mBank S.A.

IFRS Condensed Financial Statements for the first half of 2018

Contents

1. Selected financial data

The selected financial data presented below are supplementary information to the condensed consolidated financial statements of mBank S.A. Group for the first half of 2018.

SELECTED FINANCIAL DATA FOR THE BANK		in PLN'000		in EUR'000	
		Period from 01.01.2018 to 30.06.2018	Period from 01.01.2017 to 30.06.2017	Period from 01.01.2018 to 30.06.2018	Period from 01.01.2017 to 30.06.2017
I.	Interest income	1 891 855	1 731 802	446 245	407 732
II.	Fee and commission income	752 471	686 234	177 491	161 566
III.	Net trading income	172 872	144 031	40 777	33 910
IV.	Operating profit	952 319	904 646	224 630	212 988
V.	Profit before income tax	873 875	677 745	206 127	159 567
VI.	Net profit	698 207	489 528	164 691	115 254
VII.	Net cash flows from operating activities	2 538 113	(3 828 941)	598 682	(901 479)
VIII.	Net cash flows from investing activities	37 740	(230 434)	8 902	(54 253)
IX.	Net cash flows from financing activities	(852 285)	(1 016 100)	(201 034)	(239 229)
X.	Net increase / decrease in cash and cash equivalents	1 723 568	(5 075 475)	406 550	(1 194 960)
XI.	Basic earnings per share (in PLN/EUR)	16.50	11.58	3.89	2.73
XII.	Diluted earnings per share (in PLN/EUR)	16.49	11.57	3.89	2.72
XIII.	Declared or paid dividend per share (in PLN/EUR)	5.15	-	1.21	-

SELECTED FINANCIAL DATA FOR THE BANK		in PLN'000			in EUR'000		
		As at			As at		
		30.06.2018	31.12.2017	30.06.2017	30.06.2018	31.12.2017	30.06.2017
I.	Total assets	132 012 206	124 569 483	123 939 705	30 266 922	29 866 332	29 324 430
II.	Amounts due to banks	4 567 999	5 089 716	8 654 205	1 047 322	1 220 292	2 047 606
III.	Amounts due to customers	106 613 859	99 331 571	96 113 526	24 443 750	23 815 381	22 740 690
IV.	Own Equity	14 516 164	14 287 561	13 655 732	3 328 174	3 425 534	3 230 979
V.	Share capital	169 248	169 248	169 143	38 804	40 578	40 020
VI.	Number of shares	42 312 122	42 312 122	42 285 676	42 312 122	42 312 122	42 285 676
VII.	Book value per share (in PLN/EUR)	343.07	337.67	322.94	78.66	80.96	76.41
VIII.	Total capital ratio	23.65	24.62	25.12	23.65	24.62	25.12

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 30 June 2018: EUR 1 = 4.3616, 31 December 2017: EUR 1 = 4.1709, 30 June 2017: EUR 1 = PLN 4.2265.

- 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 the first half of 2018 and 2017: EUR 1 = PLN 4.2395 and EUR 1 = PLN 4.2474 respectively.

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

2. Condensed financial data

Condensed income statement

	Note	Period from 01.04.2018 to 30.06.2018	Period from 01.01.2018 to 30.06.2018	Period from 01.04.2017 to 30.06.2017	Period from 01.01.2017 to 30.06.2017
Interest income, including:		970 880	1 891 855	868 812	1 731 802
Interest income on financial assets at amortised cost		*708 388*	*1 369 664*	*643 677*	*1 258 544*
Interest income on financial assets at fair value through other comprehesive income		*118 289*	*237 115*	*166 304*	*333 553*
Income similar to interest on financial assets at fair value through profit or loss		*144 203*	*285 076*	*58 831*	*139 705*
Interest expenses		(214 838)	(415 900)	(196 075)	(401 342)
Net interest income		**756 042**	**1 475 955**	**672 737**	**1 330 460**
Fee and commission income		384 352	752 471	348 457	686 234
Fee and commission expenses		(149 583)	(291 481)	(142 405)	(278 005)
Net fee and commission income		**234 769**	**460 990**	**206 052**	**408 229**
Dividend income		194 769	194 936	165 827	165 981
Net trading income, including:		87 143	172 872	62 451	144 031
Foreign exchange result		*78 622*	*149 873*	*57 281*	*136 421*
Gains or losses on financial assets and liabilities held for trading		*11 089*	*26 394*	*10 204*	*13 527*
Gains or losses from hedge accounting		*(2 568)*	*(3 395)*	*(5 034)*	*(5 917)*
Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss		(20 519)	(58 447)	n/a	n/a
Gains less losses from investment securities, investments in subsidiaries and associates		*n/a*	*n/a*	(10 556)	(8 920)
Gains less losses from financial assets and liabilities not measured at fair value through profit or loss and investments in subsidiaries and associates, including:		(299)	1 453	n/a	n/a
Gains less losses from debt securities measured at fair value through other comprehensive income		*1 842*	*6 031*	*n/a*	*n/a*
Gains less losses from investments in subsidiaries and associates		*-*	*(22)*	*n/a*	*n/a*
Gains less losses from derecognition		*(2 141)*	*(4 556)*	*n/a*	*n/a*
Other operating income		13 992	24 100	11 039	20 741
Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss		(164 176)	(241 143)	(104 437)	(184 701)
Overhead costs		(400 172)	(878 157)	(373 325)	(839 671)
Depreciation		(52 760)	(112 364)	(45 930)	(91 309)
Other operating expenses		(35 684)	(87 876)	(24 840)	(40 195)
Operating profit		**613 105**	**952 319**	**559 018**	**904 646**
Tax on the Bank's balance sheet items		(91 247)	(183 175)	(87 349)	(173 103)
Share in profits (losses) of entities under the equity method		(147 822)	104 731	(106 600)	(53 798)
Profit before income tax		**374 036**	**873 875**	**365 069**	**677 745**
Income tax expense		(90 061)	(175 668)	(91 283)	(188 217)
Net profit		**283 975**	**698 207**	**273 786**	**489 528**

Net profit attributable to Owners of mBank S.A.		**283 975**	**698 207**	**273 786**	**489 528**
Weighted average number of ordinary shares	**5.26**	**42 312 122**	**42 312 122**	**42 280 676**	**42 280 403**
Earnings per share (in PLN)	**5.26**	**6.71**	**16.50**	**6.48**	**11.58**
Weighted average number of ordinary shares for diluted earnings	**5.26**	**42 338 828**	**42 338 828**	**42 306 110**	**42 305 837**
Diluted earnings per share (in PLN)	**5.26**	**6.71**	**16.49**	**6.47**	**11.57**

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

Condensed statement of comprehensive income

	Period from 01.04.2018 to 30.06.2018	Period from 01.01.2018 to 30.06.2018	Period from 01.04.2017 to 30.06.2017	Period from 01.01.2017 to 30.06.2017
Net profit	**283 975**	**698 207**	**273 786**	**489 528**
Other comprehensive income net of tax, including:	**(38 433)**	**33 956**	**72 349**	**137 310**
Items that may be reclassified subsequently to the income statement				
Exchange differences on translation of foreign operations (net)	13	67	319	275
Cash flows hedges (net)	(7 218)	20 236	134	3 108
Share of other comprehensive income of entities under the equity method (net)	(893)	181	1 523	2 066
Change in valuation of available for sale financial assets (net)	*n/a*	*n/a*	70 373	131 861
Debt instruments at fair value through other comprehensive income (net)	(37 570)	4 294	*n/a*	*n/a*
Items that will not be reclassified to the income statement				
Fair value changes of equity instruments measured at fair value through other comprehensive income (net)	7 235	9 178	*n/a*	*n/a*
Total comprehensive income (net)	**245 542**	**732 163**	**346 135**	**626 838**

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

Condensed statement of financial position

ASSETS	30.06.2018	31.12.2017	30.06.2017
Cash and balances with the Central Bank	5 513 509	7 383 518	5 808 672
Financial assets held for trading and derivatives held for hedges	5 501 438	2 781 351	4 674 201
Loans and advances to banks	*n/a*	6 063 702	7 113 557
Non-trading financial assets mandatorily at fair value through profit or loss, including:	2 514 191	*n/a*	*n/a*
Equity instruments	11 070	*n/a*	*n/a*
Loans and advances to customers	2 503 121	*n/a*	*n/a*
Investment securities	*n/a*	31 110 560	29 607 690
Financial assets at fair value through other comprehensive income	23 062 789	*n/a*	*n/a*
Loans and advances to customers	*n/a*	73 431 738	73 169 273
Financial assets at amortised cost, including:	91 352 494	*n/a*	*n/a*
Debt securities	9 314 878	*n/a*	*n/a*
Loans and advances to credit institutions	7 340 475	*n/a*	*n/a*
Loans and advances to customers	74 697 141	*n/a*	*n/a*
Investements in subsidiaries	2 146 382	2 060 847	1 991 780
Investments in associates	29 265	28 680	-
Non-current assets and disposal groups classified as held for sale	-	-	81 314
Intangible assets	632 477	648 191	576 399
Tangible assets	477 509	509 773	447 122
Current income tax assets	5 521	6 558	2 256
Deferred income tax assets	260 283	129 037	83 797
Other assets	516 348	415 528	383 644
AKTYWA RAZEM	**132 012 206**	**124 569 483**	**123 939 705**

LIABILITIES AND EQUITY			
Liabilities			
Financial liabilities held for trading and derivatives held for hedges	1 139 768	1 141 035	1 154 083
Financial liabilities measured at amortised cost, including:	114 067 835	106 579 430	107 000 570
Amounts due to banks	4 567 999	5 089 716	8 654 205
Amounts due to customers	106 613 859	99 331 571	96 113 526
Debt securities issued	679 244	-	-
Subordinated liabilities	2 206 733	2 158 143	2 232 839
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	27 046	37 235
Provisions	259 619	190 914	185 410
Current income tax liabilities	138 184	172 003	64 205
Deferred income tax liabilities	84	81	82
Other liabilities	1 890 552	2 171 413	1 842 388
Total liabilities	**117 496 042**	**110 281 922**	**110 283 973**
Equity			
Share capital:	**3 564 176**	**3 564 176**	**3 554 016**
Registered share capital	169 248	169 248	169 143
Share premium	3 394 928	3 394 928	3 384 873
Retained earnings:	**10 799 824**	**10 572 341**	**9 978 589**
- Profit from the previous years	10 101 617	9 482 637	9 489 061
- Profit for the current year	698 207	1 089 704	489 528
Other components of equity	**152 164**	**151 044**	**123 127**
Total equity	**14 516 164**	**14 287 561**	**13 655 732**
Total liabilities and equity	**132 012 206**	**124 569 483**	**123 939 705**

Total capital ratio	**23.65**	**24.62**	**25.12**
Common Equity Tier 1 capital ratio	**20.21**	**21.51**	**21.90**
Book value	**14 516 164**	**14 287 561**	**13 655 732**
Number of shares	**42 312 122**	**42 312 122**	**42 285 676**
Book value per share (in PLN)	**343.07**	**337.67**	**322.94**

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

Condensed statement of changes in equity

Changes in equity from 1 January to 30 June 2018

	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 financial assets at fair value through other comprehensive income	Cash flows hedges	Share in profits (losses) of entities under the equity method	Actuarial gains and losses relating to post-employment benefits	
Equity as at 1 January 2018	**169 248**	**3 394 928**	**7 145 517**	**22 638**	**1 115 143**	**2 289 043**	**-**	**(5 336)**	**164 413**	**(5 198)**	**3 770**	**(6 605)**	**14 287 561**
Effects of IFRS 9 implementation	-	-	-	-	-	(260 179)	-	-	(32 836)	-	-	-	(293 015)
Restated equity as at 1 January 2018	**169 248**	**3 394 928**	**7 145 517**	**22 638**	**1 115 143**	**2 028 864**	**-**	**(5 336)**	**131 577**	**(5 198)**	**3 770**	**(6 605)**	**13 994 546**
Total comprehensive income							**698 207**	**67**	**13 472**	**20 236**	**181**	**-**	**732 163**
Dividends	-	-	-	-	-	(217 907)	-	-	-	-	-	-	(217 907)
Transfer to supplementary capital	-	-	2 071 135	-	-	(2 071 135)	-	-	-	-	-	-	-
Stock option program for employees	**-**	**-**	**-**	**7 362**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**7 362**
- value of services provided by the employees	-	-	-	*7 362*	-	-	-	-	-	-	-	-	*7 362*
Equity as at 30 June 2018	**169 248**	**3 394 928**	**9 216 652**	**30 000**	**1 115 143**	**(260 178)**	**698 207**	**(5 269)**	**145 049**	**15 038**	**3 951**	**(6 605)**	**14 516 164**

Changes in equity from 1 January to 31 December 2017

	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 financial assets at fair value through other comprehensive income	Cash flows hedges	Share in profits (losses) of entities under the equity method	Actuarial gains and losses relating to post-employment benefits	
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)**	**(737)**	**(3 517)**	**13 023 803**
Total comprehensive income	**-**	**-**	**-**	**-**	**-**	**-**	**1 089 704**	**617**	**166 844**	**(3 653)**	**4 507**	**(3 088)**	**1 254 931**
Issuance of ordinary shares	127	-	-	-	-	-	-	-	-	-	-	-	127
Transfer to supplementary capital	-	-	2 761 506	-	-	(2 761 506)	-	-	-	-	-	-	-
Transfer to General Risk Fund	-	-	-	-	20 000	(20 000)	-	-	-	-	-	-	-
Stock option program for employees	**-**	**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)**	**3 770**	**(6 605)**	**14 287 561**

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

Changes in equity from 1 January to 30 June 2017

	Share capital		Retained earnings					Other components of 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 financial assets at fair value through other comprehensive income	Cash flows hedges	Share in profits (losses) of entities under the equity method	Actuarial gains and losses relating to post-employment benefits	Total equity
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)**	**(737)**	**(3 517)**	**13 023 803**
Total comprehensive income	**-**	**-**	**-**	**-**	**-**	**-**	**489 528**	**275**	**131 861**	**3 108**	**2 066**	**-**	**626 838**
Issuance of ordinary shares	22	-	-	-	-	-	-	-	-	-	-	-	22
Transfer to supplementary capital	-	-	2 761 506	-	-	(2 761 506)	-	-	-	-	-	-	-
Transfer to General Risk Fund	-	-	-	-	20 000	(20 000)	-	-	-	-	-	-	-
Stock option program for employees	**-**	**2 898**	**-**	**2 171**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**5 069**
- value of services provided by the employees	-	-	-	*5 069*	-	-	-	-	-	-	-	-	*5 069*
- settlement of exercised options	-	*2 898*	-	*(2 898)*	-	-	-	-	-	-	-	-	-
Equity as at 30 June 2017	**169 143**	**3 384 873**	**7 145 517**	**29 062**	**1 115 143**	**1 199 339**	**489 528**	**(5 678)**	**129 430**	**1 563**	**1 329**	**(3 517)**	**13 655 732**

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

Condensed statement of cash flows

	Period from 01.01.2018 to 30.06.2018	Period from 01.01.2017 to 30.06.2017
A. Cash flows from operating activities	**2 538 113**	**(3 828 941)**
Profit before income tax	**873 875**	**677 745**
Adjustments:	***1 664 238***	***(4 506 686)***
Income taxes paid	(279 407)	(174 599)
Amortisation	112 364	91 309
Foreign exchange (gains) losses related to financing activities	287 723	(725 853)
(Gains) losses on investing activities	(110 644)	50 257
Impairment of financial assets	-	12 262
Dividends received	(194 936)	(165 981)
Interest income (income statement)	(1 891 855)	(1 731 802)
Interest expense (income statement)	415 900	401 342
Interest received	1 788 565	1 861 846
Interest paid	(437 039)	(364 104)
Changes in loans and advances to banks	107 439	(1 126 124)
Changes in financial assets and liabilities held for trading and derivatives held for hedges	(766 951)	105 089
Changes in loans and advances to customers	(3 980 139)	(980 157)
Changes in investment securities	*n/a*	1 132 389
Changes in financial assets at fair value through other comprehensive income	(216 274)	*n/a*
Changes in securities at amortised cost	(892 857)	*n/a*
Changes of non-trading equity securities mandatorily at fair value through profit or loss	(8 956)	*n/a*
Changes in other assets	(103 876)	(33 397)
Changes in amounts due to banks	422 049	554 701
Changes in amounts due to customers	7 634 354	(3 474 491)
Changes in debt securities in issue	20 614	-
Changes in provisions	27 799	2 762
Changes in other liabilities	(269 635)	57 865
Net cash generated from/(used in) operating activities	**2 538 113**	**(3 828 941)**
B.Cash flows from investing activities	**37 740**	**(230 434)**
Investing activity inflows	**195 223**	**166 305**
Disposal of shares in subsidiaries	100	-
Disposal of intangible assets and tangible fixed assets	187	324
Dividends received	194 936	165 981
Investing activity outflows	**157 483**	**396 739**
Acquisition of shares in subsidiaries	-	223 822
Purchase of intangible assets and tangible fixed assets	157 483	172 917
Net cash generated from/(used in) investing activities	**37 740**	**(230 434)**
C. Cash flows from financing activities	**(852 285)**	**(1 016 100)**
Financing activity inflows	**845 830**	**791 742**
Proceeds from loans and advances from banks	187 200	-
Issue of debt securities	658 630	-
Issue of ordinary shares	-	22
Security deposit due to issue of Eurobonds	-	791 720
Financing activity outflows	**1 698 115**	**1 807 842**
Repayments of loans and advances from banks	1 423 990	-
Repayments of other loans and advances	-	6 754
Acquisition of shares in subsidiaries - increase of involvement	1 300	120 000
Repurchase of of subordinated liabilities	-	1 611 840
Payments of financial lease liabilities	2 856	3 668
Dividends and other payments to shareholders	217 907	-
Interest paid from loans and advances received from banks and subordinated liabilities	52 062	65 580
Net cash generated from/(used in) financing activities	**(852 285)**	**(1 016 100)**
Net increase / decrease in cash and cash equivalents (A+B+C)	**1 723 568**	**(5 075 475)**
Effects of exchange rate changes on cash and cash equivalents	67 809	14 992
Cash and cash equivalents at the beginning of the reporting period	9 750 574	14 987 684
Cash and cash equivalents at the end of the reporting period	**11 541 951**	**9 927 201**

3. Description of relevant accounting policies

The most important accounting policies applied to the drafting of these consolidated financial statements are presented below. The accounting principles adopted by the Bank were applied on an ongoing basis for all periods presented in the financial statements, except for the accounting principles applied in connection with the implementation of IFRS 9 as of 1 January 2018, as described in detail under Note 3.28 Comparative data.

3.1. Accounting basis

The Condensed Financial Statements of mBank S.A. have been prepared for the 6-month period ended 30 June 2018.

The 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, except for derivative contracts and financial assets held for trading, financial assets that do not meet SPPI criteria, financial assets assigned to business models whose objective is not to hold financial assets in order to collect contractual cash flows, equity instruments and liabilities related to cash-settled share-based payment transactions measured at fair value as well as financial assets measured at fair value through other comprehensive income and equity instruments for which it was irrevocable election has been made to present changes in fair value in other coprehensive income.

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.

The comparative data has been prepared 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 profit or loss, all derivative contracts, liabilities related to cash-settled share-based payment transactions measured at fair value.

The data for the year 2017 presented in these mBank S.A. condensed consolidated financial statements was audited by the auditor, while the data for the first half of 2017 years was reviewed by an auditor.

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.

3.2. 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 measured at fair value through profit or loss and measured at fair value through other comprehensive income.

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 that exactly discounts estimated future cash payments or receipts through the expected life of the financial assets or financial liability to the gross carrying amount of a financial asset or to the amortized cost of a financial liability. When calculating the effective interest rate, the Bank estimates the expected cash flows taking into account all the contractual terms of the financial instrument, but without taking into account the expected credit losses. This calculation takes into account all the fees and points 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.

The Bank calculates interest income using the effective interest rate to the gross carrying amount of the financial asset except for the financial assets which subsequently have become credit-impaired. In case of reclassification to the stage 3 of 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.

3.3. Fee and commission income

Income on account of fees and commissions is recognised 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 included in the calculation of the effective interest rate charge on the loan. Fees on account of syndicated loans are recognised 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 recognised 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 recognised directly in the income statement as one-off.

In addition, revenue from fee and commission include income from a fee on insurance products sold through the Internet platform for the distribution of premium in installments. The fee for the distribution of premium in installments is settled in time in accordance with the duration of the policy.

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.

3.4. 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 recognised over time as part of effective interest rate calculation for the bundled loan. 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.

Expenses directly linked to the sale of insurance products are recognised 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 recognised 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 recognised.

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.

3.5. Financial assets

The Bank classifies its financial assets to the following categories: financial assets valued at fair value through profit or loss, financial assets valued at fair value through other comprehensive income for which gains or losses may be reclassified subsequently to the income statement, financial assets valued at fair value through other comprehensive income for which gains or losses will not be reclassified subsequently to the income statement at derecognition and financial assets valued at amortized cost. Classification of the debt financial asset to the one of the above categories takes place at its initial recognition based on business model for managing financial assets and contractual cash flow characteristics. An equity instrument is classified as a financial asset at fair value through profit or loss unless at the time of initial recognition the group made an irrevocable election of specific equity investments to present subsequent fair value changes in other comprehensive income.

Standardised purchases and sales of financial assets at fair value through profit or loss and measured at fair value through other comprehensive income 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 instruments valued at fair value through profit or loss</u>

A financial asset shall be measured at fair value through profit or loss unless it is measured at amortized cost or at fair value through other comprehensive income..

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

The Bank may, at the initial recognition, irrevocably designate a the financial assets/financial liabilities at fair value through profit or loss 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.

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 profit or loss.

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 measured at fair value through profit or loss (Note 3.2), except for derivatives the recognition of which is discussed in Note 3.11, is recognized in net interest income. The valuation and result on disposal of financial assets/financial liabilities measured at fair value through profit or loss is recognized in trading income for finacial assets/liabilities held for trading or in item Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss.

Financial assets measured at at amortized cost

Financial assets measured at amortized cost are assets that meet both of the following conditions, unless the Bank designated them to fair value through profit or loss: the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flow characteristics and 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 Financial assets at amortized cost are entered into books on the transaction date. At initial recognition financial assets classified to this category are valued at fair value plus transaction costs that are directly attributable to the acquisition of the financial asset.

Financial assets measured at fair value through other comprehensive income

Financial assets measured at fair value through other comprehensive income are assets that meet both of the following conditions, unless the Bank designated them to fair value through profit or loss: the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and 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.

Interest income and expense from financial assets measured at fair value through other comprehensive income are presented in net interest income. Gains and losses from sale of available for sale investments are presented in gains less losses from financial assets and liabilities not measured at fair value through profit or loss.

Financial assets measured at fair value through other comprehensive income and financial assets measured at fair value through profit or loss are valued at the end of the reporting period according to their fair value. Financial assets measured at amortized cost, 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 profit or loss" are recognized in the income statement in the period in which they arise.

Gains and losses arising from changes in the fair value of debt financial assets measured at fair value through other comprehensive income 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.

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.

Equity instruments

Investments in equity instruments are measured at fair value through profit or loss. Upon initial recognition, the Bank may make an irrevocable election to present in other comprehensive income subsequent changes in the fair value (the option of measurement at fair value through other comprehensive income) of an investment in an equity instrument that is not held for trading and does not constitute a contingent payment recognized by the Bank as part of a business combination in accordance with IFRS 3.

In case of the financial instruments for which the option of measurement at fair value through other comprehensive income was used, the requirements regarding impairment are not applied. All gains and losses related to change in fair value, including foreign exchange differences, are recognized in other comprehensive income. There is no possibility to reclassify them to profit and loss even if the instrument is derecognized. Only dividends received related to these instruments are recognized in profit and loss when the entity's right to receive payment is established. Taking above into account equity instruments for which fair value through other comprehensive income option was used are out of scope impairment requirements.

Modification of contractual terms for financial assets

The Bank settles previously recognized financial assets and re-recognizes the financial assets in accordance with the requirements for initial recognition in case of substantial modification of contractual terms of financial assets. As substantial modification the Bank defines such a modification that meets one of the following criteria:

- Substantial increase of the credit amount of more than 10%
- Substantial prolongation of the contractual maturity of more than 12 months
- Change of currency no provided in the terms of the contract. Change of the currency provided in the terms of the agreement is such a change that defines both the rate at which it would have place and the interest rate of the loan after the change of the currency.
- Change of the borrower – only if the current borrower is exempted from the debt
- Change of the cash flow criterion from 'SPPI compliance' of a financial assets to 'SPPI non-compliance' and vice versa
- Change of the financed asset in case of object finance or project finance.

In the event of substantial modification the deferred income and expense related to this assets is recognized in the income statement and the provision is released. At the same time there is re-recognition of financial assets in accordance with the requirements for initial recognition. Any other modifications of contractual terms that do not cause derecognition of financial assets are treated as not substantial modifications and the gain or loss on modification is recognized. The effect of all identified not substantial modifications of cash flows are treated as not related to credit risk. The result on modification is the difference between present value of the modified cash flows discounted using the old effective interest rate and the effective loan exposure. Commissions received related to minor modification are settled over time using effective interest rate. All identified substantial modifications of cash flows are treated as related to credit risk. In case of substantial modification in stage 2, for which as a consequence, the exposure was moved to stage 1, the adjustment to fair value of the exposure at the initial recognition, adjusts the interest result in the subsequent periods.

Purchased or originated credit impaired financial assets (POCI assets)

POCI are financial assets measured at amortized cost that at initial recognition are credit impaired. POCI are also financial assets that are credit impaired at the moment of substantial modification. At the initial recognition POCI assets are recognized at fair value. The fair value of POCI assets at the initial recognition is calculated as present value of estimated future cash flows including credit risk discounted for the risk free rate. After the initial recognition POCI assets are measured at amortized cost. With respect to these financial assets the Bank uses credit adjusted effective interest rate in order to determine the amortized cost of financial asset and the interest income generated by these assets – CEIR. In case of POCI exposures the change of the expected credit losses relative to the estimated credit losses at the date of their initial recognition is recognized as an impairment loss. Its value can both reduce the gross value of POCI exposure and increase it in the event of a decrease of expected losses relative to its value at the date of initial recognition.

Reclassification of financial assets

Debt financial assets are reclassified when, and only when, the Bank changes its business model for managing financial assets. In such a case the assets affected by the change of business model are subject to reclassification.

Finnacial liabilities are not subject to reclassification by the Bank.

The accounting principles applied by the Bank until 31 December 2017 in the scope of classification and measurement of financial instruments are described in Note 2 of the IFRS Financial Statements of the mBank S.A. for 2017, published on 28 February 2018.

3.6. 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 recognised 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 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.

3.7. Impairment of financial assets

Financial instruments subject to estimation of allowance and provision are: financial assets measured at amortized cost, financial assets measured at fair value through other comprehensive income, loan commitments if not measured at fair value through profit or loss, financial guarantee contracts if not measured at fair value through profit or loss, leases under IAS 17, contract assets under IFRS 15, as well as trading receivables.

How exposures are classified to stages

The transfer logic is an algorithm used to classify exposures to one of the four Stages: 1, 2, 3, POCI. Stage 1 includes exposures for which provisions/write-downs are calculated on a 12-month basis. Stage 2 contains exposures for which, as at the reporting date, a significant deterioration in credit quality was identified compared to the date of their initial recognition – provisions/write-downs are calculated on a lifetime period. Stage 3 contains exposures identified as credit-impaired, while Stage POCI contains assets identified as credit-impaired at initial recognition. Once the quantitative or qualitative criteria that were used to classify the exposure in Stage 2 at the reporting date are no longer met, (the client and the exposure assigned to him or her no longer meet any of the Transfer Logic qualitative criteria or quantitative criteria), the exposure will be moved from Stage 2 to Stage 1. The exposure may also be transferred from Stage 3 to Stage 2 and from Stage 3 to Stage 1 (when no longer credit-impaired).

In case of non-financial guarantees, the Bank applied a simplified approach that the write-offs and provisions are always included in the amount Lt ECL (Stage 2).

Impairment corporate portfolio

Corporate exposures are deemed to be credit-impaired where the results of an impairment test demonstrate the need to establish valuation allowances/provisions. A client is reclassified as in default when one or more of the following criteria are met:

- any of the exposures representing the client's loan commitment to the Bank, its parent company or subsidiary is more than 90 days past due (for exposures payable to banks – more than 14 days). In the case of committed lines, the exposure is deemed to be past due on the date a specified limit is exceeded, a new limit – lower than the loan amount used – is introduced or when a loan amount is used without the consent of the Bank. No reclassification to default category is needed for customer with past due loan exposure not exceeding PLN 500 for Private Banking clients and PLN 3 000 for corporate portfolio clients, where risk increase related to commitment of a given customer is not directly impacted and no other criteria for customer default are present at the. same time.
- The Bank considers the client as unlikely to fully meet its loan commitments to the Bank, its parent company or subsidiary, demonstrating the need for corrective or restructuring measures or the exercise of collateral rights on the part of the Bank.

Impairment retail portfolio

In case of retail exposures, the identification of impaired exposure reflects the separation of exposure in the Bank's loan portfolio, for which at least one impairment trigger is active and the write-down value is different than zero. The impairment trigger for the retail exposure is:

- a discrete event or an ongoing situation based on which, taking into account all information possessed, the Bank acknowledges that without realizing the collaterals the debtor will not fully repay the Bank's receivables due to this exposure or
- the situation where, in accordance with loan agreement relating to this exposure, the collateral has been realized fully or partially, (cash flows have occurred), however the Bank's receivable related to this exposure has not been fully repaid.
- default event.

The events/situations determined by the Bank take place after the initial recognition of balance sheet loan exposure in Bank's books and affect the expected future cash flows due to the above exposure and it is possible to reliably estimate the impact.

Retail exposures are considered to be in default, if the following criterion is met:

- where at least one loan commitment of the debtor is past due for more than 90 days and total amount of past due credit exposures of the debtor (more than 31 days past due) exceed PLN 500,
- Bank accepts forced restructuring of an exposure, if as a result of it, loan exposures decrease due to the significant cancellation or extension of principal, interest or (if applicable) fees or commissions,
- Bank sells loan exposure with significant economic credit loss,
- an application has been filed to initiate bankruptcy proceedings against the debtor or the debtor has been put into bankruptcy, which may result in the termination or delay in repayment of the credit exposure towards the Bank.

In the case of retail exposures of mBank's foreign branches, the following must be taken into account:

- the main criterion for recognition as credit-impaired,
- additional criteria for recognition as credit-impaired.

The main criterion for recognizing a retail exposure as credit-impaired is deemed to be met when the exposure is more than 90 days past due, with the overdue amount exceeding the materiality threshold specified for each country on a separate basis (CZK 3000 and EUR 120).

Significant deterrioration

A significant deterioration in credit quality is recognised for the asset concerned on the basis of quantitative and qualitative criteria, with the asset being transferred to Stage 2 once at least one of such qualitative or quantitative criteria is met.

Qualitative criteria

Qualitative criteria are:

- Where an amount is more than 30 days past due (days past due, with an activation threshold) – the number of days for which the longest overdue amount of the exposure concerned is greater than or equal to 31 days).
- Occurrence of the Forborne flag (the client status shows that he or she is experiencing difficulties in repaying the loan commitment, as defined by the Bank).
- Occurrence of the Watch flag (the Bank's internal process designed to identify corporate clients who are subject to increased monitoring in terms of changes in credit quality, in accordance with the Watch List classification rules adopted by the Bank).

Quantitative criteria

The quantitative criterion of the Transfer Logic is based on a significant deterioration in credit quality, which is assessed on the basis of a relative long-term change in Probability of Default (PD), specified for the exposure at the reporting date, relative to the long-term PD specified on initial recognition. This factor is determined separately for the retail and corporate portfolio within the homogeneous segments in terms of probability of default events. Where a relative change in long-term PD exceeds "the transition threshold", the exposure is moved to Stage 2. An important issue in the process of calculating the credit quality deterioration is initial date recognition consistent in the entire Bank, against which the deterioration of credit quality is examined. Initial date re-recognition is determined for the exposures for which substantial modification of contractual terms took place. Each change of initial recognition date results in recalculation taking into account the new exposure characteristics, initial PD parameter at the new initial recognition date, against which the credit quality deterioration is examined.

Low credit risk

For exposures whose characteristics are indicative of low credit risks (LCR), expected credit losses are always determined on a 12-month basis. Exposures designated as LCR may not be transferred from Stage 1 to Stage 2, although they can be moved from Stage 1 to Stage 3 upon being recognized as credit-impaired. At the moment of implementing the IFRS 9, the Bank applies the LCR criterion to clients from the K1 segment with a PD rating grade greater than or equal to class 2.8. The LCR criterion is also applied to clients from segments such as: Governments and Banks, Local Government Units and NBFI (Non-Banking Financial Institution).

Rebuttable presumption

The Bank's approach that involves rejection of the presumption that a significant deterioration in credit quality occurs where DPD>= 31 days (rebuttable presumption) involves introducing a threshold of materiality (threshold of activation) for any outstanding amount payable to the Bank. The DPD >=31 days criterion (one of the qualitative criteria of the Transfer Logic) is not taken into account in the following cases:

1. for retail exposures - in the case of credit exposures, the sum of payable and non-payable capital does not exceed PLN 500 or an off-balance-sheet commitment of the exposure does not exceed PLN 500 (at the reporting date),
2. for corporate exposures - the sum of payable and non-payable capital at the reporting date does not exceed PLN 3 000 or an off-balance-sheet commitment of the exposure does not exceed PLN 3 000.

Estimating expected credit losses (ECL)

Valuation allowances and provisions are measured at the level of a single contract or exposure (agreement) by measuring expected credit losses (ECL). In the portfolio approach, expected credit losses are the multiplication of individual for each exposure estimated value of PD, LGD and EAD and the final value of expected credit losses is the sum of expected credit losses in particular periods discounted with the effective interest rate. If on the reporting date the exposure credit risk did not increase significantly since the initial recognition, the Bank calculates impairment provisions in the amount equal to 12-month expected credit losses (12m ECL). If the exposure credit risk increased significantly since the initial recognition (exposure is in the stage 2), the Bank calculates impairment provisions in the amount equal to life-time expected credit losses (Lt ECL). An expected loss is measured for non-zero exposures that are active at the reporting date (balance sheet and off-balance sheet). An expected credit loss is estimated separately for the balance- and off-balance-sheet part of the exposure. The parameters used to calculate an expected credit loss in Stage 1 are identical to those used to calculate a long-term credit loss in Stage 2 for t=1, where 't' stands for the first year of the forecast.

In the individual approach (all balance sheet and off-balance sheet credit exposures with an impairment in the corporate loan portfolio are treated as individually significant), the expected credit losses are calculated as a difference between the gross carrying amount of the asset and the present value of the estimated future cash flows discounted with the effective interest rate. The method of calculating the expected recoveries takes place in scenarios and depends on the Bank's chosen strategy for the client. In case of restructuring strategy, the scenarios considered assume a significant share of recoveries from the customer's own payments. In case of vindication strategy, the scenarios are based on collateral recoveries.

Use of macroeconomics scenarios in ECL estimation

The Bank is required to set an expected credit loss in a way which meets the expectations for various forward-looking macroeconomic scenarios in case of portfolio estimation of ECL. Therefore, the non-linearity factor (NLF) is set in order to adjust the value of an expected credit loss (calculated every month). The NLF factor is determined separately for retail and corporate segments at least once a year. NLFs are used as scaling factors for individual ECLs (both 12-month and lifetime) that are determined at the level of individual exposures in each segment. NLFs are calculated based on results from 3 simulation calculations at the same reporting date, which result from relevant macroeconomic scenarios.

In particular, NLF for a given segment is calculated as:

1. the probability-weighted average of the expected loss from 3 macroeconomic scenarios ('average estimation') comprising:
   a) baseline scenario
   b) optimistic scenario
   c) pessimistic scenario

2. divided by the expected loss determined under baseline scenario (reference estimate).

Simulation calculations, whose results are used to calculate NLF, are carried out on the basis of the same input data on exposure characteristics, but involve different risk parameter vectors, if the macroeconomic expectations defined in the scenarios are such as to affect the value of these parameters.

In case of individual estimation of ECL, the assumed recovery scenarios take into account various modeling of macroeconomic environment.

Loan receivable write-off

Loan receivable write-off can be partial or total.

The accounting principles applied by the Bank until 31 December 2017 regarding the impairment of financial assets are described under Note 2 of the IFRS Financial Statements of the mBank S.A. Group for 2017, published on 28 February 2018.

3.8. 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 recognised 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 initially recognised less cumulated amount of income,
- losses arising from these contracts; the amount of loss is determined in accordance with expected credit loss approach.

3.9. Cash and cash equivalents

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

3.10. Sale 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 recognised 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 recognised 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 recognised as loans and advances to other banks or other customers, depending on their nature.

When concluding a repo/sell-buy-back or reverse repo/ buy-sell-back 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 measured at fair value through profit or loss or at fair value through other comprehensive income, and also as liabilities in the case of repo/sell-buy-back transactions and as receivables in the case of reverse repo/buy-sell-back transactions measured at amortised cost.

Securities borrowed by the Bank under buy-sell-back transactions are not recognised 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 recognised as financial assets.

As a result of repo/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.

3.11. Derivative financial instruments and hedge accounting

Derivative financial instruments are recognised 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 recognised 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 3.12.

Derivative instrument embedded in the hybrid contract, the host of which is a financial asset within the scope of IFRS 9, is not separated and the hybrid contract is recognised in accordance with the requirements for classification of the financial assets.

Derivative instrument embedded in the hybrid contract, the host of which is not a financial asset within the scope of IFRS 9, is assessed for the need to separate it.

Derivative instruments, which are designated and constitute effective hedging instruments, are not classified under any of the categories specified above and are subject to the principles of hedge accounting.

In accordance with IFRS 9: (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 recognised 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 recognised asset or liability, or a forecasted transaction (cash flow hedge).

The Bank decided that it would continue to apply the hedge accounting requirements in accordance with IAS 39, instead of the requirements set forth in IFRS 9.

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 3.2 "Interest income and expenses". The remaining result from fair value measurement of derivatives is recognised in "Net trading income".

Fair value hedges

Changes in the fair value of derivative instruments designated and qualifying as fair value hedges are recognised 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. Starting from the financial statements for the first half of 2018, hedging gain or loss on the hedged item adjusts the carrying amount of the hedged item.

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 recognised in other comprehensive income. The gain or loss concerning the ineffective part is recognised in the income statement of the current period.

The amounts recognised in other comprehensive income are transferred to the income statement and recognised 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 recognised 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 recognised 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.

3.12. 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 recognised immediately in the income statement without reversal of deferred day one profits and losses.

3.13. Financial liabilities measured at amortised cost

Financial liabilities measured in amortized include borrowings, deposits taken, debt securities issued and subordinated liabilities. These liabilities are initially recognized at fair value reduced by the incurred transaction costs. After the initial recognition, these liabilities 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.

3.14. Intangible assets

The Bank measures intangible assets initially at cost. After initaial recognition, intangible assets are recognised 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.

Computer software

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

Development costs

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

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

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

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

3.15. 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 recognised 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 prospectively in accordance with the arrising need.

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).

The carrying amount of tangible fixed assets is derecognised on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from from the derecognition of tangible fixed assets are included in profit or loss when the item is derecognised.

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 recognised in the income statement.

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

The Bank classifies a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset (or 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 recognised 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.

3.17. 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 recognised in liabilities as "Provisions for deferred income tax". A deductible net difference is recognised 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 recognised 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 recognised 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 recognised 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 recognised 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 in the statement of financial position separately for each subsidiary undergoing consolidation. 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.

In the case of the Bank, the deferred income tax assets and provisions are netted against each other separately for each country where the Bank conducts its business and is obliged to settle corporate income tax.

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 recognised 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 financial instruments measured through other comprehensive income 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.

3.18. 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 recognised 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.

3.19. 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".

3.20. Leasing

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

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

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

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

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

3.21. Provisions

Loan committments and financial guarantee contracts are subject to loan loss provisions requirements according to IFRS 9 Financial Instruments.

According to IAS 37, provisions are recognised when the Group 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.

3.22. Post-employment employee benefits and other employee benefits

<u>Post-employment employee benefits</u>

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 recognised in profit or loss for the period.

3.23. Equity

Equity consists of capital and own funds attributable to owners of the Bank, and non-controlling interest 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 recognised 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 year,
- 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 financial assets at fair value through other comprehensive income,
- exchange differences on translation of foreign operations,
- actuarial gains and losses relating to post-employment benefits,
- valuation of derivative financial instruments held for cash flow hedging in relation to the effective portion of the hedge,
- the Bank's shares of other comprehensive income of entities under the equity method.

3.24. 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 presentation 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 recognised in the income statement.

Foreign exchange differences arising on account of such monetary items as financial assets measured at fair value through profit or loss are recognised under gains or losses arising in connection with changes of fair value.

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

Changes in fair value of monetary items valued through other comprehensive income cover foreign exchange differences arising from valuation at amortised cost, which are recognised in the income statement.

Items of the statement of financial position of foreign branches are converted from functional currency to the presentation currency with the application of the average exchange rate as at the end of the reporting period. Income statement items of these entities are converted to presentation currency with the application of the arithmetical mean of average exchange rates quoted by the National Bank of Poland on the last day of each month of the reporting period. Foreign exchange differences so arisen are recognised in other comprehensive income.

3.25. 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.

3.26. 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 2018.

These financial statements do not include standards and interpretations listed below 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 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.

- Amendments to IFRS 9, *Prepayment Features with Negative Compensation*, published by the International Accounting Standards Board on 12 October 2017, approved by European Union on 22 March 2018, 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.

Standards and interpretations not yet approved by the European Union:

- 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 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 IAS28 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 amendments to the above standards 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.

- Amendments to References to the Conceptual Framework in IFRS Standards (issued on 29 March 2018) effective for financial years beginning on or after 1 January 2020.

3.27. Business segments

Data concerning business segments was presented in the Condensed Consolidated Financial Statements of mBank S.A. Group for the first half of 2018, prepared in compliance with the International Financial Reporting Standards.

3.28. Comparative data

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.

The Bank decided to use the provisions of IFRS 9 allowing exemption from the obligation to transform comparative data for prior periods in relation to changes resulting from classification and measurement and impairment. At the same time the Bank introduced changes to the financial statements to adjust the presentation of financial data to the new categories introduced by IFRS 9.

As at 1 January 2018, differences in the carrying amount of financial assets and liabilities resulting from the application of IFRS 9 were recognized as a part of undistributed financial result from previous years and other components of equity in the Bank's equity.

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

In the tables below has been presented the impact resulting from changes in the classification and measurement of financial assets in connection with the implementation of IFRS9 as at 1 January 2018.

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

Restatement of statement of financial position of mBank S.A. as at 31 December 2017 in connection with the implementation of IFRS 9.

ASSETS	31.12.2017 IAS 39 carrying amount	ASSETS	Reclassification	IFRS 9 implementation	01.01.2018 IFRS 9 carrying amount
Cash and balances with the Central Bank	7 383 518	Cash and balances with the Central Bank	7 383 518	-	7 383 518
Loans and advances to banks (amortised cost)	6 063 702	Financial assets at amortised cost - loans and advances to banks	5 663 263	(499)	5 662 764
		Financial assets at fair value through other comprehensive income	400 439	705	401 144
Trading securities (fair value though profit or loss)	1 547 802	Financial assets held for trading and derivatives held for hedges	1 547 802	-	1 547 802
Derivative financial instruments (fair value though profit or loss)	1 233 549	Financial assets held for trading and derivatives held for hedges	1 233 549	-	1 233 549
Loans and advances to customers (amortised cost)	73 431 738	Financial assets at amortised cost - loans and advances to customers	70 434 975	(216 496)	70 218 479
		Non-trading financial assets mandatorily at fair value through profit or loss - loans and advances to customers	2 996 763	(29 664)	2 967 099
Investment securities	31 110 560	Non-trading financial assets mandatorily at fair value through profit or loss - equity instruments	9 934	-	9 934
		Financial assets at amortised cost - debt securities	8 566 042	(45 870)	8 520 172
		Financial assets at fair value through other comprehensive income	22 534 584	-	22 534 584
Investments in subsidiaries	2 060 847	Investments in subsidiaries	2 060 847	(22 553)	2 038 294
Investments in associates	28 680	Investments in associates	28 680	-	28 680
Intangible assets	648 191	Intangible assets	648 191	-	648 191
Tangible assets	509 773	Tangible assets	509 773	-	509 773
Current income tax assets	6 558	Current income tax assets	6 558	-	6 558
Deferred income tax assets	129 037	Deferred income tax assets	129 037	63 903	192 940
Other assets	415 528	Other assets	415 528	946	416 474
Total assets	**124 569 483**	**Total assets**	**124 569 483**	**(249 528)**	**124 319 955**

LIABILITIES AND EQUITY					
Liabilities					
Amounts due to the other banks (amortised cost)	5 089 716	Financial liabilities measured at amortised cost - Amounts due to banks	5 089 716	-	5 089 716
Derivative financial instruments (fair value though profit or loss)	1 141 035	Financial liabilities held for trading and derivatives held for hedges	1 141 035	-	1 141 035
Amounts due to customers (amortised cost)	99 331 571	Financial liabilities measured at amortised cost - amounts due to customers	99 331 571	-	99 331 571
Fair value changes of the hedged items in portfolio hedge of interest rate risk	27 046	Fair value changes of the hedged items in portfolio hedge of interest rate risk	27 046	-	27 046
Other liabilities	2 171 413	Other liabilities	2 171 413	2 581	2 173 994
Current income tax liabilities	172 003	Current income tax liabilities	172 003	-	172 003
Deferred income tax liabilities	81	Deferred income tax liabilities	81	-	81
Provisions	190 914	Provisions	190 914	40 906	231 820
Subordinated liabilities (amortised cost)	2 158 143	Financial liabilities measured at amortised cost	2 158 143	-	2 158 143
Total liabilities	**110 281 922**	**Total liabilities**	**110 281 922**	**43 487**	**110 325 409**
Equity					
Share capital	**3 564 176**	**Share capital**	**3 564 176**	**-**	**3 564 176**
Registered share capital	169 248	Registered share capital	169 248	-	169 248
Share premium	3 394 928	Share premium	3 394 928	-	3 394 928
Retained earnings:	**10 572 341**	**Retained earnings:**	**10 572 341**	**(260 179)**	**10 312 162**
- Profit from the previous years	9 482 637	- Profit from the previous years	9 482 637	(260 179)	9 222 458
- Profit for the current year	1 089 704	- Profit for the current year	1 089 704	-	1 089 704
Other components of equity	**151 044**	**Other components of equity**	**151 044**	**(32 836)**	**118 208**
Total equity	**14 287 561**	**Total equity**	**14 287 561**	**(293 015)**	**13 994 546**
TOTAL LIABILITIES AND EQUITY	**124 569 483**	**TOTAL LIABILITIES AND EQUITY**	**124 569 483**	**(249 528)**	**124 319 955**

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

Restatement of statement of financial position of mBank S.A. as at 31 December 2017 in connection with the implementation of IFRS 9.

ASSETS	01.01.2018	31.12.2017	Change
Cash and balances with the Central Bank	7 383 518	7 383 518	-
Financial assets held for trading and derivatives held for hedges	2 781 351	2 781 351	-
Loans and advances to banks	*n/a*	6 063 702	(6 063 702)
Non-trading financial assets mandatorily at fair value through profit or loss, including:	2 977 033	*n/a*	2 977 033
Equity instruments	*9 934*	*n/a*	*9 934*
Loans and advances to customers	*2 967 099*	*n/a*	*2 967 099*
Investment securities	*n/a*	31 110 560	(31 110 560)
Financial assets at fair value through other comprehensive income	22 935 728	*n/a*	22 935 728
Financial assets at amortised cost, including:	84 401 415	*n/a*	84 401 415
Debt securities	*8 520 172*	*n/a*	*8 520 172*
Loans and advances to banks	*5 662 764*	*n/a*	*5 662 764*
Loans and advances to customers	*70 218 479*	*n/a*	*70 218 479*
Loans and advances to customers	*nd*	73 431 738	(73 431 738)
Investments in subsidiaries	*2 038 294*	2 060 847	(22 553)
Investments in associates	28 680	28 680	-
Intangible assets	648 191	648 191	-
Tangible assets	509 773	509 773	-
Current income tax assets	6 558	6 558	-
Deferred income tax assets	192 940	129 037	63 903
Other assets	416 474	415 528	946
Total assets	**124 319 955**	**124 569 483**	**(249 528)**

LIABILITIES AND EQUITY			
Liabilities			
Financial liabilities held for trading and derivatives held for hedges	1 141 035	1 141 035	-
Financial liabilities measured at amortised cost, including:	106 579 430	*n/a*	106 579 430
Amounts due to banks	*5 089 716*	*n/a*	*5 089 716*
Amounts due to customers	*99 331 571*	*n/a*	*99 331 571*
Subordinated liabilities	*2 158 143*	*n/a*	*2 158 143*
Amounts due to the other banks	*n/a*	5 089 716	(5 089 716)
Amounts due to customers	*n/a*	99 331 571	(99 331 571)
Subordinated liabilities	*n/a*	2 158 143	(2 158 143)
Fair value changes of the hedged items in portfolio hedge of interest rate risk	27 046	27 046	-
Provisions	231 820	190 914	40 906
Current income tax liabilities	172 003	172 003	-
Deferred income tax liabilities	81	81	-
Other liabilities	2 173 994	2 171 413	2 581
Total liabilities	**110 325 409**	**110 281 922**	**43 487**

Equity			
Share capital	**3 564 176**	**3 564 176**	**-**
Registered share capital	169 248	169 248	-
Share premium	3 394 928	3 394 928	-
Retained earnings:	**10 312 162**	**10 572 341**	**(260 179)**
- Profit from the previous years	9 222 458	9 482 637	(260 179)
- Profit for the current year	1 089 704	1 089 704	-
Other components of equity	**118 208**	**151 044**	**(32 836)**
Total equity	**13 994 546**	**14 287 561**	**(293 015)**
TOTAL LIABILITIES AND EQUITY	**124 319 955**	**124 569 483**	**(249 528)**

Financial assets

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 under requirements of IFRS 9.

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 or loss due to a business model which objective is not to hold financial assets to collect contractual cash flows.

The impact of the valuation method change from amortized cost to the fair value for the above loans was negative and amounted to PLN 29 664 thousand excluding deferred tax effect.

Moreover, due to the methodology and approach to fair value through profit or loss of a part of the retail loan portfolio and a small number of corporate loans, in connection with the implementation of IFRS 9, which were measured at amortized cost in accordance with IAS 39, as at 1 January 2018, the value of Bank's other assets increased. The impact of this change amounted to PLN 946 thousand excluding the deferred tax effect.

The Bank has also changed 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. The impact of the change in the method of valuation of the mentioned mortgage bonds from amortized cost to fair value was positive and amounted to PLN 705 thousand excluding the deferred tax effect.

In addition, for the certain part of the debt securities portfolio classified as "Available-for-Sale" under IAS 39 the Bank decided to apply the "Held-to-Collect" business model, which objective is to hold financial assets to collect contractual cash flows, which resulted in the reclassification of these securities from the fair value through other comprehensive income into amortised cost measurement category. The impact of the change in the method of valuation of the these debt securities was negative and amounted to PLN 45 870 thousand excluding deferred tax effect. As at 30 June 2018, the fair value of securities reclassified on 1 January 2018 from measured at fair value through equity to those measured at amortized cost amounted to PLN 8 597 005 thousand. If these securities had not been reclassified, in the first half of 2018 the Bank would have recognized in other comprehensive income a gain of PLN 46 532 thousand excluding the deferred tax effect.

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, in the case of stocks and shares other than investments in subsidiaries, associates and joint ventures, the Bank at the initial application made an irrevocable 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. Related to the above the value of the Bank's investments in subsidiaries, valued using equity method, also changed. The impact of the above change was negative and amounted to PLN 22 553 thousand excluding deferred tax effect.

As at 1 January 2018 Bank did not identify financial assets which were designated as measured at fair value through profit or loss in order to eliminate "accounting mismatch".

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.

As of 1 January 2018 the value of the Bank's financial liabilities increased 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. The impact of this change amounted to PLN 2 581 thousand excluding deferred tax effect.

<u>Impairment</u>

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 identified only minor 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.

The total effect of the above changes on the category "Financial assets at amortized cost" was negative and amounted to PLN 216 995 thousand, of which PLN 216 496 thousand relates to loans and advances to clients, while PLN 499 thousand to receivables from banks. In addition, these changes also influenced the increase in provisions for off-balance sheet liabilities presented in the category "Provisions" in the amount of PLN 40 906 thousand.

As a result, the total negative impact of the implementation of IFRS 9 in the amount of PLN 356 918 thousand and the tax effect resulting from the implementation of IFRS 9 in the form of an increase in net deferred tax asset in the amount of PLN 63 903 thousand caused a decrease in the retained earnings and other items of the Bank's equity by PLN 293 015 thousand.

<u>Impact of IFRS 9 on capital adequacy</u>

The total impact of applying IFRS 9, calculated as at 1 January 2018, in relation to the total capital ratio (TCR) and the Tier1 ratio of the Bank is immaterial and amounts to no more than 5 bps.

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.

The data as at 31 December 2017 and 30 June 2017 is comparable with the current accounting period and therefore has not been adjusted.

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 recognised 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 and contingent liabilities which are impaired, change by +/-10%, the estimated loans and advances and contingent liabilities impairment would either decrease by PLN 32.7 million or increase by PLN 35.1 million as at 30 June 2018, respectively. This estimation was performed for portfolio of loans and advances and contingent liabilities individually assessed for impairment on the basis of future cash flows due to repayments and recovery from collateral - Stage 3. The rules of determining write-downs and provisions for impairment of credit exposures have been described under Note 3.7.

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 3.5.

Deferred tax assets

Deferred tax assets are recognised 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 recognised, 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 recognised 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 basing on professional judgment whether substantially all the risk and rewards incidental to ownership of an asset were transferred or not.

5. Selected explanatory information

5.1. Compliance with international financial reporting standards

The presented condensed financial statements for the half of 2018 fulfils the requirements of the International Accounting Standard (IAS) 34 "Interim Financial Reporting" relating to interim financial reports.

In addition, selected explanatory information provide additional information in accordance with Decree of the Minister of Finance dated 29 March 2018 concerning the publication of current and periodic information by issuers of securities and the conditions of acceptance as equal information required by the law of other state, which is not a member state (Journal of Laws 2018, item 757).

5.2. Consistency of accounting principles and calculation methods applied to the drafting of the half-yearly report and the last annual financial statements

The detailed description of the Bank's accounting policies is presented in Note 3 and 4 of these condensed financial statements. The accounting principles adopted by the Bank were applied on a continuous basis for all periods presented in the financial statements, except for the accounting principles applied in connection with the implementation of IFRS 9 as of 1 January 2018. The main changes in the classification, measurement and principles for creating provisions for impairment of financial instruments introduced by IFRS 9 are presented under Note 3.28 Comparative data.

5.3. Seasonal or cyclical nature of the business

The business operations of the Bank do not involve significant events that would be subject to seasonal or cyclical variations.

5.4. Nature and values of items affecting assets, liabilities, equity, net profit/(loss) or cash flows, which are extraordinary in terms of their nature, magnitude or exerted impact

- From 1 January 2018, the Bank has implemented the International Financial Reporting Standard - IFRS 9: "Financial Instruments", whose impact on the statement of financial situation and the level of own funds of the Bank as at 1 January 2018 has been presented under Note 3.28.
- On 21 March 2018, the Bank early redeemed two series of perpetual subordinated bonds in the total nominal amount of CHF 250 000 thousand (equivalent of PLN 905 125 thousand according to the average exchange rate of the National Bank of Poland of 21 March 2018). The bonds were entirely covered by Commerzbank AG. As at the repurchase date the bonds were redeemed. The Bank has made the early redemption as the funds obtained from these bonds were no longer included in Tier 2 capital, according to art. 490 of 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.

  Additionally, on 21 March 2018, the Bank drew a subordinated loan in the amount of CHF 250 000 thousand (equivalent of PLN 905 125 thousand according to the average exchange rate of the National Bank of Poland of 21 March 2018) based on a subordinated loan agreement signed with Commerzbank on 27 November 2017. Under the terms of the Agreement, the disbursement of the loan as well as the repurchase of subordinated bonds occurred by way of netting of the related claims.
- On 29 March 2018, the Polish Financial Supervision Authority gave a consent for qualifying funds from subordinated loan in the amount of CHF 250 000 thousand as instrument in the Bank's Tier 2 capital. The amount of CHF 250 000 thousand according to the average exchange rate of the National Bank of Poland of 29 March 2018 is the equivalent of PLN 893 200 thousand.
- New debt securities issue program (EMTN)

  On 11 April 2018, the Management Board of mBank SA adopted a resolution regarding a consent to establish a new programme for the issuance of debt instruments (Euro Medium Term Note Program) directly by the Bank, in many tranches and currencies, with various interest structures and due dates, up to the total amount of EUR 3 000 000 thousand ("New EMTN Programme"). The amount of EUR 3 000 000 thousand is the equivalent of PLN 12 573 300 thousand according to the average exchange rate of the National Bank of Poland of 11 April 2018.

The new EMTN Programme was established by the way of update of the existing debt instruments programme of mFinance France S.A. (mFF) of a incorporated under the laws of France with its registered office in Paris, subsidiary of mBank S.A. The update does not affect the existence of the instruments already issued by mFF nor the validity of the guarantee granted by the Bank with regard to those instruments.

Under the New EMTN Programme, on June 7, 2018, the Bank issued bonds with a total value of CHF 180 000 thousand (equivalent of PLN 660 906 thousand at the average exchange rate of the National Bank of Poland as of 7 June 2018), maturing on 7 June 2022.

5.5. Nature and amounts of changes in estimate values of items, which were presented in previous interim periods of the current reporting year, or changes of accounting estimates indicated in prior reporting years, if they bear a substantial impact upon the current interim period

The impact of the implementation as at 1 January 2018 of IFRS 9 on the statements of financial position of the Bank prepared as at 31 December 2017 has been presented under Note 3.28 of these condensed financial statements.

5.6. Issues, redemption and repayment of non-equity and equity securities

On 21 March 2018 made an early redemption of two series of perpetual subordinated bonds in the total nominal amount of CHF 250 000 thousand, which was described under point 5.4 above.

In addition, on June 7, 2018, the Bank issued bonds with a total value of CHF 180 000 thousand, which was described under point 5.4 above.

5.7. Dividends paid (or declared) altogether or broken down by ordinary shares and other shares

On 12 April 2018, the 31st Annual General Meeting of mBank S.A. adopted a resolution regarding the distribution of the net profit for 2017. The dividend for the Bank's shareholders was contributed the amount of PLN 217 907 428.30, with the amount of the dividend per share amounting to PLN 5.15. This amount represents 20% of the Bank's net profit generated in the period from 1 January to 31 December 2017.

The dividend day was set for 24 May 2018 (the dividend day), while the payment of the dividend took place on June 7, 2018.

5.8. Income and profit by business segments

Income and profit by business segments within the Bank are presented in Note 4 of the condensed consolidated financial statements for the first half of 2018.

5.9. Significant events after the end of the first half of 2018, which are not reflected in the financial statements

Events as indicated above did not occur in the Bank.

5.10. Effect of changes in the structure of the entity in the first half of 2018, including business combinations, acquisitions or disposal of subsidiaries, long-term investments, restructuring, and discontinuation of business activities

- The sale of an organised part of mFinanse

On 27 November 2017, mBank S.A. and mBank's subsidiary mFinanse S.A. ("mFinanse"), concluded a conditional agreement under which mBank was obliged to sell 100% shares in Latona S.A. to Phoebe IVS with its registered office in Denmark "Inwestor", then mFinanse was obliged to sell the organized part of the enterprise of mFinanse to Latona S.A.

In connection with the above, on 26 March 2018, the Bank sold 100% of shares in Latona S.A. to the Investor, and on 27 March 2018, mFinanse sold the organized part of 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.

As a result of the transaction, in the first half of 2018 the Group and the Bank recognised a gross profit in the amount of PLN 238 832 thousand (including into account the impact of the mFinanse valuation using the equity method in the separate financial statements). As at the date of publication of these financial statements, the Bank estimates that the maximum value of remuneration on account of the transaction is approximately PLN 435 million. Due to the nature of the transaction, the recognition of the part of the remuneration in the future will depend on the performance of the business sold. This may result in the recognition of an additional gross profit of up to PLN 161 million in the period of about 6 years from the end of the first half of 2018.

- Restructuring of mCentrum Operacji Sp. Z o.o.

On 1 March 2018, the mBank S.A. Group completed the process of reorganisation of mCentrum Operacji Sp z o.o. ("mCO"). As part of the process, two organized parts of the enterprise were separated in the form of the Development Division of Automatic Processes and the General Division. On 1 March 2018, the Development Division of Automatic Process was sold to Feronia, of which the major shareholder is Future Tech FIZ, a subsidiary of the Bank, in order to automation of the processes handled by this part of mCO, while the General Division, including the majority of processes so far serviced by mCO, was sold to the Bank.

These transactions had no impact on the financial results and net assets of the Bank and mBank S.A. Group.

5.11. Changes in contingent liabilities and commitments

In the first half of 2018, there were no changes in contingent liabilities and commitments of credit nature, i.e., guarantees, letters of credit or unutilised loan amounts, other than resulting from current operating activities of the Bank. There was no single case of granting of guarantees or any other contingent liability of any material value for the Bank.

5.12. Write-offs of the value of inventories down to net realisable value and reversals of such write-offs

In the first half of 2018, events as indicated above did not occur in the Bank.

5.13. Revaluation write-offs on account of impairment of tangible fixed assets, intangible assets, or other assets as well as reversals of such write-offs

In the first half of 2018, events as indicated above did not occur in the Bank.

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

5.14. Revaluation write-offs on account of impairment of financial assets

the period	od 01.01.2018 do 30.06.2018	od 01.01.2017 do 31.12.2017	od 01.01.2017 do 30.06.2017
Total gains less losses from investments securities, including:	***n/a***	**(12 262)**	**(12 262)**
Impairment of available for sale debt securities	*n/a*	(7 511)	(7 511)
Impairment of available for sale equity securities	*n/a*	(4 751)	(4 751)
Impairment or reversal of impairment of financial assets not measured at fair value through profit or loss, including:	**(241 143)**	**(457 889)**	**(184 701)**
Financial assets at amortised cost	(240 288)	(423 791)	(190 951)
- Debt securisties	*6*	*n/a*	*n/a*
- Loans and advances	*(240 294)*	*n/a*	*n/a*
Financial assets at fair value through other comprehensive income	(216)	n/a	n/a
- Equity instruments	*-*	*n/a*	*n/a*
- Debt securisties	*(216)*	*n/a*	*n/a*
Commitments and guarantees granted	(639)	(34 098)	6 250
Total gains less losses from financial assets not measured at fair value through profit or loss	**(241 143)**	**(470 151)**	**(196 963)**

5.15. Reversals of provisions against restructuring costs

In the first half of 2018, events as indicated above did not occur in the Bank.

5.16. Acquisitions and disposals of tangible fixed asset items

In the first half of 2018, there were no material transactions of acquisition or disposal of any tangible fixed assets.

5.17. Material liabilities assumed on account of acquisition of tangible fixed assets

In the first half of 2018, events as indicated above did not occur in the Bank.

5.18. Information about changing the process (method) of measurement the fair value of financial instruments

In connection with the implementation of IFRS 9 as of 1 January 2018, the Bank has appropriately changed the methods for determining the fair value of financial instruments, as described in detail under Note 3 "Description of relevant accounting policies".

5.19. Changes in the classification of financial assets due to changes of purpose or use of these assets

In the reporting period there were no changes in the classification of financial assets as a result of a change in the purpose or use of these assets.

5.20. Corrections of errors from previous reporting periods

In the first half of 2018 there no corrections of errors from previous reporting periods.

5.21. Information on changes in the economic situation and operating conditions that have a significant impact on the fair value of financial assets and financial liabilities of the entity, regardless of whether these assets and liabilities are included in the fair value or in the adjusted purchase price (amortized cost)

In the first half of 2018, events as indicated above did not occur in the Bank.

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

5.22. Default or infringement of a loan agreement or failure to initiate composition proceedings

In the first half of 2018, events as indicated above did not occur in the Bank.

5.23. Position of the management on the probability of performance of previously published profit/loss forecasts for the year in light of the results presented in the quarterly report compared to the forecast

mBank S.A. did not publish a performance forecast for the year 2018.

5.24. Registered share capital

The total number of ordinary shares as at 30 June 2018 was 42 312 122 shares (31 December 2017: 42 312 122 shares, 30 June 2017 - 42 285 676 shares) at PLN 4 nominal value each. All issued shares were fully paid up.

REGISTERED SHARE CAPITAL (THE STRUCTURE) AS AT 30 JUNE 2018						
Share type	**Type of privilege**	**Type of limitation**	**Number of shares**	**Series / face value of issue in PLN**	**Paid up**	**Registered on**
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 (PLN)		4				

* As at the end of the reporting period

5.25. Material share packages

In the first half of 2018, there were no changes in the holding of material share packages of the Bank.

Commerzbank AG is a shareholder holding over 5% of the share capital and votes at the General Meeting and as at 30 June 2018 it held 69.37% of the share capital and votes at the General Meeting of mBank S.A.

On 20 March 2015, the Bank received from ING Otwarty Fundusz Emerytalny (now 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., which represented 5.05% of the share capital of mBank S.A. The shares entitled to 2 130 699 votes at the General Meeting of mBank SA, which represented 5.05% of the total number of votes.

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

5.26. Earnings per share

Earning per share for 6 months

the period	from 01.01.2018 to 30.06.2018	from 01.01.2017 to 30.06.2017
Basic:		
Net profit	698 207	489 528
Weighted average number of ordinary shares	42 312 122	42 280 403
Net basic profit per share (in PLN per share)	**16.50**	**11.58**
Diluted:		
Net profit applied for calculation of diluted earnings per share	698 207	489 528
Weighted average number of ordinary shares	42 312 122	42 280 403
Adjustments for:		
- share options	26 706	25 434
Weighted average number of ordinary shares for calculation of diluted earnings per share	42 338 828	42 305 837
Diluted earnings per share (in PLN per share)	**16.49**	**11.57**

5.27. Proceedings before a court, arbitration body or public administration authority

As at 30 June 2018, the Bank was not involved in any proceedings before a court, arbitration body, or public administration authority concerning liabilities and receivables 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 30 June 2018 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. On 30 April 2018, a hearing was held before the Court which accepted supplementary verbal testimony of an expert as evidence. The Court issued a decision obliging mBank to submit certificates containing the history of changes in interest rates applied to each credit agreement covered by the proceedings by 15 June 2018. The court granted the Plaintiff's attorney a period of 21 days to collect data necessary to supplement the opinion by an expert.

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.

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. As decided by the Court on 13 March 2018, the group is composed of 1,731 persons. The said decision was appealed against by both parties. Regardless of the appeal proceedings, the Court scheduled a hearing for 5 October 2018.

4. A lawsuit filed by LPP S.A.

On 17 May 2018, mBank S.A. received a lawsuit filed by LPP S.A. with its registered office in Gdańsk seeking damages amounting to PLN 96 307 009.15 on account of interchange fee. In the lawsuit, LPP S.A. petitioned the court for awarding the damages jointly from mBank S.A. and from other domestic bank.

The plaintiff accuses the two sued banks as well as other banks operating in Poland of taking part in a collusion breaching the Competition and Consumer Protection Act and the Treaty on the Functioning of the European Union. In the plaintiff's opinion, the collusion took the form of an agreement in restriction of competition in the market of acquiring services connected with settling clients' liabilities towards the plaintiff on account of payments for goods purchased by them with payment cards in the territory of Poland. According to the plaintiff:

a. the banks agreed on the interchange fee amount for transactions made with VISA and/or MasterCard payment cards and charged the plaintiff these amounts,
b. the sued banks as well as other banks operating in Poland collaborating with the sued banks charged the plaintiff the interchange fees in the amount agreed on in the collusion and amounts of interchange fees paid by the plaintiff to the sued banks and other banks collaborating with the sued banks in the years 2008-2014,
c. the plaintiff suffered losses due to the collusion of the sued banks and other banks operating in Poland as the banks agreed on the interchange fee amount and charged the plaintiff the fee, and
d. the sued banks were aware of the legal nature of the collusion and economic consequences the plaintiff had to face due to the collusion (the plaintiff's losses: the plaintiff had to pay more than it would have paid if the sued banks and other banks collaborating with the sued banks had not entered in the collusion).

At present, mBank S.A. is preparing its statement of defence. The time limit for submitting the statement of defence expires on 17 August 2018.

Tax audits

From 23 November 2017 to 3 April 2018 at mBank S.A. was conducted 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 revealed no irregularities.

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.

5.28. Off-balance sheet liabilities

Off-balance sheet liabilities as at 30 June 2018, 31 December 2017 and 30 June 2017 were as follows:

	30.06.2018	31.12.2017	30.06.2017
1. Contingent liabilities granted and received	**47 695 500**	**44 345 080**	**39 151 367**
Commitments granted	**43 429 495**	**40 342 025**	**36 255 257**
- financing	25 931 605	25 082 366	21 905 164
- guarantees and other financial facilities	15 663 615	14 859 659	14 350 093
- other commitments	1 834 275	400 000	-
Commitments received	**4 266 005**	**4 003 055**	**2 896 110**
- financial commitments	1 476 708	13 222	200 277
- guarantees	2 789 297	3 989 833	2 695 833
2. Derivative financial instruments (nominal value of contracts)	**497 327 183**	**430 977 784**	**413 001 699**
Interest rate derivatives	386 716 975	334 207 199	315 425 819
Currency derivatives	104 688 755	93 603 439	87 647 499
Market risk derivatives	5 921 453	3 167 146	9 928 381
Total off-balance sheet items	**545 022 683**	**475 322 864**	**452 153 066**

5.29. Transactions with related entities

mBank S.A. is the parent entity of the 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.

The amounts of transactions with related entities, i.e., balances of receivables and liabilities and related costs and income as at 30 June 2018, 31 December 2017 and 30 June 2017 were as follows.

(in PLN 000's)	mBank's subsidiaries and associates			CommerzbankAG			Other companies of the Commerzbank AG Group excluding mBank S.A, subsidiaries		
As at the end of the period	**30.06.2018**	**31.12.2017**	**30.06.2017**	**30.06.2018**	**31.12.2017**	**30.06.2017**	**30.06.2018**	**31.12.2017**	**30.06.2017**
Statement of Financial Position									
Assets	15 751 702	15 030 592	14 852 059	1 464 787	610 053	720 673	-	9 084	8 463
Liabilities	9 095 044	8 085 667	8 204 048	2 972 857	4 053 070	7 290 602	34 041	37 064	28 059
Income Statement									
Interest income	154 506	269 619	122 445	53 823	110 603	58 367	277	431	199
Interest expense	(81 573)	(157 822)	(77 289)	(37 120)	(107 883)	(58 319)	(126)	(293)	(145)
Fee and commission income	5 673	18 232	6 563	630	1 158	550	17	39	23
Fee and commission expense	(88 927)	(110 433)	(48 004)	-	(5)	(3)	-	-	-
Other operating income	6 550	11 082	3 646	9	24	10	-	-	-
Overhead costs, amortisation and other operating expenses	(1 106)	(12 360)	(4 460)	(5 234)	(8 865)	(6 067)	-	-	-
Contingent liabilities granted and received									
Contingent liabilities granted	11 729 505	10 254 799	9 302 988	1 742 274	2 099 374	1 597 257	-	7 057	7 151
Contingent liabilities received	-	-	-	1 947 800	1 632 240	1 522 806	-	8 385	9 017

The total costs of remuneration of Members of the Supervisory Board, the Management Board and other key management personnel of the Bank that perform their duties from 1 January to 30 June 2018 recognised in the Bank's income statement for that period amounted to PLN 22 898 764 (in the period from 1 January to 30 June 2017: PLN 16 615 800).

With regard to the Management Board and other key management personnel the remuneration costs include also remuneration in the form of shares and share options.

5.30. Credit and loan guarantees, other guarantees granted of significant value

As at 30 June 2018, the Bank's significant exposure under guarantees granted related to the guarantee payment of all amounts to be paid in respect of debt securities issued by mFinance France S.A. (mFF), a subsidiary of the mBank S.A.

On 25 September 2013, mFF issued tranche of Eurobonds with nominal value of CHF 200 000 thousand maturing on 8 October 2018. In this case, the guarantee was granted on 25 September 2013 for the duration of the Programme, i.e. to 8 October 2018.

On 22 November 2013, mFF issued next tranche of Eurobonds with nominal value of CZK 500 000 thousand maturing on 6 December 2018. In this case, the guarantee was granted on 22 November 2013 for the duration of the Programme, i.e. to 6 December 2018.

On 24 March 2014, mFF issued next tranche of Eurobonds with nominal value of EUR 500 000 thousand maturing on 1 April 2019. In this case, the guarantee was granted on 24 March 2014 for the duration of the Programme, i.e. to 1 April 2019.

On 20 November 2014, mFF issued next tranche of Eurobonds with nominal value of EUR 500 000 thousand maturing on 26 November 2021. In this case, the guarantee was granted on 20 November 2014 for the duration of the Programme, i.e. to 26 November 2021.

On 21 September 2016, mFF issued next tranche of Eurobonds with nominal value of EUR 500 000 thousand maturing on 26 September 2020. In this case, the guarantee was granted on 21 September 2016 for the duration of the Programme, i.e. to 26 September 2020.

On 14 March 2017, mFF issued next tranche of Eurobonds with nominal value of CHF 200 000 thousand maturing on 28 March 2023. In this case, the guarantee was granted on 14 March 2017 for the duration of the Programme, i.e. to 28 March 2023.

5.31. Fair value of assets and liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement assumes that the transaction of selling the asset or transferring a liability occurs either:

- 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 marked-to-model 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 assumed 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 assumes 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.

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

	30.06.2018	
	Carrying value	Fair value
Financial assets at amortised cost		
Debt securities	**9 314 878**	**9 396 393**
Loans and advances to banks	**7 340 475**	**7 370 688**
Loans and advances to customers, including:	**74 697 141**	**74 790 461**
Individual customers	**40 120 489**	**40 934 251**
Current accounts	5 828 647	6 006 781
Term loans	34 092 802	34 728 430
Other receivables	199 040	199 040
Corporate customers	**33 921 259**	**33 206 714**
Current accounts	5 256 340	5 151 080
Term loans	28 490 138	27 880 853
Reverse repo / buy-sell-back transactions	29 025	29 025
Other loans and advances	97 071	97 071
Other receivables	48 685	48 685
Public sector customers	**655 393**	**649 496**
Financial liabilities measured at amortised cost		
Amounts due to banks	**4 567 999**	**4 568 912**
Amounts due to customers	**106 613 859**	**106 824 474**
Debt securities issued	**679 244**	**681 105**
Subordinated financial liabilities	**2 206 733**	**2 223 320**

	31.12.2017		30.06.2017	
	Carrying value	Fair value	Carrying value	Fair value
Financial assets at amortised cost				
Loans and advances to banks	**6 063 702**	**6 066 995**	**7 113 557**	**7 113 009**
Loans and advances to customers	**73 431 738**	**73 294 398**	**73 169 273**	**73 718 678**
Loans and advances to individuals	**40 861 252**	**41 140 947**	**41 975 756**	**43 140 135**
Current accounts	6 669 099	6 850 427	6 439 749	6 673 705
Term loans	34 192 153	34 290 520	35 536 007	36 466 430
Loans and advances to corporate entities	**31 392 681**	**30 970 086**	**30 006 190**	**29 405 795**
Current accounts	5 098 424	5 010 318	5 025 333	4 861 479
Term loans	26 030 530	25 696 041	24 719 402	24 282 861
Reverse repo / buy sell back transactions	57 119	57 119	93 825	93 825
Other receivables	206 608	206 608	167 630	167 630
Loans and advances to public sector	**870 182**	**875 742**	**947 842**	**933 263**
Other receivables	**307 623**	**307 623**	**239 485**	**239 485**
Financial liabilities measured at amortised cost				
Amounts due to other banks	**5 089 716**	**5 116 405**	**8 654 205**	**8 716 504**
Amounts due to customers	**99 331 571**	**99 667 451**	**96 113 526**	**96 499 715**
Subordinated liabilities	**2 158 143**	**2 137 590**	**2 232 839**	**2 154 362**

Differences between fair value presented in the table above and in the financial statements for the year 2017 and for the first half 2017 result from the update of the methodology for estimating the fair value of financial assets.

The following sections present the key assumptions and methods used by the Bank for estimation of the fair values of financial instruments:

<u>Loans and advances to banks and loans and advances to customers.</u> The fair value for loans and advances to banks and loans and advances to customers is disclosed as the present value of future cash flows using current interest rates including appropriate credit spreads and is based on the expected maturity of the respective loan agreements. The level of credit spread was determined based on market quotation of median credit spreads for Moody's rating grade. Attribution of a credit spread to a given credit exposure is based on a mapping between Moody's rating grade and internal rating grades of the Bank. To reflect the fact that the majority of the Bank's exposures is collateralised

whereas the median of market quotation is centred around unsecured issues, the Bank applied appropriate adjustments.

Financial assets at fair value through other comprehensive income. 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 for the Bank include the following:

- Contracted borrowings;
- Deposits;
- Issues of debt securities;
- Subordinated liabilities.

The fair value for these financial liabilities with more than 1 year to maturity is based on cash flows discounted using interest rates. For loans received from Commerzbank in CHF, the Bank used the curve based on quotations of Commerzbank CDS for exposures in EUR and quotations of issued bonds under EMTN programme in EUR and CHF. For the loans received from European Investment Bank in EUR the Bank used the EBI yield curve. With regard to the own issue as part of the EMTN programme the market price of the relevant financial services has been used.

In the case of deposits, the Bank has applied the curve constructed on the basis of quotations of money market rates as well as FRA and IRS contracts for appropriate currencies and maturities. In case of subordinated liabilities, the Bank used curves based on cross-currency basis swap levels taking into account the original spread on subordinated liabilities and their maturities.

In case of covered bonds and other debt securities issued by mBank Hipoteczny, for the purpose of the disclosures swap curves and forecasted initial spreads for certain issues are used.

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 following tables presents the hierarchy of fair values of financial assets and liabilities recognised in the condensed statement of financial position of the Bank at their fair values.

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

30.06.2018	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				
Financial assets held for trading and derivatives held for hedges	**5 501 438**	**3 109 443**	**1 201 911**	**1 190 084**
Loans and advances to custumers	**831 292**	**-**	**-**	**831 292**
- Individual customers	831 292	-	-	831 292
Debt securities	**3 467 544**	**3 108 752**	**-**	**358 792**
- General governments	3 108 752	3 108 752	-	-
- Credit institutions	194 793	-	-	194 793
- Other financial corporations	71 259	-	-	71 259
- Non-financial corporations	92 740	-	-	92 740
Equity securities	**691**	**691**	**-**	**-**
- Credit institutions	38	38	-	-
- Other financial corporations	78	78	-	-
- Non-financial corporations	575	575	-	-
Derivative financial instruments, including:	**1 201 911**	**-**	**1 201 911**	**-**
Derivative financial instruments held for trading:	**1 113 632**	**-**	**1 113 632**	**-**
- interest rate derivatives	595 190	-	595 190	-
- foreign exchange derivatives	445 670	-	445 670	-
- market risks derivatives	72 772	-	72 772	-
Derivative financial instruments held for hedging:	**88 279**	**-**	**88 279**	**-**
- derivatives designated as fair value hedges	85 902	-	85 902	-
- derivatives designated as cash flow hedges	2 377	-	2 377	-
Non-trading financial assets mandatorily at fair value through profit or loss	**2 514 191**	**769**	**-**	**2 513 422**
Loans and advances to custumers	**2 503 121**	**-**	**-**	**2 503 121**
- Individual customers	2 338 119	-	-	2 338 119
- Credit institutions	149 044	-	-	149 044
- Corporate custumers	15 958	-	-	15 958
Equity securities	**11 070**	**769**	**-**	**10 301**
- Other financial corporations	11 070	769	-	10 301
Financial assets at fair value through other comprehensive income	**23 062 789**	**19 232 030**	**1 999 382**	**1 831 377**
Debt securities	**23 004 670**	**19 232 030**	**1 999 382**	**1 773 258**
- Banki centralne	1 999 382	-	1 999 382	-
- General governments	18 287 323	18 250 101	-	37 222
- Credit institutions	935 557	-	-	935 557
- Other financial corporations	1 163 973	981 929	-	182 044
- Non-financial corporations	618 435	-	-	618 435
Equity securities	**58 119**	**-**	**-**	**58 119**
- Other financial corporations	58 119	-	-	58 119
Total financial assets	**31 078 418**	**22 342 242**	**3 201 293**	**5 534 883**

30.06.2018	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	**1 139 768**	**-**	**1 139 768**	**-**
Derivative financial instruments held for trading	**1 223 297**	**-**	**1 223 297**	**-**
- interest rate derivatives	678 978	-	678 978	-
- foreign exchange derivatives	476 269	-	476 269	-
- market risks derivatives	68 050	-	68 050	-
Derivative financial instruments held for trading	**(83 529)**	**-**	**(83 529)**	**-**
- derivatives designated as fair value hedges	(80 230)	-	(80 230)	-
- derivatives designated as cash flow hedges	(3 299)	-	(3 299)	-
Total financial liabilities	**1 139 768**	**-**	**1 139 768**	**-**
TOTAL RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS	**31 078 418**	**22 342 242**	**3 201 293**	**5 534 883**
FINANCIAL LIABILITIES	**1 139 768**	**-**	**1 139 768**	**-**

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

Assets Measured at Fair Value Based on Level 3 - changes in the period from 1 January to 30 June 2018	Debt trading securities	Non-trading equity securities mandatorily at fair value through profit or loss	Debt securities at fair value through other comprehensive income	Equity securities at fair value through other comprehensive income
As at the beginning of the period	**311 826**	**-**	**1 635 171**	**55 486**
Transfer between asset categories due to the implementation of IFRS 9 as at 01.01.2018	-	8 948	-	(8 948)
Restated opening balance	**311 826**	**8 948**	**1 635 171**	**46 538**
Gains and losses for the period:	**1 710**	**-**	**5 916**	**11 581**
Recognised in profit or loss:	1 710	-	-	2 392
- Net trading income	*1 710*	-	-	*2 392*
Recognised in other comprehensive income:	-	-	5 916	9 189
- Financial assets at fair value through other comprehensive income	-	-	*5 916*	*9 189*
Purchases	819 033	1 391	1 121 891	-
Redemptions	(360 274)	-	(41 063)	-
Sales	(3 606 779)	(38)	(1 088 518)	-
Issues	3 193 276	-	139 861	-
As at the end of the period	**358 792**	**10 301**	**1 773 258**	**58 119**

In the first half of 2018 there were no transfers of financial instruments between the levels of fair value hierarchy.

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
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**

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

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**	**-**

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.

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

30.06.2017	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	**3 343 084**	**3 075 717**	**-**	**267 367**
Debt securities	**3 339 048**	**3 071 681**	**-**	**267 367**
- government bonds	3 063 677	3 063 677	-	-
- treasury bills	4 987	4 987	-	-
- deposit certificates	12 093	-	-	12 093
- mortgage bonds	18 966	-	-	18 966
- banks bonds	82 352	-	-	82 352
- corporate bonds	156 973	3 017	-	153 956
Equity securities	**4 036**	**4 036**	**-**	**-**
- listed	4 036	4 036	-	-
DERIVATIVE FINANCIAL INSTRUMENTS	**1 331 117**	**-**	**1 331 117**	**-**
Derivative financial instruments held for trading	**1 206 623**	**-**	**1 206 623**	**-**
- interest rate derivatives	819 681	-	819 681	-
- foreign exchange derivatives	370 580	-	370 580	-
- market risks derivatives	16 362	-	16 362	-
Derivative financial instruments held for hedging	**124 494**	**-**	**124 494**	**-**
- derivatives designated as fair value hedges	115 965	-	115 965	-
- derivatives designated as cash flow hedges	8 529	-	8 529	-
INVESTMENT SECURITIES	**29 607 690**	**28 253 956**	**99 971**	**1 253 763**
Debt securities	**29 557 773**	**28 252 931**	**99 971**	**1 204 871**
- government bonds	27 018 950	27 018 950	-	-
- treasury bills	498 722	498 722	-	-
- money bills	99 971	-	99 971	-
- deposit certificates	220 656	-	-	220 656
- mortgage bonds	176 466	-	-	176 466
- banks bonds	135 729	-	-	135 729
- corporate bonds	1 369 404	735 259	-	634 145
- communal bonds	37 875	-	-	37 875
Equity securities	**49 917**	**1 025**	**-**	**48 892**
- unlisted	49 917	1 025	-	48 892
TOTAL FINANCIAL ASSETS	**34 281 891**	**31 329 673**	**1 431 088**	**1 521 130**

30.06.2017	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	**1 154 083**	**-**	**1 154 083**	**-**
Derivative financial instruments held for trading	**1 152 843**	**-**	**1 152 843**	**-**
- interest rate derivatives	803 245	-	803 245	-
- foreign exchange derivatives	330 516	-	330 516	-
- market risks derivatives	19 082	-	19 082	-
Derivative financial instruments held for hedging	**1 240**	**-**	**1 240**	**-**
- derivatives designated as fair value hedges	18 001	-	18 001	-
- derivatives designated as cash flow hedges	(16 761)	-	(16 761)	-
Total financial liabilities	**1 154 083**	**-**	**1 154 083**	**-**
TOTAL RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS	**34 281 891**	**31 329 673**	**1 431 088**	**1 521 130**
FINANCIAL LIABILITIES	**1 154 083**	**-**	**1 154 083**	**-**

IFRS Condensed Financial Statements for the first half of 2018 PLN (000's)

Assets Measured at Fair Value Based on Level 3 - changes in the period from 1 January to 30 June of 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:	3 471	(2 416)	(2 252)
Recognised in profit or loss:	3 471	(7 511)	(4 751)
Net trading income	*3 471*	-	-
Gains less losses from investment securities, investments in subsidiaries and associates	-	*(7 511)*	*(4 751)*
Recognised in other comprehensive income:	-	*5 095*	*2 499*
Available for sale financial assets	-	*5 095*	*2 499*
Purchases	635 748	566 429	900
Redemptions	(96 509)	(72 092)	-
Sales	(6 179 051)	(641 941)	-
Issues	5 575 518	229 512	-
As at the end of the period	**267 367**	**1 204 871**	**48 892**

In the first half of 2017 there were no transfers of financial instruments between the levels of fair value hierarchy.

Level 1

As at 30 June 2018, at level 1 of the fair value hierarchy, the Bank has presented the fair value of held for trading government bonds in the amount of PLN 3 108 752 thousand and the fair value of government bonds and treasury bills at fair value through other comprehensive income in the amount of PLN 18 250 101 thousand (31 December 2017 respectively: PLN 1 232 515 thousand and PLN 26 283 963 thousand, 30 June 2017 respectively: PLN 3 068 664 thousand and PLN 27 517 672 thousand). Level 1 includes the fair value of corporate bonds in the amount of PLN 981 929 thousand (31 December 2017 – PLN 938 243 thousand; 30 June 2017 – PLN 738 276 thousand).

In addition, as at 30 June 2018 level 1 includes the value of the registered privileged shares of Giełda Papierów Wartościowych in the amount of PLN 769 thousand (31 December 2017: PLN 986 thousand, 30 June 2017: PLN 1 025 thousand) and the value of the shares of listed companies in the amount of PLN 691 thousand (31 December 2017: PLN 744 thousand, 30 June 2017: PLN 4 036 thousand).

These instruments are classified as level 1 because their valuation is directly derived by applying current market prices quoted on active and liquid financial markets.

Level 2

Level 2 of the fair value hierarchy mainly includes the fair values of bills issued by NBP in the amount of PLN 1 999 382 thousand (31 December 2017: PLN 2 199 429 thousand, 30 June 2017: PLN 99 971 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 30 June 2018, 31 December 2017, and 30 June 2017, level 2 also includes the value of options referencing on the WIG20 index, listed on the Stock Exchange. For the valuation of index options on WIG20 the Bank applied an internal model (based on a model for implied volatility) for which market data have been used as input parameters.

Level 3

Level 3 of the hierarchy presents the fair values of commercial debt securities issued by local banks and companies (bonds and deposit certificates) in the amount of PLN 2 094 828 thousand (31 December 2017: PLN 1 911 086 thousand, 30 June 2017: PLN 1 434 363 thousand).

Level 3 includes also the fair value of local government bonds in the amount of PLN 37 222 thousand (31 December 2017: PLN 35 910 thousand, 30 June 2017: PLN 37 875 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., rate of recovery from collateral, rating migrations, default ratio volatilities) which are not observed on active markets and hence were generated by statistical analysis.

As at 30 June 2018, Level 3 includes the fair value of loans and advances to customers in the amount of PLN 3 334 413 thousand.

The fair value for 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 Group. To reflect the fact that the Group's exposures are in major part collateralised whereas the median of market quotation is centred around unsecured issues, the Group applied appropriate adjustments.

Moreover, level 3 also includes the fair value of equity securities amounting to PLN 68 420 thousand (31 December 2017: PLN 55 486 thousand, 30 June 2017: PLN 48 892 thousand). As at 30 June 2018, these amount includes the value of preferred stock in Visa Inc. in the amount of PLN 58 119 thousand (31 December 2017: PLN 46 538 thousand, 30 June 2017: PLN 40 911 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.

5.32. Other information which the issuer deems necessary to assess its human resources, assets, financial position, financial performance and their changes as well as information relevant to an assessment of the issuer's capacity to meet its liabilities

On 12 April 2018, the Supervisory Board of mBank S.A. selected members of the Management Board of mBank S.A. for a joint term of five years, with the following composition:

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.

5.33. Other information

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

On 13 January 2017, FSC endorsed the resolution on the recommendation on the restructuring of the foreign exchange 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 FX loan by means of a dedicated resolution of the Ministry of Finance (this regulatory measure is addressed to banks that apply internal ratings based approach to the calculation of the capital charge for credit risk, among others to mBank S.A.);
- 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.

- 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 1.88% 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 Financial Supervision Authority on the minimum level of capital ratios binding in 2017, the required level of capital ratios to be applied by banks in 2018, as at 30 June 2018 the required level of capital ratios amount to:

- Individual total capital ratio – 17.51% and Tier 1 capital ratio – 14.48%
- Consolidated total capital ratio – 16.98% and Tier 1 capital ratio – 14.10%.

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

- Request of the Polish Financial Supervision Authority to express an opinion by the Financial Stability Committee regarding a change of the other systemically important institution buffer imposed on mBank S.A.

In the course of administrative proceedings conducted by the Polish Financial Supervision Authority (PFSA), on 14 June 2018 , the Bank received a letter, in which the PFSA asks the Financial Stability Committee (FSC) to express its opinion regarding a change of the amount of the other systemically important institution (O-SII) buffer imposed on the Bank.

Pursuant to the PFSA's decision of 19 December 2017, the Bank is currently required to maintain the O-SII buffer in the amount equivalent to 0.75% of the total risk exposure amount calculated in accordance with Art. art. 92 par. 3 of the Regulation of the European Parliament and of the Council (EU) No. 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms, amending Regulation (EU) No. 648/2012 CRR.

As part of the review of the adequacy of the O-SII buffer, carried out by the PFSA in accordance with art. 46 par. 1 of the Act of 5 August 2015 on Macroprudential Supervision of the Financial System and Crisis Management (Journal of Laws of 2017, item 1934, as amended), the PFSA indicated that the assessment of systemic importance obtained by the Bank is the basis to impose on the Bank the O-SII buffer in the amount equivalent to 0.5% of the total risk exposure amount calculated in accordance with Art. art. 92 par. 3 of CRR, instead of the current buffer of 0.75%.

On 21 June 2018 the Bank received a decision of the FSC, in which the FSC expressed a positive opinion on the imposition on the Bank of the other systemically important institution buffer imposed on Bank.

The final decision will be issued by the PFSA. By the date of publication of these condensed consolidated financial statements, the Bank did not receive the PFSA decision.

- Proposals concerning foreign currency mortgage loans restructuring

Some proposals of restructuring of foreign currency mortgage loans for individuals have been discussed in recently years, including the solutions presented by the Chancellery of the President of the Republic of Poland. At its meeting starting on 19 October 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 13 October 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.

- Appointment of an auditor to audit financial statements

On 12 April 2018, the 31st Annual General Meeting of mBank S.A., pursuant to the applicable law and Article 11 letter n) of the By-laws of the Bank, appointed Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością spółka komandytowa as the auditor to examine the financial statements of mBank S.A. and consolidated financial statements of mBank S.A. Group for 2018 and 2019.

- Distribution of profit for 2017

On 12 April 2018, the 31st Annual General Meeting of mBank S.A. adopted a resolution regarding the distribution of the net profit for 2017. The net profit of mBank S.A. in the amount of PLN 1 089 703 775.81 will be allocated to:

1. in the amount of PLN 217 907 428.30 for a dividend for shareholders,
2. in the amount of PLN 871 796 347.51 for the Bank's supplementary capital.

Additionally, the 31st Annual General Meeting of mBank S.A. adopted a resolution regarding the distribution of the undivided profit from the previous years in the amount of PLN 1 199 399 249.57.

5.34. Events after the balance sheet date

From 30 June 2018 until the date of publication of these condensed financial statements, no events occurred, which would require additional disclosure in these condensed financial statements.

Signature of the Management Board of mBank S.A.

Date	First and last name	Position	Signature
31.07.2018	Cezary Stypułkowski	President of the Management Board	
31.07.2018	Lidia Jabłonowska-Luba	Vice-President of the Management Board, Chief Risk Officer	
31.07.2018	Frank Bock	Vice-President of the Management Board, Head of Financial Markets	
31.07.2018	Andreas Böger	Vice-President of the Management Board, Chief Financial Officer	
31.07.2018	Krzysztof Dąbrowski	Vice-President of the Management Board, Head of Operations and IT	
31.07.2018	Cezary Kocik	Vice-President of the Management Board, Head of Retail Banking	
31.07.2018	Adam Pers	Vice President of the Management Board, Head of Corporate & Investment Banking	