 90 days.

In the Czech and Slovak branches, an individual exposure is considered impaired when the overdue amount exceeds CZK 3000 or EUR 120, respectively, while the delay is more than 90 days.

Additionally, the following events are treated as impairment triggers in all branches:

a. enforced restructuring of debt,
b. bankruptcy of debtor,
c. recognition of the contract as fraudulent,
d. sale of the exposure with considerable economic loss,
e. uncollectable status of debt,
f. payout of low downpayment insurance.

3.4.6.3 Calculation of impairment losses and provisions - corporate portfolio

The intranet application IMPAIRMENT-KORPO is a tool used to calculate impairment losses for impaired exposures granted to corporate customers and banks. The classification of customers to default portfolio and calculation of impairment write-off is as follows:

a) identifying impairment indicator on individual basis (loss events) and if they exist, classifying a customer to a default category;

b) assessing estimated future cash flows (repayments) both from collateral and from repayments by a customer;

c) calculating impairment losses taking into account the current amount of estimated future recovery discounted at the effective interest rate;

d) booking of impairment losses and provisions.

In the case of customers with evidence for impairment, a comparison of the carrying value of the gross credit exposure with the value of estimated future cash flows, discounted at the original effective interest rate is made. An impairment is recognized when the discounted value of future cash flows is lower than the gross carrying amount. This results in the impairment charge for balance sheet credit exposure and/or provision for off-balance sheet credit exposure.

Otherwise, impairment is not recognized and the exposure is classified to the IBNR (Incurred But Not Reported loss) portfolio, covered by a group provision. IBNR group charge for this portfolio is created in the amount of 5% of the gross carrying amount.

3.4.6.4 Calculation of IBNR provision for portfolio with no evidence for impairment - corporate portfolio

The amount of provision is an estimate of incurred loss and is assumed at the expected level of exposure at the impairment date, considering the book value of loss (in percentage terms) and the probability of default.

The probability of disclosure of a loss is modelled using logistic regression based on financial indicators and qualitative data on financed entity. The model is calibrated on the Bank's internal data, comprising a several years' period of observation of the corporate portfolio. On the basis of the monitoring period existing in the Bank, it was estimated that 6-8 months (depending on the size of the company) is the average period between the loss event occurrence and the possibility of its identification by the Bank (loss identification period "LIP"). Therefore, the Bank performs calculations on the basis of 6-8-month horizon for probability of default obtained via scaling the original 12-month PD-rating coming from the corporate PD model. The value of incurred loss is assumed at the level of the expected value of exposure in case of default (EAD) multiplied by PD and LGD.

In the opinion of the Management Board, the profile of the corporate rating system as a model sensitive to changes in economic cycle (Point-in-Time) as well as recognition of interim financial data and warning indicators as rating assessment drivers should ensure adequate reflection of the amounts of the calculated portfolio provision to the changing market environment.

3.4.6.5 Calculation of impairment losses and provisions - retail portfolio

In the retail area, impairment charges and provisions are determined for the portfolio exposure both with evidence for impairment and with no evidence for impairment. For the purpose of measuring impairment in the retail area, the Bank applies two approaches for determining credit risk parameters. In the case of the Polish market, the Bank applies parameters analogous to those derived from the AIRB methodology (advanced internal ratings based approach for calculating capital requirement for credit risk), after necessary adjustments aimed at elimination of differences between AIRB and IAS-39. In the case of the Czech and Slovak markets, risk parameters are estimated based on migration matrices.

12-month loss identification period (LIP) based on the current internal data on banking processes and abilities to detect the incurred losses is applied in the retail area to estimate the probability of default.

3.4.6.6 Provision coverage of individual sub-portfolios

The table below shows the percentage of the Bank's balance sheet and off-balance sheet items relating to loans and advances, guarantees and other financial facilities to individuals, corporate entities an public sector and the coverage of the exposure with impairment provision for each of the Bank's internal rating categories (the description of rating model is included in Note 3.4.4).

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Sub-portfolio	31.12.2016		31.12.2015	
	Exposure (%)	Provision coverage (%)	Exposure (%)	Provision coverage (%)
1	13.83	0.01	4.80	0.02
2	35.68	0.05	41.62	0.04
3	19.39	0.17	17.58	0.15
4	20.52	0.36	23.56	0.29
5	4.47	1.05	5.02	0.98
6	0.26	2.42	0.42	2.20
7	0.57	4.77	1.50	4.15
8	0.08	1.24	1.21	0.02
Default category	5.20	54.56	4.29	57.08
Total	**100.00**	**3.04**	**100.00**	**2.68**

As at 31 December 2016, 49.51% of the loans and advances portfolio for balance sheet and off-balance sheet exposures is categorized in the top two grades of the internal rating system (31 December 2015: 46.42%).

A distribution of share of exposures for non-default portfolios remained without significant changes compared to 2015. The share of provision coverage for default portfolio slightly decreased (from 57.08% to 54.56%), mainly in corporate segment.

3.4.6.7 Repossessed collateral

The Bank classifies repossessed collaterals as assets repossessed for debt and measures them in accordance with the adopted accounting policies described in paragraph 2.18. Repossessed collaterals classified as assets held for sale shall be put up for sale on an appropriate market and sold at the soonest possible date. The process of selling collaterals repossessed by the Bank is arranged in line with the policies and procedures specified by the Debt Restructuring and Collection Department and the Retail Debt Restructuring and Collection Department for individual types of repossessed collaterals. In 2016 and 2015, the Bank did not have any repossessed collaterals that were difficult to sell.

3.4.7. mBank Forbearance Policy

Definition

The mBank's forbearance policy is a set of activities relating to negotiation and restructuration of terms of loan agreements which is defined by internal regulations.

The Bank offers forbearance to assist customers, who are temporarily in financial distress and are unable to meet their original contractual repayment terms, through agreements with less restrictive terms of repayment, without which financial difficulties would prevent satisfactory repayment under the original terms and conditions of the contract. These agreements may be initiated by the customer or the Bank entities and include e.g. debt restructuring, new repayments schedule and capital repayments deferrals with interest repayments kept.

The Bank does not consider loans with modified terms as falling under the forbearance policy in the case when changes result from the customer's application and there are no current or anticipated customer's financial difficulties, and, in addition, modifications of the contract meet the criteria of decision-making policy for a healthy portfolio.

The type of concession offered should be appropriate to the nature and the expected duration of the customer's financial distress. The Bank's belief in the customer's willingness and ability to repay the loan is necessary to conclude an agreement. Prior to granting a concession, an assessment of its impact on improving customer's ability to repay the loan is carried out.

The Bank renegotiates loan agreements with customers in financial difficulties to maximise possibility of receivables repayment and minimise the risk of default (situation when client fails to fulfil his contractual obligation).

Exposures with modified terms and conditions under forbearance policy (hereinafter - forborne exposures) are subject to regulatory and internal reporting.

Instruments used

The Bank maintains open communication with clients in order to detect any financial difficulties as early as possible and to know the reasons of such difficulties. In case of retail customers with temporary financial difficulties forbearance solutions focus on temporary reductions of contractual payments in form of capital repayments suspension with only interest repayments kept.

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For customers under long term financial distress extension of contractual repayment schedule may be offered which can include instalments reduction.

In case of debt refinancing, as a rule, client is reclassified into the default category.

For the corporate clients in financial distress, as part of the business support process, the Bank offers concessions, starting from participating in debt standstills and finishing on debt restructuring agreements. Debt restructuring agreements may improve Bank's security by replacing open financing (overdraft) with factoring or invoice discount and they can waive or ease covenants (additional conditions included in the primary agreement), if it represents optimal strategy for client's business continuity.

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

- Loan increase,
- Deferral of scheduled repayments,
- Maturity extension/extension of loan duration,
- Restructuring (medium or long term refinancing),
- Capitalization of interest,
- Interest deferrals,
- Principal deferrals,
- Covenant waiver,
- Standstills.

Risk management

Forbearance activities have been an integral part of Bank's risk management area for many years. Forbearance portfolios are subject to regular review and reporting to the area management. The effectiveness of undertaken actions, regularity of restructured transactions' service in respect of types of product and client's segment are subject to assessment. The risk analysis of retail forbearance portfolio is based on portfolio approach and corporate portfolio analysis is based on individual approach.

In corporate banking, the concession granting process is accompanied by impairment test. Recognition of impairment results in client being taken over by the specialised unit dedicated to restructuring. All loans granted to clients being served by restructuring unit have the forbearance status. Clients without impairment, who received the concession, are subject to close monitoring (Watch List – WL) by all units involved in the loan granting process. Their financial situation is subject to close monitoring and they are under constant review to establish whether any of impairment indicators had materialised.

The Bank does not use dedicated models to determine level of IBNI provision and impairment provision for forbearance portfolio.

Forbearance exit conditions

The Bank ceases to recognise the product as forborne if all of the following conditions are met:

- the agreement is recognised as performing,
- debtor financial situation's analysis showed improvement,
- two years after recognising exposure as performing have passed,
- at least from the middle of the probation period regular capital or interest payments have been made (lack of delays in repayment longer than 31 days) according to the schedule set at the moment of concession granting,
- none of the debtor exposures is overdue more than 31 days in the amount of more than PLN 500.

Portfolio characteristic

The table below presents changes in the carrying value of the forborne exposures in 2016.

31.12.2016	Gross carrying amount	Of which defaulted	Provisions created	Net value
As at 31.12.2015	**1 851 027**	**1 159 631**	**622 652**	**1 228 375**
Outputs	(566 915)	(516 826)	(314 980)	(251 935)
New forbearance	294 587	152 365	66 258	228 329
Changes on existing loans	(44 132)	(13 217)	24 736	(68 868)
As at 31.12.2016	**1 534 567**	**781 953**	**398 666**	**1 135 901**

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31.12.2015	Gross carrying amount	Of which defaulted	Provisions created	Net value
As at 31.12.2014	**1 945 585**	**1 551 974**	**710 353**	**1 235 232**
Outputs	(396 636)	(337 346)	(186 920)	(209 716)
New forbearance	441 931	156 103	71 322	370 609
Changes on existing loans	(139 853)	(211 100)	27 897	(167 750)
As at 31.12.2015	**1 851 027**	**1 159 631**	**622 652**	**1 228 375**

Forbearance portfolio as at 31 December 2016

31.12.2016	Gross carrying amount	Of which defaulted	Provisions created	Net value
Loans and advances to banks	-	-	-	-
Loans and advances to customers, including:	1 534 567	808 387	398 666	1 135 901
Loans to individuals:	747 806	214 766	76 275	671 531
- Current accounts	48 261	7 739	2 580	45 681
- Term loans, including:	699 545	207 027	73 695	625 850
housing and mortgage loans	616 865	142 209	45 815	571 050
Loans to corporate clients:	786 761	593 621	322 391	464 370
corporate & institutional enterprises	402 874	258 838	83 683	319 191
medium & small enterprises	383 887	334 783	238 708	145 179
Loans and advances to public sector	-	-	-	-
Total	**1 534 567**	**808 387**	**398 666**	**1 135 901**

Forbearance portfolio as at 31 December 2015

31.12.2015	Gross carrying amount	Of which defaulted	Provisions created	Net value
Loans and advances to banks	-	-	-	-
Loans and advances to customers, including:	1 851 027	1 159 631	622 652	1 228 375
Loans to individuals:	694 456	187 684	69 767	624 689
- Current accounts	52 130	5 871	2 472	49 658
- Term loans, including:	642 326	181 813	67 295	575 031
housing and mortgage loans	513 689	116 469	36 390	477 299
Loans to corporate clients:	1 156 571	971 947	552 885	603 686
corporate & institutional enterprises	572 641	436 131	244 645	327 996
medium & small enterprises	583 930	535 816	308 240	275 690
Loans and advances to public sector	-	-	-	-
Total	**1 851 027**	**1 159 631**	**622 652**	**1 228 375**

The share of credit forbearance portfolio constitutes 2.05% (2015: 2.45%) of the whole portfolio. The most of forbearance portfolio (53%) is defaulted (2015: 63%). Default portfolio is covered in 49% by the special-purpose provision (2015: 54%) and furthermore the risk of lack of payment is mitigated by collaterals taken in the nominal amount of PLN 1.00 billion, the same value as in 2015).

Forborne exposures by type of concession as at 31 December 2016

31.12.2016 Type of concession	Gross carrying amount	Of which defaulted	Provisions created	Net value
Refinancing	153 590	75 492	41 942	111 648
Modification of terms and conditions	1 380 977	732 895	356 724	1 024 253
Total	**1 534 567**	**808 387**	**398 666**	**1 135 901**

Forborne exposures by type of concession as at 31 December 2015

31.12.2015 Type of concession	Gross carrying amount	Of which defaulted	Provisions created	Net value
Refinancing	379 348	275 337	192 952	186 396
Modification of terms and conditions	1 471 679	884 294	429 700	1 041 979
Total	**1 851 027**	**1 159 631**	**622 652**	**1 228 375**

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Forborne exposures by geographical breakdown as at 31 December 2016

31.12.2016	Gross carrying amount	Of which defaulted	Provisions created	Net value
Poland	1 253 405	527 225	185 302	1 068 103
Other countries	281 162	281 162	213 364	67 798
Total	**1 534 567**	**808 387**	**398 666**	**1 135 901**

Forborne exposures by geographical breakdown as at 31 December 2015

31.12.2015	Gross carrying amount	Of which defaulted	Provisions created	Net value
Poland	1 424 609	733 213	366 884	1 057 725
Other countries	426 418	426 418	255 768	170 650
Total	**1 851 027**	**1 159 631**	**622 652**	**1 228 375**

Forborne, not impaired exposures by period of overdue as 31 December 2016

31.12.2016 Overdue period	Gross carrying amount	Of which defaulted	Provisions created	Net value
Not past due	588 816	3 909	33	588 783
Past due less than 30 days	110 312	1 642	3	110 309
Past due 31 - 90 days	27 147	2 477	167	26 980
Past due over 90 days	2 691	2 684	29	2 662
Total	**728 966**	**10 712**	**232**	**728 734**

Forborne, not impaired exposures by period of overdue as 31 December 2015

31.12.2015 Overdue period	Gross carrying amount	Of which defaulted	Provisions created	Net value
Not past due	578 603	4 357	4 295	574 308
Past due less than 30 days	92 479	4 490	2 478	90 001
Past due 31 - 90 days	18 411	11	616	17 795
Past due over 90 days	721	721	32	689
Total	**690 214**	**9 579**	**7 421**	**682 793**

Forborne, impaired exposures by period of overdue as at 31 December 2016

31.12.2016 Overdue period	Gross carrying amount	Of which defaulted	Provisions created	Net value
Not past due	134 612	127 911	36 114	98 498
Past due less than 30 days	38 982	38 156	8 518	30 464
Past due 31 - 90 days	29 784	29 384	11 948	17 836
Past due over 90 days	602 223	602 224	341 854	260 369
Total	**805 601**	**797 675**	**398 434**	**407 167**

Forborne, impaired exposures by period of overdue as at 31 December 2015

31.12.2015 Overdue period	Gross carrying amount	Of which defaulted	Provisions created	Net value
Not past due	385 886	380 315	200 536	185 350
Past due less than 30 days	47 575	43 235	11 104	36 471
Past due 31 - 90 days	36 698	35 848	17 434	19 264
Past due over 90 days	690 654	690 654	386 157	304 497
Total	**1 160 813**	**1 150 052**	**615 231**	**545 582**

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Forborne exposures by the industry as at 31 December 2016

31.12.2016 Sectors	Gross carrying amount	Of which defaulted	Provisions created	Net value
Forestry	220 378	220 378	164 622	55 756
Financial activities	313	313	16	297
Food sector	6 227	4 467	830	5 397
Construction	25 608	12 594	6 618	18 990
Other services activities	4	4	4	-
Scientific and technical activities	5 053	5 053	699	4 354
Electronics and household equipment	68 693	-	-	68 693
Power, power and heating distribution	2 108	2 108	659	1 449
Retail trade	6 183	6 183	2 979	3 204
Wholesale trade	51 908	37 409	28 840	23 068
Hotels and restaurants	51 364	43 950	2 395	48 969
Information and communication	15 605	15 603	13 871	1 734
Arts, entertainment	49 597	49 597	37 345	12 252
Metals	33 907	16 121	12 150	21 757
Health care	2 744	2 744	264	2 480
Fuels and chemicals	17 432	7 155	4 386	13 046
Industry	10 202	10 202	9 387	815
Real estate management	104 944	104 028	26 002	78 942
Agriculture	1 737	1 737	1 621	116
Textiles and clothing	881	881	44	837
Transport and logistics	6 057	3 024	558	5 499
Services	34 177	34 177	1 721	32 456
Municipal services	4 129	94	94	4 035
Other	815 316	230 565	83 561	731 755
Total	**1 534 567**	**808 387**	**398 666**	**1 135 901**

Forborne exposures by the industry as at 31 December 2015

31.12.2015 Sectors	Gross carrying amount	Of which defaulted	Provisions created	Net value
Forestry	231 521	215 010	161 051	70 470
Financial activities	1 837	423	89	1 748
Food sector	32 832	31 971	9 853	22 979
Construction	44 964	31 976	17 709	27 255
Scientific and technical activities	15 030	13 136	8 203	6 827
Education	1 714	1 316	81	1 633
Electronics and household equipment	96 706	5 980	6 876	89 830
Power, power and heating distribution	100 013	100 013	25 876	74 137
Retail trade	82 086	62 017	22 189	59 897
Wholesale trade	84 844	50 527	38 909	45 935
Hotels and restaurants	65 051	53 027	6 998	58 053
Information and communication	65 647	63 792	33 316	32 331
Arts, entertainment	47 718	47 303	35 451	12 267
Metals	207 192	205 038	157 336	49 856
Health care	4 720	4 513	614	4 106
Fuels and chemicals	13 390	7 631	4 288	9 102
Other manufactoring	13 583	12 612	6 764	6 819
Real estate management	45 495	29 846	10 548	34 947
Agriculture	3 799	3 788	3 320	479
Textiles and clothing	5 156	3 353	947	4 209
Transport and logistics	10 410	6 295	2 980	7 430
Services	62 860	56 831	16 098	46 762
Municipal services	257	197	116	141
Other	614 202	153 036	53 040	561 162
Total	**1 851 027**	**1 159 631**	**622 652**	**1 228 375**

3.4.8 Counterparty risk that arises from derivatives transactions

The credit exposure on mBank portfolio from derivatives transactions is calculated as the sum of the replacement cost for each transaction (which is its current net present value - NPV) and its estimated future potential exposure (Add-on). Moreover bank uses credit mitigation techniques such as netting and collateralization. Therefore netting is taken into account if there are close-out netting agreements in place, whereas CSA agreements are required to collateralize the exposure. CSAs allow for variation margin to be called if current valuation of the portfolio exceeds the predefined level (threshold). Therefore, credit exposure of the derivatives portfolio is adjusted appropriately based on whether the collateral is paid or received and in accordance with the binding agreements.

Credit exposure control is performed through an integrated system and in real time. In particular the level of the allocated credit exposure limit usage is monitored and checked intraday. Credit exposure limits are subject to limit decomposition into different products and maturities. In case of central clearing houses additionally posted types of collateral (initial margin, default fund) have been taken into account.

The decomposition of the mBank credit exposure of the derivatives portfolio based on the counterparty type is as follows:

- 37% banks,
- 33% central clearing houses (CCP),
- 21% corporates,
- 9% financial institutions.

The decomposition of the mBank credit exposure of the derivatives portfolio based on client type is as follows:

Client type	Credit exposure 2016 (PLN mln)	Credit exposure 2015 (PLN mln)
Bank CSA	1 267	1 608
Bank uncollateralized	93	226
CCP	1 242	445
Corpo collateralized	(8)	(12)
Corpo limit	794	670
Non-Bank Financial Institution	324	254
Private Banking	0	(1)

Compared to the end of year 2015 there was a significant increase in credit exposure with central counterparties (CCP): 31 December 2016 PLN 1 242 million (31 December 2015: PLN 445 million). This is a result of EMIR regulation (clearing obligation).

Total counterparty risk exposures for mBank of the derivatives portfolio decomposed into current NPV and add-on has been depicted below:

(PLN m)	Banks		CCP		Corporates and other customers	
	2016	2015	2016	2015	2016	2015
NPV	56.31	107.20	0.07	0.09	321.96	246.06
add-on	1 303.79	1 726.76	1 241.97	444.84	828.70	695.21
collateral	(38.95)	(1.35)	(99.21)	(14.26)	41.06	30.28

In order to reflect credit risk embedded in derivative instruments, the Bank uses correction to fair value that takes into account the element of credit risk of the counterparty. Write off due to credit risk of contractor is based on expected loss until maturity of the contract and is calculated at the level of Bank in accordance with the adopted CVA/DVA methodology. The amount of the correction is then allocated to individual transactions. The value of this correction is included in income statement in net trading income.

The table below presents the percentage of derivatives with the correction due to credit risk of the counterparty, which constitute the component of financial assets in the total carrying value for each of the Bank's internal rating categories (the rating model is described under Note 3.4.4).

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Sub-portfolio	31.12.2016		31.12.2015	
	Fair value %	Provision coverage (%)	Fair value %	Provision coverage (%)
1	47.22	0.12	29.39	0.17
2	30.84	0.18	34.04	0.10
3	6.37	2.70	29.42	0.53
4	12.71	0.50	3.03	1.63
5	1.20	2.58	3.05	0.74
6	0.07	1.42	0.03	4.21
7	1.31	0.54	0.03	3.11
8	0.09	0.00	1.00	0.05
Default category	0.19	2.02	0.01	5.53
Total	**100.00**	**0.39**	**100.00**	**0.31**

3.5. Debt Instruments: treasury bonds and other eligible debt securities

31 December 2016	Trading securities			Investment debt securities	Total
Rating	Government bonds	Treasury bills	Other debt securities		
AAA	-	-	2 884	1 987 820	1 990 704
AA- to AA+	-	-	-	-	-
A- to A+	3 503 029	-	19 034	27 609 198	31 131 261
BBB+ to BBB-	-	-	83 867	372 290	456 157
BB+ to BB-	-	-	144 822	340 024	484 846
B+ to B-	-	-	21 395	21 601	42 996
Lower than B-	-	-	-	-	-
Unrated	-	-	59 072	85 764	144 836
Total	**3 503 029**	**-**	**331 074**	**30 416 697**	**34 250 800**

31 December 2015	Trading securities			Investment debt securities	Total
Rating	Government bonds	Treasury bills	Other debt securities		
AAA	-	-	-	46 353	46 353
AA- to AA+	-	-	-	827 919	827 919
A- to A+	178 492	-	24 313	28 164 873	28 367 678
BBB+ to BBB-	-	-	225 565	399 673	625 238
BB+ to BB-	-	-	128 406	361 620	490 026
B+ to B-	-	-	-	-	-
Lower than B-	-	-	-	-	-
Unrated	-	-	-	-	-
Total	**178 492**	**-**	**378 284**	**29 800 438**	**30 357 214**

96.70% of the investments in debt securities is rated at least on A- credit rating (31 December 2015: 96.33%).

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

Geographic concentration risk

In order to actively manage the risk of concentration by country, the Bank:

- complies with the formal procedures aimed at identifying, measurement and monitoring this risk,
- complies with the formal limits mitigating the risk by country and the procedures to be followed when the limits are exceeded,
- uses a management reporting system, which enables monitoring the risk level by country and supports the decision-making process related to management,
- maintains contacts with a selected group of the largest banks with good ratings, which are active in handling foreign transactions. On some markets, where the risk is difficult to estimate, the Bank avails itself of the services of its foreign correspondent banks, e.g. Commerzbank, and insurance in the Export Credit Insurance Corporation ("KUKE"), which covers the economic and political risk.

As at 31 December 2016 there was no substantial level of geographical concentration in the credit portfolio of mBank. In terms of exposure relating to countries other than Poland there was no substantial share of impaired exposures.

Sector concentration risk

mBank analyses the sector concentration risk in order to build mBank's corporate portfolio in a safe and effective way.

Monitoring and analysis covers all the sectors in which the Bank's exposure exceeds 5% of the total amount of exposures at the end of a given reporting period, and sectors additionally indicated by the Chief Risk Officer.

The Bank manages industrial concentration risk determining industrial limits. Unless the Corporate and Investment Banking Risk Committee (KRK) decides otherwise, an industrial limit for any sector is set for on a level not higher than:

- 12% of the gross loan portfolio in the prior reporting period for low risk sectors;
- 10% of the gross loan portfolio in the prior reporting period for medium risk sectors;
- 5% of the gross loan portfolio in the prior reporting period for high risk sectors.

In the case of exceeding any industrial limit or an expectation that such a limit may be exceeded in the next reporting period, activities preventing the exceeding of limits are implemented and any decision in this regard shall be taken by the KRK.

The table below presents the structure of concentration of mBank exposures in particular sectors:

The structure of concentration of carrying amounts of exposure of mBank S.A.:

No.	Sectors	Principal exposure (in PLN thousand)	%	Principal exposure (in PLN thousand)	%
		31.12.2016		31.12.2015	
1.	Household customers	44 707 271	59.79	43 796 808	59.24
2.	Financial activities	9 709 323	12.99	8 698 555	11.77
3.	Wholesale trade	2 738 578	3.66	2 580 864	3.49
4.	Real estate management	1 974 407	2.64	1 543 899	2.09
5.	Retail trade	1 820 515	2.43	1 931 620	2.61
6.	Construction	1 666 719	2.23	1 421 763	1.92
7.	Food sector	1 469 607	1.97	1 423 773	1.93
8.	Fuels and chemicals	1 185 495	1.59	1 362 047	1.84
9.	Power, power and heating distribution	1 106 462	1.48	1 434 958	1.94
10.	Metals	990 655	1.32	934 208	1.26
11.	Information and communication	966 282	1.29	870 952	1.18
12.	Forestry	954 506	1.28	1 170 058	1.58
13.	Public administration	829 675	1.11	1 062 693	1.44
14.	Transport and logistics	549 292	0.73	762 754	1.03
15.	Services	547 545	0.73	221 874	0.30
16.	Motorization	352 321	0.47	385 523	0.52
17.	Electronics and household equipment	341 724	0.46	421 591	0.57
18.	Industry	308 628	0.41	355 447	0.48
19.	Mining	302 855	0.41	395 697	0.54
20.	Scientific and technical activities	287 648	0.38	235 359	0.32
21.	Municipal services	270 312	0.36	208 654	0.28
22.	Hotels and restaurants	213 363	0.29	182 856	0.25
23.	Arts, entertainment	102 747	0.14	244 745	0.33

As at 31 December 2016, the total exposure of the Bank in the above sectors (excluding household customers) amounted to 38.37% of the credit portfolio (31 December 2015 – 37.67%).

The risk of investing in these sectors (in a 3-point scale, i.e., low, medium, high) as at the end of 2016 and 2015 was estimated by the mBank's sector analysts according to the following table.

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No.	Sectors	31.12.2016	31.12.2015
1.	Financial activities	medium	medium
2.	Wholesale trade	medium	medium
3.	Real estate management	medium	medium
4.	Retail trade	medium	medium
5.	Construction	medium	medium
6.	Food sector	medium	medium
7.	Fuels and chemicals	medium	medium
8.	Power, power and heating distribution	medium	medium
9.	Metals	high	high
10.	Information and communication	medium	medium
11.	Forestry	medium	medium
12.	Public administration	low	low
13.	Transport and logistics	medium	medium
14.	Services	medium	medium
15.	Motorization	medium	medium
16.	Electronics and household equipment	medium	medium
17.	Industry	medium	medium
18.	Mining	high	high
19.	Scientific and technical activities	medium	medium
20.	Municipal services	medium	medium
21.	Hotels and restaurants	medium	medium
22.	Arts, entertainment	high	high

Large exposures concentration risk

The purpose of management of the large exposures concentration risk is an ongoing monitoring of the level of limits set by the CRR Regulation. In order to ensure safety against the risk of exceeding the regulatory limits in mBank:

- internal limits, lower than those specified in the CRR Regulation, are set,
- daily monitoring of large exposures is carried out and the participants of the lending and investment processes are immediately informed in the case of internal limits exceeding.

These activities have a direct impact on the Bank's decisions concerning new exposures and the increase of existing exposures to customers and groups of affiliated customers.

mBank pays particular attention to the correct identification of the scale of risk of significant credit exposures defined in the Bank's internal regulations. In the case of exceeding specified amount of exposure/limit to a customer/group of affiliated customers identified as bulk risk, the financing requires additional decision of the Bank's Management Board irrespective of the PD-rating and the decision-making level.

Bank monitors exposures to a customer or group of affiliated customers considered a large exposure limit ie. exposures after taking into account the effect of the credit risk mitigation (in accordance with art. 401-403 CRR Regulation) and exemptions (art. 390 paragraph. 6, Art. 400, Art. 493, paragraph. 3 CRR Regulation), which are equal or exceed 10% of the eligible capital. At the end of 2016 there was no exposure in line with the above definition.

3.7. Market risk

3.7.1 Organization of risk management

In the process of organisation of the market risk management, the Bank follows rules and requirements set forth in the KNF regulations and recommendations, in particular in Recommendations A and I.

The fundamental principle applied in the organisation of the market risk management in the Bank is the separation of risk control and monitoring functions from structures undertaking and operationally managing Bank's risk positions. Monitoring and controlling of the market risk is performed by the Financial Markets Risk Department (DRR) under supervision of the Vice-president of the Management Board (CRO), while the market risk positions are operationally managed by Financial Markets Department DFM), Own Transactions Division in Brokerage Bureau (BM_WTW) and Treasury Department (DS) reporting to the Vice-president of the Management Board – Head of Financial Markets. In H1 2016 mDom Maklerski was merged with mBank. As a result of the merger of units carrying out its operations focusing on financial instruments traded on the stock exchanges in both entities Own Transactions Division in Brokerage Bureau was established and replaced prevailing Brokerage Bureau. Increase of market risk measures caused by the merger was insignificant.

Debt Securities Issue Department (DCM) is responsible for debt issuance and managing of non-government debt securities in banking book. Moreover, the investment positions sensitive to market risk factors (e.g. prices of shares listed on the WSE) and positions in non-government debt securities are managed in the Structured and Mezzanine Finance Department (DFS). DCM and DFS are operating in the Corporate & Investment Banking area.

Market risk management is performed in a single process by the Financial Markets Risk Department (DRR), which is responsible for measurement of exposures to market risk of the Bank's front-office units portfolios by the use of market risk measures: Value at Risk (VaR) and stress tests. DRR is responsible for control of utilisation of the limits for these risk measures established by the Management Board and the Financial Markets Risk Committee (KRF) and provides daily and periodical reporting on the market risk exposure to managers of the Bank's front-office units, to the Financial Markets Risk Committee, and directly to the CRO. DRR develops also methodologies for market risk measurement, pre-settlement counterparty risk of derivative transactions and establishes valuation models for financial instruments. The models risk management process is under supervision of the Model Risk Committee.

Moreover, the Financial Markets Risk Department is responsible for calculation and reconciliation of financial results on transactions carried out by the front-office units and provides daily valuation of financial instruments to the Finance Area. The valuation of derivative transactions with the Bank's clients is also delivered to the business units responsible for managing clients (Corporate and Investment Banking area). Valuations prepared by DRR are the basis for managing collaterals for concluded transactions on derivative instruments.

DRR is responsible for the administration of the front-office IT systems, i.e. administration of users' access rights to the systems, parameterization in the systems of financial instruments, as well as counterparties and issuers and is responsible for market data input to the systems. DRR monitors utilization of counterparty limits (pre-settlement, settlement, issuer and country risk limits) and escalates if limits are exceeded. Moreover, DRR verifies the market conformity of the transactions concluded by the front-office units and supervises the process of modification and deletion of deals in the front-office systems.

3.7.2 Tools and measures

In the course of Bank's operations, the Bank is exposed to market risk, which is defined as a risk resulting from unfavourable change of the current valuation of financial instruments in the Bank's portfolios due to changes of the market risk factors, in particular interest rates, foreign exchange rates, stock share prices and indices, implied volatilities of relevant options and credit spreads.

The Bank identifies market risk primarily on the trading book positions valuated at fair value (either directly to market prices or via models) and as such may lead to losses reported in Bank's financial results. Furthermore, the Bank assigns market risk to its banking positions independently of the accounting rules of calculating financial results on these positions. In particular, in order to reflect the interest rate risk of the retail and corporate banking products with unspecified interest revaluation dates or rates administered by the Bank, the Bank uses the so-called replicating portfolio models. Bank presents active approach to capital management which resulted in case of market risk measurements in capital modelling within 5-year investment horizon. Market risk measures applicable to interest rate banking book positions are based on net present value (NPV) models.

Exposure to market risk is quantified by:

- measurement of the Value at Risk (VaR),
- measurement of expected loss under condition that this loss exceeds Value at Risk (ES – Expected Shortfall),
- measurement of the Value at Risk in stressed conditions (Stressed VaR),
- measurement of economic capital to cover market risk,
- stress tests scenario analyses.

The Value at Risk (VaR) is calculated using historical method on a daily basis for a 1-day and a 10-day holding period and a 95%, 97.5% and 99% confidence level. In this method, historical data concerning risk factors for last 254 business days are taken into consideration. From September 2015 measurement of the Value at Risk in stressed conditions was introduced. In case of this measure the calculation is analogous to Value at Risk calculation, but the only difference is in time of stressed conditions, which is marked out on the basis of 7-year series of Value at Risk based on following 12-months windows of risk factors changes from last 8 years. In 2016 it was a year which ended up in June 2009. This period is verified at least once a year.

The VaR methodology takes into account the following risk factors:

- interest rates,
- foreign exchange rates,
- shares prices and equity indices and its volatilities,
- credit spreads (to the extent reflecting market fluctuations of debt instruments prices, reflecting credit spread for corporate bonds, and spread between government yield curve and swap curve - for government bonds).

The expected loss under condition that it exceeds Value at Risk (ES) is calculated on the basis of daily VaR calculation as the average of six worst losses.

The economic capital for market risk is a capital to cover losses in the course of one year coming from changes in valuation of financial instruments which built Bank's portfolios and resulting from changes of prices and values of market parameters.

Stress tests are additional measures of market risk, supplementing the measurement of the Value at Risk, which show the hypothetical changes in the current valuation of the Bank's portfolios, which would take place as a result of realisation of the so-called stress scenarios – i.e. market situations at which the risk factors would reach specified extreme values, assuming static portfolio.

Stress tests consist of two parts: standard stress tests designated for standard risk factors: currency exchange rates, interest rates, stock prices and their volatility, as well as a stress test, which involves changes in credit spreads. In this way, there was addressed among others, the need for covering in stress tests analysis the independent effect of basis risk (the spread between interest rates on government bonds and IRS), which the Bank is exposed to, due to maintaining a portfolio of Treasury bonds.

Market risk, in particular interest rate risk of the banking book is also quantified by calculation of the Earnings at Risk (EaR) measure for the banking portfolio, which is described in chapter concerning interest rate risk.

In order to mitigate market risk exposure, by decision of the Supervisory Board (with respect to mBank Group portfolio), the Management Board (with respect to mBank portfolio) and the Financial Markets Risk Committee (with respect to business lines portfolios) limits on VaR at 97,5% confidence level for 1-day holding period and stress tests limits are established.

3.7.3 Risk measurement

Value at Risk, Expected Shortfall

In 2016, Bank's market risk exposure, as measured by the Value at Risk (VaR, for one day holding period, at 97.5% confidence level), was in relation to the established limits on moderate level. The average utilisation of VaR limit for Financial Markets Department (DFM), whose positions consist of trading book portfolios, amounted to 46% (PLN 2.5 million), for the Own Transactions Division in Brokerage Bureau (BM_WTW) 20% (PLN 0.2 million), while for the Treasury Department (DS), whose positions are classified solely to the banking book, it was 79% (PLN 33.3 million) for the positions without capital modelling and 60% (PLN 25.1 million) for the positions with capital modelling.

The average utilization of VaR limit for Debt Securities Issue Department (DCM) is 43% (PLN 0.8 million). The average utilisation of the VaR limit for the position of the Structured and Mezzanine Finance Department (DFS) accounted for 16% (PLN 8 thousand).

In 2016, the VaR figures for mBank's portfolio were driven mainly by portfolios of instruments sensitive to interest rates and separated credit spread – the banking book T-bonds portfolios managed by Treasury Department and the trading book portfolios and interest rate exchange positions managed by Financial Markets Department.

The DFM portfolios of instruments sensitive to changes in exchange rates like FX spots, currency options, as well as the exposure of BM_WTW to equity price risk and risk of implied volatility of options traded on the Warsaw Stock Exchange, had a relatively low impact on the Bank's risk profile.

mBank VaR and ES

The tables below present VaR and Expected Shortfall statistics for the Bank's portfolio.

PLN 000's	2016				2015			
	31.12.2016	Mean	Maximum	Minimum	31.12.2015	Mean	Maximum	Minimum
VaR IR	12 903	13 721	18 454	11 042	13 688	16 085	23 329	12 739
VaR FX	772	547	816	351	496	685	1 096	453
VaR EQ	199	214	791	62	79	5 170	6 588	67
VaR CS	21 249	21 172	30 150	19 856	26 320	23 916	26 345	20 426
VaR	**28 037**	**35 306**	**40 726**	**27 124**	**29 943**	**27 877**	**34 881**	**21 266**
ES	**42 093**	**42 983**	**49 041**	**38 046**	**40 007**	**37 576**	**45 102**	**28 954**

VaR IR – interest rate risk
VaR FX – currency risk
VaR EQ – equity risk
VaR CS – credit spread risk

Stressed Value at Risk

The new Value at Risk in stressed conditions was introduced from September 2015 (it is observed measure). The table below presents statistics of this measure for mBank for last quarter of 2015 and for 2016.

PLN 000's	2016				2015			
	31.12.2016	Mean	Maximum	Minimum	31.12.2015	Mean	Maximum	Minimum
Stressed VaR IR	45 288	43 671	50 339	36 293	37 742	35 742	39 293	31 053
Stressed VaR FX	2 339	1 363	2 655	576	1 338	1 376	2 933	516
Stressed VaR EQ	422	342	1 495	2	4	8 721	13 074	4
Stressed VaR CS	87 930	87 516	96 278	74 731	73 992	75 255	77 899	73 530
Stressed VaR	**124 833**	**119 771**	**130 662**	**105 462**	**103 060**	**111 038**	**116 945**	**102 035**

Economic capital for market risk

The average utilisation of limit on economic capital for market risk for mBank Group in 2016 amounted to 52% (PLN 681.5 million). The average level of economic capital for mBank was equal to PLN 668.9 million. As of end of 2016 the economic capital for market risk for mBank Group was PLN 783.0 million, and for mBank was PLN 767.3 million. For comparison, at the end of 2015 values of this measures were PLN 655.8 million and PLN 643.5 million, respectively.

Stress testing

The average utilisation of stress test limits for mBank Group in 2016 was 59% (PLN 797.2 million) for portfolio without capital modelling and 58% (PLN 788.1 million) for portfolio including capital modelling.

Average utilisation of stress test limits in mBank in 2016 amounted to 60% (PLN 776.6 million) for portfolio without capital modelling.

The average utilisation of the limits in 2016 for the Treasury Department portfolio without capital modelling was 69% (PLN 655.3 million) and 72% (PLN 692.0 million) including capital modelling. For the DFM portfolio the average utilisation was 37% (PLN 91.8 million), for BM_WTW portfolio 17% (PLN 1.3 million), for DCM portfolio 55% (PLN 33.2 million) and for DFS portfolio 33% (PLN 232 thousand). The most significant part of presented stress test values constitutes credit spread stress test for government bonds portfolio because stress test scenarios include scenario in which credit spreads increase on average by 100 bps.

The table below presents utilisation of stress test for mBank in 2016 in comparison to 2015 (without capital modelling).

PLN million	2016				2015			
	31.12.2016	Mean	Maximum	Minimum	31.12.2015	Mean	Maximum	Minimum
Base ST	97	82	120	20	74	107	134	68
CS ST	752	695	782	623	640	689	770	611
Total ST	**849**	**777**	**892**	**656**	**714**	**796**	**900**	**699**

Base stress test – standard stress test
CS stress test – stress test for credit spread scenarios
Total stress test – total stress test (sum of standard stress test and stress test for credit spread scenarios).

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3.8. Currency risk

The Bank is exposed to changes in currency exchange rates due to its financial assets and liabilities other than PLN. The following tables present the exposure of the Bank to currency risk as at 31 December 2016 and 31 December 2015. The tables below present assets and liabilities of the Bank at balance sheet carrying amount, for each currency.

31.12.2016	PLN	EUR	USD	CHF	CZK	Other	Total
ASSETS							
Cash and balances with the Central Bank	5 823 151	2 276 894	30 065	8 197	996 597	23 847	**9 158 751**
Loans and advances to banks	5 277 251	1 585 741	271 818	9 005	86 169	78 785	**7 308 769**
Trading securities	3 837 606	-	-	-	-	-	**3 837 606**
Derivative financial instruments	1 294 257	386 238	34 762	90 807	2 199	10 043	**1 818 306**
Loans and advances to customers	37 011 311	11 446 065	1 378 666	19 085 388	3 246 761	135 940	**72 304 131**
Investment securities	28 780 082	941 402	38 392	-	707 904	-	**30 467 780**
Investments in subsidiaries	1 779 371	2 848	-	-	-	-	**1 782 219**
Intangible assets	539 421	388	-	-	643	-	**540 452**
Tangible fixed assets	470 516	5 283	-	-	5 896	-	**481 695**
Other assets, including tax assets	470 764	13 109	1 382	485	29 811	5	**515 556**
Total assets	**85 283 730**	**16 657 968**	**1 755 085**	**19 193 882**	**5 075 980**	**248 620**	**128 215 265**
LIABILITIES							
Amounts due to the Central Bank	-	-	-	-	-	-	**-**
Amounts due to other banks	1 197 491	911 791	212 237	6 181 492	-	3	**8 503 014**
Derivative financial instruments and other trading liabilities	1 353 562	251 361	29 249	-	-	10 078	**1 644 250**
Amounts due to customers	65 672 603	23 087 202	2 342 800	1 468 984	5 796 818	591 913	**98 960 320**
Hedge accounting adjustments related to fair value of hedged items	-	74 745	-	12 414	407	-	**87 566**
Other liabilities including tax liabilities	1 658 518	63 213	78 685	3 709	59 241	6 949	**1 870 315**
Provisions	173 007	7 939	698	349	654	1	**182 648**
Subordinated liabilities	1 263 940	-	-	2 679 409	-	-	**3 943 349**
Total liabilities	**71 319 121**	**24 396 251**	**2 663 669**	**10 346 357**	**5 857 120**	**608 944**	**115 191 462**
Net on-balance sheet position	**13 964 609**	**(7 738 283)**	**(908 584)**	**8 847 525**	**(781 140)**	**(360 324)**	**13 023 803**
Loan commitments and other commitments	**18 952 354**	**1 814 812**	**461 548**	**338**	**366 855**	**5 183**	**21 601 090**
Guarantees, banker's acceptances, documentary and commercial letters of credit	**4 433 584**	**7 829 008**	**182 679**	**823 460**	**84 616**	**20 307**	**13 373 654**

31.12.2015	PLN	EUR	USD	CHF	CZK	Other	Total
ASSETS							
Cash and balances with the Central Bank	5 574 275	158 265	47 965	14 535	78 932	56 639	**5 930 611**
Loans and advances to banks	2 820 660	1 762 378	235 417	732	107 010	55 124	**4 981 321**
Trading securities	558 590	-	-	-	-	-	**558 590**
Derivative financial instruments	2 911 503	330 983	48 001	56 263	3 996	-	**3 350 746**
Loans and advances to customers	35 910 767	11 220 234	1 534 571	19 630 704	2 845 762	142 064	**71 284 102**
Hedge accounting adjustments related to fair value of hedged items	-	-	-	-	130	-	**130**
Investment securities	28 292 518	862 205	-	-	827 919	-	**29 982 642**
Investments in subsidiaries	1 756 059	2 188	-	-	-	-	**1 758 247**
Intangible assets	472 773	261	-	-	782	-	**473 816**
Tangible fixed assets	475 476	3 592	-	-	5 799	-	**484 867**
Other assets, including tax assets	298 854	1 832	5 899	-	3 707	6	**310 298**
Total assets	**79 071 475**	**14 341 938**	**1 871 853**	**19 702 234**	**3 874 037**	**253 833**	**119 115 370**
LIABILITIES							
Amounts due to the Central Bank	-	-	-	-	-	-	**-**
Amounts due to other banks	2 361 649	545 290	198 567	9 069 323	61	8 301	**12 183 191**
Derivative financial instruments and other trading liabilities	2 946 703	194 202	63 013	-	-	-	**3 203 918**
Amounts due to customers	61 768 572	16 246 078	1 707 708	1 319 760	4 577 142	304 891	**85 924 151**
Hedge accounting adjustments related to fair value of hedged items	-	57 142	-	20 659	767	-	**78 568**
Other liabilities including tax liabilities	1 236 825	76 633	62 356	3 501	42 205	9 016	**1 430 536**
Provisions	219 399	4 614	695	354	280	2	**225 344**
Subordinated liabilities	1 263 940	-	-	2 563 375	-	-	**3 827 315**
Total liabilities	**69 797 088**	**17 123 959**	**2 032 339**	**12 976 972**	**4 620 455**	**322 210**	**106 873 023**
Net on-balance sheet position	**9 274 387**	**(2 782 021)**	**(160 486)**	**6 725 262**	**(746 418)**	**(68 377)**	**12 242 347**
Loan commitments and other commitments	**17 205 395**	**1 387 865**	**460 708**	**-**	**330 750**	**19 845**	**19 404 563**
Guarantees, banker's acceptances, documentary and commercial letters of credit	**3 747 517**	**5 409 553**	**160 952**	**787 880**	**82 392**	**19 590**	**10 207 884**

3.9. Interest rate risk

In the process of managing interest rate risk of the banking book, the risk monitoring and control functions are performed by the Financial Markets Risk Department supervised by the Vice-president of the Management Board (CRO), whereas operational management of risk positions takes place in the Treasury Department supervised by the Vice-president of the Management Board, Head of Financial

Markets. This way the Bank ensures independence of risk measurement, monitoring and control functions from operational activity, which gives rise to the positions taken by the bank.

Interest rate risk of the banking book results from the exposure of the bank's interest income and capital to adverse change in the levels of interest rates. Guided by the KNF recommendations, in particular Recommendation G, the Bank monitors the banking book structure in terms of repricing gap as well as basis risk, yield curve risk and customer option risk.

The basic measures used to control interest rate risk in the banking book are

- the repricing gap (difference between assets, liabilities and off-balance banking book positions, measured in defined repricing buckets, based on next potential interest rate change of interest rate sensitive products), and
- the net interest earnings exposed to risk (EaR - Earnings at Risk – potential decrease of interest income in one year horizon due to unfavourable change of market interest rates. The measure assumes constant volume and structure of banking book, constant construction of interest rate, constant interest margin and parallel shift of the yield curve. EaR is calculated for 5 main currencies - PLN, CHF, EUR, CZK, USD).

Moreover, the Bank performs also stress test analyses aimed to estimate the impact of adverse interest rate fluctuations on net interest earnings and the economic value of the banking portfolio. Interest rate risk of the banking book is also quantified using market risk measures: Value at Risk (VaR) and stress tests.

Exposure to interest rate risk is limited for the banking portfolio by means of repricing gap limits (management action triggers) and market risk limits imposed on the value at risk (VaR) and stress tests. The utilisation of all those limits is monitored and controlled on a daily basis.

Interest income subject to risk

As of 31 December 2016 and 31 December 2015, a sudden, permanent and unfavourable shift of market interest rates by 100 basis points for all maturities would result in decrease in the interest income within 12 months after the year-end date by the following amounts.

(PLN mln)	2016				2015			
	31.12.2016	Mean	Maximum	Minimum	31.12.2015	Mean	Maximum	Minimum
PLN	171.8	78.3	180.0	34.7	99.4	55.4	122.2	8.4
USD	9.3	7.5	13.8	1.2	3.7	2.4	7.5	0.7
EUR	64.9	70.6	142.3	50.2	52.5	37.3	63.1	0.0
CHF	0.0	4.1	21.6	0.0	2.4	8.1	38.8	0.0
CZK	3.1	4.1	7.5	2.4	2.7	2.3	4.8	1.3

To calculate these values, the Bank assumed that the structure of financial assets and liabilities disclosed in the financial statements as of above indicated dates would be fixed during the year and the Bank would not take any measures to change related exposure to interest rate change risk. In calculation there were included positions resulted from modelling of repricing period according to replicating portfolio method.

Stress tests

The Bank runs also other analyses of the changes of the economic value of the banking book under stress test scenarios. Under the stress test, which assumes unfavourable shift of the interest rates for respective currencies by 200 bps, the economic value of the banking book at the end of 2016 would change by PLN 658.1 million (at the end of 2015: PLN 497.9 million). During the calculation of these values no correlation between currencies was taken into account and it was assumed that clients interest rates cannot fall below 0.

Important position in banking portfolio, in respect of fair value calculations, is debt securities portfolio in PLN (NBP bills, Polish Treasury bonds and bills). Interest rate risk of this portfolio is calculated additionally using stress test methodology (described above in p. 3.7). The methodology includes changes of market interest rates scenarios as well as credit spread, which in case of treasury debt securities may reflect basis risk (spread changes between government and swap curve).

mBank S.A. interest rate risk

The following tables present the Bank's exposure to interest rate risk. The tables present the Bank's financial instruments at carrying amounts, categorised by the earlier of: contractual repricing or maturity dates.

IFRS Financial Statements 2016 PLN (000's)

31.12.2016	Up to 1 month	1-3 months	3-12 months	1-5 years	More than 5 years	Non-interest bearing	Total
ASSETS							
Cash and balances with the Central Bank	2 780 247	-	-	-	-	6 378 504	**9 158 751**
Loans and advances to banks	3 725 356	2 718 995	681 593	-	-	182 825	**7 308 769**
Trading securities, investment securities and investments in subsidiaries	8 911 865	385 958	3 432 026	20 543 861	980 593	1 833 302	**36 087 605**
Loans and advances to customers	57 229 062	9 657 163	2 320 435	2 868 525	522	228 424	**72 304 131**
Other assets and derivative financial instruments	268 398	360 343	505 176	425 380	54 179	572 626	**2 186 102**
Total assets	**72 914 928**	**13 122 459**	**6 939 230**	**23 837 766**	**1 035 294**	**9 195 681**	**127 045 358**
LIABILITIES							
Amounts due to the Central Bank	-	-	-	-	-	-	**-**
Amounts due to other banks	3 554 311	4 947 423	-	-	-	1 280	**8 503 014**
Amounts due to customers	74 272 306	9 901 491	8 169 140	6 379 866	171 284	66 233	**98 960 320**
Subordinated liabilities	1 465 581	1 977 101	500 667	-	-	-	**3 943 349**
Other liabilities and derivative financial instruments	232 336	324 483	579 944	348 361	47 808	1 904 058	**3 436 990**
Total liabilities	**79 524 534**	**17 150 498**	**9 249 751**	**6 728 227**	**219 092**	**1 971 571**	**114 843 673**
Total interest repricing gap	**(6 609 606)**	**(4 028 039)**	**(2 310 521)**	**17 109 539**	**816 202**		

31.12.2015	Up to 1 month	1-3 months	3-12 months	1-5 years	More than 5 years	Non-interest bearing	Total
ASSETS							
Cash and balances with the Central Bank	2 551 372	-	-	-	-	3 379 239	**5 930 611**
Loans and advances to banks	2 360 752	1 990 616	446 067	10 056	-	173 830	**4 981 321**
Trading securities, investment securities and investments in subsidiaries	11 192 757	407 071	4 410 636	13 451 704	1 215 110	1 622 201	**32 299 479**
Loans and advances to customers	55 940 216	9 683 037	2 038 208	3 213 216	226 071	183 354	**71 284 102**
Other assets and derivative financial instruments	474 124	654 067	1 191 765	679 005	101 110	529 694	**3 629 765**
Total assets	**72 519 221**	**12 734 791**	**8 086 676**	**17 353 981**	**1 542 291**	**5 888 318**	**118 125 278**
LIABILITIES							
Amounts due to the Central Bank	-	-	-	-	-	-	**-**
Amounts due to other banks	5 768 851	6 390 976	21 310	-	-	2 054	**12 183 191**
Amounts due to customers	63 598 275	9 342 686	9 546 150	3 185 413	196 722	54 905	**85 924 151**
Subordinated liabilities	1 435 282	1 891 372	500 661	-	-	-	**3 827 315**
Other liabilities and derivative financial instruments	444 281	663 942	1 226 852	609 835	108 327	1 536 945	**4 590 182**
Total liabilities	**71 246 689**	**18 288 976**	**11 294 973**	**3 795 248**	**305 049**	**1 593 904**	**106 524 839**
Total interest repricing gap	**1 272 532**	**(5 554 185)**	**(3 208 297)**	**13 558 733**	**1 237 242**		

3.10. Liquidity risk

Sources of liquidity risk

The Liquidity Risk is understood as the risk of failure to fund assets and meet payment obligations arising from balance sheet and off-balance sheet items owed by the Bank in a timely manner and at a market price.

The reasons for Liquidity Risk may appear with respect to assets, liabilities and off-balance sheet liabilities and receivables.

As regards to **assets**, their main sources of liquidity risk are market Liquidity Risk and untimely repayments of loans. Market liquidity risk is a threat of complete or partial impossibility of liquidating the assets held, or the possibility of selling these assets only at an unfavourable price. It is covered in liquidity analysis by taking conservative assumptions regarding the liquidity of assets (Liquidity Reserves in particular) and capacity for their liquidation reflected in liquidation profile (in ANL Stress scenario). For this reason in a market crisis scenario (ANL Stress Market scenario) and combined scenario (ANL Stress Combined) it is assumed to use lombard credit and repo transactions offered by NBP collateralized by eligible securities taking into account adequate haircuts applied by NBP. Liquidity Risk from untimely repayments of the loans is related to rapid materialization of credit risk related to the market of the retail or commercial real estate.

As regards to **liabilities**, the risks posed by funding and withdrawal of funds by the clients are the most common source of the Liquidity Risk. The former is a type of risk in terms of which, should the crisis occur, funding can be acquired only at a higher price, and in an extreme situation, it is not possible to acquire funding or renew existing. The latter is a type of threat associated with uncertainty as to the behaviour of clients whose decisions (for instance, about withdrawal of deposited funds) may weaken the Bank's ability to service its current financial obligations.

A source of risk for **off-balance sheet liabilities** is a risk posed by clients' behaviour and unexpected drawdown of granted lines. It also concerns the use of intraday and overdraft lines by custody and corporate clients. Materialisation of such a risk may be experienced as severe especially in the case of high concentration of commitments. In respect of derivatives transactions concluded embedded with CSA agreements (Credit Support Annex) or settled by CCP, Liquidity Risk can materialize in consequence of adverse and severe changes in market conditions resulting in sudden decrease in valuation of derivatives instruments and related to necessity of pledging the collateral.

Daily operations of the Bank require settlements of various payment operations. Such activity generates high level of liquidity needs during a business day. Intraday liquidity facility (technical credit) on a systemic level is offered by NBP to allow for undisturbed flow of cash in the banking system. In order to use the facility Bank maintains adequate portfolio of eligible securities.

Taking into account **mBank Group** the liquidity risk is also identified as a possibility of unexpected growth in significant liquidity needs of subsidiaries of mBank. In line with the decision of the Bank's Management Board of 25 November 2014 a centralised approach to the management of the Group's financing was introduced in order to increase the effectiveness of the used liquidity resources and to ensure better tenor match of financing with assets. Subsidiaries are financed through the agency of DS, the exceptions are mBank Hipoteczny and mLeasing, which additionally obtain funding on the market through the issue of covered bonds (mBank Hipoteczny) and through issuance of short-term debt securities (mBank Hipoteczny and mLeasing). The risk of unexpected growth in significant liquidity needs of the subsidiaries of mBank may occur as a result of e.g. no possibility of obtaining external financing (mBank Hipoteczny and mLeasing) or unexpected increase in materialisation of credit risk.

Liquidity Risk may appear as a result of usage of inappropriate models in liquidity analysis (e.g. deposit base stable part model), which may lead to underestimation of Liquidity Risk. It is monitored by verification and back-testing models pursuant to Model management Policy.

Organization of risk management

In order to ensure that the liquidity risk management process is effective, the Management Board of the Bank lies down an adequate organizational structure and delegates powers to dedicated units and Committees. Liquidity risk management is conducted based on three lines of defence. The existing process covers the liquidity risk management area at both the strategic and operational level (I line of defence), the liquidity risk measurement and control area (II line of defence) and Internal Audit (III line of defence) performing independent assessment of both the first and second line of defence.

Liquidity risk management aims at ensuring and maintaining the Bank's and the Group's ability to fulfil both current and future liabilities taking into account the cost of liquidity. The liquidity management process consists of procedures that aim at identification, measurement, controlling, monitoring, reducing and defining the acceptable level of exposure to risks. This process can be divided into two main elements in the operational sense: the part involving all forms of liquidity management and the part of controlling and monitoring liquidity risk. The mBank Group Assets and Liabilities Management Committee, the Financial Markets Risk Committee and the Management Board of the Bank are responsible for liquidity management on the strategic level. Below mentioned organisational units are responsible for liquidity management and control.

- **The Treasury Department (DS)** I line of defence, performs treasury functions for the Bank and is responsible for providing necessary funds for settlements in the Bank's accounts within the scope of intraday liquidity risk management, implementing strategic recommendations made by the mBank Group Assets and Liabilities Management Committee, calibrating the structure of the future cash flows within the limits imposed by the Supervisory Board Management Board and the Financial Markets Risk Committee, maintaining adequate liquidity reserves to secure liquidity within the limits imposed by the Supervisory Board, Management Board and the Financial Markets Risk Committee. The Treasury Department is supported in these functions by the Financial Institutions Department, in relation to funding from domestic and foreign banks and international financial institutions, and the Financial Markets Department, in relation to issues of the Bank's debt securities. Moreover DS is responsible for monitoring of liquidity risk and financing of subsidiaries of mBank Group in terms of compliance with internal documentation of the Bank, participating as an observer on behalf of the Bank in ALCO meetings of the subsidiaries of mBank Group (in particular mBank Hipoteczny S.A.).
- **The Financial Markets Settlement and Services Department (DOF)** – is responsible for operational supervision over cash flows in accounts.
- **The Custody Services Department (DCU)** –acts in the scope of settlements of transactions on securities.
- **The Financial Markets Risk Department (DRR)** – II line of defence, is in charge of controlling and monitoring liquidity risk of the Bank on the strategic level and reporting to the Vice-president of the Management Board - Chief Risk Officer, the Financial Markets Risk Committee

and the mBank Group Assets and Liabilities Management Committee. The Department monitors financial liquidity on a daily basis using methods based on cash flow analysis. Liquidity risk measurement is based on the regulatory model and an internal model, which has been established taking into consideration the specific character of the Bank, the volatility of the deposit base, the level of funding concentration, and the projected development of particular portfolios.

- **The Internal Audit Department (DAW)** – III line of defence, performs independent assessment of both the first and second line of defence.

The objective of liquidity risk management is to ensure and maintain the Bank's ability to fulfil both current and future commitments. The Bank achieves this objective by diversifying stable funding sources in terms of client group (from whom acquires deposits), product and currency groups, and at the same time, optimizes its balance sheet in terms of profitability. Long-term activities of mBank in this scope are carried out taking into account conditions on funding capacity and business profitability.

In 2016, the liquidity situation was monitored and kept at a level adequate to the Bank's needs by adjusting the deposit base and securing additional funding sources depending on the development of lending activity and other funding needs.

Tools and measures used in measuring liquidity risk

As part of liquidity risk management, a range of risk measures are being analysed. The basic measure reflecting the Bank's liquidity situation is the mismatch account of future cash flows, and the mismatch gap related with it. It covers all the assets, liabilities and off-balance sheet items of the Bank in all the currencies and time-bands set by the Bank. In 2016, the Bank held liquidity surplus, adequate to Bank's business activity and current market situation, in the form of a portfolio of liquid treasury and money market securities that may be pledged or sold at any time without any considerable loss in value. In accordance with KNF Resolution No. 386/2008 on establishing liquidity measures binding on banks, the Bank calculates the supervisory liquidity measures. In 2016, the supervisory limits on short-term and long-term liquidity measures were not exceeded. Moreover, in line with the Resolution, the Bank conducts an in-depth analysis of long-term liquidity and sets internal limits (management action triggers) on involvement in long-term assets. Relevant analysis of the stability and structure of the funding sources, including the core and concentration level of term deposits and current accounts are performed. Additionally, the Bank analyses the variability of the balance sheet and off-balance sheet items, in particular the open credit line facilities and current account and overdrafts limits utilisation.

The ongoing analysis covers not only liquidity under normal conditions, but also on the assumption of a potential liquidity loss. In order to determine the Bank's resistance to major unfavourable events, the Bank conducts scenario analyses covering extreme assumptions on the operation of financial markets, behavioural events relative to the Bank's clients and both mentioned factors combined. For this purpose three scenarios are performed on regular basis: ANL Stress reflecting idiosyncratic crisis, ANL Stress Market reflecting market wide crisis and ANL Stress Combined combining two aforementioned scenarios.

Main assumptions in ANL Stress scenario:

- outflow of customer deposits,
- materialization of undrawn commitments,
- sale of liquid securities in the market in estimated amounts,
- use of central bank secured lending for unsold amount of liquid securities.

Main assumptions in ANL Stress Market scenario:

- outflow of customer deposits,
- materialization of undrawn commitments,
- inability to sell Liquidity Reserve in the market,
- use of central bank secured lending for unsold amount of liquid securities.

ANL Stress Combined combines the assumption behind ANL Stress and ANL Stress Market scenarios.

In addition a reverse stress test for liquidity risk is performed in the Bank on annual basis and an intraday liquidity crisis scenario on a monthly basis.

Liquidity stress tests are used in the Bank for operational management of liquidity risk and are reported to the Financial Markets Risk Committee, Assets and Liabilities Committee of the mBank Group (ALCO) as well as Supervisory Board of the Bank. In addition, the scenarios used in Bank's Contingency Plan are consistent with those used in liquidity stress testing.

The Bank has also adequate procedures in case mBank is threatened with financial liquidity loss. Base on severity of risk factors and the degree of the threat of financial loss relevant actions are defined either in the Contingency Plan in case of a threat of losing financial liquidity by mBank Group (Contingency Plan) or in the Recovery Plan mBank Group (Recovery Plan).

Execution of the strategy of ensuring liquidity of the Bank consists in active management of the structure of future cash flows and keeping a liquidity reserves adequate to the liquidity needs, resulting from the activity and structure of the balance sheet of the Bank, obligations to subsidiaries and the current market situation. For this purpose the Bank keeps a surplus of liquid and unencumbered assets constituting the Liquidity Reserves, for which there is a possibility of pledging, transaction on repo market or selling at any time without significant loss in value. Liquidity Reserves were composed of Polish Government debt securities in PLN and EUR, bills issued by the National Bank of Poland in PLN and Czech Republic's Government debt securities in CZK. Values of these Reserves amounted to:

Value of Liquidity Reserves (in PLN million)	
31.12.2016	**31.12.2015**
25 034	22 900

In order to support the process of liquidity risk management, a system of early warnings indicators was developed in the Bank. It is composed of indicators monitoring the level of regulatory and internal limits and additionally, indicators monitoring significant changes of market factors, as well as changes in the Bank's balance sheet. Exceedance of thresholds by defined indicators may be a trigger for the launch of the Contingency Plan or the Recovery Plan.

Due to the use by the Bank of FX swap i CIRS instruments to convert surpluses in local currencies into foreign currencies, internal limits are in place on the use of these instruments. Moreover, in order to limit the concentration in FX swaps, the amounts obtained in such transactions are monitored in monthly time bands up to 1 year.

Other measures of liquidity risk are calculated and reported in the Bank as follows:

- concentrations of funding sources,
- stability of deposit base,
- early withdrawals of deposits,
- ratio of long-term funding for the real estate market.

The Bank includes product's liquidity in its liquidity risk management framework. It is reflected in terms of measuring of market liquidity of Treasury bonds, which make up Liquidity Reserves. The analysis is performed on monthly basis and takes account of market liquidity determinants such as: market trading, order book depth, purchase/sale transaction spread and issue volume. The measurement of market liquidity is included in the ANL Base and ANL Stress risk measures, where the scenarios structure provides for liquidating State Treasury bonds held by the Bank in line with market trading in particular series of bonds. A similar check is carried out in the context of the market potential of pledging particular bond series.

The measurement, limiting and reporting the liquidity risk

At the Bank, there is a reporting process of liquidity risk. It covers both daily information delivery to entities engaged in operational management of liquidity risk and entities controlling liquidity risk management on operational level, as well as regular reporting to higher management levels for the purpose of making strategic decisions on liquidity risk.

Daily reporting covers:

- regulatory measures,
- liquidity gaps for mBank, mBank Group and material subsidiaries from liquidity risk perspective with the utilization of limits imposed on these measures,
- intraday liquidity,
- other internal liquidity risk measures.

Weekly reporting covers:

- Early Warnings Indicators (EWI).

Monthly reporting covers:

- regulatory measures and internal liquidity measures to the Management Board members and Financial Markets Risk Committee (KRF),
- regulatory measures, internal liquidity measures and forecasts of liquidity measures based on business development forecasts to Assets and Liabilities Committee of the mBank Group.

Regulatory measures and internal liquidity measures are reported on a quarterly basis to the Bank's Supervisory Board.

For the purpose of current monitoring of liquidity, the Bank establishes values of realistic, cumulated gap of cash flows misfit. The gap is calculated on the basis of contractual cash flows (Note 3.10.1). Cash flows in portfolios of non-banking customers' deposits, overdrafts and term loans are mainly amended. In the calculation of the liquidity measures the Bank takes into account the possibilities of raising the funds by selling or pledging the debt securities from Bank's Liquidity Reserves.

Value of realistic, bucket and cumulative gap of cash flows misfit (in PLN million)				
Time range	gap - 31.12.2016		gap - 31.12.2015	
	bucket	cumulative	bucket	cumulative
up to 1 working day	8 024	8 024	10 494	10 494
up to 3 working days	7 421	15 445	(5 946)	4 548
up to 7 calendar days	380	15 825	(5 946)	4 548
up to 15 calendar days	(838)	14 987	3 610	8 158
up to 1 month	2 605	17 592	775	8 933
up to 2 months	1 003	18 595	1 637	10 570
up to 3 months	(993)	17 602	442	11 012
up to 4 months	139	17 741	427	11 439
up to 5 months	133	17 874	(256)	11 183
up to 6 months	88	17 962	74	11 257
up to 7 months	197	18 159	247	11 504
up to 8 months	181	18 340	196	11 700
up to 9 months	118	18 458	52	11 752
up to 10 months	(797)	17 661	(516)	11 236
up to 11 months	182	17 843	(1 674)	9 562
up to 12 months	(1 998)	15 845	588	10 150

The above values should be interpreted as liquidity surplus/deficit in relevant time buckets. Since 21st May 2016 the data have included Dom Maklerski mBanku, which was merged with mBank S.A. on that day. Due to the positive dynamics of non-banking term deposits and current accounts (PLN 10 billion – with fixed exchange rate as of 31 December 2016 used in calculations) exceeding dynamics of loans portfolio development (PLN 1.3 billion – with fixed exchange rate as of 31 December 2016 used in calculations) increase of liquidity level as of the end of 2016 has been noticed.

In 2016 increase of liquidity level was related to the issue of EUR 500 million of bonds under the Euro Medium Term Note Program (EMTN) by the company mFF. Decrease of indebtedness towards main shareholder, Commerzbank A.G., is a result of repayment of CHF 800 million borrowings. Simultaneously, taking into account in cash flow mismatch cumulated gap, debt from Commerzbank remained to be repaid in 2017 in amount of CHF 750 million of borrowings and CHF 400 million of subordinated debt.

ANL methodology contains an additional component, which is aimed at preparing the Bank for a significant changes in foreign exchange rates, resulting in negative valuation of CIRS and Fx-Swap transactions and thus generating liquidity needs stemming from the necessity to supplement collateral with the counterparties (position value as of the end of 2016 – PLN 966 million).

Moreover the Bank calculates the amount of additional collateral requirement resulting from signed agreements with the counterparties that the Bank would have to deliver in case of potential rating downgrade. As of 31 December 2016 Bank would not have to post additional collateral due to the positive valuation of the transactions.

In 2016 Bank's liquidity remained at a safe level which was reflected in surplus of liquid assets over short-term liabilities according to ANL in various scenarios and supervisory liquidity measures.

ANL gaps mismatch in terms up to 1 month and up to 1 year within 2016 and supervisory liquidity measures M1, M2 and LCR are presented in the following table.

Measure*	2016			
	31.12.2016	Mean	Maximum	Minimum
ANL Base 1M**	20 428	16 767	21 088	12 252
ANL Base 1Y**	18 694	16 597	20 837	12 392
ANL Stress 1M**	17 579	14 473	18 903	10 377
ANL Stress 1Y**	15 845	14 303	18 473	10 109
ANL Market 1M**	17 436	13 310	18 405	9 650
ANL Combined 1M**	16 411	12 437	17 404	8 706
M1	15 117	13 570	17 974	7 681
M2	1.42	1.40	1.54	1.26
M3	4.79	4.82	5.20	4.03
M4	1.41	1.34	1.41	1.28
LCR	200%	154%	200%	126%

** ANL Base, ANL Stress, ANL Stress Market, ANL Stress Combined and M1 are shown in PLN million, M2 is a relative measure presented as a decimal, ANL Stress is limited up to 1Y, ANL Stress Market and ANL Stress Combined are limited up to 1M*

*** Means, maximums and minimums are calculated for period starting from 1st February 2016.*

Short-term liquidity supervisory measures (M1, M2) in 2016 remained on safe level with a minimum value of PLN 7,7 billion (M1) above the limit of 0. The long-term coverage ratios (M3, M4) are characterized by high stability on safe level, above minimum established by regulatory authority equal to 1. In particular, M3 oscillated between 4.03 and 5.20 in 2016, whereas M4 between 1.28 and 1.41. The LCR measure remained on safe level, significantly exceeding 100%.

Funding sources

The strategic assumptions concerning the diversification of funding sources and profitable structure of the balance sheet are reflected in the financial plan of mBank defined by selected measures, e.g. L/D ratio (Loans to Deposits). The Bank measures a specific relation of loans to deposits in order to maintain a stable structure of its balance sheet. In 2016, L/D ratio improved from 83.0% to 73.1%. The Bank aims at building a stable deposit base by offering to clients deposit and investment products, regular and specific-purpose savings offerings, as well as operating deposits of the subsidiaries. Funds acquired from the Bank's clients constitute the major funding source for the business activity. The second largest funding source is the portfolio of long-term loans from banks (with maturities over 1 year), in particular from Commerzbank (Note 27). The loans together with subordinated loans (Note 30) are the core funding source for the portfolio of mortgage loans in CHF. According to the suspension of granting new mortgage loans in CHF, Bank's receivables in this currency have been decreasing successively along with credit repayments. The funds obtained from the repayment of the mentioned loans are used to reduce the Bank's debt in CHF owed mBank's main shareholder. In 2016, the debt to Commerzbank AG was reduced by CHF 800 million - repayment of borrowings.

Moreover, in order to acquire funding (also in foreign currencies) the Bank uses mid-term and long-term instruments, including credit line facilities within Commerzbank Group and on the international market (outstanding loans from EBI as of the end of 2016 – equivalent of PLN 4.2 billion) as well as FX swap and CIRS transactions. In 2016 mBank Group issued EUR 500 million of bonds under the Euro Medium Term Note Program (EMTN), (commitment as of the end of 2016 – EUR 1.5 billion), at the same time in 2016, the Bank recorded increase in net liabilities due to FX swap and CIRS in CHF.

When making funding-related decisions, in order to match the term structure of its funding sources with the structure of long-term assets, the Bank takes into consideration the supervisory liquidity measures and limits, as well as the internal liquidity risk limits.

3.10.1 Cash flows from transactions in non-derivative financial instruments

The table below shows cash flows the Bank is required to settle, resulting from financial liabilities. The cash flows have been presented as at the year-end date, categorised by the remaining contractual maturities. The amounts denominated in foreign currencies were converted to Polish zloty at the average rate of exchange announced by the National Bank of Poland at the year-end date. The amounts disclosed in maturity dates analysis are undiscounted contractual cash flows.

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Liabilities (by contractual maturity dates) as at 31.12.2016

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Amounts due to the Central Bank	-	-	-	-	-	**-**
Amounts due to other banks	1 502 129	53 182	3 127 552	3 897 537	-	**8 580 400**
Amounts due to customers	73 623 165	7 523 500	5 898 982	10 367 203	2 400 626	**99 813 476**
Subordinated liabilities	34 420	1 649 178	34 768	198 036	2 422 238	**4 338 640**
Other liabilities	1 345 001	-	-	-	-	**1 345 001**
Total liabilities	**76 504 715**	**9 225 860**	**9 061 302**	**14 462 776**	**4 822 864**	**114 077 517**
Assets (by remaining contractual maturity dates)						
Total assets	**21 651 115**	**3 976 243**	**18 091 969**	**57 593 251**	**37 292 354**	**138 604 932**
Net liquidity gap	**(54 853 600)**	**(5 249 617)**	**9 030 667**	**43 130 475**	**32 469 490**	**24 527 415**

Liabilities (by contractual maturity dates) as at 31.12.2015

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Amounts due to the Central Bank	-	-	-	-	-	**-**
Amounts due to other banks	2 826 397	95 895	3 219 210	6 162 615	-	**12 304 117**
Amounts due to customers	62 651 370	7 155 930	6 965 983	5 357 648	4 754 575	**86 885 506**
Subordinated liabilities	1 018 826	1 596	39 277	1 774 492	1 441 788	**4 275 979**
Other liabilities	1 045 218	-	-	-	-	**1 045 218**
Total liabilities	**67 541 811**	**7 253 421**	**10 224 470**	**13 294 755**	**6 196 363**	**104 510 820**
Assets (by remaining contractual maturity dates)						
Total assets	**20 773 177**	**4 115 719**	**18 352 516**	**44 528 064**	**39 449 432**	**127 218 908**
Net liquidity gap	**(46 768 634)**	**(3 137 702)**	**8 128 046**	**31 233 309**	**33 253 069**	**22 708 088**

The assets which ensure the payment of all the liabilities and lending commitments comprise cash in hand, cash at the Central Bank, cash in transit and treasury bonds and other eligible bonds, amounts due from banks, loans and advances to customers.

In the normal course of business, some of the loans granted to customers with the contractual repayment date falling due within the year, will be prolonged. Moreover, a part of debt securities, were pledged as collateral for liabilities. The Bank could ensure cash for unexpected net outflows by selling securities and availing itself of other sources of financing, such as the market of securities secured with assets.

3.10.2 Cash flows from derivatives

Derivative financial instruments settled in net amounts

Derivative financial instruments settled in net amounts by the Bank comprise:

- Futures,
- Forward Rate Agreements (FRA),
- Options,
- Warrants,
- Interest rate swaps (IRS),
- Cross currency interest rate swaps (CIRS),
- Security forwards.

The table below shows derivative financial liabilities of the Bank, which valuation as of end of 2016 was negative, grouped by appropriate remaining maturities as at the balance sheet date and are presented as contractual maturities apart from Other up to 1 month and Futures contracts which are presented as net present value (NPV). The amounts denominated in foreign currencies were converted to Polish zloty at the average rate of exchange announced by the National Bank of Poland at the balance sheet date.

31.12.2016

Derivatives settled on a net basis	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Forward Rate Agreements (FRA)	2 199	958	3 050	-	-	**6 207**
Overnight Index Swaps (OIS)	1 174	798	168	-	-	**2 140**
Interest Rate Swaps (IRS)	84 342	205 545	255 400	872 290	185 941	**1 603 518**
Cross Currency Interest Rate Swaps (CIRS)	22 017	(5 020)	(35 874)	(35 365)	1 331	**(52 911)**
Options	7 508	502	(5 854)	(4 070)	(120)	**(2 034)**
Futures contracts	-	(1)	-	-	-	**(1)**
Other	2 477	6 844	12 605	850	-	**22 776**
Total derivatives settled on a net basis	**119 717**	**209 626**	**229 495**	**833 705**	**187 152**	**1 579 695**

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Derivatives settled on a net basis	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Forward Rate Agreements (FRA)	4 405	12 096	2 815	505	-	**19 821**
Overnight Index Swaps (OIS)	78	331	616	93	-	**1 118**
Interest Rate Swaps (IRS)	74 438	364 372	694 395	1 665 275	280 731	**3 079 211**
Cross Currency Interest Rate Swaps (CIRS)	14 888	(2 452)	(18 874)	(8 278)	984	**(13 732)**
Options	(2 766)	1 377	(11 212)	(141)	(2)	**(12 744)**
Other	113	2 064	3 576	381	-	**6 134**
Total derivatives settled on a net basis	**91 156**	**377 788**	**671 316**	**1 657 835**	**281 713**	**3 079 808**

Derivative financial instruments settled in gross amounts

Derivative financial instruments settled in gross amounts by the Bank comprise foreign exchange derivatives: currency forwards and currency swaps.

The table below presents derivative financial liabilities/assets of the Bank, which will be settled on a gross basis, grouped by appropriate remaining maturities as at the balance sheet date. The amounts denominated in foreign currencies were converted to Polish zloty at the average rate of exchange announced by the National Bank of Poland at the balance sheet date

31.12.2016

Derivatives settled on a gross basis	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Currency derivatives:						
-outflows	**18 477 230**	**5 981 653**	**6 121 559**	**932 698**	-	**31 513 140**
-inflows	**18 552 994**	**6 003 320**	**6 115 410**	**915 710**	-	**31 587 434**

31.12.2015

Derivatives settled on a gross basis	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Currency derivatives:						
-outflows	**15 156 879**	**4 718 725**	**8 797 835**	**1 051 490**	-	**29 724 929**
-inflows	**15 186 423**	**4 705 652**	**8 868 583**	**1 034 073**	-	**29 794 731**

The amounts disclosed in the table are undiscounted contractual outflows/inflows.

The amounts presented in the table above are nominal cash flows of currency derivatives, which have not been settled, while the Note 19 shows nominal values of all open derivative transactions.

Detailed data concerning liquidity risk related to off-balance sheet items are presented in the Note 36.

3.11. Operational risk

Operational risk is understood as the risk of loss resulting from a mismatch or unreliability of internal processes, people or systems or external events. In accordance with the Risk Catalogue of mBank Group, operational risk includes, in particular, the following sub-categories:

- legal risk,
- IT systems risk,
- personnel and organizational risk,
- security risk,
- compliance risk.

Operational risk does not include reputational risk, however materialization of operational risk may increase reputational risk.

Organization of risk management

Operational risk management is performed in mBank and, at the consolidated level, in mBank Group.

The Integrated Risk and Capital Management Department (DKR) is responsible for the measurement, control and monitoring of operational risk level in the Bank and in mBank Group.

Within the scope of its operational risk control function, the DKR closely co-operates with other units and projects within the Bank involved in operational risk, in particular with the Compliance Department, the Legal Department, the Internal Audit Department and the Security Department. The results of operational risk control and monitoring are reported to the Risk Committee of the Supervisory Board, the Management Board of the Bank, the committees of Business and Risk Forum of mBank Group, and the Chief Risk Officer.

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While organizing the operational risk management process, the Bank takes into account regulatory requirements, which are the starting point for preparation of framework for the operational risk control and management system in the Bank and the Group.

General principle of operational risk management in the Bank is to minimize it that is to reduce the causes of operational events, the probability of their occurrence and the severity of potential consequences. Cost vs benefits analysis is considered while deciding on an acceptable operational risk level.

Tools and measures

Operational risk control and management consists of a set of activities aimed at identifying, monitoring, measurement, assessment, reporting as well as reduction, avoidance, transfer or acceptance of operational risk, the Bank is exposed to in particular areas of its operations. It is based on quantitative and qualitative methods and tools for operational risk control. The tools applied by the Bank intend to cause-oriented operational risk management and focus on bottom-up approach to identify risk.

Qualitative tools are aimed at establishing (within the Bank and the mBank Group) consistent qualitative assessment of internal and external factors affecting the operational risk management process.

The basic qualitative tool is the Internal Control System Self-assessment (ICS) process, which enables to identify and assess the most important operational risks and control mechanisms in the Group, and then to develop and implement necessary corrective action plans.

In addition, in order to control operational risk, mBank collects data about operational risk events and losses of the Group, collects and monitors key risk indicators, and develops and performs operational scenario analyses in order to identify exposure to potential high-severity events. At the same time, the communication with all areas of the Bank (business and support areas) is maintained for the purpose of monitoring and taking preventive actions once the risk of critical events has been signalled in any area.

Operational losses

The vast majority of the Bank's operational losses refers to the following business lines (separated in accordance with the CRR Regulation): commercial banking, retail banking and trading and sales.

In terms of losses by risk category, the Bank incurs the highest losses in three categories of operational risk: (i) crimes committed by outsiders; (ii) execution, delivery and process management; (iii) customers, products and business practices.

The following table presents the distribution of actual net losses (net of recoveries) by operational risk category, incurred by mBank in 2016:

Operational risk category	Distribution	Value of losses in relation to the value of gross profit
Crimes committed by outsiders	44%	1.4%
Customers, products and business practices	43%	1.4%
Execution, delivery and process management	3%	0.1%
Other*	10%	-0.3%
Total	100%	2.6%

**in other categories recoveries were higher than losses*

The level of operational risk losses is constantly monitored and regularly reported to the management and Supervisory Board of the Bank. Monitoring takes place at the level of individual transactions and at the level of the value of total losses. In the case of single operational events with a high loss or a total of losses exceeding the set thresholds, analysis of the causes and development of corrective action plans that will reduce the occurrence of similar losses in the future is required.

3.11.1 Compliance risk

Compliance risk management in mBank is realized in particular in accordance with the provisions of the Compliance policy at mBank S.A., which is a set of guidelines and organisational principles, which the Bank performs fulfilling the requirements of Polish law and taking into account compliance rules of the Commerzbank Group, without prejudice to the provisions of Polish law. The Policy includes also a set of basic rules of conduct for the Bank's employees and main processes of compliance risk identification that allow to manage compliance risk on all levels of the Bank's organisation.

The compliance risk is understood as a consequence of failure to observe the law, internal regulations and standards of conduct adopted by the Bank. Compliance risk management aims to mitigate the risk connected with the Bank's failure to observe and comply with the law, internal regulations, and the standards of conduct adopted by the Bank. Non-compliance of the Bank's operation with internal regulations, mentioned above, is understood as non-compliance of the internal regulations with the generally applicable law and standards of conduct adopted by the Bank, including the failure to implement recommendations issued by the KNF and other supervisory authorities executing their tasks towards financial institutions.

Providing compliance of the Bank's internal regulations with the provisions of law (Polish and international) and adopted by the Bank standards of conduct as well as observing internal rules by the Bank employees aims to mitigate the compliance risk and to eliminate or minimize the possibility of occurrence of the following risks: legal, reputational, imposed sanctions and financial losses as well as the one resulting from discrepancies in interpretation of the law.

All the Bank employees are responsible for implementation of the provisions hereof, in line with their scope of responsibilities as well as granted authorisations.

Compliance Department is responsible for coordination and supervision of the compliance management process. In particular the Compliance Department is:

- developing and implementing guidelines, rules and standard procedures at the Bank in the compliance area, including common standards applicable in the Commerzbank AG Group, subject to stipulations of the Polish legal requirements,
- exercising supervision over the execution of tasks from the compliance area, including advisory and merit-based instruction as well as controlling organisational units of the Bank responsible for their execution,
- exercising supervision, including advisory and merit-based instruction, over implementing common standards of operation in the compliance area within mBank Group by relevant compliance forces in foreign branches and in subsidiaries,
- identifying risk in the compliance area,
- introducing control policies and procedures in the scope of operation of Compliance Department, to minimise the risks hereof,
- adjusting hereof and internal regulations, whose owner is Compliance Department, to the changing legal conditions and standards of conduct,
- building the compliance culture especially by preparing professional materials and organising and conducting training for the employees of the Bank in issues related to compliance processes,
- maintaining ongoing contacts with the unit responsible for the performance of the compliance area in Commerzbank AG Group for the purpose of the implementation of common standards.

The supervision over introduction by the mBank Group entities common rules in the compliance area is exercised in particular on the basis of concluded contracts and additional agreements that specify, among others the reporting obligations of the subsidiaries and rules of supervision visits in those entities conducted by authorised organizational units of the Bank.

Neither the Director nor the employees of Compliance Department execute processes which are then subject to control by Compliance Department, are involved in operation which could result in a conflict of interests with their duties performed at Compliance Department. In particular, their advisory functions with respect to performance of compliance tasks by organisational units cannot be combined with any other consultations provided to those units.

3.12. Business risk

Business risk shall mean the risk of losses resulting from deviations between actual net operating result of the mBank Group and the planned level. The calculation of deviations between actual and planned values is done separately for revenues and costs. Business risk includes, in particular, strategic risk connected with the possibility of occurrence of negative financial consequences as a result of wrong or disadvantageous decisions or their wrong implementation. It is assumed, that the results of the strategic decisions are reflected in deviations between actual operating result and the planned level in one-year horizon.

Business risk is included in the calculation of economic capital of mBank and mBank Group.

Controlling and Management Information Department is responsible for development of methodology and measurement of economic capital for business risk and preparing information on the changes of its level, as well as for the stress testing of business risk.

In order to manage effectively and reduce business risk, the following actions are taken:

- coordination of the planning process by the Controlling and Management Information Department, which includes also verification of the planned data,
- regular analysis of the causes of observed deviations of the actual financial performance of the mBank Group organizational units from the planned level,
- the results of the above analysis are included in the form of comments to the financial results of the Group provided to the Management Board,
- periodic verification of the adopted strategy,
- regular analysis of the competitors' activities.

3.13. Model risk

Model risk is understood as the risk of negative consequences connected with the decisions made on the basis of the output data of models which have been improperly constructed or are improperly administered. Model risk may result in financial losses or in the loss of potential profits, improper business or strategic decisions or negatively influence the bank's reputation.

The following specific subcategories can be distinguished, in particular, in model risk:

- **Data risk** covering: availability, quality, retrieval, processing, aggregation, storage, ensuring sufficient length of time series, feeding models with data.
- **Assumptions/methodology risk** which determines the logic and functionality combined with the goals to be achieved, suitability to actual conditions and methods/tools/techniques used, inclusion of factors affecting the modelling process, dependence between complexity and resilience to overfitting, integration of simplifications with the characteristics of the modelled phenomenon, expert contribution, use of latent elements, stability of estimates with due regard to estimation errors.
- **Models administration risk** connected with the quality of documentation and regulations concerning the model management process, model risk, model implementation and use, information related to the quality of model operation and the process of communicating it, change management, overruling.
- **Risk inextricably linked with the restrictions** connected with modelling a given phenomenon - when aiming to achieve specific effectiveness of model operation, one should first test the susceptibility of a given phenomenon to modelling.
- **Risk of interdependence** - which occurs when estimating the aggregate risk level and results from the reliance on the same sources, construction techniques, assumptions, testing methods and use of other model components as input data on the assumption that the input models are of at least medium significance.

Model risk management is coordinated by the Integrated Risk and Capital Management Department through its Validation Unit.

Integrated Risk and Capital Management Department (Validation Unit) performs the following tasks:

- develops policies and organizes the process of managing risk models,
- organizes and monitors the process of model risk assessment in the Bank's organizational units and the Group subsidiaries responsible for model development and ensures consistency of model risk assessment within the Group.

Model risk is managed on a systemic basis by a proper internal regulations concerning model risk management process, in particular monitoring and validation of models.

The Model Management Policy determines the participants and the framework for model management process, including issues related to the development of models in the Group, their approval, implementation, verification/validation, monitoring, implementation of changes and the associated reporting process. It also defines principles of models' significance classification and model risk measurement and monitoring in line with the Recommendation W requirements, published by the KNF.

Model Risk Committee plays significant role in model risk management process, which was described in the previous sections of this document. It recommends, among others, model risk tolerance level, which is finally approved by the Management Board and the Supervisory Board.

3.14. Reputational risk

In today's competitive environment, the reputation of a company is increasingly gaining in importance. Banks, as public trust companies, are expected not only to be profitable and offer shareholders an adequate return, but also to be ethical, environmentally friendly, and socially responsible.

The aim of management of reputational risk, defined as a risk resulting from a negative perception of the image of the bank or other member of the group among their stakeholders, is to identify, assess and address reputational risk in specific processes in order to protect and strengthen the good name of mBank and mBank Group.

The bank's business units, foreign branches, and subsidiaries are directly responsible for any reputational risk arising from their own business activities. The key role in reputational risk management is played by the Communication and Marketing Strategy Department, which is in charge of shaping the image and brand of the bank and mBank Group.

Communication and Marketing Strategy Department is responsible for:

- development and realisation of external communication strategy of mBank and mBank Group,
- planning and realisation of marketing activities for business lines, with exclusion of retail banking (where the responsibility rests with the Retail Banking Marketing Department),
- monitoring of activities related to the Bank's image, reputation and recognition,
- management of crisis situations which bear the reputational risk for the Bank and the mBank Group.

Important roles in the reputational risk management are played by other organizational units of the bank, including Compliance Department and Integrated Risk and Capital Management Department, which is responsible for: development of reputational risk management strategy in cooperation with other organizational units and supervision over the Internal Control System Self-assessment (ICS), including also aspects of reputational risk.

The following tools and methods are used in mBank to monitor and manage reputational risk:

- mBank's values (client-centric organization, simplicity, professionalism, engagement and forward looking), which are the mBank's code used while building either business relations or internal inside of the Group,
- engagement culture survey - perception of mBank by its employees,
- Corporate Social Responsibility: taking responsible action for the benefit of customers, employees, the environment and local communities (including employee volunteer work) and participation in projects of the mBank Foundation,
- monitoring of press publications, comments in the Internet and social media,
- customer satisfaction analysis in retail and corporate banking,
- new product process: reputational risk is one of the aspects analyzed during the new products' implementation process,
- analysis of customers' complaints.

Reputational Risk Management Strategy of mBank Group describes rules and components of reputational risk management, and emphasizes, in particular, such issues as: reputational risk profile as well as organization and methods of reputational risk management.

3.15. Capital risk

Capital risk management is performed in mBank and, at a consolidated level, in mBank Group.

Departament Controllingu i Informacji Zarządczej odpowiada za:

- development of the Capital Management Policy of mBank Group;
- measurement of efficiency of the capital utilization and monitoring return on capital ratios, as well as updating the respective methodology;
- forecasting and planning own funds for the Bank and mBank Group.

Integrated Risk and Capital Management Department is responsible for:

- monitoring of capital adequacy, risk bearing capacity and risk profile of the Group;
- organization of the processes of planning, forecasting and monitoring regulatory and internal capital;

- development of the risk bearing capacity concept and the methodology of limiting regulatory and internal capital;
- sensitivity analyses, stress tests and analyses of influence of new products and new calculation methods for capital adequacy;
- monitoring regulatory requirements regarding the application of AIRB method in calculating capital requirements,
- preparation of reports and information for the statutory bodies of the mBank and for the purposes of consolidated supervision in regards to capital adequacy, risk bearing capacity and risk profile of the Bank and mBank Group.

In order to prevent materialization of capital risk, understood as risk resulting from the lack of sufficient capital to absorb unexpected losses, the Bank applies a capital management process.

The capital management in mBank Group is organised as a process including planning, steering and controlling within the frames of regulatory and internal capital. Within the framework of capital management process, regular monitoring of capital adequacy and effectiveness is conducted, aimed at assurance that adequate and optimum level of capital is maintained in mBank Group. This is supported by stress testing procedures, designed to provide in depth view on current capital position, as well as its possible development in the future.

The capital management in mBank Group is a multi-level process including all subsidiaries and organisational units whose activity influences the level of own funds requirements as well as the value of internal capital.

The capital management process in mBank Group is documented. The Capital Management Policy constitutes the core documentation in this respect. It is directly linked to the Strategy of mBank Group, Risk Management Strategy, the Multi-year Financial Plan of mBank Group and with the ICAAP documentation.

The underlying assumption of the Capital Management Policy is to ensure effective planning and utilisation of the capital base within the mBank and mBank Group, among others, through determining the Bank's dividend policy. This is provided mainly by applying risk appetite guidelines and developing guidelines to assure sufficient capital to cover risks identified in business activity, as well as defining the organisational framework for the efficient functioning of capital management system.

The Capital Management Policy is based on two fundamental pillars:

- maintenance of optimal level and structure of own funds, assuring capital adequacy above the established minimum requirement (including risk appetite defined by the Management Board) as well as ensuring coverage against all material risks identified in mBank Group's activity,
- effective use of the capital base, guaranteeing achievement of expected returns, including return on regulatory capital and risk adjusted capital.

In addition, the document focuses on capital management in an environment of capital shortage, in particular in case of activation of the capital protection plan.

3.16. Fair value of financial assets and liabilities

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

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

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

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

The Bank estimated that the fair value of short-term financial liabilities (less than 1 year) is equal to the balance sheet values of such items.

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In addition, the Bank assumed that the estimated fair value of financial assets and financial liabilities longer than 1 year is based on discounted cash flows using appropriate interest rates.

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

	31.12.2016		31.12.2015	
	Carrying value	Fair value	Carrying value	Fair value
Financial assets				
Loans and advances to banks	**7 308 769**	**7 305 171**	**4 981 321**	**4 979 660**
Loans and advances to customers	**72 304 131**	**73 328 021**	**71 284 102**	**71 966 423**
Loans and advances to individuals	**43 195 950**	**44 244 310**	**42 267 085**	**43 122 732**
current accounts	5 843 990	5 885 276	5 214 087	5 283 678
term loans including:	37 351 960	38 359 034	37 052 998	37 839 054
- housing and mortgage loans	30 446 487	31 254 411	31 068 708	31 735 223
Loans and advances to corporate entities	**27 792 724**	**27 773 747**	**27 460 318**	**27 301 254**
current accounts	3 995 482	3 972 501	3 883 744	3 859 771
term loans	23 574 294	23 578 298	22 513 237	22 378 146
- corporate & institutional enterprises	12 704 969	12 696 003	12 507 545	12 458 501
- medium & small enterprises	10 869 325	10 882 295	10 005 692	9 919 645
reverse repo / buy sell back transactions	56 676	56 676	1 031 029	1 031 029
other	166 272	166 272	32 308	32 308
Loans and advances to public sector	**1 087 033**	**1 081 540**	**1 373 344**	**1 359 082**
Other receivables	**228 424**	**228 424**	**183 355**	**183 355**
Financial liabilities				
Amounts due to other banks	**8 503 014**	**8 525 938**	**12 183 191**	**11 980 394**
Amounts due to customers	**98 960 320**	**99 283 334**	**85 924 151**	**86 013 567**
Subordinated liabilities	**3 943 349**	**3 853 900**	**3 827 315**	**3 919 644**

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

<u>Loans and advances to banks and loans and advances to customers.</u> The fair value for loans and advances to banks and loans and advances to customers is disclosed as the present value of future cash flows using current interest rates including appropriate credit spreads and is based on the expected maturity of the respective loan agreements. The level of credit spread was determined based on market quotation of median credit spreads for Moody's rating grade. Attribution of a credit spread to a given credit exposure is based on a mapping between Moody's rating grade and internal rating grades of the Bank. To reflect the fact that the majority of the Bank's exposures is collateralised whereas the median of market quotation is centred around unsecured issues, the Bank applied appropriate adjustments.

<u>Available for sale financial assets</u>. Listed available for sale financial instruments held by the Bank are valued at fair value. The fair value of debt securities not listed at an active market is calculated using current interest rates taking into account credit spreads for an appropriate issuer.

<u>Financial liabilities</u>. Financial instruments representing liabilities include the following:

- Contracted borrowings;
- Deposits;
- Issues of debt securities;
- Subordinated liabilities.

The fair value for these financial liabilities with more than 1 year to maturity is based on cash flows discounted using interest rates. For loans received from Commerzbank in CHF, the Bank used the curve based on quotations of Commerzbank CDS for exposures in EUR, and quotations of issued bonds under EMTN programme in EUR and CHF. For the loans received from European Investment Bank in EUR the Bank used the EBI yield curve.

In the case of deposits, the Bank has applied the curve constructed on the basis of quotations of money market rates as well as FRA and IRS contracts for appropriate currencies and maturities. In case of subordinated liabilities the Bank used curves based on cross-currency basis swap levels taking into account the original spread on subordinated liabilities and their maturities.

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The Bank assumed that the fair values of these instruments with less than 1 year to maturity was equal to the carrying amounts of the instruments.

The table below presents the fair value hierarchy of financial assets and liabilities measured at fair value in accordance with the assumptions and methods described above, exclusively for disclosure as at 31 December 2016 and as at 31 December 2015.

31.12.2016	Including:	Level 1 Quoted prices in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
VALUATION ONLY FOR PURPOSES OF DISCLOSURE				
FINANCIAL ASSETS				
Loans and advances to banks	7 305 171	-	-	7 305 171
Loans and advances to customers	73 328 021	-	-	73 328 021
FINANCIAL LIABILITIES				
Amounts due to other banks	8 525 938	-	6 987 831	1 538 107
Amounts due to customers	99 283 334	-	13 821 680	85 461 654
Subordinated liabilities	3 853 900	-	3 853 900	-
Total financial assets	**80 633 192**	**-**	**-**	**80 633 192**
Total financial liabilities	**111 663 172**	**-**	**24 663 411**	**86 999 761**

31.12.2015	Including:	Level 1 Quoted prices in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
VALUATION ONLY FOR PURPOSES OF DISCLOSURE				
FINANCIAL ASSETS				
Loans and advances to banks	4 979 660	-	-	4 979 660
Loans and advances to customers	71 966 423	-	-	71 966 423
FINANCIAL LIABILITIES				
Amounts due to other banks	11 980 394	-	9 146 976	2 833 418
Amounts due to customers	86 013 567	-	6 740 303	79 273 264
Subordinated liabilities	3 919 644	-	3 919 644	-
Total financial assets	**76 946 083**	**-**	**-**	**76 946 083**
Total financial liabilities	**101 913 605**	**-**	**19 806 923**	**82 106 682**

Level 1

In the Bank there are no assets and financial liabilities at fair value only for the purpose of disclosure that would be included in level 1.

Level 2

Level 2 includes the fair value of long-term loans received from banks, the fair value of long-term deposits placed by customers and the fair value of the loan received from the EIB (Note 28). In addition, at level 2, the Bank has presented subordinated liabilities.

The fair value of financial liabilities with more than 1 year to maturity is based on cash flows discounted using interest rates. For received loans in EUR the Bank used the swap curve amended by the spread determined based on observable Commerzbank CDS quotations in EUR for various maturities and a fixed spread which represents the assumed credit spread differential for Bank risk (derived from market quotation of bond issued under the EMTN programme). For the loans in other currencies, the above spreads for EUR were applied and cross currency swaps quotations to EUR. In case of the loans received from European Investment Bank in EUR, the Bank used EIB yield curve and the value of margin which was agreed upon the last contract. Based on that assumption, the spread of Bank to market swap curve was estimated. In case of deposits the Bank used the curve based on overnight rates, term cash rates, as well as FRA contracts for appropriate currencies and maturities. For debt securities in issue the Bank used the prices directly from the market for these securities. For the purpose of measurement of subordinated liabilities the Bank used obtained primary market spreads of subordinated bonds issued by the Bank and if required corresponding cross-currency basis swap levels for the respective maturities.

Level 3

Level 3 includes the fair value of loans and advances to banks and loans and advances to customers. The fair value for loans and advances to banks and loans and advances to customers is disclosed as the present value of future cash flows using current interest rates including appropriate credit spreads and is based on the expected maturity of the respective loan agreements. The level of credit spread was determined based on market quotation of median credit spreads for Moody's rating grade. Attribution of a credit spread to a given credit exposure is based on a mapping between Moody's rating grade and internal rating grades of mBank. To reflect the fact that the majority of the Bank's exposures is collateralised whereas the median of market quotation is centred around unsecured issues, the Bank performed appropriate adjustments.

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Level 3 also includes liabilities due to banks and to customers with maturity up to one year, for which the Bank assumed that their fair value is equal to the carrying value.

Moreover, the level 3 includes the fair value of liabilities due to banks and to customers with maturity exceeding one year, for which were used valuation methods using at least one significant input data not based on observable market data.

The following tables present fair value hierarchy of financial assets and liabilities recognized in the statement of financial position of the Bank at their fair values.

31.12.2016	Including:	Level 1	Level 2	Level 3
		Quoted prices in active markets	Valuation techniques based on observable market data	Other valuation techniques
RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS				
TRADING SECURITIES	**3 837 606**	**3 509 416**	**-**	**328 190**
Debt securities	***3 834 103***	***3 505 913***	***-***	***328 190***
- government bonds	3 503 029	3 503 029	-	-
- deposit certificates	16 146	-	-	16 146
- mortgage bonds	19 034	-	-	19 034
- banks bonds	128 516	-	-	128 516
- corporate bonds	167 378	2 884	-	164 494
Equity securities	***3 503***	***3 503***	***-***	***-***
- listed	3 503	3 503	-	-
DERIVATIVE FINANCIAL INSTRUMENTS	***1 818 306***	***-***	***1 818 306***	***-***
Derivative financial instruments held for trading	***1 635 609***	***-***	***1 635 609***	***-***
- interest rate derivatives	1 215 427	-	1 215 427	-
- foreign exchange derivatives	378 840	-	378 840	-
- market risks derivatives	41 342	-	41 342	-
Derivative financial instruments held for hedging	***182 697***	***-***	***182 697***	***-***
- derivatives designated as fair value hedges	154 511	-	154 511	-
- derivatives designated as cash flow hedges	28 186	-	28 186	-
INVESTMENT SECURITIES	**30 467 780**	**27 707 542**	**1 584 615**	**1 175 623**
Debt securities	***30 416 697***	***27 706 703***	***1 584 615***	***1 125 379***
- government bonds	27 348 734	27 348 734	-	-
- money bills	1 584 615	-	1 584 615	-
- deposit certificates	50 466	-	-	50 466
- mortgage bonds	223 494	-	-	223 494
- banks bonds	140 880	-	-	140 880
- corporate bonds	1 031 538	357 969	-	673 569
- communal bonds	36 970	-	-	36 970
Equity securities	***51 083***	***839***	***-***	***50 244***
- unlisted	51 083	839	-	50 244
TOTAL FINANCIAL ASSETS	**36 123 692**	**31 216 958**	**3 402 921**	**1 503 813**

31.12.2016	Including:	Level 1	Level 2	Level 3
		Quoted prices in active markets	Valuation techniques based on observable market data	Other valuation techniques
FINANCIAL LIABILITIES				
Derivative financial instruments	***1 644 250***	***-***	***1 644 250***	***-***
Derivative financial instruments held for trading	***1 625 897***	***-***	***1 625 897***	***-***
- interest rate derivatives	1 237 989	-	1 237 989	-
- foreign exchange derivatives	356 947	-	356 947	-
- market risks derivatives	30 961	-	30 961	-
Derivative financial instruments held for trading	***18 353***	***-***	***18 353***	***-***
- derivatives designated as fair value hedges	19 309	-	19 309	-
- derivatives designated as cash flow hedges	(956)	-	(956)	-
Total financial liabilities	***1 644 250***	***-***	***1 644 250***	***-***
TOTAL RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS	**36 123 692**	**31 216 958**	**3 402 921**	**1 503 813**
FINANCIAL LIABILITIES	**1 644 250**	**-**	**1 644 250**	**-**

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Assets Measured at Fair Value Based on Level 3 - changes in 2016	Debt trading securities	Debt investment securities	Equity investment securities
As at the beginning of the period	**377 310**	**827 986**	**181 449**
Gains and losses for the period:	**4 415**	**(14 343)**	**85 169**
Recognised in profit or loss:	4 415	-	252 015
- Net trading income	*4 415*	*-*	*7 959*
- Gains less losses from investment securities, investments in subsidiaries and associates	*-*	*-*	*244 056*
Recognised in other comprehensive income:	*-*	*(14 343)*	*(166 846)*
- Available for sale financial assets	*-*	*(14 343)*	*(166 846)*
Purchases	3 314 524	1 549 259	5 238
Redemptions	(589 093)	(54 750)	-
Sales	(11 442 434)	(1 774 404)	(221 612)
Issues	8 662 494	552 540	-
Transfers into Level 3	974	39 091	-
As at the end of the period	**328 190**	**1 125 379**	**50 244**

Transfers between levels in 2016	Transfer into level 1	Transfer out of level 1	Transfer into level 2	Transfer out of level 2
Trading securities	**-**	**(974)**	**-**	**-**
Debt securities	***-***	***(974)***	***-***	***-***
Investment securities	-	(39 091)	-	-
Debt securities	-	*(39 091)*	-	-

In 2016 there were two transfers from level 1 to level 3 of fair value hierarchy. One transfer resulted from unavailability of market price for communal bonds, and the other from low liquidity of bank bonds

With regard to financial instruments valuated in repetitive way to the fair value classified as level 1 and 2 in hierarchy of fair value, any cases in which transfer between these levels may occur, are monitored by Financial Market Risk Department on the basis of internal rules. In case if there is no market price used to a direct valuation for more than 5 working days, the method of valuation is changed, i.e. change from marked-to-market valuation to marked-to-model valuation under the assumption that the valuation model for the respective type of this instrument has been already approved. The return to marked-to-market valuation method takes place after a period of at least 10 working days in which the market price was available on a continuous basis. If there is no market prices for a debt treasury bonds the above terms are respectively 2 and 5 working days.

31.12.2015	Including:	Level 1	Level 2	Level 3
		Quoted prices in active markets	Valuation techniques based on observable market data	Other valuation techniques
RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS				
TRADING SECURITIES	**558 590**	**181 280**	**-**	**377 310**
Debt securities	***556 776***	***179 466***	***-***	***377 310***
- government bonds	178 492	178 492	-	-
- deposit certificates	73 124	-	-	73 124
- mortgage bonds	6 081	-	-	6 081
- banks bonds	248 156	974	-	247 182
- corporate bonds	50 923	-	-	50 923
Equity securities	***1 814***	***1 814***	***-***	***-***
- listed	1 814	1 814	-	-
DERIVATIVE FINANCIAL INSTRUMENTS	***3 350 746***	***-***	***3 350 746***	***-***
Derivative financial instruments held for trading	***3 183 026***	***-***	***3 183 026***	***-***
- interest rate derivatives	2 814 961	-	2 814 961	-
- foreign exchange derivatives	348 317	-	348 317	-
- market risks derivatives	19 748	-	19 748	-
Derivative financial instruments held for hedging	***167 720***	***-***	***167 720***	***-***
- derivatives designated as fair value hedges	116 959	-	116 959	-
- derivatives designated as cash flow hedges	50 761	-	50 761	-
INVESTMENT SECURITIES	**29 982 642**	**22 000 686**	**6 972 521**	**1 009 435**
Debt securities	***29 800 438***	***21 999 931***	***6 972 521***	***827 986***
- government bonds	21 959 984	21 959 984	-	-
- money bills	6 972 521	-	6 972 521	-
- mortgage bonds	11 372	-	-	11 372
- banks bonds	233 158	-	-	233 158
- corporate bonds	583 456	-	-	583 456
- communal bonds	39 947	39 947	-	-
Equity securities	***182 204***	***755***	***-***	***181 449***
- unlisted	182 204	755	-	181 449
TOTAL FINANCIAL ASSETS	**33 891 978**	**22 181 966**	**10 323 267**	**1 386 745**

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31.12.2015	Including:	Level 1 Quoted prices in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
FINANCIAL LIABILITIES				
Derivative financial instruments	***3 203 918***	**-**	***3 203 918***	**-**
Derivative financial instruments held for trading	***3 203 714***	**-**	***3 203 714***	**-**
- interest rate derivatives	2 842 768	-	2 842 768	-
- foreign exchange derivatives	343 222	-	343 222	-
- market risks derivatives	17 724	-	17 724	-
Derivative financial instruments held for trading	***204***	**-**	***204***	**-**
- derivatives designated as fair value hedges	204	-	204	-
Total financial liabilities	***3 203 918***	**-**	***3 203 918***	**-**
TOTAL RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS	**33 891 978**	**22 181 966**	**10 323 267**	**1 386 745**
FINANCIAL LIABILITIES	**3 203 918**	**-**	**3 203 918**	**-**

Assets Measured at Fair Value Based on Level 3 - changes in 2015	Debt trading securities	Equity trading securities	Derivative financial instruments	Debt investment securities	Equity investment securities
As at the beginning of the period	**626 687**	**22**	**469**	**635 432**	**7 665**
Gains and losses for the period:	**(1 870)**	**(18)**	**(469)**	**7 183**	**169 681**
Recognised in profit or loss:	(1 870)	(18)	(469)	4 049	2 438
- Net trading income	*(1 870)*	*(18)*	*(469)*	-	*99*
- Gains less losses from investment securities, investments in subsidiaries and associates	-	-	-	*4 049*	*2 339*
Recognised in other comprehensive income:	-	-	-	*3 134*	*167 243*
- Available for sale financial assets	-	-	-	*3 134*	*167 243*
Purchases	2 246 493	-	-	815 904	6 840
Redemptions	(281 307)	-	-	(137 219)	-
Sales	(9 526 873)	-	-	(1 796 381)	(2 737)
Issues	7 314 180	-	-	1 303 067	-
Transfers out of Level 3	-	*(4)*	-	-	-
As at the end of the period	**377 310**	**-**	**-**	**827 986**	**181 449**

Transfers between levels in 2015	Transfer into level 1	Transfer out of level 1	Transfer into level 2	Transfer out of level 2
Investment securities	**4**	**-**	**-**	**-**
Equity securities	4	-	-	-

In 2015 there has been observed one transfer from level 3 to level 1 of fair value hierarchy which resulted from the effect of valuation techniques revision applied to minority stakes of low value held by the Bank.

According to the fair value methodology applied by the Bank, financial assets and liabilities are classified as follows:

- Level 1: prices quoted on active markets for the same instrument (without modification);
- Level 2: valuation techniques based on observable market data;
- Level 3: valuation methods for which at least one significant input data is not based on observable market data.

Level 1

As at 31 December 2016, at Level 1 of the fair value hierarchy, the Bank has presented the fair value of held for trading government bonds in the amount of PLN 3 503 029 thousand (see Note 18) and the fair value of investment government bonds in the amount of PLN 27 348 734 thousand (see Note 22) (31 December 2015 respectively: PLN 178 492 thousand and PLN 21 959 984 thousand). Level 1 also includes the fair value of corporate bonds in the amount of PLN 360 853 thousand (31 December 2015 – 0). As at 31 December 2015 Level 1 also includes the fair value of local government bonds in the amount of PLN 39 947 thousand and fair value of bonds issued by one bank in the amount of PLN 974 thousand.

In addition, as at 31 December 2016 level 1 includes the value of the registered privileged shares of Giełda Papierów Wartościowych in the amount of PLN 839 thousand (31 December 2015: PLN 755 thousand) and the value of the shares of listed companies in the amount of PLN 3 503 thousand (31 December 2015: PLN 1 814 thousand).

These instruments are classified as level 1 because their valuation is directly derived by applying current market prices quoted on active and liquid financial markets.

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Level 2

Level 2 of the fair value hierarchy includes the fair values of short term bills issued by NBP in the amount of PLN 1 584 615 thousand (31 December 2015: PLN 6 972 521 thousand), whose valuation is based on a NPV model (discounted future cash flows) fed with interest rate curves generated by transformation of quotations taken directly from active and liquid financial markets.

In addition, the level 2 category includes the valuation of derivative financial instruments borne on models consistent with market standards and practices, using parameters taken directly from the markets (e.g., foreign exchange rates, implied volatilities of fx options, stock prices and indices) or parameters which transform quotations taken directly from active and liquid financial markets (e.g., interest rate curves).

As at 31 December 2016 and 31 December 2015, level 2 also includes the value of options referencing on the WIG20 index, listed on the Stock Exchange. For the valuation of index options on WIG20 the Bank applied an internal model (based on a model for implied volatility) for which market data have been used as input parameters.

Level 3

Level 3 of the hierarchy presents the fair values of commercial debt securities issued by local banks and companies (bonds, deposit certificates and mortgage bonds) in the amount of PLN 1 416 599 thousand (31 December 2015: PLN 1 205 296 thousand).

Level 3 includes also the fair value of local government bonds in the amount of PLN 36 970 thousand (31 December 2015 – 0).

The above mentioned debt instruments are classified as level 3 because in addition to parameters which transform quotations taken directly from active and liquid financial markets (interest rate curves), their valuation uses credit spread estimated by the Bank by means of an internal credit risk model and reflects the credit risk of the issuer. The model uses parameters (e.g., rate of recovery from collateral, rating migrations, default ratio volatilities) which are not observed on active markets and hence were generated by statistical analysis. The model has been modified in 2016 by adding an additional factor adjusting credit spreads to market levels.

Impact of change in credit spreads on the fair value of debt securities classified as level 3 is presented in the table below. The amount reflects change in credit risk in relation to purchase date.

Issuer	Change of fair value resulting from change in credit risk	
	31.12.2016	31.12.2015
Credit institutions	9 763	1 549
Non-financial customers	6 254	2 537
Total	**16 017**	**4 086**

Moreover, level 3 covers mainly the fair value of equity securities amounting to PLN 50 244 thousand (31 December 2015: PLN 181 449 thousand). As at 31 December 2016, these amount includes the value of preferred stock in Visa Inc. in the amount of PLN 38 392 thousand. As at 31 December 2015 this amount includes the value of Visa Europe Ltd. shares in the amount of PLN 167 243 thousand which was valuated at fair value on the basis on information held by the Bank in connection with the takeover transaction of Visa Europe Ltd by Visa Inc. The other equity securities presented at level 3 have been valuated using the market multiples method. The market multiples method, consists of valuating the equity capital of a company by using a relation between the market values of the own equity capital or market values of the total capital invested in comparable companies (goodwill) and selected economic and financial figures.

3.17. Other activities

The Bank provides custody, trustee, corporate administration, investment management and advisory services to third parties. In connection with these, the Bank makes decisions concerning the allocation, purchase and sale of a wide variety of financial instruments. Assets held in a fiduciary capacity are not included in these financial statements.

4. Major estimates and judgments made in connection with the application of accounting policy principles

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

Impairment of loans and advances

The Bank reviews its loan portfolio in terms of possible impairments at least once per quarter. In order to determine whether any impairment loss should be recognized in the income statement, the Bank assesses whether any evidence exists that would indicate some measurable reduction of estimated future cash flows attached to the loan portfolio. The methodology and the assumptions, on the basis of which the estimated cash flow amounts and their anticipated timing are determined, are regularly verified. If the current value of estimated cash flows for portfolio of loans and advances which are impaired, change by +/-10%, the estimated loans and advances impairment would either decrease by PLN 25.2 million or increase by PLN 30.8 million respectively. This estimation was performed for portfolio of loans and advances individually assessed for impairment on the basis of future cash flows due to repayments and recovery from collateral.

The rules of determining write-downs and provisions for impairment of credit exposures have been described under Note 3.4.6.

Fair value of derivatives and other financial instruments

The fair value of financial instruments not listed on active markets is determined by applying valuation techniques. All the models are approved prior to being applied and they are also calibrated in order to assure that the obtained results indeed reflect the actual data and comparable market prices. As far as possible, observable market data originating from an active market are used in the models. Methods for determining the fair value of financial instruments are described in Note 2.7. If the current value of interest rates used for valuation change by +/- 1 bp, the fair value of financial instruments would either decrease or increase by PLN 9.3 million PLN respectively.

Impairment of available for sale investments

The Bank reviews its debt securities classified as available for sale investments at each reporting date to assess whether they are impaired. This requires similar judgment as applied to the individual assessment of loans and advances. The Bank also records impairment charges on available for sale equity investments when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is "significant" or "prolonged" requires professional judgment. In making this judgment, the Bank evaluates, among other factors, historical share price movements and duration and extent to which the fair value of an investment is less than its cost.

Deferred tax assets

Deferred tax assets are recognized in respect of tax losses to the extent that it is probable that future taxable profit will be available against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits.

Revenue and expenses from sale of insurance products bundled with loans

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

The remuneration included in fee and commission income is recognized partly as upfront income and partly including deferring over time based on the analysis of the stage of completion of the service.

Now, the Bank leads in case of insurance policies bundled with loans to upfront recognition less than 10% of bancassurance income associated with cash and car loans and 0% to approximately 25% of bancassurance income associated with mortgage loans. Recognition of the remaining part of the income is spread over the economic life of the associated loans. Expenses directly linked to the sale of insurance products are recognized using the same pattern.

Liabilities due to post-employment employee benefits

The costs of post-employment employee benefits are determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, future salary increases, mortality rates and other factors. Due to the long–term nature of these liabilities, such estimates are subject to significant uncertainty.

Leasing classification

The Bank makes judgement classifying lease agreements as finance lease or operating lease based on the economic substance of the transaction basing on professional judgment whether substantially all the risk and rewards incidental to ownership of an asset were transferred or not.

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5. Net interest income

	Year ended 31 December	
	2016	**2015**
Interest income		
Loans and advances including the unwind of the impairment provision discount	2 313 715	2 218 951
Investment securities	695 421	743 943
Cash and short-term placements	56 381	50 421
Trading debt securities	79 719	52 552
Interest income on derivatives classified into banking book	183 820	148 544
Interest income on derivatives concluded under the fair value hedge	45 060	35 223
Interest income on derivatives concluded under cash flow hedge	15 874	14 140
Other	4 106	10 720
Total interest income	**3 394 096**	**3 274 494**
Interest expense		
Arising from amounts due to banks	(75 004)	(92 443)
Arising from amounts due to customers	(772 211)	(869 339)
Arising from issue of debt securities	-	(11 612)
Arising from subordinated liabilities	(68 661)	(78 966)
Other	(12 034)	(13 775)
Total interest expense	**(927 910)**	**(1 066 135)**

In 2016, interest income related to impaired financial assets amounted to PLN 95 082 thousand (for the period ended 31 December 2015: PLN 103 829 thousand).

Net interest income per client groups is as follows.

	Year ended 31 December	
	2016	**2015**
Interest income		
From banking sector	431 633	413 208
From clients, including:	2 962 463	2 861 286
- individual clients	1 446 482	1 372 848
- corporate clients	798 753	777 429
- public sector	717 228	711 009
Total interest income	**3 394 096**	**3 274 494**
Interest expense		
From banking sector	(86 227)	(108 141)
From clients, including:	(773 022)	(867 416)
- individual clients	(381 602)	(371 559)
- corporate clients	(377 768)	(458 472)
- public sector	(13 652)	(37 385)
From debt securities in issue and from subordinated liabilities	(68 661)	(90 578)
Total interest expense	**(927 910)**	**(1 066 135)**

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6. Net fee and commission income

	Year ended 31 December	
	2016	**2015**
Fee and commission income		
Payment cards-related fees	361 907	342 310
Credit-related fees and commissions	244 547	214 944
Commissions for agency service regarding sale of insurance products of external financial entities	17 882	46 669
Fees from brokerage activity and debt securities issue	109 292	24 760
Commissions from bank accounts	168 857	162 595
Commissions from money transfers	110 265	102 554
Commissions due to guarantees granted and trade finance commissions	54 508	44 351
Commissions for agency service regarding sale of other products of external financial entities	81 073	70 568
Commissions on trust and fiduciary activities	25 017	22 337
Fees from portfolio management services and other management-related fees	8 957	-
Fees from cash services	51 082	39 686
Other	25 882	20 734
Fee and commission income	**1 259 269**	**1 091 508**
Fee and commission expense		
Payment cards-related fees	(229 856)	(204 864)
Commissions paid to external entities for sale of the Bank's products	(113 826)	(98 468)
Discharged brokerage fees	(48 572)	(12 386)
Cash services	(47 906)	(40 666)
Fees to NBP and KIR	(11 453)	(10 614)
Other discharged fees	(124 434)	(101 655)
Total fee and commision expense	**(576 047)**	**(468 653)**

7. Dividend income

	Year ended 31 December	
	2016	**2015**
Trading securities	410	140
Securities available for sale	166 423	197 732
Total dividend income	**166 833**	**197 872**

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8. Net trading income

	Year ended 31 December	
	2016	2015
Foreign exchange result	**265 741**	**285 786**
Net exchange differences on translation	231 445	257 929
Net transaction gains/(losses)	34 296	27 857
Other net trading income and result on hedge accounting	**(16 196)**	**8 224**
Interest-bearing instruments	(6 548)	(5 327)
Equity instruments	(358)	(230)
Market risk instruments	4 811	2 382
Result on fair value hedge accounting, including:	3 523	15 006
- Net profit on hedged items	(9 128)	(1 279)
- Net profit on fair value hedging instruments	12 651	16 285
Ineffective portion of cash flow hedge	(17 624)	(3 607)
Total net trading income	**249 545**	**294 010**

"Foreign exchange result" includes profit/(loss) on spot transactions and forward contracts, options, futures and on translation of assets and liabilities denominated in foreign currencies. "Interest-bearing instruments" include the profit/(loss) on money market instrument trading, swap contracts for interest rates, options and other derivative instruments. "Equity instruments" include the valuation and profit/(loss) on global trade in equity securities. "Market risk instruments" include profit/(loss) on: bond futures, index futures, security options, stock exchange index options, and options on futures contracts as well as the result from securities forward transactions and commodity swaps.

The Bank applies fair value hedge accounting and cash flow hedge accounting. Detailed information on hedge accounting are included in Note 20 "Hedge accounting".

9. Other operating income

	Year ended 31 December	
	2016	2015
Income from services provided	16 859	19 741
Income due to release of provisions for future commitments	6 753	7 799
Income from sale or liquidation of fixed assets, intangible assets and assets held for sale	373	234
Compensations, penalties and fines received	230	73
Income from recovering receivables designated previously as prescribed, remitted or uncollectible	581	1 758
Other	43 954	26 776
Total other operating income	**68 750**	**56 381**

Income from services provided is earned on non-banking activities.

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10. Overhead costs

	Year ended 31 December	
	2016	2015
Staff-related expenses	(719 820)	(670 570)
Material costs, including:	(589 577)	(548 033)
- logistics cost	(292 687)	(283 348)
- IT costs	(126 232)	(97 917)
- marketing costs	(115 651)	(109 570)
- consulting costs	(39 478)	(41 752)
- other material costs	(15 529)	(15 446)
Taxes and fees	(18 373)	(21 598)
Contributions and transfers to the Bank Guarantee Fund	(158 176)	(274 195)
Contributions to the Borrowers Support Fund	-	(51 727)
Contributions to the Social Benefits Fund	(5 607)	(5 872)
Total overhead costs	**(1 491 553)**	**(1 571 995)**

In 2016 in the item "Contribution and transfers to the Bank Guarantee Fund" includes of mBank's payment in the amount of PLN 10 898 thousand intended for the payment of guaranteed depositors of Bank Spółdzielczy w Nadarzynie (the Co-operative Bank in Nadarzyn).

In 2015 in the item "Contribution and transfers to the Bank Guarantee Fund" was caused by mBank obligation to contribute in the amount of PLN 141 284 thousand via the BFG fund in the bail-out of Spółdzielczy Bank Rzemiosła i Rolnictwa w Wołominie depositors.

On 9 September 2015 the Parliament of the Republic of Poland passed the "Act on support for borrowers that are in a financial distress and took a housing loan". The act sets principles for providing returnable financial support to natural persons obliged to repay housing loans who are in a financial distress as well as the terms and conditions for using it. The support will be paid from the Borrowers Support Fund, financed by contributions made by lenders proportionally to their share in the volume of housing loans portfolio granted to households which is above 90 days past due in respect of principal or interest repayment.

According to the information dated on 5 January 2016 received from the Council of the Borrowers Support Fund, the payments of the Bank was calculated in the amount PLN 51 727 thousand. mBank made appropriate provision (Note 32 "Provisions") and its cost has been included in the financial result of mBank for the year 2015. The payment was made on 18 February 2016.

"Material costs" consist of tangible assets operating lease payment costs (mainly real estate) of PLN 29 133 thousand (2015: PLN 27 836 thousand).

Staff-related expenses in 2016 and 2015 are presented below.

	Year ended 31 December	
	2016	2015
Wages and salaries	(591 543)	(540 836)
Social security expenses	(92 221)	(85 595)
Expenses related to post-employment benefits	(572)	(513)
Remuneration concerning share-based payments, including:	(9 223)	(15 744)
- share-based payments settled in mBank S.A. shares	(9 088)	(14 459)
- cash-settled share-based payments	(135)	(1 285)
Other staff expenses	(26 261)	(27 882)
Staff-related expenses, total	**(719 820)**	**(670 570)**

Cash-settled share-based payments relate to the cost of 2008 incentive programme for the Management Board Members of the Bank in its part based on Commerzbank shares. Detailed information regarding incentive programmes to which share-based payments relate, is included under the Note 44 "Share-based incentive programmes".

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11. Other operating expenses

	Year ended 31 December	
	2016	**2015**
Provisions for future commitments	(24 567)	(17 179)
Costs arising from impairment provisions created for other receivables (excluding loans and advances)	(927)	(782)
Donations made	(2 621)	(2 599)
Costs arising from sale or liquidation of fixed assets, intangible assets and assets held for resale	(483)	(275)
Compensations, penalties and fines paid	(1 359)	(2 438)
Costs arising from receivables and liabilities recognised as prescribed, remitted and uncollectible	(92)	(140)
Other operating costs	(72 892)	(37 283)
Total other operating expenses	**(102 941)**	**(60 696)**

In 2016, provisions for future commitments include provisions for legal proceedings of PLN 19 684 thousand (2015: PLN 8 744 thousand) (Note 32).

12. Net impairment losses on loans and advances

	Year ended 31 December	
	2016	**2015**
Net impairment losses on amounts due from other banks (Note 17)	(472)	(212)
Net impairment losses on loans and advances to customers (Note 21)	(314 228)	(329 199)
Net impairment losses on contingent liabilities (Note 32)	2 505	4 086
Total net impairment losses on loans and advances	**(312 195)**	**(325 325)**

13. Income tax expense

	Year ended 31 December	
	2016	**2015**
Current tax	(361 451)	(259 330)
Deferred income tax (Note 33)	10 636	7 533
Total income tax	**(350 815)**	**(251 797)**
Profit before tax	**1 570 154**	**1 553 030**
Tax calculated at Polish current tax rate (19%)	(298 329)	(295 076)
Income not subject to tax *)	50 463	75 205
Costs other than tax deductible costs **)	(102 949)	(25 892)
Deferred tax losses incurred by mBank branch in the Czech Republic in previous years	-	(6 034)
Income tax expense	**(350 815)**	**(251 797)**
Effective tax rate calculation		
Profit before income tax	1 570 154	1 553 030
Income tax	(350 815)	(251 797)
Effective tax rate	**22.34%**	**16.21%**

*) Includes i.e. intragroup dividends excluded from taxation under Article 20 item 3 of Corporate Income Tax Act from 15 February 1992 (Journal of Laws No 21, item 86).

**) Includes i.e. impact of banking tax introduced by the Act on Tax on Certain Financial Institutions from 15 January 2016 (Journal of Laws 2016, item 68) and non-deductible costs according to Article 16 item 1 of Corporate Income Tax Act from 15 February 1992 (Journal of Laws No 21, item 86).

Information about deferred income tax is presented in Note 33. The tax on the Bank's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the parent as presented above.

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14. Earnings per share

Earnings per share for 12 months

	Year ended 31 December	
	2016	**2015**
Basic:		
Net profit	1 219 339	1 301 233
Weighted average number of ordinary shares	42 252 790	42 221 351
Net basic profit per share (in PLN per share)	**28.86**	**30.82**
Diluted:		
Net profit applied for calculation of diluted earnings per share	1 219 339	1 301 233
Weighted average number of ordinary shares	42 252 790	42 221 351
Adjustments for:		
- share options	27 496	25 809
Weighted average number of ordinary shares for calculation of diluted earnings per share	42 280 286	42 247 160
Diluted earnings per share (in PLN per share)	**28.84**	**30.80**

According to IAS 33, the Bank prepares a calculation of the diluted earnings per share taking into account contingently issuable shares as part of the incentive programmes is described in the Note 44. The calculations did not include those elements of the incentive programmes, which were antidilutive for the presented periods that could potentially dilute basic earnings per share in the future.

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

The diluted earnings per share are calculated by adjusting the weighted average number of ordinary shares as if all possible ordinary shares causing the dilution were replaced with shares. The Bank has one category of potential ordinary shares causing the dilution: share options. The number of diluting shares is computed as the number of shares that would be issued if all share options were executed at the market price, determined as the average annual closing price of the Bank's shares.

15. Other comprehensive income

Disclosure of tax effects relating to each component of other comprehensive income	Year ended 31 December 2016			Year ended 31 December 2015		
	Before-tax amount	Tax (expense) benefit	Net amount	Before-tax amount	Tax (expense) benefit	Net amount
Items that may be reclassified subsequently to the the income statement	**(549 764)**	**102 306**	**(447 458)**	**(163 674)**	**48 486**	**(115 188)**
Exchange differences on translation of foreign operations	337	-	337	684	-	684
Change in valuation of available for sale financial assets	(545 931)	101 742	(444 189)	(159 928)	47 736	(112 192)
Cash flow hedges (net)	(2 968)	564	(2 404)	(3 947)	750	(3 197)
Share of other comprehensive income of entities under the equity method	(1 202)	-	(1 202)	(483)	-	(483)
Items that will not be reclassified to the income statement	**411**	**(78)**	**333**	**(1 873)**	**355**	**(1 518)**
Actuarial gains and losses relating to post-employment benefits	411	(78)	333	(1 873)	355	(1 518)
Total other comprehensive income	**(549 353)**	**102 228**	**(447 125)**	**(165 547)**	**48 841**	**(116 706)**

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The table below presents detailed information concerning other comprehensive income for the years 2016 and 2015.

	Year ended 31 December	
	2016	**2015**
Items that may be reclassified subsequently to the the income statement	**(447 458)**	**(115 188)**
Exchange differences on translating foreign operations	**337**	**684**
Unrealised gains (positive differences) arising during the year (net)	(2 618)	3 882
Unrealised losses (negative differences) arising during the year (net)	2 955	(3 198)
Available-for-sale financial assets	**(444 189)**	**(112 192)**
Unrealised gains on debt instruments arising during the year (net)	2 925	35 771
Unrealised losses on debt instruments arising during the year (net)	(297 740)	(110 055)
Reclassification adjustments of gains (losses) on debt instruments to the income statement (net)	(14 292)	(5 112)
Unrealised gains on equity instruments arising during the year (net)	204 247	135 467
Unrealised losses on equity instruments arising during the year (net)	(135 464)	(38 493)
Reclassification adjustments of gains (losses) on equity instruments to the income statement (net)	(203 865)	(129 770)
Cash flow hedges	**(2 404)**	**(3 197)**
Unrealized gains arising during the year (net)	3	8 256
Unrealized losses arising during the year (net)	(2 407)	-
Reclassification adjustments for gains (losses) included in the income statement (net)	-	(11 453)
Share of other comprehensive income of entities under the equity method	**(1 202)**	**(483)**
Share of other comprehensive income of entities under the equity method during the year	(1 202)	(483)
Items that will not be reclassified to the income statement	**333**	**(1 518)**
Actuarial gains and losses relating to post-employment benefits	**333**	**(1 518)**
Actuarial gains	333	-
Actuarial losses	-	(1 518)
Total other comprehensive income (net)	**(447 125)**	**(116 706)**

In 2016, unrealized gains on equity instruments arising during the year in the amount of PLN 204 247 thousand and reclassification of gains on equity instruments to the income statement in the amount of PLN 203 865 thousand relate mainly to takeover transaction of Visa Europe Limited by Visa Inc. Detailed information regarding this transaction has been described under Note 22.

In 2015, the reclassification of gains on equity instruments to the income statement in the amount of PLN 129 770 thousand applies to the sale of PZU S.A. shares.

In 2015, unrealized gains on equity instruments include positive valuation of the share in Visa Europe Ltd (Visa Europe) in the gross amount of EUR 39 245 thousand - the equivalent of PLN 167 243 thousand (according to the average NBP exchange rate as of 31 December 2015).

16. Cash and balances with central bank

	31.12.2016	**31.12.2015**
Cash in hand	1 149 698	1 330 044
Current account	8 009 053	4 600 567
Total cash and balances with the Central Bank (Note 43)	**9 158 751**	**5 930 611**

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

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- PLN 2 674 432 thousand for the period from 30 November 2016 to 1 January 2017,
- PLN 2 551 278 thousand for the period from 31 December 2015 to 31 January 2016.

As at 31 December 2016, the former part of the reserve bore 1.35% interest (31 December 2015: 1.35%).

17. Loans and advances to banks

	31.12.2016	31.12.2015
Current accounts	458 115	330 926
Placements with other banks (up to 3 months)	1 867 789	452 402
Included in cash equivalents (Note 43)	**2 325 904**	**783 328**
Loans and advances	4 094 771	3 002 633
Term placements with other banks	-	29 390
Reverse repo / buy-sell-back transactions	-	593 465
Other receivables	890 351	574 204
Total (gross) loans and advances to banks	**7 311 026**	**4 983 020**
Provisions created for loans and advances to banks (negative amount)	**(2 257)**	**(1 699)**
Total (net) loans and advances to banks	**7 308 769**	**4 981 321**
Short-term (up to 1 year)	**3 806 105**	**2 379 913**
Long-term (over 1 year)	**3 502 664**	**2 601 408**

The item "Other receivables" includes cash collaterals (as at 31 December 2016 in the amount of PLN 429 519 thousand, as at 31 December 2015: PLN 367 970 thousand) placed with other banks under the derivative transactions concluded by the Bank (Note 37).

The following table presents receivables from Polish and foreign banks:

	31.12.2016	31.12.2015
Loans and advances to Polish banks (gross)	5 481 585	4 131 916
Provisions created for loans and advances to Polish banks	(62)	(152)
Loans and advances to foreign banks (gross)	1 829 441	851 104
Provisions created for loans and advances to foreign banks	(2 195)	(1 547)
Total (net) loans and advances to banks	**7 308 769**	**4 981 321**

As at 31 December 2016, the variable rate loans to banks amounted to PLN 4 064 881 thousand and the fixed rate loans to banks amounted to PLN 29 890 thousand (as at 31 December 2015 – variable rate loans to banks amounted to PLN 2 986 866 thousand and fixed rate loans to PLN 15 767 thousand).

As at 31 December 2016 and 31 December 2015, the term placements with other banks were fixed rated and amounted to PLN 1 867 789 thousand and PLN 481 792 thousand respectively. An average interest rate for placements in other banks and loans granted to other banks amounted to 1.32% (31 December 2015: 1.33%).

The following table presents the changes in provisions for losses on loans and advances to banks:

	31.12.2016	31.12.2015
Provisions for loans and advances to banks as at the beginning of the period	**(1 699)**	**(1 484)**
- provisions created (Note 12)	(3 658)	(5 120)
- release of provision (Note 12)	3 186	4 908
- foreign exchange differences	(86)	(3)
Provisions for loans and advances to banks as at the end of the period	**(2 257)**	**(1 699)**

As at 31 December 2016 provisions for loans and advances to banks includes the amount of PLN 1 525 thousand provision for impaired loans.

As at 31 December 2015 provisions for loans and advances to banks in the whole related to the loans without impairment.

Loans and advances to banks	31.12.2016		31.12.2015	
	exposure in PLN '000	share/coverage (%)	exposure in PLN '000	share/coverage (%)
Neither past due nor impaired	7 280 542	99.58	4 983 020	100.00
Past due but not impaired	-	-	-	-
Impaired	30 484	0.42	-	-
Total, gross	**7 311 026**	**100.00**	**4 983 020**	**100.00**
Provision (provision for impaired loans and advances as well as IBNI provision)	(2 257)	0.03	(1 699)	0.03
Total, net	**7 308 769**	**99.97**	**4 981 321**	**99.97**

Loans and advances to banks neither past due nor impaired

Loans and advances to banks		
Sub-portfolio	31.12.2016	31.12.2015
1	5 456 459	3 558 944
2	1 391 810	1 096 822
3	246 902	173 829
4	64 314	29 263
5	-	45 451
6	-	-
7	1 945	14 336
8	119 112	64 375
Total	**7 280 542**	**4 983 020**

18. Trading securities

	31.12.2016			31.12.2015		
	Trading securities without pledge	Pledged trading securities	Total trading securities	Trading securities without pledge	Pledged trading securities	Total trading securities
Debt securities:	**3 079 840**	**754 263**	**3 834 103**	**540 079**	**16 697**	**556 776**
Issued by government	2 748 766	754 263	3 503 029	161 795	16 697	178 492
- government bonds	2 748 766	754 263	3 503 029	161 795	16 697	178 492
Other debt securities	331 074	-	331 074	378 284	-	378 284
- bank's bonds	128 516	-	128 516	248 156	-	248 156
- deposit certificates	16 146	-	16 146	73 124	-	73 124
- corporate bonds	167 378	-	167 378	50 923	-	50 923
- communal bonds	19 034	-	19 034	6 081	-	6 081
Equity securities:	**3 503**	**-**	**3 503**	**1 814**	**-**	**1 814**
- listed	3 503	-	3 503	1 814	-	1 814
Total debt and equity securities	**3 083 343**	**754 263**	**3 837 606**	**541 893**	**16 697**	**558 590**

Trading securities include securities used to secure sell-buy-back transactions with customers, the market value of which as at 31 December 2016 amounted to PLN 754 263 thousand (31 December 2015: PLN 16 697 thousand).

19. Derivative financial instruments

The Bank has the following derivative instruments:

Forward currency transactions represent commitments to purchase foreign and local currencies, including outstanding spot transactions. **Futures for currencies and interest rates** are contractual commitments to receive or pay a specific net value, depending on currency rate of exchange or interest rate variations, or to buy or sell a foreign currency or a financial instrument on a specified future date for a fixed price established on the organised financial market. Because futures contracts are collateralised with fair-valued cash or securities and the changes of the face value of such contracts are accounted for daily in reference to stock exchange quotations, the credit risk is marginal. **FRA contracts** are similar to futures except that each FRA is negotiated individually and each requires payment on a specific future date of the difference between the interest rate set in the agreement and the current market rate on the basis of theoretical amount of capital.

Currency and interest rate swap contracts are commitments to exchange one cash flow for another cash flow. Such a transaction results in swap of currencies or interest rates (e.g., fixed to variable interest rate) or combination of all these factors (e.g., cross-currency CIRS). With the exception of specific currency swap contracts, such transactions do not result in swaps of capital. The credit risk of the Bank consists of the potential cost of replacing swap contracts if the parties fail to discharge their liabilities. This risk is monitored daily by reference to the current fair value, proportion of the face value of the contracts and market liquidity. The Bank evaluates the parties to such contracts using the same methods as for its credit business, to control the level of its credit exposure.

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The Bank applies fair value hedge accounting for fixed interest rate security deposit given by the Bank's subsidiary entity. Moreover, the Bank applies cash flow hedge accounting of variable rate loans indexed to market rates, granted by the Bank. Hedging instrument in both types of hedge accounting are fix to float Interest Rate Swap.

Detailed information on hedge accounting are presented in Note 20 below.

Currency and interest rate options are agreements, pursuant to which the selling party grants the buying party the right, but not an obligation, to purchase (call option) or sell (put option) a specific quantity of a foreign currency or a financial instrument at a predefined price on or by a specific date or within an agreed period. In return for accepting currency or interest rate risk, the buyer offers the seller a premium. An option can be either a public instrument traded at a stock exchange or a private instrument negotiated between the Bank and a customer (private transaction). The Bank is exposed to credit risk related to purchased options only up to the balance sheet value of such options, i.e. the fair value of the options.

Market risk transactions include futures contracts as well as commodity options, stock options and index options.

Face values of certain types of financial instruments provide a basis for comparing them to instruments disclosed in the statement of financial position but they may not be indicative of the value of the future cash flows or of the present fair value of such instruments. For this reason, the face values do not indicate the level of the Bank's exposure to credit risk or price change risk. Derivative instruments can have positive value (assets) or negative value (liabilities), depending on market interest or currency exchange rate fluctuations. The aggregate fair value of derivative financial instruments may be subject to strong variations.

The fair values of derivatives held by the Bank is presented below.

	Contract amount		Fair value	
	Purchase	Disposal	Assets	Liabilities
As at 31 December 2016				
Derivatives held for trading				
Foreign exchange derivatives				
- Currency forwards	17 619 549	17 568 019	211 526	80 443
- Currency swaps	14 928 969	14 906 305	97 607	108 021
- Cross-currency interest rate swaps	10 064 507	10 157 587	35 145	124 419
- OTC currency options bought and sold	1 985 060	2 451 218	34 562	44 064
Total OTC derivatives	**44 598 085**	**45 083 129**	**378 840**	**356 947**
- Currency futures	155 494	155 830	-	-
Total foreign exchange derivatives	**44 753 579**	**45 238 959**	**378 840**	**356 947**
Interest rate derivatives				
- Interest rate swap, OIS	142 509 393	142 509 393	1 381 293	1 418 513
- Forward rate agreements	13 225 000	15 200 000	7 383	6 204
- OTC interest rate options	221 806	400 927	1 000	1 089
Total OTC interest rate derivatives	**155 956 199**	**158 110 320**	**1 389 676**	**1 425 806**
- Interest rate futures	110 543	1 473	-	-
Total interest rate derivatives	**156 066 742**	**158 111 793**	**1 389 676**	**1 425 806**
Market risk transactions	**2 161 160**	**4 297 119**	**41 342**	**30 961**
Total derivative assets / liabilities held for trading	**202 981 481**	**207 647 871**	**1 809 858**	**1 813 714**
Derivatives held for hedging				
Derivatives designated as fair value hedges	7 983 710	7 983 710	154 511	19 309
- Interest rate swaps	7 983 710	7 983 710	154 511	19 309
Derivatives designated as cash flow hedges	2 665 000	2 665 000	30 926	1 786
- Interest rate swaps	2 665 000	2 665 000	30 926	1 786
Total derivatives held for hedging	**10 648 710**	**10 648 710**	**185 437**	**21 095**
Offsetting effect	**-**	**-**	**(176 989)**	**(190 559)**
Total recognised derivative assets/ liabilities	**213 630 191**	**218 296 581**	**1 818 306**	**1 644 250**
Short-term (up to 1 year)	96 569 330	98 250 790	617 497	526 050
Long-term (over 1 year)	117 060 861	120 045 791	1 200 809	1 118 200

Except of valuation of derivatives, the offsetting effect includes PLN 20 204 thousand of placed collaterals and PLN 6 634 thousand of collaterals received in connection with the derivative transactions subject to compensation.

	Contract amount		Fair value	
	Purchase	Disposal	Assets	Liabilities
As at 31 December 2015				
Derivatives held for trading				
Foreign exchange derivatives				
- Currency forwards	13 962 295	14 011 671	105 911	118 931
- Currency swaps	16 897 716	16 778 526	151 039	91 040
- Cross-currency interest rate swaps	6 446 870	6 492 050	43 495	78 674
- OTC currency options bought and sold	3 439 254	4 097 450	47 872	54 577
Total OTC derivatives	**40 746 135**	**41 379 697**	**348 317**	**343 222**
- Currency futures	80 433	80 339	-	-
Total foreign exchange derivatives	**40 826 568**	**41 460 036**	**348 317**	**343 222**
Interest rate derivatives				
- Interest rate swap, OIS	205 429 613	205 429 613	2 789 981	2 821 011
- Forward rate agreements	30 032 000	37 839 000	22 713	19 186
- OTC interest rate options	222 315	326 127	2 267	2 571
Total OTC interest rate derivatives	**235 683 928**	**243 594 740**	**2 814 961**	**2 842 768**
- Interest rate futures	-	738	-	-
Total interest rate derivatives	**235 683 928**	**243 595 478**	**2 814 961**	**2 842 768**
Market risk transactions	**2 582 949**	**1 471 990**	**19 748**	**17 724**
Total derivative assets / liabilities held for trading	**279 093 445**	**286 527 504**	**3 183 026**	**3 203 714**
Derivatives held for hedging				
Derivatives designated as fair value hedges	5 245 822	5 245 822	116 959	204
- Interest rate swaps	5 245 822	5 245 822	116 959	204
Derivatives designated as cash flow hedges	2 455 000	2 455 000	50 761	-
- Currency swaps	2 455 000	2 455 000	50 761	-
Total derivatives held for hedging	**7 700 822**	**7 700 822**	**167 720**	**204**
Total recognised derivative assets/ liabilities	**286 794 267**	**294 228 326**	**3 350 746**	**3 203 918**
Short-term (up to 1 year)	142 619 518	149 213 874	853 120	831 817
Long-term (over 1 year)	144 174 749	145 014 452	2 497 626	2 372 101

In the both reporting periods, market risk transactions comprise the fair values of: stock index options, shares and other equity securities, futures for commodities, swap contracts for commodities.

Under financial derivative instruments the Bank presented derivative instruments in the amount of PLN 1 012 thousand (liabilities), which have been separated from the structured investment deposits (31 December 2015: PLN 1 173 thousand).

As at 31 December 2016 and 31 December 2015, the Bank did not hold any financial assets and financial liabilities designated upon initial recognition as at fair value through the income statement.

20. Hedge accounting

Fair value hedge accounting

The Bank has been applying fair value hedge accounting. The interest rate risk is the only type of risk hedged for which hedge accounting is applied.

At the end of each month, the Bank evaluates effectiveness of the applied hedging by carrying out analysis of changes in fair value of the hedged and hedging instruments in respect of the hedged risk.

Description of the hedging relation

The Bank hedges against the risk of change in fair value:

- fixed interest rate security deposit submitted by the mFinance France (mFF), a subsidiary of mBank, with funds arising from the issuance of Eurobonds. The hedged risk results from changes in interest rates.
- loan received by mBank from European Investment Bank. An Interest Rate Swap is the hedging instrument changing the fixed interest rate to a variable interest rate.

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Hedged items

The hedged items are:

- fixed interest rate security deposit given by mFF in the amount of CHF 198 967,
- fixed interest rate security deposit given by mFF in the amount of CZK 500 000,
- fixed interest rate security deposit given by mFF in the amount of EUR 495 615,
- fixed interest rate security deposit given by mFF in the amount of EUR 498 750,
- fixed interest rate security deposit given by mFF in the amount of EUR 498 750.
- fixed interest rate loan received from European Investment Bank with a nominal value of EUR 100 000 thousand.

In all cases described above, the risk of changes in interest rates is the only type of risk hedged within hedge accounting applied by the Group. The result of the valuation of hedged items and hedging instruments is presented in the position "Other net trading income and result on hedge accounting" in Note 8.

Hedging instruments

IRS is the hedging instrument swapping the fixed interest rate for a variable interest rate.

Presentation of the result from hedged and hedging transactions

Fair value adjustment of the hedged assets and liabilities as well as valuation of the hedging instruments is recognized in the income statement as the income from trading operation.

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

	Year ended 31 December	
	2016	2015
Interest income on derivatives concluded under the fair value hedge (Note 5)	45 060	35 223
Net profit on hedged items (Note 8)	(9 128)	(1 279)
Net profit on fair value hedging instruments (Note 8)	12 651	16 285
The total results of fair value hedge accounting recognised in the income statement	**48 583**	**50 229**

Cash flow hedge accounting

The Bank applies cash flow hedge accounting of the part of loans at a variable interest rate indexed to the market rate, granted by the Bank. An Interest Rate Swap is the hedging instrument changing the variable interest rate to a fixed interest rate. The interest rate risk is the hedged risk within applied by the Bank cash flow hedge accounting. The ineffective portion of the gains or losses on the hedging instrument is presented in Note 8 "Other net trading income and result on hedge accounting". Portion of the gains or losses on the hedging instrument that is an effective hedge, is presented in the statement of comprehensive income as "Cash flow hedges (net)".

The period from January 2017 to November 2021 is the period in which the cash flows are expected, and when they are expected to have an impact on the result.

The following note presents other comprehensive income due to cash flow hedges as at 31 December 2016 and 31 December 2015.

	Year ended 31 December	
	2016	2015
Other gross comprehensive income from cash flow hedge at the beginning of the period	**1 061**	**5 008**
- Unrealised gains/losses included in other gross comprehensive income during the reporting period	(2 968)	(3 947)
Accumulated other gross comprehensive income at the end of the reporting period	**(1 907)**	**1 061**
Deferred income tax on accumulated other comprehensive income at the end of the reporting period	362	(202)
Accumulated net other comprehensive income at the end of the reporting period	**(1 545)**	**859**
Impact on other comprehensive income in the reporting period (gross)	(2 968)	(3 947)
Deferred tax on cash flow hedges	564	750
Impact on other comprehensive income in the reporting period (net)	**(2 404)**	**(3 197)**

	Year ended 31 December	
	2016	2015
Gains/losses rocognised in comprehensive income (gross) during the reporting period, including:		
- Unrealised gains/losses included in other comprehensive income (gross)	(2 968)	(3 947)
- Amount included as interest income in income statement	15 874	14 140
- Ineffective portion of hedge recognised in other net trading income	(17 624)	(3 607)
Impact on other comprehensive income in the reporting period (gross)	**(4 718)**	**6 586**

Total result on cash flow hedge accounting recognized in the income statement

	Year ended 31 December	
	2016	2015
Interest income on derivatives concluded under the cash flow hedge (Note 5)	15 874	14 140
Ineffective portion of cash flow hedge (Note 8)	(17 624)	(3 607)
The total results of cash flow hedge accounting recognised in the income statement	**(1 750)**	**10 533**

Below is given the timetable prepared as at 31 December 2016, presenting the periods in which the cash flows from loans secured under the cash flow hedge accounting are expected and their impact on the profit and loss account.

Cash flows from loans secured under the cash flow hedge accounting (PLN 000's)		
up to 3 months	**period from 3 months to 1 year**	**period from 1 year to 5 years**
10 631	16 492	48 498

Below is given the timetable prepared as at 31 December 2015, presenting the periods in which the cash flows from loans secured under the cash flow hedge accounting were expected and their impact on the profit and loss account.

Cash flows from loans secured under the cash flow hedge accounting (PLN 000's)		
up to 3 months	**period from 3 months to 1 year**	**period from 1 year to 5 years**
10 294	26 890	19 604

The fair value (equal to the book value) of hedging derivatives is presented under Note 19 "Derivative financial instruments".

21. Loans and advances to customers

	31.12.2016	31.12.2015
Loans and advances to individuals:	**44 707 271**	**43 796 808**
- current accounts	6 458 369	5 897 129
- term loans, including:	38 248 902	37 899 679
housing and mortgage loans	30 958 397	31 557 258
Loans and advances to corporate entities:	**28 746 183**	**28 577 197**
- current accounts	4 185 972	4 088 604
- term loans:	24 337 263	23 425 256
corporate & institutional enterprises	12 733 757	12 665 060
medium & small enterprises	11 603 506	10 760 196
- reverse repo / buy-sell-back transactions	56 676	1 031 029
- other	166 272	32 308
Loans and advances to public sector	**1 087 740**	**1 374 411**
Other receivables	**228 424**	**183 355**
Total (gross) loans and advances to customers	**74 769 618**	**73 931 771**
Provisions for loans and advances to customers (negative amount)	(2 465 487)	(2 647 669)
Total (net) loans and advances to customers	**72 304 131**	**71 284 102**

Short-term (up to 1 year)	26 716 486	25 183 989
Long-term (over 1 year)	45 587 645	46 100 113

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As at 31 December 2016, gross amount of variable rate loans amounted to PLN 73 019 115 thousand and fixed rate loans amounted to PLN 1 750 503 thousand (as at 31 December 2015 respectively: 69 917 613 thousand and PLN 4 014 158 thousand). An average interest rate for loans granted to customers (excluding reverse repos) amounted to 3.09% (31 December 2015: 3.12%).

In 2016, the item "other" includes receivables in the amount of 135 977 thousand from the National Depository of Securities CCP in connection with the Brokerage Office activity.

The item "other" includes cash collaterals (as at 31 December 2016 in the amount of PLN 28 287 thousand, as at 31 December 2015: PLN 32 303 thousand) placed by the Bank under derivatives transactions (Note 37).

In 2016 and 2015, under the project carried out by the Group of financing mortgage loans from funds obtained from the issue of mortgage bonds, mBank relocated a part of loans to mBank Hipoteczny S.A. This transfer had a form of sale on market conditions and related to retail receivables in the nominal amount of PLN 530 million (2015 respectively: PLN 469 million related to retail receivables and PLN 220 million related to corporate receivables).

Provisions for loans and advances

	31.12.2016	31.12.2015
Incurred but not identified losses		
Gross balance sheet exposure	70 864 716	69 755 424
Impairment provisions for exposures analysed according to portfolio approach	(188 644)	(202 772)
Net balance sheet exposure	**70 676 072**	**69 552 652**
Receivables with impairment		
Gross balance sheet exposure	3 904 902	4 176 347
Provisions for receivables with impairment	(2 276 843)	(2 444 897)
Net balance sheet exposure	**1 628 059**	**1 731 450**

Movements in provisions for loans and advances

MOVEMENTS IN PROVISIONS FOR LOANS AND ADVANCES TO CUSTOMERS AS OF 2016	Provisions as at 01.01.2016	Provisions created	Release of provisions	Reclassification and foreign exchange differences	Write-offs	Provisions as at 31.12.2016
Loans and advances to individuals	**(1 529 723)**	**(884 853)**	**617 184**	**(13 914)**	**299 985**	**(1 511 321)**
Current accounts	(683 042)	(326 194)	222 533	(26)	172 350	**(614 379)**
Term loans, including:	(846 681)	(558 659)	394 651	(13 888)	127 635	**(896 942)**
Housing and mortgage loans	(488 550)	(286 094)	232 063	(9 044)	39 715	**(511 910)**
Loans and advances to corporate entities	**(1 116 879)**	**(334 812)**	**287 893**	**(6 079)**	**216 418**	**(953 459)**
Current accounts	(204 860)	(98 524)	64 928	10 870	37 096	**(190 490)**
Term loans, including:	(912 019)	(236 288)	222 965	(16 949)	179 322	**(762 969)**
Corporate & institutional enterprises	(157 515)	(38 664)	73 697	(19 847)	113 541	**(28 788)**
Medium & small enterprises	(754 504)	(197 624)	149 268	2 898	65 781	**(734 181)**
Loans and advances to public sector	**(1 067)**	**(197)**	**557**	**-**	**-**	**(707)**
Total movements in provisions for loans and advances to customers	**(2 647 669)**	**(1 219 862)**	**905 634**	**(19 993)**	**516 403**	**(2 465 487)**

MOVEMENTS IN PROVISIONS FOR LOANS AND ADVANCES TO CUSTOMERS AS OF 2015	Provisions as at 01.01.2015	Provisions created	Release of provisions	Reclassification and foreign exchange differences	Write-offs	Provisions as at 31.12.2015
Loans and advances to individuals	**(1 478 093)**	**(1 150 382)**	**928 806**	**169 578**	**368**	**(1 529 723)**
Current accounts	(593 854)	(429 843)	260 277	80 195	183	**(683 042)**
Term loans, including:	(884 239)	(720 539)	668 529	89 383	185	**(846 681)**
Housing and mortgage loans	(539 032)	(450 128)	425 440	75 034	136	**(488 550)**
Loans and advances to corporate entities	**(1 055 102)**	**(638 876)**	**530 943**	**(6 538)**	**52 694**	**(1 116 879)**
Current accounts	(241 111)	(150 230)	150 225	6 341	29 915	**(204 860)**
Term loans, including:	(813 991)	(488 646)	380 718	(12 879)	22 779	**(912 019)**
Corporate & institutional enterprises	(193 948)	(173 802)	205 938	(184)	4 481	**(157 515)**
Medium & small enterprises	(620 043)	(314 844)	174 780	(12 695)	18 298	**(754 504)**
Loans and advances to public sector	**(1 317)**	**(8 462)**	**8 772**	**(64)**	**4**	**(1 067)**
Total movements in provisions for loans and advances to customers	**(2 534 512)**	**(1 797 720)**	**1 468 521**	**162 976**	**53 066**	**(2 647 669)**

Loans and advances to customers	31.12.2016		31.12.2015	
	exposure in PLN '000	share/coverage (%)	exposure in PLN '000	share/coverage (%)
Neither past due nor impaired	68 928 523	92.19	67 890 900	91.83
Past due but not impaired	1 936 193	2.59	1 864 524	2.52
Impaired	3 904 902	5.22	4 176 347	5.65
Total, gross	**74 769 618**	**100.00**	**73 931 771**	**100.00**
Provision (provision for impaired loans and advances as well as IBNI provision)	(2 465 487)	3.30	(2 647 669)	3.58
Total, net	**72 304 131**	**96.70**	**71 284 102**	**96.42**

The total amount of recognized provision for loans and advances has been PLN 2 465 487 thousand (as at 31 December 2015: PLN 2 647 669 thousand) of which PLN 2 276 843 thousand (as at 31 December 2015: PLN 2 444 897 thousand) represented the individually impaired loans and advances to customers and the remaining amount of PLN 188 644 thousand represented the portfolio provision (as at 31 December 2015 PLN 202 772 thousand).

92.19% of the loans and advances portfolio has been considered to be neither past due nor impaired (31 December 2015: 91.83%).

Loans and advances neither past due nor impaired

31 December 2016	Individuals			Corporate entities					Public sector	Other receivables	Total - Loans and advances to customers
			including:		Term loans						
Sub-portfolio	Current accounts	Term loans	housing and mortgage loans	Current accounts	corporate & institutional enterprises	medium & small enterprises	Reverse repo / buy-sell-back transactions	Other			
1	159 577	9 287 514	9 206 248	90 633	27 424	400 816	-	20 439	27 602	-	10 014 005
2	1 336 592	17 793 173	16 000 937	993 576	9 002 292	1 436 928	-	143 825	680 603	-	31 386 989
3	1 010 228	3 517 730	1 904 957	730 179	2 379 696	3 798 834	-	6	343 154	-	11 779 827
4	1 753 167	2 920 008	909 473	1 699 863	1 228 783	3 984 201	-	-	36 121	-	11 622 143
5	685 038	1 119 044	488 866	407 193	13 935	864 082	-	-	260	-	3 089 552
6	54 296	114 492	65 706	16 457	-	20 468	-	-	-	-	205 713
7	125 959	292 173	182 398	11 037	-	18 731	-	-	-	-	447 900
8	29 661	-	-	31 226	-	-	56 676	-	-	228 410	345 973
Default category	2 275	34 132	28 503	-	-	-	-	-	-	14	36 421
Total	**5 156 793**	**35 078 266**	**28 787 088**	**3 980 164**	**12 652 130**	**10 524 060**	**56 676**	**164 270**	**1 087 740**	**228 424**	**68 928 523**

31 December 2015	Individuals			Corporate entities					Public sector	Other receivables	Total - Loans and advances to customers
			including:		Term loans						
Sub-portfolio	Current accounts	Term loans	housing and mortgage loans	Current accounts	corporate & institutional enterprises	medium & small enterprises	Reverse repo / buy-sell-back transactions	Other			
1	73 738	2 784 347	2 748 338	173 605	135 496	357 596	-	15 857	19 102	-	3 559 741
2	986 459	21 859 600	20 810 550	865 087	8 800 032	950 763	-	16 446	910 399	-	34 388 786
3	1 078 038	4 941 330	3 492 288	554 663	1 670 328	3 078 575	-	5	353 910	-	11 676 849
4	1 676 851	3 374 483	1 230 970	1 688 765	1 701 494	3 912 961	-	-	87 106	-	12 441 660
5	525 269	1 251 197	687 710	505 774	155 116	1 204 018	-	-	3 894	-	3 645 268
6	50 144	174 096	103 541	17 110	-	16 416	-	-	-	-	257 766
7	141 419	432 953	301 722	46 768	-	53 325	-	-	-	-	674 465
8	-	-	-	5	-	-	1 031 029	-	-	183 355	1 214 389
Default category	3 733	28 243	25 152	-	-	-	-	-	-	-	31 976
Total	**4 535 651**	**34 846 249**	**29 400 271**	**3 851 777**	**12 462 466**	**9 573 654**	**1 031 029**	**32 308**	**1 374 411**	**183 355**	**67 890 900**

Loans and advances past due but not impaired

Gross amounts of loans and advances, which were past due but not impaired are presented below by classes of assets. No impairment is recognized in respect of loans and advances past due for less than 90 days, unless other available information indicates their impairment.

31 December 2016	Individuals			Corporate entities					Public sector	Other receivables	Total - Loans and advances to customers
			including:		Term loans						
	Current accounts	Term loans	housing and mortgage loans	Current accounts	corporate & institutional enterprises	medium & small enterprises	Reverse repo / buy-sell-back transactions	Other			
Past due up to 30 days	415 164	1 162 343	860 223	-	-	7 351	-	2 002	-	-	1 586 860
Past due 31 - 60 days	44 472	193 112	128 047	1	1 274	-	-	-	-	-	238 859
Past due 61 - 90 days	17 977	55 847	31 878	-	104	-	-	-	-	-	73 928
Past due over 90 days	11 963	24 554	14 517	29	-	-	-	-	-	-	36 546
Total	**489 576**	**1 435 856**	**1 034 665**	**30**	**1 378**	**7 351**	**-**	**2 002**	**-**	**-**	**1 936 193**

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31 December 2015	Individuals			Corporate entities					Public sector	Other receivables	Total - Loans and advances to customers
	Current accounts	Term loans	including: housing and mortgage loans	Current accounts	Term loans: corporate & institutional enterprises	Term loans: medium & small enterprises	Reverse repo / buy-sell-back transactions	Other			
Past due up to 30 days	411 472	1 131 361	891 939	81	1 665	41 662	-	-	-	-	1 586 241
Past due 31 - 60 days	30 107	157 923	107 757	2	10 389	10 154	-	-	-	-	208 575
Past due 61 - 90 days	12 780	34 425	20 175	88	-	-	-	-	-	-	47 293
Past due over 90 days	8 568	13 847	7 402	-	-	-	-	-	-	-	22 415
Total	**462 927**	**1 337 556**	**1 027 273**	**171**	**12 054**	**51 816**	**-**	**-**	**-**	**-**	**1 864 524**

Loans and advances individually impaired

As at 31 December 2016, loans and advances individually impaired amounted to PLN 1 628 059 thousand (as at 31 December 2015: PLN 1 731 450 thousand). Gross amounts of loans and advances individually impaired (i.e., before taking into consideration the cash flows from collateral held and expected repayments) are presented below by classes of assets.

	Individuals			Corporate entities					Public sector	Other receivables	Total - Loans and advances to customers
	Current accounts	Term loans	including: housing and mortgage loans	Current accounts	Term loans: corporate & institutional enterprises	Term loans: medium & small enterprises	Reverse repo / buy-sell-back transactions	Other			
31 December 2016											
Loans and advances with impairment	812 000	1 734 780	1 136 644	205 778	80 249	1 072 095	-	-	-	-	**3 904 902**
Provisions for loans and advances with impairment	(562 478)	(805 799)	(473 856)	(178 169)	(21 515)	(708 882)	-	-	-	-	**(2 276 843)**
31 December 2015											
Loans and advances with impairment	898 551	1 715 874	1 129 714	236 656	190 540	1 134 726	-	-	-	-	**4 176 347**
Provisions for loans and advances with impairment	(636 432)	(752 963)	(439 388)	(189 838)	(146 815)	(718 849)	-	-	-	-	**(2 444 897)**

The Bank applies a conservative approach in the area of verification of collateral value and setting of acceptable LtV levels. The policy, in this respect, imposes particularly significant restrictions in case of transactions with probability of default higher than average (non-purpose loans and consolidation loans) and/or secured on low-liquid real estate (localized on not well developed markets).

Financial effect of collaterals

The note below presents the influence of value of collaterals received by the Bank in relation to the loans granted by the Bank on the provisions level.

As at 31 December 2016	Gross amount	Provisions created	Provisions without cash flow from collaterals	Financial effect of collaterals
Balace sheet data				
Loans and advances to banks	**7 311 026**	**(2 257)**	**(2 257)**	**-**
Loans and advances to customers, including:	**74 769 618**	**(2 465 487)**	**(3 196 684)**	**731 197**
Loans to individuals:	44 707 271	(1 511 321)	(1 785 834)	274 513
− Current accounts	6 458 369	(614 379)	(629 109)	14 730
− Term loans, including:	38 248 902	(896 942)	(1 156 725)	259 783
housing and mortgage loans	30 958 397	(511 910)	(738 682)	226 772
Loans to corporate clients:	28 523 235	(953 459)	(1 410 101)	456 642
− Current accounts	4 185 972	(190 490)	(208 214)	17 724
− Term loans:	24 337 263	(762 969)	(1 201 887)	438 918
corporate & institutional enterprises	12 733 757	(28 788)	(87 138)	58 350
medium & small enterprises	11 603 506	(734 181)	(1 114 749)	380 568
Loans and advances to public sector	1 087 740	(707)	(749)	42
Total balance sheet data	**82 080 644**	**(2 467 744)**	**(3 198 941)**	**731 197**
Off-balance sheet data:				
Loan commitments and other commitments	21 601 090	(30 788)	(38 572)	7 784
Guarantees, banker's acceptances, documentary and commercial letters of credit	13 373 654	(12 588)	(17 601)	5 013
Total off-balance sheet data:	**34 974 744**	**(43 376)**	**(56 173)**	**12 797**

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As at 31 December 2015	Gross amount	Provisions created	Provisions without cash flow from collaterals	Financial effect of collaterals
Balace sheet data				
Loans and advances to banks	**4 983 020**	**(1 699)**	**(1 716)**	**17**
Loans and advances to customers, including:	**73 931 771**	**(2 647 669)**	**(3 499 889)**	**852 220**
Loans to individuals:	43 796 808	(1 529 723)	(1 868 796)	339 073
− Current accounts	5 897 129	(683 042)	(703 700)	20 658
− Term loans, including:	37 899 679	(846 681)	(1 165 096)	318 415
housing and mortgage loans	31 557 258	(488 550)	(743 157)	254 607
Loans to corporate clients:	27 513 860	(1 116 879)	(1 630 026)	513 147
− Current accounts	4 088 604	(204 860)	(252 635)	47 775
− Term loans:	23 425 256	(912 019)	(1 377 391)	465 372
corporate & institutional enterprises	12 665 060	(157 515)	(205 283)	47 768
medium & small enterprises	10 760 196	(754 504)	(1 172 108)	417 604
Loans and advances to public sector	1 374 411	(1 067)	(1 067)	-
Total balance sheet data	**78 914 791**	**(2 649 368)**	**(3 501 605)**	**852 237**
Off-balance sheet data:				
Loan commitments and other commitments	19 404 563	(30 044)	(36 149)	6 105
Guarantees, banker's acceptances, documentary and commercial letters of credit	10 207 884	(15 546)	(19 696)	4 150
Total off-balance sheet data:	**29 612 447**	**(45 590)**	**(55 845)**	**10 255**

22. Investment securities

	31.12.2016			31.12.2015		
	Investment securities without pledge	Pledged investment securities	Total investment securities	Investment securities without pledge	Pledged investment securities	Total investment securities
Debt securities:	**23 743 219**	**6 673 478**	**30 416 697**	**24 406 027**	**5 394 411**	**29 800 438**
Issued by government	20 675 256	6 673 478	27 348 734	16 565 573	5 394 411	21 959 984
- government bonds	20 675 256	6 673 478	27 348 734	16 565 573	5 394 411	21 959 984
Issued by central bank	1 584 615	-	1 584 615	6 972 521	-	6 972 521
Other debt securities	1 483 348	-	1 483 348	867 933	-	867 933
- deposit certificates	50 466	-	50 466	-	-	-
- bank's bonds	140 880	-	140 880	233 158	-	233 158
- mortgage bonds	223 494	-	223 494	11 372	-	11 372
- corporate bonds	1 031 538	-	1 031 538	583 456	-	583 456
- communal bonds	36 970	-	36 970	39 947	-	39 947
Equity securities:	**51 083**	**-**	**51 083**	**182 204**	**-**	**182 204**
Unlisted	51 083	-	51 083	182 204	-	182 204
Total debt and equity securities:	**23 794 302**	**6 673 478**	**30 467 780**	**24 588 231**	**5 394 411**	**29 982 642**
Short-term (up to 1 year)	**4 374 301**	**57 216**	**4 431 517**	**10 632 634**	**88 905**	**10 721 539**
Long-term (over 1 year)	**19 420 001**	**6 616 262**	**26 036 263**	**13 955 597**	**5 305 506**	**19 261 103**

As at 31 December 2016, equity securities include fair value of preferred shares of Visa Inc. in the amount of PLN 38 392 thousand. As at 31 December 2015, equity securities include fair value of shares of Visa Europe Ltd. in the amount of PLN 167 243 thousand.

As at 31 December 2016 the Bank created provisions for impairment of equity securities valued at fair value on the amount to PLN 7 677 thousand (31 December 2015: 0).

As at 31 December 2016, the carrying values of debt securities with fixed interest rates amounted to PLN 23 612 422 thousand and debt securities with variable interest rates PLN 6 804 275 thousand (31 December 2015 respectively: PLN 24 447 400 thousand and PLN 5 353 038 thousand).

The above note includes government bonds pledged under the Bank Guarantee Fund (BFG), government bonds pledged as sell-buy-back transactions, government bonds pledged as collateral for the loans received from the European Investment Bank and government bonds pledged as collateral for deposit placed by the customer.

In accordance with the Act of 10 June 2016 on the Bank Guarantee Fund, Deposit Guarantee Scheme and Resolution, as at 31 December 2016 the Bank held government bonds and bills included in the statement of financial position in the amount of PLN 559 550 thousand with a nominal value of PLN 546 142 thousand (31 December 2015: carrying value - PLN 566 178 thousand; nominal value -

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PLN 535 000 thousand), which were pledged as collateral for the Bank Guarantee Fund and were deposited in a separate account at the National Depository of Securities.

Gains and losses from investment securities, investments in subsidiaries and associates

	Year ended 31 December	
	2016	2015
Sale/redemption of financial assets available for sale	269 329	133 645
Gains less losses related to sale of subsidiaries and associates	3	163 704
Impairment of investment equity securities	(7 677)	-
Impairment of investments in subsidiaries	(442)	(8 096)
Total gains less losses from investment securities, investments in subsidiaries and associates	**261 213**	**289 253**

- Closing of the takeover of Visa Europe Limited (Visa Europe) by Visa Inc. transaction

On 21 June 2016, the Bank received the information regarding the closing of the Visa Europe Limited takeover by Visa Inc. transaction on the terms described below.

On 21 June 2016, as a result of the settlement of the takeover of Visa Europe by Visa Inc. transaction, the Bank received in cash the amount of EUR 46.5 million, equivalent to PLN 204.2 million (at the average NBP exchange rate of 21 June 2016) and 16 878 preferred shares of Visa Inc. Series C (preferred shares). In addition, as a result of the changed conditions of the settlement, the before expected *"earn-out"* payment has been replaced by increase of the amount payable in cash in the second quarter of 2016 and the deferred amount payable in cash in the second quarter of 2019 (deferred payment). The total amount of deferred payment attributable to all the participants of the Transaction will amount to EUR 1.12 billion, of which the Bank's share amounts to 0.3582436136%. Deferred payment may be subject to some adjustments when in the period preceding the date of payment one or more of participating entities cease to exist without a successor or if the body representing the members of Visa Europe (Visa Europe Member Representative) considers that it would be in the interest of beneficiaries to retain some cash in order to protect the value of capital component of the settlement. Preferred shares will be converted into Visa Inc. common shares. Conversion of all preferred shares will take place no later than in 2028. The current conversion rate of the preferred shares into common shares amounts to 13.952. It can be subject to a decrease until 2028 depending on potential liabilities resulting from litigation proceedings concerning "interchange" during that period. The preferred shares were classified as investment securities and measured at fair value by reference to the market price of listed ordinary shares including a discount which takes into account preferred shares market illiquidity and adjustments related to litigation proceedings (current or potential) in which Visa Inc. is involved that have an influence on conversion rate.

In connection with the settlement of the above described transaction, the Bank realised profit in the amount of PLN 251 732 thousand which constitutes the majority of the position "Sale/redemption of financial assets available for sale" in the year 2016.

In 2016 and 2015, the impairment of investments in subsidiaries relates to the write-offs of the Bank's involvement in the company Call Center Poland S.A. that was in 100% sold by the Bank in 2016 (Note 23).

In 2016, the impairment of available for sale equity securities applies to the company Polski Standard Płatności Sp. z o.o.

In 2015, the item "Gains less losses related to sale of subsidiaries and associates" includes mainly the profit on sale of BRE Ubezpieczenia TUiR S.A. shares in the amount of PLN 168 265 thousand.

Moreover, in 2015, the item "Sale/redemption of financial assets available for sale" includes the profit on sale of equity securities in the amount of PLN 127 333 thousand mainly of PZU S.A. shares in the amount of PLN 124 994 thousand as well as profit on sale of treasury bonds and mortgage bonds in the amount of PLN 6 312 thousand.

Movements in investment securities

	31.12.2016	31.12.2015
Investment securities		
As at the beginning of the period	**29 982 642**	**27 246 034**
Exchange differences	58 002	21 388
Additions	139 980 506	310 544 680
Disposals (sale, redemption and forfeiture)	(139 165 813)	(307 800 045)
Losses from impairment of equity securities and debt securities available for sale	(7 677)	-
Gains / (losses) from changes in fair value	(379 880)	(29 415)
As at the end of the period	**30 467 780**	**29 982 642**

As at 31 December 2016 and 31 December 2015 there were no impairment provisions of the debt investment securities.

23. Investments in subsidiaries

31 December 2016 (in PLN 000's)

No.	Name of the company	Country of registration	Assets	Liabilities	Revenues	Net profit / (loss)	% interest held	Carrying value
1.	**mFinanse S.A. (previously Aspiro S.A.)**	Poland	455 974	165 840	304 456	125 574	100.00	205 807
2.	**BDH Development Sp. z o.o.**	Poland	91 768	1 210	18 442	(2 116)	100.00	90 558
3.	**BRE Property Partner Sp. z o.o.**	Poland	2 930	118	1 469	895	100.00	1 536
4.	**Garbary Sp. z o.o.**	Poland	43 440	111	201	(2 168)	100.00	43 329
5.	**JMD III Sp. z o.o.**	Poland	-	4	6	(8)	100.00	20
6.	**mBank Hipoteczny S.A.**	Poland	10 652 140	9 745 806	355 607	37 837	100.00	894 716
7.	**mCentrum Operacji Sp. z o.o.**	Poland	44 242	9 798	36 796	(321)	100.00	34 444
8.	**mCorporate Finance S.A.**	Poland	506	127	3 554	(101)	99.998	5 532
9.	**mFaktoring S.A.**	Poland	1 502 921	1 430 526	56 938	11 342	100.00	72 395
10.	**mFinance France S.A.**	France	7 574 029	7 571 150	141 190	891	100.00	2 848
11.	**mLeasing Sp. z o.o.**	Poland	8 216 046	7 883 676	370 884	56 329	100.00	332 450
12.	**mLocum S.A.**	Poland	229 841	92 886	105 038	14 702	79.99	94 996
13.	**Octopus Sp. z o.o.**	Poland	3 248	12	256	196	99.90	3 047
14.	**Tele -Tech Investment Sp. z o.o.**	Poland	120 819	120 278	10 224	31	100.00	541
								1 782 219

31 December 2015 (in PLN 000's)

No.	Name of the company	Country of registration	Assets	Liabilities	Revenues	Net profit / (loss)	% interest held	Carrying value
1.	**Aspiro S.A.**	Poland	483 894	210 507	392 984	197 052	100.00	187 244
2.	**BDH Development Sp. z o.o.**	Poland	93 428	754	12 278	(4 649)	100.00	92 674
3.	**Call Center Poland S.A.**	Poland	19 994	19 655	24 755	(1 346)	100.00	2 000
4.	**Dom Maklerski mBanku S.A.**	Poland	1 013 833	880 350	121 190	22 320	100.00	133 483
5.	**Garbary Sp. z o.o.**	Poland	43 370	73	265	(2 089)	100.00	43 297
6.	**JMD III Sp. z o.o.**	Poland	10	5	-	(2)	100.00	20
7.	**mBank Hipoteczny S.A.**	Poland	8 407 344	7 636 787	275 172	8 159	100.00	759 396
8.	**mCentrum Operacji Sp. z o.o.**	Poland	43 105	8 307	37 159	(64)	100.00	34 798
9.	**mCorporate Finance SA**	Poland	1 736	1 256	4 570	121	100.00	5 532
10.	**mFaktoring S.A.**	Poland	1 387 780	1 326 727	61 742	(27 124)	100.00	61 053
11.	**mFinance France S.A.**	France	5 147 035	5 145 130	167 102	(10)	99.998	1 904
12.	**mLeasing Sp. z o.o.**	Poland	6 942 275	6 666 492	332 212	43 793	100.00	275 783
13.	**mLocum S.A.**	Poland	221 840	58 839	101 670	14 399	79.99	110 725
14.	**MLV 45 Sp. z o.o.**	Poland	74	6	120	(10)	100.00	8
15.	**mWealth Management SA**	Poland	50 621	7 380	47 810	22 090	100.00	46 773
16.	**Octopus Sp. z o.o.**	Poland	3 055	1	16	6	99.90	3 047
17.	**Tele -Tech Investment Sp. z o.o.**	Poland	106 586	106 076	8 990	(138)	100.00	510
								1 758 247

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Changes in investments in subsidiaries

	31.12.2016	31.12.2015
Investments in subsidiaries		
As at the beginning of the period	**1 758 247**	**1 580 226**
Foreign exchange differences	(18)	-
Increase	103 754	516 867
Decrease	(171 294)	(348 121)
Changes resulting from the application of the equity method, including:	91 972	17 371
- recognised in the income statement	93 174	17 854
- recognised in the other components of equity	(1 202)	(483)
Impairment/release of impairment	(442)	(8 096)
As at the end of the period	**1 782 219**	**1 758 247**

In 2016, the item "Increase" relates mainly to the increase of equity in the companies mBank Hipoteczny S.A. and Garbary Sp. z o.o. by PLN 100 000 thousand and PLN 2 200 thousand respectively as well as to the purchase of 100% shares of the company BRE Property Partner Sp. z o.o. in the amount of PLN 1 536 thousand.

In 2016, most of the amount under the item "Decrease" relates to the division of Dom Maklerski mBanku S.A. and mWealth Management Sp. z o.o. which was described in detail under Note 34.

In 2016 and 2015, write-offs relate to the impairment of shares in the company Call Center Poland S.A., which were sold by the Bank in the first quarter of 2016.

In 2015, most of the amount under the item "Increase" as well as the whole amount under the item "Decrease" relates to the reorganisation in mBank S.A. Group resulting from MLV45 Sp. z o.o. spółka komandytowa activity cessation . The reorganisation had the form of a transfer of shares held by the company MLV45 Sp. z o.o. spółka komandytowa in the companies: mBank Hipoteczny S.A., mLeasing Sp. o.o., mFaktoring S.A. and mLocum S.A. under the direct control of mBank S.A. On 10 September 2015, shareholders of MLV45 Sp. z o.o. spółka komandytowa - mBank S.A. and MLV45 Sp. z o.o. adopted a resolution on MLV45 Sp. z o.o. spółka komandytowa liquidation, opening a liquidation procedure and appointing a liquidator. The application for the opening of the liquidation procedure was submitted to the District Court for the Capital City of Warsaw, 12th Division of the National Court Register on 10 September 2015 and the company was deleted from the register on 22 December 2015. The afore-mentioned reorganisation steps have had no impact on the continuing full control mBank S.A. exercises over the mentioned subsidiaries.

Moreover, the item "Increase" relates to the increase of equity in mBank Hipoteczny S.A., Octopus Sp. z o.o., Garbary Sp. z o.o., mFinance France S.A., Tele-Tech Investment Sp. z o.o. and JMD III Sp z o.o by: PLN 140 000 thousand, PLN 2 997 thousand, PLN 1 326 thousand, PLN 1 182 thousand, PLN 500 thousand and PLN 10 thousand, respectively.

24. Intangible assets

	31.12.2016	31.12.2015
Goodwill	3 532	-
Patents, licences and similar assets, including:	320 119	317 812
- computer software	247 168	224 531
Other intangible assets	4 044	5 115
Intangible assets under development	212 757	150 889
Total intangible assets	**540 452**	**473 816**

In 2016 and 2015, the Bank performed impairment tests of intangible assets under development. As a result of the tests, impairment has been not stated.

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Movements in intangible assets

Movements in intangible assets from 1 January to 31 December 2016	Acquired concessions, patents, licences and other similar assets		Other intangible assets	Intangible assets under development	Goodwill	Total intangible assets
		including: acquired computer software				
Gross value of intangible assets as at the beginning of the period: 01.01.2016	**915 979**	**645 801**	**10 982**	**150 889**	**-**	**1 077 850**
Increase (due to)	**129 498**	**99 416**	**10**	**169 849**	**3 532**	**302 889**
- purchase	9 024	-	8	130 784	-	139 816
- transfer from intangible assets under development	91 409	81 423	2	-	-	91 411
- development costs	-	-	-	23 698	-	23 698
- other increases	29 065	17 993	-	15 367	3 532	47 964
Decrease (due to)	**(28 835)**	**(28 495)**	**(403)**	**(107 981)**	**-**	**(137 219)**
- liquidation	(28 787)	(28 495)	(403)	-	-	(29 190)
- transfer to intangible assets given to use	-	-	-	(91 411)	-	(91 411)
- other decreases	(48)	-	-	(16 570)	-	(16 618)
Gross value of intangible assets as at the end of the period: 31.12.2016	**1 016 642**	**716 722**	**10 589**	**212 757**	**3 532**	**1 243 520**
Accumulated amortization as at the beginning of the period: 01.01.2016	**(598 167)**	**(421 270)**	**(5 867)**	**-**	**-**	**(604 034)**
Amortization for the period (due to)	**(98 356)**	**(48 284)**	**(678)**	**-**	**-**	**(99 034)**
- amortization	(106 154)	(65 617)	(1 081)	-	-	(107 235)
- other increases	(20 989)	(11 162)	-	-	-	(20 989)
- liquidation	28 787	28 495	403	-	-	29 190
Accumulated amortization as at the end of the period: 31.12.2016	**(696 523)**	**(469 554)**	**(6 545)**	**-**	**-**	**(703 068)**
Net value of intangible assets as at the end of the period: 31.12.2016	**320 119**	**247 168**	**4 044**	**212 757**	**3 532**	**540 452**

Movements in intangible assets from 1 January to 31 December 2015	Acquired concessions, patents, licences and other similar assets		Other intangible assets	Intangible assets under development	Total intangible assets
		including: acquired computer software			
Gross value of intangible assets as at the beginning of the period: 01.01.2015	**882 959**	**652 654**	**10 975**	**87 059**	**980 993**
Increase (due to)	**78 287**	**26 340**	**7**	**109 830**	**188 124**
- purchase	34 124	-	2	80 955	115 081
- transfer from intangible assets under development	31 683	14 689	5	-	31 688
- development costs	-	-	-	20 376	20 376
- other increases	12 480	11 651	-	8 499	20 979
Decrease (due to)	**(45 267)**	**(33 193)**	**-**	**(46 000)**	**(91 267)**
- liquidation	(33 591)	(33 193)	-	-	(33 591)
- transfer to intangible assets given to use	-	-	-	(31 688)	(31 688)
- other decreases	(11 676)	-	-	(14 312)	(25 988)
Gross value of intangible assets as at the end of the period: 31.12.2015	**915 979**	**645 801**	**10 982**	**150 889**	**1 077 850**
Accumulated amortization as at the beginning of the period: 01.01.2015	**(551 178)**	**(408 742)**	**(4 737)**	**-**	**(555 915)**
Amortization for the period (due to)	**(46 989)**	**(12 528)**	**(1 130)**	**-**	**(48 119)**
- amortization	(80 540)	(45 697)	(1 130)	-	(81 670)
- other increases	(40)	(24)	-	-	(40)
- liquidation	33 591	33 193	-	-	33 591
Accumulated amortization as at the end of the period: 31.12.2015	**(598 167)**	**(421 270)**	**(5 867)**	**-**	**(604 034)**
Net value of intangible assets as at the end of the period: 31.12.2015	**317 812**	**224 531**	**5 115**	**150 889**	**473 816**

In 2016, the goodwill in the amount of PLN 3 532 thousand has arisen due to the division of the company mWealth Management S.A., which was described in detail under Note 34.

25. Tangible assets

	31.12.2016	31.12.2015
Tangible assets, including:	409 893	403 079
- land	1 033	1 033
- buildings and structures	158 577	163 485
- equipment	150 344	122 234
- vehicles	28 495	39 855
- other tangible assets	71 444	76 472
Tangible assets under construction	71 802	81 788
Total tangible assets	**481 695**	**484 867**

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Movements in tangible assets

Movements in tangible assets from 1 January to 31 December 2016	Land	Buildings and structures	Equipment	Vehicles	Other fixed assets	Tangible assets under construction	Total
Gross value of tangible assets as at the beginning of the period: 01.01.2016	**1 033**	**304 383**	**547 828**	**58 756**	**390 973**	**81 924**	**1 384 897**
Increase (due to)	**-**	**877**	**94 291**	**6 269**	**28 044**	**80 990**	**210 471**
- purchase	-	266	26 388	-	1 513	67 180	95 347
- transfer from tangible assets under construction	-	569	51 705	-	20 799	-	73 073
- other increases	-	42	16 198	6 269	5 732	13 810	42 051
Decrease (due to)	**-**	**(80)**	**(32 861)**	**(18 052)**	**(15 522)**	**(90 976)**	**(157 491)**
- sale	-	-	(28 345)	(1 200)	(5 994)	-	(35 539)
- liquidation	-	(80)	(4 477)	-	(9 528)	-	(14 085)
- transfer to tangible assets	-	-	-	-	-	(73 073)	(73 073)
- other decreases	-	-	(39)	(16 852)	-	(17 903)	(34 794)
Gross value of tangible assets as at the end of the period: 31.12.2016	**1 033**	**305 180**	**609 258**	**46 973**	**403 495**	**71 938**	**1 437 877**
Accumulated depreciation as at the beginning of the period: 01.01.2016	**-**	**(91 628)**	**(425 594)**	**(18 901)**	**(314 370)**	**-**	**(850 493)**
Depreciation for the period (due to)	**-**	**(5 705)**	**(33 320)**	**423**	**(17 550)**	**-**	**(56 152)**
- depreciation charge	-	(5 686)	(51 578)	(7 291)	(28 036)	-	(92 591)
- other increases	-	(38)	(11 506)	(507)	(4 857)	-	(16 908)
- sale	-	-	25 297	351	5 959	-	31 607
- liquidation	-	19	4 446	-	9 384	-	13 849
- other decreases	-	-	21	7 870	-	-	7 891
Accumulated depreciation as at the end of the period: 31.12.2016	**-**	**(97 333)**	**(458 914)**	**(18 478)**	**(331 920)**	**-**	**(906 645)**
Impairment losses as at the beginning of the period: 01.01.2016	**-**	**(49 270)**	**-**	**-**	**(131)**	**(136)**	**(49 537)**
Impairment losses as at the end of the period: 31.12.2016	**-**	**(49 270)**	**-**	**-**	**(131)**	**(136)**	**(49 537)**
Net value of tangible assets as at the end of the period: 31.12.2016	**1 033**	**158 577**	**150 344**	**28 495**	**71 444**	**71 802**	**481 695**

Movements in tangible assets from 1 January to 31 December 2015	Land	Buildings and structures	Equipment	Vehicles	Other fixed assets	Tangible assets under construction	Total
Gross value of tangible assets as at the beginning of the period: 01.01.2015	**1 033**	**304 737**	**497 662**	**56 731**	**402 824**	**71 438**	**1 334 425**
Increase (due to)	**-**	**-**	**78 612**	**5 329**	**14 864**	**94 308**	**193 113**
- purchase	-	-	26 841	-	2 580	77 682	107 103
- transfer from tangible assets under construction	-	-	50 930	-	11 715	-	62 645
- other increases	-	-	841	5 329	569	16 626	23 365
Decrease (due to)	**-**	**(354)**	**(28 446)**	**(3 304)**	**(26 715)**	**(83 822)**	**(142 641)**
- sale	-	-	(4 079)	-	(881)	-	(4 960)
- liquidation	-	(354)	(11 906)	-	(12 335)	-	(24 595)
- transfer to tangible assets	-	-	-	-	-	(62 645)	(62 645)
- other decreases	-	-	(12 461)	(3 304)	(13 499)	(21 177)	(50 441)
Gross value of tangible assets as at the end of the period: 31.12.2015	**1 033**	**304 383**	**547 828**	**58 756**	**390 973**	**81 924**	**1 384 897**
Accumulated depreciation as at the beginning of the period: 01.01.2015	**-**	**(86 492)**	**(408 119)**	**(13 331)**	**(308 124)**	**-**	**(816 066)**
Depreciation for the period (due to)	**-**	**(5 136)**	**(17 475)**	**(5 570)**	**(6 246)**	**-**	**(34 427)**
- depreciation charge	-	(5 233)	(45 495)	(7 798)	(31 692)	-	(90 218)
- other increases	-	(615)	(102)	(39)	(246)	-	(1 002)
- sale	-	-	4 006	-	864	-	4 870
- liquidation	-	87	11 844	-	11 551	-	23 482
- other decreases	-	625	12 272	2 267	13 277	-	28 441
Accumulated depreciation as at the end of the period: 31.12.2015	**-**	**(91 628)**	**(425 594)**	**(18 901)**	**(314 370)**	**-**	**(850 493)**
Impairment losses as at the beginning of the period: 01.01.2015	**-**	**(49 270)**	**-**	**-**	**(131)**	**(136)**	**(49 537)**
Impairment losses as at the end of the period: 31.12.2015	**-**	**(49 270)**	**-**	**-**	**(131)**	**(136)**	**(49 537)**
Net value of tangible assets as at the end of the period: 31.12.2015	**1 033**	**163 485**	**122 234**	**39 855**	**76 472**	**81 788**	**484 867**

The entire value of vehicles is related to finance lease agreement.

The recoverable value of impaired tangible assets is the net sale price determined on the basis of market prices for similar assets.

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26. Other assets

	31.12.2016	31.12.2015
Other, including:	**367 796**	**279 019**
- debtors	126 724	138 004
- interbank balances	11 520	2 365
- other accruals	150 972	99 293
- accrued income	47 532	36 283
- inventories	2 646	3 074
- other	28 402	-
Total other assets	**367 796**	**279 019**
Short-term (up to 1 year)	169 454	145 131
Long-term (over 1 year)	198 342	133 888

In 2016, the item "other" relates entirely to the settlements of securities transactions in connection with the Brokerage Office activity.

As at 31 December 2016, the above note includes financial assets in amount of PLN 166 646 thousand (31 December 2015: PLN 140 369 thousand).

Other financial assets included in the note above

	31.12.2016	31.12.2015
Gross other financial assets, including:	**180 580**	**143 922**
- Not past due	166 340	133 107
- Past due from 1 to 90 days	5 642	5 847
- Past due over 90 days	8 598	4 968
- Provisions for impaired assets (negative amount)	(13 934)	(3 553)
Net other financial assets	**166 646**	**140 369**

27. Amounts due to other banks

	31.12.2016	31.12.2015
Current accounts	959 658	1 424 073
Term deposits	44 293	144 870
Loans and advances received	6 964 907	9 349 773
Repo / sell-buy-back transactions	114 322	778 145
Liabilities in respect of cash collaterals	361 725	427 026
Payables to be settled	1 280	2 053
Other	56 829	57 251
Amounts due to other banks	**8 503 014**	**12 183 191**
Short-term (up to 1 year)	4 863 141	6 076 967
Long-term (over 1 year)	3 639 873	6 106 224

On 31 December 2016, the value of fixed rate deposits from other banks was PLN 44 293 thousand (31 December 2015: PLN 144 870 thousand). In the both reporting periods there were no variable rate term deposits.

As at 31 December 2016 and as at 31 December 2015, loans and advances received were variable rate loans.

The average interest rate for loans and deposits obtained from banks in 2016 amounted to 0.68% (31 December 2015: - 0.69%).

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mBank S.A. did not provide collateral related to loans from other banks. The Bank did not note any violations of contractual terms related to liabilities in respect of loans received.

28. Amounts due to customers

	31.12.2016	31.12.2015
Individual customers:	**53 494 777**	**45 671 744**
Current accounts	38 051 354	32 022 887
Term deposits	15 380 844	13 604 623
Other liabilities:	62 579	44 234
- liabilities in respect of cash collaterals	31 033	22 140
- other	31 546	22 094
Corporate customers:	**44 926 009**	**39 652 525**
Current accounts	22 148 665	16 841 006
Term deposits	8 952 129	12 315 556
Loans and advances received	4 201 768	3 634 064
Repo transactions	1 600 487	1 093 712
Other liabilities:	8 022 960	5 768 187
- liabilities in respect of cash collaterals	7 962 137	5 710 450
- other	60 823	57 737
Public sector customers:	**539 534**	**599 882**
Current accounts	466 078	468 038
Term deposits	65 507	131 104
Other liabilities:	7 949	740
- liabilities in respect of cash collaterals	3	-
- other	7 946	740
Total amounts due to customers	**98 960 320**	**85 924 151**

Short-term (up to 1 year)	**85 163 858**	**75 246 365**
Long-term (over 1 year)	**13 796 462**	**10 677 786**

As at 31 December 2016 and 31 December 2015, the majority of the deposits from retail and corporate customers bore fixed interest rates. The average interest rate for amounts due to customers (excluding repos) amounted to 0.85% (31 December 2015: -1.08%).

As at 31 December 2016, the balance of loans and advances received included a loan received from European Investment Bank amounting to PLN 4 201 768 thousand (31 December 2015: PLN 3 634 064 thousand). The loan was collateralized with treasury bonds, which have been disclosed as pledge assets under Note 22 and Note 37.

29. Debt securities in issue

In November 2015 mBank S.A. redeemed bonds in the amount of PLN 385 000 thousand, therefore, as of 31 December 2016 and as of 31 December 2015, the Bank had no liabilities arising from the issue of securities.

The transactions regarding Bank's bonds which constitute subordinated liabilities have been described under Note 30 below.

30. Subordinated liabilities

SUBORDINATED LIABILITIES	Nominal value	Currency	Terms of interest rate (%)	Effective interest rate (%)	Redemption date	As at the end of the period (in PLN '000)
As at 31 December 2016						
- Commerzbank AG	400 000	CHF	3M LIBOR + 1.2%*	0.4598	08.03.2017	1 647 425
- Commerzbank AG	80 000	CHF	3M LIBOR + 3.4%**	2.6612	perpetual [1)]	329 676
- Commerzbank AG	170 000	CHF	3M LIBOR + 2.2%***	1.4668	perpetual [1)]	702 308
- Investors not associated with mBank S.A.	500 000	PLN	6M WIBOR + 2.25%	4.0000	20.12.2023	500 573
- Investors not associated with mBank S.A.	750 000	PLN	6M WIBOR + 2.1%	3.8600	17.01.2025	763 367
						3 943 349

SUBORDINATED LIABILITIES	Nominal value	Currency	Terms of interest rate (%)	Effective interest rate (%)	Redemption date	As at the end of the period (in PLN '000)
As at 31 December 2015						
- Commerzbank AG	400 000	CHF	3M LIBOR + 1.2%*	0.3800	08.03.2017	1 576 159
- Commerzbank AG	80 000	CHF	3M LIBOR + 1.4%**	0.6310	perpetual [1)]	315 213
- Commerzbank AG	170 000	CHF	3M LIBOR + 2.2%***	1.4750	perpetual [1)]	672 003
- Investors not associated with mBank S.A.	500 000	PLN	6M WIBOR + 2.25%	4.0200	20.12.2023	500 567
- Investors not associated with mBank S.A.	750 000	PLN	6M WIBOR + 2.1%	3.8900	17.01.2025	763 373
						3 827 315

* Margin amounting to 0.7% was in force within the period of first five years. From June 2012, margin amounting to 1.2% is in force.

** Margin amounting to 1.4% was in force up to December 2016. From 20 December 2016 margin amounting to 3.4% is in force.

*** Margin amounting to 2.2% is in force up to January 2018. Within the period of next years it will be equal to 4.2%.

1) Debt securities become due on the initiative of the Bank no earlier than two years after the issue date or on the initiative of Commerzbank, not earlier than five years after the issue date, after obtaining the approval of the KNF.

The effective interest rate specified in the tables above means the interest rate at the inception day of the last interest period.

In 2016 and 2015, the Bank did not note any delays in repayments of interest instalments and was not in default of any other contractual provisions related to its subordinated liabilities.

According to the decision dated 8 January 2015 Bank obtained a written permission of the KNF to include in Tier 2 capital the amount of PLN 750 000 thousand constituting subordinated liabilities from the bonds issue dated 17 December 2014 on total nominal value of PLN 750 000 thousand with redemption date on 17 January 2025 on terms that meet the requirements arising from the CRR Regulation.

According to the decision dated 14 February 2014 mBank obtained a written permission of the KNF to include in Tier 2 capital the amount of PLN 500 000 thousand constituting subordinated liabilities from the bonds issue dated 3 December 2013 on total nominal value of PLN 500 000 thousand and with 10 years maturity on terms that meet the requirements arising from the CRR Regulation.

According to Article 484 (5) of the CRR Regulation, subordinated liabilities from the bonds issue with undefined maturity are included in Tier 2 capital calculation with application of the rules of grandfathering and limits of grandfathering in transitional period ongoing from 1 January 2014 till 31 December 2021.

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Movements in subordinated liabilities

	31.12.2016	31.12.2015
As at the beginning of the period	**3 827 315**	**4 127 724**
- disposals (repayment)	-	(637 661)
- exchange differences	115 635	337 144
- other changes	399	108
Subordinated liabilities as at the end of the period	**3 943 349**	**3 827 315**
Short-term (up to 1 year)	1 664 119	16 799
Long-term (over 1 year)	2 279 230	3 810 516

In June 2015, the Bank made a partial repayment of the subordinated loan in the amount of CHF 90 million thousand (equivalent to PLN 359 019 thousand at the exchange rate of 24 June 2015) taken on 24 June 2008 with the maturity date on 24 June 2018.

Moreover, in June 2015 the Bank made a partial repayment of the subordinated loan in the amount of CHF 70 million (equivalent to PLN 278 719 thousand at the exchange rate of 18 June 2015) taken on 18 December 2007 in the amount of CHF 120 000 with the maturity date on 18 December 2017 and partially repaid on 18 June 2014 in the amount of CHF 50 000 (equivalent to PLN 170 090 thousand at the exchange rate of 18 June 2014).

31. Other liabilities

	31.12.2016	31.12.2015
Other liabilities, including		
- tax liabilities	47 011	11 338
- interbank settlements	781 638	412 278
- creditors	435 504	505 135
- accrued expenses	127 859	127 805
- deferred income	197 062	155 967
- provisions for post-employment employee benefits	12 918	12 332
- provisions for holiday equivalents	19 067	17 926
- provisions for other liabilities to employees	136 761	120 647
- other	34 920	22 836
Total other liabilities	**1 792 740**	**1 386 264**

As at 31 December 2016, the note presented above includes financial liabilities in the amount of PLN 1 345 001 thousand (31 December 2015: PLN 1 045 218 thousand). Cash flows resulting from those financial liabilities have been presented under Note 3.10.1. The other components of presented liabilities, except for part of provisions for post-employment benefits that were calculated on actuarial basis as a rule, are short-term liabilities.

In 2016, liabilities from creditors include the value of financial lease in the amount of PLN 29 653 thousand (in 2015: PLN 41 396 thousand).

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Movements in provisions for post-employment employee benefits

	31.12.2016	31.12.2015
Provisions for post-employment employee benefits		
As at the beginning of the period (by type)	**12 332**	**10 099**
pension and disability provisions	5 964	4 943
provisions for death severance	3 657	3 030
provisions for the Social Benefit Fund	2 711	2 126
Change in the period (due to)	**586**	**2 233**
Provisions created, due to:	**572**	**513**
pension and disability provisions	350	317
provisions for death severance	121	115
provisions for the Social Benefit Fund	101	81
Interest expense, due to:	**360**	**320**
pension and disability provisions	173	158
provisions for death severance	110	98
provisions for the Social Benefit Fund	77	64
Actuarial gains and losses recognised in other comprehensive income (Note 15), due to:	**(411)**	**1 873**
pension and disability provisions	(668)	723
provisions for death severance	(202)	421
provisions for the Social Benefit Fund	459	729
Benefits paid, due to:	**(729)**	**(473)**
pension and disability provisions	(370)	(177)
provisions for death severance	-	(7)
provisions for the Social Benefit Fund	(359)	(289)
Other changes, due to:	**794**	**-**
pension and disability provisions	569	-
provisions for death severance	225	-
As at the end of the period (by type)	**12 918**	**12 332**
pension and disability provisions	6 018	5 964
provisions for death severance	3 911	3 657
provisions for the Social Benefit Fund	2 989	2 711
Short-term (up to 1 year)	**687**	**1 064**
pension and disability provisions	410	817
provisions for death severance	224	199
provisions for the Social Benefit Fund	53	48
Long-term (over 1 year)	**12 231**	**11 268**
pension and disability provisions	5 608	5 147
provisions for death severance	3 687	3 458
provisions for the Social Benefit Fund	2 936	2 663

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	31.12.2016	31.12.2015
Breakdown of actuarial gains and losses		
Change in financing assumptions, due to:	**(1 292)**	**458**
pension and disability provisions	(592)	182
provisions for death severance	(372)	115
provisions for the Social Benefit Fund	(328)	161
Change in demographic assumptions, due to:	**270**	**571**
pension and disability provisions	112	281
provisions for death severance	132	11
provisions for the Social Benefit Fund	26	279
Other changes, due to:	**611**	**844**
pension and disability provisions	(188)	260
provisions for death severance	38	295
provisions for the Social Benefit Fund	761	289

The discount rate is one of the key assumptions used in the actuarial valuation of provisions for post-employment benefits. If the discount rate used in the calculation of these provisions was decreased by 0.5 p.p., the value of the provisions would increase by PLN 563 thousand, and in the case of an increase of the discount rate by 0.5 p.p. the value of the provisions would fall by PLN 517 thousand.

32. Provisions

	31.12.2016	31.12.2015
For off-balance sheet granted contingent liabilities *	43 376	45 590
For legal proceedings	113 192	99 526
Other	26 080	80 228
Total provisions	**182 648**	**225 344**

* includes valuation of financial guarantees

As at 31 December 2015, other provisions include the provision for payment for the Borrowers Support Fund in the amount of PLN 51 727 thousand. The cost of the provision has been included in mBank's income statement for the year 2015 under overhead costs (Note 10). The payment was made on 18 February 2016.

The estimated maturity of granted contingent liabilities has been presented under Note 36.

The estimated cash flow due to created provisions for legal proceedings and other provisions is expected to crystalize over 1 year.

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Movements in provisions

	31.12.2016	31.12.2015
As at the beginning of the period (by type)	**225 344**	**176 878**
For off-balance sheet granted contingent liabilities	45 590	49 610
For legal proceedings	99 526	96 933
Other	80 228	30 335
Change in the period (due to)	**(42 696)**	**48 466**
- increase of provisions, due to:	137 628	215 262
for off-balance-sheet granted contingent liabilities (Note 12)	*113 948*	*146 612*
for legal proceedings	*19 684*	*8 744*
other	*3 996*	*59 906*
- release of provisions, due to:	(119 138)	(150 698)
for off-balance-sheet granted contingent liabilities (Note 12)	*(116 453)*	*(150 698)*
for legal proceedings	*(2 310)*	-
other	*(375)*	-
- write-offs	(61 488)	(16 167)
- foreign exchange differences	302	69
As at the end of the period (by type)	**182 648**	**225 344**
For off-balance sheet granted contingent liabilities	43 376	45 590
For legal proceedings	113 192	99 526
Other	26 080	80 228

Provisions for off-balance sheet granted contingent liabilities

	31.12.2016	31.12.2015
Incurred but not identified losses		
Off-balance sheet contingent liabilities	34 942 356	29 584 188
Provisions for off-balance sheet contingent liabilities analysed according to portfolio approach (negative amount)	(25 772)	(31 131)
Net off-balance sheet contingent liabilities	**34 916 584**	**29 553 057**
Off-balance sheet granted contingent liabilities with impairment		
Off-balance sheet contingent liabilities	32 388	28 259
Provisions for off-balance sheet contingent liabilities analysed individually (negative amount)	(17 604)	(14 459)
Net off-balance sheet contingent liabilities	**14 784**	**13 800**

33. Assets and liabilities for deferred income tax

Assets and liabilities for deferred income tax are calculated for all temporary differences in accordance with the balance sheet method, using an effective income tax rate of 19% in 2016 and 2015.

Assets and liabilities for deferred income tax are not recognized as short term assets and liabilities.

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

Deferred income tax assets	As at 01.01.2016	Recognised in the income statement	Recognised in other comprehensive income	Other changes	As at 31.12.2016
Interest	40 301	(122)	-	-	**40 179**
Valuation of investment securities	42 719	(12 832)	15 942	-	**45 829**
Provisions for impairment of loans and advances	193 618	27 297	-	-	**220 915**
Provisions for employee benefits	27 188	3 306	(78)	-	**30 416**
Other provisions	17 773	(12 121)	-	-	**5 652**
Prepayments/accruals	23 361	(524)	-	-	**22 837**
Other negative temporary differences	44 650	(3 292)	-	547	**41 905**
Total deferred income tax assets	**389 610**	**1 712**	**15 864**	**547**	**407 733**

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Deferred income tax liabilities	As at 01.01.2016	Recognised in the income statement	Recognised in other comprehensive income	Other changes	As at 31.12.2016
Interest	(54 743)	(1 257)	-	-	**(56 000)**
Valuation of derivative financial instruments	(36 089)	1 530	564	-	**(33 995)**
Valuation of investment securities	(149 805)	(7 136)	87 785	-	**(69 156)**
Interest and fees received in advance	(38 626)	17 730	-	-	**(20 896)**
Difference between tax and book value of tangible and intangible assets	(47 304)	1 652	-	-	**(45 652)**
Prepayments regarding amortization of applied investment relief	(18 657)	-	-	-	**(18 657)**
Other positive temporary differences	(13 189)	(3 595)	-	-	**(16 784)**
Total deferred income tax liabilities	**(358 413)**	**8 924**	**88 349**	**-**	**(261 140)**

Deferred income tax assets	As at 01.01.2015	Recognised in the income statement	Recognised in other comprehensive income	Other changes	As at 31.12.2015
Interest	44 399	(4 098)	-	-	**40 301**
Valuation of investment securities	21 340	15 763	5 616	-	**42 719**
Provisions for impairment of loans and advances	203 961	(10 343)	-	-	**193 618**
Provisions for employee benefits	29 229	(2 396)	355	-	**27 188**
Other provisions	6 683	11 090	-	-	**17 773**
Prepayments/accruals	23 538	(177)	-	-	**23 361**
Tax losses carried forward	6 034	(6 034)	-	-	**-**
Other negative temporary differences	25 591	16 738	-	2 321	**44 650**
Total deferred income tax assets	**360 775**	**20 543**	**5 971**	**2 321**	**389 610**

Deferred income tax liabilities	As at 01.01.2015	Recognised in the income statement	Recognised in other comprehensive income	Other changes	As at 31.12.2015
Interest	(50 170)	(4 573)	-	-	**(54 743)**
Valuation of derivative financial instruments	(24 312)	(12 527)	750	-	**(36 089)**
Valuation of investment securities	(155 275)	5 910	(440)	-	**(149 805)**
Interest and fees received in advance	(40 451)	1 825	-	-	**(38 626)**
Difference between tax and book value of tangible and intangible assets	(43 911)	(3 393)	-	-	**(47 304)**
Prepayments regarding amortization of applied investment relief	(18 657)	-	-	-	**(18 657)**
Other positive temporary differences	(12 937)	(252)	-	-	**(13 189)**
Total deferred income tax liabilities	**(345 713)**	**(13 010)**	**310**	**-**	**(358 413)**

Interest income included in the profit and loss account	31.12.2016	31.12.2015
Interest	(1 379)	(8 671)
Valuation of derivative financial instruments	1 530	(12 527)
Valuation of securities	(19 968)	21 673
Provisions for impairment of loans and advances	27 297	(10 343)
Provisions for employee benefits	3 306	(2 396)
Other provisions	(12 121)	11 090
Prepayments/accruals	(524)	(177)
Interest and fees received in advance	17 730	1 825
Difference between tax and book value of tangible and intangible assets	1 652	(3 393)
Deferred tax losses carried forward	-	(6 034)
Other temporary differences	(6 887)	16 486
Total deferred income tax included in the profit and loss account (Note 13)	**10 636**	**7 533**

Deferred tax assets are recognised, because it is probable that future taxable profit will occur.

A level of deferred tax asset for the year 2016 and 2015 does not include tax losses of the foreign branch in Slovakia. Potential including of the tax losses into deferred tax asset in years to come will depend upon an assessment of the corporate income tax base level in a future (including the periods scheduled for settlement of tax losses). Right to tax losses' settlement expires between 2017 and 2018 year.

34. Brokerage Office

On 20 May 2016, there was a division of Dom Maklerski mBanku S.A. ("mDM") and mWealth Management S.A. ("mWM"), the Group entities.

The division of mDM was effected in accordance with the procedure specified in Art. 529 § 1.1 of the Commercial Companies Code ("CCC"), i.e. through a transfer to:

- the Bank of a part of the assets and liabilities of mDM in the form of an organised part of the enterprise of mDM connected with the provision of brokerage services;
- mCentrum Operacji sp. z o.o., of a part of the assets and liabilities of mDM in the form of an organised part of the enterprise of mDM connected with the servicing of and rendering of human resources and payroll services.

The division of mWM was effected in accordance with the procedure specified in Art. 529 § 1.1 of the CCC, i.e. through a transfer to:

- the Bank of a part of the assets and liabilities of mWM in the form of an organised part of the enterprise of mWM connected with the provision of brokerage services, as well as other activities that do not constitute the Operations of the Office of the Real Estate Market and Alternative Investments as defined below; and
- through a transfer to BRE Property Partner sp. z o.o., the subsidiary of mBank, of a part of the assets and liabilities of mWM in the form of an organised part of the enterprise of mWM connected with advisory and intermediation services, within the scope of acquiring and investing in real estate as well as other alternative investments (investment gold, investment silver, fine art), in favour of natural persons as well as the performance of an analysis within the scope of the real estate market.

With reference to the mDM division and the mWM division, on 20 May 2016 the striking off took place:

- of mDM from the National Court Register by the District Court for the Capital City of Warsaw in Warsaw, XII Commercial Division of the National Court Register;
- of mWM from the National Court Register by the District Court for the Capital City of Warsaw in Warsaw, XII Commercial Division of the National Court Register.

Consequently, pursuant to Art. 530 § 1 of the CCC, as a result of the mDM division and the mWM division, mDM and mWM were wound up without going into liquidation on the date on which they were struck off the register while their activities were taken over and continued by mBank and other Group entities.

The above mentioned division of mDM and mWM was settled on the basis of the accounting values and had no impact on the net result of mBank for the year 2016 and the net assets of mBank as at 31 December 2016. Approach has been applied prospectively – income statement and statement of the financial data of mDM and mWM were included in the financial data of mBank from the date of the distribution, while the comparative data has not been restated.

As a result of the division, mBank took over assets of the both companies related to brokerage activities. The main components of the acquired assets include: on the assets side - cash, cash and cash equivalents, cash of customers and advances to customers due to concluded transactions while on the liabilities side – amounts due to customers in respect with the concluded transactions and other liabilities. As a result, at the date of the division total assets of the Bank rose by about PLN 1.0 billion.

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

As at 31 December 2016, the Bank was not involved in any proceedings before a court, arbitration body, or public administration authority concerning liabilities of the Bank or its subsidiaries, which represent at least 10% of the Bank's equity. Moreover, the total value of claims concerning liabilities of the Bank or its subsidiary in all proceedings before a court, an arbitration body or a public administration authority as at 31 December 2016 was also not higher than 10% of the Bank's equity.

The Bank monitors the status of all legal proceedings brought against the Bank and the level of required provisions.

Report on major proceedings brought against the Bank

1. Lawsuit brought by Bank Pekao SA (previously BPH SA) against Garbary Sp. z o.o. ("Garbary")

   BPH brought the case to court on 17 February 2005. The value of the dispute was estimated at PLN 42 854 thousand. The purpose was to cancel actions related to the creation of Garbary and the contribution in kind. The dispute focuses on determination of the value of the right to perpetual usufruct of land and related buildings that ZM Pozmeat SA contributed in kind to Garbary as payment for a stake in ZM Pozmeat SA share capital worth PLN 100 000 thousand. On 6 June 2006, the District Court in Poznań issued a verdict according to which the claims were dismissed in their entirety. The claimant filed an appeal against that verdict. On 6 February 2007, the Court of Appeal dismissed the claimant's appeal. The claimant filed the last resort appeal against the ruling of the Court of Appeal. On 2 October 2007, the Supreme Court revoked the ruling of the Court of Appeal and referred the case back. After re-examining the case, the Court of Appeal dismissed the ruling of the District Court in Poznań on 4 March 2008 and referred the case back. On 16 September 2010, the District Court in Poznań dismissed the claim in whole. On 19 October 2010, BPH filed an appeal against the ruling in question. On 24 February 2011, the Court of Appeal made a decision on revoking the ruling and discontinuance of proceedings involving Bank Pekao S.A. (the Bank entered in the proceedings as successor of BPH) justified by lack of title to bring the action before the court on the side of the Bank. The case was returned to the court of the first instance where it was continued with the participation of Pekao SA (previously BPH SA) as the claimant. Bank Pekao SA (previously BPH SA) filed the last resort appeal against the aforesaid decision with the Supreme Court. On 25 April 2012, the Supreme Court revoked the aforesaid decision of the Court of Appeal and referred the case back. On 9 April 2014 the Court of Appeal changed the ruling of the District Court and considered the activities connected with setting up the company Garbary and contribution in kind as ineffective in relation to Bank Pekao SA (previously BPH SA). The Bank filed an annulment appeal to the Supreme Court from above mentioned judgment. On 5 August 2015 the Supreme Court issued a decision in which it has declined acceptance of the complaint for consideration. Possibility of settlement of the dispute is being analyzed, with consideration of the legal conditions of efficient enforcement of the judgment.

2. Lawsuit brought by Bank Pekao SA (previously BPH SA) against the Bank and Tele-Tech Investment Sp. z o.o. ("TTI")

   On 17 November 2007, BPH brought to court a case for damages in the amount of PLN 34 880 thousand plus statutory interest from 20 November 2004 to the date of payment, due to alleged illegal actions such as the sale by ZM Pozmeat SA to TTI of all shares in the equity of Garbary Sp. z o.o. (previously Milenium Center Sp. z o.o.), an important part of its assets, while ZM Pozmeat SA was at risk of insolvency.

   In its reply to the claim, the Bank petitioned the Court for dismissing the claim on the grounds of there being no legal basis for allowing the claim. On 1 December 2009, the Court decided to suspend the case until the completion of Pozmeat's bankruptcy proceedings. On 26 January 2011, the court has decided to reinstate suspended proceedings due to the closing of the insolvency procedure. On 5 June 2012, the court once again decided to suspend the proceedings until the case filed by Bank Pekao SA (previously BPH SA) against Garbary Sp. z o.o. is finally settled. In November 2015, a decision to resume the suspended proceedings was made.

3. Claims of clients of Interbrok

   From 14 August 2008, 170 entities who were clients of Interbrok Investment E. Dróżdż i Spółka Spółka jawna (hereinafter referred to as Interbrok) called the Bank for amicable settlement in the total amount of PLN 385 520 thousand and via the District Court in Warsaw. In addition, 9 legal compensation suits have been delivered to the Bank. Eight of the nine suits where placed by former clients of Interbrok for the total amount of PLN 800 thousand with the reservation that the claims may be extended up to the total amount of PLN 5 950 thousand. The Plaintiffs alleged that the Bank aided and abetted Interbrok's illegal activities, which caused damage to the Plaintiffs. Seven of the suits against mBank were dismissed on substantive grounds and thus ended with a valid court order. As regards the 8th case, the Plaintiff withdrew the action and the waiver of claims and the Regional Court discontinued the proceedings. In the 9th case the value of the subject of litigation amounts to PLN 275 423 thousand together with statutory interest and legal costs. The amount set forth in the petition is to cover the receivables, acquired by the Plaintiff by way of assignment, due to parties aggrieved by Interbrok on account of the reduction (as a result of Interbrok's bankruptcy) of the receivables by a return of the deposits paid by the aggrieved for making investments on the forex market. The Plaintiff claims the Bank's liability on the grounds of the Bank's aiding to commit the illicit act of Interbrok involving the pursuit of brokerage activity without a permit. At present, the case is being heard by the court of first instance.

   The Bank moves for dismissal of the claims in entirety and objects to charges raised in the legal suits. The legal analysis of the abovementioned claims indicates that there are no significant grounds to state that the Bank bears liability in the said case.

4. Class action against mBank S.A. concerning changes in interest rate clause

   On 4 February 2011, the Bank received a class action brought to the District Court in Łódź on 20 December 2010 by the Municipal Ombudsman who represents a group of 835 persons – retail clients of the Bank. The petitioners demand that a responsibility of the Bank is determined for improper performance of mortgage credit agreements. In particular, it was indicated that the Bank improperly applied provisions of the agreements concerning interest rates adjustment, namely that the Bank did not reduce interest rates on loans, although, according to the petitioners, it should have. The Bank rejects the above reasoning. On 18 February 2011, the Bank submitted a formal answer to the court, in which it applied for a dismissal of the claim as a whole.

On 6 May 2011, the District Court in Łódź decided to reject the application of mBank S.A. for dismissing the claim and decided that the case will proceed as a class action. On 13 June 2011, mBank S.A. lodged a complaint against this decision with the Court of Appeal in Łódź. On 28 September 2011, the Court of Appeal dismissed the complaint of mBank S.A. Currently, the case proceeds as a class action. The time for joining the class ended in March 2012. As at 17 October 2012, the approved class consisted of 1 247 members. Moreover, the District Court in Łódź ruled against setting up a cash deposit for mBank S.A. requested by the Bank. The Bank lodged a complaint against this ruling. On 29 November 2012, the Court of Appeal in Łódź dismissed the Bank's complaint about setting up the cash deposit. The ruling is valid and the Plaintiff is not obliged to pay the cash deposit. The final response to the petition was sent in January 2013, while the Plaintiff replied to it in a pleading filed on 15 February 2013. By a decision dated 18 February 2013, the District Court in Łódź decided to refer the case to mediation. In a letter dated 26 February 2013, the Municipal Consumer Ombudsman raised an objection to the mediation. On 22 June 2013, a trial was conducted, and on 3 July 2013, the Court announced its judgment in which it took into account the action in its entirety acknowledging that the Bank improperly performed the agreement whereby the consumers sustained a loss. On 9 September 2013, the Bank filed an appeal against the aforementioned verdict. Under the sentence of 30 April 2014, the Court of Appeal in Łódź dismissed the appeal of mBank, upholding the decision of the District Court expressed in the appealed verdict. The aforementioned verdict is legally valid, however, after having received its written justification, mBank lodged an annulment appeal to the Supreme Court. The annulment appeal was brought by mBank on 3 October 2014. On 7 October 2014 the Court of Appeal in Łódź ceased the enforceability of the judgement of District Court in Łódź until consideration of Bank's annulment appeal. On 18 February 2015, the Supreme Court received the annulment appeal filed by mBank. On 14 May 2015, the Supreme Court revoked the judgments of the Court of Appeal in Łódź and remanded the case to the Court of Appeal in Łódź for re-examination. On 24 September 2015 the Court of Appeal in Łódź admitted evidence from an opinion of an expert in order to verify the correctness of adjustments made by mBank in mortgage loan interest rates subject to class action in the period of 1 January 2009 to 28 February 2010.

The expert witness prepared a principal opinion and a supplementary opinion. The parties now have time to inform each other of their stances on the expert witness' opinion. The last hearing was on 24 February 2017. The case is pending.

5. Class action against mBank S.A. concerning indexation clauses

   On 4 April 2016, the Municipal Ombudsman representing a group of 390 individuals, retail banking clients of mBank, who concluded agreements on CHF-indexed mortgage loans with mBank, filed a class action with the Regional Court in Łódź against mBank. In a letter of 23 May 2016 the claimant added another 144 persons to the list of the group members. The statement of claim included alternative claims for declaring invalidity of the loan agreements in part i.e. in the scope of the provisions related to indexation, or declaring that the agreements in question are invalid in whole, or finding that the provisions of the agreement related to indexation are invalid in the scope where indexation of over 20% and below 20% of the value of the CHF exchange rate from the table of exchange rates of mBank S.A. from the date of conclusion of each of the loan agreements was permitted. The statement of claim in question was served on mBank on 13 June 2016. At the hearing on 19 December 2016, the Court decided that the case would proceed as a class action and dismissed the Bank's application for establishing a cash deposit. The Bank filed a complaint against the above mentioned decision. The case is pending.

As at 31 December 2016, the Bank was not involved in any proceedings before a court, arbitration body, or public administration authority concerning receivables of the Bank or its subsidiaries, which represent at least 10% of the Bank's equity. The total value of claims concerning receivables of the Bank or its subsidiaries in all proceedings before a court, an arbitration body or a public administration authority underway at 31 December 2016 was also not higher than 10% of the Bank's equity.

Taxes

The tax authorities, may inspect at any time the books and records within 5 years subsequent to the reported tax year, and may impose additional tax assessments and penalties. The Management Board is not aware of any circumstances, which may give rise to a potential tax liability in this respect.

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36. Off-balance sheet liabilities

Off-balance sheet liabilities of the Bank comprise:

- Loan commitments

The amounts and deadlines by which the Bank will be obliged to realise its off-balance sheet liabilities by granting loans or other monetary services are presented in the table below.

- Guarantees and other financial facilities

Guarantees are presented in the table below based on the earliest contractual maturity date.

- Operating lease liabilities

The following table presents the Bank's off-balance sheet commitments granted and received as well as nominal value of open positions of derivative transactions of the Bank as at 31 December 2016 and 31 December 2015.

31.12.2016		Up to 1 year	1 - 5 years	Over 5 years	Total
1.	**Contingent liabilities granted and received**	**22 465 978**	**13 920 265**	**1 270 051**	**37 656 294**
	Commitments granted	**21 269 832**	**12 816 725**	**982 775**	**35 069 332**
	1. Financing	17 585 423	3 604 271	505 984	21 695 678
	a) Loan commitments	17 560 920	3 534 186	505 984	21 601 090
	b) Operating lease commitments	24 503	70 085	-	94 588
	2. Guarantees and other financial facilities	3 684 409	9 212 454	476 791	13 373 654
	a) Banker's acceptances	21 562	-	-	21 562
	b) Guarantees and standby letters of credit	3 662 847	9 212 454	476 791	13 352 092
	Commitments received	**1 196 146**	**1 103 540**	**287 276**	**2 586 962**
	a) Financial commitments received	779	-	-	779
	b) Guarantees received	1 195 367	1 103 540	287 276	2 586 183
2.	**Derivative financial instruments (nominal value of contracts)**	**194 820 120**	**203 397 910**	**33 708 742**	**431 926 772**
	1. Interest rate derivatives	123 802 952	179 135 335	32 537 668	335 475 955
	2. Currency derivatives	69 669 171	20 144 772	178 595	89 992 538
	3. Market risk derivatives	1 347 997	4 117 803	992 479	6 458 279
	Total off-balance sheet items	**217 286 098**	**217 318 175**	**34 978 793**	**469 583 066**

31.12.2015		Up to 1 year	1 - 5 years	Over 5 years	Total
1.	**Contingent liabilities granted and received**	**20 869 028**	**7 000 378**	**3 554 681**	**31 424 087**
	Commitments granted	**20 036 217**	**6 433 624**	**3 217 604**	**29 687 445**
	1. Financing	16 783 485	2 025 057	671 019	19 479 561
	a) Loan commitments	16 762 057	1 971 487	671 019	19 404 563
	b) Operating lease commitments	21 428	53 570	-	74 998
	2. Guarantees and other financial facilities	3 252 732	4 408 567	2 546 585	10 207 884
	a) Banker's acceptances	11 142	-	-	11 142
	b) Guarantees and standby letters of credit	3 225 073	4 408 567	2 546 585	10 180 225
	c) Documentary and commercial letters of credit	16 517	-	-	16 517
	Commitments received	**832 811**	**566 754**	**337 077**	**1 736 642**
	a) Guarantees received	832 811	566 754	337 077	1 736 642
2.	**Derivative financial instruments (nominal value of contracts)**	**291 833 392**	**242 701 003**	**46 488 198**	**581 022 593**
	1. Interest rate derivatives	223 054 121	227 992 009	43 634 920	494 681 050
	2. Currency derivatives	67 757 825	12 656 451	1 872 328	82 286 604
	3. Market risk derivatives	1 021 446	2 052 543	980 950	4 054 939
	Total off-balance sheet items	**312 702 420**	**249 701 381**	**50 042 879**	**612 446 680**

The above operating lease liabilities relate entirely to the lease of buildings.

The leasing agreement for the Bank's headquarters is the most important leasing agreement concluded by the Bank. According to the agreement, the leasing period ends on 31 December 2020. The agreement has been concluded for a definite period and, in principal, is not subject to early termination. The agreement provides for the possibility of purchasing the leased object upon a written application of the lessee at least 6 months and no more than 12 months prior to the termination of the leasing agreement, as well as the pre-emptive right under the conditions specified in the agreement. Under the agreement the Bank shall ensure proper maintenance of the object of leasing.

The nominal values of derivatives are presented in the Note 19.

As at 31 December 2016, commitments received by the Bank in the amount of PLN 2 586 962 thousand (31 December 2015: PLN 1 736 642 thousand), related mainly to guarantees received as collateral of loans and advances.

37. Pledged assets

Assets may be pledged as collateral for repo/sell-buy-back transactions, derivative contracts with other banks. Collateral may be also placed due to stock market derivatives such as futures, options and participation in stock market.

Collateral may be placed in different form (e.g. cash, securities and pledged assets).

Similarly, customers establish collateral on their assets to secure the transaction with the Bank. If securities are subject to collateral (in buy-sell-back transaction) they can be re-pledged in the opposite transaction (sell-by-back).

Moreover the Bank accepts collaterals in the form of properties (esp. real estates) related to credit type transactions like mortgage loans, credit lines, banking guarantees.

The table below presents the breakdown of the measures possible to pledge by the main items of the statement of financial position of mBank, as at 31 December 2016 and 31 December 2015. Treasury securities are the main assets position capable for supporting funding and collateral needs are treasury securities. Treasury securities are the main component of the Banks's liquidity collateral that can be eligible to pledge.

31.12.2016

Position (PLN 000's)	Assets			Collateral received in kind of securities related with buy sell back transactions			Assets available for pledge (3+6)
	Total	Pledged	Eligible for pledge	Received	Reused	Available for pledge	
	1	2	3	4	5	6	7
Debt securities (Note 18 and Note 22)	**34 250 800**	**7 427 741**	**25 652 046**	**-**	**-**	**-**	**25 652 046**
- NBP bills	1 584 615	-	1 584 615	-	-	-	1 584 615
- Government bonds	30 851 763	7 427 741	23 424 022	-	-	-	23 424 022
- Mortgage bonds	242 528	-	242 528	-	-	-	242 528
- Other	1 571 894	-	400 881	-	-	-	400 881
Cash collaterals (due to derivatives transactions) (Note 17 and 21)	457 806	457 806	-	-	-	-	-
Property collateral	-	-	-	-	-	-	-
Other assets	93 506 659	-	-	-	-	-	-
Total	**128 215 265**	**7 885 547**	**25 652 046**	**-**	**-**	**-**	**25 652 046**

31.12.2015

Position (PLN 000's)	Assets			Collateral received in kind of securities related with buy sell back transactions			Assets available for pledge (3+6)
	Total	Pledged	Eligible for pledge	Received	Reused	Available for pledge	
	1	2	3	4	5	6	7
Debt securities (Note 18 and Note 22)	**30 357 214**	**5 411 108**	**23 757 289**	**1 571 852**	**668 953**	**902 989**	**24 660 278**
- NBP bills	6 972 521	-	6 972 521	-	-	-	6 972 521
- Government bonds	22 138 476	5 411 108	16 727 368	1 571 852	668 953	902 989	17 630 357
- Mortgage bonds	17 453	-	17 453	-	-	-	17 453
- Other	1 228 764	-	39 947	-	-	-	39 947
Cash collaterals (due to derivatives transactions) (Note 17 and 21)	400 273	400 273	-	-	-	-	-
Property collateral	-	-	-	-	-	-	-
Other assets	88 357 883	-	-	-	-	-	-
Total	**119 115 370**	**5 811 381**	**23 757 289**	**1 571 852**	**668 953**	**902 989**	**24 660 278**

The value of treasury securities presented as pledged assets, except for collaterals due to sell-buy-back transactions, includes collateral of liabilities due to the loan received from the EIB, the security deposit placed by the client and funds guaranteed under the Bank Guarantee Fund (BFG).

38. Registered share capital

The total number of ordinary shares as at 31 December 2016 was 42 280 127 shares (31 December 2015: 42 238 924 shares) of PLN 4 nominal value each. All issued shares were fully paid up.

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REGISTERED SHARE CAPITAL (THE STRUCTURE) AS AT 31 DECEMBER 2016						
Share type	**Type of preference**	**Type of restrictions**	**Number of shares**	**Series / issue value**	**Paid up**	**Year of registration**
ordinary bearer*	-	-	9 988 000	39 952 000	fully paid in cash	1986
ordinary registered*	-	-	12 000	48 000	fully paid in cash	1986
ordinary bearer	-	-	2 500 000	10 000 000	fully paid in cash	1994
ordinary bearer	-	-	2 000 000	8 000 000	fully paid in cash	1995
ordinary bearer	-	-	4 500 000	18 000 000	fully paid in cash	1997
ordinary bearer	-	-	3 800 000	15 200 000	fully paid in cash	1998
ordinary bearer	-	-	170 500	682 000	fully paid in cash	2000
ordinary bearer	-	-	5 742 625	22 970 500	fully paid in cash	2004
ordinary bearer	-	-	270 847	1 083 388	fully paid in cash	2005
ordinary bearer	-	-	532 063	2 128 252	fully paid in cash	2006
ordinary bearer	-	-	144 633	578 532	fully paid in cash	2007
ordinary bearer	-	-	30 214	120 856	fully paid in cash	2008
ordinary bearer	-	-	12 395 792	49 583 168	fully paid in cash	2010
ordinary bearer	-	-	16 072	64 288	fully paid in cash	2011
ordinary bearer	-	-	36 230	144 920	fully paid in cash	2012
ordinary bearer	-	-	35 037	140 148	fully paid in cash	2013
ordinary bearer	-	-	36 044	144 176	fully paid in cash	2014
ordinary bearer	-	-	28 867	115 468	fully paid in cash	2015
ordinary bearer	-	-	41 203	164 812	fully paid in cash	2016
Total number of shares			**42 280 127**			
Total registered share capital				**169 120 508**		
Nominal value per share		**4**				

* As at the end of the reporting period

In 2016, the National Depository of Securities (KDPW) has registered 41 203 shares of mBank S.A., which were issued as part of the conditional increase in the share capital of the Bank by issuance of shares with no subscription rights for the existing shareholders in order to enable beneficiaries of the incentive programmes to take up shares in mBank S.A. As a result of the above registration, in 2016 the Bank's share capital increased by PLN 164 812.

Commerzbank AG is a shareholder holding over 5% of the share capital and votes at the General Meeting and as at 31 December 2016 it held 69.42% of the share capital and votes at the General Meeting of mBank S.A.

In 2016, there were no changes in the holding of material share packages of the Bank.

On 20 March 2015, the Bank received from ING Otwarty Fundusz Emerytalny (Fund) a notification that the total numbers of votes controlled at the General Meeting of mBank S.A. increased over 5%.

Prior to the acquisition, the Fund held 2 110 309 shares of mBank S.A., which constituted 4.99% of mBank S.A. share capital and entitled it to exercise 2 110 309 votes at the General Meeting of mBank S.A. On 18 March 2015, in the brokerage account of the Fund there were 2 130 699 shares of mBank S.A., representing 5.05% of the share capital of mBank S.A. The shares entitle to 2 130 699 votes at the General Meeting of mBank SA, which represent 5.05% of the total number of votes.

39. Share premium

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

The increase of share premium in 2016 and 2015 results from the issue of shares under incentive programmes described under Note 44.

40. Retained earnings

Retained earnings include: other supplementary capital, other reserve capital, general banking risk reserve, profit (loss) from the previous year and profit for the current year.

Other supplementary capital, other reserve capital and general banking risk reserve are created from profit for the current year and their aim is described in the By-laws or in other regulations of the law.

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	31.12.2016	31.12.2015
Other supplementary capital	4 384 011	4 384 011
Other reserve capital	26 891	32 976
General banking risk reserve	1 095 143	1 065 143
Profit from the previous year	2 761 506	1 490 284
Profit for the current year	1 219 339	1 301 233
Total retained earnings	**9 486 890**	**8 273 647**

According to the Polish legislation, each bank is required to allocate 8% of its net profit to a statutory undistributable other supplementary capital until this supplementary capital reaches 1/3 of the share capital.

In addition, the Bank transfers some of its net profit to the general banking risk reserve to cover unexpected risks and future losses. The general banking risk reserve can be distributed only on consent of shareholders at a general meeting.

41. Other components of equity

	31.12.2016	31.12.2015
Exchange differences on translating foreign operations	**(5 953)**	**(6 290)**
Unrealized gains (positive differences)	3 706	6 324
Unrealized losses (negative differences)	(9 659)	(12 614)
Available-for-sale financial assets	**(2 431)**	**441 758**
Unrealized gains on debt instruments	68 772	360 744
Unrealized losses on debt instruments	(89 072)	(1 881)
Unrealized gains on equity instruments	1 307	168 075
Deferred income tax	16 562	(85 180)
Cash flow hedges	**(1 545)**	**859**
Unrealized gains	1 065	1 061
Unrealized losses	(2 972)	-
Deferred income tax	362	(202)
Actuarial gains and losses relating to post-employment benefits	**(3 517)**	**(3 850)**
Actuarial (losses)	(4 342)	(4 753)
Deferred income tax	825	903
Share of other comprehensive income of entities under the equity method	**(737)**	**465**
Share of other comprehensive income of entities under the equity method	(737)	465
Total other components of equity	**(14 183)**	**432 942**

In 2015, unrealized gains on equity instruments relate mainly to the valuation of the stake in Visa Europe Ltd.

Detailed information concerning participation in the Visa Europe Ltd. has been presented under Note 22.

42. Dividend per share

On 24 March 2016, the 29th Ordinary General Meeting of mBank S.A., adopted the resolution on division of the 2015 net profit which does not provide for the payment of dividend for the year 2015.

43. Explanatory notes to the cash flow statements

Cash and cash equivalents

For the purposes of the cash flow statement cash and cash equivalents include the following balances with maturities of less than three months.

	31.12.2016	31.12.2015
Cash and balances with the Central Bank (Note 16)	9 158 751	5 930 611
Loans and advances to banks (Note 17)	2 325 904	783 328
Trading securities (Note 18)	3 503 029	178 492
Total cash and cash equivalents	**14 987 684**	**6 892 431**

Supplementary information to the cash flow statement

Explanation of differences between the change in the balances resulting from the balance sheet and the change disclosed in the cash flows from operating activities

(PLN 000's)	Year ended 31 December	
	2016	2015
Loans and advances to banks - change in the balance of the statement of financial position	**(2 327 448)**	**666 726**
The difference between the interest accrued and paid in cash in the period	(70 361)	(60 414)
Exclusion of a change in the balance of cash and cash equivalents	1 542 576	(314 554)
Total change in loans and advances to banks	**(855 233)**	**291 758**
Trading securities - change in the balance of the statement of financial position	**(3 279 016)**	**692 474**
Exclusion of a change in the balance of cash and cash equivalents	**3 324 537**	**(439 414)**
Total change in trading securities	**45 521**	**253 060**
Derivative financial instruments - change in the balance of the statement of financial position	**(27 228)**	**(27 802)**
The difference between the interest accrued and paid in cash in the period	81 994	91 987
Valuation included in other comprehensive income	(2 967)	(3 948)
Total change in derivative financial instruments	**51 799**	**60 237**
Loans and advances to customers including hedge accounting adjustments related to fair value hedged items - change in the balance of the statement of financial position	**(1 019 899)**	**(1 753 903)**
The difference between the interest accrued and paid in cash in the period	**(59 986)**	**5 808**
Total change in loans and advances to customers	**(1 079 885)**	**(1 748 095)**
Investment securities - change in the balance of the statement of financial position	**(509 110)**	**(2 883 566)**
Valuation included in other comprehensive income	(584 986)	(130 627)
The difference between the interest accrued and paid in cash in the period	(39 471)	(245 966)
Sale of investments securities and subsidiaries	165 243	(124 994)
Increase of involvement in subsidiaries included in financing activity	102 200	154 229
Total change in investment securities	**(866 124)**	**(3 230 924)**
Changes in other assets - change in the balance of the statement of financial position	**(88 777)**	**(79 614)**
Balances unrealised in cash recognised in income statement	**(4 294)**	**48 562**
Total change in other assets	**(93 071)**	**(31 052)**
Amounts due to other banks - change in the balance of the statement of financial position	**(3 680 177)**	**(1 201 033)**
The difference between the interest accrued and paid in cash in the period	(60 042)	(91 899)
Exclusion of change in cash flows from financing activity	2 380 870	1 952 769
Total change in amounts due to other banks	**(1 359 349)**	**659 837**
Amounts due to customers including hedge accounting adjustments related to fair value hedged items - change in the balance of the statement of financial position	**13 045 167**	**6 612 834**
The difference between the interest accrued and paid in cash in the period	(138 151)	140 405
Exclusion of change in cash flows from financing activity	(2 723 902)	1 697 108
Total change in amounts due to customers	**10 183 114**	**8 450 347**
Debt securities in issue - change in the balance of the statement of financial position	**-**	**(386 423)**
Exclusion of change in cash flows from financing activity	-	385 000
Total change in debt securities in issue	**-**	**(1 423)**

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Changes in other liabilities - change in the balance of the statement of financial position	**406 476**	**273 459**
Valuation of incentive programmes recognised in income statement (Note 10)	9 088	14 458
Exclusion of tax liabilities of certain financial institutions	29 820	-
Unsettled part of the liabilities due to long-term agreements related to the sale of BRE TUiR shares and distribution agreements	-	55 500
Exclusion of settlements arising from the application of the equity method	20 460	-
Actuarial gains and losses relating to post-employment benefits recognised in other comprehensive income (Note 15)	411	(1 873)
Total change in other liabilities	**466 255**	**341 544**

Interest received and paid included in operating activities

	Year ended 31 December	
	2016	**2015**
Interest income, including:		
Loans and advances to banks	126 742	110 835
Loans and advances to customers	2 375 517	2 213 301
Trading debt securities	79 719	52 552
Investment securities	901 357	989 446
Interest income on derivatives classified into banking book	101 826	56 557
Interest income on derivatives concluded under hedge accounting	60 934	49 363
Other interest income	2 290	10 562
Total interest income	**3 648 385**	**3 482 616**

	Year ended 31 December	
	2016	**2015**
Interest expense, including:		
Settlements with banks due to deposits received	(14 962)	(544)
Settlements with customers due to deposits received	(642 102)	(852 459)
Security deposit received in relation with the guarantee granted to secure underwriting of securities	(130 947)	(157 285)
Other interest expense	(3 992)	(1 701)
Total interest expense	**(792 003)**	**(1 011 989)**

Cash flows from investing activities

Except for dividends received by the Bank, income from the sale of fixed assets as well as sale of shares of subsidiary (Note 23), the Bank received the funds in connection with the settlement of the takeover transaction of Visa Europe Limited by Visa Inc.

Cash flows from financing activities

Cash flows from financing activities mainly relate to the settlements due to long-term loans received from other banks (Note 27) and the European Investment Bank (Note 28).

In addition, in 2016 the inflows from financing activities of the Bank include the security deposit received by the Bank from the subsidiary mFinance France S.A. under the guarantee provided by the Bank in connection with the issuance of Eurobonds with a nominal value of EUR 500 000 thousand.

44. Share-based incentive programmes

2008 Incentive Programme for the Management Board Members of the Bank

On 14 March 2008 the Ordinary General Meeting of mBank, by adopting a relevant resolution, expressed consent to carry out an incentive programme for Members of the Bank's Management Board. Under the programme Members of the Bank's Management Board have the right to take up bonds with pre-emptive rights to acquire mBank shares or, as initially planned, shares of the ultimate parent entity, Commerzbank AG.

In 2010, the programme was changed in the part concerning shares of Commerzbank, so that Members of the Management Board may obtain the right to receive cash equivalent corresponding to the value of the shares of Commerzbank calculated based on the average share price on the date when the right to receive the equivalent originated.

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All the rights under payments settled in cash equivalent based on shares of Commerzbank and all the rights under payments settled in mBank S.A. shares within the framework of the programme have already been granted and settled. The last settlements under this programme have been completed in 2016.

The bonds were purchased by eligible persons and the rights to acquire shares under the conditional increase of share capital resulting from bonds has been completed.

Share-Based Payments Settled in Cash

All rights under payments settled as a cash equivalent based on Commerzbank shares under the program have already been granted. Since payments are settled in three equal annual deferred tranches on the lapse of, respectively, 12, 24 and 36 months from the date of the right acquisition by the Management Board Members for a given year of the programme, the cost of Commerzbank share-based payments settled in cash were recognised in the income statement in correspondence with liabilities to employees. The Bank's obligations arising from the unsettled parts of the programme were valued at fair value through the income statement until its settlement. The last settlements under this programme have been settled 2016.

Share-Based Payments Settled in mBank S.A. Shares

All rights under payments settled in mBank S.A. shares under the programme have already been granted. Since payments are settled in three equal annual deferred tranches on the lapse of, respectively, 12, 24 and 36 months from the date of the right acquisition by the Management Board Members for a given year of the programme, the cost of share-based payments settled in shares were recognised in the income statement in correspondence with other reserve capital. The last settlements under the programme were settled in 2016.

This was equity-settled share-based program.

The table below presents the number and weighted average exercise prices of share options related to the 2008 incentive programme for Management Board Members of the Bank.

	31.12.2016		31.12.2015	
	Number of options	Weighted average exercise price (in PLN)	Number of options	Weighted average exercise price (in PLN)
Outstanding at the beginning of the period	**181**	**-**	**3 650**	**-**
Granted during the period	-	-	-	-
Forfeited during the period	-	-	-	-
Exercised during the period*	181	4	3 469	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**-**	**-**	**181**	**-**
Exercisable at the end of the period	**-**	**-**	**-**	**-**

* In 2016, the weighted average price of the shares at the option exercise date was PLN 329.60 (in 2015 PLN 399.40).

2012 Incentive Programme for the Management Board Members of the Bank

On 7 December 2012, the Supervisory Board on the basis of recommendation of the Remuneration Committee, adopted Rules of the Incentive Programme at mBank S.A. which replaced the Rules of the Incentive Programme at mBank S.A. of 14 March 2008.

Under the programme, Members of the Bank's Management Board have the right to receive a bonus, including non-cash bonus paid in the Bank's shares, including phantom shares.

Cash bonus under the programme was paid for 2012-2013 and presented as an obligation to employees and referred to profit and loss account in a given year for which it was awarded.

Non-cash bonus, in which members of the Board have a right to take up bonds with pre-emptive rights to acquire shares, was granted under the programme for 2012-2013. The right to purchase the bonds will be realized in three equal annual deferred tranches, on the lapse of, respectively, 12, 24 and 36 months from the date of acquiring the right to non-cash bonus by the Management Board Member. Conditions of receiving as well as the amount of deferred tranche not paid out yet under non-cash bonus depend on the assessment of the financial position of the Bank by the Remuneration Committee and the performance evaluation of member of the Board for a period longer than one financial year.

The Supervisory Board on the basis of recommendations issued by the Remuneration Committee can make a decision on suspending in whole or limiting the right to acquire bonds with pre-emptive rights to take up the shares of the Bank relating to the deferred tranche in whole or partially due to the later assessment of the performance of the Member of the Management Board over a period of time longer than one financial year (i.e. for the period of at least 3 years), which takes into account the business cycle of the Bank as well as the risk related to the bank's operation, but only when the acts or omissions of the Member of the Management Board had a direct and adverse impact on the bank's financial result and market position within the assessment period. The Supervisory Board, on the basis of the recommendation of the Remuneration Committee of the Supervisory Board, can make a decision on suspending in whole or decreasing the bonus amount for a given financial year in relation to deferred tranche not paid out yet, in the situation referred to in Article 142 (1) of the Banking Law Act. Suspending in whole or decreasing any deferred tranche by the Remuneration Committee of the Supervisory Board can also apply to the deferred tranche not paid out yet to the Member of the Management Board after termination or expiry of the management contract.

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Bonds may be acquired by eligible persons in the years 2014-2021.

The table below presents the number and weighted average exercise prices of share options related to the 2012 incentive programme for Management Board Members of the Bank.

	31.12.2016		31.12.2015	
	Number of options	Weighted average exercise price (in PLN)	Number of options	Weighted average exercise price (in PLN)
Outstanding at the beginning of the period	**19 363**	**-**	**33 352**	**-**
Granted during the period	-	-	-	-
Forfeited during the period	-	-	-	-
Exercised during the period*	13 982	4	13 989	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**5 381**	**-**	**19 363**	**-**
Exercisable at the end of the period	**-**	**-**	**-**	**-**

* In 2016, the weighted average price of the shares at the option exercise date was PLN 329.60 (in 2015 PLN 399.40).

Cash Part of the Bonus

40% of the bonus base amount for the year is recognised as a liability to employees and charged to the income statement in the year for which it was granted.

Share-Based Payments Settled in mBank S.A. Shares

60% of the bonus base amount constitutes a payment settled in mBank S.A. shares.

As payments are settled in three equal annual deferred tranches on the lapse of, respectively, 12, 24 and 36 months from the date of acquisition by the member of the Board of the right for a given year of the programme, the cost of payments settled in shares is recognised in the income statement in the correspondence with other reserve capital. The last settlements of this program are planned in 2017.

This is equity-settled share-based program.

<u>2014 Incentive Programme for the Management Board Members of the Bank</u>

On 31 March 2014 the Supervisory Board in accordance with the recommendation of Remuneration Committee adopted a Regulation of the Incentive Programme in mBank S.A., which replaced the Regulation of the Incentive Programme in mBank S.A. dated at 7 December 2012.

Under the program the members of the Board have the right to bonus, including non-cash bonus paid in Bank's shares, including phantom shares.

The net ROE of mBank S.A. Group and the monthly remuneration of the member of the Board as at 31 December form the basis for acquisition by Members of the Management Board of the right to bonus and for calculation of the amount of bonus for a given financial year. Equivalent of 50% of the base amount calculated based on ROE constitutes the so-called first part of the bonus. In regard to the remaining 50% of the base amount, the Remuneration Committee of the Supervisory Board can grant the second part of the bonus if it decides that a given Member of the Management Board achieved the annual/multi-year business and development objective. The decision of granting the second part of the bonus is the sole responsibility of Remuneration Committee of the Supervisory Board, which according to its own judgement and decision confirm MBO achievement taking into account the situation on financial markets in the last/previous financial period.

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The sum of the first and the second part of bonus is the base bonus of the member of the Board for a given financial period. 40% of the base bonus constitutes non-deferred bonus and is paid in the year of determination of base bonus as follows: 50% in form of cash payment and 50% in Bank's shares or bonds with pre-emptive rights to acquire shares or phantom shares.

60% of the base bonus is deferred bonus and is paid in three equal tranches in the next three following years after the year of determining the base bonus as follows: 50% of each of the deferred tranches in form of cash payment and 50% of each of the deferred tranches in form of non-cash payment in Bank's shares or bonds with pre-emptive rights to acquire shares or phantom shares.

The Supervisory Board on the basis of recommendation of Remuneration Committee can make a decision to suspend in whole or reduce the amount of deferred tranche due to the later assessment of the performance of the Member of the Management Board over a period of time longer than one financial year (i.e. for the period of at least 3 years), which takes into account the business cycle of the Bank as well as the risk related to the bank's operations, but only when the acts or omissions of the Member of the Management Board had a direct and adverse impact on the Bank's financial result and market position within the assessment period and when at least one of the elements included in the assessment card is not fulfilled.

Remuneration Committee of the Supervisory Board can make a decision on suspending in whole or decreasing the non-deferred and deferred bonus amount for a given financial year, including deferred tranches not paid out yet, in the situation referred to in Article 142 (1) of the Banking Law Act. Suspending in whole or decreasing the non-deferred and deferred bonus, as well as any deferred tranche by the Remuneration Committee of the Supervisory Board can also apply to the non-deferred and deferred bonus, including deferred tranche not paid out yet after expiry or termination of the management contract.

The table below presents the number and weighted average exercise prices of share options related to the 2014 incentive programme for Management Board Members of the Bank.

	31.12.2016		31.12.2015	
	Number of options	Weighted average exercise price (in PLN)	Number of options	Weighted average exercise price (in PLN)
Outstanding at the beginning of the period	**9 776**	**-**	**-**	**-**
Granted during the period	17 828	-	16 295	-
Forfeited during the period	-	-	-	-
Exercised during the period*	10 394	4	6 519	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**17 210**	**-**	**9 776**	**-**
Exercisable at the end of the period	**-**	**-**	**-**	**-**

* In 2016, the weighted average price of the shares at the option exercise date was PLN 329.60 (in 2015 PLN 399.40).

Cash Part of the Bonus

50% of the base amount constitutes bonus cash payment. It is recognised as a liability to employees and charged to the income statement in the correspondence to liability to employees.

Share-Based Payments Settled in mBank S.A. Shares

50% of the base amount constitutes bonus payment settled in mBank S.A. shares. The cost of payments settled in shares is recognised in the income statement in the correspondence with other reserve capital.

This is equity-settled share-based program.

On 2 March 2015 the Supervisory Board extended the duration of the program from 31 December 2018 until 31 December 2021 in accordance with the recommendation of the Remuneration Committee.

2008 Incentive Programme for Key Managers of mBank Group

On 27 October 2008 the Extraordinary General Meeting of the Bank adopted an incentive programme for the key management staff of mBank S.A. Group.

The programme participants include:

- Bank Directors;
- Other key managers.

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They are responsible for taking decisions which have material impact on the implementation of a strategy specified by the Bank's Management Board, the Group's results, stability and security of business and development and creating added value of the organization.

In 2010, the Management Board of the Bank decided to launch the programme and approved the list of participants for Tranche III. Within Tranche III 13,000 options were granted. In 2011 within the Tranche IV and V programme 20,000 options and 19,990 options were granted. The rights started to be exercised in 2012 for Tranche III, in 2013 for Tranche IV and in 2014 for Tranche V. In 2011 a decision was taken on suspension of the programme and not activating the remaining tranches. All bonds granted under this program have already been acquired by eligible persons.

Share-Based Payments Settled in mBank S.A. Shares

The cost of the programme for key managers is charged to the income statement and recognised in correspondence with other reserve capital.

The cost of payments settled in shares is recognised in the income statement as of the date of award of the program until the acquisition date of rights, i.e.:

- from 23.08.2010 to 30.04.2012 for Tranche III;
- from 1.02.2011 to 30.04.2013 for Tranche IV;
- from 1.02.2011 to 30.04.2014 for Tranche V.

This is equity-settled share-based program.

The table below presents the number and weighted average exercise prices of share options related to the 2008 incentive programme for key managers of mBank Group.

	31.12.2016		31.12.2015	
	Number of options	Weighted average exercise price (in PLN)	Number of options	Weighted average exercise price (in PLN)
Outstanding at the beginning of the period	**100**	**-**	**1 277**	**-**
Granted during the period	-	-	-	-
Forfeited during the period	-	-	-	-
Exercised during the period*	100	4	1 177	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**-**	**-**	**100**	**-**
Exercisable at the end of the period	**-**	**-**	**100**	**-**

* In 2016, the weighted average price of the shares at the option exercise date was PLN 329.60 (in 2015 PLN 399.40).

<u>Employee programme for key management staff of mBank Group of 2013</u>

On 11 April 2013, the Extraordinary General Meeting of the Bank adopted a resolution amending the rules of the employee programme, which replaced the incentive programme for key management staff of mBank Group from 2008.

The aim of the programme is to ensure growth in the value of the Company's shares by linking the interest of the key management staff of mBank S.A. Group with the interest of the Company and its shareholders and implementing in mBank S.A. Group variable components of remuneration of the persons holding managerial positions at mBank S.A. Group in accordance with the Resolution of the KNF.

The programme applies to the employees having a material impact on the risk profile of mBank S.A. Group, in particular Members of the Management Board of strategic subsidiaries, Bank Directors and key staff of mBank, whose decisions have a significant impact on the implementation of the strategy specified by the Bank's Management Board, results of mBank S.A. Group, growth in the value of the Bank.

During the programme the rights to acquire bonds under Tranche VI have been granted, which may be exercised in three equal parts after 12, 24 and 36 months from the date of granting these rights, in accordance with the internal regulations adopted in mBank S.A. Group specifying rules of variable remuneration of the employees having a material impact on the risk profile at mBank S.A. Group.

The bonds may be acquired by the entitled persons during the programme term, but not later than by 31 December 2022.

The Bank's Management Board/Supervisory Board of the Company, where the Programme is carried out can take a decision on suspending the Programme in whole or decreasing the number of bonds or the number of bonds deferred in a given tranche for the entitled person in the case of occurrence of the situations referred to in Article 142 (1) of the Banking Law Act, occurrence of balance sheet loss or loss of liquidity, meeting the conditions set forth in the agreements with the program participants, forming the basis for provision of work or other services for the Bank and subsidiaries.

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Cash Part of the Bonus

The bonus in the amount of 50% of the base amount for the year is recognised as a liability to employees and charged to the income statement in the year for which it was granted.

Share-Based Payments Settled in mBank S.A. Shares

As payments are settled in three equal annual deferred tranches on the lapse of, respectively, 12, 24 and 36 months from the date of acquisition by the programme participants of the right for a given year of the programme, the cost of this part of the programme is charged to the income statement and recognised in correspondence with other reserve capital.

This is equity-settled share-based program.

The table below presents the number and weighted average exercise prices of share options related to the 2013 incentive programme for key managers of mBank Group.

	31.12.2016		31.12.2015	
	Number of options	Weighted average exercise price (in PLN)	Number of options	Weighted average exercise price (in PLN)
Outstanding at the beginning of the period	**1 486**	**-**	**2 233**	**-**
Granted during the period	-	-	-	-
Forfeited during the period	-	-	-	-
Exercised during the period*	744	4	747	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**742**	**-**	**1 486**	**-**
Exercisable at the end of the period	**-**	**-**	**-**	**-**

* In 2016, the weighted average price of the shares at the option exercise date was PLN 329.60 (in 2015 PLN 399.40).

Employee programme for key management staff of mBank Group of 2014

On 31 March 2014, the Supervisory Board of the Bank adopted on the basis of recommendation of Remuneration Committee a resolution amending the rules of the employee programme, which replaced the incentive programme for key management staff of mBank Group from 2013, whereas in regard to the persons who acquired bonds or were granted right to acquire bonds in Tranches III, IV, V and VI the programme will be carried out under the previous principles.

The aim of the programme is to ensure growth in the value of the Company's shares by linking the interest of the key management staff of mBank S.A. Group with the interest of the Company and its shareholders and implementing in mBank S.A. Group variable components of remuneration of the persons holding managerial positions at mBank S.A. Group.

Beginning with Tranche VII the right to purchase bonds granted to the entitled person will be divided into four parts, which may be realized respectively: I part – non-deferred bonds representing 50% of the 60% of the amount of discretionary bonus granted for a given financial year in the year of granting the right, and then another three equal parts – deferred bonds constituting 50% of the 40% of the amount of discretionary bonus granted for a given financial year on the lapse of 12, 24 and 36 months from the date of granting the rights, in accordance with the internal regulations adopted in mBank S.A. Group specifying rules of variable remuneration of the employees having a material impact on the risk profile at mBank S.A. Group.

The Bank's Management Board/Supervisory Board of the Company, where the Programme is carried out may take a decision on suspending the Programme in whole or decreasing the number of bonds or the number of bonds deferred in a given tranche for the entitled person in case of occurrence of the situations, referred to in Article 142 (1) of the Banking Law Act, occurrence of balance sheet loss or loss of liquidity, meeting the conditions set forth in the agreements with the program participants, forming the basis for provision of work or other services for the Bank and subsidiaries.

Cash Part of the Bonus

The bonus in the amount of 50% of the base amount for the year is cash payment. It is recognised as a liability to employees and charged to the income statement in the correspondence to the liability to employees.

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Share-Based Payments Settled in mBank S.A. Shares

The bonus in the amount of 50% of the base amount constitutes a payment settled in mBank S.A. shares.

The cost of payments settled in shares is recognised in the income statement in the correspondence with other reserve capital.

This is equity-settled share-based program.

On 2 March 2015 the Supervisory Board extended the duration of the program from 31 December 2019 until 31 December 2022 in accordance with the recommendation of the Remuneration Committee.

The table below presents the number and weighted average exercise prices of share options related to the 2014 incentive programme for key managers of mBank Group.

	31.12.2016		31.12.2015	
	Number of options	Weighted average exercise price (in PLN)	Number of options	Weighted average exercise price (in PLN)
Outstanding at the beginning of the period	**2 322**	**-**	**-**	**-**
Granted during the period	24 789	-	5 288	-
Forfeited during the period	-	-	-	-
Exercised during the period*	15 802	4	2 966	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**11 309**	**-**	**2 322**	**-**
Exercisable at the end of the period	**-**	**-**	**206**	**-**

* In 2016, the weighted average price of the shares at the option exercise date was PLN 329.60 (in 2015 PLN 399.40).

Summary of the Impact of the Programmes on the Bank's balance sheet and income statement

Share-Based Payments Settled in Shares

The table below presents changes in other reserve capital generated by the above mentioned incentive programmes for share-based payments settled in mBank S.A. shares.

	31.12.2016	31.12.2015
Incentive programs		
As at the beginning of the period	**32 976**	**30 256**
- value of services provided by the employees	9 088	14 459
- settlement of exercised options	(15 173)	(11 739)
As at the end of the period	**26 891**	**32 976**

Share-Based Payments Settled in Cash

The incentive programme for the Management Board of the Bank in the part relating to Commerzbank shares has no impact on other reserves as its cost is taken to the income statement in correspondence with liabilities. The value of provided services associated with this part of the programme amounted to PLN 135 thousand in 2016 (31 December 2015: PLN 1 285 thousand) (Note 10). As at 31 December 2016, the value of liabilities under this program amounted to PLN 0. All settlements under this program have already been completed.

Cash Payments

The cost of the cash part of the programmes is presented in Note 10 "Overhead costs".

45. Transactions with related entities

mBank S.A. is the parent entity of mBank S.A. Group and Commerzbank AG is the ultimate parent of the Group as well as the direct parent of mBank S.A.

All transactions between the Bank and related entities were typical and routine transactions concluded on terms, which not differ from arm's length terms, and their nature, terms and conditions resulted from the current operating activities conducted by the Bank. Transactions concluded with related entities as a part of regular operating activities include loans, deposits and foreign currency transactions.

In 2016 and 2015, under the project carried out by the Group of financing mortgage loans from funds obtained from the issue of mortgage bonds, mBank relocated a part of loans to mBank Hipoteczny S.A. This transfer had a form of sale on market conditions and related to retail receivables in the nominal amount of PLN 530 million (2015 respectively: PLN 469 million related to retail receivables and PLN 220 million related to corporate receivables).

The Bank provides standard financial services to the Bank's key management personnel, Members of the Supervisory Board of the Bank and close members of their families, which comprise i.e.: maintaining bank accounts, taking deposits, granting loans or other financial services. In the Bank's opinion, these transactions are concluded on market terms and conditions.

Pursuant the Banking Law, the extension of a loan, cash advance, bank guarantee or other guarantee to the Members of the Management Board and Supervisory Board of the Bank, persons holding managerial positions at the Bank as well as at entities related financially or organisationally therewith, is governed by the By-Laws adopted by the Supervisory Board of mBank S.A.

The By-Laws set out detailed rules and debt limits for loans, cash advances, bank guarantees, and other guarantees in relation to aforementioned persons and entities which are consistent with the Bank's internal regulations defining the competences of granting credit decisions concerning retail and corporate clients of the Bank. A decision to grant a loan, cash advances, bank guarantee or other guarantee to a Member of the Management Board and Supervisory Board of the Bank, person holding managerial position at the Bank or an entity related financially or organisationally therewith in excess of the limits set by the Banking Law is taken by the resolution of the Management Board and by the resolution of the Supervisory Board.

The terms and conditions of such loans, cash advances, bank guarantees or other guarantees, including in particular those related to interest rates as well as fees and commissions, cannot be more advantageous than the terms and conditions offered by the Bank to its retail or corporate clients, respectively.

The table below presents the values of transactions between the Bank and companies of mBank Group and: Members of the Supervisory Board and the Management Board of mBank, key executive management of mBank, Members of the Supervisory Board and the Management Board of Commerzbank and other related persons and entities, as well as the amount of transactions with mBank subsidiaries and other Commerzbank AG Group entities. The amounts of transactions include assets, liabilities and related costs and income as at 31 December 2016 and 31 December 2015 and for the respective periods then ended are as follows:

(in PLN 000's)	Supervisory Board, Management Board and key management personnel of mBank S.A .as well as Supervisory Board and Management Board of Commerzbank AG		Other related persons *		mBank's subsidiaries		Commerzbank AG Group		Other companies of the Commerzbank AG Group excluding mBank S.A. subsidiaries	
As at the end of the period	**31.12.2016**	**31.12.2015**	**31.12.2016**	**31.12.2015**	**31.12.2016**	**31.12.2015**	**31.12.2016**	**31.12.2015**	**31.12.2016**	**31.12.2015**
Statement of Financial Position										
Assets	7 764	7 747	49	30	13 390 749	11 058 645	698 299	567 886	1 783	13 559
Liabilities	25 091	46 920	1 768	2 833	7 800 587	6 249 037	9 570 604	12 219 206	34 643	875
Separate Income Statement										
Interest income	308	920	2	2	192 094	172 096	125 233	174 384	785	1 273
Interest expense	(472)	(872)	(24)	(34)	(136 306)	(177 416)	(129 296)	(209 400)	(359)	(92)
Commission income	57	18	6	4	10 671	35 651	-	-	-	-
Commission expense	-	-	-	-	(99 261)	(120 337)	-	-	-	-
Other operating income	-	-	-	-	12 244	12 405	18	20	-	-
Overhead costs amortization and depreciation and other operating expenses	-	-	-	-	(20 120)	(9 702)	(9 503)	(9 285)	-	-
Contingent liabilities granted and received										
Commitments granted	1 341	827	114	60	8 906 259	5 959 926	1 295 444	1 357 006	12 923	22 197
Commitments received	-	-	-	-	-	-	1 442 052	594 695	12 422	24 063

* Other related persons and entities include: close family members of Members of the Supervisory and the Management Board of mBank, key executive management of mBank, Members of the Supervisory Board and the Management Board of Commerzbank, entities controlled or jointly controlled by above mentioned persons.

In 2016 and 2015, no provisions were created in connection with credits granted to related entities.

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Management Board Remuneration

At the end of 2016, the Management Board of mBank S.A. has been working in the seven person team with the following members:

1. Cezary Stypułkowski – President of the Management Board,
2. Lidia Jabłonowska-Luba – Vice-President of the Management Board, Chief Risk Officer,
3. Przemysław Gdański – Vice-President of the Management Board, Head of Corporate and Investment Banking,
4. Christoph Heins – Vice-President of the Management Board, Chief Financial Officer,
5. Hans-Dieter Kemler – Vice-President of the Management Board, Head of Financial Markets,
6. Cezary Kocik – Vice-President of the Management Board, Head of Retail Banking,
7. Jarosław Mastalerz – Vice-President of the Management Board, Head of Operations and IT.

Changes in the Management Board of mBank S.A.

- On 12 April 2016, mBank S.A. received from Mr. Joerg Hessenmueller information about his resignation from the post of the Vice President of the Management Board, Chief Financial Officer taking effect as of 30 June 2016. The reason for the resignation of Mr. Hessenmueller is taking up new responsibilities within the Commerzbank Group.
- On 10 June 2016, the Supervisory Board of mBank S.A. adopted a resolution appointing Mr. Christoph Heins as a Vice President of the Management Board, Chief Financial Officer with the effect as of 1 July 2016, until the end of current term of the Management Board.
- On 12 December 2016, the Bank was informed that the Executive Vice-President, Mr. Hans -Dieter Kemler intends to resign from his position in the Bank's functions in the near future. The reason for the resignation of Mr. Kemler are his future plans to take on new tasks within the German Landesbank Hessen Thueringen (Helaba) as a member of the Board responsible for capital markets, treasury and asset management.
- On 16 February 2017, the Bank was informed that the Executive Vice-President, Mr. Jarosław Mastalerz intends to resign from his position in the Bank's functions in the near future. The reason for the resignation of Mr. Mastalerz is his intended to personal involvement in the development and commercialization of new technologies in the financial sector, within the project implemented in cooperation with the Bank.

Information on the salaries, bonuses and benefits paid and due to the Members of the Management Board of the Bank who were performing their functions at the end of 2016, as at 31 December 2016 is presented below:

		Remuneration paid in 2016 (in PLN)			
		Basic salary	Other benefits	Bonus for 2015	Deffered bonus*
1.	Cezary Stypułkowski	2 725 108	252 868	500 000	325 000
2.	Lidia Jabłonowska-Luba	1 500 000	170 504	280 000	180 000
3.	Przemysław Gdański	1 500 000	194 440	280 000	180 000
4.	Christoph Heins	841 392	368 824	-	-
5.	Hans-Dieter Kemler	1 509 926	348 238	280 000	180 000
6.	Cezary Kocik	1 500 000	185 316	300 000	200 000
7.	Jarosław Mastalerz	1 500 000	203 396	340 000	180 000
	Total	**11 076 426**	**1 723 586**	**1 980 000**	**1 245 000**

* In 2016, there was paid the first deferred tranche as the settlement of the cash equivalent of bonus for the year 2014.

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Remuneration of the former Management Board Members paid in the year 2016:

		Remuneration paid in 2016 (in PLN)				
		Basic salary	Other benefits	Bonus for 2015	Deffered bonus*	Cash settlement of the incentive program based on Commerzbank shares**
Remuneration of the former Management Board Members who ceased performing their functions in the year 2016						
1.	Joerg Hessenmueller	781 500	93 768	300 000	190 000	-
Remuneration of the former Management Board Members who ceased performing their functions in the year 2012						
1.	Christian Rhino	-	-	-	-	134 206

* In 2016, Mr. Joerg Hessenmueller received a cash equivalent in settlement of the first tranche of bonus for the year 2014.

** The settlement relates to the incentive programme for members of the Management Board of 2008, in a part based on the shares of Commerzbank. In 2016, Mr. Christian Rhino received a cash equivalent for Commerzbank shares in settlement of the third tranche of the incentive programme for 2012.

Information on the salaries, bonuses and benefits paid and due to the Members of the Management Board of the Bank who were performing their functions at the end of 2015, as at 31 December 2015 is presented below:

		Remuneration paid in 2015 (in PLN)			
		Basic salary	Other benefits	Bonus for 2014	Cash settlement of the incentive program based on Commerzbank shares*
1.	Cezary Stypułkowski	2 092 108	174 833	650 000	827 941
2.	Lidia Jabłonowska-Luba	1 219 483	228 872	360 000	-
3.	Przemysław Gdański	1 200 000	143 184	360 000	658 950
4.	Joerg Hessenmueller	1 263 000	166 535	380 000	-
5.	Hans-Dieter Kemler	1 218 561	366 354	360 000	688 900
6.	Cezary Kocik	1 200 000	156 825	400 000	-
7.	Jarosław Mastalerz	1 200 000	125 670	360 000	778 749
	Total	**9 393 152**	**1 362 273**	**2 870 000**	**2 954 540**

* For Mr. Przemysław Gdański, Mr Hans-Dieter Kemler and Mr. Jarosław Mastalerz, the settlement relates to the incentive programme for members of the Management Board of 2008, in a part based on the shares of Commerzbank. In 2015, the listed Members of the Board received a cash equivalent for Commerzbank shares in settlement of the third tranche of the incentive programme for 2011. For Mr. Cezary Stypułkowski, the settlement relates to deferred, based on the shares of Commerzbank part of the bonus for 2011.

Moreover, in 2015 as settlement related to the incentive programme for 2008 in a part based on the shares of Commerzbank, Mr. Christian Rhino eligible former member of the Management Board received a cash equivalent for Commerzbank shares in settlement of the second tranche of the incentive programme for 2012 in the amount of PLN 213 065.

The total compensation of members of the Management Board consists of: basic salary, bonuses, termination payments of management agreement, prohibition of competitiveness payment, insurance costs and accommodation costs.

The above mentioned benefits are short-term employee benefits.

In accordance with the Bank's remuneration system, the members of the Management Board of the Bank may be eligible to receive bonuses for the year 2016, which would be paid out in 2017. Therefore, a provision was created for the payment of a cash bonus for 2015 for the members of the Management Board, which amounted to PLN 4 970 850 as of 31 December 2016. The final decision concerning the level of the bonus will be taken by the Remuneration Committee of the Supervisory Board by 1 March 2017.

In 2016 and 2015, the members of the Management Board of mBank S.A. did not receive compensation for their role as members of the management boards and supervisory boards of the Bank's related companies.

The total amount of remuneration received in 2016 by Bank's Management Board members was PLN 17 390 280 (2015: PLN 16 579 965).

Information on the rules of payment other component of remuneration (severance payment) for the members of the Management Board

From the date of appointment of the members of the Management Board for the new term, i.e. from the date of General Shareholders Meeting approving the financial results for the year 2012 all members of the Management Board, in case of cancellation the managers from the Management Board before the expiration of the term, have got the severance payment in the amount which depends on years spent with the organization and is calculated as follows: (i) 4 monthly salaries if the member held his post for a period shorter than 1 year, (ii) 8 monthly salaries if the member held his position for more than 1 year but less than 2 years and (iii) 12 monthly salaries if the member held his post for more than 2 but less than 5 years, (iv) 18 monthly salaries if the member held his post for more than 5 years. If not appointed for next term of the office, the Management Board members are entitled to severance in the amount of 12 monthly salaries.

Supervisory Board Compensation

As at the end of the year 2016, the composition of the Supervisory Board of mBank S.A. was as follows:

1. Maciej Leśny – Chairman of the Supervisory Board, Chairman of the Executive Committee, Member of the Audit Committee, Member of the Risk Committee, Member of the Remuneration Committee,
2. Dr Andre Carls – Member of the Supervisory Board, Chairman of the Remuneration Committee, Member of the Audit Committee, Member of the Executive Committee,
3. Stephan Engels – Deputy Chairman of the Supervisory Board, Chairman of the Audit Committee, Member of the Executive Committee, Member of the Remuneration Committee,
4. Dr Marcus Chromik - Member of the Supervisory Board, Chairman of the Risk Committee,
5. Michael Mandel - Member of the Supervisory Board,
6. Thorsten Kanzler- Member of the Supervisory Board, Member of the Risk Committee,
7. Teresa Mokrysz – Member of the Supervisory Board, Member of the Executive Committee,
8. Waldemar Stawski – Member of the Supervisory Board, Member of the Audit Committee,
9. Dr Agnieszka Słomka-Gołębiowska – Member of the Supervisory Board, Member of the Risk Committee,
10. Prof. Marek Wierzbowski – Member of the Supervisory Board, Member of the Remuneration Committee.
11. Joerg Hessenmueller - Member of the Supervisory Board,
12. Wiesław Thor - Member of the Supervisory Board.

Changes in the Supervisory Board of mBank S.A.

- On 16 March 2016 the Bank received a letter from Mr. Martin Blessing, Member of the Bank's Supervisory Board and Member of the Executive Committee with a resignation from the aforementioned positions. The resignation is to take effect as of 30 April 2016.
- On 24 March 2016, the Supervisory Board of mBank S.A. adopted a resolution appointing Mr. Michael Mandel as a member of the Supervisory Board with effect as of 1 May 2016. He will replace Mr. Martin Blessing until the end of a current term of the Management Board (ie. the date of the General Meeting of the Bank approving the financial statements of the Bank for the year 2016).
- On 27 October 2016, the Bank received from Mr. Martin Zielke, Deputy Chairman of the Supervisory Board of the Bank, Member of the Remuneration Committee and Member of the Executive Committee a letter of resignation from his function. The resignation took place on 15 December 2016.
- On 15 December 2016, the Supervisory Board of mBank S.A. appointed Mr. Joerg Hessenmueller as a Member of the Supervisory Board of mBank S.A., in place of the outgoing Mr. Martin Zielke, with effect from 16 December 2016 for the period until the end of the current term of the Supervisory Board. In the period from April 2012 to June 2016, Mr. Joerg Hessenmueller was the member of the Management Board of mBank S.A. responsible for the area of finance. Since July 2016, he has been the Managing Director of the Commerzbank Group, responsible for Group Management Development & Strategy.

Information about the Supervisory Board members' salaries, bonuses and benefits paid as at 31 December 2016 and 31 December 2015 is presented below:

		Remuneration paid in 2016 (in PLN)	Remuneration paid in 2015 (in PLN)
1.	Maciej Leśny	367 235	367 235
2.	Andre Carls	252 000	252 000
3.	Marcus Chromik	-	-
4.	Stephan Engels	-	-
5.	Joerg Hessenmueller	-	-
6.	Michael Mandel	-	-
7.	Thorsten Kanzler	216 000	216 000
8.	Teresa Mokrysz	220 225	220 225
9.	Agnieszka Słomka-Gołębiowska	221 435	221 435
10.	Waldemar Stawski	221 435	221 435
11.	Wiesław Thor	149 435	149 435
12.	Marek Wierzbowski	216 000	216 000
	Martin Zielke*	-	-
	Martin Blessing**	-	-
	Stefan Schmittmann***	-	-
	Total	**1 863 765**	**1 863 765**

* On 15 December 2016, Mr. Martin Zielke resigned from the office.
** On 30 April 2016, Mr. Martin Blessing resigned from the office.
*** On 31 December 2015, Mr. Stefan Schmittmann resigned from the office.

In accordance with the wording of paragraph 11(j) of the By-laws of mBank S.A., the General Meeting determines remuneration for members of the Supervisory Board in a resolution. Remuneration of the Management Board members is determined by the Supervisory Board (paragraph 22.1(e) of the By-laws of mBank S.A.).

The total compensation of Members of the Supervisory Board, the Management Board and other key executive management of the Bank that perform their duties in 2016 amounted to PLN 24 397 959 (2015: PLN 22 920 768).

Information regarding proprietary position in Bank shares by Members of the Management Board and by Members of the Supervisory Board

As at 31 December 2016, the Bank shares were held by four Members of the Management Board: Mr. Cezary Stypułkowski – 12 359 shares, Mr. Przemysław Gdański – 3 500 shares, Mr. Cezary Kocik – 1 394 shares and Mr. Jarosław Mastalerz – 4 180 shares.

As at 31 December 2015, the Bank shares were held by five Members of the Management Board: Mr. Cezary Stypułkowski – 6 784 shares, Mrs. Lidia Jabłonowska-Luba – 818 shares, Mr. Przemysław Gdański – 4 689 shares, Mr. Joerg Hessenmueller – 1 254 shares and Mr. Jarosław Mastalerz – 818 shares.

As at 31 December 2016 the Members of the Supervisory Board of the Bank had no Bank's shares. As at 31 December 2015, the Bank shares were held by one Member of the Supervisory Board of mBank S.A., Mr. Wiesław Thor – 2 192 shares. As at 31 December 2015, the other Members of the Supervisory Board of the Bank had no Bank's shares.

46. Acquisitions and disposals

On 20 May 2016 there was a division of Dom Maklerski mBanku S.A. ("mDM") and division of mWealth Management S.A. ("mWM"), which has been described in detail under Note 34 of these financial statements. The division of mDM and mWM was settled based on the book value had no impact on net income of mBank for the year 2016 and net assets of mBank as at 31 December 2016.

Moreover, in the first half of 2016, the Bank sold shares of its subsidiary Call Center Poland S.A., for the price of PLN 2 000 thousand.

47. Information about the registered audit company

The entity entitled to audit financial statements, with which mBank S.A. concluded an agreement is PricewaterhauseCoopers Sp. z o.o. The agreement to conduct an audit of mBank S.A. financial statements and consolidated financial statements of mBank S.A. Group was concluded on 24 March 2016.

The choice of a new auditor to audit the financial statements of mBank S.A. and consolidated financial statements of mBank S.A. Group for the year 2016 had been made on 24 March 2016 by XXIX Annual General Meeting of mBank S.A., acting under section 11 letter. n) of the By-Lows of the Bank.

The total gross amount of PricewaterhauseCoopers Sp. z o.o. remuneration related to the audit and review of stand-alone financial statements and consolidated financial statements of mBank S.A. was PLN 3 346 thousand in 2016.

In 2016, the total amount of remaining gross remuneration paid to PricewaterhauseCoopers Sp. z o.o. in respect of other services for mBank S.A. was PLN 464 thousand.

In 2015, the registered audit company with which mBank S.A. signed an agreement was Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością sp. k., and the total amount of gross remuneration related to the audit and review of stand-alone financial statements and consolidated financial statements of mBank S.A. was PLN 2 759 thousand.

The total gross amount of remaining remuneration paid in 2015 to Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością sp. k. in respect of other services for mBank S.A. was PLN 1 007 thousand.

48. Capital adequacy

One of the main tasks of the balance sheet management is to ensure an appropriate level of capital. Within the framework of the capital management policy mBank prepares the guidelines for the most effective planning and use of capital basis which:

- are compliant with external and internal regulations in force,
- guarantee a continuity of financial targets achievement, which render an appropriate rate of return for shareholders,
- ensure the maintenance of a strong capital basis being a fundamental support for business development.

The capital management policy in mBank is based on:

- maintenance of an optimal level and structure of own funds with the application of available methods and means, like among others retention of net profit, subordinated loan or issue of shares,
- effective use of existing capital, among others through application of a set of measures of effective use of the capital, limitation of activities that do not provide an expected rate of return and development of products with lower capital absorption.

Effective use of capital is an integral part of the capital management policy oriented at reaching an optimal rate of return on capital and as a result forming a stable fundament of reinforcement of the capital basis in future periods. This enables to maintain the Common Equity Tier 1 capital ratio (calculated as a quotient of Common Equity Tier 1 capital to the total risk exposure amount), Tier 1 ratio (calculated as a quotient of Tier 1 capital to the total risk exposure amount) and the total capital ratio (calculated as a quotient of own funds and the total risk exposure amount) at least on the level required by the supervision authority.

The strategic goals of mBank are aimed at maintaining the total capital ratio as well as the Common Equity Tier 1 capital ratio above the level required by the supervision authority. It allows to maintain business development while meeting the supervisory requirements in the long perspective.

Capital ratios

The adequacy assessment of the capital base, including among others: the calculation of capital ratios and the leverage ratio, the own funds, the total capital requirement and the regulatory floor requirement in the mBank was made according to the following regulations:

- the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR Regulation),
- the Banking Act of 29 August 1997 (Dz.U. from year 2002 No 72, item 665) with further amendments,
- the Act on Macroprudential Supervision of the Financial System and Crisis Management of 5 August 2015 (Dz.U. 2015 item 1513),
- the Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council with further amendments (ITS Regulation).

The capital ratios of mBank in 2016 were driven by the following factors:

- inclusion in Common Equity Tier 1 capital the remaining part of the net profit of mBank for the year 2015, not included in Common Equity Tier 1 capital on the basis of the KNF decision obtained in 2015;
- inclusion in Common Equity Tier 1 capital the verified net profit of the mBank for the first, second and third quarters of the year 2016, net of expected charges and dividends, on the basis of the KNF decisions from 21 June 2016, 7 September 2016 and 14 December, 2016 respectively;
- inclusion in an individual Common Equity Tier 1 capital the verified retained earnings of mBank resulting from the change of valuation method of investments in subsidiaries, associates and joint ventures from the cost method to the equity method in connection with change of accounting policy, on the basis of the KNF decision from 29 December 2016;
- classification of capital instruments issued within incentive programs in the period from 1 January 2016 till 31 July 2016 as instruments in Common Equity Tier 1 capital on the basis of the KNF decision from 29 December 2016;
- change of calculation methodology for the additional value adjustments deducted from Common Equity Tier 1 capital;
- change of the limit for unrealized gains measured at the fair value included in the own funds calculation from 40% in 2015 to 60% in 2016;
- the change of the limit for grandfathered subordinated instruments included in the own funds;
- adjustment of the application of the regulatory floor to the requirements of article 500 of the CRR Regulation, also complying with the provisions of the ITS Regulation. The adjustment was implemented to ensure a full comparability, transparency and compliance of the Bank's capital position presented in the financial statement and regulatory reporting with the approach used by the EU parent institution (Commerzbank AG) and observed in other EU member states. The method used by the Bank in the past followed the local authorities' approach to the issue at hand. The Polish Financial Supervision Authority within correspondence conducted by the Bank on the subject of the abovementioned adjustment, stated that it is not coherent with the local regulatory approach to own funds assessment which has been used so far and is still expected to be used;
- extensions of the AIRB approach and the changes of the AIRB models - the implementation of the material change to the internal corporate LGD model for which the Bank obtained the joint consent of the European Central Bank and of the KNF on 15 September 2016;
- the expansion of the Bank's business activity;
- depreciation of the Polish currency against the foreign currencies.

As a result of the Act on Macro-prudential Supervision over the Financial System and Crisis Management in the Financial System (the Act) that entered into force in 2015 and transposed the CRD IV provisions to the Polish prudential regulations, as of 31 December 2016 Bank was obliged to ensure adequate own funds to meet conservation buffer of 1.25% of total risk exposure amount.

As of the end of 2016 the countercyclical capital buffer rate set for relevant exposures in Poland according with the article 83 of the Act amounted to 0%. mBank specific countercyclical capital buffer calculated in accordance with the provisions of the Act as the weighted average of the countercyclical buffer rates that apply in the countries where the relevant credit exposures of the Bank are located, amounted to 0% as of 31 December 2016.

In the fourth quarter of 2016, the Bank received an administrative decision of the KNF that identified mBank as other systemically important institutions (O-SII) and imposed a capital buffer of 0,5% of the total risk exposure amount, calculated in accordance with article 92(3) of the Regulation, to be maintained on individual and consolidated levels.

The all-in-one combined buffer requirement set for mBank as of the end of 2016 amounted to 1.75%.

Additionally, as a result of risk assessment carried out by the KNF within the supervisory review and evaluation process (BION), in particular with regard to the evaluation of the risk related to the portfolio of foreign exchange retail mortgage loans, the mBank received on the consolidated level an individual recommendation to maintain own funds to cover additional capital requirement of 3.25 % for total capital ratio and 2.44 % for Tier 1 capital ratio. (On individual basis: 3.81% and 2.86% respectively).

The high level of additional capital requirements resulted from the fact that the KNF applied one methodology to all banks in Poland. This did not take into account the results of the internal models applied by mBank to the calculation of capital requirements for credit risk. According to KNF's methodology, the calculation of the additional capital requirement for each and every bank uses as a starting point the risk weight under the standardised approach (100%) used in Poland for calculation of capital requirements for credit risk relating to foreign exchange mortgage loans. Consequently, more than half of the additional capital requirements calculated by the KNF for mBank comes from "aligning" the capital requirement to the requirement calculated under the standardised approach. The second important component affecting an additional capital requirement within Pillar II related to the BION supervisory evaluation quantifying the risk of foreign exchange retail mortgage loans portfolio, where taking into account the specificity of the Bank portfolio, the following factors were taken into account:

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- the share in portfolio of loans with LTV >100%,
- the level of the Bank margin from the foreign exchange retail mortgage loans portfolio
- sensitivity of the Bank's total capital ratio to exchange rates and interest rates changes,
- the Bank preparation for loans portfolio conversion.

The level of required capital ratios encompasses:

- the basic requirement of KNF addressed to the banks in Poland to maintain the total capital ratio of 12% and the Tier 1 ratio of 9%;
- the combined buffer requirement of 1.75%;
- the additional capital charge in Pillar II resulting from foreign exchange mortgage loans portfolio – 3.81%.

Capital ratios on individual basis were above required values during and at end of 2016 as well as during and at the end of 2015.

mBank	31.12.2016		31.12.2015	
Capital ratio	Required level	Reported level	Required level	Reported level
Total capital ratio	17.56%	24.07%	16.39%	20.18%
Tier 1 ratio	13.61%	20.59%	12.29%	16.70%
Common Equity Tier 1 ratio	12.88%	20.59%	-	16.70%

Without adjustment of the approach to the application of the regulatory floor to the requirements of article 500 of the CRR Regulation, capital ratios of mBank as of 31 December 2016 would amount to: total capital ratio = 21.93%, Common Equity Tier 1 ratio = 18.76%. Additionally, had the Bank adjusted the approach to the application of the regulatory floor as of 31 December 2015 the capital ratios of mBank would increase respectively: by 0.33% in case of total capital ratio and by 0.27% in case of Tier 1 ratio and Common Equity Tier 1 ratio.

The second component of adequacy assessment of the Bank capital base, alongside the calculation of capital ratios and their comparison with the required levels (taking into account the combined buffer requirement and the additional capital charge within Pillar II), verifies whether the Bank meets the requirements resulting from article 500 of the CRR Regulation. To this end, own funds are compared to the value of the „regulatory floor" accounting for 80% of the comparable standardised-driven total capital requirement. This parallel calculation is meant to ensure that the Bank own funds calculated under internal rating based approach are sufficient and they do not fall below 80% of the own funds that the Bank would have to maintain under the standardised approach. mBank's own funds are well above the level determined by the regulatory floor.

Own Funds

In accordance with the CRR Regulation, own funds consist of Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital, however items that could be treated as Additional Tier 1 capital are not identified.

Common Equity Tier 1 capital of mBank contains:

- paid up capital instruments and the related share premium accounts,
- previous years retained earnings,
- independently reviewed interim profits,
- accumulated other comprehensive income,
- other reserves,
- funds for general banking risk,
- items deducted from a Common Equity Tier 1 (CET1) capital (fair value gains and losses arising from the institution's own credit risk related to derivative liabilities, value adjustments due to the

requirements for prudent valuation, intangible assets, AIRB shortfall of credit risk adjustments to expected losses, own CET1 instruments, regulatory adjustments relating to accumulated other comprehensive income and net impairment losses).

Tier 2 capital of mBank contains:

- capital instruments and the related share premium accounts (subordinated liabilities with specified maturity),
- amount of qualifying items referred to in Article 484 (5) of the CRR Regulation and the related share premium accounts subject to phase out from Tier 2 capital (subordinated liabilities resulting from securities of unspecified maturity).

The own funds of mBank as of 31 December 2016 amounted to PLN 13 433 772 thousand. Additionally the Common Equity Tier 1 capital of mBank amounted to PLN 11 492 865 thousand.

Total risk exposure amount

The total risk exposure amount contains:

- risk weighted exposure amounts for credit risk, counterparty credit risk, dilution risk and free deliveries,
- risk exposure amount for market risk, containing position risk, foreign exchange risk and commodities risk,
- risk exposure amount for operational risk,
- risk exposure amount for credit valuation adjustment,
- other risk exposure amounts containing amounts resulted from application of supervisory floor.

As at 31 December 2016 the AIRB approach was applied to the calculation of own funds requirements for credit and counterparty credit risk for the following portfolios:

- mBank corporate portfolio,
- mBank retail mortgage loan portfolio,
- mBank real estate-related specialized lending exposure (IRB slotting approach),
- mBank retail non-mortgage exposures (conditional consent),
- mBank retail microenterprises mortgage loan portfolio (conditional consent),
- bank exposures (conditional consent).

In case of portfolios with conditional consent to the application of AIRB approach, mBank applies supervisory floor, which means that where the own funds requirement for credit risk calculated under AIRB approach is lower than the own funds requirement for credit risk calculated under standardised approach, it is necessary to supplement it up to the level of the own funds requirement for credit risk calculated under standardised approach.

In 2016 the implementation of the material change to the internal LGD model for mBank corporate portfolio (having satisfied the suspensive conditions) took place for which the Bank obtained the joint consent of the European Central Bank and of the KNF on 15 September 2016.

With regard to conditional consent to the application of AIRB approach to the calculation of own funds requirement for credit risk for mBank retail non-mortgage exposures, mBank retail microenterprises mortgage loan portfolio and portfolio of bank exposures high significance conditions specified by the bank supervision have been met, and the Bank I waiting for formal confirmation by the bank supervision.

The total risk exposure amount of mBank as of 31 December 2016 amounted to PLN 55 821 861 thousand, including PLN 49 077 766 thousand of risk-weighted exposure amount for credit risk, counterparty credit risk and supervisory floor.

Internal capital

The ICAAP (Internal Capital Adequacy Assessment Process) implemented in mBank aims at adjusting own funds to the level and the profile of risk arising from mBank's operations.

Due to the fact that both, the total capital requirement of mBank calculated according to the CRR Regulation and the internal capital estimated for mBank according to the Resolution No. 258/2011 are lower than own funds, the own funds as at 31 December 2016 were maintained on the level consistent with the requirements of the CRR Regulation.

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The internal capital of Bank as at 31 December 2016 amounted to PLN 3 613 181 thousand.

Capital adequacy	31.12.2016	31.12.2015
Common Equity Tier 1 Capital	**11 492 865**	**9 859 893**
Total Own Funds	**13 433 772**	**11 915 951**
Risk weighted exposure amounts for credit, counterparty credit, dilution risk and free deliveries:	48 939 431	51 577 447
- including under standardised approach	11 451 615	10 765 886
- including under AIRB approach	37 486 311	40 811 340
- including risk exposure amount for contributions to the default fund of a CCP	1 505	221
Settlement / delivery risk exposure amount	-	-
Total risk exposure amount for position, foreign exchange and commodities risks	824 349	627 907
Total risk exposure amount for operational risks	5 706 442	5 613 843
Additional risk exposure amount due to fixed overheads	-	-
Total risk exposure amount for credit valuation adjustments	213 304	262 151
Total risk exposure amount for large exposures in the trading book	-	-
Other risk exposure amounts	138 335	958 621
Total risk exposure amount	**55 821 861**	**59 039 969**
Comon Equity Tier 1 capital ratio	**20.59%**	**16.70%**
Total capital ratio	**24.07%**	**20.18%**
Internal capital	**3 613 181**	**3 619 044**

OWN FUNDS	31.12.2016	31.12.2015
Own funds	**13 433 772**	**11 915 951**
TIER 1 CAPITAL	**11 492 865**	**9 859 893**
Common Equity Tier 1 Capital	**11 492 865**	**9 859 893**
Capital instruments eligible as CET1 Capital	3 550 593	3 535 412
Paid up capital instruments	169 016	168 916
Share premium	3 381 975	3 366 802
(-) Own CET1 instruments	(398)	(306)
Retained earnings	3 220 308	1 509 068
Previous years retained earnings	2 761 506	1 223 305
Profit or loss eligible	458 802	285 763
Accumulated other comprehensive income	(14 183)	432 477
Other reserves	4 410 902	4 416 987
Funds for general banking risk	1 095 143	1 065 143
Adjustments to CET1 due to prudential filters	(44 333)	(70 999)
Fair value gains and losses arising from the institution's own credit risk related to derivative liabilities	(5 880)	(4 418)
(-) Value adjustments due to the requirements for prudent valuation	(38 453)	(66 581)
(-) Intangible assets	(505 612)	(439 280)
(-) Other intangible assets gross amount	(540 452)	(473 816)
Deferred tax liabilities associated to other intangible assets	34 840	34 536
(-) IRB shortfall of credit risk adjustments to expected losses	(180 877)	(169 249)
Other transitional adjustments to CET1 Capital	(22 390)	(268 841)
CET1 capital elements or deductions - other	(16 686)	(150 825)
Additional Tier 1 capital	**-**	**-**
TIER 1 CAPITAL	**1 940 907**	**2 056 058**
Capital instruments and subordinated loans eligible as T2 capital	1 250 000	1 250 000
Tier 2 capital elements or deductions - other	-	-
Transitional adjustments due to grandfathered T2 capital instruments and subordinated loans	690 907	806 058

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Credit risk	**31.12.2016**	**31.12.2015**
Risk weighted exposure amounts for credit risk, counterparty credit risk, dilution risk and free deliveries	**48 939 431**	**51 577 447**
Standardised approach	**11 451 615**	**10 765 886**
SA exposure classes excluding securitisation positions	11 451 615	10 765 886
Central governments or central banks	33 608	17 925
Regional governments or local authorities	197 874	245 276
Public sector entities	16 533	17 226
Multilateral Development Banks	-	-
International Organisations	-	-
Institutions	631 279	600 312
Corporates	3 431 635	3 610 130
Retail	809 205	943 541
Secured by mortgages on immovable property	1 921 372	1 694 660
Exposures in default	218 609	221 228
Items associated with particular high risk	28 833	17 594
Covered bonds	-	-
Claims on institutions and corporates with a short-term credit assessment	-	-
Collective investments undertakings (CIU)	-	-
Equity	4 151 269	3 394 111
Other items	11 398	3 883
AIRB approach	**37 486 311**	**40 811 340**
AIRB approaches when neither own estimates of LGD nor Conversion Factors are used	-	-
AIRB approaches when own estimates of LGD and/or Conversion Factors are used	35 916 711	39 732 471
Central governments and central banks	-	-
Institutions	1 601 493	2 267 332
Corporates - SME	4 406 293	4 445 331
Corporates - Specialised Lending	1 986 271	1 728 869
Corporates - Other	12 142 226	14 339 594
Retail - Secured by real estate SME	1 098 692	1 281 631
Retail - Secured by real estate non-SME	6 930 867	8 601 759
Retail - Qualifying revolving	-	-
Retail - Other SME	2 034 073	1 811 983
Retail - Other non-SME	5 716 796	5 255 972
Equity AIRB	-	-
Securitisation positions IRB	-	-
Other non credit-obligation assets	1 569 600	1 078 869
Risk exposure amount for contributions to the default fund of a CCP	**1 505**	**221**

49. Other information

- Proposals concerning foreign currency mortgage loans restructuring

Some proposals of restructuring of foreign currency mortgage loans for individuals have been discussed recently, including the solutions presented by the Chancellery of the President of the Republic of Poland. At its meeting starting on 19 October 2016, the Sejm of the Republic of Poland has begun work on three draft laws governing in different ways the above issue: presented by the President of the Republic of Poland draft law on the principles of reimbursement of certain claims arising from credit and loan agreements and parliamentary drafts of law on restructuring loans denominated in or indexed to a currency other than the Polish currency and to prohibiting granting of such loans and of law on special rules for the restructuring of foreign currency mortgage loans due to changes in foreign currency exchange rates in relation to the Polish currency. At the moment of these financial statements publication the final form of the proposed solutions is not known yet. Therefore, at the moment, the Bank is not able to estimate reliably either the implementation probability of the discussed solutions or the potential impact of the final solutions on the financial statements of the Bank and the mBank Group.

50. Events after the balance sheet date

- Recommendations of Financial Stability Committee ("FSC") on the restructuring of the FX housing loans portfolio

On 13 January 2017, FSC endorsed the resolution No 14/2017 on the recommendation on the restructuring of the FX housing loans portfolio. The resolution includes a list of recommendations, the most important of which are:

- to increase the minimum LGD for exposures secured by mortgages on residential property, the purchase of which was financed by an FX loan by means of a dedicated resolution of the Ministry of Finance (this regulatory measure is addressed to banks that apply internal ratings based approach to the calculation of the capital charge for credit risk, among others to mBank S.A.);

- to increase by the KNF the additional capital requirements related to FX housing loans by taking into account additional risk types: operational risk, market risk and collective risk of default;

- to impose a systemic risk buffer of 3% by the Ministry of Finance that would apply to all exposures on the territory of the Republic of Poland;

- to increase the risk weight used by the banks to calculate capital requirements to the level of 150% for FX exposures secured by mortgages on immovable property by means of a dedicated resolution of the Ministry of Finance.

At the date of publication of these financial statements, the final method of implementation of the FSC recommendation is not known. Therefore, the Bank is not able at the moment to estimate the potential impact of the proposed solutions on the capital ratios and financial statements of mBank S.A. and mBank Group.

Date	First and last name	Position	Signature
1.03.2017	Cezary Stypułkowski	President of the Management Board	
1.03.2017	Lidia Jabłonowska-Luba	Vice-President of the Management Board, Chief Risk Officer	
1.03.2017	Przemysław Gdański	Vice President of the Management Board, Head of Corporate & Investment Banking	
1.03.2017	Christoph Heins	Vice-President of the Management Board, Chief Financial Officer	
1.03.2017	Hans-Dieter Kemler	Vice-President of the Management Board, Head of Financial Markets	
1.03.2017	Cezary Kocik	Vice-President of the Management Board, Head of Retail Banking	
1.03.2017	Jarosław Mastalerz	Vice-President of the Management Board, Head of Operations and IT	