Bank Hipoteczny

2015

Disclosures in accordance with the disclosure policy of mBank Hipoteczny S.A. as at 31 December 2015

Warsaw, 25 March 2016

Contents

1. Introduction

On the basis of Regulation (UE) 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 (hereinafter referred to as CRR Regulation) and on the basis of other regulations laying down implementing technical standards with regard to information disclosure, also in accordance with the Disclosure Policy of mBank Hipoteczny S.A. (hereinafter referred to as Bank) available on website www.mhipoteczny.pl, information based on standalone data for Bank (the Bank has no subsidiaries) according to the requirements of the CRR Regulation are contained in the presented document.

If not stated specifically further in the report, all the amounts are presented in PLN thousand.

2. The scope of prudential consolidation

The Bank does not own any subsidiary, therefore, the following data are standalone data of the Bank. The Bank is a part of mBank Group.

3. Reconciliation of Common Equity Tier 1 capital item in relation to own funds of the institution and balance sheet in the audited financial statement

Reconciliation of equities included in the financial statement of the Bank for 2015 prepared in accordance with International Financial Reporting Standards to positions included in the own funds of the Bank as at 31 December 2015 is presented below.

Reconciliation	Financial Statement for the year 2015	Items not included in own funds and regulatory adjustments	Own funds in part regarding Common Equity Tier 1 capital
Equity	**31.12.2015**	**31.12.2015**	**31.12.2015**
Share capital:	**514 855**	**-**	**514 855**
Registered share capital	299 000	-	299 000
Share premium	215 855	-	215 855
Retained earnings:	**266 631**	**(13 835)**	**252 796**
Other supplementary capital	211 340	-	211 340
General banking risk reserve	36 500	-	36 500
Profit for the current year	18 791	(13 835)	4 956
Other components of equity	**849**	**(509)**	**340**
Valuation of available for sale financial assets	825	(495)	330
Actuarial gains and losses relating to post-employment benefits	24	(14)	10
Regulatory adjustments	**-**	**(127 979)**	**(127 979)**
Intangible assets	-	(8 048)	(8 048)
IRB shortfall of credit risk adjustments to expected losses	-	(108 764)	(108 764)
Net impairment write-downs on loans and advances	-	(11 167)	(11 167)

4. Capital adequacy

The guiding principle of managing of capital in the Bank is maintaining of the capital on the level ensuring stable development of the Bank and covering of both minimum capital requirement and remaining risk categories recognised by the Bank as significant. Capital management is based on principles specified in the Banking Law and good practices.

The main aim of capital management is to ensure that capital resources to the Bank that will be sufficient to cover risk exposures, and in particular ensuring of implementation of required capitalisation within the limits of risk appetite.

The Bank manages the capital for risk covering using system of limits and early warning indicators, basing the core of the concept on principles formulated within consolidated supervision in the Capital Group, supporting implementation of strategic capital objectives. The Bank acts within Principles of capital management and planning policy which aim is to ensure effective use of available capital.

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. It allows to maintain the ratio of Common Equity Tier 1 capital (calculated as the quotient of Common Equity Tier 1 capital and total amount of risk exposure) as well as the total capital ratio (calculated as the quotient of own funds and the total amount of risk exposure) at least at the level required by supervising institution.

Strategic capital objectives of the Bank are oriented towards maintaining of both total capital ratio and Common Equity Tier 1 capital ratio on the level appropriately higher than level required by the supervising institution. It allows to maintain safe business development meeting the supervisory requirements in the long perspective.

5. Own funds

Own funds include Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital. As at 31 December 2015, the Bank does not identify Additional Tier 1 capital. Detailed information on particular elements of the Bank's own funds as at 31 December 2015 are presented in point 5.1. Point 5.2 presents the structure of own funds of the Bank as at 31 December 2015.

5.1. Main information

COMMON EQUITY TIER 1 CAPITAL

Capital instruments and the related share premium accounts

As at 31 December 2015, the item Capital instruments and the related share premium accounts includes share capital and supplementary capital from the sales of shares above nominal value reduced by the Bank's costs of issuing. In case of issues that took place after 28 July 2013, in accordance with the Banking Law Act and CRR Regulation, the Bank obtained approval of the Financial Supervision Authority (KNF) to classify them to Common Equity Tier 1 capital.

Capital instruments and the related share premium accounts	
Registered share capital	299 000
Supplementary capital from the sales of shares above nominal value	215 855
Total	**514 855**

Detailed information concerning share and supplementary capital are presented in Notes 36 and 37 of the financial statement of mBank Hipoteczny S.A. for 2015.

Accumulated other comprehensive income

The item Accumulated other comprehensive income presents unrealised gains and losses that constitute the Bank's other components of equity as at 31 December 2015 in the amount of PLN 849 thousand. The structure of accumulated other comprehensive income of the Bank as at 31 December 2015 is described below.

Accumulated other comprehensive income	**31.12.2015**
Instruments available for sale	**825**
- unrealized gains on debt instruments	1 018
- deferred tax	(193)
Actuarial gains and losses on fringe benefits after employment period	**24**
- actuarial gains	30
- deferred tax	(6)
Total accumulated other comprehensive income	**849**

Other reserve capitals

Other reserve capitals constitute the other supplementary capital made of profit deductions and is intended for purposes specified in the articles of association or other provisions of law. As at 31 December 2015 other reserve capitals amounted to PLN 211 340 thousand.

Fund for general banking risk

The Bank allocates part of the net profit to the fund for general banking risk to cover unexpected risks and future losses. The fund for general banking risk is subject to distribution only with the consent of shareholders expressed during general meeting. As at 31 December 2015, the fund for general banking risk amounted to PLN 36 500 thousand.

Independently reviewed interim profits

In the calculation of Common Equity Tier 1 capital as at 31 December 2015 a verified net profit of mBank Hipoteczny S.A. for the first half of 2015 was included. Net profit achieved by mBank Hipoteczny S.A. in the first half of 2015 amounted to PLN 4 956 thousand. In accordance with the decision dated 13 November 2015, the Bank obtained KNF approval for classification of net profit for the first half of 2015 to Common Equity Tier 1 capital in the amount of PLN 4 956 thousand.

REGULATORY ADJUSTMENTS/DEDUCTIONS FROM THE COMMON EQUITY TIER 1 CAPITAL

Intangible assets

In accordance with Art. 37 of the CRR Regulation, intangible assets are included in the account of Common Equity Tier 1 capital after reduction by the amount of associated deferred tax liabilities. In the calculation of Common Equity Tier 1 capital as at 31 December 2015 the amount of PLN 8 048 thousand on account of tangible assets was included.

Negative amounts resulting from the calculation of expected loss amounts

The Bank, which constitutes an institution that calculates risk-weighted exposure amounts using IRB method, is obliged to include negative amounts resulting from the calculation of expected loss amounts in the calculation of own funds. According to Article 36 (1d), the negative amounts resulting from the calculation specified in Articles 158 and 159 of the CRR Regulation were included in Common Equity Tier 1 capital as at 31 December 2015 in the amount of PLN 108 764 thousand.

Net impairment losses

In the item of net impairment losses as at 31 December 2015, the value of net impairment losses due to the loss of value of loans and advances in the period from 1 July 2015 to 31 December 2015 was presented, recognised in the profit and loss account in the amount of PLN 11 167 thousand. Used approach is consistent with provisions of the Commission Delegated Regulation (EU) No. 183/2014 dated 20 December 2013 that supplements the CRR Regulation in relation to technical regulatory standards regarding determination of the manner of calculation of adjustments resulting from specific and general credit risk.

Regulatory adjustments relating to unrealised gains and losses

In accordance with the Banking Law Act, in 2015 in the calculation of Common Equity Tier 1 capital institutions should include unrealised losses associated with assets or liabilities valuated according to fair value in the amount of 100% of their value, while unrealised profits could be valued in the amount of 40% of their value. Regulatory adjustments in the amount of PLN 509 thousand, related to unrealised profits as at 31 December 2015, constitute an item adjusting the position of the cumulated comprehensive income, referred to above.

ADDITIONAL TIER 1 CAPITAL

As at 31 December 2015, instruments that could be treated as Additional Tier 1 capital are not identified in the Bank.

TIER 2 CAPITAL

Capital instruments and subordinated loans

In accordance with the decision dated 17 December 2012, mBank Hipoteczny S.A. obtained approval of KNF to classify funds in the amount of PLN 100 000 thousand to supplementary funds in accordance with terms and conditions of the subordinated loan agreement concluded on 16 October 2012 between mBank Hipoteczny S.A. and mBank S.A. with a repayment date on 19 December 2022. As at 31 December 2015, the full amount of loan, that is PLN 100 000 thousand, was classified to Tier 2 capital.

In accordance with the provisions of Commission Implementing Regulation (EU) No. 1423/2013 dated 20 December 2013, establishing technical implementing standards in the scope of requirements regarding disclosure of information on own funds of institutions in accordance with the CRR Regulation (hereinafter referred to as Regulation No. 1423/2013), the description of main characteristics of capital instruments included in own funds of the Bank as at 31 December 2015 is presented on the next page in the table prepared on the basis of a template that constitute appendix II to the Regulation No. 1423/2013.

TOTAL CAPITAL

The total capital item includes the amount of own funds of the Bank as at 31 December 2015 that constitutes the sum of Common Equity Tier 1 capital and Tier 2 capital. Own funds of the Bank as at 31 December 2015 amounted to PLN 740 012 thousand.

Capital instruments' main features

			Series A	Series B	Series C	Series D	Series E	Series F
1	Issuer	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.	mBank Hipoteczny S.A.
2	Unique identifier (eg. CUSIP or Bloomberg identifier for private placement)	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
3	Governing law(s) of the instrument	Polish	Polish	Polish	Polish	Polish	Polish	Polish
	Regulatory treatment							
4	Transitional CRR rules	Tier 2 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital
5	Post-transitional CRR rules	Tier 2 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital	Tier 1 Capital
6	Eligible at solo/(sub-)consolidated / solo & (sub-)consolidated(sub-)	Solo	Solo	Solo	Solo	Solo	Solo	Solo
7	Instrument type (types to be specified by each jurisdiction)	„zobowiązania podporządkowane" – Polish Banking Law Act Art. 127.1	Ordinary share, Art. 28 CRR	Ordinary share, Art. 28 CRR	Ordinary share, Art. 28 CRR	Ordinary share, Art. 28 CRR	Ordinary share, Art. 28 CRR	Ordinary share, Art. 28 CRR
8	Amount recognised in regulatory capital (currency in million, as of most recent reporting date)	PLN 100	PLN 50	PLN 85	PLN 40	PLN 100	PLN 100	PLN 140
9	Nominal amount of instrument	Issue currency: PLN 100M; In reporting currency: PLN 100M	PLN 50M	PLN 85M	PLN 40M	PLN 100M	PLN 100M	PLN 140M
9a	Issue price	100.00%	PLN 100	PLN 100	PLN 100	PLN 100	PLN 1 000	PLN 1 000
9b	Redemption price	100.00%	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
10	Accounting classification	Liability – amortised cost	Share capital	Share capital	Share capital	Share capital	Share capital	Share capital
11	Original date of issue	16-10-2012	18-03-1999	15-03-2000	20-01-2006	23-11-2012	13-11-2014	24-07-2015
12	Perpetual or dated	Dated	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual
13	Original maturity date	19-12-2022	No term	No term	No term	No term	No term	No term
14	Issuer call subject to prior supervisory approval	Yes	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
15	Optional call date, contingent call dates and redemption amount	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
16	Subsequent call dates, if applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
	Coupons / dividends							
17	Fixed or floating dividend/coupon	Floating coupon	Floating dividend	Floating dividend	Floating dividend	Floating dividend	Floating dividend	Floating dividend
18	Coupon rate and any related index	PLN WIBOR 3M+3.5%	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
19	Existence of a dividend stopper	Not applicable	No	No	No	No	No	No
20a	Fully discretionary, partially discretionary or mandatory (in terms of timing)	Mandatory	Partly discretionary	Partly discretionary	Partly discretionary	Partly discretionary	Partly discretionary	Partly discretionary
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	Mandatory	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary	Fully discretionary
21	Existence of the option of increasing interest or other incentives to redeem	No	No	No	No	No	No	No
22	Nonculmulative or cumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative	Noncumulative
23	Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible
24	If convertible or non-convertible, conversion trigger(s)	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
25	If convertible, fully or partially	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
26	If convertible, conversion rate	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
27	If convertible, mandatory or optional conversion	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
28	If convertible, specify instrument type convertible into	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
29	If convertible, specify issuer of instrument it converts info	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
30	Write-down features	Not applicable	No	No	No	No	No	No
31	If write-down, write-down trigger(s)	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
32	If write-down, full or partial	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
33	If write-down, permanent or temporary	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
34	If write-down, description of write-up mechanism	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	The lowest priority of satisfaction and will rank only to the extent permitted by applicable laws relating to creditors' right	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
36	Non-compliant transitional features	No	No	No	No	No	No	No
37	If yes, specify non-compliant features	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable

5.2. Own funds structure

In accordance with provisions of the Regulation No. 1423/2013, the structure of own funds based on a template that constitute appendix VI to the Regulation No. 1423/2013 is presented below. Taking into account the clarity and the value in use of the document for its recipients, in the table below the scope of disclosures is limited to non-zero items.

Common Equity Tier 1 capital: instruments and reserves	Amount at disclosure date (As at 31.12.2015)
Capital instruments and the related share premium accounts	514 855
Accumulated other comprehensive income (to include unrealised gains and losses under the applicable accounting standards)	849
Other reserve capital	211 340
Funds for general banking risk	36 500
Independently reviewed interim profits net of any foreseeable charge or dividend	4 956
Common Equity Tier 1 (CET1) capital before regulatory adjustments	**768 500**
Common Equity Tier 1 capital: regulatory adjustments	
Intangible assets (net of related deferred tax liability)	(8 048)
Negative amount resulting from the calculation of expected loss amounts	(108 764)
Net impairment losses	(11 167)
Regulatory adjustments relating to unrealised gains and losses pursuant to Article 467 and 468 of the CRR Regulation	(509)
Of which: filter for unrealised gain related to assets or liabilities measured at fair value	(509)
Total regulatory adjustments to Common Equity Tier 1 capital	**(128 488)**
Common Equity Tier 1 capital	**640 012**
Additional Tier 1 capital	**-**
Common Equity Tier 1 capital (Tier 1 capital = Common Equity Tier 1 capital + Additional Tier 1 capital)	**640 012**
Tier 2 capital: instruments and provisions	
Capital instruments and the related share premium accounts	100 000
Tier 2 capital before regulatory adjustments	**100 000**
Tier 2 capital	**100 000**
Total capital (Tier 1 capital + Tier 2 capital)	**740 012**
Total risk weighted assets	**5 358 363**
Capital ratios and buffers	
Common Equity Tier 1 (as a percentage of risk exposure amount)	**11.94%**
Tier 1 (as a percentage of risk exposure amount)	**11.94%**
Total capital (as a percentage of risk exposure amount)	**13.81%**

6. Capital requirements

6.1. Internal capital adequacy assessment – description of the approach

mBank Hipoteczny S.A. obtained consent issued by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) on 14 August 2012 in cooperation with KNF (KNF letter dated 27 August 2012) to apply internal rating methods in terms of assignment of exposures due to specialist lending to risk category (IRB slotting approach method) to calculate capital requirement due to credit risk. On the basis of consent issued on 2 April 2014 by BaFin in cooperation with KNF (KNF letter dated 10 April 2014), the Bank extended applied IRB Approach with further rating models.

By the letter dated 12 December 2013, the Bank informed KNF on the extension of the plan of gradual implementation of internal rating method in mBank Hipoteczny S.A. with the class of retail exposures secured on housing real estates. In the second half of 2016, the Bank plans to submit motion to KNF for a consent to cover this portfolio with internal rating method.

In the calculation of total capital ratio of the Bank as at 31 December 2015, the total capital requirement was designated taking into account the capital requirement due to credit risk with application of the IRB method in accordance with provisions of the CRR Regulation and also own funds were designated with an application of deduction resulting from the IRB Approach and were at the level higher than 80% of comparative total capital requirement (so called regulatory floor), in accordance with provisions of the CRR Regulation.

6.2. Results of the internal capital adequacy assessment

The key element of the risk management process in the Bank is the mechanism that assumes maintaining of own funds on the level that provides the ability to absorb unexpected losses due to any types of risks resulting from the business activity conducted by the Bank. This aim is implemented in the scope of ICAAP (Internal Capital Adequacy Assessment Process) which through mechanisms of estimation of adequacy of internal capital reinforces associations between risk profile (level), risk management mechanism and owned capital.

Through the implementation of the ICAAP, the Bank performs current and future assessment of capital adequacy in the context of necessity to maintain it, even in very difficult economic conditions and ensures that an institution owns adequate internal capital in relation to the risk profile. The process is subject to regular reviews implemented by the Management Board of the Bank and is supervised by the Supervisory Board.

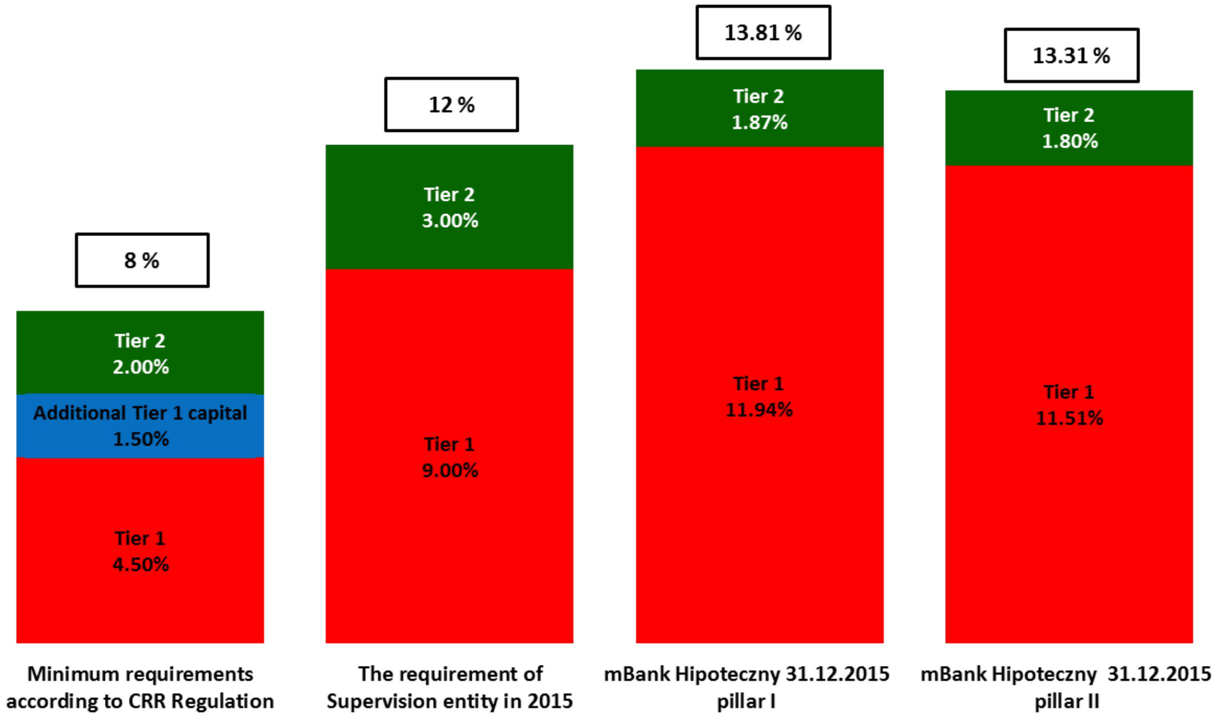
Internal capital is value estimated by the Bank that is necessary to cover all significant types of risks identified in the operations in the scope of risk inventory process - it constitutes the sum of economic capital used to cover types of risks included in the process of calculation of economic capital and the capital used for covering of remaining types of risks (including hard to quantify risks).

Economic capital is determined using appropriate quantitative methods allowing for reflection of the degree of risk in an adequate manner. Currently total economic capital covers the following elements:

- economic capital to cover credit risk,
- economic capital to cover market risk,
- economic capital to cover operational risk,
- economic capital to cover business risk.

Capital for covering remaining types of risks (including hard to quantify risks) is estimated in accordance with the rules defined in the ICAAP.
The risk management system is associated with capital and process management at its planning. Risk appetite is defined as acceptable level of risk specified in terms of value and expressed using internal capital, which is defined by the Risk Management Strategy of the Bank.

Supervisory requirements in terms of capital ratios



The Bank maintains capital ratios above minimal levels that result from provisions of the CRR Regulation, as well as above levels that were expected from the Bank in 2015 by the banking supervision (total capital ratio - 12%, Tier 1 capital ratio - 9%).

Strategic capital objectives of the Bank are oriented towards maintaining of both total capital ratio and Common Equity Tier 1 capital ratio on the level appropriately higher than level required by the supervising institution. It allows to maintain safe business development meeting the supervisory requirements in the long perspective.

Capital ratios are calculated on the basis of the total amount of risk exposure, corresponding to the sum of risk exposure amounts for particular types of risks, calculated in accordance with provisions of the CRR Regulation.

6.3. Quantitative data regarding capital adequacy

The total amount of risk exposure of the Bank as at 31 December 2015 consists of:

- risk-weighted exposure amount for credit risk, counterparty credit risk, calculated using the IRB slotting approach and a standardised approach for exposures permanently excluded from the IRB Approach as well as exposures subject to temporary exclusion,
- operational risk exposure amount, calculated using basic indicator approach.

There is no trading portfolio in the Bank, therefore, the Bank does not calculate risk-weighted exposure amounts in relation to other types of risks.

31.12.2015	Risk exposure amount	Own funds requirement
TOTAL	**5 358 363**	**428 669**
Credit risk	**5 188 556**	**415 084**
Under IRB approach	3 715 701	297 256
Under standardised approach	1 472 855	117 828
Operational risk	169 807	13 585
Total capital ratio	**13.81%**	
Common Equity Tier 1 capital ratio	**11.94%**	
Tier 1 capital ratio	**11.94%**	

The below table presents the risk-weighted exposure amount for credit risk and counterparty credit risk in division that takes into account applied approaches and classes of exposures in the scope of the approach

31.12.2015	Gross exposure	Exposure value pre CCF and CRM*	Total exposure covered by guarantees**	Risk weighted exposure amount	Own funds requirement
Credit and counterparty credit risk	**9 547 516**	**9 540 370**	**268 189**	**5 188 556**	**415 084**
IRB approach	**5 329 617**	**5 327 465**	**-**	**3 715 701**	**297 256**
Corporates - Specialised Lending	5 258 901	5 258 901	-	3 676 423	294 114
Other non-credit-obligation assets	70 716	68 564	-	39 278	3 142
Standardised Approach	**4 217 899**	**4 212 905**	**268 189**	**1 472 855**	**117 828**
Central governments or central banks exposures	757 623	757 623	-	-	-
Regional governments or local authorities exposures	92 693	92 666	-	72 171	5 774
Public sector entities exposures	53 624	53 608	53 608	-	-
Institutions exposures	249 355	249 355	-	312	25
Corporates exposures	214 391	214 326	214 326	-	-
Retail exposures	173 117	172 981	-	120 192	9 615
Secured by mortgages on immovable property exposures	2 663 342	2 662 201	255	1 267 045	101 363
Exposures in default	13 746	10 137	-	13 127	1 050
Equities exposures	8	8	-	8	1

** CCF - Credit Conversion Factor, CRM - Credit Risk Mitigation*

*** Total exposure covered by guarantees relates to exposures which basic collateral is a guarantee of local government units that meets the requirements of the CRR Regulation.*

The table below presents exposures for which the requirement is calculated using standard approach broken down by exposures permanently excluded from the IRB Approach and exposures subject to temporary exclusion

31.12.2015	Gross exposure	Exposure value pre CCF and CRM	Total exposure covered by guarantees	Risk weighted exposure amount	Own funds requirement
Standardised Approach	**4 217 899**	**4 212 905**	**268 189**	**1 472 855**	**117 828**
Exposures under the permanent partial use of the standardised approach	1 527 468	1 523 379	268 189	226 413	18 113
Exposures under the standardised approach with prior supervisory permission to carry out a sequential IRB implementation	2 690 431	2 689 526	-	1 246 442	99 715

The table below presents credit exposures for which the requirement was calculated using the IRB slotting Approach broken down into supervisory categories of risk as at 31 December 2015

Risk category	Gross exposure	Of which: off balance sheet exposures	Risk weighted exposure amount	Average risk weight
1	8 813	-	6 169	70.00%
2	4 572 024	858 842	3 256 199	87.69%
3	344 001	1 251	394 162	115.00%
4	7 957	-	19 893	250.00%
5*	326 106	276	-	0.00%
Total	**5 258 901**	**860 369**	**3 676 423**	**83.58%**

** category for exposure in default*

7. Capital buffers

Provisions of CRD IV directive, in particular provisions regarding capital buffers, were transposed into a national legislation, which took place in 2015 with the endorsement of the Act on Macro-prudential Supervision over the Financial System and Crisis Management in the Financial System (hereinafter the Act) and with an update of the Banking Law. The Act defined capital buffers in force beginning from January 2016, all banks in Poland should meet. As of 31 December 2015 there were no requirements regarding capital buffers Bank should adress.

8. Leverage ratio

Since 2014, the Bank calculates the leverage ratio in accordance with provisions of the CRR Regulation. Introduction of indicator that shows the relation between Tier 1 capital and the value of balance sheet and off-balance sheet exposures aims to limit inadequate borrowing of banks in relation to owned capital base.

Until 31 December 2016 the European Commission will present a report regarding influence and effectiveness of the leverage ratio to the European Parliament and Council. Where appropriate, the report will be accompanied by a legislative proposal regarding introduction of applied number of levels of the leverage ratio which institutions operating in accordance with different business models would be obliged to apply.

Information in terms of leverage ratio presented below are accordant with supervisory reports submitted by the Bank to the Polish National Bank (NBP). According to the instructions of the European Commission given to banks by NBP, calculations are made according to the rules of CRR Regulation without taking into account amendments introduced by the Commission Delegated Regulation 2015/62 as of 10 October 2014 (hereinafter Regulation 2015/62), until the European Commission implementing regulation will be updated.

Leverage ratio calculated as at 31 December 2015 in accordance with the Regulation 2015/62 would amount to 7.57%. The increase of leverage ratio results from the change of credit conversion factor applied for off-balance sheet items of medium risk, not associated with financing of trade. Without the changes introduced with the Regulation 2015/62, the credit conversion factor amounts to 100%, and 50% after including the changes.

The table below shows the value of exposure, capital and leverage ratio of the Bank calculated in accordance with the transitional definition of Tier 1 capital as at 31 December 2015.

	31.12.2015
Exposure value, of which:	**8 512 926**
Derivatives: Market value	32 212
Derivatives: Add-on Mark-to-Market Method	11 868
Undrawn credit facilities, which may be cancelled unconditionally at any time without notice	86 037
Other off-balance sheet items	119 580
Other assets	8 391 717
Tier 1 capital - transitional definition	(128 488)
Tier 1 capital - transitional definition	**640 012**
Leverage Ratio - using a transitional definition of Tier 1	**7.52%**

Reconciliation of the measure of the total exposure taken into account in the process of calculation of the leverage ratio with information disclosed in the financial statement of the Bank for 2015

	31.12.2015
Total assets as per published financial statements	**8 419 125**
Adjustments for derivative financial instruments (result of replacing the valuation of these instruments by their balance sheet equivalent)	11 868
Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	205 617
Other adjustments	4 804
Total exposures amount	**8 641 414**

The leverage ratio is subject to constant monitoring. The Bank monitors the level of leverage ratio on the basis of quarterly information, analyses possible significant changes and their reasons.

The level of the leverage ratio above 5% is recognised as safe and does not require any additional actions. In case of decline of the ratio below indicated level, the ALCO Committee will consider taking appropriate actions.

In the scope of applicable management information system, the report on the current level of leverage ratio and possible risks regarding maintaining safe levels of the factor, taking into account the influence of current losses and losses possible to predict in the future, the influence of current dynamic and planned dynamics of lending activity is submitted to the ALCO Committee. The process of analysis is implemented through the control of implementation of strategy, plans and financial projection.

9. Applied credit risk mitigation techniques

9.1 Assessment of collaterals and their management

The policies and processes for on- and off-balance sheet netting

Financial assets and financial liabilities are offset and the net amount is reported in the statement on financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realise the asset and settle liability simultaneously.

The main types of guarantor and credit derivative counterparty and their creditworthiness

As at 31 December 2015, the Bank did not own derivative credit instruments.

Collaterals

Credit risk taken by the Bank by means of providing loan products to clients may be reduced through collaterals. Types of collaterals accepted by the Bank and the principles of their establishment are described in detail in the internal regulations of the Bank.

The rules of valuation of loan collaterals and collateral management are described in applicable policies and procedures of the Bank. An important element of the collateral policy is an assumption that by taking decision on granting of a product that bears credit risk, the Bank aims to obtain a collateral of the highest quality and value adequate to the scale of risk.

Fulfilment of a protective role by a collateral occurs in accordance with conditions discussed in the part "Main types of collaterals". The Bank regularly monitors the quality of collaterals, the monitoring covers in particular the effectiveness of the legal establishment of the collateral, valuation of the collateral and validity of documentation, e.g. assignment of rights from collateral agreement.

Collaterals on real estates

In the process of granting mortgage loans, the Bank assesses and determines the value of collaterals in accordance with provisions of the Act on Covered bonds and Mortgage Banks and the Regulations of determining the mortgage lending value of the property (hereinafter the Regulations) approved by KNF.

The process of determining the mortgage lending value of the property (hereinafter BHWN) is implemented by employees of the Bank who meet competence requirements specified in the Regulations. The basis for determining of BHWN is an expert's opinion on the mortgage lending value developed in accordance with regulations applicable in the Bank. BHWN determined by an employee of the Bank ensures adequacy of collateral over the whole duration of agreement and constitutes a basis for indicating of maximum amount of loan, in accordance with provisions of the Act on Covered bonds and Mortgage Banks.

Retail area (portfolio of loans granted in cooperation with mBank S.A.)

The Bank carefully selects real estates that may constitute a subject of collateral. The scope of process of collateral assessment covers analysis of features of a real estate proposed for collateral and analysis of liquidity of a local market of similar real estate resulting with assignment of a real estate to specified segment, i.e. typical/unusual real estate. Applied segmentation aims to ensure assumed effectiveness of recovery from accepted collateral.

The Bank applies additional limitations in the scope of relation of loan amount to the level of determined actual amount, reflecting the current level of prices for similar real estate available on the market. The indicator may not exceed:

- 80% of determined actual volume for typical residential real estates,
- 70% of determined actual volume for unusual residential real estates.

In case of covering a loan with insurance of low own contribution, the Bank allows for granting of a loan in the amount exceeding the abovementioned ratios, however, not more than up to the established BHWN.

The Bank periodically monitors the value and quality of owned legal collaterals of mortgage loans portfolio. In the scope of this process for residential real estate, the Bank analyses changes in prices of real estates on the market in order to identify evidence of impairment for a credit exposure.

Corporates

The Bank observes the rule that in accordance with the Act on Covered bonds and Mortgage Banks the value of LTV ratio must not exceed 100%. Additional information furthermore, in the Credit Policy of the Bank maximum values of the LTV ratio were determined that depend on the type of financed real estate and are as follow[1]:

- 90% for office, commercial and warehouse properties and
- 80% for housing developers and hotels.

The Bank periodically monitors the value of real estates that are the subject of collateral. The monitoring also covers collaterals entered into the Cover Register. The principles of monitoring of the value of collaterals are described in detailed internal regulations of the Bank.

In the scope of corporate loan monitoring, the legal status of real estates, on which mortgages are established for the Bank, is verified. The verification is done through reviewing of a land register via website of the Ministry of Justice.

The validity of insurance policies of real estates that constitute mortgage collateral for the Bank is monitored and reported to the Management Board of the Bank in monthly cycles.

9.2. Main types of collaterals

Retail

- Mortgage on real estates

A mortgage on a financed (or other) real property is a basic collateral for mortgage loans. The Bank accepts only a first charge mortgage entry. The mortgage registration equals 150% of the original loan exposure. The Bank secures itself only on those real properties the type of right to which was indicated in the Act on Covered bonds and Mortgage Banks (exclusion relates to cooperative ownership right).

- Bridging insurance

For loans, for which the target collateral has the form of a mortgage on a real property, a so- called "bridging insurance" is used up until the time when that mortgage is established.

[1] The Bank defined three levels of criteria: fully accordant with the Credit Policy of the Bank, exclusion from the Credit Policy and not covered by the Credit Policy (knock-out criteria)

- Assignment of rights from insurance policy against fire and other accidents of a mortgaged real property

In case of all loans secured with a mortgage on a real property, the Bank requires provision of insurance of a real property against fire and other accidents in the entire duration of the loan agreement.

- Claim for establishing of a mortgage in the future

In case of loans granted for purchase of a real property from a developer, until removal of a purchased real property from a land register kept for a real property covered with investment, a claim for establishing of a mortgage on a purchased real property in the future is entered for the Bank in section IV. This collateral is provided in the Act on Covered bonds and Mortgage Banks and is applied alongside bridging insurance.

- Transfer of receivables from development agreement

In case of loans granted for purchase of a real property from a developer, the Bank requires transfer of receivables resulting from agreement concluded between the developer and the client, which, in case of a failure of a final agreement, secures the Bank's claim in terms of paid amount of loan.

Corporates

In case of mortgage loans, the basic collateral is a mortgage on a financed real property. The Bank accepts only a first charge mortgage entry. The Bank secures itself only on those real properties the type of right to which was indicated in the Act on Covered bonds and Mortgage Banks.

Additional collateral is applied by the Bank in case of loans in the corporate area:

- declaration of submission to enforcement under Art. 777 of the Code of Civil Procedure;
- assignment from lease agreements;
- assignment from insurance policy;
- pledge on shares of the company owned by the borrower or pledge on shares of the company of the borrower's general partner;
- pledge on the bank account of the borrower;
- power of attorney to the bank account of the borrower;
- promissory note guaranteed by sponsors or partners as a transition collateral until the time of establishing of a mortgage on a real property.

Public sector

In case of loans for local government units (JST) and loans guaranteed by JST granted to special purpose companies established by them and health care institutions, mandatory legal collaterals of repayment of a granted loan are:

- for JST - Blank promissory note of the Borrower together with bill declaration;
- for health care institutions and special purpose companies established by JST - JST guarantee according to civil law;

The following may constitute an additional collateral of repayment of a loan:

- mortgage on real property;
- assignment of rights from insurance policy of construction against all construction risks of a real property;
- assignment of rights from insurance policy against fire and other accidents of a mortgaged real property;
- assignments or a pledge on receivables due to lease agreements;
- bank guarantee;
- pledge on rights, including pledge on shares of a special purpose company;
- accession to a loan debt.

Values of exposures per type of recognised collateral broken down to exposure classes are presented in Note 6.3 to this document. As a recognition of a collateral, the Bank uses unfunded credit protection in a form of guarantees of local government units that meet the requirements of the CRR Regulation.

9.3. Market or credit risk concentration

Due to the fact that the scope of activity is limited by an act, the Bank is exposed to increased risk of concentration on the real property market. Taking this into account, the Bank aims for maximum available diversification of credit risk and avoiding its excessive concentration, which consists in limiting of involvement in single entities and groups of affiliated investors. Thus understood limitation is achieved through systematic increasing of share of retail mortgage loans in the balance sheet of the Bank.

To actively manage the concentration risk, the Bank has an internal system that limits the market and credit risk concentration. At the same time, the Bank observes supervisory guidelines regarding the limits of lending and concentration. Risk limits are threshold values the observance of which aims to ensure implementation of objectives given the available resources. The structure and the level of limits is established by the Management Board of the Bank, and all cases of exceeding of internal concentration limits are reported to the Management Board of the Bank immediately after their occurrence.

Due to increasingly greater differentiation between particular segments of real property market, the Bank takes into account the concentration into separate types of financed real property while developing the policy of income producing real estate and sales plans as well as in current credit decisions in a given segment. The Bank has established and monitored exposures in particular segments of the real estate market, appropriately to the risk associated with them.

Additionally, the Bank monitors the market for its geographical differentiation in order to identify markets with variable saturation in particular real estate segments. For that reason, the Bank controls the risk resulting from geographical concentration through establishing and monitoring of limits for financing of projects in particular provinces.

Having regard to limitation of concentration of risk resulting from exposure in the same currency, the Bank monitors the currency structure of exposure portfolio on a monthly basis.

The Bank controls the concentration limits of exposures to single entity or group of entities related by equity or organisationally, which amounts to 25% of eligible capital of the Bank, and additionally on a daily basis monitors exposures for exceeding of 10% of the eligible capital of the Bank in relation to a single entity or group of entities related by equity or organisationally.

The Bank analyses key market risk concentrations associated with its operations and business events. Within risk concentration analysis, the Bank monitors e.g. influence of changes of market risk factors, such as: exchange rates, interest rates.

10. Credit risk adjustments

10.1. Past due and impaired exposures– definitions used

Definition of past due exposures

The exposures against clients, for whom at least one receivable is past due by one or more days, are assumed as past due exposures. Whereby, in case of portfolio granted in cooperation with mBank S.A., the past due exposure is an exposure on delayed contracts (by one or more days). No impairment is recognised in respect of loans and advances past due for less than 90 days, unless other available information indicates their impairment. In rare cases for loans and advances overdue by over 90 days, the Bank does not recognise impairment if there is particular evidence demonstrating lack of impairment of those loans and advances.

Definition of impaired exposures

The Bank measures the impairment of credit exposures in accordance with International Accounting Standard no. 39.

For the purposes of impairment analysis four portfolios are distinguished in the Bank:

- retail portfolio obtained in cooperation with mBank S.A.,
- commercial portfolio,
- JST portfolio,
- portfolio of remaining retail loans.

Commercial portfolio is divided into two sub-portfolios, distinguishing commercial loans (developer loans, commercial loans and loans for legal persons) and other loans for individual entrepreneurs.

Credit exposure is considered to be burdened with evidence of impairment when for a debtor (owner of the contract) an evidence of default is identified.

The Bank applies uniform definition of default in all areas of credit risk management, including for the purposes of calculation of impairment losses, provisions and capital requirement. The default definition is based on the definition included in the CRR Regulation.

The Bank assumes that a default occurred in relation to given debtors, if at least one of the following events took place:

a) any of the exposures of a client against the Bank, Bank’s parent company is pas due by over 90 days and the overdue amount exceeds PLN 500 for retail clients and PLN 3000 for other clients,

b) deterioration of counterparty/transaction credit quality. The Bank recognises that the debtor probably will not fully fulfil its credit obligations against the Bank, parent entity of the Bank without actions of the Bank, such as implementation of a collateral, if such exists,

c) qualification of an entity to a default situation by the Bank’s parent entity.

In case of retail portfolio obtained in cooperation with mBank, exceeding of threshold amount of PLN 500 occurs when the total past due amount on all credit exposures of the debtor (overdue by over 31 days) exceeds PLN 500.

Reclassification of at least one liability of a client to the default category causes reclassification of all liabilities of the client to the default category.

The following indicate deterioration of credit quality of a client/transaction in accordance with the above definition:

a) preparation of a loss impairment as a result of significant deterioration of debtor's creditworthiness,

b) sale by the Bank of an exposure with significant economic loss associated with changes in its creditworthiness,

c) the Bank's permission for forced restructuring of credit liability, if it may cause reduction of financial liabilities through amortisation of significant part of the liability or deferring of payment of the principal amount, interests or - if applicable - commission,

d) filing by the Bank of a bankruptcy motion against debtor or filing similar motion in respect of credit obligations of the debtor towards the Bank, the parent of the Bank,

e) declaration of bankruptcy of a debtor or obtaining by the debtor of similar legal protection, causing avoidance or delay of repayment of credit liabilities against the Bank, Bank's parent company.

For portfolios of corporate loans, JST and other retail loans apart from hard evidence (specified above) that determine *default* event occurrence, the Bank identifies soft evidence. Occurrence of a soft evidence does not automatically cause necessity for classification as a default event. Soft evidences have supplementary nature. These are issues which Bank should additionally consider during analysis of the situation of the borrower and which may indicate its deterioration. If in the Bank's opinion identified soft evidence have significant meaning for a particular case, the Bank should proceed with an assessment whether a default event occurred regardless of lack of hard evidence.

10.2. Quantitative information

Specific and general credit risk adjustments

While determining the value of exposure, the Bank applies the following adjustments due to particular credit risk:

- adjustments regarding loss impairments of exposures of individual significance,
- adjustments regarding loss impairments of exposures that are not individually significant, determined within group assessment,
- adjustments regarding impairment losses incurred as a result of events that occurred, but were not reported yet (referred to as IBNR impairment losses) for an exposure without recognised impairment

Due to application of International Financial Reporting Standards, the Bank does not apply adjustments for general credit risk.

Retail portfolio obtained in cooperation with mBank S.A.

Calculation of impairment losses on balance sheet credit exposures and provisions on off-balance sheet credit exposures in parameters based on risk determined using methodology applied for advanced method of internal ratings (AIRB) on the basis of group models applicable in mBank Group (the Bank is a local user). Those parameters are subjected to adjustments that aim to fulfil applicable regulations.

Estimation of a provision for transactions which lost their value is made on the basis of LGD model for default clients which on the basis of historical data estimates future discounted recoveries conditioned by a type of transaction, the level of its security, the time the client is in a default state and occurrence of delay.

Retail loan portfolio, JST and other retail loans

The Bank calculated loss impairments on the basis of individual analysis (commercial and JST portfolio) and portfolio analysis (retail portfolio and those exposures from the commercial and JST portfolio for which no value loss was identified in the individual analysis).

In case of no evidence of impairment against credit exposure, in the portfolio analysis an impairment loss is calculated for incurred, but not identified losses.

The portfolio analysis covers all retail and commercial loans not covered by the individual analysis. The Bank applies estimated parameters for the purposes of impairment measurement specifying the rate of healing (ZLGD), indicator of faulty collaterals (BD) and indicator of relationship between recovery and the value of collateral (CCR), as well as individual for each exposure indicator of relationship between a debt and the value of collateral (LTV) used for determination of LGD in the portfolio analysis and additionally parameters PD and LIP. The Bank assumes that LIP amounts to 8 months for the commercial loan portfolio and 12 months for retail loans. PD parameter is currently determined using 3 year time series. LGD parameter is estimated on the basis of data from 2009, selection of the scope of data is made in order to ensure adequacy of estimation of the amount of impairment losses to current economic conditions. Each of separated portfolios has its own set of ZLGD, BD, CRR and PD parameters.

In case of finding of evidence of impairment, the Bank calculates impairment losses in the individual analysis for commercial and JST portfolio. The process of calculation in the individual analysis consists in:

a) determination of estimated future cash flows (repayments) both from collaterals and payments made by borrowers, including planned costs,
b) in the calculation of difference between balance sheet value of a given asset and current value of estimated profits and costs discounted with effective interest rate,
c) booking of impairment losses.

In case of evidence of impairment and individual analysis of a given credit exposure, not stating the loss of value, impairment loss is calculated on the basis portfolio parameters analysis.

In case of assets for which a permanent impairment was identified, the Bank executes stricter monitoring, e.g. revaluation of the mortgage lending value of the property constituting collateral of a loan.

Subjective distribution of exposures

The distribution of gross exposure of the Bank broken down by exposure classes and depending on the type of counterparty is presented below. The summary includes the division into the value of exposures for standard and IRB methods.

31.12.2015	Standardised Approach		IRB		Total		Average gross exposure in 2015**
	Gross exposure	EAD*	Gross exposure	EAD*	Gross exposure	EAD*	
Central governments or central banks exposures	757 623	757 623	-	-	757 623	757 623	827 283
Regional governments or local authorities exposures	92 693	360 855	-	-	92 693	360 855	101 276
Public sector entities exposures	53 624	-	-	-	53 624	-	55 870
Institutions exposures	249 355	249 355	-	-	249 355	249 355	119 914
Corporates exposures, of which:	214 391	-	5 258 901	4 398 532	5 473 292	4 398 532	5 346 497
- SME exposures	214 391	-	5 258 901	4 398 532	5 473 292	4 398 532	5 346 497
Retail exposures, of which:	173 117	160 256	-	-	173 117	160 256	182 457
- natural persons exposures	173 117	160 256	-	-	173 117	160 256	182 457
Secured by mortgages on immovable property exposures	2 663 342	2 614 921	-	-	2 663 342	2 614 921	1 936 202
- SME exposures	118 492	117 922	-	-	118 492	117 922	130 923
- natural persons exposures	2 544 850	2 496 999	-	-	2 544 850	2 496 999	1 805 280
Exposures in default	13 746	10 097	-	-	13 746	10 097	13 559
- SME exposures	7 409	5 568	-	-	7 409	5 568	7 221
- natural persons exposures	6 337	4 529	-	-	6 337	4 529	6 339
Equity exposures	8	8	-	-	8	8	8
Other non-credit-obligation assets	-	-	70 716	68 564	70 716	68 564	75 769

**EAD (Exposure At Default) - the value of exposure after application of credit risk mitigation techniques and application of credit conversion factors for off-balance sheet items*

***Average gross exposure in 2015 was determined as average exposure at the end of four quarters of 2015.*

The residual maturity breakdown

The summary of gross exposures per residual maturity dates broken down by applied methods and exposure classes within a method as at 31 December 2015 is presented below

	1D - 3M	3M - 6M	6M - 12M	1Y - 5Y	> 5Y	No term	Total
IRB approach	**55 522**	**75 168**	**88 581**	**1 344 712**	**3 694 918**	**70 716**	**5 329 617**
Corporates exposure - Specialised Lending	55 522	75 168	88 581	1 344 712	3 694 918	-	5 258 901
Other non-credit-obligation assets	-	-	-	-	-	70 716	70 716
Standardised Approach	**693 847**	**106 146**	**9 863**	**259 614**	**3 148 421**	**8**	**4 217 899**
Central governments or central banks exposures	478 982	99 276	2 070	177 295	-	-	757 623
Regional governments or local authorities exposures	16	100	5 175	17 697	69 705	-	92 693
Public sector entities exposures	-	-	102	-	53 522	-	53 624
Institutions exposures	209 173	4 920	-	10 229	25 033	-	249 355
Corporates exposures	-	-	2 375	11 416	200 600	-	214 391
Retail exposures	-	-	-	621	172 496	-	173 117
Secured by mortgages on immovable property exposures	20	45	112	40 295	2 622 870	-	2 663 342
Exposures in default	5 656	1 805	29	2 061	4 195	-	13 746
Equities exposures	-	-	-	-	-	8	8
Total	**749 369**	**181 314**	**98 444**	**1 604 326**	**6 843 339**	**70 724**	**9 547 516**

Impaired exposures and overdue exposure per client type

Client type	Gross exposures with impairment recognised	Specific credit risk adjustments for exposures with impairment recognised	Overdue gross exposures	Specific credit risk adjustments for exposures with impairment recognised
Cash and balances with the central bank	-	-	-	-
Amonuts due from other banks	-	-	-	-
Loans and advances to clients, in which:	204 295	83 051	372 281	83 594
Corporate clients	198 551	81 276	343 112	81 829
Individual clients	5 744	1 775	29 169	1 765
Public sector clients	-	-	-	-
Other receivables	-	-	-	-
Total	**204 295**	**83 051**	**372 281**	**83 594**

Impaired exposures and overdue exposure per client type broken down by countries

Client type	Gross exposures with impairment recognised	Specific credit risk adjustments for exposures with impairment recognised	Overdue gross exposures	Specific credit risk adjustments for exposures with impairment recognised
Poland	204 249	83 045	372090	83 588
Austria	46	6	46	6
Germany	-	-	145	1
Total	**204 295**	**83 051**	**372 281**	**83 594**

Reconciliation of changes of adjustments for impaired exposures

Change in adjustment amounts in 2015	As at 01.01.2015	Created	Release	Receivables write-offs	Other adjustments	As at 31.12.2015
Balance-sheet exposures	78 998	26 741	(7 698)	(15 069)	79	83 051
Off-balance sheet exposures	-	-	-	-	-	-
Total	**78 998**	**26 741**	**(7 698)**	**(15 069)**	**79**	**83 051**

11. Operational risk

By operational risk the Bank understand a possibility to incur loss resulting from inadequate or defective internal processes, systems, errors or activities undertaken by an employee of the Bank and external events.

While organizing the operational risk management process, the Bank takes into account regulatory requirements. Resolutions, as well as recommendations of the Financial Supervision Authority (in particular including Recommendation M) constitute starting point for preparation of the framework of control system and operational risk management.

The general principle of operational risk management in the Bank is its minimisation - limitation of causes of occurrence of operational events, reduction of probability of their occurrence and the severity of potential effects.

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.

mBank Hipoteczny is a specialised bank, established and operating on the basis of the Act of Covered bonds and Mortgage Banks. Its basic specialisation consists in ability to issue mortgage covered bonds and public sector covered bonds that constitute key sources of financing in the bank’s balance sheet. This specialisation determines limited product range of the Bank. The Bank offers mortgage loans for financing of real estates in two business lines - commercial banking and retail banking. The sources of client acquisition are: own sales conducted by specialised services of the Bank, sales via the branch network of mBank Group and sales via other sale channels.

For retail customers this process is implemented within the so called agency model in collaboration with mBank S.A. and within a pooling model, in the scope of which the Bank acquires mortgage loans granted by mBank S.A. that can constitute the basis for issuing of covered bonds.

With the introduction of retail lending, mechanisms of detection and operational risk management were launched in this area. The process of fraud detection and registration mechanisms and mechanisms of analysing errors in transactions and customer complaints was launched. The Bank observes all changes that influence the operational risk profile. So far the collected data do not indicate increasing of operational risk level in the retail banking line. As the portfolio of loans granted to natural persons develops, the increase of losses for retail banking business line may be anticipated, which, however, due to the nature of conducted activity, should not reach the distribution of the operational risk, typical for commercial banks. This phenomenon is subject to constant monitoring.
The Bank has Business Continuity Plan that was implemented and tested within implementation of Recommendation D.

Within classification of the Bank's activity, in accordance with the CRR Regulation, the following business lines are separated:

- Trading and sales,
- Commercial banking,
- Retail banking,
- Payments and settlement.

In 2015, 97% of actual losses were assigned to the commercial banking line. The sum of actual losses without recovery amounted to PLN 1 810 thousand. The largest operational loss in the reported period was assigned to the loss event category "Execution of transactions, delivery and operational processes management" in accordance with appendix no. 1 to Recommendation M of KNF regarding operational risk management in banks and the CRR Regulation.

Losses are monitored according to the following risk categories:

- Crimes committed by employees,
- Crimes committed by outsiders,
- Deliberate destruction,
- Staff habits and workplace safety,
- Customers, products and business practices,
- Natural disasters and public safety,
- IT irregularities,
- Execution, delivery and process management.

According to the above distribution, the largest losses in 2015 were incurred by the Bank due to the category - execution, delivery and process management.
With application of database, information on losses resulting from operational risk are recorded with a focus on the reason of their occurrence and analysing for necessary corrective actions.

12. Remuneration policy in respect of persons having significant influence on the risk profile of the Bank

Information on the policy of variable remuneration

Principles of establishing variable remuneration components of persons holding managerial positions, who have significant influence on the risk profile of the Bank are specified by "Policy for remuneration of persons having significant influence on the risk profile of mBank Hipoteczny S.A.", hereinafter referred to as "Policy", adopted by the Resolution of the Supervisory Board no. 27/2015 dated 26 June 2015. They were established on the basis of:

- Resolution No. 258/2011 of the Polish Financial Supervision Authority dated 4 October 2011 on detailed principles of functioning of the risk management system and internal control system and specific terms of assessing internal capital as well as the principles of determining a policy on variable items of remuneration of persons holding managerial positions in the bank, hereinafter PFSA Resolution No. 258/2011 and
- principles defined in directive of the European Parliament and of the Council 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (Capital Requirements Directive IV, CRD IV).

The purpose of adopted Policy is to support proper and effective risk management, provision of making decisions not burdened with excessive risk, i.e. risk going beyond accepted by the Supervisory Board willingness to take risks by the Bank and to support implementation of strategy and limitation of conflicts of interest.
The list of positions having significant influence on the Bank's risk profile including justification of their selection are specified in a separate document accepted by the Bank's Management Board and Supervisory Board - "Policy of identification of employees having significant influence on the bank's risk profile", corresponding to the requirements of Commission Delegated Regulation (EU) no. 604/2014 dated 4 March 2014 that supplements the directive of the European Parliament and Council 2013/36/UE in relation to regulatory technical standards in relation to quality criteria and appropriate quantitative criteria of determining of categories of employees, whose professional activity has significant influence on the risk profile of the institution.

The Supervisory Board is the governing body that supervise remunerations. In 2015 there were five meetings of the Supervisory Board. During the meeting held on 26 June 2015 the Policy in respect of persons having significant influence on the risk profile of the Bank and the Policy of identification of employees having significant influence on the Bank's risk profile were approved. The Bank did not use services of an external consultant while establishing the abovementioned Policies.

The most important information concerning the formation of remuneration

Variable remuneration includes bonuses granted to a member of the Management Board or other employees for a given financial year. Variable remuneration is established in a transparent manner, possible to verify, ensuring effective implementation of the Policy.
The maximum level of the amount of variable remuneration components of persons covered by the Policy may not exceed 100% of the basic remuneration paid to a given employee for a financial year.
Variable remuneration is part of total remuneration (annual basic remuneration and variable remuneration) for Management Board members or other employees. Variable remuneration is established taking into account market practices, in both banking sector and nationwide market, verified on the basis of market payroll reports and remuneration policy of the mBank Group.

A part of variable remuneration is paid in phantom shares. The number of phantom shares, which will be established for a member of the Management Board or other employee for a given financial year on the account of variable remuneration (both non-deferred and deferred part), constitutes a result of dividing the amount of the variable remuneration established in accordance with the Policy principles by the value of a phantom share at the end of financial year for which the remuneration is established.
The value of phantom share is the quotient of book value of the shares of the Bank and the number of ordinary shares, where the book value of the Bank is defined as: total assets reduced by total liabilities of

the Bank. The book value of the Bank and the number of ordinary shares are derived from the financial statement of the Bank for a financial year for which variable remuneration is granted after its previous approval by the Supervisory Board. The number of phantom shares can take fractional values and is rounded to 4 decimal places.

Members of the Management Board

The amount of bonus for particular members of the Management Board is established by the Supervisory Board which takes into account whether a member of the Management Board completed an established annual/multi-annual business and development objective - Management By Objective ("MBO"). The decision on granting of a bonus and its amount is the exclusive competence of the Supervisory Board which according to its own assessment and decision confirms achieving of MBO, taking into account situation on financial markets in the last/previous financial periods.

Variable remuneration is granted in accordance with the following rules:

1) 60% of the bonus amount is granted in the year following a given financial year (non-deferred bonus):
   - 50% in a form of cash payment,
   - 50% in a form of non-cash payment in phantom shares of the Bank.
2) 40% of the bonus will be deferred to three successive years in three equal, annual tranches. Bonus within each trench is granted to a member of the Management Board upon meeting of specified conditions, in an analogous manner as 60% of the bonus amount granted after the financial year for which the bonus is calculated, i.e.:
   - 50% in a form of cash payment,
   - 50% in a form of non-cash payment in phantom shares of the Bank.

Employees who are not members of the Management Board:

The Bank's Management Board executes an annual assessment, or an assessment covering longer periods, of an employee's work and if it deems that the employee completed an established annual/multi-annual business and development objective - ("MBO"), after considering the complete amount of the employee's remuneration, may make a decision that will establish the amount of so called discretionary bonus. The decision on granting of a discretionary bonus and its amount is the exclusive competence of the Management Board of the Bank which according to its own assessment and decision confirms achieving of MBO, taking into account situation on financial markets in the last/previous financial periods.

MBO is established by the Management Board of the Bank (objectives must result from objectives established for the Management Board of the bank - the principle of cascading of objectives to subsequent levels of management) for subsequent financial year within a term accordant with a schedule applicable for a given year. In accordance with principles of establishing of MBO business and development objectives adopted in the Bank:

- group quantitative objectives (at the Bank's level) constitute up to 20%,
- individual quantitative objectives constitute 65% to 90% of the objectives (objectives established depending on the responsibility of a given position, objectives cascaded by the member of the Management Board that supervises that position),
- individual quality objectives constitute up to 20% of the objectives.

Variable remuneration is granted in accordance with the following rules:

1) 60% of the bonus is granted in the year following the given accounting year:
   - 50% in a form of cash payment,
   - 50% in a form of non-cash payment in phantom shares of the Bank,
2) 40% of the bonus will be deferred to three successive years in three equal, annual tranches. The bonus under each tranche is granted to an employee upon meeting specific conditions, in the same way to the 60% of the bonus granted after the accounting year for which the bonus is calculated, i.e.:
   - 50% in a form of cash payment,
   - 50% in a form of non-cash payment in phantom shares of the Bank.

The costs resulting from the deferred tranches in the form of the shares are settled according to the IFRS.

Information on the criteria of performance assessment, which are the basis for the rights to the remuneration components

Members of the Management Board

Deferred tranches of the bonus granted for a given accounting year shall be issued for a member of the Management Board in three equal, annual parts.

The Supervisory Board may decide to suspend in whole or reduce the amount of deferred trench due to subsequent evaluation of work of a member of the Management Board in a term longer than 1 financial year (i.e. for a period of at least 3 years) which takes into account the business cycle of the Bank as well as risk associated with conducting activity by the Bank, but only when actions or omissions of a member of the Management Board had direct or negative impact on financial result and market position of the Bank in the period of assessment. The aforementioned assessment of the performance of member of the Management Board (over a longer period of time) will be made annually and communicated internally at the Bank, together with the assessment of the performance of the member of the Management Board for a given period.

The Supervisory Board may decide to suspend in whole or to reduce the amount of bonus for a given financial year, also in terms of deferred trench that has not been paid yet, in a situation referred to in Art. 142 (1) of the Banking Law Act. Suspending in whole or reduction of a bonus, as well as any deferred trench, may also relate to a bonus and/or deferred trench not paid to a member of the Management Board after expiration or termination of the management agreement.

Employees who are not members of the Management Board:

The deferred tranches of the discretionary bonus for a given accounting year will be issued for the employee in three equal, annual parts.

The Management Board of the Bank may decide to suspend in whole or reduce the amount of deferred trench:

- if it finds that in a longer-term (period of at least 3 years) an employee through its actions or omissions directly and negatively impacted financial result and market position of the Bank in the assessment period. In the assessment of actions or omissions of an employee the Management Board of the Bank takes into account e.g. results of the MBO assessment of the employee,
- in case of termination of an employment contract with the exclusion of reasons specified in the employment contract/internal regulations of the Bank.

The Supervisory Board may decide to suspend in whole or to reduce the amount of discretionary bonus for a given financial year, as well as in terms of Deferred trench that has not been paid yet, in case of a balance sheet loss or threat of its occurrence or a risk of insolvency or losing of liquidity by the Bank. Suspending in whole or reduction of discretionary bonus, as well as any trench Deferred by the Management Board of the Bank, may also relate to discretionary bonus or Deferred trench paid to an employee after expiration or termination of an Employment contract.

Main parameters and rules for determining of remunerations of persons holding managerial positions in mBank Hipoteczny S.A., including the manner of linking of the amount of remuneration with results in case of remunerations depending on the results

Members of the Management Board

The decision on granting of a discretionary bonus and its amount is the exclusive competence of the Supervisory Board which according to its own assessment and decision confirms achieving of MBO, taking into account situation on financial markets in the last/previous financial periods. The Manager, until the end of March of a financial year following the financial year for which the so called discretionary bonus is determined, will submit to the Supervisory Board a written report on implementation of MBO for a financial year for which a discretionary bonus is determined. MBO will be determined by the Supervisory Board in consultation with the Manager for subsequent financial year until 31 December of the year preceding the financial year.

Employees who are not members of the Management Board:

Variable remuneration for employees who are not members of the Board shall be granted by the Bank's Management Board, which on the basis of the results achieved under the annual/long- term business-development objective - Management By Objectives ("MBO" defined according to the aforementioned description), after taking into account the value of the total remuneration of an employee (i. a. comparison of the employee's remuneration to the market benchmark provided by an external company specializing in the development of such data), determines the amount of the so-called discretionary bonus. Bonus is not automatically calculated and its awarding and amount depend on a joint decision of the Management Board of the Bank.

This document presents the Policy for remuneration of persons having significant influence on the risk profile of the Bank that was approved in June 2015 and entered into force on 1 July 2015. Remuneration programmes that were in force in previous years which were not settled yet are described in the Bank's financial statements in Note 42.

Aggregated quantitative information on remuneration broken down into senior management and employees whose actions have significant influence on the Bank's risk profile:

Aggregated quantitative information regarding remuneration broken down into areas of activity (in PLN):

Business Line	Total renumeration (fixed + variable)
Bank's Management Board	2 971 881
Other employees	3 023 712
Total	**5 995 593**

Value of remuneration for 2015 broken down into fixed and variable remuneration as well as number of persons that receive it:

	Number of employees	Fixed renumeration	Variable renumeration	Total renumeration
Management Board members	4	2 371 800	600 081	2 971 881
Other employees	11	2 904 639	119 073	3 023 712
Total	**15**	**5 276 439**	**719 154**	**5 995 593**

Value of variable remuneration paid in 2015 broken down into cash and phantom shares (in PLN):

	Variable renumeration - cash payment	Variable renumeration - phantom shares payment	Total variable renumeration
Management Board members	270 000	330 081	600 081
Other employees	108 000	11 073	119 073
Total	**378 000**	**341 154**	**719 154**

In 2015 there were no persons employed in the Bank who received remuneration in the amount of at least EUR 1 million.

Value of remuneration with deferred payment broken down into part already granted and part that was not yet granted (in PLN):

	Variable renumeration with deferred payment - granted excecuted part in 2015 - shares	Variable renumeration with deferred payment - not granted part (not executed, not yet possible in 2015 - shares)	Variable renumeration with deferred payment - not granted part (not executed, not yet possible in 2015 - cash)	Total deferred variable renumeration
Management Board members	60 081	249 965	60 000	370 046
Other employees	11 073	81 200	120 000	212 273
Total	**71 154**	**331 165**	**180 000**	**582 319**

Value of remuneration with deferred payment granted in a given financial year, paid and reduced within adjustment associated with results (in PLN):

	Deferred variable renumeration from previous years granted in 2015	Deferred variable renumeration from previous years paid in 2015
Management Board members	60 081	60 081
Other employees	11 073	11 073
Total	**71 154**	**71 154**

Deferred variable remunerations owed for 2015 were not adjusted downwards due to risk.

No payments associated with taking up of an employment and termination of an employment occurred in 2015.