Management Board Report
on the performance of mBank Hipoteczny S.A.
in 2022

Official Management Board Report on Performance of mBank Hipoteczny SA in 2022 was prepared in accordance with the requirements of the ESEF. This document is not the official version of the Management Board Report on Performance of mBank Hipoteczny SA in 2022, but was prepared on the basis of the original prepared in the ESEF format and is a copy of it. 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.

Table of content

1. Introduction

mBank Hipoteczny SA (Bank, mBH) is a specialized mortgage bank, whose activity in 2022 focused on three key business areas:

(1) retail area, based in strategic cooperation with mBank S.A. (mBank) and acquiring residential mortgages for natural persons (retail loans) (retail pooling),

(2) refinancing area, in particular through issuance of mortgage covered bonds, securing stable and long term funding from capital markets for mBank Group,

(3) loan portfolio management area, aimed at legacy exposures i.e.: (1) JST portfolio - loans granted to municipalities and other entities benefiting from local government's guarantee, discontinued in 2012, (2) CRE portfolio - loans financing rent generating commercial real estate properties, discontinued in 2018 and portfolio of retail loans, originated directly before August 2013.

Bank's balance sheet size at the end of December 2022 amounted to PLN 13.2 billion, of which ca. 82.39% consisted of high quality retail mortgages acquired from mBank.

mBH (at the end of December 2022) issued PLN 5.27 billion of covered bonds, i.e. 30.5% of total covered bonds volume issued by Polish mortgage banks.

Financial standing assessment - rating

Financial creditworthiness of the Bank and its covered bonds has been assessed by international rating agency Moody's Investors Service Ltd.

As of reporting date following ratings were outstanding:

	Rating by Moody's Agency	Outlook	Date of decision	Decision
Long-term Issuer Ratings	Baa1	Stable	13-07-2021	Upgrading
Short-term Issuer Ratings	Prime-2	-	13-07-2021	Affirming
Long-term Counterparty Risk Ratings	A2	-	13-07-2021	Upgrading
Short-term Counterparty Risk Ratings	Prime-1	-	13-07-2021	Upgrading
Long-term Counterparty Risk Assessment	A2(cr)	-	13-07-2021	Upgrading
Short-term Counterparty Risk Assessment	Prime-1	-	13-07-2021	Upgrading
Mortgage Covered Bonds	Aa1	-	13-07-2021	Upgrading

COVID 19 pandemic

In 2022 mBH continued activities initiated in previous years aimed at guaranteeing safety for our clients and employees, facing COVID 19 pandemic and its consequences.

Bank offered support to its customers following the framework of Anti-crisis Shield 4.0, valid since 23 June 2020, where customers who lost employment or main source of income after 13 March 2020 were entitled to suspend repayment of their loans for up to 3 months without incurring interest. Such facility constituted a legal moratorium as per EBA Guidelines, and was available until local Act on crowdfunding and borrower support has been adopted. Through the year 2022

3 applications for such support have been received and 3 requests have been approved. Regarding retail exposure provisioning, Bank moves such exposures to stage 3 or (after fulfilling specified quality criteria) to stage 2. Such approach remains in accordance with the opinion of expert panel sponsored by KNF.

On 16 May 2022 state of pandemic on the territory of Poland has been abolished and replaced with the state of pandemic contingency, whereas remote working may still be mandatory. Due to improved pandemic condition Bank decided to introduce a requirement of mandatory on-site presence on 4 days in a month, later increased to 8 days a month (two days a week).

Bank's strategy

In December 2022, mBH adopted objectives for its operating strategy for 2023–2026, which is aimed at:

(1) acquisition of retail mortgages from mBank;
(2) financing them with regular issues of covered bonds;
(3) improvement of IT platform and data security;
(4) risk management;
(5) supporting organizational culture based on common values, ensuring respect for diversity, employee development and satisfactory work conditions.

Together with mBank, mBH is implementing a newly developed ESG agenda for the Group. The mBank Group is aware of its responsibility for the climate, society, financial standing of its clients and compliance with the declared ESG values.

Key projects

Carbon footprint and decarbonisation strategy of the mBank Group

In 2022, a project entitled "Carbon footprint and decarbonisation strategy of the mBank Group" was launched within the mBank Group. The project is carried out in cooperation with the Climate Strategies Poland Foundation. The aim of the project is to achieve carbon neutrality within scopes 1 and 2 (own emissions) by 2030 and scope 3 in categories 13 and 15 (portfolio emissions) by 2050.

Implementation of AIRB method

Bank continues to prepare the introduction of AIRB method, initiated in 2016. Filing the application to KNF is planned for 2026 after fulfilling formal conditions by the bank.

Definition of Default

The Bank prepared and implemented changes related to the entry into force of the European Commission regulation EU No 2018/171 issued pursuant to Article 178 of the Regulation No 575/2013 (CRR) on changes in the definition of default applied by banks.

Currently, works are in progress on the implementation of the ECB recommendations, including the implementation of the calculation of the number of days past due at the level of mBank Group for the purposes of identifying an indicator of overdue payments and the automation of the cross default process.

IBOR

In 2022, as part of the joint project of the mBank Group, the Bank continued its work on the implementation of solutions stemming from Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts, […] the so-called fallback clauses. Bank proposed annexes to loan agreements to customers who have loans granted in the agency model or obtained in the pooling model in cooperation with mBank.

Electronic Power of Attorney Flow

An application for electronic power of attorney flow at the Bank has been implemented. The application streamlines the circulation of powers of attorney and authorizations, the purchase of electronic signatures for the Bank's employees, and also enables reporting and ensures transparency of the process. Solutions adopted in the project allow for minimization of paper documentation that contributes to ESG strategy.

Implementation of the amendment to the Act on Covered Bonds and Mortgage Banks

8 July 2022 amended Act on Covered Bonds and Mortgage Banks came into force. The Act implements the provisions of common European law into Polish legislation. Project team developed and implemented changes to internal procedures and IT systems in order to successfully comply with new legal requirements.

Division by spin-off mBH

In 2022, intensive activities were carried out to prepare the mBH division plan. The Bank will be divided by transferring, to mBank, a portion of property (assets and liabilities) as well as rights and obligations of the Bank in the form of an organized part of the enterprise, which is an organizationally and financially separated set of tangible and intangible components within the existing mBH enterprise, related to granting and servicing loans, including:

(1) mortgage-backed loans for the financing of commercial real estate;

(2) loans granted to local government units or guaranteed by them;

(3) mortgage-backed loans granted to natural persons for purposes unrelated to business activity, in respect of which the loan agreement with the customer was concluded by 25 July 2013, meeting certain criteria

together with information systems dedicated to servicing the aforementioned loans and employees necessary to carry out such activities, tangible assets, rights and obligations related to conducting this activity, as well as other assets and liabilities necessary to carry out specific business tasks within the scope of such banking activity.

The division is planned for the second quarter of 2023, once the following conditions have been met:

(1) obtaining a permit of the Polish Financial Supervision Authority for the division of the bank, amendments to its Articles of Association and reduction of own funds;
(2) adoption of AGM resolutions of mBH and mBank on consent to the division.

Third formal condition, i.e. removal of the loans to be transferred from the cover pool, has been fulfilled in October 2022.

2. External environment

2.1. Macroeconomic and legal environment

The world economy is at a stage of limited activity. Several factors affect such economic slowdown:

(1) the continuing risk of increasing number of COVID-19 cases;
(2) problems with the supply chain;
(3) high prices of oil, food, and energy raw materials.

Russia's invasion of Ukraine sent shockwaves throughout the world. Its effects are caused by significant increases in energy prices and the uncertainty of energy supplies. These factors translate into record inflation levels, which amounted to 17.2% in September 2022.

In October 2021, the National Bank of Poland launched a cycle of interest rate raises. The total scale of increases in the reference rate of the National Bank of Poland reached 6.75 pp. (from 0.1% to 6.75%) by October 2022.

At the same time, the two key central banks, the FED and the ECB, are in the middle of a cycle of interest rate raises. At the FED, the primary rate may reach 4.6% in 2023, provided, however, that the situation in the U.S. labour market remains relatively stable.

A slowdown deepened by interest rate increases decreases the prospect of GDP growth in 2023 to just 0.4%. Inhibiting economic growth may lead to an increase in the unemployment rate and weakening of the labour market. Labour market dilution can reduce pressure on wage growth and, as a result, base inflation. In its long-term analyses, mBank expects a decline in inflation in 2023.

In the case of ending the cycle of interest rate raises, in combination with the continuing monetary tightening in developed markets, we can expect a negative impact on the PLN exchange rate against EUR and USD. The Polish currency will still be sensitive to the geopolitical situation in the region. Weak PLN will increase inflation in terms of imported goods, especially energy raw materials. Increased state expenditure (e.g. compensation of energy prices, expenditures of the defense sector, increased costs of public debt) may contribute to further increases in the profitability of Polish government bonds.

Concerns about recession in European economies and ideas on taxation of excess profits in the energy sector cause increased volatility on stock markets.

Due to the increased risk of insolvency of some groups of borrowers in an environment of rising interest rates, there are doubts as to the condition of the banking sector. The decrease in the sector's condition was influenced by the government's announcement of a general programme of borrower assistance introduced by the Act on social financing for business ventures and borrower assistance (the so-called loan vacation) of 7 July 2022. It enables suspension of repayment of a total of 8 loan instalments in 2022 and 2023. The financial effect of the so-called loan vacation was a one-off loss in the income statement of banks, which reduced the level of own funds. Lower own funds limit the possibility to absorb credit risk, other events burdening the financial result of banks, as well as develop the credit business.

The rising interest rates entail an increase in legal risk related to floating rate lending agreements. WIBOR has been adjusted to the requirements of the BMR, and WIRON will replace it in the future.

We are seeing a significant decrease in credit activity. This resulted from an increase in interest rates on mortgage loans and recommendations of the Polish Financial Supervision Authority. It recommends that banks apply a more conservative approach to assessing the creditworthiness of clients. According to the data published by BIK, the value of requests for retail mortgage loans fell as much as 72.9% y/y. mBank also recorded a decrease in acquisition. This translated into the sales value. If such a downward trend continues in the future on the mortgage loan market, it will affect the slower development of the volume of green assets intended for transfer to mBH. This limitation determines a lower potential to issue green covered bonds.

In July 2021, loans with a periodic fixed interest rate were added to the banks' offer. It was also possible to convert loans granted with variable interest rates into a fixed interest rate on a periodical basis. Rising interest rates increased interest in this product and in the conversion among banking sector clients. As a result of this trend, in the area of pooling, mBH will extend its activities by developing a temporary fixed interest rate loan transfer model.

Key macroeconomic indicators 2022–2023

	GDP (% y/y)	Individual consumption y/y	Investment y/y	Inflation rate (eop)	Unemployment rate (eop)	USD/PLN	EUR/PLN
2022 Q1	8,5	6,6	4,3	11	5,4	4,2	4,65
2022 Q2	5,5	6,4	7,1	15,5	4,9	4,48	4,7
2022 Q3	2	3,5	5	16,6	5,1	4,75	4,8
2022 Q4	0,3	4,5	3	16,6	5,5	4,85	4,9
2023 Q1	-2,3	4,2	-4	18,6	5,7	4,66	4,8
2023 Q2	-0,1	2,8	-2	15,6	5,6	4,57	4,8
2023 Q3	1,1	2,4	1	13,5	5,5	4,27	4,7
2023 Q4	2,1	2,5	3	10,8	5,9	4,11	4,6

Source: https://www.mbank.pl/pdf/serwis-ekonomiczny/raporty/mpc_092022.pdf

The Act of 7 April 2022 amending the Act on Covered Bonds and Mortgage Banks and certain other acts (Journal of Laws item 872) implemented Directive (EU) of the European Parliament and of the Council 2019/2162 of 27 November 2019 on the issue of bonds and public supervision and amending Directives 2009/65/EC and 2014/59/EU (CB Directive), pertaining to the principles of issuing covered bonds and the principles of activity of their issuers (mortgage banks). The Directive stipulated that on 8 July 2022 all laws and regulations implementing the CB Directive should already be in force in the member states. The aforementioned Act established that the provisions implementing the Directive would enter into force on 8 July 2022. The Act will not cause a significant change in the model of operation of mortgage banks in Poland; it focuses in principle solely on the issues of necessary implementation of the provisions of the CB Directive and does not take into account the broader postulates of mortgage banks as regards improvement of their operations. However, in line with the postulates of the mortgage bank environment, the level of statutory overcollateralisation of covered mortgage bonds was reduced from 110% to 105%, adequately to the requirements of Article 129 of the CRR, and the portfolio limit for credit exposures in which LTV exceeds 60% was eliminated (deletion of Article 13 paragraph 1 of the Act). From the organizational point of view, an important change for the better is the deletion from the Act of the obligation to disclose, in the land and mortgage register of the real property constituting the collateral, information on entry of the secured receivables in the register of collaterals of covered bonds. Removing this obligation will significantly reduce the administrative burden on mortgage banks and remove the necessity to incur the costs of entries and deletions of the information specified in the land and mortgage register.

To the extent resulting from the necessary implementation of the CB Directive, the following solutions have been adopted, among other things:

(1) a change in the principles of maintaining the liquidity buffer (Article 18 paragraph 3a), which is to include the surplus created from assets meeting the conditions set out in Article 18 paragraph 3c of the Act, in the amount not lower than the maximum cumulative net liquidity outflow in the next 180 days. The net liquidity outflow comprises outflows of payments due on a given payment date, including payments of the nominal value of covered bonds and interest under these covered bonds as well as payments arising from derivative instruments under the covered bonds issue programme, after deducting the proceeds from payments due on the same date under assets constituting a collateral for covered bonds;

(2) regulation of the rules and terms of participation of derivatives hedging currency and interest rate risk in the register of collaterals for covered bonds, concerning the documentation of these transactions, status and reliability of the counterparty, valuation of instruments as well as establishment of the requirement of non-termination of derivative instrument contracts in the event of bankruptcy or initiation of compulsory restructuring of a mortgage bank;

(3) introduction of definitions linking the terms contained in the Act on Covered Bonds and Mortgage Banks to those used in the CB Directive, such as the cover pool, introduction of labeling, which enables the investors to determine to which standard given covered bond conforms. Rules for using the name “European Covered Bond” for those covered bonds

which are fully compliant with the CB Directive and the "European Covered Bond (Premium)" for those that additionally meet the requirements imposed by Regulation 575/2013 (CRR) have been set.

(4) introduction of obligation:
   a. for the trustee to submit annual reports on their activity to the PFSA;
   b. for the mortgage bank to submit the information specified in Article 33c of the Act to the PFSA on an annual basis, no later than by 31 March, as at the last day of the previous year;

(5) detailed definition of the principles of supervision by the PFSA over the issuers of covered bonds, issuing consents for the covered bond issue programme, as well as the obligations of the PFSA itself as the authority supervising the issuers of covered bonds;

(6) introduction of statutory disclosure requirements on the issuer's website. The Bank performed disclosure on a voluntary basis based on the ECBC standard (HTT - Harmonised Transparency Template) before the Act entered into force. Currently the Bank performs dual disclosures based on HTT and statutory requirements;

(7) implementation of regulations on the imposition of penalties by the PFSA on issuers and persons acting on their behalf;

(8) clarification of the position of creditors of collateral derivatives entered in the register of collaterals for covered bonds in bankruptcy proceedings as equal to that of covered bond holders.

On 21 June 2022, a new Regulation of the Minister of Finance on conducting a collateralization analysis of covered bonds and coverage balance and liquidity tests was issued. It is of particular importance due to the need to adapt information systems to the new method of calculation.

On 1 January 2022, Recommendation Z of the Polish Financial Supervision Authority on principles of corporate governance at banks (hereinafter the "Recommendation") entered into force. The Recommendation is a set of good practices regarding the principles of internal governance of the bank, and its contents were developed taking into account the positions of European supervisory authorities from the banking sector and capital market. The provisions of the Recommendation supplement the documents developed so far by the PFSA in the area of internal governance in banks (including development and supplementation of Recommendation H and Recommendation M). The Bank has adjusted internal rules and procedures and processes to the requirements of Recommendation Z. In the second half of 2021, the Bank developed amendments to the aforementioned regulations in order to implement the requirements of Recommendation Z in a timely manner. On 13 October 2022, the Act of 9 February 2022 amending the Code of Commercial Companies Act and certain other acts (Journal of Laws, item 807, as amended) entered into force. The amendments to the Code of Commercial Companies needed to be implemented in the Bank's Articles of Association and in the By-laws of the Supervisory Board and By-laws of the Management Board. The relevant amendments have been made, however, as regards the Articles of Association, the Bank is awaiting the PFSA's approval of the content of the amendments.

As of 1 January 2022, also Recommendation R entered into force. In April 2021, the PFSA published an amended version of Recommendation R concerning the principles of credit exposure classification, estimation and recognition of expected credit losses and credit risk management. It is a set of principles and guidelines for the classification of credit exposures, estimation and recognition of expected credit losses in accordance with the accounting policy and credit risk management policy adopted and applicable at the bank. Principles and guidelines for the classification of credit exposures, estimation and recognition of expected credit losses and credit risk management do not include financial assets measured at fair value through profit or loss. Recommendation R includes provisions resulting from the entry into force, as of 1 January 2018, of International Financial Reporting Standard (IFRS) 9 Financial Instruments (in accordance with Commission Regulation (EU) 2016/2067 of 22 November 2016). Recommendation R constituted the basis for introducing changes to the principles of valuation of credit risk of credit exposures in the bank's internal regulations, including in the accounting policy, and its inclusion constitutes a change of estimates.

In the first half of 2022, as part of the joint project of the mBank Group, the Bank continued implementation of solutions stemming from Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts [...] (hereinafter — the BMR Regulation), with a view to introducing the so-called fallback clauses into contractual relationships with customers. On the basis of the Business Continuity Plan adopted at the Bank and the project schedule, the Bank started signing annexes to loan agreements for customers who had previously received offers of annexes until the end of 2021 (fallback clauses) and who have loans from own sales carried out by the Bank until 2013. In relation to customers who have loans granted under the agency model or acquired under the pooling model in cooperation with mBank, the Bank coordinated further project activities with mBank in the face of a significant and likely change in the legal environment, concerning replacement of WIBOR with another reference indicator. The probability of the so-called national competent authority (within the meaning of the BMR Regulation) establishing a replacement of WIBOR in the form of an indicator determined on the basis of the percentage calculated as a result of fixing of the POLONIA Reference Rate results from Article 85 of the Act of 7 July 2022 on Social Financing for Business Ventures and Assistance to Borrowers. The planned entry into force of the aforementioned act and the risk of occurrence of an event involving WIBOR resulted in the necessity to adjust the Bank’s Business Continuity Plan and adjust the draft annexes containing the fallback clauses, which were offered to customers in 2022.

The second quarter of 2022 was dominated by the so-called “credit vacation” announced by the government, works on the draft act on this matter, the process of issuing opinions, including by the Polish Bank Association, which drew attention in particular to the serious financial consequences for banks and the prospect of their losses. On 7 July 2022, the Act on Crowdfunding for Business Ventures and Assistance to Borrowers was adopted, which in Article 73 introduced the possibility for the consumer to use the so-called credit vacation, i.e. suspension of payment of four loan instalments in 2022 and four instalments in 2023 in relation to a mortgage loan taken out to satisfy their own housing needs. In total, it means 8 instalments over a year and a half; the principal remains to be repaid, but no interest is charged during the suspension period. This means actual losses for the bank, which both loses the agreed remunerations and incurs refinancing costs.

2.2. Mortgage covered bond market

Covered bonds are issued in 30 different European countries. The increased popularity of this instrument has exported it outside Europe. It became a global product, with issuers in such countries as: Australia, Canada, New Zealand, Singapore, South Korea, or Brazil.

For 20 years, the covered bonds market has been gradually developing in Poland, and the volume of outstanding bonds amounted to ca. PLN 18.3 billion (EUR 3.9 billion) as at the end of June 2022. This accounted for ca. 3.91% of the value of retail mortgage loans granted by banks in Poland (conclusions based on Bloomberg and PFSA's statistics). In comparison, in Hungary the ratio of the value of covered bonds in trading to the total amount of mortgage loans (both retail and corporate) amounted to 33% as at the end of 2021. On a macro scale, the most important markets for issuers of covered bonds are France, Germany and Canada, which jointly account for 59% of all issues of covered bonds denominated in euro in the period from the beginning of the year until May 2022.

The entry into force of the Act on Covered Bonds and Mortgage Banks of 29 August 1997 (the Act on Covered Bonds) resulted in the legal framework for the market for covered bonds. The Act provided the basis for the development of this market. According to it, the issuer of covered bonds is a specialized credit institution (mortgage bank), subject to supervision by the Polish Financial Supervision Authority.

The next amendment to the Act on Covered Bonds of 1 January 2016 contributed significantly to the improvement of the legal infrastructure for mortgage banking. In particular, it increased safety of the business activity and strengthened the rights of investors acquiring covered bonds. These changes adapted the Polish covered bond to the European market standards and the requirements of rating agencies.

On 8 July 2022, the Act implementing the Directive of the European Parliament and of the Council on the issue of covered bonds and public supervision over covered bonds (the so-called CB Directive) entered into force together with implementing acts. It introduced definitions combining the terms contained in the Act on Covered Bonds with those used in the CB Directive, such as the "group of underlying assets". The implementation of the Directive has also produced specific solutions:

(1) the principles of maintaining the liquidity buffer have been changed, which results in a decrease in its level in relation to the previous legal status;
(2) the required overcollateralization was adjusted to the CRR requirements. Its level was reduced from 110% to 105%, thus increasing the issue opportunities;
(3) the limit of receivables exceeding 60% of the mortgage lending value in the bank's portfolio has been abolished;
(4) the terms and conditions for participation of currency risk-hedging and interest rate risk-hedging derivatives were regulated in the register of collaterals for covered bonds.

Following the CB Directive, the act introduces the concept of "European covered bonds" and "European premium covered bonds". The introduction of the so-called labelling is intended to enable international investors to quickly determine what standards a given security matches. The solutions adopted result in Polish covered bonds being marked as a "European premium covered bond".

The position of creditors of collateral derivatives entered in the register of collaterals for covered bonds in bankruptcy proceedings was clarified as equal to that of covered bond holders. This is an important element eliminating legal uncertainty as to the derivative counterparties' positions.

The amendment to the Act eliminated the obligation to disclose the information on entering receivables in the register of collaterals for covered bonds in the land and mortgage register. This is an important and favourable change – it will reduce costs and administrative burden on mortgage banks.

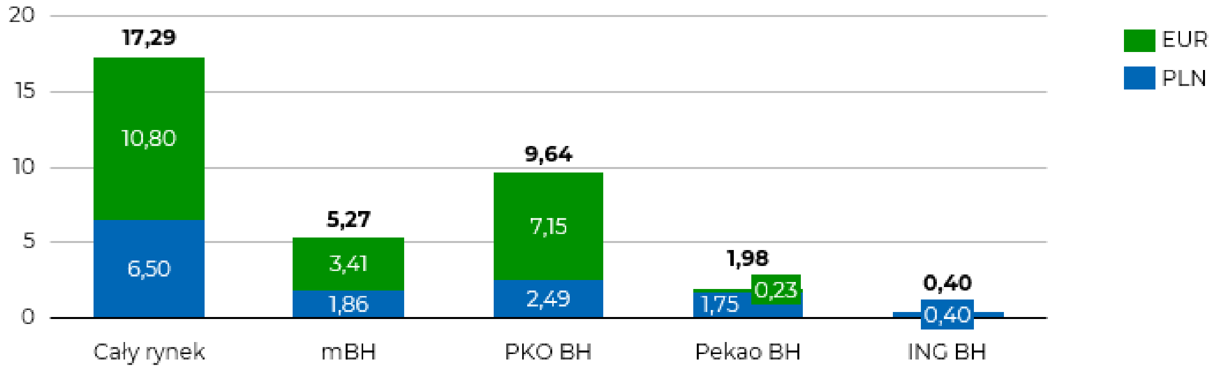
All the aforementioned legal changes allowed the growth of mortgage banking – five mortgage banks conducted mortgage covered bond issue activities in Poland in 2022: mBH, Pekao Bank Hipoteczny, PKO Bank Hipoteczny, ING Bank Hipoteczny, and Millennium Bank Hipoteczny. Banking groups with mortgage banks in their structures represent 65% of the mortgage loan market.

It will be very important to build a credible image and better recognition of mortgage banks in the markets, thanks to, among other things, international certificates such as "The Covered Bond Label". It confirms the high quality of covered bonds offered and high standards in terms of information transparency.

Another key issue for mortgage banks is to support the Sustainable Development Goals. This will translate in a positive way into the development and well-being of the society. On the other hand, this will allow banks access to investors for whom the ESG objectives (E – Environment, S – Social Responsibility, G – Governance) are one of the key criteria for cooperation.

Until 30 June 2022, three mortgage banks (mBH, PKO Bank Hipoteczny, ING Bank Hipoteczny) have established issue programmes under which covered bonds are listed on foreign markets through the stock exchange in Luxembourg. Covered bonds issued on the basis of these programmes are intended mainly for institutional foreign investors.

Mortgage covered bonds of Polish banks in domestic and foreign trades as at 31 December 2022.



Source: Financial statements of Polish mortgage banks and information on issuance.

For more than 23 years, we have been holding an important position on the Polish covered bonds market. We set the state-of-the-art standards and market practices.

As at 30 December 2022, our covered bonds valued at PLN 5.27 billion were publicly traded. This translated into a market share of 30.5%.

We have implemented a ground-breaking and innovative model of cooperation with mBank in the Polish banking sector. It consists in building the retail mortgage loan portfolio refinanced by covered bonds. In this way, we confirmed our pioneering and strategic role – we set the directions for further development of the covered bonds market in Poland.

Other mortgage banks replicated the pooling model developed by us, but they were created under the assumption of a light organizational and technological structure. mBH will strive to develop an effective business model in the next few years. This is an important part of our strategy.

We are actively looking for investors on the domestic and foreign markets. We want to maintain our issue readiness. Therefore:

(1) we maintain relations with institutional investors, relevant market entities (rating agencies, dealers, stock exchanges), in particular thanks to the support and brand recognition of mBank and Commerzbank. We want to conduct issues at all times, including in the event of tensions and economic crises;
(2) we maintain financial and organizational infrastructure.

The limited demand for covered bonds in Poland results from the lack of systemic incentives for long-term savings:
(1) decrease in assets under the management of OFE;
(2) low popularity of IKE, IKZE, as well as PPK and PPE;

(3) MIFID restrictions on transactions with natural persons;
(4) the need for a banking tax to be paid by financial institutions, which significantly reduces the profitability of investments;
(5) low profitability of using letters in repo or loan repo transactions with the National Bank of Poland;
(6) the lack of the NBP covered bonds buy-back programme;
(7) competition in the form of debt securities issued by banks in order to meet MREL/TLAC requirements (very difficult to estimate at this moment).

The alternative to the domestic market is the European one, where central banks are active in the context of covered bonds. For example, as part of the CBPP3 programme, the ECB focused a portfolio of nearly EUR 300 billion (as of April 2022).

Historically, we have proven that we are able to place the issued bonds on the European market. Our strategy continues to assume that we will be able to organise issues of this kind. However, the regulatory environment is unstable and temporarily recorded a high level of excess liquidity of the Polish banking market. Therefore, there are periods in which we issue the majority of our covered bonds as a non-public offering.

We understand what our role is in the Group. Therefore, we maintain issue readiness, we have an adequate level of collateral in the form of adequate credit quality, and the necessary infrastructure.

The Group and, consequently, we aim at issuing only debt instruments with allocation for ESG purposes. The growing importance of green covered bonds among investors, for whom ESG factors are important, provides an opportunity to develop the Polish market for green covered bonds.

2.3. Residential property market

In the residential property market, 2021 was marked by high activity both on the supply side and on the demand side. The beginning of 2022 was dominated by a gradual decrease in demand caused by the continued increases in interest rates by the Monetary Policy Council, as well as changes resulting from the recommendations of the Polish Financial Supervision Authority with regard to a more conservative approach to creditworthiness calculation (increase in the prudential buffer concerning the change in interest rates from min. 2.5 pp. to min. 5 pp.). As a result, the number of newly signed credit agreements, according to the data of Amron Sarfin, amounted to 86.17 thousand at the end of June 2022, which represented a decrease by approx. 30.6% year-on-year. The value of newly granted mortgage loans amounted to nearly PLN 30.5 billion, which means a decrease by approx. 24.0% y/y. The outlook for the credit market in 2022 is strongly correlated with the uncertainty factors regarding the future economic, pandemic and fiscal situation, as well as the situation in Ukraine and possible economic implications of this conflict. Russia's invasion of Ukraine contributed to the outflow of Ukrainian employees from Poland, increased prices of fuel, electricity and other raw materials, and consequently, to increased investment costs.

In the first half of 2022, more flats were commissioned than in the previous year, which was the result of a large number of projects commenced after the market slowdown at the turn of 2020/2021. The number of flats for which construction permits were issued or pre-construction notifications were made with a construction project and the number of flats whose construction has commenced decreased.

In the first half of 2022, sales of residential premises by developers operating in the six[1] largest domestic markets dropped by ca. 49.7% y/y and amounted to ca. 19.6 thousand premises at the end of June this year. The highest level of sales was recorded in Warsaw (approx. 5.8 thousand flats) and the lowest in Łódź (approx. 1.8 thousand flats).

In the new supply, apart from the investments held for actual sale, there were a lot of investments which have been prepared for many months but, given the reduced demand, they were not put up for sale in the previous period. These investments appeared mainly in the last days of June this year, so that their further sale could be carried out on the terms and conditions applicable prior to 1 July this year, i.e. without the need to meet the requirements of the new Development Act. In fact, these premises will be put up for sale either at the end of the year, or in the first quarters of the next year. In this situation, the number of flats whose sale formally started in Q2 this year proved to be very high: more than 19 thousand, but in real terms, only about 11.5 thousand can be treated as actual new supply. As a result, the new supply from the period between January and June of this year was estimated at about 25 thousand premises.

At the end of Q2 this year, the share of flats completed in 2022 was relatively high, although slightly lower than at the end of Q1 this year (approx. 29% vs approx. 35%) in the offer structure, according to the project completion date declared by the developer. Flats with the planned completion date in 2023 accounted for ca. 44% (approx. 48% in Q1 this year). The offer of flats with the planned commissioning date in 2024 and later significantly increased (27%, ↑by 10 pp. q/q), which may indicate the aforementioned response to the entry into force of the amendment to the Development Act, i.e. these flats being still subject to the pre-amendment rules.

Despite a visible decrease in the number of the agreements concluded, prices of flats continued to grow in the first half of the year. However, a slowdown in the average price of flats sold is visible, especially in Warsaw, Gdańsk, Wrocław, in Q2 this year, which may be reflected in the pricing policy in the next quarters.

The average transaction price per 1 sqm., on the primary market in H1 2022, for nine major cities[2] increased by approx. 18.2% y/y. The highest average transaction price on the primary market at

[1]Due to the data availability, the analysis was based on 6 cities: Warsaw, Łódź, Krakow, Poznań, Wrocław and Tricity.

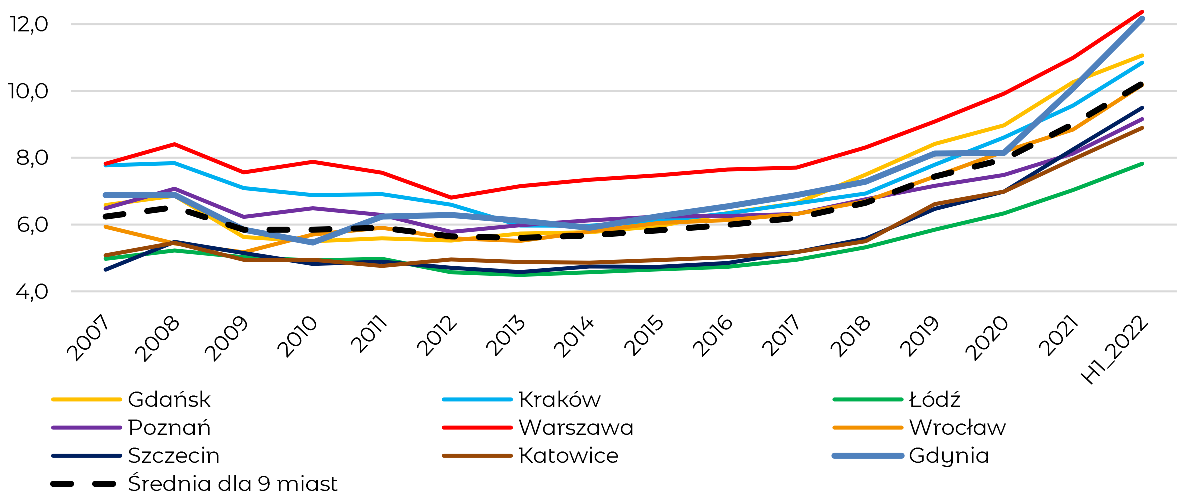
[2]The analysis was based on 9 cities: Warsaw, Krakow, Gdańsk, Gdynia, Wrocław, Łódź, Poznań, Szczecin and Katowice, with the largest market share.

the end of June this year was recorded in Warsaw and amounted to ca. PLN 12.3 thousand/sqm., and the lowest transaction price in Łódź was ca. PLN 7.8 thousand/sqm.

The highest average increase in transaction prices per sqm. was observed in Gdynia (↑by approx. 26.0% y/y) and in Szczecin (↑by approx. 22.6% y/y), and the lowest increase in Gdańsk (↑by approx. 10.4% y/y), in Poznań (↑by approx. 15.3% y/y) and in Warsaw (↑by approx. 15.9% y/y).

The change in average transaction prices on the primary market in 9 largest cities of Poland in the period between 2007 and H1 2022 is presented below.

Transaction prices on the primary market (in PLN '000/sqm.)

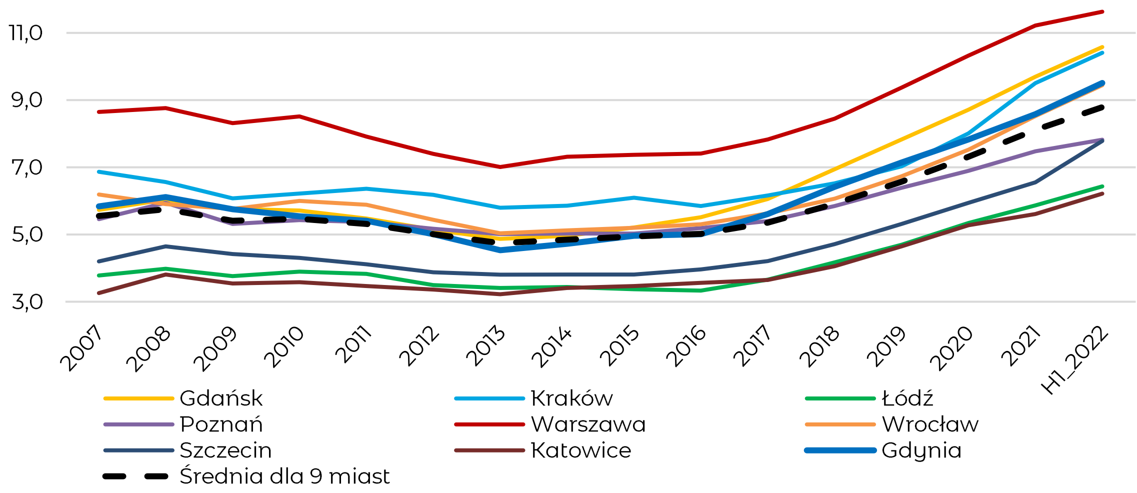


Source: National Bank of Poland, prepared by mBH

The survey of average transaction prices per sqm. in H1 2022, for nine major cities on the secondary market, showed an increase of around 12.8% year-on-year. The highest dynamics was recorded in Szczecin (↑by ca. 24.5% y/y), Gdynia (↑by ca. 14.8% y/y) and in Łódź (↑by ca. 14.5% y/y). The lowest price increase on the secondary market was recorded in Warsaw (↑by approx. 5.3% y/y) and in Poznań (↑by approx. 6.3% y/y). The highest average transaction price on the secondary market at the end of June this year occurred in Warsaw and amounted to ca. PLN 11.6 thousand/sqm., and the lowest transaction price in Katowice was ca. PLN 6.2 thousand/sqm.

The change in average transaction prices on the secondary market in 9 largest cities of Poland in the period between 2007 and H1 2022 is presented on the chart below.

Transaction prices on the secondary market (in PLN '000/sqm.)

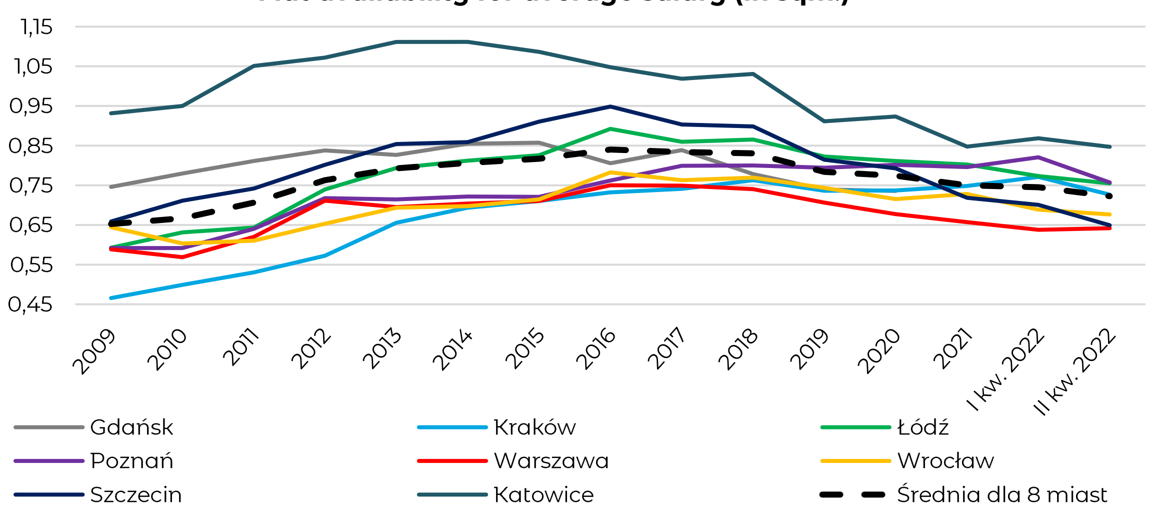


Source: National Bank of Poland, prepared by mBH.

At the end of June 2022, the rate of flat availability deteriorated in most of the cities analyzed due to continued high prices of flats and, at the same time, a slower increase in salaries.

Cities with the highest rate of flat availability were Katowice with ca. 0.85 sqm. (↓0.1% y/y), Poznań with ca. 0.76 sqm. (↓4.9% y/y) and Łódź with ca. 0.75 sqm. (↓6.0% y/y). The lowest level of the flat availability rate stood at ca. 0.64 sqm. (↓2.4% y/y) in Warsaw and ca. 0.68 sqm. (↓7.0% y/y) in Wrocław. The average rate for 8 cities under analysis was approx. 0.72 sqm. at the end of June 2022. The details can be found below.

Flat availability for average salary (in sqm.)



The exposure period[3] required to sell all the flats available in the current offer extended to approx. 3.5 quarters at the end of June 2022. The shortest time of the offer sell-out occurred in Warsaw (about 3.0 quarters) and the longest one in Łódź (about 4.1 quarters).

The most sought flats were the premises from the so-called popular segment (with 2 or 3 rooms). Daily experiences during the pandemic indicate a change in the preferences of buyers and increased interest in flats with a larger number of rooms, with terraces/balconies or gardens, in well-connected suburban locations or outside agglomerations.

The main factors affecting the residential property market will be as follows:

(1) a decrease in the demand for flats in the context of high interest rates, increased loan costs and a substantial weakening of the creditworthiness of persons applying for financing at banks,
(2) rising inflation, slowdown of the growth rate of real wages, deterioration in the availability of flats,
(3) uncertainty as to the domestic and global economic situation, uncertainties related to the ongoing war in Ukraine, risk of economic downturn, concerns about the financial and professional future of prospective buyers,
(4) continued high rates of flat rental, e.g. due to the housing needs of war refugees from Ukraine, increased demand for flat rental from persons who have no creditworthiness after the tightening of the credit policy by banks,
(5) suspension, staging of new housing investments in the context of high supply in progress and continued high housing construction costs, with the inability to transfer this increase to housing prices in a situation of a weak demand, a decrease in the profitability of new projects,
(6) development of institutional lease in major agglomerations – possible further transactions between developers and institutional clients in order to maintain liquidity and stability of sales, in exchange for the abandonment of a part of the margin resulting from the sale of a larger package of flats.

2.4. Mortgage loan market

NBP data indicate a large growth potential for residential mortgage loan market in Poland. As of end of June 2022, Polish banks held total PLN 512.2 billion worth of mortgage assets, which translates into 4,6% increase against previous year. PLN denominated loans amounted to PLN 404.3 billion or 78,9% of total mortgage loan volume and increased by 7.1% y/y. Total residential mortgage balance to market price GDP ratio amounted to 18.9% at the end of first quarter 2022, that is significantly below EU average of ca. 40%.

[3] Exposure period – the time of sale counted as the number of flats in the offer at the end of the quarter in relation to the average sales from the previous year.

3. Financial results

3.1. Key financial ratios

	31.12.2022	31.12.2021
ROA net[1)]	-2.33%	0.15%
ROA gross[1)]	-2.81%	0.23%
ROE net[3)]	-23.52%	1.48%
ROE gross[4)]	-28.35%	2.37%
Cost to income ratio (C/I)[5)]	56.91%	50.76%
Net interest margin[6)]	1.04%	1.10%
Cost of risk[7)]	0.37%	0.17%
Total Capital Ratio	15.71%	18.73%

1) net result / average assets, 2) gross result / average assets, 3) net result / average equity, 4) gross result / average equity, 5) (overhead costs + amortisation and depreciation) / total income (defined as net interest income + net fee and commission income + net trading income + other operating income - other operating expenses + other income), 6) interest income / average earning assets ,7) net write-downs for impairment of credit and loans (excluding impact of credit guarantee) / average balance of credits and loans granted to clients

Statement on financial situation

In PLN thousand	31.12.2022	31.12.2021	Dynamics
ASSETS	**13,177,225**	**12,981,822**	**1.51%**
Loans and advances to customers (at amortized cost)	11,468,142	11,608,275	-1.21%
Loans and advances to customers (at fair value through profit or loss)	100,822	120,205	-16.12%
Financial assets at fair value through other comprehensive income	1,171,608	732,393	59,97%
Other assets	436,653	520,949	
LIABILITIES AND EQUITY	**13,177,225**	**12,981,822**	**1.51%**
Debt securities in issue	6,581,915	7,603,677	-13.44%
Amounts due to banks	5,544,817	3,959,446	40,04%
Share capital	884,631	884,631	0.00%
Other liabilities	165,862	534,068	-68,94%

Total assets as of 31 December 2022 amounted to PLN 13.2 billion, which translates into only 1.5% increase relative to end of 2021. Such small balance sheet growth, despite execution of PLN 2 billion pooling plan, results mainly from recognizing credit vacation provision in valuation of retail mortgage portfolio and unusually increased level of prepayments on this portfolio. Additionally, in 2022 commercial real estate portfolio amortized due to scheduled and early repayments.

On liabilities side, outstanding mortgage covered bond balance at the end of December 2022 was 13.4% lower than in December 2021, due to redemption of 5 tranches of covered bonds with total value of EUR 120 million and PLN 1 000 million and new issue of 2 tranches worth PLN 700 million.

3.2. Profit and loss account

In PLN thousand	2022	2021	Dynamics
Net interest income	132,104	139,723	-5.45%
Net fee and commission income	(8,515)	(7,790)	9.31%
Net trading income	18,534	(145)	+/-
Net income on modification	(350,659)	(2,796)	+/-
Net impairment write-downs on loans and advances	(36,821)	(2,401)	1433.57%
Overhead costs	(64,981)	(51,445)	26.31%
Amortization and depreciation	(14,406)	(13,264)	8.61%
Operating result	**(333,461)**	**61,235**	**+/-**
Tax on the Bank's balance sheet items	(32,221)	(31,063)	3.73%
Gross profit	**(365,682)**	**30,172**	**+/-**
Income tax	62,304	(11,370)	+/-
Net profit	**(303,378)**	**18,802**	**+/-**
Weighted average number of ordinary shares / weighted average diluted number of ordinary shares	3,360,000	3,360,000	0.00%
Net profit per ordinary share / Diluted profit per ordinary share (in PLN)	-90.29	5.60	+/-

In 2022 Bank's results were impacted mainly by:

(1) Credit vacations – negative impact on net interest income of PLN 351.9 million
(2) Increased provisioning – by PLN 40.2 million vs 2021 - due to: (a) collateral value changes, (b) developments in existing and new execution/bankruptcy proceedings and (c) changes to model risk parameters (recalibration and updates to macroeconomic forecasts),
(3) Contributions to BFG resolution fund and Borrower Support Fund, which were substantially higher than in 2021 and amounted to PLN 19.6 million (vs. PLN 9.2 million in 2021)

In 2022 Bank's revenue, calculated as total of interest income, fee income, trading income, other operating revenues and costs, amounted to PLN 139 680 thousand (in 2021: PLN 130 272 thousand). This revenue is sourced solely from activities on the territory of the Republic of Poland.

4. mBH operations

4.1. Lending

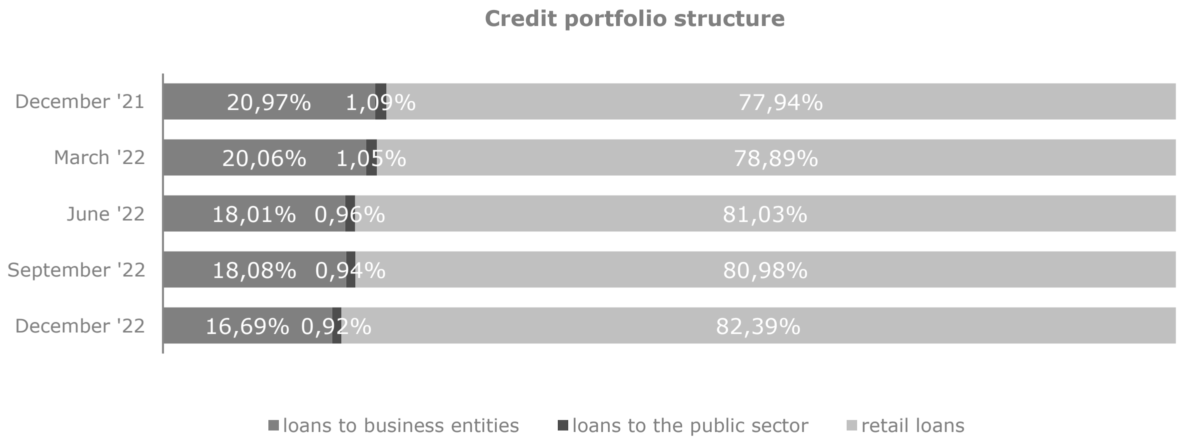
mBH operating model, consequently implemented since 2013, is mainly based on outsourcing of several activities under outsourcing agreements.

Two major contracts covering two key Bank activity segments, i.e. retail portfolio and CRE portfolio, have been signed in 2014 and 2018 respectively. They define the process of acquisition of retail loans and rules of post-sale servicing, support of credit risk management process and delivery of IT systems for both portfolios.

Based on the agreement of 2014, mBH pooled in 2022 seven tranches of retail loans for total amount of PLN 2 billion, systematically increasing their share in loan book of the Bank.

Share of CRE and JST loan portfolio (serviced directly by mBH) decreases according to adopted strategy, and will fall to zero as a consequence of spin-off planned for 2023.

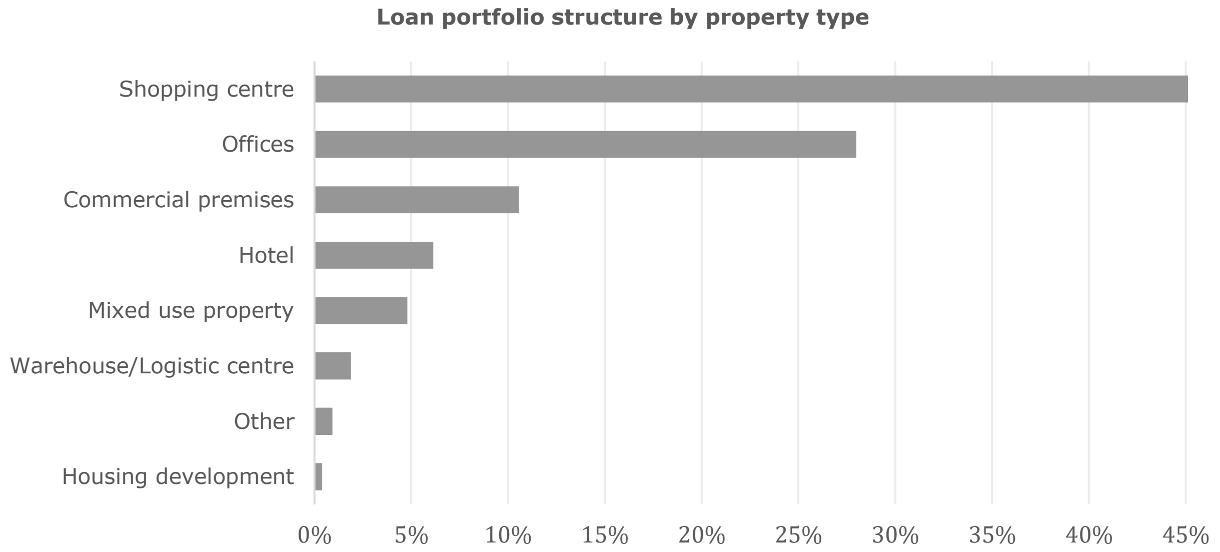
The structure of the loan portfolio



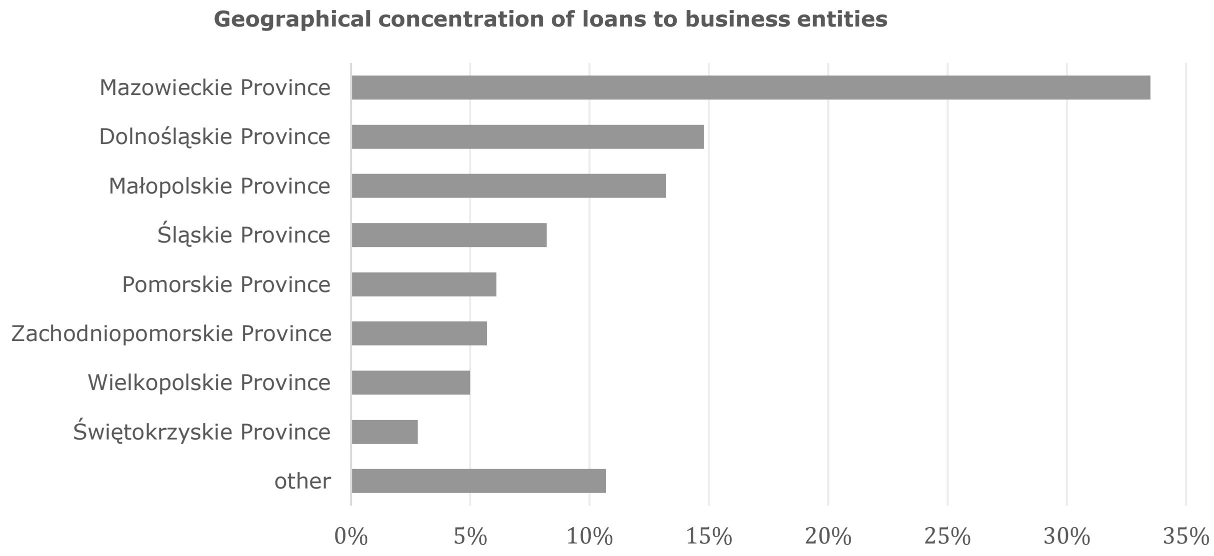
Corporate loans

As stated in the strategy, the Bank focuses on managing the existing portfolio, which is subject to regular reduction in connection with scheduled and early repayments.

Net balance sheet exposure to business entities amounted to PLN 1,923.1 million. The dominant part (98.2%) accounted for refinancing of completed commercial facilities, the exposure in housing projects constituted 0.40%, and credits for financing of construction of commercial objects 1.4%.



In the area of commercial real estate the Bank's portfolio consists of loans financing in particular shopping centers and office buildings.



The largest number of financed projects is concentrated in Mazowieckie province, where 33.5% of all credit resources is involved. In Dolnośląskie, Małopolskie and Wielkopolskie province the total balance sheet exposure accounts for 36.2%.

As of the reporting date loans granted in EUR (74.3%) and PLN (25.1%) dominated the corporate loans portfolio.

Public sector loans (JST)

As stated in the strategy, this portfolio does not contain new agreements, which in connection with significant prepayments is reflected in a lower, as compared to 31 December 2021, balance sheet exposure to public sector. As at the reporting date the exposure was PLN 106 million (down by 17.2%).

Retail loans to natural persons

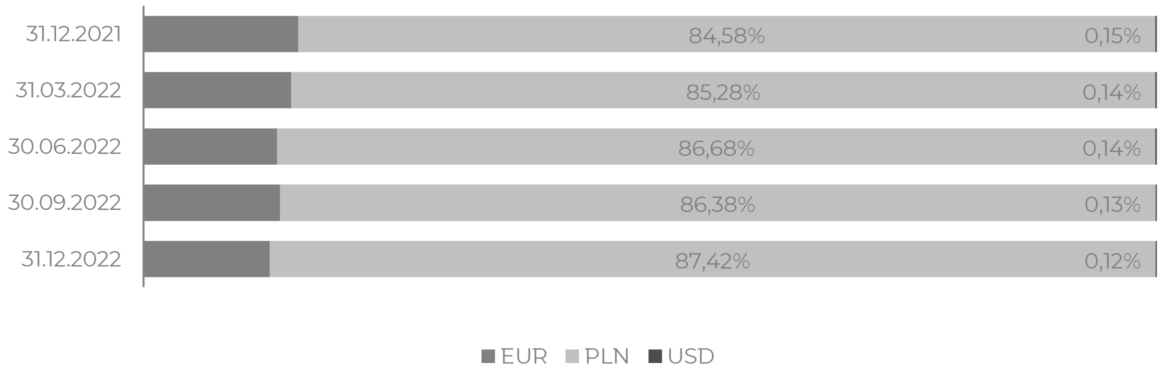
In 2022, the Bank's activities in the area of retail loans focused on acquiring new retail assets via the pooling model. The Bank actively cooperated with mBank with the aim to develop the product and maximize sales of retail loans at the side of mBank, meeting the requirements of transfer to the Bank. The pooling process currently in place allows assets to be transferred in monthly cycles.

Loan portfolio currency structure

The currency structure of the loan portfolio changed. Compared to the end of 2021, the share of loans in PLN rose by 2.84 percentage points and as at the end of 2022 they accounted for 87.42% of the loan portfolio. The share of loans in EUR amounted to 12.46%.

The Bank was not involved in any activity outside the Republic of Poland.

Loan portfolio currency structure



4.2. Covered bond issuance and refinancing

Third key activity area of the bank is securing funding by issuance of covered bonds.

mBH is a mortgage bank with the longest history of issues of covered bonds on the Polish capital market. The value of outstanding mortgage covered bonds issued by the Bank as at the reporting date was PLN 5.27 billion, which accounts for 30.5% of the total market, which amounts to approximately PLN 17.3 billion.

In 2022, the Bank issued two series of covered bonds in a prospectus-free offer, with the total value of PLN 700 million. As at the reporting date, the value of mortgage covered bonds issued by the Bank in a prospectus-free offer amounts to PLN 1.3 billion.

The Bank covered bonds are instruments that carry low investment risk, resulting from the statutory requirement of multi-tiered security of their issue and trade.

Issues of mortgage bonds of the Bank in the public offering

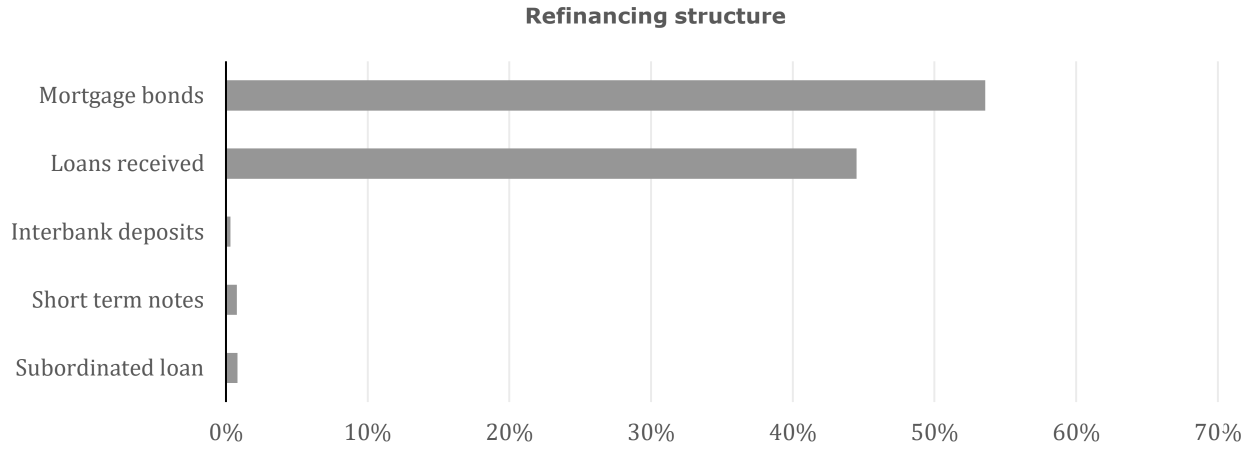
Issue date	Redemption date	Currency	Value	Rating Moody's Investor Service Ltd.
04.08.2014	20.02.2023	PLN	200,000,000	Aa1
15.04.2015	16.10.2023	PLN	250,000,000	Aa1
11.10.2017	15.09.2023	PLN	1,000,000,000	Aa1
22.06.2018	10.06.2024	PLN	310,000,000	Aa1
22.02.2019	20.12.2028	PLN	100,000,000	Aa1
TOTAL		**PLN**	**1,860,000,000**	
Issue date	**Redemption date**	**Currency**	**Value**	**Rating Moody's Investor Service Ltd.**
28.02.2014	28.02.2029	EUR	8,000,000	Aa1
17.03.2014	15.03.2029	EUR	15,000,000	Aa1
30.05.2014	30.05.2029	EUR	20,000,000	Aa1
24.04.2015	24.04.2025	EUR	11,000,000	Aa1
28.09.2016	20.09.2026	EUR	13,000,000	Aa1
26.10.2016	20.09.2026	EUR	35,000,000	Aa1
01.02.2017	01.02.2024	EUR	24,900,000	Aa1
26.04.2018	05.03.2025	EUR	300,000,000	Aa1
12.11.2019	15.09.2025	EUR	300,000,000	Aa1
TOTAL		**EUR**	**726,900,000**	

Issues of mortgage bonds of the Bank in the prospectus-free offer

Issue date	Redemption date	Currency	Value	Rating Moody's Investor Service Ltd.
03.09.2021	03.09.2026	PLN	100,000,000	n/a
10.09.2021	10.12.2026	PLN	500,000,000	n/a
24.02.2022	10.09.2027	PLN	500,000,000	n/a
22.06.2022	22.06.2027	PLN	200,000,000	n/a
SUMA		**PLN**	**1,300,000,000**	

In 2022 the Bank issued unsecured bonds with the total value of PLN 35 million.

As of the reporting date, the Bank held 2 issued series for the total amount of PLN 95 million. The Bank's offer includes zero-coupon bonds and coupon bonds denominated in PLN with a maturity of over 1 year.



The loans and advances received relate to the territory of Poland, while the outstanding mortgage covered bonds issued are publicly traded and it is not possible to determine the territorial structure of the refinancing in this respect.

The following table present information on the Bank's loan agreements entered into in 2022.

Contracts signed

Contract date	Repayment date	Interest rate	Currency	Amount
06.05.2022	31.12.2027	fixed	PLN	250,000,000
26.07.2022	26.07.2027	floating	PLN	300,000,000
TOTAL				**550,000,000**

On 6 May 2022, the Bank signed a loan agreement with mBank for the amount of PLN 250 million at a fixed interest rate, then on 19 December 2022 the Bank signed an annex to the agreement, thereby increasing the amount of exposure to PLN 400 million and extending the loan repayment term until 31 December 2028.

On 26 July 2022, the Bank signed a loan agreement with mBank for the amount of PLN 300 million at a variable interest rate.

The basis for issuing of covered bonds

According to the Act on covered bonds and mortgage banks, the basis for the issuing of mortgage covered bonds are receivables entered into the cover register for mortgage bonds, secured by mortgages established on the right of perpetual usufruct or the right of ownership of the real estate entered into the land and mortgage registry as the first item.

As of the reporting date the collateral of mortgage covered bonds consisted of receivables of value PLN 8,130.33 million from total number of 32,403 loans granted to retail customers.

Additionally to the credit receivables, treasury bonds of nominal value of PLN 270 million and CIRS with nominal value of EUR 300 million were also entered into the mortgage cover register.

By the end of October 2022 all loans subject to spin-off to mBank planned for 2023 have been withdrawn from cover pool.

The level of over-collateralization (including substitute cover) of mortgage covered bonds amounted to 29.8%.

The Bank raises funds for the lending activity predominantly through issuing of covered bonds and subsequently through issuing short-term bonds and received loans, mainly from the interbank market.

5. Risk management

The risk management process is defined and regulated by strategies, policies and procedures adopted by the Management Board and approved by the Supervisory Board.

The Bank manages all identified types of banking risk and carries out ICAAP (Internal Capital Adequacy Assessment Process) and ILAAP (Internal Liquidity Adequacy Assessment Process) processes, whereby:

(1) the risk management process is appropriate to the scale of operations and the materiality, scale and complexity of a given risk and is constantly adapted to new factors and sources of risk,

(2) risk management methods, models, their assumptions and systems are adjusted to the scale and complexity of the risk and are periodically verified and validated,

(3) the organizational structure of risk management ensures the independence of the risk area,

(4) the risk management process is integrated with planning and controlling processes and supports the implementation of the Bank's strategy, while maintaining compliance with the risk management strategy, in particular with regard to the level of risk tolerance,

(5) the risk management process is consistent with the mBank Group's risk management principles, including the use of group risk models adapted to the specific nature of the Bank's operations.

The Bank's risk management system consists of:

(1) risk identification,
(2) risk measurement or assessment,
(3) risk control,
(4) risk forecasting and monitoring,
(5) risk reporting,
(6) management activities.

Risk management is supervised by the Bank's Supervisory Board, which regularly receives information about the risk profile and the most important activities undertaken in the area of risk management.

The Management Board of the Bank is responsible for risk management, including supervision and monitoring of activities undertaken by the Bank in the area of risk management. The Bank's Management Board takes the most important decisions affecting the Bank's risk level and adopts internal regulations regarding risk management.

The Bank discloses in the Financial Statements and the Management Board's Report, on an individual basis, information in accordance with the provisions of the CRR Regulation and Recommendation M, in particular concerning:

(1) its own funds,

(2) compliance with capital requirements,
(3) use of credit risk mitigation techniques,
(4) capital buffers,
(5) financial leverage,
(6) use of credit risk adjustments,
(7) the current remuneration policy for persons having a material impact on the risk profile,
(8) operational risk,
(9) use of the IRB Approach to credit risk.
(10) Liquidity coverage ratio (LCR), liquidity buffers and net liquidity outflows.

Detailed information on the scope of information disclosed, the manner of its verification and publication is contained in the document Information Policy of mBH on capital adequacy and other information to be disclosed, available on the Bank's website (https://www.mhipoteczny.pl).

5.1. Credit risk

Loan portfolio

The principles for granting loans have been specified in the Bank's Credit Policy and the management of existing loan portfolio is done mainly through current monitoring of credit exposures.

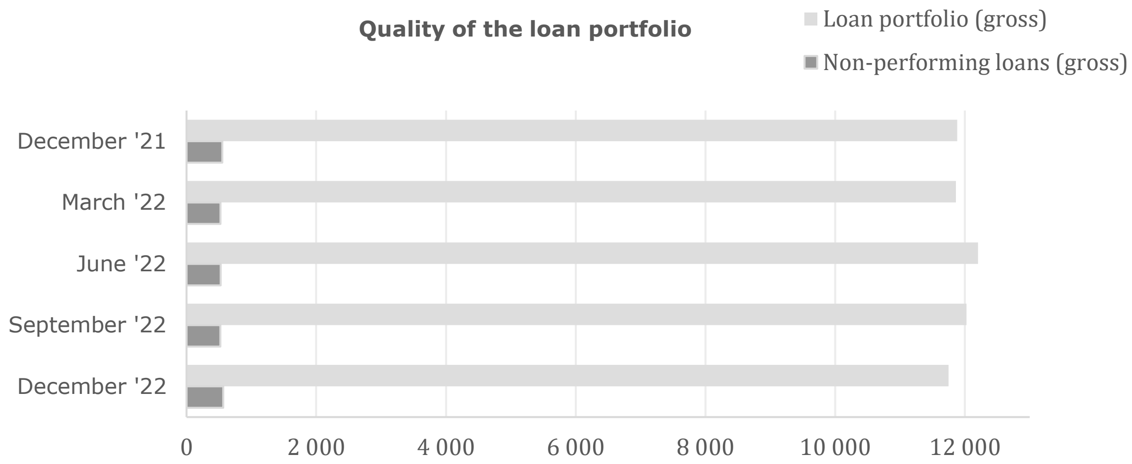
The share of non-performing loans in the loan portfolio increased in 2022 from the level of 4.71% to 4.81%. Most of the loans are repaid in a timely manner, and the borrowers of higher risk profile are subjected to a more strict monitoring.

Since 29 July 2022, as part of the government support for borrowers, retail clients have been able to take advantage of the so-called "credit holidays" and suspend the repayment of loan instalments for a single loan agreement denominated in Polish zlotys (PLN) for 2 months in the third and fourth quarter of 2022 and for one month in each of the four quarters of 2023. As at 31 December 2022, out of the 93% of the eligible retail loan portfolio, 71% of loans were covered by credit holidays. This portfolio is subject to separate monitoring.

Impairment provisions (including the adjustment to the fair value and CEIR) reaching PLN 192.4 million together with mortgages on the financed real estates in the total amount of PLN 18 327 million constitute an appropriate security against potential losses resulting from credit risk.

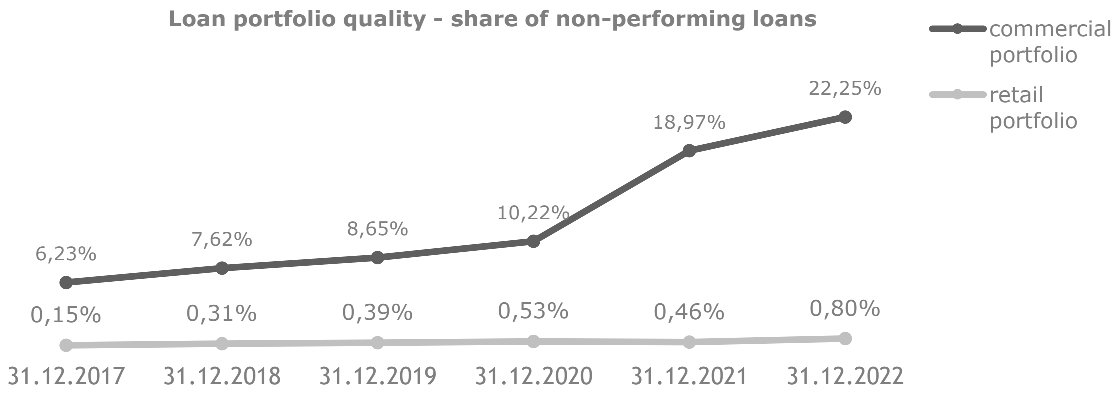
The level of NPL coverage with provisions amounted to 31%.

Non-performing loans* in the loan portfolio (gross value, in PLN million)



* non-performing loans – loans classified in basket 3 or POCI, in accordance with IFRS 9

The retail portfolio is characterised by very high quality, which results from the applied credit policy (until the moment of transferring the whole process of selling retail mortgage loans to mBank), the risk criteria that the Bank has defined for loans purchased through pooling from mBank as well as the fact that this portfolio is young (the average age of contracts in this portfolio is 5,3 years). As of the reporting date there were only 266 loans with reported loss of value. Loans for natural persons are monitored monthly for timely repayments and correctness in terms of established effective mortgage collaterals. Realisation of all contractual obligations of the client is verified in the same monitoring period (including insuring of the real estate and assignment of the rights under insurance policies).

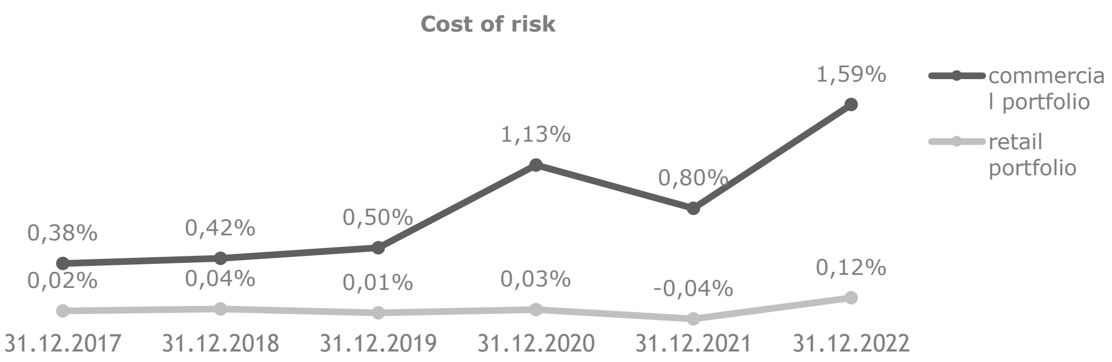


*retail portfolio – the portfolio of loans granted in cooperation with mBank. (agency portfolio) and the portfolio acquired from mBank (the pooling portfolio)

The share of non-performing loans in the commercial portfolio remained high due to the discontinuation of acquisition of new commercial assets (and thus a decrease in the size of the commercial portfolio) and defaults of subsequent borrowers in 2022.

The cost of risk is a material indicator observed by the Bank. This value increased compared to 2021. The cost of risk in commercial portfolio is remained high in 2022 due to cumulative impact of armed conflict in Ukraine, rising interest rates and delayed impact of the pandemic on the market for office facilities.

In the commercial portfolio, the increase in the cost of write-downs is a result of increased additional write-downs for loans in default due to changes in the value of collateral and the development of situations under enforcement/bankruptcy proceedings. In the case of the retail portfolio in 2022 there was a cyclical increase in write-downs due to an increase in the LGD parameter (caused by increases in interest rates), recalibration of models and a systematic increase in the balance of portfolio with indication of impairment caused by a natural cycle of portfolio maturation.



*retail portfolio – the portfolio of loans granted in cooperation with mBank. (agency portfolio) and the portfolio acquired from mBank (the pooling portfolio)

Credit risk management

The Bank assumes that the level of credit risk will be maintained in line with the risk appetite defined by the target level of capital adequacy and exposure limits. At the same time the objective of the credit risk management is ensuring the quality required by the Act on covered bonds and mortgage banks for individual exposures in order to utilise them to the greatest extent as a basis for issuing of covered bonds.

Following a change in the model of the Bank's activity in the commercial area financing, the Bank concentrates exclusively on the management of the existing portfolio of commercial loans without developing it.

Rating system

<u>Specialised financing portfolio</u>

The Bank obtained permission to apply the IRB approach to the portfolio of specialised financing for commercial real estate (SPL). To analyse the credit portfolio, the Bank uses rating models that are annually updated and regularly reviewed by the validation unit and the internal audit. Currently, rating systems cover 99% of the total sum of the risk-weighted credit exposures in line with the standardised approach, taking into account portfolios covered by the phasing-in plan, and 34% without taking into account those portfolios. The difference results from the fact that 65% of the total sum of exposures weighted using the standardised approach are retail exposures acquired as part of the cooperation with mBank, which are currently covered by the phasing-in plan for the IRB approach approved by the Polish Financial Supervision Authority (KNF), and in the future, the Bank intends to seek the consent of the competent supervisory authorities to use statistical methods to calculate regulatory capital requirements regarding this portfolio's credit risk.

In the area of commercial loans, the Bank uses a rating model based on the supervisory criteria defined for specialized lending in Commission Delegated Regulation (EU) 2021/598 of 14 December 2020 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council (hereinafter referred to as: Regulation) with regard to regulatory technical standards for assigning risk weights to specialized lending exposures.

Ratings analyzing the structure of transactions apply to financing carried out:

(1) using "project finance", where in principle, the borrower is a special purpose vehicle (SPV),

(2) for various types of transactions relating to finished commercial facilities (both for the purchase of immovable property by an SPV and shares in SPVs, and for refinancing of a finished facility owned by an SPV based in the Republic of Poland), as well as the financing of their construction.

For the purpose of determining the risk parameters of exposures classified as specialised lending (FN), the Bank applies supervisory regulations and parameters which define the requirements for the use of supervisory risk weights. These requirements in particular apply to:

(1) the need to take into account the risk factors indicated by the Supervisor;

(2) distinguishing 4 categories of risk for non-defaulting obligors and one category for defaulting obligors, and;

(3) the use of risk weight values and expected loss (EL) values for exposures classified as specialised lending;

Exposures are assigned to the relevant supervisory categories following a risk assessment of the transaction using the defined supervisory categories.

The distribution of exposures by supervisory categories is presented in the table below.

KNF category	Gross exposure	Off-balance-sheet	Average CCF	EAD post-CRM and post-CCF	Number of contracts	RWA	Average RWA (%)	EL
1	10,057	0	0	10,057	3	7,040	70.00%	40
2	1,345,391	0	0	1,345,391	109	1,158,830	86.13%	9,723
3	233,543	0	0	233,543	28	268,574	115.00%	6,539
4	4,632	0	0	4,632	1	11,580	250.00%	371
5	485,044	0	0	485,044	32	0	0.00%	242,522
Total	**2,078,667**	**0**	**0**	**2,078,667**	**173**	**1,446,025**	**69.57%**	**259,195**

With regard to the portfolio covered by the IRB approach, the rating model used in the SPL area is subject to a monitoring process conducted at least annually by model Owners who are independent of model Users. The monitoring includes analyses at the level of individual cases as well as portfolio analyses. More frequent verification of the rating system by model Owners depends on the occurrence of factors (internal and/or external) that may have a significant impact on the value of the model's component parameters. The efficiency of elements of the rating system is also assessed on a current basis by model Owners with regard to loans for which default has occurred.

The rating model for the SPL portfolio is also subject to annual validation that is executed by the Validation Unit, which is independent of the units responsible for creation, modification and use of rating models at the Bank. The validation of the rating system for the specialised lending area is qualitative and quantitative. The qualitative validation includes, among other things, assessment of principles of model creation, examination of theoretical correctness and appropriateness of implementation of rating models, analysis of the quality of the data used for model creation. Within the quantitative validation, the functioning of the model in terms of the discriminatory power of the model and the stability of the model are primarily assessed.

The rating system of the SPL area is also subject to annual reviews of the Bank's rating systems. As part of the review, the Internal Audit Position assesses corporate governance, the segmentation rules and the correctness of determining the capital requirement, the stress tests used in the capital adequacy assessment, the integrity of the rating process, the credit risk mitigation methods and the data quality management process.

<u>Retail portfolio acquired in cooperation with mBank</u>

For the purpose of assessing the credibility of a retail customer who has a mortgage-backed credit product as well as of monitoring/reporting credit risk for this portfolio, group credit risk models are used, of which the Bank is a local user. Detailed terms and conditions as well as the scope of cooperation between the Banks with regard to group risk models are stipulated in provisions of a separate agreement on risk management cooperation. The capital requirement for credit risk for this part of the portfolio is calculated using the standardised approach because as at 30 June 2022 it is included in the phasing-in plan.

The following models being part of the rating system are used in the retail banking area:

(1) the Loss Given Default (LGD) model. In this model, loss is defined as a function depending on the level of recovery from the customer's own repayments and the possible value of the collateral on the real estate, realised during the enforcement proceedings,

(2) the Credit Conversion Factor (CCF) model. This factor is an integral element of the EAD model (CCF as the degree to which off-balance-sheet liabilities have been met by the customer
on the date of the default),

(3) the Probability of Default (PD) model, which is a model integrating the models functioning in the retail banking area – application, behavioural and models based on the external data from the Credit Information Bureau (BIK).

Description of the factors that influenced the expected losses in the previous period

In the commercial portfolio the amount of expected losses was higher than in the corresponding period of the previous year.

As part of setting up provisions for the corporate portfolio in 2022, the Bank regularly updated the PD parameter and responded on an ongoing basis to any symptoms of deterioration in the financial situation of borrowers under baskets 1 and 2. Similarly, within the portfolio of restructured loans and loans under debt collection, the level of allowances was updated due to changes in the value of collateral and developments under enforcement/bankruptcy proceedings. The increase in the cost of allowances, as compared to 2021, results from higher additional allowances for commercial loans in default situations.

In the case of the retail portfolio acquired as part of cooperation with mBank, the reason for the key changes in the value of allowance was changes in the models used for the calculation of expected credit risk losses.In 2022, the Bank made the following significant changes in the models used to determine the expected credit risk losses:

(1) implementation of a new behavioural card as part of the PD 12M model, the associated PD LT and TL calibrations for the indications of this model. The estimated impact of the change on the level of expected loss was -0.61 million (positive impact on the result),
(2) update of macroeconomic indicators used in models, taking into account changes in macroeconomic scenarios in the ratio of non-linearity of projections. The estimated impact of these changes on the level of expected credit loss will amount to approx. PLN +2 million (negative impact on the result)
(3) periodic re-calibration of PD LT and LGD LT models. The estimated impact of these changes on the level of expected credit loss amounted to approx. PLN +2.3 million (negative impact on the result),
(4) update of macroeconomic indicators used in models, with the inclusion of changes in macroeconomic scenarios in the ratio of non-linearity of projections. The estimated impact of these changes on the level of expected credit loss amounted to approx. PLN +0.56 million (negative impact on the result).

Lawsuits brought by the Bank, insolvency proceedings

In the second half of 2022, the bankruptcy relating to two loans of two companies personally linked by a shareholder and the President of the Management Board declared on 26 April 2019, was economically concluded (the Bank was satisfied for the amounts of PLN 12,383,410.02 and PLN 1,280,228.68 respectively).

On 29 January 2019, the Bank filed a petition for bankruptcy in a commercial case where the loan is collateralized with residential units in Plewiska near Poznań. On 17 April 2019, the Court declared bankruptcy in the case in question and appointed a receiver. On 14 December 2022, the Court approved a composition that stipulated satisfying the Bank for a total amount of PLN 11 million. The Bank is currently waiting for the Court's decisions to become final and for the disbursement of funds under the composition.

One of the Clients who was in the process of restructuring filed a petition to open simplified Covid composition proceedings (under Shield 4.0). On 25 August 2020, the Client announced the opening of the proceedings in question in the Court and Commercial Gazette. As the composition had not been accepted, the proceedings were discontinued. Subsequently, in December 2020, the Client filed two petitions with the Court - for the opening of recovery proceedings and for bankruptcy. On 8 January 2021, the Bank also filed a petition for bankruptcy of the Client. On 27 May 2021, the Court declared bankruptcy. The decision is final. The receiver seized the real property over and evaluated it. In January 2022, the Bank complained against that valuation. On 20.06.2022, the Court issued a decision allowing part of the Bank's objections regarding the description and evaluation. On 19 September 2022, the Court announced the closing of the description and evaluation of the business, against which the Bank filed a complaint on 5 October 2022. By way of a decision dated 3 November 2022, the Court dismissed the Bank's repeated objections. By way of a decision dated 29 November 2022, the Court approved the terms of the tender, i.e. the deadline for the submission of bids being set on 7 February 2023 and the bid opening date of 14 February 2023. The case is pending.

On 16 December 2020, a company (a shopping centre owner) published a declaration in the Court and Commercial Gazette on the opening of simplified Covid composition proceedings (under Shield 4.0). On 15 April 2021, the company submitted composition proposals with the Court. On 13 October 2021, the Court issued a decision approving the composition, which became final on 21 November 2021. In December 2021 and 2022, the company repaid instalments under the composition. The implementation of the composition is in progress. The company, in agreement with the Bank, commenced the sale of the shopping centre in order to repay the loan.

In one of the cases, the Reprivatisation Commission issued a decision which resulted in the closing of the land and mortgage registers kept for five real properties encumbered with mortgage in favour of the Bank.

The Bank complained against the decisions of the Reprivatisation Commission which resulted in the borrower losing the ownership of the premises mortgaged in favour of the Bank (credited), which puts loan repayment at risk (rent for the lease of premises constituted the source of loan repayment), as well as the mortgage itself (loan collateral).

Both decisions challenged by the Bank were annulled with the judgements of the Regional Administrative Court in Warsaw dated 17 March 2021, while the Bank's complaints were dismissed on the grounds of lack of legal interest. The Reprivatisation Commission and the Bank submitted cassation appeals in respect of both judgements; currently, there is no information on the date of hearings before the Supreme Administrative Court.

The Bank's complaints regarding the notification on the closure of the land and mortgage registers of the mortgaged real property were dismissed, following which the judgements in question were annulled. After the case was referred to the Court of 1st Instance, the complaints were dismissed again, following which the judgements in question were annulled again. The case is pending and the Bank is taking the steps necessary to reinstate the collateral.

Notwithstanding the above steps, the Bank has requested an entry of mortgage on the primary property from which individual units were separated (there was no reason for the mortgage to expire, therefore, the primary land and mortgage register should still contain relevant entries if the land and mortgage registers for individual units were closed). So far, the request has not been examined.

So far, no order has been issued regarding submission of the cassation appeals filed by the Reprivatisation Commission and the Bank against the aforementioned judgement of the Regional Administrative Court in Warsaw of 17 March 2021, Case file No I SA/Wa 1448/18. Proceedings concerning cassation appeals against the judgement of the Regional Administrative Court in Warsaw of 17 March 2021, Case file No I SA/Wa 1454/18 are conducted before the Supreme Administrative Court under Case file No I OSK 989/22.

On 31 May 2022, the Bank filed a petition for bankruptcy of an debtor in a commercial case in which two commercial premises located in Warsaw constitute the collateral. The case has been at the restructuring stage so far. on 23 June 2022, the notice of the petition was published in the National Register of Debtors. On 14 November 2022, an interim court supervisor was appointed in the case and prepared a report on the company's financial standing (filed with the Court on 19 December 2022).

On 25 May 2022, the Bank filed bankruptcy petitions for three companies with personal ties. Two companies are the Bank's borrowers, the third one — a limited debtor due to accession to the Bank's borrower's debt. On 31 May this year, the National Register of Debtors recorded bankruptcy petitions of these entities. On 16 November 2022, interim court supervisors were appointed in the cases. On 28 December 2022, the Court established receivership in one of the companies. In the other cases, the Bank is expecting the establishment of receivership. The Bank obtained enforcement clauses in the form of notarised declarations of submission to enforcement under Article 777 of the Code of Civil Procedure. Due to pending bankruptcy proceedings – it did not initiate the enforcement.

In the second half of 2022, 7 lawsuits were filed in the area of retail loans for a total amount of PLN 2,327,276.05. Six cases are at the judicial stage; in one case an enforcement title has been issued and the case is currently at the enforcement stage. In the second half of the year, there were 4 total repayments in the area of retail loans.

In the second half of 2022, in the commercial area, the Bank did not file to the Courts any new lawsuits or petitions for bankruptcy regarding commercial debtors, other than those mentioned above. In the second half of the year, two of the bankruptcy proceedings were economically concluded. The Bank is currently waiting for a Court decision to discontinue the bankruptcy proceedings in the aforementioned cases. One loan was also repaid in full at the restructuring stage.

Sale of receivables to the Securitisation Fund

In July this year, two commercial receivables were sold to the Securitisation Fund. The value of credit exposures covered by the sale was PLN 27,188,284.75.

Attempts to sell receivables in a public tender in the second half of the year:

On 7 November and 18 December 2022, the Bank posted press announcements of the sale of 7 commercial receivables for a total amount of EUR 11,172,128.75 and PLN 10,920,158.60.

5.2. Market risk

The risk of loss resulting from adverse changes of market parameters from the point of view of the term structure of items in the portfolio of the Bank is maintained as low as possible, which results from the nature of the Bank's activity, properly functioning system of risk limitation and managing of the risk at the operational level.

In order to limit the market risk, the Bank adjusts the currency and term structure of acquired sources of financing to the structure of loans, uses linear plain vanilla derivatives and concludes spot or forward currency transactions and FX SWAP transactions.

The amount of market risk the Bank is exposed to in the day horizon is determined using Value at Risk (VaR) method at the confidence level of 97.5%. As of the reporting date VaR amounted to PLN 4,703.10 thousand. The currency risk was PLN 373.52 thousand, the interest rate risk was PLN 3,546.66 thousand and the credit spread risk was PLN 2,671.66 thousand.

The interest rate risk results from exposure of the financial result and the Bank's capital to adverse effect of interest rates changes. The Bank manages the interest rate gap through matching the repicing dates of assets and liabilities. The sensitivity of the Bank's portfolio to interest rates fluctuations is determined on the basis of results of stress tests and scenario analyses. According to data as at the reporting date, the decrease in the economic value of the bank's equity (EVE) in relation to the bank's own funds was 2,78%. Interest rate risk is also measured in relation to the bank's net interest income. Earnings at Risk (EaR) and Net Interest Income (NII) ratios reached 2.02% (EaR) and 5.40% (NII), respectively. The bank portfolio items exposed to interest rate risk are hedged with linear interest rate derivatives.

The currency risk is limited through immediate closing the foreign exchange position. The measurement of scale and structure of currency risk is done on the basis of the current foreign exchange position taking into account anticipated repayments and disbursements of loans. The currency risk is limited using foreign exchange position limits for each currency.

5.3. Liquidity risk

When organising liquidity risk management processes, the Bank complies with legal requirements and includes supervisory recommendations, in particular PFSA Recommendations and EBA Guidelines on liquidity risk management.

The Bank has a set of procedures, adapted to the scale and profile of the Bank's operations, defining the process and setting a framework for managing the liquidity risk. The roles and responsibilities in the liquidity risk management process, the manner of measuring, monitoring, limiting, managing and controlling liquidity risk, and the principles of setting and updating the limits are all defined. In order to secure the Bank's liquidity, in the event of stress conditions of an internal, external nature or their combination, a surplus of high quality unencumbered liquid assets is maintained in case the negative scenarios materialise (Liquidity reserve).

In the rules of conducting stress tests, the Bank took into account the rules for the development of liquidity stress tests scenarios. By conducting the stress tests, the Bank assesses the potential change in liquidity risk exposure in particular time frames of the liquidity gaps and the ability to cover the refinancing source demand for particular test scenarios.

In carrying out the stress tests, it takes into account the impact on the Bank's economic standing of unfavourable events or fluctuations in macroeconomic and financial parameters and takes into account the loan factor.

Based on the outcome of the stress tests, the Bank may revise its liquidity risk management policy. The outcome of the stress tests may be the basis for a decision of the Bank's Management Board to modify the liquidity management policies specified in the Contingency Plan in the event of a liquidity crisis.

The outcome of the stress tests is the basis for determining the required liquidity reserve and internal limits.

Liquidity risk management is conducted at the level of intraday, short-, medium- and long-term liquidity, the lack of which means inability to finance assets and timely settle liabilities in the normal course of business of the Bank.

At the reporting date, the liquidity reserve amounted to approx. 8.34% of the balance sheet total.

The long-term situation of the Bank in terms of liquidity is stable. Loans obtained from mBank have significant share in financing of long-term receivables.

Due to necessity to maintain liquidity indicators on an appropriate level, the needs to bridge the mismatch of the assets structure to the liabilities that finance them as well as increasing the stability of financing sources, mBH will continue actions aimed at replacing short-term financing with financing in a form of new issues of covered bonds with maturity period of 5 years or more.

Net outflows coverage ratio, determining the relation of the liquidity buffer to the net liquidity outflows under stressed conditions lasting 30 calendar days (LCR) amounted to 852.9%.

The ratio of the Bank's own funds and stable liabilities that provide stable funding to illiquid assets and receivables that require stable funding (NSFR) was 116.6%.

The liabilities limit, resulting from Art. 15.2 of the "Act on covered bonds and mortgage banks", was used in 59.9%. In 2022 this limit was not exceeded.

As at the reporting date average maturity of issued mortgage covered bonds was 2.6 of a year while average maturity of loans obtained from other banks was 6.3 of a year.

The Bank has a management information system based on banking systems and applications supporting the measurement and monitoring of liquidity risk. This system ensures that information on liquidity risk is received, enables impact assessment as regards management decisions, and is used to monitor risk and control the limits. The Bank prepares reports on liquidity risk on a daily, monthly and quarterly basis. Liquidity risk reports, containing information on liquidity risk exposure and information on the use of limits for this risk, are presented to the ALCO committee at least once every two months and to the Management Board of the Bank and the Supervisory Board on a quarterly basis. In order to better manage liquidity risk and supervise this process, the Management Board of the Bank and persons responsible for liquidity risk management have on-going access to daily reports.

At least once a year, the Bank reviews the liquidity risk management system within the ILAAP process, including review and assessment of the individual elements of the liquidity risk management process in accordance with the Rules for internal liquidity adequacy assessment process (ILAAP) at mBH.

5.4. Operational risk

The Bank has a simplified organisational structure, and the products offered are consistent with the nature of the mortgage bank's activity.

In the first half 2022 the Bank maintained the business model in which it based the development of its loan portfolio on a formula of close cooperation with mBank, i.e. assuming that the sales will be executed by the forces of mBank, thus limiting the operational risk connected with the loan sale stage. It had an impact on reducing the level of the operational risk of the Bank, nevertheless it increased the significance of the tasks entrusted in the outsourced processes, relating to the processes of loan acquisition by pooling and maintenance of the loan portfolio. The outsourcing processes are subject to continuous monitoring.

Additionally, the year 2022 brought dynamic changes in the external environment, such as an international conflict, the increasing number of hybrid attacks, the legal risk related to housing loans or the need to seamlessly comply with requirements and regulations at EU and national level, which elevated the materiality of operational risk in banks' activities.

Due to simplified nature of the activities of a mortgage bank, one can claim that some of the indicated risk factors do not have a direct impact on the Bank's activity. However, the Management Board of the Bank is aware that in the case of their materialization, they may indirectly affect the activities of the Bank as an institution which is a part of the financial market or the Capital Group. In such a case, all actions of the Bank will be coordinated and taken within the framework of the mBank group.

The factors influencing the increase of Bank's level of exposure to operational risk:

(1) increasing risk of cyber-attacks, due to maintaining remote working mode as well as the war in Ukraine,
(2) dynamic changes in the external environment, including legal environment,
(3) changes in the organizational structure,
(4) IT projects and undertakings,
(5) turnover of employees,
(6) the profile of operational activity, related to the transfer of the sales process of retail and commercial loans to mBank.

The factors that stabilize the Bank's level of exposure to operational risk:

(1) control and operational risk management system at each level of the organizational hierarchy,
(2) simple organisational structure, no subsidiaries,
(3) small scale and the degree of complexity resulting from the specificity characteristic for mortgage banks,
(4) no electronic banking services,
(5) procedures governing the process of making decisions on entrusting of activities (analysis of benefits, risks and means of their limitation, business continuity plans and insourcer's financial situation as well as the ability to implement services in a timely and qualitative manner).
(6) Bank's Business Continuity Plan,
(7) highly qualified staff,
(8) efficient internal control system,
(9) monitoring of the quality of the outsourced tasks (periodic control of the insourcer with monitoring of post-control recommendations; monitoring of the quality and timeliness of service performance, also for the purpose of calculation of the remuneration level).

In the second half of 2022, the main course of action in the area of business continuity management was based on an analysis of threats and potential scenarios associated with Russia's invasion of Ukraine, as well as electricity cuts. Relevant recommendations were made, the implementation of which will be monitored in 2023.

The Bank monitors and analyses any changes affecting its operational risk profile.

The Bank focuses its efforts on deepening operational risk awareness and building an organizational culture that enables it to develop appropriate risk mitigation mechanisms.

5.5. Model risk

The Bank has a Model Management Policy (MMP), which is subject to periodic review to ensure that it is up-to-date with current conditions and the organization of processes in the Bank. Responsibility for periodic reviews of this policy and supervision over the correctness of this policy shall rest with a unit responsible for organization of the model management process at the Bank.

The Management Board of the Bank is responsible for approving the MMP which introduces uniform principles concerning the process of model management at the Bank, as well as for specifying in the strategy and operational plans of intentions regarding the scope of use of the models, taking into account model risk and the characteristics of the mechanisms used in risk management. The Management Board supervises the process of model risk control and the correctness of their functioning, delegating the decision-making powers with regard to the key aspects of model functioning to the Model Risk Committee. This Committee functions as a dedicated body responsible for the supervision over the process of model risk management, whose detailed responsibilities, composition and decision-making procedure are defined in the relevant internal documents.

The Bank also has other regulations in place that allow it to actively manage and effectively mitigate model risk so that the aggregate level of model risk does not exceed the applicable tolerance level.

Currently, all of the Bank's models assume a low risk exposure, which, combined with the materiality criterion of the models, means a low level of risk for each model, and a low aggregated level of model risk. The model risk tolerance is maintained. Compared to the previous year, there is no change in the aggregated level of model risk.

5.6. Covered bonds investment risk

In 2022 the investment risk profile associated with covered bonds issued by mBH did not change. Those securities are a financial instrument of a low investment risk, resulting from the requirements of multi-stage collateralisation of their issuing and trade by the issuer, accordant with the Act on covered bonds and mortgage banks. In addition to compliance with a number of statutory requirements, high safety of investing in covered bonds is also a result of the Bank's conservative policy of valuation of real estate constitute their collateral, which has been applied for many years. According to the Act on covered bonds and mortgage banks, the minimum level of over-collateralisation of mortgage and public sector covered bonds as at the reporting date was 5%.

5.7. Internal control system

An internal control system has been implemented at the Bank that takes into account the requirements of the law and supervisory recommendations as well as the profile and scale of operations.

The internal control system was defined in the Rules of the internal control system approved by the Supervisory Board.

The internal control system is organised at the Bank at three lines of defense, where:

(1) the first line of defense comprises risk management in operating activities of the Bank, performed by organisational units of the Bank/autonomous positions;

(2) the second line of defense comprises:

   a. risk management by designated organisational units/designated employees of organisational units, irrespectively of risk management at the first line of defense;

   b. the operations of the security unit performed by the IT and Security Department,

   c. the operation of the compliance unit performed by the Compliance Department;

(3) the third line of defense comprises the operation of the internal audit unit performed by the employees of Internal Audit Position.

As part of its internal control system, the Bank has established the following functions:

(1) **control function** – which comprises all controls put in place in the processes executed in the Bank, independent monitoring of the compliance with these controls and reporting within the function.

Internal controls are an integral part of the Bank's day-to-day operations and comprise:

a. internal procedures on the Bank's operations,

b. reviews of reports by the Management Board of the Bank,

c. inspections conducted by the directors of departments and offices/autonomous positions,

d. physical security,

e. a system of limits and rules for controlling them,

f. rules for taking credit decisions and the system of authorisations,

g. principles of verifying the transaction details and activities, and results of risk management models,

h. activities aimed at controlling the quality and accuracy of the implemented tasks.

The control of accurate operation of the internal controls is made on an ongoing basis by each employee as part of their functions, and periodically, as part of horizontal and vertical testing, by heads of organizational units or their appointees.

(2) **Compliance Department (CD)** - compliance cell with the following responsibilities:

a. it manages compliance risk (construed as the risk of effects of non-compliance with legal regulations, internal regulations and market standards) through identification, assessment, controlling, monitoring and reporting on compliance risk regarding the law, internal regulations and market standards;
b. it performs horizontal monitoring within the compliance unit and vertical monitoring tasks within the so-called second line of defence, assigned to the compliance unit to assure compliance of the Bank's operations with legal regulations, internal regulations and market standards. Morerover, CD performs other tasks, provided that it does not undermine its effectiveness and independence.

The Compliance Department is responsible for implementation of the standards of the mBank Group and, indirectly, of Commerzbank AG in areas regarded as "compliance areas" in accordance with the Group standards, which include in particular:

a. anti-money laundering and counter-terrorist financing
b. application of the sanctions policy
c. protection of personal data
d. outsourcing
e. preventing conflicts of interest, fraud and corruption
f. supervision over the process of handling of client's complaints
g. Inside information according to Market Abuse Regulation.

(3) **Internal Audit Position** - independent internal audit department whose task is to independently and objectively examine and assess the adequacy of the risk management system and the internal audit system. Internal audit supports the Bank in achieving objectives through systematic and disciplined approach to examination, assessment and improvement of effectiveness of risk management, audit and organizational governance processes.

Within the scope of its activity the internal audit provides services:

a. providing - covering objective assessment of evidence, performed by internal auditors in order to provide independent opinion and proposals related to a process, system or other issues,
b. consulting - covering advisory and related service activities, which nature and scope are arranged in detail with principal, and which purpose is to add value to and improve organisational governance, risk management and internal audit processes.

Internal Audit Position, within the scope of implemented function, is subject to periodical assessment of independent competent entity from outside the Bank. The entity is selected by the Bank's Management Board and approved by the Audit Committee. The work assessment covers compliance of the internal audit with IIA Standards, Recommendation H and best market practices.

The adequacy and effectiveness of the internal control system is assessed on the basis of:

a. the annual report on the activity of the Internal Audit Position, including int. al. the assessment of the adequacy and effectiveness of the internal control system and the risk management system,
b. the annual assessment of the adequacy and effectiveness of the Bank's Control Function carried out by the Risk Analysis and Management Department, which takes into account identified critical and significant irregularities and the results of the self-assessment of the effectiveness of operational risk management,
c. the annual report of the Compliance Department on compliance risk management at the Bank,
d. information of the Bank's Management Board on the performance of tasks assigned to this body within the internal control system,
e. information important for the adequacy and effectiveness of the internal control system obtained from the parent entity,
f. findings made by the statutory auditor,
g. the annual assessment of the Supervisory Review and Evaluation Process (SREP) carried out by Polish Financial Supervision Authority,
h. findings resulting from the activities of control bodies,
i. assessments and opinions rendered by external entities which are important for the adequacy and effectiveness of the internal control system.

5.8. Remuneration policy

The Bank runs a remuneration scheme for the Bank's Management Board and employees with significant influence on Bank's risk profile, based on phantom shares settled in cash; the scheme is further referred to as the "Policy". These benefits are accounted for in accordance with IAS 19 "Employee benefits". Phantom share valuation is debited to relevant period expenses with a credit to liabilities. Costs are recognised over time during the period of the right to benefits and included in "General administrative expenses". Allocation of phantom shares results from their valuation for the assessment period. Phantom shares valuation is calculated always as at the end of a reporting period by dividing Bank's book value over the number of ordinary shares. The payout under phantom shares depends on the average valuation of these shares obtained on the basis of two values: the phantom share value at the end of the annual period preceding the payment date and the phantom share value at the end of the first half of the year in which the payment is due in a given reporting period. The aforementioned average value is multiplied by the number of phantom shares to be executed in a given period, and the outcome determines the amount of the cash payment resulting from phantom shares held. The final value of the premium, which is a product of the number of shares and their estimated value as at the balance sheet date preceding the realisation of each of the deferred tranches is subject to actuarial discounting. The discounted amount is reduced by amounts of allocations to the relevant provision, which are subject to annual actuarial discounting at the same date. The actuarial discount is the product of the financial discount and the probability of each of the participants individually reaching the moment of obtaining full entitlement to each of the deferred tranches. Annual allocations are calculated according to the Projected Unit Credit Method. The aforementioned probability was determined using the Multiple Decrement Model, where the following three risks were taken into account: the possibility of dismissal, the risk of total incapacity for work, the risk of death.

6. Directions of development and key elements of the Bank strategy

6.1. Mission statement

With regard to the real estate market, the mission of mBH is to support the development of an effective mechanism for financing the real estate market in Poland by issuing long-term debt securities (covered bonds), which are an instrument that makes it possible to refinance attractive forms of real estate financing based on strong competences, the longest market experience and the highest standard of service.

With regard to mBank Group, the mission of mBH is to provide stable, long-term and safe refinancing.

From the investors' point of view, the mission of mBH is to ensure a high level of long-term covered bonds with a high level of security.

The vision

mBH will be focused on issuing covered bonds in Poland and on the international market within the most cost-effective business model possible, i.e. aimed at maximising synergies within mBank Group, in particular on using the available resources of each bank, primarily mBank, in accordance with their economic purpose, as well as the knowledge and experience within mBank Group.

In view of the development of the covered bond market in Poland the Bank's ambition is to maintain its current position among the leading issuers of such instruments in Poland.

Strategic initiatives in mBH are grouped around five pillars:

(1) acquiring retail mortgage loans from mBank;
(2) financing them through regular issues of covered bonds;
(3) improving the IT platform and data security;
(4) risk management;
(5) fostering an organisational culture based on shared values, ensuring respect for diversity, professional development of employees and satisfactory working conditions.

Strengthening mBank Group's independence with regard to the financing of its operations and better matching the time horizon of financing with assets is a key element of the financing strategy. The issuance of covered bonds is a factor supporting the financing of operations on the real estate market.

mBank Group assumes a dynamic growth of the issuance operations of the Bank in the coming years. The issuance of covered bonds allows the Bank to generate stable and long-term financing on affordable terms.

The Bank assumes issuance of covered bonds secured by residential mortgage loans acquired in cooperation with mBank.

Covered bonds will be issued both in PLN and in EUR, and their maturity will vary between 4 and 7 years.

6.2. Bank authorities

Shareholders

As at the reporting date, the total number of ordinary shares was 3,360,000 shares with a nominal value of PLN 100 per share.

The Bank did not issue preferred shares, there are no limitations of rights associated with shares. All shares participate equally in the dividend distribution. All issued shares are fully paid. The Bank does not possess own shares.

As of the reporting date the ownership structure of registered share capital of the Bank is as follows:

Name of shareholder	Registered share capital in PLN	Shares		Votes at the General Meeting of Shareholders	
		Amount	%	Amount	%
mBank S.A.	336,000,000	3,360,000	100.00	3,360,000	100.00
Total	**336,000,000**	**3,360,000**	**100.00**	**3,360,000**	**100.00**

The Bank does not collaborate with international public institutions.

Management Board

The Management Board of mBH included in 2022 the following members:

(1) Piotr Cyburt – President of the Management Board – from 1 Jan 2022 to 28 Apr 2022
(2) Andrzej Kulik – Member of the Management Board – from 1 Jan 2022 to 31 Dec 2022
(3) Krzysztof Dubejko – Member of the Management Board - from 1 Jan 2022 to 2 Dec 2022
(4) Katarzyna Dubaniewicz – Member of the Management Board – from 29 Apr 2022 to 31 Dec 2022
(5) Jolanta Pankiewicz– Member of the Management Board – from 1 Jul 2022 to 31 Dec 2022
(6) Krzysztof Dubejko – President of the Management Board – from 2 Dec 2022 to 31 Dec 2022

<u>Appointment and dismissal of members of the Management Board and their rights:</u>

The Supervisory Board appoints and dismisses members of the Management Board of the Bank, including the President of the Management Board.
Appointing of two members of the Management Board, including the President of the Management Board and a member of the Management Board responsible for risk takes place upon Financial Supervision Authority approval. A request for approval is submitted by the Supervisory Board.

The Management Board of the Bank manages the Bank's operations and represents it. The Management Board adopts annual financial plans and operating strategy which are approved by the Supervisory Board. In these plans, the Management Boards specifies the maximum volume of mortgage bond and bond issues for a given year. The scope of activities of the Bank's Management Board includes all matters not reserved for the competence of other Bank's bodies based on its Articles of Association or the provisions of the law.

Supervisory Board

Composition of mBHSupervisory Board in 2022:

(1) Andreas Boeger – Supervisory Board Chairman
(2) Marek Lusztyn - Supervisory Board Vice-Chairman
(3) Frank Bock – Supervisory Board Member
(4) Aleksandra Buczkowska – Supervisory Board Member (till 14 Dec 2022)
(5) Paweł Graniewski – Independent Supervisory Board Member
(6) Grzegorz Ostrowski – Supervisory Board Member
(7) Michał Popiołek - Supervisory Board Member
(8) Mikołaj Tatarkiewicz - Supervisory Board Member
(9) Mariusz Tokarski – Independent Supervisory Board Member.
(10) Łukasz Maculewicz - Supervisory Board Member (since 14 Dec 2022)

According to the wording of paragraph 14 clause 1 point 5 of the Articles of Association of mBH, the General Meeting, in a form of resolution, makes a decision regarding appointment or dismissal of the Supervisory Board members and determination of principles of their remuneration. Members of the Supervisory Board meet the suitability requirements defined according to the Bank's Policy on the assessment of qualifications (suitability), appointment and dismissal of members of the supervisory and management body at mBH.

According to the wording of paragraph 3 clause 1 point 9 and 10 of the Rules and Regulations of the Supervisory Board of mBH, powers of the Supervisory Board include appointing and removing from office the President and other members of the Management Board, as well as assigning the functions of Vice President of the Management Board and member of the Management Board responsible for oversight over the management of risks material to the Bank's operations, as well as determining the terms and conditions of the contracts and remuneration for the members of the Bank's Management Board and representing the Bank at the execution of contracts with the Management Board members.

Four Committees operate within the Supervisory Board: Audit Committee, Nominating Committee, Remuneration Committee and Risk Committee.

Audit Committee

The Audit Committee included the following members:

(1) Paweł Graniewski - Committee Chairman
(2) Andreas Boeger - Committee Member
(3) Mariusz Tokarski - Committee Member

In 2022 the Audit Committee held meeting on 7 March, 8 April, 12 October and 15 December.

Nomination Committee

The Nomination Committee was composed of:

(1) Andreas Boeger - Chairman of the Committee
(2) Paweł Graniewski - Member of the Committee
(3) Marek Lusztyn - Member of the Committee.

In 2022 the Nominating Committee met on 6 April, 29 June and 13 December.

Remuneration Committee

The Remuneration Committee included the following members:

(1) Andreas Boeger – Committee Chairman
(2) Frank Bock - Committee Vice-Chairman
(3) Marek Lusztyn – Committee Member.

In 2022 the Remuneration Committee held meetings on 6 April, 29 June and 13 December.

Risk Committee

The Risk Committee included the following members:

(1) Marek Lusztyn - Committee Chairman
(2) Michał Popiołek – Committee Member
(3) Mikołaj Tatarkiewicz – Committee Member.

In 2022 the Risk Committee held meeting on 14 March, 4 July and 14 December.

The procedure for convening and powers of the General Meeting of Shareholders

General Meeting of Shareholders is convened as ordinary (annual) and extraordinary meeting, in accordance with the Bank's Articles of Association and the provisions of the commercial companies' code.

Key competencies of the General Meeting of Shareholders include decision making through resolutions on the following matters:

(1) review and approval of the Management Board's report on Bank's activities and financial statements for the previous financial year,
(2) acknowledgement of the fulfilment of duties by the Bank's authorities (vote of confidence),
(3) Bank's profit distribution or loss coverage,
(4) amendments to articles of association,
(5) appointment and dismissal of members of the Supervisory Board and determination of their remuneration,
(6) increasing or decreasing Bank's share capital,
(7) liquidation, disposal of the entire Bank's enterprise or merger (combination) with another bank,
(8) appointment of receivers and determination of their remuneration,
(9) any decisions relating to claims for rectification of damages caused during the establishment of the company or during its management or supervision,
(10) decision on dividend payment date,
(11) disposal or establishing lien on Bank's real property being the location of Bank's authorities,
(12) matters submitted by the Supervisory Board,
(13) matters submitted by shareholders under the procedure provided for by the articles of association,
(14) granting consent for the Bank to purchase or sell shares or other equity interests, or to establish or join other business organisations; such consent not being required if the purchase of shares or equity interests in other companies takes place under enforcement, insolvency or restructuring proceedings or other arrangement with the Bank's debtors, or if the Bank sells shares or equity interests purchased in the manner just described; in such a case, the Bank's Management Board shall inform the Supervisory Board of the above actions,
(15) other matters reserved under the law or the provisions of the Articles of Association.

Rules on amending articles of association

In accordance with Art. 430 §1 of the CCC the change of articles of association requires resolution of the general meeting and entry into register. Pursuant to art. 34 par. 2 Banking Law the change of bank's articles of association requires approval of the Financial Supervision Authority.

7. Other information

Loans and interest rates

Variable interest rates applied in the Bank are based on LIBOR or EURIBOR interest rates for foreign currency loans and WIBOR for loans in PLN. The loan interest rate in a given day is equal to the sum of margins of the Bank established in the agreement as well as the base rate.

In accordance with Recommendation S, the Bank's offer now includes the possibility of conversion of variable rates into periodically fixed rates for the period of 5 years.

Transactions with affiliated entities

The direct parent entity of mBH is mBank. The direct parent entity of mBank is Commerzbank AG.

All transactions between the Bank and affiliated entities were typical and routine transactions, according to the Management board concluded on conditions that did not vary from the market conditions, and their nature and conditions resulted from current operational activity conducted by the Bank. Transactions with affiliated entities concluded in the scope of ordinary operational activity cover loans, deposits, liabilities arising from the issue of debt securities and derivative transactions.

Information on meeting of requirements specified in Art. 22aa of the Banking Law Act by members of the Supervisory Board and the Management Board

On 26 May 2021, the Annual General Meeting of mBH appointed the Supervisory Board of the next term of office, composed as above. The General Meeting verified the candidates for the Supervisory Board members and decided that they fulfilled the requirements set forth in Article 22a of the Banking Law.

On 8 April 2022, the Supervisory Board appointed the Management Board for a new term of office, after prior assessment of suitability of candidates for Management Board members, and concluded that all candidates meet the requirements set out in Article 22a of the Banking Law.

Proceedings before a court, arbitration body or public administration authority

Information on pending proceedings is provided in note 29 to the Financial Statement.

Public aid

In 2022, the Bank did not receive any public subsidies, in particular on the basis of the Act on the Government support for the financial institutions dated February 12, 2009 (Journal of Laws of 2014 item 158).

Guarantees and sureties granted by the Bank

No guarantees or sureties were granted by the Bank in 2022.

Events after the balance sheet date

(1) On 15 February 2023, the Bank signed a loan agreement with mBank for PLN 900 million. The loan is intended to finance current operations and will be disbursed in three tranches.

(2) In accordance with the terms of the securities issue, the Bank redeemed:

a. on 3 January 2023 1 series of unsecured bonds with a total value of PLN 60,000 thousand,

b. on 20 February 2023 1 series of mortgage bonds with a total value of PLN 200,000 thousand.

8.Statements of the Management Board

Corporate governance

In its activity the Bank is guided by the rules of corporate governance and best banking practices which set high standards based on transparency of operations, ethics in business and maintaining the balance between interests of all entities involved in the functioning of the Company.

On 16 December 2014 the Management Board, and on 19 January 2015 the Supervisory Board accepted the application of the Principles of Corporate Governance for Supervised Institutions ("Principles"), adopted by the Financial Supervision Authority on 22 July 2014, with the exclusion of Principles indicated in § 8 para. 4, §25 para.1, § 29 , §53-57. The principles addressed to shareholders were presented by the Management Board on the Annual General Meeting of mBH on 22 April 2015. On the same day, the General Meeting adopted resolution No 15 on the application of Principles of Corporate Governance for Supervised Institutions, in which it adopted these Principles for application within the scope in which they relate to the general meeting, excluding the principle set forth in § 29 of the Principles (remuneration for holding the position of a Member of the Supervisory Board is awarded by the General Meeting only to an independent member). The resolution came into force on the date of adoption.

The Principles are available at:

https://www.knf.gov.pl/dla_rynku/regulacje_i_praktyka/zasady_ladu_korporacyjnego

Principles of Corporate Governance for Supervised Institutions is the only set of corporate governance rules followed by the Bank. The Bank did not adopt any other voluntary rules of corporate governance to be followed, nor does it apply any corporate governance practices which go beyond the requirements provided for in the national law.

The Bank has excluded the application of the Principles of Corporate Governance for Supervised Institutions as regards the rules set out in §8(4), §25(1), §29, §53-57. The justification of waiver of said Principles is presented in an Appendix to the Management Board's Resolution No 247 of 16.12.2014.

§8 (4): The Bank does not apply the following Principles: If it is justified by the number of shareholders, the supervised institution should strive to facilitate the participation of all shareholders in the meeting of the decision-making body of the supervised institution by, without limitation, enabling active participation in the meetings of the decision-making body using electronic means.

Shares of mBH are acquired indirectly or directly by the sole shareholder i.e. mBank. The General Meetings are held without a formal convocation, and 100% of the share capital shall always be represented at the General Meetings. Accordingly, the number of shareholders does not justify the need for organizing meetings by the use of electronic devices.

§25(1): The Bank does not follow the Principle: Supervision exercised by the supervisory body should be of permanent nature, and the supervisory body meetings should be held as needed. If an audit committee or other committees operate in the supervised institution, and they have been entrusted with specific matters of the supervised institution's activity, meetings of the supervisory body should be held at least four times a year, and otherwise at least every two months.

Deviation from the above Principle is dictated by the close cooperation with the shareholder, in particular as regards consolidated supervision, large exposure risk management, application of statistical methods, risk area, compliance, internal audit, and elaborate regular reporting. The above cooperation results in particular from the obligation defined in Resolution of the Polish Financial Supervision Authority No 258/2011 on detailed principles of operation of the risk management system and the internal control system, and detailed conditions for estimation of internal capital by banks and for reviews of the internal capital retention and estimation process and the principles of determining the policy of variable components of the remunerations of persons in managerial positions at banks, concerning the obligation of risk management by the shareholder (mBank) in subsidiaries. In view of the above, the Supervisory Board's meetings held 3 times a year are sufficient to ensure security of the Bank.

§29: The Bank does not apply the Principle:

(1) Remuneration of members of the supervisory body shall be established adequately to the function they hold and to the scale of operations of the supervised institution. Members of the supervisory body appointed to work on committees, including the audit committee, should be remunerated adequately to the additional tasks performed on the committee.
(2) Remuneration of members of the supervisory body, unless payment of such remuneration is prohibited by the law, should be established by the decision-making body.
(3) The rules for remunerating members of the supervisory body should be transparent and included in the relevant internal regulation of the supervised institution.

Remuneration for holding the position of a member of the Supervisory Board is awarded by the General Meeting to an independent member. The other Board Members do not receive remuneration.

The Bank does not apply the Principles:

§ 53.

The supervised institution which manages assets at a client's risk should efficiently manage the assets so as to provide the required protection of the clients' interests.

§ 54.

(1) The supervised institution should employ the available corporate supervision measures over entities – issuers of securities under management, in particular when the level of involvement in the securities is considerable or when it is required for protection of the clients' interests.
(2) The supervised institution which manages assets at the client's risk should introduce transparent rules of cooperation with other financial institutions when executing corporate supervision over entities – issuers of securities under management.
(3) The supervised institution which manages assets at the client's risk shall create and communicate to clients the policy of corporate supervision measure used, which includes the procedures of participation and voting at meetings of the decision-making bodies.

§ 55. In its operations, the supervised institution which manages assets at the client's risk should avoid situations which might cause a conflict of interests, and if a conflict of interests arises, the institution should be guided by the client's interest, and notify the client thereof.

§ 56. The supervised institution which manages assets at the client's risk should introduce transparent rules for cooperation with other supervised institutions with respect to transactions executed at the client's risk.

§ 57. The supervised institution, when acquiring assets at the client's risk, should act in the client's interest. The decision-making process should be duly documented.

Deviation from the above Principles is dictated by the fact that the Bank, as a specialized institution, does not engage in the activity of asset management at the client's risk.

The Bank does not use any restrictions concerning the exercise of the voting right afforded by the securities. As regards the transfer of ownership of the securities, the only restriction is that issuances of covered bonds in the primary market are not addressed to individual (retail) investors and in the case of issuances introduced abroad – additionally that they are not addressed to Polish residents.

Rules for appointment and dismissal of the management:

The Supervisory Board shall appoint and dismiss members of the Management Board of the Bank, including the President of the Management Board, taking into account the assessment of fulfilment of the requirements, referred to in Article 22aa of the Banking Law. The President of the Management Board and the Management Board Member supervising the management of material risk in the Bank's operations shall be appointed and the function of the member of the Management Board supervising the management of material risk in the Bank's operations shall be entrusted to the appointed member of the Management Board with the consent of the Polish Financial Supervision Authority. The application for such consent shall be submitted by the Supervisory Board. Promptly after appointing the Management Board and changing the composition thereof, the Supervisory Board shall notify the Polish Financial Supervision Authority of the composition of the Management Board and changes in the composition thereof, and shall provide the information resulting from the assessment referred to in (1) on fulfilment by the members of the Management Board of the requirements referred to in Article 22aa of the Banking Law. The assessment is carried out on the basis of the Bank's Policy on the assessment of qualifications (suitability), appointment and dismissal of members of the Bank's Body at mBH (Suitability Policy). Additionally, the Supervisory Board shall notify the Polish Financial Supervision Authority of the approval of and changes in the internal division of competence in the Management Board of the Bank. The Management Board shall be composed of the President of the Management Board and other members of the Management Board. The internal division of competence in the Management Board of the Bank shall be established by the Management Board and approved by the Supervisory Board. The President and other members of the Management Board shall be appointed for a joint 3-year term of office. Mandates of the Management Board members shall expire on the day of the General Meeting that approves the financial statements for the last full financial year of the term of office of the Management Board members at the latest. Furthermore, the mandate of a Management Board member shall also expire in case of death, resignation or dismissal of the member from the Management Board. Members of the Bank's Management Board may be dismissed at any time before their term of office expires. The Management Board of the Bank shall manage the Bank's affairs and shall represent the Bank. The Management Board shall accept the annual financial plans and the business strategy, which shall be approved by the Supervisory Board. The Management Board defines the maximum size of covered bond and bond issues in a given year in annual financial plans and business strategies.

The Bank also adopted the Policy of identification of key functions in the bank, appointment and dismissal of employees performing these functions and assessment of their qualifications (suitability) in accordance with Recommendation Z.

Audit Committee

The Bank complies with the regulations governing the appointment, composition and operation of the audit committee, including those which apply to fulfilment by the audit committee members of the independence criteria and the requirements of knowledge and skills in banking and in accounting and financial statements auditing.

The Audit Committee of the Supervisory Board of mBH operates in accordance with the Rules of the Audit Committee introduced upon Resolution of the Supervisory Board No 36/2017 of 28 December 2017. In 2018 the Audit Committee's members were appointed upon Resolution of the Supervisory Board No 26/2017 of 17 August 2017. All members of the Audit Committee satisfy the requirements of knowledge and skills in banking and in accounting and financial statements auditing, which they acquired through education and professional experience.

The basic tasks of the Audit Committee result from the Act of 11 May 2017 on statutory auditors, audit firms and public supervision, the Bank's Articles of Association, the Regulations of the Supervisory Board, "Recommendations regarding the operation of the Audit Committee" adopted by the Polish Financial Supervision Authority.

The Audit Committee performs the tasks of the audit committee provided for in the mandatory legal regulations by way of performing ongoing supervision, based on the information provided by the Management Board of mBH, the certified auditor, the Internal Audit Position, the Compliance Department, the Accounting and Clearance Department and by way of meetings.

The Audit Committee with Resolution No. 6/2017 of December 14, 2017 adopted the "Policy regarding the selection of an audit firm and the audit company conducting the audit by entities related to this auditing company and by a member of the auditing company's network of permitted services that are not auditing the financial statements at mBH together with the attachment " Procedure for selecting the Audit Company in mBank Hipoteczny SA". The policy meets the requirements of the Act on statutory auditors, auditing companies and public supervision as well as the Regulation of the European Parliament and the Council of the European Union of 16/04/2014 No. 537/2014.

mBH's policy on the selection of an audit firm includes the principle of statutory auditor rotation. The duration of total uninterrupted statutory audit engagements referred to in Article 17 (1) paragraph 2 of Regulation (EU) No. 537/2014 carried out by the same audit firm or an audit firm related to this audit firm, or any member of the network operating within the European Union to which these audit firms belong, must not exceed five years. The key statutory auditor may carry out a statutory audit again in the bank after at least three years of the completion of the last statutory audit. In the case of a statutory audit, the first agreement on statutory audit is concluded with an audit firm for the period not shorter than two years with an option to extend it for another two-year period.

Pursuant to the policy on the performance of permitted non-audit services in mBH by the audit firm carrying out the audit, by entities related to the audit firm and by a member of an audit firm network, a statutory auditor or an audit firm carrying out the audit, or any member of the network to which the statutory auditor or the audit firm belongs, must not directly or indirectly provide to the audited entity, to its parent undertaking or to its controlled undertakings within the Union:

- any prohibited non-audit services in the period between the beginning of the period audited and the issuing of the audit report;

- any services that consist in designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems.

Under Article 136 of the Act on Statutory Auditors, prohibited services do not include the following:

(1) services that consist in:
   a. conducting due diligence procedures with regard to economic and financial condition,
   b. issuing comfort letters in connection with prospectuses issued by the audited entity, in accordance with the national standard of related services and by means of agreed procedures,
(2) assurance services with regard to pro forma financial information, forecasts of results or estimated results, published in the prospectus issued by the audited entity,
(3) examination of historical financial information of the prospectus,
(4) verification of consolidation packages,
(5) confirmation of fulfilment of conditions of the concluded loan contracts on the basis of the analysis of financial information coming from financial statements audited by a given audit firm,
(6) assurance services in reporting concerning corporate governance, risk management and corporate social responsibility,
(7) services consisting in the assessment of compliance of information revealed by financial institutions and investment companies with the requirements for disclosing information concerning capital adequacy and variable remuneration,
(8) certification concerning financial statements or other financial information for supervision bodies, the supervisory board or other supervisory authority of the company, or owners, exceeding the scope of the statutory audit, to help these authorities to perform their statutory duties.

The audit firm auditing the financial statements of mBank and mBank Group provided the permitted non-audit services to mBH. Therefore, the Audit Committee each time assessed the independence of the audit firm and granted its consent to the provision of the services.

Diversity policy

When selecting and appointing Members of the Management Board and proposing candidates for Members of the Supervisory Board, mBH takes into account the diversity issue. When deciding on the composition of the Management Board, the Supervisory Board makes every effort to ensure its diversity, especially in terms of age, education, professional experience and participation of women. The Supervisory Board pays attention to the diversity of educational background and professional experience of the Management Board Members. The age structure of the Supervisory Board Members should be diverse. Moreover, the Supervisory Board aims at ensuring that its members have diverse educational background and professional experience. The Supervisory Board also lays emphasis on the adequate participation of women. By 2028, the total participation of women in the Management Board and the Supervisory Board will have amounted to no less than 30% of all members. The recommended number of women in the Management Board is minimum one.

True and fair picture in the presented reports

The Management Board of mBH declares that according to their best knowledge:

(1) the financial statements and the comparative figures were prepared in compliance with the binding accounting principles and present a true, fair and clear picture of the financial position and the condition of the assets of the Bank as well as its financial performance,

(2) the report of the Management Board on activities presents a true picture of the situation of mBH, including a description of the main risks and threats.

The process of preparation of the financial data for the purpose of reporting is automated and based on the Bank's accounting data. Preparation of the data in the source systems is subject to formalized operational and acceptance procedures. The set of accounting balances based on the main ledger system of the Bank is created in a process which includes the relevant internal controls. Manual adjustments are subject to special control.

The Bank continuously monitors changes in legislation and internal bylaws governing the preparation of financial reports and updates the internal bylaws on an ongoing basis, adjusting the IT systems if necessary.

Preparation of the financial statements of mBH is the responsibility of the Financial Reporting Unit of the Accounting and Clearing Department. Keeping of the financial books and administration of the model chart of accounts is the responsibility of the Accounting and Clearing Department.

The Bank prepares annual and condensed semi-annual financial statements which are submitted to the Management Board of mBH for approval. At the same time the statements are submitted to the members of the Audit Committee of the Supervisory Board. Following consultations with an external auditor and members of the Management Board, the Audit Committee recommends adoption or rejection of the annual financial statements to the Supervisory Board.

The annual and condensed semi-annual financial statements of mBH are subject to an independent audit and review by a certified auditor. The certified auditor for the Bank is selected upon a resolution of the Supervisory Board of mBH The recommendation concerning the certified auditor selection is issued by the Audit Committee of the Supervisory Board.

mBH complies with the rules of rotation of the certified auditor. On 2 March 2018 the Supervisory Board of mBH selected Ernst & Young Audyt Polska sp. z o.o. spółka komandytowa to be the auditor and to audit the financial statements of mBH for the years 2018-2019. On 26 March 2020 the Supervisory Board renewed the commission for the audit of the Bank's financial statements for 2020-2022. Previously, this company was authorized to audit the financial statements of mBH in the period 2013-2015. In the period of 2016-2017, the Bank's financial statements were audited by PricewaterhouseCoopers sp. z o.o. On 7 March 2022 the Supervisory Board selected KPMG Audyt Sp. z o.o. sp. k. as the audit firm to provide audit services related to statutory audits and reviews of the financial statements of mBH for the years 2022 and 2023. On 28 October 2021 an agreement was concluded concerning partial termination of the agreement that the Bank had concluded with Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością sp. k., with its registered office in Warsaw, in the part concerning the audit of the Bank's financial statements and the review of the Bank's condensed financial statements for 2022 and the verification of the consolidation packages for 2022. Details of the audit firm's remuneration can be found in note 40 to the Bank's Financial Statements.