mBank S.A.

IFRS Financial Statements 2017

Selected financial data

The selected financial data are supplementary information to these financial statements of mBank S.A. for 2017.

		in PLN '000		in EUR '000	
		Year ended 31.12.2017	Year ended 31.12.2016	Year ended 31.12.2017	Year ended 31.12.2016
I.	Interest income	3 550 968	3 394 096	836 565	775 669
II.	Fee and commission income	1 405 071	1 259 269	331 018	287 787
III.	Net trading income	303 383	249 545	71 473	57 030
IV.	Operating profit	1 811 796	1 789 234	426 837	408 902
V.	Profit before income tax	1 470 224	1 570 154	346 367	358 835
VI.	Net profit	1 089 704	1 219 339	256 721	278 661
VII.	Net cash flows from operating activities	(1 266 974)	8 348 347	(298 484)	1 907 888
VIII.	Net cash flows from investing activities	(345 968)	122 765	(81 506)	28 056
IX.	Net cash flows from financing activities	(3 584 484)	(363 482)	(844 461)	(83 068)
X.	Total net increase / decrease in cash and cash equivalents	(5 197 426)	8 107 630	(1 224 451)	1 852 876
XI.	Basic earnings per share (in PLN/EUR)	25.77	28.86	6.07	6.60
XII.	Diluted earnings per share (in PLN/EUR)	25.75	28.84	6.07	6.59
XIII.	Declared or paid dividend per share (in PLN/EUR)	-	-	-	-

		in PLN '000		in EUR '000	
		As at		As at	
		31.12.2017	31.12.2016	31.12.2017	31.12.2016
I.	Total assets	124 569 483	128 215 265	29 866 332	28 981 751
II.	Amounts due to the Central Bank	-	-	-	-
III.	Amounts due to other banks	5 089 716	8 503 014	1 220 292	1 922 019
IV.	Amounts due to customers	99 331 571	98 960 320	23 815 381	22 368 969
V.	Equity	14 287 561	13 023 803	3 425 534	2 943 898
VI.	Share capital	169 248	169 121	40 578	38 228
VII.	Number of shares	42 312 122	42 280 127	42 312 122	42 280 127
VIII.	Book value per share (in PLN/EUR)	337.67	308.04	80.96	69.63
IX.	Total capital ratio	24.62	24.07	24.62	24.07

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

- for items of the statement of financial position – exchange rate announced by the National Bank of Poland as at 31 December 2017: EUR 1 = 4.1709 and 31 December 2016: EUR 1 = PLN 4.4240.
- for items of the 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 2017 and 2016: EUR 1 = PLN 4.2447 and EUR 1 = PLN 4.3757 respectively.

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Income statement

	Note	Year ended 31 December	
		2017	2016□
Interest income	5	3 550 968	3 394 096
Interest expense	5	(792 483)	(927 910)
Net interest income		**2 758 485**	**2 466 186**
Fee and commission income	6	1 405 071	1 259 269
Fee and commission expense	6	(588 155)	(576 047)
Net fee and commission income		**816 916**	**683 222**
Dividend income	7	166 285	166 833
Net trading income, including:	8	303 383	249 545
Foreign exchange result		*290 535*	*265 741*
Other net trading income and result on hedge accounting		*12 848*	*(16 196)*
Gains less losses from investment securities, investments in subsidiaries and associates, including:	22	8 231	261 213
Gains less losses from investment securities		*9 908*	*261 652*
Gains less losses from investments in subsidiaries and associates		*(1 677)*	*(439)*
Other operating income	9	113 938	68 750
Net impairment losses on loans and advances	12	(457 889)	(312 195)
Overhead costs	10	(1 589 578)	(1 491 553)
Amortisation	25,26	(200 856)	(199 826)
Other operating expenses	11	(107 119)	(102 941)
Operating profit		**1 811 796**	**1 789 234**
Taxes on the Bank's balance sheet items		(350 830)	(312 254)
Share in profits (losses) of entities under the equity method	23,24	9 258	93 174
Profit before income tax		**1 470 224**	**1 570 154**
Income tax expense	13	(380 520)	(350 815)
Net profit		**1 089 704**	**1 219 339**

Net profit		**1 089 704**	**1 219 339**
Weighted average number of ordinary shares	14	**42 290 313**	**42 252 790**
Basic earnings per share (in PLN)	14	**25.77**	**28.86**
Weighted average number of ordinary shares for diluted earnings	14	**42 314 242**	**42 280 286**
Diluted earnings per share (in PLN)	14	**25.75**	**28.84**

Notes presented on pages 10–141 constitute an integral part of these Financial Statements.

IFRS Financial Statements 2017 PLN (000's)

Statement of comprehensive income

	Note	Year ended 31 December	
		2017	2016
Net profit		**1 089 704**	**1 219 339**
Other comprehensive income net of tax, including:	15	**165 227**	**(447 125)**
Items that may be reclassified subsequently to the income statement			
Exchange differences on translation of foreign operations (net)		617	337
Change in valuation of available for sale financial assets (net)		166 844	(444 189)
Cash flows hedges (net)		(3 653)	(2 404)
Share of other comprehensive income of entities under the equity method		4 507	(1 202)
Items that will not be reclassified to the income statement			
Actuarial gains and losses relating to post-employment benefits (net)		(3 088)	333
Total comprehensive income net of tax, total		**1 254 931**	**772 214**

Notes presented on pages 10–141 constitute an integral part of these Financial Statements.

IFRS Financial Statements 2017 PLN (000's)

Statement of financial position

ASSETS	Note	31.12.2017	31.12.2016
Cash and balances with the Central Bank	16	7 383 518	9 158 751
Loans and advances to banks	17	6 063 702	7 308 769
Trading securities	18	1 547 802	3 837 606
Derivative financial instruments	19	1 233 549	1 818 306
Loans and advances to customers	21	73 431 738	72 304 131
Investment securities	22	31 110 560	30 467 780
Investments in subsidiaries	23	2 060 847	1 782 219
Investments in associates	24	28 680	-
Intangible assets	25	648 191	540 452
Tangible assets	26	509 773	481 695
Current income tax assets		6 558	1 067
Deferred income tax assets	33	129 037	146 693
Other assets	27	415 528	367 796
Total assets		**124 569 483**	**128 215 265**

LIABILITIES AND EQUITY			
Liabilities			
Amounts due to the Central Bank		-	-
Amounts due to other banks	28	5 089 716	8 503 014
Derivative financial instruments	19	1 141 035	1 644 250
Amounts due to customers	29	99 331 571	98 960 320
Hedge accounting adjustments related to fair value of hedged items	20	27 046	87 566
Other liabilities	31	2 171 413	1 792 740
Current income tax liabilities		172 003	77 475
Deferred income tax liabilities	33	81	100
Provisions	32	190 914	182 648
Subordinated liabilities	30	2 158 143	3 943 349
Total liabilities		**110 281 922**	**115 191 462**
Equity			
Share capital:		**3 564 176**	**3 551 096**
- Registered share capital	38	169 248	169 121
- Share premium	39	3 394 928	3 381 975
Retained earnings:	**40**	**10 572 341**	**9 486 890**
- Profit from the previous years		9 482 637	8 267 551
- Profit for the current year		1 089 704	1 219 339
Other components of equity	**41**	**151 044**	**(14 183)**
Total equity		**14 287 561**	**13 023 803**
Total liabilities and equity		**124 569 483**	**128 215 265**

Total capital ratio	**48**	**24.62**	**24.07**
Common Equity Tier 1 capital ratio	**48**	**21.51**	**20.59**
Book value		**14 287 561**	**13 023 803**
Number of shares		**42 312 122**	**42 280 127**
Book value per share (in PLN)		**337.67**	**308.04**

Notes presented on pages 10–141 constitute an integral part of these Financial Statements.

IFRS Financial Statements 2017 PLN (000's)

Statement of changes in equity

Changes from 1 January to 31 December 2017

	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 2017		**169 121**	**3 381 975**	**4 384 011**	**26 891**	**1 095 143**	**3 980 845**	**-**	**(5 953)**	**(2 431)**	**(1 545)**	**(3 517)**	**(737)**	**13 023 803**
Total comprehensive income	15							**1 089 704**	**617**	**166 844**	**(3 653)**	**(3 088)**	**4 507**	**1 254 931**
Transfer to General Risk Fund		-	-	-	-	20 000	(20 000)	-	-	-	-	-	-	-
Transfer to supplementary capital		-	-	2 761 506	-	-	(2 761 506)	-	-	-	-	-	-	-
Issue of shares	38	127	-	-	-	-	-	-	-	-	-	-	-	127
Stock option program for employees	39, 44	-	12 953	-	(4 253)	-	-	-	-	-	-	-	-	8 700
- value of services provided by the employees		-	-	-	*8 700*	-	-	-	-	-	-	-	-	*8 700*
- settlement of exercised options		-	*12 953*	-	*(12 953)*	-	-	-	-	-	-	-	-	-
Equity as at 31 December 2017		**169 248**	**3 394 928**	**7 145 517**	**22 638**	**1 115 143**	**1 199 339**	**1 089 704**	**(5 336)**	**164 413**	**(5 198)**	**(6 605)**	**3 770**	**14 287 561**

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 of other comprehensive income of associates	
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**

Notes presented on pages 10–141 constitute an integral part of these Financial Statements.

IFRS Financial Statements 2017 PLN (000's)

Statement of cash flows

	Note	Year ended 31 December	
		2017	**2016**
A. Cash flows from operating activities		**(1 266 974)**	**8 348 347**
Profit before income tax		**1 470 224**	**1 570 154**
Adjustments:		***(2 737 198)***	***6 778 193***
Income taxes paid		(306 870)	(325 315)
Amortisation	25, 26	200 856	199 826
Foreign exchange (gains) losses on financing activities		(1 209 867)	584 298
(Gains) losses on investing activities		(21 910)	(362 429)
Impairment of investment securities and investments in subsidiaries and associates	23, 24	12 262	8 119
Dividends received	7	(166 285)	(166 833)
Interest income (income statement)	5	(3 550 968)	(3 394 096)
Interest expenses (income statement)	5	792 483	927 910
Interest received		3 953 778	3 648 385
Interest paid		(721 824)	(792 003)
Changes in loans and advances to banks		(53 979)	(855 233)
Changes in trading securities		19 290	45 521
Changes in assets and liabilities on derivative financial instruments		156 864	51 799
Changes in loans and advances to customers		(1 231 153)	(1 079 885)
Changes in investment securities		(661 970)	(866 124)
Changes in other assets		(40 665)	(93 071)
Changes in amounts due to other banks		112 640	(1 359 349)
Changes in amounts due to customers		(419 452)	10 183 114
Changes in provisions		8 266	(42 696)
Changes in other liabilities		391 306	466 255
Net cash generated from/(used in) operating activities		**(1 266 974)**	**8 348 347**
B.Cash flows from investing activities		**(345 968)**	**122 765**
Investing activity inflows		***199 735***	***371 906***
Disposal of shares in subsidiaries		32 863	2 000
Disposal of intangible assets and tangible fixed assets		587	4 041
Dividends received	7	166 285	166 833
Other investing inflows		-	199 032
Investing activity outflows		**545 703**	**249 141**
Acquisition of shares in subsidiaries		227 339	-
Purchase of intangible assets and tangible fixed assets		318 364	249 141
Net cash generated from/(used in) investing activities		**(345 968)**	**122 765**
C. Cash flows from financing activities		**(3 584 484)**	**(363 482)**
Financing activity inflows		***1 214 313***	***3 165 800***
Proceeds from loans and advances from other banks		-	570 635
Proceeds from other loans and advances		422 466	439 000
Issue of ordinary shares		127	165
Security deposit due to issue of Eurobonds		791 720	2 156 000
Financing activity outflows		**4 798 797**	**3 529 282**
Repayments of loans and advances from other banks		2 711 025	3 266 045
Repayments of other loans and advances		223 612	12 844
Acquisition of shares in subsidiaries - increase of involvement		121 700	102 200
Decrease of subordinated liabilities	30	1 611 840	-
Payments of financial lease liabilities		7 272	9 517
Interest paid from loans and advances received from other banks and subordinated liabilities		123 348	138 676
Net cash generated from/(used in) financing activities		**(3 584 484)**	**(363 482)**
Net increase / decrease in cash and cash equivalents (A+B+C)		**(5 197 426)**	**8 107 630**
Effects of exchange rate changes on cash and cash equivalents		(39 684)	(12 377)
Cash and cash equivalents at the beginning of the reporting period		14 987 684	6 892 431
Cash and cash equivalents at the end of the reporting period	**43**	**9 750 574**	**14 987 684**

Notes presented on pages 10–141 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 SA. 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 2017, the headcount of mBank S.A. amounted to 5 414 FTEs (Full Time Equivalents) - 6 415 persons (31 December 2016: 5 364 FTEs - 6 313 persons).

The Management Board of mBank S.A. approved these financial statements for issue on 28 February 2018.

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 2017. Comparative data presented in these financial statements relate to the period of 12 months ended on 31 December 2016.

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 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 2017 were published on 28 February 2018.

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. Portfolio management fees and other fees for management, advisory and other services are recognized on the basis of service contracts, usually in proportion to the passage of time. 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 as upfront income 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 bundled 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 response 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.

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".

The detailed rules of determining write-downs and provisions for impairment of credit exposures have been described under Note 3.4.6.

<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.

Renegotiated agreements

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 other banks, amounts due from other banks and government securities acquired for the purpose of short-term resale. Cash and cash equivalents are measured using amortised cost.

2.10. Sell and repurchase agreements

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 in the "buy sell back" transactions are not recognized in the financial statements, unless they are sold to third parties. In such case the purchase and sale transactions are recorded in the financial statements 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 repackaging) 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 and deposits taken are initially recognized at fair value reduced by the incurred transaction costs. After the initial recognition, borrowings and deposits taken 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 initial 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. Amortization is accrued by the straight line method taking into account the expected period of economic useful life of the respective intangible assets.

<u>Computer software</u>

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".

<u>Development costs</u>

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 than 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 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 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 and its sale must be highly probable, i.e., the appropriate level of management must be committed to a plan to sell the asset, 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, amortisation 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

Assets repossessed for debt 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

mBank S.A. as a Lessee

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. 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 Bank's 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 risk reserve,
- undistributed profit for the previous years,
- net profit (loss) for the current year.

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

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 due to dividends payable under "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 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. Conversely, 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 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.

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 because 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 2017.

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.

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

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 Group continues to apply IAS 39 accounting for macro hedges. The new standard is effective for annual periods beginning on or after 1 January 2018.

  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.

  Quantitative and qualitative information, including the analysis of main changes resulting from adoption of the standard on the presentation and valuation of financial instruments in the financial statements for the annual periods starting from 1 January 2018 has been presented under the end of these 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.

  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 15, *Clarifications to IFRS 15 Revenue from Contracts with Customers*, published by International Accounting Standards Board on 12 April 2016, approved by European Union on 31 October 2017, 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 IFRS 4, *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*, published by International Accounting Standards Board on 12 September 2016, approved by European Union on 3 November 2017, 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.

- IFRS 16, *Leases*, published by the International Accounting Standards Board on 13 January 2016, approved by European Union on 31 October 2017, 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 operating lease assets and corresponding liability in the financial statements of the Bank as lessor. 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.

- Annual Improvements to IFRS Standards 2014-2016 Cycle, changing 3 standards (IFRS 1, IFRS 12, IAS 28), published by International Accounting Standards Board on 8 December 2016, approved by European Union on 7 February 2018, 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 or discontinued operation 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.

Standards and interpretations not yet approved by the European Union:

- 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 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 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 interpretation will have no significant impact on the financial statements in the period of its initial application.

- IFRIC Interpretation 23 *Uncertainty over Income Tax Treatments*, published by International Accounting Standards Board on 7 June 2017, binding for annuals periods starting on or after 1 January 2019.

  IFRIC Interpretation 23 addresses, in particular, when there is uncertainty over income tax treatments, whether an entity considers uncertain tax treatments separately, what assumptions an entity makes about the examination of tax treatments by taxation authorities, how an entity determines taxable profit (tax loss), tax bases, unused tax losses, tax rates and how an entity considers changes in facts and circumstances.

  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 their initial application.

- Amendments to IFRS 9, *Prepayment Features with Negative Compensation*, published by the International Accounting Standards Board on 12 October 2017, binding for annual periods starting on or after 1 January 2019.

  Amendments to IFRS 9 introduce the statements with reference to contractual prepayment feature, when the lender could be forced to accept the prepayment amount that is substantially less than unpaid amounts of principal and interest. Such a prepayment amount would be a payment to the borrower from the lender, instead of compensation from the borrower to the lender. Such a financial asset would be eligible to be measured at amortized cost or fair value through other comprehensive income (subject to an assessment of the business model in which they are held), however, the negative compensation must be reasonable compensation for early termination of the contract.

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

- Amendments to IAS 28, *Long-term Interests in Associates and Joint Ventures*, published by the International Accounting Standards Board on 12 October 2017, binding for annual periods starting on or after 1 January 2019.

  Amendments to IAS 28 clarify that an entity applies IFRS 9 "Financial Instruments" to other financial instruments in an associate or joint venture to which the equity method is not applied. These instruments include long-term interests that, in substance, form part of the entity's net investment in an associate or joint venture. In amendments to IAS 28 it has been clarified that the requirements of IFRS 9 apply to long-term interests before an entity applies share of losses requirements from IAS 28 and in applying IFRS 9, the entity does not take account of any adjustments to the carrying amount of long-term interests that arise from applying IAS 28.

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

- IFRS 17, *Insurance contracts*, published by the International Accounting Standards Board on 18 May 2017, binding for annual periods starting on or after 1 January 2021.

  IFRS 17 defines a new approach to the recognition, valuation, presentation and disclosure of insurance contracts. The main purpose of IFRS 17 is to guarantee the transparency and comparability of insurers' financial statements. In order to meet this requirement the entity will disclose a lot of quantitative and qualitative information enabling the users of financial statements to assess the effect that insurance contracts within the scope of IFRS 17 have on the financial position, financial performance and cash flows of the entity. IFRS 17 introduces a number of significant changes in relation to the existing requirements of IFRS 4. They concern, among others: aggregation levels at which the calculations are made, methods for the valuation of insurance liabilities, recognition a profit or loss over the period the entity provides insurance coverage, reassurance recognition, separation of the investment component and presentation of particular items of the balance sheet and profit and loss account of reporting units including the separate presentation of insurance revenues, insurance service expenses and insurance finance income or expenses.

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

- Annual Improvements to IFRS Standards 2015-2017 Cycle, published by the International Accounting Standards Board on 12 December 2017, binding for annual periods starting on or after 1 January 2019.

  The improvements to the following standards were implemented during the cycle: IFRS 3 in terms of clarifying that when an entity obtains control of a business that is a joint operation, it remeasures previously held interests in that business, IFRS 11 in terms of clarifying that when an entity obtains joint control of a business that is a joint operation, the entity does not remeasure previously held interests in that business, IAS 12 in terms of clarifying that all income tax consequences of dividends (i.e. distribution of profits) should be recognized in profit or loss, regardless of how the tax arises, IAS 23 in terms of clarifying that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalization rate on general borrowings.

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

- Amendments to IAS 19, *Plan Amendment, Curtailment or Settlement*, published by the International Accounting Standards Board on 7 February 2018, binding for annual periods starting on or after 1 January 2019.

  Amendments to IAS 19 specifies how an entity determines pension expenses when changes to a defined benefit pension plan occur. IAS 19 'Employee Benefits' specifies how an entity accounts for a defined benefit plan. When a change to a plan – an amendment, curtailment or settlement- takes place, IAS 19 requires an entity to remeasure its net defined benefit liability or asset. The amendments require an entity to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. By requiring the use of updated assumptions, the amendments are expected to provide useful information to users of financial statements.

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

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 has implemented the necessary solutions for the particular requirements based on the results of gap analysis and the defined methodological assumptions.

Summary of key IFRS 9 requirements

Classification and measurement of financial instruments

Financial assets

In accordance with IFRS 9, on initial recognition a financial asset are classified for the following valuation categories:

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

A financial asset is classified to one of above categories on initial recognition on the basis:

- the Bank'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 is 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 is 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" (IAS39) with the concept of „expected credit loss" has significant influence on the way of modelling credit risk parameters and the final amount of loss allowance. The loss identification period applied according to IAS39 does not exists anymore, and with it the IBNR (incurred but not reported) category of loss allowance has been eliminated.

In accordance with IFRS 9, the loss allowance is calculated in the following categories:

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.

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The method of calculating the impairment of the financial assets also has an impact on the interest income recognition. Interest income on financial assets allocated to Stages 1 and 2 is calculated based on the gross carrying amount of the exposure, whereas interest income allocated to Stage 3 on the net carrying amount of the exposure (similarly to impaired assets under the requirements of IAS 39).

Hedge accounting

In accordance with the IFRS9 provisions, only on the day of initial application the Bank had the opportunity to 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 (i.e. in the absence of the conditions to stop the application of hedge accounting, as defined in the standard).

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

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

As at 1 January 2018 changes in the requirements regarding classification and measurement and impairment of financial assets, had moderately negative impact on the Bank's financial position and own funds.

In the table below the Bank presents the impact on equity as at 1 January 2018 resulting from changes in the classification and measurement of financial assets without taking into account the effect of deferred tax.

Assets	IAS 39 measurement method	IFRS 9 measurement method	IAS 39 carrying amount	IFRS 9 classification and measurement	IFRS 9 impairment	IFRS 9 carrying amount
Loans and advances to banks	amortized cost	amortized cost	5 663 263	-	(499)	5 662 764
Loans and advances to banks	amortized cost	fair value through other comprehensive income	400 439	734	-	401 173
Loans and advances to customers	amortized cost	amortized cost	70 558 668	-	(216 564)	70 342 104
Loans and advances to customers	amortized cost	fair value through profit or loss	2 873 070	(28 953)	-	2 844 117
Investment equity securities	fair value through other comprehensive income	fair value through profit or loss	9 934	-	-	9 934
Investment debt securities	fair value through other comprehensive income	amortized cost	8 566 042	(45 870)	-	8 520 172
Investments in subsidiaries	at equity including results under IAS 39	at equity including results under IFRS 9	2 060 847	(22 553)	-	2 038 294
Total assets			**90 132 263**	**(96 642)**	**(217 063)**	**89 818 558**

Liabilities			IAS 39/ IAS 37 carrying amount	IFRS 9 classification and measurement	IFRS 9 impairment	IFRS 9 carrying amount
Other liabilities			2 171 413	1 674	-	2 173 087
Provisions			190 914	-	41 646	232 560
Total liabilities			**2 362 327**	**1 674**	**41 646**	**2 405 647**

As at 1 January 2018, the total value of impact of the implementation of IFRS 9 in the amount minus PLN 357 025 thousand and the effect of deferred tax resulting from the implementation of IFRS 9 in the form of an increase of net deferred income tax assets in the amount of PLN 63 910 thousand decreased the amount of retained earnings and other components of equity by PLN 293 115 thousand.

Impact of IFRS 9 on capital adequacy

The total fully-loaded impact of IFRS 9 calculated as on 1 January 2018 is insignificant (no more than 5bps) on Group and Bank TCR and Tier1 ratio.

The Bank decided, for the purpose of capital adequacy calculation, including calculation of own funds, based on the Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017 (Regulation) amending Regulation (EU) No 575/2013 in light of Article 1 paragraph 9 of the Regulation, not to apply the transitional arrangements that would mitigate the impact on capital resulting from the introduction of IFRS9.

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

Below the Bank disclosed the qualitative information about the Bank's approach to the implementation of IFRS 9, which in the Bank's opinion, will allow the recipients of the financial statements to understand the impact of IFRS 9 on the Bank's financial position and capital management.

Classification and measurement of financial instruments

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, reviewed the financial assets in the Bank's portfolio, which were a part of its portfolio after 31 December 2017 by:

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.

As at 1 January 2018, the Bank changed the classification of the certain part of retail portfolio (cash loans, renewable loans and credit cards) and small number of corporate loans (single investment 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.

The Bank changed also the classification of part of corporate loans (part of syndicated loans portfolio) measured at amortised cost under IAS 39, which as a result of implementation of IFRS 9 are measured at fair value through profit and loss due to a business model whose objective is not achieved by collecting contractual cash flows.

Moreover, the Bank changed also the classification of mortgage bonds of mBank Hipoteczny measured at amortised cost under IAS 39, which as a result of implementation of IFRS 9 are measured at fair value through other comprehensive income due to a business model whose objective is achieved by both collecting contractual cash flows and selling.

In addition, for the certain part of the debt securities portfolio classified as "Available-for-Sale" under IAS 39 the Bank decided application of the "Held-to-Collect" business model, which resulted in the reclassification of these securities from the fair value through other comprehensive income into amortised cost measurement category. As at 31 December 2017 the Bank held 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 at the initial application made an irrevocably choice to measure one of the equity instrument at fair value through other comprehensive income. The rest of the equity instruments the Bank measures at fair value through profit and loss in accordance with IFRS 9. If the Bank chose 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.

As at 1 January 2018, the net asset value of mBank's subsidiaries, i.e. mBank Hipoteczny and mLeasing changed as a result of implementation of IFRS 9. The subsidiaries are accounted for using equity method in the stand alone financial statement of mBank. Related to the above the value of the Bank's investments in subsidiaries, valued using equity method, also changed.

As at 31 December 2017 the Bank did 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.

Financial liabilities

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

The Bank did not elect an option to measure financial liabilities at fair value. If this option is chosen, the change in fair value resulting from changes in the level of own credit risk would be recognized in other comprehensive income. At the moment of derecognition of financial liability, the value previously recognized in other comprehensive income would not be reclassified to financial result.

As of 1 January 2018 the value of the Bank's financial liabilities changed due to the methodology and approach to fair value measurement through profit and loss for the part of retail loan portfolio and a small number of corporate loans as a result of the implementation of IFRS 9, which under IAS 39 were measured at amortised cost.

Impairment

The implementation of the new impairment model based on the concept of ECL resulted in the moderate increase of the Bank's loss allowance, particularly with regard to exposures allocated to Stage 2 and 3. 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 resulted in the earlier recognition of credit losses which causes an increase in loss allowance. Increase in loss allowance in stage 3 is mainly driven by a change in "cure" definition, so it is in line with "default" definition and takes into account life-time losses for re-defaulting assets evaluated on portfolio basis, as well as implementation of scenario approach for individually assessed borrowers. With regard to retail exposures classified to Stage 1 the Bank did not identify the change in the level of impairment allowances. In the corporate segment the Bank identified 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 was 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 developed and implemented a new methodology of loss allowance calculation as well as implemented appropriate changes in IT systems and processes functioning at 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 has 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.

Hedge accounting

The Bank assumed 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 have no impact on the financial position of the Bank.

Comparative data

The Bank decided to use IFRS 9 statements allowing exemption from the obligation to restate comparative data of prior periods in relation to the changes arising from the classification and measurement as well as impairment. Differences in carrying value of financial assets and financial liabilities resulting from the application of IFRS 9 were recognized as part of the result from previous years in the Bank's equity as at 1 January 2018.

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2.27. Business segments

Data concerning business segments was presented in the Consolidated Financial Statements of mBank S.A. Group for the year 2017, prepared in compliance with the International Financial Reporting Standards and published on 28 February 2018.

2.28. Comparative data

The data as at 31 December 2016 are comparable with the current accounting period data and therefore has not been adjusted.

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 2017 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 2017 and mBank S.A. Management Board Report for the year 2017 are not the part of mBank S.A. Financial Statements.

Type of risk	Information	Location of information for 2017		
		Annual Report of mBank		Disclosures regarding capital adequacy
		Management Board Report	Financial Statements	
General information	Location of risk management disclosures	-	p. 32	p. 3
	Glossary of terms	-	p. 33	-
	External environment	-	p. 34	-
Principles of risk management	Division of responsibilities in the risk management process	-	p. 35	-
	Risk culture	-	p. 39	-
	Internal capital adequacy assessment process (ICAAP)	-	p. 41	p. 26
	Risk appetite	-	p. 43	-
	Stress tests within ICAAP/ILAAP	-	p. 44	p. 26
	Required capital and liquidity planning	-	p. 44	p. 9
Credit risk	Organization of risk management	p. 59	p. 46	-
	Credit policy	p. 62	p. 47	-
	Collaterals accepted	-	p. 47	p. 71, 74
	Rating system	-	p. 48	-
	Monitoring and validation of models	-	p. 49	-
	Calculating impairment charges and provisions	p. 64	p. 49	p. 84
	mBank forbearance policy	-	p. 52	-
	Counterparty risk that arises from derivative transactions	-	p. 57	-
	Concentration risk	-	p. 59	p. 77
Market risk	Organization of risk management	-	p. 61	-
	Tools and measures	p. 66	p. 62	-
	Risk measurement	p. 67	p. 63	-
	Interest rate risk in the banking book	p. 68	p. 65	-
	Currency risk	-	p. 64	-
Liquidity risk and funding	Strategy of liquidity risk	p. 71	p. 67	-
	The measurement, limiting and	p. 72	p. 70	-

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	reporting the liquidity risk			
	Funding sources	-	p. 72	-
Operational risk	Tools and measures	p. 73	p. 75	p. 98
	Operational losses	-	p. 75	-
	Compliance risk	-	p. 76	-
Other risks	Business risk	-	p. 77	-
	Model risk	-	p. 77	-
	Reputational risk	-	p. 78	-
	Capital risk	-	p. 78	-
	Regulatory risk	-	p. 79	-
Capital adequacy		p. 74	p. 135	p. 9
Leverage ratio		p. 76, 83, 84	p. 34, 137	p. 67

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 at the time of default (amount).

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 – **Expected Loss** taking into account the probability of default (amount).

ICAAP – Internal Capital Adequacy Assessment Process.

ILAAP – Internal Liquidity Adequacy Assessment Process.

Internal capital (IC) – the amount of capital estimated by the Bank required to cover unexpected loss arising from 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 relative loss in case of 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, capital requirement on delivery settlement risk and counterparty 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 other types of risk, ie:

- 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 2017 – 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.

On 23 November 2016, the European Commission published a proposal of amendments to the supervisory regulations in force for European banks, including CRR/CRD IV and the Bank Recovery and Resolution Directive (BRRD), subject to legislative works during 2017 which have not yet been finalized.

The proposed amendments to the CRR include new methods of calculating capital requirements for counterparty credit risk and market risk (based on the proposals of the Basel Committee on Banking Supervision) which would replace the methods used so far. A change in the approach to the treatment of exposure to a central counterparty and the extension of capital "incentives" for banks financing small and medium-sized enterprises were also proposed. The proposal includes also the binding 3% minimum value of the leverage ratio (prudential measure) as well as significant modifications relating to the net stable funding ratio (NSFR) together with its minimum level of 100%. Introduction of the minimum standard for Global systemically important institutions (GSIIs) with regard to total loss absorbing capacity (TLAC) is proposed.

The amendments to the CRD IV include more detailed guidelines on restrictions on profit-sharing. They explain the relationship between additional capital requirements under Pillar 2, minimum requirements for own funds, the combined buffer requirements, and requirements for own funds and eligible liabilities the banks are obliged to fulfill. Extension of supervisory expectations concerning identification, assessment and management of interest rate risk in the banking book and the definition of a 'standard shock' were proposed.

Proposed amendments would be applicable two to four years after the entry into force of the amended CRR and CRD IV.

In terms of the recovery and resolution, there were proposed changes concerning the construction of the ratio of minimum requirement for own funds and eligible liabilities in order to ensure consistency of this ratio with TLAC.

Out of the proposed amendments to supervisory regulations two elements were separated and fast-tracked in order to swiftly finalize the legislative proposals to ensure their application in the European Union starting from 1 January 2018. The endorsed amendments were related to transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and gradual withdrawal of the exclusion of public sector exposures from the large exposure regime (amendments to CRR) and to the ranking of unsecured debt instruments in insolvency hierarchy (amendments to BRRD).

Recommendations of the KNF

On 1 January 2017 the updated Recommendation C of the KNF concerning concentration risk management (which replaced the Recommendation C on exposure concentration risk management issued by the banking supervision in 2002) came into force. The updated Recommendation defines the principles of identification, measurement, monitoring and limiting concentration risk in banks.

In April 2017, the KNF issued the updated Recommendation H concerning internal control system in banks (which replaced the Recommendation H issued by banking supervision in 2011). The updated Recommendation applies to banks from December 31, 2017 and includes significant changes that were implemented in domestic and international law and recommendations.

3.3. Principles of risk management

3.3.1 Division of responsibilities in the risk management process

1. **Supervisory Board,** through the **Risk Committee,** exercises constant supervision over the Bank's operations in the risk taking area, which includes approving the Risk Management Strategy of the Group and supervising its implementation.

2. **Management Board of the Bank** accepts the Risk Management Strategy of the Group and is responsible for defining and implementing the principles of managing individual risk types and for their consistency with the Strategy. Moreover, the Management Board defines the organisational structure of the Bank, ensuring the separation of roles, and allocates the tasks and responsibilities to individual units.

   The Management Board undertakes actions to ensure that the Bank maintains a policy enabling management of all risks relevant to the Bank's operations and has appropriate procedures for this purpose. In particular it is responsible for developing, implementing, effectiveness and updating written strategies and procedures for: internal control system, risk management system, internal capital adequacy assessment process, capital management and capital planning.

3. **Chief Risk Officer** is responsible for integrated risk and capital management 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 limits (in accordance with internal regulations), and for processes of managing the risk of the retail credit portfolio and corporate portfolio.

4. **Committees:**

a/ **Business and Risk Forum** is a platform for making decisions and dialogue for organizational units in particular business lines and the risk management area in mBank as well as between mBank and the Group subsidiaries.

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 in mBank and respective organizational units in mBank Group subsidiaries.

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

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

- risk policies,
- processes and tools for risk assessment,
- risk limitation system,
- assessing the quality and profitability of portfolio of exposures to clients,
- liquidity risk issues such as methodology and limits,
- approval of introducing new products to the offer.

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

- approves new and redesigned models, as well as amendments thereto, deciding also about the resignation from the application of the model,
- makes decisions on the scope of application of the group and external models, including central models, in banking processes,
- recommends the tolerance level for model risk and submits its findings to the decision of the Management Board and the Supervisory Board,
- makes final decision regarding approval of significance assigned to a model,
- approves preventive and remedial measures indicated within the results of monitoring,
- accepts the schedule for validation of models and the results of each model validation.

The organization of the Committee ensures an adequate level of independence between the various participants of the model risk management process and enables to avoid conflicts of interest between them. Moreover, this Committee provides the Validation Unit with the ability to issue binding recommendations with 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,
- 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 credit decisions as well as decisions on debt conversion into shares, stocks, and on taking over properties in return for debts (applies to the Bank).

f/ **Investment Banking Committee** is responsible, in particular, for the control and management of risks (including market, credit, reputational and operational) of the Brokerage House transactions and making decisions regarding the execution of these transactions.

g/ **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.

h/ **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.

i/ **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:

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.

Integrated Risk and Capital Management Department:

- integrated risk, capital and liquidity management in the Bank and the mBank Group, in particular through: control of risk profile, capital and liquidity adequacy and risk bearing capacity, integration of risk valuation; integration of control of non-financial risks and Internal Control System Self-assessment (ICS),
- identifying, measuring, controlling, monitoring and developing methods for measuring market risk, interest rate risk of the banking book, liquidity risk and counterparty risk,
- monitoring of overall risk profile of organizational units in the area of financial markets,
- managing the process of integrated risk, capital and liquidity reporting.

Risk Projects and Architecture 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.

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.

Processes and Risk Measurement 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 sectoral 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),
- verification of value, liquidity and attractiveness of real estate and movables provided for collateral of loans.

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.

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.

Validation Unit:

- integration of model and their risk management, and validation of quantitative models.

Position for risk development:

- managing development activities of the managerial staff and employees of the risk management area.

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 (capital risk, business risk, reputational risk, legal risk, compliance risk, outsourcing risk, IT risk, cyber 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

The foundations of the risk management culture implemented in the Bank and the mBank Group have been specified in the Risk Management Strategy of mBank Group and strategies for managing individual types of risk (retail and corporate portfolio credit risk, market risk, liquidity risk, operational risk, reputational risk) approved by the Management Board and the Supervisory Board of mBank.

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) whose task is to take risk and capital aspects into consideration when making all business decisions, within the risk appetite set for the Group.
- The second line of defence, mainly **Risk** (risk management area), **IT, Security** and **Compliance** function, is responsible for determining framework and guidelines concerning managing individual risks, supporting Business in their implementation as well as supervising the control functions and risk exposure. To ensure that the Business is supported and supervised in an objective manner, the second line functions act independently of the Business.
- The third line of defence is **Internal Audit**, ensuring independent assessment of activities connected with risk management performed by the first and the second line of defence.

Pillars of risk management

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

- **Customer Focus** which means striving to understand and balance specific needs of the Risk's various stakeholders (Business, Management Board, Supervisory Board, shareholders, regulatory authorities).
- **One Risk** understood as an integrated approach to risk management and responsibility towards the clients for all types of risk defined in the Risk Catalogue of mBank Group.
- **Risk vs Rate of Return** perspective understood as a support for the business decision-making process based on the long-term relationship between risk and the 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 activities undertaken as part of the implementation of the mBank Group strategy. This support is organized around five challenges facing the risk management area in the coming years:

- **Empathy** understood in the risk management area as an active adaptation of risk management to the changing needs of various customer groups.
- Promoting the experience of **mobility**.
- **Efficiency** understood as: measuring, improving and automating risk processes in the culture of Lean; shaping - through a partner dialogue – the risk appetite that ensures a safe and profitable balance sheet of the bank.
- **Engaged employees**. This challenge is realized through building a work environment which fosters innovation, attracts, retains and develops employees with knowledge of business and risk management, curious to find solutions and openly communicating.
- **Technological advantage**, which means implementation of risk management based on a common integrated data platform (CDL) and searching for technological solutions enabling innovative risk management.

Key changes in the risk area in 2017

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 activities carried out in 2017 are described below:

- Establishment of the Investment Banking Committee. The tasks performed by the Committee are described under Note 3.3.1.
- The IFRS 9 implementation project was continued. The IFRS 9 standard has been in force since January 2018. The mBank Group completed key project work including the implementation of all critical databases and calculators to the extent necessary for the application of the new standard from January 1, 2018. The project will be continued in 2018 in the scope of other changes and adaptations in IT systems. More information about the project were included under Note 2.26.
- Risk appetite was defined for the subsequent planning horizon with special attention paid to 2018. Conclusions from analyses and discussions on potential impact on the Group of several issues identified during the managerial dialogue with particular emphasis on the package of non-financial risks, were taken into account while formulating risk appetite.
- The Limit Book was updated and limits for 2018 were set. Limits for new LAB measures (which replaced previously used ANL measures) were introduced within liquidity limits.
- Review and update of the Risk Management Strategy of the mBank Group and the other strategies for managing particular risks (credit risk in the corporate and the retail areas, market risk, liquidity risk, operational risk and reputational risk).
- Implementation of the Concentration Risk Management Strategy of mBank Group. The strategy, defining the framework for managing concentration risk using the existing system of limits and stress tests, was approved by the Management Board and the Supervisory Board of the Bank.
- The internal capital adequacy assessment process (ICAAP) and the internal liquidity assessment process (ILAAP) were reviewed. The results of the reviews were presented to the Management Board and the Supervisory Board.
- Periodic risk inventory process was carried out resulting in the update of the Risk Catalogue of mBank Group. The process was carried out in accordance with the modified rules (as a result of ICAAP review). The key change consisted in inclusion in the Catalogue of all risks identified in the Group's operations (previously the Catalogue included the list of material risks).
- Programme of continuous increase of work efficiency based on the Lean Management rules was continued. Further processes in the risk management area are reviewed and streamlined using the lean philosophy and tools. The purpose of the programme is to allow the growing number of tasks accompanying business growth and increasing number of regulatory requirements without the need to significantly increase resources and to reallocate resources from the streamlined operating areas to the areas where resources need to be increased due to the realized projects or growing scope of tasks.

3.3.3 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 Internal Capital Adequacy Assessment Process (ICAAP) 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 in mBank Group includes:

- risk inventory in the mBank Group,
- estimation of internal capital for coverage of risk,
- capital aggregation,
- stress tests,
- setting limits on the utilization of capital resources,
- planning and allocation of capital,
- 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 Bank's Management Board and supervised by the Supervisory Board of the Bank on a regular basis.

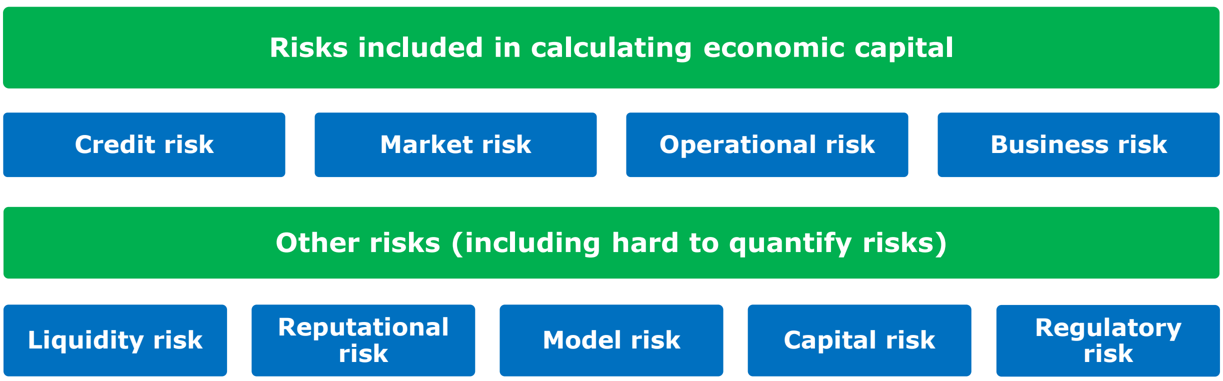
Material risks in mBank Group's operations

The Management Board is taking activities for ensuring that the Bank 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 (including hard to quantify risks) may be estimated.

The following risks were recognized as material for the Group as at 31 December 2017:



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.

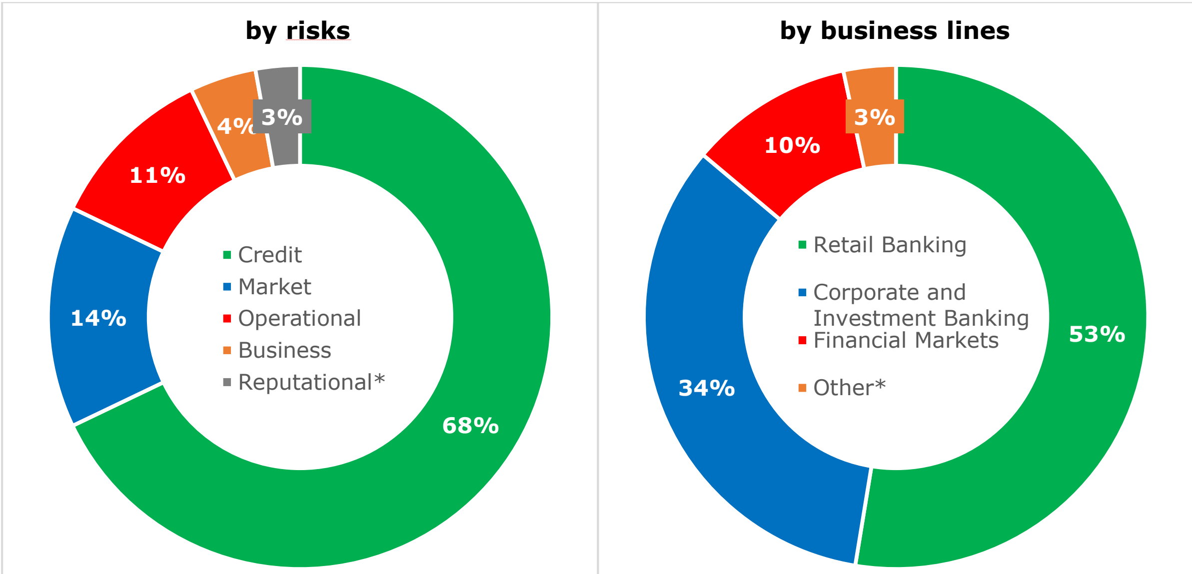
In 2017 (similarly as in 2016), the mBank calculated the economic capital at the 99.91% confidence level over a one-year time horizon, for all risk types. Diversification between different risks was not included while calculating the total of economic capital.

In accordance with internal regulations, the decision concerning the amount of capital for coverage of other risks (including hard to quantify risks) is taken by the Capital Management Committee. In 2017 the Bank maintained capital to cover reputational risk.

<u>Structure of internal capital and total capital requirement</u>

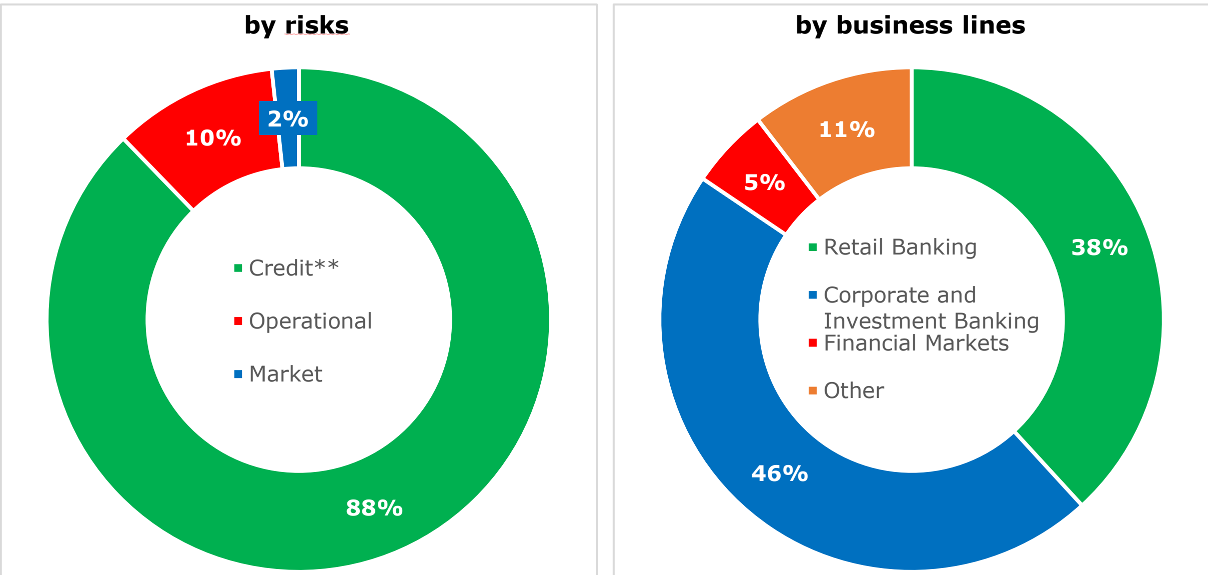
The charts below present the structure of internal capital and the total capital requirements of mBank as of 31.12.2017 by risks and business lines.

Structure of internal capital of mBank as of 31.12.2017



**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 31.12.2017



***The item presenting "Credit" risk includes also supervisory floor for AIRB portfolio of 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).

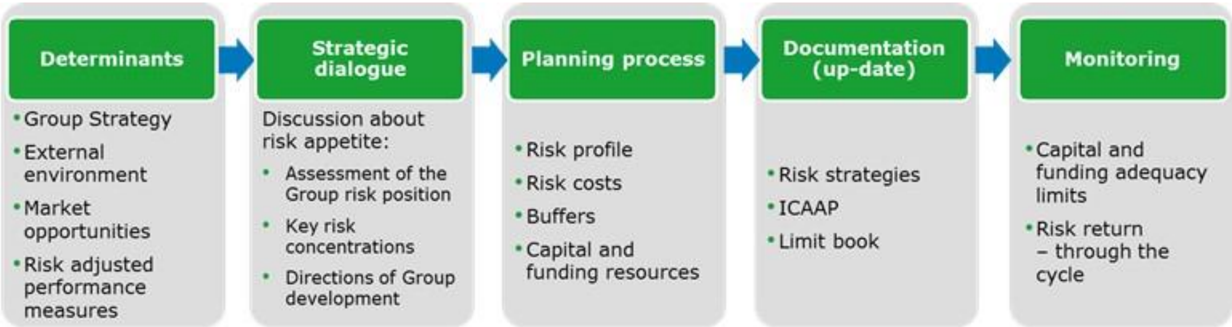
Significantly lower share of internal capital assigned to the Corporate and Investment Banking (compared to the share of this business line in the structure of total capital requirement) results from the diversification effect recognized in the model of economic capital for credit risk. The opposite 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).

3.3.4 Risk appetite

Risk appetite is defined within the mBank Group as the maximum risk, in terms of both amount and structure, which the Bank 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. During the central (Top-down) and business general planning process stages risk appetite statements undergo further decomposition into key metrics and targets, which are then cascaded down into the organization during the business operating phase of planning (Bottom-up). 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 required 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 of the Group 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". In order to ensure its safe functioning apart from limits the Group applies monitoring action triggers and early warning indices.

3.3.5 Stress tests within ICAAP and ILAAP

Stress tests are an essential component of the ICAAP and ILAAP used for managing the Bank and the Group and for capital and liquidity 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, i.e. the most probable (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 corresponding scenario accepted by the consolidating entity. 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/ regulatory capital ratios,

3/ stressed potential risk coverage (RCP) and own funds,

4/ the liquidity measures (internal and supervisory) 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 and analysed 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 materialized in risk coverage potential are simulated. The macroeconomic stress scenario results are included in the Group's risk bearing capacity (RBC) analysis on a monthly basis.

The Group and the Bank 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 an additional element of the analysis of the Bank's and the Group's robustness to negative macroeconomic and idiosyncratic factors.

3.3.6 Required capital and liquidity planning

Required capital and liquidity planning

<u>Stage I (central planning, i.e. *Top-Down*) and Stage II (business general planning)</u>

Those stages of capital and liquidity planning take the form of the strategic dialog between the Management Board, Risk, Finance and Business, following which the desired directions of business development are determined to support the realization of the business goals of the mBank Group.

The Group plans business activities and related risk appetite within 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 (including re-parameterization of risk pricing models).

Based on the strategic directions, the available capital is compared with the demand for capital (resulting from business development and stress test results). 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.

In terms of liquidity risk, the estimations are made of both regulatory measures and internal liquidity measures including stress tests, and in this respect the adequacy of planned liquidity buffer of the Bank and the Group is analyzed. Should the achieved results exceed the levels assumed in the risk appetite and limits, then business goals need to be revised.

After determining the strategic directions of development it is analyzed what key risk concentrations are identified in the current and planned risk profile. For the purposes of determining the buffers and limits the Management Board decide on the acceptable level of risk factors to which the Group is susceptible through identified concentrations. 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 position of the Group is determined through appropriate 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.

Stage III (business operational planning, i.e. *Bottom-up*)

At this stage the capital needed is clarified in order to determine an efficient capital allocation at lower levels.

In each business line partial plans based on accepted macroeconomic assumptions, financial targets and the assessment of business growth potential are worked out.

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.

In terms of liquidity risk, the estimations are made of both regulatory measures and internal liquidity measures including stress tests, and in this respect the adequacy of planned liquidity buffer of the Bank and the Group is analyzed. Should the achieved results exceed the levels assumed in the risk appetite and limits, then business goals need to be revised.

On the basis of the operational phase of planning, the Funding Strategy of mBank Group is prepared and approved by the Bank's Management Board. The Strategy presents ways to provide funding in particular currencies needed for the planned development of the Group's assets. The strategy is prepared for normal conditions but also includes estimate of liquidity measures for crisis conditions.

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 risks in mBank's retail banking and its main operational responsibility 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). The DZR is also 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 for polish market, 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.
- **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.
- **Processes and Risk Measurement Department (DPR)** responsible for: development of corporate credit risk strategy and policies, as well as cross-sectional portfolio analyses including industry ones; preparation of reports and statements in particular for supervisory authorities and the Bank's governing bodies; development and implementation of the corporate credit process principles and monitoring its effectiveness; administration of applications supporting the corporate credit process; development and quality control of rating models for retail and corporate customers and financial institutions in the Bank and mBank Group subsidiaries; verification of real estate and movables provided by customers for collateral in terms of their value, liquidity and attractiveness.
- **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); 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 consolidated supervision purposes.

- **Validation Unit** is responsible for organizing the process of managing models applied for credit risk management and evaluation as well as validating such models.

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, 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 Processes and Risk Measurement 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 in the process of granting credit products. The collateral is an important part of the credit policy. The primary role of collateral is to reduce the credit risk of the transaction and provide the Bank with a realistic opportunity to repay receivables. In making a decision about granting a credit risk bearing product, the Bank strives to obtain collateral adequate to the accepted risk. The Bank accepts collateral only upon its assessment and provided it meets the condition of no significant correlation between the credibility of the debtor and the collateral value. Specific types of collateral that are required depend on the risk bearing product, the tenor of the transaction and the risk of the client. The most common collateral accepted are:

- mortgage on real estate,
- cession of receivables (cession of rights),
- registered pledge,
- monetary deposit,
- guarantee deposit or cash blocked,
- guarantees and warranties,
- transfer of ownership to vehicle.

The value of fixed assets taken as collateral (other than vehicles) is determined on the basis of a valuation prepared by a licensed expert. Valuations submitted to the Bank is verified by a team of specialists located in the risk management area, that verifies the correctness of the market value assumptions and assesses the liquidity of the collateral. Each collateral is monitored.

In the corporate banking area, in the case of collateral on fixed assets or financial assets, the final value of collateral is brought to a most realistic value (MRV) using Empirical Coverage Factor (ECF), which reflects the pessimistic variant of debt recovery from the collateral through forced sale. Personal collateral is assesed taking into account the finacial standing of provider. The Bank assigns the risk parameter PSW (which is an equivalent of Most Realistic Value for fixed assets collateral). In cases when PD parameter of the collateral provider is equal or worse than PD parameter of the debtor, then PSW parameter is zero.

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The Bank implemented a dedicated collateral policy in the area of corporate banking in December 2017. The most important elements of this policy are:

- indication of collateral preferred and unrecommended,
- recommendations regarding the requirements of collateral in specific situations,
- frequency of collateral monitoring,
- Bank's approach to collateral with MRV parameter equal to zero.

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 till CC	n/a	D
	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 EAD model,
- 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 List 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, i.e. the model owner and users. The 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.
8. Bank expects a loss on a client's exposure.

<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 receivables

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-offs is as follows:

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

b) estimating future cash flows 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 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.

In case when the value of estimated future cash flows is higher than the carrying value of the gross credit exposure and impairment is not recognized, but there are premises to classify the client into the default category, there is created a provision in account for 5% of total balance volume.

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 6-9 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 6-9-months 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 letters of credit 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	31.12.2017		31.12.2016	
	Exposure (%)	Provision coverage (%)	Exposure (%)	Provision coverage (%)
1	9.16	0.01	11.56	0.01
2	39.17	0.03	38.16	0.04
3	14.20	0.12	13.76	0.16
4	17.47	0.36	16.91	0.35
5	4.78	1.04	3.65	1.08
6	0.38	2.23	0.21	2.44
7	1.02	4.65	0.54	4.35
8	9.92	0.05	10.86	0.07
Default category	3.90	55.96	4.35	54.93
Total	**100.00**	**2.38**	**100.00**	**2.56**

As at 31 December 2017, 48.33% 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 2016: 49.72%).

A distribution of share of exposures for non-default portfolios remained without significant changes compared to 2016. The share of provision coverage for default portfolio slightly increased (from 54.56% to 55.96%).

3.4.6.7 Repossessed collateral

The Bank classifies repossessed collaterals as assets repossessed for debts and measures them in accordance with the adopted accounting policies described in paragraph 2.18. Assets repossessed for debts 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 2017 and 2016, the Bank did not have any repossessed collaterals that were difficult to sell.

3.4.7. mBank Forbearance Policy

Definition

The Bank's forbearance policy is a set of activities relating to renegotiation and restructuring 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 and include e.g. debt restructuring, changes of repayment schedule and capital repayments and/or interest repayments deferrals.

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.

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 mBank 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,
- Change 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 measures have been an integral part of the mBank's risk management area for many years. Forborne 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 forborne portfolio is based on portfolio approach and corporate portfolio analysis is based on individual approach.

In corporate banking, for every bank's exposures on debtors with recognized loss event, impairment test is performed. Recognition of impairment results in debtor being taken over by the specialised unit dedicated to restructuring, who is responsible for assigning credit strategy against the debtor, i.e. Restructuring or Collection (Vindication). All loans granted to clients under Restructuring strategy being served by Debt Restructuring and Collection Department have the forborne 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 mBank does not use dedicated models to determine level of portfolio provision and special-purpose provision for forborne portfolio.

Forborne exit conditions – corporate banking area

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

- debtor financial situation's analysis showed improvement and the exposure has been recognised as performing and it was reclassified from the nonperforming category,
- at least two years after recognising exposure as performing have passed (probation period),
- for at least 12 months period significant and regular capital or interest payments have been made since the date of recognising the exposure as performing,
- none of the debtor exposures is overdue more than 30 days at the end of reporting period.

Forborne exit conditions – retail banking area

The Bank ceases to recognise the contract as forborne when all of the following conditions are met:

- the contract is recognised as performing – including contract reclassified from the non-performing category,
- at least two years after recognising exposure as performing have passed or the contract was not recognized as non-performing when the forbearance measures were granted,
- at least from the middle of the probation period (i.e. two years from classifying the contract as forborne) regular capital or interest payments were made (lack of significant delays in repayment longer than 31 days),

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- none of the debtor's exposures are overdue more than 31 days and at the same time no amount exceeds PLN 500 at the end of the probation period,
- an analysis of the financial situation of the debtor based on the client's rating was performed, and the cut-off point for each segment is as follows:

Mortgage loans for private individuals (ML OF)	3.4
Mortgage loans for microenterprises (ML MF)	4.4
Non-mortgage loans for private individuals (NML OF)	4.4
Non-mortgage loans for microenterprises (NML MF)	4.0

The result of customer analysis with worse rating than the above is negative.

Portfolio characteristic

Due to extension of the forbearance exposition in 2017, including the exposure arising from receivables from credit and financial institutions, the comparative data for 2016 was updated.

The table below presents changes in the carrying value of the forborne exposures in 2017.

31.12.2017	Gross carrying amount	Of which defaulted	Provisions created	Net value
As at 31.12.2016	**1 534 980**	**808 790**	**406 589**	**1 128 391**
Outputs	(1 092 924)	(413 551)	(132 769)	(960 155)
New forbearance	1 224 280	449 835	224 075	1 000 205
Changes on existing loans	23 749	24 501	22 207	1 542
As at 31.12.2017	**1 690 085**	**869 575**	**520 102**	**1 169 983**

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**	**1 164 015**	**622 653**	**1 228 374**
Outputs	(566 503)	(534 768)	(302 566)	(263 937)
New forbearance	294 588	192 458	66 258	228 330
Changes on existing loans	(44 132)	(12 915)	20 244	(64 376)
As at 31.12.2016	**1 534 980**	**808 790**	**406 589**	**1 128 391**

Forborne portfolio as at 31 December 2017

31.12.2017	Gross carrying amount	Of which defaulted	Provisions created	Net value
Loans and advances to banks	292	291	291	1
Loans and advances to customers, including:	1 689 793	869 284	519 811	1 169 982
Loans to individuals:	1 015 182	289 422	118 225	896 957
- Current accounts	120 044	12 496	6 754	113 290
- Term loans, including:	895 138	276 926	111 471	783 667
housing and mortgage loans	725 040	170 991	67 760	657 280
Loans to corporate clients:	674 611	579 862	401 586	273 025
corporate & institutional enterprises	296 589	242 555	171 224	125 365
medium & small enterprises	378 022	337 307	230 362	147 660
Total	**1 690 085**	**869 575**	**520 102**	**1 169 983**

Forborne portfolio as at 31 December 2016

31.12.2016	Gross carrying amount	Of which defaulted	Provisions created	Net value
Loans and advances to banks	412	403	403	9
Loans and advances to customers, including:	1 534 568	808 387	406 186	1 128 382
Loans to individuals:	786 762	214 766	82 928	703 834
- Current accounts	48 262	7 739	3 134	45 128
- Term loans, including:	738 500	207 027	79 794	658 706
housing and mortgage loans	616 865	142 209	49 818	567 047
Loans to corporate clients:	747 806	593 621	323 258	424 548
corporate & institutional enterprises	363 919	258 838	83 926	279 993
medium & small enterprises	383 887	334 783	239 332	144 555
Total	**1 534 980**	**808 790**	**406 589**	**1 128 391**

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The share of credit forborne portfolio constitutes 2.22% (2016: 2.05%) of the whole portfolio. More than half of forborne portfolio (51%) is defaulted (2016: 50%). Default portfolio is covered in 60% by the special-purpose provision (2016: 49%) and furthermore the risk of lack of payment is mitigated by collaterals taken in the nominal amount of PLN 0.95 billion (2016: PLN 1.00 billion).

Forborne exposures by type of concession as at 31 December 2017

31.12.2017 Type of concession	Gross carrying amount	Of which defaulted	Provisions created	Net value
Refinancing	67 692	54 481	31 881	35 811
Modification of terms and conditions	1 622 393	815 094	488 221	1 134 172
Total	**1 690 085**	**869 575**	**520 102**	**1 169 983**

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	153 591	75 492	42 089	111 502
Modification of terms and conditions	1 381 389	733 298	364 500	1 016 889
Total	**1 534 980**	**808 790**	**406 589**	**1 128 391**

Forborne exposures by geographical breakdown as at 31 December 2017

31.12.2017	Gross carrying amount	Of which defaulted	Provisions created	Net value
Poland	1 449 239	628 728	339 315	1 109 924
Other countries	240 846	240 847	180 787	60 059
Total	**1 690 085**	**869 575**	**520 102**	**1 169 983**

Forborne exposures by geographical breakdown as at 31 December 2016

31.12.2016	Gross carrying amount	Of which defaulted	Provisions created	Net value
Poland	1 253 817	527 627	193 225	1 060 592
Other countries	281 163	281 163	213 364	67 799
Total	**1 534 980**	**808 790**	**406 589**	**1 128 391**

Forborne, not impaired exposures by period of overdue as 31 December 2017

31.12.2017 Overdue period	Gross carrying amount	Of which defaulted	Provisions created	Net value
Not past due	679 306	6 841	3 390	675 916
Past due less than 30 days	121 453	4 580	2 672	118 781
Past due 31 - 90 days	29 777	2 007	865	28 912
Past due over 90 days	12 626	12 623	216	12 410
Total	**843 162**	**26 051**	**7 143**	**836 019**

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	588 819	3 909	2 714	586 105
Past due less than 30 days	110 312	1 642	2 415	107 897
Past due 31 - 90 days	27 147	2 477	904	26 243
Past due over 90 days	2 698	2 684	30	2 668
Total	**728 976**	**10 712**	**6 063**	**722 913**

Forborne, impaired exposures by period of overdue as at 31 December 2017

31.12.2017 Overdue period	Gross carrying amount	Of which defaulted	Provisions created	Net value
Not past due	187 968	185 291	79 020	108 948
Past due less than 30 days	47 996	47 989	16 777	31 219
Past due 31 - 90 days	30 532	29 817	11 601	18 931
Past due over 90 days	580 427	580 427	405 561	174 866
Total	**846 923**	**843 524**	**512 959**	**333 964**

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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	134 763	128 062	37 750	97 013
Past due less than 30 days	38 982	38 157	8 606	30 376
Past due 31 - 90 days	29 784	29 384	12 065	17 719
Past due over 90 days	602 475	602 475	342 105	260 370
Total	**806 004**	**798 078**	**400 526**	**405 478**

The tables below present forborne exposures in particular sectors according to the new sector division based on the chain value concept introduced in January 2017, where under one single sector have been focused entities operating activities related to a given market (suppliers, manufacturers, vendors). Data as at 31 December 2016 was adjusted accordingly and presented in a new breakdown according to the classification binding in the Bank.

Forborne exposures by the industry as at 31 December 2017

31.12.2017 Sectors	Gross carrying amount	Of which defaulted	Provisions created	Net value
Financial sector	617	617	313	304
Food sector	32 666	28 551	14 995	17 671
Construction	49 019	37 657	23 325	25 694
Chemicals and plastic products	52 259	16 274	15 213	37 046
Wood, furniture and paper products	226 180	226 180	173 581	52 599
Scientific and technical activities	11 724	11 724	8 235	3 489
Electronics	77	77	77	-
Power, power and heating distribution	16 569	16 569	11 471	5 098
Pharmacy	2 013	2 013	2 013	-
Retail trade	5 550	5 550	2 214	3 336
Wholesale trade	30 435	30 435	24 398	6 037
Hotels and restaurants	9 173	2 173	505	8 668
Information and communication	15 032	15 032	13 462	1 570
IT	615	615	391	224
Arts, entertainment and recreation	33 925	33 925	25 559	8 366
Construction materials	2 136	2 136	107	2 029
Media	463	212	230	233
Metals	15 363	15 363	11 450	3 913
Motorization	12 421	6 421	5 064	7 357
Human health	940	941	47	893
Household customers	1 053 121	311 384	124 749	928 372
Fuels	3 509	3 509	3 442	67
Other manufacturing activity	16 656	4 343	1 927	14 729
Real estate	88 449	88 449	52 181	36 268
Agriculture, forestry and fishing	5 687	5 687	4 644	1 043
Associations and organizations	252	-	2	250
Textiles and wearing apparel	2 165	669	96	2 069
Transport and logistics	2 699	2 699	254	2 445
Services	370	370	157	213
Total	**1 690 085**	**869 575**	**520 102**	**1 169 983**

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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
Financial sector	725	718	422	303
Food sector	10 658	6 114	994	9 664
Construction	25 608	12 594	6 724	18 884
Chemicals and plastic products	5 853	2 335	966	4 887
Wood, furniture and paper products	220 020	220 020	164 364	55 656
Scientific and technical activities	5 053	5 053	699	4 354
Electronics	59 298	-	65	59 233
Power, power and heating distribution	2 110	2 110	660	1 450
Pharmacy	25	25	25	-
Retail trade	3 421	3 421	673	2 748
Wholesale trade	33 938	30 698	26 485	7 453
Hotels and restaurants	51 364	43 951	2 461	48 903
Information and communication	15 062	15 062	13 626	1 436
IT	497	497	201	296
Arts, entertainment and recreation	49 597	49 597	37 345	12 252
Construction materials	2 529	2 529	129	2 400
Media	405	402	302	103
Metals	42 380	16 119	12 208	30 172
Motorization	14 581	7 815	6 054	8 527
Human health	2 744	2 744	264	2 480
Household customers	815 308	230 562	90 300	725 008
Other manufacturing activity	19 597	10 202	9 479	10 118
Real estate	104 944	104 028	26 002	78 942
Agriculture, forestry and fishing	4 014	4 014	3 483	531
Associations and organizations	3	3	3	-
Textiles and wearing apparel	881	881	44	837
Transport and logistics	6 057	3 024	576	5 481
Services	34 179	34 178	1 723	32 456
Unclassified	4 129	94	312	3 817
Total	**1 534 980**	**808 790**	**406 589**	**1 128 391**

3.4.8 Counterparty risk that arises from derivatives transactions

The credit exposure on mBank portfolio 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). The Bank uses credit mitigation techniques such as netting and collateralization including hedges. Therefore netting is taken into account if there are close-out netting agreements in place, whereas CSA (Credit Support Annex) agreements are required to collateralise the exposure. CSAs allow for variation margin to be called if current valuation of the clients 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 between the Bank and counterparty. For the purpose of the counterparty risk calculation only positive NPV at the portfolio level is taken into account.

Credit exposure control is performed through an integrated system and in real time. In particular the level of the allocated credit exposure limit on derivative instruments usage is monitored and checked intraday. Credit exposure limits on derivatives are subject to limit decomposition into different products and maturities. In case of central counterparties (CCP) 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:

- 51.8% banks,
- 8.0% central counterparties (CCP),
- 28.6% corporates,
- 11.5% financial institutions,
- 0.1% others.

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

Client type	Credit exposure 2017 (PLN mln)	Credit exposure 2016 (PLN mln)
Bank CSA	1 211	1 267
Bank uncollateralized	4	93
CCP	188	1 242
Corpo collateralized	(2)	(8)
Corpo limit	675	794
Non-Bank Financial Institution	269	324
Private Banking	(0)	0

Compared to the end of 2016 there was a significant decrease in credit exposure with central counterparties (PLN 188 million in 2017 against PLN 1 242 million in 2016), mainly as a result of the modification of CCP credit exposure calculation methodology (NGR approach implemented).

Positive NPV (netting included) and inflows & outflows of the collateral of the derivatives portfolio has been depicted below:

(PLN mln)	Banks*		CCP*		Corporates and others			
					CSA	w/o CSA	CSA	w/o CSA
	2017	2016	2017	2016	2017		2016	
NPV	29.55	56.31	4.27	0.07	3.26	162.30	-	321.96
collateral	84.00	50.00	(124.86)	(71.60)	-	56.68	-	41.06

**collateral presents paid/received initial margin*

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).

Sub-portfolio	31.12.2017		31.12.2016	
	Fair value %	Provision coverage (%)	Fair value %	Provision coverage (%)
1	29.02	0.17	47.22	0.12
2	49.06	0.09	30.84	0.18
3	11.61	1.18	6.37	2.70
4	6.51	0.45	12.71	0.50
5	1.05	0.67	1.20	2.58
6	0.01	0.18	0.07	1.42
7	0.58	1.08	1.31	0.54
8	1.99	0.18	0.09	-
Default category	0.17	0.29	0.19	2.02
Total	**100.00**	**0.28**	**100.00**	**0.39**

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

31 December 2017	Trading securities			Investment debt securities	Total
Rating	Government bonds	Treasury bills	Other debt securities		
AAA	-	-	2 717	3 134 954	3 137 671
AA- to AA+	-	-	5 000	11 522	16 522
A- to A+	1 232 515	-	37 831	26 171 029	27 441 375
BBB+ to BBB-	-	-	200 897	1 266 535	1 467 432
BB+ to BB-	-	-	61 712	301 725	363 437
B+ to B-	-	-	5 908	95 122	101 030
Lower than B-	-	-	-	-	-
Unrated	-	-	478	73 201	73 679
Total	**1 232 515**	**-**	**314 543**	**31 054 088**	**32 601 146**

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**

93.85% of the investments in debt securities is rated at least on A- credit rating (31 December 2016: 96.70%).

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 2017 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

The Bank analyses the sector concentration risk in order to build mBank's corporate portfolio in a safe and effective way and manages industrial concentration risk determining industrial limits.

Limiting covers the sectors in which the Bank's exposure exceeds 5% of the total amount of exposures in corporate portfolio at the end of a given reporting period, and sectors indicated by the Corporate and Investment Banking Risk Committee (KRK).

The Bank set industrial limits 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;
- 7% of the gross loan portfolio in the prior reporting period for high risk sectors.

In the case when the utilisation of the limit exceeds 90%, activities preventing the exceeding of limits are implemented; decision in this regard shall be taken by the KRK.

The table below presents the structure of concentration of mBank S.A. exposures in particular sectors according to the new sector division based on the chain value concept introduced in January 2017, where under one single sector have been focused entities operating activities related to a given market (suppliers, manufacturers, vendors). Data as at 31 December 2016 was adjusted accordingly and presented in a new breakdown according to the classification binding in the Bank.

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)	%
		31.12.2017		31.12.2016	
1.	Household customers	42 429 287	55.83	44 707 271	59.79
2.	Rental and leasing activities	9 077 915	11.94	8 463 552	11.32
3.	Financial sector	2 598 575	3.42	1 589 004	2.12
4.	Food sector	2 043 541	2.69	1 877 278	2.51
5.	Construction	1 980 594	2.61	1 684 162	2.25
6.	Real estate	1 724 357	2.27	1 974 407	2.64
7.	Motorisation	1 571 582	2.07	1 190 948	1.59
8.	Metals	1 440 698	1.90	1 322 281	1.77
9.	Construction materials	1 247 678	1.64	940 437	1.26
10.	Chemicals and plastic products	1 162 484	1.53	1 014 798	1.36
11.	Wood, furniture and paper products	1 086 777	1.43	983 184	1.31
12.	Wholesale trade	920 211	1.21	763 920	1.02
13.	Power, power and heating distribution	847 668	1.11	1 234 545	1.65
14.	Fuels	737 881	0.97	654 775	0.88
15.	Transport and logistics	704 467	0.93	604 167	0.81
16.	Information and communication	693 574	0.91	504 517	0.67
17.	Retail trade	657 137	0.86	744 180	0.99
18.	Public administration	656 278	0.86	829 675	1.11
19.	Agriculture, forestry and fishing	430 091	0.57	295 057	0.39
20.	Textiles and wearing apparel	416 865	0.55	363 528	0.49
21.	Scientific and technical activities	347 815	0.46	267 186	0.36
22.	Other manufacturing activity	335 505	0.44	313 464	0.42
23.	IT	335 169	0.44	97 892	0.13
24.	Media	331 153	0.43	379 807	0.51
25.	Services	324 291	0.43	207 737	0.28
26.	Municipal services	275 540	0.36	270 312	0.36
27.	Pharmacy	205 129	0.27	170 742	0.23
28.	Household equipment	183 222	0.24	159 611	0.21
29.	Hotels and restaurants	122 614	0.16	213 363	0.29
30.	Electronics	111 119	0.15	80 942	0.11
31.	Arts, entertainment and recreation	108 597	0.14	107 138	0.14
32.	Education and scientific research	75 356	0.10	101 619	0.14
33.	Human health	57 602	0.08	57 508	0.08
34.	Mining	50 914	0.07	43 867	0.06
35.	Military industry	45 961	0.06	51 078	0.07
36.	Shipbuilding industry	38 474	0.05	12 928	0.02
37.	Associations and organisations	3 998	0.01	4 126	0.01

As at 31 December 2017, the total exposure of the Bank in the above sectors (excluding household customers) amounted to 43.36% of the credit portfolio (31 December 2016 – 39.56%).

The risk of investing in sectors being limited by the Bank, i.e. sectors where the Bank's exposures exceeds 5% of the corporate portfolio as at the end of 2017 was estimated in line with the principles of classification sectors to limitation, accepted by the KRK in January 2017.

The table below presents the risk of limited sectors as at the end of 2017 and 2016 (where the risk was determined in line with internal rules in force till the end of 2016).

No.	Sectors	31.12.2017	31.12.2016
1.	Financial sector	low	medium
2.	Fuels	medium	medium
3.	Food sector	medium	medium
4.	Construction	high	medium
5.	Motorisation	medium	medium
6.	Metals	medium	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 the Bank:

- 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.

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 considered a large exposure limit i.e. 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 of CRR Regulation), which are equal or exceed 10% of the eligible capital. At the end of 2017 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, mBank follows requirements resulting from the law and supervisory recommendations, in particular the KNF Recommendations (among others A, C, G and I) and the EBA guidelines, concerning market risk management.

The fundamental principle applied in the organisation of the market risk management in the Bank is the separation of the market risk control and monitoring functions from the functions related to opening and keeping open market risk positions. Monitoring and controlling of the market risk is performed by the Integrated Risk and Capital Management Department (DKR) under supervision of the Vice-president of the Management Board Chief Risk Officer (CRO), while the market risk positions are operationally managed by the Financial Markets Department (DFM), the Own Transactions Division in Brokerage Bureau (BM_WTW) and the Treasury Department (DS) reporting to the Vice-president of the Management Board – Head of Financial Markets.

The Debt Securities Issue Department (DCM) is responsible for debt instruments issuance and managing of non-government debt securities in the 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 Integrated Risk and Capital Management Department (DKR), 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. DKR 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. DKR 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 Integrated Risk and Capital Management 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 DKR are the basis for managing collaterals for concluded transactions on derivative instruments.

DKR 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. DKR monitors utilization of counterparty limits (pre-settlement, settlement, issuer and country risk limits) and escalates if limits are exceeded. Moreover, DKR 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 mBank'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.

mBank identifies market risk 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 mBank'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 mBank, the Bank uses the so-called replicating portfolio models. The 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. In case of Value at Risk in stressed conditions 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 9-year series of Value at Risk based on following 12-months windows of risk factors changes from last 10 years. In 2017 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 (including tenor basis risk and cross-currency basis risk),
- 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 mBank'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 decisions of the Supervisory Board (with respect to the mBank Group portfolio), the Management Board (with respect to the mBank portfolio) and the Financial Markets Risk Committee (with respect to the business lines portfolios) limits on VaR at 97,5% confidence level for a 1-day holding period and stress tests limits are established.

3.7.3 Risk measurement

Value at Risk, Expected Shortfall

In 2017, Bank's market risk exposure, as measured by the Value at Risk (VaR, for a 1-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 the Financial Markets Department (DFM), whose positions consist of trading book portfolios, amounted to 28% (PLN 1.6 million), for the Own Transactions Division in Brokerage Bureau (BM_WTW) 12% (PLN 0.1 million), while for the Treasury Department (DS), whose positions are classified solely to the banking book, it was 43% (PLN 18.1 million) for the positions without capital modelling and 37% (PLN 15.7 million) for the positions with capital modelling.

The average utilization of VaR limit for the Debt Securities Issue Department (DCM) is 29% (PLN 0.5 million). The average utilisation of the VaR limit for the position of the Structured and Mezzanine Finance Department (DFS) accounted for 25% (PLN 13.9 thousand).

In 2017, the VaR figures for the Bank'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 the Treasury Department and the trading book portfolios and interest rate exchange positions managed by the Financial Markets Department.

The DFM portfolios of instruments sensitive to changes in exchange rates like FX transactions, 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.

The decrease of Value-at-Risk was caused in 2017 mainly by decrement of interest rates and diminishing of their volatility, as well as shortening of average maturity of the Treasury bonds portfolio.

mBank VaR and ES

The table below presents VaR and Expected Shortfall statistics for mBank's portfolio.

PLN 000's	2017				2016			
	31.12.2017	Mean	Maximum	Minimum	31.12.2016	Mean	Maximum	Minimum
VaR IR	9 423	9 970	15 641	5 281	12 903	13 721	18 454	11 042
VaR FX	545	360	870	138	772	547	816	351
VaR EQ	53	140	1 151	15	199	214	791	62
VaR CS	11 441	13 980	23 320	10 431	21 249	21 172	30 150	19 856
VaR	**14 038**	**18 685**	**34 560**	**13 429**	**28 037**	**35 306**	**40 726**	**27 124**
ES	**24 433**	**29 842**	**43 970**	**23 124**	**42 093**	**42 983**	**49 041**	**38 046**

VaR IR – interest rate risk (without separated spread rate)
VaR FX – currency risk
VaR EQ – equity risk
VaR CS – credit spread risk

Stressed Value at Risk

The Value at Risk in stressed conditions is an observed measure. The table below presents statistics of this measure for mBank for 2016 and for 2017.

PLN 000's	2017				2016			
	31.12.2017	Mean	Maximum	Minimum	31.12.2016	Mean	Maximum	Minimum
Stressed VaR IR	41 214	39 289	48 768	27 827	45 288	43 671	50 339	36 293
Stressed VaR FX	313	1 002	3 000	258	2 339	1 363	2 655	576
Stressed VaR EQ	188	315	2 720	22	422	342	1 495	2
Stressed VaR CS	81 534	82 007	91 849	73 903	87 930	87 516	96 278	74 731
Stressed VaR	**112 531**	**112 242**	**124 823**	**101 868**	**124 833**	**119 771**	**130 662**	**105 462**

Economic capital for market risk

The average utilisation of limit on economic capital for market risk for the mBank Group in 2017 amounted to 53% (PLN 689.8 million). The average level of economic capital for mBank was equal to PLN 673.2 million. As of end of 2017 the economic capital for market risk for the mBank Group was PLN 514.7 million, and for the Bank was PLN 500.8 million. For comparison, at the end of 2016 values of this measures were PLN 783.0 million and PLN 767.3 million, respectively.

Stress testing

The average utilisation of stress test limits for the mBank Group in 2017 was 59% (PLN 791.9 million) for portfolio without capital modelling and 61% (PLN 870.4 million) for portfolio including capital modelling.

The average utilisation of stress test limits in mBank in 2017 amounted to 56% (PLN 773.6 million) for portfolio without capital modelling.

The average utilisation of the stress test limits in 2017 for the Treasury Department portfolio without capital modelling was 66% (PLN 670.4 million) and 72% (PLN 753.1 million) including capital modelling. For the DFM portfolio the average utilisation was 32% (PLN 81.4 million), for the BM_WTW portfolio 13% (PLN 1.0 million), for the DCM portfolio 59% (PLN 38.4 million) and for the DFS portfolio 26% (PLN 376 thousand). The most significant part of the presented stress test values constitutes credit spread stress test for government bonds portfolio because stress test scenarios include a scenario in which credit spreads increase on average by 100 bps.

The table below presents utilisation of stress test for mBank in 2017 in comparison to 2016 (without capital modelling).

PLN million	2017				2016			
	31.12.2017	Mean	Maximum	Minimum	31.12.2016	Mean	Maximum	Minimum
Base ST	141	85	147	9	97	82	120	20
CS ST	694	688	767	624	752	695	782	623
Total ST	**835**	**774**	**882**	**638**	**849**	**777**	**892**	**656**

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).

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 2017 and 31 December 2016. The tables below present assets and liabilities of the Bank at balance sheet carrying amount, for each currency.

31.12.2017	PLN	EUR	USD	CHF	CZK	Other	Total
ASSETS							
Cash and balances with the Central Bank	3 953 764	1 840 180	35 783	5 515	1 526 714	21 562	**7 383 518**
Loans and advances to banks	4 708 864	655 520	323 855	532	318 218	56 713	**6 063 702**
Trading securities	1 547 675	127	-	-	-	-	**1 547 802**
Derivative financial instruments	789 877	289 876	47 193	103 836	2 767	-	**1 233 549**
Loans and advances to customers	42 913 392	10 816 596	869 627	15 198 740	3 526 422	106 961	**73 431 738**
Investment securities	29 511 801	993 919	46 538	-	558 302	-	**31 110 560**
Investments in subsidiaries	2 060 615	232	-	-	-	-	**2 060 847**
Investments in associates	28 680	-	-	-	-	-	**28 680**
Intangible assets	647 277	424	-	-	490	-	**648 191**
Tangible fixed assets	499 448	3 917	-	-	6 408	-	**509 773**
Other assets, including tax assets	494 561	16 335	187	76	39 962	2	**551 123**
Total assets	**87 155 954**	**14 617 126**	**1 323 183**	**15 308 699**	**5 979 283**	**185 238**	**124 569 483**
LIABILITIES							
Amounts due to the Central Bank	-	-	-	-	-	-	**-**
Amounts due to other banks	1 237 708	963 563	208 960	2 678 686	245	554	**5 089 716**
Derivative financial instruments	938 024	168 527	29 784	-	4 700	-	**1 141 035**
Amounts due to customers	64 850 139	22 141 234	2 822 077	2 421 584	6 600 075	496 462	**99 331 571**
Hedge accounting adjustments related to fair value of hedged items	-	25 528	-	1 518	-	-	**27 046**
Other liabilities including tax liabilities	2 001 871	107 480	125 944	2 468	91 402	14 332	**2 343 497**
Provisions	144 168	45 196	331	303	916	-	**190 914**
Subordinated liabilities	1 264 006	-	-	894 137	-	-	**2 158 143**
Total liabilities	**70 435 916**	**23 451 528**	**3 187 096**	**5 998 696**	**6 697 338**	**511 348**	**110 281 922**
Net on-balance sheet position	**16 720 038**	**(8 834 402)**	**(1 863 913)**	**9 310 003**	**(718 055)**	**(326 110)**	**14 287 561**
Loan commitments and other commitments	**22 123 547**	**2 053 535**	**518 899**	**-**	**437 605**	**-**	**25 133 586**
Guarantees, banker's acceptances, documentary and commercial letters of credit	**5 175 453**	**7 588 032**	**660 512**	**1 424 294**	**86 497**	**33 148**	**14 967 936**

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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	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**

3.9. Interest rate risk

In the process of management of interest rate risk in the banking book, the risk monitoring and control functions are performed by the Integrated Risk and Capital Management Department supervised by the Vice-president of the Management Board Chief Risk Officer, whereas the operational management of risk positions takes place in the Treasury Department supervised by the Vice-president of the Management Board, Head of Financial Markets. Hereby the Bank ensures independence of risk measurement, monitoring and control functions from operational activity creating the Bank's positions.

Interest rate risk of the banking book is the risk resulting from the exposure of the Bank's interest income and capital to the adverse impact of interest rates movements. Following recommendations of KNF, in particular Recommendation G, and EBA guidelines (EBA/GL/2015/08) from 5 October 2015 on the management of interest rate risk arising from non-trading activities, the Bank monitors the banking book structure in terms of repricing risk, 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 (a difference between assets, liabilities and off-balance sheet banking book positions, measured in defined repricing buckets, based on the repricing date of the interest rate sensitive products),
- the net interest income exposed to risk (EaR - Earnings at Risk – a potential decrease of interest income in a 1-year horizon due to unfavourable changes of the market interest rates. The measure assumes constant volume and structure of the banking book, unchangeable 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 conducts also stress test analyses to estimate the impact of adverse interest rate movements on the net interest income and the economic value of the banking book portfolio. Interest rate risk of the banking book is also quantified by the market risk measures: Value at Risk (VaR) and stress tests.

For the banking portfolio the admissible level of exposure to interest rate risk is restricted by MAT limits (management action triggers) for repricing gap 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 2017 and 31 December 2016, a sudden, permanent and unfavourable shift of the market interest rates by 100 basis points for all maturities would reduce annual interest income within 12 months following the year-end date EaR by the following amounts:

(PLN mln)	2017				2016			
	31.12.2017	Mean	Maximum	Minimum	31.12.2016	Mean	Maximum	Minimum
PLN	186.0	137.4	254.3	86.8	171.8	78.3	180.0	34.7
USD	14.9	13.6	17.9	8.6	9.3	7.5	13.8	1.2
EUR	84.9	94.1	113.1	67.3	64.9	70.6	142.3	50.2
CHF	0.0	0.0	0.1	0.0	0.0	4.1	21.6	0.0
CZK	12.0	4.8	12.0	2.2	3.1	4.1	7.5	2.4

To calculate these values, the Bank assumed that the structure of financial assets and liabilities disclosed in the financial statements for above presented dates would be fixed over the course of the year and the Bank would not take any activities to change related exposure to the interest rate risk. In these calculation the Bank included positions with modelled repricing period in accordance with replicating portfolios methodology.

Stress tests

The Bank conducts also calculations of the changes in the economic value of the banking book portfolio having the nature of stress test scenarios. The change of the economic value of the banking book portfolio being a result of the conducted stress test, which assumes a scenario of the unfavourable interest rates shift by 200 basis points of the yield curve for a given currency, amounted to PLN 511.7 million at the end of 2017 (at the end of 2016: PLN 658.1 million). When calculating these values no correlation between currencies and no possibility of dropping clients interest rates below 0 are assumed.

The debt securities portfolio in PLN (money bills, Polish Treasury bills and bonds) constitutes the significant position priced at fair value in the banking book portfolio. The interest rate risk of this portfolio is also calculated using the stress test methodology (described above in Note 3.7). The methodology includes scenarios of changes of market interest rates and credit spread, which in case of treasury debt securities may reflect basis risk (spread changes between the government curve 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.

31.12.2017	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	2 887 583	-	-	-	-	4 495 935	**7 383 518**
Loans and advances to banks	2 483 444	3 187 025	168 876	-	-	224 357	**6 063 702**
Trading securities, investment securities and investments in subsidiaries	8 336 653	580 534	7 513 585	14 914 761	1 256 357	2 145 999	**34 747 889**
Loans and advances to customers	54 531 340	12 799 958	2 325 375	2 773 245	42 802	959 018	**73 431 738**
Other assets and derivative financial instruments	219 013	227 705	276 175	362 231	46 043	517 910	**1 649 077**
Total assets	**68 458 033**	**16 795 222**	**10 284 011**	**18 050 237**	**1 345 202**	**8 343 219**	**123 275 924**
LIABILITIES							
Amounts due to the Central Bank	-	-	-	-	-	-	**-**
Amounts due to other banks	2 492 481	2 529 076	62 564	-	-	5 595	**5 089 716**
Amounts due to customers	77 509 921	8 774 621	6 904 565	5 506 540	568 750	67 174	**99 331 571**
Subordinated liabilities	1 371 849	285 627	500 667	-	-	-	**2 158 143**
Other liabilities and derivative financial instruments	156 159	235 993	366 935	297 058	38 600	2 217 703	**3 312 448**
Total liabilities	**81 530 410**	**11 825 317**	**7 834 731**	**5 803 598**	**607 350**	**2 290 472**	**109 891 878**
Total interest repricing gap	**(13 072 377)**	**4 969 905**	**2 449 280**	**12 246 639**	**737 852**		

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**		

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. For this reason in a market crisis scenario and combined scenario 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. Risk of untimely loans repayments is connected with 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 derivative transactions concluded 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 derivative 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 the Bank maintains adequate portfolio of eligible securities.

Taking into account the 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 the 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 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 Assets and Liabilities Management Committee of the mBank

Group (ALCO), 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.

- **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 Assets and Liabilities Management Committee of the mBank Group (ALCO), calibrating the structure of the future cash flows within the limits imposed by the Supervisory Board, the Management Board and the Financial Markets Risk Committee, maintaining adequate liquidity reserves to secure liquidity within the limits imposed by the Supervisory Board, the 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 the 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 the mBank Group (in particular mBank Hipoteczny S.A.).
- **Financial Markets Settlement and Services Department (DOF)** – I line of defence, is responsible for the operational supervision over correctness of cash flows in the accounts.
- **Custody Services Department (DCU)** – I line of defence, acts in the scope of settlements of transactions on securities.
- **Integrated Risk and Capital Management Department (DKR)** – 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 Assets and Liabilities Management Committee of the mBank Group (ALCO). 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.
- **Internal Audit Department (DAW)** – III line of defence, performs independent assessment of 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's groups (from whom acquires deposits), products and currencies, 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 2017, 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.

The internal liquidity adequacy assessment process (ILAAP)

In order to review the liquidity risk management system in the Bank and the Group, the ILAAP process was developed. As part of this process all elements of the liquidity risk management system are subject to review including:

- Liquidity risk management strategy,
- Stress tests,
- Liquidity contingency plan,
- Liquidity buffer,
- Intraday liquidity risk management,
- Early warning system,
- Identification and measurement of liquidity risk,
- Reporting system.

The review is performed annually. The conclusions of the conducted review are presented to the Financial Markets Risk Committee, the Management Board and the Supervisory Board and serve for further improvement and development of the liquidity risk management.

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 is mismatch, and the mismatch gap. 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 2017, the Bank held liquidity surplus, adequate to the 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 2017, 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 stress test scenarios were performed (until 05.12.2017) 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 Reserves in the securities market,
- use of central bank secured lending for unsold amount of liquid securities.

ANL Stress Combined combined the assumptions behind ANL Stress and ANL Stress Market scenarios.

From 06.12.2017, a new methodology for measuring the liquidity gap (LAB) was implemented at the Bank and the Group level, including normal conditions scenario LAB Base Case, stress scenarios subject to limits:

- LAB Bank Stress (short-term) – short-term scenario (up to 2 weeks) of the idiosyncratic stress,
- LAB Market Stress (long-term) – long-term scenario (up to 2 months) of the market crisis,
- LAB Combined Stress I – combined stress scenario that presents the effects of the simultaneous occurrence of short-term idiosyncratic stress and long-term market related stress,

as well as stress scenarios which are not limited:

- LAB Bank Stress (long-term),
- LAB Market Stress (short-term),
- LAB Combined Stress II.

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, the Assets and Liabilities Committee of the mBank Group (ALCO) as well as the Supervisory Board of the Bank. In addition, the scenarios used in the 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 balance sheet structure of future cash flows and keeping 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 as well as the demand for liquid assets, resulting from the conducted stress tests. 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 the Polish Government debt securities in PLN and EUR, bills issued by the National Bank of Poland in PLN and the Czech Republic's Government debt securities in CZK. Values of these Reserves amounted to:

Value of Liquidity Reserves (in PLN million)	
31.12.2017	31.12.2016
25 727	25 034

In order to support the process of liquidity risk management, a system of early warnings indicators and recovery 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 structure. 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:

- concentration 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 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 turnover, order book depth, purchase/sale transaction spread and issue volume. The measurement of market liquidity is reflected in internal liquidity measures, where the scenarios structure provides for liquidating the 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, the mBank Group and the 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 the Assets and Liabilities Committee of the mBank Group (ALCO).

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. The realistic gap is calculated on the basis of contractual cash flows (Note 3.10.1). Mainly cash flows in portfolios of non-banking customers' deposits, overdrafts and term loans are 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 the Bank's Liquidity Reserves.

In the LAB methodology, the LAB Base Case measure is the primary management measure and it is also used for limiting the liquidity gap in particular foreign currencies. This function in the ANL methodology was performed by ANL Bank Stress.

Value of realistic, bucket and cumulative gap of cash flows misfit (in PLN million)

Time range	gap ANL Bank Stress- 5.12.2017		gap ANL Bank Stress - 31.12.2016	
	bucket	cumulative	bucket	cumulative
up to 1 working day	6 264	6 264	8 024	8 024
up to 3 working days	6 592	12 856	7 421	15 445
up to 7 calendar days	(451)	12 405	380	15 825
up to 15 calendar days	(1 083)	11 322	(838)	14 987
up to 1 month	1 236	12 558	2 605	17 592
up to 2 months	(408)	12 150	1 003	18 595
up to 3 months	388	12 538	(993)	17 602
up to 4 months	61	12 599	139	17 741
up to 5 months	153	12 752	133	17 874
up to 6 months	244	12 996	88	17 962
up to 7 months	384	13 380	197	18 159
up to 8 months	(45)	13 335	181	18 340
up to 9 months	(379)	12 956	118	18 458
up to 10 months	(1 338)	11 618	(797)	17 661
up to 11 months	250	11 868	182	17 843
up to 12 months	110	11 978	(1 998)	15 845

Time range	gap LAB Base Case- 31.12.2017	
	bucket	cumulative
up to 1 working day	19 464	19 464
up to 3 working days	519	19 983
up to 7 calendar days	(2 311)	17 672
up to 15 calendar days	(154)	17 518
up to 1 month	1 799	19 317
up to 2 months	(2 167)	17 150
up to 3 months	(761)	16 389
up to 4 months	(620)	15 769
up to 5 months	(227)	15 542
up to 6 months	(428)	15 114
up to 7 months	230	15 344
up to 8 months	(429)	14 915
up to 9 months	(1 136)	13 779
up to 10 months	(1 577)	12 202
up to 11 months	(437)	11 765
up to 12 months	(361)	11 404

The above values should be interpreted as liquidity surplus/deficit in relevant time buckets. Due to the positive dynamics of loans portfolio (PLN 4.9 billion - the exchange rate as of 31 December 2017 used in calculations) exceeding the dynamics of non-banking term deposits and current accounts (PLN 1.8 billion – the exchange rate as of 31 December 2017 used in calculations) the decrease in the level of liquidity as of the end of 2017 has been noticed.

In 2017 the indebtedness towards main shareholder, Commerzbank AG, decreased as a result of repayment of CHF 750 million borrowings. Simultaneously, in the cumulated cash flow gap as of the end of 2017, the outstanding debt owed to Commerzbank AG to be repaid in 2018 is included in the amount of CHF 750 million.

Liquidity gap methodology contains an additional component, which is aimed at preparing the Bank for 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 2017 – PLN 1 417 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 2017 the Bank would not have to post additional collateral.

In 2017 the Bank's liquidity remained at a safe level which was reflected in surplus of liquid assets over short-term liabilities according to ANL/LAB in various scenarios and supervisory liquidity measures.

ANL/LAB cash flows gaps mismatch in terms up to 1 month and up to 1 year within 2017 and values of regulatory measures M1–M4 and LCR are presented in the following table:

Measure*	2017			
	31.12.2017	Mean	Maximum	Minimum
ANL Base 1M**	14 947	17 188	22 210	13 373
ANL Base 1Y**	14 396	15 965	21 137	12 518
ANL Stress 1M**	12 529	14 602	19 471	10 992
ANL Stress 1Y**	11 978	13 380	18 398	10 138
ANL Market 1M**	9 702	13 230	18 278	8 064
ANL Combined 1M**	8 858	12 330	17 324	7 243
LAB Base Case 1M***	19 317	16 233	19 317	13 607
LAB Base Case 1Y***	11 404	11 331	12 426	10 134
LAB Base Stress 1M***	13 057	11 240	13 133	9 512
LAB Market Stress 1M***	16 571	14 550	16 632	12 973
LAB Combined Stress 1M***	12 533	10 951	12 660	9 637
M1	12 867	12 881	17 995	9 658
M2	1.35	1.37	1.60	1.23
M3	4.52	4.71	4.93	4.29
M4	1.39	1.39	1.43	1.36
LCR	165%	178%	239%	142%

** ANL, LAB and M1 measures are shown in PLN million; M2, M3, M4 and LCR are relative measures presented as a decimal.*
*** The value as of 5th December 2017. Mean, maximum and minimum are calculated for period until 5th December 2017.*
**** Mean, maximum and minimum are calculated for period starting from 6th December 2017.*

Short-term liquidity supervisory measures (M1, M2) in 2017 remained on safe level with a minimum value of PLN 9.7 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 4.29 and 4.93 in 2017, whereas M4 between 1.36 and 1.43. 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 Group defined by selected measures, e.g. L/D ratio (Loans to Deposits). It measures a specific relation of loans to deposits in order to maintain a stable structure of its balance sheet. In 2017, L/D ratio slightly changed from 73.1% to 73.9%. 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 along with the portfolio of long-term loans from banks (with maturities over 1 year), in particular from Commerzbank (Note 28). 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, the Bank's receivables in this currency have been decreasing successively along with loans repayments. The funds obtained from the repayment of the mentioned loans are used to reduce the Bank's debt in CHF owed to the main shareholder. In 2017, the debt to Commerzbank AG was reduced by CHF 750 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 2017 – equivalent of PLN 4.1 billion) as well as FX swap and

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CIRS transactions. In 2017 the Bank recorded increase in net liabilities due to FX swap and CIRS transactions 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 optimally, 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.

Liabilities (by contractual maturity dates) as at 31.12.2017

	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	1 615 424	1 281 417	1 678 135	545 232	-	5 120 208
Amounts due to customers	76 572 571	6 703 332	4 793 198	9 604 594	2 329 351	100 003 046
Subordinated liabilities	33 470	335	34 842	198 636	2 235 613	2 502 896
Other liabilities	1 713 879	-	-	-	-	1 713 879
Total liabilities	79 935 344	7 985 084	6 506 175	10 348 462	4 564 964	109 340 029
Assets (by remaining contractual maturity dates)						
Total assets	21 801 367	4 450 403	22 111 067	52 525 958	33 905 948	134 794 743
Net liquidity gap	(58 133 977)	(3 534 681)	15 604 892	42 177 496	29 340 984	25 454 714

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

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

<u>Derivative financial instruments settled in net amounts</u>

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 2017 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.

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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)	-	-	30	-	-	**30**
Overnight Index Swaps (OIS)	171	936	119	-	-	**1 226**
Interest Rate Swaps (IRS)	94 666	180 637	85 864	682 683	105 432	**1 149 282**
Cross Currency Interest Rate Swaps (CIRS)	2 510	(3 853)	(1 234)	(7 170)	-	**(9 747)**
Options	1 613	2 605	4 291	14 790	(141)	**23 158**
Futures contracts	-	(1)	-	-	-	**(1)**
Other	1 130	2 668	2 967	17 498	-	**24 263**
Total derivatives settled on a net basis	**100 090**	**182 992**	**92 037**	**707 801**	**105 291**	**1 188 211**

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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)	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**

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.

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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	**19 635 416**	**7 232 771**	**4 174 407**	**1 018 469**	**-**	**32 061 063**
-inflows	**19 616 689**	**7 196 084**	**4 158 371**	**957 840**	**-**	**31 928 984**

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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**

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, systems, mistakes or activities taken by the employee of the Bank or external events. In accordance with the Risk Catalogue of mBank Group, operational risk includes, in particular, the following sub-categories:

- legal risk,
- IT risk,
- cyber risk
- compliance risk,
- conduct risk,
- external fraud risk,
- outsourcing risk.

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

Organisation 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.

While organising 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 minimise 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 and retail banking.

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 2017:

Operational risk category	Distribution	Value of losses in relation to the value of gross profit
Crimes committed by outsiders	58.4%	0.63%
Customers, products and business practices	24.3%	0.26%
Execution, delivery and process management	14.0%	0.15%
Other	3.3%	0.04%
Total	100.0%	1.08%

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 is realized in mBank, in particular, in accordance with the provisions of the Compliance Policy at mBank S.A. The Policy is a set of guidelines and organisational rules, that the Bank performs fulfilling the requirements of Polish law and taking into account compliance principles applicable in the Commerzbank Group, subject to stipulations of the Polish law. The Policy defines also the basic rules of conduct for the Bank's employees and the main processes of compliance risk identification that allow to manage compliance risk at all levels of the Bank's organisation.

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.

Ensuring compliance of the Bank's internal regulations with the provisions of Polish and international law and with the standards of conduct adopted by the Bank as well as observing internal rules by the Bank's employees is aimed at mitigating compliance risk and eliminating or minimizing the possibility of occurrence of: legal risk, reputational risk, the risk of imposition of sanction and financial losses and the risk resulting from discrepancies in interpretation of the law.

All the Bank employees are responsible for the implementation of compliance risk management process in line with the scope of their duties as well as granted authorisations.

The Compliance Department is responsible for the coordination and supervision of the compliance risk 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 risks in the compliance area,
- implementing control policies and procedures within the scope of operation of the Compliance Department, to minimise the risks,
- adjusting Compliance Policy at mBank S.A. and internal regulations owned by the Compliance Department, to the changing legal conditions and standards of conduct,
- building a compliance culture especially by preparing professional materials and organising and conducting training sessions for the Bank employees on issues related to compliance processes,
- maintaining ongoing contacts with the unit responsible for compliance in the Commerzbank AG Group in order to agree on the implementation of common standards.

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

Neither the Director nor the employees of the Compliance Department execute processes which are then subject to control by the Compliance Department, are involved in operation which could result in a conflict of interests with their duties performed at the 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.
- **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 Validation Unit, which performs, in particular, 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 proper internal regulations concerning model and their 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 requirements of Recommendation W published by the KNF.

An important role in the model and their risk management process is played by the Model Risk Committee, whose functions are described in Note 3.3.1. 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 institution, 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 reduce reputational risk in specific processes in order to protect and strengthen the good name of mBank and mBank Group.

The all Bank's organizational 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 the Bank 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.

Moreover, 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 analysed 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.

Controlling and Management Information Department is responsible for:

- 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 of regulatory requirements regarding capital adequacy, including the application of AIRB method in calculating capital requirements,
- preparation of reports and information for the statutory bodies of the Bank and for the purposes of consolidated supervision in regards to capital adequacy, risk bearing capacity and risk profile of the Bank and mBank Group.

The Bank applies a capital management process in order to prevent materialization of capital risk, understood as risk resulting from the lack of capital as well as lack of the possibility to achieve sufficient capital adequate to the business activity's risk undertaken by the Bank, required to absorb unexpected losses and meet regulatory requirements assuring further independent acting by the Bank.

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 conducting analyses and 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. Regulatory risk

Regulatory risk, understood as the risk of changes in legal regulations or introduction of new regulations concerning specific area of the Group's activity affecting capital adequacy or liquidity, is addressed by the Group in the framework of the capital and liquidity risk management process. In mBank Group this risk is related, in particular, to the FX mortgage loan portfolio.

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3.17. Fair value of assets and liabilities

Fair value is the price that would be received from the sale of asset or paid to transfer a liability in an ordinary 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.

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 recognised in the statement of financial position of the Bank at their fair values.

	31.12.2017		31.12.2016	
	Carrying value	Fair value	Carrying value	Fair value
Financial assets				
Loans and advances to banks	**6 063 702**	**6 066 995**	**7 308 769**	**7 308 633**
Loans and advances to customers	**73 431 738**	**73 294 398**	**72 304 131**	**72 940 340**
Loans and advances to individuals	**40 861 252**	**41 140 947**	**43 195 950**	**44 020 713**
current accounts	6 669 099	6 850 427	5 843 990	5 940 407
term loans including:	34 192 153	34 290 520	37 351 960	38 080 306
- housing and mortgage loans	26 265 580	25 845 001	30 446 487	30 460 210
Loans and advances to corporate entities	**31 392 681**	**30 970 086**	**27 792 724**	**27 584 290**
current accounts	5 098 424	5 010 318	3 995 482	3 922 918
term loans	26 030 530	25 696 041	23 574 294	23 438 424
- corporate & institutional enterprises	13 866 594	13 770 035	12 704 969	12 679 892
- medium & small enterprises	12 163 936	11 926 006	10 869 325	10 758 532
reverse repo / buy sell back transactions	57 119	57 119	56 676	56 676
other	206 608	206 608	166 272	166 272
Loans and advances to public sector	**870 182**	**875 742**	**1 087 033**	**1 106 913**
Other receivables	**307 623**	**307 623**	**228 424**	**228 424**
Financial liabilities				
Amounts due to other banks	**5 089 716**	**5 116 405**	**8 503 014**	**8 525 938**
Amounts due to customers	**99 331 571**	**99 667 451**	**98 960 320**	**99 283 334**
Subordinated liabilities	**2 158 143**	**2 137 590**	**3 943 349**	**3 853 900**

Differences between the fair value at the end of 2016 presented in the table above and in the financial statements for 2016 stem from the update of the methodology for estimating the fair value of financial assets. Changes in the methodology include, among others, taking into account the costs of capital and liquidity.

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 calculated as the present value of future cash flows (adjusted by prepayments) using current interest rates, including credit spread, cost of liquidity and cost of capital margin. 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

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the fact that the Bank's exposures are in major part collateralised whereas the median of market quotation is centred around unsecured issues, the Bank applied appropriate adjustments.

Available for sale financial assets. 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.

Financial liabilities. 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 from capital and interest rates using discounted factor. 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 interbank market rates as well as FRA and IRS contracts for appropriate currencies and maturities. In case of measurement 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.

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.

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: prices quoted on active markets for the similar instruments or other valuation techniques for which all significant input data are based on observable market data;
- Level 3: valuation methods for which at least one significant input data is not based on observable market data.

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 2017 and as at 31 December 2016.

31.12.2017	Including:	Level 1	Level 2	Level 3
		Quoted prices in active markets	Valuation techniques based on observable market data	Other valuation techniques
VALUATION ONLY FOR PURPOSES OF DISCLOSURE				
FINANCIAL ASSETS				
Loans and advances to banks	6 066 995	-	-	6 066 995
Loans and advances to customers	73 294 398	-	-	73 294 398
FINANCIAL LIABILITIES				
Amounts due to other banks	5 116 405	-	3 421 029	1 695 376
Amounts due to customers	99 667 451	-	12 799 584	86 867 867
Debt securities in issue	-	-	-	-
Subordinated liabilities	2 137 590	-	2 137 590	-
Total financial assets	**79 361 393**	**-**	**-**	**79 361 393**
Total financial liabilities	**106 921 446**	**-**	**18 358 203**	**88 563 243**

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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	7 308 633	-	-	7 308 633
Loans and advances to customers	72 940 340	-	-	72 940 340
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
Debt securities in issue	-	-	-	-
Subordinated liabilities	3 853 900	-	3 853 900	-
Total financial assets	**80 248 973**	**-**	**-**	**80 248 973**
Total financial liabilities	**111 663 172**	**-**	**24 663 411**	**86 999 761**

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 loans received from the EIB (Note 28). In addition, at level 2, the Bank has presented subordinated liabilities.

The fair value of financial liabilities included at Level 2 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:

(i) the fair value of loans and advances to banks and loans and advances to customers, which is disclosed, as described earlier, based on quotation of median credit spreads for Moody's ratings,
(ii) 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,
(iii) 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.

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31.12.2017	Including:	Level 1 Quoted prices in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS				
TRADING SECURITIES	**1 547 802**	**1 235 976**	**-**	**311 826**
Debt securities	***1 547 058***	***1 235 232***	**-**	***311 826***
- government bonds	1 232 515	1 232 515	-	-
- deposit certificates	14 096	-	-	14 096
- mortgage bonds	23 150	-	-	23 150
- banks bonds	98 601	-	-	98 601
- corporate bonds	178 696	2 717	-	175 979
Equity securities	***744***	***744***	**-**	**-**
- listed	744	744	-	-
DERIVATIVE FINANCIAL INSTRUMENTS	***1 233 549***	**-**	***1 233 549***	**-**
Derivative financial instruments held for trading	***1 112 564***	**-**	***1 112 564***	**-**
- interest rate derivatives	676 944	-	676 944	-
- foreign exchange derivatives	390 969	-	390 969	-
- market risks derivatives	44 651	-	44 651	-
Derivative financial instruments held for hedging	***120 985***	**-**	***120 985***	**-**
- derivatives designated as fair value hedges	91 290	-	91 290	-
- derivatives designated as cash flow hedges	29 695	-	29 695	-
INVESTMENT SECURITIES	**31 110 560**	**27 220 475**	**2 199 429**	**1 690 656**
Debt securities	***31 054 088***	***27 219 489***	***2 199 429***	***1 635 170***
- government bonds	26 283 963	26 283 963	-	-
- money bills	2 199 429	-	2 199 429	-
- deposit certificates	221 700	-	-	221 700
- mortgage bonds	420 230	-	-	420 230
- banks bonds	204 436	-	-	204 436
- corporate bonds	1 688 420	935 526	-	752 894
- communal bonds	35 910	-	-	35 910
Equity securities	***56 472***	***986***	**-**	***55 486***
- unlisted	56 472	986	-	55 486
TOTAL FINANCIAL ASSETS	**33 891 911**	**28 456 451**	**3 432 978**	**2 002 482**

31.12.2017	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, including:	***1 141 036***	**-**	***1 141 036***	**-**
Derivative financial instruments held for trading	***1 116 216***	**-**	***1 116 216***	**-**
- interest rate derivatives	692 377	-	692 377	-
- foreign exchange derivatives	389 746	-	389 746	-
- market risks derivatives	34 093	-	34 093	-
Derivative financial instruments held for hedging	***24 820***	**-**	***24 820***	**-**
- derivatives designated as fair value hedges	23 334	-	23 334	-
- derivatives designated as cash flow hedges	1 486	-	1 486	-
Total financial liabilities	***1 141 036***	**-**	***1 141 036***	**-**

TOTAL RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS	**33 891 911**	**28 456 451**	**3 432 978**	**2 002 482**
FINANCIAL LIABILITIES	**1 141 036**	**-**	**1 141 036**	**-**

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Assets Measured at Fair Value Based on Level 3 - changes in 2017	Debt trading securities	Debt investment securities	Equity investment securities
As at the beginning of the period	**328 190**	**1 125 379**	**50 244**
Gains and losses for the period:	**6 486**	**(14 791)**	**3 339**
Recognised in profit or loss:	6 486	(7 511)	(4 751)
- Net trading income	*6 486*	-	-
- Gains less losses from investment securities, investments in subsidiaries and associates	-	*(7 511)*	*(4 751)*
Recognised in other comprehensive income:	-	*(7 280)*	*8 090*
- Available for sale financial assets	-	*(7 280)*	*8 090*
Purchases	1 249 977	742 433	2 000
Redemptions	(253 687)	(153 246)	-
Sales	(11 164 940)	(2 836 805)	-
Issues	10 145 800	2 772 200	-
Transfers out of Level 3	-	-	*(97)*
As at the end of the period	**311 826**	**1 635 170**	**55 486**

Transfers between levels in 2017	Transfer into level 1	Transfer out of level 1	Transfer into level 2	Transfer out of level 2
Investment securities	**97**	**-**	**-**	**-**
Equity securities	97	-	-	-

In 2017, one transfer from level 3 to level 1 of the fair value hierarchy took place and concerned a company whose shares were admitted to public trading.

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
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**

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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
FINANCIAL LIABILITIES				
Derivative financial instruments, including:	**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 hedging	***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**	**-**

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 Integrated Risk and Capital Management 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.

Level 1

As at 31 December 2017, 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 1 232 515 thousand (see Note 18) and the fair value of investment government bonds in the amount of PLN 26 283 963 thousand (see Note 22) (31 December 2016 respectively: PLN 3 503 029 thousand and PLN 27 348 734 thousand). Level 1 also includes the fair value of corporate bonds in the amount of PLN 938 243 thousand (31 December 2016 – PLN 360 853 thousand).

In addition, as at 31 December 2017 level 1 includes the value of the registered privileged shares of Giełda Papierów Wartościowych in the amount of PLN 986 thousand (31 December 2016: PLN 839 thousand) and the value of the shares of listed companies in the amount of PLN 744 thousand (31 December 2016: PLN 3 503 thousand).

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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.

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 2 199 429 thousand (31 December 2016: PLN 1 584 615 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 2017 and 31 December 2016, level 2 also includes the value of options referencing on the WIG20 index. 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 1 911 086 thousand (31 December 2016: PLN 1 416 599 thousand).

Level 3 includes also the fair value of local government bonds in the amount of PLN 35 910 thousand (31 December 2016 – PLN 36 970 thousand).

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. PD, LGD) and information acquired from the market (including credit spreads implied from transactions). Credit risk parameters PD and LGD are not observed on active markets and hence were generated by statistical analysis. 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	
	31.12.2017	31.12.2016
Credit institutions	(986)	(9 763)
Non-financial enterprises	(6 497)	(6 254)
Total	**(7 483)**	**(16 017)**

Moreover, level 3 covers mainly the fair value of equity securities amounting to PLN 55 486 thousand (31 December 2016: PLN 50 244 thousand). As at 31 December 2017, these amount includes the value of preferred stock in Visa Inc. in the amount of PLN 46 538 thousand (31 December 2016: PLN 38 392 thousand). 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.

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 35.1 million or increase by PLN 44.7 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 3.17. 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" decline in value 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 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 recognised partly as upfront income and partly including deferring over time based on the analysis of the stage of completion of the service.

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 method. 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 programmes, 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 based 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	
	2017	**2016**
Interest income		
Loans and advances including the unwind of the impairment provision discount	2 562 453	2 313 715
Investment securities	678 120	695 421
Cash and short-term placements	57 616	56 381
Trading debt securities	63 651	79 719
Interest income on derivatives classified into banking book	118 273	183 820
Interest income on derivatives concluded under the fair value hedge accounting	49 731	45 060
Interest income on derivatives concluded under cash flow hedge accounting	15 780	15 874
Other	5 344	4 106
Total interest income	**3 550 968**	**3 394 096**
Interest expense		
Arising from amounts due to banks	(58 778)	(75 004)
Arising from amounts due to customers	(649 464)	(772 211)
Arising from subordinated liabilities	(69 017)	(68 661)
Other	(15 224)	(12 034)
Total interest expense	**(792 483)**	**(927 910)**

In 2017, interest income related to impaired financial assets amounted to PLN 95 162 thousand (for the period ended 31 December 2016: PLN 95 082 thousand).

Net interest income per client groups is as follows.

	Year ended 31 December	
	2017	**2016**
Interest income		
From banking sector	389 643	431 633
From other customers, including:	3 161 325	2 962 463
- individual clients	1 546 461	1 446 482
- corporate clients	941 413	798 753
- public sector	673 451	717 228
Total interest income	**3 550 968**	**3 394 096**
Interest expense		
From banking sector	(71 636)	(86 227)
From other customers, including:	(651 830)	(773 022)
- individual clients	(333 963)	(381 602)
- corporate clients	(292 728)	(377 768)
- public sector	(25 139)	(13 652)
From debt securities in issue and from subordinated liabilities	(69 017)	(68 661)
Total interest expense	**(792 483)**	**(927 910)**

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6. Net fee and commission income

	Year ended 31 December	
	2017	**2016**
Fee and commission income		
Payment cards-related fees	372 887	361 907
Credit-related fees and commissions	271 449	244 547
Commissions for agency service regarding sale of insurance products of external financial entities	16 288	17 882
Fees from brokerage activity and debt securities issue	142 110	109 292
Commissions from bank accounts	186 677	168 857
Commissions from money transfers	119 562	110 265
Commissions due to guarantees granted and trade finance commissions	65 807	54 508
Commissions for agency service regarding sale of other products of external financial entities	103 912	81 073
Commissions on trust and fiduciary activities	26 344	25 017
Fees from portfolio management services and other management-related fees	14 794	8 957
Fees from cash services	53 258	51 082
Other	31 983	25 882
Total fee and commission income	**1 405 071**	**1 259 269**
Fee and commission expense		
Payment cards-related fees	(244 656)	(229 856)
Commissions paid to external entities for sale of the Bank's products	(119 996)	(113 826)
Discharged brokerage fees	(28 626)	(48 572)
Cash services expenses	(47 537)	(47 906)
Fees to NBP and KIR	(13 057)	(11 453)
Other discharged fees	(134 283)	(124 434)
Total fee and commision expense	**(588 155)**	**(576 047)**

7. Dividend income

	Year ended 31 December	
	2017	**2016**
Trading securities	11	410
Securities available for sale	166 274	166 423
Total dividend income	**166 285**	**166 833**

8. Net trading income

	Year ended 31 December	
	2017	**2016**
Foreign exchange result	**290 535**	**265 741**
Net exchange differences on translation	292 979	231 445
Net transaction gains/(losses)	(2 444)	34 296
Other net trading income and result on hedge accounting	**12 848**	**(16 196)**
Interest-bearing instruments	17 733	(6 548)
Equity instruments	(130)	(358)
Market risk instruments	6 165	4 811
Result on fair value hedge accounting, including:	(4 381)	3 523
- Net profit on hedged items	60 519	(9 128)
- Net profit on fair value hedging instruments	(64 900)	12 651
Ineffective portion of cash flow hedge	(6 539)	(17 624)
Total net trading income	**303 383**	**249 545**

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"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" includes the profit/(loss) on money market instrument trading, swap contracts for interest rates, options and other derivative instruments. "Equity instruments" includes 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	
	2017	**2016**
Income from services provided	15 154	16 859
Income due to release of provisions for future commitments	60 920	6 753
Income from sale or liquidation of fixed assets, intangible assets and assets held for sale	944	373
Compensations, penalties and fines received	455	230
Income from recovering receivables designated previously as prescribed, remitted or uncollectible	842	581
Other	35 623	43 954
Total other operating income	**113 938**	**68 750**

Income from services provided is earned on non-banking activities.

10. Overhead costs

	Year ended 31 December	
	2017	**2016**
Staff-related expenses	(764 480)	(719 820)
Material costs, including:	(624 920)	(589 577)
- logistics cost	(315 179)	(292 687)
- IT costs	(133 446)	(126 232)
- marketing costs	(105 804)	(115 651)
- consulting costs	(55 878)	(39 478)
- other material costs	(14 613)	(15 529)
Taxes and fees	(18 814)	(18 373)
Contributions and transfers to the Bank Guarantee Fund	(174 924)	(158 176)
Contributions to the Social Benefits Fund	(6 440)	(5 607)
Total overhead costs	**(1 589 578)**	**(1 491 553)**

In 2016 in the item "Contribution and transfers to the Bank Guarantee Fund" includes the costs 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 item "Material costs" consist of tangible assets operating lease payment costs (mainly real estate) of PLN 28 566 thousand (2016: PLN 29 133 thousand).

Staff-related expenses in 2017 and 2016 are presented below.

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	Year ended 31 December	
	2017	**2016**
Wages and salaries	(625 772)	(591 543)
Social security expenses	(100 259)	(92 221)
Expenses related to post-employment benefits	(623)	(572)
Remuneration concerning share-based payments, including:	(8 700)	(9 223)
- share-based payments settled in options on mBank S.A. shares	(8 700)	(9 088)
- cash-settled share-based payments	-	(135)
Other staff expenses	(29 126)	(26 261)
Staff-related expenses, total	**(764 480)**	**(719 820)**

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".

11. Other operating expenses

	Year ended 31 December	
	2017	**2016**
Provisions for future commitments	(50 083)	(24 567)
Costs arising from provisions created for other receivables (excluding loans and advances)	(1 201)	(927)
Donations made	(2 625)	(2 621)
Costs arising from sale or liquidation of fixed assets, intangible assets and assets held for resale	(695)	(483)
Compensations, penalties and fines paid	(2 478)	(1 359)
Costs arising from receivables and liabilities recognised as prescribed, remitted and uncollectible	(4)	(92)
Costs arising from impairment provisions created for tangible fixed assets and intangible assets	(8 200)	-
Other operating costs	(41 833)	(72 892)
Total other operating expenses	**(107 119)**	**(102 941)**

In 2017, provisions for future commitments include provisions for legal proceedings of PLN 32 997 thousand (2016: PLN 19 684 thousand) (Note 32).

12. Net impairment losses on loans and advances

	Year ended 31 December	
	2017	**2016**
Net impairment losses on loans and advances to banks (Note 17)	1 118	(472)
Net impairment losses on loans and advances to customers (Note 21)	(424 909)	(314 228)
Net impairment losses on contingent liabilities (Note 32)	(34 098)	2 505
Total net impairment losses on loans and advances	**(457 889)**	**(312 195)**

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13. Income tax expense

	Year ended 31 December	
	2017	**2016**
Current tax	(402 911)	(361 451)
Deferred income tax (Note 33)	22 391	10 636
Total income tax	**(380 520)**	**(350 815)**
Profit before tax	**1 470 224**	**1 570 154**
Tax calculated at Polish current tax rate (19%)	(279 343)	(298 329)
Income not subject to tax *)	46 056	50 463
Costs other than tax deductible costs **)	(147 233)	(102 949)
Total tax liability	**(380 520)**	**(350 815)**
Effective tax rate calculation		
Profit (loss) before income tax	1 470 224	1 570 154
Income tax	(380 520)	(350 815)
Effective tax rate	**25.88%**	**22.34%**

*) Includes i.e. 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 certain financial institutions 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.

14. Earnings per share

<u>Earnings per share for 12 months</u>

	Year ended 31 December	
	2017	**2016**
Basic:		
Net profit	1 089 704	1 219 339
Weighted average number of ordinary shares	42 290 313	42 252 790
Net basic profit per share (in PLN per share)	**25.77**	**28.86**
Diluted:		
Net profit applied for calculation of diluted earnings per share	1 089 704	1 219 339
Weighted average number of ordinary shares	42 290 313	42 252 790
Adjustments for:		
- share options	23 070	27 496
Weighted average number of ordinary shares for calculation of diluted earnings per share	42 313 383	42 280 286
Diluted earnings per share (in PLN per share)	**25.75**	**28.84**

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 reporting 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 as ratio of net profits attributable to Bank's shareholder and 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.

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15. Other comprehensive income

Disclosure of tax effects relating to each component of other comprehensive income	Year ended 31 December 2017			Year ended 31 December 2016		
	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	**219 597**	**(51 282)**	**168 315**	**(549 764)**	**102 306**	**(447 458)**
Exchange differences on translation of foreign operations	617	-	617	337	-	337
Available for sale financial assets	218 984	(52 140)	166 844	(545 931)	101 742	(444 189)
Cash flow hedges	(4 511)	858	(3 653)	(2 968)	564	(2 404)
Share of other comprehensive income of entities under the equity method	4 507	-	4 507	(1 202)	-	(1 202)
Items that will not be reclassified to the income statement	**(3 812)**	**724**	**(3 088)**	**411**	**(78)**	**333**
Actuarial gains and losses relating to post-employment benefits	(3 812)	724	(3 088)	411	(78)	333
Total other comprehensive income	**215 785**	**(50 558)**	**165 227**	**(549 353)**	**102 228**	**(447 125)**

The table below presents detailed information concerning other comprehensive income for the years 2017 and 2016.

	Year ended 31 December	
	2017	2016
Items that may be reclassified subsequently to the the income statement, including:	**168 315**	**(447 458)**
Exchange differences on translating foreign operations	**617**	**337**
Unrealised gains (positive differences) arising during the year (net)	1 361	(2 618)
Unrealised losses (negative differences) arising during the year (net)	(744)	2 955
Available-for-sale financial assets	**166 844**	**(444 189)**
Unrealised gains on debt instruments arising during the year (net)	219 276	2 925
Unrealised losses on debt instruments arising during the year (net)	(46 717)	(297 740)
Reclassification adjustments of gains (losses) on debt instruments to the income statement (net)	(17 537)	(14 292)
Unrealised gains on equity instruments arising during the year (net)	12 287	204 247
Unrealised losses on equity instruments arising during the year (net)	(44)	(135 464)
Reclassification adjustments of gains (losses) on equity instruments to the income statement (net)	(421)	(203 865)
Cash flow hedges	**(3 653)**	**(2 404)**
Unrealized gains arising during the year (net)	1 468	3
Unrealized losses arising during the year (net)	(5 121)	(2 407)
Share of other comprehensive income of entities under the equity method	**4 507**	**(1 202)**
Share of other comprehensive income of entities under the equity method during the year	4 507	(1 202)
Items that will not be reclassified to the income statement, including:	**(3 088)**	**333**
Actuarial gains and losses relating to post-employment benefits	**(3 088)**	**333**
Actuarial gains	-	333
Actuarial losses	(3 088)	-
Total other comprehensive income (net)	**165 227**	**(447 125)**

In 2017, unrealized gains on debt instruments arising during the year in the amount of PLN 219 276 thousand relate mainly to positive valuation of debt securities of the banking book, caused by a decrease in interest rates in the first half of 2017, resulting from interest rate drops in global markets.

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.

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16. Cash and balances with central bank

	31.12.2017	31.12.2016
Cash in hand (treasury)	1 286 132	1 149 698
Current account	6 097 386	8 009 053
Total cash and balances with the Central Bank (Note 43)	**7 383 518**	**9 158 751**

On the basis of the Act on the National Bank of Poland of 29 August 1997, mBank holds a mandatory reserve deposit. The arithmetic mean of daily balances of the mandatory reserve that the mBank is obliged to maintain during a given period in the current account with NBP amounted to:

- PLN 2 736 636 thousand for the period from 30 November 2017 to 1 January 2018,
- PLN 2 674 432 thousand for the period from 30 November 2016 to 1 January 2017,

As at 31 December 2017, the mandatory reserve in Central Bank bore 1.35% interest (31 December 2016: 1.35%).

17. Loans and advances to banks

	31.12.2017	31.12.2016
Current accounts	386 071	458 115
Placements with other banks (up to 3 months)	748 470	1 867 789
Included in cash equivalents (Note 43)	**1 134 541**	**2 325 904**
Loans and advances	4 565 013	4 094 771
Other receivables	365 175	890 351
Total (gross) loans and advances to banks	**6 064 729**	**7 311 026**
Provisions created for loans and advances to banks (negative amount)	**(1 027)**	**(2 257)**
Total (net) loans and advances to banks	**6 063 702**	**7 308 769**
Short-term (up to 1 year)	**1 963 628**	**3 806 105**
Long-term (over 1 year)	**4 100 074**	**3 502 664**

The item "Other receivables" includes cash collaterals (as at 31 December 2017 in the amount of PLN 259 111 thousand, as at 31 December 2016: PLN 429 519 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:

	31.12.2017	31.12.2016
Loans and advances to Polish banks (gross)	4 733 226	5 481 585
Provisions created for loans and advances to Polish banks	(58)	(62)
Loans and advances to foreign banks (gross)	1 331 503	1 829 441
Provisions created for loans and advances to foreign banks	(969)	(2 195)
Total (net) loans and advances to banks	**6 063 702**	**7 308 769**

As at 31 December 2017, the variable rate loans to banks amounted to PLN 4 559 190 thousand and the fixed rate loans to banks amounted to PLN 5 823 thousand (as at 31 December 2016 – variable rate loans to banks amounted to PLN 4 064 881 thousand and fixed rate loans to PLN 29 890 thousand).

As at 31 December 2017 and 31 December 2016, the term placements with other banks were fixed rated and amounted to PLN 748 470 thousand and PLN 1 867 789 thousand respectively. An average interest rate for placements in other banks and loans granted to other banks amounted to 1.60% (31 December 2016: 1.32%).

The following table presents the changes in provisions for losses on loans and advances to banks:

	31.12.2017	31.12.2016
Provisions for loans and advances to banks as at the beginning of the period	**(2 257)**	**(1 699)**
- provisions created (Note 12)	(1 193)	(3 658)
- release of provision (Note 12)	2 311	3 186
- foreign exchange differences	112	(86)
Provisions for loans and advances to banks as at the end of the period	**(1 027)**	**(2 257)**

As at 31 December 2017, the amount of provisions created for loans and advances to banks includes the amount of PLN 217 thousand of provision for individually impaired loans (31 December 2016: PLN 1 525 thousand).

Loans and advances to banks	31.12.2017		31.12.2016	
	exposure in PLN '000	share/coverage (%)	exposure in PLN '000	share/coverage (%)
Neither past due nor impaired	6 064 512	100.00	7 280 542	99.58
Past due but not impaired	-	-	-	-
Impaired	217	0.00	30 484	0
Total, gross	**6 064 729**	**100.00**	**7 311 026**	**100.00**
Provision (provision for impaired loans and advances as well as IBNI provision)	(1 027)	0.02	(2 257)	0.03
Total, net	**6 063 702**	**99.98**	**7 308 769**	**99.97**

Loans and advances to banks neither past due nor impaired

Należności od banków		
Pod-portfel	**31.12.2017**	**31.12.2016**
1	5 391 046	5 456 459
2	520 955	1 391 810
3	38 430	246 902
4	37 521	64 314
5	9	-
6	2 144	-
7	-	1 945
8	74 407	119 112
Razem	**6 064 512**	**7 280 542**

18. Trading securities

	31.12.2017			31.12.2016		
	Trading securities without pledge	Pledged trading securities	Total trading securities	Trading securities without pledge	Pledged trading securities	Total trading securities
Debt securities:	**1 521 221**	**25 837**	**1 547 058**	**3 079 840**	**754 263**	**3 834 103**
Issued by government	1 206 678	25 837	1 232 515	2 748 766	754 263	3 503 029
- government bonds	1 206 678	25 837	1 232 515	2 748 766	754 263	3 503 029
Other debt securities	314 543	-	314 543	331 074	-	331 074
- bank's bonds	98 601	-	98 601	128 516	-	128 516
- deposit certificates	14 096	-	14 096	16 146	-	16 146
- corporate bonds	178 696	-	178 696	167 378	-	167 378
- mortgage bonds	23 150	-	23 150	19 034	-	19 034
Equity securities:	**744**	**-**	**744**	**3 503**	**-**	**3 503**
- listed	744	-	744	3 503	-	3 503
Total debt and equity securities	**1 521 965**	**25 837**	**1 547 802**	**3 083 343**	**754 263**	**3 837 606**

Trading securities include securities used to secure sell-buy-back transactions with customers, the market value of which as at 31 December 2017 amounted to PLN 25 837 thousand (31 December 2016: PLN 754 263 thousand).

19. Derivative financial instruments

The Bank has the following types of 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.

The Bank applies fair value hedge accounting for fixed interest rate security deposit given by the Bank's subsidiary entity and fixed interest rate loans received by the Bank from EIB. Moreover, the Bank applies cash flow hedge accounting of part of the credit portfolio 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 in the table below.

	Contract amount		Fair value	
	Purchase	Disposal	Assets	Liabilities
As at 31 December 2017				
Derivatives held for trading				
Foreign exchange derivatives				
- Currency forwards	18 628 052	18 846 094	103 092	266 381
- Currency swaps	14 321 496	14 235 515	130 586	63 715
- Cross-currency interest rate swaps	11 936 364	11 850 069	124 380	23 570
- OTC currency options bought and sold	1 809 601	1 802 752	32 911	36 080
Total OTC derivatives	**46 695 513**	**46 734 430**	**390 969**	**389 746**
- Currency futures	86 599	86 897	-	-
Total foreign exchange derivatives	**46 782 112**	**46 821 327**	**390 969**	**389 746**
Interest rate derivatives				
- Interest rate swap, OIS	149 208 192	149 208 193	782 159	793 620
- Forward rate agreements	1 125 000	3 350 000	711	81
- OTC interest rate options	376 149	493 415	2 470	2 544
Total OTC interest rate derivatives	**150 709 341**	**153 051 608**	**785 340**	**796 245**
- Interest rate futures	10 767	491	-	-
Total interest rate derivatives	**150 720 108**	**153 052 099**	**785 340**	**796 245**
Market risk transactions	**1 304 405**	**1 862 741**	**44 651**	**34 093**
Total derivative assets / liabilities held for trading	**198 806 625**	**201 736 167**	**1 220 960**	**1 220 084**
Derivatives held for hedging				
Derivatives designated as fair value hedges	9 252 496	9 252 496	93 149	25 193
- Interest rate swaps	9 252 496	9 252 496	93 149	25 193
Derivatives designated as cash flow hedges	5 965 000	5 965 000	30 312	2 103
- Interest rate swaps	5 965 000	5 965 000	30 312	2 103
Total derivatives held for hedging	**15 217 496**	**15 217 496**	**123 461**	**27 296**
Offsetting effect	**-**	**-**	**(110 872)**	**(106 345)**
Total recognised derivative assets/ liabilities	**214 024 121**	**216 953 663**	**1 233 549**	**1 141 035**
Short-term (up to 1 year)	**77 957 156**	**81 074 200**	**404 580**	**400 487**
Long-term (over 1 year)	**136 066 965**	**135 879 463**	**828 969**	**740 548**

	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 30 024 thousand of placed collaterals and PLN 34 551 thousand of collaterals received in connection with the derivative transactions subject to compensation (31 December 2016: PLN 20 204 thousand and PLN 6 634 thousand respectively).

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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 127 thousand (liabilities), which have been separated from the structured investment deposits (31 December 2016: PLN 1 012 thousand).

As at 31 December 2017 and 31 December 2016, 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 in order to confirm that hedging relationships are effective in accordance with the accounting policy described in Note 2.11.

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.
- loans 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.

Hedged items

The hedged items are:

- fixed interest rate security deposit given by mFF in the amount of CHF 198 967 thousand,
- fixed interest rate security deposit given by mFF in the amount of CZK 500 000 thousand,
- fixed interest rate security deposit given by mFF in the amount of EUR 495 615 thousand,
- fixed interest rate security deposit given by mFF in the amount of EUR 498 750 thousand,
- fixed interest rate security deposit given by mFF in the amount of EUR 498 750 thousand,
- fixed interest rate security deposit given by mFF in the amount of CHF 199 275 thousand,
- fixed interest rate loans received by mBank from European Investment Bank with a nominal value of EUR 100 000 thousand and a nominal value of CHF 113 110 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 Bank. 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	
	2017	2016
Interest income on derivatives concluded under the fair value hedge accounting (Note 5)	49 731	45 060
Net profit on hedged items (Note 8)	60 519	(9 128)
Net profit on fair value hedging instruments (Note 8)	(64 900)	12 651
The total results of fair value hedge accounting recognised in the income statement	**45 350**	**48 583**

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 portfolio, 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 in the position "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 2018 to February 2023 is the period in which the cash flows are expected, and when they are expected to have an impact on the results.

The following note presents other comprehensive income due to cash flow hedges as at 31 December 2017 and 31 December 2016.

	Year ended 31 December	
	2017	**2016**
Other gross comprehensive income from cash flow hedge at the beginning of the period	**(1 907)**	**1 061**
- Unrealised gains/losses included in other gross comprehensive income during the reporting period	(4 511)	(2 968)
Accumulated other gross comprehensive income at the end of the reporting period	**(6 418)**	**(1 907)**
Deferred income tax on accumulated other comprehensive income at the end of the reporting period	1 220	362
Accumulated other net comprehensive income at the end of the reporting period	**(5 198)**	**(1 545)**
Impact on other comprehensive income in the reporting period (gross)	(4 511)	(2 968)
Deferred tax on cash flow hedges	858	564
Impact on other comprehensive income in the reporting period (net)	**(3 653)**	**(2 404)**

	Year ended 31 December	
	2017	**2016**
Gains/losses recognised in comprehensive income (gross) during the reporting period, including:		
- Unrealised gains/losses included in other comprehensive income (gross)	(4 511)	(2 968)
- Amount included as interest income in income statement during the reporting period	15 780	15 874
- Ineffective portion of hedge recognised included in other net trading income in income statement	(6 539)	(17 624)
Impact on other comprehensive income in the reporting period (gross)	**4 730**	**(4 718)**

Total result on cash flow hedge accounting recognized in the income statement

	Year ended 31 December	
	2017	**2016**
Interest income on derivatives concluded under the cash flow hedge (Note 5)	15 780	15 874
Ineffective portion of cash flow hedge (Note 8)	(6 539)	(17 624)
The total results of cash flow hedge accounting recognised in the income statement	**9 241**	**(1 750)**

Below is given the timetable prepared as at 31 December 2017, 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**
25 720	77 036	297 008

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 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
10 631	16 492	48 498

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

	31.12.2017	31.12.2016
Loans and advances to individuals:	**42 429 287**	**44 707 271**
- current accounts	7 324 329	6 458 369
- term loans, including:	35 104 958	38 248 902
housing and mortgage loans	26 714 885	30 958 397
Loans and advances to corporate entities:	**32 388 582**	**28 746 183**
- current accounts	5 310 093	4 185 972
- term loans:	26 814 762	24 337 263
corporate & institutional enterprises	13 878 266	12 733 757
medium & small enterprises	12 936 496	11 603 506
- reverse repo / buy-sell-back transactions	57 119	56 676
- other	206 608	166 272
Loans and advances to public sector	**870 705**	**1 087 740**
Other receivables	**307 623**	**228 424**
Total (gross) loans and advances to customers	**75 996 197**	**74 769 618**
Provisions for loans and advances to customers (negative amount)	(2 564 459)	(2 465 487)
Total (net) loans and advances to customers	**73 431 738**	**72 304 131**
Short-term (up to 1 year)	**28 078 761**	**26 716 486**
Long-term (over 1 year)	**45 352 977**	**45 587 645**

As at 31 December 2017, gross amount of variable interest rate loans amounted to PLN 74 594 744 thousand and fixed interest rate loans amounted to PLN 1 401 453 thousand (as at 31 December 2016 respectively: PLN 73 019 115 thousand and PLN 1 750 503 thousand). An average interest rate for loans granted to customers (excluding reverse repos) amounted to 3.34% (31 December 2016: 3.09%).

In 2017, the above note includes receivables in the amount of PLN 155 195 thousand from the National Depository of Securities CCP in connection with the Brokerage Office activity (in 2016: PLN 135 977 thousand).

In addition, the item "other" includes cash collaterals (as at 31 December 2017 in the amount of PLN 106 274 thousand, as at 31 December 2016: PLN 28 287 thousand) placed by the Bank under derivatives transactions (Note 37).

The table below presents the currency structure of housing and mortgage loans granted to individual customers.

	31.12.2017	31.12.2016
Housing and mortgage loans to individuals (in PLN 000's), including:	**26 714 885**	**30 958 397**
- PLN	5 246 249	5 120 325
- CHF	14 932 401	18 725 950
- EUR	3 288 198	3 889 676
- CZK	2 973 145	2 850 232
- USD	245 162	332 216
- Other currency	29 730	39 998
Housing and mortgage loans to individuals in original currencies (main currencies in 000's)		
- PLN	5 246 249	5 120 325
- CHF	4 186 029	4 548 114
- EUR	788 367	879 222
- CZK	18 217 800	17 411 313
- USD	70 423	79 491

Provisions for loans and advances

	31.12.2017	31.12.2016
Incurred but not identified losses		
Gross balance sheet exposure	72 023 490	70 864 716
Impairment provisions for exposures analysed according to portfolio approach	(200 813)	(188 644)
Net balance sheet exposure	**71 822 677**	**70 676 072**
Receivables with impairment		
Gross balance sheet exposure	3 972 707	3 904 902
Provisions for receivables with impairment	(2 363 646)	(2 276 843)
Net balance sheet exposure	**1 609 061**	**1 628 059**

Movements in provisions for loans and advances

MOVEMENTS IN PROVISIONS FOR LOANS AND ADVANCES TO CUSTOMERS AS OF 2017	Provisions as at 01.01.2017	Provisions created	Release of provisions	Reclassification and foreign exchange differences	Write-offs	Provisions as at 31.12.2017
Loans and advances to individuals	**(1 511 321)**	**(953 739)**	**639 154**	**42 604**	**215 267**	**(1 568 035)**
Current accounts	(614 379)	(365 080)	230 620	7 928	85 681	**(655 230)**
Term loans, including:	(896 942)	(588 659)	408 534	34 676	129 586	**(912 805)**
Housing and mortgage loans	(511 910)	(246 253)	211 533	34 730	62 595	**(449 305)**
Loans and advances to corporate entities	**(953 459)**	**(298 367)**	**187 862**	**16 526**	**51 537**	**(995 901)**
Current accounts	(190 490)	(96 967)	62 726	(7 152)	20 214	**(211 669)**
Term loans, including:	(762 969)	(201 400)	125 136	23 678	31 323	**(784 232)**
Corporate & institutional enterprises	(28 788)	(13 875)	29 702	1 289	-	**(11 672)**
Medium & small enterprises	(734 181)	(187 525)	95 434	22 389	31 323	**(772 560)**
Loans and advances to public sector	**(707)**	**(105)**	**286**	**3**	**-**	**(523)**
Total movements in provisions for loans and advances to customers	**(2 465 487)**	**(1 252 211)**	**827 302**	**59 133**	**266 804**	**(2 564 459)**

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)**

Loans and advances to customers	31.12.2017		31.12.2016	
	exposure in PLN '000	share/coverage (%)	exposure in PLN '000	share/coverage (%)
Neither past due nor impaired	70 104 249	92.25	68 928 523	92.19
Past due but not impaired	1 919 241	2.52	1 936 193	2.59
Impaired	3 972 707	5.23	3 904 902	5.22
Total, gross	**75 996 197**	**100.00**	**74 769 618**	**100.00**
Provision (provision for impaired loans and advances as well as IBNI provision)	(2 564 459)	3.37	(2 465 487)	3.30
Total, net	**73 431 738**	**96.63**	**72 304 131**	**96.70**

The total amount of recognized provision for loans and advances has been PLN 2 564 459 thousand (as at 31 December 2016: PLN 2 465 487 thousand) of which PLN 2 363 646 thousand (as at 31 December 2016: PLN 2 276 843 thousand) represents the individually impaired loans and advances to customers and the remaining amount of PLN 200 813 thousand represented the portfolio provision (as at 31 December 2016 PLN 188 644 thousand).

92.25% of the loans and advances to customers portfolio has been considered to be neither past due nor impaired (31 December 2016: 92.19%).

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Loans and advances neither past due nor impaired

31 December 2017	Individuals			Corporate entities							
			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	Public sector	Other receivables	Total - Loans and advances to customers
1	138 420	6 991 020	6 950 197	183 829	113 320	589 342	-	20 675	23 956	-	8 060 562
2	1 379 136	15 806 002	14 166 382	1 340 330	11 182 608	2 082 475	-	185 927	657 772	-	32 634 250
3	1 303 710	4 007 797	2 359 048	958 435	1 407 841	4 224 857	-	6	158 022	-	12 060 668
4	2 023 991	3 745 801	767 202	2 002 686	986 611	3 676 597	-	-	30 955	-	12 466 641
5	741 318	1 239 641	488 071	485 512	56 038	1 218 711	-	-	-	-	3 741 220
6	70 484	132 784	78 324	10 439	-	2 522	-	-	-	-	216 229
7	136 879	266 697	168 271	22 723	-	20 158	-	-	-	-	446 457
8	46 383	-	-	37 934	-	-	57 119	-	-	307 596	449 032
Default category	1 353	27 809	25 279	1	-	-	-	-	-	27	29 190
Total	**5 841 674**	**32 217 551**	**25 002 774**	**5 041 889**	**13 746 418**	**11 814 662**	**57 119**	**206 608**	**870 705**	**307 623**	**70 104 249**

31 December 2016	Individuals			Corporate entities							
			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	Public sector	Other receivables	Total - Loans and advances to customers
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**

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 2017	Individuals			Corporate entities							
			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	Public sector	Other receivables	Total - Loans and advances to customers
Past due up to 30 days	528 690	1 036 462	675 128	11 822	112	5 434	-	-	-	-	1 582 520
Past due 31 - 60 days	45 849	155 990	88 793	223	7 874	15 636	-	-	-	-	225 572
Past due 61 - 90 days	19 706	47 683	16 597	-	167	-	-	-	-	-	67 556
Past due over 90 days	12 583	30 983	7 895	27	-	-	-	-	-	-	43 593
Total	**606 828**	**1 271 118**	**788 413**	**12 072**	**8 153**	**21 070**	**-**	**-**	**-**	**-**	**1 919 241**

31 December 2016	Individuals			Corporate entities							
			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	Public sector	Other receivables	Total - Loans and advances to customers
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**

Loans and advances individually impaired

As at 31 December 2017, loans and advances individually impaired amounted to PLN 1 609 061 thousand (as at 31 December 2016: PLN 1 628 059 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.

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	Individuals			Corporate entities					Public sector	Other receivables	Total - Loans and advances to customers
	Current accounts	Term loans	including:	Current accounts	Term loans		Reverse repo / buy-sell-back transactions	Other			
			housing and mortgage loans		corporate & institutional enterprises	medium & small enterprises					
31 December 2017											
Loans and advances with impairment	875 827	1 616 289	923 698	256 132	123 695	1 100 764	-	-	-	-	**3 972 707**
Provisions for loans and advances with impairment	(594 481)	(822 419)	(422 221)	(196 861)	(6 185)	(743 700)	-	-	-	-	**(2 363 646)**
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)**

The Bank applies a conservative approach in the area of verification of collateral value and setting of acceptable LtV ratio 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 2017	Gross amount	Provisions created	Provisions without cash flow from collaterals	Financial effect of collaterals
Balace sheet data				
Loans and advances to banks	**6 064 729**	**(1 027)**	**(1 028)**	**1**
Loans and advances to customers, including:	**75 996 197**	**(2 564 459)**	**(3 139 493)**	**575 034**
Loans to individuals:	42 429 287	(1 568 035)	(1 882 876)	314 841
− Current accounts	7 324 329	(655 230)	(668 180)	12 950
− Term loans, including:	35 104 958	(912 805)	(1 214 696)	301 891
housing and mortgage loans	26 714 885	(449 305)	(718 030)	268 725
Loans to corporate clients:	32 124 855	(995 901)	(1 256 070)	260 169
− Current accounts	5 310 093	(211 669)	(244 691)	33 022
− Term loans:	26 814 762	(784 232)	(1 011 379)	227 147
corporate & institutional enterprises	13 878 266	(11 672)	(12 375)	703
medium & small enterprises	12 936 496	(772 560)	(999 004)	226 444
Loans and advances to public sector	870 705	(523)	(547)	24
Total balance sheet data	**82 060 926**	**(2 565 486)**	**(3 140 521)**	**575 035**
Off-balance sheet data:				
Loan commitments and other commitments	25 416 098	(26 510)	(30 302)	3 792
Guarantees, banker's acceptances, documentary and commercial letters of credit	14 859 659	(49 144)	(67 103)	17 959
Total off-balance sheet data:	**40 275 757**	**(75 654)**	**(97 405)**	**21 751**

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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22. Investment securities

	31.12.2017			31.12.2016		
	Investment securities without pledge	Pledged investment securities	Total investment securities	Investment securities without pledge	Pledged investment securities	Total investment securities
Debt securities:	**24 554 862**	**6 499 226**	**31 054 088**	**23 743 219**	**6 673 478**	**30 416 697**
Issued by government	19 985 105	6 298 858	26 283 963	20 675 256	6 673 478	27 348 734
- government bonds	19 985 105	6 298 858	26 283 963	20 675 256	6 673 478	27 348 734
Issued by central bank	2 199 429	-	2 199 429	1 584 615	-	1 584 615
Other debt securities	2 370 328	200 368	2 570 696	1 483 348	-	1 483 348
- deposit certificates	221 700	-	221 700	50 466	-	50 466
- bank's bonds	204 436	-	204 436	140 880	-	140 880
- mortgage bonds	219 862	200 368	420 230	223 494	-	223 494
- corporate bonds	1 688 420	-	1 688 420	1 031 538	-	1 031 538
- communal bonds	35 910	-	35 910	36 970	-	36 970
Equity securities:	**56 472**	**-**	**56 472**	**51 083**	**-**	**51 083**
Unlisted	56 472	-	56 472	51 083	-	51 083
Total debt and equity securities:	**24 611 334**	**6 499 226**	**31 110 560**	**23 794 302**	**6 673 478**	**30 467 780**
Short-term (up to 1 year)	**9 022 269**	**515 246**	**9 537 515**	**4 374 301**	**57 216**	**4 431 517**
Long-term (over 1 year)	**15 589 065**	**5 983 980**	**21 573 045**	**19 420 001**	**6 616 262**	**26 036 263**

As at 31 December 2017, equity securities include fair value of preferred shares of Visa Inc. in the amount of PLN 46 538 thousand (as at 31 December 2016 - PLN 38 392 thousand).

As at 31 December 2017 the Bank created provisions for impairment of equity securities valued at fair value in the amount of PLN 12 428 thousand (31 December 2016: 7 677).

As at 31 December 2017, the carrying values of debt securities with fixed interest rates amounted to PLN 23 085 478 thousand and debt securities with variable interest rates PLN 7 968 610 thousand (31 December 2016 respectively: PLN 23 612 422 thousand and PLN 6 804 275 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 (BFG), Deposit Guarantee Scheme and Resolution, as at 31 December 2017 the Bank held government bonds and bills included in the statement of financial position in the amount of PLN 618 872 thousand with a nominal value of PLN 604 378 thousand (31 December 2016: carrying value - PLN 559 550 thousand; nominal value - PLN 546 142 thousand), which were pledged as collateral for the BFG 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	
	2017	2016
Sale/redemption of financial assets available for sale	22 170	269 329
Gains less losses related to sale of subsidiaries and associates	(1 677)	3
Impairment of investment equity securities	(4 751)	(7 677)
Impairment of available for sale debt securities	(7 511)	-
Impairment of investments in subsidiaries	-	(442)
Total gains less losses from investment securities, investments in subsidiaries and associates	**8 231**	**261 213**

In 2017 and 2016, the impairment of available for sale equity securities applies to the company Polski Standard Płatności Sp. z o.o.

In 2017, gains less losses related to sale of subsidiaries and associates concern the sale of shares of mLocum S.A. to Archicom S.A. The transaction has been described in Note 24.

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In 2016, due to closing of the takeover transaction of Visa Europe Limited by Visa Inc. the Bank achieved a result of PLN 251 732 thousand, which constitutes the majority of the item "Sale/redemption of financial assets available for sale".

In 2016 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 the first quarter of 2016.

Movements in investment securities

	31.12.2017	31.12.2016
Investment securities		
As at the beginning of the period	**30 467 780**	**29 982 642**
Exchange differences	(62 431)	58 002
Additions	101 188 239	139 980 506
Disposals (sale, redemption, forfeiture, reclassification)	(100 646 358)	(139 165 813)
Losses from impairment of investment equity securities	(4 751)	(7 677)
Gains / (losses) from changes in fair value	168 081	(379 880)
As at the end of the period	**31 110 560**	**30 467 780**

As at 31 December 2017 and 31 December 2016 there were no impairment provisions of the debt investment securities.

Movements in provisions for losses on investment securities

	31.12.2017	31.12.2016
Provisions for losses on debt securities		
Listed		
As at the beginning of the period	**-**	**-**
Allowance for impairment	(7 511)	-
Reclassification	7 511	-
As at the end of the period	**-**	**-**
Provisions for losses on equity securities		
Unlisted		
As at the beginning of the period	**(7 677)**	**-**
Allowance for impairment	(4 751)	(7 677)
As at the end of the period	**(12 428)**	**(7 677)**
Total provisions for investment securities		
As at the beginning of the period	**(7 677)**	**-**
Allowance for impairment	(12 262)	(7 677)
Reclassification	7 511	-
As at the end of the period	**(12 428)**	**(7 677)**

23. Investments in subsidiaries

31 December 2017 (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.**	Poland	401 684	132 606	313 733	114 375	100.00	192 877
2.	**BDH Development Sp. z o.o.**	Poland	89 570	429	7 948	(1 417)	100.00	84 641
3.	**BRE Property Partner Sp. z o.o.**	Poland	2 930	118	1 469	896	100.00	1 536
4.	**Falest Investments S.A.**	Poland	3 233	176	227	(443)	100.00	3 517
5.	**Future Tech Fundusz Inwestycyjny Zamknięty**	Poland	222 111	1 682	1 489	(2 932)	98.04	218 602
6.	**Garbary Sp. z o.o.**	Poland	42 423	31 773	231	(34 379)	100.00	10 650
7.	**Latona S.A.**	Poland	56	1	-	(43)	100.00	122
8.	**mBox Sp z o.o. (previously JMD III Sp. z o.o.)**	Poland	5 601	27	7 689	3 078	100.00	2 520
9.	**mBank Hipoteczny S.A.**	Poland	12 162 622	11 111 766	393 200	19 648	100.00	1 035 382
10.	**mCentrum Operacji Sp. z o.o.**	Poland	43 008	6 728	42 702	6 435	100.00	35 380
11.	**mCorporate Finance S.A.**	Poland	1 283	788	4 919	116	100.00	5 532
12.	**mFaktoring S.A.**	Poland	1 858 275	1 773 799	61 364	12 081	100.00	84 476
13.	**mFinance France S.A.**	France	7 803 280	7 802 108	158 712	(1 569)	99.998	232
14.	**mLeasing Sp. z o.o.**	Poland	9 546 376	9 164 597	426 044	48 568	100.00	381 779
15.	**Octopus Sp. z o.o.**	Poland	3 441	12	263	193	99.90	3 047
16.	**Tele -Tech Investment Sp. z o.o.**	Poland	124 256	123 702	10 606	13	100.00	554
								2 060 847

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.**	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)	100.00	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	99.998	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

Changes in investments in subsidiaries

	31.12.2017	**31.12.2016**
Investments in subsidiaries		
As at the beginning of the period	**1 782 219**	**1 758 247**
Foreign exchange differences	(116)	(18)
Increase	349 059	103 754
Decrease	(95 002)	(171 294)
Changes resulting from the application of the equity method, including:	24 687	91 972
- recognised in the income statement	20 180	93 174
- recognised in the other components of equity	4 507	(1 202)
Impairment/release of impairment	-	(442)
As at the end of the period	**2 060 847**	**1 782 219**

In 2017, the item "Increase" relates to the Bank's acquisition of 400 000 units of investment certificates issued by Future Tech Fundusz Inwestycyjny Zamknięty with a total amount of PLN 221 200 thousand (see Note 46), increase of equity in the companies mBank Hipoteczny S.A. and Garbary Sp. z o.o. respectively by: PLN 120 000 thousand and PLN 1 700 thousand as well as the acquisition of 100% shares in the companies mBox Sp. z o.o., Falest Investments S.A. and Latona S.A. by the amounts of PLN 2 520 thousand, PLN 3 517 thousand and PLN 122 thousand respectively.

In 2017, the item "Decrease" relates mainly the sale of the majority stake of mLocum S.A. and the transfer of the remaining shares of the company to "Investments in associates". The transaction has been described under Note 24 below.

In 2016, the item "Increase" relates mainly to the increase of equity in mBank Hipoteczny S.A. and Garbary Sp. z o.o. entities by respectively PLN 100 000 thousand and PLN 2 200 thousand 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 S.A. which was described in detail under Note 34.

In 2016 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.

24. Investments in associates

On 2 June 2017, mBank S.A. signed a preliminary conditional agreement on the sale of mLocum S.A. shares to Archicom S.A. After meeting the conditions precedent, on 31 July 2017 were sold 14 120 880 shares representing 51% of the share capital of mLocum S.A. Sale of the remaining 8 026 120 shares representing 28.99% of the share capital of mLocum S.A. will take place no later than on 30 June 2020. From 31 July 2017, the mLocum's shares held by the Bank have been presented in the statement of financial position under "Investments in associates".

The sale transaction results from mBank Group's concentration on its core financial operations and the sale of mLocum S.A. shares to a sector-leading company will allow to make better use of its potential and to achieve business objectives on the Polish market.

On 3 January 2018, an amendment to the Statute of mLocum S.A. was registered, regarding the change of the name of the company and its branches. Currently, the company is called Archicom Polska S.A.

Information on the interest in the associate measured using the equity method, is provided below.

31 December 2017 (in PLN 000's)

Name of the company	Country of registration	Assets	Liabilities	Revenues	Net profit / (loss)	% interest held	Carrying value
Archicom Polska S.A. (previously mLocum S.A.)	Poland	221 516	87 554	117 680	24 419	28.99	28 680

In 2016, the Bank did not have any investments in associates.

25. Intangible assets

	31.12.2017	31.12.2016
Goodwill	3 532	3 532
Patents, licences and similar assets, including:	343 395	320 119
- computer software	238 301	247 168
Other intangible assets	3 142	4 044
Intangible assets under development	298 122	212 757
Total intangible assets	**648 191**	**540 452**

In 2017 and 2016, 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 2017	Patents, licences and other similar assets	including: computer software	Other intangible assets	Intangible assets under development	Goodwill	Total intangible assets
Gross value of intangible assets as at the beginning of the period: 01.01.2017	**1 016 642**	**716 722**	**10 589**	**212 757**	**3 532**	**1 243 520**
Increase (due to)	**118 334**	**41 941**	**152**	**188 582**	**-**	**307 068**
- purchase	54 168	-	150	136 125	-	190 443
- transfer from intangible assets under development	62 453	41 941	2	-	-	62 455
- development costs	-	-	-	22 853	-	22 853
- other increases	1 713	-	-	29 604	-	31 317
Decrease (due to)	**(18 828)**	**(1 212)**	**-**	**(103 217)**	**-**	**(122 045)**
- liquidation	(18 466)	(983)	-	-	-	(18 466)
- transfer to intangible assets given to use	-	-	-	(62 455)	-	(62 455)
- other decreases	(362)	(229)	-	(40 762)	-	(41 124)
Gross value of intangible assets as at the end of the period: 31.12.2017	**1 116 148**	**757 451**	**10 741**	**298 122**	**3 532**	**1 428 543**
Accumulated amortization as at the beginning of the period: 01.01.2017	**(696 523)**	**(469 554)**	**(6 545)**	**-**	**-**	**(703 068)**
Amortization for the period (due to)	**(76 230)**	**(49 596)**	**(1 054)**	**-**	**-**	**(77 284)**
- amortization	(94 760)	(50 623)	(1 054)	-	-	(95 814)
- liquidation	18 466	983	-	-	-	18 466
- other decreases	64	44	-	-	-	64
Accumulated amortization as at the end of the period: 31.12.2017	**(772 753)**	**(519 150)**	**(7 599)**	**-**	**-**	**(780 352)**
Net value of intangible assets as at the end of the period: 31.12.2017	**343 395**	**238 301**	**3 142**	**298 122**	**3 532**	**648 191**

Movements in intangible assets from 1 January to 31 December 2016	Patents, licences and other similar assets	including: computer software	Other intangible assets	Intangible assets under development	Goodwill	Total intangible assets
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**

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.

26. Tangible assets

	31.12.2017	**31.12.2016**
Tangible assets, including:	376 795	409 893
- land	1 033	1 033
- buildings and structures	153 733	158 577
- equipment	138 829	150 344
- vehicles	20 620	28 495
- other tangible assets	62 580	71 444
Tangible assets under construction	132 978	71 802
Total tangible assets	**509 773**	**481 695**

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Movements in tangible assets

Movements in tangible assets from 1 January to 31 December 2017	Land	Buildings and structures	Equipment	Vehicles	Other tangible assets	Tangible assets under construction	Total
Gross value of tangible assets as at the beginning of the period: 01.01.2017	**1 033**	**305 180**	**609 258**	**46 973**	**403 495**	**71 938**	**1 437 877**
Increase (due to)	**-**	**867**	**61 307**	**-**	**20 279**	**133 755**	**216 208**
- purchase	-	-	31 470	-	1 349	115 728	148 547
- transfer from tangible assets under construction	-	867	29 372	-	18 930	-	49 169
- other increases	-	-	465	-	-	18 027	18 492
Decrease (due to)	**-**	**-**	**(20 949)**	**(4 231)**	**(14 455)**	**(72 579)**	**(112 214)**
- sale	-	-	(7 232)	(90)	(6 801)	-	(14 123)
- liquidation	-	-	(13 181)	-	(6 954)	-	(20 135)
- transfer to tangible assets	-	-	-	-	-	(49 169)	(49 169)
- other decreases	-	-	(536)	(4 141)	(700)	(23 410)	(28 787)
Gross value of tangible assets as at the end of the period: 31.12.2017	**1 033**	**306 047**	**649 616**	**42 742**	**409 319**	**133 114**	**1 541 871**
Accumulated depreciation as at the beginning of the period: 01.01.2017	**-**	**(97 333)**	**(458 914)**	**(18 478)**	**(331 920)**	**-**	**(906 645)**
Depreciation for the period (due to)	**-**	**(5 711)**	**(43 673)**	**(3 644)**	**(14 688)**	**-**	**(67 716)**
- depreciation charge	-	(5 711)	(64 512)	(6 255)	(28 564)	-	(105 042)
- sale	-	-	7 219	90	6 799	-	14 108
- liquidation	-	-	13 154	-	6 654	-	19 808
- other decreases	-	-	466	2 521	423	-	3 410
Accumulated depreciation as at the end of the period: 31.12.2017	**-**	**(103 044)**	**(502 587)**	**(22 122)**	**(346 608)**	**-**	**(974 361)**
Impairment losses as at the beginning of the period: 01.01.2017	**-**	**(49 270)**	**-**	**-**	**(131)**	**(136)**	**(49 537)**
- increase	-	-	(8 200)	-	-	-	(8 200)
Impairment losses as at the end of the period: 31.12.2017	**-**	**(49 270)**	**(8 200)**	**-**	**(131)**	**(136)**	**(57 737)**
Net value of tangible assets as at the end of the period: 31.12.2017	**1 033**	**153 733**	**138 829**	**20 620**	**62 580**	**132 978**	**509 773**

Movements in tangible assets from 1 January to 31 December 2016	Land	Buildings and structures	Equipment	Vehicles	Other tangible 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**

In 2017, the costs of impairment losses for tangible assets relate to an impairment loss of IT device in the amount of PLN 8 200 thousand.

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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27. Other assets

	31.12.2017	31.12.2016
Other assets, including:	**415 528**	**367 796**
- debtors	143 339	126 724
- interbank balances	27 405	11 520
- other accruals	142 972	150 972
- accrued income	72 786	47 532
- inventories	4 651	2 646
- other	24 375	28 402
Total other assets	**415 528**	**367 796**
Short-term (up to 1 year)	**199 881**	**169 454**
Long-term (over 1 year)	**215 647**	**198 342**

In 2017 and in 2016, the item "other" relates entirely to the settlements of securities transactions in connection with the Brokerage Office activity.

As at 31 December 2017, the above note includes financial assets in amount of PLN 195 119 thousand (31 December 2016: PLN 166 646 thousand).

Other financial assets included in the note above

	31.12.2017	31.12.2016
Gross other financial assets, including:	**202 371**	**180 580**
- Not past due	193 125	166 340
- Past due from 1 to 90 days	4 520	5 642
- Past due over 90 days	4 726	8 598
- Provisions for impaired assets (negative amount)	(7 252)	(13 934)
Net other financial assets	**195 119**	**166 646**

28. Amounts due to other banks

	31.12.2017	31.12.2016
Current accounts	903 817	959 658
Term deposits	90 442	44 293
Loans and advances received	3 394 340	6 964 907
Repo / sell-buy-back transactions	182 295	114 322
Liabilities in respect of cash collaterals	412 425	361 725
Payables to be settled	5 595	1 280
Other	100 802	56 829
Amounts due to other banks	**5 089 716**	**8 503 014**
Short-term (up to 1 year)	**4 571 748**	**4 863 141**
Long-term (over 1 year)	**517 968**	**3 639 873**

As at 31 December 2017, the value of fixed rate deposits from other banks was PLN 90 442 thousand (31 December 2016: PLN 44 293 thousand). In the both reporting periods there were no variable rate term deposits.

As at 31 December 2017 and as at 31 December 2016, loans and advances received from banks were variable interest rate loans.

The average interest rate for loans and deposits obtained from banks in 2017 amounted to 0.80% (31 December 2016: - 0.68%).

mBank 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.

29. Amounts due to customers

	31.12.2017	31.12.2016
Individual customers:	**55 693 463**	**53 494 777**
Current accounts	43 733 114	38 051 354
Term deposits	11 819 154	15 380 844
Other liabilities, due to:	141 195	62 579
- liabilities in respect of cash collaterals	62 214	31 033
- other	78 981	31 546
Corporate customers:	**42 425 328**	**44 926 009**
Current accounts	21 536 076	22 148 665
Term deposits	8 095 092	8 952 129
Loans and advances received	4 142 944	4 201 768
Repo transactions	439 637	1 600 487
Other liabilities, due to:	8 211 579	8 022 960
- liabilities in respect of cash collaterals	8 149 634	7 962 137
- other	61 945	60 823
Public sector customers:	**1 212 780**	**539 534**
Current accounts	623 231	466 078
Term deposits	585 389	65 507
Other liabilities, due to:	4 160	7 949
- liabilities in respect of cash collaterals	-	3
- other	4 160	7 946
Total amounts due to customers	**99 331 571**	**98 960 320**
Short-term (up to 1 year)	**86 908 844**	**85 163 858**
Long-term (over 1 year)	**12 422 727**	**13 796 462**

As at 31 December 2017 and 31 December 2016, 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 0.67% (31 December 2016: 0.85%).

As at 31 December 2017, loans and advances received include loans received from European Investment Bank amounting to PLN 4 142 944 thousand (31 December 2016: PLN 4 201 768 thousand). The two of those loans with fixed interest rate are collateralized with treasury bonds, which have been disclosed as pledge assets under Note 22 and Note 37.

As at 31 December 2017, the amount of cash collateral liabilities to corporate customers includes security deposits in the amount of PLN 7 801 298 thousand, accepted from mFinance France S.A. (mFF), in connection with guarantees granted by the Bank for amounts to be paid for debt securities issued by the mFF (31 December 2016 – security deposits in the amount of PLN 7 568 289 thousand).

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 2017						
- Commerzbank AG	80 000	CHF	3M LIBOR + 3.4%**	2.6412	perpetual [1)]	285 627
- Commerzbank AG	170 000	CHF	3M LIBOR + 2.2%***	1.4740	perpetual [1)]	608 510
- Investors not associated with mBank S.A.	500 000	PLN	6M WIBOR + 2.25%	4.0600	20.12.2023	500 581
- Investors not associated with mBank S.A.	750 000	PLN	6M WIBOR + 2.1%	3.9100	17.01.2025	763 425
						2 158 143

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

* 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 20 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 2017 and 2016, 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 mBank obtained permission of the KNF to include in Tier 2 capital the amount of PLN 750 000 thousand constituting subordinated liability 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 liability 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.

Movements in subordinated liabilities

	31.12.2017	31.12.2016
As at the beginning of the period	**3 943 349**	**3 827 315**
- disposals (repayment, early redemption)	(1 611 840)	-
- exchange differences	(172 605)	115 635
- other changes	(761)	399
Subordinated liabilities as at the end of the period	**2 158 143**	**3 943 349**
Short-term (up to 1 year)	**2 337**	**1 664 119**
Long-term (over 1 year)	**2 155 806**	**2 279 230**

On 8 March 2017, mBank S.A. redeemed subordinated bonds in the amount of CHF 400 000 thousand (equivalent of PLN 1 611 840 thousand at the average NBP exchange rate as of 8 March 2017), issued on 8 March 2007 and acquired by Commerzbank AG.

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31. Other liabilities

	31.12.2017	31.12.2016
Other liabilities, including		
- tax liabilities	41 079	47 011
- interbank settlements	1 012 280	781 638
- creditors	527 971	435 504
- accrued expenses	173 628	127 859
- deferred income	206 367	197 062
- provisions for post-employment employee benefits	16 924	12 918
- provisions for holiday equivalents	20 924	19 067
- provisions for other liabilities to employees	146 267	136 761
- other	25 973	34 920
Total other liabilities	**2 171 413**	**1 792 740**

As at 31 December 2017, the note presented above includes financial liabilities in the amount of PLN 1 713 879 thousand (31 December 2016: PLN 1 345 001 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 2017, liabilities from creditors include the value of financial lease in the amount of PLN 21 523 thousand (in 2016: PLN 29 653 thousand).

Movements in provisions for post-employment employee benefits

	31.12.2017	31.12.2016
Provisions for post-employment employee benefits		
As at the beginning 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
Change in the period (due to)	**4 006**	**586**
Provisions created, due to:	**623**	**572**
pension and disability provisions	392	350
provisions for death severance	122	121
provisions for the Social Benefit Fund	109	101
Interest expense, due to:	**440**	**360**
pension and disability provisions	204	173
provisions for death severance	132	110
provisions for the Social Benefit Fund	104	77
Actuarial gains and losses recognised in other comprehensive income (Note 15), due to:	**3 812**	**(411)**
pension and disability provisions	2 365	(668)
provisions for death severance	(520)	(202)
provisions for the Social Benefit Fund	1 967	459
Benefits paid, due to:	**(869)**	**(729)**
pension and disability provisions	(483)	(370)
provisions for the Social Benefit Fund	(386)	(359)
Other changes, due to:	**-**	**794**
pension and disability provisions	-	569
provisions for death severance	-	225
As at the end of the period (by type)	**16 924**	**12 918**
pension and disability provisions	8 496	6 018
provisions for death severance	3 644	3 911
provisions for the Social Benefit Fund	4 783	2 989

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Short-term (up to 1 year)	**1 001**	**687**
pension and disability provisions	688	410
provisions for death severance	246	224
provisions for the Social Benefit Fund	67	53
Long-term (over 1 year)	**15 923**	**12 231**
pension and disability provisions	7 808	5 608
provisions for death severance	3 399	3 687
provisions for the Social Benefit Fund	4 716	2 936

	31.12.2017	31.12.2016
Breakdown of actuarial gains and losses		
Change in financing assumptions, due to:	**661**	**(1 292)**
pension and disability provisions	225	(592)
provisions for death severance	141	(372)
provisions for the Social Benefit Fund	295	(328)
Change in demographic assumptions, due to:	**1 909**	**270**
pension and disability provisions	1 815	112
provisions for death severance	(794)	132
provisions for the Social Benefit Fund	888	26
Other changes, due to:	**1 242**	**611**
pension and disability provisions	325	(188)
provisions for death severance	133	38
provisions for the Social Benefit Fund	784	761

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 as at 31 December 2017 was decreased by 0.5 p.p., the value of the provisions would increase by PLN 593 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 549 thousand.

32. Provisions

	31.12.2017	31.12.2016
For off-balance sheet granted contingent liabilities *	75 654	43 376
For legal proceedings	95 282	113 192
Other	19 978	26 080
Total provisions	**190 914**	**182 648**

* includes valuation of financial guarantees

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

	31.12.2017	31.12.2016
As at the beginning 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
Change in the period (due to)	**8 266**	**(42 696)**
- increase of provisions, due to:	182 736	137 628
for off-balance-sheet granted contingent liabilities (Note 12)	*135 665*	*113 948*
for legal proceedings	*32 997*	*19 684*
other	*14 074*	*3 996*
- release of provisions, due to:	(161 721)	(119 138)
for off-balance-sheet granted contingent liabilities (Note 12)	*(101 567)*	*(116 453)*
for legal proceedings	*(45 360)*	*(2 310)*
other	*(14 794)*	*(375)*
- write-offs	(2 723)	(61 488)
- utilization	(5 486)	-
- reclassification	(2 587)	-
- foreign exchange differences	(1 953)	302
As at the end of the period (by type)	**190 914**	**182 648**
For off-balance sheet granted contingent liabilities	75 654	43 376
For legal proceedings	95 282	113 192
Other	19 978	26 080

Provisions for off-balance sheet granted contingent liabilities

	31.12.2017	31.12.2016
Incurred but not identified losses		
Off-balance sheet contingent liabilities	40 110 411	34 942 356
Provisions for off-balance sheet contingent liabilities analysed according to portfolio approach (negative amount)	(27 461)	(25 772)
Net off-balance sheet contingent liabilities	**40 082 950**	**34 916 584**
Off-balance sheet granted contingent liabilities with impairment		
Off-balance sheet contingent liabilities	165 346	32 388
Provisions for off-balance sheet contingent liabilities analysed individually (negative amount)	(48 193)	(17 604)
Net off-balance sheet contingent liabilities	**117 153**	**14 784**

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 2017 and 2016.

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 01.01.2017	Recognised in the income statement	Recognised in other comprehensive income	Other changes	As at 31.12.2017
Interest accured	40 179	(2 299)	-	-	**37 880**
Valuation of investment securities	45 829	2 352	(14 649)	-	**33 532**
Provisions for impairment of loans and advances	220 915	1 671	-	-	**222 586**
Provisions for employee benefits	30 416	1 928	724	-	**33 068**
Other provisions	5 652	(764)	-	-	**4 888**
Prepayments/accruals	22 837	7 476	-	-	**30 313**
Other negative temporary differences	41 905	184	-	(2)	**42 087**
Total deferred income tax assets	**407 733**	**10 548**	**(13 925)**	**(2)**	**404 354**

Deferred income tax liabilities	As at 01.01.2017	Recognised in the income statement	Recognised in other comprehensive income	Other changes	As at 31.12.2017
Interest accured	(56 000)	(856)	-	-	**(56 856)**
Valuation of derivative financial instruments	(33 995)	14 116	857	-	**(19 022)**
Valuation of investment securities	(69 156)	(21 386)	(26 958)	-	**(117 500)**
Interest and fees received in advance	(20 896)	19 358	-	-	**(1 538)**
Difference between tax and book value of tangible and intangible assets	(45 652)	585	-	-	**(45 067)**
Prepayments regarding amortization of applied investment relief	(18 657)	-	-	-	**(18 657)**
Other positive temporary differences	(16 784)	26	-	-	**(16 758)**
Total deferred income tax liabilities	**(261 140)**	**11 843**	**(26 101)**	**-**	**(275 398)**

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 accured	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**

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 accured	(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 included in the income statement	31.12.2017	31.12.2016
Interest accured	(3 155)	(1 379)
Valuation of derivative financial instruments	14 116	1 530
Valuation of securities	(19 034)	(19 968)
Provisions for impairment of loans and advances	1 671	27 297
Provisions for employee benefits	1 928	3 306
Other provisions	(764)	(12 121)
Prepayments/accruals	7 476	(524)
Interest and fees received in advance	19 358	17 730
Difference between tax and book value of tangible and intangible assets	585	1 652
Other temporary differences	210	(6 887)
Total deferred income tax included in the profit and loss account (Note 13)	**22 391**	**10 636**

Deferred tax assets are recognised, because it is probable that future taxable profit will occur.

A level of deferred tax asset for the year 2017 and 2016 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 2018 and 2021 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 2017, 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 2017 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.

Information on the most important court proceedings relating to the issuer's contingent liabilities

1. Claims of Interbrok's clients

   Since 14 August 2008, 170 entities which have been clients of Interbrok Investment E. Dróżdż i Spółka Spółka jawna (hereinafter Interbrok) called the Bank for amicable settlement for the total amount of PLN 385 520 thousand via the District Court in Warsaw. Nine compensation lawsuits were filed against the Bank. Eight of the nine lawsuits were filed by former clients of Interbrok for the total amount of PLN 800 thousand with the proviso that the claims may be extended up to the total amount of PLN 5 950 thousand. The plaintiffs alleged that the Bank had aided in Interbrok's illegal activities, which caused damage to them. With regard to seven of the afore-mentioned cases, legal proceedings against the Bank were dismissed and the cases were finally concluded. In the eighth case, a plaintiff withdrew their suit waiving the claim and the Regional Court dismissed the action. As far as the ninth suit is concerned, the amount in dispute is PLN 275 423 thousand, including statutory interest and costs of proceedings. According to the claims brought in the suit, this amount comprises the receivables, acquired by the plaintiff by way of assignment, due to the parties aggrieved by

Interbrok on account of a 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 aid in committing the illicit act of Interbrok, consisting in unlicensed brokerage operations. On 7 November 2017, the Regional Court in Warsaw dismissed the action in its entirety. The ruling is not final.

2. Class action against mBank S.A. concerning the clause on changing interest rate

On 4 February 2011, a class action filed with the Regional Court in Łódź on 20 December 2010 by the Municipal Consumer Ombudsman representing a group of 835 individuals, the Bank's retail banking clients, was served on the Bank. The class action was filed to determine the Bank's liability for the improper performance of mortgage loan agreements. It was in particular claimed that the Bank had improperly applied provisions of agreements on changing interest rate, namely that the Bank had not lowered interest on loans, despite the fact that, according to the plaintiff, it was obliged to do so. The Bank does not agree with the above-mentioned allegations. On 18 February 2011, the Bank responded to the lawsuit filing for its dismissal in whole.

On 6 May 2011, the Regional Court in Łódź decided to dismiss the application for dismissing the lawsuit, filed by mBank S.A., and admitted the case to be heard as a class action. In response to this decision, mBank S.A. filed a complaint with the Court of Appeal in Łódź on 13 June 2011. However, the Court of Appeal in Łódź dismissed mBank S.A.'s complaint on 28 September 2011. Currently, the case proceeds as a class action. Until March 2012, new individuals had been joining the class action. As at 17 October 2012, the group of class members consisted of 1 247 individuals. The Regional Court in Łódź did not establish bail for the benefit of mBank S.A., which was applied for by the Bank. The Bank filed a complaint about this decision. But on 29 November 2012, the Court of Appeal in Łódź overturned the Bank's complaint about the establishment of bail. The judgment is binding and the plaintiff is not obliged to pay bail. The final statement of defence was sent in January 2013 and on 15 February 2013, the plaintiff answered it in a pleading. By its decision of 18 February 2013, the Regional Court in Łódź submitted the case to mediation. On 26 February 2013, the Municipal Consumer Ombudsman appealed against the case being submitted to mediation. On 22 June 2013, a trial was held and on 3 July 2013, the Court announced its judgment allowing the claim in full. According to the Court, the Bank did not properly execute the agreements concluded with consumers, as a result of which they suffered losses. The Bank appealed against this judgment on 9 September 2013. However, on 30 April 2014, the Court of Appeal in Łódź dismissed the appeal of mBank S.A., upholding the stance adopted by the Regional Court expressed in the judgment. Upon receiving a written justification of the judgment, mBank S.A. brought a cassation appeal. The cassation appeal was filed with the Supreme Court by mBank S.A. on 3 October 2014. By its decision of 7 October 2014, the Court of Appeal in Łódź suspended the enforcement of the judgment passed by the Regional Court until the cassation appeal of mBank S.A. has been resolved. On 18 February 2015, the Supreme Court accepted the cassation appeal filed by mBank S.A. for review. On 14 May 2015, the Supreme Court revoked the ruling of the Court of Appeal in Łódź and referred the case back to that court for re-examination. By the decision of 24 September 2015, the Court of Appeal in Łódź admitted the expert opinion evidence in order to verify the legality of mBank's actions connected with changing the interest rates on the mortgage loans covered by the class action in the period from 1 January 2009 to 28 February 2010.

mBank S.A. received the expert's opinion in April 2016. Both parties filed pleadings in which they commented on the opinion. On 22 June 2016, the Court of Appeal in Łódź obliged the expert to submit a supplementary opinion answering the comments made by the parties. The supplementary opinion was issued in September 2016. The expert sustained all the arguments and the standpoint presented in the initial opinion.

On 24 February 2017, a trial was held during which the court admitted the oral supplementary expert opinion as evidence; however, the opinion did not allay the Court's doubts so by the resolution of 6 April 2017, the Court of Appeal admitted another written supplementary expert opinion as evidence. The supplementary opinion was issued by an expert and presented to Parties for comments. On 29 September 2017, the Bank submitted a comprehensive piece of writing with its comments on the opinion. The Parties have been exchanging their opinions to date - mBank provided further explanations relating to the manner and methodology of setting the loan interest rate. The Bank is waiting for the date of the hearing before the Court of Appeal in Łódź to be set.

3. Class action against mBank S.A. concerning indexation clauses

On 4 April 2016, the Municipal Consumer Ombudsman representing a group of 390 individuals, retail clients of mBank, who concluded agreements on CHF-indexed mortgage loans with mBank, filed a class action with the Regional Court in Łódź against the Bank. With subsequent pleadings, the plaintiff reported other individuals who gradually joined the class action.

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The class action includes alternative claims for declaring invalidity of the loan agreements in part i.e. in the scope of the provisions related to indexation, or in whole; or for finding that the indexation provisions are invalid as they permit indexation of over 20% and below 20% at the CHF exchange rate from the table of exchange rates of mBank S.A. applicable as at the date of conclusion of each of the loan agreements.

By its decision of 19 December 2016, the Regional Court in Łódź admitted the case to be heard as a class action. mBank filed a complaint about this decision; however, the Court of Appeal in Łódź dismissed the complaint on 15 March 2017.

By its decision of 9 May 2017, the Regional Court in Łódź decided on instigating a class action and set the time limit of three months from the publication of the decision for persons whose claims may be covered by the class action to join the class. Within the time limit set, 352 persons joined the group of class members. At present, there are 1 717 individuals in the group. The Court has not set the date of the trial.

As at 31 December 2017, 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 2017 was also not higher than 10% of the Bank's equity.

Taxes

On 23 November 2017 at mBank S.A. has started the tax inspection regarding the correctness of settlement of the tax on goods and services due to the import of services for 2015, conducted by employees of the Mazowiecki Customs and Tax Office in Warsaw. The tax audit is under way.

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.

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 financial 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 2017 and 31 December 2016.

31.12.2017		Up to 1 year	1 - 5 years	Over 5 years	Total
1.	**Contingent liabilities granted and received**	**27 125 386**	**15 090 392**	**2 129 302**	**44 345 080**
	Commitments granted	**25 276 841**	**13 374 764**	**1 690 420**	**40 342 025**
	1. Financing	20 567 540	4 013 179	501 647	25 082 366
	a) Loan commitments	20 544 310	3 970 141	501 647	25 016 098
	b) Operating lease commitments	23 230	43 038	-	66 268
	2. Guarantees and other financial facilities	4 309 301	9 361 585	1 188 773	14 859 659
	a) Banker's acceptances	-	-	-	-
	b) Guarantees and standby letters of credit	4 309 301	9 361 585	1 188 773	14 859 659
	3. Other commitments	400 000	-	-	400 000
	Commitments received	**1 848 545**	**1 715 628**	**438 882**	**4 003 055**
	a) Financial commitments received	13 222	-	-	13 222
	b) Guarantees received	1 835 323	1 715 628	438 882	3 989 833
2.	**Derivative financial instruments (nominal value of contracts)**	**159 031 356**	**238 279 075**	**33 667 353**	**430 977 784**
	1. Interest rate derivatives	87 608 656	214 666 186	31 932 357	334 207 199
	2. Currency derivatives	70 029 917	22 143 926	1 429 596	93 603 439
	3. Market risk derivatives	1 392 783	1 468 963	305 400	3 167 146
	Total off-balance sheet items	**186 156 742**	**253 369 467**	**35 796 655**	**475 322 864**

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**

The above presented 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 2017, commitments received by the Bank in the amount of PLN 4 003 055 thousand (31 December 2016: PLN 2 586 962 thousand), related mainly to guarantees received as collateral of loans and advances granted.

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 2017 and 31 December 2016. Treasury securities are the main component of the Banks's liquidity collateral that can be eligible to pledge.

31.12.2017

Position (PLN 000's)	Assets			Collateral received in kind of securities related with buy sell back transactions			Assets available for pledge (3+6)
	Total assets	Pledged assets	Eligible for pledge assets	Received	Reused	Available for pledge	
	1	2	3	4	5	6	7
Debt securities (Note 18 and Note 22) including:	**32 601 146**	**6 525 063**	**24 608 420**	**-**	**-**	**-**	**24 608 420**
- NBP bills	2 199 429	-	2 199 429	-	-	-	2 199 429
- Government bonds	27 516 478	6 324 695	21 191 783	-	-	-	21 191 783
- Mortgage bonds	443 380	200 368	243 012	-	-	-	243 012
- Other non-treasury securities	2 441 859	-	974 196	-	-	-	974 196
Cash collaterals (due to derivatives transactions) (Note 17 and 21)	365 385	365 385	-	-	-	-	-
Property collateral	-	-	-	-	-	-	-
Other assets	91 602 952	-	-	-	-	-	-
Total	**124 569 483**	**6 890 448**	**24 608 420**	**-**	**-**	**-**	**24 608 420**

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 assets	Pledged assets	Eligible for pledge assets	Received	Reused	Available for pledge	
	1	2	3	4	5	6	7
Debt securities (Note 18 and Note 22) including:	**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 non-treasury securities	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**

The value of treasury securities presented as pledged assets, except for collaterals due to sell-buy-back transactions, includes Bank's collateral of liabilities due to the fixed interest rate 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 2017 was 42 312 122 shares (31 December 2016: 42 280 127 shares) of PLN 4 nominal value each. All issued shares were fully paid up.

REGISTERED SHARE CAPITAL (THE STRUCTURE) AS AT 31 DECEMBER 2017						
Share type	**Type of preference**	**Type of restrictions**	**Number of shares**	**Series / issue nominal value (PLN)**	**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
ordinary bearer	-	-	31 995	127 980	fully paid in cash	2017
Total number of shares			**42 312 122**			
Total registered share capital				**169 248 488**		
Nominal value per share (in PLN)		**4**				

* As at the end of the reporting period

In 2017, the National Depository of Securities (KDPW) has registered 31 995 shares of mBank, 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. As a result of the above registration, in 2017 the mBank's share capital increased by PLN 127 980.

On 30 March 2017, the 30th Ordinary General Meeting of mBank S.A., adopted the resolution on amending the By-laws of mBank S.A. and authorization of the Management Board of mBank S.A. upon the consent of the Supervisory Board of mBank S.A. to increase the share capital of mBank S.A. by an amount not higher than PLN 60 000 000 through the issue of bearer shares with the option to exclude pre-emptive rights of existing shareholders of mBank S.A. in whole or in part.

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Commerzbank AG is a shareholder holding over 5% of the share capital and votes at the General Meeting and as at 31 December 2017 it held 69.37% of the share capital and votes at the General Meeting of mBank S.A.

In 2017, 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 (currently: Nationale-Nederlanden 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 S.A., 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 2017 and 2016 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 years 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.

	31.12.2017	31.12.2016
Other supplementary capital	7 145 517	4 384 011
Other reserve capital	22 638	26 891
General banking risk reserve	1 115 143	1 095 143
Profit from the previous year	1 199 339	2 761 506
Profit for the current year	1 089 704	1 219 339
Total retained earnings	**10 572 341**	**9 486 890**

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.

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41. Other components of equity

	31.12.2017	31.12.2016
Exchange differences on translating foreign operations	**(5 336)**	**(5 953)**
Unrealized gains (foreign exchange gains)	3 671	3 706
Unrealized losses (foreign exchange losses)	(9 007)	(9 659)
Available-for-sale financial assets	**164 413**	**(2 431)**
Unrealized gains on debt instruments	191 650	68 772
Unrealized losses on debt instruments	(7 562)	(89 072)
Unrealized gains on equity instruments	15 903	1 307
Deferred income tax	(35 578)	16 562
Cash flow hedges	**(5 198)**	**(1 545)**
Unrealized gains	2 877	1 065
Unrealized losses	(9 295)	(2 972)
Deferred income tax	1 220	362
Actuarial gains and losses relating to post-employment benefits	**(6 605)**	**(3 517)**
Actuarial (losses)	(8 154)	(4 342)
Deferred income tax	1 549	825
Share of other comprehensive income of entities under the equity method	**3 770**	**(737)**
Share of other comprehensive income of subsidiaries and associates	3 770	(737)
Total other components of equity	**151 044**	**(14 183)**

In 2017, unrealized gains on equity instruments relate mainly to positive valuation of debt securities of the banking book, caused by a decrease in interest rates in the first half of 2017, resulting from interest rate drops in global markets.

42. Dividend per share

On 30 March 2017, the 30th Ordinary General Meeting of mBank S.A., adopted the resolution on division of the 2016 profit which does not provide for the payment of dividend for the year 2016.

43. Explanatory notes to the statement of cash flows

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.

	31.12.2017	31.12.2016
Cash and balances with the Central Bank (Note 16)	7 383 518	9 158 751
Loans and advances to banks (Note 17)	1 134 541	2 325 904
Trading securities (Note 18)	1 232 515	3 503 029
Total cash and cash equivalents	**9 750 574**	**14 987 684**

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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

	Year ended 31 December	
	2017	**2016**
Loans and advances to banks - change in the balance of the statement of financial position	**1 245 067**	**(2 327 448)**
The difference between the interest accrued and paid in cash in the reporting period	(107 683)	(70 361)
Exclusion of a change in the balance of cash and cash equivalents	(1 191 363)	1 542 576
Total change in loans and advances to banks	**(53 979)**	**(855 233)**
Trading securities - change in the balance of the statement of financial position	**2 289 804**	**(3 279 016)**
Exclusion of a change in the balance of cash and cash equivalents	**(2 270 514)**	**3 324 537**
Total change in trading securities	**19 290**	**45 521**
Derivative financial instruments - change in the balance of the statement of financial position	**81 542**	**(27 228)**
The difference between the interest accrued and paid in cash in the period	79 833	81 994
Valuation included in other comprehensive income	(4 511)	(2 967)
Total change in derivative financial assets	**156 864**	**51 799**
Loans and advances to customers - change in the balance of the statement of financial position	**(1 127 607)**	**(1 019 899)**
The difference between the interest accrued and paid in cash in the reporting period	**(103 546)**	**(59 986)**
Total change in loans and advances to customers	**(1 231 153)**	**(1 079 885)**
Investment securities and investments in subsidiaries and associates- change in the balance of the statement of financial position	**(950 088)**	**(509 110)**
Valuation included in other comprehensive income	218 984	(584 986)
The difference between the interest accrued and paid in cash in the period	(298 392)	(39 471)
Sale of investments securities and investments in subsidiaries	(32 863)	165 243
Exclusion of a change in the balance resulting from valuation using equity method in investments in subsidiaries and associates	51 350	-
Increase of involvement in subsidiaries and non-controlling interests included in financing activity	349 039	102 200
Total change in investment securities	**(661 970)**	**(866 124)**
Changes in other assets - change in the balance of the statement of financial position	**(47 732)**	**(88 777)**
Balances unrealised in cash recognised in income statement	**7 066**	**(4 294)**
Total change in other assets	**(40 666)**	**(93 071)**
Amounts due to other banks - change in the balance of the statement of financial position	**(3 413 298)**	**(3 680 177)**
The difference between the interest accrued and paid in cash in the reporting period	(42 415)	(60 042)
Exclusion of change in cash flows from financing activity	3 568 353	2 380 870
Total change in amounts due to other banks	**112 640**	**(1 359 349)**
Amounts due to customers including hedge accounting adjustments related to fair value hedged items - change in the balance of the statement of financial position	**310 731**	**13 045 167**
The difference between the interest accrued and paid in cash in the reporting period	40 773	(138 151)
Exclusion of change in cash flows from financing activity	(770 956)	(2 723 902)
Total change in amounts due to customers	**(419 452)**	**10 183 114**
Changes in other liabilities - change in the balance of the statement of financial position	**378 673**	**406 476**
Valuation of incentive programmes recognised in income statement (Note 10)	8 700	9 088
Exclusion of tax liabilities of certain financial institutions	833	29 820
Exclusion of settlements arising from the application of the equity method	2 376	20 460
Actuarial gains and losses relating to post-employment benefits recognised in other comprehensive income (Note 15)	724	411
Total change in other liabilities	**391 306**	**466 255**

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Interests received and paid from operating activities

	Year ended 31 December	
	2017	2016
Interest income, including:		
Loans and advances to banks	165 299	126 742
Loans and advances to customers	2 666 791	2 375 517
Trading debt securities	63 651	79 719
Investment securities	949 535	901 357
Interest income on derivatives classified into banking book	38 440	101 826
Interest income on derivatives concluded under hedge accounting	65 511	60 934
Other interest income	4 551	2 290
Total interest income	**3 953 778**	**3 648 385**

	Year ended 31 December	
	2017	2016
Interest expense, including:		
Settlements with banks due to deposits received	(16 363)	(14 962)
Settlements with customers due to deposits received	(545 329)	(642 102)
Security deposit received in relation with the guarantee granted to secure underwriting of securities	(152 612)	(130 947)
Other interest expense	(7 520)	(3 992)
Total interest expense	**(721 824)**	**(792 003)**

Cash flows from investing activities

In 2017, cash flows from investing activities were related to the acquisition, sale and increase of shares in subsidiaries as well as dividends received by the Bank. Other cash flows from this activity relate to settlements in connection with the purchase of intangible assets and fixed assets.

Except for dividends received by the Bank, income from the sale of fixed assets as well as sale of shares of subsidiary (Note 23), cash flows from investing activities comprise the funds received in 2016 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 28) and the European Investment Bank (Note 29).

In addition, in 2017 and 2016 the inflows from financing activities of the Bank include the security deposits received 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 CHF200 000 and EUR 500 000 thousand respectively.

The following table presents the change in liabilities as part of financial activities.

	As at 31.12.2016	Cash flows	Change not connected with cash fows	As at 31.12.2017
Loans and advances to banks (Note 28)	6 964 907	(2 758 658)	(811 909)	3 394 340
Loans and advances to other customers (Note 29)	4 201 768	192 646	(251 470)	4 142 944
Liabilities due to security deposits received in relation with the granted guarantees (Note 29)	7 568 289	791 720	(558 711)	7 801 298
Subordinated liabilities (Note 30)	3 943 349	(1 681 347)	(103 859)	2 158 143
Total liabilities from financing activities	**22 678 313**	**(3 455 639)**	**(1 725 949)**	**17 496 725**

In the change not related to cash flows were included exchange differences and accrued interest.

44. Share-based incentive programmes

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, of which the last settlements were completed in 2016.

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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 of the Supervisory Board 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.

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.

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.

	31.12.2017		31.12.2016	
	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	**5 381**	**-**	**19 363**	**-**
Granted during the period	-	-	-	-
Forfeited during the period	574	-	-	-
Exercised during the period*	4 807	4	13 982	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**-**	**-**	**5 381**	**-**
Exercisable at the end of the period	**-**	**-**	**-**	**-**

* In 2017, the weighted average price of the shares was PLN 421.21 (in 2016 PLN 329.60).

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 were recognised in the income statement in the correspondence with other reserve capital. The last settlements of this program were carried out in 2017.

This was equity-settled share-based program.

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2014 Incentive Programme for the Management Board Members of the Bank

On 31 March 2014 the Supervisory Board in accordance with the recommendation of Remuneration Committee of the Supervisory Board 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 Management Board Members have the right to bonus, including non-cash bonus paid in Bank's shares, including phantom shares.

The net ROE of mBank 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.

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 of share options related to the 2014 incentive programme for Management Board Members of the Bank.

	31.12.2017		31.12.2016	
	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	**17 210**	**-**	**9 776**	**-**
Granted during the period	11 993	-	17 828	-
Forfeited during the period	3 385	-	-	-
Exercised during the period*	10 276	4	10 394	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**15 542**	**-**	**17 210**	**-**
Exercisable at the end of the period	**-**	**-**	**-**	**-**

* In 2017, the weighted average price of the shares was PLN 421.21 (in 2016 PLN 329.60).

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.

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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 Supervisory Board Remuneration Committee.

Employee programme for key management staff of mBank Group of 2013

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, of which the last settlements were completed in 2016.

The aim of the programme was 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 Group variable components of remuneration of the persons holding managerial positions at mBank Group in accordance with the Resolution of the KNF.

The programme was applied to the employees having a material impact on the risk profile of mBank 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 Group, growth in the value of the Bank.

During the programme the rights to acquire bonds with pre-emptive rights to subscribe for the Bank's shares under Tranche VI have been granted, which might be exercised after 12, 24 and 36 months from the date of granting these rights, in accordance with the internal regulations adopted in mBank Group specifying rules of variable remuneration of the employees having a material impact on the risk profile at mBank Group.

The Bank's Management Board/Supervisory Board of the Company, where the Programme was carried out could decide to suspend the implementation of the Programme in whole or decrease 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.

All bonds granted under this programme have already been acquired by eligible persons.

Cash Part of the Bonus

The bonus in the amount of 50% of the base amount for the year was recognised as a liability to employees and was charged to the income statement in the year that 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 was charged to the income statement and recognised in correspondence with other reserve capital.

The last settlements related to this program were realized in 2017.

This was 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.

	31.12.2017		31.12.2016	
	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	**742**	**-**	**1 486**	**-**
Granted during the period	-	-	-	-
Forfeited during the period	-	-	-	-
Exercised during the period*	742	4	744	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**-**	**-**	**742**	**-**
Exercisable at the end of the period	**-**	**-**	**-**	**-**

* In 2017, the weighted average price of the shares was PLN 421.21 (in 2016 PLN 329.60).

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Employee programme for key management staff of mBank Group of 2014

On 31 March 2014, the Supervisory Board of the mBank 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 with pre-emptive rights to acquire shares of the Bank or were granted right to acquire bonds in Tranches III, IV, V and VI the programme was to 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 Group with the interest of the Company and its shareholders and implementing in mBank Group variable components of remuneration of the persons holding managerial positions at mBank 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 Group specifying rules of variable remuneration of the employees having a material impact on the risk profile at mBank 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.

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 change in the number and weighted average exercise prices of share options related to the 2014 incentive programme for key managers of mBank Group.

	31.12.2017		31.12.2016	
	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	**11 309**	**-**	**2 322**	**-**
Granted during the period	20 339	-	24 789	-
Forfeited during the period	82	-	-	-
Exercised during the period*	16 170	4	15 802	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**15 396**	**-**	**11 309**	**-**
Exercisable at the end of the period	**-**	**-**	**-**	**-**

* In 2017, the weighted average price of the shares was PLN 421.21 (in 2016 PLN 329.60).

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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.

	31.12.2017	31.12.2016
Incentive programs		
As at the beginning of the period	**26 891**	**32 976**
- value of services provided by the employees	8 700	9 088
- settlement of exercised options	(12 953)	(15 173)
As at the end of the period	**22 638**	**26 891**

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, under the project carried out by the mBank 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 in 2017 was related to retail receivables in the nominal amount of PLN 530 million. In 2017 transfers described above did not occur.

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 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 with transactions with other Commerzbank AG Group entities. The amounts of transactions include assets, liabilities and related costs and income as at 31 December 2017 and 31 December 2016 and for the respective periods then ended are as follows:

(in PLN 000's)	Members of Supervisory Board, Management Board and key management personnel of mBank as well as Supervisory Board and Management Board of Commerzbank AG		Other related persons *		mBank's subsidiaries		Commerzbank AG		Other companies of the Commerzbank AG Group excluding mBank subsidiaries	
As at the end of the period	**31.12.2017**	**31.12.2016**	**31.12.2017**	**31.12.2016**	**31.12.2017**	**31.12.2016**	**31.12.2017**	**31.12.2016**	**31.12.2017**	**31.12.2016**
Statement of Financial Position										
Assets	1 522	7 764	85	49	15 030 592	13 390 749	610 053	698 299	9 084	1 783
Liabilities	11 895	25 091	1 140	1 768	8 085 667	7 800 587	4 053 070	9 570 604	37 064	34 643
Income Statement										
Interest income	14	308	3	2	269 619	192 094	110 603	125 233	431	785
Interest expense	(118)	(472)	(7)	(24)	(157 822)	(136 306)	(107 883)	(129 296)	(293)	(359)
Commission income	76	57	13	6	18 232	10 671	1 158	-	39	-
Commission expense	-	-	-	-	(110 433)	(99 261)	(5)	-	-	-
Other operating income	-	-	-	-	11 082	12 244	24	18	-	-
Overhead costs amortisation and other operating expenses	-	-	-	-	(12 360)	(20 120)	(8 865)	(9 503)	-	-
Contingent liabilities granted and received										
Commitments granted	635	1 341	121	114	10 254 799	8 906 259	2 099 374	1 295 444	7 057	12 923
Commitments received	-	-	-	-	-	-	1 632 240	1 442 052	8 385	12 422

* 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 2017 and 2016, no provisions were created in connection with credits granted to related entities.

<u>Management Board Remuneration</u>

At the end of 2017, 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. Frank Bock - Vice-President of the Management Board, Head of Financial Markets,
4. Andreas Böger - Vice-President of the Management Board, Chief Financial Officer,
5. Krzysztof Dąbrowski - Vice-President of the Management Board, Head of Operations and IT,
6. Cezary Kocik – Vice-President of the Management Board, Head of Retail Banking,
7. Adam Pers - Vice-President of the Management Board, Head of Corporate and Investment Banking.

Changes in the Management Board of mBank S.A.

- On 1 March 2017, Vice-President of the Management Board of mBank S.A., Mr. Hans-Dieter Kemler resigned from his function at the Bank. The resignation has taken effect as of 30 April 2017. Mr. Kemler decided to resign as he was offered the position of a member of the management board in German Landesbank Hessen Thueringen (Helaba) responsible for financial markets, Treasury and asset management.
- On 30 March 2017, Vice President of the Management Board, Mr. Jarosław Mastalerz, resigned from his function in the Bank. The resignation took place on 31 March 2017. The reason for the Mr. Mastalerz resignation was his intention to engage in development and commercializing of new technologies in the finance sector within the project realized in cooperation with the Bank.
- On 30 March 2017, Vice President of the Management Board of mBank S.A. – Chief Financial Officer, Mr. Christoph Heins, resigned from his function in the Bank. The resignation was taken place on 30 June 2017.
- By the resolution of the Supervisory Board of mBank S.A., on 30 March 2017, Mr. Krzysztof Dąbrowski was appointed to the position of Vice President of the Management Board of mBank S.A. – the Head of Operations and Information Technology with the effect as of 1 April 2017 until the end of the current term of office of the Management Board.
- By the resolution of the Supervisory Board of mBank S.A., on 30 March 2017, Mr. Frank Bock was appointed to the position of Vice President of the Management Board of mBank S.A. - Head of Financial Markets with the effect as of 1 May 2017 until the end of the current term of office of the Management Board.
- By the resolution of the Supervisory Board of mBank S.A., on 30 March 2017, Mr. Andreas Böger was appointed to the position of Vice President of the Management Board of mBank S.A. - Chief Financial Officer with the effect as of 1 July 2017 until the end of the current term of office of the Management Board.

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- On 12 September 2017, Vice-President of the Management Board of mBank S.A. - Head of Corporate and Investment Banking, Mr. Przemysław Gdański, resigned from his function at the Bank. The resignation took place on October 25, 2017. On 25 October 2017 the Supervisory Board of mBank S.A. appointed Mr. Adam Pers, as the Bank's Vice-President of the Management Board Head of Corporate and Investment Banking the effect as of 26 October 2017. Until that date Mr. Adam Pers was the Managing Director for the Financial Markets.

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 2017, as at 31 December 2017 is presented below:

		Remuneration paid in 2017 (in PLN)			
		Basic salary	Other benefits	Bonus for 2016	Deferred bonus*
1.	Cezary Stypułkowski	2 661 046	237 960	460 831	575 000
2.	Lidia Jabłonowska-Luba	1 500 000	173 320	250 000	320 000
3.	Frank Bock	1 061 379	229 370	-	-
4.	Andreas Böger	797 633	68 338	-	-
5.	Krzysztof Dąbrowski	1 125 000	87 939	-	-
6.	Cezary Kocik	1 500 000	189 036	250 000	350 000
7.	Adam Pers	272 727	19 266	-	-
	Total	**8 917 785**	**1 005 229**	**960 831**	**1 245 000**

* In 2017, there was paid the second deferred tranche as a settlement of the cash equivalent of bonus for the year 2014 and the first deferred tranche as a settlement of the cash equivalent of bonus for the year 2015.

Remuneration of the former Management Board Members paid in the year 2017:

		Remuneration paid in 2017 (in PLN)				
		Basic salary	Other benefits	Bonus for 2016	Deferred bonus*	Allowance
Remuneration of the former Management Board Members who ceased performing their functions in the year 2017						
1.	Christoph Heins	776 684	269 061	125 000	-	-
2.	Hans-Dieter Kemler	500 000	127 984	200 000	320 000	-
3.	Jarosław Mastalerz	665 926	101 811	250 000	350 000	-
4.	Przemysław Gdański	1 442 587	168 052	250 000	320 000	1 500 000
Remuneration of the former Management Board Members who ceased performing their functions in the year 2016						
1.	Joerg Hessenmueller	-	-	125 000	340 000	-

* In 2017, Members of the Management Board who ceased to perform their functions in 2017 and Mr. Joerg Hessenmueller received the second deferred tranche as part of the settlement of the cash equivalent of bonus for the year 2014 and the first deferred tranche as part of cash bonus settlement for the year 2015.

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	Deferred 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	Deferred 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.

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 2017, which would be paid out in 2018. Therefore, a provision was created for the payment of a cash bonus for 2017 for the members of the Management Board, which amounted to PLN 4 127 210 as of 31 December 2017. The final decision concerning the level of the bonus will be taken by the Remuneration Committee of the Supervisory Board by 28 February 2018.

In 2017 and 2016, 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 2017 by Bank's Management Board members was PLN 19 495 950 (2016: PLN 17 390 280).

<u>Information on the rules of payment other component of remuneration (severance payment) for the members of the Management Board of the Bank</u>

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 right to receive 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.

<u>Supervisory Board Compensation</u>

On 30 March 2017, the 30th Ordinary General Meeting of mBank S.A., elected 12-member Supervisory Board of mBank S.A. for a joint term of three years, with the following composition:

1. Maciej Leśny – Chairman of the Supervisory Board, Chairman of the Executive and Nominations Committee, Member of the Remuneration Committee,
2. Stephan Engels – Deputy Chairman of the Supervisory Board, Member of the Remuneration Committee,
3. Tomasz Bieske – Member of the Supervisory Board, Member of the Audit Committee, Member of the Remuneration Committee,
4. Andre Carls – Member of the Supervisory Board, Chairman of the Remuneration Committee, Member of the Executive and Nominations Committee, Member of the Audit Committee,
5. Marcus Chromik – Member of the Supervisory Board, Chairman of the Risk Committee,
6. Janusz Fiszer – Member of the Supervisory Board, Member of the Audit Committee,
7. Mirosław Godlewski – Member of the Supervisory Board, Member of the Risk Committee,

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8. Jörg Hessenmüller– Member of the Supervisory Board, Member of the Audit Committee,
9. Thorsten Kanzler – Member of the Supervisory Board, Member of the Risk Committee,
10. Michael Mandel – Member of the Supervisory Board,
11. Teresa Mokrysz – Member of the Supervisory Board, Member of the Executive and Nominations Committee,
12. Agnieszka Słomka-Gołębiowska – Member of the Supervisory Board, Member of the Risk Committee, Member of the Audit Committee.

At the end of 2017, the composition of the Supervisory Board of mBank S.A. remained unchanged.

Information about the Supervisory Board members' salaries, bonuses and benefits paid as at 31 December 2017 and 31 December 2016 is presented below:

		Remuneration paid in 2017 (in PLN)	Remuneration paid in 2016 (in PLN)
1.	Maciej Leśny	367 235	367 235
2.	Stephan Engels	-	-
3.	Tomasz Bieske	319 656	-
4.	Andre Carls	279 000	252 000
5.	Marcus Chromik	-	-
6.	Janusz Fiszer	162 000	-
7.	Mirosław Godlewski	162 000	-
8.	Joerg Hessenmueller	210 000	-
9.	Thorsten Kanzler	216 000	216 000
10.	Michael Mandel	-	-
11.	Teresa Mokrysz	220 225	220 225
12.	Agnieszka Słomka-Gołębiowska	248 435	221 435
	Wiesław Thor*	37 812	149 435
	Waldemar Stawski*	55 812	221 435
	Marek Wierzbowski*	54 000	216 000
	Martin Zielke**	-	-
	Martin Blessing***	-	-
	Total	**2 332 175**	**1 863 765**

* The term of office expired on 30 March 2017.
** On 15 December 2016, Mr. Martin Zielke resigned from the office.
*** On 30 April 2016, Mr. Martin Blessing 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 2017 amounted to PLN 28 135 617 (2016: PLN 24 397 959).

<u>Information regarding proprietary position in Bank shares by Members of the Management Board and by Members of the Supervisory Board</u>

As at 31 December 2017, the Bank shares were held by two Members of the Management Board: Mr. Cezary Stypułkowski – 16 275 shares and Mr. Krzysztof Dąbrowski – 1 117 shares.

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 2017, the Bank shares were held by one Member of the Supervisory Board of mBank S.A., Mr. Jörg Hessenmüller – 6 118 shares. As at 31 December 2016, the Members of the Supervisory Board of the Bank had no Bank's shares.

46. Acquisitions and disposals

- On 22 June 2017, the Future Tech Fundusz Inwestycyjny Zamknięty (the "Fund") was registered, in which mBank S.A. acquired 400 000 investment certificates accounting for 100% of the issue, worth in total PLN 221 200 thousand. As at 30 June 2017 the Bank held of 100% of the certificates issued by the Fund, so the Bank consolidate the Fund starting from June 2017. The Fund's capital increased by PLN 2 216 thousand in August 2017. As at 31 December 2017, the Bank held 98.04% of the Fund's investment certificates, while the remaining 1.96% was owned by minority shareholders. Quercus Towarzystwo Funduszy Inwestycyjnych S.A. is the entity managing the Fund.

- On 31 July 2017 the Bank sold 14 120 880 shares, representing 51% of the share capital of mLocum S.A. Sale of the remaining 8 026 120 shares representing 28.99% of the share capital of mLocum S.A. will take place no later than 30 June 2020. The transaction was described in detail under Note 24 "Investments in associates".
- On 27 November 2017, mBank S.A. and the subsidiary of mBank S.A. mFinanse S.A. ("mFinanse"), entered into a conditional agreement under which mBank is obliged to sell 100%, i.e. 100 000 shares in Latona S.A. in favor of Phoebe IVS with its registered office in Denmark, and then mFinanse is obliged to sell the organized part of the enterprise mFinanse to Latona S.A. The organized part of the enterprise is a separate activity, under which, on the basis of agency agreements, mFinanse performs insurance intermediation activities in the field of group insurance contracts as an insurance agent. The completion of the transaction is planned for the first quarter of 2018, after fulfillment of the conditions precedent specified in the agreement, which are standard in this type of transactions. At the time of sale, Latona S.A. will belong to the buyer.

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 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 3 721 thousand in 2017 (in 2016: PLN 3 346 thousand).

In 2017, 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 2 154 thousand (in 2016: PLN 464 thousand).

48. Capital adequacy

One of the Bank's main tasks is to ensure an adequate level of capital. As part of the capital management policy, the Bank creates a framework and guidelines for the most effective planning and use of the capital base, 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 the Bank is based on two pillars:

- 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 the level higher than 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 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 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 Banking Act of 29 August 1997 (Dz.U. from year 2002, No. 72, item 665) with further amendments,
- the Act on Macro-prudential Supervision of the Financial System and Crisis Management of 5 August 2015 (Dz.U. 2015, item 1513),
- Regulation of the Minister of Development and Finance of May 25th, 2017 on the application of higher risk weights to credit exposures secured by mortgages on real estate property.

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 2017 Bank was obliged to ensure adequate own funds to meet conservation buffer designated under the provisions of the Act of 1.25% of total risk exposure amount.

As of the end of 2017 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 2 bps as of 31 December 2017. Exposures of foreign branches in Czech Republic and in Slovakia, where countercyclical buffer rates as of 31 December 2017 amounted to 0.5%, had an impact on the mBank specific countercyclical capital buffer.

In 2016 the Bank received an administrative decision of the KNF that identified the Bank as other systemically important institutions (O-SII). The Bank was a subject to a capital buffer which on the basis of KNF administrative decision of December 19th, 2017 amounted to 0.75% of the total risk exposure amount, calculated in accordance with article 92(3) of the CRR Regulation, to be maintained on individual and consolidated levels. Bank has applied the required capital buffer defined in the December 2017 decision to 2017 year end data.

The all-in-one combined buffer requirement set for mBank as of the end of 2017 amounted to 2.02%.

Additionally, as a result of risk assessment carried out in 2017 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 Bank received on the stand-alone level an individual recommendation to maintain own funds to cover additional capital requirement of 4.10% for total capital ratio and 3.07% for Tier 1 capital ratio (on consolidated basis: 3.53% and 2.65% respectively). The additional capital requirement designated by KNF included also additional risk factors related to currency housing loans within the area of operational risk, market risk and risk of collective default by borrowers.

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 the Bank to the calculation of capital requirements for credit risk. According to KNF's methodology, the calculation for each and every bank uses as a starting point the risk weight under the standardised approach 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:

- 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:

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- the basic requirement of KNF in terms of capital ratios addressed to the banks in Poland to maintain the total capital ratio of 12% and the Tier 1 ratio of 9%;
- the additional capital charge in Pillar II on individual basis associated with the portfolio of foreign currency housing loans: 4.10% at the level of total capital ratio and 3.07% at the level of Tier 1 capital;
- the combined buffer requirement of 2.02%.

In 2017 capital ratios on individual basis were above the required values.

mBank	31.12.2017		31.12.2016	
Capital ratio	Required level	Reported level	Required level	Reported level
Total capital ratio	18.12%	24.62%	17.56%	24.07%
Tier 1 ratio	14.09%	21.51%	13.61%	20.59%

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 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 will not fall below 80% of the own funds that the Bank would have to maintain under the standardised approach. The Bank's own funds are well above the level determined by the reference value.

The individual leverage ratio calculated in accordance with the provisions of CRR Regulation and Commission Delegated Regulation (EU) 2015/62 of October 10, 2014, amending Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to the leverage ratio, including provisions regarding transitional period, amounted to 9.05%.

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 within mBank.

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 2017 amounted to PLN 14 440 192 thousand. Additionally the Common Equity Tier 1 capital of mBank amounted to PLN 12 614 436 thousand.

Total risk exposure amount (TRFA)

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 2017 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,
- 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 2017 mBank Group received an official confirmation from the European Central Bank and the KNF regarding the Bank's fulfilment of the high significance conditions stipulated in the conditional consent to apply the internal rating based approach to the calculation of the capital charge for credit risk for mBank retail non-mortgage exposures. It allows to fully apply the advanced internal rating based approach to calculation of the own funds requirement for credit risk for the given portfolio.

With regard to conditional consent to the application of AIRB approach to the calculation of own funds requirement for credit risk for 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 is waiting for formal confirmation by the bank supervision.

The total risk exposure amount of mBank as of 31 December 2017 amounted to PLN 58 647 034 thousand, including PLN 51 460 011 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 the Bank (calculated according to the CRR Regulation) and the internal capital (estimated for the Bank according to the Regulation of the Minister of Development and Finance of March 6th, 2017 on the risk management system and internal control system, remuneration policy and a detailed method for internal capital assessment at bank) are lower than own funds, the own funds as at 31 December 2017 were maintained at the level consistent with the requirements of the CRR Regulation.

The internal capital of mBank as at 31 December 2017 amounted to PLN 3 519 167 thousand.

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Capital adequacy	31.12.2017	31.12.2016
Common Equity Tier 1 Capital	**12 614 436**	**11 492 865**
Total Own Funds	**14 440 192**	**13 433 772**
Risk weighted exposure amounts for credit, counterparty credit, dilution risk and free deliveries:	51 328 997	48 939 431
- including under standardised approach	13 420 326	11 451 615
- including under AIRB approach	37 907 456	37 486 311
- including risk exposure amount for contributions to the default fund of a CCP	1 215	1 505
Settlement / delivery risk exposure amount	-	-
Total risk exposure amount for position, foreign exchange and commodities risks	756 256	824 349
Total risk exposure amount for operational risks	6 178 124	5 706 442
Additional risk exposure amount due to fixed overheads	-	-
Total risk exposure amount for credit valuation adjustments	252 643	213 304
Total risk exposure amount for large exposures in the trading book	-	-
Other risk exposure amounts	131 014	138 335
Total risk exposure amount	**58 647 034**	**55 821 861**
Comon Equity Tier 1 capital ratio	**21.51%**	**20.59%**
Total capital ratio	**24.62%**	**24.07%**
Internal capital	**3 519 167**	**3 613 181**

OWN FUNDS	31.12.2017	31.12.2016
Own funds	**14 440 192**	**13 433 772**
TIER 1 CAPITAL	**12 614 436**	**11 492 865**
Common Equity Tier 1 Capital	**12 614 436**	**11 492 865**
Capital instruments eligible as CET1 Capital	3 563 819	3 550 593
Paid up capital instruments	169 143	169 016
Share premium	3 394 928	3 381 975
(-) Own CET1 instruments	(252)	(398)
Retained earnings	1 587 319	3 220 308
Previous years retained earnings	1 199 339	2 761 506
Profit or loss eligible	387 980	458 802
Accumulated other comprehensive income	151 044	(14 183)
Other reserves	7 168 155	4 410 902
Funds for general banking risk	1 115 143	1 095 143
Adjustments to CET1 due to prudential filters	(33 000)	(44 333)
Fair value gains and losses arising from the institution's own credit risk related to derivative liabilities	(1 938)	(5 880)
(-) Value adjustments due to the requirements for prudent valuation	(31 062)	(38 453)
(-) Intangible assets	(612 441)	(505 612)
(-) Other intangible assets gross amount	(648 191)	(540 452)
Deferred tax liabilities associated to other intangible assets	35 750	34 840
(-) IRB shortfall of credit risk adjustments to expected losses	(165 809)	(180 877)
Other transitional adjustments to CET1 Capital	(29 915)	(22 390)
CET1 capital elements or deductions - other	(129 879)	(16 686)
Additional Tier 1 capital	**-**	**-**
TIER 1 CAPITAL	**1 825 756**	**1 940 907**
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	575 756	690 907

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Credit risk	**31.12.2017**	**31.12.2016**
Risk weighted exposure amounts for credit risk, counterparty credit risk, dilution risk and free deliveries	**51 328 997**	**48 939 431**
Standardised approach	**13 420 326**	**11 451 615**
SA exposure classes excluding securitisation positions	13 420 326	11 451 615
Central governments or central banks	30 116	33 608
Regional governments or local authorities	154 778	197 874
Public sector entities	19 850	16 533
Multilateral Development Banks	-	-
International Organisations	-	-
Institutions	149 192	631 279
Corporates	4 613 502	3 431 635
Retail	1 240 917	809 205
Secured by mortgages on immovable property	1 025 535	1 921 372
Exposures in default	562 806	218 609
Items associated with particular high risk	34 520	28 833
Covered bonds	-	-
Claims on institutions and corporates with a short-term credit assessment	-	-
Collective investments undertakings (CIU)	-	-
Equity	5 571 812	4 151 269
Other items	17 298	11 398
AIRB approach	**37 907 456**	**37 486 311**
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	36 268 686	35 916 711
Central governments and central banks	-	-
Institutions	1 234 473	1 601 493
Corporates - SME	4 928 974	4 406 293
Corporates - Specialised Lending	1 791 791	1 986 271
Corporates - Other	12 705 172	12 142 226
Retail - Secured by real estate SME	1 048 526	1 098 692
Retail - Secured by real estate non-SME	5 532 303	6 930 867
Retail - Qualifying revolving	-	-
Retail - Other SME	2 384 652	2 034 073
Retail - Other non-SME	6 642 795	5 716 796
Equity AIRB	-	-
Securitisation positions IRB	-	-
Other non credit-obligation assets	1 638 770	1 569 600
Risk exposure amount for contributions to the default fund of a CCP	**1 215**	**1 505**

49. Other information

- Recommendations of Financial Stability Committee (FSC) on the restructuring of the foreign currency housing loans portfolio

On 13 January 2017, FSC endorsed the resolution on the recommendation on the restructuring of the foreign currency housing loans portfolio. The resolution includes a list of recommendations, part of which were introduced in the year 2017. Two of the recommendations that may have significant impact on the Group but have not yet been introduced, are:

➢ to increase the minimum LGD for exposures secured by mortgages on residential properties, the purchase of which was financed by an foreign currency 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.);

➢ introduction of changes in the rules of operation of the Borrower Support Fund, which would lead to a greater use of the funds to support borrowers in difficult financial situation - recommendation not introduced. In October 2017 the Parliament of the Republic of Poland has begun work on the draft of the amendment to the *act on support of borrowers in financial difficulties, who had taken* *out a housing loan* as well as a *law on corporate income tax*, proposed by the President of the Republic of Poland, which address the FSC recommendation.

Due to ongoing work on the implementation of these recommendations Bank is not able to assess at this moment the potential impact of the aforementioned changes on the capital ratios and financial statements of the Bank and the Group.

- 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 October 19, 2016, the Parliament 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*. In addition, on October 13, 2017, the Parliament of the Republic of Poland has begun work on the draft *of the amendment of the act on support of borrowers in financial difficulties, who had taken out a housing loan as well as a law on corporate income tax*, proposed by the President of the Republic of Poland. 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

- Requirements on mBank Group capital ratios in 2018

Starting from 2018 the binding conservation capital buffer defined in the Act on Macro-prudential Supervision over the Financial System and Crisis Management in the Financial System of 5 August 2015 (Dz.U. 2015, item 1513) increased to 1.875% of the total risk exposure amount.

Starting from 1 January 2018, banks in Poland has been obliged to meet systemic risk buffer of 3% on individual and consolidated basis, resulting from entry into force of the Regulation of the Minister of Development and Finance with regard to systemic risk buffer, addressing one of the mentioned FSC recommendations. The regulation introduces systemic risk buffer of 3% of the total risk exposure amount applied to all exposures located in Poland. Due to the fact that not all exposures are located in Poland, mBank having two foreign branches in Czech Republic and in Slovakia, the systemic risk buffer rate to be applied to mBank Group shall be slightly below 3%.

Taking into account the above mentioned capital buffers and the position of KNF on the minimum level of capital ratios binding in 2018, the required level of capital ratios for 2018 will amount to:

- Individual total capital ratio – 17.59% and Tier 1 capital ratio – 14.56%
- Consolidated total capital ratio – 17.04% and Tier 1 capital ratio – 14.16%.

At the date of publication of these financial statements, mBank S.A. fulfils the KNF requirements related to the required capital ratios for 2018 on both individual and consolidated levels.