Letter of the President of the Management Board of mBank S.A. to the Shareholders

Dear Shareholders,

The events unfolding in 2020 globally, in Poland, and in mBank Group, were largely determined by the Covid-19 pandemic. The conditions of business and everyday life of millions of people changed to the extent unimaginable a year ago. Temporary economic lockdowns, mobility restrictions, sanitary regimes, imposed strict rules and requirements of social distancing posed an immense challenge to the customary practice in all areas. Adaptation to the new circumstances had to be fast. From the perspective of companies, including banks, it included mass-scale remote work, quick addition of digitally available services, and migration to e-commerce. Meanwhile, Poland experienced its first recession in nearly thirty years with GDP dropping by 2.8% in 2020. In response to the economic slump, which hit the most in Q2, a range of crisis mitigation and support schemes were offered to companies and borrowers. Therefore, it would seem that the key driver of the financial performance of mBank Group in 2020 was the pandemic and its various implications. However, our results were more significantly affected by the rising debate concerning Swiss franc loans and accompanying court cases. As a consequence, in addition to a higher cost of risk and strong pressure on revenue, our net profit was determined by huge provisions set up against legal risk. The annual result reached only PLN 104 million, nearly 90% less than a year earlier.

Another adverse factor which hit the banking sector was a series of three interest rate cuts imposed by the Monetary Policy Council (RPP) in H1 2020 to a historical low of 0.1%. It impacted our margin which dropped by 37 basis points compared to 2019. Nevertheless, we generated a modestly higher (up by 0.2% year on year) net interest income exceeding PLN 4.0 billion. It was possible thanks to intensive efforts of both business lines which focused on interest rate adjustments. We offset the interest income gap by reducing significantly our cost of funding. Supported by overliquidity across the market and gradual elimination of term deposits, we paid only 0.06% for the entire deposit base in Q4 2020, that was 52 basis points less than in the corresponding period a year earlier.

Since the very beginning of 2020, I was proud to track a development of our fee and commission income, which double-digit dynamics was well above the sector average and the growth delivered by our main competitors. Thanks to gradual modifications of tariffs combined with high market volatility and emerging investment opportunities, our net fee and commission income improved by nearly 19% compared to 2019. Its strong growth was mainly driven by brokerage activity and FX exchange. Clients' interest and transaction volumes in both those areas were visibly intensified. Other categories of fees, including those charged on loans, bank accounts, payment cards and insurance product distribution, also improved.

With additional pressure on the bank's profits caused by the pandemic, we focused in 2020 more than ever before on cost savings and adjustments. Excluding contribution to the BFG, our cost base increased by 2% year on year. It resulted mainly from rising depreciation. Personnel expenses, constituting the biggest cost item, were cut by 4.4% compared to 2019 by reducing variable remuneration component, in particular the bonus pool. mBank Group's headcount decreased by 84 FTEs year on year at the end of 2020. To better address market challenges, we realigned our organizational structure. We also trimmed the composition of the management board by one member. We continued to optimise and automate our processes, including both internal and client-related ones, opening the opportunity of employee redeployment depending on needs and improving the scalability of our business. We also did not cease investing in future growth and innovation, as reflected by some increase in IT and project spending. Moreover, we completed mBank's new head office in Warsaw in 2020. While finishing work on the top floors continues, the infrastructure is in large part ready to accommodate our staff. The building will eventually house our personnel from all locations in Warsaw, including the subsidiaries. That transition was accompanied by a modest rise in administrative and real estate expenses.

Given the challenging operating conditions of 2020, it would have seemed that we would be hard pressed to maintain the steady improvement of our efficiency. However, thanks to disciplined cost management combined with an increase of total revenues by 6% year on year, mBank Group's cost/income ratio decreased further and stood at 41.1% in 2020 compared to 42.2% in 2019. It is much better than the sector average and consistently puts us among the leaders in the financial services industry. Operational efficiency and focus on keeping the sustained competitive advantage of our platform remain key pillars of our strategy. This is particularly relevant in times of dynamic and unforeseeable market developments which require immediate adaptation. In 2020, we enabled our clients to execute many banking operations completely remotely. Individual customers now have the option of opening a personal account on a smartphone without ever visiting a branch or meeting a courier. We modified the mortgage lending process so clients need to come to the bank only once to sign the agreement after completing all other formal requirements from home via a dedicated document sharing application. Digitisation in corporate banking also stepped up. We implemented an end-to-end electronic process for opening of bank accounts and granting of access to the transactional system without meeting an advisor or printing documents.

Given the uncertainty about the impact of the pandemic on our clients and their continued debt repayments after the expiry of credit moratoria, we conservatively set up more provisions against expected credit loss. As a result, our cost of risk stood at 119 basis points and provisions increased by 63% in 2020. We were the first bank in Poland to offer in March a suspension of loan payments for up to six months and an extension of the term of loans by the deferral period to our individual, business and corporate clients. An important element of support for enterprises were also funds from the PFR Financial Shield aid program, which could be conveniently applied for through mBank's transaction systems. Since spring 2020, we have monitored our exposures on the ongoing basis, especially in industries badly hit by the pandemic-related restrictions. So far, the situation in our both business segments has been assessed as good and stable, and our initial concerns have largely not materialised. The loan book quality has not deteriorated materially. mBank Group's NPL ratio stood at 4.8% and the coverage ratio was at 58.2% as at 31 December 2020.

Managing the balance sheet structure was ever more demanding in 2020. Huge overliquidity in the Polish banking industry forced our loan-to-deposit ratio to fall below 80%, the lowest in 15 years. As a result of tighter financing conditions in the early phase of the pandemic combined with visibly weaker client demand, mBank Group's loan portfolio net of the FX effect rose by only 2% to PLN 113.5 billion in 2020. Mortgage loans continued on a growth trajectory almost without interruption. Thanks to process enhancements, new sales of housing loans increased by 10% year on year and our market share improved by nearly 1 percentage point to 7.9% as at 31 December 2020. Consumer credit fared less well. After a drop by half in Q2 2020, new production has not yet recovered to the pre-pandemic level. On the other hand, with significant transfers of support funds from PFR to companies combined with households' precautionary savings and reduction of spending, customer deposits at mBank increased by a high 18% to PLN 137.7 billion in 2020. In an environment of interest rates close to 0%, this strong inflows were accompanied by a transition of the term structure as most cash was deposited in current accounts. In view of those market developments, we decided to resign from issuing bonds under EMTN programme and covered bonds by mBank Hipoteczny.

In addition to its comfortable liquidity situation, mBank Group maintained a strong capital position. Our Tier 1 ratio stood at 17.0% and the TCR amounted to 19.9% as at 31 December 2020. Our surplus on top of the minimum level required by the local regulator had been significant even before the elimination of the systemic risk buffer, which used to be set at 3.0% in Poland. After its reduction to 0%, combined with the annual revision of the other buffers, including for the risk of FX mortgage loans for households, we are now 5.8-6.0 percentage points above the KNF requirements on a consolidated basis. The weak ROE reached in 2020 was a function of low profit rather than our sub-optimally high capital base. The reported ratio was at 0.6%. Net of the adverse impact of provisions against the legal risk of CHF loans, ROE stood at 6.8%. Excluding also the banking tax, which reduced our profits by PLN 531 million, ROE would rise to 10.0%, despite a lower net interest margin and a high cost of risk. This clearly shows that the underlying profitability of mBank Group remained above the cost of capital even in such a difficult and challenging year. However, the heavy fiscal burdens and the hardly acceptable development of the court verdicts concerning CHF loans brought our reported return to a level which is certainly unsatisfactory for our shareholders. Displeasure of investors might be amplified by no dividend payment for yet another year as well as underperformance of our share price, which dropped by 54.0% in 2020 compared to WIG-Banks index losing 29.6%. Our business and capitalisation are highly impacted by the factors which remain beyond our control in spite of strenuous management efforts. The effective tax rate was 83.0%, what given our net profit of PLN 104 million, demonstrates the scale of the fiscal burdens shouldered by banks in Poland. We strive to make sure that those adverse developments do not put in shadow our solid business fundamentals and prospects of further profitable growth. In partnership with our key stakeholders, we keep a focus on delivering value that they appreciate and we can effectively generate.

For several years, mBank has been paying more and more attention to ESG (environmental, social, governance) issues. We aspire to be a leader of this area in the banking sector. Our initiatives vary in scale and scope. It is worth mentioning that due to the high interest in 2020, we raised the credit limit for financing renewable energy sources twice to PLN 4 billion. This is how we actively support green transition of the economy. I am very proud that we continue to "play together" with the Great Orchestra of Christmas Charity (WOŚP). As a strategic partner and sponsor, we process financial operations during money collections at the grand finales, and we contribute additional funds to match the donations of our clients. In addition to our mFoundation, which facilitates the development of mathematical education for children and youth through grant programs, competitions and numerous actions, in 2020 we established the fund "m jak malarstwo" (Polish: m is for painting), supporting Polish contemporary art. The proceeds obtained from auctions of works from the collection accumulated over the years in the bank will be allocated to the purchase of works by young artists, selected by a professional panel. We regularly run social campaigns raising awareness of cybercrime and promoting safe internet use. Drawing upon the expertise based on our strong position in e-commerce, we offered a set of tools for firms to open an e-shop and start doing business online. As a result, they gained a possibility not only to reach out to new customers but also had a chance to survive the lockdown in the brick-and-mortar economy. A component of our proposition was also a quick payment gateway, Paynow, where the merchant's account is immediately credited after each transaction.

The new mBank Group's Strategy approved in December 2019 is titled "Growth fuelled by our clients". We focus in the first place on the acquisition of young individuals and dynamic businesses in promising sectors and aspire to accompany them at every stage of their lives and development by designing our products, services, access channels and customer service models adequate to their needs. We believe that the demographic profile of our client base will in the coming years constitute an additional revenue potential for mBank, supporting the dynamics of future profits. As at the end of 2020, we had more than 5.6 million retail clients, including above 1 million in the Czech Republic and Slovakia. In turn, our corporate client portfolio increased to 29.1 thousand enterprises. We have significantly improved our market shares in all strategic products over the last three years. Our growth at a rate superior to that of our competitors proves that we offer convenient, user-friendly, safe, accessible and tailored solutions which address clients' needs and are favoured by our target groups.

As I mentioned at the beginning, mBank's financial results in 2020 were mainly hit by provisions against the legal risk of housing loans indexed with foreign currencies, in particular the Swiss franc. Due to the dramatically unfavourable trends in the court verdicts, we wrote off more than PLN 1 billion in provisions. That is because judges are not familiar with the regulatory limitations imposed on banks while supervisory bodies are not quick to introduce the general public to those realities. At the same time, we face an extreme pro-consumer bias prevailing in certain industries.

It should be recalled that at the time when clients' demand for housing loans indexed with foreign currencies was strong, i.e. in 2004-2008, there were no regulations under which the banks' FX rates published in exchange rate tables according to the Banking Law could be considered unfair, a reason for borrowers to contest their liabilities. Unfortunately, the judicial rulings in the past months have evolved in a direction which is very unfavourable to lenders. Despite no regulations required banks to apply NBP's average exchange rate or define specific FX rate algorithms in their credit agreements, many borrowers are trying to evade the consequences of the FX risk they had knowingly accepted and use the lawfully applied FX rate tariffs as an argument to contest the FX provisions related to indexation underlying such mortgage loans. Although that is economically unfounded, harmful to contractual obligations and manifestly in breach of the principle of proportionality, it is alas how Polish courts adjudicate.

In December 2020, the Chairman of the Polish Financial Supervision Authority (KNF) took the initiative to resolve the problem. He expressed an expectation that banks should offer arrangements to their FX borrowers whereby exposures would be converted and recalculated as if the loans had always been PLN contracts. Most banks in that position, including mBank, are working to develop a common formula to be offered to clients. Such a solution would come at a huge cost to banks, probably on a one-off basis. The resulting loss for our bank could equal or under certain conditions exceed our existing surplus of own funds above the capital requirements. In my opinion, that proposal is too far-reaching and excessively generous to borrowers at the expense of shareholders and depositors. However, assuming that the initiative attracts the support of the supervisory institutions, the resulting agreements are considered inviolable, and the NBP participates in the currency conversion operation, the management board of mBank intends to actively apply to the shareholders for their final decision on potential participation in this initiative along with an in-depth evaluation of its financial impact. This action goes beyond the usual powers of the management board and the supervisory board.

In conclusion, may I assure you that with our competences, high employee engagement and capabilities to effectively execute non-standard projects, we will keep up our competitive edge and maintain the capacity of achieving our goals despite the demanding operating environment.

May I thank all of you, our Shareholders, for your trust in us and your confidence in the strong foundations of our business model and unfailing growth potential that will ensure steady accretion of our shareholder value.

I would like to thank the Supervisory Board for their close cooperation and support throughout this difficult year faced with the uncertain environment which necessitated special measures.

Yours sincerely,

Cezary Stypułkowski