mBank S.A.

IFRS Financial Statements 2019

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 2019.

		in PLN '000		in EUR '000	
		Year ended 31.12.2019	Year ended 31.12.2018 - restated	Year ended 31.12.2019	Year ended 31.12.2018 - restated
I.	Interest income	**4 454 856**	**3 961 606**	**1 035 580**	**928 451**
II.	Fee and commission income	**1 553 921**	**1 467 005**	**361 226**	**343 810**
III.	Net trading income	**442 789**	**352 317**	**102 931**	**82 570**
IV.	Operating profit	**2 089 910**	**1 824 229**	**485 822**	**427 530**
V.	Profit before income tax	**1 484 465**	**1 693 310**	**345 080**	**396 848**
VI.	Net profit	**980 980**	**1 303 820**	**228 039**	**305 566**
VII.	Net cash flows from operating activities	**(141 371)**	**1 919 196**	**(32 863)**	**449 787**
VIII.	Net cash flows from investing activities	**(114 728)**	**(221 674)**	**(26 670)**	**(51 952)**
IX.	Net cash flows from financing activities	**(797 392)**	**(871 422)**	**(185 362)**	**(204 228)**
X.	Total net increase / decrease in cash and cash equivalents	**(1 053 491)**	**826 100**	**(244 895)**	**193 607**
XI.	Basic earnings per share (in PLN/EUR)	**23.17**	**30.81**	**5.39**	**7.22**
XII.	Diluted earnings per share (in PLN/EUR)	**23.16**	**30.79**	**5.38**	**7.22**
XIII.	Declared or paid dividend per share (in PLN/EUR)	**-**	**5.15**	**-**	**1.21**

		in PLN '000		in EUR '000	
		31.12.2019	31.12.2018 - restated	31.12.2019	31.12.2018 - restated
I.	Total assets	**149 228 273**	**137 679 609**	**35 042 450**	**32 018 514**
II.	Amounts due to other banks	**1 180 782**	**3 167 210**	**277 277**	**736 560**
III.	Amounts due to customers	**121 936 987**	**109 873 386**	**28 633 788**	**25 551 950**
IV.	Equity	**16 115 007**	**15 130 170**	**3 784 198**	**3 518 644**
V.	Share capital	**169 401**	**169 348**	**39 779**	**39 383**
VI.	Number of shares	**42 350 367**	**42 336 982**	**42 350 367**	**42 336 982**
VII.	Book value per share (in PLN/EUR)	**380.52**	**357.37**	**89.36**	**83.11**
VIII.	Total capital ratio	**22.84**	**24.20**	**22.84**	**24.20**

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 2019: EUR 1 = 4.2585 and 31 December 2018: EUR 1 = PLN 4.3000.
- 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 2019 and 2018: EUR 1 = PLN 4.3018 and EUR 1 = PLN 4.2669 respectively.

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IFRS Financial Statements 2019 PLN (000's)

Income statement

	Note	Year ended 31 December	
		2019	2018 - restated
Interest income, including:	5	4 454 856	3 961 606
Interest income accounted for using the effective interest method		*3 946 091*	*3 357 644*
Income similar to interest on financial assets at fair value through profit or loss		*508 765*	*603 962*
Interest expenses	5	(910 160)	(874 097)
Net interest income		**3 544 696**	**3 087 509**
Fee and commission income	6	1 553 921	1 467 005
Fee and commission expenses	6	(642 257)	(575 803)
Net fee and commission income		**911 664**	**891 202**
Dividend income	7	320 295	126 391
Net trading income, including:	8	442 789	352 317
Foreign exchange result		*381 018*	*303 985*
Gains or losses on financial assets and liabilities held for trading		*57 986*	*52 721*
Gains or losses from hedge accounting		*3 785*	*(4 389)*
Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss	9	72 103	(155 485)
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	18 387	13 396
Gains less losses from debt securities measured at fair value through other comprehensive income		*37 178*	*16 149*
Gains less losses from investments in subsidiaries and associates		*(1 247)*	*290*
Gains less losses from derecognition		*(17 544)*	*(3 043)*
Other operating income	11	52 015	56 491
Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss	14	(633 130)	(468 902)
Result on provisions for legal risk related to foreign currency loans	30	(387 786)	(20 349)
Overhead costs	12	(1 747 369)	(1 699 470)
Depreciation	25, 26	(329 546)	(227 743)
Other operating expenses	13	(174 208)	(131 128)
Operating profit		**2 089 910**	**1 824 229**
Tax on the Bank's balance sheet items		(426 432)	(387 857)
Share in profits (losses) of entities under the equity method	23	(179 013)	256 938
Profit before income tax		**1 484 465**	**1 693 310**
Income tax expense	15	(503 485)	(389 490)
Net profit		**980 980**	**1 303 820**
Net profit attributable to Owners of mBank S.A.		**980 980**	**1 303 820**
Weighted average number of ordinary shares	**16**	**42 340 263**	**42 318 253**
Earnings per share (in PLN)	**16**	**23.17**	**30.81**
Weighted average number of ordinary shares for diluted earnings	**16**	**42 358 529**	**42 343 775**
Diluted earnings per share (in PLN)	**16**	**23.16**	**30.79**

Notes presented on pages 10–143 constitute an integral part of these Financial Statements.

IFRS Financial Statements 2019 PLN (000's)

Statement of comprehensive income

	Note	Year ended 31 December	
		2019	**2018**
Net profit		**980 980**	**1 303 820**
Other comprehensive income net of tax, including:	**17**	**(6 143)**	**70 595**
Items that may be reclassified subsequently to the income statement			
Exchange differences on translation of foreign operations (net)		9	176
Cash flows hedges (net)	19	38 507	88 841
Share of other comprehensive income of entities under the equity method		3 250	(650)
Change in valuation of debt instruments at fair value through other comprehensive income (net)		(45 929)	*(15 264)*
Items that will not be reclassified to the income statement			
Actuarial gains and losses relating to post-employment benefits (net)		(1 980)	(2 508)
Total comprehensive income (net)		**974 837**	**1 374 415**

Notes presented on pages 10–143 constitute an integral part of these Financial Statements.

IFRS Financial Statements 2019 PLN (000's)

Statement of financial position

ASSETS	Note	31.12.2019	31.12.2018 - restated	01.01.2018 - restated
Cash and balances with the Central Bank	18	7 861 776	9 182 971	7 383 518
Financial assets held for trading and hedging derivatives	19	2 921 749	2 156 551	2 519 015
Non-trading financial assets mandatorily at fair value through profit or loss, including:	20	2 035 189	2 567 330	3 494 652
Equity instruments		*87 597*	*12 226*	*9 934*
Debt securities		*133 774*	*58 130*	*46 538*
Loans and advances to customers		*1 813 818*	*2 496 974*	*3 438 180*
Financial assets at fair value through other comprehensive income	21	30 298 647	28 173 110	25 013 655
Financial assets at amortised cost, including:	22	101 310 293	91 111 844	82 191 823
Debt securities		*11 234 873*	*9 000 540*	*8 520 172*
Loans and advances to credit institutions		*7 337 703*	*5 909 341*	*5 662 764*
Loans and advances to customers		*82 737 717*	*76 201 963*	*68 008 887*
Investements in subsidiaries		2 164 112	2 300 324	2 038 294
Investments in associates	23	-	-	28 680
Non-current assets and disposal groups classified as held for sale	24	91 605	-	-
Intangible assets	25	823 109	693 210	648 191
Tangible assets	26	945 606	537 001	509 773
Current income tax assets		11 878	9 336	6 558
Deferred income tax assets	31	273 257	295 347	192 940
Other assets	27	491 052	652 585	416 474
TOTAL ASSETS		**149 228 273**	**137 679 609**	**124 443 573**
LIABILITIES AND EQUITY	**Note**			
LIABILITIES				
Financial liabilities held for trading and hedging derivatives	19	987 933	1 016 214	1 141 035
Financial liabilities measured at amortised cost, including:	28	128 979 983	118 372 483	106 703 048
Amounts due to banks		*1 180 782*	*3 167 210*	*5 089 716*
Amounts due to customers		*121 936 987*	*109 873 386*	*99 455 189*
Debt securities issued		*3 361 997*	*2 857 724*	-
Subordinated liabilities		*2 500 217*	*2 474 163*	*2 158 143*
Fair value changes of the hedged items in portfolio hedge of interest rate risk		136	-	27 046
Provisions	30	737 167	255 882	231 820
Current income tax liabilities		150 859	244 389	172 003
Deferred income tax liabilities	31	82	83	81
Other liabilities	29	2 257 106	2 660 388	2 205 202
TOTAL LIABILITIES		**133 113 266**	**122 549 439**	**110 480 235**
EQUITY				
Share capital:		**3 579 818**	**3 574 686**	**3 564 176**
Registered share capital	35	169 401	169 348	169 248
Share premium	36	3 410 417	3 405 338	3 394 928
Retained earnings:	**37**	**12 364 550**	**11 378 702**	**10 292 975**
Profit from the previous years		11 383 570	10 074 882	10 292 975
Profit for the current year		980 980	1 303 820	-
Other components of equity	**38**	**170 639**	**176 782**	**106 187**
TOTAL EQUITY		**16 115 007**	**15 130 170**	**13 963 338**
TOTAL LIABILITIES AND EQUITY		**149 228 273**	**137 679 609**	**124 443 573**

Total capital ratio	**44**	**22.84**	**24.20**	
Common Equity Tier 1 capital ratio	**44**	**19.42**	**20.46**	
Book value		**16 115 007**	**15 130 170**	**13 963 338**
Number of shares		**42 350 367**	**42 336 982**	**42 312 122**
Book value per share (in PLN)		**380.52**	**357.37**	**330.01**

Notes presented on pages 10–143 constitute an integral part of these Financial Statements.

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Statement of changes in equity

Changes from 1 January to 31 December 2019

	Share capital		Retained earnings					Other components of equity					Total
	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 operation	Valuation of financial assets at fair value through other comprehensive income	Cash flow hedges	Share in profits (losses) of entities under the equity method	Actuarial gains and losses relating to post-employment benefits	
Equity as at 1 January 2019	**169 348**	**3 405 338**	**9 216 652**	**22 452**	**1 115 143**	**1 024 455**	**-**	**(5 160)**	**104 292**	**83 643**	**3 120**	**(9 113)**	**15 130 170**
Total comprehensive income	**-**	**-**	**-**	**-**	**-**	**-**	**980 980**	**9**	**(45 929)**	**38 507**	**3 250**	**(1 980)**	**974 837**
Issuance of ordinary shares	53	-	-	-	-	-	-	-	-	-	-	-	53
Stock option program for employees	**-**	**5 079**	**-**	**4 868**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**9 947**
- value of services provided by the employees	-	-	-	*9 947*	-	-	-	-	-	-	-	-	*9 947*
- settlement of exercised options	-	*5 079*	-	*(5 079)*	-	-	-	-	-	-	-	-	-
Equity as at 31 December 2019	**169 401**	**3 410 417**	**9 216 652**	**27 320**	**1 115 143**	**1 024 455**	**980 980**	**(5 151)**	**58 363**	**122 150**	**6 370**	**(11 093)**	**16 115 007**

Changes from 1 January to 31 December 2018

	Share capital		Retained earnings					Other components of equity					Total
	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 operation	Valuation of financial assets at fair value through other comprehensive income	Cash flow hedges	Share in profits (losses) of entities under the equity method	Actuarial gains and losses relating to post-employment benefits	
Equity as at 1 January 2018	**169 248**	**3 394 928**	**7 145 517**	**22 638**	**1 115 143**	**2 289 043**	**-**	**(5 336)**	**164 413**	**(5 198)**	**3 770**	**(6 605)**	**14 287 561**
Effects of corrections of errors	-	-	-	-	-	(31 208)	-	-	-	-	-	-	(31 208)
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**	**2 009 677**	**-**	**(5 336)**	**119 556**	**(5 198)**	**3 770**	**(6 605)**	**13 963 338**
Total comprehensive income	**-**	**-**	**-**	**-**	**-**	**-**	**1 303 820**	**176**	**(15 264)**	**88 841**	**(650)**	**(2 508)**	**1 374 415**
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**	**(279 365)**	**1 303 820**	**(5 160)**	**104 292**	**83 643**	**3 120**	**(9 113)**	**15 130 170**

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Statement of cash flows

	Note	Year ended 31 December	
		2019	2018 - restated
Profit before income tax		**1 484 465**	**1 693 310**
Adjustments:		***(1 625 836)***	***225 886***
Income taxes paid		(568 734)	(438 310)
Depreciation	25, 26	329 546	227 743
Foreign exchange (gains) losses related to financial activities		69 969	293 782
(Gains) losses on investing activities		137 920	(276 120)
Change of valuation of investment in subsidiaries not measured at equity method	23	1 247	3 065
Dividends received	7	(320 295)	(126 391)
Interest income (income statement)	5	(4 454 856)	(3 961 606)
Interest expense (income statement)	5	910 160	874 097
Interest paid		4 793 999	4 254 508
Interest received		(986 693)	(809 154)
Changes in loans and advances to banks		(1 752 313)	(714 713)
Changes in financial assets and liabilities held for trading and hedging derivatives		(82 340)	(49 719)
Changes in loans and advances to customers		(9 834 916)	(7 440 081)
Changes in financial assets at fair value through other comprehensive income		1 382 375	(3 663 898)
Changes in securities at amortised cost		(2 234 333)	(277 005)
Changes in non-trading equity securities mandatorily at fair value through profit and loss		(151 015)	(13 884)
Changes in other assets		146 745	(237 928)
Changes in amounts due to banks		(1 410 583)	734 367
Changes in amounts due to customers		12 342 908	11 332 836
Changes in issued debt securities		10 337	27 871
Changes in provisions		481 285	24 062
Changes in other liabilities		(436 249)	462 364
A. Cash flows from operating activities		**(141 371)**	**1 919 196**
Disposal of shares in associates		-	54 759
Disposal of shares in subsidiaries	23	26 264	100
Disposal of intangible assets and tangible fixed assets		5 681	350
Dividends received	7	320 295	126 391
Aqusition of shares in subsidiaries	23	(161 055)	(17 512)
Purchase of intangible assets and tangible fixed assets		(305 913)	(385 762)
B. Cash flows from investing activities		**(114 728)**	**(221 674)**
Proceeds from loans and advances from banks		-	187 200
Proceeds from other loans and advances		544 735	648 378
Issue of debt secutities	28	476 036	2 812 921
Proceeds from new subordinated liabilities	28	-	750 000
Issue of ordinary shares		53	100
Repayments of loans advances from banks		(560 027)	(2 945 100)
Repayments of other loans and advances		(1 058 369)	(1 501 535)
Aquisition of shares on subsidiaries - increase of involvement		-	(1 300)
Repurchase or repayment of subordinated liabilities	28	-	(500 000)
Payments of financial lease liabilities		n/a	(5 928)
Payments due to lease agreements		(109 846)	n/a
Dividends and other payments to shareholders		-	(217 907)
Interest paid from loans and advances received from banks and subordinated liabilities		(89 974)	(98 251)
C. Cash flows from financing activities		**(797 392)**	**(871 422)**
Net increase / decrease in cash and cash equivalents (A+B+C)		**(1 053 491)**	**826 100**
Effect of exchange rate changes in cash and cash equivalents		(9 408)	20 996
Cash and cash equivalents at the beginning of the reporting period		10 597 670	9 750 574
Cash and cash equivalents at the end of the reporting period	**40**	**9 534 771**	**10 597 670**

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 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 2019, the headcount of mBank S.A. amounted to 6 072 FTEs (Full Time Equivalents) (31 December 2018: 5 839 FTEs).

As at 31 December 2019, the headcount of mBank S.A. amounted to 7 106 persons (31 December 2018: 6 766 persons).

The Management Board of mBank S.A. approved these financial statements for issue on 26 February 2020

2. Description of relevant accounting policies

The most important accounting policies applied to the drafting of these consolidated financial statements are presented below. These principles were applied consistently over all presented periods, except for the accounting principles applied in connection with the implementation of IFRS 16 as of 1 January 2019, which is described in more detail in Note 2.26.

2.1. Accounting basis

These Financial Statements of mBank S.A. have been prepared for the 12-month period ended 31 December 2019. Comparative data presented in these financial statements relate to the period of 12 months ended on 31 December 2018.

The Financial Statements of mBank S.A. have been prepared on a historical cost basis in compliance with the International Financial Reporting Standards (IFRS) as adopted for use in the European Union, except for derivative financial instruments, other financial assets and liabilities held for trading and financial assets and liabilities designated at fair value through profit or loss (FVTPL), debt and equity instruments at fair value through other comprehensive income (FVOCI) and liabilities related to cash-settled share-based payment transactions, all of which have been measured at fair value. Non-current assets held for sale or group of these assets classified as held for sale are stated at the lower of the carrying value and fair value less costs to sell.

The data for the year 2018 presented in these mBank S.A. condensed financial statements was audited by the auditor.

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

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

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

The Bank also prepares consolidated financial statements in accordance with IFRS. mBank S.A. Group Consolidated Financial Statements for the year 2019 were approved on 26 February 2020.

2.2. Interest income and expenses

All interest income on financial instruments carried at amortised cost using the effective interest rate method, 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, are recognised in the income statement.

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 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 of a financial asset or a group of similar financial assets to the Stage 3, 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:

<u>Step 1: Identifying the contract's with a customer</u>

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 discount.

<u>Step 2: Identifying performance obligations in the contract</u>

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).

<u>Step 3: Determining the transaction price</u>

The transaction price reflects the amount of consideration that the Bank expects to be entitled to in exchange for distinct good or service transferred as provided by the terms of the contract 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.

<u>Step 4: Allocating the transaction price to the preformance obligations</u>

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.

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 installment payment for premium on insurance products sold through the Internet platform. The fee on installment payment 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 is offered to the customer only with the loan, i.e. it is 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, in accordance with 5-step model described above.

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 the funds are disbursed or made available to the borrower's account. Derivative financial instruments are recognized beginning from the date of transaction.

A financial asset is de-recognized if Bank loses control over any contractual rights attached to that asset, which usually takes place if the financial instrument is disposed of or if all cash flows attached to the instrument are transferred to an independent third party.

<u>Financial assets measured at fair value through profit or loss</u>

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

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

The Bank may, at the initial recognition, irrevocably designate a financial asset 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 classified to this category are valued at fair value upon initial recognition.

After initial recognition, financial assets classified in this category are measured at the end of the reporting period at fair value.

Gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are recognized in the income statement in the period in which they arise.

Interest income on financial assets 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 measured at fair value through profit or loss is recognized in trading income for finacial assets held for trading or in gains or losses on non-trading financial assets mandatorily at fair value through profit or loss.

<u>Financial assets measured at at amortized cost</u>

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. After initial recognition, these assets are measured at amortized cost using the effective interest rate.

<u>Financial assets measured at fair value through other comprehensive income</u>

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 financial assets measured at fair value through other comprehensive income 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.

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 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.

<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 asset is recognised 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 and are recognised in net interest income. 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.

2.6. Offsetting of 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 expected credit losses 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 IFRS 16, contract assets under IFRS 15, as well as trading receivables.

A detailed description of issues regarding the principles of estimation of expected credit losses is presented in Note 3.3.6.

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 expected credit losses 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 – expected credit losses are calculated over a lifetime period.

Stage 3 contains exposures identified as credit-impaired.

Stage POCI contains assets identified as credit-impaired at initial recognition.

A detailed description of issues regarding the principles of classification of exposures to stages is presented in Note 3.3.6.1.

Significant deterioration in credit quality

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.

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.

A detailed description of issues regarding the significant deterioration in credit quality is presented in Note 3.3.6.1.1.

Low credit risk

According to the IFRS 9, the Bank distinguishes a category of assets with low credit risk (ang. Low Credit Risk, LCR). Assets marked as LCR are not subject to the process of identifying indications of significant deterioration of credit quality (if they are not in the default status, they are in Basket 1).

A detailed description of issues regarding the low credit risk criteria is presented in Note 3.3.6.1.2.

Impairment

The Bank applies a common default definition in all areas of credit risk management, including for the purpose of calculating expected credit losses and capital requirement. The basis for the adopted definition of default is the definition of default in the CRR Regulation.

The customer is reclassified to the default category in case of loss event occurrence. Reclassification of at least one customer credit liability to the default category reclassifies all credit and non-credit liabilities of the customer to the default category.

A detailed description of issues regarding loss events is presented in Note 3.3.6.1.3 (corporate) and 3.3.6.1.4 (retail).

Estimating expected credit losses (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 on and off-balance-sheet exposures. The calculation of expected credit losses uses:

- portfolio approach: concerning exposures for which no loss event was identified at the reporting date and exposures from the retail portfolio with identified loss event (excluding exposures for which an individual approach is used),
- individual approach: concerning all corporate exposures and all Private Banking customer exposures registered in corporate systems for which a loss event was identified, as well as in specific cases of retail microfirms exposures for which a loss event was identified.

A detailed description of issues regarding expected credit losses estimation is presented in Note 3.3.6.2.

Loan receivable write-off

Loan receivable write-off can be partial or total. In case of retail banking, writing off receivables can be done in the case of:

1. Debt recovery is not possible e.g.:
    a. the claim limitation,
    b. fraud – inability to identify the debtor,
    c. limitation of inheritors' liability,
    d. the claim was questioned by the debtor in court.
2. Lack of recovery e.g.:
    a. the enforcement proceedings have been completed and the whole debt was not recovered - then the unrecovered portion is written off,
    b. bankruptcy proceeding has been rejected or has been completed due to debtors lack of liquidation assets to cover the costs of the proceedings,
    c. the conclusion is that a claim is as a bad debt.

Due to the periodically executed debt sale of NPL, only fraud cases are systematically written off. Other cases are included to the debt sale portfolio.

In case of corporate portfolio, writing off receivables is carried out when all recovery options are exhausted. This happens when:

1. Bankruptcy proceedings have been completed, the debtor was removed from the National Court Register and the whole debt was not recovered - then the unrecovered portion is written off.
2. Restructuring proceedings have been initiated and the arrangement implies that part of the debt will be written off - then part of the debt is written off as well.
3. Enforcement proceedings are pending which have not led to the repayment of the debt - then part of the debt is written off as well.
4. The claim is questioned by the debtor in court. According with the decision of the court the claims are waved.

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 or 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 or buy/sell back) are recognised as loans and advances to other banks or other customers, depending on their nature.

When concluding a repo or sell/buy back or reverse repo or 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 or sell/buy back transactions and as receivables in the case of reverse repo or 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 or 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. 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. 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 data, 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 at amortised cost 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".

<u>Development costs</u>

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

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

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

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

2.15. Tangible fixed assets

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

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

Liabilities or assets for deferred 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 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

A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The Bank shall reassess whether a contract is, or contains, a lease if the terms and conditions of the contract are changed.

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 and it controls the use of the asset throughout the period of use.

<u>mBank S.A. Bank as a lessee</u>

If lease definition is fullfilled, the Bank recognizes the right to use of the leased asset and a financial liability representing its obligation to make future lease payments in the amount of discounted future cash flows throughout the lease period.

The Bank as a lessee applies simplified approach and it does not apply the requirements in terms of recognition, measurement and presentation for short-term lease contracts lasting no longer than 12 months for each class of underlying asset as well as for lease contracts for which the underlying asset is of low value, i.e. less than PLN 20 000 for separate leases. Lease payments are recognized as costs using straight-line method throughout the lease period for lease contracts for which the Bank applies simplified approach.

Perpetual usufruct right is classified as a lease according to IFRS 16 due to the occurrence of future fees for the use of this right. The Bank assumed that the lease period for this type of contracts is the remaining period of the right granted since the transition to IFRS 16.

The Bank shall determine the lease term as the non-cancellable period of a lease, together with both:

- periods covered by an option to extend the lease if the Bank as a lessee is reasonable certain to exercise that option, and
- periods covered by an option to terminate the lease if the Bank as a lessee is reasonable certain not to exercise that option,

The Bank shall reassess whether it is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease. The Bank shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise an option to extend a lease, or not to exercise an option to terminate a lease. The Bank shall reassess whether it is reasonably certain to exercise an extension option, or not to exercise a termination option, upon the occurrence of either a significant event or a significant change in circumstances that is within the control of the Bank as a lessee, and that affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term. The Bank shall revise the lease term if there is a change in the non-cancellable period of a lease.

At the commencement date, the Bank as a lessee shall measure the right-of-use asset at cost. 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 Bank as a lessee in connection with the conclusion of the leasing contract and
- an estimate of the costs to be incurred by the Bank as a lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories.

After the commencement date, the Bank as a lessee shall measure the right-of-use asset at cost:

- less any accumulated depreciation and any accumulated impairment losses and,
- adjusted for any remeasurement of the lease liability,

The Bank applies the depreciation requirements in IAS 16 Property, Plant and Equipment in depreciating the right-of-use asset and requirements in IAS 36 Impairment of Assets to determine whether the right-of-use asset is impaired.

At the commencement date, the Bank shall measure the lease liability at the present value of the lease payments that are not paid at that date. At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments:

- fixed lease payments less any lease incentives,
- variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date,
- 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 and,
- payment of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Variable lease payments that depend on an index or a rate include, for example, payments linked to a customer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates.

After the commencement date, the Bank shall measure the lease liability by:

- increasing the carrying amount to reflect interest on the lease liability,
- reducing the carrying amount to reflect the lease payments made and,
- remeasuring the carrying amount to reflect any reassessment or lease modifications or to reflect revised in-substance fixed lease payments.

Bank discounts lease payments using the interest rate of lease if this rate can be easily determined. Otherwise, the Bank applies the marginal interest rate of lessee. As the lessee the Bank estimates the discount rate taking into account the duration and the currency of the contract.

All right-of-use assets are classified in tangible fixed assets (Note 26).

Cash payments of lease liabilities are classified in statement of cash flows within financial activities. Short term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability are classified in statement of cash flows within operating activites.

<u>mBank S.A. Bank as a lessor</u>

- In operating lease:

Bank recognizes the lease payments from operating leases as income on a straight-line basis or in another systematic manner. Bank recognizes costs, including depreciation, incurred in order to obtain benefits from leasing. Bank adds the initial direct costs incurred in order to obtain operating leasing to the carrying value of the underlying asset and it recognizes these costs as expenses incurred throughout the lease period on the same basis as lease revenues. The method of depreciation of leased out depreciable assets should be the same as that foreseen by the normal depreciation rules adopted by the Bank with regard to similar assets, and the depreciation charges should be calculated in accordance with IAS 16 and IAS 38. In order to determine whether there has been any impairment of the object of the lease, the Bank applies IAS 36.

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 Bank has a present legal or constructive obligation as a result of past events, it is more likely that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated.

2.22. Post-employment employee benefits and other employee benefits

Post-employment employee benefits

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

Equity-settled share-based payment transactions

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

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 Bank by-laws.

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 years,
- net profit (loss) for the current year.

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

Moreover, other reserve capital comprises valuation of incentive programs based on Bank's shares.

Dividends for a given year, which have been approved by the General Meeting but not distributed at the end of the reporting period, are shown under the liabilities due to dividends payable under "Other liabilities".

Other components of equity

Other components of equity result from:

- valuation of 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

Functional currency and presentation currency

The items contained in financial reports of particular entities of the Bank, including foreign branches of the Bank, are valued in the currency of the basic economic environment in which the given entity conducts its business activities ("functional currency"). The financial statements are presented in the Polish zloty, which is the presentation currency of the Bank.

Transactions and balances

Transactions denominated in foreign currencies are converted to the functional currency at the exchange rate in force at the transaction date. Foreign exchange gains and losses on such transactions as well as balance sheet revaluation of monetary assets and liabilities denominated in foreign currency are recognised in the income statement.

Foreign exchange differences arising on account of such monetary items as financial assets measured at fair value through profit or loss are recognised under gains or losses arising in connection with changes of fair value. 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. Conversely, 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 interpretations which have been endorsed and binding for annual periods starting on 1 January 2019.

IFRS 16 Leases

The Standard was issued by International Accounting Standards Board (IASB) on 13 January 2016 and was endorsed by the European Union on 31 October 2017. IFRS 16 applies for annual reporting periods beginning on or after 1 January 2019. The incoming standard supersedes regulations binding until 31 December 2018: IAS 17 Leasing, IFRIC Interpretation 4 and SIC Interpretations 15 and 27.

The new standard introduced a single lessee accounting model. As per IFRS 16, the contract is, or contains, a lease, if the contract 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 from 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 future lease payments, excluding short-term lease contracts lasting no longer than 12 months and lease contracts concerning immaterial lease assets.

The expenses related to the use of leased assets, previously presented as overhead costs, currently are 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 consisted of all finance and operating leasing contracts, 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 leasing contracts and the collection of data necessary for the correct accounting treatment of these transactions have been developed and implemented.

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, due to significant economic factors discouraging the Bank from terminating the contract)
- 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 Bank 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 were 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.

IFRS Financial Statements 2019 PLN (000's)

Impact on the consolidated statement of financial position of mBank

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

	31 December 2018 (without IFRS16 effect)	IFRS 16 effect	1 January 2019 (with IFRS16 effect)
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	118 372 483	527 562	118 900 045
including Lease liabilities	-	*527 562*	*527 562*

The reconciliation of the difference between the amounts of future lease payments due to non-cancellable 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:

	01.01.2019
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 were 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 did not affect retained earnings and equity of the Bank as at 1 January 2019.

Impact on capital ratios

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

Standards and interpretations endorsed by the European Union:

Published Standards and Interpretations which have been early adopted

- Amendments to IFRS 9, IAS 39 and IFRS 7, Interest Rate Benchmark Reform, published by International Accounting Standards Board on 26 September 2019, endorsed by European Union on 16 January 2020 and binding for annuals periods starting on or after 1 January 2020.

  Amendments to IFRS 9, IAS 39 and IFRS 7 conclude phase one of the International Accounting Standards Board's work to respond to the effects of Interbank Offered Rates (IBOR) reform on financial reporting. The amendments provide temporary reliefs which enable hedge accounting to continue during the period of uncertainty before the replacement of an existing interest rate benchmark with an alternative risk-free interest rate. As a result of interest rate benchmark reform, there may be uncertainties about the timing and amount of benchmark-based cash flows of the hedged item or the hedging instrument during the period before the replacement of an existing interest rate benchmark with an alternative nearly risk-free interest rate. This may lead to uncertainty whether a forecast transaction is highly probable and whether prospectively the hedging relationship is expected to be highly effective.

  The Bank exercised its right to apply earlier the amendments to the standards and therefore it did not verify effectiveness of hedging relationships.

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

- Amendments to IAS 1 and IAS 8, Definition of Material, published by the International Accounting Standards Board on 31 October 2018, endorsed by European Union on 10 December 2019, 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.

  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), endorsed by European Union on 6 December 2019 and effective for financial years beginning on or after 1 January 2020.

  Amendments to References to the 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.

  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.

Standards and interpretations not yet endorsed by the European Union:

These financial statements do not include standards and interpretations listed below which await endorsement of the European Union.

- IFRS 17, *Insurance contracts*, published by the International Accounting Standards Board ("IASB") 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.

  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.

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, Classification of liabilities as current or non-current, published by International Accounting Standards Board on 23 January 2020, binding for annuals periods starting on or after 1 January 2022.

  Amendments to IAS 1 affect the requirements for the presentation of liabilities in the financial statements. In particular, they explain one of the criteria for classifying liabilities as non-current.

  mBank 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 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.

2.27. Business segments

Data concerning business segments was presented in the Consolidated Financial Statements of mBank S.A. Group for the year 2019, prepared in compliance with the International Financial Reporting Standards and published on 26 February 2020.

2.28. Comparative data

- Presentation of result on provisions for legal risk related to foreign currency loans

Since the end of 2019 a new line item in the income statement has been separated in which the Bank presents the result on provisions for legal risk related to foreign currency loans. Previously the expenses of creating provisions for court cases relating to foreign currency loans were presented as Other operating expenses, and income relating to release of those provisions was presented within Other operating income. The change in presentation is relevant to the understanding of the financial performance of the Bank. The comparative data have been adjusted accordingly, which resulted in the decrease of other operating income in 2018 by PLN 2 626 thousand and decrease of other operating expenses by PLN 22 975 thousand. The result on provisions for legal risk related to foreign currency loans in 2018 was negative and amounted to PLN 20 349 thousand.

- The recognition of some transactions of purchase and sale of securities

In the fourth quarter 2019, the Bank adjusted the recognition of transactions in Treasury securities which in the previous years were incorrectly classified as outright buy or sale of securities and should have been classified as buy/sell back ("BSB") or sell/buy back ("SBB") transactions instead.

As part of pursued financial operations, the Bank trades in securities issued by the Treasury. Apart from outright buy or sale, the Bank concludes BSB and SBB transactions in T-bills and T-bonds. Outright buy or sale of securities is understood as unconditional acquisition or disposal of securities. A 'BSB transaction' means a transaction by which the Bank buys a securities for which a commitment has been made to resell them at a contractual date and for a specified contractual price. A 'SBB transaction' means a transaction by which the bank sells securities for which a commitment has been made to repurchase them at a contractual date and for a specified contractual price.

Some concluded transactions of purchase and sale of securities which, when considered jointly, were equivalent to BSB or SBB transactions taking into account their economic nature. Such transactions had been incorrectly recognised by the Bank as unconditional sale or purchase transactions in line with their legal nature until December 2018. In accordance with substance over form principle, Bank adjusted the recognition of those transactions. This adjustment resulted in an increase in the carrying amount of debt securities held for trading and in the amounts due to banks arising from SBB transactions by PLN 30 439 thousand as at 31 December 2018, and an increase in receivables arising from BSB transactions presented in the item "Loans and advances to clients measured at amortised cost" by PLN 385 954 thousand, an increase in the amounts due to clients by PLN 123 618 thousand and a decrease in the value of debt securities held for trading by PLN 262 336 thousand as at 1 January 2018.

The said adjustment also resulted in recognising an additional tax on selected financial institutions (banking tax). In the period from 1 February 2016 to 31 December 2017 the tax on selected financial institutions (together with late payment interest) should have been higher by PLN 31 208 thousand and by PLN 13 665 thousand in the period from 1 January 2018 to 31 December 2018. Due to the above the Bank adjusted the retained earnings by the respective amounts in correspondence with the liabilities to tax authorities. As a result Bank also corrected the preliminary recognition of provision for the banking tax through the income statement of 2019.

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The impact of the adjustments on the comparative data presented in these financial statements for relevant reporting periods is presented below.

Restatement of income statement of mBank S.A. for 2018

	Period from 01.01.2018 to 31.12.2018 before restatement	Restatement	Period from 01.01.2018 to 31.12.2018 after restatement
Interest income, including:	3 961 606	-	3 961 606
Interest income accounted for using the effective interest method	*3 357 644*	-	*3 357 644*
Income similar to interest on financial assets at fair value through profit or loss	*603 962*	-	*603 962*
Interest expenses	(874 097)	-	(874 097)
Net interest income	**3 087 509**	**-**	**3 087 509**
Fee and commission income	1 467 005		1 467 005
Fee and commission expenses	(575 803)		(575 803)
Net fee and commission income	**891 202**	**-**	**891 202**
Dividend income	126 391	-	126 391
Net trading income, including:	352 317	-	352 317
Foreign exchange result	*303 985*	-	*303 985*
Gains or losses on financial assets and liabilities held for trading	*52 721*	-	*52 721*
Gains or losses from hedge accounting	*(4 389)*	-	*(4 389)*
Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss	(155 485)	-	(155 485)
Gains less losses from financial assets and liabilities not measured at fair value through profit or loss and investments in subsidiaries and associates, including:	13 396	-	13 396
Gains less losses from debt securities measured at fair value through other comprehensive income	*16 149*	-	*16 149*
Gains less losses from investments in subsidiaries and associates	*290*	-	*290*
Gains less losses from derecognition	*(3 043)*	-	*(3 043)*
Other operating income	59 117	(2 626)	56 491
Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss	(468 902)	-	(468 902)
Result on provisions for legal risk related to foreign currency loans	-	(20 349)	(20 349)
Overhead costs	(1 699 470)	-	(1 699 470)
Depreciation	(227 743)	-	(227 743)
Other operating expenses	(154 103)	22 975	(131 128)
Operating profit	**1 824 229**	**-**	**1 824 229**
Tax on the Bank's balance sheet items	(374 192)	(13 665)	(387 857)
Share in profits (losses) of entities under the equity method	256 938	-	256 938
Profit before income tax	**1 706 975**	**(13 665)**	**1 693 310**
Income tax expense	(389 490)	-	(389 490)
Net profit	**1 317 485**	**(13 665)**	**1 303 820**
Earnings per share (in PLN)	**31.13**	(0.32)	**30.81**
Diluted earnings per share (in PLN)	**31.11**	(0.32)	**30.79**

Restatement of statement of comprehensive income of mBank S.A. for 2018

	Period from 01.01.2018 to 31.12.2018 before restatement	Restatement	Period from 01.01.2018 to 31.12.2018 after restatement
Net profit	**1 317 485**	**(13 665)**	**1 303 820**
Other comprehensive income net of tax	**70 595**	**-**	**70 595**
Total comprehensive income (net)	**1 388 080**	**(13 665)**	**1 374 415**

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Restatement of statement of financial position of mBank S.A. as at 31 December 2018

ASSETS	31.12.2018 before restatement	Restatement	31.12.2018 after restatement
Financial assets held for trading and hedging derivatives	2 126 112	30 439	2 156 551
Other items of assets	135 523 058	-	135 523 058
TOTAL ASSETS	**137 649 170**	**30 439**	**137 679 609**

LIABILITIES	31.12.2018 before restatement	Restatement	31.12.2018 after restatement
Financial liabilities measured at amortised cost, including:	118 342 044	30 439	118 372 483
- Amount due to banks	*3 136 771*	*30 439*	*3 167 210*
Other liabilities	2 615 515	44 873	2 660 388
Other items of liabilities	1 516 568	-	1 516 568
TOTAL LIABILITIES	**122 474 127**	**75 312**	**122 549 439**
EQUITY	**31.12.2018 before restatement**	**Restatement**	**31.12.2018 after restatement**
Share capital	**3 574 686**	**-**	**3 574 686**
Retained earnings	**11 423 575**	**(44 873)**	**11 378 702**
- Profit from the previous year	10 106 090	(31 208)	10 074 882
- Profit for the current year	1 317 485	(13 665)	1 303 820
Other components of equity	**176 782**	**-**	**176 782**
TOTAL EQUITY	**15 175 043**	**(44 873)**	**15 130 170**
TOTAL LIABILITIES AND EQUITY	**137 649 170**	**30 439**	**137 679 609**

Restatement of statement of cash flow of mBank S.A. for 2018

	Period from 01.01.2018 to 31.12.2018 before restatement	Restatement	Period from 01.01.2018 to 31.12.2018 after restatement
Profit before income tax	**1 706 975**	**(13 665)**	**1 693 310**
Adjustments, incuding:	**212 221**	**13 665**	**225 886**
Changes in financial assets and liabilities held for trading and hedging derivatives	243 056	(292 775)	(49 719)
Changes in loans and advances to customers	(7 826 035)	385 954	(7 440 081)
Changes in amounts due to other banks	703 928	30 439	734 367
Changes in amounts due to customers	11 456 454	(123 618)	11 332 836
Changes in other liabilities	448 699	13 665	462 364
Other adjustments	(4 813 881)	-	(4 813 881)
A. Cash flows from operating activities	**1 919 196**	**-**	**1 919 196**
B.Cash flows from investing activities	**(221 674)**	**-**	**(221 674)**
C. Cash flows from financing activities	**(871 422)**	**-**	**(871 422)**
Net increase / decrease in cash and cash equivalents (A+B+C)	**826 100**	**-**	**826 100**
Effects of exchange rate changes on cash and cash equivalents	20 996	-	20 996
Cash and cash equivalents at the beginning of the reporting period	9 750 574	-	9 750 574
Cash and cash equivalents at the end of the reporting period	**10 597 670**	**-**	**10 597 670**

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Restatement of statement of financial position of mBank S.A. as at 1 January 2018

ASSETS	**01.01.2018 before restatement**	**Restatement**	**01.01.2018 after restatement**
Financial assets held for trading and hedging derivatives	2 781 351	(262 336)	2 519 015
Financial assets at amortised cost, including:	81 805 869	385 954	82 191 823
- Loans and advances to customers	*67 622 933*	*385 954*	*68 008 887*
Other items of assets	39 732 735	-	39 732 735
TOTAL ASSETS	**124 319 955**	**123 618**	**124 443 573**

LIABILITIES	**01.01.2018 before restatement**	**Restatement**	**01.01.2018 after restatement**
Financial liabilities measured at amortised cost, including:	106 579 430	123 618	106 703 048
- Amount due to banks	*99 331 571*	*123 618*	*99 455 189*
Other liabilities	2 173 994	31 208	2 205 202
Other items of liabilities	1 571 985	-	1 571 985
TOTAL LIABILITIES	**110 325 409**	**154 826**	**110 480 235**
EQUITY	**01.01.2018 before restatement**	**Restatement**	**01.01.2018 after restatement**
Share capital	**3 564 176**	**-**	**3 564 176**
Retained earnings	**10 324 183**	**(31 208)**	**10 292 975**
- Profit from the previous year	10 324 183	(31 208)	10 292 975
Other components of equity	**106 187**	**-**	**106 187**
TOTAL EQUITY	**13 994 546**	**(31 208)**	**13 963 338**
TOTAL LIABILITIES AND EQUITY	**124 319 955**	**123 618**	**124 443 573**

The aforementioned changes in the comparative data, as presented above, were provided for in these financial statements in all the notes to which they referred. The data on capital ratios for comparative periods remained unchanged.

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.

3.1. mBank risk management in 2019 – external environment

The Bank is in the process of introducing changes resulting from the Delegated Commission Regulation (EU) 2018/1620 of 13 July 2018 with regard to liquidity coverage requirement for credit institutions and their impact on the method used to calculate the LCR. The Bank applies the LCR as a key ratio for measuring liquidity risk in the context of the recovery plan.

Currently, in light of the publication of Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 and Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending the CRR/CRD IV regulatory package (Capital Requirements Regulation & Capital Requirements Directive), the mBank Group is working on the analysis of the new regulatory requirements and their implementation. Most of the amendments to the CRR Regulation will be applicable 2 years after the effective date of the regulation.

The proposed amendments include new methods of calculating capital requirements for counterparty credit risk and market risk, which shall 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 binding 3% minimum value of the leverage ratio was introduced as the prudential measure. The Bank analyses changes with regard to the calculation of the net stable funding ratio (NSFR) which was introduced as the prudential measure at the minimum binding level of 100%, applicable form 28 June 2021.

In 2019 an amendment to the CRR Regulation was published, aiming at reducing the risk posed by high volumes of non-performing loans. It introduces the minimum level required to cover losses due to non-performing loans. In the event that this requirement is not met by the bank, it introduces a penalty in the form of a subsequent reduction of Tier 1 capital by the difference between the level of actual coverage and the level of the required minimum coverage. The minimum required level of coverage of losses is introduced progressively, so the effects of the new regulation will be visible few years after the entry into force.

The amendments to the CRD IV, published in 2019, include more detailed guidelines on restrictions on profit-sharing. The provisions on the use of supervisory tools for micro and macro prudential purposes have been clarified and changes in the calibration of capital buffers have been proposed. Supervisory expectations have been addressed as to the need for a standardized methodology of interest rate risk management in the banking portfolio in order to identify, assess, manage and mitigate risk. Amended provisions of CRD IV should be introduced to the Polish regulations by the end of 2020.

In light of the publication of Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending BRRD (Bank Recovery and Resolution Directive), the requirements regarding recovery and resolution also changed. New provisions require transposition into the national law. The Directive proposed changes to the design of the MREL ratio to make it consistent with TLAC ratio (total loss absorbing capacity). The amendments to the BRDD are expected to be implemented in the legislation in Poland by the end of 2020.

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

- Between 2016-2019 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. guidelines for estimating the LGD parameter, appropriate to the economic downturn and a technical standard for the estimation and identification of the economic downturn in IRB modeling.

Due to potentially wide range of changes that will be necessary in order to implement regulations by banks, they will be implemented within the timeframe envisaged by the EBA.

- Beginning from 30 June 2019 the EBA guidelines on management of non-performing and forborne exposures entered into force; they are accompanied by changes in reporting and disclosures regarding non-performing and forborne exposures that would apply from 2020.

- In February 2019 the EBA published revised Guidelines on outsourcing arrangements, which are consistent with the requirements on outsourcing under the Payments Services Directive (PSD2) and the Markets in Financial Instruments Directive (MiFID II) and aim at ensuring that banks can apply a single framework on outsourcing for all their banking, investment and payment activities. PFSA expects banks to comply with the guidelines by 30 June 2020.

- In June 2019 the EBA published draft guidelines on loan origination and monitoring for consultation purposes. The final version is expected to be published by 30 June 2020. The guidelines aim to ensure that banks have robust and prudent standards for taking credit risk, managing and monitoring risk and that new lending is of high credit quality. Banks should also align their practices with consumer protection rules and anti-money laundering requirements.

- In November 2019 the EBA published guidelines on information and communication technology (ICT) and security risk management to be applied from 30 June 2020, which aim at ensuring that banks can safely manage the abovementioned risks.

In order to update the good practices of banks in their operations, also in the context of new recommendations and requirements defined by the European supervisors, including regulatory solutions and practices in other countries, the Polish Financial Supervisory Authority (PFSA) has just accomplished or has been working on:

- update of Recommendation S on good practices in the management of credit exposures secured by mortgages, in the scope of taking into account the rules on mortgage loans with a fixed interest rate; updated recommendation should be implemented by banks till 31 December 2020,

- new Recommendation Z on the rules of internal governance in banks,

- update of Recommendation R on the rules for credit risk management and recognizing expected credit losses,

- update of Recommendation G on interest rate risk management.

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 appear that implement the provisions of the Basel standards into the European Union regulations, the Bank analyses the proposed regulatory changes and assesses their impact.

3.2. Principles of risk management

3.2.1. 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.

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, 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.

3.2.2 Division of responsibilities in the risk management process

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.

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.

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. 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 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.

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.

Committees:

- **The Committees of the Business and Risk Forum of mBank Group** (Retail Banking Risk Committee – KRD, Corporate and Investment Banking Risk Committee – KRK, Financial Markets Risk Committee – KRF) are 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 the Bank and the Group subsidiaries. In particular, the Committees take decisions and make recommendations concerning risk management principles, risk policies, risk appetite, risk limits' definitions and values for given business line.

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

- **The Balance Sheet Management Committee (BSM)** 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.

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

- **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.

- **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).

- **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.

- **Foreign Branch Supervision Committee of mBank S.A.** is responsible, among others, for issuing recommendations 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.

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.

3.2.3. Internal capital and liquidity adequacy assessment process (ICAAP/ILAAP)

The mBank Group applies the internal capital adequacy assessment process (ICAAP) aimed at maintaining own funds at the level adequate to the profile and the level of risk in its operations. The ICAAP includes:

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

The liquidity adequacy assessment process (ILAAP) implemented in mBank Group plays a key role in maintaining the Bank's and the Group's business continuity by ensuring an appropriate liquidity and financial position. ILAAP comprises of:

- Group's liquidity and funding risk inventory,
- calculation of liquidity measures, including modelling of selected banking products,
- balance sheet planning and setting limits in line with the risk appetite,
- management, taking into account the stress tests, risk measures, contingency plan, early warning indicators (EWI), recovery indicators (RI) and limits monitoring,
- process review and assessment,
- Funds Transfer Pricing (FTP) system,
- model validation.

The ICAAP and ILAAP are reviewed by the Bank's Management Board on a regular basis. Reviews of these processes are supervised by the Supervisory Board of the Bank.

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. Therefore, the mBank Group carries out an annual process of identifying and assessing risk materiality. All material types of risk are included in the Risk Management Strategy of mBank Group, in particular in the process of risk bearing capacity management.

The following risks were recognized as material for the Group as at 31 December 2019: credit risk market risk, operational risk, business risk (including strategic risk), liquidity risk, reputational risk, model risk, capital risk (including risk of excessive leverage) and regulatory risk.

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.

Capital and liquidity buffers

Risk appetite is determined below the available resources determined by the minimum supervisory requirements on capital adequacy and liquidity, set in the European and Polish regulations, in order to ensure that the Group is functioning in an uninterrupted manner in the case of negative changes in the

Group or in its environment, thereby providing the ability to assure risk bearing capacity. 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. To determine the appropriate volume of the liquidity buffer, a minimum level of LCR above the regulatory requirement has been established.

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 and potential negative macroeconomic changes.

As a result of internal 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 risk bearing capacity must be ensured (limits must be ensured in normal conditions) in accordance with ICAAP principles,
- internal targets set for regulatory capital ratios must be observed,
- financial liquidity and adequate structural liquidity of the Group must be ensured at all times in accordance with 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 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 Bank's activity. In addition to the limits, monitoring action triggers and early warning indicators are also used to ensure the safe operation of the Bank.

3.2.5 Stress tests within ICAAP and ILAAP

Stress tests are used in the management and capital and liquidity planning of the Bank. Stress tests allow an assessment of the Bank'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.

As part of ICAAP, the Bank carries out stress tests using various scenarios, including historical scenarios, macroeconomic scenarios for economic downturn, scenarios that take into account idiosyncratic events, in the context of specific risk concentrations in the Bank. Such analyses take into account different levels of severity of the scenarios, which are characterised by different probability levels regarding their realisation.

The ILAAP scenarios include negative 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.

Bank carries out so called reverse stress tests, the goal of which is to identify events potentially leading to unviability of the Bank. Reverse stress tests are used for making strategic decisions concerning the acceptable risk profile of the Bank.

3.3. Credit risk

3.3.1 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).

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 (standard applications evaluated internally, other with the use of external appraisal report which is additionally evaluated internally).

3.3.2 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.

3.3.3 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.

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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 or mBank in accordance with signed agreements. At the same time, the master agreements provide for early settlement of the transaction with the client in the event of breach of contract. mBank applies an Early Warning Process in order to monitor the usage of limits on derivatives and the Bank's ability to respond to the client when the exposure due to open derivative transactions 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.

3.3.4 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);
- Loss Given Default (LGD) model for non-default portfolio (for in-default portfolio individual method of estimating recoveries is used). Model consists of components: recoveries from unsecured part of the credit (based on contractual and customer factors, information from financial statement), recoveries from secured part of exposure (based on collateral factors);
- Exposure at Default (EAD) model, which includes Credit Conversion Factor (CCF) model and Limit Utilization (LU) model. The components are based on contract and customer characteristics;
- 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-	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. The ultimate loss level is determined basing on integration of three components:
  - recovery rate for cured cases (based on mean recoveries achieved for cured defaults),
  - recovery rate for non-cured cases (based on contractual factors, bank-client relations and collateral characteristic),
  - probability of cure (based on socio-demographic factors and full product structure of contract owner).

  Estimation of loss level takes place in homogenous segments, taking into account the type of product and the type of collateral. Separate models are in place for non-default and in-default portfolio,
- Exposure at Default (EAD) model, which includes Credit Conversion Factor (CCF) model, Limit Utilization (LU) model and Prepayments model. The components are based on contract and customer characteristics,
- PD model with a modular structure, which integrates results of scoring cards dedicated to the retail area:
  - application scoring cards (based on socio-demographic factors, factors describing the characteristics of business activity and factors related to the specificity of applied credit products),
  - behavioural scoring cards (based on information on the history of credit and deposit relation with the Bank),
  - internal scoring card based on Credit Information Bureau data (regarding the data about liabilities held outside the Bank).

3.3.5 Monitoring and validation of models

All models of risk parameters applied in mBank, 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 and 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.

3.3.6 Calculating expected credit losses

The method of calculating expected credit losses 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.

3.3.6.1 How exposures are classified to stages

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

- Stage 1 – exposures for which the risk did not increase significantly since the initial recognition in the loan portfolio,
- 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,
- Stage 3 – exposures for which credit-impairment was found during its lifetime in portfolio,
- 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 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. In case of exposures classified as forborne, the additional condition for reclassification to Stage 1 is the 24-month probation period during which the loan has a performing status.

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 (except for the restructuring), and in case of the corporate customers when:

- the loss events that caused the classification of a client to the stage 3 do not longer exist, and
- 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
- the overdue debt has been repaid, and
- the indebtedness is timely handled for at least 12 months after the change of contractual terms, or
- 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.

3.3.6.1.1 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. 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.

3.3.6.1.2 Low credit risk criteria

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. 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).The LCR criteria is not used in the retail banking segment.

3.3.6.1.3 Impairment triggers - corporate portfolio

The list of definite loss events in corporate portfolio:

- 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 for corporate customers and PLN 500 for Private Banking customers;
- The Bank has sold exposures with a significant economic loss related to the decrease of the debtor creditworthiness;
- 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:
  - reduction of financial liabilities by remitting part of these obligations, or
  - 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;
- 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;
- 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;
- Termination of part or whole credit agreement by the Bank and the beginning of restructuring/collection procedures;
- Client's fraud;
- 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.

3.4.6.1.4 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 list of definite loss events in corporate portfolio:

- 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 Czech and Slovak branches, an individual exposure is considered impaired when the overdue amount exceeds CZK 3 000 or EUR 120, respectively and the delay exceeds 90 days;
- Enforced restructuring of debt;
- Bankruptcy of debtor;
- Recognition of the contract as fraudulent;
- Sale of the exposure with considerable economic loss;
- Uncollectable status of debt;
- Payout of low downpayment insurance.

3.3.6.2 Calculation of expected credit losses

Expected credit losses (ECL) are measured at the level of a single contract or exposure (agreement). 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. The calculation of expected credit losses does not use a collective approach (assigning one parameter value to selected portfolios).

If on the reporting date the exposure credit risk did not increase significantly since the initial recognition, expected credit losses are calculated in 12-month horizon (12m ECL). If the exposure credit risk increased significantly since the initial recognition (exposure is in the stage 2), the Bank calculates expected credit losses in the life-time horizon (Lt ECL). 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 case of non-financial guarantees, the Group applied an approach that the expected credit losses are always included in lifetime horizon (Lt ECL).

The individual approach concerns all balance sheet and off-balance sheet credit exposures with an impairment in the corporate loan portfolio and Private Banking loan portfolio, which is registered in corporate systems, as well as selected credit exposures with an impairment in the retail microfirms loan portfolio (used in the case of exposures with mortgage collateral with a debt balance over PLN 300 thousand and arrears over 1 year). 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, considered scenarios are developed for exposures and assume a significant share of recoveries from the customer's own payments. In case of vindication strategy, the scenarios are developed for each recovery source (collateral) separately. Bank identifies scenarios per exposure/recovery source, minimum 2 are considered obligatory, provided one of them reflects a partial loss on exposure/recovery source. Weight of scenario results from an expert assessment of the likelihood of scenarios based on the relevant facts of the case, in particular, on existing security and their type, client's financial situation, client's willingness to cooperate, the risks that may occur in the case and micro- and macroeconomic factors.

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.

3.3.6.2.1 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 (calculated every month). The values of NLF are used as scaling factors for individual ECLs. 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 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:

- the probability-weighted average of the expected loss from 3 macroeconomic scenarios ('average estimation') comprising: baseline scenario, optimistic scenario, pessimistic scenario. The weights of scenarios are consistent with probabilities of realization each scenario – 60% for base, 20% for optimistic and 20% for pessimistic.

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- 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.

Additionally, the inclusion of forward-looking information takes place in the models of all three credit risk parameters estimated in the lifetime horizon (Lt PD, Lt EAD, Lt LGD). 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 and financial indicators (employment in the enterprise sector, employment rate, level of export/import, salaries, monetary financial institutions receivables from households, profitability of bonds), 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.

3.3.6.2.2. Significant model changes

In the third quarter of 2019, due to significant changes on the cure rate level, the Lt LGD model for retail segment was adjusted accordingly. The changes included adjusting the models to the currently observed cure rate levels, changing the assumptions regarding the estimation methods and shortening the calibration window to highlight the PIT character of the model. Impact of the above changes to the level of expected credit loss amounted to PLN 45 million (negative impact on profit).

In the fourth quarter of 2019, the Bank has recalibrated the allocation level to stage 2 for the retail portfolio, resulting in a change in the allocation level to 8% for the retail non-mortgage loan portfolio and to 5% for the retail mortgage loan portfolio. The change was dictated by the improvement of the adequacy for the quantitative criterion of the Transfer Logic algorithm, and, as a consequence, the increase in the precision of estimation of the expected credit loss. Impact of the above change to the level of expected credit loss amounted to PLN 21 million (positive impact).

3.3.6.3 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 3.3.4).

<u>Portfolio measured at amortised cost</u>

Sub - portfolio	31.12.2019		31.12.2018	
	Exposure (%)	Provision coverage (%)	Exposure (%)	Provision coverage (%)
1	11.61	0.01	10.94	0.01
2	37.99	0.04	44.70	0.04
3	15.83	0.15	12.57	0.18
4	24.08	0.51	21.42	0.46
5	4.85	2.01	4.27	1.65
6	0.60	4.34	0.34	4.19
7	1.51	10.13	1.22	9.66
8	0.70	0.21	1.52	0.04
default	2.83	64.55	3.02	64.22
Total	**100.00**	**2.27**	**100.00**	**2.28**

As at 31 December 2019, 49.60% of the loans and advances portfolio for balance sheet and off-balance sheet exposures is categorised in the top two grades of the internal rating system (31 December 2018: 55.64%)

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Portfolio measured at fair value through other comprehensive income

Sub - portfolio	31.12.2019		31.12.2018	
	Exposure (%)	Provision coverage (%)	Exposure (%)	Provision coverage (%)
1	29.93	0.01	32.27	0.01
2	60.74	0.04	55.83	0.05
3	5.69	0.19	8.22	0.27
4	2.43	0.51	2.75	0.85
5	0.77	2.10	0.67	2.22
6	0.14	3.33	0.07	3.44
7	0.27	6.31	0.17	5.67
default	0.03	24.25	0.02	19.19
Total	**100.00**	**0.10**	**100.00**	**0.11**

As at 31 December 2019, 90.67% of the loans and advances is categorized in the top two grades of the internal rating system (31 December 2018: 88.10%).

3.3.7 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).

3.3.7.1 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.

3.3.7.2 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.

3.3.8 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 for individual types of repossessed collaterals. In 2019 and 2018, the Bank did not have any repossessed collaterals that were difficult to sell.

3.3.9 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 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 borrowers in order to detect any financial difficulties as early as possible and to know the reasons of such difficulties. In case of retail borrowers 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 borrowers under long term financial distress extension of contractual repayment schedule may be offered which can include instalments reduction.

For the corporate borrowers in financial distress, as part of the business support process, the mBank offers concessions, starting from participating in debt standstills and concluding on debt restructuring agreements. Debt restructuring agreements may improve Bank's collateral position 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 borrower's business continuity.

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

- maturity extension/extension of loan duration,
- restructuring (medium or long term refinancing),
- capitalization of interest,
- interest deferrals,
- principal deferrals,
- covenant waiver,
- standstills.

Risk management

Forbearance measures have been an integral part of the mBank's risk management area for many years. Forborne portfolios are subject to regular review and reporting to the area management. The effectiveness of undertaken actions, regularity of restructured transactions' service in respect of types of product and borrower'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 to 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 bank's exposures to borrowers in financial difficulties with granted concessions (incl. classified as default) 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.

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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 exposure had been recognised as performing have passed (probation period),
- for the last 12 months of probation period, significant and regular capital or interest payments have been made by the borrower (overdue not exceeding 30 days),
- none of the debtor exposures is overdue more than 30 days at the end of probation 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

	31.12.2019			31.12.2018		
	Gross carrying amount	Accumulated impairment	Net value / Fair value	Gross carrying amount	Accumulated impairment	Net value / Fair value
Loans and advances from customers measured at amortised cost	**85 481 126**	**(2 743 409)**	**82 737 717**	**78 876 920**	**(2 674 957)**	**76 201 963**
of which: forborne exposures	1 881 940	(572 640)	1 309 300	1 588 893	(544 525)	1 044 368
of which: defaulted	*1 068 052*	*(551 625)*	*516 427*	*1 022 673*	*(531 352)*	*491 321*
Loans and advances from customers measured at fair value through other comprehensive income	**8 429 828**	**(8 138)**	**8 421 690**	**4 583 149**	**(4 839)**	**4 578 310**
of which: forborne exposures	8 664	(159)	8 505	1 598	(13)	1 585
of which: defaulted	*112*	*(11)*	*101*	*118*	-	*118*
Loans and advances from customers measured at fair value through profit and loss			**1 813 818**			**2 496 974**
of which: forborne exposures			97 608			112 495
of which: defaulted			*79 230*			*74 711*
Forborne exposures, total			**1 415 413**			**1 158 448**
of which: defaulted			*595 758*			*566 150*

Change of net carrying value of forborne exposures	31.12.2019	31.12.2018
As at the beginning of the period	**1 158 448**	**1 169 983**
Outputs	(282 588)	(378 987)
New forbearance	620 746	444 559
Changes on existing loans	(81 193)	(77 107)
As at the end of the period	**1 415 413**	**1 158 448**

The analysis carried out for the above reporting periods showed a negligible share of exposures that leave the forbearance status within one year and then return to it.

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Forborne exposures by client segment	31.12.2019	31.12.2018
Loans and advances to customers, including:		
Individual customers:	577 763	719 573
of which: housing and mortgage loans to natural persons	*505 974*	*528 198*
Corporate customers	837 650	438 875
Total	**1 415 413**	**1 158 448**

Forborne exposures by the type of concession	31.12.2019	31.12.2018
Refinancing	148 288	101 560
Modification of terms and conditions	1 267 125	1 056 888
Total	**1 415 413**	**1 158 448**

Forborne exposures by geographical breakdown	31.12.2019	31.12.2018
Poland	1 360 206	1 114 671
Other countries	55 207	43 777
Total	**1 415 413**	**1 158 448**

Forborne exposures by period of overdue	31.12.2019	31.12.2018
Not past due	956 169	715 556
Past due less than 30 days	167 217	154 091
Past due 31 – 90 days	64 784	77 148
Past due over 90 days	227 243	211 653
Total	**1 415 413**	**1 158 448**

Forborne exposures by industry	31.12.2019	31.12.2018
Natural persons	577 761	659 359
Construction	143 660	22 504
Scientific and technical activities	103 741	5 123
Financial sector	101 841	103 038
Food sector	86 417	45 162
Textiles and wearing apparel	65 377	4 338
Transport and logistics	62 130	14 891
Wood, furniture and paper products	51 759	53 645
Construction materials	41 954	14 932
Real estate	30 189	19 890
Other	150 584	215 566
Total	**1 415 413**	**1 158 448**

3.3.10 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:

- 36% banks,
- 9% central counterparties (CCP),
- 6% financial institutions,
- 49% 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 2019 (PLN m)	Credit exposure 2018 (PLN m)
Bank CSA	1 169	1 222
Bank uncollateralized	1	2
CCP	282	229
Corpo limit	1 616	919
Non-Bank Financial Institution	205	274
Private Banking	(2)	(4)
Corpo collateralized and other	(15)	(18)

**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**
	2019	2018	2019	2018	2019		2018	
NPV	32.11	26.78	-	5.87	1.23	129.73	38.45	127.48
Collateral received (including collateral posted to custodian)	154.86	86.93	-	-	-	51.31	-	41.26
Collateral posed (including collateral posted to custodian)	55.30	0.64	256.45	194.97	-	-	-	-

**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 3.3.4) is presented in Note 19.

3.4. 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.

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As at 31 December 2019 and 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 corporate portfolio for low risk sectors but not higher than 60% of Tier 1;
- 10% of the gross loan corporate portfolio for medium risk sectors but not higher than 50% of Tier 1;
- 7% of the gross loan corporate portfolio for high risk sectors but not higher than 35% of Tier 1.

In the case when the utilisation of the limit exceeds 90%, activities preventing the exceeding of the 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, where under one single sector have been focused entities operating activities related to a given market (suppliers, manufacturers, vendors).

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

No.	Sectors	Gross value	%	Gross value	%
		31.12.2019		31.12.2018	
1.	Natural persons	43 104 957	50.43%	40 049 073	50.77%
2.	Rental and leasing activities	11 670 459	13.65%	10 856 879	13.76%
3.	Financial sector	3 428 979	4.01%	4 718 423	5.98%
4.	Construction	2 804 445	3.28%	1 990 393	2.52%
5.	Real estate	2 756 688	3.22%	1 817 855	2.30%
6.	Food sector	2 468 869	2.89%	2 349 781	2.98%
7.	Motorisation	1 815 006	2.12%	1 576 542	2.00%
8.	Construction materials	1 638 084	1.92%	1 433 131	1.82%
9.	Chemicals and plastic products	1 540 904	1.80%	1 588 136	2.01%
10.	Metals	1 466 224	1.72%	1 658 255	2.10%
11.	Wood, furniture and paper products	1 305 453	1.53%	939 399	1.19%
12.	Wholesale trade	1 105 200	1.29%	1 073 499	1.36%
13.	Power and heating distribution	1 094 863	1.28%	973 836	1.23%
14.	Retail trade	923 994	1.08%	589 554	0.75%
15.	Information and communication	887 218	1.04%	830 609	1.05%
16.	Transport and logistics	807 018	0.94%	751 697	0.95%
17.	Pharmacy	728 256	0.85%	203 681	0.26%
18.	Fues	685 829	0.80%	938 345	1.19%
19.	Textiles and wearing apparel	545 493	0.64%	366 831	0.47%
20.	IT	478 797	0.56%	419 563	0.53%

Total Bank's engagement as at 31 December 2019 in sectors described above (apart from natural persons) amounts to 44.62% (31 December 2018: 44.45%).

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.

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The table below presents the risk of limited sectors as at the end of 2019 and 2018.

No.	Sectors	31.12.2019	31.12.2018
1.	Finanacial sector	low	low
2.	Fuels	medium	medium
3.	Food sector	medium	medium
4.	Construction	high	high
5.	Motorisation	medium	medium
6.	Metals	high	medium
7.	Chemistry and materials	medium	medium

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 2019 there was no exposure in line with the above definition.

3.5. Market risk

In its operations, the Bank is exposed to market risk, which is defined as a risk resulting from unfavourable change of the current valuation of financial instruments in the Bank's portfolios due to changes of the market risk factors, in particular:

- interest rates;
- foreign exchange rates;
- stock share prices and indices;
- implied volatilities of relevant options;
- 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).

In terms of the banking book, the Bank distinguishes the interest rate risk, which defines as the risk of an adverse change in both the current valuation of the banking book position and the net interest income as a result of changes in interest rates.

3.5.1 Organisation of risk management

In the process of organisation of the market risk management, the Bank follows requirements resulting from the law and supervisory recommendations, in particular the PFSA 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 mBank is the separation of the market risk control and monitoring functions from the functions related to opening and keeping open market risk positions.

3.5.2 Tools and measures

For the purpose of internal management, the Bank quantifies exposure to market risk, both for banking and trading book, by measuring:

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

The Bank allocates market risk to positions in the banking book, irrespective of the method of presentation of the financial result on those positions used for financial accounting purposes. Market risk measures for interest rate positions in the banking books are determined on the basis of Net Present Value (NPV).

The Bank monitors market risk on a daily basis. For selected risk measures, the measurement is conducted on a weekly basis (Stressed VaR, CS BPV by rating classes) or monthly (economic capital).

For the banking book, the Bank also uses the following measures (described in more detail in the chapter on interest rate risk):

- sensitivity of the economic value of equity (delta EVE);
- sensitivity of net interest income (delta NII);
- repricing gap.

The Value at Risk (VaR) is calculated for each risk factor using the historical method for a 1-day and a 10-day holding period and a 95%, 97.5% and 99% confidence level, assuming a static portfolio. In this method, historical data concerning risk factors for last 254 business days are taken into consideration.

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

The Value at Risk in stressed conditions is a measure of the potential portfolio loss under adverse market conditions that deviate from typical market behaviour. The calculation is analogous to the Value at Risk calculation, and the only difference is the period of occurrence of stressed conditions, which is determined on the basis of series of Value at Risk based on successive 12-month windows of risk factors changes since 2007.

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 the 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. They show the hypothetical changes in the current valuation of the Bank'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 a static portfolio.

Stress tests consist of two parts: standard stress tests designated for standard risk factors (foreign exchange rates, interest rates, stock prices and their volatility), as well as stress tests, which involve 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 government yield curve and swap curve), which the Bank is exposed to, due to maintaining the portfolio of Treasury bonds.

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

In order to reflect the interest rate risk of the retail and corporate banking products with unspecified interest revaluation dates or rates administered by mBank, the Bank uses the so-called replicating portfolio models. 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 approved bank's strategy to stabilise 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 the net interest income. The VaR and IR BPV measurement results presented later in the report show the perspective including modelling. In 2019, there is a change in presentation compared to 2018, when the values were given without taking into account the modelling of stable parts of capital and current accounts, insensitive to changes in interest rates.

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The measurement methodology is subject to initial and periodic validation carried out by the Validation Unit and control by the Internal Audit Department.

In order to mitigate market risk exposure the limits are established on:

- VaR at 97,5% confidence level for a 1-day holding period;
- stress tests results;
- sensitivity measures IR BPV and CS BPV.

Decisions regarding the values of market risk limits are taken by:

- the Supervisory Board (with respect to the mBank Group’s portfolio);
- the Management Board (with respect to the mBank’s portfolio);
- the Financial Markets Risk Committee (with respect to the business units’ portfolios).

3.5.3 Market risk profile

Value at Risk

In 2019, the 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 table below presents VaR and Stressed VaR for the mBank’s portfolio:

PLN ths	2019		2018	
	31.12.2019	Mean	31.12.2018	Mean
VaR IR	3 778	3 759	3 248	3 443
VaR FX	728	961	341	421
VaR EQ	0	0	0	51
VaR CS	20 989	21 241	17 839	13 255
VaR	**21 978**	**21 344**	**17 776**	**13 436**
Stressed VaR	**94 229**	**104 269**	**104 743**	**90 316**

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

The measurement results are presented taking into the account the estimation of stable parts of capital and current accounts, invulnerable to interest rate fluctuation. There is a change of presentation in comparison to 2018, when the values waere presented without including of estimation.

The Value at Risk (VaR) was largely influenced by the portfolios of instruments sensitive to the interest rates and the separate credit spread - mainly the portfolios of the treasury bonds (in the banking and trading books) and positions resulting from interest rate swap transactions.

Sensitivity measures

The table presents the values of IR BPV and CS BPV (+1 b.p.) for the mBank’s portfolio, broken down into the banking and trading books:

PLN ths	IR BPV		CS BPV	
	31.12.2019	31.12.2018	31.12.2019	31.12.2018
Banking book	263	(237)	(8 075)	(7 957)
Trading book	56	33	(504)	21
Total	**319**	**(204)**	**(8 579)**	**(7 936)**

The credit spread sensitivity (CS BPV) for the mBank’s banking book, results in c.a. 40% from the positions in debt securities valued at amortized cost. Changes in market price have no impact on the revaluation reserve or the income statement for these positions.

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Economic capital for market risk

The Bank calculates economic capital to cover market risk without taking into account the modelling of stable parts of capital and current accounts, insensitive to changes in interest rates.

In 2019, the average level of economic capital for market risk for mBank amounted to PLN 1 041.0 million (in 2018: PLN 752.9 million). As of the end of 2019 economic capital for market risk for mBank amounted to PLN 1 134.8 million (at the end of 2018: PLN 912.7 million). The economic capital increased in 2019 mainly due to the change of observation in the 12-month window taken to calculation (increase of interest rates volatility), as well as an increase in the volume and duration of the bond portfolio.

3.6. Currency risk

The Bank is exposed to changes in currency exchange rates due to its financial assets and liabilities other than PLN. The following tbales present the exposure of bank to currency risk as at 31 December 2019 and 31 December 2018.

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

31.12.2019	PLN	EUR	USD	CHF	CZK	OTHER	TOTAL
ASSETS							
Cash and cash balances with central banks	6 795 432	826 679	34 340	6 883	184 482	13 960	7 861 776
Financial assets held for trading and hedging derivatives	2 700 406	163 458	53 957	3 926	2	-	2 921 749
Non-trading financial assets mandatorily at fair value through profit or loss, including:	1 825 305	76 110	133 774	-	-	-	2 035 189
Equity instruments	86 498	1 099	-	-	-	-	87 597
Debt securities	-	-	133 774	-	-	-	133 774
Loans and advances to customers	1 738 807	75 011	-	-	-	-	1 813 818
Financial assets at fair value through other comprehensive income	29 418 235	549 880	76 748	-	253 784	-	30 298 647
Financial assets at amortised cost	65 836 182	12 967 718	1 074 247	13 945 492	7 352 297	134 357	101 310 293
Debt securities	11 234 873	-	-	-	-	-	11 234 873
Loans and advances to banks	3 238 886	495 210	91 312	994	3 485 082	26 219	7 337 703
Loans and advances to customers	51 362 423	12 472 508	982 935	13 944 498	3 867 215	108 138	82 737 717
Investments in associates	2 162 760	1 352	-	-	-	-	2 164 112
Non-current assets and disposal groups classified as held for sale	91 605	-	-	-	-	-	91 605
Intangible assets	822 857	38	-	-	214	-	823 109
Tangible assets	906 367	7 828	-	-	31 411	-	945 606
Current income tax assets	-	-	-	-	11 878	-	11 878
Deferred income tax assets	270 880	-	-	-	2 377	-	273 257
Other assets	429 875	21 917	13 410	-	25 850	-	491 052
TOTAL ASSETS	**111 259 904**	**14 614 980**	**1 386 476**	**13 956 301**	**7 862 295**	**148 317**	**149 228 273**
LIABILITIES							
Financial liabilities held for trading and hedging derivatives	742 029	196 782	40 685	-	8 437	-	987 933
Financial liabilities measured at amortised cost, including:	89 187 865	23 281 268	3 640 393	4 972 229	7 394 510	503 718	128 979 983
Amounts due to banks	526 434	440 681	212 927	696	-	44	1 180 782
Amounts due to customers	87 141 985	20 682 291	3 427 466	2 787 061	7 394 510	503 674	121 936 987
Debt securities issued	-	2 158 296	-	1 203 701	-	-	3 361 997
Subordinated liabilities	1 519 446	-	-	980 771	-	-	2 500 217
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	-	-	-	136	-	136
Provisions	696 781	36 749	1 451	1 435	701	50	737 167
Current income tax liabilities	124 874	-	-	-	25 985	-	150 859
Deferred income tax liabilities	-	82	-	-	-	-	82
Other liabilities	1 884 250	93 966	142 107	3 005	107 598	26 180	2 257 106
TOTAL LIABILITIES	**92 635 799**	**23 608 847**	**3 824 636**	**4 976 669**	**7 537 367**	**529 948**	**133 113 266**
Net on-balance sheet position	**18 624 105**	**(8 993 867)**	**(2 438 160)**	**8 979 632**	**324 928**	**(381 631)**	**16 115 007**
Loan commitments and other commitments	25 341 747	1 930 463	337 433	2	510 904	696	**28 121 245**
Guarantees, banker's acceptances, documentary and commercial letters of credit	6 530 383	5 639 817	955 210	781 668	1 667	48 110	**13 956 855**

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31.12.2018	PLN	EUR	USD	CHF	CZK	OTHER	TOTAL
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 hedging derivatives	1 825 085	254 459	61 362	15 272	373	-	2 156 551
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	**99 970 803**	**14 197 795**	**1 762 723**	**14 854 999**	**6 733 608**	**159 681**	**137 679 609**
LIABILITIES							
Financial liabilities held for trading and hedging derivatives	709 759	236 830	61 415	-	8 210	-	1 016 214
Financial liabilities measured at amortised cost, including:	78 049 243	25 477 337	3 382 132	3 780 593	7 190 096	493 082	118 372 483
Amounts due to banks	1 849 100	1 097 880	212 225	563	416	7 026	3 167 210
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	2 323 934	102 725	132 775	3 998	80 972	15 984	2 660 388
TOTAL LIABILITIES	**81 516 367**	**25 865 936**	**3 577 220**	**3 784 911**	**7 295 883**	**509 122**	**122 549 439**
Net on-balance sheet position	**18 454 436**	**(11 668 141)**	**(1 814 497)**	**11 070 088**	**(562 275)**	**(349 441)**	**15 130 170**
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	6 375 093	7 782 517	763 694	760 553	5 472	25 778	15 713 107

3.7. Interest rate risk

In the process of management of interest rate risk in the banking book 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 the Polish Financial Supervisory Authority (PFSA), in particular Recommendation G, and EBA guidelines (EBA/GL/2018/02) the Bank monitors the banking book structure in terms of repricing risk, basis risk, yield curve risk and customer option risk.

The basic measures of interest rate risk in the banking book are:

- the repricing gap (the difference between assets, liabilities and off-balance sheet banking book positions, measured in defined repricing buckets, based on repricing date of the interest rate sensitive products);
- sensitivity of net interest income (delta NII), i.e. the difference of net interest income between the base and alternative scenarios, assuming different possibilities of shifting the profitability curve and changes in the balance sheet structure;
- sensitivity of the economic value of equity (delta EVE), i.e. the difference in the present value of cash flows between the base scenario and the alternative scenario, assuming various shifts in the profitability curve, including those in line with the EBA guidelines on the regulatory outlier test.

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The interest rate risk on the banking portfolio is hedged and managed based on the repricing gap limits for the entire portfolio, including separately for significant currencies, limits for market risk - imposed on Value at Risk (VaR), stress tests as well as BPV and CS BPV. Reports on the above measures are prepared on a daily basis.

The Bank calculates on monthly basis and reports quarterly the level of sensitivity of net interest income calculated for 22 scenarios of interest rate changes, taking into account changes in the level of the yield curve (including parallel curve shift, its steepening and flattening) and the base risk, both in static, dynamic and outflow balance over a 5-year horizon. The main assumptions used to calculate the measure are:

- the use of customer rates, decomposed into a trade margin and market rate;
- for products without a specific maturity date, assigning repricing dates based on the replicating portfolio model;
- limits applied to the level of lower interest rate changes to 0%;
- behavioral options including deposit termination and loan prepayments are calculated on the basis of the historical average.

In addition, the Bank calculates on a monthly basis and reports quarterly the sensitivity of the economic value of capital for 14 scenarios (including regulatory shock scenarios described in the EBA guidelines) taking into account changes in the level and slope of the yield curve as well as currency and credit spreads, broken down into values in currencies together and separately for material currencies based on the following assumptions:

- taking into account cash flows from interest rate sensitive assets and liabilities, including commercial margins;
- use of risk-free curves, except of debt securities, in case of debt securities the curve includes credit spread;
- exclusion of capital from liabilities;
- run-off balance sheet.

In the case of calculated sensitivity measures of net interest income and economic value of capital the Bank takes into account the risk of partial or total repayment of the loan before its maturity. The prepayment algorithm used is based on the historical average and its result is the annual prepayment rate by major currencies (PLN, CHF, EUR, CZK) and the portfolio of retail and corporate clients. As at 31 December 2019, the percentage annual prepayments estimated for the purposes of the above-mentioned risk measures were as follows: retail clients (8.7%), corporate clients (18%).

As at 31 December 2019 and 31 December 2018, the sensitivity of net interest income (based on a static balance sheet over a 12-month horizon) and the economic value of capital (for the outflow balance) in standard (regulatory) shock scenarios for interest rate risk are presented in the table below:

	Δ NII		Δ EVE	
	31.12.2019	31.12.2018	31.12.2019	31.12.2018
Sudden parallel up by 200 bp	193 591	100 352	(597 790)	(534 376)
Sudden parallel down by 200 bp	(857 302)	(649 544)	659 163	574 611
Parallel shock up	184 864	83 148	(621 015)	(557 863)
Parallel shock down	(1 229 657)	(756 903)	683 062	598 575
Steepener shock	(639 348)	(298 938)	27 127	88 247
Flattener shock	(53 429)	(160 831)	(129 019)	(180 644)
Short rates shock up	(9 013)	(130 320)	(305 383)	(333 653)
Short rates shock down	(1 426 397)	(185 353)	116 267	127 634
Maximum	(1 426 397)	(756 903)	(621 015)	(557 863)
Tier 1 Capital	14 053 467	13 419 690	14 053 467	13 419 690

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Absolut increase of ΔNII in most of scenarios was caused by several reasons combined. First reason was annual update of shocks values in stress scenarios. In 2019 more conservative, absolute higher, shocks were used for most of scenarios, especially for PLN currency. It has significant impact on increase of short rates down scenario. Another reason were changes in methodology of calculation ΔNII measure which took place in 2019, the most important of them was including option risk (credits prepayments, deposits withdrawals). Changes of ΔNII could be caused also by increase of balance sheet total which was observed between 2018 and 2019.

mBank S.A. interest rate risk

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

31.12.2019	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	3 738 681	-	-	-	-	4 123 095	**7 861 776**
Loans and advances to banks	4 772 011	2 280 219	99 132	-	-	186 341	**7 337 703**
Debt and equity securities and investments in subsidiaries	7 510 602	1 525 085	7 359 375	17 809 852	697 648	2 477 088	**37 379 650**
Loans and advances to customers	63 928 626	24 369 970	1 804 644	2 779 647	14 767	248 260	**93 145 914**
Other assets and derivative financial instruments	151 238	124 862	169 465	227 783	24 000	752 032	**1 449 380**
Total assets	**80 101 158**	**28 300 136**	**9 432 616**	**20 817 282**	**736 415**	**7 786 816**	**147 174 423**
Liabilities							
Amounts due to banks	980 863	189 900	-	-	-	10 019	**1 180 782**
Amounts due to customers	99 644 812	9 432 228	6 743 769	5 523 769	2 071	590 338	**121 936 987**
Debt securities in issue	-	-	-	3 361 997	-	-	**3 361 997**
Subordinated liabilities	763 355	980 771	756 091	-	-	-	**2 500 217**
Other liabilities and derivative financial instruments	94 739	136 706	275 903	186 144	19 807	2 531 740	**3 245 039**
Total liabilities	**101 483 769**	**10 739 605**	**7 775 763**	**9 071 910**	**21 878**	**3 132 097**	**132 225 022**
Total interest repricing gap	**(21 382 611)**	**17 560 531**	**1 656 853**	**11 745 372**	**714 537**		

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	5 685 196	1 719 955	10 411 106	14 594 313	1 291 606	2 370 679	**36 072 855**
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	**72 382 671**	**22 343 507**	**12 860 351**	**18 022 252**	**1 337 780**	**9 198 155**	**136 144 716**
Liabilities							
Amounts due to banks	1 979 322	895 617	288 985	-	-	3 286	**3 167 210**
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	162 712	176 765	283 365	209 898	25 736	2 818 126	**3 676 602**
Total liabilities	**88 650 337**	**11 446 515**	**9 811 093**	**9 130 890**	**81 949**	**2 928 301**	**122 049 085**
Total interest repricing gap	**(16 267 666)**	**10 896 992**	**3 049 258**	**8 891 362**	**1 255 831**		

3.8. 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.

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.

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. 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.

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.

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 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, maintains liquidity buffer and 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 2019, 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, in the form of loans from banks and bond issues, 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 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 2019, 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 PFSA Resolution No. 386/2008 on establishing liquidity measures binding on banks and in accordance with Commission Delegated Regulation (EU) No 2015/61 of 10 October 2014 the Bank calculates the supervisory liquidity measures. In 2019, the supervisory limits were not exceeded. Moreover 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 liquidity under normal and stress 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 and/or behavioural events relative to the Bank's clients.

For this purpose stress test scenarios are regularly calculated in the short- and long-term, in the bank, market and combined scenarios.

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.

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). Scenarios used in both plans are consistent with the above stress tests.

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 and bills issued by Czech National Bank in CZK. Values of these reserves amounted to:

Value of liquidity reserves (in PLN million)	
31.12.2019	**31.12.2018**
32 750	25 700

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;
- liquidity risk concentration within off-balance sheet positions related to related to financial and guarantee liabilities.

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) and the Balance Sheet Management Committee.

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 3.8.1). 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 cumulative gap of cash flows misfit (in PLN million)				
Time bucket	LAB Base Case - 31.12.2019		LAB Base Case - 31.12.2018	
	bucket	cumulative	bucket	cumulative
up to 1 working day	18 801	18 801	19 207	19 207
up to 3 working days	(1 210)	17 591	417	19 624
up to 7 calendar days	0	17 591	(2 987)	16 637
up to 15 calendar days	(568)	17 023	64	16 701
up to 1 month	(2 340)	14 683	(330)	16 371
up to 2 months	1 979	16 662	1 937	18 308
up to 3 months	(6)	16 656	(574)	17 734
up to 4 months	(94)	16 562	(2 218)	15 516
up to 5 months	(476)	16 086	(1 105)	14 411
up to 6 months	(13)	16 073	(933)	13 478
up to 7 months	(225)	15 848	(12)	13 466
up to 8 months	(335)	15 513	(366)	13 100
up to 9 months	(2 318)	13 195	150	13 250
up to 10 months	(565)	12 630	761	14 011
up to 11 months	(142)	12 488	(109)	13 902
up to 12 months	361	12 849	349	14 251

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 13.8 billion - the exchange rate of 31 December 2019 was used in calculation) had a positive impact on the level of liquidity gap, exceeding the dynamics of the development of lending activities (PLN 10.1 billion - the exchange rate of 31 December 2019 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 resulting from repayment of EUR 500m of unsecured funding, repayment of EUR 376m of secured funding and obtaining CHF 263m.

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 2019 the Bank would not have to post additional collateral.

In 2019 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.

LAB cash flows gaps mismatch in terms up to 1 month and up to 1 year within 2019 and values of regulatory measures M3–M4 and LCR are presented in the following table:

	31.12.2019	31.12.2018
LAB Base Case 1M	14 683	16 371
LAB Base Case 1Y	12 849	14 251
M3	4.30	4.95
M4	1.38	1.38
LCR	169%	190%

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

The long-term coverage ratios (M3, M4) are characterized by high stability on safe level, above minimum established by regulatory authority equal to 1. 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 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 2019, L/D ratio slightly changed from 75.9% to 76.4%. The Bank aims at building a stable deposit base by offering to clients deposit and investment products, regular and specific-purpose savings offerings. 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) and issuance of debt securities (Note 28). The loans and issuances 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.

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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.

3.8.1 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.

31.12.2019	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Amounts due to banks	996 811	1 301	3 932	192 315	-	**1 194 359**
Amounts due to customers	100 484 733	8 616 606	6 856 140	4 732 630	1 682 154	**122 372 263**
Debt securities in issue	44 102	-	-	3 325 247	-	**3 369 349**
Subordinated liabilities	34 828	5 068	57 163	307 123	2 684 908	**3 089 090**
Other liabilities	1 599 469	-	-	-	-	**1 599 469**
Total liabilities	**103 159 943**	**8 622 975**	**6 917 235**	**8 557 315**	**4 367 062**	**131 624 530**
Assets (by remaining contractual maturity dates)						
Total assets	**21 436 868**	**8 327 215**	**23 517 037**	**68 982 682**	**42 589 608**	**164 853 410**
Net liquidity gap	**(81 723 075)**	**(295 760)**	**16 599 802**	**60 425 367**	**38 222 546**	**33 228 880**

31.12.2018	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Amounts due to banks	2 271 518	47 156	672 059	197 996	-	**3 188 729**
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	**89 920 181**	**7 406 424**	**9 387 663**	**10 719 850**	**4 337 424**	**121 771 542**
Assets (by remaining contractual maturity dates)						
Total assets	**19 587 593**	**7 030 055**	**25 850 898**	**58 057 672**	**38 945 095**	**149 471 313**
Net liquidity gap	**(70 332 588)**	**(376 369)**	**16 463 235**	**47 337 822**	**34 607 671**	**27 669 771**

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.

Lease liabilities by maturity dates (undiscounted) are presented in the note 28.

Remaining contractual maturities for guarantees issued are presented in the note 33.

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3.8.2 Cash flows from derivatives

Derivatives settled in a net basis

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.

31.12.2019	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Forward Rate Agreements (FRA)	597	338	242	27	-	**1 204**
Interest Rate Swaps (IRS)	43 506	189 028	335 858	1 409 739	159 838	**2 137 969**
Cross Currency Interest Rate Swaps (CIRS)	(1 213)	(7 053)	(17 266)	12 699	1 415	**(11 418)**
Options	2 863	8 875	21 751	8 177	3	**41 669**
Other	2 309	87 475	171 391	184 307	-	**445 482**
Total derivatives settled on a net basis	**48 062**	**278 663**	**511 976**	**1 614 949**	**161 256**	**2 614 906**

31.12.2018	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	3 211	16 929	7 024	(50)	**30 810**
Other	5 226	3 735	15 765	18 833	**-**	**43 559**
Total derivatives settled on a net basis	**30 458**	**133 993**	**379 710**	**1 100 134**	**51 079**	**1 695 374**

Derivative financial instruments settled in gross amounts

Derivative financial instruments settled in gross amounts by the Bank comprise foreign exchange derivatives: curency 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.

31.12.2019	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Currency derivatives						
- outflows	13 752 578	4 905 390	5 777 105	3 784 871	-	28 219 944
- inflows	13 734 007	4 897 816	5 761 983	3 702 077	-	28 095 883

31.12.2018	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

The amounts dosclosed 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 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.

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3.9. 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. Operational risk includes, in particular, the following material sub-categories: legal risk, IT risk, cyber risk, compliance risk, conduct risk, external fraud risk, outsourcing risk. Operational risk does not include reputational risk, however materialisation of operational risk may increase reputational risk.

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

The aim of operational risk management in the Bank 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.

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 assess the most important risks, control mechanisms and independent monitoring of control mechanisms, and then to develop and implement necessary corrective action plans.

In addition, 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 Group incurs the highest losses in two categories of operational risk: (i) crimes committed by outsiders; (ii) 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 2019:

Operational risk category	Distribution	Value of losses in relations to the value of gross profit
Crimes committed by outsiders	6.73%	2.01%
Customers, products and business practices	92.42%	27.53%
Other	0.85%	0.25%
Total	**100.00%**	**29.79%**

The high share of losses in the 'Customers, products and business practices' category in 2019 resulted from the creation of legal risk provisions for foreign currency loans. More information on the above provisions is provided in Note 4 and Note 32.

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.

3.9.1 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 sets forth general rules for ensuring compliance of operations pursued by the Bank with provisions of law, internal regulations and market standards.

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 Polish Financial Supervision Authority (PFSA) and other supervisory authorities executing their tasks towards financial institutions.

In order to guarantee compliance, the objectives of the internal control system are met within the three lines of defence. The first level comprises risk management in operational activities. The second level comprises at least risk management by employees holding dedicated positions or working in dedicated organisational units, irrespective of risk management performed at the first level, and the measures taken by the Compliance Department. The third level comprises operations of the Internal Audit Department. At all three levels, the Bank's employees apply control mechanisms and independently monitor observance of these mechanisms.

Compliance of the bank's internal rules with the Polish and international law and with market standards adopted by the bank and observing internal rules by the bank employees guarantees fulfilment of the objectives of the internal control system and mitigates compliance risk, and eliminates or minimises the possibility of occurrence of the following risks: legal risk, reputational risk, risk of imposing sanctions and financial losses and risk resulting from discrepancies in interpretations 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.

The supervision over the implementation of common compliance standards by the mBank Group subsidiaries is exercised in a manner that does not violate applicable law, prudential regulations and independence of employees performing the compliance function in the subsidiaries, in particular under agreements concluded with the subsidiaries.

3.10. 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.

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 and informing the Management Board about results of the above analyses,
- periodic verification of the adopted strategy,
- regular analysis of the competitors' activities.

3.11. 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, improper business or strategic decisions or negatively influence the Bank's reputation.

The following specific subcategories can be distinguished, in particular, in model risk: risk inextricably linked with the restrictions connected with modelling a given phenomenon, assumption/methodology risk, data risk, models administration risk, and risk of interdependence.

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

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

3.12. Reputational risk

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 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 analyzed 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.

3.13. Capital risk

In mBank 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 enabling further independent functioning of the Bank. Capital risk encompasses the risk of excessive leverage. Capital risk management is performed, at an individual level, in mBank and, at a consolidated level, in mBank Group.

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 future developments resulting from the stress scenarios adopted for the analysis.

More information on capital adequacy of mBank Group is provided in Note 44.

3.14. 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

3.15. 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.

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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.

The approach to the method used for the loans that are fair valued in line of IFRS9 requirements, is described in the point 3.3.7.

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 recognised in General Ledger at 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.

	31.12.2019		31.12.2018	
	Carrying value	Fair value	Carrying value	Fair value
Financial assets at amortised cost				
Debt securities	**11 234 873**	**11 409 164**	**9 000 540**	**9 148 798**
Loans and advances to banks	**7 337 703**	**7 334 393**	**5 909 341**	**5 884 788**
Loans and advances to customers, including:	**82 737 717**	**82 724 274**	**76 201 963**	**75 912 683**
Loans and advances to individuals	**41 456 124**	**42 383 476**	**38 441 362**	**38 895 475**
Current accounts	6 828 579	7 011 607	5 809 898	5 972 041
Term loans	34 265 519	35 009 843	32 271 991	32 563 961
Other	362 026	362 026	359 473	359 473
Loans and advances to corporate entities	**40 995 685**	**40 057 005**	**37 235 689**	**36 495 606**
Current accounts	5 934 931	5 799 411	5 859 055	5 744 813
Term loans	34 638 535	33 835 375	30 103 484	29 477 643
Rreverse repo or buy/sell back transactions	13 398	13 398	1 146 263	1 146 263
Other loans and advances	158 911	158 911	111 955	111 955
Other	249 910	249 910	14 932	14 932
Loans and advances to public sector	**285 908**	**283 793**	**524 912**	**521 602**
Financiel liabilities at amortised cost				
Amounts due to banks	**1 180 782**	**1 180 747**	**3 167 210**	**3 165 645**
Amounts due to customers	**121 936 987**	**122 037 314**	**109 873 386**	**109 893 816**
Debt securities in issue	**3 361 997**	**3 407 731**	**2 857 724**	**2 844 520**
Subordinated liabilities	**2 500 217**	**2 519 770**	**2 474 163**	**2 492 101**

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.

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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 the loans received from European Investment Bank in EUR the Bank used the EBI yield curve. With regard to the own issue as part of the EMTN programme the market price of the relevant financial services has been used.

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

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

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

- Level 1: prices quoted on active markets for the same instrument (without modification);
- Level 2: prices quoted on active markets for the similar instruments or other valuation techniques for which all significant input data are based on observable market data;
- Level 3: valuation methods for which at least one significant input data is not based on observable market data.

The table below presents the fair value hierarchy of financial assets and liabilities measured at fair value in accordance with the assumptions and methods described above, exclusively for disclosure as at 31 December 2019 and as at 31 December 2018.

31.12.2019	**Including:**	**Level 1**	**Level 2**	**Level 3**
		Quoted prices in active markets	**Valuation techniques based on observable market data**	**Other valuation techniques**
VALUATION ONLY FOR PURPOSES OF DISCLOSURE				
FINANCIAL ASSETS				
Debt securities	11 409 164	11 409 164	-	-
Loans and advances to banks	7 334 393	-	-	7 334 393
Loans and advances to customers	82 724 274	-	-	82 724 274
FINANCIAL LIABILITIES				
Amounts due to banks	1 180 747	-	189 885	990 862
Amounts due to customers	122 037 314	-	7 158 593	114 878 721
Debt securities in issue	3 407 731	3 407 731	-	-
Subordinated liabilities	2 519 770	-	2 519 770	-
Total financial assets	**101 467 831**	**11 409 164**	**-**	**90 058 667**
Total financial liabilities	**129 145 562**	**3 407 731**	**9 868 248**	**115 869 583**

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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
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 banks	3 165 645	-	474 235	2 691 410
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	**118 396 082**	**2 844 520**	**12 427 484**	**103 124 078**

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. 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.

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Positions recognised in General Ledger at 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.

31.12.2019	Including:	Level 1 Quoted prices in active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS				
Financial assets held for trading and hedging derivatives	**2 921 749**	**1 330 541**	**958 328**	**632 880**
Loans and advances to customers	172 689	-	-	172 689
Debt securities	1 790 732	1 330 541	-	460 191
Derivative financial instruments, including:	958 328	-	958 328	-
Derivative financial instruments held for trading:	1 058 084	-	1 058 084	-
Hedging derivative financial instruments:	392 705	-	392 705	-
Offsetting effect	(492 461)	-	(492 461)	-
Non-trading financial assets mandatorily at fair value through profit or loss	**2 035 189**	**825**	**-**	**2 034 364**
Loans and advances to customers	1 813 818	-	-	1 813 818
Debt securities	133 774	-	-	133 774
Equity securities	87 597	825	-	86 772
Financial assets at fair value through other comprehensive income	**30 298 647**	**17 388 493**	**2 999 645**	**9 910 509**
Loans and advances to customers	8 421 690	-	-	8 421 690
Debt securities	21 876 957	17 388 493	2 999 645	1 488 819
TOTAL FINANCIAL ASSETS	**35 255 585**	**18 719 859**	**3 957 973**	**12 577 753**
FINANCIAL LIABILITIES				
Derivative financial instruments, including:	**987 933**	**-**	**987 933**	**-**
Derivative financial instruments held for trading	1 108 063	-	1 108 063	-
Hedging derivative financial instruments	11 887	-	11 887	-
Offsetting effect	(132 017)	-	(132 017)	-
TOTAL FINANCIAL LIABILITIES	**987 933**	**-**	**987 933**	**-**

Assets Measured at Fair Value Based on Level 3 - changes in 2019	Debt trading securities	Non-trading debt securities mandatorily at fair value through profit or loss	Non-trading equity securities mandatorily at fair value through profit or loss	Debt securities at fair value through other comprehensive income	Equity securities at fair value through other comprehensive income
As at the beginning of the period	**328 102**	**58 130**	**11 456**	**1 742 614**	**-**
Gains and losses for the period:	**1 777**	**75 644**	**75 316**	**(9 660)**	**-**
Recognised in profit or loss:	1 777	75 644	75 316	-	-
- Net trading income	*1 777*	*320*	(10)	-	-
- Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss	-	*75 324*	75 326	-	-
Recognised in other comprehensive income:	-	-	-	(9 660)	-
- Financial assets at fair value through other comprehensive income	-	-	-	*(9 660)*	-
Purchases	*2 044 401*	-	-	1 397 817	-
Redemptions	*(531 490)*	-	-	(274 629)	-
Sales	*(6 819 158)*	-	-	(2 155 733)	-
Issues	*5 436 559*	-	-	788 410	-
As at the end of the period	**460 191**	**133 774**	**86 772**	**1 488 819**	**-**

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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
RECURRING FAIR VALUE MEASUREMENTS				
FINANCIAL ASSETS				
Financial assets held for trading and hedging derivatives	**2 156 551**	**778 733**	**1 006 550**	**371 268**
Loans and advances to customers	43 166	-	-	43 166
Debt securities	1 106 835	778 733	-	328 102
Derivative financial instruments, including:	1 006 550	-	1 006 550	-
Derivative financial instruments held for trading:	1 030 994	-	1 030 994	-
Hedging derivative financial instruments:	309 484	-	309 484	-
Offsetting effect	(333 928)	-	(333 928)	-
Non-trading financial assets mandatorily at fair value through profit or loss	**2 567 330**	**770**	**-**	**2 566 560**
Loans and advances to customers	2 496 974	-	-	2 496 974
Debt securities	58 130	-	-	58 130
Equity securities	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 customers	4 578 310	-	-	4 578 310
Debt securities	23 594 800	21 352 274	499 912	1 742 614
TOTAL FINANCIAL ASSETS	**32 896 991**	**22 131 777**	**1 506 462**	**9 258 752**
FINANCIAL LIABILITIES				
Derivative financial instruments, including:	**1 016 214**	**-**	**1 016 214**	**-**
Derivative financial instruments held for trading	1 105 239	-	1 105 239	-
Hedging derivative financial instruments	5 766	-	5 766	-
Offestting effect	(94 791)	-	(94 791)	-
TOTAL FINANCIAL LIABILITIES	**1 016 214**	**-**	**1 016 214**	**-**

Assets Measured at Fair Value Based on Level 3 - changes in 2018	Debt trading securities	Non-trading debt securities mandatorily at fair value through profit or loss	Non-trading equity securities mandatorily at fair value through profit or loss	Debt securities at fair value through other comprehensive income	Equity securities at fair value through other comprehensive income
As at the beginning of the period	**311 826**	**-**		**1 635 170**	**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	-	2 546	2 189 754	-
Redemptions	(442 675)	-	-	(316 279)	-
Sales	(6 615 676)	-	(38)	(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 and 2019 there were no transfers of financial instruments between the levels of fair value hierarchy.

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 the Balance Risk 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.

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Level 1

As at 31 December 2019, at level 1 of the fair value hierarchy, Bank has presented the fair value of held for trading government bonds in the amount of PLN 1 330 541 thousand and the fair value of government bonds and treasury bills measured at fair value through other comprehensive income in the amount of PLN 16 404 265 thousand (31 December 2018 respectively: PLN 778 733 thousand and PLN 20 121 684 thousand. Level 1 includes the fair values of corporate bonds in the amount of PLN 984 228 thousand (31 December 2018: PLN 1 230 590 thousand).

In addition, as at 31 December 2019, level 1 includes the value of the registered privileged shares of Giełda Papierów Wartościowych in the amount of PLN 825 thousand (31 December 2018: PLN 770 thousand).

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

Level 2

Level 2 of the fair value hierarchy mainly includes the fair values of bills issued by NBP in the amount of PLN 2 999 645 thousand (31 December 2018: PLN 499 912 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 2019 and 31 December 2018, level 2 also includes the value of options referencing on the WIG20 index. For options valuation on WIG 20 index an internal Bank's model (based on implied volatility model) using market parameters is applied

Level 3

Level 3 of the hierarchy presents the fair values of commercial debt securities issued by local banks and companies in the amount of PLN 2 046 502 thousand (31 December 2018: PLN 2 092 458 thousand) and includes i.a. 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.

Level 3 includes also the fair value of local government bonds in the amount of PLN 36 282 thousand (31 December 2018 - PLN 36 388 thousand).

Model valuation for these items assumes a valuation based on the market interest rate yield curve adjusted by the level of credit spread. The credit spread parameter reflects the credit risk of the security issuer and is determined in accordance with the Bank's internal model. This model uses credit risk parameters (e.g. PD, LGD) and information obtained from the market (including implied spreads from transactions). PD and LGD parameters are not observed on active markets and therefore have been determined on the basis of statistical analyses. Both models - the valuation of debt instruments and the credit spread model were built internally in the Bank by risk units, were approved by the Model Risk Committee and are subject to periodic monitoring and validation carried out by an entity independent of the units responsible for building and maintaining the model.

Impact of change in credit spreads on the fair value of debt securities classified as level 3 is presented in the table bleow. The amount reflects change in credit risk in relation to purchase date.

Issuer	Change of fair value resulting from change in credit risk	
	31.12.2019	31.12.2018
Credit institutions	(622)	(592)
Non-financial enterprises	(406)	(2 120)
Total	**(1 028)**	**(2 712)**

Level 3 as at 31 December 2019 includes the value of loans and advances to customers in the amount of PLN 10 408 197 thousand (31 December 2018: PLN 7 118 450 thousand).

The Fair Value calculation for loans and advances to customers is based on its discounted estimated future cash flows. Future cash flows are determined taking into account:

- repayment schedule
- time value of money, based on risk-free interest rates set in the process of forecasting interest flows,

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- 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.

Moreover, level 3 covers mainly the fair value of equity securities amounting to PLN 86 772 thousand (31 December 2018: PLN 11 456 thousand). 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.

The table below presents the sensitivity of the fair value measurement to the change of unobservable parameters used in the models for financial instruments measured at fair value at level 3.

Portfolio	Fair value 31.12.2019	Sensitivity to change of unobservable parameter		Description
		(+)	(-)	
Commercial debt securities measured at fair value through other comprehensive income	1 488 819	(38 323)	38 323	The unobservable parameter is the credit spread. Sensitivity was calculated assuming a change in the credit spread by 100 bp. As the value of the parameter increases, the Bank expects a loss (-), while a decrease there is expected a profit (+).
Commercial debt securities measured at fair value through profit or loss	460 191	(12 422)	12 422	
Loans and advances to customers held for trading	172 689	(130)	137	The valuation model uses credit risk parameters (PD and LGD). Sensitivity was calculated assuming a change in PD and LGD by +/- 10%. As the value of the parameter increases, the Bank expects a loss (-), while a decrease there is expected a profit (+).
Loans and advances to customers at fair value through profit or loss	1 813 818	(29 063)	28 962	
Loans and advances to customers at fair value through other comprehensive income	8 421 690	(3 449)	3 239	

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 as well as contingent liabilities which are impaired, change by +/-10%, the estimated loans and advances as well as contingent liabilities impairment would either decrease by PLN 34.6 million or increase by PLN 37.1 million as at 31 December 2019, respectively (as at 31 December 2018: PLN 33.7 million and PLN 42.7 million, respsctively). 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 3.3.6.

Provisions for legal risks

Provisions for legal proceedings are recognized for the value in dispute and other costs on each reporting date based on an estimate of the probability of loss. However, the Bank's final liability may differ from the provisions that have been recognized, as a high degree of judgement is involved in assessing the probability of uncertain liabilities in such legal proceedings and quantifying them. These estimates may turn out to be inaccurate at a later stage of the proceedings.

The Bank closely observes the developments in courts verdicts in legal proceedings regarding mortgage and housing loans in CHF, including impact of the CJEU judgment described in Note 32. In the 4th quarter of 2019 the Bank decided to change the methodology of the measurement of provisions for legal risk regarding individual court cases concerning indexation clauses in mortgage and housing loans in CHF as a result of the observed increase of total number of individual court cases as well as change in verdicts issued by the courts in such legal cases. As at 31 December 2019 the Bank measured the provisions for the population of mortgage and housing loans in CHF using "expected value" method allowed by the IAS 37 in which the obligation is estimated by weighting all possible outcomes by their associated probabilities. The amount of provisions for individual cases concerning indexation clauses calculated using the new approach amounted to PLN 417 653 thousand which represented an increase of PLN 387 088 thousand compared to the amount as of 31 December 2018.

The methodology applied by the Bank depends on numerous assumptions, all associated with the significant degree of expert judgement made by the Bank, among which the most important are: an expected population of borrowers who will file a lawsuit against the Bank, the probability of losing the case having final and binding judgement, the distribution of expected verdicts judged by the courts and the loss to be incurred by the Bank in case of a losing the case in court.

The population of borrowers who will file a lawsuit against the Bank has been projected for a period of next 5 years based on the Bank's history of legal cases in the past and assumes a significant increase in inflow of new cases. The Bank assumes that vast majority of the projected cases will be filed within first 3 years. If the assumed number of inflowing cases changed by +/- 20% and all other relevant assumptions remained constant the amount of the provision would change by +/- PLN 48.2 million.

The probability of loss has been calculated using data from the Bank's history of final and binding positive and negative verdicts available as of 31 December 2019. The final rulings to-date in the indexation clauses proceedings are favourable to the Bank in the majority of the cases. As the number of final verdicts is not statistically representative (too few binding verdicts have been issued by courts in cases related to mBank) the assumption of probability of loss takes also into account expert judgements by the Bank about the future trends in the court verdicts. If the assumed probability of loss changed by +/- 10% and all other relevant assumptions remained constant the amount of the provision would change by +/- PLN 41.8 million.

The methodology also takes into account the expected level of loss in case of losing the case by the Bank. The projected loss rate was calculated using the probabilities of different verdicts that may be issued. As currently there is still no homogenous line of verdicts taken by the courts in such cases the Bank took into account three possible losing scenarios of outcomes in legal proceedings: (i) the contract is partially invalid; the contract is not invalid, but the indexation mechanism is eliminated, which transforms a loan indexed to CHF into a PLN loan subject to the interest rate of the loan indexed to CHF, (ii) the contract is invalid in whole; the change in the contract resulting from deletion of the exchange rate norm (assuming that the norm defines the main subject matter of the contract) would be too far-reaching and (iii) the contract on a mortgage indexed to the CHF is not invalid and the loan remains a mortgage indexed to the CHF; the gap should be filled by interpreting the contract based on a norm referring to the fixing rate of the NBP. Each of this scenarios is associated with a different level of predicted losses for the Bank. The Bank calculated the average level of loss weighted with the probabilities of occurrence of those scenario in case of negative final and binding judgement. The probabilities of those scenarios applied by the Bank has been based on the assessment of the Bank consulted with the external legal advisor. If the assumed weighted average loss changed by +/- 5% and all other relevant assumptions remained constant the amount of the provision would change by +/- PLN 20.9 million.

The method used to calculate the provision is based on parameters that are highly judgmental and with a high range of possible values. It is possible that the provision will have to be adjusted significantly in the future, particularly that important parameters used in calculations are interdependent.

Prepayments of retail loans

CJEU ruled on 11 September 2019 that in case concerning consumer loans paid off prematurely the consumer has the right to a reduction in the total cost of the loan in the event of early repayment of the credit. The interpretation constituted an answer to a prejudicial question asked in a court case in which a few banks have participated including mBank.

The above ruling impacts consumer loans granted on 18 December 2011 or later, in the amount not exceeding 255 550 PLN or its equivalent in other currency and mortgage loans granted on 22 July 2017 or later with no limit of the loan amount, which have been paid off fully or partially.

In 2019 the Bank recognised in other operating expense (Note 13) the amount of PLN 24.8 million for potential reimbursements od commissions in relation to early repayments of loans before the date of the verdict. As of 31 December 2019 the provision recorded within other provisions (Note 30) related to those costs amounted to PLN 16.3 million.

In case of loans that were prepaid after the date of the verdict the commissions to be yet returned to clients are recorded as amounts due to the clients amounted to PLN 20.7 million.

Additionally, as a result of the verdict the Bank revised its estimates regarding the amounts and timing of the cash flows related to the loans granted before the date of the CJEU verdict which are expected to be repaid before the contractual term. The change of these estimates was recognised as cumulative catch-up in accordance with the IFRS 9 by decreasing interest income by PLN 47.8 million. The amount was recognised within other provisions (Note 30).

The total negative impact of early repayments of retail loans on the Bank's 2019 gross profit amounted to PLN 93.3 million, of which PLN 68.5 million reduced net interest income and PLN 24.8 million increased other operating expenses.

The above estimates are burdened with significant uncertainty regarding the number of customers who will request the Bank to refund commissions regarding earlier repayments made by the CJEU verdict as well as the expected rate of loan prepayments in the future.

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

Estimates relating to leases, where the Bank is a lessee, in areas such as determination of the duration of contracts, determining the interest rate used to discount future cash flows and determination of the depreciation rate of right-of-use assets are presented in Note 2.26.

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5. Net interest income

	Year ended 31 December	
	2019	2018
Interest income		
Interest income accounted for using the effective interest method	**3 946 091**	**3 357 644**
Interest income of financial assets at amortised cost, including:	3 248 623	2 755 453
- Loans and advances	*2 959 366*	*2 490 597*
- Debt securities	*232 177*	*203 363*
- Cash and short-term placements	*55 066*	*54 307*
- Other	*2 014*	*7 186*
Interest income on financial assets at fair value through other comprehensive income	697 468	602 191
- Debt securities	*456 258*	*479 083*
- Loans and advances	*241 210*	*123 108*
Income similar to interest on financial assets at fair value through profit or loss, including:	**508 765**	**603 962**
Financial assets held for trading	53 908	74 379
- Loans and advances	*4 434*	*1 324*
- Debt securities	*49 474*	*73 055*
Non-trading financial assets mandatorily at fair value through profit or loss, including:	180 648	262 784
- Loans and advances	*180 648*	*262 784*
Interest income on derivatives classified into banking book	173 933	168 538
Interest income on derivatives concluded under the fair value hedge	45 739	57 904
Interest income on derivatives concluded under the cash flow hedge	54 537	40 357
Total interest income	**4 454 856**	**3 961 606**

	Year ended 31 December	
	2019	2018
Interest expenses		
Financial liabilities measured at amortised cost, including:	(899 193)	(859 901)
- deposits	*(666 118)*	*(582 776)*
- loans received	*(13 081)*	*(28 949)*
- issue of debt securities	*(32 405)*	*(10 198)*
- subordinated liabilities	*(76 167)*	*(75 300)*
- leasing agreements	*(2 914)*	*n/a*
- other financial liabilities	*(108 508)*	*(162 678)*
Other	(10 967)	(14 196)
Total interest expense	**(910 160)**	**(874 097)**

In 2019, interest income related to impaired financial assets amounted to PLN 118 286 thousand (for the period ended 31 December 2018: PLN 98 710 thousand).

Interest income in 2019 was affected by recognition of cumulative effect of change in estimates regarding the amounts and timing of the cash flows related to the loans which are expected to be repaid before the contractual term. The issue was described in detail in Note 4.

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Net interest income per client groups is as follows.

	Year ended 31 December	
	2019	2018
Interest income		
From banking sector	466 478	477 369
From other customers, including:	3 988 378	3 484 237
- individual clients	2 082 435	1 785 282
- corporate clients	1 296 317	1 064 754
- public sector	609 626	634 201
Total interest income	**4 454 856**	**3 961 606**
Interest expenses		
From banking sector	(56 427)	(62 400)
From other customers, including:	(745 161)	(726 199)
- individual clients	(333 100)	(402 679)
- corporate clients	(370 740)	(284 254)
- public sector	(41 321)	(39 266)
From debt securities in issue and from subordinated liabilities	(32 405)	(10 198)
Subordinated liabilities	(76 167)	(75 300)
Total interest expense	**(910 160)**	**(874 097)**

6. Net fee and commission income

	Year ended 31 December	
	2019	2018
Fee and commission income		
Payment cards-related fees	435 878	389 951
Credit-related fees and commissions	350 035	313 575
Commissions from bank accounts	210 930	207 941
Commissions from money transfers	145 376	132 895
Commissions for agency service regarding sale of insurance products of external financial entities	49 857	17 102
Fees from brokerage activity and debt securities issue	89 903	105 463
Commissions due to guarantees granted and trade finance commissions	84 475	77 779
Commissions for agency service regarding sale of other products of external financial entities	54 001	86 054
Commissions on trust and fiduciary activities	28 027	26 478
Fees from portfolio management services and other management-related fees	14 161	11 594
Fees from cash services	48 570	54 788
Other	42 708	43 385
Fee and commission income	**1 553 921**	**1 467 005**

	Year ended 31 December	
	2019	2018
Fee and commission expense		
Payment cards-related fees	(241 198)	(213 566)
Commissions paid to external entities for sale of the Bank's products	(153 711)	(130 569)
Commissions paid for agency service regarding sale of insurance products of external financial entities	(14 279)	(5 828)
Discharged brokerage fees	(28 846)	(26 772)
Cash services	(41 944)	(50 060)
Fees to NBP and KIR	(14 706)	(13 456)
Other discharged fees	(147 573)	(135 552)
Total fee and commision expense	**(642 257)**	**(575 803)**

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7. Dividend income

	Year ended 31 December	
	2019	**2018**
Financial assets held for trading	-	4
Financial assets at fair value through profit or loss	4 220	3 554
Investments in subsidiaries, joint ventures and associates accounted for using equity method	316 075	122 833
Total dividend income	**320 295**	**126 391**

8. Net trading income

	Year ended 31 December	
	2019	**2018**
Foreign exchange result	**381 018**	**303 985**
Net exchange differences on translation	352 675	366 255
Net transaction gains/(losses)	28 343	(62 270)
Gains or losses on financial assets and liabilities held for trading	**57 986**	**52 721**
Derivatives, including:	24 146	49 749
- Interest-bearing instruments	*16 256*	*40 782*
- Market risk instruments	*7 890*	*8 967*
Equity instruments	-	(754)
Debt securities	33 981	3 589
Loans and advances	(141)	137
Gains or losses from hedge accounting	**3 785**	**(4 389)**
Net profit on hedged items	(34 543)	(42 627)
Net profit on fair value hedging instruments	39 154	34 846
Ineffective portion of cash flow hedge	(826)	3 392
Net trading income	**442 789**	**352 317**

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.

The Bank applies fair value hedge accounting and cash flow hedge accounting. Detailed information on hedge accounting are included in Note 19.

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

	Year ended 31 December	
	2019	**2018**
Equity instruments	75 382	(217)
Debt securities	75 324	7 028
Loans and advances	(78 603)	(162 296)
Total gains or losses on non-trading financial assets mandatorily at fair value through profit or loss	**72 103**	**(155 485)**

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In the item of gains on non-trading equity instruments mandatorily measured at fair value through profit or loss, the Bank recognized a profit in the amount of PLN 45 058 thousand resulting from the revaluation of shares in Polski Standard Płatności Sp. z o.o., made in connection with the start of strategic cooperation with Mastercard.

The amount of PLN 75 324 thousand related to the gains on debt securities stems from the revaluation of VISA preference shares (presented as debt securities as they do not match the definition of an equity instrument), out of which PLN 48 369 thousand the Bank recognised in connection with the verification of the value of shares and the change in the approach to the haircuts levels included in the valuation model.

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 December	
	2019	2018
Gains less losses related to sale of debt securities measured at fair value through other comprehensive income	37 178	16 149
Gains less losses related to sale of investments in subsidiaries and associates	(1 247)	290
Gains less losses from derecognition, including:	(17 544)	(3 043)
- Financial assets at fair value through other comprehensive income	*(17 843)*	*(551)*
- Financial assets at amortised cost	*299*	*(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	**18 387**	**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 31.12.2019		Year ended 31.12.2018	
	Gains	Losses	Gains	Losses
Loans and advances	11 272	(28 816)	7 266	(10 309)
Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss	**11 272**	**(28 816)**	**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.

11. Other operating income

	Year ended 31 December	
	2019	2018
Gains from sale or liquidation of fixed assets, intangible assets, assets held for sale and inventories	6 162	754
Income from services provided	5 809	12 356
Income due to release of provisions for future commitments	9 515	1 770
Income from recovering receivables designated previously as prescribed, remitted or uncollectible	4 654	97
Income from compensations, penalties and fines received	311	268
Other	25 564	41 246
Total other operating income	**52 015**	**56 491**

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

	Year ended
	31 December 2019
Net operating income due to operating lease and subleasing right-of-use assets	
- Income from operating lease	1 839
- Income from right-of-use assets in sublease	13 144
- Amortisation cost of assets in operating lease and right-of-use assets	(14 983)
Total net operating income due to operating lease	**-**

Income from subleasing of right-of-use assets relate to the sublease of office space.

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12. Overhead costs

	Year ended 31 December	
	2019	**2018**
Staff-related expenses	(905 664)	(836 292)
Material costs, including:	(563 763)	(658 229)
- costs of administration and real estate services	(223 522)	(319 500)
- IT costs	(140 061)	(143 537)
- marketing costs	(135 529)	(129 782)
- consulting costs	(56 489)	(57 465)
- other material costs	(8 162)	(7 945)
Taxes and fees	(27 949)	(22 934)
Contributions and transfers to the Bank Guarantee Fund	(242 395)	(175 160)
Contributions to the Social Benefits Fund	(7 598)	(6 855)
Total overhead costs	**(1 747 369)**	**(1 699 470)**

In 2019, the item "Material costs" consists of: costs related to short-term lease agreements of PLN 1 742 thousand, costs related to leases of low-value assets in the amount of PLN 2 952 thousand and costs related to variable lease payments not included in the measurement of the lease liability (included in overhead costs) in the amount of PLN 3 130 thousand.

In 2018, the item "Material costs" consists of tangible assets operating lease payment costs (mainly real estate) of PLN 27 997 thousand.

Staff-related expenses in 2019 and 2018 are presented below.

	Year ended 31 December	
	2019	**2018**
Wages and salaries	(733 289)	(681 804)
Social security expenses	(122 065)	(111 178)
Remuneration concerning share-based payments, including:	(9 947)	(10 224)
- share-based payments settled in mBank S.A. shares	*(9 947)*	*(10 224)*
Other staff expenses	(40 363)	(33 086)
Staff-related expenses, total	**(905 664)**	**(836 292)**

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

13. Other operating expenses

	Year ended 31 December	
	2019	**2018**
Losses from sale or liquidation of fixed assets, intangible assets, assets held for resale and inventories	(2 526)	(1 456)
Provisions for future commitments	(51 399)	(34 828)
Costs arising from provisions created for other receivables (excluding loans and advances)	(1 196)	(1 249)
Donations made	(6 003)	(14 523)
Compensation, penalties and fines paid	(4 237)	(2 144)
Debt collection related costs	(41 838)	(36 941)
Other operating costs	(67 009)	(39 987)
Total other operating expenses	**(174 208)**	**(131 128)**

In 2019, the item "Other operating expenses" includes a cost in the amount of PLN 26 283 thousand, created as a result of the Bank's decision to select an alternative method of taxing with income tax the interest paid by the Bank in relation to bonds issued before 1 January 2019 on foreign public markets under the EMTN program.

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In item „Provisions for future commitments" in 2019 the Bank recognised the costs of potential reimbursements of commissions to clients amounting to PLN 24 800 thousand in relations to prepayments of retail loans. The issue was described in detail in Note 4.

Costs of services provided concern non-banking services.

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

	Year ended 31 December	
	2019	**2018**
Financial assets at amortised cost, including:	**(585 884)**	**(475 028)**
- Debt securities	8	(52)
Stage 1	*8*	*(52)*
- Loans and advances	(585 892)	(474 976)
Stage 1	*(83 690)*	*(55 582)*
Stage 2	*(35 915)*	*(40 004)*
Stage 3	*(465 750)*	*(388 071)*
POCI	*(537)*	*8 681*
Financial assets at fair value through other comprehensive income	**(4 268)**	**(3 004)**
- Debt securities	171	*95*
Stage 1	*927*	*408*
Stage 2	*(756)*	*(313)*
- Loans and advances	(4 439)	(3 099)
Stage 1	*(1 996)*	*(898)*
Stage 2	*(1 880)*	*(2 065)*
Stage 3	*(550)*	*(136)*
POCI	*(13)*	-
Commitments and guarantees given	**(42 978)**	**9 130**
Stage 1	*(5 992)*	*(1 212)*
Stage 2	*(4 969)*	*(4 270)*
Stage 3	*(28 227)*	*14 379*
POCI	*(3 790)*	*233*
Net impairment losses on financial assets not measured at fair value through profit or loss	**(633 130)**	**(468 902)**

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15. Income tax expense

	Year ended 31 December	
	2019	**2018**
Current tax	(493 100)	(517 615)
Deferred income tax	(10 385)	128 125
Total income tax	**(503 485)**	**(389 490)**
Profit before tax	**1 484 465**	**1 693 310**
Tax calculated at Polish current tax rate (19%)	(282 048)	(321 729)
Income not subject to tax*	61 713	73 365
Costs other than tax deductible costs**	(283 150)	(141 126)
Total tax liability	**(503 485)**	**(389 490)**
Effective tax rate calculation		
Profit (loss) before income tax	1 484 465	1 693 310
Income tax	(503 485)	(389 490)
Effective tax rate	**33.92%**	**23.00%**

** Includes i.a. dividends excluded from taxation under Article 20 item 3 of Corporate Income Tax Act from 15 February 1992 (Journal of Laws 2019, item 865).*

*** The position includes i.a. impact of banking tax introduced by the Act on Tax on Certain Financial Institutions from 15 January 2016 (Journal of Laws 2016, item 68) in 2018, provisions established for legal risk related to the portfolio of mortgage and housing loans in CHF and other expenses non-deductible costs according to Article 16 item 1 of Corporate Income Tax Act from 15 February 1992 (Journal of Laws 2019, item 865).*

The current tax breakdown by country is presented below.

	Year ended 31 December	
	2019	**2018**
Poland	(465 937)	(502 344)
Czech Republic	(27 163)	(15 271)
Total current tax	**(493 100)**	**(517 615)**

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

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

	Year ended 31 December	
	2019	**2018**
Basic:		
Net profit	980 980	1 303 820
Weighted average number of ordinary shares	42 340 263	42 318 253
Net basic profit per share (in PLN per share)	**23.17**	**30.81**
Diluted:		
Net profit, applied for calculation of diluted earnings per share	980 980	1 303 820
Weighted average number of ordinary shares	42 340 263	42 318 253
Adjustments for:		
- share options	18 266	25 522
Weighted average number of ordinary shares for calculation of diluted earnings per share	42 358 529	42 343 775
Diluted earnings per share (in PLN per share)	**23.16**	**30.79**

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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 2019			Year ended 31 December 2018		
	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	**8 009**	**(12 172)**	**(4 163)**	**102 145**	**(29 042)**	**73 103**
Exchange differences on translation of foreign operations	9	-	9	176	-	176
Cash flow hedges	47 539	(9 032)	38 507	109 681	(20 840)	88 841
Share of other comprehensive income of entities under the equity method	3 250	-	3 250	(650)	-	(650)
Debt instruments at fair value through other comprehensive income	(42 789)	(3 140)	(45 929)	(7 062)	(8 202)	(15 264)
Items that will not be reclassified to the income statement	**(2 444)**	**464**	**(1 980)**	**(3 097)**	**589**	**(2 508)**
Actuarial gains and losses relating to post-employment benefits	(2 444)	464	(1 980)	(3 097)	589	(2 508)
Total comprehensive income (net)	**5 565**	**(11 708)**	**(6 143)**	**99 048**	**(28 453)**	**70 595**

The table below presents detailed information concerning other comprehensive income for the years 2019 and 2018.

	Year ended 31 December	
	2019	2018
Items that may be reclassified subsequently to the the income statement, including:	**(4 163)**	**73 103**
Exchange differences on translating foreign operations	**9**	**176**
Unrealised gains or losses on echange differences on translation of foreign operations included in other comprehensive income	9	176
Unrealised gains (positive differences) arising during the year (net)	*2 012*	*117*
Unrealised losses (negative differences) arising during the year (net)	*(2 003)*	*59*
Cash flows hedges (effective part)	**38 507**	**88 841**
Unrealised gain or losses included in other comprehensive inocme	82 682	121 530
Unrealized gains arising during the year (net)	*82 682*	*121 530*
Reclassification to the income statement (net)	(44 175)	(32 689)
Valuation of debt instruments at fair value through other comprehensive income (net)	**(45 929)**	**(15 264)**
Unrealised gains or losses on valuation of debt instruments included in other comprehensive income	(33 658)	*(2 183)*
Unrealised gains on debt instruments arising during the year (net)	*59 860*	*62 488*
Unrealised losses on debt instruments arising during the year (net)	*(93 518)*	*(64 671)*
Reclassification adjustments of gains (losses) on debt instruments to the income statement (net)	(12 271)	*(13 081)*
Share of other comprehensive income of entities under the equity method	**3 250**	**(650)**
Share of other comprehensive income of associates arising during the year (net)	3 250	(650)
Items that will not be reclassified to profit or loss	**(1 980)**	**(2 508)**
Actuarial gains and losses relating to post-employment benefits	(1 980)	(2 508)
Actuarial losses	*(1 980)*	*(2 508)*
Total comprehensive income (net)	**(6 143)**	**70 595**

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In 2018 unrealized gains on debt instruments arising during the year in the amount of PLN 62 488 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.

18. Cash and balances with central bank

	31.12.2019	31.12.2018
Cash on hand	1 271 472	1 724 452
Cash balances at central banks	6 590 304	7 458 519
Total cash and cash balances with central banks	**7 861 776**	**9 182 971**

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 3 562 715 thousand for the period from 31 December 2019 to 30 January 2020,
- PLN 3 129 048 thousand for the period from 31 December 2018 to 30 January 2019.

As at 31 December 2019, the mandatory reserve in Central Bank bore 0.50% interest (31 December 2018: 0.50%).

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

Financial assets held for trading and hedging derivatives

	31.12.2019	31.12.2018
Derivatives	**958 328**	**1 006 550**
- Derivatives held for trading classified into banking book	138 691	82 358
- Derivatives held for trading classified into trading book	919 393	948 636
- Derivatives designated as fair value hedges	119 423	112 816
- Derivatives designated as cash flow hedges	273 282	196 668
- Offsetting effect	(492 461)	(333 928)
Debt securities	**1 790 732**	**1 106 835**
- General governments	1 330 541	778 733
pledged securities	*162 038*	*538 345*
- Credit institutions	211 401	187 644
- Other financial corporations	139 144	72 626
- Non-financial corporations	109 646	67 832
Loans and advances to customers	**172 689**	**43 166**
- Corporate customers	172 689	43 166
Total financial assets held for trading and hedging derivatives	**2 921 749**	**2 156 551**

Trading securities include securities used to secure sell/buy back transactions with customers, the market value of which as at 31 December 2019 amounted to PLN 162 038 thousand (31 December 2018: PLN 538 345 thousand).

Financial liabilities held for trading and hedging derivatives

	31.12.2019	31.12.2018
Derivatives, including:	987 933	1 016 214
- Derivatives held for trading classified into banking book	106 364	110 083
- Derivatives held for trading classified into trading book	1 001 699	995 156
- Derivatives designated as fair value hedges	6 451	5 766
- Derivatives designated as cash flow hedges	5 436	-
- Offsetting effect	(132 017)	(94 791)
Financial liabilities held for trading and hedging derivatives	**987 933**	**1 016 214**

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 and cash flow hedge accounting. Detailed information on hedge accounting are presented in these notes 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 2019	Contract amount		Fair value	
	Purchase	Disposal	Assets	Liabilities
Derivatives held for trading				
Foreign exchange derivatives				
- Currency forwards	16 794 196	17 075 856	44 517	184 798
- Currency swaps	12 755 613	12 597 992	133 030	53 899
- Cross-currency interest rate swaps	11 659 765	11 697 787	36 749	51 859
- OTC currency options bought and sold	4 018 320	4 324 731	30 626	56 647
Total OTC derivatives	**45 227 894**	**45 696 366**	**244 922**	**347 203**
- Currency futures	282 677	283 586	-	-
Total foreign exchange derivatives	**45 510 571**	**45 979 952**	**244 922**	**347 203**
Interest rate derivatives				
- Interest rate swap, OIS	213 325 615	213 325 616	700 137	651 973
- Forward rate agreements	7 150 000	5 725 850	42	24
- OTC interest rate options	422 692	414 647	108	230
Total interest rate derivatives	**220 898 307**	**219 466 113**	**700 287**	**652 227**
Market risk transactions	**2 611 910**	**2 860 643**	**112 875**	**108 633**
Total derivative assets / liabilities held for trading	**269 020 788**	**268 306 708**	**1 058 084**	**1 108 063**
Hedging derivatives				
Derivatives designated as fair value hedges	10 491 195	10 491 195	119 423	6 451
- Interest rate swaps	10 491 195	10 491 195	119 423	6 451
Derivatives designated as cash flow hedges	15 365 000	15 365 000	273 282	5 436
- Interest rate swaps	15 365 000	15 365 000	273 282	5 436
Total hedging derivatives	**25 856 195**	**25 856 195**	**392 705**	**11 887**
Offsetting effect	**-**	**-**	**(492 461)**	**(132 017)**
Total recognised derivative assets/ liabilities	**294 876 983**	**294 162 903**	**958 328**	**987 933**
Short-term (up to 1 year)	99 381 174	98 541 489	282 248	643 538
Long-term (over 1 year)	195 495 809	195 621 414	676 080	344 395

As at 31 December 2018	Contract amount		Fair value	
	Purchase	Disposal	Assets	Liabilities
Derivatives held for trading				
Foreign exchange derivatives				
- 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 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**
Hedging derivatives				
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 hedging derivatives	**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

Except of valuation of derivatives, the offsetting effect includes PLN 4 503 thousand of placed collaterals and PLN 364 947 thousand of collaterals received in connection with the derivative transactions subject to compensation (31 December 2018: PLN 7 210 thousand and PLN 246 348 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 2019 and 31 December 2018, 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	31.12.2019		31.12.2018	
	Derivatives	Loans and advances to customers	Derivatives	Loans and advances to customers
1	731 610	-	688 869	-
2	286 591	85 408	313 999	-
3	316 716	38 423	256 684	43 166
4	39 797	48 858	60 931	-
5	11 136	-	10 158	-
6	121	-	-	-
7	1 183	-	-	-
8	63 388	-	9 556	-
default	247	-	281	-
offsetting effect	(492 461)		(333 928)	
Total	**958 328**	**172 689**	**1 006 550**	**43 166**

Rating	31.12.2019	31.12.2018
	Debt securities	Debt securities
1.0 - 1.2	1 330 541	778 733
1.4 - 1.6	62 302	21 339
1.8 - 2.0	91 569	83 232
2.2 - 2.8	168 051	176 169
3.0 - 3.8	138 269	47 362
Total	**1 790 732**	**1 106 835**

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,
- part of the fixed interest rate mortgage portfolio granted by mBank's foreign branch in Czech Republic. The hedged risk results from changes in interest rates.

Hedged items

The hedged items are:

- fixed interest rate security deposits given by mFF with a nominal value of EUR 1 000 000 thousand,
- fixed interest rate security deposit given by mFF with a nominal value of CHF 200 000 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 305 000 thousand,
- fixed rate bonds issued by mBank S.A. with a nominal value of EUR 500 000 thousand,
- part of the fixed interest rate mortgage portfolio, denominated in CZK, granted by mBank's foreign branch in the Czech Republic.

Hedging instruments

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

Presentation of the result from hedged and hedging transactions

Fair value adjustment of the hedged assets and liabilities as well as valuation of the hedging instruments is recognized in the income statement as the income from trading operation except for interest income and interest cost of interest part of valuation of hedging instruments, presented in item "Interest income/cost on derivatives concluded under the fair value hedge accounting".

Hedged items – fair value hedges

31.12.2019	Carrying amount of the hedged items in the statement of financial position	Accumulated amount of fair value hedge adjustment of hedged item included in carrying amount of hedged item recognised in the statement of financial position	The line item in the statement of financial position that includes hedged item	The change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period
Fixed interest rate mortgage loans in CZK	23 981	(136)	Financial assets at amoritsed cost – Loans and advances to customers	(136)
Fixed interest rate security deposits given by mFF	(5 097 329)	(44 953)	Financial liabilities measured at amortised cost – Amounts due to customers	2 251
Fixed rate bonds issued by mBank S.A.	(3 361 997)	(33 373)	Financial liabilities measured at amortised cost – Debt securities issued	(15 068)
Fixed interest rate loans received by mBank from European Investment Bank	(2 128 603)	(25 753)	Financial liabilities measured at amortised cost – Amounts due to customers – Loans and advances received	(21 590)
TOTAL				**(34 543)**

31.12.2018	Carrying amount of the hedged items in the statement of financial position	Accumulated amount of fair value hedge adjustment of hedged item included in carrying amount of hedged item recognised in the statement of financial position	The line item in the statement of financial position that includes hedged item	The change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period
Fixed interest rate security deposits given by mFF	(7 302 746)	(47 204)	Financial liabilities measured at amortised cost – Amounts due to customers	(6 227)
Fixed rate bonds issued by mBank S.A.	(2 857 724)	(18 305)	Financial liabilities measured at amortised cost – Debt securities issued	(18 305)
Fixed interest rate loans received by mBank from European Investment Bank	(1 537 999)	(4 163)	Financial liabilities measured at amortised cost – Amounts due to customers – Loans and advances received	(18 095)
TOTAL				**(42 367)**

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Nominal values of hedging derivatives - fair value hedges

Nominal value	up to 1 month	1-3 months	3-12 months	1-5 years	over 5 years	Total
Interest Rate Swaps (IRS)						
31.12.2019	-	-	2 129 250	6 687 324	1 674 621	**10 491 195**
31.12.2018	-	-	2 150 000	7 900 308	1 531 738	**11 582 046**

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

	Year ended 31 December	
	2019	**2018**
Interest income on derivatives concluded under the fair value hedge accounting (Note 5)	45 739	57 904
Net profit on hedged items (Note 8)	(34 543)	(42 627)
Net profit on fair value hedging instruments (Note 8)	39 154	34 846
The total result of fair value hedge accounting recognised in the income statement	**50 350**	**50 123**

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)".

Hedged items – cash flow hedges

	Nominal value of hedged items		The change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period		The balances in the cash flow hedge reserve for continuing hedges	
	31.12.2019	**31.12.2018**	**31.12.2019**	**31.12.2018**	**31.12.2019**	**31.12.2018**
Loans and advances to customers - loans in variable interest rate indexed to the market rate	15 365 000	11 530 000	161 352	111 872	122 150	83 643

Nominal values of hedging derivatives - cash flow hedges

31.12.2019	up to 1 month	1-3 months	3-12 months	1-5 years	over 5 years	Total
INTEREST RATE RISK						
Interest rate swaps hedging cash flows arising from granted loans with a variable interest rate denominated in PLN						
Nominal value	-	200 000	3 590 000	11 375 000	200 000	**15 365 000**
The average rate of fixed leg	-	1.865%	1.967%	2.095%	1.928%	

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 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 2020 to October 2029 is the period in which the cash flows are expected, and when they are expected to have an impact on the results.

Below is given the timetable prepared as at 31 December 2019 and 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.

	up to 3 months	period from 3 months to 1 year	period from 1 year to 5 years
31.12.2019	65 461	161 170	439 290
31.12.2018	47 130	136 956	401 142

The following note presents other comprehensive income due to cash flow hedges as at 31 December 2019 and 31 December 2018.

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	Year ended 31 December	
	2019	2018
Other gross comprehensive income from cash flow hedge at the beginning of the period	**103 263**	**(6 418)**
Unrealised gains/losses included in other gross comprehensive income during the reporting period	102 076	150 038
The amount transferred in the period from comprehensive income to profit and loss	(54 537)	(40 357)
- *net interest income*	*(54 537)*	*(40 357)*
Accumulated other gross comprehensive income at the end of the reporting period	**150 802**	**103 263**
Deferred income tax on accumulated other comprehensive income at the end of the reporting period	(28 652)	(19 620)
Accumulated other net comprehensive income at the end of the reporting period	**122 150**	**83 643**
Impact on other comprehensive income in the reporting period (gross)	47 539	109 681
Deferred tax on cash flow hedges	(9 032)	(20 840)
Impact on other comprehensive income in the reporting period (net)	**38 507**	**88 841**

Total result on cash flow hedge accounting recognized in other gross comprehensive income

	Year ended 31 December	
	2019	2018
Gains/losses recognised in comprehensive income (gross) during the reporting period, including:		
Unrealised gains/losses included in other comprehensive income (gross)	47 539	109 681
Results of cash flow hedge accounting recognised in the income statement	53 711	43 749
- Amount included as interest income in income statement during the reporting period	*54 537*	*40 357*
- Ineffective portion of hedge recognised included in other net trading income in income statement	*(826)*	*3 392*
Impact on other comprehensive income in the reporting period (gross)	**101 250**	**153 430**

Impact of the IBOR reform

In connection with the amendments to the standards IFRS 9, IAS 39 and IFRS 7 Interest Rate Benchmark Reform, described in the Note 2.26, the Bank took advantage of the possibility of earlier application of these changes in 2019 and it did not verify effectiveness of hedging relationships. The amendments provide temporary reliefs which enable the Bank's hedge accounting to be continued during the period of uncertainty, before the replacement of an existing interest rate benchmark with an alternative risk free interest rate.

As a result of an ongoing reform of the interest rate reference benchmark and its replacement with a risk free alternative interest rate, the Bank has established a project to manage the transition for any of its contracts that could be affected.

The table below indicates the nominal amount and weighted average maturity of derivatives in hedging relationships that will be affected by IBOR reform, analyzed by interest rate basis. The derivative hedging instruments provide a close approximation to the extent of the risk exposure the Bank manages through hedging relationships.

31.12.2019	Nominal amount	Average maturity (years)
Interest Rate Swaps		
LIBOR CHF (3 months)	3 654 877	6.3
EURIBOR (3 months)	6 813 600	5.2
WIBOR (1 months)	2 000 000	3.5
WIBOR (3 months)	12 965 000	4.4
WIBOR (6 months)	400 000	2.7
PRIBOR (3 months)	22 718	5.0
Interest Rate Swaps, total	**25 856 195**	

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

	31.12.2019	31.12.2018
Equity instruments	**87 597**	**12 226**
- Other financial corporations	87 597	12 226
Debt securities	**133 774**	**58 130**
- Other financial corporations	133 774	58 130
Loans and advances to customers	**1 813 818**	**2 496 974**
Individual customers	1 685 799	2 370 872
Corporate customers	121 348	113 199
Public sector customers	6 671	12 903
Total non-trading financial assets mandatorily at fair value through profit or loss	**2 035 189**	**2 567 330**
Short-term (up to 1 year) gross	1 339 448	1 656 437
Long-term (over 1 year) gross	695 741	910 893

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

Sub-portfolio	31.12.2019	31.12.2018
	Loans and advances to customers	Loans and advances to customers
1	24 968	16 707
2	334 142	515 725
3	333 443	490 355
4	512 714	766 109
5	282 977	323 173
6	35 206	43 171
7	140 715	175 617
default	149 653	166 117
Total	**1 813 818**	**2 496 974**

Rating	31.12.2019	31.12.2018
	Debt securities	Debt securities
1.8 – 2.0	133 774	58 130
Total	**133 774**	**58 130**

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21. Financial assets at fair value through other comprehensive income

31.12.2019	Carrying amount	Gross carrying amount				Accumulated impairment			
		Stage 1	Stage 2	Stage 3	POCI	Stage 1	Stage 2	Stage 3	POCI
Debt securities	**21 876 957**	**21 840 198**	**41 121**	**-**	**-**	**(3 242)**	**(1 120)**	**-**	**-**
- Central banks	2 999 645	2 999 645	-	-	-	-	-	-	-
- General governments, including:	16 440 547	16 440 616	-	-	-	(69)	-	-	-
pledged assets	*1 232 295*	*1 232 295*	-	-	-	-	-	-	-
- Credit institutions, including:	719 910	721 033	-	-	-	(1 123)	-	-	-
pledged assets	*129 714*	*129 714*	-	-	-	-	-	-	-
- Other financial corporations	1 162 968	1 163 964	-	-	-	(996)	-	-	-
- Non-financial corporations	553 887	514 940	41 121	-	-	(1 054)	(1 120)	-	-
Loans and advances to customers	**8 421 690**	**7 907 525**	**519 400**	**2 796**	**107**	**(2 874)**	**(4 560)**	**(693)**	**(11)**
Individual customers	8 421 690	7 907 525	519 400	2 796	107	(2 874)	(4 560)	(693)	(11)
Total financial assets at fair value through other comprehensive income	**30 298 647**	**29 747 723**	**560 521**	**2 796**	**107**	**(6 116)**	**(5 680)**	**(693)**	**(11)**

Short-term (up to 1 year) gross	3 976 795
Long-term (over 1 year) gross	26 334 352

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**	**27 785 120**	**396 621**	**625**	**118**	**(5 495)**	**(3 736)**	**(143)**	-

Short-term (up to 1 year) gross	6 448 927
Long-term (over 1 year) gross	21 733 557

As at 31 December 2019, the carrying amounts of debt securities with fixed interest rates amounted to PLN 11 325 027 thousand and debt securities with variable interest rates PLN 10 556 292 thousand (31 December 2018: PLN 12 587 229 thousand and PLN 11 012 106 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.

In accordance with the Act of 10 June 2016 on the Bank Guarantee Fund (BFG), Deposit Guarantee Scheme and Resolution, as at 31 December 2019 the Bank held government bonds and bills included in the statement of financial position in the amount of PLN 634 764 thousand with a nominal value of PLN 625 660 thousand, which were pledged as collateral for the BFG and were deposited in a separate account at the National Depository of Securities (31 December 2018: PLN 546 848 thousand and PLN 540 169 thousand, respectively)

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 56 244 thousand (31 December 2018: PLN 58 603 thousand).

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Movements in expected credit losses allowance on financial assets at fair value through other comprehensive income

As at 31 December 2019	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	**(4 535)**	**-**	**-**	**-**	**(963)**	**2 518**	**(1 382)**	**(4 362)**
Stage 1	(4 171)	(214)	72	-	(963)	2 367	(333)	(3 242)
Stage 2	(364)	214	(72)	-	-	151	(1 049)	(1 120)
Loans and advances to customers	**(4 839)**	**-**	**-**	**-**	**(1 020)**	**1 557**	**(3 836)**	**(8 138)**
Stage 1	(1 324)	(9 126)	1 028	1	(1 020)	468	7 099	(2 874)
Stage 2	(3 372)	9 057	(1 225)	151	-	830	(10 001)	(4 560)
Stage 3	(143)	69	197	(152)	-	259	(923)	(693)
POCI	-	-	-	-	-	-	(11)	(11)
Expected credit loss allowance, total	**(9 374)**	**-**	**-**	**-**	**(1 983)**	**4 075**	**(5 218)**	**(12 500)**

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 loss allowance, total	**(6 481)**	**-**	**-**	**-**	**(3 150)**	**1 727**	**(1 470)**	**(9 374)**

Explanation of changes in the financial instruments gross carrying amount impacting the changes on expected credit losses allowance

As at 31 December 2019	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	**23 599 335**	**-**	**-**	**-**	**4 360 167**	**(7 006 081)**	**927 898**	**21 881 319**
Stage 1	23 577 614	12 952	(40 218)	-	4 360 167	(6 997 311)	926 994	21 840 198
Stage 2	21 721	(12 952)	40 218	-	-	(8 770)	904	41 121
Loans and advances to customers	**4 583 149**	**-**	**-**	**-**	**5 071 765**	**(1 540 121)**	**315 035**	**8 429 828**
Stage 1	4 207 506	204 783	(83 095)	(2 012)	4 690 757	(1 420 963)	310 549	7 907 525
Stage 2	374 900	(204 783)	83 095	(153)	381 008	(119 158)	4 491	519 400
Stage 3	625	-	-	2 165	-	-	6	2 796
POCI	118	-	-	-	-	-	(11)	107
Financial assets at fair value through other comprehensive income, gross	**28 182 484**	**-**	**-**	**-**	**9 431 932**	**(8 546 202)**	**1 242 933**	**30 311 147**

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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 2019	Stage 1	Stage 2	Stage 3	POCI	TOTAL
Debt securities at fair value through other comprehensive income					
1.0 – 1.2	20 134 432	-	-	-	20 134 432
1.4 – 1.6	484 159	-	-	-	484 159
1.8 – 2.0	496 788	-	-	-	496 788
2.2 – 2.8	286 248	-	-	-	286 248
3.0 – 3.8	438 571	-	-	-	438 571
4.0 – 5.0	-	41 121	-	-	41 121
Gross carrying amount	**21 840 198**	**41 121**	**-**	**-**	**21 881 319**
Accumulated impairment	(3 242)	(1 120)	-	-	(4 362)
Total carrying amount	**21 836 956**	**40 001**	**-**	**-**	**21 876 957**

As at 31 December 2019	Stage 1	Stage 2	Stage 3	POCI	TOTAL
Loans and advances to customers at fair value through other comprehensive income					
1	2 466 839	55 953	-	-	2 522 792
2	4 891 872	228 321	-	-	5 120 193
3	390 388	89 056	-	-	479 444
4	139 367	65 569	-	-	204 936
5	18 711	46 539	-	-	65 250
6	348	11 379	-	-	11 727
7	-	22 583	-	-	22 583
default	-	-	2 796	107	2 903
Gross carrying amount	**7 907 525**	**519 400**	**2 796**	**107**	**8 429 828**
Accumulated impairment	(2 874)	(4 560)	(693)	(11)	(8 138)
Total carrying amount	**7 904 651**	**514 840**	**2 103**	**96**	**8 421 690**

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As at 31 December 2018	Stage 1	Stage 2	Stage 3	POCI	Total
Debt securities at fair value through other comprehensive income					
1.0 - 1.2	21 593 567	-	-	-	21 593 567
1.4 - 1.6	476 056	-	-	-	476 056
1.8 - 2.0	397 603	-	-	-	397 603
2.2 - 2.8	598 604	-	-	-	598 604
3.0 - 3.8	431 396	21 721	-	-	453 117
4.0 - 5.0	60 887	-	-	-	60 887
unrated	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**

As at 31 December 2018	Stage 1	Stage 2	Stage 3	POCI	Total
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

As at 31 December 2019	Gross amount	Accumulated impairment	Accumulated impairment without cash flow from collaterals	Financial effect of collaterals
Balance sheet data				
Loans and advances to customers	8 429 828	(8 138)	(12 301)	4 163
Individual customers	8 429 828	(8 138)	(12 301)	4 163
Total balance sheet data	**8 429 828**	**(8 138)**	**(12 301)**	**4 163**

As at 31 December 2018	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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22. Financial assets at amortised cost

31.12.2019	Carrying amount	Gross carrying amount				Accumulated impairment			
		Stage 1	Stage 2	Stage 3	POCI	Stage 1	Stage 2	Stage 3	POCI
Debt securities	**11 234 873**	**11 234 952**	**-**	**-**	**-**	**(79)**	**-**	**-**	**-**
- General governments, including:	9 975 484	9 975 484	-	-	-	-	-	-	-
pledged assets	*1 799 235*	*1 799 235*	-	-	-	-	-	-	-
- Other financial corporations	1 259 389	1 259 468	-	-	-	(79)	-	-	-
Loans and advances to banks	**7 337 703**	**7 338 835**	**-**	**-**	**-**	**(1 132)**	**-**	**-**	**-**
Loans and advances to customers	**82 737 717**	**76 631 868**	**5 342 180**	**3 296 627**	**210 451**	**(269 215)**	**(217 482)**	**(2 240 936)**	**(15 776)**
Individual customers	41 456 124	37 968 053	3 029 231	2 005 514	102 159	(185 019)	(188 813)	(1 272 461)	(2 540)
Corporate customers	40 995 685	38 377 609	2 312 949	1 291 111	108 292	(83 898)	(28 669)	(968 473)	(13 236)
Public sector customers	285 908	286 206	-	2	-	(298)	-	(2)	-
Total financial assets at amortised cost	**101 310 293**	**95 205 655**	**5 342 180**	**3 296 627**	**210 451**	**(270 426)**	**(217 482)**	**(2 240 936)**	**(15 776)**

Short-term (up to 1 year) gross	38 720 527
Long-term (over 1 year) gross	65 334 386

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	**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 and government bonds pledged as collateral for the loans received from the European Investment Bank.

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 155 531 thousand (31 December 2018: PLN 70 312 thousand).

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Loans and advances to banks

	31.12.2019	31.12.2018
Current accounts	296 254	400 962
Placements with other banks (up to 3 months)	46 200	265 443
Included in cash equivalents (Note 40)	**342 454**	**666 405**
Loans and advances	2 820 611	3 375 420
Reverse repo or buy/sell back	3 362 331	1 217 595
Other receivables	813 439	651 439
Total (gross) loans and advances to banks	**7 338 835**	**5 910 859**
Provisions created for loans and advances to banks (negative amount)	**(1 132)**	**(1 518)**
Total (net) loans and advances to banks	**7 337 703**	**5 909 341**
Short-term (up to 1 year) gross	4 371 320	2 457 419
Long-term (over 1 year) gross	2 967 515	3 453 440

The item "Other receivables" includes cash collaterals in the amount of PLN 390 464 thousand, placed with other banks under the derivative transactions concluded by the Bank (Note 34) (31 December 2018: PLN 372 352 thousand).

As at 31 December 2019, the variable rate loans to banks amounted to PLN 2 801 328 thousand and the fixed rate loans to banks amounted to PLN 19 283 thousand (31 December 2018: PLN 3 346 528 thousand and PLN 28 892 thousand, respectively).

As at 31 December 2019 and 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 1.70% (31 December 2018: 1.66%).

The following table presents receivables from Polish and foreign banks:

	31.12.2019		31.12.2018	
	Loans and advances to Polish banks	Loans and advances to foreign banks (gross)	Loans and advances to Polish banks	Loans and advances to foreign banks (gross)
Gross carrying amount	3 230 655	4 108 180	3 761 278	2 149 581
Accumulated impairment	(58)	(1 074)	(102)	(1 416)
Loans and advances to banks, net	**3 230 597**	**4 107 106**	**3 761 176**	**2 148 165**

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Loans and advances to customers

Loans and advances to customers 31.12.2019	Gross carrying amount	including:		
		Individual customers	Corporate customers	Public sector customers
Current accounts	13 732 870	7 493 468	6 236 243	3 159
Term loans, including:	70 964 003	35 249 463	35 431 491	283 049
- housing and mortgage loans to natural persons	*23 011 901*	*23 011 901*		
Reverse repo or buy/sell back	13 398	-	13 398	-
Other loans and advances	158 919	-	158 919	-
Other receivables	611 936	362 026	249 910	-
Total gross carrying amount	**85 481 126**	**43 104 957**	**42 089 961**	**286 208**

Loans and advances to customers 31.12.2019	Accumulated impairment	including:		
		Individual customers	Corporate customers	Public sector customers
Current accounts	(966 201)	(664 889)	(301 312)	-
Term loans, including:	(1 777 200)	(983 944)	(792 956)	(300)
- housing and mortgage loans to natural persons	*(388 729)*	*(388 729)*		
Other loans and advances	(8)	-	(8)	-
Total accumulated impairment	**(2 743 409)**	**(1 648 833)**	**(1 094 276)**	**(300)**

Total gross carrying amount	**85 481 126**	**43 104 957**	**42 089 961**	**286 208**
Total accumulated impairment	(2 743 409)	(1 648 833)	(1 094 276)	(300)
Total carrying amount	**82 737 717**	**41 456 124**	**40 995 685**	**285 908**

Short-term (up to 1 year) gross	32 584 995
Long-term (over 1 year) gross	52 896 131

Loans and advances to customers 31.12.2018	Gross carrying amount	including:		
		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 natural persons	*23 868 510*	*23 868 510*		
Reverse repo or 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	including:		
		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 natural persons	*(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 2019, gross amount of variable interest rate loans amounted to PLN 84 315 753 thousand and fixed interest rate loans amounted to PLN 1 165 373 thousand (31 December 2018: PLN 77 978 592 thousand and PLN 898 328 thousand, respectively). In 2019, an average interest rate for loans granted to customers (excluding reverse repos) amounted to 3.55% (in 2018: 3.42%).

In the item loans and advances granted to individual customers were also included loans granted to microenterprises serviced by mBank S.A. Retail Banking.

As at 31 December 2019, the above note includes receivables in the amount of PLN 49 898 thousand from the National Depository of Securities CCP in connection with the Brokerage Office activity (31 December 2018: PLN 174 563 thousand).

In addition, the item "other" includes cash collaterals in the amount of PLN 27 234 thousand placed by the Bank under derivatives transactions (Note 34)(31 December 2018: PLN 15 844 thousand).

The currency structure of housing and mortgage loans

	31.12.2019	31.12.2018
Housing and mortgage loans to natural persons (in PLN 000's), including:	**22 623 172**	**23 437 671**
- PLN	2 697 947	2 552 883
- CHF	13 561 831	14 409 167
- EUR	3 107 607	3 171 106
- CZK	3 024 539	3 053 157
- USD	204 749	227 414
- other	26 499	23 944
Housing and mortgage loans to natural persons in original currencies (main currencies in 000's)		
- PLN	2 697 947	2 552 883
- CHF	3 458 504	3 775 394
- EUR	729 742	737 467
- CZK	18 046 175	18 249 594
- USD	53 914	60 487

The table above presents net carrying value of housing and mortgage loans to natural persons in currency breakdown.

Credit quality of financial assets at amortised cost according to internal rating system

As at 31 December 2019	Stage 1	Stage 2	Stage 3	POCI	TOTAL
Debt securities at amortised cost					
1.0 – 1.2	11 234 952	-	-	-	11 234 952
Total gross carrying amount	**11 234 952**	**-**	**-**	**-**	**11 234 952**
Total accumulated impairment	(79)	-	-	-	(79)
Total carrying amount	**11 234 873**	**-**	**-**	**-**	**11 234 873**

As at 31 December 2019	Stage 1	Stage 2	Stage 3	POCI	TOTAL
Loans and advances to banks at amortised cost					
1	7 018 012	-	-	-	7 018 012
2	180 326	-	-	-	180 326
3	5 146	-	-	-	5 146
4	66 160	-	-	-	66 160
5	5 336	-	-	-	5 336
8	63 855	-	-	-	63 855
Total gross carrying amount	**7 338 835**	**-**	**-**	**-**	**7 338 835**
Total accumulated impairment	(1 132)	-	-	-	(1 132)
Total carrying amount	**7 337 703**	**-**	**-**	**-**	**7 337 703**

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As at 31 December 2019	Stage 1	Stage 2	Stage 3	POCI	TOTAL
Loans and advances to customers at amortised cost					
1	6 992 838	36 129	-	-	7 028 967
2	34 981 121	887 929	-	4 276	35 873 326
3	9 116 150	358 130	-	807	9 475 087
4	20 834 753	1 297 305	-	75 270	22 207 328
5	3 406 403	1 216 206	-	2 446	4 625 055
6	195 944	382 585	-	371	578 900
7	414 607	1 163 879	-	15 331	1 593 817
8	690 052	17	-	-	690 069
default	-	-	3 296 627	111 950	3 408 577
Total gross carrying amount	**76 631 868**	**5 342 180**	**3 296 627**	**210 451**	**85 481 126**
Total accumulated impairment	(269 215)	(217 482)	(2 240 936)	(15 776)	(2 743 409)
Total carrying amount	**76 362 653**	**5 124 698**	**1 055 691**	**194 675**	**82 737 717**

As at 31 December 2018	Stage 1	Stage 2	Stage 3	POCI	TOTAL
Debt securities at amortised cost					
1.0 – 1.2	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**

As at 31 December 2019	Stage 1	Stage 2	Stage 3	POCI	TOTAL
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**

As at 31 December 2019	Stage 1	Stage 2	Stage 3	POCI	TOTAL
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**

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Movements in expected credit losses allowance

As at 31 December 2019	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	**(87)**	**-**	**-**	**-**	**-**	**-**	**8**	**-**	**-**	**(79)**
Stage 1	(87)	-	-	-	-	-	8	-	-	(79)
Loans and advances to banks	**(1 518)**	**-**	**-**	**-**	**(1 560)**	**1 529**	**417**	**-**	**-**	**(1 132)**
Stage 1	(1 518)	-	-	-	(1 560)	1 529	417	-	-	(1 132)
Loans and advances to customers	**(2 674 957)**	**-**	**-**	**-**	**(163 024)**	**142 516**	**(632 367)**	**584 423**	**-**	**(2 743 409)**
Stage 1	(179 563)	(363 283)	97 646	2 540	(108 488)	47 741	234 192	-	-	(269 215)
Stage 2	(181 969)	315 460	(123 732)	123 009	(8 243)	18 257	(360 264)	-	-	(217 482)
Stage 3	(2 299 047)	47 823	26 086	(125 549)	(46 063)	73 360	(501 969)	584 423	-	(2 240 936)
POCI	(14 378)	-	-	-	(230)	3 158	(4 326)	-	-	(15 776)
Expected credit losses allowance, total	**(2 676 562)**	**-**	**-**	**-**	**(164 584)**	**144 045**	**(631 942)**	**584 423**	**-**	**(2 744 620)**

Movements in expected credit losses resulting from changes in models are described in Note 3.3.6.2.2.

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)**

Explanation of changes in the gross carrying amount impacting the changes on expected credit losses allowance

As at 31 December 2019	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	**9 000 627**	**-**	**-**	**-**	**1 952 008**	**(486 122)**	**-**	**768 439**	**11 234 952**
Stage 1	9 000 627	-	-	-	1 952 008	(486 122)	-	768 439	11 234 952
Loans and advances to banks	**5 910 859**	**-**	**-**	**-**	**3 803 238**	**(2 377 277)**	**-**	**2 015**	**7 338 835**
Stage 1	5 910 859	-	-	-	3 803 238	(2 377 277)	-	2 015	7 338 835
Loans and advances to customers	**78 876 920**	**-**	**-**	**-**	**27 361 283**	**(15 436 819)**	**(584 423)**	**(4 735 835)**	**85 481 126**
Stage 1	69 249 777	2 450 972	(2 230 509)	(463 917)	25 952 092	(13 966 476)	-	(4 360 071)	76 631 868
Stage 2	6 064 485	(2 303 093)	2 296 047	(322 931)	1 138 969	(1 228 801)	-	(302 496)	5 342 180
Stage 3	3 367 114	(147 879)	(65 538)	757 272	258 536	(234 321)	(584 423)	(54 134)	3 296 627
POCI	195 544	-	-	29 576	11 686	(7 221)	-	(19 134)	210 451
Financial assets at amortised cost, gross	**93 788 406**	**-**	**-**	**-**	**33 116 529**	**(18 300 218)**	**(584 423)**	**(3 965 381)**	**104 054 913**

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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

31.12.2019	Gross amount	Accumulated impairment	Accumulated impairment without cash flow from collaterals	Financial effect of collaterals
Balance sheet data				
Loans and advances to banks	7 338 835	(1 132)	(1 146)	14
Loans and advances to customers	85 481 126	(2 743 409)	(3 159 778)	416 369
Individual customers, including:	43 104 957	(1 648 833)	(1 815 534)	166 701
- housing and mortgage loans to natural persons	*23 011 901*	*(388 729)*	*(530 549)*	*141 820*
Corporate customers	42 089 961	(1 094 276)	(1 343 944)	249 668
Public sector customers	286 208	(300)	(300)	-
Total balance sheet data	**92 819 961**	**(2 744 541)**	**(3 160 924)**	**416 383**
Off-balance sheet data				
Loan commitments and other commitments	28 121 245	(62 296)	(66 500)	4 204
Guarantees, banker's acceptances, documentary and commercial letters of credit	13 956 855	(89 568)	(93 446)	3 878
Total off-balance sheet data	**42 078 100**	**(151 864)**	**(159 946)**	**8 082**

31.12.2018	Gross amount	Accumulated impairment	Accumulated impairment without cash flow from collaterals	Financial effect of collaterals
Balance sheet data				
Loans and advances to banks	5 910 859	(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 to natural persons	*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	**84 787 779**	**(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**

23. Investments in subsidiaries

31 December 2019 (PLN 000's)

No.	Name of the company	Country of registration	Assets	Liabilities	Revenues	Net profit / (loss)	% interest held	Carrying value
1.	**BRE Property Partner Sp. z o.o.**	Poland	1 828	18	7	(422)	100.00	1 536
2.	**mServices Sp. z o.o.**	Poland	5 673	279	989	390	100.00	5 395
3.	**mElements S.A.**	Poland	16 724	1 293	11 976	1 349	100.00	15 432
4.	**Future Tech Fundusz Inwestycyjny Zamknięty**	Poland	203 607	1 763	4 718	(9 856)	98.04	201 055
5.	**Garbary Sp. z o.o.**	Poland	6 722	28	224	69	100.00	6 693
6.	**mBank Hipoteczny S.A.**	Poland	13 191 251	11 919 452	195 866	45 382	100.00	1 254 662
7.	**mBox Sp z o.o.**	Poland	7 938	7 165	391	8	100.00	773
8.	**mCentrum Operacji Sp. z o.o. w likwidacji** *	Poland	-	-	116	(425)	-	-
9.	**mInvestment Banking S.A. (previously mCorporate Finance S.A.)**	Poland	4 516	2 666	666	683	100.00	3 171
10.	**mFaktoring S.A.**	Poland	2 419 145	2 298 480	47 262	19 580	100.00	120 785
11.	**mFinance France S.A.**	France	5 055 588	5 054 188	3 016	1 382	99.998	1 412
12.	**mFinanse S.A.**	Poland	465 465	286 186	92 961	24 389	100.00	66 310
13.	**mLeasing Sp. z o.o.**	Poland	12 657 331	12 181 296	269 021	75 684	100.00	475 234
14.	**Octopus Sp. z o.o.**	Poland	440	1	20	(3)	99.90	50
15.	**Tele -Tech Investment Sp. z o.o.**	Poland	150 729	150 180	166	15	100.00	549
16.	**CSK Sp. z o.o.**	Poland	11 057	46	4	(10)	100.00	11 055
17.	**Unitop Sp. z o.o.**	Poland	150 493	192 372	52 066	(11 743)	100.00	-
								2 164 112

** In December 2019, mCentrum Operacji Sp. z o.o. w likwidacji was liquidated and removed from KRS.*

31 December 2018 (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.**	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

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Changes in investments in subsidiaries

	31.12.2019	31.12.2018
Investments in subsidiaries		
As at the beginning of the period	**2 300 324**	**2 060 847**
Impact of IFRS 9 implementation	n/a	(22 553)
As at the beginning of the period (adjusted)	**2 300 324**	**2 038 294**
Foreign exchange differences	34	85
Increase	161 056	17 512
Decrease	(28 687)	(7 019)
Changes resulting from the application of the equity method, including:	(175 763)	254 517
- recognised in the income statement	*(179 013)*	*255 167*
- rocognised in the other components of equity	*3 250*	*(650)*
Change of valuation of investment in subsidiaries not measured at equity method	(1 247)	(3 065)
Transfer to non-current assets held for sale (Note 24)	(91 605)	-
As at the end of the period	**2 164 112**	**2 300 324**

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 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 2019 the Bank, through valuation of mFinanse using the equity method, recognised a net profit in the amount of PLN 235 million, of which PLN 21.5 million in 2019. 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 97 million in the period of approximately 4 years from the end of 2019.

24. Non-current assets held for sale

On 7 November 2019, as part of implementing the mBank Group plan to withdraw from development activity and focus on the main activity in the financial industry, mBank S.A. signed a conditional agreement for the sale of shares in the company BDH Development Sp. z o.o. (BDH) to Archicom Polska S.A. The conclusion of the final agreement on the sale of shares will take place after all the conditions precedent are met in the form of the sale by BDH of shares held in CSK Sp. z o. o. (condition met), registration by the registry court of the reduction in BDH's share capital related to the redemption of shares, and the President of the Office for Competition and Consumer Protection's consent to the concentration consisting in the acquisition by Archicom Polska S.A. control over BDH. The parties undertook to sign a promised agreement transferring the value of BDH shares no later than 31 December 2020.

In connection with the above agreement, in accordance with the accounting principles described in Note 2.16, as at 31 December 2019, the Group classified BDH as non-current assets held for sale.

25. Intangible assets

	31.12.2019	31.12.2018
Goodwill	3 532	3 532
Patents, licences and similar assets, including:	632 536	397 683
- computer software	528 500	331 428
Other intangible assets	-	1 910
Intangible assets under development	187 041	290 085
Total intangible assets	**823 109**	**693 210**

In 2019 and 2018, 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 2019	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	**1 203 312**	**902 335**	**9 961**	**290 085**	**3 532**	**1 506 890**
Increase (due to)	**350 010**	**265 219**	**-**	**251 075**	**-**	**601 085**
- purchase	26 466	10	-	204 664	-	231 130
- transfer from intangible assets under development	321 896	265 209	-	-	-	321 896
- development costs	-	-	-	25 830	-	25 830
- other increases	1 648	-	-	20 581	-	22 229
Decrease (due to)	**(102 817)**	**(32 543)**	**-**	**(354 119)**	**-**	**(456 936)**
- liquidation	(102 808)	(32 535)	-	-	-	(102 808)
- transfer to intangible assets given to use	-	-	-	(321 896)	-	(321 896)
- other decreases	(9)	(8)	-	(32 223)	-	(32 232)
Gross value of intangible assets as at the end of the period	**1 450 505**	**1 135 011**	**9 961**	**187 041**	**3 532**	**1 651 039**
Accumulated amortization as at the beginning of the period	**(805 629)**	**(570 907)**	**(8 051)**	**-**	**-**	**(813 680)**
Amortization for the period (due to)	**(12 340)**	**(35 604)**	**(1 910)**	**-**	**-**	**(14 250)**
- amortization	(114 427)	(68 206)	(1 910)	-	-	(116 337)
- non-current assets held for sale	102 078	32 594	-	-	-	102 078
- other decreases	9	8	-	-	-	9
Accumulated amortization as at the end of the period	**(817 969)**	**(606 511)**	**(9 961)**	**-**	**-**	**(827 930)**
Net value of intangible assets as at the end of the period	**632 536**	**528 500**	**-**	**187 041**	**3 532**	**823 109**

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	**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	**1 203 312**	**902 335**	**9 961**	**290 085**	**3 532**	**1 506 890**
Accumulated amortization as at the beginning of the period	**(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	**(805 629)**	**(570 907)**	**(8 051)**	**-**	**-**	**(813 680)**
Net value of intangible assets as at the end of the period	**397 683**	**331 428**	**1 910**	**290 085**	**3 532**	**693 210**

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26. Tangible assets

	31.12.2019	31.12.2018
Tangible assets, including:	**413 767**	**425 410**
- land	1 033	1 033
- buildings and structures	153 452	154 858
- equipment	167 136	158 319
- vehicles	30	12 029
- other fixed assets	92 116	99 171
Fixed assets under construction	**69 815**	**111 591**
Right-of-use, including:	**462 024**	**n/a**
- real estate	391 063	n/a
- perpetual usufruct of land	48 358	n/a
- vehicles	21 470	n/a
- other	1 133	n/a
Total tangible assets	**945 606**	**537 001**

Movements in tangible assets

Movements in tangible assets from 1 January to 31 December 2019	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	**1 033**	**313 260**	**701 846**	**34 064**	**389 101**	**111 591**	**1 550 895**
Restatement to Right-of-use as an effect of IFRS16 implementation	-	-	-	(34 017)	-	-	(34 017)
Gross value of tangible assets as at the beginning of the period (restated)	**1 033**	**313 260**	**701 846**	**47**	**389 101**	**111 591**	**1 516 878**
Increase (due to)	**-**	**5 577**	**86 372**	**-**	**22 921**	**75 636**	**190 506**
- purchase	-	-	28 650	-	1 307	52 406	82 363
- transfer from tangible assets under construction	-	5 577	57 717	-	21 445	-	84 739
- other increases	-	-	5	-	169	23 230	23 404
Decrease (due to)	**-**	**(266)**	**(218 067)**	**-**	**(49 140)**	**(117 412)**	**(384 885)**
- sale	-	(235)	(35 612)	-	(4 319)	-	(40 166)
- liquidation	-	-	(120 918)	-	(10 139)	-	(131 057)
- transfer to tangible assets	-	-	-	-	-	(84 739)	(84 739)
- other decreases	-	(31)	(61 537)	-	(34 682)	(32 673)	(128 923)
Gross value of tangible assets as at the end of the period	**1 033**	**318 571**	**570 151**	**47**	**362 882**	**69 815**	**1 322 499**
Accumulated depreciation as at the beginning of the period	**-**	**(109 132)**	**(535 327)**	**(22 035)**	**(289 930)**	**-**	**(956 424)**
Restatement to Right-of-use as an effect of IFRS16 implementation	-	-	-	22 029	-	-	22 029
Accumulated depreciation as at the beginning of the period (restated)	**-**	**(109 132)**	**(535 327)**	**(6)**	**(289 930)**	**-**	**(934 395)**
Depreciation for the period (due to)	**-**	**(6 717)**	**132 312**	**(11)**	**19 164**	**-**	**144 748**
- depreciation charge	-	(6 976)	(76 874)	(11)	(26 455)	-	(110 316)
- sale	-	235	27 366	-	4 297	-	31 898
- liquidation	-	-	120 459	-	9 551	-	130 010
- other decreases	-	24	61 361	-	31 771	-	93 156
Accumulated depreciation as at the end of the period	**-**	**(115 849)**	**(403 015)**	**(17)**	**(270 766)**	**-**	**(789 647)**
Impairment losses as at the beginning of the period	**-**	**(49 270)**	**(8 200)**	**-**	**-**	**-**	**(57 470)**
- decrease	-	-	8 200	-	-	-	8 200
Impairment losses as at the end of the period	**-**	**(49 270)**	**-**	**-**	**-**	**-**	**(49 270)**
Net value of tangible assets as at the end of the period	**1 033**	**153 452**	**167 136**	**30**	**92 116**	**69 815**	**483 582**

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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	**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**

Almost 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.

Movements in right-of-use assets

Movements in right-of-use from 1 January to 31 December 2019	Real estate	Perpetual usufruct of land	Vehicles	Other	Total
Gross value of right-of-use as at the beginning of the period	**463 727**	**49 046**	**37 576**	**371**	**550 720**
Increase (due to)	**48 984**	**-**	**18 548**	**1 559**	**69 091**
- new contracts	-	-	18 548	-	18 548
- modification of contracts	48 984	-	-	1 559	50 543
Decrease (due to)	**(7 914)**	**-**	**(23 596)**	**-**	**(31 510)**
- termination of contracts	-	-	(23 596)	-	(23 596)
- modification of contracts	(7 914)	-	-	-	(7 914)
Gross value of right-of-use as at the end of the period	**504 797**	**49 046**	**32 528**	**1 930**	**588 301**
Accumulated depreciation as at the beginning of the period	**-**	**-**	**(22 029)**	**-**	**(22 029)**
Depreciation for the period (due to)	**(113 734)**	**(688)**	**10 971**	**(797)**	**(104 248)**
- depreciation charge	(111 041)	(688)	(5 350)	(797)	(117 876)
- other increases	(3 306)	-	-	-	(3 306)
- modification of contracts	613	-	-	-	613
- other decreases	-	-	16 321	-	16 321
Accumulated depreciation as at the end of the period	**(113 734)**	**(688)**	**(11 058)**	**(797)**	**(126 277)**
Net value of right-of-use as at the end of the period	**391 063**	**48 358**	**21 470**	**1 133**	**462 024**

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27. Other assets

	31.12.2019	31.12.2018
Other assets:	**491 052**	**652 585**
- debtors, including:	239 243	383 307
payment cards settlements	*110 118*	*145 953*
KDPW receivables under compensation scheme	*12 825*	*11 745*
- interbank balances	18 003	20 432
- settlements of securities transactions	15 518	11 346
- other accruals	154 319	180 319
- accrued income	59 821	50 537
- inventories	3 311	5 677
- other	837	967
Total other assets	**491 052**	**652 585**
Short-term (up to 1 year)	431 092	577 565
Long-term (over 1 year)	59 960	75 020

In 2019 and in 2018, 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 2019, the above note includes financial assets in amount of PLN 272 764 thousand (31 December 2018: PLN 416 052 thousand).

Other financial assets included in the note above

	31.12.2019	31.12.2018
Gross other financial assets, including:	**288 844**	**432 350**
- not past due	279 694	423 194
- past due from 1 to 90 days	2 483	4 650
- past due over 90 days	6 667	4 506
- provisions for impaired assets (negative amount)	(16 080)	(16 298)
Net other financial assets	**272 764**	**416 052**

Movements of impairment allowance for other assets

	31.12.2019	31.12.2018
As at the beginning of the period	**(16 298)**	**(14 430)**
Change in the period (due to):	**218**	**(1 868)**
- increase of provisions	(1 664)	(2 353)
- release of provisions	-	371
- write-offs	1 878	132
- foreign exchange differences	4	(18)
As at the end of the period	**(16 080)**	**(16 298)**

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28. Financial liabilities measured at amortised cost

Amounts due to other banks and customers

31.12.2019	Amounts due to banks	Amounts due to customers	including:		
			Individual customers	Corporate customers	Public sector customers
Deposits	**542 360**	**112 834 953**	**77 525 267**	**34 493 637**	**816 049**
Current accounts	438 112	88 131 618	62 639 670	24 881 011	610 937
Term deposits	-	24 527 928	14 885 597	9 437 219	205 112
Repo or sell/buy back transactions	104 248	175 407	-	175 407	-
Loans and advances received	**189 900**	**2 980 294**	**-**	**2 980 294**	**-**
Other financial liabilities	**448 522**	**6 121 740**	**138 966**	**5 940 011**	**42 763**
Liabilities in respect of cash collaterals	301 021	5 476 246	43 805	5 430 829	1 612
Lease liabilities	-	465 790	-	424 930	40 860
Other	147 501	179 704	95 161	84 252	291
Total financial liabilities measured at amortised cost	**1 180 782**	**121 936 987**	**77 664 233**	**43 413 942**	**858 812**

Short-term (up to 1 year)	990 897	114 981 598
Long-term (over 1 year)	189 885	6 955 389

31.12.2018	Amounts due to banks	Amounts due to customers	including:		
			Individual customers	Corporate customers	Public sector customers
Deposits	**1 909 993**	**98 559 750**	**65 766 023**	**32 055 092**	**738 635**
Current accounts	922 620	74 185 593	52 064 463	21 658 695	462 435
Term deposits	156 391	23 661 076	13 701 560	9 683 316	276 200
Repo or sell/buy back transactions	830 982	713 081	-	713 081	-
Loans and advances received	**747 334**	**3 457 264**	**-**	**3 457 264**	**-**
Other financial liabilities	**509 883**	**7 856 372**	**157 403**	**7 698 453**	**516**
Liabilities in respect of cash collaterals	348 776	7 652 993	51 341	7 601 652	-
Other	161 107	203 379	106 062	96 801	516
Total financial liabilities measured at amortised cost	**3 167 210**	**109 873 386**	**65 923 426**	**43 210 809**	**739 151**

Short-term (up to 1 year)	2 979 151	100 548 035
Long-term (over 1 year)	188 059	9 325 351

As at 31 December 2019, there were no deposits from other banks. As at 31 December 2018 the value of fixed rate deposits from other banks was PLN 156 391 thousand.

As at 31 December 2019 and as at 31 December 2018, loans and advances received from banks were variable interest rate loans.

The average interest rate for loans and deposits obtained from banks in 2019 amounted to 1.30% (31 December 2018: 1.09%).

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.

As at 31 December 2019 and 31 December 2018, 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 0.61% (31 December 2018: 0.67%).

As at 31 December 2019, loans and advances received include loans received from European Investment Bank amounting to PLN 2 980 294 thousand (31 December 2018: PLN 3 457 264 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.

As at 31 December 2019, the amount of cash collateral liabilities to corporate customers includes security deposits in the amount of PLN 5 097 329 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 2018: security deposits in the amount of PLN 7 302 746 thousand).

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Lease liabilities

Lease liablilities breakdown by maturity dates is presented below:

	31.12.2019
Lease liabilities breakdown by maturity dates	
up to 3 months	29 642
from 3 months to 1 year	84 657
from 1 year to 5 years	216 255
over 5 years	173 105
Total	**503 659**

Debt securities issued

31 December 2019 Debt securities by type:	Nominal value (currency of issue)	Carrying amount of the liability by maturity date				Total carrying value
		up to 3 months	from 3 to 12 months	from 1 to 5 years	more than 5 years	
Bonds, including:		**-**	**-**	**3 361 997**	**-**	**3 361 997**
- EUR	500 000	-	-	2 158 296	-	2 158 296
- CHF	305 000	-	-	1 203 701	-	1 203 701
Total		**-**	**-**	**3 361 997**	**-**	**3 361 997**

31 December 2018 Debt securities by type:	Nominal value (currency of issue)	Carrying amount of the liability by maturity date				Total carrying value
		up to 3 months	from 3 to 12 months	from 1 to 5 years	more than 5 years	
Bonds, including:		**-**	**-**	**2 857 724**	**-**	**2 857 724**
- EUR	500 000	-	-	2 165 045	-	2 165 045
- CHF	180 000	-	-	692 679	-	692 679
Total		**-**	**-**	**2 857 724**	**-**	**2 857 724**

Bank has not registered any contractual conditions infringement related to liabilities due to debt security issuance.

Movements in debt securities in issue

	31.12.2019	31.12.2018
As at the beginning of the period	**2 857 724**	**-**
Additions (issue)	476 036	2 820 056
Exchange differences	11 184	16 932
Other changes	17 053	20 736
Debt securities in issue as at the end of the period	**3 361 997**	**2 857 724**

Issues in 2019

- On 5 April 2019, under the new Euro Medium Term Note Program (EMTN Program), mBank issued unsecured bonds with a nominal value of CHF 125 000 thousand (equivalent of PLN 477 775 thousand at the average NBP exchange rate of 5 April 2019), with maturity on 4 October 2024.

Issues in 2018

- New debt securities issue program (EMTN)

  On 11 April 2018, the Management Board of mBank S.A. 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 will be established by the way of update of the existing debt instruments programme of mFinance France S.A. (mFF), 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 7 June 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 5 September 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.

Subordinated liabilities

31.12.2019	Nominal value	Currency	Terms of interest rate (%)	Effective interest rate (%)	Redemption date	As at the end of the period (in PLN '000)
- Commerzbank AG	250 000	CHF	3M LIBOR + 2.75%	2.04	21.03.2028	980 771
- Investors not associated with mBank S.A	550 000	PLN	6M WIBOR + 1.8%	3.59	10.10.2028 1)	554 418
- Investors not associated with mBank S.A	200 000	PLN	6M WIBOR + 1.95%	3.74	10.10.2030 1)	201 674
- Investors not associated with mBank S.A	750 000	PLN	6M WIBOR + 2.1%	3.89	17.01.2025	763 354
						2 500 217

31.12.2018	Nominal value	Currency	Terms of interest rate (%)	Effective interest rate (%)	Redemption date	As at the end of the period (in PLN '000)
- 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 10 October 2025.*

The effective interest rate specified in the tables above means the interest rate at the inception day of the last interest period.

Movements in subordinated liabilities

	31.12.2019	31.12.2018
As at the beginning of the period	**2 474 163**	**2 158 143**
- additions (new loans)	-	1 655 125
- disposals (early redemption)	-	(1 405 125)
- exchange differences	26 175	65 850
- other changes	(121)	170
Subordinated liabilities as at the end of the period	**2 500 217**	**2 474 163**
Short-term (up to 1 year)	19 892	20 012
Long-term (over 1 year)	2 480 325	2 454 151

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 CRR Regulation.

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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 9 October 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 10 October 2028, and 400 pieces of 12-year subordinated bonds with a nominal value of PLN 500 thousand each, with maturity on 10 October 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 28 November 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 3 December 2013, with a total nominal value of PLN 500,000 thousand.

According to the decision dated 8 January 2015 mBank obtained permission of the PFSA 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.

In 2019 and 2018, 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.

29. Other liabilities

	31.12.2019	31.12.2018
Other liabilities, including		
- tax liabilities	219 179	191 433
- interbank settlements	848 300	776 259
- creditors	568 225	1 070 233
settlements due to payment cards	*167 642*	*537 361*
liabilities payable to Bank Guarantee Fund	*175 632*	*105 021*
- accrued expenses	182 944	201 772
- deferred income	217 174	207 450
- provisions for post-employment employee benefits	23 701	20 644
- provisions for holiday equivalents	26 683	24 155
- provisions for other liabilities to employees	169 962	163 508
- other	938	4 934
Total other liabilities	**2 257 106**	**2 660 388**

As at 31 December 2019, the note presented above includes financial liabilities in the amount of PLN 1 599 469 thousand (31 December 2018: PLN 2 048 264 thousand). Cash flows resulting from those financial liabilities have been presented under Note 3.8.1. 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.

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Movements in provisions for post-employment employee benefits

Period from 1 January to 31 December 2019	Pension and disability provisions	Provisions for death severance	Provisions for the Social Benefit Fund	Total
Provisions for post-employment employee benefits				
As at the beginning of the period	**10 421**	**4 216**	**6 007**	**20 644**
Change in the period (due to)	**1 042**	**455**	**1 560**	**3 057**
Provisions created	603	113	269	**985**
Interest expense	275	118	169	**562**
Actuarial gains and losses recognised in other comprehensive income (Note 17), due to:	560	227	1 657	**2 444**
- Change in financing assumptions	*846*	*354*	*1 286*	***2 486***
- Change in demographic assumptions	*176*	*84*	*65*	***325***
- Other changes	*(462)*	*(211)*	*306*	***(367)***
Benefits paid	(396)	(3)	(535)	**(934)**
As at the end of the period (by type)	**11 463**	**4 671**	**7 567**	**23 701**
Short-term (up to 1 year)	1 514	278	83	**1 875**
Long-term (over 1 year)	9 949	4 393	7 484	**21 826**

Period from 1 January to 31 December 2018	Pension and disability provisions	Provisions for death severance	Provisions for the Social Benefit Fund	Total
Provisions for post-employment employee benefits				
As at the beginning of the period	**8 496**	**3 646**	**4 782**	**16 924**
Change in the period (due to)	**1 925**	**570**	**1 225**	**3 720**
Provisions created	652	145	214	**1 011**
Interest expense	264	112	150	**526**
Actuarial gains and losses recognised in other comprehensive income (Note 17), due to:	1 392	322	1 383	**3 097**
- Change in financing assumptions	*348*	*149*	*477*	***974***
- Change in demographic assumptions	*123*	*(19)*	*25*	***129***
- Other changes	*921*	*192*	*881*	***1 994***
Benefits paid	(383)	(9)	(522)	**(914)**
As at the end of the period (by type)	**10 421**	**4 216**	**6 007**	**20 644**
Short-term (up to 1 year)	9 000	276	76	**9 352**
Long-term (over 1 year)	1 421	3 940	5 931	**11 292**

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 2019 was decreased by 0.5 p.p., the value of the provisions would increase by PLN 1 777 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 1 573 thousand (31 December 2018, respectively: PLN 701 thousand and PLN 648 thousand).

30. Provisions

	31.12.2019	31.12.2018
Provisions for legal proceedings, including:	484 672	106 233
- *provisions for individual cases concerning indexation clauses in mortgage and housing loans in CHF*	*417 653*	*30 565*
- *provisions for other legal proceedings relating to loans in foreign currencies*	*61 103*	*67 258*
- *provisions for remaining legal proceedings*	*5 916*	*8 410*
Off-balance commitments and guarantees given	151 864	107 095
Other provisions	100 631	42 554
Provisions, total	**737 167**	**255 882**

Estimated dates of granted contingent liabilities realisation are presented in Note 34.

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The estimated cash flow due to created provisions for legal proceedings and other provisions is expected to crystalize over 1 year.

The description regarding individual cases concerning indexation clauses in mortgage and housing loans in CHF is presented in Note 32.

The methodology of the measurement of provisions for legal risk regarding individual court cases concerning indexation clauses in mortgage and housing loans in CHF is presented in Note 4.

The item Other provisions includes provisions recognized related to the judgment of the CJEU regarding reimbursement of commissions in case of earlier loan repayments, which is described in detail in Note 4.

Movements in provisions

Change from 1 January to 31 December	2019			
	provisions for individual cases concerning indexation clauses in mortgage and housing loans in CHF	provisions for other legal proceedings relating to loans in foreign currencies	provisions for remaining legal proceedings	other provisions
Provisions as at the beginning of the period	**30 565**	**67 258**	**8 410**	**42 554**
Change in the period, due to:	**387 088**	**(6 155)**	**(2 494)**	**58 077**
- increase of provisions	387 855	3 776	2 114	135 705
- release of provisions	(339)	(3 506)	(2 894)	(5 947)
- utilization	(428)	(6 425)	(1 714)	(71 985)
- reclassification to non-current assets held for sale	-	-	-	302
- foreign exchange differences	-	-	-	2
Provisions as at the end of the period (by type)	**417 653**	**61 103**	**5 916**	**100 631**

Change from 1 January to 31 December	2018			
	provisions for individual cases concerning indexation clauses in mortgage and housing loans in CHF	provisions for other legal proceedings relating to loans in foreign currencies	provisions for remaining legal proceedings	other provisions
Provisions as at the beginning of the period	**14 696**	**72 701**	**7 885**	**19 978**
Change in the period, due to:	**15 869**	**(5 443)**	**525**	**22 576**
- increase of provisions	19 544	3 431	525	27 890
- release of provisions	-	(2 626)	-	(649)
- write-offs	(3 714)	*(6 248)*	-	(4 700)
- foreign exchange differences	39	-	-	35
Provisions as at the end of the period (by type)	**30 565**	**67 258**	**8 410**	**42 554**

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Movements in provisions for loan commitments, guarantees and other financial facilities and other commitments

Change in the period from 1 January to 31 December	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	**55 600**	**-**	**-**	**-**	**34 356**	**(43 090)**	**15 430**	**62 296**
Stage 1	30 265	32 226	(4 584)	(112)	20 756	(12 320)	(31 941)	34 290
Stage 2	18 243	(32 226)	4 656	(145)	10 730	(11 234)	33 465	23 489
Stage 3	6 231	-	(72)	257	1 695	(19 479)	13 504	2 136
POCI	861	-	-	-	1 175	(57)	402	2 381
Guarantees and other financial facilities	**51 495**	**-**	**-**	**-**	**60 502**	**(28 484)**	**6 055**	**89 568**
Stage 1	2 784	1 484	(674)	(3)	13 852	(7 847)	(4 815)	4 781
Stage 2	4 994	(1 484)	674	(189)	2 773	(1 755)	(300)	4 713
Stage 3	47 154	-	-	192	43 877	(20 477)	8 938	79 684
POCI	(3 437)	-	-	-	-	1 595	2 232	390
Other commitments	**-**	**-**	**-**	**-**	**109**	**(109)**	**-**	**-**
Stage 1	-	-	-	-	109	(109)	-	-
Provisions on off-balance sheet items	**107 095**	**-**	**-**	**-**	**94 967**	**(71 683)**	**21 485**	**151 864**

Change in the period from 1 January to 31 December	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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31. Deferred income tax assets and liabilities

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 2019 and 2018.

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 01.01.2019	Recognised in the income statement	Recognised in other comprehensive income	Other changes	As at 31.12.2019
Interest accured	43 658	(12 426)	-	-	31 232
Valuation of securities	39 831	10 802	(419)	-	50 214
Provisions for impairment of loans and advances	409 662	5 980	-	-	415 642
Provisions for employee benefits	37 618	1 163	464	-	39 245
Other provisions	5 410	16 412	-	-	21 822
Prepayments/accruals	35 350	(3 200)	-	-	32 150
Differences between carrying and tax value of fixed tangible assets and intangible assets	-	91 601	-	-	91 601
Other negative temporary differences	41 224	674	-	4	41 902
Total deferred income tax assets	**612 753**	**111 006**	**45**	**4**	**723 808**

Deferred income tax liabilities	As at 01.01.2019	Recognised in the income statement	Recognised in other comprehensive income	Other changes	As at 31.12.2019
Interest accured	(48 254)	(8 078)	-	-	(56 332)
Valuation of derivative financial instruments	(44 754)	(11 305)	(9 032)	-	(65 091)
Valuation of investment securities	(111 765)	(20 439)	(2 721)	-	(134 925)
Interest and fees received in advance	(6 962)	(9 451)	-	-	(16 413)
Difference between tax and book value of tangible and intangible assets	(42 100)	(79 193)	-	-	(121 293)
Prepayments regarding amortization of applied investment relief	(18 657)	-	-	-	(18 657)
Other positive temporary differences	(44 997)	7 075	-	-	(37 922)
Total deferred income tax liabilities	**(317 489)**	**(121 391)**	**(11 753)**	**-**	**(450 633)**

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 Difference between tax and book value of tangible and intangible assets includes the impact of IFRS16 on the deferred tax.

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The item "Other positive temporary differences" includes the impact of the creation of deferred tax provision in the amount of PLN 18 774 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 (in 2018: PLN 22 529 thousand). 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 1 January 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.

	31.12.2019	31.12.2018
Interest accured	(20 504)	14 380
Valuation of derivative financial instruments	(11 305)	(4 892)
Valuation of securities	(9 637)	8 231
Provisions for impairment of loans and advances	5 980	84 662
Provisions for employee benefits	1 163	3 961
Other provisions	16 412	522
Prepayments/accruals	(3 200)	5 037
Interest and fees received in advance	(9 451)	(5 424)
Difference between tax and book value of tangible and intangible assets	12 408	2 967
Other temporary differences	7 749	18 681
Total deferred income tax included in the profit and loss account	**(10 385)**	**128 125**

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

A level of deferred tax asset for the year 2019 and 2018 does not include tax losses of the foreign branch in Slovakia in the amount respectively: EUR 1 986 thousand (equivalent of PLN 8 457 thousand at the average exchange rate of the National Bank of Poland as of 31 December 2019) and 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). 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 2020 and 2023 year.

Bank recognizes deferred tax liabilities or assets related to temporary differences arising from investments in subsidiaries and associates except that the implementation of the temporary differences is controlled by Bank and it is probable that in the foreseeable future, these differences will not be reversed. At the end of 2019 Bank did not include settlements on temporary differences in the total amount of PLN 1 449 790 thousand incurred due to investments in subsidiaries and affiliated companies in deferred tax calculation (at the end of 2018: PLN 1 443 977 thousand).

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

The Bank monitors the status of all court cases brought against entities of the Bank, including the status of court rulings regarding loans in foreign currencies in terms of shaping of and possible changes in the line of verdicts of the courts, as well as the level of required provisions for legal proceedings.

The Bank creates provisions for litigations against entities of the Bank, which as a result of the risk assessment involve a probable outflow of funds from fulfilling the liability and when a reliable estimate of the amount of the liability can be made. The amount of provisions is determined taking into account the amounts of outflow of funds calculated on the basis of scenarios of potential settlements of disputable issues and their probability estimated by the Bank based on the previous decisions of courts in similar matters and the experience of the Bank.

The value of provisions for litigations as at 31 December 2019 amounted to PLN 484 672 thousand (PLN 106 321 thousand as at 31 December 2018). A potential outflow of funds due to the fulfilment of the obligation takes place at the moment of the final resolution of the cases by the courts, which is beyond the control of the Bank.

<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. 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 thousand 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.

   mBank S.A. has submitted its statement of defense and requested that the action be dismissed. The court accepted the Defendants' requests to summon sixteen banks to join the proceedings and ordered that the banks be served with the summons.

3. A lawsuit filed by Polski Koncern Naftowy ORLEN S.A.

   On 7 February 2020, mBank S.A. received a lawsuit filed by Polski Koncern Naftowy ORLEN S.A. (Orlen) with its registered office in Płock seeking damages amounting to PLN 635 681 thousand on account of interchange fee. In the lawsuit, Orlen petitioned the court for awarding the damages jointly from mBank S.A. and other Polish bank and also from Master Card Europe and VISA Europe Management Services.

   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, i.e. a collusion restricting competition in the market of acquiring services connected with settling clients' liabilities towards the plaintiff on account of card payments for goods and services purchased by clients on the territory of Poland.

   At present, mBank S.A. is preparing its statement of defence

4. 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.

   As at 17 October 2012, the group of class members consisted of 1,247 individuals. 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. 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. 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. The case is pending.

As of 31 December 2019 the total value of claims in this class actions amounted to PLN 5.2 million.

5. 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.

   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.

   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. On 19 October 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 submitted a response.

   As of 31 December 2019 the total value of claims in this class actions amounted to PLN 377 million.

6. Individual court proceedings concerning indexation clauses in CHF

   Apart from the class action proceedings there are also individual court proceedings initiated against the Bank by its customers in connection with CHF loan agreements. As at 31 December 2019, 3 715 (30 September 2019: 3 371 proceedings) individual court proceedings were initiated against the Bank by its customers in connection with CHF loan agreements with the total value of claims amounting to PLN 443.2 million (30 September 2019: PLN 366.6 million). The value of provisions for all individual court proceedings related to CHF loan agreements amounted to PLN 478.8 million as at 31 December 2019.

   Out of the individual proceedings, 2 902 (30 September 2019: 2 478 proceedings) proceedings with the total value of claims amounting to PLN 430.1 million (30 September 2019: PLN 352.5 million)related to indexation clauses in CHF loan agreements and include claims for declaring ineffectiveness or invalidity in part (i.e. to the extent that the agreement contains contractual provisions related to indexation) or invalidity in whole of the loan agreements. The final rulings to-date in the indexation clauses proceedings are favourable to the Bank in the majority of the cases.

   The carrying amount of mortgage and housing loans granted to individual customers in CHF presented in the consolidated financial statements of mBank S.A. as of 31 December 2019 amounted to PLN 13.6 billion (i.e. CHF 3.5 billion) compared to PLN 14.4 billion (i.e. CHF 3.8 billion) as at the end of 2018. Additionally the volume of the portfolio of loans granted in CHF that were already fully repaid as of 31 December 2019 amounted to PLN 6.3 billion.

   Bank's approach to the measurement of provisions for legal risk associated with this portfolio of loans has been described in the Note 4.

Ruling of the Court of Justice of the European Union regarding a CHF mortgage

On 3 October 2019 the Court of Justice of the European Union (CJEU) issued the ruling in the prejudicial mode regarding a mortgage linked to the Swiss franc granted by a Polish bank. The submitted prejudicial questions were to determine, among other things, if a generally applicable custom can be used where there is no provision in domestic law that could replace an abusive exchange rate clause. In accordance with CJEU's ruling, the question of abusiveness will be decided by Polish courts. CJEU did not refer to this issue. In addition, CJEU did not make a clear-cut decision regarding the consequences of an exchange rate clause being considered abusive by a domestic court. However, the possibility of a credit agreement being performed further in PLN and with interest calculated according to LIBOR was found doubtful by the Court. If an exchange rate clause is found abusive, a domestic court must decide whether the agreement in question can be performed further or should be declared invalid, taking into account the client's will and the consequences of invalidity for the client. CJEU approved the application of a disposable norm (in the bank's opinion article 358 of the Polish Civil Code referring to the NBP fixing rate can be considered to be a disposable norm), if the invalidity of the agreement would be unfavourable for the client. CJEU rejected the application of general provisions referring to a custom or equity principles.

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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.

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.

On 1 April 2019 the Bank received PFSA response to the objections to the inspection protocol as well as PFSA recommendations in regard to the adjustment of Bank's activity as a depositary bank for investment funds to the applicable law. All objections of the Bank have been rejected by the regulator.

On 25 April 2019, Bank submitted to PFSA Office a declaration of actions taken as realization of post-inspection recommendations. PFSA by letter dated 4 September 2019 objected to the implementation of selected recommendations. On 11 October 2019 Bank submitted to PFSA the response addressing given objections, in which the description of taken actions was further specified as well as some new solutions for implementation were presented. On 5 December 2019, the PFSA Office sent to the Bank a reply to the letter containing the acceptance of some of the Bank's activities aimed at implementing post-audit recommendations and clarifications of other expectations that are being implemented. The Bank will notify the PFSA about completion and implementation of recommendations.

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,
- Other liabilities.

Loan commitments, guarantees and other financial facilities and other commitments

31.12.2019	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	26 965 277	1 139 112	14 041	2 815	34 290	23 489	2 136	2 381
Guarantees and other financial facilities	12 803 973	963 174	186 466	3 242	4 781	4 713	79 684	390
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 2019 and as at 31 December 2018.

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Guarantees are presented in the table below based on the earliest contractual maturity date.

31.12.2019	up to 1 year	from 1 to 5 years	more than 5 years	Total
1. Contingent liabilities granted and received	**33 528 882**	**9 127 453**	**3 416 420**	**46 072 755**
Commitments granted	**31 132 784**	**7 970 988**	**2 974 328**	**42 078 100**
1. Financing	23 559 675	3 025 421	1 536 149	**28 121 245**
a) Loan commitments	23 559 675	3 025 421	1 536 149	**28 121 245**
2. Guarantees and other financial facilities	7 573 109	4 945 567	1 438 179	**13 956 855**
a) Guarantees and standby letters of credit	7 573 109	4 945 567	1 438 179	**13 956 855**
Commitments received	**2 396 098**	**1 156 465**	**442 092**	**3 994 655**
- Financial commitments received	392 130	-	-	**392 130**
- Guarantees received	2 003 968	1 156 465	442 092	**3 602 525**
2. Derivative financial instruments (nominal value of contracts)	**197 922 663**	**351 961 915**	**39 155 308**	**589 039 886**
Interest rate derivatives	130 836 704	325 103 183	36 136 923	**492 076 810**
Currency derivatives	63 299 194	25 661 914	2 529 415	**91 490 523**
Market risk derivatives	3 786 765	1 196 818	488 970	**5 472 553**
Total off-balance sheet items	**231 451 545**	**361 089 368**	**42 571 728**	**635 112 641**

31.12.2018	up to 1 year	from 1 to 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**

The nominal values of derivatives are presented in the Note 19.

As at 31 December 2019, commitments received by the Bank in the amount of PLN 3 994 655 thousand (31 December 2018: PLN 3 579 994 thousand), related mainly to guarantees received as collateral of loans and advances granted.

On 5 July 2019, mBank S.A. concluded a lease agreement for space in the Mennica Legacy Tower building, located at 21 Pereca street in Warsaw, to which the Bank's Warsaw headquarters will be moved. The subject of the lease will be released in two phases. The space release in the first phase will take place on 1 October 2020, while the second phase will be released on 1 February 2021. The lease agreement has been concluded for a fixed period of 124 months from the date of the start of the first phase of the lease.

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34. Pledged assets

Assets may be pledged as collateral for repo or 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 2019 and 31 December 2018. Treasury securities are the main component of the Banks's liquidity collateral that can be eligible to pledge.

31.12.2019	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, 20, 21 and 22), including:	**35 036 336**	**3 323 282**	**29 787 956**	**3 362 331**	**-**	**3 362 331**	**33 150 287**
- NBP bills	2 999 645	-	2 999 645	-	-	-	2 999 645
- Government bonds	27 746 572	3 193 568	24 553 004	3 362 331	-	3 362 331	27 915 335
- Mortgage bonds	493 861	129 714	-	-	-	-	-
- Other non-treasury securities	3 796 258	-	2 235 307	-	-	-	2 235 307
Cash collaterals (due to derivatives transactions) (Note 22)	417 698	417 698	-	-	-	-	-
Other assets	113 774 239	-	-	-	-	-	-
Total	**149 228 273**	**3 740 980**	**29 787 956**	**3 362 331**	**-**	**3 362 331**	**33 150 287**

31.12.2018	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, 20, 21 and 22), including:	**33 760 305**	**5 212 292**	**26 786 311**	**1 480 632**	**599**	**1 480 033**	**28 266 344**
- NBP bills	499 912	-	499 912	-	-	-	499 912
- Government bonds	28 678 805	4 881 622	23 797 183	1 480 632	599	1 480 033	25 277 216
- 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	-	-	-	-	-
Other assets	103 531 108	-	-	-	-	-	-
Total	**137 679 609**	**5 600 488**	**26 786 311**	**1 480 632**	**599**	**1 480 033**	**28 266 344**

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.

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35. Registered share capital

The total number of ordinary shares as at 31 December 2019 was 42 350 367 shares (31 December 2018: 42 336 982 shares) of PLN 4 nominal value each. All issued shares were fully paid up.

REGISTERED SHARE CAPITAL (THE STRUCTURE) AS AT 31 DECEMBER 2019						
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
ordinary bearer	-	-	13 385	53 540	fully paid in cash	2019
Total number of shares			**42 350 367**			
Total registered share capital				**169 401 468**		
Nominal value per share (PLN)		**4**				

*As at the end of the reporting period

In 2019, the National Depository of Securities (KDPW) has registered 13 385 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 2019 the mBank's share capital increased by PLN 53 540.

Commerzbank AG is a shareholder holding over 5% of the share capital and votes at the General Meeting and as at 31 December 2019 it held 69.31% of the share capital and votes at the General Meeting of mBank S.A.

- Commerzbank AG announcement regarding the approval of the strategy including, among others, the potential sale of mBank S.A. shares

On 26 September 2019, Commerzbank AG published a communication according to which the new business strategy of Commerzbank was approved by the Management and Supervisory board of Commerzbank. The strategy provides for sale of the majority stake in mBank held by Commerzbank. The potential sale of the Bank's shares would depend on obtaining the required regulatory approvals.

- The changes in the ownership structure of Bank's material shares packages

On 30 September 2019 mBank S.A. was notified by Nationale-Nederlanden Powszechne Towarzystwo Emerytalne S.A. about increasing the share in the total number of votes at the General Meeting of the Bank above 5% resulting from the purchase of mBanks' shares at the WSE, settled on 24 September 2019. As a result of the same transaction, the funds managed by Nationale-Nederlanden Powszechne

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Towarzystwo Emerytalne S.A.: Nationale-Nederlanden Otwarty Fundusz Emerytalny (OFE) and Nationale-Nederlanden Dobrowolny Fundusz Emerytalny (DEF) increased their share in the total number of votes at the General Meeting of mBank S.A. above 5%.

From 24 September 2019, OFE and DEF together have 2 129 384 shares of mBank S.A., which represents 5.030% of the share capital of mBank S.A. and entitles to 2 129 384 votes at the General Meeting of mBank S.A.

On 23 September 2019, before the acquisition of mBank S.A. shares, the Fund held 2 116 439 shares of mBank S.A., which represented 4.999% of the share capital of mBank S.A. and entitled to 2 116 439 votes at the General Meeting of mBank S.A.

On 25 October 2019 mBank S.A. was notified by Nationale-Nederlanden Powszechne Towarzystwo Emerytalne S.A. about decreasing the share in the total number of votes at the General Meeting of mBank S.A. below 5% resulting from the sale of the mBanks' shares at the WSE on 17 October 2019. As a result of the same transaction, the funds managed by Nationale-Nederlanden Powszechne Towarzystwo Emerytalne S.A.: OFE and DEF decreased their share in the total number of votes at the General Meeting of mBank S.A. below 5%.

From 25 October 2019, OFE and DEF together have 2 092 050 shares of mBank S.A., which represents 4.94% of the share capital of mBank S.A. and entitles to 2 092 050 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 2019 and 2018 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.

	31.12.2019	31.12.2018
Other supplementary capital	9 216 652	9 216 652
Other reserve capital	27 320	22 452
General banking risk reserve	1 115 143	1 115 143
Profit from the previous year	1 024 455	(279 365)
Profit for the current year	980 980	1 303 820
Total retained earnings	**12 364 550**	**11 378 702**

According to the Polish legislation, each bank is required to allocate 8% of its net profit to a statutory undistributable other supplementary capital until this supplementary capital reaches 1/3 of the share capital.

In addition, the Bank transfers some of its net profit to the general banking risk reserve to cover unexpected risks and future losses. The general banking risk reserve can be distributed only on consent of shareholders at a general meeting.

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38. Other components of equity

	31.12.2019	31.12.2018
Exchange differences on translating foreign operations	**(5 151)**	**(5 160)**
Unrealized gains (foreign exchange gains)	1 275	3 278
Unrealized losses (foreign exchange losses)	(6 426)	(8 438)
Valuation of debt instruments at fair value through other comprehensive income	**58 363**	**104 292**
Unrealized gains on debt instruments	115 567	184 042
Unrealized losses on debt instruments	(21 815)	(47 501)
Deferred income tax	(35 389)	(32 249)
Cash flow hedges	**122 150**	**83 643**
Unrealized gains	150 802	103 263
Deferred income tax	(28 652)	(19 620)
Actuarial gains and losses relating to post-employment benefits	**(11 093)**	**(9 113)**
Actuarial (losses)	(13 695)	(11 251)
Deferred income tax	2 602	2 138
Share of other comprehensive income of entities under the equity method	**6 370**	**3 120**
Share of other comprehensive income of subsidiaries and associates	6 370	3 120
Total other components of equity	**170 639**	**176 782**

In 2019, the decrease in the value of unrealized gains on debt instruments compared to 2018 results from the realization of the result on debt securities maturing in 2019.

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.

39. Dividend per share

On 28 March 2019, the 32nd Annual General Meeting of mBank S.A. adopted a resolution regarding the distribution of the net profit for 2018. The net profit of mBank S.A. in the amount of PLN 1 317 484 thousand was allocated in the amount of PLN 248 158 thousand for covering losses from previous years. The remaining part of the profit in the amount of PLN 1 069 327 thousand was left undivided.

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.

	31.12.2019	31.12.2018
Cash and balances with the Central Bank (Note 18)	7 861 776	9 182 971
Loans and advances to banks (Note 22)	342 454	666 405
Trading securities issued by General governments (Note 19)	1 330 541	748 294
Total cash and cash equivalents	**9 534 771**	**10 597 670**

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Supplementary information to the cash flow statement

Explanation of differences between the change in the balances resulting from the balance sheet and the change disclosed in the cash flows from operating activities

	Year ended 31 December 2019	Year ended 31 December 2018
Loans and advances to banks - change in the balance of the statement of financial position	**(1 428 362)**	**(246 577)**
Exclusion of a change in the balance of cash and cash equivalents	(323 951)	(468 136)
Total change in loans and advances to banks	**(1 752 313)**	**(714 713)**
Financial assets held for trading and hedging derivatives - change in the balance of the statement of financial position	**(793 479)**	**237 643**
The difference between the interest accrued and paid in cash in the period	81 353	87 178
Valuation included in other comprehensive income	47 539	109 681
Exclusion of a change in the balance of cash and cash equivalents	582 247	(484 221)
Total change in financial assets held for trading and hedging derivatives	**(82 340)**	**(49 719)**
Loans and advances to customers change in the balance of the statement of financial position	**(9 695 978)**	**(7 251 867)**
The difference between the interest accrued and paid in cash in the period	(138 938)	(188 214)
Total change in loans and advances to customers	**(9 834 916)**	**(7 440 081)**
Financial assets at fair value through other comprehensive income - change in the balance of the statement of financial position	**1 717 843**	**(3 159 455)**
Valuation included in other comprehensive income	(42 789)	(7 062)
The difference between the interest accrued and paid in cash in the period	(292 679)	(497 381)
Total change in financial assets at fair value through other comprehensive income	**1 382 375**	**(3 663 898)**
Debt securities measured at amortised cost - change in the balance of the statement of financial position	**(2 234 333)**	**(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	**(2 234 333)**	**(277 005)**
Other assets - change in the balance of the statement of financial position	**161 533**	**(236 111)**
Balances unrealised in cash recognised in the income statement	(14 788)	(1 817)
Total change of other assets	**146 745**	**(237 928)**
Amounts due to other banks - change in the balance of the statement of financial position	**(1 986 428)**	**(1 922 506)**
The difference between the interest accrued and paid in cash in the reporting period	18 745	12 176
Exclusion of change in cash flows from financing activity	557 100	2 644 697
Total change in amounts due to other banks	**(1 410 583)**	**734 367**
Amounts due to customers - change in the balance of the statement of financial position	**12 063 601**	**10 391 152**
The difference between the interest accrued and paid in cash in the reporting period	(384 665)	207 320
Exclusion of change in cash flows from financing activity, including payments due to lease agreements	663 972	734 364
Total change in amounts due to customers	**12 342 908**	**11 332 836**
Debt securities in issue - change in the balance of the statement of financial position	**504 273**	**2 857 724**
The difference between the interest accrued and paid in cash in the reporting period	(5 558)	-
Exclusion of change in cash flows from financing activity	(488 378)	(2 829 853)
Total change in debt securities in issue	**10 337**	**27 871**
Changes in other liabilities - change in the balance of the statement of financial position	**78 003**	**479 254**
Valuation of incentive programmes recognised in income statement (Note 12)	9 947	10 224
Exclusion of tax liabilities of certain financial institutions	(40 470)	45
Actuarial gains and losses relating to post-employment benefits recognised in other comprehensive income	(2 444)	(3 097)
Total change in other liabilities	**45 036**	**486 426**

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Interests received and paid from operating activities

	Year ended 31 December	
	2019	**2018**
Interest income, including:		
Loans and advances to banks	184 808	161 966
Loans and advances to customers	3 391 809	2 959 928
Debt securities	1 019 467	947 367
Interest income on derivatives classified into banking book	92 580	81 360
Interest income on derivatives concluded under hedge accounting	100 276	98 261
Other interest income	5 059	5 626
Total interest income	**4 793 999**	**4 254 508**

	Year ended 31 December	
	2019	**2018**
Interest expense, including:		
Settlements with banks due to deposits received	(18 480)	(12 176)
Settlements with customers due to deposits received	(824 184)	(643 801)
Security deposit received in relation with the guarantee granted to secure underwriting of securities	(93 338)	(146 295)
Issuance of debt securities in issue	(26 847)	-
Other interest expense	(23 844)	(6 882)
Total interest expense	**(986 693)**	**(809 154)**

Cash flows from investing activities

In 2019 and 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).

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

	As at 31.12.2018	Cash flows	Change not connected with cash fows	As at 31.12.2019
Loans and advances to banks (Note 28)	747 334	(567 863)	10 429	189 900
Loans and advances to other customers (Note 28)	3 457 264	(519 145)	42 175	2 980 294
Lease liabilities (Note 28)	-	(109 846)	575 636	465 790
Debt securities in issue (Note 28)	2 857 724	476 036	28 237	3 361 997
Subordinated liabilities (Note 28)	2 474 163	(76 627)	102 681	2 500 217
Total liabilities from financing activities	**9 536 485**	**(797 445)**	**759 158**	**9 498 198**

	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	(2 780 372)	133 366	747 334
Loans and advances to other customers (Note 28)	4 142 944	(858 648)	172 968	3 457 264
Debt securities in issue (Note 28)	-	2 812 921	44 803	2 857 724
Subordinated liabilities (Note 28)	2 158 143	179 712	136 308	2 474 163
Total liabilities from financing activities	**9 695 427**	**(646 387)**	**487 445**	**9 536 485**

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% paid in cash 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.

	31.12.2019		31.12.2018	
	Number of options	Weighed average exercise price (in PLN)	Number of options	Weighed average exercise price (in PLN)
Outstanding at the beginning of the period	**12 229**	**-**	**15 542**	**-**
Granted during the period	-	-	8 021	-
Forfeited during the period	-	-	-	-
Exercised during the period*	6 019	4	11 334	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**6 210**	**-**	**12 229**	**-**
Exercisable at the end of the period	**-**	**-**	**-**	**-**

* In 2019, the weighted average price of the shares was PLN 388.23 (in 2018: PLN 430.59).

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 2 March 2015, the Supervisory Board of the mBank extended the duration of the program from 31 December 2019 to 31 December 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 tranches 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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	31.12.2019		31.12.2018	
	Number of options	Weighed average exercise price (in PLN)	Number of options	Weighed average exercise price (in PLN)
Outstanding at the beginning of the period	**13 293**	**-**	**15 396**	**-**
Granted during the period	-	-	11 423	-
Forfeited during the period	342	-	-	-
Exercised during the period*	7 366	4	13 526	4
Expired during the period	-	-	-	-
Outstanding at the end of the period	**5 585**	**-**	**13 293**	**-**
Exercisable at the end of the period	**-**	**-**	**-**	**-**

* In 2019, the weighted average price of the shares was PLN 388.23 (in 2018: PLN 430.59).

2018 incentive programme for the Management Board Members and key staff of mBank Group – mBank Risk Takers

On 7 June 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 9 May 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 27 October 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 14 March 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 1 January 2018 to 31 December 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 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).

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The bonus consists of the non-deferred part (60% of the bonus) and the deferred part (40% of the bonus).

Both, the deferred and non-deferred part are divided into equal portions: 50% paid in cash and 50% paid in subscription warrants.

The non-deferred part is paid in cash 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.

The table below presents change in the number and weighted average exercise prices of share options related to the 2018 incentive programme for Management Board Members of the Bank and for key managers of mBank Group.

	31.12.2019
	Number of options
Outstanding at the beginning of the period	**-**
Granted during the period	17 870
Forfeited during the period	803
Exercised during the period	-
Expired during the period	-
Outstanding at the end of the period	**17 067**
Exercisable at the end of the period	**-**

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Summary of the Impact of the Programmes on the Bank's balance sheet and income statement

Share-Based Payments Settled in Shares

The table below presents changes in other reserve capital generated by the above mentioned incentive programmes for share-based payments settled in mBank S.A. shares.

	31.12.2019	31.12.2018
Incentive programs		
As at the beginning of the period	**22 452**	**22 638**
- value of services provided by the employees	9 947	10 224
- settlement of exercised options	(5 079)	(10 410)
As at the end of the period	**27 320**	**22 452**

Cash Payments

The cost of the cash part of the programmes is presented in Note 12.

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 2019 and 31 December 2018 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	**31.12.2019**	**31.12.2018**	**31.12.2019**	**31.12.2018**	**31.12.2019**	**31.12.2018**	**31.12.2019**	**31.12.2018**	**31.12.2019**	**31.12.2018**
Statement of Financial Position										
Assets	2 040	3 247	2 058	1 583	16 967 391	16 098 429	457 033	555 690	19	7 587
Liabilities	23 422	14 909	1 484	1 955	5 613 881	8 179 812	1 817 780	1 918 804	67 848	56 543
Income Statement										
Interest income	53	90	70	49	363 564	319 373	59 928	100 581	698	535
Interest expense	(158)	(77)	(3)	(2)	(104 091)	(163 020)	(23 709)	(65 321)	(480)	(273)
Commission income	46	93	11	7	19 736	14 851	4 353	3 771	49	84
Commission expense	-	-	-	-	(243 129)	(187 180)	(1 030)	(4 828)	-	-
Other operating income	-	-	-	-	13 331	21 554	1 468	1 458	-	-
Overhead costs amortisation and other operating expenses	-	-	-	-	(13 511)	(6 485)	(7 076)	(8 647)	-	-
Contingent liabilities granted and received										
Commitments granted	957	583	407	462	7 005 347	10 058 396	2 124 709	1 842 625	3 502	-
Commitments received	-	-	-		-	-	1 816 577	2 074 354	-	-

** 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 2019 and 2018, no provisions were created in connection with credits granted to related entities.

<u>Supervisory Board and Management Board Remuneration</u>

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

1. Cezary Stypułkowski – President of the Management Board,
2. Lidia Jabłonowska-Luba – Vice-President of the Management Board, Chief Risk Officer,
3. Frank Bock – Vice-President of the Management Board, Head of Financial Markets,
4. Andreas Böger – Vice-President of the Management Board, Chief Financial Officer,
5. Krzysztof Dąbrowski – Vice-President of the Management Board, Head of Operations and IT,
6. Cezary Kocik – Vice-President of the Management Board, Head of Retail Banking,
7. Adam Pers – Vice-President of the Management Board, Head of Corporate and Investment Banking.

At the end of 2019, 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 2019 and at the end of 2018, remuneration of the former Management Board Members and remuneration of Supervisory Board Members.

Renumeration paid (in PLN)	2019	2018
mBank Management Board		
Basic salary	13 570 816	13 924 321
Other benefits	1 891 377	1 282 195
Bonus for previous year	1 560 000	1 306 634
Deferred bonus	1 762 899	1 892 082
Remuneration of the former Management Board Members		
Bonus for previous year	-	291 668
Deferred bonus	980 834	1 385 000
mBank Supervisory Board		
Basic salary	2 066 528	2 425 920

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.

The total amount of remuneration received in 2019 by Bank's Management Board members was PLN 18 787 092 (in 2018: PLN 18 405 232).

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 2019, which would be paid out in 2020. Therefore, a provision was created for the payment of a cash bonus for 2019 for the members of the Management Board, which amounted to PLN 4 113 206 as of 31 December 2019 (31 December 2018: PLN 4 752 541). The final decision concerning the level of the bonus will be taken by the Remuneration Committee of the Supervisory Board by 28 February 2020.

In 2019 and 2018, 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 compensation of Members of the Supervisory Board, the Management Board and other key executive management of the Bank that perform their duties in 2019 amounted to PLN 27 410 813 (2018: PLN 28 757 076).

Detailed information on the remuneration of individual Members of the Management Board and the Supervisory Board, as well as the composition of the Supervisory Board and information about former Members of the Management Board were presented in the Management Board Report on the Performance of mBank S.A. Group in 2019 in item 14.6. "Composition, powers and procedures of the Management Board and the Supervisory Board".

Information regarding proprietary position in Bank shares by Members of the Management Board and by Members of the Supervisory Board

As at 31 December 2019, the Bank shares were held by five Members of the Management Board: Mr. Cezary Stypułkowski – 21 249 shares, Mr. Frank Bock – 334 shares, Mr. Andreas Böger – 270 shares, Mr. Krzysztof Dąbrowski – 1 000 shares and Mr. Cezary Kocik – 1 040 shares.

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 2019 and 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 2019 and 31 December 2018, other Members of the Supervisory Board of the Bank had no Bank's shares.

43. Acquisitions and disposals

- The liquidation of the company mCentrum Operacji Sp. z o.o.

On 1 March 2018, the Group completed the process of reorganisation of mCentrum Operacji Sp z o.o. ("mCO"). As part of the process, two organized parts of the enterprise were separated in the form of the Development Division of Automatic Processes and the General Division. On 1 March 2018, the Development Division of Automatic Process was sold to Feronia S.A., of which the major shareholder is Future Tech FIZ, a subsidiary of the Bank, in order to automation of the processes handled by this part of mCO, while the General Division, including the majority of processes so far serviced by mCO, was sold to the Bank. As a consequence of described process, mCO was put into liquidation in May 2019. In December 2019, mCO was removed in National Court Register.

44. 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 1 September 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 2019 Bank was obliged to ensure adequate own funds to meet conservation buffer of 2.5% of total risk exposure amount.

As of the end of 2019 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 7 b.p. as of 31 December 2019. 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 2019 were: 1.5% and 1.5%.

In 2016 the Bank received an administrative decision of the PFSA that identified mBank as other systemically important institutions (O-SII) and imposed a capital buffer of the total risk exposure amount. Pursuant to the PFSA decision of 14 October 2019 the Bank was obliged to maintain the capital buffer of 0.75% 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 2019.

Starting from 1 January 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 2.81% in December 2019.

Consequently, the combined buffer requirement set for the mBank as at the end of 2019 amounted to 6.13% of the total risk exposure amount.

Additionally, as a result of risk assessment carried out in 2019 by the PFSA 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 3.62% for total capital ratio and 2.71% for Tier 1 capital. Additional capital requirement set by PFSA in 2019 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.

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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 2019 capital ratios on the individual level were above the required values taking into account the abovementioned components.

mBank	31.12.2019		31.12.2018	
Capital ratio	Required level	Reported level	Required level	Reported level
Total capital ratio	17.75%	22.84%	17.40%	24.20%
Tier 1 ratio	14.84%	19.42%	14.36%	20.46%

The stand-alone leverage ratio, calculated in accordance with the provisions of the CRR Regulation and Commission Delegated Regulation (EU) 2015/62 of 10 October 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 8.6%.

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 2019 amounted to PLN 16 533 792 thousand. Additionally the Common Equity Tier 1 capital of mBank amounted to PLN 14 053 467 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.

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As at 31 December 2019 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 2019 amounted to PLN 72 383 689 thousand, including PLN 64 160 136 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.

These resources are at safe level. The value of Bank's internal funds in regulatory approach is substantially higher than value required to cover the total Bank's capital requirement calculated in line with CRR regulation. Simillary, in the economic approach, the capital resources in a form of risk coverage potential, are substantially higher that internal capital estimated for Bank in line with Regulation of the Minister for Development and Finance of 6 March 2017 on the risk management system and internal control system, remuneration policy and the detailed way of estimating internal capital in banks.

The internal capital of Bank as at 31 December 2019 amounted to PLN 5 258 374 thousand.

Capital adequacy	31.12.2019	31.12.2018
Common Equity Tier 1 Capital	**14 053 467**	**13 419 690**
Total Own Funds	**16 533 792**	**15 873 840**
Risk weighted exposure amounts for credit, counterparty credit, dilution risk and free deliveries:	63 989 925	57 879 780
- including under standardised approach	16 407 944	14 968 233
- including under AIRB approach	47 579 507	42 909 950
- including risk exposure amount for contributions to the default fund of a CCP	2 474	1 597
Total risk exposure amount for position, foreign exchange and commodities risks	909 567	791 333
Total risk exposure amount for operational risks	7 129 641	6 518 022
Total risk exposure amount for credit valuation adjustments	184 345	221 288
Other risk exposure amounts	170 211	171 170
Total risk exposure amount	**72 383 689**	**65 581 593**
Comon Equity Tier 1 capital ratio	**19.42%**	**20.46%**
Total capital ratio	**22.84%**	**24.20%**
Internal capital	**5 258 374**	**4 686 349**

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OWN FUNDS	31.12.2019	31.12.2018
Own funds	**16 533 792**	**15 873 840**
TIER 1 CAPITAL	**14 053 467**	**13 419 690**
Common Equity Tier 1 Capital	**14 053 467**	**13 419 690**
Capital instruments eligible as CET1 Capital	3 579 747	3 574 636
Paid up capital instruments	169 330	169 330
Share premium	3 410 417	3 405 338
(-) Own CET1 instruments	-	(32)
Retained earnings	1 250 228	243 436
Previous years retained earnings	1 024 454	(248 157)
Profit or loss eligible	225 774	491 593
Accumulated other comprehensive income	170 639	176 782
Other reserves	9 243 973	9 239 105
Funds for general banking risk	1 115 143	1 115 143
Adjustments to CET1 due to prudential filters	(40 665)	(38 284)
Fair value gains and losses arising from the institution's own credit risk related to derivative liabilities	(2 166)	(2 101)
(-) Value adjustments due to the requirements for prudent valuation	(38 499)	(36 183)
(-) Intangible assets	(795 458)	(664 175)
(-) Other intangible assets gross amount	(823 110)	(693 210)
Deferred tax liabilities associated to other intangible assets	27 652	29 035
(-) IRB shortfall of credit risk adjustments to expected losses	(8 559)	(56 921)
Provision for cash flow hedging instruments	(122 150)	(83 643)
CET1 capital elements or deductions - other	(339 431)	(86 389)
TIER 2 CAPITAL	**2 480 325**	**2 454 150**
Capital instruments and subordinated loans eligible as T2 capital	2 480 325	2 454 150

Credit risk	31.12.2019	31.12.2018
Risk weighted exposure amounts for credit risk, counterparty credit risk, dilution risk and free deliveries	**63 989 924**	**57 879 780**
Standardised approach	**16 407 945**	**14 968 233**
SA exposure classes excluding securitisation positions	16 407 945	14 968 233
Central governments or central banks	729 282	30 402
Regional governments or local authorities	51 800	93 945
Public sector entities	15 553	24 745
Institutions	241 509	233 527
Corporates	6 143 713	5 744 233
Retail	1 532 911	1 343 170
Secured by mortgages on immovable property	1 102 194	1 069 732
Exposures in default	238 331	282 165
Items associated with particular high risk	29 747	2 902
Equity	6 269 843	6 130 153
Other items	53 062	13 259
AIRB approach	**47 579 505**	**42 909 950**
AIRB approaches when own estimates of LGD and/or Conversion Factors are used	45 506 855	40 734 029
Institutions	741 377	1 229 148
Corporates - SME	5 676 168	5 077 050
Corporates - Specialised Lending	3 276 443	1 944 703
Corporates - Other	17 508 048	16 066 241
Retail - Secured by real estate SME	1 002 315	901 557
Retail - Secured by real estate non-SME	5 294 470	5 433 050
Retail - Other SME	2 945 128	2 627 879
Retail - Other non-SME	9 062 906	7 454 401
Other non credit-obligation assets	2 072 650	2 175 921
Risk exposure amount for contributions to the default fund of a CCP	**2 474**	**1 597**

45. Other information

- Commerzbank AG announcement regarding the approval of the strategy including, among others, the potential sale of mBank S.A shares.

On 26 September 2019, Commerzbank AG published a communication according to which the new business strategy of Commerzbank was approved by the Management and Supervisory board of Commerzbank. The strategy provides for sale of the majority stake in mBank held by Commerzbank. The potential sale of the Bank's shares would depend on obtaining the required regulatory approvals.

46. Events after the balance sheet date

- Tax Capital Group of mBank

Since 1 January 2020 mBank S.A., mBank Hipoteczny S.A., mFinanse S.A. and mLeasing Sp. z o. o. established, based on Corporate Income Tax Act, Tax Capital Group of mBank ("TCG"). According to Corporate Income Tax Act, mBank – as a dominant entity – represents TCG with respect described by tax law. In a year preceding establishing the TCG, there was no tax losses in either of the entity that is a member of TCG. The TCG agreement has been concluded for 4 years.