## Opinion of the Supervisory Board of mBank S.A. on the situation of the Bank in 2020 including assessment of the internal control system and the Bank's relevant risk management system

*Basis: Rule II.Z.10.1 of the Best Practice of WSE Listed Companies 2016*

2020 has been the hardest year for Poland's economy since early 1990s. Preliminary estimates released by Statistics Poland show that Poland's real gross domestic product (GDP) shrank by 2.8% in 2020. The decrease was observed in both gross fixed capital formation (by over 8%) and total consumption expenditure, including household consumption expenditure (by approx. 3%). Nevertheless, Poland's key economic figures are still better compared with the majority of EU countries, thanks to large-scale fiscal stimulus, strong ties with Germany's economy, and relatively low share of the tourism industry in the GDP. With many sectors still in lockdown, the labour market is holding up relatively well.

The pandemic reinforced the downward trend in the profitability of the banking sector, which had emerged before Covid-19 struck. Following a massive decline in economic activity, the costs of credit risk soared. The sector's profitability was adversely affected by three interest cuts totalling 140 basis points, which pushed net interest income down. In addition to the pressure from falling income, the sector's financial performance was also adversely affected by provisions for legal risk connected with FX housing loans, impairment losses on other assets, and high tax and regulatory charges.

mBank Group performed well in the challenging external environment. It was active and successful in offering aid tools to clients who ran into difficulties due to the pandemic. The pandemic situation accelerated digitalisation of processes. mBank added a number of new features to the mobile app and online banking, enabling clients to bank from the safety of their home.

In 2020, income posted by mBank Group reached its all-time high of nearly PLN 5.9 billion. Lower interest income was partly offset by a significant reduction in the Group's funding costs. The Group's income was driven mainly by net fee and commission income spurred by rising client base, higher transactionality, changes in the offer, revised fees and commissions, and hefty income from brokerage business.

High profitability and strict cost discipline made it possible to improve the cost/income ratio to 41.1% compared with 2019, even amid higher depreciation and rising contributions to the Bank Guarantee Fund (BFG).

The profit of mBank Group was negatively affected by impairment of and change in the fair value of loans and advances as well as provisions for legal risk connected with FX loans. Risk cost went up from 79 bp in 2019 to 119 bp in 2020 as a result of the bank's active and conservative approach to estimating the potential impact of the Covid-19 pandemic on the credit portfolio and the economy (and to estimating the level of portfolio provisions). Underlying the increase in provisions for legal risk connected with individual lawsuits concerning indexation clauses in agreements on CHF mortgage and housing loans was a change in court rulings unfavourable from the bank's perspective and a rise in the number of lawsuits filed by clients.

As a result, the Group's net profit attributable to Owners of the bank amounted to PLN 103.8 million compared with PLN 1,010.4 million in 2019.

Taking into account the extremely difficult external environment in 2020, the Supervisory Board would like to emphasize the Group's outstanding ability to generate income and manage costs effectively. Despite rising risk costs, the quality of the credit portfolio remained high. The share of non-performing loans grew only slightly - to 4.8%. from 4.5% at the end of 2019. It means that the NPL ratio for the Group is considerably lower than the banking sector average.

When uncertainty is high, ample capital base proves to be of vital importance. The Total Capital Ratio and the Tier 1 capital ratio at the consolidated level stood at 19.9% and 17.0%, respectively, as at December 31, 2020, well above the supervisory levels set for the Group. This proves the high ability of the Group to absorb potential shocks.

The Group's liquidity was safe and high in 2020, as reflected by the considerable surplus of liquid assets over short-term liabilities in the LAB and LCR tenors calculated at Group level.

**Assessment of the internal control system and the Bank's relevant risk management system**

**The internal control system** encompasses the following:

- control function designed to ensure the application of control mechanisms, which includes positions, groups of employees or organisational units responsible for performing tasks assigned to this function;
- compliance unit responsible for identifying, evaluating, controlling, monitoring and reporting the risk of the bank's non-compliance with laws, internal regulations and market standards;
- independent internal audit unit responsible for independent and objective monitoring and evaluation of the adequacy and effectiveness of the risk management system and the internal control system.

The obligations of the Management Board of the Bank, the Supervisory Board and the Audit Committee in the internal control system are set out in the rules of those bodies, the By-laws of the bank and other regulations approved by those bodies.

The Audit Committee monitors the functioning of the internal control system on an ongoing basis. In 2020 the Audit Committee was regularly provided with audit information from the audits conducted in the mBank and mBank Group subsidiaries, including assessments of the major findings related to internal control and risk management systems. Furthermore, the Chairperson of the Supervisory Board and Members of the Audit Committee received copies of reports on all audits conducted by the Internal Audit Department at the bank and in the mBank Group subsidiaries. The Audit Committee also received regular reports on compliance risk management and control functions, including identified irregularities and recovery actions taken. The Audit Committee of the Supervisory Board is also supported by an external auditor providing it with the results of and conclusions from the audit of financial statements.

The Supervisory Board, based on the information received in 2020, does not identify any major irregularities in the functioning of the internal control system (including the control function, the compliance unit, and the internal audit unit), and considers it to be to the scope and complexity of the Bank's operations, organisational structure, and risk management system.

**The Group's risk management system** is based on the three-lines-of-defence concept.

The first line of defence comprises management of risk inherent in the Bank's operations and is based on business units which in their day-to-day operations generate risks impacting on the achievement of the Bank's goals.

The second line of defence, in particular the risk management area, the security area, and the compliance area, is responsible for setting the framework and guidelines for managing individual risks, supporting business lines in their implementation, and for supervising the control functions and risk exposures.

The third line of defence comprises Internal Audit, which independently evaluates risk management in the first and second line of defence.

Every business line of the bank has its dedicated risk committee: the Retail Banking Risk Committee, the Corporate and Investment Banking Risk Committee, and the Financial Markets Risk Committee, which establish risk management principles and define risk appetite for the respective business lines. Risk-related issues are also an important subject of the work of other committees operating at the bank, chaired by members of the Management Board.

The bank has in place methodologies and processes under which risks are identified and evaluated in order to estimate their potential impact on the current and future operation. The comprehensive risk management structure is complemented by a coherent system of monitoring and reporting the level of risk and limit overruns. The reporting system encompasses the key management levels. The

Supervisory Board is provided with periodic reports assessing the level of identified risk and effectiveness of measures taken by the Management Board.

On matters of risks, the Supervisory Board acts through its Risk Committee exercising ongoing supervision of all risks, in particular credit risk (including concentration risk), market risk, operational risk, liquidity risk, reputational risk and business risk. The Risk Committee issues recommendations on significant exposures carrying the risk of a single business entity.

Last year the Committee dealt with many major risk-related issues, such as: impact of the current and expected macroeconomic conditions on the Bank's credit portfolio, the Group's exposure to treasury bonds or bonds guaranteed by the State Treasury, changes in the number of lawsuits and court rulings regarding the portfolio of FX loans in the context of legal risk provisions, quality of the credit portfolio and impairment losses, and changes in the fair value of loans and advances.

Following the received information, the Supervisory Board is of the opinion that the risk management system is adequate to the scope and complexity of the bank's activities, its size and risk profile. The risk management structure is optimised and adjusted in response to changing external environment. The system covers all risks relevant to the Group's operations. Risks are identified, measured, monitored and controlled.

In view of the above, the Supervisory Board positively assesses the management system in mBank and mBank Group in 2020, in the very uncertain environment the Supervisory Board expresses its gratitude to the Management Board and the employees for the engagement and efforts taken to ensure proper and stable functioning of the bank.

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Chairwoman of the Supervisory Board