

**Evaluation of operations of ING Bank Hipoteczny S.A. in 2019
prepared by the Supervisory Board taking into account the
evaluation of internal control systems, risk management,
compliance and internal audit function**



ING Bank Hipoteczny S.A. (the Bank) was established on 26 February 2018, upon obtaining a permit issued by the Polish Financial Supervision Authority on 16 January 2018.

ING Bank Hipoteczny S.A. is a subsidiary of ING Bank Śląski S.A. which as at 31 December 2019 held 100% shares in the share capital of ING Bank Hipoteczny S.A. The latter is a member of the Group which in this document is referred to as the ING Bank Śląski S.A. Group. (the Group).

As at 31 December 2019, the share capital of ING Bank Hipoteczny S.A. amounted to PLN 210,000,000.00 and was fully taken up by ING Bank Śląski S.A. ING Bank Hipoteczny S.A.'s shares were paid in cash.

The Bank runs business based on the strategic cooperation with ING Bank Śląski S.A., acquiring debt under mortgage-backed loan agreements. The strategic objective of the Bank is to provide the Group with long-term and stable funding by way of issue of covered bonds.

Business landscape

As at 31 December 2019, banks' receivables under residential loans in Poland totalled PLN 443.2 billion or went up by 6.6% y/y (as per the data published by the National Bank of Poland). The balance of loans awarded in PLN rose by 12.3% y/y and closed at PLN 323.1 billion.

The Polish mortgage market is almost entirely dominated by variable interest rate loans. Currently, banks are introducing more and more widely to their offers loans based on a periodically fixed interest rate, which enjoy a growing interest of customers.

As at the end of December, the strategic partner to the Bank, ING Bank Śląski S.A. was ranked number two and number four in terms of sale and volume of the portfolio of PLN mortgage loans respectively.

A large demand for residential properties, developing economy and low interest rates are conducive to further growth of the market of mortgage loans.

Operations of ING Bank Hipoteczny S.A.

In 2019, ING Bank Hipoteczny S.A started operations and began to build the portfolio of mortgage loans forming the collateral for the future issue of covered bonds. In the first year of business, as part of its strategy, the Bank acquired the portfolio of mortgage loans from ING Bank Śląski S.A. worth over PLN 3,2 billion. The acquired portfolios were most notably funded with the loan drawn from the parent entity and issue of green mortgage bonds worth PLN 400 million. The above operations were the primary drivers of the financial results of the Bank.

Investors in the local market showed great interest in the inaugural issue of green bonds. The book of demand built considerably went over the initially assumed levels. The above resulted, among others, from the high quality of collaterals for covered bonds on the lending portfolio as well as from the certification obtained by the Bank, granted by the Climate Bonds Initiative (CBI) in connection with satisfaction of positive environmental impact standards. By issuing green covered bonds, the Bank also supports the financing of energy-efficient buildings.

The Supervisory Board supervises the Bank's operations, ensuring compliance with relevant legal regulations, in particular those concerning accounting, finance and reporting. The duties of the Supervisory Board also include supervision over processes related to management of particular risks in ING Bank Hipoteczny S.A. with the support of the Audit and Risk Committee. Based on the Committee's recommendations, the Supervisory Board accept and approve the risk management strategy in the Bank's operations, the main principles of the policy in this respect as well as the risk appetite level. Further, the Supervisory Board monitors the utilisation of internal limits vis-à-vis the current strategy of

the Bank. The Audit and Risk Committee provides support to the Supervisory Board in monitoring the risk management process, including operational risk, non-compliance, credit risk and market risk. The Committee also supervises: the process of internal capital estimation, capital adequacy assessment and risk assessment of models related to calculation of capital and other models. The Committee voices its opinion about the overall readiness of the Bank to take the risk in the current and long term perspective. Similarly, it is the Committee's task to monitor the financial reporting process. In this context, the Committee analyses from time to time the Bank's financial statements and the results of the audit of those statements. The Audit and Risk Committee also analyses the results of the work of the entity authorized to audit financial statements, ensuring its independence and effectiveness. Moreover, the Committee monitors the effectiveness of internal control and internal audit systems and assesses the effectiveness of measures taken to mitigate compliance risk and assesses the quality of compliance risk management.

In the opinion of the Supervisory Board, the risk management system in ING Bank Hipoteczny S.A. covers all material risks. In the processes of their identification, measurement, management and reporting, instruments and techniques appropriate for each identified risk category are used. In 2019, ING Bank Hipoteczny S.A. satisfied the requirements of safe operation and capital adequacy, in particular:

- pursued a prudent lending policy - the Bank had in its portfolio only loans granted in Polish zlotys (PLN). Lending processes and procedures were consistent with supervisory requirements and best market practices. The Bank held a diversified, good quality, credit portfolio - in the entire 2019, only 2 impaired loans were identified (in Stage 3), which accounted for only about 0.016% of the total gross exposure - i.e. significantly less than the average of the entire banking sector, the parameters (PD, LGD) and risk costs were low. The average LtV based on the banking and mortgage value of the real estate remained stable below 63%;
- had the highest market standards, policies and systems in the area of market risk management. Throughout 2019, individual market risk categories were managed actively so that their levels were within the agreed limits effective at the Bank;
- maintained a stable liquidity position. In 2019, supervisory liquidity measures were above regulatory limits;
- actively managed the risk of the models used by the Bank, so that its level remain within the limits of the assumed model risk appetite;
- actively managed and maintained the level of non-financial risk below accepted loss limits, within the limits of the non-financial risk appetite;
- had an adequate level of equity to meet supervisory requirements.

ING Bank Hipoteczny S.A. has an efficient Internal Control System covering all organisational units of the Bank and all three lines of defence. The main objectives of the Internal Control System were achieved in 2019. As regards ensuring regulatory compliance, supervisory requirements, internal regulations and market standards, gaps have been identified for which the Bank has identified and is carrying out definite corrective actions.

The Bank has a formal reporting path for the scale and nature of the identified irregularities, as well as the status of corrective actions and disciplinary measures taken. In particular, information on open critical and high risk recommendations is submitted to the Audit and Risk Committee on a quarterly basis. Corrective actions are implemented and their status is monitored on an ongoing basis.

The independence of the Compliance function and of the Internal Auditor is ensured. The Internal Auditor function has been provided with adequate human resources indispensable for the effective performance of its tasks in 2019. As regards the Compliance function, recruitment process for the Compliance Expert position has been initiated following the identified need to strengthen HR thereof.

The internal control system that is in place at the Bank secures the Bank effectively enough against

unexpected events with respect to granted financing, non-financial, market, liquidity or capital adequacy risks.

In December 2019, the total capital ratio of ING Bank Hipoteczny S.A. was at the level of 17.03%.

In the opinion of the Supervisory Board, the Bank's attention should still be focused on activities that increase the scale of its operations while maintaining an appropriate security level, such as:

- adequate capital management in order to ensure safe lending portfolio growth and fulfilment of all present and future regulatory requirements,
- increase in the volume of mortgage loans including green assets which are used for the issue of covered bonds,
- obtaining financing through another issue of covered bonds,
- maintaining an adequate level of liquid assets,
- further improvement of cost effectiveness while maintaining high quality processes, through the optimal use of existing resources.

In the opinion of the Supervisory Board, the Bank's current strategy of increasing the scale of its operations, which has been followed for the last 12 months, will lead to the intended financial results in subsequent reporting periods.

In 2020, the Bank will keep on following the adopted strategy while maintaining adequate capital base in relation to the planned increase in the volume of mortgage loans.