mBank S.A.

IFRS Financial Statements 2018

This document is a translation from the original Polish version. In case of any discrepancies between the Polish and English versions, the Polish version shall prevail.

Selected financial data

The selected financial data are supplementary information to these financial statements of mBank S.A. for 2018.

	in PLN '000		in EUR '000	
	Year ended 31.12.2018	Year ended 31.12.2017	Year ended 31.12.2018	Year ended 31.12.2017
I. Interest income	3 961 606	3 550 968	928 451	836 565
II. Fee and commission income	1 467 005	1 405 071	343 810	331 018
III. Net trading income	352 317	303 383	82 570	71 473
IV. Operating profit	1 824 229	1 811 796	427 530	426 837
V. Profit before income tax	1 706 975	1 470 224	400 050	346 367
VI. Net profit	1 317 485	1 089 704	308 769	256 721
VII. Net cash flows from operating activities	1 919 196	(1 266 974)	449 787	(298 484)
VIII. Net cash flows from investing activities	(221 674)	(345 968)	(51 952)	(81 506)
IX. Net cash flows from financing activities	(871 422)	(3 584 484)	(204 228)	(844 461)
X. Total net increase / decrease in cash and cash equivalents	826 100	(5 197 426)	193 607	(1 224 451)
XI. Basic earnings per share (in PLN/EUR)	31.13	25.77	7.30	6.07
XII. Diluted earnings per share (in PLN/EUR)	31.11	25.75	7.29	6.07
XIII. Declared or paid dividend per share (in PLN/EUR)	5.15	-	1.21	-

	in PLN '000		in EUR '000	
	31.12.2018	31.12.2017	31.12.2018	31.12.2017
I. Total assets	137 649 170	124 569 483	32 011 435	29 866 332
II. Amounts due to other banks	3 136 771	5 089 716	729 482	1 220 292
III. Amounts due to customers	109 873 386	99 331 571	25 551 950	23 815 381
IV. Equity	15 175 043	14 287 561	3 529 080	3 425 534
V. Share capital	169 348	169 248	39 383	40 578
VI. Number of shares	42 336 982	42 312 122	42 336 982	42 312 122
VII. Book value per share (in PLN/EUR)	358.43	337.67	83.36	80.96
VIII. Total capital ratio	24.20	24.62	24.20	24.62

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

- for items of the statement of financial position – exchange rate announced by the National Bank of Poland as at 31 December 2018: EUR 1 = 4.300 and 31 December 2017: EUR 1 = PLN 4.1709.
- 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 2018 and 2017: EUR 1 = PLN 4.2669 and EUR 1 = PLN 4.2447 respectively.

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Income statement

	Note	Year ended 31 December	
		2018	2017
Interest income, including:	5	3 961 606	3 550 968
Interest income accounted for using the effective interest method		*3 357 644*	*3 303 533*
Income similar to interest on financial assets at fair value through profit or loss		*603 962*	*247 435*
Interest expenses	5	(874 097)	(792 483)
Net interest income		**3 087 509**	**2 758 485**
Fee and commission income	6	1 467 005	1 405 071
Fee and commission expenses	6	(575 803)	(588 155)
Net fee and commission income		**891 202**	**816 916**
Dividend income	7	126 391	166 285
Net trading income, including:	8	352 317	303 383
Foreign exchange result		*303 985*	*290 535*
Gains or losses on financial assets and liabilities held for trading		*52 721*	*23 768*
Gains or losses from hedge accounting		*(4 389)*	*(10 920)*
Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss	9	(155 485)	*n/a*
Gains less losses from investment securities, investments in subsidiaries and associates	10	*n/a*	8 231
Gains less losses from financial assets and liabilities not measured at fair value through profit or loss and investments in subsidiaries and associates, including:	10	13 396	-
Gains less losses from debt securities measured at fair value through other comprehensive income		*16 149*	*n/a*
Gains less losses from investments in subsidiaries and associates		*290*	*n/a*
Gains less losses from derecognition		*(3 043)*	*n/a*
Other operating income	11	59 117	113 938
Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss	14	(468 902)	(457 889)
Overhead costs	12	(1 699 470)	(1 589 578)
Depreciation	25, 26	(227 743)	(200 856)
Other operating expenses	13	(154 103)	(107 119)
Operating profit		**1 824 229**	**1 811 796**
Tax on the Bank's balance sheet items		(374 192)	(350 830)
Share in profits (losses) of entities under the equity method	43	256 938	9 258
Profit before income tax		**1 706 975**	**1 470 224**
Income tax expense	15	(389 490)	(380 520)
Net profit		**1 317 485**	**1 089 704**

Net profit attributable to Owners of mBank S.A.		**1 317 485**	**1 089 704**
Weighted average number of ordinary shares	**16**	**42 318 253**	**42 290 313**
Earnings per share (in PLN)	**16**	**31.13**	**25.77**
Weighted average number of ordinary shares for diluted earnings	**16**	**42 343 775**	**42 313 383**
Diluted earnings per share (in PLN)	**16**	**31.11**	**25.75**

Notes presented on pages 11–169 constitute an integral part of these Financial Statements.

IFRS Financial Statements 2018 PLN (000's)

Statement of comprehensive income

	Note	Year ended 31 December	
		2018	2017
Net profit		**1 317 485**	**1 089 704**
Other comprehensive income net of tax, including:	**17**	**70 595**	**165 227**
Items that may be reclassified subsequently to the income statement			
Exchange differences on translation of foreign operations (net)		176	617
Cash flows hedges (net)	19	88 841	(3 653)
Share of other comprehensive income of entities under the equity method		(650)	4 507
Change in valuation of available for sale financial assets (net)		*n/a*	166 844
Change in valuation of debt instruments at fair value through other comprehensive income (net)		(15 264)	*n/a*
Items that will not be reclassified to the income statement			
Actuarial gains and losses relating to post-employment benefits (net)		(2 508)	(3 088)
Total comprehensive income (net)		**1 388 080**	**1 254 931**

IFRS Financial Statements 2018 PLN (000's)

Statement of financial position

ASSETS	Note	31.12.2018	31.12.2017
Cash and balances with the Central Bank	18	9 182 971	7 383 518
Financial assets held for trading and derivatives held for hedges	19	2 126 112	2 781 351
Loans and advances to banks	22	*n/a*	6 063 702
Non-trading financial assets mandatorily at fair value through profit or loss, including:	20	2 567 330	*n/a*
Equity instruments		*12 226*	*n/a*
Debt securities		*58 130*	*n/a*
Loans and advances to customers		*2 496 974*	*n/a*
Investment securities	21	*n/a*	31 110 560
Financial assets at fair value through other comprehensive income	21	28 173 110	*n/a*
Loans and advances to customers	22	*n/a*	73 431 738
Financial assets at amortised cost, including:	22	91 111 844	*n/a*
Debt securities		*9 000 540*	*n/a*
Loans and advances to credit institutions		*5 909 341*	*n/a*
Loans and advances to customers		*76 201 963*	*n/a*
Investements in subsidiaries	23	2 300 324	2 060 847
Investments in associates	24	-	28 680
Intangible assets	25	693 210	648 191
Tangible assets	26	537 001	509 773
Current income tax assets		9 336	6 558
Deferred income tax assets	31	295 347	129 037
Other assets	27	652 585	415 528
Total Assets		**137 649 170**	**124 569 483**

Notes presented on pages 11–169 constitute an integral part of these Financial Statements.

IFRS Financial Statements 2018 PLN (000's)

LIABILITIES AND EQUITY	Note	31.12.2018	31.12.2017
L i a b i l i t i e s			
Financial liabilities held for trading and derivatives held for hedges	19	1 016 214	1 141 035
Financial liabilities measured at amortised cost, including:		118 342 044	106 579 430
Amounts due to banks	*28*	*3 136 771*	*5 089 716*
Amounts due to customers	*28*	*109 873 386*	*99 331 571*
Debt securities issued	*28*	*2 857 724*	*-*
Subordinated liabilities	*28*	*2 474 163*	*2 158 143*
Fair value changes of the hedged items in portfolio hedge of interest rate risk		-	27 046
Provisions	30	255 882	190 914
Current income tax liabilities		244 389	172 003
Deferred income tax liabilities	31	83	81
Other liabilities	29	2 615 515	2 171 413
T o t a l l i a b i l i t i e s		**122 474 127**	**110 281 922**
E q u i t y			
Share capital:	**35**	**3 574 686**	**3 564 176**
Registered share capital		169 348	169 248
Share premium		3 405 338	3 394 928
Retained earnings:	**37**	**11 423 575**	**10 572 341**
Profit from the previous years		10 106 090	9 482 637
Profit for the current year		1 317 485	1 089 704
Other components of equity	**38**	**176 782**	**151 044**
T o t a l e q u i t y		**15 175 043**	**14 287 561**
TOTAL LIABILITIES AND EQUITY		**137 649 170**	**124 569 483**
Total capital ratio	**45**	**24.20**	**24.62**
Common Equity Tier 1 capital ratio	**45**	**20.46**	**21.51**
Book value		**15 175 043**	**14 287 561**
Number of shares		**42 336 982**	**42 312 122**
Book value per share (in PLN)		**358.43**	**337.67**

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IFRS Financial Statements 2018 PLN (000's)

Statement of changes in equity

Changes from 1 January to 31 December 2018

	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 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	-	-	-	-	-	(248 158)	-	-	(44 857)	-	-	-	(293 015)
Restated equity as at 1 January 2018	**169 248**	**3 394 928**	**7 145 517**	**22 638**	**1 115 143**	**2 040 885**	**-**	**(5 336)**	**119 556**	**(5 198)**	**3 770**	**(6 605)**	**13 994 546**
Total comprehensive income	**-**	**-**	**-**	**-**	**-**	**-**	**1 317 485**	**176**	**(15 264)**	**88 841**	**(650)**	**(2 508)**	**1 388 080**
Issuance of ordinary shares	100	-	-	-	-	-	-	-	-	-	-	-	100
Dividends	-	-	-	-	-	(217 907)	-	-	-	-	-	-	(217 907)
Transfer to supplementary capital	-	-	2 071 135	-	-	(2 071 135)	-	-	-	-	-	-	-
Stock option program for employees	**-**	**10 410**	**-**	**(186)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**10 224**
- value of services provided by the employees	-	-	-	*10 224*	-	-	-	-	-	-	-	-	*10 224*
- settlement of exercised options	-	*10 410*	-	*(10 410)*	-	-	-	-	-	-	-	-	-
Equity as at 31 December 2018	**169 348**	**3 405 338**	**9 216 652**	**22 452**	**1 115 143**	**(248 157)**	**1 317 485**	**(5 160)**	**104 292**	**83 643**	**3 120**	**(9 113)**	**15 175 043**

Changes from 1 January to 31 December 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	**-**	**-**	**-**	**-**	**-**	**-**	**1 089 704**	**617**	**166 844**	**(3 653)**	**4 507**	**(3 088)**	**1 254 931**
Issue of 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**

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Statement of cash flows

	Note	Year ended 31 December	
		2018	2017
A. Cash flows from operating activities		**1 919 196**	**(1 266 974)**
Profit before income tax		**1 706 975**	**1 470 224**
Adjustments:		***212 221***	***(2 737 198)***
Income taxes paid		(438 310)	(306 870)
Amortisation	25, 26	227 743	200 856
Foreign exchange (gains) losses related to financing activities		293 782	(1 209 867)
(Gains) losses on investing activities		(276 120)	(21 910)
Impairment of financial assets	21	*n/a*	12 262
Change of valuation of investment in subsidiaries not measured at equity method	23	3 065	n/a
Dividends received	7	(126 391)	(166 285)
Interest income (income statement)	5	(3 961 606)	(3 550 968)
Interest expense (income statement)	5	874 097	792 483
Interest received		4 254 508	3 953 778
Interest paid		(809 154)	(721 824)
Changes in loans and advances to banks		(714 713)	(53 979)
Changes in financial assets and liabilities held for trading and derivatives held for hedges		243 056	176 154
Changes in loans and advances to customers		(7 826 035)	(1 231 153)
Changes in investment securities		*n/a*	(661 970)
Changes in financial assets at fair value through other comprehensive income		(3 663 898)	*n/a*
Changes in securities at amortised cost		(277 005)	*n/a*
Changes of non-trading equity securities mandatorily at fair value through profit or loss		(13 884)	*n/a*
Changes in other assets		(237 928)	(40 665)
Changes in amounts due to banks		703 928	112 640
Changes in amounts due to customers		11 456 454	(419 452)
Changes in debt securities in issue		27 871	-
Changes in provisions		24 062	8 266
Changes in other liabilities		448 699	391 306
Net cash generated from/(used in) operating activities		**1 919 196**	**(1 266 974)**
B.Cash flows from investing activities		**(221 674)**	**(345 968)**
Investing activity inflows		**181 600**	**199 735**
Disposal of shares in associates		54 759	-
Disposal of shares in subsidiaries		100	32 863
Disposal of intangible assets and tangible fixed assets		350	587
Dividends received	7	126 391	166 285
Investing activity outflows		**403 274**	**545 703**
Acquisition of shares in subsidiaries		17 512	227 339
Purchase of intangible assets and tangible fixed assets		385 762	318 364
Net cash generated from/(used in) investing activities		**(221 674)**	**(345 968)**
C. Cash flows from financing activities		**(871 422)**	**(3 584 484)**
Financing activity inflows		**4 398 599**	**1 214 313**
Proceeds from loans and advances from banks		187 200	-
Proceeds from other loans and advances		648 378	422 466
Issue of debt securities	28	2 812 921	-
Increase of subordinated liabilities	28	750 000	-
Issue of ordinary shares		100	127
Security deposit due to issue of Eurobonds		-	791 720
Financing activity outflows		**5 270 021**	**4 798 797**
Repayments of loans and advances from banks		2 945 100	2 711 025
Repayments of other loans and advances		1 501 535	223 612
Acquisition of shares in subsidiaries - increase of involvement		1 300	121 700
Repurchase of of subordinated liabilities	28	500 000	1 611 840
Payments of financial lease liabilities		5 928	7 272
Dividends and other payments to shareholders		217 907	-
Interest paid from loans and advances received from banks and subordinated liabilities		98 251	123 348
Net cash generated from/(used in) financing activities		**(871 422)**	**(3 584 484)**
Net increase / decrease in cash and cash equivalents (A+B+C)		**826 100**	**(5 197 426)**
Effects of exchange rate changes on cash and cash equivalents		20 996	(39 684)
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	**40**	**10 597 670**	**9 750 574**

Notes presented on pages 11–169 constitute an integral part of these Financial Statements.

Explanatory notes to the financial statements

1. Information regarding mBank S.A.

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

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

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

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

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

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

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

As at 31 December 2018, the headcount of mBank S.A. amounted to 5 839 FTEs (Full Time Equivalents) - 6 766 persons (31 December 2017: 5 414 FTEs - 6 415 persons).

The Management Board of mBank S.A. approved these financial statements for issue on 26 February 2019.

2. Description of relevant accounting policies

The most important accounting policies applied to the drafting of these 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 2.28 Comparative data.

2.1. Accounting basis

The financial statements of mBank S.A. have been prepared for the 12-month period ended 31 December 2018. Comparative data presented in these financial statements relate to the period of 12 months ended on 31 December 2017.

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 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. Shares in subsidiaries, associates and joint ventures are settled using the equity method of accounting.

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

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

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

The Bank also prepares consolidated financial statements in accordance with IFRS. mBank S.A. Group Consolidated Financial Statements for the year 2018 were published on 27 February 2019.

2.2. Interest income and expenses

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

2.3. Fee and commission income

Fee and commission income is recognised in accordance with IFRS 15 using a 5-step model for revenue recognition, which consists of:

Step 1: Identifying the contract's with a customer

The Bank accounts for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

1. the parties to the contract have approved the contract (in writing, orally or in accordance with business practices) and are committed to perform their respective obligations;
2. the Bank can identify each party's rights regarding the goods or services to be transferred;
3. the Bank can identify the payment terms for the goods or services to be transferred;
4. the contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and
5. it is probable that the Bank will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, the Bank considers only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the Bank may offer the customer a price concession.

Step 2: Identifying performance obligations in the contract

The performance obligation is a promise (presumed or specified) to provide the client with goods or services that are identified at the time of entering into the contract on the basis of contractual terms as well as the Bank's business practice.

At contract inception, the Bank assesses the goods or services promised in a contract with a customer and identifies as a performance obligation each promise to transfer to the customer either:

1. a good or service (or a bundle of goods or services) that is distinct; or
2. a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

A good or service that is promised to a customer is distinct if both of the following criteria are met:

1. the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and
2. the Bank's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the good or service is distinct within the context of the contract)

The Bank identifies options for purchasing additional goods or services for the customer (loyalty points) as separate obligations to provide benefits, if they give the customer relevant rights (material law, which the client would not have obtained if he did not conclude the contract).

If a third party is involved in the process of providing selected services for the client, the Bank assesses whether it acts as an agent or principal, taking into account in particular the possibility of controlling the given service before it is passed on to the client (control principle).

Step 3: Determining the transaction price

The transaction price in a contract reflects the amount of consideration that the Bank expects to be entitled to in exchange for distinct good or service transferred and the Bank's business practice.

The transaction price is the amount of remuneration which, in line with the Group's expectations, will be due in exchange for transfer of promised goods or services to the client, excluding amounts collected on behalf of third parties.

Determining the transaction price can become complex where a contract includes any of the following: variable consideration, a significant financing component, non-cash consideration, consideration payable to a customer. In terms of variable remuneration (e.g. rebates from payment organizations), the Bank estimates the amount of remuneration to which it will be entitled in exchange for the transfer of promised services.

Step 4: Allocating the transaction price to the preformance obligations

The transaction price is allocated to each separate performance obligation, or distinct good or service, so that revenue is recorded at an amount that depicts the amount of consideration that the Bank expects to be entitled to in exchange for transferring the promised goods or services. The transaction price is allocated to each performance obligation based on the relative fair value model.

Step 5: Recognition of revenue when (or as) the Bank satisfies a performance obligation

The Bank recognises revenue when (or as) it satisfies a performing obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). The Bank recognizes at a point in time the fees charged at a point in time not related directly to origination of loans and advances. Fees for services delivered over time longer than 3 months are recognised by the Bank over time. As the fee and commission income, the Bank treats also fees and commissions recognised over time on a straight line basis, related to loans and advances with not established timing of cash flows, for which effective interest rate is not possible to be determined. Straight line method for those services presents fairly the timing of transfer of services, because they are delivered evenly over time.

Accounting principles related to recognition of fee income from sale of assurance products bundled with loans and advances are described under Note 2.4.

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 on 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.

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

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

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

The remuneration included in interest income is 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.

2.5. 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 at derecognition, 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.

Financial instruments valued at fair value through profit or loss

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 to reduce an accounting mismatch.

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 2.2), except for derivatives the recognition of which is discussed in Note 2.11, is recognized in net interest income. The valuation and result on disposal of financial assets/financial liabilities 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.

<u>Equity instruments</u>

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.

<u>Modification of contractual terms for financial assets</u>

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 not provided for in the terms of the contract. Change of the currency provided for in the terms of the agreement is such a change that defines both the FX 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.

2.6. Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to offset the 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.

2.7. 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.

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 exposure to the Bank, its parent company or subsidiary is more than 90 days past due (for banks exposures – 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.

2.8. Financial guarantee contracts

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

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

- the amount of the loss allowance determined in accordance with IFRS 9,
- the amount initially recognised less when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15.

2.9. Cash and cash equivalents

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

2.10. Sell and repurchase agreements

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

2.11. 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 2.12.

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 2.2 "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 designated to the hedge accounting

Changes of the fair value of derivative instruments that are not designated to 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.

2.12. Gains and losses on initial recognition

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

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

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

2.13. 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.

2.14. 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.

<u>Computer software</u>

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

2.15. Tangible fixed assets

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

Subsequent costs are included in the asset's carrying amount or are 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.

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

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

2.17. Deferred income tax

The Bank creates a deferred income tax on the temporary difference arising between the carrying amount of an asset or liability in the statement of financial position and its tax base. A taxable net difference is 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.

2.18. Assets repossessed for debt

Assets repossessed for debt represents financial and non-financial assets acquired by the Bank in settlement of overdue loans. The assets are initially 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.

2.19. Prepayments, accruals and deferred income

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

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

2.20. Leasing

mBank S.A. as a Lessee

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

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

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

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

2.21. Provisions

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.

2.22. Post-employment employee benefits and other employee benefits

Post-employment employee benefits

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

Equity-settled share-based payment transactions

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

2.23. Equity

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

Registered share capital

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

- Own shares

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

<u>Other components of equity</u>

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.

2.24. Valuation of items denominated in foreign currencies

<u>Functional currency and presentation currency</u>

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.

<u>Transactions and balances</u>

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. Foreign exchange differences arising on account of such monetary items as equity instruments measured at fair value through other comprehensive income are recognised in other comprehensive income.

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

When a gain or loss on a non-monetary item is 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.

2.25. Trust and fiduciary activities

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

The Bank provides custody, trustee, corporate administration, investment management and advisory services to third parties. Fee and commission income from trust and fiduciary activities is recognised in accordance with IFRS 15 using a 5-step model for revenue recognition, described in the Note 2.5. In connection with these, the Bank makes decisions concerning the allocation, purchase and sale of a wide variety of financial instruments. Assets held in a fiduciary capacity are not included in these financial statements because as they do not belong to the Bank.

2.26. New standards, interpretations and amendments to published standards

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

  Quantitative and qualitative information, including the analysis of main changes resulting from adoption of the standard on the financial statements for the annual periods starting from 1 January 2019 has been presented under the end of these note.

- 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.

- IFRIC Interpretation 23 *Uncertainty over Income Tax Treatments*, published by International Accounting Standards Board on 7 June 2017, approved by European Union on 23 October 2018, 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, approved by European Union on 8 February 2019, 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.

Standards and interpretations not yet approved by the European Union:

- 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 defined benefit 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.

  Conceptual Framework in IFRS Standards is a document that sets out the objective of the financial reporting, the qualitative characteristics of useful financial information, a description of the reporting entity, definitions of an asset, a liability, equity, income and expenses, criteria of recognition assets and liabilities in financial statements and guidance on when to derecognize them, measurement bases and guidance on when to use them, as well as concepts and guidance on presentation and disclosure.

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

- Amendments to IFRS 3, Definition of a Business, published by the International Accounting Standards Board on 22 October 2018, binding for annual periods starting on or after 1 January 2020.

  Amendments to IFRS 3 clarify the definition of a business, with the objective of assisting entities to determine whether a transaction should be accounted for as a business combination or as an asset acquisition. The main amendments are to clarify that to be considered a business, an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. The assessment of whether the market participants are capable of replacing any missing inputs or processes and continuing to produce outputs has been removed. Moreover, guidance and illustrative examples have been added to help entities assess whether a substantive process has been acquired, and the definitions of a business and of outputs have been narrowed by focusing on goods and services provided to customers and by removing the reference to an ability to reduce costs. An optional concentration test has been added that permits a simplified assessment of whether an acquired set of activities and assets is not a business.

  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 1 and IAS 8, Definition of Material, published by the International Accounting Standards Board on 31 October 2018, binding for annual periods starting on or after 1 January 2020.

  Amendments to IAS 1 and IAS 8 clarify the definition of material and its application by aligning the wording of the definition of material across IFRS Standards and other publications and making minor improvements to that wording, as well as including some of the supporting requirements in IAS 1 Presentation of Financial Statements in the definition to give them more prominence. The explanation accompanying the definition of material was clarified. The amendments have the objective to help entities make better materiality judgements without substantively changing existing requirements.

  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 IFRS 10 and IAS 28 Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture (issued on 11 September 2014) - the endorsement process of these Amendments has been postponed by EU - the effective date was deferred indefinitely by IASB.

IFRS 16 Leases

The Standard was issued by International Accounting Standards Board (IASB) on January 13, 2016 and it has been endorsed by the European Union. IFRS 16 applies for annual reporting periods beginning in or after 1 January 2019. The incoming standard supersedes regulations effectual until December 31, 2018: IAS 17 Leasing, IFRIC Interpretation 4 and SIC Interpretations 15 and 27.

The incoming standard introduces a single lessee accounting model, convergent with finance lease model under IAS 17. As per IFRS 16, the contract is, or contains, a lease, if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Transfer of the right of use occurs when it concerns an identified asset, for which the lessee possesses the right to obtain substantially all of the economic benefits of the asset and controls the use of the asset throughout the period of use.

If lease definition is executed, a company recognizes the right to use of the leased asset and a financial liability representing its obligation to make in the amount of discounted future lease payments, excluding short-term lease contracts lasting no longer than 12 months and leases of low-value assets .

The expenses related to the use of leased assets, previously presented as overhead costs, currently are to be classified as depreciation and interest expenses.

Right-of-use assets are depreciated on a straight-line basis, while liabilities under lease agreements are settled using the effective interest rate.

Impact of IFRS 16 on financial statements

In the first quarter of 2019, the Bank completed the implementation of IFRS 16 (project), which was planned in three stages:

- stage I - analysis of all contracts for purchase of services, regardless of the current qualification, aimed at selecting those contracts on the basis of which the Bank uses assets belonging to suppliers,

- stage II – assessment of contracts identified in the first stage in terms of meeting the criteria for considering leasing in accordance with IFRS 16,

- stage III - implementation of IFRS 16 based on the developed concept.

The object of the analyzes was all financial leasing contracts, operating lease, rental agreements, as well as the right of perpetual usufruct of land. In addition, the transactions of acquired services (costs of external services within operating activities) were analyzed in terms of the use of an identified asset.

As part of the project, the Bank made relevant changes to the accounting policy and operational procedures. Methodologies for the correct identification of contracts that are leasing and the collection of data necessary for the correct accounting treatment of these transactions have been developed and implemented. In addition, the Bank has implemented relevant changes in the IT systems of the Bank companies, so that they are adapted to collect and process relevant data.

In the financial statements lease agreements have been shown, in which the Bank acts as a lessor for third parties. The previous accounting treatment by the lessor has been largely unchanged by IFRS 16. This means that the lessor continues to classify leases as operating leases or finance leases and their accounting treatment as two separate types of leasing. Nevertheless, additional disclosures are required from 2019.

The Bank decided to implement the standard on 1 January 2019. In accordance with the transitional provisions included in IFRS 16, the new principles were adopted retrospectively with reference to the cumulative effect of the initial application of the new standard to equity as at 1 January 2019. Therefore, comparative data for the financial year 2018 have not been restated (modified retrospective approach).

Individual adjustments resulting from the implementation of IFRS 16 are described below.

Description of adjustments

(a) Recognition of leasing liabilities

After the adoption of IFRS 16, the Bank recognizes lease liabilities in connection with a lease that was previously classified as an operating lease in accordance with the principles of IAS 17 Leasing. The liabilities result primarily from lease contracts for real estate, the right of perpetual usufruct of land and car leasing. These liabilities have been measured at the present value of lease payments remaining to be paid at the date of application of IFRS 16, discounted using the leasing interest rate as at 1 January 2019, calculated on the basis of the Bank's incremental borrowing rate.

At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments for the right to use the underlying asset during the lease term:

- fixed payments less any lease incentives receivable,

- variable lease payments that depend on market index or a rate

- amounts expected to be payable by the lessee under residual value guarantees,

- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option,

- payment of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

In order to calculate discount rates for IFRS 16, the Bank assumed that the discount rate should reflect the cost of financing that would be incurred to purchase the leased asset.

As at 1 January 2019, the discount rate calculated by the Bank amounted to:

- for contracts in PLN: 1.95%

- for contracts in EUR: 0.02%

- for contracts in USD: 2.93%

- for contracts in CZK: 2.19%

(b) Recognition of right-of-use assets

Right-of-use assets are measured at cost and presented in the statement of financial position together with the assets owned by the Bank along with the breakdown of additional information in the explanatory notes.

The cost of right-of-use assets includes:

- the amount of the initial measurement of the lease liability,

- any lease payments made at or before the commencement date, less any lease incentives received,

- initial direct costs incurred by the lessee in connection with the conclusion of the leasing contract,

- an estimate of the costs to be incurred by the lessee in dismantling and removing the underlying asset or carry out renovations.

(c) Application of estimates

The implementation of IFRS 16 required making certain estimates and calculations that have an impact on the valuation of lease liabilities and right-of-use assets. They include, among others:

- determination of the duration of contracts (for contracts with an indefinite period or with the possibility of extending the Bank applied the reasonably certain period of lease),

- determining the interest rate used to discount future cash flows,

- determination of the depreciation rate.

(d) The use of practical simplifications

When applying IFRS 16 for the first time, the Group applied the following practical simplifications allowed by the standard:

- applying one discount rate to the portfolio of leasing agreements with similar features,

- contracts for operating leases with the remaining lease period of less than 12 months as at 1 January 2019 will be treated as short-term leasing,

- for operating lease contracts for which the underlying asset is of low value (less than PLN 20,000), the Bank did not recognize any lease liabilities or related right-of-use assets. Lease payments on this account are recognized as expenses during the leasing period.

- the exclusion of initial direct costs in the measurement of right-of-use assets on the date of initial application, and

- using the time perspective (using the knowledge gained after the fact) in determining the leasing period, if the contract includes options for extending or terminating the lease agreement.

Impact on the statement of financial position

The impact of the implementation of IFRS 16 on the recognition of additional financial liabilities and related right-of-use is presented in the tables below:

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	31 December 2018 (without IFRS16 effect)	IFRS 16 effect	1 January 2019
ASSETS			
Tangible fixed asstes	537 001	516 704	1 053 705
including Right-of-use assets	-	528 691	528 691
Liabilities and equity			
Financial liabilities at amortised cost	118 342 044	527 562	118 869 606
including Lease liabilities	-	527 562	527 562

The reconciliation of the difference between the amounts of future lease payments due to irrevocable operating leases as at the end of 2018 and the lease liabilities recognized as at the date of initial application of IFRS 16 are as follows:

	2019
Commitments due to operating lease as at 31 December 2018 (without discount)	556 112
The impact of the discount using the Bank's incremental borrowing rate	(39 347)
Plus: finance lease liabilities as at 31 December 2018	10 797
Lease liabilities as at 1 January 2019	**527 562**
Other adjustments to right-of-use assets	1 129
Right-of-use assets as at 1 January 2019	**528 691**

Impact on the income statement

Since 2019 in the Bank's income statement, a change in the classification of costs will appear (rental costs will be replaced by depreciation and interest expense) and the time of recognition (recognition of leasing costs will be faster due to recognition of interest cost using the effective interest rate method) which was previously not applied to contracts other than those classified as finance leasing in accordance with IAS 17).

Impact on equity

The implementation of IFRS 16 does not affect retained earnings and equity of the Group as at 1 January 2019.

Impact on capital ratios

Due to the inclusion of lease agreements in the Group's balance sheet as at 1 January 2019 the total amount of risk exposures increased, and thus the total capital ratio of the Group decreased by ca. 19 basis points.

2.27. Business segments

Data concerning business segments was presented in the Consolidated Financial Statements of mBank S.A. Group for the year 2018, prepared in compliance with the International Financial Reporting Standards and published on 27 February 2019.

2.28. 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.

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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.

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.

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 (loans and receivables - 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 (financial assets at 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 (financial assets at 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 (loans and receivables - amortised cost)	73 431 738	Financial assets at amortised cost - loans and advances to customers	67 838 393	(215 460)	67 622 933
		Financial assets at fair value through other comprehensive income - loans and advances to customers(2	2 125 501	(1 036)	2 124 465
		Non-trading financial assets mandatorily at fair value through profit or loss - loans and advances to customers(1	3 467 844	(29 664)	3 438 180
Investment securities (available for sale financial assets - fair value through other comprehensive income)	31 110 560	Non-trading financial assets mandatorily at fair value through profit or loss - equity instruments	9 934	-	9 934
		Non-trading financial assets mandatorily at fair value through profit or loss - debt securities(3	46 538	-	46 538
		Financial assets at amortised cost - debt securities	8 566 042	(45 870)	8 520 172
		Financial assets at fair value through other comprehensive income	22 488 046	-	22 488 046
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**	**(248 158)**	**10 324 183**
- Profit from the previous years	9 482 637	- Profit from the previous years	9 482 637	(248 158)	9 234 479
- 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**	**(44 857)**	**106 187**
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**

1, 2, 3) – in the fourth quarter of 2018, the Bank corrected the disclosure of the impact of the implementation of IFRS 9 as at January 1, 2018. The changes are described in detail below.

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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:	3 494 652	*n/a*	3 494 652
Equity instruments	*9 934*	*n/a*	*9 934*
Debt securities (3	*46 538*	*n/a*	*46 538*
Loans and advances to customers (1	*3 438 180*	*n/a*	*3 438 180*
Investment securities	*n/a*	31 110 560	(31 110 560)
Financial assets at fair value through other comprehensive income(2	25 013 655	*n/a*	25 013 655
Financial assets at amortised cost, including:	81 805 869	*n/a*	81 805 869
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	*67 622 933*	*n/a*	*67 622 933*
Loans and advances to customers	*n/a*	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:	**10 324 183**	**10 572 341**	**(248 158)**
- Profit from the previous years	9 234 479	9 482 637	(248 158)
- Profit for the current year	1 089 704	1 089 704	-
Other components of equity	**106 187**	**151 044**	**(44 857)**
Total equity	**13 994 546**	**14 287 561**	**(293 015)**
TOTAL LIABILITIES AND EQUITY	**124 319 955**	**124 569 483**	**(249 528)**

1, 2, 3) – in the fourth quarter of 2018, the Bank corrected the disclosure of the impact of the implementation of IFRS 9 as at January 1, 2018. The changes are described in detail below.

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 mostly in connection with the leverage element in these contracts increasing the volatility of cash flows.

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 31 December 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 6 936 917 thousand. If these securities had not been reclassified, during the 2018 the Bank would have recognized in other comprehensive income a gain of PLN 79 348 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". A at 1 January 2018 the Bank measured the equity instruments at fair value through profit and loss.

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".

In Q4 2018, the Bank adjusted the disclosure concerning the impact of IFRS 9 implementation as at January 1, 2018, by introducing the following changes:

1) the portfolio of loans and advances granted to clients worth PLN 471 081 thousand, composed mainly of credit cards whose interest structure was based on the quadrupled lombard rate, was recorded in "Non-trading financial assets measured at fair value through profit or loss." Before, the portfolio was recorded in "Financial assets measured at amortised cost." The banking sector had doubts about the classification of loans whose interest was based on the quadrupled lombard rate and classification of such portfolios varied among banks as at the implementation date of IFRS 9. In view of the emerging market practice, the bank ultimately decided to classify the portfolio as measured at fair value through profit or loss. The bank measured the credit portfolio at fair value. Taking into account the materiality principle, the bank recorded the differences arising from the change in measurement of the credit portfolio in the profit or loss for the current period and did not adjust the impact of IFRS 9 on the bank's equity as at January 1, 2018.

2) the portfolio of loans and advances granted to clients comprising retail mortgage loans worth PLN 2 124 465 thousand was recorded in "Financial assets measured at fair value through other comprehensive income" due to a change in business model assessment as at the implementation date of IFRS 9. The adjustment concerned the portfolio of retail mortgage loans which in the future could be sold to mBank's

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subsidiary mBank Hipoteczny and serve as collateral for covered bond issues. The bank measured the credit portfolio at fair value. Guided by the materiality principle, however, it did not adjust the impact of the measurement on equity as at the date when IFRS 9 was applied for the first time.

3) the preferred shares in VISA with a fair value of PLN 46 538 thousand were moved from "Financial assets measured at fair value through other comprehensive income" to "Non-trading financial assets measured at fair value through profit or loss" as, according to IAS 32, they do not match the definition of an equity instrument. Due to its characteristics, the instrument fails the SPPI test. These instruments were classified as available for sale and measured at fair value through other comprehensive income in accordance with IAS 39. The adjustment of the opening balance resulted in the measurement of these instruments in the net amount of PLN 12 021 thousand being moved from "Other components of equity" to the "Profit from the previous years."

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.

Impairment

The implementation of the new impairment model based on the concept of ECL resulted in the 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.

The table below presents the reconciliation of the closing balance of impairment losses in accordance with IAS 39 and provisions for contingent liabilities calculated in accordance with IAS 37 as at December 31, 2017 with the new expected credit losses as at January 1, 2018.

	31.12.2017 IAS 39 carrying amount		Reclassification	IFRS 9 implementation	01.01.2018 IFRS 9 carrying amount
Loans and advances to banks (loans and receivables - amortised cost)	(1 027)	Financial assets at amortised cost - loans and advances to banks	(1 027)	(509)	(1 536)
Loans and advances to customers (loans and receivables - amortised cost)	(2 564 459)	Financial assets at amortised cost - loans and advances to customers	(2 427 702)	(314 019)	(2 741 721)
		Financial assets at fair value through other comprehensive income - loans and advances to customers	(776)	(1 050)	(1 826)
		Non-trading financial assets mandatorily at fair value through profit or loss - loans and advances to customers	(135 981)	135 981	-
Investment securities (available for sale financial assets - fair value through other comprehensive income)	(12 428)	Non-trading financial assets mandatorily at fair value through profit or loss - equity instruments	(12 428)	12 428	-
		Financial assets at amortised cost - debt securities	-	(35)	(35)
		Financial assets at fair value through other comprehensive income	-	(4 655)	(4 655)
Other assets	(14 430)	Other assets	(14 430)	-	(14 430)
T o t a l	**(2 592 344)**	**T o t a l**	**(2 592 344)**	**(171 859)**	**(2 764 203)**
Provisions	75 654	Provisions	75 654	40 906	116 560
T o t a l	**75 654**	**T o t a l**	**75 654**	**40 906**	**116 560**

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The column "Impact of IFRS 9 Implementation", in addition to the growth resulting from the new impairment model based on the concept of ECL, includes also an increase in credit losses as a result of adjusting the gross carrying amount to the requirements of IFRS 9 (change in the presentation of impairment interest adjustment – according to IFRS 9 impairment interest is presented as an element of impairment allowance, while under IAS 39 it was presented as an element of gross carrying amount) and a decrease in credit losses for receivables classified as POCI. The presentation changes relating to impairment interest adjustment and decrease in credit losses for receivables classified as POCI have no impact on the Bank's equity.

Impact of IFRS 9 on equity

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.

Impact of IFRS 9 on capital adequacy

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 is comparable with the current accounting period and therefore has not been adjusted.

3. Risk Management

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

3.1. General information

Location of risk management disclosures

mBank's risk management disclosures for 2018 are included in the Annual Report of the Bank and in the Disclosures regarding capital adequacy.

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

Disclosures regarding capital adequacy of mBank S.A. Group as at 31 December 2018 and mBank S.A. Management Board Report for the year 2018 are not the part of mBank S.A. Financial Statements.

Type of risk	Information	Location of information for 2018		
		Annual Report of mBank		Disclosures regarding capital adequacy
		Management Board Report	Financial Statements	
General information	Location of risk management disclosures	-	p. 39	-
	Glossary of terms	-	p. 40	-
	External environment	-	p. 42	-
Principles of risk management	Division of responsibilities in the risk management process	-	p. 44	-
	Risk culture	-	p. 43	-
	Internal capital adequacy assessment process (ICAAP)	-	p. 48	p. 16
	Risk appetite	-	p. 51	-
	Stress tests within ICAAP/ILAAP	-	p. 52	p. 17
	Required capital and liquidity planning	-	p. 52	p. 6

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Credit risk	Organization of risk management	p. 45	p. 53	-
	Credit policy	-	p. 55	-
	Collaterals accepted	-	p. 55	p. 52, 54
	Rating system	-	p. 56	-
	Monitoring and validation of models	-	p. 56	-
	Calculating impairment charges and provisions	p. 46	p. 57	p. 61
	mBank forbearance policy	-	p. 61	-
	Counterparty risk that arises from derivative transactions	-	p. 66	-
	Concentration risk	-	p. 67	p. 55
Market risk	Organization of risk management	-	p. 70	-
	Tools and measures	p. 51	p. 71	-
	Risk measurement	p. 52	p. 72	-
	Interest rate risk in the banking book	p. 53	p. 75	-
	Currency risk	-	p. 74	-
Liquidity risk and funding	Strategy of liquidity risk	p. 55	p. 76	-
	The measurement, limiting and reporting the liquidity risk	p. 56	p. 80	-
	Funding sources	-	p. 81	-
Operational risk	Tools and measures	p. 56	p. 78	p. 73
	Operational losses	-	p. 83	-
	Compliance risk	-	p. 85	-
Other risks	Business risk	-	p. 86	-
	Model risk	-	p. 86	-
	Reputational risk	-	p. 87	-
	Capital risk	-	p. 87	-
	Regulatory risk	-	p. 88	-
Capital adequacy		p. 57	p. 163	p. 6
Leverage ratio		p. 59, 65, 66, 74, 75	p. 41, 42, 164, 165	p. 49

Glossary of terms

Add-on - estimated future potential exposure.

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

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

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

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

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

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

EAD (Exposure at Default) – estimated value of exposure at the time of default (amount).

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

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

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

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

ICAAP – Internal Capital Adequacy Assessment Process.

ILAAP – Internal Liquidity Adequacy Assessment Process.

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

KNF - Polish Financial Supervision Authority

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

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

LGD (Loss Given Default) – estimated relative loss in case of default (%).

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

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

PD – Probability of Default (%).

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

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

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

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

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

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

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

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

- market risk,
- operational risk,
- other risks, e.g. credit valuation adjustment risk, large exposures in the banking book, etc.

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

3.2. mBank risk management in 2018 – external environment

The rules on prudential requirements for banks set out in the Capital Requirements Regulation on prudential requirements for credit institutions and investment firms (CRR) and the Capital Requirements Directive (CRD IV) on access to the activity of banks and the prudential supervision, implementing provisions of Basel III, are effective in the European Union since 2014. The provisions of CRD IV were transposed into a national legislation, which took place in 2015 with the endorsement of the Act on Macro-prudential Supervision over the Financial System and Crisis Management in the Financial System and with an update of the Banking Law. mBank has adjusted its processes and tools to meet the regulatory requirements related to capital (including the leverage ratio) and liquidity ratios as well as new reporting requirements. The Group is currently implementing the provisions of numerous delegated and implementing regulations of the European Commission supplementing the CRR Regulation, introducing technical EBA standards.

In 2016 changes were implemented in the methodology of calculating LCR, introduced by Regulation (EU) 2015/61 of 17 January 2015 to supplement Regulation (EU) No. 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions.

The Bank has been running a project related to the implementation of EMIR [Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories] and has fulfilled current regulatory obligations resulting from provisions of EMIR regulation.

In addition, ongoing work is still underway to implement the further requirements of the MiFIR [Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012] and MiFID II [Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU]. The Bank meets all regulatory requirements resulting from those regulations (in particular reporting to the ARM system, pre- and post-transaction transparency).

On 20 June 2018, the Act of 10 May 2018 amending the act on payment services and some other acts entered into force. The Act implements in Poland the Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market (PSD2). The bank has a project aimed at adapting the bank to the new requirements of PSD2 Directive. The deadline for adapting the activity to the new act was 20 December 2018. The bank is continuing work on the PSD2 program in order to adapt to the requirements of technical standards, for which the deadline for implementation is 14 September 2019.

On 23 November 2016, the European Commission published a proposal of amendments to the supervisory regulations in force for European banks, including CRR/CRD IV and the Bank Recovery and Resolution Directive (BRRD), subject to legislative works during 2017 and 2018 which have not yet been finalized.

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

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

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

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

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

The risk management rules in mBank may be also affected by the regulatory changes planned by the European Banking Authority (EBA):

- Between 2016-2018 the EBA published, as part of a broader regulatory initiative concerning revision of the Internal Ratings Based Approach (AIRB), documents which include:

  a) guidelines for the application of a consistent default definition, including determining materiality thresholds for credit exposures in default,

  b) draft of methodology of assessment by the supervisory authorities if banks meet regulatory requirements for the use of the Internal Ratings Based Approach (AIRB),

  c) guidelines for estimating PD and LGD parameters and dealing with defaulted exposures,

  d) drafts of guidelines for estimating the LGD parameter, appropriate to the economic downturn and a draft of technical standard for the estimation and identification of the economic downturn in IRB modelling.

  Due to potentially wide range of changes that will be necessary in order to implement regulations by banks, the deadline for the implementation of these documents has been predetermined by the end of 2020.

- In October 2018, the EBA published draft guidelines on management of non-performing and forborne exposures (as part of credit risk management by banks) that would apply from 30 June, 2019; the draft guidelines are accompanied by changes in reporting and disclosures regarding non-performing and forborne exposures that would apply from the end of 2019.

- In July 2018, the EBA published a series of documents aimed at strengthening the risk management in banks:

  a) an update of guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing,

  b) an update of guidelines on institutions' stress testing,

  c) an update of guidelines on the management of interest rate risk arising from non-trading book activities (IRRBB), including i.a. the method for calculating the standardised supervisory shock.

  The deadline for implementing the documents was set for January 2019, with the exception of the document regarding the interest rate risk, where it is later i.e. 30 June 2019, and where the transition period for the selected requirements is provided until the end of December 2019.

The Bank also monitors regulatory changes resulting from the work of the Basel Committee on Banking Supervision, in particular those related to the review and revision of the methodologies for calculating capital requirements (the so-called Basel IV). As new legislative proposals, that implement the provisions of the Basel standards into the European Union regulations, appear the Bank analyses the proposed regulatory changes and assesses their impact on the Bank and the Group.

3.3. Principles of risk management

3.3.1 Risk culture

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

Lines of defence

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

- The first line of defence consists of **Business** (business lines) whose task is to take risk and capital aspects into consideration when making all business decisions, within the risk appetite set for the Group.
- The second line of defence, mainly **the risk management area**, **IT, Security** and **Compliance** function, is responsible for determining framework and guidelines concerning managing individual risks, supporting Business in their implementation as well as supervising the control functions and

risk exposure. To ensure that the Business is supported and supervised in an objective manner, the second line functions act independently of the Business.

- The third line of defence is **Internal Audit**, ensuring independent assessment of activities connected with risk management performed by the first and the second line of defence.

Pillars of risk management

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

- **Customer Focus** which means striving to understand and balance specific needs of the risk management area's various stakeholders (Business, Management Board, Supervisory Board, shareholders, regulatory authorities).
- **One Risk** understood as an integrated approach to risk management and responsibility towards the clients for all types of risk defined in the Risk Catalogue of mBank Group.
- **Risk vs Rate of Return** perspective understood as a support for the business decision-making process based on the long-term relationship between risk and the rate of return, avoiding tail risks.

Vision of the risk management area

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

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

Mission of the risk management area

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

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

3.3.2 Division of responsibilities in the risk management process

1. **Supervisory Board** exercises constant supervision over the Bank's operations in the risk taking area, which includes approving the Risk Management Strategy of the Group and supervising its implementation.
2. **Risk Committee of the Supervisory Board** exercises constant supervision over the risk, in particular issues recommendations regarding approval of risk management strategies, including the Risk Management Strategy of mBank Group, by the Supervisory Board.
3. **Management Board of the Bank** accepts the Risk Management Strategy of the Group and is responsible for defining and implementing the principles of managing individual risk types and for their consistency with the Strategy. Moreover, the Management Board defines the organisational structure of the Bank, ensuring the appropriate distribution of key roles from the point of view of the risk management, and allocates the tasks and responsibilities to individual organizational units.

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

4. **Chief Risk Officer** is responsible for integrated risk and capital management of the Bank and the Group in the scope of: defining strategies and policies, measuring, controlling and independent reporting on all risk types (in particular credit risk, market risk, liquidity risk, non-financial risk including operational risk), approving limits (in accordance with internal regulations), and for processes of managing the risk of the retail credit portfolio and corporate portfolio.

5. **Committees:**

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

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

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

The committees are composed of the representatives of business lines and respective risk management departments in mBank and respective organizational units in mBank Group subsidiaries.

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

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

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

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

The organization of the Committee ensures an adequate level of independence between the various participants of the model risk management process and enables to avoid conflicts of interest between them. Moreover, this Committee provides the Validation Unit with the ability to issue binding recommendations with an adequate priority.

c/ **The Balance Sheet Management Committee** (since 18 December 2018) is responsible for the systematic monitoring of the bank's balance sheet structure and the allocation of funds within acceptable risks in order to optimize the financial result. In particular, the Committee:

- introduces the principles of managing the bank's balance sheet,
- implements activities ensuring an adequate level of financing in the bank,
- recommends the Bank's Management Board changes in the strategic approach to the balance sheet management.

d/ **Assets and Liabilities Committee of the mBank Group** (ALCO) is an expert committee responsible for monitoring the structure of assets and liabilities and recommending their optimization to the Balance Sheet Management Committee (BSM). ALCO is also responsible for preparing materials for discussion at the BSM Committee.

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

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

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

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

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

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

Organisational units of the risk management area

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

The risk management area is functioning within the following organizational structure:

The roles played by particular organizational units of the risk management area in the process of identifying, measuring, monitoring, controlling and reporting risk have been strictly defined. They are presented below.

Integrated Risk Management Department:

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

Risk Projects and Architecture Department:

- Risk Projects Portfolio Management,
- performing the function of competence centre in the area of process management,
- managing the lean program in the risk management area,
- development and optimization of the architecture of IT processes and applications in the risk management area,
- managing the IT applications in the risk management area (maintenance and development),

- risk data management and cooperation with the finance area within the scope of centralized management information system,
- developing and stimulating the digital transformation of the risk management area.

Corporate Risk Assessment Department:

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

Processes and Risk Measurement Department:

- developing and implementation of corporate credit process and supervision over its effectiveness,
- preparing corporate credit risk management strategy of mBank Group as well as credit policies including policies regarding sectoral risk appetite,
- preparing portfolio analysis and reports for the purpose of management of corporate credit risk,
- developing and monitoring the quality of rating models for retail and corporate clients and financial institutions (credit risk modelling) in the Bank and mBank Group subsidiaries,
- verification of value, liquidity and attractiveness of real estate and movables provided for collateral of loans.

Retail Risk Management Department:

- ensuring coherent development of the decision-making methodology and managing the Bank's retail loan portfolio,
- ensuring internal regulations and reporting environment in the risk management of the retail banking area,
- maintaining and developing IT tools supporting risk management processes and analytical processes conducted,
- creating and developing a methodology for credit fraud prevention processes and exercising control over operational risk in the credit process.

Retail Debt Restructuring and Collection Department:

- handling the processes of debt restructuring and collection of receivables arising from retail loans granted on the Polish market,
- debt sale transaction of NPL for receivables arising from retail loans granted on the Polish market.

Credit Processes and Retail Risk Assessment Department:

- making credit decisions concerning retail banking products,
- financial monitoring in respect of retail products on the Polish market,
- preventing credit fraud through effective use of anti-fraud systems and tools.

Validation Division:

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

3.3.3 Internal capital adequacy assessment process (ICAAP)

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

The internal capital adequacy assessment process in mBank Group includes:

- risk inventory in the mBank Group,
- estimation of internal capital for coverage of risk,

- capital aggregation,
- stress tests,
- setting limits on the utilization of capital resources,
- planning and allocation of capital,
- monitoring consisting in a permanent identification of risk involved in mBank Group operations and analysis of the level of capital for risk coverage.

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

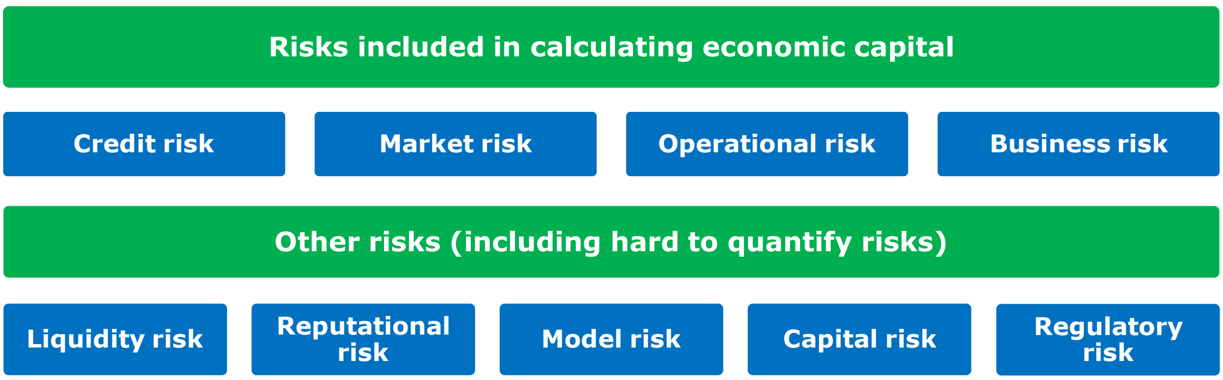
Material risks in mBank Group's operations

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

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

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

The following risks were recognized as material for the Group as at 31 December 2018:



Internal capital

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

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

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

In 2018 mBank calculated the economic capital at the 99.91% confidence level over a one-year time horizon, for the credit, market and business risks. The capital for the operational risk was calculated using the standardised approach. Diversification between different risks was not included while calculating the total of economic capital.

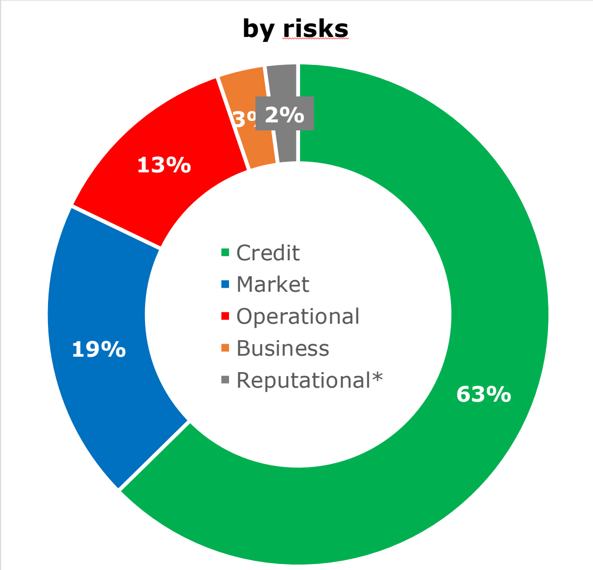
In accordance with internal regulations, the decision concerning the amount of capital for coverage of other risks (including hard to quantify risks) is taken by the Capital Management Committee. In 2018 the Bank maintained capital to cover reputational risk.

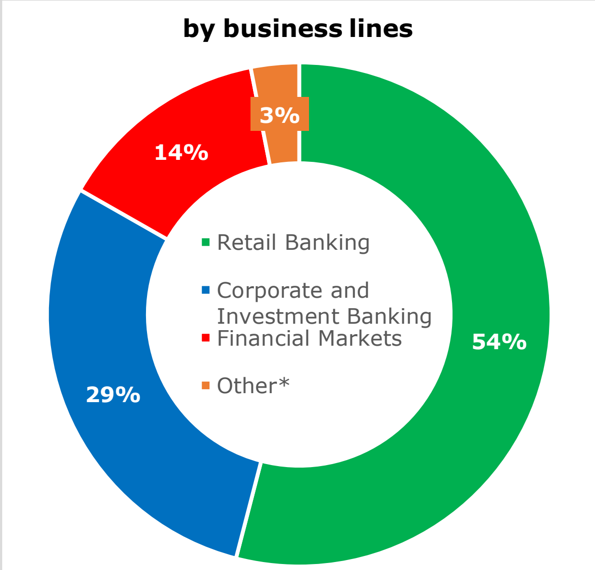
Structure of internal capital and total capital requirement

The charts below present the structure of internal capital and the total capital requirements of mBank as of 31 December 2018 by risks and business lines.

Structure of internal capital of mBank as of 31 December 2018

The internal capital of the Bank amounted to PLN 4 686 349 thousand.

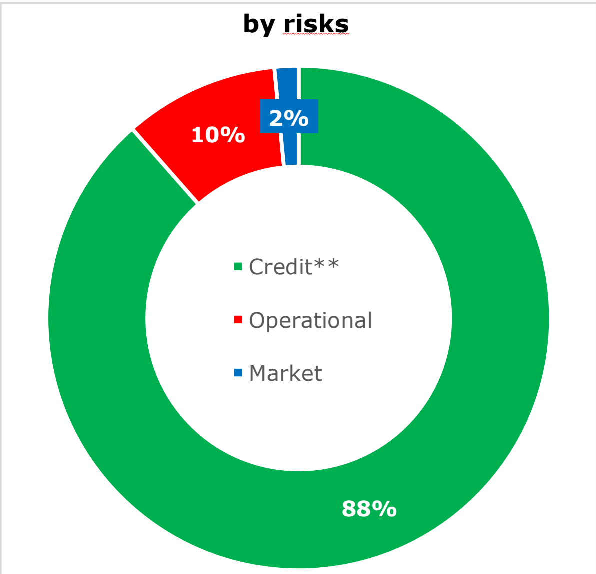


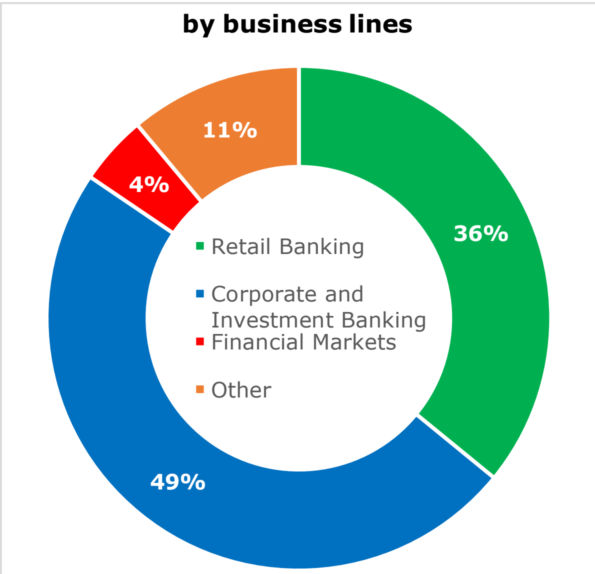


**Capital for coverage of hard to quantify risks (reputational risk) is not allocated to business lines. Reputational risk is included in „Other" on the chart presenting internal capital structure by business lines.*

Structure of total capital requirement of mBank as of 31 December 2018

The total capital requirement amounted to PLN 5 246 527 thousand.





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

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

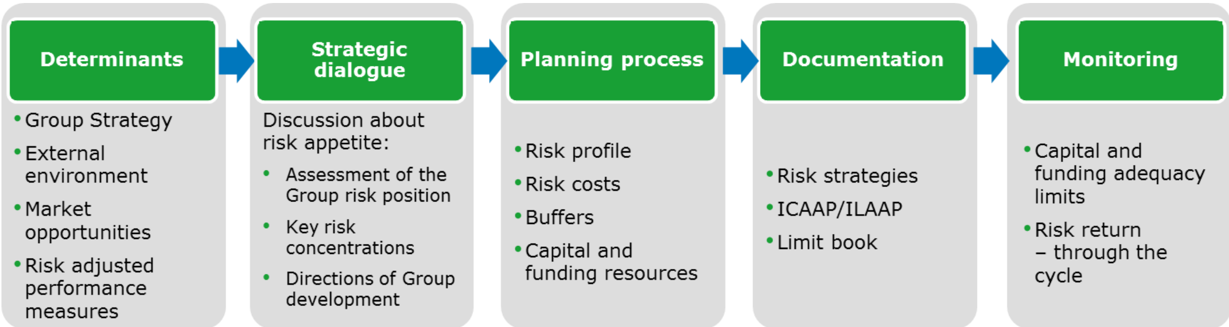
Significantly lower share of internal capital assigned to the Corporate and Investment Banking (compared to the share of this business line in the structure of total capital requirement) results from the diversification effect recognized in the model of economic capital for credit risk. The opposite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

3.3.4 Risk appetite

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

Risk appetite management framework

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



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

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

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

Capital and liquidity buffers

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

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

As a result of the discussion on risk appetite, the target capital ratios and internal liquidity buffers for the mBank Group are determined.

Risk Bearing Capacity

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

- adequate economic risk-bearing capacity must be ensured (limits must be ensured in normal conditions),
- compliance with the internal limits, set above the regulatory levels, of capital ratios,
- financial liquidity and adequate structural liquidity of the Group must be ensured (according to the ILAAP principles).

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

Risk limit system

The mBank Group applies a risk limit system in order to ensure effective allocation of risk appetite. The structure of limits translates the risk appetite into specific constraints on risks occurring in the Group's activity. In addition to the limits, monitoring action triggers and early warning indicators are also used to ensure the safe operation of the Group.

3.3.5 Stress tests within ICAAP and ILAAP

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

The stress tests are conducted assuming scenario of unfavourable economic conditions that may adversely affect the Bank's financial and liquidity position.

The risk scenarios under ICAAP include, among others, the most likely scenario of negative deviations from the base scenario, expressed in terms of macroeconomic and financial ratios, which is common for all risk types. The scenario may include idiosyncratic events.

The ILAAP scenarios include severe idiosyncratic events, events concerning the entire market and combined scenarios. These scenarios are supplemented by an reverse scenario that identifies risk factors. In addition, an integrated scenario is carried out, which also takes into account the impact of factors derived from other types of risk.

The analysed macroeconomic scenarios allow for a comprehensive analysis of: all significant risk types and scenarios' impact on the capital adequacy and liquidity of the Bank and the Group.

The Group and the Bank carry out so called reverse stress tests, the goal of which is to identify events potentially leading to unviability of the Bank and the Group. Reverse stress tests are used for the verification of capital and liquidity contingency plans of the Group and are applied for making strategic decisions concerning the acceptable risk profile of the Group. Reverse stress tests are conducted in inverse mode to classic stress tests (from effect to causes) and serve as their complement. Reverse stress tests are an additional element of the analysis of the Bank's and the Group's robustness to negative macroeconomic and idiosyncratic factors.

3.3.6 Required capital and liquidity planning

Required capital and liquidity planning

Stage I Top-Down (central planning and business planning)

This stage of capital and liquidity planning takes the form of the strategic dialog between the Management Board, risk management area, finance area and business lines, following which the desired directions of business development are determined to support the realization of the business goals of the mBank Group.

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

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

Based on the strategic directions, the available capital is compared with the demand for capital (resulting from business development and stress test results). Should the capital required to achieve business goals of the Group be greater than the capital available for allocation, then the said business goals need to be revised.

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

After determining the strategic directions of development it is analyzed what key risk concentrations are identified in the current and planned risk profile. For the purposes of determining the buffers and limits the Management Board decide on the acceptable level of risk factors to which the Group is susceptible through identified concentrations. Key risk concentrations are identified based on the reverse stress test analysis. Capital targets are set taking into account the capital needs arising from the potential materialization of key risk factors recognized in reverse stress test procedure and fixed at the levels accepted as corresponding with targeted risk tolerance. Impact of the risk factors on capital position of the Group is determined through appropriate stress test calculations.

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

Stage II Bottom-up (operational planning)

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

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

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

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

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

Available capital base

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

3.4. Credit risk

3.4.1 Organization of risk management

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

- **Credit Processes and Retail Risk Assessment Department (DPK)** is responsible for ensuring effectiveness and security of lending and post-sale service, including financial monitoring in respect of retail products on the Polish market and preventing extortion and fraud in the area of retail and corporate banking.
- **Retail Risk Management Department (DZR)** is responsible for management of credit risk and other risks in mBank's retail banking and its main operational responsibility is supervision over the automated credit process. Furthermore, DZR develops rules of credit risk rating, calculating creditworthiness, fraud prevention and other components of credit policy submitted for the approval by the Retail Banking Risk Committee. Solutions applied on the Polish market are also adapted in foreign branches (in the Czech Republic and Slovakia). The DZR is also responsible for

implementing the assessment principles in the tools supporting the credit decision-making process, reports on the quality of the credit portfolio, and monitors the quality of data used in the risk rating process. To the extent permitted by external regulations DZR participates in the risk management process of the subsidiaries having credit risk bearing retail products in the offer.

- **Retail Debt Restructuring and Collection Department (DWD)** is responsible for ensuring the execution of processes of recovering the Bank's receivables arising from granted retail loans for polish market, cohesion and completeness of internal regulations and the reporting environment in debt collection related with credit products. Activity of the area is focused on handling soft collection processes, restructuring process, collection after termination of the credit agreement, including judicial and enforcement proceedings and debt sale transaction of NPL.
- **Corporate Risk Assessment Department (DOR)** is responsible for management of the quality of the corporate loans portfolio of the Bank and subsidiaries of mBank Group including exposures under restructuring. DOR's key functions include: decision-making or participation in decision-making concerning performing and non-performing loans, including their impact on operational risk, reputational risk, liquidity risk and for capital requirements and return on invested capital; analysis, evaluation and control of credit risk of countries, banks, international financial institutions and non-financial clients of the Bank and the Group subsidiaries in the corporate and investment banking area; control of credit risk limits imposed on countries, banks, international financial institutions; the management of the credit risk provisions in the Bank's corporate and investment banking area.
- **Processes and Risk Measurement Department (DPR)** responsible for: development of corporate credit risk strategy and policies, as well as cross-sectional portfolio analyses including industry ones; preparation of reports and statements in particular for supervisory authorities and the Bank's governing bodies; development and implementation of the corporate credit process principles and monitoring its effectiveness; administration of applications supporting the corporate credit process; development and quality control of rating models for retail and corporate customers and financial institutions in the Bank and mBank Group subsidiaries; verification of real estate and movables provided by customers for collateral in terms of their value, liquidity and attractiveness.
- **Integrated Risk Management Department (DKR)** is responsible for: developing methodology and calculating capital requirement for credit risk; calculating portfolio credit provisions of the Bank and economic capital for credit risk; conducting stress tests in the area of credit risk (provisions, capital requirement, economic capital); coordinating and participating in the process of determining credit risk appetite; preparation of reports and information on credit risk (provisions, capital requirement, economic capital, stress tests) for the Bank's authorities and for consolidated supervision purposes.
- **Validation Unit** is responsible for organizing the process of managing models applied for credit risk management and evaluation as well as validating such models.

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

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

3.4.2 Credit Policy

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

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

3.4.3 Collateral accepted

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

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

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

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

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

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

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

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

3.4.4 Rating system

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

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

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

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

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

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

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

3.4.5 Monitoring and validation of models

All models of risk parameters applied in mBank and in the Group subsidiaries, including, i.a., PD models (with all components), LGD models and CCF models are subject to detailed and annual monitoring by modelling units. Moreover, the models are cyclically validated by the mBank's independent Validation Unit.

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

Reports on the performed monitoring/backtests are presented to the model users and the independent Validation Unit.

Validation

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

In case of AIRB models there is assured an independence of Validation Unit in the organizational structures of the Bank or the Group's subsidiary in relation to the units involved in the model's construction/maintenance, i.e. the model owner and users. The Validation Unit is responsible for the validation in mBank.

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

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

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

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

IRB Method Change Policy

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

3.4.6 Calculating impairment charges and provisions

The method of calculating impairment charges and provisions is consistent with the International Financial Reporting Standards. All the rules and definitions implemented in the Bank that are used in this section are in accordance with Polish banking law and requirements of Polish Financial Supervision Authority.

Financial instruments subject to estimation of credit risk costs: 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.

3.4.6.1 How exposures are classified to stages

The Bank, by implementing International Financial Reporting Standards, classifies credit exposures to stages:

1. Stage 1 – exposures for which the risk did not increase significantly since the initial recognition in the loan portfolio,
2. Stage 2 – exposures for which, as at the reporting date, a significant deterioration in credit quality was identified compared to the date of their initial recognition,
3. Stage 3 – exposures for which credit-impairment was found during its lifetime in portfolio,
4. POCI (purchased or originated credit-impaired asset) – assets identified as credit-impaired at initial recognition.

In the Bank the assigment of exposure to stage 2 takes place according to the Transfer Logic algorithm, which defines the qualitative and quantitative criteria indicating a significant increase of credit risk, while the classification exposure to the stage 3 is determined by loss-events.

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 exposure will be moved from Stage 2 to Stage 1. The exposure may also be transferred from Stage 3 to Stage 2 or to Stage 1 in case of the retail part of the portfolio when the impairment triggers are no longer met, and in case of the corporate customers when:

1. the loss events that caused the classification of a client to the stage 3 do not longer exist, and
2. the economic and financial situation of the debtor has improved to the extent which gives a high probability of repayment of all credit obligations in accordance with the conditions resulting from the original agreement or from the contract specifying the restructuring terms, and

3. the overdue debt has been repaid, and
4. the indebtedness is timely handled for at least 12 months after the change of contractual terms, or
5. the balance of the client's credit and non-credit obligations equals to zero as a result of: their total repayment by the customer, recovery of the Bank's receivables as a result of the debt collection activities or the receivables write-off.

3.4.6.1.1 Significant deterrioration of credit quality (classification to stage 2)

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 are:

- More than 30 days past due, involving materiality threshold (The number of days for which the longest overdue amount of the exposure concerned is greater than or equal to 31 days. At the same time, the amount of capital or an off-balance-sheet commitment is greater than or equal to PLN 500 in case of retail exposure and greater than or equal to PLN 3000 in case of corporate exposure).
- 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).

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.

3.4.6.1.2 Impairment triggers - corporate portfolio

The list of definite loss events in corporate portfolio:

1. The number of days past due is above 90 days (14 days in the case of banks) and the overdue amount exceeds PLN 3,000 and PLN 500 for Private Banking.
2. The Bank has sold exposures with a significant economic loss related to the decrease of the debtor creditworthiness.
3. The Bank performed enforced restructuring of the exposure, which resulted in the change of the loan/transaction service schedule due to the lack of possibility of the obligor to meet his obligations under loan/transaction agreement, as initially stipulated, which resulted in:
   a. reduction of financial liabilities by remitting part of these obligations, or
   b. postponing the repayment of the substantial part of the principal, interest or (if it refers to) commission; provided that the lack of approval for restructuring would cause more than 90 calendar days delay in repayment of substantial part of the obligation.
4. Filing by the debtor or filing by the Bank, the parent or subsidiary entity of the Bank a bankruptcy motion against debtor or filing similar motion in respect of credit obligations of the debtor towards the Bank, the parent or subsidiary entity of the Bank.
5. Bankruptcy of debtor or acquiring by him a similar legal protection resulting in his evasion of or delay in repayment of credit obligations towards the Bank, the parent or subsidiary entity of the Bank.
6. Termination of part or whole credit agreement by the Bank and the beginning of restructuring/collection procedures.
7. Client's fraud.
8. Bank expects a loss on a client's exposure.

In addition the Bank identifies so-called 'soft' loss events, introduced in order to signal situations, which may result in the loss of the debtor's ability to repay loan to the Bank. In the event of their occurrence, an in-depth analysis (taking into account the specificity of the entity's operations) is performed and individual decision on the classification of the exposure to one of the stages is made.

3.4.6.1.3 Impairment triggers - retail receivables

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

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

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

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

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

3.4.6.2 Calculation of impairment losses and provisions

Valuation allowances and provisions are measured at the level of a single contract or exposure (agreement) by measuring expected credit losses (ECL). In the group 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).

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.

For the valuation of expected credit losses the Bank uses data contained in the Bank's transaction systems and dedicated tools implemented for the purposes of IFRS 9.

3.4.6.2.1 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. The non-linearity factor (NLF) is set in order to adjust the value of an expected credit loss. The values of NLF are used as scaling factors for individual ECLs. The NLF values are calculated based 3 simulations, which result from relevant macroeconomic scenarios (baseline, optimistic, pessimistic scenario).

Additionally, the inclusion of forward-looking information takes place in the models of all three credit risk parameters estimated in the lifetime horizon (LtPD, LtEAD, LtLGD). Forward-looking data is used to determine parameter values over a period of over 12 months to 3 years, which allows for consistency with macroeconomic forecasts performed by the Bank and mid-term planning. In the estimates the Bank uses, among others, generally available macroeconomic indicators, expectations regarding interest rates and exchange rates, as well as changes in property prices.

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

3.4.6.2.2. Significant model changes

In the third quarter of 2018, due to changes in retail debt collection process, appropriate adjustments were made to LT LGD model for retail segment. In addition to amendments reflecting the current process, other modification were implemented including updated assumptions for residual recoveries and recoveries for cures. Impact of the above adjustments on expected credit loss amounted to PLN 32 million.

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3.4.6.3 Credit risk costs coverage of individual sub-portfolios

The tables below show the percentage of the Bank's balance sheet and off-balance sheet items relating to loans and advances, guarantees and letters of credit to individuals, corporate entities an public sector and the coverage of the exposure with credit risk costs for each of the Bank's internal rating categories (the description of rating model is included in Note 3.4.4).

Portfolio measured at amortized cost

Sub - portfolio	31.12.2018		31.12.2017	
	Exposure (%)	Provision coverage (%)	Exposure (%)	Provision coverage (%)
1	10.94	0.01	9.16	0.01
2	44.70	0.04	39.17	0.03
3	12.57	0.18	14.20	0.12
4	21.42	0.46	17.47	0.36
5	4.27	1.65	4.78	1.04
6	0.34	4.19	0.38	2.23
7	1.22	9.66	1.02	4.65
8	1.52	0.04	9.92	0.05
Default category	3.02	64.22	3.90	55.96
Total	**100.00**	**2.28**	**100.00**	**2.38**

As at 31 December 2018, 55.64% of the loans and advances portfolio for balance sheet and off-balance sheet exposures is categorized in the top two grades of the internal rating system (31 December 2017: 48.33%).

The changes in the portfolio coverage between 2018 and 2017 result from the implementation of IFRS 9.

Portfolio measured at Fair Value through Other Comprehensive Income

Sub - portfolio	31.12.2018	
	Exposure (%)	Provision coverage (%)
1	32.27	0.01
2	55.83	0.05
3	8.22	0.27
4	2.75	0.85
5	0.67	2.22
6	0.07	3.44
7	0.17	5.67
Default category	0.02	19.19
Total	**100.00**	**0.11**

As at 31 December 2018, 88.10% of the loans and advances is categorized in the top two grades of the internal rating system.

3.4.7 Fair value for credit assets

If the conditions for the measurement of a credit asset at amortized cost (IFRS 9, par. 4.1.2) are not met, then it is measured at FVtPL (Fair Value through Profit & Loss) or by FVOCI (Fair Value through Other Comprehensive Income).

3.4.7.1 Fair value valuation of non-impaired credit assets

The valuation for non-impaired exposure is based on its discounted estimated future cash flows.

Future cash flows are determined taking into account:

- repayment schedule, and in the absence of a schedule (revolving products) - based on a statistical estimation of the annual credit limit utilization in expected behavioral exposure period,
- time value of money, based on risk-free interest rates set in the process of forecasting interest flows,

- cash flows amount and their schedule fluctuations stemming from the option of prepayment (early partial or full repayment of the principal) included in the loan agreement by applied by prepayment factors,
- uncertainty of cash flows resulting from credit risk throughout the forecasted lifetime of the exposure by modifying contract flows using multi-year credit risk parameters LT PD and LT LGD,
- other factors that would be taken into consideration by the potential exposure buyer (overhead costs and the profit margin expected by market participants) during the process of calibration of the discount rate used in the valuation process.

Due to requirements of IFRS 13 for the exposures for which there are no quotes on an active market, the Bank calibrates the discount rate based on fair value at the date of the initial recognition (i.e. the cost price of exposure). Calibration margin reflects market valuation of costs related to maintaining exposures in the portfolio and market expectations about profit margin realized on similar exposures.

3.4.7.2 Fair value valuation of impaired credit assets

Impaired credit assets are valuated based on expected recoveries. In the case of retail exposures the valuation is reflected by LGD parameters, and for corporate exposures refers to individual recovery scenarios.

3.4.8 Repossessed collateral

The Bank classifies repossessed collaterals as assets repossessed for debts and measures them in accordance with the adopted accounting policies described in paragraph 2.18. Assets repossessed for debts classified as assets held for sale shall be put up for sale on an appropriate market and sold at the soonest possible date. The process of selling collaterals repossessed by the Bank is arranged in line with the policies and procedures specified by the Debt Restructuring and Collection Department and the Retail Debt Restructuring and Collection Department for individual types of repossessed collaterals. In 2018 and 2017, the Bank did not have any repossessed collaterals that were difficult to sell.

3.4.9 Bank Forbearance Policy

Definition

The Bank's forbearance policy is a set of activities relating to renegotiation and restructuring of terms of loan agreements which is defined by internal regulations.

The Bank offers forbearance to assist customers, who are temporarily or permanently in financial distress and are unable to meet their original contractual repayment terms, through agreements with less restrictive terms of repayment, without which financial difficulties would prevent satisfactory repayment under the original terms and conditions of the contract. These agreements may be initiated by the customer or the Bank.

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

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

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

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

Instruments used

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

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

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

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

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

- Maturity extension/extension of loan duration,
- Restructuring (medium or long term refinancing) – applies to the retail banking area,
- Capitalization of interest,
- Interest deferrals,
- Principal deferrals,
- Covenant waiver,
- Standstills.

Risk management

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

In corporate banking, every bank's exposures on debtors with recognized loss event is classified as default and impairment test is required to be carried out. Every exposure classified as default is being taken over by the specialised unit dedicated to restructuring, who is responsible for assigning and execution optimal strategy against the debtor, i.e. Restructuring or Collection (Vindication). All exposures classified as default and being under Restructuring strategy have the forborne status. Non-default clients, i.e. without recognized loss event, who received the concession (forbearance measures), are subject to close monitoring (Watch List – WL) by all units involved in the loan granting process. Their financial situation is subject to close monitoring and they are under constant review to establish whether any of impairment indicators had materialised.

mBank does not use dedicated models to determine level of portfolio provision and special-purpose provision for forborne portfolio.

Forborne exit conditions – corporate banking area

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

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

Forborne exit conditions – retail banking area

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

- the contract is recognised as performing,
- at least two years (probation period) have passed since the exposure was recognised as performing,
- at least from the middle of the abovementioned probation period regular capital or interest payments were made (lack of significant delays in repayment longer than 31 days),
- none of the debtor's exposures are overdue more than 31 days and at the same time the due amount does not exceed PLN 500 at the end of the 2-year probation period.

Portfolio characteristic

The table below presents changes in the carrying value of the forborne exposures in 2018.

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31.12.2018	Gross carrying amount	Of which defaulted	Accumulated impairment/FV adjustments	Net value
As at 31.12.2017	**1 690 085**	**869 575**	**520 102**	**1 169 983**
Outputs	(410 030)	(94 975)	(31 043)	(378 987)
New forbearance	678 046	563 475	233 487	444 559
Changes on existing loans	(245 002)	(230 460)	(167 895)	(77 107)
As at 31.12.2018	**1 713 099**	**1 107 615**	**554 651**	**1 158 448**

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

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

Forborne portfolio as at 31 December 2018

31.12.2018	Gross carrying amount	Of which defaulted	Accumulated impairment/FV adjustments	Net value
Loans and advances to banks and other financial corporations	106 296	106 296	18 235	88 061
Loans and advances to customers, including:	1 606 803	1 001 319	536 416	1 070 387
Loans to individuals:	858 267	310 094	138 694	719 573
- Current accounts	149 645	46 781	31 943	117 702
- Term loans, including:	708 622	263 313	106 751	601 871
housing and mortgage loans	608 909	208 650	80 711	528 198
Loans to corporate clients:	748 536	691 225	397 722	350 814
corporate & institutional enterprises	412 960	379 212	248 208	164 752
medium & small enterprises	335 576	312 013	149 514	186 062
Total	**1 713 099**	**1 107 615**	**554 651**	**1 158 448**

Forborne portfolio as at 31 December 2017

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

The share of credit forborne portfolio constitutes 2.05% (2017: 2.22%) of the whole portfolio. 65% of the forborne portfolio is reported in the default category (2017 - 51%). Default portfolio is covered in 50% by the impairment allowance / fair value adjustment related to credit risk (2017: 60%).

Forborne exposures by type of concession as at 31 December 2018

31.12.2018 Type of concession	Gross carrying amount	Of which defaulted	Accumulated impairment/FV adjustments	Net value
Refinancing	134 937	134 937	33 377	101 560
Modification of terms and conditions	1 578 162	972 678	521 274	1 056 888
Total	**1 713 099**	**1 107 615**	**554 651**	**1 158 448**

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Forborne exposures by type of concession as at 31 December 2017

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

Forborne exposures by geographical breakdown as at 31 December 2018

31.12.2018	Gross carrying amount	Of which defaulted	Accumulated impairment/FV adjustments	Net value
Poland	1 663 606	1 058 122	548 935	1 114 671
Other countries	49 493	49 493	5 716	43 777
Total	**1 713 099**	**1 107 615**	**554 651**	**1 158 448**

Forborne exposures by geographical breakdown as at 31 December 2017

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

Forborne, not impaired exposures by period of overdue as 31 December 2018

31.12.2018 Overdue period	Gross carrying amount	Of which defaulted	Accumulated impairment/FV adjustments	Net value
Not past due	487 006	69 425	6 149	480 857
Past due less than 30 days	114 295	199	4 400	109 895
Past due 31 - 90 days	50 612	1 388	3 115	47 497
Past due over 90 days	20 077	20 075	10 462	9 615
Razem	**671 990**	**91 087**	**24 126**	**647 864**

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

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

Forborne, impaired exposures by period of overdue as at 31 December 2018

31.12.2018 Overdue period	Gross carrying amount	Of which defaulted	Accumulated impairment/FV adjustments	Net value
Not past due	344 269	331 351	109 570	234 699
Past due less than 30 days	52 319	47 581	8 123	44 196
Past due 31 - 90 days	36 116	29 192	6 465	29 651
Past due over 90 days	608 405	608 404	406 367	202 038
Razem	**1 041 109**	**1 016 528**	**530 525**	**510 584**

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

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

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Forborne exposures by the industry as at 31 December 2018

31.12.2018 Sectors	Gross carrying amount	Of which defaulted	Accumulated impairment/FV adjustments	Net value
Household equipment	15 873	15 197	8 838	7 035
Financial sector	136 292	135 259	33 254	103 038
Food sector	90 238	86 760	45 076	45 162
Construction	66 323	60 230	43 819	22 504
Chemicals and plastic products	62 058	32 206	24 860	37 198
Wood, furniture and paper products	82 302	81 267	28 657	53 645
Scientific and technical activities	23 519	19 646	18 396	5 123
Education and scientific research	1 826	1 722	578	1 248
Electronics	224	134	104	120
Power, power and heating distribution	124 432	124 432	53 300	71 132
Pharmacy	2 824	2 691	2 103	721
Retail trade	21 607	15 756	9 523	12 084
Wholesale trade	38 307	37 028	29 268	9 039
Hotels and restaurants	38 913	16 854	8 604	30 309
Information and communication	21 790	21 615	20 037	1 753
IT	6 248	5 902	5 306	942
Arts, entertainment and recreation	9 306	8 655	6 924	2 382
Rental and leasing activities	109	100	-	109
Construction materials	30 883	30 847	15 951	14 932
Media	2 735	575	567	2 168
Metals	23 164	22 420	18 043	5 121
Motorization	5 911	5 202	2 652	3 259
Human health	992	735	33	959
Household customers	774 932	265 895	115 573	659 359
Fuels	5 451	3 480	3 328	2 123
Other manufacturing activity	11 519	11 493	7 511	4 008
Real estate	37 491	31 386	17 601	19 890
Agriculture, forestry and fishing	43 660	43 607	27 086	16 574
Textiles and wearing apparel	5 002	1 300	664	4 338
Transport and logistics	16 311	15 417	1 420	14 891
Services	6 480	3 427	1 160	5 320
Municipal services	6 377	6 377	4 415	1 962
Total	**1 713 099**	**1 107 615**	**554 651**	**1 158 448**

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Forborne exposures by the industry as at 31 December 2017

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

3.4.10 Counterparty risk that arises from derivatives transactions

The credit exposure on mBank portfolio to derivative transactions is calculated as the sum of the replacement cost of each transaction (which is its current net present value - NPV) and its estimated future potential exposure (Add-on). Moreover the bank uses credit mitigation techniques such as netting and collateralization. The former is implemented if close-out netting agreement is signed, whereas the latter requires prior CSA or suitable clauses in the framework agreement concluded in order to collateralize the exposure. CSA states that the variation margin may be called if current valuation of the portfolio exceeds the predefined level (threshold). Moreover, as far as existing agreements are concerned, additional collateral (initial margin, etc.) may also be exchanged. Credit exposure to the derivatives portfolio is adjusted appropriately depending on the collateral being paid or received in accordance with the binding agreements. For the purpose of the counterparty risk calculation only positive NPV at the derivative portfolio level is taken into account.

Credit exposure control is performed through an integrated system in real time. In particular the level of the allocated credit exposure limit usage is monitored on a daily basis. In addition, compliance with restrictions resulting from credit decisions, supervisory regulations and business decisions is controlled. Credit exposure limits are subject to limit decomposition into different products and maturities.

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

- 47% banks,
- 9% central counterparties (CCP),
- 10% financial institutions,
- 34% corporates, private banking and others.

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

Client type	Credit exposure 2018 (PLN m)	Credit exposure 2017 (PLN m)
Bank CSA	1 222	1 211
Bank uncollateralized	2	4
CCP	229	188
Corpo limit	919	675
Non-Bank Financial Institution	274	269
Private Banking	(4)	(0)
Corpo collateralized and others	(18)	(2)

**negative exposure means overcollateralization*

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

(PLN m)	Banks*		CCP*		Corporates and others			
					CSA	w/o CSA	CSA	w/o CSA
	2018	2017	2018	2017	2018		2017	
NPV	26.78	29.55	5.87	4.27	38.45	127.48	3.26	162.30
collateral received	86.93	84.00	-	-	-	41.26	-	56.68
collateral posted	0.64	-	194.97	124.86	-	-	-	-

**collateral excluding variation margin and default fund (collateral posted to the CCP lest one of its participants defaults)*

***collateral based on NPV and its estimated future potential exposure*

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

The value of derivatives, which are financial assets for each category of internal rating used by the Bank (a description of the rating model is presented in Note 3.4.4) is presented in Note 19.

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

Geographic concentration risk

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

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

As at 31 December 2018 there was no substantial level of geographical concentration in the credit portfolio of mBank. In terms of exposure relating to countries other than Poland there was no substantial share of impaired exposures.

Sector concentration risk

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

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

The Bank set industrial limits on a level not higher than:

- 12% of the gross loan portfolio in the prior reporting period for low risk sectors;
- 10% of the gross loan portfolio in the prior reporting period for medium risk sectors;
- 7% of the gross loan portfolio in the prior reporting period for high risk sectors.

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

The table below presents the structure of concentration of mBank S.A. exposures in particular sectors according to the sector division based on the chain value concept introduced in January 2017, where under one single sector have been focused entities operating activities related to a given market (suppliers, manufacturers, vendors).

As at 31 December 2018 the table includes loans and advances at amortized cost and does not include the loans and advances measured at fair value through profit or loss. Comparative data as at 31 December 2017 remained unchanged.

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

No.	Sectors	Gross value 31.12.2018	%	Gross value 31.12.2017	%
1.	Household customers	40 049 073	50,77	42 429 287	55,83
2.	Rental and leasing activities	10 856 879	13,76	9 077 915	11,94
3.	Financial sector	4 718 423	5,98	2 598 575	3,42
4.	Food sector	2 349 781	2,98	2 043 541	2,69
5.	Construction	1 990 393	2,52	1 980 594	2,61
6.	Real estate	1 817 855	2,30	1 724 357	2,27
7.	Metals	1 658 255	2,10	1 440 698	1,90
8.	Chemicals and plastic products	1 588 136	2,01	1 162 484	1,53
9.	Motorisation	1 576 542	2,00	1 571 582	2,07
10.	Construction materials	1 433 131	1,82	1 247 678	1,64
11.	Wholesale trade	1 073 499	1,36	920 211	1,21
12.	Power, power and heating distribution	973 836	1,23	847 668	1,11
13.	Wood, furniture and paper products	939 399	1,19	1 086 777	1,43
14.	Fuels	938 345	1,19	737 881	0,97
15.	Information and communication	830 609	1,05	693 574	0,91
16.	Transport and logistics	751 697	0,95	704 467	0,93
17.	Retail trade	589 554	0,75	657 137	0,86
18.	Services	463 318	0,59	324 291	0,43
19.	Public administration	430 374	0,55	656 278	0,86
20.	IT	419 563	0,53	335 169	0,44
21.	Agriculture, forestry and fishing	408 991	0,52	430 091	0,57
22.	Other manufacturing activity	397 964	0,50	335 505	0,44
23.	Scientific and technical activities	378 893	0,48	347 815	0,46
24.	Textiles and wearing apparel	366 831	0,46	416 865	0,55
25.	Media	313 746	0,40	331 153	0,43
26.	Household equipment	265 959	0,34	183 222	0,24
27.	Municipal services	249 838	0,32	275 540	0,36
28.	Pharmacy	203 681	0,26	205 129	0,27
29.	Arts, entertainment and recreation	111 582	0,14	108 597	0,14
30.	Electronics	102 685	0,13	111 119	0,15
31.	Hotels and restaurants	101 502	0,13	122 614	0,16
32.	Education and scientific research	69 468	0,09	75 356	0,10
33.	Mining	63 631	0,08	50 914	0,07
34.	Shipbuilding industry	48 982	0,06	38 474	0,05
35.	Human health	45 195	0,06	57 602	0,08
36.	Military industry	31 018	0,04	45 961	0,06
37.	Associations and organisations	3 145	0,00	3 998	0,01

As at 31 December 2018, the total exposure of the Bank in the above sectors (excluding household customers) amounted to 48.87% of the credit portfolio (31 December 2017 – 43.36%).

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

The table below presents the risk of limited sectors as at the end of 2018 and 2017.

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No.	Sectors	31.12.2018	31.12.2017
1.	Financial sector	low	low
2.	Fuels	medium	medium
3.	Food sector	medium	medium
4.	Construction	high	high
5.	Motorisation	medium	medium
6.	Metals	medium	medium
7.	Chemistry and materials	medium	*n/a*

Large exposures concentration risk

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

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

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

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

Bank monitors exposures considered a large exposure limit i.e. exposures after taking into account the effect of the credit risk mitigation (in accordance with art. 401-403 CRR Regulation) and exemptions (art. 390 paragraph 6, Art. 400, Art. 493, paragraph 3 of CRR Regulation), which are equal or exceed 10% of the eligible capital. At the end of 2018 there was no exposure in line with the above definition.

3.6. Market risk

3.6.1 Organisation of risk management

In the process of organisation of the market risk management, mBank follows requirements resulting from the law and supervisory recommendations, in particular the KNF Recommendations (among others A, C, G and I) and the EBA guidelines, concerning market risk management.

The fundamental principle applied in the organisation of the market risk management in the Bank is the separation of the market risk control and monitoring functions from the functions related to opening and keeping open market risk positions. Monitoring and controlling of the market risk is performed by the Integrated Risk Management Department (DKR) under supervision of the Vice-president of the Management Board - Chief Risk Officer (CRO), while the market risk positions are operationally managed by the Financial Markets Department (DFM), the Own Transactions Division in Brokerage Bureau (BM_WTW) and the Treasury Department (DS) reporting to the Vice-president of the Management Board – Head of Financial Markets. From the beginning of 2019, the Brokerage Bureau will not be able to open its own market risk position.

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

Market risk management is performed in a single process by the Integrated Risk Management Department (DKR), which is responsible for measurement of exposures to market risk of the Bank's front-office units portfolios by the use of market risk measures: Value at Risk (VaR) and stress tests. DKR is responsible for control of utilisation of the limits for these risk measures established by the Management Board and the Financial Markets Risk Committee (KRF) and provides daily and periodical reporting on the market risk exposure to managers of the Bank's front-office units, to the Financial Markets Risk Committee, directly to the CRO, to the Management Board and the Supervisory Board.

DKR develops also methodologies for market risk measurement, pre-settlement counterparty risk of derivative transactions and establishes valuation models for financial instruments. The models risk management process is under supervision of the Model Risk Committee.

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

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

3.6.2 Tools and measures

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

mBank identifies market risk on the trading book positions valuated at fair value (either directly to market prices or via models) and as such may lead to losses reported in mBank's financial results. Furthermore, the Bank assigns market risk to its banking positions independently of the accounting rules of calculating financial results on these positions. Market risk measures applicable to interest rate banking book positions are based on net present value (NPV) models.

Exposure to market risk is quantified by:

- measurement of the Value at Risk (VaR),
- measurement of expected loss under condition that this loss exceeds Value at Risk (ES – Expected Shortfall),
- measurement of the Value at Risk in stressed conditions (Stressed VaR),
- measurement of economic capital to cover market risk,
- stress tests scenario analyses,
- determination of portfolio sensitivities to changes of market prices or market parameters (BPV – Basis Point Value, CS BPV – Credit Spread Basis Point Value).

The Value at Risk (VaR) is calculated using historical method on a daily basis for a 1-day and a 10-day holding period and a 95%, 97.5% and 99% confidence level. In this method, historical data concerning risk factors for last 254 business days are taken into consideration. In case of Value at Risk in stressed conditions the calculation is analogous to Value at Risk calculation, but the only difference is in time of stressed conditions, which is marked out on the basis of 10-year series of Value at Risk based on following 12-months windows of risk factors changes from last 11 years. In 2018 it was a year which ended up in June 2009. This period is verified at least once a year.

The VaR methodology takes into account the following risk factors:

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

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

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

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

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

BPV is a sensitivity measure of the current valuation of mBank's portfolios to an increase in interest rates by 1 basis point, and CS BPV for an increase in credit spread by 1 basis point.

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

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

In order to reflect the interest rate risk of the retail and corporate banking products with unspecified interest revaluation dates or rates administered by the mBank, the Bank uses the so-called replicating portfolio models. Since the beginning of 2018 the approach to current accounts takes into account the division of the stable part into the parts sensitive and insensitive to changes in interest rates. The tenor structure adopted for stable parts of the capital and current accounts, insensitive to changes in interest rates, reflects the bank's strategy to stabilize the net interest income.

Measurement and analysis of market risk takes place in two perspectives (including and without taking into account the modelling of stable parts of capital and current accounts, insensitive to changes in interest rates), which allows controlling the impact on the market risk level of the applied strategy for stabilising net interest income.

3.6.3 Risk measurement

Value at Risk, Expected Shortfall

In 2018, Bank's market risk exposure, as measured by the Value at Risk (VaR, for a 1-day holding period, at 97.5% confidence level), was in relation to the established limits on moderate level.

The average utilisation of VaR limits for the Financial Markets Department (DFM), whose positions consist of trading book portfolios, amounted to 20% (PLN 1.2 million), for the Own Transactions Division in the Brokerage Bureau (BM_WTW) 5% (PLN 0.1 million), while for the Treasury Department (DS), whose positions are classified solely to the banking book, it was 38% (PLN 26.3 million) for portfolio without modelling of stable parts of capital and current accounts, insensitive to changes in interest rates and 32% (PLN 12.8 million) for portfolio with modelling of stable parts of capital and current accounts, insensitive to changes in interest rates.

The average utilization of VaR limit for the Debt Securities Issue Department (DCM) amounted to 23% (PLN 0.5 million). The average utilisation of the VaR limit for the position of the Structured and Mezzanine Finance Department (DFS) accounted for 8% (PLN 31.6 thousand).

In 2018, the VaR figures for the Bank's portfolio were driven mainly by portfolios of instruments sensitive to interest rates and separated credit spread – the banking book T-bonds portfolios managed by the Treasury Department and the trading book portfolios and interest rate exchange positions managed by the Financial Markets Department.

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

The increase of Value at Risk in 2018 was mainly caused by the change in approach to stable parts of current accounts insensitive to changes in interest rates and the observations change in the 12-month window taken to calculation (increase of interest rates volatility).

The table below presents Value at Risk and Expected Shortfall statistics for mBank's portfolio.

PLN 000's	2018				2017			
	31.12.2018	Mean	Maximum	Minimum	31.12.2017	Mean	Maximum	Minimum
VaR IR	24 788	25 516	28 412	22 679	9 423	9 970	15 641	5 281
VaR FX	341	421	832	132	545	360	870	138
VaR EQ	0	51	979	0	53	140	1 151	15
VaR CS	17 839	13 255	19 184	10 659	11 441	13 980	23 320	10 431
VaR	**27 209**	**26 976**	**32 177**	**20 129**	**14 038**	**18 685**	**34 560**	**13 429**
ES	**32 638**	**32 276**	**37 197**	**26 884**	**24 433**	**29 842**	**43 970**	**23 124**

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

Stressed Value at Risk

The Value at Risk in stressed conditions is an observed measure. The table below presents statistics of this measure for mBank for 2017 and for 2018.

PLN 000's	2018				2017			
	31.12.2018	Mean	Maximum	Minimum	31.12.2017	Mean	Maximum	Minimum
Stressed VaR IR	98 784	88 934	100 962	78 383	41 214	39 289	48 768	27 827
Stressed VaR FX	774	1 633	4 087	192	313	1 002	3 000	258
Stressed VaR EQ	0	116	600	0	188	315	2 720	22
Stressed VaR CS	98 495	87 849	105 504	80 128	81 534	82 007	91 849	73 903
Stressed VaR	**165 408**	**152 201**	**172 973**	**139 907**	**112 531**	**112 242**	**124 823**	**101 868**

Economic capital for market risk

The average utilisation of limit on economic capital for market risk for the mBank Group in 2018 amounted to 47% (PLN 765,6 million). The average level of economic capital for mBank was equal to PLN 752.9 million. As of end of 2018 the economic capital for market risk for the mBank Group was PLN 925.6 million, and for mBank was PLN 912.7 million. For comparison, at the end of 2017 values of these measures were PLN 514.7 million and PLN 500.8 million, respectively. The economic capital increased in 2018 mainly due to the change in approach to stable parts of current accounts insensitive to changes in interest rates and the observation change in the 12-month window taken to calculation (increase of interest rates volatility).

Stress testing

The average utilisation of stress test limits for the mBank Group in 2018 was 65% (PLN 1 353.7 million) for portfolio without modelling of stable parts of capital and current accounts, insensitive to changes in interest rates and 59% (PLN 884.7 million) for portfolio with modelling of stable parts of capital and current accounts, insensitive to changes in interest rates.

Average utilisation of stress test limits in mBank in 2018 amounted to 67% (PLN 1326.1 million) for portfolio without modelling of stable parts of capital and current accounts, insensitive to changes in interest rates.

The average utilisation of the stress test limits in 2018 for the DS portfolio without modelling of stable parts of capital and current accounts, insensitive to changes in interest rates was 76% (PLN 1 191.4 million) and 70% (PLN 746.7 million) including modelling of stable parts of capital and current accounts, insensitive to changes in interest rates. For the DFM portfolio the average utilisation was 34% (PLN 95.2 million), for the BM_WTW portfolio 12% (PLN 0.8 million), for the DCM portfolio 65% (PLN 45.4 million) and for the DFS portfolio 44% (PLN 2.4 million). The most significant part of the presented stress test values constitutes credit spread stress test for government bonds portfolio because stress test scenarios include a scenario in which credit spreads increase on average by 100 bps.

The table below presents utilisation of stress test for the mBank in 2018 (without modelling of stable parts of capital and current accounts, insensitive to changes in interest rates) in comparison to 2017 (without capital modelling):

PLN 000's	2018				2017			
	31.12.2018	Mean	Maximum	Minimum	31.12.2017	Mean	Maximum	Minimum
Base ST	802	612	839	393	141	85	147	9
CS ST	689	714	768	657	694	688	767	624
Total ST	**1 491**	**1 326**	**1 601**	**1 104**	**835**	**774**	**882**	**638**

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

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3.7. Currency risk

The Bank is exposed to changes in currency exchange rates due to its financial assets and liabilities other than PLN. The following tables present the exposure of the Bank to currency risk as at 31 December 2018 and 31 December 2017.

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

31.12.2018	PLN	EUR	USD	CHF	CZK	INNE	Razem
Assets							
Cash and cash balances with central banks	5 908 261	516 028	44 148	10 499	2 670 180	33 855	9 182 971
Financial assets held for trading and derivatives held for hedging	1 794 646	254 459	61 362	15 272	373	-	2 126 112
Non-trading financial assets mandatorily at fair value through profit or loss, including:	2 439 178	70 022	58 130	-	-	-	2 567 330
Equity instruments	11 155	1 071	-	-	-	-	12 226
Debt securities	-	-	58 130	-	-	-	58 130
Loans and advances to customers	2 428 023	68 951	-	-	-	-	2 496 974
Financial assets at fair value through other comprehensive income	27 231 937	682 448	-	-	258 725	-	28 173 110
Financial assets at amortised cost	58 167 057	12 656 426	1 574 542	14 829 210	3 758 828	125 781	91 111 844
Debt securities	9 000 540	-	-	-	-	-	9 000 540
Loans and advances to banks	4 566 366	868 002	377 184	4 313	42 046	51 430	5 909 341
Loans and advances to customers	44 600 151	11 788 424	1 197 358	14 824 897	3 716 782	74 351	76 201 963
Investments in associates	2 300 271	53	-	-	-	-	2 300 324
Intangible assets	692 797	253	-	-	160	-	693 210
Tangible assets	517 928	3 115	-	-	15 958	-	537 001
Current income tax assets	-	-	-	-	9 336	-	9 336
Deferred income tax assets	293 430	-	-	-	1 917	-	295 347
Other assets	594 859	14 991	24 541	18	18 131	45	652 585
TOTAL ASSETS	**99 940 364**	**14 197 795**	**1 762 723**	**14 854 999**	**6 733 608**	**159 681**	**137 649 170**
Liabilities							
Financial liabilities held for trading and derivatives held for hedging	709 759	236 830	61 415	-	8 210	-	1 016 214
Financial liabilities measured at amortised cost, including:	78 018 804	25 477 337	3 382 132	3 780 593	7 190 096	493 082	118 342 044
Amounts due to banks	1 818 661	1 097 880	212 225	563	416	7 026	3 136 771
Amounts due to customers	74 680 664	22 214 412	3 169 907	2 132 667	7 189 680	486 056	109 873 386
Debt securities issued	-	2 165 045	-	692 679	-	-	2 857 724
Subordinated liabilities	1 519 479	-	-	954 684	-	-	2 474 163
Provisions	203 882	48 961	898	320	1 765	56	255 882
Current income tax liabilities	229 549	-	-	-	14 840	-	244 389
Deferred income tax liabilities	-	83	-	-	-	-	83
Other liabilities	2 279 061	102 725	132 775	3 998	80 972	15 984	2 615 515
TOTAL LIABILITIES	**81 441 055**	**25 865 936**	**3 577 220**	**3 784 911**	**7 295 883**	**509 122**	**122 474 127**
Net on-balance sheet position	18 499 309	(11 668 141)	(1 814 497)	11 070 088	(562 275)	(349 441)	**15 175 043**
Loan commitments and other commitments	24 312 955	1 988 667	421 343	-	521 964	2 483	**27 247 412**
Guarantees, banker's acceptances, documentary and commercial letters of credit	6 375 092	7 782 517	763 694	760 553	5 472	25 778	**15 713 106**

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

3.8. Interest rate risk

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

Interest rate risk of the banking book is the risk resulting from the exposure of the Bank's interest income and capital to the adverse impact of interest rates movements. Following recommendations of KNF, in particular Recommendation G, and EBA guidelines (EBA/GL/2015/08) from 5 October 2015 on the management of interest rate risk arising from non-trading activities, the Bank monitors the banking book structure in terms of repricing risk, basis risk, yield curve risk and customer option risk.

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

- the repricing gap (a difference between assets, liabilities and off-balance sheet banking book positions, measured in defined repricing buckets, based on the repricing date of the interest rate sensitive products),
- the net interest income exposed to risk (EaR - Earnings at Risk – a potential decrease of interest income in a 1-year horizon due to unfavourable changes of the market interest rates. The measure assumes constant volume and structure of the banking book, unchangeable construction of interest rate, constant interest margin and parallel shift of the yield curve. EaR is calculated for 5 main currencies - PLN, CHF, EUR, CZK, USD).

Moreover, the Bank conducts also stress test analyses to estimate the impact of adverse interest rate movements on the net interest income and the economic value of the banking book portfolio. Interest rate risk of the banking book is also quantified by the market risk measures: Value at Risk (VaR), stress tests, BPV and CS BPV.

For the banking portfolio the admissible level of exposure to interest rate risk is restricted by MAT limits (management action triggers) for repricing gap and market risk limits imposed on the Value at Risk (VaR) and stress tests and for the selected portfolios on BPV and CS BPV. The utilisation of those limits is monitored and controlled on a daily basis.

Interest income subject to risk

As of 31 December 2018 and 31 December 2017, a sudden, permanent and unfavourable shift of the market interest rates by 100 basis points for all maturities would reduce annual interest income within 12 months following the year-end date EaR by the following amounts:

PLN m	2018				2017			
	31.12.2018	Mean	Maximum	Minimum	31.12.2017	Mean	Maximum	Minimum
PLN	185.4	144.1	202.8	96.9	186.0	137.4	254.3	86.8
USD	13.3	13.5	16.3	8.9	14.9	13.6	17.9	8.6
EUR	101.3	104.6	117.6	88.1	84.9	94.1	113.1	67.3
CHF	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0
CZK	13.2	23.4	38.4	9.2	12.0	4.8	12.0	2.2

To calculate these values, the Bank assumed that the structure of financial assets and liabilities disclosed in the financial statements for above presented dates would be fixed over the course of the year and the Bank would not take any activities to change related exposure to the interest rate risk. The calculations for 2018 do not include modelling of stable parts of capital and current accounts, insensitive to changes in interest rates, and for 2017 capital modelling.

Stress tests

The Bank conducts also calculations of the changes in the economic value of the banking book portfolio having the nature of stress test scenarios. The change of the economic value of the banking book portfolio being a result of the conducted stress test, which assumes a scenario of the unfavourable interest rates shift by 200 basis points of the yield curve for a given currency, amounted to PLN 1 444.7 million at the end of 2018 for portfolio without modelling of stable parts of capital and current accounts, insensitive to changes in interest rates and PLN 632.9 million for portfolio with modelling of stable parts of capital and current accounts, insensitive to changes in interest rates (at the end of 2017: PLN 511.7 million, without capital modelling). When calculating these values no correlation between currencies and no possibility of dropping clients interest rates below 0 are assumed.

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

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mBank S.A. interest rate risk

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

31.12.2018	Up to 1 month	1-3 months	3-12 months	1-5 years	More than 5 years	Non-interest bearing	Total
ASSETS							
Cash and balances with the Central Bank	3 298 155	-	-	-	-	5 884 816	**9 182 971**
Loans and advances to banks	2 892 625	2 871 145	87 456	15 265	-	42 851	**5 909 342**
Debt and equity securities and investments in subsidiaries	5 654 757	1 719 955	10 411 106	14 594 313	1 291 606	2 370 679	**36 042 416**
Loans and advances to customers	60 353 108	17 601 232	2 184 211	3 150 612	15 948	15 302	**83 320 413**
Other assets and derivative financial instruments	153 587	151 175	177 578	262 062	30 226	884 507	**1 659 135**
Total assets	**72 352 232**	**22 343 507**	**12 860 351**	**18 022 252**	**1 337 780**	**9 198 155**	**136 114 277**
LIABILITIES							
Amounts due to the Central Bank	228	-	-	-	-	-	**228**
Amounts due to other banks	1 948 655	895 617	288 985	-	-	3 286	**3 136 543**
Amounts due to customers	85 744 985	9 419 449	8 482 582	6 063 268	56 213	106 889	**109 873 386**
Debt securities in issue	-	-	-	2 857 724	-	-	**2 857 724**
Subordinated liabilities	763 318	954 684	756 161	-	-	-	**2 474 163**
Other liabilities and derivative financial instruments	117 839	176 765	283 365	209 898	25 736	2 818 126	**3 631 729**
Total liabilities	**88 575 025**	**11 446 515**	**9 811 093**	**9 130 890**	**81 949**	**2 928 301**	**121 973 773**
Total interest repricing gap	**(16 222 793)**	**10 896 992**	**3 049 258**	**8 891 362**	**1 255 831**		

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

3.9. Liquidity risk

Sources of liquidity risk

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

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

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

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

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

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

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

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

Organization of risk management

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

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

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

- **Financial Markets Settlement and Services Department (DOF)** – I line of defence, is responsible for the operational supervision over correctness of cash flows in the accounts.
- **Custody Services Department (DCU)** – I line of defence, acts in the scope of settlements of transactions on securities.
- **Integrated Risk and Capital Management Department (DKR)** – II line of defence, is in charge of controlling and monitoring liquidity risk of the Bank on the strategic level and reporting to the Vice-president of the Management Board - Chief Risk Officer, the Financial Markets Risk Committee and the Assets and Liabilities Management Committee of the mBank Group (ALCO). The Department monitors financial liquidity on a daily basis using methods based on cash flow analysis. Liquidity risk measurement is based on the regulatory model and an internal model, which has been established taking into consideration the specific character of the Bank, the volatility of the deposit base, the level of funding concentration and the projected development of particular portfolios.
- **Internal Audit Department (DAW)** – III line of defence, performs independent assessment of the first and second line of defence.
- **Validation Division –** in the scope of models validation used for the purpose of liquidity risk management.

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

In 2018, the liquidity situation was monitored and kept at a level adequate to the Bank's needs by adjusting the deposit base and securing additional funding sources depending on the development of lending activity and other funding needs.

The internal liquidity adequacy assessment process (ILAAP)

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

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

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

Tools and measures used in measuring liquidity risk

As part of liquidity risk management, a range of risk measures are being analysed. The basic measure is mismatch gap. It covers all the assets, liabilities and off-balance sheet items of the Bank in all the currencies and time-bands set by the Bank. In 2018, the Bank held liquidity surplus, adequate to the Bank's business activity and current market situation, in the form of a portfolio of liquid treasury and money market securities that may be pledged or sold at any time without any considerable loss in value.

In accordance with KNF Resolution No. 386/2008 on establishing liquidity measures binding on banks and in accordance with Commission Delegated Regulation (EU) No 2015/61 of October 10, 2014 the Bank calculates the supervisory liquidity measures. In 2018, the supervisory limits were not exceeded. Moreover, in line with the Resolution, the Bank conducts an in-depth analysis of long-term liquidity and sets internal limits (management action triggers) on involvement in long-term assets. Internal limits and appropriate buffers are also imposed on supervisory measures. Relevant analysis of the stability and structure of the funding sources, including the core and concentration level of term deposits and current accounts are performed. Additionally, the Bank analyses the variability of the balance sheet and off-balance sheet items, in particular the open credit line facilities and current account and overdrafts limits utilisation.

The ongoing analysis covers not only liquidity under normal conditions, but also on the assumption of a potential liquidity loss. In order to determine the Bank's resistance to major unfavourable events, the Bank conducts scenario analyses covering extreme assumptions on the operation of financial markets, behavioural events relative to the Bank's clients and both mentioned factors combined.

For this purpose limited stress test scenarios were regularly performed:

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

as well as stress scenarios which are not limited:

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

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

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

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

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

Value of Liquidity Reserves (in PLN million)	
31.12.2018	**31.12.2017**
25 700	25 727

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

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

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

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

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

The measurement, limiting and reporting the liquidity risk

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

Daily reporting covers:

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

Weekly reporting covers:

- early warnings indicators (EWI).

Monthly reporting covers:

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

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

For the purpose of current monitoring of liquidity, the Bank establishes values of realistic, cumulated gap of cash flows. The realistic gap is calculated on the basis of contractual cash flows (Note 3.9.1). Mainly cash flows in portfolios of non-banking customers' deposits, overdrafts and term loans are amended. In the calculation of the liquidity measures the Bank takes into account the possibilities of raising the funds by selling or pledging the debt securities from the Bank's Liquidity Reserves.

In the LAB methodology, the LAB Base Case measure is the primary management measure and it is also used for limiting the liquidity gap in particular foreign currencies.

Value of realistic, bucket and cumulative gap of cash flows misfit (in PLN million)				
Time range	gap ANL Bank Stress- 31.12.2018		gap ANL Bank Stress - 31.12.2017	
	bucket	cumulative	bucket	cumulative
up to 1 working day	19 207	19 207	19 464	19 464
up to 3 working days	417	19 624	519	19 983
up to 7 calendar days	(2 987)	16 637	(2 311)	17 672
up to 15 calendar days	64	16 701	(154)	17 518
up to 1 month	(330)	16 371	1 799	19 317
up to 2 months	1 937	18 308	(2 167)	17 150
up to 3 months	(574)	17 734	(761)	16 389
up to 4 months	(2 218)	15 516	(620)	15 769
up to 5 months	(1 105)	14 411	(227)	15 542
up to 6 months	(933)	13 478	(428)	15 114
up to 7 months	(12)	13 466	230	15 344
up to 8 months	(366)	13 100	(429)	14 915
up to 9 months	150	13 250	(1 136)	13 779
up to 10 months	761	14 011	(1 577)	12 202
up to 11 months	(109)	13 902	(437)	11 765
up to 12 months	349	14 251	(361)	11 404

The above values should be interpreted as liquidity surplus/deficit in relevant time buckets. The dynamics of the development of non-bank term deposits and current accounts (PLN 10.8 billion - the exchange rate of December 31, 2018 was used in calculation) had a positive impact on the level of liquidity gap, exceeding the dynamics of the development of lending activities (PLN 6.5 billion - the exchange rate of December 31, 2018 was used in calculation).

The level of liquidity gap was adversely affected by the development of wholesale funding - repayment exceeded the value of acquired funding, including a drop in debt to the main shareholder, Commerzbank AG resulting from the repayment of CHF 750 million. Thus, the process of repayment of unsecured loans in CHF with Commerzbank AG was completed.

In 2018, the LAB methodology, which was implemented in 2017, was still being developed, which had a negative impact on the level of liquidity gap.

Liquidity gap methodology contains an additional component, which is aimed at preparing the Bank for significant changes in foreign exchange rates and interest rates, resulting in negative valuation of transactions and thus generating liquidity needs stemming from the necessity to supplement collateral with the counterparties (position value as of the end of 2018 – PLN 2 287 million).

Moreover the Bank calculates the amount of additional collateral requirement resulting from signed agreements with the counterparties that the Bank would have to deliver in case of potential rating downgrade. As of 31 December 2018 the Bank would not have to post additional collateral.

In 2018 the Bank's liquidity remained at a safe level which was reflected in surplus of liquid assets over short-term liabilities according to LAB in various scenarios and supervisory liquidity measures.

Since the beginning of 2018, the measures M1 and M2 defined in KNF Resolution No. 386/2008 on establishing liquidity measures binding banks ceased to apply as regulatory measures and therefore the Bank resigned from their presentation.

LAB cash flows gaps mismatch in terms up to 1 month and up to 1 year within 2018 and values of regulatory measures M3–M4 and LCR are presented in the following table:

Measure*	2018			
	31.12.2018	Mean	Maximum	Minimum
LAB Base Case 1M	16 371	17 510	24 677	12 420
LAB Base Case 1Y	14 252	10 130	14 828	4 634
LAB Bank Stress 1M	12 669	11 676	17 571	6 650
LAB Market Stress 1M	14 562	14 454	19 008	10 051
LAB Combined Stress 1M	9 177	9 806	14 012	5 410
M3	4.95	4.66	5.06	4.09
M4	1.38	1.39	1.41	1.35
LCR	190%	178%	240%	137%

Measure*	2017			
	31.12.2017	Mean	Maximum	Minimum
LAB Base Case 1M**	19 317	16 233	19 317	13 607
LAB Base Case 1Y**	11 405	11 331	12 426	10 134
LAB Bank Stress 1M**	13 057	11 240	13 133	9 512
LAB Market Stress 1M**	16 571	14 550	16 632	12 973
LAB Combined Stress 1M**	12 533	10 951	12 660	9 637
M3	4.52	4.71	4.93	4.29
M4	1.39	1.39	1.43	1.36
LCR	165%	178%	239%	142%

**LAB measures are shown in PLN million; M3, M4 and LCR are relative measures presented as a decimal.*

*** Mean, maximum and minimum are calculated for period starting from 6th December 2017.*

The long-term coverage ratios (M3, M4) are characterized by high stability on safe level, above minimum established by regulatory authority equal to 1. In particular, M3 oscillated between 4.09 and 5.06 in 2018, whereas M4 between 1.35 and 1.41. The LCR measure remained on safe level, significantly exceeding 100%.

Funding sources

The strategic assumptions concerning the diversification of funding sources and profitable structure of the balance sheet are reflected in the financial plan of mBank Group defined by selected measures, e.g. L/D ratio (Loans to Deposits). It measures a specific relation of loans to deposits in order to maintain a stable structure of its balance sheet. In 2018, L/D ratio slightly changed from 73.9% to 75.9%. The Bank aims at building a stable deposit base by offering to clients deposit and investment products, regular and specific-purpose savings offerings, as well as operating deposits of the subsidiaries. Funds acquired from the Bank's clients constitute the major funding source for the business activity along with the portfolio of long-term loans from banks (with maturities over 1 year) (Note 28). The loans together with subordinated loans (Note 28) are the core funding source for the portfolio of mortgage loans in CHF. According to the suspension of granting new mortgage loans in CHF, the Bank's receivables in this currency have been decreasing successively along with loans repayments. The funds obtained from the repayment of the mentioned loans are used to reduce the Bank's debt in CHF owed to the main shareholder. In 2018, the debt to Commerzbank AG was reduced by CHF 750 million - repayment of borrowings.

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Moreover, in order to acquire funding (also in foreign currencies) the Bank uses mid-term and long-term instruments, including credit line facilities on the international markets, unsecured issuances, bilateral loans as well as FX swap and CIRS transactions.

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

3.9.1 Cash flows from transactions in non-derivative financial instruments

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

Liabilities (by contractual maturity dates) as at 31.12.2018

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Amounts due to other banks	2 241 079	47 156	672 059	197 996	-	**3 158 290**
Amounts due to customers	85 555 928	7 327 456	8 659 164	7 300 192	1 605 173	**110 447 913**
Debt securities in issue	9 553	26 998	-	2 918 057	-	**2 954 608**
Subordinated liabilities	34 918	4 814	56 440	303 605	2 732 251	**3 132 028**
Other liabilities	2 048 264	-	-	-	-	**2 048 264**
Total liabilities	**89 889 742**	**7 406 424**	**9 387 663**	**10 719 850**	**4 337 424**	**121 741 103**
Assets (by remaining contractual maturity dates)						
Total assets	**19 557 154**	**7 030 055**	**25 850 898**	**58 057 672**	**38 945 095**	**149 440 874**
Net liquidity gap	**(70 332 588)**	**(376 369)**	**16 463 235**	**47 337 822**	**34 607 671**	**27 699 771**

Liabilities (by contractual maturity dates) as at 31.12.2017

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Amounts due to other banks	1 615 424	1 281 417	1 678 135	545 232	-	**5 120 208**
Amounts due to customers	76 572 571	6 703 332	4 793 198	9 604 594	2 329 351	**100 003 046**
Subordinated liabilities	33 470	335	34 842	198 636	2 235 613	**2 502 896**
Other liabilities	1 713 879	-	-	-	-	**1 713 879**
Total liabilities	**79 935 344**	**7 985 084**	**6 506 175**	**10 348 462**	**4 564 964**	**109 340 029**
Assets (by remaining contractual maturity dates)						
Total assets	**21 801 367**	**4 450 403**	**22 111 067**	**52 525 958**	**33 905 948**	**134 794 743**
Net liquidity gap	**(58 133 977)**	**(3 534 681)**	**15 604 892**	**42 177 496**	**29 340 984**	**25 454 714**

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

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

3.9.2 Cash flows from derivatives

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

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

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

The table below shows derivative financial liabilities of the Bank, which valuation as of end of 2018 was negative, grouped by appropriate remaining maturities as at the balance sheet date and are presented as contractual maturities apart from Other up to 1 month and Futures contracts which are presented as net present value (NPV). The amounts denominated in foreign currencies were converted to Polish zloty at the average rate of exchange announced by the National Bank of Poland at the balance sheet date.

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31.12.2018

Derivatives settled on a net basis	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Forward Rate Agreements (FRA)	31	284	2 814	700	-	**3 829**
Interest Rate Swaps (IRS)	13 853	141 991	386 111	1 122 770	57 553	**1 722 278**
Cross Currency Interest Rate Swaps (CIRS)	7 652	(15 228)	(41 909)	(49 193)	(6 424)	**(105 102)**
Options	3 696	640	(2 447)	(202)	(50)	**1 637**
Other	2 134	3 376	8 742	18 833	-	**33 085**
Total derivatives settled on a net basis	**27 366**	**131 063**	**353 311**	**1 092 908**	**51 079**	**1 655 727**

Derivatives settled on a net basis	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Forward Rate Agreements (FRA)	-	-	30	-	-	**30**
Overnight Index Swaps (OIS)	171	936	119	-	-	**1 226**
Interest Rate Swaps (IRS)	94 666	180 637	85 864	682 683	105 432	**1 149 282**
Cross Currency Interest Rate Swaps (CIRS)	2 510	(3 853)	(1 234)	(7 170)	-	**(9 747)**
Options	1 613	2 605	4 291	14 790	(141)	**23 158**
Futures contracts	-	(1)	-	-	-	**(1)**
Other	1 130	2 668	2 967	17 498	-	**24 263**
Total derivatives settled on a net basis	**100 090**	**182 992**	**92 037**	**707 801**	**105 291**	**1 188 211**

Derivative financial instruments settled in gross amounts

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

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

31.12.2018

Derivatives settled on a gross basis	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Currency derivatives:						
-outflows	**17 177 186**	**4 190 224**	**5 062 397**	**2 018 037**	**-**	**28 447 844**
-inflows	**17 175 957**	**4 177 897**	**5 036 250**	**1 987 573**	**-**	**28 377 677**

31.12.2017

Derivatives settled on a gross basis	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Currency derivatives:						
-outflows	**19 635 416**	**7 232 771**	**4 174 407**	**1 018 469**	**-**	**32 061 063**
-inflows	**19 616 689**	**7 196 084**	**4 158 371**	**957 840**	**-**	**31 928 984**

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

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

Detailed data concerning liquidity risk related to off-balance sheet items are presented in the Note 33.

3.10. Operational risk

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

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

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

Organisation of risk management

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

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

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

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

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

Tools and measures

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

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

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

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

Operational losses

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

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

The following table presents the distribution of actual net losses (net of recoveries) by operational risk category, incurred by mBank in 2018:

Operational risk category	Distribution	Value of net losses in relations to the value of gross profit
Crimes committed by outsiders	26.0%	0.40%
Customers, products and business practices	55.3%	0.85%
Execution, delivery and process management	10.6%	0.16%
Other	8.1%	0.12%
Total	100.0%	1.53%

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

3.10.1 Compliance risk

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

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

The compliance risk management system at the Bank takes place at three independent levels. The first level refers to the management of risk related to operating activities. The second level comprises at least: risk management by employees holding dedicated positions or working in dedicated organisational sub-units, taking place irrespective of the risk management performed at the first level and the Compliance Department operations. The third level comprises operations of the Internal Audit Department. At all the three levels, within the risk management system, the Bank's employees, as part of performance of business duties, apply control mechanisms or monitor observance of control mechanism independently.

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

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

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

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

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

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

3.11. Business risk

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

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

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

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

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

3.12. Model risk

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

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

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

Model risk management is coordinated by the Validation Unit, which performs, in particular, the following tasks:

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

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

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

An important role in the model and their risk management process is played by the Model Risk Committee, whose functions are described in Note 3.3.2. It recommends, among others, model risk tolerance level, which is finally approved by the Management Board and the Supervisory Board.

3.13. Reputational risk

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

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

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

Communication and Marketing Strategy Department is responsible for:

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

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

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

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

Reputational Risk Management Strategy of mBank Group describes rules and components of reputational risk management.

3.14. Capital risk

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

Controlling and Management Information Department is responsible for:

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

Integrated Risk Management Department is responsible for:

- monitoring and reporting of capital adequacy (including planning and forecasting), risk bearing capacity and risk profile of the Group;
- development of the risk bearing capacity concept and the methodology of limiting regulatory and internal capital;
- conducting sensitivity analyses, stress tests and analyses of influence of new products, new calculation methods and new regulatory requirements (including also the use of the AIRB method) for capital adequacy.

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

The capital management in mBank Group is organised as a process including planning, steering and controlling regulatory and internal capital. Within the framework of capital management process, regular monitoring of capital adequacy and effectiveness is conducted, aimed at assurance that adequate and optimum level of capital is maintained in mBank Group. This is supported by stress test analyses, aiming to provide in depth view on current capital position, as well as its possible development in the future.

The capital management process in mBank Group is documented and the core element of this documentation is the Capital Management Policy. Its underlying assumption is to ensure effective planning and utilisation of the capital base within the mBank and mBank Group, among others, through determining the Bank's dividend policy. This is provided mainly by applying risk appetite guidelines and developing guidelines to assure sufficient capital to cover risks identified in business activity, as well as defining the organisational framework for the efficient functioning of capital management system.

The Capital Management Policy is based on two fundamental pillars:

- maintenance of optimal level and structure of own funds, assuring capital adequacy above the established minimum requirement (including risk appetite defined by the Management Board) as well as ensuring coverage against all material risks identified in mBank Group's activity,
- effective use of the capital base, guaranteeing achievement of expected returns, including return on regulatory capital and risk adjusted capital.

In addition, the document focuses on capital management in an environment of capital shortage, in particular in case of activation of the capital protection plan.

3.15. Regulatory risk

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

3.16. Fair value of assets and liabilities

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

- on the main market for the asset or liability,
- in the absence of a main market, for the most advantageous market for the asset or liability.

In line with IFRS9, for accounting purposes, the Bank determines the valuation of its assets and liabilities through amortised cost or through fair value. In addition, for the positions that are valued through amortised cost, there is calculated and disclosed the fair value, but only for disclosure purposes – according to IFRS7.

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The approach to the method used for the loans that are fair valued in line of IFRS9 requirements, is described in the point 3.4.7.

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 are valued by market models using prices observable in the market. Domestic commercial papers are marked to model (by discounting cash flows), which in addition to market interest rate curve uses credit spreads estimated internally.

For disclosure purposes, the Bank estimated that the fair value of short-term financial liabilities (less than 1 year) is equal to the balance sheet values of such items. In addition, the Bank assumed that the estimated fair value of financial assets and financial liabilities longer than 1 year is based on discounted cash flows using appropriate interest rates.

Positions that are recognised in GL through amortised cost

The following table presents a summary of balance sheet values and fair values for each group of financial assets and liabilities not recognised in the statement of financial position of the Bank at their fair values.

	31.12.2018	
	Carrying value	Fair value
Financial assets at amortised cost		
Debt securities	**9 000 540**	**9 148 798**
Loans and advances to banks	**5 909 341**	**5 884 788**
Loans and advances to customers, including:	**76 201 963**	**75 912 683**
Loans and advances to individuals	**38 441 362**	**38 895 475**
Current accounts	5 809 898	5 972 041
Term loans	32 271 991	32 563 961
Other	359 473	359 473
Loans and advances to corporate entities	**37 235 689**	**36 495 606**
Current accounts	5 859 055	5 744 813
Term loans	30 103 484	29 477 643
Reverse repo / buy sell back transactions	1 146 263	1 146 263
Other loans and advances	111 955	111 955
Other	14 932	14 932
Loans and advances to public sector	**524 912**	**521 602**
Financial liabilities at amortised cost		
Amounts due to other banks	**3 136 771**	**3 135 206**
Amounts due to customers	**109 873 386**	**109 893 816**
Debt securities in issue	**2 857 724**	**2 844 520**
Subordinated liabilities	**2 474 163**	**2 492 101**

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	31.12.2017	
	Carrying value	**Fair value**
Financial assets at amortised cost		
Loans and advances to banks	**6 063 702**	**6 057 550**
Loans and advances to customers	**73 431 738**	**73 614 389**
Loans and advances to individuals	**40 861 252**	**41 661 023**
Current accounts	6 669 099	6 825 992
Term loans	34 192 153	34 835 031
Loans and advances to corporate entities	**31 392 681**	**30 781 787**
Current accounts	5 098 424	4 980 510
Term loans	26 030 530	25 537 550
Reverse repo / buy sell back transactions	57 119	57 119
Other loans and advances	206 608	206 608
Loans and advances to public sector	**870 182**	**863 956**
Other receivables	**307 623**	**307 623**
Financial liabilities at amortised cost		
Amounts due to other banks	**5 089 716**	**5 116 405**
Amounts due to customers	**99 331 571**	**99 667 451**
Subordinated liabilities	**2 158 143**	**2 137 590**

Differences between the fair value at the end of 2017 presented in the table above and in the financial statements for 2017 stem 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:

Loans and advances to banks and loans and advances to customers. The fair value for loans and advances to banks and loans and advances to customers is calculated as the estimated value of future cash flows (adjusted by prepayments) using current interest rates, including credit spread, cost of liquidity and cost of capital margin. The level of credit spread was determined based on market quotation of median credit spreads for Moody's rating grade. Attribution of a credit spread to a given credit exposure is based on a mapping between Moody's rating grade and internal rating grades of the Bank. To reflect the fact that the Bank's exposures are in major part collateralised whereas the median of market quotation is centred around unsecured issues, the Bank applied appropriate adjustments.

Financial liabilities. Financial instruments representing liabilities include the following:

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

The fair value for these financial liabilities with more than 1 year to maturity is based on cash flows discounted from capital and interest rates using discounted factor. For loans received from Commerzbank in CHF, the Bank used the curve based on quotations of Commerzbank CDS for exposures in EUR, and quotations of issued bonds under EMTN programme in EUR and CHF. For the loans received from European Investment Bank in EUR the Bank used the EBI yield curve.

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

The Bank assumed that the fair values of these instruments with less than 1 year to maturity was equal to the carrying amounts of the instruments.

According to the fair value methodology applied by the Bank, financial assets and liabilities are classified as follows:

- Level 1: prices quoted on active markets for the same instrument (without modification);

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- Level 2: prices quoted on active markets for the similar instruments or other valuation techniques for which all significant input data are based on observable market data;
- Level 3: valuation methods for which at least one significant input data is not based on observable market data.

The table below presents the fair value hierarchy of financial assets and liabilities measured at fair value in accordance with the assumptions and methods described above, exclusively for disclosure as at 31 December 2018 and as at 31 December 2017.

31.12.2018	Including:	Level 1 Quoted prices in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
VALUATION ONLY FOR PURPOSES OF DISCLOSURE				
FINANCIAL ASSETS				
Debt securities	9 148 798	9 148 798	-	-
Loans and advances to banks	5 884 788	-	-	5 884 788
Loans and advances to customers	75 912 683	-	-	75 912 683
FINANCIAL LIABILITIES				
Amounts due to other banks	3 135 206	-	474 235	2 660 971
Amounts due to customers	109 893 816	-	9 461 148	100 432 668
Debt securities in issue	2 844 520	2 844 520	-	-
Subordinated liabilities	2 492 101	-	2 492 101	-
Total financial assets	**90 946 269**	**9 148 798**	**-**	**81 797 471**
Total financial liabilities	**118 365 643**	**2 844 520**	**12 427 484**	**103 093 639**

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
VALUATION ONLY FOR PURPOSES OF DISCLOSURE				
FINANCIAL ASSETS				
Loans and advances to banks	6 057 550	-	-	6 057 550
Loans and advances to customers	73 614 389	-	-	73 614 389
FINANCIAL LIABILITIES				
Amounts due to other banks	5 116 405	-	3 421 029	1 695 376
Amounts due to customers	99 667 451	-	12 799 584	86 867 867
Subordinated liabilities	2 137 590	-	2 137 590	-
Total financial assets	**79 671 939**	**-**	**-**	**79 671 939**
Total financial liabilities	**106 921 446**	**-**	**18 358 203**	**88 563 243**

Level 1

Level 1 of financial assets includes the value of treasury securities and EIB bonds whose valuation consists in the direct use of market current prices of these instruments originating from active and liquid financial markets.

Level 1 of financial liabilities includes the fair value of bonds issued by the Bank (Note 28). For the purpose of disclosures the Bank applied market price of the issued debt securities.

Level 2

Level 2 includes the fair value of long-term loans received from banks, the fair value of long-term deposits placed by customers and the fair value of the loans received from the EIB (Note 28). In addition, at level 2, the Bank has presented subordinated liabilities.

The fair value of financial liabilities included at Level 2 with more than 1 year to maturity is based on cash flows discounted using interest rates. For received loans in EUR the Bank used the swap curve amended by the spread determined based on observable Commerzbank CDS quotations in EUR for various maturities and a fixed spread which represents the assumed credit spread differential for Bank risk (derived from market quotation of bond issued under the EMTN programme). For the loans in other currencies, the above spreads for EUR were applied and cross currency swaps quotations to EUR. In case of the loans received from European Investment Bank in EUR, the Bank used EIB yield curve and the value of margin which was agreed upon the last contract. Based on that assumption, the spread of Bank to market swap curve was estimated. In case of deposits the Bank used the curve based on overnight rates, term cash rates, as well as FRA contracts for appropriate currencies and maturities. For debt securities in issue the Bank used the prices directly from the market for these securities. For the purpose of measurement of subordinated liabilities the Bank used obtained primary market spreads of subordinated bonds issued by the Bank and if required corresponding cross-currency basis swap levels for the respective maturities.

Level 3

Level 3 includes:

(i) the fair value of loans and advances to banks and loans and advances to customers, which is disclosed, as described earlier, based on quotation of median credit spreads for Moody's ratings,
(ii) liabilities due to banks and to customers with maturity up to one year, for which the Bank assumed that their fair value is equal to the carrying value,
(iii) the fair value of liabilities due to banks and to customers with maturity exceeding one year, for which were used valuation methods using at least one significant input data not based on observable market data.

Positions that are recognised in GL through fair value

The following tables present fair value hierarchy of financial assets and liabilities recognized in the statement of financial position of the Bank at their fair values.

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31.12.2018	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				
Financial assets held for trading and derivatives held for hedges	**2 126 112**	**748 294**	**1 006 550**	**371 268**
Loans and advances to custumers	**43 166**	**-**	**-**	**43 166**
- Credit institutions	43 166	-	-	43 166
Debt securities	**1 076 396**	**748 294**	**-**	**328 102**
- General governments	748 294	748 294	-	-
- Credit institutions	187 644	-	-	187 644
- Other financial corporations	72 626	-	-	72 626
- Non-financial corporations	67 832	-	-	67 832
Derivative financial instruments, including:	**1 006 550**	**-**	**1 006 550**	**-**
Derivative financial instruments held for trading:	**707 967**	**-**	**707 967**	**-**
- interest rate derivatives	405 799	-	405 799	-
- foreign exchange derivatives	139 908	-	139 908	-
- market risks derivatives	162 260	-	162 260	-
Derivative financial instruments held for hedging:	**298 583**	**-**	**298 583**	**-**
- derivatives designated as fair value hedges	107 059	-	107 059	-
- derivatives designated as cash flow hedges	191 524	-	191 524	-
Non-trading financial assets mandatorily at fair value through profit or loss	**2 567 330**	**770**	**-**	**2 566 560**
Loans and advances to custumers	**2 496 974**	**-**	**-**	**2 496 974**
- Individual customers	2 370 872	-	-	2 370 872
- Credit institutions	113 199	-	-	113 199
- Corporate custumers	12 903	-	-	12 903
Debt securities	**58 130**	**-**	**-**	**58 130**
- Other financial corporations	58 130	-	-	58 130
Equity securities	**12 226**	**770**	**-**	**11 456**
- Other financial corporations	12 226	770	-	11 456
Financial assets at fair value through other comprehensive income	**28 173 110**	**21 352 274**	**499 912**	**6 320 924**
Loans and advances to custumers	**4 578 310**	**-**	**-**	**4 578 310**
- Individual customers	4 578 310	-	-	4 578 310
Debt securities	**23 594 800**	**21 352 274**	**499 912**	**1 742 614**
- Banki centralne	499 912	-	499 912	-
- General governments	20 158 072	20 121 684	-	36 388
- Credit institutions	838 036	-	-	838 036
- Other financial corporations	1 488 643	1 230 590	-	258 053
- Non-financial corporations	610 137	-	-	610 137
Total financial assets	**32 866 552**	**22 101 338**	**1 506 462**	**9 258 752**

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31.12.2018	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, including:	**1 016 214**	**-**	**1 016 214**	**-**
Derivative financial instruments held for trading	**1 021 350**	**-**	**1 021 350**	**-**
- interest rate derivatives	614 890	-	614 890	-
- foreign exchange derivatives	235 758	-	235 758	-
- market risks derivatives	170 702	-	170 702	-
Derivative financial instruments held for hedging	**(5 136)**	**-**	**(5 136)**	**-**
- derivatives designated as fair value hedges	9	-	9	-
- derivatives designated as cash flow hedges	(5 145)	-	(5 145)	-
Total financial liabilities	**1 016 214**	**-**	**1 016 214**	**-**
TOTAL RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS	**32 866 552**	**22 101 338**	**1 506 462**	**9 258 752**
FINANCIAL LIABILITIES	**1 016 214**	**-**	**1 016 214**	**-**

Assets Measured at Fair Value Based on Level 3 - changes in 2018	Loans and advances held for trading	Non-trading loans and advances mandatorily at fair value through profit or loss	Non-trading debt securities mandatorily at fair value through profit or loss	Loans and advances at fair value through other comprehensive income	Debt securities at fair value through other comprehensive income
As at the beginning of the period	**311 826**	**-**	**-**	**1 635 170**	**55 486**
Transfer between asset categories due to the implementation of IFRS 9 as at 01.01.2018	**-**	**46 538**	**8 948**	**-**	**(55 486)**
Restated opening balance	**311 826**	**46 538**	**8 948**	**1 635 170**	**-**
Gains and losses for the period:	**2 257**	**11 592**	**-**	**9 120**	**-**
Recognised in profit or loss:	2 257	11 592	-	-	-
- Net trading income	*2 257*	*4 564*	-	-	-
- Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss	-	*7 028*	-	-	-
Recognised in other comprehensive income:	-	-	-	9 120	-
- Financial assets at fair value through other comprehensive income	-	-	-	*9 120*	-
Purchases	1 350 961	-	19 507	2 189 754	-
Redemptions	(442 675)	-	-	(316 279)	-
Sales	(6 615 676)	-	(16 999)	(2 031 205)	-
Issues	5 721 409	-	-	256 054	-
As at the end of the period	**328 102**	**58 130**	**11 456**	**1 742 614**	**-**

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

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

31.12.2017	Including:	Level 1 Quoted prices in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
FINANCIAL LIABILITIES				
Derivative financial instruments, including:	**1 141 036**	**-**	**1 141 036**	**-**
Derivative financial instruments held for trading	**1 116 216**	**-**	**1 116 216**	**-**
- interest rate derivatives	692 377	-	692 377	-
- foreign exchange derivatives	389 746	-	389 746	-
- market risks derivatives	34 093	-	34 093	-
Derivative financial instruments held for hedging	**24 820**	**-**	**24 820**	**-**
- derivatives designated as fair value hedges	23 334	-	23 334	-
- derivatives designated as cash flow hedges	1 486	-	1 486	-
Total financial liabilities	**1 141 036**	**-**	**1 141 036**	**-**
TOTAL RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS	**33 891 911**	**28 456 451**	**3 432 978**	**2 002 482**
FINANCIAL LIABILITIES	**1 141 036**	**-**	**1 141 036**	**-**

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

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

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

With regard to financial instruments valuated in repetitive way to the fair value classified as level 1 and 2 in hierarchy of fair value, any cases in which transfer between these levels may occur, are monitored by Integrated Risk and Capital Management Department on the basis of internal rules. In case if there is no market price used to a direct valuation for more than 5 working days, the method of valuation is changed, i.e. change from marked-to-market valuation to marked-to-model valuation under the assumption that the valuation model for the respective type of this instrument has been already approved. The return to marked-to-market valuation method takes place after a period of at least 10 working days in which the market price was available on a continuous basis. If there is no market prices for a debt treasury bonds the above terms are respectively 2 and 5 working days.

Level 1

As at 31 December 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 748 294 thousand (see Note 19) and the fair value of government bonds at fair value through other comprehensive income, in the amount of PLN 20 121 684 thousand (see Note 21) (31 December 2017 respectively: PLN 1 232 515 thousand and PLN 26 283 963 thousand). Level 1 also includes the fair value of corporate bonds in the amount of PLN 1 230 590 thousand (31 December 2017 – PLN 938 243 thousand).

In addition, as at 31 December 2018 level 1 includes the value of the registered privileged shares of Giełda Papierów Wartościowych in the amount of PLN 770 thousand (31 December 2017: PLN 986 thousand). As at 31 December 2017 level 1 also includes the value of the shares of listed companies in the amount of PLN 744 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 includes the fair values of short term bills issued by NBP in the amount of PLN 499 912 thousand (31 December 2017: PLN 2 199 429 thousand), whose valuation is based on a NPV model (discounted future cash flows) fed with interest rate curves generated by transformation of quotations taken directly from active and liquid financial markets.

In addition, the level 2 category includes the valuation of derivative financial instruments borne on models consistent with market standards and practices, using parameters taken directly from the markets (e.g., foreign exchange rates, implied volatilities of fx options, stock prices and indices) or parameters which transform quotations taken directly from active and liquid financial markets (e.g., interest rate curves).

As at 31 December 2018 and 31 December 2017, level 2 also includes the value of options referencing on the WIG20 index. For the valuation of index options on WIG20 the Bank applied an internal model (based on a model for implied volatility) for which market data have been used as input parameters.

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Level 3

Level 3 of the hierarchy presents the fair values of commercial debt securities issued by local banks and companies (bonds, deposit certificates and mortgage bonds) in the amount of PLN 2 034 328 thousand (31 December 2017: PLN 1 911 086 thousand).

Level 3 includes also the fair value of local government bonds in the amount of PLN 35 910 thousand (31 December 2017 – PLN 35 910 thousand).

In addition, level 3 includes the fair value of a debt instrument measured at fair value through profit or loss, resulting from the reclassification of preferred stock in Visa Inc.

The above mentioned debt instruments are classified as level 3 because in addition to parameters which transform quotations taken directly from active and liquid financial markets (interest rate curves), their valuation uses credit spread estimated by the Bank by means of an internal credit risk model and reflects the credit risk of the issuer. The model uses parameters (e.g. PD, LGD) and information acquired from the market (including credit spreads implied from transactions). Credit risk parameters PD and LGD are not observed on active markets and hence were generated by statistical analysis. Impact of change in credit spreads on the fair value of debt securities classified as level 3 is presented in the table below. The amount reflects change in credit risk in relation to purchase date.

Issuer	Change of fair value resulting from change in credit risk	
	31.12.2018	31.12.2017
Credit institutions	(592)	(986)
Non-financial enterprises	(2 120)	(6 497)
Total	**(2 712)**	**(7 483)**

As at 31 December 2018, Level 3 includes the fair value of loans and advances to customers in the amount of PLN 7 075 284 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 covers mainly the fair value of equity securities amounting to PLN 11 456 thousand (31 December 2017: PLN 55 486 thousand). As at 31 December 2017, these amount includes the value of preferred stock in Visa Inc. in the amount of PLN 46 538 thousand. The other equity securities presented at level 3 have been valuated using the market multiples method. The market multiples method, consists of valuating the equity capital of a company by using a relation between the market values of the own equity capital or market values of the total capital invested in comparable companies (goodwill) and selected economic and financial figures.

4. Major estimates and judgments made in connection with the application of accounting policy principles

The Bank applies estimates and adopts assumptions which impact the values of assets and liabilities presented in the subsequent period. Estimates and assumptions, which are continuously subject to assessment, rely on historical experience and other factors, including expectations concerning future events, which seem justified under the given circumstances.

Impairment of loans and advances

The Bank reviews its loan portfolio in terms of possible impairments at least once per quarter. In order to determine whether any impairment loss should be 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 33.7 million or increase by PLN 42.7 million as at 31 December 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 3.4.6.

Fair value of derivatives and other financial instruments

The fair value of financial instruments not listed on active markets is determined by applying valuation techniques. All the models are approved prior to being applied and they are also calibrated in order to assure that the obtained results indeed reflect the actual data and comparable market prices. As far as possible, observable market data originating from an active market are used in the models. Methods for determining the fair value of financial instruments are described in Note 2.5.

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.

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5. Net interest income

	Year ended 31 December	
	2018	**2017**
Interest income		
Interest income of financial assets at amortised cost, including:	**2 755 453**	**2 625 413**
- Loans and advances	*2 490 597*	*2 562 453*
- Debt securities	*203 363*	*n/a*
- Cash and short-term placements	*54 307*	*57 616*
- Other	*7 186*	*5 344*
Interest income on financial assets at fair value through other comprehensive income	**602 191**	**678 120**
- Debt securities	*479 083*	*n/a*
- Loans and advances	*123 108*	*n/a*
Investment securities	*n/a*	678 120
Income similar to interest on financial assets at fair value through profit or loss, including:	**603 962**	**247 435**
Financial assets held for trading	74 379	63 651
- Loans and advances	1 324	*n/a*
- Debt securities	73 055	63 651
Non-trading financial assets mandatorily at fair value through profit or loss, including:	262 784	*n/a*
- Loans and advances	262 784	*n/a*
Interest income on derivatives classified into banking book	168 538	118 273
Interest income on derivatives concluded under the fair value hedge	57 904	49 731
Interest income on derivatives concluded under the cash flow hedge	40 357	15 780
Total interest income	**3 961 606**	**3 550 968**

	Year ended 31 December	
	2018	**2017**
Interest expenses		
Financial liabilities measured at amortised cost, including:	(859 901)	(784 765)
- Deposits	*(582 776)*	*(494 795)*
- Loans received	*(28 949)*	*(55 085)*
- Issue of debt securities	*(10 198)*	*-*
- Subordinated liabilities	*(75 300)*	*(69 017)*
- Other financial liabilities	*(162 678)*	*(165 868)*
Other	(14 196)	(7 718)
Total interest expense	**(874 097)**	**(792 483)**

In 2018, interest income related to impaired financial assets amounted to PLN 98 710 thousand (for the period ended 31 December 2017: PLN 95 162 thousand).

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Net interest income per client groups is as follows.

	Year ended 31 December	
	2018	2017
Interest income		
From banking sector	477 369	389 643
From other customers, including:	3 484 237	3 161 325
- individual clients	1 785 282	1 546 461
- corporate clients	1 064 754	941 413
- public sector	634 201	673 451
Total interest income	**3 961 606**	**3 550 968**
Interest expenses		
From banking sector	(62 400)	(71 636)
From other customers, including:	(726 199)	(651 830)
- individual clients	(402 679)	(333 963)
- corporate clients	(284 254)	(292 728)
- public sector	(39 266)	(25 139)
From debt securities in issue and from subordinated liabilities	**(10 198)**	**-**
Subordinated liabilities	**(75 300)**	**(69 017)**
Total interest expense	**(874 097)**	**(792 483)**

6. Net fee and commission income

	Year ended 31 December	
	2018	2017
Fee and commission income		
Payment cards-related fees	389 951	372 887
Credit-related fees and commissions	313 575	271 449
Commissions for agency service regarding sale of insurance products of external financial entities	17 102	16 288
Fees from brokerage activity and debt securities issue	105 463	142 110
Commissions from bank accounts	207 941	186 677
Commissions from money transfers	132 895	119 562
Commissions due to guarantees granted and trade finance commissions	77 779	65 807
Commissions for agency service regarding sale of other products of external financial entities	86 054	103 912
Commissions on trust and fiduciary activities	26 478	26 344
Fees from portfolio management services and other management-related fees	11 594	14 794
Fees from cash services	54 788	53 258
Other	43 385	31 983
Fee and commission income	**1 467 005**	**1 405 071**

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	Year ended 31 December	
	2018	**2017**
Fee and commission expense		
Payment cards-related fees	(213 566)	(244 656)
Commissions paid to external entities for sale of the Bank's products	(130 569)	(119 996)
Discharged brokerage fees	(26 772)	(28 626)
Cash services	(50 060)	(47 537)
Fees to NBP and KIR	(13 456)	(13 057)
Other discharged fees	(141 380)	(134 283)
Total fee and commision expense	**(575 803)**	**(588 155)**

In 2018, in connection with the implementation of IFRS 15, the Bank netted part of its revenues and expenses due to fees and commissions from card organizations required by the new regulations. The change in the presentation did not affect the net result on fees and commissions.

7. Dividend income

	Year ended 31 December	
	2018	**2017**
Financial assets held for trading	4	11
Available for sale securities	*n/a*	3 417
Financial assets at fair value through profit or loss	3 554	*n/a*
Investments in subsidiaries, joint ventures and associates accounted for using equity method	122 833	*162 857*
Total dividend income	**126 391**	**166 285**

8. Net trading income

	Year ended 31 December	
	2018	**2017**
Foreign exchange result	**303 985**	**290 535**
Net exchange differences on translation	366 255	292 979
Net transaction gains/(losses)	(62 270)	(2 444)
Gains or losses on financial assets and liabilities held for trading	**52 721**	**23 768**
Derivatives, including:	49 749	23 181
- Interest-bearing instruments	*40 782*	*17 016*
- Market risk instruments	*8 967*	*6 165*
Equity instruments	(754)	(130)
Debt securities	3 589	717
Loans and advances	137	-
Gains or losses from hedge accounting	**(4 389)**	**(10 920)**
Net profit on hedged items	(42 627)	60 519
Net profit on fair value hedging instruments	34 846	(64 900)
Ineffective portion of cash flow hedge	3 392	(6 539)
Net trading income	**352 317**	**303 383**

The foreign exchange result includes profit/(loss) on spot and forward contracts, options, futures and recalculated assets and liabilities denominated in foreign currencies. The result on derivative transactions of interest-bearing instruments includes the result of swap contracts for interest rates, options and other derivatives. The result of the market risk instruments operations include profit/(loss) on: bond futures, index futures, security options, stock exchange index options, and options on futures contracts as well as the result from securities forward transactions and commodity swaps. The result on capital instruments operations includes the valuation and result on trading in equity securities held for trading.

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The Bank applies fair value hedge accounting and cash flow hedge accounting. Detailed information on hedge accounting are included in Note 19 "Financial assets held for trading and derivatives held for hedges".

9. Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss

	Year ended 31 December	
	2018	**2017**
Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss		
Equity instruments	(217)	*n/a*
Debt securities	7 028	*n/a*
Loans and advances	(162 296)	*n/a*
Total gains or losses on non-trading financial assets mandatorily at fair value through profit or loss	**(155 485)**	***n/a***

10. Gains less losses from financial assets and liabilities not measured at fair value through profit or loss and investments in subsidiaries and associates

	Year ended 31.12.2018
Gains less losses related to sale of debt securities measured at fair value through other comprehensive income	16 149
Gains less losses related to sale of investments in subsidiaries and associates	290
Gains less losses from derecognition, including:	(3 043)
- Financial assets at fair value through other comprehensive income	(551)
- Financial assets at amortised cost	(2 492)
Gains less losses from financial assets and liabilities not measured at fair value through profit or loss and investments in subsidiaries and associates	**13 396**

Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss by instrument

	Year ended 31 December 2018	
	Gains	**Losses**
Loans and advances	7 266	(10 309)
Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss	**7 266**	**(10 309)**

The result from the derecognition includes the result from the sale of retail mortgage loans that were transferred from mBank to mBank Hipoteczny in pooling transactions.

Gains and losses from investment securities, investments in subsidiaries and associates.

	Year ended 31.12.2017
Sale/redemption of financial assets available for sale	22 170
Gains less losses related to sale of subsidiaries and associates	(1 677)
Impairment of investment equity securities	(4 751)
Impairment of available for sale debt securities	(7 511)
Total gains less losses from investment securities, investments in subsidiaries and associates	**8 231**

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

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

11. Other operating income

	Year ended 31 December	
	2018	2017
Income from sale or liquidation of fixed assets, intangible assets, assets held for sale and inventories	754	944
Income from services provided	12 356	15 154
Income due to release of provisions for future commitments	4 396	60 920
Income from recovering receivables designated previously as prescribed, remitted or uncollectible	97	842
Income from compensations, penalties and fines received	268	455
Other	41 246	35 623
Total other operating income	**59 117**	**113 938**

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

12. Overhead costs

	Year ended 31 December	
	2018	2017
Staff-related expenses	(836 292)	(764 480)
Material costs, including:	(658 229)	(624 920)
- costs of administration and real estate services	(319 500)	(315 179)
- IT costs	(143 537)	(133 446)
- marketing costs	(129 782)	(105 804)
- consulting costs	(57 465)	(55 878)
- other material costs	(7 945)	(14 613)
Taxes and fees	(22 934)	(18 814)
Contributions and transfers to the Bank Guarantee Fund	(175 160)	(174 924)
Contributions to the Social Benefits Fund	(6 855)	(6 440)
Total overhead costs	**(1 699 470)**	**(1 589 578)**

The item "Material costs" consist of tangible assets operating lease payment costs (mainly real estate) of PLN 27 997 thousand (2017: PLN 28 566 thousand).

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Staff-related expenses in 2018 and 2017 are presented below.

	Year ended 31 December	
	2018	**2017**
Wages and salaries	(681 804)	(625 772)
Social security expenses	(111 178)	(100 259)
Employee contributions related to post-employment benefits	-	(623)
Remuneration concerning share-based payments, including:	(10 224)	(8 700)
- share-based payments settled in mBank S.A. shares	(10 224)	(8 700)
Other staff expenses	(33 086)	(29 126)
Staff-related expenses, total	**(836 292)**	**(764 480)**

Detailed information regarding incentive programmes to which share-based payments relate, is included under the Note 41 "Share-based incentive programmes".

13. Other operating expenses

	Year ended 31 December	
	2018	**2017**
Costs arising from sale or liquidation of fixed assets, intangible assets, assets held for resale and inventories	(1 456)	(695)
Provisions for future commitments	(57 803)	(50 083)
Costs arising from provisions created for other receivables (excluding loans and advances)	(1 249)	(1 201)
Donations made	(14 523)	(2 625)
Compensation, penalties and fines paid	(2 144)	(2 478)
Impairment provisions created for tangible fixed assets and intangible assets	-	(8 200)
Other operating costs	(76 928)	(41 837)
Total other operating expenses	**(154 103)**	**(107 119)**

In 2018, provisions for future commitments include provisions for legal proceedings of PLN 23 499 thousand (2017: PLN 32 997 thousand) (Note 30).

Other operating costs include debt collection expenses in the amount of PLN 36 941 thousand (31 December 2017: PLN 21 861 thousand).

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14. Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss

	Year ended 31 December	
	2018	**2017**
Financial assets at amortised cost, including:	**(475 028)**	**(423 791)**
- Debt securities	(52)	*n/a*
Stage 1	*(52)*	*n/a*
- Loans and advances	(474 976)	(423 791)
Stage 1	*(55 582)*	*n/a*
Stage 2	*(40 004)*	*n/a*
Stage 3	*(388 071)*	*n/a*
POCI	*8 681*	*n/a*
Financial assets at fair value through other comprehensive income	**(3 004)**	***n/a***
- Debt securities	95	*n/a*
Stage 1	*408*	*n/a*
Stage 2	*(313)*	*n/a*
- Loans and advances	(3 099)	*n/a*
Stage 1	*(898)*	*n/a*
Stage 2	*(2 065)*	*n/a*
Stage 3	*(136)*	*n/a*
Commitments and guarantees given	**9 130**	**(34 098)**
Stage 1	*(1 212)*	*n/a*
Stage 2	*(4 270)*	*n/a*
Stage 3	*14 379*	*n/a*
POCI	*233*	*n/a*
Net impairment losses on financial assets not measured at fair value through profit or loss	**(468 902)**	**(457 889)**

15. Income tax expense

	Year ended 31 December	
	2018	**2017**
Current tax	(517 615)	(402 911)
Deferred income tax	128 125	22 391
Total income tax	**(389 490)**	**(380 520)**
Profit before tax	**1 706 975**	**1 470 224**
Tax calculated at Polish current tax rate (19%)	(324 325)	(279 343)
Income not subject to tax *)	73 365	46 056
Costs other than tax deductible costs **)	(138 530)	(147 233)
Total tax liability	**(389 490)**	**(380 520)**
Effective tax rate calculation		
Profit (loss) before income tax	1 706 975	1 470 224
Income tax	(389 490)	(380 520)
Effective tax rate	**22.82%**	**25.88%**

*) Includes i.a. dividends excluded from taxation under Article 20 item 3 of Corporate Income Tax Act from 15 February 1992 (Journal of Laws No 21, item 86).

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**) Includes i.a. impact of certain financial institutions tax introduced by the Act on Tax on Certain Financial Institutions from 15 January 2016 (Journal of Laws 2016, item 68) and non-deductible costs according to Article 16 item 1 of Corporate Income Tax Act from 15 February 1992 (Journal of Laws No 21, item 86).

Information about deferred income tax is presented in Note 31. The tax on the Bank's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the parent as presented above.

16. Earnings per share

Earnings per share for 12 months

	Year ended 31 December	
	2018	2017
Basic:		
Net profit	1 317 485	1 089 704
Weighted average number of ordinary shares	42 318 253	42 290 313
Net basic profit per share (in PLN per share)	**31.13**	**25.77**
Diluted:		
Net profit, applied for calculation of diluted earnings per share	1 317 485	1 089 704
Weighted average number of ordinary shares	42 318 253	42 290 313
Adjustments for:		
- share options	25 522	23 070
Weighted average number of ordinary shares for calculation of diluted earnings per share	42 343 775	42 313 383
Diluted earnings per share (in PLN per share)	**31.11**	**25.75**

According to IAS 33, the Bank prepares a calculation of the diluted earnings per share taking into account contingently issuable shares as part of the incentive programmes is described in the Note 41. The calculations did not include those elements of the incentive programmes, which were antidilutive for the presented reporting periods that could potentially dilute basic earnings per share in the future.

The basic earnings per share are computed as the quotient of the Bank stockholders' share of the profit and the weighted average number of ordinary shares during the year.

The diluted earnings per share are calculated by as ratio of net profits attributable to Bank's shareholder and the weighted average number of ordinary shares as if all possible ordinary shares causing the dilution were replaced with shares. The Bank has one category of potential ordinary shares causing the dilution: share options. The number of diluting shares is computed as the number of shares that would be issued if all share options were executed at the market price, determined as the average annual closing price of the Bank's shares.

17. Other comprehensive income

Disclosure of tax effects relating to each component of other comprehensive income	Year ended 31 December 2018			Year ended 31 December 2017		
	Before-tax amount	Tax (expense) benefit	Net amount	Before-tax amount	Tax (expense) benefit	Net amount
Items that may be reclassified subsequently to the the income statement	**102 145**	**(29 042)**	**73 103**	**219 597**	**(51 282)**	**168 315**
Exchange differences on translation of foreign operations	176	-	176	617	-	617
Cash flow hedges	109 681	(20 840)	88 841	(4 511)	858	(3 653)
Change in valuation of available for sale financial assets	*n/a*	*n/a*	*n/a*	218 984	(52 140)	166 844
Debt instruments at fair value through other comprehensive income	(7 062)	(8 202)	(15 264)	*n/a*	*n/a*	*n/a*
Share of other comprehensive income of entities under the equity method	(650)	-	(650)	4 507	-	4 507
Items that will not be reclassified to the income statement	**(3 097)**	**589**	**(2 508)**	**(3 812)**	**724**	**(3 088)**
Actuarial gains and losses relating to post-employment benefits	(3 097)	589	(2 508)	(3 812)	724	(3 088)
Total comprehensive income (net)	**99 048**	**(28 453)**	**70 595**	**215 785**	**(50 558)**	**165 227**

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The table below presents detailed information concerning other comprehensive income for the years 2018 and 2017.

	Year ended 31 December	
	2018	**2017**
Items that may be reclassified subsequently to the the income statement, including:	**73 103**	**168 315**
Exchange differences on translating foreign operations	**176**	**617**
Unrealised gains or losses on echange differences on translation of foreign operations included in other comprehensive income	176	617
Unrealised gains (positive differences) arising during the year (net)	117	1 361
Unrealised losses (negative differences) arising during the year (net)	59	(744)
Cash flows hedges (effective part)	**88 841**	**(3 653)**
Unrealised gain or losses included in other comprehensive inocme	88 841	(3 653)
Unrealized gains arising during the year (net)	81 311	1 468
Unrealized losses arising during the year (net)	7 530	(5 121)
Available-for-sale financial assets	***n/a***	**166 844**
Unrealised gains on debt instruments arising during the year (net)	*n/a*	219 276
Unrealised losses on debt instruments arising during the year (net)	*n/a*	(46 717)
Reclassification adjustments of gains (losses) on debt instruments to the income statement (net)	*n/a*	(17 537)
Unrealised gains on equity instruments arising during the year (net)	*n/a*	12 287
Unrealised losses on equity instruments arising during the year (net)	*n/a*	(44)
Reclassification adjustments of gains (losses) on equity instruments to the income statement (net)	*n/a*	(421)
Valuation of debt instruments at fair value through other comprehensive income (net)	**(15 264)**	***n/a***
Unrealized gains or losses on valuation of debt instruments included in other comprehensive income	(2 183)	*n/a*
Unrealised gains on debt instruments arising during the year (net)	62 488	*n/a*
Unrealised losses on debt instruments arising during the year (net)	(64 671)	*n/a*
Reclassification adjustments of gains (losses) on debt instruments to the income statement (net)	(13 081)	*n/a*
Share of other comprehensive income of entities under the equity method	**(650)**	**4 507**
Share of other comprehensive income of associates arising during the year (net)	(650)	4 507
Items that will not be reclassified to profit or loss	**(2 508)**	**(3 088)**
Actuarial gains and losses relating to post-employment benefits	(2 508)	(3 088)
Actuarial losses	*(2 508)*	*(3 088)*
Total comprehensive income (net)	**70 595**	**165 227**

In 2018 unrealized gains on debt instruments arising during the year in the amount of PLN 83 311 thousand relate mainly to positive valuation of debt securities of the banking book, caused by a decrease in interest rates in the last quarter of 2018, resulting from interest rate drops in global markets.

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

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18. Cash and balances with central bank

	31.12.2018	31.12.2017
Cash on hand	1 724 452	1 286 132
Cash balances at central banks	7 458 519	6 097 386
Total cash and cash balances with central banks	**9 182 971**	**7 383 518**

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

- PLN 3 129 048 thousand for the period from 31 December 2018 to 30 January 2019,
- PLN 2 736 636 thousand for the period from 30 November 2017 to 1 January 2018.

As at 31 December 2018, the mandatory reserve in Central Bank bore 0.50% interest (31 December 2017: 1.35%).

19. Financial assets and liabilities held for trading and derivatives held for hedges

Financial assets held for trading and derivatives held for hedges

	31.12.2018	31.12.2017
Derivatives	**1 006 550**	**1 233 549**
- Derivatives held for trading classified into banking book	82 358	120 353
- Derivatives held for trading classified into trading book	948 636	1 100 607
- Derivatives designated as fair value hedges	112 816	93 149
- Derivatives designated as cash flow hedges	196 668	30 312
- Offsetting effect	(333 928)	(110 872)
Equity instruments	**-**	**744**
- Non-financial corporations	-	744
Debt securities	**1 076 396**	**1 547 058**
- General governments	748 294	1 232 515
pledged securities	*538 345*	*25 837*
- Credit institutions	187 644	135 846
- Other financial corporations	72 626	80 260
- Non-financial corporations	67 832	98 437
Loans and advances to customers	**43 166**	***n/a***
- Corporate customers	43 166	*n/a*
Total financial assets held for trading and derivatives held for hedging	**2 126 112**	**2 781 351**

Trading securities include securities used to secure sell-buy-back transactions with customers, the market value of which as at 31 December 2018 amounted to PLN 680 310 thousand (31 December 2017: PLN 25 837 thousand).

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Financial liabilities held for trading and derivatives held for hedges

	31.12.2018	31.12.2017
Derivatives	1 016 214	1 141 035
- Derivatives held for trading classified into banking book	110 083	112 155
- Derivatives held for trading classified into trading book	995 156	1 107 929
- Derivatives designated as fair value hedges	5 766	25 193
- Derivatives designated as cash flow hedges	-	2 103
- Offsetting effect	(94 791)	(106 345)
Financial liabilities held for trading and derivatives held for hedging	**1 016 214**	**1 141 035**

Derivative financial instruments

The Bank has the following types of derivative instruments:

Forward currency transactions represent commitments to purchase foreign and local currencies, including outstanding spot transactions. **Futures for currencies and interest rates** are contractual commitments to receive or pay a specific net value, depending on currency rate of exchange or interest rate variations, or to buy or sell a foreign currency or a financial instrument on a specified future date for a fixed price established on the organised financial market. Because futures contracts are collateralised with fair-valued cash or securities and the changes of the face value of such contracts are accounted for daily in reference to stock exchange quotations, the credit risk is marginal. **FRA contracts** are similar to futures except that each FRA is negotiated individually and each requires payment on a specific future date of the difference between the interest rate set in the agreement and the current market rate on the basis of theoretical amount of capital.

Currency and interest rate swap contracts are commitments to exchange one cash flow for another cash flow. Such a transaction results in swap of currencies or interest rates (e.g., fixed to variable interest rate) or combination of all these factors (e.g., cross-currency CIRS). With the exception of specific currency swap contracts, such transactions do not result in swaps of capital. The credit risk of the Group consists of the potential cost of replacing swap contracts if the parties fail to discharge their liabilities. This risk is monitored daily by reference to the current fair value, proportion of the face value of the contracts and market liquidity. The Group evaluates the parties to such contracts using the same methods as for its credit business, to control the level of its credit exposure.

The Bank applies fair value hedge accounting for fixed interest rate security deposit given by the Bank's subsidiary entity, fixed interest rate loans received by the Bank from EIB and fixed interest rate bonds issued by the Bank directly. Moreover, the Bank applies cash flow hedge accounting of part of the credit portfolio of variable rate loans indexed to market rates, granted by the Bank. Hedging instrument in both types of hedge accounting are fix to float Interest Rate Swap.

Detailed information on hedge accounting are presented in these Note below.

Currency and interest rate options are agreements, pursuant to which the selling party grants the buying party the right, but not an obligation, to purchase (call option) or sell (put option) a specific quantity of a foreign currency or a financial instrument at a predefined price on or by a specific date or within an agreed period. In return for accepting currency or interest rate risk, the buyer offers the seller a premium. An option can be either a public instrument traded at a stock exchange or a private instrument negotiated between the Group and a customer (private transaction). The Group is exposed to credit risk related to purchased options only up to the balance sheet value of such options, i.e. the fair value of the options.

Market risk transactions include futures contracts as well as commodity options, stock options and index options.

Face values of certain types of financial instruments provide a basis for comparing them to instruments disclosed in the statement of financial position but they may not be indicative of the value of the future cash flows or of the present fair value of such instruments. For this reason, the face values do not indicate the level of the Group's exposure to credit risk or price change risk. Derivative instruments can have positive value (assets) or negative value (liabilities), depending on market interest or currency exchange rate fluctuations. The aggregate fair value of derivative financial instruments may be subject to strong variations.

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The fair values of derivatives held by the Bank is presented in the table below.

As at 31 December 2018	Contract amount		Fair value	
	Purchase	Disposal	Assets	Liabilities
Derivatives held for trading				
- Currency forwards	16 599 306	16 716 930	48 948	83 543
- Currency swaps	13 181 808	13 229 322	42 828	39 092
- Cross-currency interest rate swaps	14 303 665	14 385 388	19 317	76 435
- OTC currency options bought and sold	2 682 292	2 653 710	28 815	36 688
Total OTC derivatives	**46 767 071**	**46 985 350**	**139 908**	**235 758**
- Currency futures	214 746	214 838	-	-
Total foreign exchange derivatives	**46 981 817**	**47 200 188**	**139 908**	**235 758**
Interest rate derivatives				
- Interest rate swap, OIS	180 890 058	180 890 058	728 302	698 115
- Forward rate agreements	3 950 000	4 160 000	94	62
- OTC interest rate options	442 582	627 381	430	602
Total OTC interest rate derivatives	**185 282 640**	**185 677 439**	**728 826**	**698 779**
Total interest rate derivatives	**185 282 640**	**185 677 439**	**728 826**	**698 779**
Market risk transactions	1 616 088	2 669 503	162 260	170 702
Total derivative assets / liabilities held for trading	**233 880 545**	**235 547 130**	**1 030 994**	**1 105 239**
Derivatives held for hedging				
Derivatives designated as fair value hedges	11 582 046	11 582 046	112 816	5 766
- Interest rate swaps	11 582 046	11 582 046	112 816	5 766
Derivatives designated as cash flow hedges	11 530 000	11 530 000	196 668	-
- Interest rate swaps	11 530 000	11 530 000	196 668	-
Total derivatives held for hedging	**23 112 046**	**23 112 046**	**309 484**	**5 766**
Offsetting effect	**-**	**-**	**(333 928)**	**(94 791)**
Total recognised derivative assets/ liabilities	**256 992 591**	**258 659 176**	**1 006 550**	**1 016 214**
Short-term (up to 1 year)	80 137 736	81 159 173	87 251	318 191
Long-term (over 1 year)	176 854 855	177 500 003	919 299	698 023

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

Except of valuation of derivatives, the offsetting effect includes PLN 7 210 thousand of placed collaterals and PLN 246 348 thousand of collaterals received in connection with the derivative transactions subject to compensation (31 December 2017: PLN 30 024 thousand and PLN 34 551 thousand respectively).

In the both reporting periods, market risk transactions comprise the fair values of: stock index options, shares and other equity securities, futures for commodities, swap contracts for commodities.

As at 31 December 2018 and 31 December 2017, the Bank did not hold any financial assets and financial liabilities designated upon initial recognition as at fair value through the income statement.

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Credit quality of financial assets held for trading and derivatives according to internal rating system

Sub-portfolio	31.12.2018		31.12.2017	
	Derivatives	Loans and advances to customers	Derivatives	Loans and advances to customers
1	688 869	-	392 057	n/a
2	313 999	-	655 967	n/a
3	256 684	43 166	156 945	n/a
4	60 931	-	88 046	n/a
5	10 158	-	14 249	n/a
6	-	-	87	n/a
7	-	-	7 857	n/a
8	9 556	-	26 878	n/a
other	-	-	-	n/a
default	281	-	2 335	n/a
Offsetting effect	(333 928)	-	(110 872)	n/a
Total	1 006 550	43 166	1 233 549	n/a

Rating	31.12.2018	31.12.2017
	Debt securities	Debt securities
AAA	748 294	2 717
AA- to AA+	21 339	5 000
A- to A+	83 232	1 270 346
BBB+ to BBB-	176 169	200 897
BB+ to BB-	47 362	61 712
B+ to B-	-	5 908
Unrated	-	478
Total	**1 076 396**	**1 547 058**

Hedge accounting

In accordance with the IFRS9 provisions, only on the day of initial application the Bank had the opportunity to choose as its accounting policy element to continue to apply the IAS 39 hedge accounting requirements instead of the IFRS 9 requirements.

IFRS 9 requires the Bank to ensure that its hedging relationships are compliant with the risk management strategy applied by the Bank and its objectives. IFRS 9 introduces new requirements with regard to the assessment of hedge effectiveness, rebalancing of the hedge relationship as well as it prohibits voluntary discontinuation of hedge accounting (i.e. in the absence of the conditions to stop the application of hedge accounting, as defined in the standard).

The Bank decided to continue from 1 January 2018, to apply the hedge accounting requirements in accordance with IAS 39.

The Bank determines the hedge ratio based on the nominal value of the hedged item and hedging instrument and it is 1:1.

The sources of hedge ineffectiveness for hedging relationships for which the ineffectiveness arises include mismatch of cash flow dates and repricing periods, base mismatch (e.g. another WIBOR), CVA/DVA mismatch which is in hedging instrument and is not in hedged instrument and mismatch due to initial valuation of hedging instruments if a previously acquired derivative was included in hedging relationship.

Fair value hedge accounting

The Bank has been applying fair value hedge accounting. The interest rate risk is the only type of risk hedged for which hedge accounting is applied. Result from the valuation of hedged items and hedging instruments is presented in the line "Gains or losses from hedge accounting" in the Note 8.

At the end of each month, the Bank evaluates effectiveness of the applied hedging by carrying out analysis of changes in fair value of the hedged and hedging instruments in respect of the hedged risk in order to confirm that hedging relationships are effective in accordance with the accounting policy described in Note 2.11.

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Description of the hedging relation

The Bank hedges against the risk of change in fair value:

- fixed interest rate security deposit submitted by the mFinance France (mFF), a subsidiary of mBank, with funds arising from the issuance of Eurobonds. The hedged risk results from changes in interest rates,
- loans received by mBank from European Investment Bank. The hedged risk results from changes in interest rates,
- fixed rate bonds issued by mBank S.A. The hedged risk results from changes in interest rates.

Hedged items

The hedged items are:

- fixed interest rate security deposits given by mFF in the amount of EUR 1 490 460 thousand,
- fixed interest rate security deposit given by mFF in the amount of CHF 199 275 thousand,
- fixed interest rate loans received by mBank from European Investment Bank with a nominal value of EUR 500 000 thousand, CHF 113 110 thousand and CHF 175 560 thousand,
- fixed rate bonds issued by mBank S.A. with a nominal value of CHF 180 000 thousand,
- fixed rate bonds issued by mBank S.A. with a nominal value of EUR 500 000 thousand.

Hedging instruments

IRS is the hedging instrument swapping the fixed interest rate for a variable interest rate.

Nominal values of hedging derivatives - fair value hedging

31.12.2018	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
			Interest rate swaps (IRS)			
Nominal value	-	-	2 150 000	7 900 308	1 531 738	**11 582 046**

Presentation of the result from hedged and hedging transactions

Fair value adjustment of the hedged assets and liabilities as well as valuation of the hedging instruments is recognized in the income statement as the income from trading operation.

The total results of fair value hedge accounting recognised in the income statement

	Year ended 31 December	
	2018	2017
Interest income on derivatives concluded under the fair value hedge accounting (Note 5)	57 904	49 731
Net profit on hedged items (Note 8)	(42 627)	60 519
Net profit on fair value hedging instruments (Note 8)	34 846	(64 900)
The total results of fair value hedge accounting recognised in the income statement	**50 123**	**45 350**

Cash flow hedge accounting

The Bank applies cash flow hedge accounting of the part of loans at a variable interest rate indexed to the market rate portfolio, granted by the Bank. An Interest Rate Swap is the hedging instrument changing the variable interest rate to a fixed interest rate. The interest rate risk is the hedged risk within applied by the Bank cash flow hedge accounting. The ineffective portion of the gains or losses on the hedging instrument is presented in Note 8 in the position "Other net trading income and result on hedge accounting". Portion of the gains or losses on the hedging instrument that is an effective hedge, is presented in the statement of comprehensive income as "Cash flow hedges (net)".

Nominal values of hedging derivatives - cash flow hedges

31.12.2018	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
			INTEREST RATE RISK			
Interest rate swaps (IRS) hedging cash flows arising from granted loans with a variable interest rate denominated in PLN						
Nominal value	150 000	750 000	300 000	10 330 000	-	**11 530 000**
The average rate of fixed leg	1,965%	1,822%	2,013%	2,189%	-	-

The period from January 2019 to October 2023 is the period in which the cash flows are expected, and when they are expected to have an impact on the results.

The following note presents other comprehensive income due to cash flow hedges as at 31 December 2018 and 31 December 2017.

	Year ended 31 December	
	2018	2017
Other gross comprehensive income from cash flow hedge at the beginning of the period	**(6 418)**	**(1 907)**
- Unrealised gains/losses included in other gross comprehensive income during the reporting period	109 681	(4 511)
Accumulated other gross comprehensive income at the end of the reporting period	**103 263**	**(6 418)**
Deferred income tax on accumulated other comprehensive income at the end of the reporting period	(19 620)	1 220
Accumulated other net comprehensive income at the end of the reporting period	**83 643**	**(5 198)**
Impact on other comprehensive income in the reporting period (gross)	109 681	(4 511)
Deferred tax on cash flow hedges	(20 840)	858
Impact on other comprehensive income in the reporting period (net)	**88 841**	**(3 653)**

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

	Year ended 31 December	
	2018	2017
Gains/losses recognised in comprehensive income (gross) during the reporting period, including:		
- Unrealised gains/losses included in other comprehensive income (gross)	109 681	(4 511)
- Amount included as interest income in income statement during the reporting period	40 357	15 780
- Ineffective portion of hedge recognised included in other net trading income in income statement	3 392	(6 539)
Impact on other comprehensive income in the reporting period (gross)	**153 430**	**4 730**

	Year ended 31 December	
	2018	2017
Interest income on derivatives concluded under the cash flow hedge (Note 5)	40 357	15 780
Ineffective portion of cash flow hedge (Note 8)	3 392	(6 539)
The total results of cash flow hedge accounting recognised in the income statement	**43 749**	**9 241**

Below is given the timetable prepared as at 31 December 2018, presenting the periods in which the cash flows from loans secured under the cash flow hedge accounting are expected and their impact on the profit and loss account.

Cash flows from loans secured under the cash flow hedge accounting (PLN 000's)		
up to 3 months	**period from 3 months to 1 year**	**period from 1 year to 5 years**
47 130	136 956	401 142

Below is given the timetable prepared as at 31 December 2017, presenting the periods in which the cash flows from loans secured under the cash flow hedge accounting are expected and their impact on the profit and loss account.

Cash flows from loans secured under the cash flow hedge accounting (PLN 000's)		
up to 3 months	**period from 3 months to 1 year**	**period from 1 year to 5 years**
25 720	77 036	297 008

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20. Non-trading financial assets mandatorily at fair value through profit or loss

	31.12.2018	31.12.2017
Equity instruments	**12 226**	***n/a***
- Other financial corporations	12 226	*n/a*
Debt securities	**58 130**	***n/a***
- Other financial corporations	58 130	*n/a*
Loans and advances to customers	**2 496 974**	***n/a***
Individual customers	2 370 872	*n/a*
Corporate customers	113 199	*n/a*
Public sector customers	12 903	*n/a*
Total non-trading financial assets mandatorily at fair value through profit or loss	**2 567 330**	***n/a***
Short-term (up to 1 year) gross	1 656 437	*n/a*
Long-term (over 1 year) gross	910 893	*n/a*

Credit quality of non-trading financial assets mandatorily at fair value through profit or loss according to internal rating system

Subportfolio	31.12.2018
	Loans and advances to customers
1	16 707
2	515 725
3	490 355
4	766 109
5	323 173
6	43 171
7	175 617
default	166 117
Total	**2 496 974**

Rating	31.12.2018
	Debt securities
A- to A+	58 130
Total	**58 130**

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21. Financial assets at fair value through other comprehensive income

31.12.2018	Carrying amount	Gross carrying amount				Accumulated impairment			
		Stage 1	Stage 2	Stage 3	POCI	Stage 1	Stage 2	Stage 3	POCI
Debt securities	**23 594 800**	**23 577 614**	**21 721**	**-**	**-**	**(4 171)**	**(364)**	**-**	**-**
- Central banks	499 912	499 912	-	-	-	-	-	-	-
- General governments, including:	20 158 072	20 158 150	-	-	-	(78)	-	-	-
pledged assets	*2 206 004*	*2 206 004*	-	-	-	-	-	-	-
- Credit institutions, including:	838 036	839 688	-	-	-	(1 652)	-	-	-
pledged assets	*330 670*	*330 670*	-	-	-	-	-	-	-
- Other financial corporations	1 488 643	1 478 557	11 333	-	-	(1 059)	(188)	-	-
- Non-financial corporations	610 137	601 307	10 388	-	-	(1 382)	(176)	-	-
Loans and advances to customers	**4 578 310**	**4 207 506**	**374 900**	**625**	**118**	**(1 324)**	**(3 372)**	**(143)**	**-**
Individual customers	4 578 310	4 207 506	374 900	625	118	(1 324)	(3 372)	(143)	-
Total financial assets at fair value through other comprehensive income	**28 173 110**								

Short-term (up to 1 year) gross	6 448 927
Long-term (over 1 year) gross	21 733 557

As at 31 December 2018, the carrying amounts of debt securities with fixed interest rates amounted to PLN 12 587 229 thousand and debt securities with variable interest rates PLN 11 012 106 thousand.

The loans and advances shown in the note above are the value of mortgage contracts for individual customers which can be transferred from mBank to mBank Hipoteczny as part of pooling.

The above note includes government bonds pledged under the Bank Guarantee Fund (BFG), government bonds pledged as sell-buy-back transactions, government bonds pledged as collateral for the loans received from the European Investment Bank and government bonds pledged as collateral for deposit placed by the customer.

In accordance with the Act of 10 June 2016 on the Bank Guarantee Fund (BFG), Deposit Guarantee Scheme and Resolution, as at 31 December 2018 the Bank held government bonds and bills included in the statement of financial position in the amount of PLN 546 848 thousand with a nominal value of PLN 540 169 thousand, which were pledged as collateral for the BFG and were deposited in a separate account at the National Depository of Securities.

In addition the Bank held government bonds, which were securing the payment commitment to the BFG guarantee fund and forced restructuring fund in the amount of PLN 128 915 thousand.

Movements in expected credit losses allowance on financial assets at fair value through other comprehensive income

As at 31 December 2018	As at the beginning of the period	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	New financial assets originated or purchased	Financial assets derecognised during the period	Changes in credit risk	As at the end of the period
Debt securities	**(4 655)**	**-**	**-**	**-**	**(757)**	**1 838**	**(961)**	**(4 535)**
Stage 1	(4 655)	-	51	-	(757)	1 838	(648)	(4 171)
Stage 2	-	-	(51)	-	-	-	(313)	(364)
Loans and advances to customers	**(1 826)**	**-**	**-**	**-**	**(2 393)**	**(111)**	**(509)**	**(4 839)**
Stage 1	(510)	(1 956)	170	-	(742)	(19)	1 733	(1 324)
Stage 2	(1 316)	1 956	(170)	-	(1 571)	(92)	(2 179)	(3 372)
Stage 3	-	-	-	-	(80)	-	(63)	(143)
Expected credit losses allowance, total	**(6 481)**	**-**	**-**	**-**	**(3 150)**	**1 727**	**(1 470)**	**(9 374)**

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Explanation of changes in the financial instruments gross carrying amount impacting the changes on expected credit losses allowance

As at 31 December 2018	As at the beginning of the period	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	New financial assets originated or purchased	Financial assets derecognised during the period	Other movements	As at the end of the period
Debt securities	**22 492 701**	**-**	**-**	**-**	**9 079 466**	**(8 955 734)**	**982 902**	**23 599 335**
Stage 1	22 492 701	-	(21 472)	-	9 079 466	(8 955 734)	982 653	23 577 614
Stage 2	-	-	21 472	-	-	-	249	21 721
Loans and advances to customers	**2 126 291**	**-**	**-**	**-**	**2 285 423**	**(312 134)**	**483 569**	**4 583 149**
Stage 1	1 936 965	72 690	(103 018)	(315)	2 285 423	(310 937)	326 698	4 207 506
Stage 2	189 326	(72 690)	103 018	-	-	(1 197)	156 443	374 900
Stage 3	-	-	-	195	-	-	430	625
POCI	-	-	-	120	-	-	(2)	118
Financial assets at fair value through other comprehensive income, gross	**24 618 992**	**-**	**-**	**-**	**11 364 889**	**(9 267 868)**	**1 466 471**	**28 182 484**

Credit quality of financial assets at fair value through other comprehensive income according to internal rating system

As at 31 December 2018	Stage 1	Stage 2	Stage 3	POCI	Total
Debt securities at fair value through other comprehensive income					
AAA	21 593 567	-	-	-	21 593 567
AA- do AA+	476 056	-	-	-	476 056
A- do A+	397 603	-	-	-	397 603
BBB+ do BBB-	598 604	-	-	-	598 604
BB+ do BB-	431 396	21 721	-	-	453 117
B+ do B-	60 887	-	-	-	60 887
bez ratingu	19 501	-	-	-	19 501
Gross carrying amount	**23 577 614**	**21 721**	**-**	**-**	**23 599 335**
Accumulated impairment	(4 171)	(364)	-	-	(4 535)
Total carrying amount	**23 573 443**	**21 357**	**-**	**-**	**23 594 800**
Loans and advances to customers at fair value through other comprehensive income					
1	1 463 502	15 422	-	-	1 478 924
2	2 403 676	155 740	-	-	2 559 416
3	283 720	92 791	-	-	376 511
4	52 261	73 589	-	-	125 850
5	3 688	27 017	-	-	30 705
6	-	3 401	-	-	3 401
7	659	6 940	-	-	7 599
default	-	-	625	118	743
Gross carrying amount	**4 207 506**	**374 900**	**625**	**118**	**4 583 149**
Accumulated impairment	(1 324)	(3 372)	(143)	-	(4 839)
Total carrying amount	**4 206 182**	**371 528**	**482**	**118**	**4 578 310**

Financial effect of collaterals

	Gross amount	Accumulated impairment	Accumulated impairment without cash flow from collaterals	Financial effect of collaterals
Balance sheet data				
Loans and advances to customers	4 583 149	(4 839)	(8 325)	3 486
Individual customers	4 583 149	(4 839)	(8 325)	3 486
Total Balance sheet data	**4 583 149**	**(4 839)**	**(8 325)**	**3 486**

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The note below presents the carrying amount of investment securities in accordance with IAS 39 as at 31 December 2017.

Investment securities	31.12.2017
Equity securities	**56 472**
- Other financial corporations	56 472
Debt securities	**31 054 088**
- Central banks	2 199 429
- General governments, including:	26 319 873
pledged assets	*6 298 858*
- Credit institutions, including:	846 366
pledged assets	*200 368*
- Other financial corporations	1 103 781
- Non-financial corporations	584 639
Total investment securities	**31 110 560**

As at 31 December 2017, equity securities include fair value of preferred shares of Visa Inc. in the amount of PLN 46 538 thousand.

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

As at 31 December 2017, the carrying values of debt securities with fixed interest rates amounted to PLN 23 085 478 thousand and debt securities with variable interest rates PLN 7 968 610 thousand.

The above note includes government bonds pledged under the Bank Guarantee Fund (BFG), government bonds pledged as sell-buy-back transactions, government bonds pledged as collateral for the loans received from the European Investment Bank.

In accordance with the Act of 10 June 2016 on the Bank Guarantee Fund (BFG), Deposit Guarantee Scheme and Resolution, as at 31 December 2017 the Bank held government bonds and bills included in the statement of financial position in the amount of PLN 618 872 thousand with a nominal value of PLN 604 378 thousand, which were pledged as collateral for the BFG and were deposited in a separate account at the National Depository of Securities.

Movements in investment securities

	31.12.2017
Investment securities	
As at the beginning of the period	**30 467 780**
Exchange differences	(62 431)
Additions	101 188 239
Disposals (sale, redemption, forfeiture, reclassification)	(100 646 358)
Losses from impairment of investment equity securities	(4 751)
Gains / (losses) from changes in fair value	168 081
As at the end of the period	**31 110 560**

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Movements in provisions for losses on investment securities

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

Debt Instruments: treasury bonds and other eligible debt securities

31 December 2017	Investment debt securities
Rating	
AAA	3 134 954
AA- to AA+	11 522
A- to A+	26 171 029
BBB+ to BBB-	1 266 535
BB+ to BB-	301 725
B+ to B-	95 122
Unrated	73 201
Total	**31 054 088**

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22. Financial assets at amortised cost

	Carrying amount	Gross carrying amount				Accumulated impairment			
		Stage 1	Stage 2	Stage 3	POCI	Stage 1	Stage 2	Stage 3	POCI
Debt securities	**9 000 540**	**9 000 627**	**-**	**-**	**-**	**(87)**	**-**	**-**	**-**
- General governments, including:	7 742 000	7 742 000	-	-	-	-	-	-	-
pledged assets	*2 137 273*	*2 137 273*	-	-	-	-	-	-	-
- Other financial corporations	1 258 540	1 258 627	-	-	-	(87)	-	-	-
Loans and advances to banks	**5 909 341**	**5 910 859**	**-**	**-**	**-**	**(1 518)**	**-**	**-**	**-**
Loans and advances to customers	**76 201 963**	**69 249 777**	**6 064 485**	**3 367 114**	**195 544**	**(179 563)**	**(181 969)**	**(2 299 047)**	**(14 378)**
Individual customers	38 441 362	33 541 356	4 319 671	2 084 129	103 918	(108 059)	(160 334)	(1 336 953)	(2 366)
Corporate customers	37 235 689	35 182 972	1 744 814	1 282 982	91 626	(70 967)	(21 635)	(962 091)	(12 012)
Public sector customers	524 912	525 449	-	3	-	(537)	-	(3)	-
Total financial assets at amortised cost	**91 111 844**	**84 161 263**	**6 064 485**	**3 367 114**	**195 544**	**(181 168)**	**(181 969)**	**(2 299 047)**	**(14 378)**

Short-term (up to 1 year) gross	34 328 921
Long-term (over 1 year) gross	59 459 485

The above note includes government bonds pledged under the Bank Guarantee Fund, government bonds pledged as sell-buy-back transactions, government bonds pledged as collateral for the loans received from the European Investment Bank.

Loans and advances to banks

	31.12.2018
Current accounts	400 962
Placements with other banks (up to 3 months)	265 443
Included in cash equivalents (Note 40)	**666 405**
Loans and advances	3 375 420
Other receivables	1 869 034
Total (gross) loans and advances to banks	**5 910 859**
Provisions created for loans and advances to banks (negative amount)	**(1 518)**
Total (net) loans and advances to banks	**5 909 341**
Short-term (up to 1 year) gross	2 457 419
Long-term (over 1 year) gross	3 453 440

The item "Other receivables" includes cash collaterals in the amount of PLN 372 352 thousand, placed with other banks under the derivative transactions concluded by the Bank (Note 34).

The following table presents receivables from Polish and foreign banks:

31.12.2018	**Loans and advances to Polish banks**	**Loans and advances to foreign banks (gross)**
Gross carrying amount	3 761 278	2 149 581
Accumulated impairment	(102)	(1 416)
Loans and advances to banks, net	**3 761 176**	**2 148 165**

As at 31 December 2018, the variable rate loans to banks amounted to PLN 3 346 528 thousand and the fixed rate loans to banks amounted to PLN 28 892 thousand.

As at 31 December 2018 the term placements with other banks were fixed rated. An average interest rate for placements in other banks and loans granted to other banks amounted to 1.66%.

Loans and advances to customers

Loans and advances to customers 31.12.2018	Gross carrying amount	Individual customers	Corporate customers	Public sector customers
Current accounts	12 601 460	6 474 554	6 126 325	581
Term loans, including:	64 642 831	33 215 046	30 902 914	524 871
- housing and mortgage loans to individual customers	*23 868 510*	*23 868 510*	-	-
Reverse repo / buy-sell-back	1 146 263	-	1 146 263	-
Other loans and advances	111 961	-	111 961	-
Other receivables	374 405	359 473	14 932	-
Total gross carrying amount	**78 876 920**	**40 049 073**	**38 302 395**	**525 452**

Loans and advances to customers 31.12.2018	Accumulated impairment	Individual customers	Corporate customers	Public sector customers
Current accounts	(931 926)	(664 656)	(267 270)	-
Term loans, including:	(1 743 025)	(943 055)	(799 430)	(540)
- housing and mortgage loans to individual customers	*(430 839)*	*(430 839)*	-	-
Other loans and advances	(6)	-	(6)	-
Total accumulated impairment	**(2 674 957)**	**(1 607 711)**	**(1 066 706)**	**(540)**

Total gross carrying amount	**78 876 920**	**40 049 073**	**38 302 395**	**525 452**
Total accumulated impairment	(2 674 957)	(1 607 711)	(1 066 706)	(540)
Total carrying amount	**76 201 963**	**38 441 362**	**37 235 689**	**524 912**

Short-term (up to 1 year) gross	31 128 966
Long-term (over 1 year) gross	47 747 954

As at 31 December 2018, gross amount of variable interest rate loans amounted to PLN 77 978 592 thousand and fixed interest rate loans amounted to PLN 898 328 thousand. An average interest rate for loans granted to customers (excluding reverse repos) amounted to 3.42%.

In the item loans and advances granted to corporate clients were also included loans granted to microenterprises serviced by mBank S.A. Retail Banking.

In 2018, the above note includes receivables in the amount of PLN 174 563 thousand from the National Depository of Securities CCP in connection with the Brokerage Office activity.

In addition, the item "other" includes cash collaterals in the amount of PLN 15 844 thousand placed by the Bank under derivatives transactions (Note 34).

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

	31.12.2018
Housing and mortgage loans to individuals (in PLN 000's), including:	**23 868 510**
- PLN	2 868 609
- CHF	14 511 212
- EUR	3 178 564
- CZK	3 058 557
- USD	227 578
- Other currency	23 990
Housing and mortgage loans to individuals in original currencies (main currencies in 000's)	
- PLN	2 868 609
- CHF	3 802 131
- EUR	739 201
- CZK	18 281 871
- USD	60 531

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Credit quality of financial assets at amortised cost according to internal rating system

As at 31 December 2018	Stage 1	Stage 2	Stage 3	POCI	Total
Debt securities at amortised cost					
AAA	9 000 627	-	-	-	9 000 627
Total gross carrying amount	**9 000 627**	**-**	**-**	**-**	**9 000 627**
Total accumulated impairment	(87)	-	-	-	(87)
Total carrying amount	**9 000 540**	**-**	**-**	**-**	**9 000 540**
Loans and advances to banks at amortised cost					
1	4 259 619	-	-	-	4 259 619
2	325 879	-	-	-	325 879
3	5 231	-	-	-	5 231
4	59 152	-	-	-	59 152
5	3 697	-	-	-	3 697
8	1 257 281	-	-	-	1 257 281
Total gross carrying amount	**5 910 859**	**-**	**-**	**-**	**5 910 859**
Total accumulated impairment	(1 518)	-	-	-	(1 518)
Total carrying amount	**5 909 341**	**-**	**-**	**-**	**5 909 341**
Loans and advances to customers at amortised cost					
1	6 372 529	77 460	-	-	6 449 989
2	32 547 722	1 442 238	-	2 661	33 992 621
3	9 537 373	468 848	-	883	10 007 104
4	16 307 511	1 288 189	-	4 762	17 600 462
5	2 540 900	1 371 291	-	3 931	3 916 122
6	123 152	235 924	-	322	359 398
7	175 631	1 180 447	-	11 846	1 367 924
8	1 644 959	88	-	-	1 645 047
default	-	-	3 367 114	171 139	3 538 253
Total gross carrying amount	**69 249 777**	**6 064 485**	**3 367 114**	**195 544**	**78 876 920**
Total accumulated impairment	(179 563)	(181 969)	(2 299 047)	(14 378)	(2 674 957)
Total carrying amount	**69 070 214**	**5 882 516**	**1 068 067**	**181 166**	**76 201 963**

Movements in expected credit losses allowance

As at 31 December 2018	As at the beginning of the period	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	New financial assets originated or purchased	Financial assets derecognised during the period	Changes in credit risk	Write-offs	Other movements	As at the end of the period
Debt securities	**(35)**	**-**	**-**	**-**	**(23)**	**-**	**(29)**	**-**	**-**	**(87)**
Stage 1	(35)	-	-	-	(23)	-	(29)	-	-	(87)
Loans and advances to banks	**(1 536)**	**-**	**-**	**-**	**(606)**	**880**	**(494)**	**238**	**-**	**(1 518)**
Stage 1	(1 309)	-	-	-	(606)	880	(483)	-	-	(1 518)
Stage 3	(227)	-	-	-	-	-	(11)	238	-	-
Loans and advances to customers	**(2 741 721)**	**-**	**-**	**-**	**(133 992)**	**109 366**	**(549 371)**	**640 946**	**(185)**	**(2 674 957)**
Stage 1	(122 813)	(131 909)	37 831	3 198	(91 334)	34 554	91 029	-	(119)	(179 563)
Stage 2	(136 784)	120 617	(68 371)	58 770	(6 667)	7 001	(156 485)	-	(50)	(181 969)
Stage 3	(2 482 124)	11 292	30 540	(59 662)	(42 776)	66 875	(464 122)	640 946	(16)	(2 299 047)
POCI	-	-	-	(2 306)	6 785	936	(19 793)	-	-	(14 378)
Expected credit losses allowance, total	**(2 743 292)**	**-**	**-**	**-**	**(134 621)**	**110 246**	**(549 894)**	**641 184**	**(185)**	**(2 676 562)**

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Explanation of changes in the gross carrying amount impacting the changes on expected credit losses allowancee

As at 31 December 2018	As at the beginning of the period	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	New financial assets originated or purchased	Financial assets derecognised during the period	Write-offs	Other movements	As at the end of the period
Debt securities	**8 520 207**	**-**	**-**	**-**	**2 036 548**	**(1 480 189)**	**-**	**(75 939)**	**9 000 627**
Stage 1	8 520 207	-	-	-	2 036 548	(1 480 189)	-	(75 939)	9 000 627
Loans and advances to banks	**5 663 668**	**-**	**-**	**-**	**2 001 352**	**(1 809 123)**	**(238)**	**55 200**	**5 910 859**
Stage 1	5 663 441	-	-	-	2 001 352	(1 809 123)	-	55 189	5 910 859
Stage 3	227	-	-	-	-	-	(238)	11	-
Loans and advances to customers	**70 296 756**	**-**	**-**	**-**	**23 829 997**	**(12 560 172)**	**(640 946)**	**(2 048 715)**	**78 876 920**
Stage 1	60 581 598	1 647 714	(2 224 822)	(322 923)	22 547 733	(11 132 687)	-	(1 846 836)	69 249 777
Stage 2	5 891 991	(1 590 713)	2 329 852	(285 239)	981 732	(1 049 149)	-	(213 989)	6 064 485
Stage 3	3 617 860	(57 001)	(105 030)	601 165	200 543	(245 382)	(640 946)	(4 095)	3 367 114
POCI	205 307	-	-	6 997	99 989	(132 954)	-	16 205	195 544
Financial assets at amortised cost, gross	**84 480 631**	**-**	**-**	**-**	**27 867 897**	**(15 849 484)**	**(641 184)**	**(2 069 454)**	**93 788 406**

Financial effect of collaterals

31.12.2018	Gross amount	Accumulated impairment	Accumulated impairment without cash flow from collaterals	Financial effect of collaterals
Balace sheet data				
Loans and advances to banks	5 910 860	(1 518)	(1 531)	13
Loans and advances to customers	78 876 920	(2 674 957)	(3 097 582)	422 625
Individual customers, including:	40 049 073	(1 607 711)	(1 792 733)	185 022
- housing and mortgage loans	*23 868 510*	*(430 839)*	*(582 009)*	*151 170*
Corporate customers	38 302 395	(1 066 706)	(1 304 269)	237 563
Public sector customers	525 452	(540)	(580)	40
Total balance sheet data	**84 787 780**	**(2 676 475)**	**(3 099 113)**	**422 638**
Off-balance sheet data				
Loan commitments and other commitments	27 247 412	(55 600)	(59 752)	4 152
Guarantees, banker's acceptances, documentary and commercial letters of credit	15 713 107	(51 495)	(55 163)	3 668
Total off-balance sheet data	**42 960 519**	**(107 095)**	**(114 915)**	**7 820**

The following note presents loans and advances to banks as well as loans and advances to customers according to IAS 39, as at 31 December 2017.

Loans and advances to banks

	31.12.2017
Current accounts	386 071
Placements with other banks (up to 3 months)	748 470
Included in cash equivalents (Note 40)	**1 134 541**
Loans and advances	4 565 013
Other receivables	365 175
Total (gross) loans and advances to banks	**6 064 729**
Provisions created for loans and advances to banks (negative amount)	**(1 027)**
Total (net) loans and advances to banks	**6 063 702**
Short-term (up to 1 year) gross	1 964 655
Long-term (over 1 year) gross	4 100 074

The item "Other receivables" includes cash collaterals in the amount of PLN 259 111 thousand placed with other banks under the derivative transactions concluded by the Bank (Note 34).

The following table presents receivables from Polish and foreign banks:

	31.12.2017
Loans and advances to Polish banks (gross)	4 733 226
Provisions created for loans and advances to Polish banks	(58)
Loans and advances to foreign banks (gross)	1 331 503
Provisions created for loans and advances to foreign banks	(969)
Total (net) loans and advances to banks	**6 063 702**

As at 31 December 2017, the variable rate loans to banks amounted to PLN 4 559 190 thousand and the fixed rate loans to banks amounted to PLN 5 823.

As at 31 December 2017 the term placements with other banks were fixed rated. An average interest rate for placements in other banks and loans granted to other banks amounted to 1.60%.

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

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

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

Loans and advances to banks	31.12.2017	
	exposure in PLN '000	share/coverage (%)
Neither past due nor impaired	6 064 512	100.00
Past due but not impaired	-	-
Impaired	217	0.00
Total, gross	**6 064 729**	**100.00**
Provision (provision for impaired loans and advances as well as IBNI provision)	(1 027)	0.02
Total, net	**6 063 702**	**99.98**

Loans and advances to banks neither past due nor impaired

Sub-portfolio	31.12.2017
1	5 391 046
2	520 955
3	38 430
4	37 521
5	9
6	2 144
8	74 407
Default category	217
Total	**6 064 729**

Loans and advances to customers

	31.12.2017
Loans and advances to individuals:	**42 429 287**
- current accounts	7 324 329
- term loans, including:	35 104 958
housing and mortgage loans	26 714 885
Loans and advances to corporate entities:	**32 388 582**
- current accounts	5 310 093
- term loans:	26 814 762
corporate & institutional enterprises	13 878 266
medium & small enterprises	12 936 496
- reverse repo / buy-sell-back transactions	57 119
- other	206 608
Loans and advances to public sector	**870 705**
Other receivables	**307 623**
Total (gross) loans and advances to customers	**75 996 197**
Provisions for loans and advances to customers (negative amount)	(2 564 459)
Total (net) loans and advances to customers	**73 431 738**
Short-term (up to 1 year) gross	30 643 220
Long-term (over 1 year) gross	45 352 977

As at 31 December 2017, gross amount of variable interest rate loans amounted to PLN 74 594 744 thousand and fixed interest rate loans amounted to PLN 1 401 453 thousand. An average interest rate for loans granted to customers (excluding reverse repos) amounted to 3.34%.

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

In addition, the item "other" includes cash collaterals in the amount of PLN 106 274 thousand placed by the Bank under derivatives transactions (Note 34).

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

	31.12.2017
Housing and mortgage loans to individuals (in PLN 000's), including:	**26 714 885**
- PLN	5 246 249
- CHF	14 932 401
- EUR	3 288 198
- CZK	2 973 145
- USD	245 162
- pozostałe waluty	29 730
Housing and mortgage loans to individuals in original currencies (main currencies in 000's)	
- PLN	5 246 249
- CHF	4 186 029
- EUR	788 367
- CZK	18 217 800
- USD	70 423

Provisions for loans and advances

	31.12.2017
Incurred but not identified losses	
Gross balance sheet exposure	72 023 490
Impairment provisions for exposures analysed according to portfolio approach	(200 813)
Net balance sheet exposure	**71 822 677**
Receivables with impairment	
Gross balance sheet exposure	3 972 707
Provisions for receivables with impairment	(2 363 646)
Net balance sheet exposure	**1 609 061**

Movements in provisions for loans and advances

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

Loans and advances to customers	31.12.2017	
	share/coverage (%)	udział/ pokrycie (%)
Neither past due nor impaired	70 104 249	92.25
Past due but not impaired	1 919 241	2.52
Impaired	3 972 707	5.23
Total, gross	**75 996 197**	**100.00**
Provision (provision for impaired loans and advances as well as IBNI provision)	(2 564 459)	3.37
Total, net	**73 431 738**	**96.63**

The total amount of recognized provision for loans and advances has been PLN 2 564 459 thousand of which PLN 2 363 646 thousand represents the individually impaired loans and advances to customers and the remaining amount of PLN 200 813 thousand represented the portfolio.

92.25% of the loans and advances to customers portfolio has been considered to be neither past due nor impaired.

Loans and advances neither past due nor impaired

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

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Loans and advances past due but not impaired

Gross amounts of loans and advances, which were past due but not impaired are presented below by classes of assets. No impairment is recognized in respect of loans and advances past due for less than 90 days, unless other available information indicates their impairment.

31 December 2017	Individuals			Corporate entities					Public sector	Other receivables	Total - Loans and advances to customers
	Current accounts	Term loans	including: housing and mortgage loans	Current accounts	Term loans: corporate & institutional enterprises	Term loans: medium & small enterprises	Reverse repo / buy-sell-back transactions	Other			
Past due up to 30 days	528 690	1 036 462	675 128	11 822	112	5 434	-	-	-	-	1 582 520
Past due 31 - 60 days	45 849	155 990	88 793	223	7 874	15 636	-	-	-	-	225 572
Past due 61 - 90 days	19 706	47 683	16 597	-	167	-	-	-	-	-	67 556
Past due over 90 days	12 583	30 983	7 895	27	-	-	-	-	-	-	43 593
Total	**606 828**	**1 271 118**	**788 413**	**12 072**	**8 153**	**21 070**	**-**	**-**	**-**	**-**	**1 919 241**

Loans and advances individually impaired

As at 31 December 2017, loans and advances individually impaired amounted to PLN 1 609 061 thousand. Gross amounts of loans and advances individually impaired (i.e., before taking into consideration the cash flows from collateral held and expected repayments) are presented below by classes of assets.

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

Financial effect of collaterals

The note below presents the influence of value of collaterals received by the Bank in relation to the loans granted by the Bank on the provisions level.

As at 31 December 2017	Gross amount	Provisions created	Provisions without cash flow from collaterals	Financial effect of collaterals
Balace sheet data				
Loans and advances to banks	**6 064 729**	**(1 027)**	**(1 028)**	**1**
Loans and advances to customers, including:	**75 996 197**	**(2 564 459)**	**(3 139 493)**	**575 034**
Loans to individuals:	42 429 287	(1 568 035)	(1 882 876)	314 841
- housing and mortgage loans	*26 714 885*	*(449 305)*	*(718 030)*	*268 725*
Loans to corporate clients	32 124 855	(995 901)	(1 256 070)	260 169
Loans and advances to public sector	870 705	(523)	(547)	24
Total balance sheet data	**82 060 926**	**(2 565 486)**	**(3 140 521)**	**575 035**
Off-balance sheet data:				
Loan commitments and other commitments	25 416 098	(26 510)	(30 302)	3 792
Guarantees, banker's acceptances, documentary and commercial letters of credit	14 859 659	(49 144)	(67 103)	17 959
Total off-balance sheet data:	**40 275 757**	**(75 654)**	**(97 405)**	**21 751**

23. Investments in subsidiaries

31 December 2018 r. (in PLN 000's)

No.	Name of the company	Country of registration	Assets	Liabilities	Revenues	Net profit / (loss)	% interest held	Carrying value
1.	**BDH Development Sp. z o.o.**	Poland	88 446	187	86	(882)	100.00	83 759
2.	**BRE Property Partner Sp. z o.o.**	Poland	2 250	19	288	(120)	100.00	1 536
3.	**mServices Sp. z o.o.**	Poland	5 006	1	32	-	100.00	5 012
4.	**mElements S.A. (previously Falest Investments S.A.)**	Poland	15 911	1 175	5 745	(832)	100.00	15 121
5.	**Future Tech Fundusz Inwestycyjny Zamknięty**	Poland	213 516	1 839	3 139	(8 255)	98.04	210 172
6.	**Garbary Sp. z o.o.**	Poland	25 107	30	19 945	18 327	100.00	25 203
7.	**mBank Hipoteczny S.A.**	Poland	12 381 889	11 299 960	177 144	42 750	100.00	1 065 750
8.	**mBox Sp z o.o.**	Poland	16 810	11 588	9 423	(331)	100.00	5 225
9.	**mCentrum Operacji Sp. z o.o.**	Poland	29 307	292	9 779	2 512	100.00	29 017
10.	**mCorporate Finance S.A.**	Poland	3 401	2 233	5 763	673	100.00	658
11.	**mFaktoring S.A.**	Poland	2 245 315	2 144 230	39 080	16 609	100.00	100 976
12.	**mFinance France S.A.**	France	7 257 341	7 257 308	1 028	(1 167)	99.998	53
13.	**mFinanse S.A.**	Poland	799 648	349 647	421 431	294 974	100.00	358 003
14.	**mLeasing Sp. z o.o.**	Poland	11 555 535	11 155 433	209 276	48 414	100.00	399 255
15.	**Octopus Sp. z o.o.**	Poland	445	2	23	4	99.90	50
16.	**Tele -Tech Investment Sp. z o.o.**	Poland	139 577	139 043	135	(20)	100.00	534
								2 300 324

31 December 2017 (in PLN 000's)

No.	Name of the company	Country of registration	Assets	Liabilities	Revenues	Net profit / (loss)	% interest held	Carrying value
1.	**BDH Development Sp. z o.o.**	Poland	89 570	429	7 948	(1 417)	100.00	84 641
2.	**BRE Property Partner Sp. z o.o.**	Poland	2 930	118	1 469	896	100.00	1 536
3.	**Falest Investments S.A.**	Poland	3 233	176	227	(443)	100.00	3 517
4.	**Future Tech Fundusz Inwestycyjny Zamknięty**	Poland	222 111	1 682	1 489	(2 932)	98.04	218 602
5.	**Garbary Sp. z o.o.**	Poland	42 423	31 773	231	(34 379)	100.00	10 650
6.	**Latona S.A.**	Poland	56	1	-	(43)	100.00	122
7.	**mBank Hipoteczny S.A.**	Poland	12 162 622	11 111 766	393 200	19 648	100.00	1 035 382
8.	**mBox Sp z o.o.**	Poland	5 601	27	7 689	3 078	100.00	2 520
9.	**mCentrum Operacji Sp. z o.o.**	Poland	43 008	6 728	42 702	6 435	100.00	35 380
10.	**mCorporate Finance S.A.**	Poland	1 283	788	4 919	116	100.00	5 532
11.	**mFaktoring S.A.**	Poland	1 858 275	1 773 799	61 364	12 081	100.00	84 476
12.	**mFinance France S.A.**	France	7 803 280	7 802 108	158 712	(1 569)	99.998	232
13.	**mFinanse S.A.**	Poland	401 684	132 606	313 733	114 375	100.00	192 877
14.	**mLeasing Sp. z o.o.**	Poland	9 546 376	9 164 597	426 044	48 568	100.00	381 779
15.	**Octopus Sp. z o.o.**	Poland	3 441	12	263	193	99.90	3 047
16.	**Tele -Tech Investment Sp. z o.o.**	Poland	124 256	123 702	10 606	13	100.00	554
								2 060 847

Changes in investments in subsidiaries

	31.12.2018	31.12.2017
Investments in subsidiaries		
As at the beginning of the period	**2 060 847**	**1 782 219**
Impact of IFRS 9 implementation	**(22 553)**	**-**
As at the beginning of the period (adjusted)	**2 038 294**	**1 782 219**
Foreign exchange differences	85	(116)
Increase	17 512	349 059
Decrease	(7 019)	(95 002)
Changes resulting from the application of the equity method, including:	254 517	24 687
- recognised in the income statement	*255 167*	*20 180*
- recognised in the other components of equity	*(650)*	*4 507*
Change of valuation of investment in subsidiaries not measured at equity method	(3 065)	-
As at the end of the period	**2 300 324**	**2 060 847**

In 2018 the recognised in the income statement of the change resulting from the valuation using the equity method mainly relates to the valuation of mFinanse, which sold the organized part of the enterprise to Latona S.A. The transaction is described in detail in Note 43.

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

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

24. Investments in associates

On 2 June 2017, mBank S.A. signed a preliminary conditional agreement on the sale of mLocum S.A. shares to Archicom S.A. After meeting the conditions precedent, on 31 July 2017 were sold 14 120 880 shares representing 51% of the share capital of mLocum S.A.

From 31 July 2017, the mLocum's shares held by the Bank were presented in the statement of financial position under position "Investments in associates".

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

Sale of the remaining 8 026 120 shares representing 28.99% of the share capital of Archicom Polska S.A. (previously mLocum S.A.) took place on 20 December 2018. Thus, the share sale transaction was finalized. As at December 31, 2018, the Bank did not have any investments in associates.

Information on the interest in the associate measured using the equity method as at 31 December 2017 is provided below.

31 December 2017 (in PLN 000's)

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

25. Intangible assets

	31.12.2018	31.12.2017
Goodwill	3 532	3 532
Patents, licences and similar assets, including:	397 683	343 395
- computer software	331 428	238 301
Other intangible assets	1 910	3 142
Intangible assets under development	290 085	298 122
Total intangible assets	**693 210**	**648 191**

In 2018 and 2017, the Bank performed impairment tests of intangible assets under development. As a result of the tests, impairment has been not stated.

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Movements in intangible assets

Movements in intangible assets from 1 January to 31 December 2018	Patents, licences and other similar assets		Other intangible assets	Intangible assets under development	Goodwill	Total intangible assets
		Computer software				
Gross value of intangible assets as at the beginning of the period: 01.01.2018	**1 116 148**	**757 451**	**10 741**	**298 122**	**3 532**	**1 428 543**
Increase (due to)	**176 474**	**144 982**	**1**	**213 853**	**-**	**390 328**
- purchase	7 941	34	-	157 446	-	165 387
- transfer from intangible assets under development	165 683	144 863	1	-	-	165 684
- development costs	-	-	-	22 727	-	22 727
- other increases	2 850	85	-	33 680	-	36 530
Decrease (due to)	**(89 310)**	**(98)**	**(781)**	**(221 890)**	**-**	**(311 981)**
- liquidation	(88 997)	(98)	-	-	-	(88 997)
- transfer to intangible assets given to use	-	-	-	(165 684)	-	(165 684)
- other decreases	(313)	-	(781)	(56 206)	-	(57 300)
Gross value of intangible assets as at the end of the period: 31.12.2018	**1 203 312**	**902 335**	**9 961**	**290 085**	**3 532**	**1 506 890**
Accumulated amortization as at the beginning of the period: 01.01.2018	(772 753)	(519 150)	(7 599)	-	-	**(780 352)**
Amortization for the period (due to)	**(32 876)**	**(51 757)**	**(452)**	**-**	**-**	**(33 328)**
- amortization	(121 237)	(51 799)	(996)	-	-	(122 233)
- other increases	(636)	(56)	-	-	-	(636)
- liquidation	88 997	98	-	-	-	88 997
- other decreases	-	-	544	-	-	544
Accumulated amortization as at the end of the period: 31.12.2018	**(805 629)**	**(570 907)**	**(8 051)**	**-**	**-**	**(813 680)**
Net value of intangible assets as at the end of the period: 31.12.2018	**397 683**	**331 428**	**1 910**	**290 085**	**3 532**	**693 210**

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

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26. Tangible assets

	31.12.2018	31.12.2017
Tangible assets, including:	425 410	376 795
- land	1 033	1 033
- buildings and structures	154 858	153 733
- equipment	158 319	138 829
- vehicles	12 029	20 620
- other fixed assets	99 171	62 580
Fixed assets under construction	111 591	132 978
Total tangible assets	**537 001**	**509 773**

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Movements in tangible assets

Movements in tangible assets from 1 January to 31 December 2018	Land	Buildings and structures	Equipment	Vehicles	Other tangible assets	Tangible assets under construction	Total
Gross value of tangible assets as at the beginning of the period: 01.01.2018	**1 033**	**306 047**	**649 616**	**42 742**	**409 319**	**133 114**	**1 541 871**
Increase (due to)	**-**	**7 213**	**87 097**	**67**	**64 901**	**129 038**	**288 316**
- purchase	-	-	34 556	47	2 722	97 221	134 546
- transfer from tangible assets under construction	-	3 392	47 810	-	60 725	-	111 927
- other increases	-	3 821	4 731	20	1 454	31 817	41 843
Decrease (due to)	**-**	**-**	**(34 867)**	**(8 745)**	**(85 119)**	**(150 561)**	**(279 292)**
- sale	-	-	(2 982)	(214)	(1 358)	-	(4 554)
- liquidation	-	-	(31 158)	-	(83 733)	-	(114 891)
- transfer to tangible assets	-	-	-	-	-	(111 927)	(111 927)
- other decreases	-	-	(727)	(8 531)	(28)	(38 634)	(47 920)
Gross value of tangible assets as at the end of the period	**1 033**	**313 260**	**701 846**	**34 064**	**389 101**	**111 591**	**1 550 895**
Accumulated depreciation as at the beginning of the period	**-**	**(103 044)**	**(502 587)**	**(22 122)**	**(346 608)**	**-**	**(974 361)**
Depreciation for the period (due to)	**-**	**(6 088)**	**(32 740)**	**87**	**56 678**	**-**	**17 937**
- depreciation charge	-	(6 088)	(66 578)	(5 436)	(27 408)	-	(105 510)
- other increases	-	-	(147)	-	(457)	-	(604)
- sale	-	-	2 968	214	1 155	-	4 337
- liquidation	-	-	30 916	-	83 388	-	114 304
- other decreases	-	-	101	5 309	-	-	5 410
Accumulated depreciation as at the end of the period	**-**	**(109 132)**	**(535 327)**	**(22 035)**	**(289 930)**	**-**	**(956 424)**
Impairment losses as at the beginning of the period	**-**	**(49 270)**	**(8 200)**	**-**	**(131)**	**(136)**	**(57 737)**
- decrease	-	-	-	-	131	136	267
Impairment losses as at the end of the period	**-**	**(49 270)**	**(8 200)**	**-**	**-**	**-**	**(57 470)**
Net value of tangible assets as at the end of the period	**1 033**	**154 858**	**158 319**	**12 029**	**99 171**	**111 591**	**537 001**

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

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

The entire value of vehicles is related to finance lease agreement.

The recoverable value of impaired tangible assets is the net sale price determined on the basis of market prices for similar assets.

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27. Other assets

	31.12.2018	31.12.2017
Other assets, including:	**652 585**	**415 528**
- debtors	383 307	143 339
- interbank balances	20 432	27 405
- settlements of securities transactions	11 346	24 375
- other accruals	180 319	142 972
- accrued income	50 537	72 786
- inventories	5 677	4 651
- other	967	-
Total other assets	**652 585**	**415 528**
Short-term (up to 1 year)	577 565	199 881
Long-term (over 1 year)	75 020	215 647

In 2018 and in 2017, the item "settlements of the securities transaction" relates entirely to the settlements of securities transactions in connection with the Brokerage Office activity.

As at 31 December 2018, the above note includes financial assets in amount of PLN 416 052 thousand (31 December 2017: PLN 195 119 thousand).

Other financial assets included in the note above

	31.12.2018	31.12.2017
Gross other financial assets, including:	**432 350**	**209 549**
- Not past due	423 194	200 303
- Past due from 1 to 90 days	4 650	4 520
- Past due over 90 days	4 506	4 726
- Provisions for impaired assets (negative amount)	(16 298)	(14 430)
Net other financial assets	**416 052**	**195 119**

Movements of impairment allowance for other assets

	31.12.2018
As at the beginning of the period	**14 430**
Change in the period (due to)	1 868
- increase of provisions	2 353
- release of provisions	(371)
- write-offs	(132)
- foreign exchange differences	18
As at the end of the period	**16 298**

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28. Financial liabilities measured at amortised cost

Amounts due to other banks

	31.12.2018	31.12.2017
Current accounts	922 620	903 817
Term deposits	156 391	90 442
Loans and advances received	747 334	3 394 340
Repo / sell-buy-back transactions	800 543	182 295
Liabilities in respect of cash collaterals	348 776	412 425
Payables to be settled	3 286	5 595
Other	157 821	100 802
Amounts due to other banks	**3 136 771**	**5 089 716**
Short-term (up to 1 year)	2 948 712	4 571 748
Long-term (over 1 year)	188 059	517 968

As at 31 December 2018, the value of fixed rate deposits from other banks was PLN 156 391 thousand (31 December 2017: PLN 90 442 thousand). In the both reporting periods there were no variable rate term deposits.

As at 31 December 2018 and as at 31 December 2017, loans and advances received from banks were variable interest rate loans.

The average interest rate for loans and deposits obtained from banks in 2018 amounted to 1.09% (31 December 2017: - 0.80%).

mBank did not provide collateral related to loans from other banks. The Bank did not note any violations of contractual terms related to liabilities in respect of loans received.

Amounts due to customers

	31.12.2018	31.12.2017
Individual customers:	**65 923 426**	**55 693 463**
Current accounts	52 064 463	43 733 114
Term deposits	13 701 560	11 819 154
Other liabilities, due to:	157 403	141 195
- liabilities in respect of cash collaterals	51 341	62 214
- other	106 062	78 981
Corporate customers:	**43 210 809**	**42 425 328**
Current accounts	21 658 695	21 536 076
Term deposits	9 683 316	8 095 092
Loans and advances received	3 457 264	4 142 944
Repo transactions	713 081	439 637
Other liabilities, due to:	7 698 453	8 211 579
- liabilities in respect of cash collaterals	7 601 652	8 149 634
- other	96 801	61 945
Public sector customers:	**739 151**	**1 212 780**
Current accounts	462 435	623 231
Term deposits	276 200	585 389
Other liabilities, due to:	516	4 160
- other	516	4 160
Total amounts due to customers	**109 873 386**	**99 331 571**
Short-term (up to 1 year)	100 548 035	86 908 844
Long-term (over 1 year)	9 325 351	12 422 727

As at 31 December 2018 and 31 December 2017, the majority of the deposits from retail and corporate customers bore fixed interest rates. The average interest rate for amounts due to customers (excluding repos) amounted to 0.67% (31 December 2017: 0.67%).

As at 31 December 2018, loans and advances received include loans received from European Investment Bank amounting to PLN 3 457 264 thousand (31 December 2017: PLN 4 142 944 thousand). The two of those loans with fixed interest rate are collateralized with treasury bonds, which have been disclosed as pledge assets under Note 21, Note 22 and Note 34 us pledge asstes.

As at 31 December 2018, the amount of cash collateral liabilities to corporate customers includes security deposits in the amount of PLN 7 302 746 thousand, accepted from mFinance France S.A. (mFF), in connection with guarantees granted by the Bank for amounts to be paid for debt securities issued by the mFF (31 December 2017 – security deposits in the amount of PLN 7 801 298 thousand).

Debt securities issued

As at 31 December 2018

Debt securities in issue by category	Nominal value	Contractual interest rate	Guarantee/ collateral	Redemption date	Carrying value
Long-term issues					
Bonds (in CHF)	180 000	0.565%	no collateral	07.06.2022	692 679
Bonds (in EUR)	500 000	1.058%	no collateral	05.09.2022	2 165 045
Debt securities in issue (carrying value in PLN '000)					**2 857 724**

- 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, the Bank made two issues:

- 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,

- on September 5, 2018, the Bank issued bonds with a total value of EUR 500 000 thousand (equivalent of PLN 2 159 150 thousand at the average exchange rate of the National Bank of Poland as of 5 September 2018), maturing on 5 September 2022.

Movements in debt securities in issue

	31.12.2018
As at the beginning of the period	**-**
Additions (issue)	2 820 056
Exchange differences	16 932
Other changes	20 736
Debt securities in issue as at the end of the period	**2 857 724**

Subordinated liabilities

SUBORDINATED LIABILITIES	Nominal value	Currency	Terms of interest rate (%)	Effective interest rate (%)	Redemption date	As at the end of the period (in PLN '000)
As at 31 December 2018						
- Commerzbank AG	250 000	CHF	3M LIBOR + 2,75%	2.01	21.03.2028	954 684
- Investors not associated with mBank S.A.	550 000	PLN	6M WIBOR + 1,8%	3.59	10.10.2028 1)	554 469
- Investors not associated with mBank S.A.	200 000	PLN	6M WIBOR + 1,95%	3.74	10.10.2030 1)	201 693
- Investors not associated with mBank S.A.	750 000	PLN	6M WIBOR + 2,1%	3.91	17.01.2025	763 317
						2 474 163

1) The issue conditions assume the possibility of early redemption of bonds with a nominal value of PLN 550,000 thousand on 10 October 2023, and bonds with a nominal value of PLN 200,000 thousand on October 10, 2025.

SUBORDINATED LIABILITIES	Nominal value	Currency	Terms of interest rate (%)	Effective interest rate (%)	Redemption date	As at the end of the period (in PLN '000)
As at 31 December 2017						
- Commerzbank AG	80 000	CHF	3M LIBOR + 3,4%*	2.6412	perpetual	285 627
- Commerzbank AG	170 000	CHF	3M LIBOR + 2,2%**	1.4740	perpetual	608 510
- Investors not associated with mBank S.A.	500 000	PLN	6M WIBOR + 2,25%	4.0600	20.12.2023	500 581
- Investors not associated with mBank S.A.	750 000	PLN	6M WIBOR + 2,1%	3.9100	17.01.2025	763 425
						2 158 143

* Margin amounting to 1.4% was in force up to 20 December 2016. From 20 December 2016 margin amounting to 3.4% is in force.

** Margin amounting to 2.2% is in force up to January 2018. Within the period of next years it will be equal to 4.2%.

The effective interest rate specified in the tables above means the interest rate at the inception day of the last interest period.

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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.

On October 9, 2018, mBank S.A. issued two series of subordinated bonds with a total nominal value of PLN 750 000 thousand. 1 100 pieces of 10-year subordinated bonds with a nominal value of PLN 500 thousand each were issued, with maturity on October 10, 2028, and 400 pieces of 12-year subordinated bonds with a nominal value of PLN 500 thousand each, with maturity on October 10, 2030.

The Bank applied to the Polish Financial Supervision Authority for permission to be included in the supplementary capital of the Bank, in accordance with art. 127 para. 3 point 2 letter b) of the Banking Law Act, a monetary liability in the amount of PLN 750 000 thousand PLN obtained by the Bank for the above-mentioned subordinated bond issue. The Bank obtained such consent on November 28, 2018.

On 20 December 2018, after obtaining the relevant consent of the Polish Financial Supervision Authority, the Bank made an earlier redemption of subordinated bonds issued on December 3, 2013, with a total nominal value of PLN 500,000 thousand.

According to the decision dated 8 January 2015 mBank obtained permission of the KNF to include in Tier 2 capital the amount of PLN 750 000 thousand constituting subordinated liability from the bonds issue dated 17 December 2014 on total nominal value of PLN 750 000 thousand with redemption date on 17 January 2025 on terms that meet the requirements arising from the CRR Regulation.

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

In 2018 and 2017, the Bank did not note any delays in repayments of interest instalments and was not in default of any other contractual provisions related to its subordinated liabilities.

Movements in subordinated liabilities

	31.12.2018	31.12.2017
As at the beginning of the period	**2 158 143**	**3 943 349**
- additions (issue)	1 655 125	-
- disposals (repayment, early redemption)	(1 405 125)	(1 611 840)
- exchange differences	65 850	(172 605)
- other changes	170	(761)
Subordinated liabilities as at the end of the period	**2 474 163**	**2 158 143**
Short-term (up to 1 year)	20 012	2 337
Long-term (over 1 year)	2 454 151	2 155 806

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29. Other liabilities

	31.12.2018	31.12.2017
Other liabilities, including		
- tax liabilities	146 560	41 079
- interbank settlements	776 259	1 012 280
- creditors	1 070 233	527 971
- accrued expenses	201 772	173 628
- deferred income	207 450	206 367
- provisions for post-employment employee benefits	20 644	16 924
- provisions for holiday equivalents	24 155	20 924
- provisions for other liabilities to employees	163 508	146 267
- other	4 934	25 973
Total other liabilities	**2 615 515**	**2 171 413**

As at 31 December 2018, the note presented above includes financial liabilities in the amount of PLN xxx thousand (31 December 2017: PLN 1 713 879 thousand). Cash flows resulting from those financial liabilities have been presented under Note 3.9.1. The other components of presented liabilities, except for part of provisions for post-employment benefits that were calculated on actuarial basis as a rule, are short-term liabilities.

In 2018, liabilities from creditors include the value of financial lease in the amount of PLN 12 366 thousand (in 2017: PLN 21 523 thousand).

Movements in provisions for post-employment employee benefits

	31.12.2018	31.12.2017
Provisions for post-employment employee benefits		
As at the beginning of the period (by type)	**16 924**	**12 918**
- pension and disability provisions	8 496	6 018
- provisions for death severance	3 646	3 911
- provisions for the Social Benefit Fund	4 782	2 989
Change in the period (due to)	**3 720**	**4 006**
Provisions created, due to:	**1 011**	**623**
- pension and disability provisions	652	392
- provisions for death severance	145	122
- provisions for the Social Benefit Fund	214	109
Interest expense, due to:	**526**	**440**
- pension and disability provisions	264	204
- provisions for death severance	112	132
- provisions for the Social Benefit Fund	150	104
Actuarial gains and losses recognised in other comprehensive income (Note 17), due to:	**3 097**	**3 812**
- pension and disability provisions	1 392	2 365
- provisions for death severance	322	(519)
- provisions for the Social Benefit Fund	1 383	1 966
Benefits paid, due to:	**(914)**	**(869)**
- pension and disability provisions	(383)	(483)
- provisions for death severance	(9)	-
- provisions for the Social Benefit Fund	(522)	(386)
As at the end of the period (by type)	**20 644**	**16 924**
- pension and disability provisions	10 421	8 496
- provisions for death severance	4 216	3 646
- provisions for the Social Benefit Fund	6 007	4 782

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	31.12.2018	31.12.2017
Short-term (up to 1 year)	**9 352**	**1 000**
- pension and disability provisions	9 000	688
- provisions for death severance	276	245
- provisions for the Social Benefit Fund	76	67
Long-term (over 1 year)	**11 292**	**15 924**
- pension and disability provisions	1 421	7 808
- provisions for death severance	3 940	3 399
- provisions for the Social Benefit Fund	5 931	4 717

	31.12.2018	31.12.2017
Breakdown of actuarial gains and losses		
Change in financing assumptions, due to:	**974**	**661**
- pension and disability provisions	348	225
- provisions for death severance	149	141
- provisions for the Social Benefit Fund	477	295
Change in demographic assumptions, due to:	**129**	**1 909**
- pension and disability provisions	123	1 815
- provisions for death severance	(19)	(794)
- provisions for the Social Benefit Fund	25	888
Other changes, due to:	**1 994**	**1 242**
- pension and disability provisions	921	325
- provisions for death severance	192	133
- provisions for the Social Benefit Fund	881	784

The discount rate is one of the key assumptions used in the actuarial valuation of provisions for post-employment benefits. If the discount rate used in the calculation of these provisions as at 31 December 2018 was decreased by 0.5 p.p., the value of the provisions would increase by PLN 701 thousand, and in the case of an increase of the discount rate by 0.5 p.p. the value of the provisions would fall by PLN 648 thousand.

30. Provisions

	31.12.2018	31.12.2017
For legal proceedings	106 233	95 282
Commitments and guarantees given	107 095	75 654
Other provisions	42 554	19 978
Provisions, total	**255 882**	**190 914**

Provisions for commitments and guarantees given have been recognized according to IFRS 9.

The estimated maturity of granted contingent liabilities has been presented under Note 33.

The estimated cash flow due to created provisions for legal proceedings and other provisions is expected to crystalize over 1 year.

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Movements in provisions

	31.12.2018	31.12.2017
As at the beginning of the period (by type)	**190 914**	**182 648**
For legal proceedings	95 282	113 192
Commitments and guarantees given	75 654	43 376
Other provisions	19 978	26 080
Impact of the implementation of IFRS 9 on 1 January 2018	**40 906**	***n/a***
- increase in provisions for commitments and guarantees given	40 906	*n/a*
As at the beginning of the period (by type)	**231 820**	**182 648**
For legal proceedings	95 282	113 192
Commitments and guarantees given	116 560	43 376
Other provisions	19 978	26 080
Change in the period (due to)	**24 062**	**8 266**
- increase of provisions, due to:	96 736	182 736
- for legal proceedings	*23 499*	*32 997*
- commitments and guarantees given	*45 347*	*135 665*
- other provisions	*27 890*	*14 074*
- release of provisions, due to:	(60 181)	(161 721)
- for legal proceedings	*(2 635)*	*(45 360)*
- commitments and guarantees given	*(56 897)*	*(101 567)*
- other provisions	*(649)*	*(14 794)*
- write-offs	(14 672)	(2 723)
- utilization	-	(5 486)
- reclassification to other positions of statement of financial position	-	(2 587)
- foreign exchange differences	2 179	(1 953)
As at the end of the period (by type)	**255 882**	**190 914**
For legal proceedings	106 233	95 282
Commitments and guarantees given	107 095	75 654
Other provisions	42 554	19 978

Movements in provisions for loan commitments, guarantees and other financial facilities and other commitments

Stan na 31 December 2018	As at the beginning of the period	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	Increases due to granting and takeover	Reductions caused by deletion from the balance sheet	Changes in credit risk	As at the end of the period
Loan commitments	**43 986**	**-**	**-**	**-**	**20 988**	**(16 545)**	**7 171**	**55 600**
Stage 1	26 607	17 547	(2 851)	(4)	15 148	(8 756)	(17 426)	30 265
Stage 2	16 948	(17 547)	2 851	(11)	3 972	(6 351)	18 381	18 243
Stage 3	431	-	-	15	1 014	(1 438)	6 209	6 231
POCI	-	-	-	-	854	-	7	861
Guarantees and other financial facilities	**72 427**	**-**	**-**	**-**	**11 156**	**(14 588)**	**(17 500)**	**51 495**
Stage 1	5 131	322	(324)	(3)	4 994	(6 792)	(544)	2 784
Stage 2	1 806	(322)	419	-	1 860	(1 050)	2 281	4 994
Stage 3	65 490	-	(95)	3	5 313	(6 745)	(16 812)	47 154
POCI	-	-	-	-	(1 011)	(1)	(2 425)	(3 437)
Other commitments	**147**	**-**	**-**	**-**	**-**	**(152)**	**5**	**-**
Stage 1	147	-	-	-	-	(152)	5	-
Provisions on off-balance sheet items	**116 560**	**-**	**-**	**-**	**32 144**	**(31 285)**	**(10 324)**	**107 095**

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Provisions for off-balance sheet granted contingent liabilities as at 31 December 2017

	31.12.2017
Incurred but not identified losses	
Off-balance sheet contingent liabilities	40 110 411
Provisions for off-balance sheet contingent liabilities analysed according to portfolio approach (negative amount)	(27 461)
Net off-balance sheet contingent liabilities	**40 082 950**
Off-balance sheet granted contingent liabilities with impairment	
Off-balance sheet contingent liabilities	165 346
Provisions for off-balance sheet contingent liabilities analysed individually (negative amount)	(48 193)
Net off-balance sheet contingent liabilities	**117 153**

31. Assets and liabilities for deferred income tax

Assets and liabilities for deferred income tax are calculated for all temporary differences in accordance with the balance sheet method, using an effective income tax rate of 19% in 2018 and 2017.

Assets and liabilities for deferred income tax are not recognized as short term assets and liabilities.

Changes in assets and liabilities for deferred income tax are presented below:

Deferred income tax assets	As at 01.01.2018	Impact of the implementation of IFRS 9 on 1 January 2018	Restated opening balance	Recognised in the income statement	Recognised in other comprehensive income	Other changes	As at 31.12.2018
Interest accured	37 880	-	37 880	5 778	-	-	43 658
Valuation of securities	33 532	-	33 532	6 036	263	-	39 831
Provisions for impairment of loans and advances	222 586	102 414	325 000	84 662	-	-	409 662
Provisions for employee benefits	33 068	-	33 068	3 961	589	-	37 618
Other provisions	4 888	-	4 888	522	-	-	5 410
Prepayments/accruals	30 313	-	30 313	5 037	-	-	35 350
Other negative temporary differences	42 087	-	42 087	(1 173)	-	310	41 224
Total deferred income tax assets	**404 354**	**102 414**	**506 768**	**104 823**	**852**	**310**	**612 753**

Deferred income tax liabilities	As at 01.01.2018	Impact of the implementation of IFRS 9 on 1 January 2018	Restated opening balance	Recognised in the income statement	Recognised in other comprehensive income	Other changes	As at 31.12.2018
Interest accured	(56 856)	-	(56 856)	8 602	-	-	(48 254)
Valuation of derivative financial instruments	(19 022)	-	(19 022)	(4 892)	(20 840)	-	(44 754)
Valuation of investment securities	(117 500)	9 582	(107 918)	2 195	(6 042)	-	(111 765)
Interest and fees received in advance	(1 538)	-	(1 538)	(5 424)	-	-	(6 962)
Difference between tax and book value of tangible and intangible assets	(45 067)	-	(45 067)	2 967	-	-	(42 100)
Prepayments regarding amortization of applied investment relief	(18 657)	-	(18 657)	-	-	-	(18 657)
Other positive temporary differences	(16 758)	(48 093)	(64 851)	19 854	-	-	(44 997)
Total deferred income tax liabilities	**(275 398)**	**(38 511)**	**(313 909)**	**23 302**	**(26 882)**	**-**	**(317 489)**

The item "Other positive temporary differences" includes the impact of the creation of deferred tax provision in the amount of PLN 22 529 thousand resulting from the implementation of IFRS 9 in respect of recognized in previous years tax-deductible costs from the provision for incurred undocumented credit risk. According to art. 12 para. 4 of the Act of 27 October 2017 on amendments to the Personal Income Tax Act, the Corporate Income Tax Act and the Act on Flat Rate Income Tax on Certain Revenue Earned by Natural Persons, in the event that the Bank included IBNR to the tax-deductible costs before January 1, 2018, after the entry into force of the amendment the Bank is obliged to recognize income up to the amount previously recognized as tax cost. The Bank recognizes revenues on this account pro rata for a period of 7 consecutive tax years.

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

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

	31.12.2018	31.12.2017
Interest accured	14 380	(3 155)
Valuation of derivative financial instruments	(4 892)	14 116
Valuation of securities	8 231	(19 034)
Provisions for impairment of loans and advances	84 662	1 671
Provisions for employee benefits	3 961	1 928
Other provisions	522	(764)
Prepayments/accruals	5 037	7 476
Interest and fees received in advance	(5 424)	19 358
Difference between tax and book value of tangible and intangible assets	2 967	585
Other temporary differences	18 681	210
Total deferred income tax included in the profit and loss account (Note 15)	**128 125**	**22 391**

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

A level of deferred tax asset for the year 2018 and 2017 does not include tax losses of the foreign branch in Slovakia in the amount respectively: EUR 1 693 thousand (equivalent of PLN 7 279 thousand at the average exchange rate of the National Bank of Poland as of 31 December 2018) and EUR 1 567 thousand (equivalent of PLN 6 536 thousand at the average exchange rate of the National Bank of Poland as of 31 December 2018). Potential including of the tax losses into deferred tax asset in years to come will depend upon an assessment of the corporate income tax base level in a future (including the periods scheduled for settlement of tax losses). Right to tax losses' settlement expires between 2019 and 2022 year.

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

As at 31 December 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 would represent at least 10% of the Bank's equity. Moreover, the total value of claims concerning liabilities of the Bank or its subsidiary in all proceedings before a court, an arbitration body or a public administration authority as at 31 December 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.

<u>Information on the most important court proceedings relating to the issuer's contingent liabilities</u>

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 386,086 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. The plaintiff appealed.

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. In June, the Bank filed a comprehensive pleading, in which min. he calls for an expert change. We expect the date of the hearing.

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. On 5 October 2018, after conducting the substantive hearing, hearing the parties and presenting final votes, the court closed the hearing. October 19, 2018 the court issued a judgment in which it dismissed all claim of the plaintiff. In the oral justification, the court stated that the Plaintiff had not shown that he had a legal interest in bringing the claim in question, and also referred to the validity of loan agreements indexed by CHF, stressing that both the contract itself and the indexation clause are in compliance with both applicable regulations and rules of social coexistence. On 11 January 2019, the appeal of the plaintiff to which the Bank will prepare the replica has been served.

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

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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).

mBank S.A. has submitted its statement of defence on 16 August 2018. The hearing was held on November 23, 2018. The court postponed the hearing and requested the Plaintiff to address formal irregularities in a pleading (reply to the statement of defence). The court accepted the Defendants' requests to summon sixteen banks to join the proceedings and ordered that the banks be served with the summons.

Taxes

On 24 September 2018, mBank S.A. was requested by the Head of the First Masovian Tax Office in Warsaw to submit the tax documentation referred to in Article 9a (1)-(3a) of the Corporate Income Tax Act concerning transactions concluded in 2016 with related entities.

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.

Inspection by the Office of the Polish Financial Supervision Authority (PFSA Office)

In the period from October till December 2018 the PFSA Office employees carried out an inspection in the Bank in order to investigate whether the activities of mBank S.A. in the area of fulfilling its duties as the depositary were in conformity with the law and agreements on the performance of functions of the depositary, in particular in conformity with the Act of 27 May 2004 on Investment Funds and Management of Alternative Investment Funds (Journal of Laws of 2018, item 1355, as later amended).

The detailed findings of the inspection were presented in the protocol delivered to the Bank on 11 February 2019. On 25 February 2019 the Bank delivered to the PFSA office its objections to the protocol as well as additional explanations related to the issues being the subject of the inspection.

As of the day of the preparation of these financial statements the final stance of the UKNF related to the issues being the subject of the above inspection is not known.

33. Off-balance sheet liabilities

Off-balance sheet liabilities of the Bank comprise:

- Loan commitments

The amounts and deadlines by which the Bank will be obliged to realise its off-balance sheet financial liabilities by granting loans or other monetary services are presented in the table below.

- Guarantees and other financial facilities

Guarantees are presented in the table below based on the earliest contractual maturity date.

- Other liabilities.

Loan commitments, guarantees and other financial facilities and other commitments

31.12.2018	Nominal amount of off-balance sheet commitments and financial guarantees under IFRS 9 impairment				Provisions on off-balance sheet commitments and financial guarantees under IFRS 9 impairment			
	Stage 1	Stage 2	Stage 3	POCI	Stage 1	Stage 2	Stage 3	POCI
Loan commitments	26 308 567	879 761	21 047	961	30 265	18 243	6 231	861
Guarantees and other financial facilities	14 715 461	872 767	119 779	5 100	2 784	4 994	47 154	(3 437)
Other commitments	37 076	-	-	-	-	-	-	-

The following table presents the Bank's off-balance sheet commitments granted and received as well as nominal value of open positions of derivative transactions of the Bank as at 31 December 2018 and as at 31 December 2017.

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31.12.2018	Up to 1 year	1-5 years	More than 5 years	Total
1. Contingent liabilities granted and received	**31 250 298**	**12 890 608**	**2 445 996**	**46 586 902**
Commitments granted	**29 748 567**	**11 149 168**	**2 109 173**	**43 006 908**
1. Financing	22 653 325	3 641 394	962 006	**27 256 725**
a) Loan commitments	22 606 936	3 641 394	962 006	**27 210 336**
b) Other financial commitments	46 389	-	-	**46 389**
2. Guarantees and other financial facilities	7 058 166	7 507 774	1 147 167	**15 713 107**
a) Guarantees and standby letters of credit	7 058 166	7 507 774	1 147 167	**15 713 107**
3. Other commitments	37 076	-	-	**37 076**
Commitments received	**1 501 731**	**1 741 440**	**336 823**	**3 579 994**
a) Financial commitments received	-	381 660	-	**381 660**
b) Guarantees received	1 501 731	1 359 780	336 823	**3 198 334**
2. Derivative financial instruments (nominal value of contracts)	**161 296 836**	**315 492 667**	**38 862 264**	**515 651 767**
Interest rate derivatives	90 331 695	291 995 862	34 856 614	**417 184 171**
Currency derivatives	68 729 285	22 965 070	2 487 650	**94 182 005**
Market risk derivatives	2 235 856	531 735	1 518 000	**4 285 591**
Total off-balance sheet items	**192 547 134**	**328 383 275**	**41 308 260**	**562 238 669**

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

The nominal values of derivatives are presented in the Note 19.

As at 31 December 2018, commitments received by the Bank in the amount of PLN 3 579 994 thousand (31 December 2017: PLN 4 003 055 thousand), related mainly to guarantees received as collateral of loans and advances granted.

34. Pledged assets

Assets may be pledged as collateral for repo/sell-buy-back transactions, derivative contracts with other banks. Collateral may be also placed due to stock market derivatives such as futures, options and participation in stock market.

Collateral may be placed in different form (e.g. cash, securities and pledged assets).

Similarly, customers establish collateral on their assets to secure the transaction with the Bank. If securities are subject to collateral (in buy-sell-back transaction) they can be re-pledged in the opposite transaction (sell-buy-back).

Moreover the Bank accepts collaterals in the form of properties (esp. real estates) related to credit type transactions like mortgage loans, credit lines, banking guarantees.

The table below presents the breakdown of the measures possible to pledge by the main items of the statement of financial position of mBank, as at 31 December 2018 and 31 December 2017. Treasury securities are the main component of the Banks's liquidity collateral that can be eligible to pledge.

31.12.2018

Position (PLN 000's)	Assets			Collateral received in kind of securities related with buy sell back transactions			Assets available for pledge (3+6)
	Total assets	Pledged assets	Eligible for pledge assets	Received	Reused	Available for pledge	
	1	2	3	4	5	6	7
Debt securities (Note 19, Note 20, Note 21 and Note 22) including:	**33 729 866**	**5 212 292**	**26 755 872**	**1 480 632**	**599**	**1 480 033**	**28 235 905**
- NBP bills	499 912	-	499 912	-	-	-	499 912
- Government bonds	28 648 366	4 881 622	23 766 744	1 480 632	599	1 480 033	25 246 777
- Mortgage bonds	838 036	330 670	-	-	-	-	-
- Other non-treasury securities	3 743 552	-	2 489 216	-	-	-	2 489 216
Cash collaterals (due to derivatives transactions) (Note 22)	388 196	388 196	-	-	-	-	-
Property collateral	-	-	-	-	-	-	-
Other assets	103 531 108	-	-	-	-	-	-
Total	**137 649 170**	**5 600 488**	**26 755 872**	**1 480 632**	**599**	**1 480 033**	**28 235 905**

31.12.2017

Position (PLN 000's)	Assets			Collateral received in kind of securities related with buy sell back transactions			Assets available for pledge (3+6)
	Total assets	Pledged assets	Eligible for pledge assets	Received	Reused	Available for pledge	
	1	2	3	4	5	6	7
Debt securities (Note 19, Note 20, Note 21 and Note 22) including:	**32 601 146**	**6 525 063**	**24 608 420**	**-**	**-**	**-**	**24 608 420**
- NBP bills	2 199 429	-	2 199 429	-	-	-	2 199 429
- Government bonds	27 516 478	6 324 695	21 191 783	-	-	-	21 191 783
- Mortgage bonds	443 380	200 368	243 012	-	-	-	243 012
- Other non-treasury securities	2 441 859	-	974 196	-	-	-	974 196
Cash collaterals (due to derivatives transactions) (Note 22)	365 385	365 385	-	-	-	-	-
Property collateral	-	-	-	-	-	-	-
Other assets	91 602 952	-	-	-	-	-	-
Total	**124 569 483**	**6 890 448**	**24 608 420**	**-**	**-**	**-**	**24 608 420**

The value of treasury securities presented as pledged assets, except for collaterals due to sell-buy-back transactions, includes Bank's collateral of liabilities due to the fixed interest rate loan received from the EIB, collateral for the guaranteed deposits fund under the Bank Guarantee Fund (BFG) and collateral for the payment commitment to the BFG guarantee fund and forced restructuring fund.

35. Registered share capital

The total number of ordinary shares as at 31 December 2018 was 42 336 982 shares (31 December 2017: 42 312 122 shares) of PLN 4 nominal value each. All issued shares were fully paid up.

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REGISTERED SHARE CAPITAL (THE STRUCTURE) AS AT 31 DECEMBER 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
ordinary bearer	-	-	24 860	99 440	fully paid in cash	2018
Total number of shares			**42 336 982**			
Total registered share capital				**169 347 928**		
Nominal value per share (PLN)		**4**				

* As at the end of the reporting period

In 2018, the National Depository of Securities (KDPW) has registered 24 860 shares of mBank, which were issued as part of the conditional increase in the share capital of the Bank by issuance of shares with no subscription rights for the existing shareholders in order to enable beneficiaries of the incentive programmes to take up shares in mBank. As a result of the above registration, in 2018 the mBank's share capital increased by PLN 99 440.

Commerzbank AG is a shareholder holding over 5% of the share capital and votes at the General Meeting and as at 31 December 2018 it held 69.33% of the share capital and votes at the General Meeting of mBank S.A.

In 2018 there were no changes in the ownership structure of significant blocks of shares in the Bank, whereas on February 4, 2019, the Bank received from Nationale-Nederlanden Otwarty Fundusz Emerytalny (Fund) a notification of a reduction in the total number of votes at the General Meeting of mBank S.A. to less than 5%. Until 28 January 2019, Fund held 2 117 564 shares in mBank S.A., which accounted for 5.002% of the share capital of mBank S.A. and entitled to 2 117 564 votes at the general meeting of mBank S.A. From January 29, 2019, Fund holds 2 101 872 shares in mBank S.A., which constitutes 4.965% of the share capital of mBank S.A. and entitles to 2 101 872 votes at the general meeting of mBank S.A.

36. Share premium

Share premium is formed from the share premium obtained from the issue of shares reduced by the direct costs incurred with that issue. This capital is intended to cover all losses that may result from the business activity of the Bank.

The increase of share premium in 2018 and 2017 results from the issue of shares under incentive programmes described under Note 41.

37. Retained earnings

Retained earnings include: other supplementary capital, other reserve capital, general banking risk reserve, profit (loss) from the previous years and profit for the current year.

Other supplementary capital, other reserve capital and general banking risk reserve are created from profit for the current year and their aim is described in the By-laws or in other regulations of the law.

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	31.12.2018	31.12.2017
Other supplementary capital	9 216 652	7 145 517
Other reserve capital	22 452	22 638
General banking risk reserve	1 115 143	1 115 143
Profit from the previous year	(248 157)	1 199 339
Profit for the current year	1 317 485	1 089 704
Total retained earnings	**11 423 575**	**10 572 341**

According to the Polish legislation, each bank is required to allocate 8% of its net profit to a statutory undistributable other supplementary capital until this supplementary capital reaches 1/3 of the share capital.

In addition, the Bank transfers some of its net profit to the general banking risk reserve to cover unexpected risks and future losses. The general banking risk reserve can be distributed only on consent of shareholders at a general meeting.

38. Other components of equity

	31.12.2018	31.12.2017
Exchange differences on translating foreign operations	**(5 160)**	**(5 336)**
Unrealized gains (foreign exchange gains)	3 278	3 671
Unrealized losses (foreign exchange losses)	(8 438)	(9 007)
Cash flow hedges	**83 643**	**(5 198)**
Unrealized gains	103 263	2 877
Unrealized losses	-	(9 295)
Deferred income tax	(19 620)	1 220
Valuation of financial assets at fair value through other comprehensive income	**104 292**	***n/a***
Unrealized gains on debt instruments	184 042	*n/a*
Unrealized losses on debt instruments	(47 501)	*n/a*
Deferred income tax	(32 249)	*n/a*
Available-for-sale financial assets	***n/a***	**164 413**
Unrealized gains on debt instruments	*n/a*	191 650
Unrealized losses on debt instruments	*n/a*	(7 562)
Unrealized gains on equity instruments	*n/a*	15 903
Deferred income tax	*n/a*	(35 578)
Actuarial gains and losses relating to post-employment benefits	**(9 113)**	**(6 605)**
Actuarial (losses)	(11 251)	(8 154)
Deferred income tax	2 138	1 549
Share of other comprehensive income of entities under the equity method	**3 120**	**3 770**
Share of other comprehensive income of subsidiaries and associates	3 120	3 770
Total other components of equity	**176 782**	**151 044**

In 2018, unrealized gains on equity instruments relate mainly to positive valuation of debt securities of the banking book, caused by a decrease in interest rates in the last quarter of 2018, resulting from interest rate drops in global markets.

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

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39. Dividend per share

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.

40. Explanatory notes to the statement of cash flows

Cash and cash equivalents

For the purposes of the cash flow statement cash and cash equivalents include the following balances with maturities of less than three months.

	31.12.2018	31.12.2017
Cash and balances with the Central Bank (Note 18)	9 182 971	7 383 518
Loans and advances to banks (Note 22)	666 405	1 134 541
Trading securities issued by General governments (Note 19)	748 294	1 232 515
Total cash and cash equivalents	**10 597 670**	**9 750 574**

Supplementary information to the cash flow statement

Explanation of differences between the change in the balances resulting from the balance sheet and the change disclosed in the cash flows from operating activities

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	Year ended 31 December 2018
Loans and advances to banks - change in the balance of the statement of financial position	**(246 577)**
Exclusion of a change in the balance of cash and cash equivalents	(468 136)
Total change in loans and advances to banks	**(714 713)**
Financial assets held for trading and derivatives held for hedges - change in the balance of the statement of financial position	**530 418**
The difference between the interest accrued and paid in cash in the period	87 178
Valuation included in other comprehensive income	109 681
Exclusion of a change in the balance of cash and cash equivalents	(484 221)
Total change in financial assets held for trading and derivatives held for hedges	**243 056**
Loans and advances to customers - change in the balance of the statement of financial position	**(7 637 821)**
The difference between the interest accrued and paid in cash in the period	(188 214)
Total change in loans and advances to customers	**(7 826 035)**
Financial assets at fair value through other comprehensive income - change in the balance of the statement of financial position	**(3 159 455)**
Valuation included in other comprehensive income	(7 062)
The difference between the interest accrued and paid in cash in the period	(497 381)
Total change in financial assets at fair value through other comprehensive income	**(3 663 898)**
Debt securities measured at amortised cost - change in the balance of the statement of financial position	**(480 368)**
The difference between the interest accrued and paid in cash in the period	203 363
Total change in debt securities measured at amortised cost	**(277 005)**
Otherther assets - change in the balance of the statement of financial position	**(236 111)**
Balances unrealised in cash recognised in income statement	(1 817)
Total change in other assets	**(237 928)**
Amounts due to other banks - change in the balance of the statement of financial position	**(1 952 945)**
The difference between the interest accrued and paid in cash in the reporting period	12 176
Exclusion of change in cash flows from financing activity	2 644 697
Total change in amounts due to other banks	**703 928**
Amounts due to customers - change in the balance of the statement of financial position	**10 514 770**
The difference between the interest accrued and paid in cash in the reporting period	207 320
Exclusion of change in cash flows from financing activity	734 364
Total change in amounts due to customers	**11 456 454**
Debt securities in issue - change in the balance of the statement of financial position	**2 857 724**
Exclusion of change in cash flows from financing activity	(2 829 853)
Total change in debt securities in issue	**27 871**
Changes in other liabilities - change in the balance of the statement of financial position	**465 589**
Valuation of incentive programmes recognised in income statement (Note 12)	10 224
Exclusion of settlements arising from valuation of assets held to sale	3 304
Exclusion of tax liabilities of certain financial institutions	(3 259)
Actuarial gains and losses relating to post-employment benefits recognised in other comprehensive income (Note 17)	(3 097)
Total change in other liabilities	**472 761**

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	Year ended 31 December 2017
Loans and advances to banks - change in the balance of the statement of financial position	**1 245 067**
The difference between the interest accrued and paid in cash in the reporting period	(107 683)
Exclusion of a change in the balance of cash and cash equivalents	(1 191 363)
Total change in loans and advances to banks	**(53 979)**
Trading securities - change in the balance of the statement of financial position	**2 289 804**
Exclusion of a change in the balance of cash and cash equivalents	**(2 270 514)**
Total change in trading securities	**19 290**
Derivative financial instruments - change in the balance of the statement of financial position	**81 542**
The difference between the interest accrued and paid in cash in the period	79 833
Valuation included in other comprehensive income	(4 511)
Total change in derivative financial assets	**156 864**
Loans and advances to customers - change in the balance of the statement of financial position	**(1 127 607)**
The difference between the interest accrued and paid in cash in the reporting period	**(103 546)**
Total change in loans and advances to customers	**(1 231 153)**
Investment securities and investments in subsidiaries and associates- change in the balance of the statement of financial position	**(950 088)**
Valuation included in other comprehensive income	218 984
The difference between the interest accrued and paid in cash in the period	(298 392)
Sale of investments securities and investments in subsidiaries	(32 863)
Exclusion of a change in the balance resulting from valuation using equity method in investments in subsidiaries and associates	51 350
Increase of involvement in subsidiaries and non-controlling interests included in financing activity	349 039
Total change in investment securities	**(661 970)**
Changes in other assets - change in the balance of the statement of financial position	**(47 732)**
Balances unrealised in cash recognised in income statement	**7 066**
Total change in other assets	**(40 666)**
Amounts due to other banks - change in the balance of the statement of financial position	**(3 413 298)**
The difference between the interest accrued and paid in cash in the reporting period	(42 415)
Exclusion of change in cash flows from financing activity	3 568 353
Total change in amounts due to other banks	**112 640**
Amounts due to customers including hedge accounting adjustments related to fair value hedged items - change in the balance of the statement of financial position	**310 731**
The difference between the interest accrued and paid in cash in the reporting period	40 773
Exclusion of change in cash flows from financing activity	(770 956)
Total change in amounts due to customers	**(419 452)**
Changes in other liabilities - change in the balance of the statement of financial position	**378 673**
Valuation of incentive programmes recognised in income statement (Note 12)	8 700
Exclusion of tax liabilities of certain financial institutions	833
Exclusion of settlements arising from the application of the equity method	2 376
Actuarial gains and losses relating to post-employment benefits recognised in other comprehensive income (Note 17)	724
Total change in other liabilities	**391 306**

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Interests received and paid from operating activities

	Year ended 31 December	
	2018	2017
Interest income, including:		
Loans and advances to banks	161 966	165 299
Loans and advances to customers	2 959 928	2 666 791
Trading debt securities	73 055	63 651
Debt securities measured at fair value through other comprehensive income	874 312	949 535
Interest income on derivatives classified into banking book	81 360	38 440
Interest income on derivatives concluded under hedge accounting	98 261	65 511
Other interest income	5 626	4 551
Total interest income	**4 254 508**	**3 953 778**

	Year ended 31 December	
	2018	2017
Interest expense, including:		
Settlements with banks due to deposits received	(12 176)	(16 363)
Settlements with customers due to deposits received	(643 801)	(545 329)
Security deposit received in relation with the guarantee granted to secure underwriting of securities	(146 295)	(152 612)
Other interest expense	(6 881)	(7 520)
Total interest expense	**(809 153)**	**(721 824)**

Cash flows from investing activities

In 2018, cash flows from investing activities were related to the acquisition, sale and increase of shares in subsidiaries as well as dividends received by the Bank. Other cash flows from this activity relate to settlements in connection with the purchase of intangible assets and fixed assets.

Cash flows from financing activities

Cash flows from financing activities mainly relate to the inflows from issue of debt securities issued by the Bank, inflows from the issue of subordinated liabilities and settlements due to long-term loans received from other banks (Note 28) and the European Investment Bank (Note 28).

In addition, in 2017 the inflows from financing activities of the Bank include the security deposits received from the subsidiary mFinance France S.A. under the guarantee provided by the Bank in connection with the issuance of Eurobonds with a nominal value of CHF 200 000 thousand.

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

	As at 31.12.2017	Cash flows	Change not connected with cash fows	As at 31.12.2018
Loans and advances to banks (Note 28)	3 394 340	(2 785 864)	138 858	747 334
Loans and advances to other customers (Note 28)	4 142 944	(858 678)	172 998	3 457 264
Debt securities in issue (Note 28)	-	2 812 921	44 803	2 857 724
Subordinated liabilities (Note 28)	2 158 143	245 562	70 458	2 474 163
Total liabilities from financing activities	**9 695 427**	**(586 059)**	**427 117**	**9 536 485**

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

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

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41. Share-based incentive programmes

2014 Incentive Programme for the Management Board Members of the Bank

On 31 March 2014 the Supervisory Board in accordance with the recommendation of Remuneration Committee of the Supervisory Board adopted a Regulation of the Incentive Programme in mBank S.A., which replaced the Regulation of the Incentive Programme in mBank S.A. dated at 7 December 2012.

Under the program the Management Board Members have the right to bonus, including non-cash bonus paid in Bank's shares, including phantom shares.

The net ROE of mBank Group and the monthly remuneration of the member of the Board as at 31 December form the basis for acquisition by Members of the Management Board of the right to bonus and for calculation of the amount of bonus for a given financial year. Equivalent of 50% of the base amount calculated based on ROE constitutes the so-called first part of the bonus. In regard to the remaining 50% of the base amount, the Remuneration Committee of the Supervisory Board can grant the second part of the bonus if it decides that a given Member of the Management Board achieved the annual/multi-year business and development objective. The decision of granting the second part of the bonus is the sole responsibility of Remuneration Committee of the Supervisory Board, which according to its own judgement and decision confirm MBO achievement taking into account the situation on financial markets in the last/previous financial period.

The sum of the first and the second part of bonus is the base bonus of the member of the Board for a given financial period. 40% of the base bonus constitutes non-deferred bonus and is paid in the year of determination of base bonus as follows: 50% in form of cash payment and 50% in Bank's shares or bonds with pre-emptive rights to acquire shares or phantom shares.

60% of the base bonus is deferred bonus and is paid in three equal tranches in the next three following years after the year of determining the base bonus as follows: 50% of each of the deferred tranches in form of cash payment and 50% of each of the deferred tranches in form of non-cash payment in Bank's shares or bonds with pre-emptive rights to acquire shares or phantom shares.

The Supervisory Board on the basis of recommendation of Remuneration Committee can make a decision to suspend in whole or reduce the amount of deferred tranche due to the later assessment of the performance of the Member of the Management Board over a period of time longer than one financial year (i.e. for the period of at least 3 years), which takes into account the business cycle of the Bank as well as the risk related to the bank's operations, but only when the acts or omissions of the Member of the Management Board had a direct and adverse impact on the Bank's financial result and market position within the assessment period and when at least one of the elements included in the assessment card is not fulfilled.

Remuneration Committee of the Supervisory Board can make a decision on suspending in whole or decreasing the non-deferred and deferred bonus amount for a given financial year, including deferred tranches not paid out yet, in the situation referred to in Article 142 (1) of the Banking Law Act. Suspending in whole or decreasing the non-deferred and deferred bonus, as well as any deferred tranche by the Remuneration Committee of the Supervisory Board can also apply to the non-deferred and deferred bonus, including deferred tranche not paid out yet after expiry or termination of the management contract.

The table below presents the number of share options related to the 2014 incentive programme for Management Board Members of the Bank.

	31.12.2018		31.12.2017	
	Number of options	Weighted average exercise price (in PLN)	Number of options	Weighted average exercise price (in PLN)
Outstanding at the beginning of the period	**15 542**	**-**	**17 210**	**-**
Granted during the period	8 021	-	11 993	-
Forfeited during the period	-	-	3 385	-
Exercised during the period*	11 334	4	10 276	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**12 229**	**-**	**15 542**	**-**
Exercisable at the end of the period	**-**	**-**	**-**	**-**

* In 2018, the weighted average price of the shares was PLN 430.59 (in 2017 PLN 421.21).

Cash Part of the Bonus

50% of the base amount constitutes bonus cash payment. It is recognised as a liability to employees and charged to the income statement in the correspondence to liability to employees.

Share-Based Payments Settled in mBank S.A. Shares

50% of the base amount constitutes bonus payment settled in mBank S.A. shares. The cost of payments settled in shares is recognised in the income statement in the correspondence with other reserve capital.

This is equity-settled share-based program.

On 2 March 2015 the Supervisory Board extended the duration of the program from 31 December 2018 until 31 December 2021 in accordance with the recommendation of the Supervisory Board Remuneration Committee.

Employee programme for key management staff of mBank Group of 2014

On 31 March 2014, the Supervisory Board of the mBank adopted on the basis of recommendation of Remuneration Committee a resolution amending the rules of the employee programme, which replaced the incentive programme for key management staff of mBank Group from 2013, whereas in regard to the persons who acquired bonds with pre-emptive rights to acquire shares of the Bank or were granted right to acquire bonds in Tranches III, IV, V and VI the programme was to be carried out under the previous principles.

On March 2, 2015, the Supervisory Board of the mBank extended the duration of the program from December 31, 2019 to December 31, 2022 in accordance with the recommendation of the Remuneration Committee.

The aim of the programme is to ensure growth in the value of the Company's shares by linking the interest of the key management staff of mBank Group with the interest of the Company and its shareholders and implementing in mBank Group variable components of remuneration of the persons holding managerial positions at mBank Group.

The bonds granted under the III, IV, V and VI were purchased by entitled persons, and the rights to subscribe for shares under the conditional capital increase resulting from the bonds were exercised.

The last settlements of the above-mentioned Tranches were realized in 2017.

Beginning with Tranche VII the right to purchase bonds granted to the entitled person will be divided into four parts, which may be realized respectively: I part – non-deferred bonds representing 50% of the 60% of the amount of discretionary bonus granted for a given financial year in the year of granting the right, and then another three equal parts – deferred bonds constituting 50% of the 40% of the amount of discretionary bonus granted for a given financial year on the lapse of 12, 24 and 36 months from the date of granting the rights, in accordance with the internal regulations adopted in mBank Group specifying rules of variable remuneration of the employees having a material impact on the risk profile at mBank Group.

The Bank's Management Board/Supervisory Board of the Company, where the Programme is carried out may take a decision on suspending the Programme in whole or decreasing the number of bonds or the number of bonds deferred in a given tranche for the entitled person in case of occurrence of the situations, referred to in Article 142 (1) of the Banking Law Act, occurrence of balance sheet loss or loss of liquidity, meeting the conditions set forth in the agreements with the program participants, forming the basis for provision of work or other services for the Bank and subsidiaries.

Cash Part of the Bonus

The bonus in the amount of 50% of the base amount for the year is cash payment. It is recognised as a liability to employees and charged to the income statement in the correspondence to the liability to employees.

Share-Based Payments settled in mBank S.A. shares

The bonus in the amount of 50% of the base amount constitutes a payment settled in mBank S.A. shares.

The cost of payments settled in shares is recognised in the income statement in the correspondence with other reserve capital.

This is equity-settled share-based program.

Under this program, starting from Tranche VII, a bonus was granted for the years 2014-2017. The last settlements fall on 2021.

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

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	31.12.2018		31.12.2017	
	Number of options	Weighted average exercise price (in PLN)	Number of options	Weighted average exercise price (in PLN)
Outstanding at the beginning of the period	**15 396**	**-**	**11 309**	**-**
Granted during the period	11 423	-	20 339	-
Forfeited during the period	-	-	82	-
Exercised during the period*	13 526	4	16 170	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**13 293**	**-**	**15 396**	**-**
Exercisable at the end of the period	**-**	**-**	**-**	**-**

* In 2018, the weighted average price of the shares was PLN 430.59 (in 2017 PLN 421.21).

2018 incentive programme for the Management Board Members and key staff of mBank Group – mBank Risk Takers

On April 18, 2018, the Supervisory Board, acting in line with the recommendation of the Remuneration Committee of the Supervisory Board and the decision of the Annual General Meeting of mBank S.A. of May 18, 2018, adopted the mBank S.A. Incentive Programme Rules.

The Programme replaced the existing programmes, that is the employee programme introduced by the resolution of the Extraordinary General Meeting of mBank S.A. of October 27, 2008, as amended, and the programme for the Management Board Members, introduced by the resolution of the Annual General Meeting of mBank S.A. of March 14, 2008, as amended. At the same time, the rights arising from bonds acquired under the replaced programmes will be exercised under the rules of those programmes.

The new programme will be implemented from January 1, 2018 to December 31, 2028. Eligible persons under the programme include persons holding positions identified as having a material impact on the bank's risk profile pursuant to the Risk Takers Identification Policy, referred to as Risk Takers I or Risk Takers II, excluding Risk Takers II – Members of the Management Board of mBank Hipoteczny S.A., which applies a different incentive programme.

"Risk Taker I" means a Member of the Management Board of the bank. "Risk Taker II" means a person holding a position identified as having a material impact on the bank's risk profile pursuant to the Risk Takers Identification Policy, including a person holding a position of a Management Board Member in an mBank Group subsidiary.

On the terms and conditions stipulated in the Rules and the Risk Takers Remuneration Policy, Risk Takers will be able to acquire warrants free of charge, and, by way of exercising the rights arising from the warrants, to acquire shares.

Bonus for Risk Takers I

The Supervisory Board determines the bonus amount for a given calendar year for each Management Board Member individually, based on the assessment of MBO achievement with respect to the period of at least 3 years, with the proviso that the bonus amount depends on the bonus pool. The bonus pool is a total of base amounts calculated for each Management Board Member. The base amount is calculated as a multiple of the base salary, which depends on the Economic Profit (EP); EP is calculated for the period of 3 years pursuant to the rules specified in the Risk Takers Remuneration Policy.

The bonus consists of the non-deferred part (40% of the bonus) and the deferred part (60% of the bonus).

Both, the deferred part and the non-deferred part, are divided into equal portions: 50% paid in cash and 50% paid in subscription warrants. The non-deferred part in cash is paid in the year when the bonus is granted. The other half of the non-deferred part (50%) is paid in the form of subscription warrants, not earlier than after the lapse of 12 months from the date of the Annual General Meeting of mBank S.A.

The deferred part, both the cash portion and the subscription warrant portion, is paid in 5 equal annual tranches. In each tranche, the cash portion is paid once the consolidated financial statements of mBank Group for the previous calendar year have been approved, and the subscription warrant portion is paid not earlier than after the lapse of 12 months from the date on which the consolidated financial statements are approved.

Bonus for Risk Takers II

The bonus amount for a given calendar year is determined on the basis of: assessment of MbO achievement for the period of the last three calendar years, the Economic Profit of mBank Group and the result of a business line/subsidiary/organisational unit, by the bank's Management Board for Risk Takers II (the bank's employees) or by a subsidiary's Supervisory Board for Risk Takers II (Members of the Management Board of an mBank Group subsidiary).

The bonus consists of the non-deferred part (60% of the bonus) and the deferred part (40% of the bonus).

Both, the deferred part and the non-deferred part are divided into equal portions: 50% paid in cash and 50% paid in subscription warrants.

The non-deferred part in cash is paid in the year when the bonus is granted. The other half of the non-deferred part (50%) is paid in the form of subscription warrants, not earlier than after the lapse of 12 months from the date of the Annual General Meeting of mBank S.A.

The deferred part, both the cash portion and the subscription warrant portion, is paid in 3 equal annual tranches. In each tranche, the cash portion is paid once the consolidated financial statements of mBank Group for the previous calendar year have been approved, and the subscription warrant portion is paid not earlier than after the lapse of 12 months from the date on which the consolidated financial statements are approved.

In the case when the bonus amount determined for a Risk Taker II (the bank's employee) for a given calendar year does not exceed PLN 200,000, the total amount of the bonus may be, based on a relevant decision of the bank's Management Board, paid in cash in a non-deferred form.

The deferred bonus part for Risk Takers I and Risk Takers II is assessed in terms of its determination and payment. The Supervisory Board of mBank (with respect to Risk Takers I), the Management Board of mBank (with respect to Risk Takers II – the bank's employees) or the Supervisory Board of an mBank Group subsidiary (with respect to Risk Takers II – Members of the subsidiary's Management Board) may decide to withhold the full amount or to reduce the amount of a deferred tranche if it concludes that in a time horizon longer than one financial year, i.e. a period of at least 3 years, the Risk Taker had a direct and negative impact on the financial result or the market position of the bank/subsidiary/group, violated the rules and standards adopted in mBank Group or directly contributed to significant financial losses, where at least one of the scorecard components has not been met or any of the premises stipulated in Article 142 (2) of the Banking Law Act has occurred.

If the circumstances referred to above occur at the stage of determining the Risk Taker bonus amount, the Supervisory Board of mBank/the Supervisory Board of the subsidiary/the Management Board of mBank may decide not to grant a bonus for a given calendar year or to reduce it.

Moreover, a Risk Taker I or Risk Taker II may be obliged, under the rules and within the time limit determined by the decision of the Supervisory Board of mBank/the Supervisory Board of the subsidiary/the Management Board of mBank, to return the bonus granted and paid for a given calendar year (i.e. the non-deferred part and all deferred parts) if he/she has violated rules and standards adopted in mBank Group, has materially violated the generally applicable law or has directly contributed to significant financial losses being the consequence of his/her deliberate adverse actions to the detriment of mBank Group/the subsidiary or has contributed to financial sanctions being imposed on the bank/subsidiary by supervisory bodies under a final and non-appealable decision.

The decision determining the occurrence of the said events may be taken by the end of the calendar year when the last tranche of the deferred part of the bonus granted for the year in which the event occurred is paid.

In the case of a resolution of the General Meeting of mBank S.A. on payment of dividend for a given year, a Risk Taker I and a Risk Taker II to whom the bonus has been granted within the deferred or non-deferred part is entitled to a cash equivalent, regardless of the bonus, pursuant to the rules specified in the Risk Takers Remuneration Policy, in connection with the deferral of the portion paid in subscription warrants.

The bonus paid under the said programme will first be granted to Risk Takers I and Risk Takers II in 2019 for 2018.

Summary of the Impact of the Programmes on the Bank's balance sheet and income statement

Share-Based Payments Settled in Shares

The table below presents changes in other reserve capital generated by the above mentioned incentive programmes for share-based payments settled in mBank S.A. shares.

	31.12.2018	31.12.2017
Incentive programs		
As at the beginning of the period	**22 638**	**26 891**
- value of services provided by the employees	10 224	8 700
- settlement of exercised options	(10 410)	(12 953)
As at the end of the period	**22 452**	**22 638**

Cash Payments

The cost of the cash part of the programmes is presented in Note 12 "Overhead costs".

42. Transactions with related entities

mBank S.A. is the parent entity of mBank S.A. Group and Commerzbank AG is the ultimate parent of the Group as well as the direct parent of mBank S.A.

All transactions between the Bank and related entities were typical and routine transactions concluded on terms, which not differ from arm's length terms, and their nature, terms and conditions resulted from the current operating activities conducted by the Bank. Transactions concluded with related entities as a part of regular operating activities include loans, deposits and foreign currency transactions.

The Bank provides standard financial services to the Bank's key management personnel, Members of the Supervisory Board of the Bank and close members of their families, which comprise i.e.: maintaining bank accounts, taking deposits, granting loans or other financial services. In the Bank's opinion, these transactions are concluded on market terms and conditions.

Pursuant the Banking Law, the extension of a loan, cash advance, bank guarantee or other guarantee to the Members of the Management Board and Supervisory Board of the Bank, persons holding managerial positions at the Bank as well as at entities related financially or organisationally therewith, is governed by the By-Laws adopted by the Supervisory Board of mBank S.A.

The By-Laws set out detailed rules and debt limits for loans, cash advances, bank guarantees, and other guarantees in relation to aforementioned persons and entities which are consistent with the Bank's internal regulations defining the competences of granting credit decisions concerning retail and corporate clients of the Bank. A decision to grant a loan, cash advances, bank guarantee or other guarantee to a Member of the Management Board and Supervisory Board of the Bank, person holding managerial position at the Bank or an entity related financially or organisationally therewith in excess of the limits set by the Banking Law is taken by the resolution of the Management Board and by the resolution of the Supervisory Board.

The terms and conditions of such loans, cash advances, bank guarantees or other guarantees, including in particular those related to interest rates as well as fees and commissions, cannot be more advantageous than the terms and conditions offered by the Bank to its retail or corporate clients, respectively.

The table below presents the values of transactions between the Bank and Members of the Supervisory Board and the Management Board of mBank, key executive management of mBank, Members of the Supervisory Board and the Management Board of Commerzbank and other related persons and entities, as well as with transactions with other Commerzbank AG Group entities. The amounts of transactions include assets, liabilities and related costs and income as at 31 December 2018 and 31 December 2017 and for the respective periods then ended are as follows:

(in PLN 000's)	Members of Supervisory Board, Management Board and key management personnel of mBank as well as Supervisory Board and Management Board of Commerzbank AG		Other related persons *		mBank's subsidiaries		Commerzbank AG		Other companies of the Commerzbank AG Group excluding mBank subsidiaries	
As at the end of the period	**31.12.2018**	**31.12.2017**	**31.12.2018**	**31.12.2017**	**31.12.2018**	**31.12.2017**	**31.12.2018**	**31.12.2017**	**31.12.2018**	**31.12.2017**
Statement of Financial Position										
Assets	3 247	1 522	1 583	85	16 098 429	15 030 592	555 690	610 053	7 587	9 084
Liabilities	14 909	11 895	1 955	1 140	8 179 812	8 085 667	1 918 804	4 053 070	56 543	37 064
Income Statement										
Interest income	90	14	49	3	319 373	269 619	100 581	110 603	535	431
Interest expense	(77)	(118)	(2)	(7)	(163 020)	(157 822)	(65 321)	(107 883)	(273)	(293)
Commission income	93	76	7	13	14 851	18 232	3 771	1 158	84	39
Commission expense	-	-	-	-	(187 180)	(110 433)	(4 828)	(5)	-	-
Other operating income	-	-	-	-	21 554	11 082	1 458	24	-	-
Overhead costs amortisation and other operating expenses	-	-	-	-	(6 485)	(12 360)	(8 647)	(8 865)	-	-
Contingent liabilities granted and received										
Commitments granted	583	635	462	121	10 058 396	10 254 799	1 842 625	2 099 374	-	7 057
Commitments received	-	-	-	-	-	-	2 074 354	1 632 240	-	8 385

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* Other related persons and entities include: close family members of Members of the Supervisory and the Management Board of mBank, key executive management of mBank, Members of the Supervisory Board and the Management Board of Commerzbank, entities controlled or jointly controlled by above mentioned persons.

In 2018 and 2017, no provisions were created in connection with credits granted to related entities.

Management Board Remuneration

On 12 April 2018, the 30th 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.

At the end of 2018, the composition of the Management Board of mBank S.A. remained unchanged.

Information on the salaries, bonuses and benefits paid and due to the Members of the Management Board of the Bank who were performing their functions at the end of 2018, as at 31 December 2018 is presented below:

		Remuneration paid in 2018 (in PLN)			
		Basic salary	Other benefits	Bonus for 2017	Deferred bonus*
1.	Cezary Stypułkowski	3 580 421	241 475	434 466	805 415
2.	Lidia Jabłonowska-Luba	1 629 000	183 087	150 000	445 000
3.	Frank Bock	1 694 638	252 467	108 334	-
4.	Andreas Böger	1 729 940	132 699	87 500	-
5.	Krzysztof Dąbrowski	1 733 565	146 847	150 000	76 667
6.	Cezary Kocik	1 879 956	199 194	250 000	475 000
7.	Adam Pers	1 676 801	126 426	126 334	90 000
	Razem	**13 924 321**	**1 282 195**	**1 306 634**	**1 892 082**

*In 2018, there was paid the third deferred tranche as a settlement of the cash equivalent of bonus for the year 2014, the second deferred tranche as a settlement of the cash equivalent of bonus for the year 2015, as well as the first tranche as a settlement of the cash equivalent of bonus for the year 2016. Mr. Krzysztof Dąbrowski and Mr. Adam Pers were paid out the deferred tranches as the settlement of cash equivalents of the bonus, granted in the period of performing function of the Managing Directors, which would be paid out in 2018.

Remuneration of the former Management Board Members paid in the year 2018:

		Remuneration paid in 2018 (in PLN)			
		Basic salary	Other benefits	Bonus for 2017	Deferred bonus*
Remuneration of the former Management Board Members who ceased performing their functions in the year 2017					
1.	Christoph Heins	-	-	75 000	62 500
2.	Jarosław Mastalerz	-	-	50 000	475 000
3.	Przemysław Gdański	-	-	166 668	445 000
Remuneration of the former Management Board Members who ceased performing their functions in the year 2016					
1.	Joerg Hessenmueller	-	-	-	402 500

* In 2018, Members of the Management Board who ceased to perform their functions in 2017 and Mr. Joerg Hessenmueller received the third deferred tranche as part of the settlement of the cash equivalent of bonus for the year 2014, the second deferred tranche as part of cash bonus settlement for the year 2015 and the first tranche as part of cash bonus settlement for the year 2016.

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Information on the salaries, bonuses and benefits paid and due to the Members of the Management Board of the Bank who were performing their functions at the end of 2017, as at 31 December 2017 is presented below:

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

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

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

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

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

The total compensation of members of the Management Board consists of: basic salary, bonuses, termination payments of management agreement, prohibition of competitiveness payment, insurance costs and accommodation costs.

The above mentioned benefits are short-term employee benefits.

In accordance with the Bank's remuneration system, the members of the Management Board of the Bank may be eligible to receive bonuses for the year 2018, which would be paid out in 2019. Therefore, a provision was created for the payment of a cash bonus for 2018 for the members of the Management Board, which amounted to PLN 4 752 541 as of 31 December 2018. The final decision concerning the level of the bonus will be taken by the Remuneration Committee of the Supervisory Board by 26 February 2019.

In 2018 and 2017, the members of the Management Board of mBank S.A. did not receive compensation for their role as members of the management boards and supervisory boards of the Bank's related companies.

The total amount of remuneration received in 2018 by Bank's Management Board members was PLN 18 405 232 (2017: PLN 19 495 950).

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

From the date of appointment of the members of the Management Board for the new term of office, i.e. from the date of the General Meeting approving the financial statements for 2017, members of the Management Board are obliged to refrain from any competitive activity within six months from the date of termination or expiration of the management contract. In addition, the Remuneration Committee may decide to extend the obligation to refrain from competitive activities for a further period of maximum of six months, or at the request of the Manager, decide to release the Manager from the obligation referred to above. During the period of restraining from any competitive activity, a Manager is entitled to a severance payment in the amount proportional to that period, equal to the product of the monthly remuneration and the number of months of period of restraining from any competitive activity.

Supervisory Board Compensation

At the end of 2018, the composition of the Supervisory Board of mBank S.A. it was as follows:

1. Maciej Leśny – Chairman of the Supervisory Board, Chairman of the Executive and Nominations Committee, Member of the Remuneration Committee,
2. Stephan Engels – Deputy Chairman of the Supervisory Board, Member of the Remuneration Committee,
3. Tomasz Bieske – Member of the Supervisory Board, Chairman of the Audit Committee, Member of the Remuneration Committee,
4. Andre Carls – Member of the Supervisory Board, Chairman of the Remuneration Committee, Member of the Executive and Nominations Committee, Member of the Audit Committee,
5. Marcus Chromik – Member of the Supervisory Board, Chairman of the Risk Committee,
6. Janusz Fiszer – Member of the Supervisory Board, Member of the Audit Committee,
7. Mirosław Godlewski – Member of the Supervisory Board, Member of the Risk Committee,
8. Jörg Hessenmüller– Member of the Supervisory Board, Member of the Audit Committee,
9. Gurjinder Singh Johal – Member of the Supervisory Board, Member of the Risk Committee,
10. Michael Mandel – Member of the Supervisory Board,
11. Teresa Mokrysz – Member of the Supervisory Board, Member of the Executive and Nominations Committee,
12. Agnieszka Słomka-Gołębiowska – Member of the Supervisory Board, Member of the Risk Committee, Member of the Audit Committee.

- Changes in the composition of the Supervisory Board of mBank S.A.

On September 11, 2018, Mr. Maciej Leśny, Chairman of the Bank's Supervisory Board, received a letter of resignation from Mr. Thorsten Kanzler, who decided to resign as member of the Bank's Supervisory Board and member of the Risk Committee of the Bank's Supervisory Board as of September 23, 2018

On September 24, 2018, by the resolution of the Supervisory Board of mBank S.A., Mr. Gurjinder Singh Johal was appointed as a member of the Supervisory Board of mBank S.A. on September 24, 2018 until the end of the current term of office of the Supervisory Board.

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Information about the Supervisory Board members' salaries, bonuses and benefits paid as at 31 December 2018 and 31 December 2017 is presented below:

		Remuneration paid in 2018 (in PLN)	Remuneration paid in 2017 (in PLN)
1.	Maciej Leśny	367 235	367 235
2.	Stephan Engels	-	-
3.	Tomasz Bieske	429 025	319 656
4.	Andre Carls	288 000	279 000
5.	Marcus Chromik	-	-
6.	Janusz Fiszer	216 000	162 000
7.	Mirosław Godlewski	216 000	162 000
8.	Joerg Hessenmueller	216 000	210 000
9.	Gurjinder Singh Johal	54 000	-
10.	Michael Mandel	-	-
11.	Teresa Mokrysz	220 225	220 225
12.	Agnieszka Słomka-Gołębiowska	257 435	248 435
	Thorsten Kanzler*	162 000	216 000
	Wiesław Thor**	-	37 812
	Waldemar Stawski**	-	55 812
	Marek Wierzbowski**	-	54 000
	Razem	**2 425 920**	**2 332 175**

* On 23 September 2018, Mr. Thorsten Kanzler resigned from the office.

** The term of office expired on 30 March 2017.

In accordance with the wording of paragraph 11(j) of the By-laws of mBank S.A., the General Meeting determines remuneration for members of the Supervisory Board in a resolution. Remuneration of the Management Board members is determined by the Supervisory Board (paragraph 22.1(e) of the By-laws of mBank S.A.).

The total compensation of Members of the Supervisory Board, the Management Board and other key executive management of the Bank that perform their duties in 2017 amounted to PLN 28 757 076 (2017: PLN 28 135 617).

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

As at 31 December 2018, the Bank shares were held by four Members of the Management Board: Mr. Cezary Stypułkowski – 19 384 shares, Mr. Frank Bock – 223 shares, Mr. Andreas Böger – 180 shares and Mr. Krzysztof Dąbrowski – 1 630 shares.

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

As at 31 December 2018, the Bank shares were held by one Member of the Supervisory Board of mBank S.A., Mr. Jörg Hessenmüller – 7 175 shares. As at 31 December 2018, the Members of the Supervisory Board of the Bank had no Bank's shares.

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

43. Acquisitions and disposals

- 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% in Latona S.A. to Phoebe IVS with its registered office in Denmark ("Investor"), 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 was a separate activity under which, on the basis of agency agreements, mFinanse performed insurance intermediation activities in the field of group insurance contracts as an insurance agent.

The maximum total remuneration for the transaction will amount to approximately PLN 435 million. As a result of the transaction, till 31 December 2018 the Bank recognised a net profit in the amount of PLN 207 469 thousand through valuation of mFinanse using the equity method. 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 net profit of up to PLN 118 million in the period of approximately 5 years from the end of 2018.

When settling the transaction, it was taken into account that the remuneration received pertains to remuneration for the sold enterprise and servicing of current payments. The recognized revenue was estimated as the current value of the transaction price paid, taking into account factors that may affect its potential decrease in the future, which required significant estimates to be made by the Management Board of the Bank. The judgments concerned, among others, periods in which a conditional price may be recognized depending on additional factors.

The Bank has assessed that it is reasonably certain that the income recognized in 2018 will not be reversed in subsequent periods.

44. Information about the registered audit company

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.

The agreement to conduct an audit of mBank S.A. financial statements and consolidated financial statements of mBank S.A. Group was concluded on 19 June 2018.

The total gross amount of Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością spółka komandytowa remuneration paid or payable related to the audit and review of stand-alone financial statements and consolidated financial statements of mBank S.A. was PLN 2 758 thousand in 2018.

The total amount of remaining gross remuneration paid or payable to Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością spółka komandytowa in respect of other services for mBank S.A. was PLN 367 thousand in 2018.

The entity entitled to audit financial statements for 2016 and 2017, with which mBank S.A. concluded an agreement was PricewaterhouseCoopers Sp. z o.o. The agreement to conduct an audit of mBank S.A. financial statements and consolidated financial statements of mBank S.A. Group was concluded on 24 March 2016.

The total gross amount of PricewaterhouseCoopers Sp. z o.o. remuneration paid or payable related to the audit and review of stand-alone financial statements and consolidated financial statements of mBank S.A. was PLN 3 721 thousand in 2017.

In 2017, the total amount of remaining gross remuneration paid or payable to PricewaterhouseCoopers Sp. z o.o. in respect of other services for mBank S.A. was PLN 2 154 thousand.

45. Capital adequacy

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

- are compliant with external and internal regulations in force,
- guarantee a continuity of financial targets achievement, ensuring an appropriate rate of return for shareholders,

- ensure the maintenance of a strong capital basis being a fundamental support for business development.

The capital management policy in mBank is based on:

- maintenance of an optimal level and structure of own funds with the application of available methods and means, like, among others, retention of net profit, subordinated loan or issue of shares,
- effective use of existing capital, among others through application of a set of measures of effective use of the capital, limitation of activities that do not provide an expected rate of return and development of products with lower capital absorption.

Effective use of capital is an integral part of the capital management policy oriented at reaching an optimal rate of return on capital and as a result forming a stable fundament of reinforcement of the capital basis in future periods. This enables to maintain the Common Equity Tier 1 capital ratio (calculated as a quotient of Common Equity Tier 1 capital to the total risk exposure amount), Tier 1 ratio (calculated as a quotient of Tier 1 capital to the total risk exposure amount) and the total capital ratio (calculated as a quotient of own funds and the total risk exposure amount) at least on the level required by the supervision authority.

The strategic goals of mBank are aimed at maintaining the total capital ratio as well as the Common Equity Tier 1 capital ratio above the level required by the supervision authority. This allows to maintain business development while meeting the supervisory requirements in the long perspective

Capital ratios

The adequacy assessment of the capital base, including among others: the calculation of capital ratios and the leverage ratio, the own funds, the total capital requirement and the regulatory floor requirement in the mBank was made according to the following regulations:

- the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June, 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR Regulation);
- the Commission Implementing Regulation (EU) No 680/2014 of 16 April, 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council with further amendments (ITS Regulation);
- the Banking Act of 29 August, 1997 (Dz.U. from year 2002 No 72, item 665) with further amendments;
- the Act on Macroprudential Supervision of the Financial System and Crisis Management of 5 August, 2015 (Dz.U. 2015 item 1513);
- the Regulation of the Minister of Development and Finance of 25 May, 2017 on the higher risk weight for exposures secured by mortgages on real estate,
- Regulation of the Minister of Development and Finance of September 1, 2017 regarding the systemic risk buffer.

As a result of the Act on Macro-prudential Supervision over the Financial System and Crisis Management in the Financial System (the Act) that entered into force in 2015 and transposed the CRD IV provisions to the Polish prudential regulations, as of 31 December 2018 Bank was obliged to ensure adequate own funds to meet conservation buffer of 1.875% of total risk exposure amount.

As of the end of 2018 the countercyclical capital buffer rate set for relevant exposures in Poland according with the article 83 of the Act amounted to 0%. mBank specific countercyclical capital buffer calculated in accordance with the provisions of the Act as the weighted average of the countercyclical buffer rates that apply in the countries where the relevant credit exposures of the Bank are located, amounted to 0.05% as of 31 December 2018. The value of the indicator was predominantly affected by the exposures of the mBank's foreign branches in the Czech Republic and Slovakia, where the countercyclical buffer rates at the end of 2018 were: 1% and 1.25%.

In 2016 the Bank received an administrative decision of the KNF that identified mBank as other systemically important institutions (O-SII) and imposed a capital buffer of the total risk exposure amount. Pursuant to the KNF decision of 31 July 2018 the Bank was obliged to maintain the capital buffer of 0.5% of the total risk exposure, calculated in accordance with article 92(3) of the Regulation, to be maintained on individual and consolidated levels. The value of the buffer specified in the administrative decision applies as of 31 December 2018.

Starting from January 1, 2018 the Regulation of the Minister of Development and Finance with regard to systemic risk buffer entered into force. The Regulation introduced 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, due to mBank two foreign branches in Czech Republic and in Slovakia, the systemic risk buffer rate applicable to the mBank amounted to 2.79% in December 2018.

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Consequently, the combined buffer requirement set for the mBank as of the end of 2018 amounted to 5,22% of the total risk exposure amount.

Additionally, as a result of risk assessment carried out in 2018 by the KNF within the supervisory review and evaluation process (SREP), in particular with regard to the evaluation of risk related to the portfolio of foreign exchange retail mortgage loans, the Bank received an individual recommendation to maintain own funds on the individual level to cover additional capital requirement of 4,18% for total capital ratio and 3,14% for Tier 1 capital (on consolidated level: 3,64% and 2,73% respectively). Additional capital requirement set by KNF in 2018 encompasses also additional risk factors related to the FX mortgage loan portfolio such as operational risk, market risk or risk of collective default of borrowers.

Higher, compared to the previous year, level of additional capital requirement resulted from the fact that the KNF applied one methodology to all banks in Poland. This does not take into account the results of internal models applied by mBank to the calculation of capital requirements for credit risk. KNF's methodology assumes a common starting point for all banks to determine the additional capital requirement, which consists in applying the risk weight from the standard method in Poland in calculating capital requirements for credit risk for currency exposures secured on real estate (150% risk weight) used in banks using the standard method. Consequently, more than half of the additional capital requirement calculated by the KNF for mBank comes from 'aligning' the capital requirement to the requirement calculated under the standardised approach. The second important component with effect on an additional capital requirement within Pillar II was related to the SREP score quantifying the risk of foreign exchange retail mortgage loans portfolio, taking into account the specific nature of the Bank portfolio, the following factors were taken into account:

- the share of loans with LTV >100% in the portfolio;
- the level of the Bank margin from the foreign exchange retail mortgage loans portfolio;
- sensitivity of the Bank's total capital ratio to exchange rates and interest rate changes;
- the Bank preparation for loan portfolio conversion.

Within 2018 capital ratios on the individual level were above the required values taking into account the abovementioned components.

mBank	31.12.2018		31.12.2017	
Capital ratio	Required level	Reported level	Required level	Reported level
Total capital ratio	17.40%	24.20%	18.12%	24.62%
Tier 1 ratio	14.36%	20.46%	14.09%	21.51%

The stand-alone leverage ratio, calculated in accordance with the provisions of the CRR Regulation and Commission Delegated Regulation (EU) 2015/62 of October 10, 2014, amending Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to the leverage ratio, including transitional definition of Tier 1 capital, amounted to 8.72%.

The Bank decided that for the purposes of the capital adequacy account, including calculation of own funds, pursuant to Article 1 paragraph 9 of Regulation (EU) 2017/2395 of the European Parliament and the Council of December 12, 2017 (Ordinance) amending the CRR Regulation, it will not apply transition period, which allows to mitigate the impact on capital related to the introduction of IFRS 9.

Hence, the capital ratios, the amount of Tier 1 capital and the leverage ratio reported in this document fully reflect the impact of IFRS 9.

Own Funds

In accordance with the CRR Regulation, own funds consist of Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital, however items that could be treated as Additional Tier 1 capital are not identified within mBank.

Common Equity Tier 1 capital of mBank contains:

- paid up capital instruments and the related share premium accounts,
- previous years retained earnings,
- independently reviewed interim profits,
- accumulated other comprehensive income,
- other reserves,
- funds for general banking risk,

- items deducted from a Common Equity Tier 1 (CET1) capital (fair value gains and losses arising from the institution's own credit risk related to derivative liabilities, value adjustments due to the requirements for prudent valuation, intangible assets, AIRB shortfall of credit risk adjustments to expected losses, own CET1 instruments, regulatory adjustments relating to accumulated other comprehensive income and net impairment losses).

Tier 2 capital of mBank contains: capital instruments and the related share premium accounts (subordinated liabilities with specified maturity),

The own funds of mBank as of 31 December 2018 amounted to PLN 15 873 840 thousand. Additionally the Common Equity Tier 1 capital of mBank amounted to PLN 13 419 690 thousand.

Total risk exposure amount (TREA)

The total risk exposure amount contains:

- risk weighted exposure amounts for credit risk, counterparty credit risk, dilution risk and free deliveries,
- risk exposure amount for market risk, containing position risk, foreign exchange risk and commodities risk,
- risk exposure amount for operational risk,
- risk exposure amount for credit valuation adjustment,
- other risk exposure amounts containing amounts resulted from application of supervisory floor.

As at 31 December 2018 the AIRB approach was applied to the calculation of own funds requirements for credit and counterparty credit risk for the following portfolios:

- mBank corporate portfolio,
- mBank retail mortgage loan portfolio,
- mBank real estate-related specialized lending exposure (IRB slotting approach),
- mBank retail non-mortgage exposures (conditional consent),
- mBank retail microenterprises mortgage loan portfolio (conditional consent),
- bank exposures (conditional consent).

In case of portfolios with conditional consent to the application of AIRB approach, mBank applies supervisory floor, which means that where the own funds requirement for credit risk calculated under AIRB approach is lower than the own funds requirement for credit risk calculated under standardised approach, it is necessary to supplement it up to the level of the own funds requirement for credit risk calculated under standardised approach.

With regard to retail mortgage exposures (microenterprises) and portfolio of commercial bank exposures, high significance conditions specified by the banking supervision have been met, and the Bank is waiting for formal confirmation by the banking supervision.

The total risk exposure amount of mBank as of 31 December 2018 amounted to PLN 65 581 592 thousand, including PLN 58 050 950 thousand of risk-weighted exposure amount for credit risk, counterparty credit risk and supervisory floor.

Internal capital

The ICAAP (Internal Capital Adequacy Assessment Process) implemented in mBank aims at adjusting own funds to the level and the profile of risk arising from mBank's operations.

Due to the fact that both, the total capital requirement of mBank calculated according to the CRR Regulation and the internal capital estimated for mBank according to the Resolution No. 258/2011 are lower than own funds, the own funds as at 31 December 2018 were maintained on the level consistent with the requirements of the CRR Regulation.

The internal capital of Bank as at 31 December 2018 amounted to PLN 4 686 349 thousand.

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Capital adequacy	31.12.2018	31.12.2017
Common Equity Tier 1 Capital	**13 419 690**	**12 614 436**
Total Own Funds	**15 873 840**	**14 440 192**
Risk weighted exposure amounts for credit, counterparty credit, dilution risk and free deliveries:	57 879 780	51 328 997
- including under standardised approach	14 968 233	13 420 326
- including under AIRB approach	42 909 950	37 907 456
- including risk exposure amount for contributions to the default fund of a CCP	1 597	1 215
Settlement / delivery risk exposure amount	-	-
Total risk exposure amount for position, foreign exchange and commodities risks	791 333	756 256
Total risk exposure amount for operational risks	6 518 022	6 178 124
Additional risk exposure amount due to fixed overheads	-	-
Total risk exposure amount for credit valuation adjustments	221 288	252 643
Total risk exposure amount for large exposures in the trading book	-	-
Other risk exposure amounts	171 170	131 014
Total risk exposure amount	**65 581 593**	**58 647 034**
Comon Equity Tier 1 capital ratio	**20.46%**	**21.51%**
Total capital ratio	**24.20%**	**24.62%**
Internal capital	**4 686 349**	**3 519 167**

OWN FUNDS	31.12.2018	31.12.2017
Own funds	**15 873 840**	**14 440 192**
TIER 1 CAPITAL	**13 419 690**	**12 614 436**
Common Equity Tier 1 Capital	**13 419 690**	**12 614 436**
Capital instruments eligible as CET1 Capital	3 574 636	3 563 819
Paid up capital instruments	169 330	169 143
Share premium	3 405 338	3 394 928
(-) Own CET1 instruments	(32)	(252)
Retained earnings	243 436	1 587 319
Previous years retained earnings	(248 157)	1 199 339
Profit or loss eligible	491 593	387 980
Accumulated other comprehensive income	176 782	151 044
Other reserves	9 239 105	7 168 155
Funds for general banking risk	1 115 143	1 115 143
Adjustments to CET1 due to prudential filters	(38 284)	(33 000)
Fair value gains and losses arising from the institution's own credit risk related to derivative liabilities	(2 101)	(1 938)
(-) Value adjustments due to the requirements for prudent valuation	(36 183)	(31 062)
(-) Intangible assets	(664 175)	(612 441)
(-) Other intangible assets gross amount	(693 210)	(648 191)
Deferred tax liabilities associated to other intangible assets	29 035	35 750
(-) IRB shortfall of credit risk adjustments to expected losses	(56 921)	(165 809)
Other transitional adjustments to CET1 Capital	(83 643)	(29 915)
CET1 capital elements or deductions - other	(86 389)	(129 879)
Additional Tier 1 capital	**-**	**-**
TIER 1 CAPITAL	**2 454 150**	**1 825 756**
Capital instruments and subordinated loans eligible as T2 capital	2 454 150	1 250 000
Tier 2 capital elements or deductions - other	-	-
Transitional adjustments due to grandfathered T2 capital instruments and subordinated loans	-	575 756

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Credit risk	31.12.2018	31.12.2017
Risk weighted exposure amounts for credit risk, counterparty credit risk, dilution risk and free deliveries	**57 879 780**	**51 328 997**
Standardised approach	**14 968 233**	**13 420 326**
SA exposure classes excluding securitisation positions	14 968 233	13 420 326
Central governments or central banks	30 402	30 116
Regional governments or local authorities	93 945	154 778
Public sector entities	24 745	19 850
Multilateral Development Banks	-	-
International Organisations	-	-
Institutions	233 527	149 192
Corporates	5 744 233	4 613 502
Retail	1 343 170	1 240 917
Secured by mortgages on immovable property	1 069 732	1 025 535
Exposures in default	282 165	562 806
Items associated with particular high risk	2 902	34 520
Covered bonds	-	-
Claims on institutions and corporates with a short-term credit assessment	-	-
Collective investments undertakings (CIU)	-	-
Equity	6 130 153	5 571 812
Other items	13 259	17 298
AIRB approach	**42 909 950**	**37 907 456**
AIRB approaches when neither own estimates of LGD nor Conversion Factors are used	-	-
AIRB approaches when own estimates of LGD and/or Conversion Factors are used	40 734 029	36 268 686
Central governments and central banks	-	-
Institutions	1 229 148	1 234 473
Corporates - SME	5 077 050	4 928 974
Corporates - Specialised Lending	1 944 703	1 791 791
Corporates - Other	16 066 241	12 705 172
Retail - Secured by real estate SME	901 557	1 048 526
Retail - Secured by real estate non-SME	5 433 050	5 532 303
Retail - Qualifying revolving	-	-
Retail - Other SME	2 627 879	2 384 652
Retail - Other non-SME	7 454 401	6 642 795
Equity AIRB	-	-
Securitisation positions IRB	-	-
Other non credit-obligation assets	2 175 921	1 638 770
Risk exposure amount for contributions to the default fund of a CCP	**1 597**	**1 215**

46. 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. In January, 2019 the Parliamentary subcommittee on FX mortgage loans legislative proposals returned to work on the project, approved earlier by the government.

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.Recommendation of the Polish Financial Supervision Authority (KNF) regarding additional capital requirement

- The proposals concerning foreign currency mortgage loans restructuring

On January 24, 2019 at its meeting the Parliamentary subcommittee on FX mortgage loans legislative proposals finally made a choice, from among the four legislative proposals presented so far, and decided to further proceed with the draft amendment of (i) the act on support of borrowers in financial difficulties and (ii) the act on corporate income tax. On February 21, 2019, the Parliamentary Finance Committee adopted the draft amendment. The abovementioned bill was submitted to the Parliament by the Office of the President of the Republic of Poland in August, 2017. At the moment of these financial statements publication the final form of the proposed solution 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.

47. Events after the balance sheet date

- Requirements on mBank Group capital ratios in 2019

Starting from 1 January 2019 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 from 1.875% to 2.50% of the total risk exposure amount.

Consequently the required level of capital ratios as of January 2019 will amount to:

- Individual total capital ratio – 18.02% and Tier 1 capital ratio – 14.98%
- Consolidated total capital ratio –17.50% and Tier 1 capital ratio – 14.59%.

At the date of publication of these financial statements, mBank S.A. fulfils the KNF requirements related to the required capital ratios for 2019 on both individual and consolidated levels.

- The estimated contribution to the Bank Guarantee Fund in 2019

In connection with the information of the Bank Guarantee Fund (BFG) dated 21 February 2019 concerning the total amount of contributions to the bank guarantee fund and the resolution fund to be paid by banks in 2019, the Bank estimated on the basis of Bank's payment structure in 2018 that the total mBank S.A. contribution to the BFG in 2019 would amount to approximately PLN 246 million.