Bank Hipoteczny

SELECTED FINANCIAL DATA DERIVED FROM THE FINANCIAL STATEMENTS

SELECTED FINANCIAL DATA	PLN thousand period from 01.01.2016 to 31.12.2016	PLN thousand period from 01.01.2015 to 31.12.2015	EUR thousand period from 01.01.2016 to 31.12.2016	EUR thousand period from 01.01.2015 to 31.12.2015
Net interest income	63 599	6 347	14 535	1 517
Net fees and commissions	(3 636)	(1 479)	(831)	(353)
Operating result	18 260	(15 536)	4 173	(3 712)
Profit / (Loss) before income tax	**18 260**	**(15 536)**	**4 173**	**(3 712)**
Net profit/ (loss)	**13 224**	**(12 596)**	**3 022**	**(3 010)**
Earnings per share for the period – basic (in PLN / EUR)	**0,02**	**(0,04)**	**0,01**	**(0,01)**
Earnings per share for the period – diluted (in PLN / EUR)	**0,02**	**(0,04)**	**0,01**	**(0,01)**
Total net comprehensive income	**(4 739)**	**(12 594)**	**(1 083)**	**(3 010)**
Net cash flows from operating activities	(4 570 020)	(309 765)	(1 044 409)	(74 022)
Net cash flows from investing activities	(204 827)	(4 965)	(46 810)	(1 186)
Net cash flows from financing activities	4 789 058	30 000	1 094 467	7 169
Net cash flows	14 211	(284 730)	3 248	(68 039)

SELECTED FINANCIAL DATA	PLN thousand as at 31.12.2016	PLN thousand as at 31.12.2015	EUR thousand as at 31.12.2016	EUR thousand as at 31.12.2015
Total assets	8 610 453	791 485	1 946 305	185 729
Total equity	781 290	286 029	176 603	67 119
Share capital	800 000	300 000	180 832	70 398
Number of shares (in thousand)	800 000	300 000	800 000	300 000
Net asset value per share (in PLN / EUR)	0,98	0,95	0,22	0,22
Diluted number of shares (in thousand)	800 000	300 000	800 000	300 000
Diluted net asset value per share (in PLN / EUR)	0,98	0,95	0,22	0,22
Capital adequacy ratio	17,1%	47,8%	17,1%	47,8%
Basic funds (Tier 1)	780 265	282 811	176 371	66 364
Total own funds	780 265	282 811	176 371	66 364

The selected financial statements items were translated into EUR using the following exchange rates:

- income statement, statement of comprehensive income and statement of cash flows items – the rate is calculated as the average of NBP exchange rates prevailing as at the last day of each month of the reporting period, i.e: EUR 1 = PLN 4.3757 for the period ended 31 December 2016 and EUR 1 = PLN 4.1848 for the period ended 31 December 2015,
- statement of financial position items – the average NBP exchange rate as at 31 December 2016: EUR 1 = PLN 4.4240 and as at 31 December 2015: EUR 1 = PLN 4.2615.

Financial Statements of PKO Bank Hipoteczny SA for the period from 1 January 2016 to 31 December 2016

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STATEMENT OF PROFIT OR LOSS

	Note	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Interest income	3	143 031	6 410	7 808
Interest expense	3	(79 432)	(63)	(63)
Net interest income		**63 599**	**6 347**	**7 745**
Fee and commission income	4	6 461	891	891
Fee and commission expense	4	(10 097)	(2 370)	(2 372)
Net fees and commissions		**(3 636)**	**(1 479)**	**(1 481)**
Income from financial instruments measured at fair value	5	1	(1)	(1)
Foreign exchange result	6	(836)	(3)	(3)
Other operating income	7	887	114	119
Other operating expense	7	(842)	(55)	(55)
Net other operating income and expense		**45**	**59**	**64**
Impairment allowance and write-downs	8	(1 610)	(229)	(229)
General administrative expenses	9	(39 303)	(20 230)	(23 330)
Operating result		**18 260**	**(15 536)**	**(17 235)**
Profit / (Loss) before income tax		**18 260**	**(15 536)**	**(17 235)**
Income tax expense	10	(5 036)	2 940	3 262
Net profit / (loss)		**13 224**	**(12 596)**	**(13 973)**
Earnings per share for the period (PLN)	11	0.02	(0.04)	(0.05)
Diluted earnings per share for the period (PLN)	11	0.02	(0.04)	(0.05)
Weighted average number of shares during the period (in thousand)		533 060	300 000	300 000
Weighted average number of diluted shares during the period (in thousand)		533 060	300 000	300 000

STATEMENT OF COMPREHENSIVE INCOME

	Note	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Net profit/(loss)		13 224	(12 596)	(13 973)
Other comprehensive income		(17 963)	2	2
Items that may be reclassified to the statement of profit and loss		(17 963)	2	2
Cash flow hedging, gross		(21 870)	-	-
Deferred tax on cash flow hedging		4 155	-	-
Net Cash flow hedging		(17 715)	-	-
Revaluation of financial assets available for sale		(306)	3	3
Deferred tax on revaluation of financial assets available for sale		58	(1)	(1)
Net gains on revaluation of financial assets available for sale		(248)	2	2
Items that may not be reclassified to the statement of profit or loss		-	-	-
Total net comprehensive income		(4 739)	(12 594)	(13 971)

STATEMENT OF FINANCIAL POSITION

	Note	31.12.2016	31.12.2015
ASSETS			
Cash and balances with the central bank	12	16 033	4
Amounts due from banks	13	12 994	14 812
Financial derivative instruments	14	27 808	-
Financial assets designated upon initial recognition at fair value through profit and loss	15	79 987	39 988
Loans and advances to customers	16	8 247 900	722 655
Investment securities available for sale	17	203 019	500
Intangible assets	18	5 312	3 176
Property, plant and equipment	19	580	647
Deferred income tax asset	10	2 440	3 261
Other assets	20	14 380	6 442
TOTAL ASSETS		**8 610 453**	**791 485**
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to banks	21	3 431 832	469 298
Financial derivative instruments	14	113	-
Amounts due to customers	22	1 549	146
Mortgage covered bonds issued	23	3 232 117	29 933
Unsecured bonds issued	24	1 151 216	-
Other liabilities	25	12 196	6 020
Provisions	26	140	59
TOTAL LIABILITIES		**7 829 163**	**505 456**
Equity			
Share capital	27	800 000	300 000
Revaluation reserve		(17 961)	2
Profit / (Loss) from previous years		(13 973)	-
Net profit / (loss) for the period		13 224	(13 973)
TOTAL EQUITY		**781 290**	**286 029**
TOTAL LIABILITIES AND EQUITY		**8 610 453**	**791 485**

Capital adequacy ratio	42	17.1%	47.8%
Net assets value (in PLN thousand)		781 290	286 029
Number of shares (in thousand)	27	800 000	300 000
Net assets value per share (in PLN)		0.98	0.95
Diluted number of shares (in thousand)		800 000	300 000
Diluted net assets value per share (in PLN)		0.98	0.95

(IN PLN THOUSAND)

STATEMENT OF CHANGES IN EQUITY

Period from 1 January 2016 to 31 December 2016	Note	Share capital	Revaluation reserve	Profit/(Loss) from prior years	Undistributed profit / (loss)	Net profit/(loss) for the period	Total equity
As at 1 January 2016		300 000	2	-	(13 973)	-	286 029
Distribution of profit/(loss) / Distribution for the Profit/(Loss) from prior years				(13 973)	13 973	-	-
The issue of shares series B	27	200 000	-	-	-	-	200 000
The issue of shares series C	27	200 000	-	-	-	-	200 000
The issue of shares series D	27	100 000	-	-	-	-	100 000
Total comprehensive income, including:		-	(17 963)	-	-	13 224	(4 739)
Net profit/(loss)		-	-	-	-	13 224	13 224
Other comprehensive income		-	(17 963)	-	-	-	(17 963)
As at 31 December 2016		800 000	(17 961)	(13 973)	-	13 224	781 290

Period from 1 January 2015 to 31 December 2015	Note	Share capital	Revaluation reserve	Profit/(Loss) from prior years	Undistributed profit / (loss)	Net profit/(loss) for the period	Total equity
As at 1 January 2015	27	300 000	-	-	(1 377)	-	298 623
Total comprehensive income, including:		-	2	-	-	(12 596)	(12 594)
Net profit/(loss)		-	-	-	-	(12 596)	(12 596)
Other comprehensive income		-	2	-	-	-	2
As at 31 December 2015		300 000	2	-	(1 377)	(12 596)	286 029

Period from 6 October 2014 to 31 December 2015	Note	Share capital	Revaluation reserve	Profit/(Loss) from prior years	Undistributed profit / (loss)	Net profit/(loss) for the period	Total equity
As at 6 October 2014		-	-	-	-	-	-
The issue of shares series A	27	300 000	-	-	-	-	300 000
Total comprehensive income, including:		-	2	-	-	(13 973)	(13 971)
Net profit/(loss)		-	-	-	-	(13 973)	(13 973)
Other comprehensive income		-	2	-	-	-	2
As at 31 December 2015		300 000	2	-	-	(13 973)	286 029

(IN PLN THOUSAND)

STATEMENT OF CASH FLOWS

	Note	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Cash flow from operating activities				
Profit/(Loss) before income tax		**18 260**	**(15 536)**	**(17 235)**
Adjustments:		**(4 588 280)**	**(294 229)**	**(292 959)**
Depreciation and amortization		1 223	669	670
Change in financial instruments designated upon initial recognition of fair value through profit or loss		(39 981)	(39 986)	(39 986)
Change in derivative financial instruments (asset)		1 145	-	-
Change in loans and advances to customers		(7 526 805)	(722 853)	(722 853)
Change in other assets		(9 234)	(6 248)	(6 442)
Change in amounts due to banks		2 962 534	469 298	469 298
Change in derivative financial instruments (liability)		(111)	-	-
Change in amounts due to customers		1 403	146	146
Change in amounts due to issued mortgage covered bonds		9 072	(67)	(67)
Change in amounts due to issued unsecured bonds		4 671	-	-
Change in provisions and impairment allowances		1 642	257	257
Change in other liabilities		6 176	4 557	6 020
Other adjustments		(15)	(2)	(2)
Net cash flow from operating activities		**(4 570 020)**	**(309 765)**	**(310 194)**
Cash flow from investing activities				
Inflows from investing activities		**60**	**-**	**-**
Sale and interests from investment securities available for sale		60	-	-
Outflows from investing activities		**(204 887)**	**(4 965)**	**(4 990)**
Acquisition of investment securities available for sale		(201 589)	(497)	**(497)**
Acquisition of intangible assets and property, plant and equipment		(3 298)	(4 468)	(4 493)
Net cash flow from investing activities		**(204 827)**	**(4 965)**	**(4 990)**
Cash flow from financing activities				
Proceeds from issue of own shares		500 000	-	300 000
Proceeds from issue of mortage covered bonds		3 154 809	30 000	30 000
Proceeds from issue of unsecured bonds		1 146 545	-	-
Interests in issued mortgage covered bonds and unsecured bonds		(12 296)	-	-
Net cash flow from financing activities		**4 789 058**	**30 000**	**330 000**
Net cash flows		**14 211**	**(284 730)**	**14 816**
Cash and cash equivalents at the beginning of the period		14 816	299 546	-
Cash and cash equivalents at the end of the period	31	**29 027**	**14 816**	**14 816**
therein restriced cash		-	-	-

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NOTES TO THE FINANCIAL STATEMENTS

1. General information

The financial statements of PKO Bank Hipoteczny Spółka Akcyjna ('PKO Bank Hipoteczny', 'the Bank') have been prepared for the period from 1 January to 31 December 2016. Due to the fact that the Bank started its activity on 6 October 2014 and extended the first financial year, apart from the comparative information disclosed for the period from 1 January to 31 December 2015, information for the period form 6 October 2014 to 31 December 2015 is also disclosed. The financial information has been presented in Polish zloty (PLN), rounded to thousands of zloty, unless indicated otherwise.

PKO Bank Hipoteczny located in Gdynia, 17 Jerzego Waszyngtona Street, 81-342 Gdynia was registered on 24 October 2014 in the Gdansk-North District Court for Gdansk, 8th Commercial Division of the National Court Register under the KRS number 0000528469. The Bank received a statistical REGON No. 222181030. The share capital amounts to PLN 800 000 000.00 and was fully paid up.

Business activities of the Bank

PKO Bank Hipoteczny is a specialized bank that operates in terms of the Mortgage bond and mortgage banks Act dated 29 August 1997, the Commercial Companies Code and other generally applicable provisions of law, the principles of good banking practice and the Bank's Statute.

PKO Bank Hipoteczny SA specializes in granting mortgage loans for individuals and acquiring portfolios of such loans form PKO Bank Polski SA. The Bank acquires loans for its portfolio, in terms of the strategic cooperation with PKO Bank Polski SA.

The main objective of PKO Bank Hipoteczny SA is to issue mortgage covered bonds, which are intended to provide the primary source of long-term financing for the mortgage loans granted or acquired by the Bank.

Statement as to whether the Bank is a parent company or a significant investor and whether it prepares consolidated financial statements

PKO Bank Hipoteczny SA is not a parent company or a significant investor in associates and jointly controlled entities, therefore PKO Bank Hipoteczny SA does not prepare consolidated financial statement, which would include the financial data of such entities.

The Parent entity of PKO Bank Hipoteczny SA is PKO Bank Polski SA, which prepares consolidated financial statements for the PKO Bank Polski Group.

Information on members of the Supervisory and Management Board of the Bank

The following table presents the composition of Management Board during the reporting period:

No.	First and Last Name	Function	Appointment Date	Resignation Date
1	Rafał Kozłowski	President of the Management Board	06.10.2014	-
2	Jakub Niesłuchowski	Vice-President of the Management Board	01.04.2015	-
3	Marek Szcześniak	Vice-President of the Management Board	01.06.2015	-

The following table shows the Supervisory Board and changes in the Supervisory Board of PKO Bank Hipoteczny SA appointed by the General Meeting of Shareholders during the reporting period:

No.	First and Last Name	Function	Appointment Date	Resignation Date
1	Jakub Papierski	Chairman of the Supervisory Board	06.10.2014	-
2	Jacek Obłękowski	Deputy-Chairman of the Supervisory Board	06.10.2014	08.04.2016
3	Piotr Mazur	Member of the Supervisory Board/ Deputy-Chairman of the Supervisory Board (since 14.04.2016)	06.10.2014	-
4	Piotr Alicki	Member of the Supervisory Board	06.10.2014	31.10.2016
5	Artur Osytek	Member of the Supervisory Board	06.10.2014	-
6	Barbara Soares da Silva	Member of the Supervisory Board	06.10.2014	-
7	Mieczysław Król	Member of the Supervisory Board	28.10.2016	-
8	Justyna Borkiewicz	Member of the Supervisory Board	28.10.2016	-
9	Adam Marciniak	Member of the Supervisory Board	28.10.2016	-

Approval of the Financial Statements

These financial statements, subject to a review and opinion of Audit and Finance Committee of the Supervisory Board and evaluation by the Supervisory Board on 3 March 2017, were approved by the Management Board for publication on 28 February 2017.

2. Summary of significant accounting policies

2.1. Statement of Compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union, effective as at 31 December 2016 and with respect to matters not regulated by the above standards, in accordance with the accounting principles as set out in the Accounting Act dated 29 September 1994 (Official Journal from 2013, item 330 with amendments) and the respective implementing regulations issued on the basis thereof.

2.2. Going concern

The financial statements of the Bank have been prepared on the going concern basis using the assumption that the Bank will continue its business operations for a period of at least 12 months from the end of the reporting period. As at the date of the signing of these financial statements, the Bank's Management Board is not aware of any facts or circumstances that could indicate a threat to the going concern assumption, for the foreseeable future, as a result of any intended or compulsory discontinuance or significant limitation of the Bank's current activities.

2.3. Basis of preparation of the financial statement

These financial statements have been prepared on a fair value basis in respect of financial assets and liabilities measured at fair value through profit or loss, including derivatives and financial assets available for sale, except those for which fair value cannot be reliably estimated. Other financial assets and liabilities (including loans and advances) are measured at amortized cost using the effective interest rate method less impairment or at purchase cost less impairment.

Non-current assets are stated at cost less accumulated depreciation or amortization and impairment allowances.

Non-current assets (or groups of the above-mentioned assets) classified as held for sale are stated at the lower of their carrying amount and fair value less costs to sell.

2.4. Foreign currencies

2.4.1. Transactions and balances denominated in foreign currencies

Foreign currency transactions are translated into the functional currency using exchange rates prevailing at the dates of the transactions. At each reporting date items are translated using the following principles:

1) monetary assets denominated in foreign currency, using a closing rate, i.e. the average rate announced by the National Bank of Poland prevailing as at the reporting date,
2) non-monetary assets measured at historical cost in foreign currency, using the exchange rate as of the date of the transaction,
3) non-monetary assets measured at fair value in foreign currency are translated, using exchange rates prevailing as at the date of the determination of fair value.

Gains and losses from the foreign currency transactions and the carrying amount of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of profit or loss.

The financial statements are presented in Polish zloty, which is the functional and presentation currency of the Bank.

2.5. Financial assets and liabilities

2.5.1 Classification

The Bank classifies financial assets into the following categories: financial assets measured at fair value through profit or loss, financial assets available for sale, loans, advances and other receivables, financial assets held to maturity. Financial liabilities are classified as follows: financial liabilities measured at fair value through profit or loss and other financial liabilities. The Bank decides on the classification of its financial assets and financial liabilities at initial recognition.

2.5.1.1 Financial assets and liabilities designated as at fair value through profit or loss

Financial assets and financial liabilities designated as at fair value through profit or loss are financial assets and financial liabilities that meet either of the following conditions:

1) they are classified as held for trading. Financial assets or financial liabilities are classified as held for trading if they are acquired or incurred principally for the purpose of sale or repurchase in the near term, are a part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-making. Derivatives are also classified as held for trading except for derivatives that are designated and effective hedging instruments.
2) upon initial recognition they are classified as designated at fair value through profit or loss. The Bank may use this designation only when:
   a. the designated financial asset or liability is a hybrid instrument which includes one or more embedded derivatives qualifying for separate recognition, and the embedded derivative financial instrument cannot significantly change the cash flows resulting from the host contract or its separation from the hybrid instrument is forbidden;
   b. it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on a different basis;
   c. a group of financial assets, financial liabilities or both is properly managed and its performance is evaluated on a fair value basis, in accordance with the written risk management principles or investment strategy of the Bank.
3) The Bank has an investment management policy according to which portfolios of financial assets classified as held for trading and financial assets designated upon initial recognition at fair value through profit or loss are managed separately.

2.5.1.2 Financial assets available for sale

Financial assets available for sale are those non-derivative financial assets that are designated as available for sale or are not classified as financial assets:

1) designated by the Bank upon initial recognition as at fair value through profit or loss,
2) held to maturity,
3) those that meet the definition of loans and advances.

2.5.1.3 Loans, advances and other receivables

Loans, advances and other receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market, other than:

1) financial assets that the Bank intends to sell immediately or in the near term, which are classified as held for trading, and those that Bank designates as at fair value through profit or loss upon initial recognition,
2) financial assets that the Bank designates upon initial recognition as available for sale,
3) financial assets for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which are classified as available for sale.

2.5.1.4 Financial assets held to maturity

Financial assets held to maturity are financial assets with fixed or determinable payments and fixed maturity that the Bank intends and is able to hold to maturity, excluding assets that the Bank designates as at fair value through profit or loss upon initial recognition, assets classified as available for sale and loans, advances and other receivables of the Bank.

2.5.1.5 Other financial liabilities

Other financial liabilities are financial liabilities other than those designated as at fair value through profit or loss which have the nature of a deposit, a loan or an advance received.

2.5.2 Accounting for transactions

Financial assets and financial liabilities, including forward transactions and standardized transactions giving rise to an obligation or a right to acquire or sell in the future a given number of specified financial instruments at a given price, are recognized in the books of account at trade date, irrespective of the settlement date provided in the contract.

2.5.3 Derecognition of financial instruments from the statement of financial position

Financial assets are derecognized from the statement of financial position when the contractual rights to cash flows from the financial asset expire, or when the Bank transfers the financial asset to another entity. The financial asset is transferred when the Bank:

1) transfers the contractual rights to receive cash flows from the financial asset, or
2) retains the contractual rights to receive cash flows from the financial asset, but assumes a contractual obligation to pay cash flows to an entity outside the Bank.

When the Bank transfers a financial asset, it evaluates the extent to which it retains the risks and rewards of ownership of the financial asset. In such a case:

1) if all the risks and rewards of ownership of the financial asset are substantially transferred, then the Bank derecognizes the financial asset from the statement of financial position,
2) if all the risks and rewards of ownership of the financial asset are substantially retained, then the financial asset continues to be recognized in the statement of financial position,
3) if substantially all the risks and rewards of ownership of the financial asset are neither transferred nor retained, the entity determines whether control of the financial asset has been retained. If the Bank has retained control, it continues to recognize the financial asset in the statement of financial position to the extent of its continuing involvement in the financial asset, if control has not been retained, then the financial asset is derecognized from the statement of financial position.

The Bank removes a financial liability (or a part of a financial liability) from its statement of financial position when the obligation specified in the contract has been settled, cancelled or has expired.

2.5.4 Valuation

When a financial asset or liability is initially recognized, it is measured at its fair value increased, in case of a financial asset or liability not designated at fair value through profit or loss, by transaction costs that are directly attributable to the acquisition or the issuance of the financial asset or liability.

The fair value is the price that would be received for the sale of an asset or paid for the transfer of a liability in a transaction carried out under regular conditions on the main (or most advantageous) market at the valuation date under current market conditions (i.e. exit price), regardless of whether this price is directly observable or estimated using another valuation technique.

Subsequent to initial recognition financial instruments are valued as follows:

2.5.4.1 Assets and financial liabilities measured at fair value through profit or loss

They are measured at fair value through profit or loss, to the line item: income from financial instruments measured at fair value.

2.5.4.2 Financial assets available for sale

They are measured at fair value, and gains and losses arising from changes in fair value (except for impairment losses) are recognized in other comprehensive income, until the asset is derecognized from the statement of financial position, when the cumulative gain/loss is recognized in the statement of profit or loss. Interest accrued using the effective interest rate on financial assets available for sale is presented in net interest income.

2.5.4.3 Loans, advances and investments held to maturity

They are measured at amortized cost using the effective interest method, less impairment losses. Loans and advances for which it is not possible to determine the schedule of future cash flows and therefore the effective interest rate, are measured at the principal due.

2.5.4.4 Other financial liabilities including liabilities resulting from the issue of mortgage covered bonds and unsecured bonds

They are measured at amortized cost using the effective interest method. If the time schedule of cash flows from a financial liability cannot be determined, and thus the effective interest rate cannot be determined reliably, the liability is measured at the amount equal to the principal due.

Debt instruments issued by the Bank, i.e. mortgage covered bonds issued and unsecured bonds issued, are recognized as financial liabilities and measured at amortized cost using effective interest method.

2.5.5 Derivative instruments

2.5.5.1 Recognition and measurement

Derivative financial instruments are recognized at fair value from the trade date. A derivative instrument becomes an asset if its fair value is positive and it becomes a liability if its fair value is negative.

The valuation of these instruments includes the counterparty's credit risk and the Bank's own credit risk.

When the estimated fair value is lower or higher than the fair value as of the preceding reporting date (for transactions concluded in the reporting period – initial fair value), the Bank presents the difference in income from financial instruments designated at fair value through profit or loss or in foreign exchange result, as appropriate, with a corresponding adjustment to 'Derivative financial instruments'.

The result of the ultimate settlement of derivative instruments transactions is recognized in income from financial instruments designated at fair value through profit or loss or in the foreign exchange result.

The notional amounts of the underlying derivative instruments are recorded and disclosed from the date of the transaction until maturity.

2.5.6. Hedge accounting

2.5.6.1 Hedge accounting criteria

The Bank applies hedge accounting when all conditions listed below have been met:

1) upon setting up the hedge, the hedge relationship, the risk management purpose of the entity and the hedging strategy were formally established and documented. The documentation includes the identification of the hedging instrument, the hedged item or transaction, the nature of the hedged risk and the manner in which the entity will assess the effectiveness of the hedging instrument in compensating changes in the fair value of the hedged item or the cash flows related to the hedged risk,
2) a hedge is expected to be highly effective in compensating changes to the fair value or cash flows resulting from the hedged risk in accordance with the initially documented risk management strategy relating to the specific hedge relationship,
3) in respect of cash flow hedges, the planned hedged transaction must be highly probable and must be exposed to changes in cash flows which may, as a result, have an impact on the statement of profit or loss,
4) the effectiveness of a hedge can be reliably assessed, i.e. the fair value or cash flows related to the hedged item and resulting from the hedged risk, and the fair value of the hedging instrument, can be reliably measured,
5) the hedge is regularly assessed and is determined to be high effective for all reporting periods for which the hedge had been established.

2.5.6.2.Discontinuing hedge accounting

The Bank discontinues hedge accounting when:

1) a hedging instrument expires, is sold, terminated or exercised (replacing one hedging instrument with another hedging instrument or extending the maturity of a given hedge instrument is not considered to be expiration or termination if such replacement or extension of period to maturity is part of the documented hedging strategy adopted by the entity). In such an instance accumulated gains or losses related to the hedging instrument which were recognised directly in other comprehensive income over the period the hedge was effective are recognised in a separate item in other comprehensive income and recognised in the statement of profit or loss on a straight-line basis over the period the hedged item is recognised in the statement of profit or loss,
2) the hedge ceases to meet the hedge accounting criteria. In such an instance accumulated gains or losses related to the hedging instrument which were recognised directly in other comprehensive income over the period the hedge was effective are recognised in a separate item in other comprehensive income and recognised in the statement of profit or loss on a straight-line basis over the period the hedged item is recognised in the statement of profit or loss,
3) the planned transaction is no longer considered probable, therefore, all the accumulated gains or losses related to the hedging instrument which were recognised directly in other comprehensive income over the period the hedge was effective, are recognised in the statement of profit or loss,
6) the hedging relationship has been formally revoked.

2.5.6.3. Fair value hedge

The Bank does not apply fair value hedge accounting.

2.5.6.4. Cash flow hedges

During 2016, the Bank initiated cash flow hedge accounting. A cash flow hedge is a hedge of the exposure to cash flow variability which can be attributed to a specific type of risk related to a recorded asset or a liability (such as the whole or a portion of future interest payments on variable interest rate debt) or a highly probable planned transaction, and could affect the statement of profit or loss.

Changes in the fair value of a derivative financial instrument designated as a cash flow hedge are recognised directly in other comprehensive income in respect of the portion constituting the effective portion of the hedge. The ineffective portion of a hedge is recognised in the statement of profit or loss as 'Net income from financial instruments designated at fair value' or 'Foreign exchange result'. Amounts recognised directly in other comprehensive income are transferred to the statement of profit or loss as 'Net interest income' or 'Foreign exchange result' in the same period or periods the hedged position is recognised in the statement of profit or loss.

Effectiveness tests are performed by valuation of hedging transactions, net of interest accrued and currency translation differences on the nominal value of the hedging transactions (with respect to CIRS transactions).

2.6. Offsetting financial instruments

Financial assets and liabilities are offset only if the Bank has a legally enforceable right to set-off the recognized amounts and intends to settle them on a net basis or simultaneously realize the particular asset and settle the liability.

2.7. Impairment of financial assets

2.7.1. Assets measured at amortized cost

At each reporting date, for loans and advances, the Bank assesses whether there is objective evidence that a given financial asset or a group of financial assets is impaired. If such evidence exists, the Bank determines the amounts of impairment allowances. An impairment loss is incurred when there is objective evidence of impairment due to one or more events that occurred after the initial recognition of the asset ('a loss event'), and the event has a reliably measurable impact on the expected future cash flows from the financial asset or group of financial assets.

Objective evidence that a financial asset or a group of financial assets is impaired includes information that comes to the attention of the Bank particularly about the following events:

1) significant financial difficulties of the issuer or the debtor,
2) breach of a contract by the issuer or the debtor, such as a default or a delinquency in contracted payments of interest or principal,
3) granting a concession by the lender to the issuer or the borrower, for economic or legal reasons relating to the borrower's financial difficulty, that the lender would not otherwise consider,
4) high probability of bankruptcy or reorganization of the issuer or the debtor.

Credit exposures, in respect of which no objective evidence of individual impairment was identified, or in spite of their occurrence no impairment loss was recognized, are assessed for impairment as a group of exposures with the same characteristics.

The measurement of the impairment loss is based on portfolio risk parameters estimated by statistical methods. If a loss is identified for an individual credit exposure, an appropriate impairment allowance is recognized. If a loss was not recognized for an individual credit exposure, the exposure is allocated to a portfolio of assets with similar characteristics, which is assessed on a collective basis and are subject to an impairment allowance recognized for the respective group for incurred but not reported loss (IBNR allowance).

The amount of the impairment allowance and IBNR allowance is the difference between the carrying amount of the asset and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred), discounted using the effective interest rate at the date the impairment trigger occurred for this particular financial asset.

The present value of estimated cash flows related to the financial assets for which collateral is held takes, into account cash flows arising from acquiring the collateral, less acquisition and selling costs.

The following portfolio parameters are used in estimating impairment allowances:

1) recovery rates estimated for the group of exposures with certain characteristics,
2) probability of reporting a loss for individual exposures (in relation to exposures from the collective IBNR portfolio).

Future cash flows regarding a group of financial assets assessed for impairment on a collective basis, are estimated on the basis of cash flows generated from contracts and historical recovery parameters generated from assets with similar risk characteristics.

Historical recovery parameters are adjusted on the basis of data from current observations, so as to take into account the impact of current conditions and exclude factors that were relevant in the past but which currently do not occur. In subsequent period, if the amount of an impairment loss is reduced because of an event subsequent to the impairment being recognized (e.g. improvement in debtor's credit rating) the impairment loss that was previously recognized is reversed by making an appropriate adjustment to impairment allowances. The amount of the reversal is recognized in the statement of profit or loss.

The Bank plans that the adopted methodology used for estimating impairment allowances will be further developed with the further the development of capacity to obtain data indicating impairment from the existing applications and information systems and those under development. As a consequence, new data obtained could influence the level of impairment allowances in the future.

The methodology and assumptions used in the estimates are reviewed on a regular basis to minimize the differences between the estimated and actual incurred losses.

2.7.2. Assets available for sale

At each reporting date, the Bank makes an assessment, whether there is objective evidence that a given financial asset classified to financial assets available for sale is impaired. If such evidence exists, the Bank determines the amounts of impairment allowances.

2.8. Leasing

The Bank is a party to operating lease agreements on the basis of which it accepts fixed assets for chargeable use over a period determined in the agreement. The Bank classifies lease contracts on the basis of the risks and rewards of ownership of the leased assets attributable to the lessor and the lessee.

Lease payments made under an operating lease and subsequent instalments are recognized in the statement of profit or loss as a cost on a straight-line basis over the term of the lease.

2.9. Property, plant and equipment and intangible assets

2.9.1. Intangible assets

Intangible assets are identifiable non-monetary assets which do not have a physical form.

2.9.1.1. Software

Acquired computer software licenses is capitalized in the amount of costs incurred on the purchase and preparation of the software for use, less accumulated amortization and impairment losses.

Further expenditure related to the maintenance of the computer software is recognized in profit or loss when incurred.

2.9.1.2. Other intangible assets

Other intangible assets acquired by the Bank are recognized at purchase price or cost to produce, less accumulated depreciation and impairment losses.

2.9.1.3. Development Costs

Development costs are recognized as intangible assets on condition that they are anticipated to generate future economic benefits and subject to meeting specific requirements and conditions, i.e. it is a possible and it is intended to complete and use the internally generated intangible asset, there are appropriate technical and financial resources to complete the development and to use the asset and it is possible to reliably measure the expenditure attributable to the intangible asset during its development which can be directly attributed to the development of the intangible asset

2.9.2. Property, plant and equipment

Property, plant and equipment are recognized at purchase price or cost of production less accumulated depreciation and impairment losses, at the end of the reporting period.

2.9.3. Subsequent expenses

The carrying amount of items of property, plant and equipment and intangible assets is increased by additional expenditures incurred during their useful life, when:

1) it is probable that the Bank will receive future economic benefits which can be assigned to the particular item of property, plant and equipment or intangible asset (higher than initially assessed, for example, measured by useful life, improvement of service quality, maintenance costs),
2) the purchase price or the cost to produce the item of property, plant and equipment or intangible assets can be measured reliably.

2.9.4. Depreciation/amortization and the useful life of property, plant and equipment and intangible assets

Depreciation/amortization is charged on all non-current assets, whose value decreases due to usage or passage of time, using the straight-line basis over the estimated useful life of the given asset. The adopted depreciation/amortization method and useful life of an asset are subject to reviews at least once a year.

In estimating useful lives of particular types of property, plant and equipment and intangible assets, following factors are considered:

1) expected physical wear and tear, estimated based on the average period of use observed to date, reflecting physical wear and tear rate, intensity of use etc.,
2) loss of utility due to technical or market obsolescence,
3) legal and other limitations regarding the use of the asset,
4) expected use of the asset estimated based on the expected production capacity or volume,
5) other factors affecting useful lives of such assets.

When the period of use of a given asset results from a contractual term, the useful life of such an asset is equal to the period defined in the contract. If the estimated useful life is shorter than the period defined in the contract, the estimated useful life is applied.

For non-financial fixed assets it is assumed that the residual value is nil, unless there is an obligation of a third party to buy back the asset, or if there is an active market which will continue to exist at the end of the asset's period of use and when it is possible to determine the value of the asset on this market.

Depreciation/amortization periods for basic groups of property, plant and equipment and intangible assets applied by PKO Bank Hipoteczny SA:

Property, plant and equipment	Periods
Leaseholds improvements (buildings, premises)	10 years
Machinery and equipment	from 2 to 5 years
Computer hardware	3 years
Intangible assets	Periods
Software	from 2 to 5 years

2.9.5. Impairment allowances for non-financial non-current assets

At each reporting date, the Bank makes an assessment of whether there are any indicators of impairment of any non-financial non-current assets (or cash-generating units). If any such indicators are identified and annually for intangible assets which are not amortized, the Bank estimates the recoverable amount, which is the higher of the fair value less costs to sell or the value in use of the non-current asset (or cash-generating unit). If the carrying amount of an asset exceeds its recoverable amount, the Bank recognizes an impairment loss in the statement of profit or loss. Estimating the above-mentioned values requires assumptions, about, among others, future expected cash flows that the Bank may receive from the continued use or disposal of the non-current asset (or cash-generating unit). The adoption of different assumptions with respect to the value of future cash flows could affect the carrying amount of certain non-current assets.

If there are indications for impairment for a group of assets, which do not generate cash flows irrespective of other assets or asset groups, and the recoverable amount of a single asset included in common assets cannot be determined, the Bank determines the recoverable amount at the level of the cash-generating unit to which the asset belongs.

An impairment allowance is recognized if the carrying value of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognized in the statement of profit or loss.

Impairment allowances in respect of cash-generating units first and foremost decrease the goodwill relating to those cash-generating units (groups of units), and then they proportionally decrease the carrying value of other assets in the unit (group of units).

In respect of other assets, the impairment allowance may be reversed if there was a change in the estimates used to determine the recoverable amount. An impairment allowance may be reversed only to the extent to which the carrying value of an asset does not exceed its carrying value, less depreciation/amortization, had the impairment allowances have not been recognized.

2.10. Accruals and deferred income

This item comprises mainly fees and commissions accounted for on a straight line basis and other income received in advance, which will be recognized in the statement of profit or loss in future reporting periods. Accruals and deferred income are presented in the statement of financial position under 'Other liabilities'.

Prepayments and deferred costs relate to particular types of expenses which will be gradually recognized in the statement of profit or loss in future reporting periods, over the period to which the costs relate. Prepayments and deferred costs are presented in the statement of financial position under 'Other assets'.

2.11. Provisions

Provisions are liabilities of uncertain amount or timing of settlement. They are recognized when the Bank has a present obligation (legal or constructive) as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

If the effect of the time value of money is material, the amount of the provision is determined by discounting the forecasted future cash flows to their present value, using the discount rate before tax which reflects the current market assessments of the time value of money and the potential risk related to a given liability.

The Bank recognizes provisions for legal claims from counterparties, customers and external institutions on obtaining information from its legal advisor of a high probability of an unfavorable outcome of the legal action, provisions for retirement benefits, provisions for liabilities and guarantees and other provisions.

Provisions for commitments of a financial nature are determined based on the expected exposure which will arise from the commitment. To determine the provision, the credit conversion factor (CCF) estimated for the portfolio of exposures with similar characteristics, is used. The CCF is then the basis for determining the amount of the provision, either by comparing it to the present value of expected future cash flows from the exposure, resulting from the commitment, determined individually or using the portfolio parameters estimated by statistical methods (a portfolio and collective basis).

All provisions are charged to the statement of profit or loss.

A detailed description of the accounting principles is presented in Note 36.4. 'Provisions for off-balance sheet credit exposures.'

2.12. Employee benefits and the determination of provisions for employee benefits

According to the Labour Code (Kodeks Pracy), employees of PKO Bank Hipoteczny SA are entitled to retirement or pension benefits upon retirement or pension. The Bank periodically performs a valuation of provisions for future liabilities to employees.

The provision for retirement and pension benefits arising from the Labour Code is recognized individually for each employee on the basis of a periodical valuation. The basis for calculating these provisions are determined by the internal regulations of the entity. The calculation takes into account all retirement and pension benefits expected to be paid in the future. The provision is recognized on the basis of a list of persons including all the necessary details of employees, in particular the length of service, age and gender. The provisions are raised at the amount of future payments, and relate to the period ending at the reporting date.

The Bank recognizes provisions for future liabilities arising from compensation and severance payments made to those employees whose employment contracts are terminated for reasons independent of the employees and periodic settlements with respect to the employee remuneration costs incurred in the current period which will be paid in future periods, including bonuses and unused annual leave, taking into account all outstanding unused holiday days.

Employee benefits also comprise variable components of remuneration of persons in managerial positions, part of which is recognized as a liability due to cash-settled share-based payments based on the shares book value.

2.13. Cost of external financing

Costs of external financing that can be directly attributed to the acquisition, construction or production of an asset, are capitalized by the Bank as part of the cost of the asset if it is probable that future economic benefits associated with the item will flow to the Bank, and that the purchase price or cost of production of the item can be measured reliably.

Other external financing costs are charged to the statement of profit or loss during the financial period in which they are incurred.

2.14. Contingent liabilities for commitments

Within its operating activities, the Bank concludes transactions, which, at their conclusion are not recognized in the statement of financial position as assets or liabilities, however which give rise to contingent liabilities. A contingent liability is:

1) a possible obligation that arises from past events and whose existence will be confirmed only at the time of occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Bank,
2) a present obligation resulting from past events, but not recognized in the statement of financial position, because it is not probable that an outflow of cash or other assets will be required to fulfil the obligation, or the amount of the obligation cannot be estimated reliably.

For off-balance sheet commitments, provisions are recognized in accordance with IAS 37 for the exposed to the risk of the counterparty default. The most significant off balance-sheet commitments are unsettled loan commitments.

2.15. Equity

Equity constitutes capital and reserves recognized in accordance with binding legal regulations and the Bank's Statute.

2.15.1 Share capital

Share capital is stated at nominal value in accordance with the Bank's Statute and the Register of Entrepreneurs in the National Court Register

2.15.2 Supplementary capital

Supplementary capital is recognized according to the Bank's Statute, from allocations made from net profits and from share premium less issue costs and it is accumulated to cover potential losses which might arise from the Bank's activities.

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Supplementary capital is recognized according to the Bank's Statute, from allocations made from net profits and from share premium less issue costs and it is accumulated to cover potential losses which might arise from the Bank's activities.

2.15.3 Revaluation reserve

The effects of the revaluation of financial assets available for sale net of the related deferred tax, the effective part of cash flow hedging resulting from hedge accounting net of the related deferred tax as well as actuarial gains and losses net of the amount of the related deferred tax are recognized in the revaluation reserve.

2.15.4 General banking risk fund

The general banking risk fund is created from net profit in accordance with the Banking Law dated 29 August 1997 (Journal of Laws of 2012, item 1376 with subsequent amendments) referred to as 'the Banking Law', and serves to cover unidentified risks of the Bank's operations.

2.15.5 Other reserves

Other reserves are created from the allocation of net profits. They serve to cover potential losses.

2.16. Determination of a financial result

The Bank recognizes all significant expenses and income in accordance with the following principles: an accrual basis, the matching principle, policies for recognition and valuation of assets and liabilities, policies for recognition of impairment losses.

2.16.1 Interest income and expense

Interest income and expense comprise interest, including premiums and discounts in respect of financial instruments measured at amortized cost and instruments valued at fair value, with the exception of derivative financial instruments. Interest income and interest expense are recognized on an accrual basis using the effective interest rate method. Interest income, with respect to financial assets or a group of similar financial assets for which an impairment allowance was recognized, is accrued based on the present values of receivables (net of impairment allowances) using the current interest rate used to discount future cash flows for the purposes of determining impairment losses.

Interest income/expense in respect of derivative financial instruments is recognized in ‘Net income from financial instruments at fair value through profit or loss’ or ‘Foreign exchange result’.

Interest income also includes deferred fees and commissions received and paid, which are recognized in the carrying value of the financial instruments.

2.16.2 Fee and commission income and expense

Fee and commission income is generally recognized on an accrual basis at the time when the related service is performed. Fee and commission income includes one-off amounts charged by the Bank for services not related directly to initiation of loans, advances and other receivables, as well as amounts charged by the Bank for services performed over a period exceeding 3 months, which are recognized on a straight-line basis. Fee and commission income also includes deferred fees and commissions recognized on a straight-line basis, with respect to loans granted with an unspecified schedule of future cash flows, for which the effective interest rate cannot be determined.

Fee and commission expense also include deferred fees and commissions recognized on a straight-line basis, with respect to external financing received with an unspecified schedule of future cash flows for which the effective interest rate cannot be determined.

The Bank does not offer insurance products with credits and loans.

2.16.3 Income from financial instruments designated as at fair value

The result on financial instruments designated as at fair value through profit or loss includes gains and losses arising from the disposal of financial instruments classified as financial assets/liabilities as at fair value through profit or loss as well as the effect of their fair value measurement.

2.16.4 Income from investment securities

Income from investment securities include gains and losses arising from disposal of financial instruments classified as available for sale and held to maturity.

2.16.5 Foreign exchange result

The foreign exchange result comprise foreign exchange gains and losses, both realized and unrealized, resulting from daily revaluation of assets and liabilities denominated in foreign currency using the National Bank of Poland average exchange rates at the reporting date, and from the revaluation of outstanding derivatives.

The Bank presented monetary assets and liabilities, representing the statement of financial position and off-balance sheet foreign currency position, translated into Polish zloty using the average National Bank of Poland exchange rates prevailing for a given currency as at the reporting date. Realized and unrealized translation differences are recognized in the statement of profit or loss.

2.16.6 Other operating income and expense

Other operating income and expense include income and expense not directly related to banking activity.

2.17. Income tax

Income tax expense is classified as into current and deferred income tax. Current income tax is recognized in the statement of profit or loss. Deferred income tax, depending on the source of the temporary differences, is recognized in the statement of profit or loss or in ‘other comprehensive income’ in the statement of comprehensive income.

2.17.1 Current income tax

Current income tax is determined on the basis of the accounting profit before tax adjusted by non-taxable income, taxable income that does not constitute accounting income, non-tax deductible expenses and tax deductible costs which are not accounting costs, in accordance with applicable tax regulations. These items mainly include income and expenses relating to accrued interest receivable and payable, impairment allowances for receivables and provisions for off-balance sheet liabilities.

2.17.2 Deferred income tax

Deferred income tax is determined as the difference between the tax base and book value of assets and liabilities for financial reporting purposes. The Bank recognizes deferred income tax assets and liabilities. Deferred tax recognized in profit or loss is determined based on the change in the difference between the carrying values and tax values of assets and liabilities, which the applicable tax rate is applied. Deferred tax assets and deferred tax liabilities of the Bank are presented in the statement of financial position as assets or liabilities respectively. The change in the balance of the deferred tax liability and deferred tax asset is included in the obligatory charges to the net result (‘Income tax expense’ in the ‘Statement of profit or loss’), except for the effects of the valuation of financial assets recognized in other comprehensive income, in relation to which changes in the deferred tax liability and deferred tax asset are also recognized in other comprehensive income.

Deferred income tax is determined taking into account the balance of the deferred tax asset and deferred tax liability at the beginning and at the end of the reporting period.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or a part of the deferred income tax asset to be realized.

Deferred income tax assets and liabilities are measured using tax rates that are expected to apply in the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred income tax assets are offset against deferred income tax liabilities only when the enforceable legal entitlement to offset current tax receivables with current tax liabilities exists and deferred income tax is related to the same taxpayer and the same tax authority.

(IN PLN THOUSAND)

2.18. Critical estimates and judgments

In preparing its financial statements, the Bank makes certain estimates and assumptions, which have a direct influence on both the financial statements and supplementary information included therein. The estimates and assumptions that are used by the Bank in determining the value of assets and liabilities as well as revenues and costs, are made based on historical data and other factors which are available and are considered to be proper in the given circumstances.

Assumptions regarding the future and the available data are used for assessing the carrying amounts of assets and liabilities which cannot be determined unequivocally using other sources. In making estimates the Bank takes into consideration the reasons for and sources of the uncertainties that are anticipated at the end of the reporting period. Actual results may differ from estimates.

Estimates and assumptions made by the Bank are subject to periodic reviews. Adjustments to estimates are recognized in the period in which the estimates were adjusted, provided that these adjustments affect only the given period. However, if the adjustments affect both the period in which the adjustments were made as well as future periods, they are recognized in the period in which the adjustments were made and in future periods.

The most significant areas in which the Bank applies estimates are presented below:

2.18.1 Impairment of loans and advances

A detailed description of the adopted accounting principles is presented in Note 2.7.1 '*Impairment of financial assets' – 'Assets measured at amortized cost*

2.18.2 Valuation of derivatives and unlisted debt securities available for sale

The fair value of non-option derivatives is determined using valuation models based on discounted cash flows expected to be received from the given financial instrument. Options are valued using option pricing models. The variables and assumptions used in a valuation include, where available, data derived from observable markets. The fair value of derivatives includes the Bank's own credit risk as well as counterparty credit risk. With respect to the valuation of derivative instruments, adjustment are made to reflect counterparty credit risk CVA (credit value adjustment) and adjustment the Bank's own credit risk DVA (debt value adjustment). The process of calculating CVA and DVA adjustments includes the selection of the method of determining the credit risk spread of the counterparty or Bank (for example a market price method based on price quotations of liquid debt instruments issued by the counterparty, a method of spread implied from Credit Default Swap contracts), an estimation of the probability of default of the counterparty or the Bank and the recovery rate, and calculation of the CVA and DVA adjustments (advanced method, taking into consideration collateral or a simplified method. As at 31 December 2016 the CVA and DVA adjustments amounted to PLN 2 972 thousand.

The valuation techniques used by the Bank for non-option derivative instruments are based on yield curves based on available market data (deposit margins on the interbank market, IRS quotations).

The fair value of debt securities not quoted on an active market is determined using valuation models based on discounted cash flows anticipated from that financial instrument.

Assumptions adopted for the fair value measurement are described in Note 33, 'Fair value of financial assets and liabilities'.

2.19 Changes in presentation of financial statements

The Bank changed the presentation of cost related to the commissions for servicing loans granted as well as purchased receivables under the Outsourcing agreement with PKO Bank Polski SA that is described in Note 32.1. These costs were previously presented in the statement of profit or loss as *Fee and commission expenses*, and are now presented as *General administrative expenses.* The revised presentation better reflects the nature of the costs incurred by the Bank in respect of commission for servicing loans and purchased receivables as such expenses would be presented as general administrative expenses had the Bank serviced these loans as part of its operations. The table below presents the restatement of information presented in the previous financial statements for the period from 6 January 2014 to 31 December 2015:

	06.10.2014 - 31.12.2015 as previously reported	restatement	06.10.2014 - 31.12.2015 restated
Interest income	7 808	-	7 808
Interest expense	(63)	-	(63)
Net interest income	**7 745**	**-**	**7 745**
Fee and commission income	891	-	891
Fee and commission expense	(2 460)	88	(2 372)
Net fees and commissions	**(1 569)**	**88**	**(1 481)**
Income from financial instruments measured at fair value	(1)	-	(1)
Foreign exchange result	(3)	-	(3)
Other operating income	119	-	119
Other operating expense	(55)	-	(55)
Net other operating income and expense	**64**	**-**	**64**
Impairment allowance and write-downs	(229)	-	(229)
General administrative expenses	(23 242)	(88)	(23 330)
Operating result	**(17 235)**	**-**	**(17 235)**
Profit / (Loss) before income tax	**(17 235)**	**-**	**(17 235)**
Income tax expense	3 262	-	3 262
Net profit / (loss)	**(13 973)**	**-**	**(13 973)**

2.20. Changes in accounting policies

The Bank prepares its financial statements in accordance with International Financial Reporting Standards adopted by the European Union in the form of European Union Commission Regulations (EU Commission).

The introduction of new standards and interpretations, which came into force in 2016 had no significant impact on these financial statements.

2.20.1.New standards and interpretations, and amendments thereto, which have been published and have been approved by the European Union, but are not yet effective and have not yet been applied by the Bank

Management does not expect the introduction of new standards, their amendments and interpretations to have a significant impact on the accounting principles applied by the Bank, with the exception of IFRS 9. The Bank intends to apply them in accordance with the effective dates specified in the relevant standards and interpretations (without early adoption), subject to approval by the European Union.

IFRS 9 "FINANCIAL INSTRUMENTS"

IFRS 9 "Financial Instruments" was published in July 2014 and endorsed for application in EU Member States on 22 November 2016 by Commission Regulation (EU) 2016/2067. It is mandatory for financial statements prepared for the financial years starting on or after 1 January 2018 (with the exception of insurance companies, which may apply the standard from 1 January 2021). The standard replaces IAS 39 "Financial Instruments: Recognition and Measurement". The classification and measurement of financial instruments, recognition and determination of their impairment and hedge accounting are amended.

Classification and Measurement:

IFRS 9 defines 3 measurement categories of financial instruments:

- amortized cost using the effective interest method (hereinafter "amortized cost"),
- fair value through other comprehensive income (hereinafter "FVOCI"), and
- fair value through profit or loss (hereinafter "FVP&L").

The above corresponds to the measurement methods known from IAS 39, however the principles of classifying items to the individual categories are completely different.

With respect to debt instruments, the classification of financial assets is based on the entity's business model and the characteristics of cash flows generated by those assets.

The test of the business model establishes whether a given instrument is maintained to obtain contractual cash flows or to realize fair value changes before the maturity date. There are three groups within the business model: "holding", "holding and selling" and "selling".

The test of the cash flow characteristics establishes whether contractual cash flows are solely payments of principal and interest (defined as consideration for the time value of money and risks related to the value of the exposure in a given period (hereinafter "SPPI").

If both these tests have been satisfied, debt assets are classified as measured at amortized cost, with the exception of the possibility of classification of instruments as FVP&L in the event that such measurement eliminates the accounting mismatch in the measurement method.

The standard introduced a new measurement category of fair value through other comprehensive income (FVOCI) which will include debt instruments used under a business model assuming both obtaining contractual cash flows and selling financial assets. The condition is that the SPPI test must be satisfied. For FVOCI measurement, all fair value changes are taken to other comprehensive income. However, changes related to impairment, interest income and exchange differences are recognized in profit or loss.

If debt financial assets do not meet any of the criteria listed above, they are classified and measured as FVP&L.

The classification of financial instruments is performed as at the adoption of IFRS 9, i.e. as at 1 January 2018 and at the moment of initial recognition of an instrument. Changes in the classification are only possible in connection with a significant change of the business model and should occur very rarely.

Financial liabilities are measured according to the existing provisions of IAS 39, with the exception of the fair value changes arising from changes in the level of an entities own credit risk recognize in other comprehensive income, for financial liabilities to which the fair value measurement option was applied.

During 2016, the Bank executed the first stage of preparation for implementation of the standard in cooperation with an external advisor to the PKO Bank Polski Group. Work performed with respect to classification and measurement comprised identifying changes in accounting policies introduced by IFRS 9, initial assessment of business models for individual asset categories and initial assessment of products in terms of cash flow characteristics.

The analysis performed with regard to classification and measurement comprised aspects such as verifying the mortgage loan product in terms of the cash flow characteristic test (SPPI test), verifying the business models adopted and performing a simulation of the effect of implementing IFRS 9 in the form of a transposition matrix presenting the change in classification of financial instruments taking into account the effect on the Bank's financial statements.

The analyses performed led to the following conclusions with respect to the impact of IFRS 9 on the approach adopted by the Bank:

- recognition of the liquidity portfolio of Treasury bills, for which valuation at fair value will be recognized in other comprehensive income and not as it is currently through profit or loss,
- recognition of the result of modification of cash flows on the originated portfolio as well as the portfolio acquired in the statement of profit or loss at modification instead of recognition over time. The Bank has initiated work on the quantification of the adjustment in this respect as of 1 January 2018 in order to allow the proper recognition of these amounts in the statement of profit or loss in the future.

(IN PLN THOUSAND)

During 2017, the second stage of the project will be carried out, aimed at implementing the changes in the IT systems and applications, processes, procedures as well as in the financial reporting processes.

Impairment

A fundamental change in the area of impairment is that IAS 39 was based on the concept of incurred losses and IFRS 9 is based on the concept of expected losses.

In accordance with the general principle, impairment will be measured as 12-month expected credit losses or lifetime expected credit losses. The measurement basis will depend on whether credit risk increased significantly from the moment of initial recognition. Loans will be allocated to 3 categories (stages):

Unimpaired portfolio (IBNR according to IAS 39)	Stage 1 (assets with low credit risk)	12-month expected credit losses
	Stage 2 (increased credit risk)	lifetime expected losses
Impaired portfolio	Impaired loans (the portfolio includes loans impaired on initial recognition, the so-called POCI loans)	lifetime expected losses

On recognition, all loans with the exception of POCI are included in stage 1.

Interest income for the so-called IBNR portfolio will be accrued on the gross amount.

During 2016, the Bank in cooperation with an external advisor to the PKO Bank Polski Group executed the first stage of the preparation for implementation of the standard, i.e. the gap analysis. During 2017, the second stage of the project will be carried out, aimed at implementing the changes in the IT systems and applications used by the risk units, processes, as well as processes and procedures.

Hedge accounting

The new standard increases the range of items that may be identified as hedged items, and also enables the designation assets or financial liabilities at fair value through profit or loss as hedging instruments. It withdraws the requirement for retrospective measurement of hedge effectiveness as well as the existing limit of 80% -125% (application of hedge accounting becomes conditional on an economic interdependence between the hedging instrument and the hedged item). In addition, it increases the scope of required disclosures regarding risk management strategy, cash flows arising from hedging transactions and the impact of hedge accounting on the financial statements.

Due to the fact that the standard is still in progress with respect to amendments relating to accounting for portfolios (macro hedges), entities have a choice of applying hedge accounting provisions: entities may either continue to apply IAS 39 or apply the new IFRS 9 standard with the exception of fair value macro hedges relating to interest rate risk.

During 2016, the Bank in cooperation with an external advisor to the PKO Bank Polski Group executed a gap analysis with respect to these requirements.

As at the date of these financial statements the Bank has not yet decided whether to apply the new standard, or to continue to apply the provisions of IAS 39.

IFRS 15 „REVENUE FROM CONTRACTS WITH CUSTOMERS”

IFRS 15 replaces IAS 11 “Construction contracts”, IAS 18 “Revenue”, IFRIC 13 “Customer Loyalty Programmes”, IFRIC 15 “Agreements for the construction of real estate”, IFRIC 18 “Transfers of Assets from Customers”, SIC 31 “Revenue – barter transactions involving advertising services”.

The main principle is the recognition of revenue in such a manner as to reflect the transaction for the transfer of goods or services to a customer at the amount that reflects the value of revenue, which the company expects in exchange for those goods or services. For the purpose of recognising revenue and its amount at the appropriate moment, the standard has a five-level analysis model, consisting of: the identification of an agreement with a customer and binding commitment, the determination of the transaction price, its appropriate allocation and the recognition of revenue on fulfilment of the obligation.

The standard excludes financial instruments (IAS 39), insurance contracts (IFRS 4) and leasing transactions (IAS 17) from its scope, hence the Bank estimates that the impact on its results will not be significant.

2.20.2. New standards and interpretations, and amendments thereto, which have not as yet been approved by the European Union

IFRS 16 „LEASES”

Effective date: 1 January 2019. The new standard will replace the current IAS 17, "Leases". Under the new standard lessee are obliged to recognize the right to use an asset and a liabilities (the obligation to pay for that right, that is, financing) as assets and liabilities for all lease contracts (and not, as previously, only for financial leases). The exceptions are short-term lease agreement with a term of up to 12 months and leases for low value items.

The Bank is a party to operating lease agreements, which are currently not recognised in the statement of financial position, however their value is not significant. In the Bank’s opinion, the new standard will not have a significant impact on the financial statements.

IAS 7 "STATEMENT OF CASH FLOWS"

Effective date: 1 January 2017. The amendments have been introduced to improve the quality of disclosures in the financial statements and are related to the requirement to provide disclosures enabling users of the financial statements to assess changes in liabilities arising from financing activities, including both changes arising from cash and non-cash transactions. The amendments relate to presentation.

OTHER CHANGES:

- The Bank has not as yet assessed the impact on the financial statements of changes to IAS 12 "Income Taxes", which clarify the recognition of Deferred tax assets with respect to debt instruments measured at fair value.
- Amendments to IFRS 10, IFRS 4 (related to IFRS 9), IAS 28 and IAS 40 and improvements to IFRS's 2014-2016 and 2014-2016 (IFRS 1, IAS 28) will have no impact on the financial statements of the Bank.

(IN PLN THOUSAND)

NOTES TO THE STATEMENT OF PROFIT OR LOSS

3. Interest income and expense

Interest income

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Interest income calculated using the effective interest rate method, with respect to financial assets, which are not valued to fair value through profit and loss, including:	**140 521**	**4 273**	**5 671**
Income from loans and advances to customers, of which:	140 461	2 602	2 602
from impaired loans	-	-	-
Income from deposits with Banks and mandatory reserve	60	1 671	3 069
Other income, including:	**2 510**	**2 137**	**2 137**
Income from financial assets designated upon initial recognition at fair value through profit and loss	1 160	2 072	2 072
Income from investment securities	1 350	0	0
Income from financial assets held to maturity	-	65	65
Total	**143 031**	**6 410**	**7 808**

Interest expense

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Interest expense calculated using the effective interest rate method, with respect to financial assets, which are not valued to fair value through profit and loss, including:	**(71 117)**	**(63)**	**(63)**
Interest expense on loans received	(5 564)	(20)	(20)
Interest expense with respect to deferred payment due to loan portfolios purchased	(40 288)	-	-
Interest expense with respect to mortgage covered bonds issued	(16 255)	(43)	(43)
Interest expense with respect to unsecured bonds issued	(9 010)	-	-
Other costs	**(8 315)**	**-**	**-**
Expense with respect to CIRS hedging transaction	(8 315)	-	-
Total	**(79 432)**	**(63)**	**(63)**

4. Fee and commission income and expense

Fee and commission income

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Fee and commission income from loans and advances to customers	6 461	891	891
including fees for property valuations	4 085	757	757
Total	**6 461**	**891**	**891**

Fee and commission expense

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Fee and commissions for operating services provided by banks	(113)	(107)	(109)
Costs associated with the mortgage covered bonds issuance programmes	(641)	(98)	(98)
Costs associated with unsecured bonds issuance programme	(799)	(28)	(28)
Costs associated with received credit facilities	(973)	(123)	(123)
Preparation of expert mortgage lending real estate valuations by real estate appraisers	(7 185)	(1 964)	(1 964)
Credit insurance costs	(386)	(50)	(50)
Total	**(10 097)**	**(2 370)**	**(2 372)**

(IN PLN THOUSAND)

5. Income from financial instruments measured at fair value

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Derivative instruments:	-	-	-
including SWAP points	-	-	-
Debt securities	1	(1)	(1)
Total	1	(1)	(1)

6. Foreign exchange result

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Foreign exchange result	(17)	(3)	(3)
Derivative result before designation to hedge accounting	(911)	-	-
Derivative result in relation to hedge accounting ineffectiveness	92	-	-
Total	**(836)**	**(3)**	**(3)**

7. Other operating income and expense

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Other operating income			
Sundry income	878	110	114
Other	9	4	5
Total	**887**	**114**	**119**

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Other operating expense			
Sundry expense	(829)	(55)	(55)
Other	(13)	(0)	(0)
Total	**(842)**	**(55)**	**(55)**

Sundry expenses for 2016 includes PLN 757 thousand of costs related to the valuation reports delivered by real estate appraisers for loans which could not be transferred to PKO Bank Hipoteczny SA. According to Debt Purchase Agreement such costs are incurred by PKO Bank Polski SA and thus are reinvoiced and presented in Sundry income. In 2015 there were no such settlements.

8. Impairment allowance and write-downs

For the period from 1 January 2016 to 31 December 2016	Balance at the beginning of the period	Increases	Decreases		Balance at the end of the period	Net-impact on the statement of profit and loss
		Recognized during the period	Derecognition of assets and settlement	Reversed during the period		
Amounts due from banks	-	-	-	-	-	-
Loans and advances to customers measured at amortized cost	198	3 003	-	1 442	1 759	(1 561)
Non-financial sector	198	3 003	-	1 442	1 759	(1 561)
housing loans	198	3 003	-	1 442	1 759	(1 561)
Provision for loans commitments	31	58	-	9	80	(49)
Total	229	3 061	-	1 451	1 839	(1 610)

For the period from 1 January 2015 to 31 December 2015	Balance at the beginning of the period	Increases	Decreases		Balance at the end of the period	Net-impact on the statement of profit and loss
		Recognized during the period	Derecognition of assets and settlement	Reversed during the period		
Amounts due from banks	-	-	-	-	-	-
Loans and advances to customers measured at amortized cost	-	198	-	-	198	(198)
Non-financial sector	-	198	-	-	198	(198)
housing loans	-	198	-	-	198	(198)
Provision for loans commitments	-	31	-	-	31	(31)
Total	-	229	-	-	229	(229)

(IN PLN THOUSAND)

For the period from 6 October 2014 to 30 June 2015	Balance at the beginning of the period	Increases	Decreases		Balance at the end of the period	Net-impact on the statement of profit and loss
		Recognized during the period	Derecognition of assets and settlement	Reversed during the period		
Amounts due from banks	-	-	-	-	-	-
Loans and advances to customers measured at amortized cost	-	**198**	-	-	**198**	**(198)**
Non-financial sector	-	198	-	-	198	(198)
housing loans	-	198	-	-	198	(198)
Provision for loans commitments	-	**31**	-	-	**31**	**(31)**
Total	-	**229**	-	-	**229**	**(229)**

9. General administrative expenses

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Employee benefits	(13 781)	(12 587)	(15 374)
Overheads	(17 238)	(6 882)	(7 186)
Amortization and depreciation, including:	(1 223)	(669)	(670)
property, plant and equipment	(233)	(156)	(157)
intangible assets	(990)	(513)	(513)
Taxes and fees, including:	(7 061)	(92)	(100)
tax on financial institutions	(4 324)	-	-
Total	**(39 303)**	**(20 230)**	**(23 330)**

Employee benefits

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Wages and salaries, including:	(12 107)	(10 860)	(13 355)
provision for variable remuneration components (Note 32.4)	(2 409)	(1 871)	(1 871)
provision for retirement and pensions benefits	(32)	(28)	(28)
Salary surcharges, including:	(1 275)	(1 394)	(1 658)
provision for surcharges for variable remuneration components (Note 32.4)	(202)	(375)	(375)
Other employee benefits	(399)	(333)	(361)
Total	**(13 781)**	**(12 587)**	**(15 374)**

The Bank presents costs of: travel, training and deductions for Company Social Benefits Funds in '*Other employee benefits*'.

Overheads

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Services in terms of supporting operations within Outsourcing agreement	(3 517)	(3 203)	(3 203)
Servicing of granted loans and purchased receivables within Outsourcing agreement	(4 085)	(88)	(88)
External services performed in terms of other contracts	(1 497)	(516)	(516)
IT costs	(1 209)	(845)	(874)
Rental expense	(1 840)	(1 390)	(1 559)
Operating lease	(243)	(197)	(239)
Payments for Banking Guarantee Fund	(3 951)	-	-
Other	(896)	(643)	(707)
Total	**(17 238)**	**(6 882)**	**(7 186)**

(IN PLN THOUSAND)

10. Income tax expense

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Statement of profit or loss			
Current income tax expense	-	-	-
Deferred income tax related to origination and reversal of temporary differences	(5 036)	2 941	3 263
Tax expense in the income statement	**(5 036)**	**2 941**	**3 263**
Tax expense in other comprehensive income related to origination and reversal of temporary differences	4 213	(1)	(1)
Total	**(823)**	**2 940**	**3 262**

Effective tax rate reconciliation

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Profit/ (loss) before income tax	**18 260**	**(15 536)**	**(17 235)**
Corporate income tax calculated using the enacted tax rate (19%) in force in Poland	(3 469)	2 952	3 275
Permanent differences between profit before income tax and taxable income, of which:	**(1 567)**	**(12)**	**(13)**
Bank Guarantee Fund prudential levy	(241)	-	-
tax on civil-law transactions	(475)	-	-
tax on financial institutions	(822)	-	-
PFRON costs	(13)	(10)	(11)
other permanent differences	(16)	(2)	(2)
Income tax in the income statement	**(5 036)**	**2 940**	**3 262**
Effective tax rate	**27.58%**	**18.92%**	**18.93%**
Temporary difference related to the deferred tax presented in the statement of profit or loss	(5 036)	2 940	3 262
Total current income tax expense in the statement of profit or loss	-	-	-

Accounts payable/receivable from current income tax

As at 31 December 2016 and 31 December 2015, the Bank did not have either liabilities or receivables from in relation to current income tax.

(IN PLN THOUSAND)

Deferred tax assets/liability

	Statement of financial position		Statement of profit or loss		
	31.12.2016	31.12.2015	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Deferred tax liability					
Interest accrued on receivables from banks	-	0	(0)	(41)	0
Interest accrued on receivables from customers	2 838	191	2 647	191	191
Interest accrued and discount on securities	219	-	219	-	-
Adjustment for straight-line and effective interest rate valuation for loan portfolio	7 217	772	6 445	772	772
Adjustment for straight-line and effective interest rate valuation for own issued bonds	1 229	0	1 229	0	0
Deferred expenses	735	547	188	547	547
Difference between carrying amount and tax value of property, plant and equipment assets and intangible fixed assets	2	4	(2)	2	4
Valuation of securities:	0	1	0	0	0
recognized in statement of profit or loss	0	0	0	0	0
recognized in other comprehensive income	0	1	n/d	n/d	n/d
Valuation of derivatives	171	-	160	-	-
recognized in statement of profit or loss	160	-	160	-	-
recognized in other comprehensive income	11	-	n/d	n/d	n/d
Gross deferred tax liability	**12 411**	**1 515**	**10 886**	**1 471**	**1 514**
Deferred income tax asset					
Interest accrued on amounts due to banks	2 618	-	2 618	-	-
Interest accrued and discount on issued bonds	1 491	(13)	1 504	(13)	8
Impairment allowance on credit exposure	349	43	306	43	43
Provision for costs	1 089	720	369	523	699
Tax loss	4 723	4 026	697	3 859	4 026
Valuation of securities:	59	-	-	-	-
recognized in statement of profit or loss	-	-	-	-	-
recognized in other comprehensive income	59	-	n/d	n/d	n/d
Valuation of derivatives	4 522	-	356	-	-
recognized in statement of profit or loss	356	-	356	-	-
recognized in other comprehensive income	4 166	-	n/d	n/d	n/d
Gross deferred income tax asset	**14 851**	**4 776**	**5 850**	**4 412**	**4 777**
Combined effect of temporary differences	**2 440**	**3 261**	**(5 036)**	**2 941**	**3 263**
Deferred income tax asset (presented in the statement of financial position)	**2 440**	**3 261**			
Net deferred tax impact on the statement of profit or loss			**(5 036)**	**2 941**	**3 263**

Deferred tax asset and liability are recognized as a result of temporary differences due to the different period of income and expense recognition for accounting and tax purposes.

The recognition of the deferred tax asset on tax loss incurred is based on projections made of the tax basis and an assessment of the probability of utilization over the period prescribed by tax law.

11. Profit/loss per share

Profit/loss per share

The profit /loss per share is calculated based on the profit/loss attributable to ordinary shareholders of the Bank divided by the weighted average number of ordinary shares during the period.

Profit/loss per share

	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Profit / (Loss) attributable to ordinary shareholders (in PLN thousand)	13 224	(12 596)	(13 973)
Weighted average number of ordinary shares during the period (in thousand)	533 060	300 000	300 000
Profit / (Loss) per share (in PLN per share)	0.02	(0.04)	(0.05)

Diluted profit / loss per share

The diluted profit/loss per share is calculated based on the profit/loss attributable to ordinary shareholders divided by the weighted average number of ordinary shares during the period, adjusted for the effects of all dilutive potential ordinary shares.

During the period ended on 31 December 2016 and on 31 December 2015, the Bank did not have instruments that could be dilutive in relation to the profit/loss per share.

NOTES TO THE STATEMENT OF FINANCIAL POSITION

12. Cash and balances with the central bank

	31.12.2016	31.12.2015
Current account in the Central Bank	16 033	4
Cash	-	-
Total	**16 033**	**4**

Obligatory reserve

As at 31 December 2016 and as at 31 December 2015, the Bank maintained an obligatory reserve in the amount of respectively PLN 15.507 thousand and PLN 0.

13. Amounts due from banks

	31.12.2016	31.12.2015
Deposits with banks	-	9 000
Current accounts	12 994	5 812
Total	**12 994**	**14 812**
Impairment allowances on receivables	-	-
Net total	**12 994**	**14 812**

Details of risks related to amounts due from banks are presented in the Note 36 '*Credit risk management*'.

Cash and cash equivalents

Current amounts due from banks as well as other cash equivalents with maturities up to 3 months from the date of acquisition, amounting to PLN 12 994 thousand as at 31 December 2016 and PLN 14 812 thousand as at 31 December 2015 are treated as cash and cash equivalents in their entirety for the purposes of the statement of cash flows.

14. Derivative hedging instrument

In 2016, the Bank started to apply hedge accounting for cash flow hedges.

14.1 Cash flow hedges

14.1.1 Hedging fluctuations in cash flows from mortgage loans in PLN due to changes in the reference interest rates and mortgage covered bonds denominated in convertible currency caused by changes in the exchange rate with the use of CIRS and FX-Forward hedging instruments.

Purpose of hedging - eliminating the risk of cash flow variability generated by mortgage loans in PLN due to changes in the reference interest rates and mortgage bonds denominated in a convertible foreign currency, with the use of CIRS and FX-Forward hedging instruments in a convertible foreign currency as a hedge of the exposure currency with a maturity in terms of payment equivalent to mortgage covered bonds issued in a convertible foreign currency.

Hedged risk - currency risk and interest rate risk.

Hedging instruments:

a) **CIRS Transactions (Cross-Currency Interest Rate Swap),** where the Bank pays coupons based on a variable rate in PLN, and receives a coupon based on a fixed rate appropriate for the convertible foreign currency. In the event of notice of the bankruptcy of PKO Bank Hipoteczny by a court, an automatic extension of the CIRS for 12 months occurs under the terms agreed at the transaction date,

b) **Series of FX-Forwards** in convertible foreign currency which hedge currency exposure, of maturity equivalent to the terms of payment of the coupon of the mortgage bonds in convertible foreign currency.

(IN PLN THOUSAND)

Hedged items:

a) **mortgage loans** included in the cover pool, with variable interest rates in PLN. Interest rates on loans are indexed to the WIBOR 3M rate. The margin on the mortgage loans, in accordance with IAS 39, are excluded from hedging,

b) **mortgage covered bonds issued** in a convertible currency at a fixed interest rate.

Periods of expected cash flows and in which an impact on the results is expected - from 1 January 2017 until 24 June 2022.

Hedge effectiveness is verified by the use of prospective and retrospective effectiveness tests. Tests are performed on a monthly basis.

Type of instrument	Carrying value/fair value of derivative instruments representing cash flow hedges related to the interest rate and/or exchange rate			
	31.12.2016		31.12.2015	
	Assets	Liabilities	Assets	Liabilities
CIRS	27 709	-	-	-
FX-Forward	99	113	-	-
Total	**27 808**	**113**	**-**	**-**

Type of instrument	The nominal value as at 31 December 2016					
	up to 1 month	from 1 month up to 3 months	from 3 months up to 1 year	from 1 year up to 5 years	over 5 years	Total
CIRS	-	-	-	-	-	-
float PLN sale					2 154 809	**2 154 809**
fixed EUR purchase (original currency)	-	-	-	-	498 510	**498 510**
FX-Forward						
PLN sale	-	-	-	-	6 036	**6 036**
EUR purchase (original currency)	-	-	-	-	1 224	**1 224**
PLN purchase	-	-	765	4 869	-	**5 634**
EUR sale (original currency)	-	-	175	1 049	-	**1 224**

Other comprehensive income from cash flow hedges	31.12.2016	31.12.2015
Other comprehensive income at beginning of period, gross	-	-
Profit/(Loss) recognized in other comprehensive income during the period	20 413	-
Amount transferred during the period from other comprehensive income to the statement of profit or loss account	42 283	-
- interest expense	(8 315)	-
- exchange result	50 598	-
Accumulated other comprehensive income at end of period gross	**(21 870)**	**-**
Tax effect	4 155	-
Accumulated other comprehensive income at end of period net	**(17 715)**	**-**
The ineffective portion of cash flow hedges recognized in the statement of profit or loss	92	-
Other comprehensive income for the period before tax	**(21 870)**	**-**
Deferred tax on cash flow hedges	4 155	-
Other comprehensive income for the period after tax	**(17 715)**	**-**

14.2 Fair value hedges

As at 31 December 2016, the Bank did not use fair value hedges.

15. Financial instruments designated upon initial recognition as at fair value through profit and loss

Debt securities by carrying amount	31.12.2016	31.12.2015
Debt securities	**79 987**	**39 988**
issued by central banks, NBP money market bills	79 987	39 988
Total	**79 987**	**39 988**

Debt securities by nominal value	31.12.2016	31.12.2015
issued by central banks, NBP money market bills	80 000	40 000
The average yield on debt securities issued by central banks	**1.523%**	**1.523%**

(IN PLN THOUSAND)

Change in financial instruments designated upon initial recognition as at fair value through profit or loss	31.12.2016	31.12.2015
Balance at the beginning of the period	39 988	-
Increases	4 172 195	7 356 292
Decreases	(4 132 201)	(7 316 305)
Changes in fair value	5	1
Balance at the end of the period	**79 987**	**39 988**

Financial instruments designated upon initial recognition as at fair value through profit and loss are classified in this portfolio as a separately managed group of financial assets, the results of which are assessed on the basis of fair value, in accordance with a documented investment policy of the Bank

At 31 December 2016 and 31 December 2015 the Bank did not have transferred financial assets that were derecognized from the financial statements as a whole, in which the Bank has maintained continuing involvement. The Bank did not have any transferred financial instruments designated upon initial recognition as at fair value through profit and loss, that were not derecognized from the statement of financial position.

Financial instruments designated upon initial recognition as at fair value through profit and loss by carrying amount – maturities

As at 31 December 2016	up to 1 month	from 1 month to 3 months	from 3 months to 1 year	from 1 year to 5 years	over 5 years	Total
Debt securities						
issued by central banks, NBP money market bills	79 987	-	-	-	-	79 987
Total	**79 987**	**-**	**-**	**-**	**-**	**79 987**

As at 31 December 2015	up to 1 month	from 1 month to 3 months	from 3 months to 1 year	from 1 year to 5 years	over 5 years	Total
Debt securities						
issued by central banks, NBP money market bills	39 988	-	-	-	-	**39 988**
Total	**39 988**	**-**	**-**	**-**	**-**	**39 988**

16. Loans and advances to customers

	31.12.2016	31.12.2015
Loans and advances to customers, gross, of which:	**8 249 659**	**722 853**
non-financial sector	**8 249 659**	**722 853**
housing	8 249 659	722 853
loans granted	2 319 574	294 663
purchased receivables	5 930 085	428 190
Impairment allowances on loans and advances	**(1 759)**	**(198)**
Loans and advances to customers, net	**8 247 900**	**722 655**

In 2016, based on the Framework Agreement Concerning the Sale of Debts signed with PKO Bank Polski SA on 17 November 2015, Bank purchased a portfolio of mortgage housing loans in the amount of PLN 5 751 707 thousand, while in 2015 the amount of PLN 429 516 thousand. The purchase price was based on market value estimated by an independent appraiser. The purchased debt were recognized on the dates of transfer to the Bank of the rights to the cash flows from individual portfolios, and all related liability for costs and economic risks, in terms of the respective agreements for the sale of debts. The purchase of debt portfolios has been financed by the liability described in Note 21. The Bank refinances debt purchased portfolios primarily through the issuance of mortgage covered bonds.

Loans granted and purchased receivables that are entered in the Bank's cover pool represent collateral for mortgage covered bonds issued by

Loans and advances to customers by method of determination of impairment allowances	31.12.2016	31.12.2015
Assessed on an individual basis	-	-
Assessed on a portfolio basis, impaired	-	-
Assessed on a collective basis (IBNR)	8 249 659	722 853
Loans and advances to customers, gross	**8 249 659**	**722 853**
Impairment allowances on exposures assessed on an individual basis	-	-
Impairment allowances on exposures assessed on a portfolio basis	-	-
Impairment allowances on exposures assessed on a collective basis (IBNR)	(1 759)	(198)
Impairment allowances - total	**(1 759)**	**(198)**
Loans and advances to customers, net	**8 247 900**	**722 655**

(IN PLN THOUSAND)

A detailed description of changes in impairment allowances are presented in Note 8 'Net impairment allowance and write-downs'.

As at 31 December 2016 and as at 31 December 2015 there were no impaired loans as well as the past due loans over 90 days. Information about the quality of the loan portfolio were also presented in Note 36.5.3.

As at 31 December 2016 and as at 31 December 2015 the Bank did not have transferred financial assets that are excluded from the financial statements as a whole for which the Bank would maintain an exposure.

17. Investment securities available for sale

	31.12.2016	31.12.2015
Debt securities available for sale, gross	**203 019**	**500**
issued by the State Treasury, treasury bonds PLN	203 019	500
Impairment allowances on debt securities available for sale	-	-
Total net debt securities available for sale	**203 019**	**500**
Total net equity securities available for sale	-	-
Total net investment securities available for sale	**203 019**	**500**

Debt securities by nominal value	31.12.2016	31.12.2015
issued by the State Treasury, treasury bonds PLN	201 980	500
The average yield on debt securities issued by the State Treasury	1.737%	1.964%

Change in investment securities available for sale	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015
Balance at the beginning of the period	500	-
Increases	202 830	497
Decreases	(5)	-
Change in fair value recognized in other comprehensive income	(306)	3
Balance at the end of the period	**203 019**	**500**

Bank Guarantee Fund

As at 31 December 2016, the Bank Guarantee Fund amounted to PLN 377.5 thousand and the Bank held assets in the amount of PLN 450.1 thousand to cover the fund. On 31 December 2016 the Bank did not hold any funds that would be covered by the guarantee protection.

Due to the lack of guaranteed funds at the date of determination, the Fund as at 31 December 2015 amounted to PLN 0.

18. Intangible assets

Period from 1 January 2016 to 31 December 2016	Assets under construction	Software	Total
Gross carying amount at the beginning of the period	-	**3 689**	**3 689**
Purchase	2 670	456	3 126
Transfers	-	-	-
Gross carying amount at the end of the period	**2 670**	**4 145**	**6 815**
Accumulated amortization and impairment allowances for impairment losses at the beginning of the period	-	**(513)**	**(513)**
Amortization	-	(990)	(990)
Impairment allowances	-	-	-
Accumulated amortization and impairment allowances for impairment losses at the end of the period	-	**(1 503)**	**(1 503)**
Net carrying amount at the beginning of the period	-	**3 176**	**3 176**
Net carrying amount at the end of the period	**2 670**	**2 642**	**5 312**

A significant intangible asset is license for Central System Module dedicated to support Cover pool register and Collateralisation review, purchased in first half of 2016, in amount of PLN 2 670 thousand. Due to ongoing adjustments of the system, it is recognized as an intangible asset under construction.

(IN PLN THOUSAND)

Period from 1 January 2015 to 31 December 2015	Assets under construction	Software	Total
Gross carying amount at the beginning of the period	-	4	4
Purchase	3 039	646	3 685
Transfers	(3 039)	3 039	-
Gross carying amount at the end of the period	-	3 689	3 689
Accumulated amortization and impairment allowances for impairment losses at the beginning of the period	-	-	-
Amortization	-	(513)	(513)
Impairment allowances	-	-	-
Accumulated amortization and impairment allowances for impairment losses at the end of the period	-	(513)	(513)
Net carrying amount at the beginning of the period	-	4	4
Net carrying amount at the end of the period	-	3 176	3 176

At 31 December 2016 and 31 December 2015 there were no intangible assets to which the Bank's ownership were subject to restrictions and or that were pledged as collateral for liabilities.

19.Property, plant and equipment

Period from 1 January 2016 to 31 December 2016	Assets under construction	Leaseholds improvements	Machinery and equipment	Other	Total
Gross carying amount of property, plant and equipment at the beginning of the period	-	28	400	376	804
Purchase	6	-	144	21	171
Transfers	(6)	6	-	-	-
Disposal or sale	-	-	(10)	-	(10)
Gross carying amount of property, plant and equipment at the end of the period	-	34	534	397	965
Accumulated depreciation at the beginning of the period	-	(0)	(106)	(51)	(157)
Depreciation	-	(3)	(152)	(78)	(233)
Disposal or sale	-	-	5	-	5
Accumulated depreciation at the end of the period	-	(3)	(253)	(129)	(385)
Net carrying amount at the beginning of the period	-	28	294	325	647
Net carrying amount at the end of the period	-	31	281	268	580

Period from 1 January 2015 to 31 December 2015	Assets under construction	Leaseholds improvements	Machinery and equipment	Other	Total
Gross carying amount of property, plant and equipment at the beginning of the period	-	-	13	9	22
Purchase	89	-	386	307	782
Transfers	(89)	28	1	60	-
Gross carying amount of property, plant and equipment at the end of the period	-	28	400	376	804
Accumulated depreciation at the beginning of the period	-	-	(1)	(0)	(1)
Depreciation	-	(0)	(105)	(51)	(156)
Accumulated depreciation at the end of the period	-	(0)	(106)	(51)	(157)
Net carrying amount at the beginning of the period	-	-	12	9	21
Net carrying amount at the end of the period	-	28	294	325	647

Other includes primarily the value of the Bank's furnishings.

At 31 December 2016 and 31 December 2015, there were no items of property, plant and equipment to which the Bank ownership was subject to restriction or that were pledged as collateral for liabilities.

(IN PLN THOUSAND)

20. Other assets

	31.12.2016	31.12.2015
Deferred expenses and prepayments, including:	5 845	3 241
deffered expenses associated with the current account revolving credit facility	1 100	1 700
deffered expenses associated with the unsecured bond issuance program	528	382
deffered expenses associated with the mortgage covered bonds issuance programmes	2 239	794
other	1 978	365
Deferred commissions from loans granted, proportionally to undrawn principle	7 020	1 417
Settlements with respect to expert valuations	1 190	1 759
Social and legal settlement	324	13
Other	1	12
Total	**14 380**	**6 442**

21. Amounts due to banks

	31.12.2016	31.12.2015
Liabilities resulting from current account facility	393 793	39 782
Liabilities for the purchase of mortgage loans	3 038 039	429 516
Total	**3 431 832**	**469 298**

Liabilities resulting from current account facility represent the utilized part of the current account revolving credit facility. On 29 October 2015, PKO Bank Hipoteczny SA and PKO Bank Polski SA, signed a Current Account Revolving Credit Agreement with a limit of PLN 900 million for the period of 3 years, which is being drawn in tranches. The interest rate was set at WIBOR3M + 70 bps per annum while the unused amount of a tranche is subject to a fee of 0.1% per annum. As at 31 December 2016 the available amount within the credit facility amounted to PLN 506 million.

Liabilities from the purchase of mortgage loans arose from the transactions concluded between PKO Bank Hipoteczny SA and PKO Bank Polski SA in 2016 regarding the sale of mortgage loans secured in the amount of PLN 5 751 707 thousand, further described in Note 16. The maturity date of the liability resulting from these transactions is agreed upon by the parties in Debt Purchase Agreement for each transaction. For loans acquired in 2016, the parties agreed that the payment is due from 8 to 12 months from the date of transfer. If the liability is not settled within 1 month from the date of transfer, the principle amount is subject to interest. The Bank refinances the purchase of loan portfolios primarily through the issuance of mortgage bonds. The liability for the purchase of mortgage loans is entirely related to portfolios acquired in the second half of 2016.

22. Amounts due to customers

	31.12.2016	31.12.2015
Amounts due to customers	**1 549**	**146**
Loan overpayments	1 549	146
Total	**1 549**	**146**

23. Mortgage covered bonds issued

	31.12.2016	31.12.2015
Mortgage covered bonds issued		
Financial instruments measured at amortized cost - mortgage covered bonds issued	3 232 117	29 933
Total	**3 232 117**	**29 933**

	31.12.2016	31.12.2015
Liabilities for issued mortgage covered bonds by maturity		
from 1 year to 5 years	1 030 566	29 933
over 5 years	2 201 551	-
Total	**3 232 117**	**29 933**

In 2016, the Bank issued mortgage covered bonds denominated in PLN with a nominal value of PLN 1 000 000 thousand and with a maturity of 5 years and 1 day from the issuance date. As at 31 December 2016 the issued mortgage covered bonds denominated in PLN were assigned a rating by Moody's Investors Service of Aa3 and were admitted to trading on a regulated OTC market on the Catalyst operated by BondSpot SA and the parallel market of the Warsaw Stock Exchange.

(IN PLN THOUSAND)

On 24 October 2016, the Bank issued mortgage covered bonds denominated in EUR with a nominal value of EUR 500 000 thousand and with a maturity fixed of 5 years and 8 months from the issuance date. The fixed interest rate during the term is 0.125%, and the yield on the pricing date was 0.178%. The Mortgage covered bonds were purchased by investors at a price of 99.702% of nominal value. The issued bonds are traded in parallel on the stock exchanges in Luxembourg and Warsaw. As at 31 December 2016, the mortgage covered bonds denominated in EUR issued by the Bank were assigned a long-term rating by Moody's Investors Service of Aa3.

The total nominal value of issued mortgage covered bonds amounted to PLN 3 242 000 thousand at 31 December 2016, and PLN 30 000 thousand at 31 December 2015.

The mortgage bonds are secured by loans secured by the highest priority mortgage. Additionally, the basis for the issue of mortgage covered bonds may also be the Bank's own funds:
a) invested in securities issued or guaranteed by the Polish National Bank, the European Central Bank, the governments and central banks of the Member States of the European Union, the Organization for Economic Cooperation and Development, with the exception of countries that are restructuring or restructured their foreign debt in the past 5 years, and the State Treasury,
b) deposited with the National Bank of Poland,
c) held in cash.

The nominal value of loans entered in the Bank's cover pool representing collateral for the mortgage bonds issued totaled PLN 4 650 411 thousand at 31 December 2016. The nominal value of additional collateral in the form of securities issued by the State Treasury amounted to PLN 85 000 thousand. As at 31 December 2015, these amounts were PLN 82 071 thousand and PLN 0 respectively. The CIRS transactions hedging the currency risk of issued bonds denominated in EUR are also registered in the cover pool.

The Bank's cover pool did not contain asset-backed securities (ABS), which did not comply with paragraph 1 of Article 80 of the Guidelines (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (as amended) during 2016 and in 2015.

Mortgage covered bonds issued as at 31 December 2016

Mortgage covered bonds	Currancy	Nominal value	Interest rates at 31.12.2016	Interest rate + margin	Guarantee / security	Date of issue	Maturity
Mortgage covered bonds (PLN) Series 1	PLN	30 000	2.48%	WIBOR3M + 0.75%	The Bank's cover pool	11.12.2015	11.12.2020
Mortgage covered bonds (PLN) Series 2	PLN	500 000	2.32%	WIBOR3M + 0.65%	The Bank's cover pool	27.04.2016	28.04.2021
Mortgage covered bonds (PLN) Series 3	PLN	500 000	2.37%	WIBOR3M + 0.59%	The Bank's cover pool	17.06.2016	18.06.2021
Mortgage covered bonds (EUR) Series 1	EUR	500 000	0.125%	fixed rate	The Bank's cover pool	24.10.2016	24.06.2022

Change in liabilities from mortgage covered bonds issued	31.12.2016	31.12.2015
Balance at beginning of the period	29 933	-
Increase, on account of	**3 221 078**	**30 043**
issuance	3 154 809	30 000
accrued intrest/amortization of discount	15 670	43
translation differences	50 599	-
Decreases, on account of	**(18 894)**	**(110)**
settlement of interest	(12 296)	-
valuation at amortized cost	(6 598)	(110)
Balance at end of the period	**3 232 117**	**29 933**

24. Unsecured bonds issued

	31.12.2016	31.12.2015
Unsecured bonds issued		
Financial instruments measured at amortized cost - bonds issued	1 151 216	-
Total	**1 151 216**	-

	31.12.2016	31.12.2015
Unsecured bonds issued by maturity		
up to 1 month	183 326	-
from 1 month up to 3 months	734 801	-
over 3 monts up to 1 year	233 089	-
Total	**1 151 216**	-

In 2016, the Bank issued unsecured bonds with a nominal value of 2 136 000 thousand PLN classified as liabilities measured at amortized cost.

(IN PLN THOUSAND)

The nominal value of the unsecured bonds outstanding amounted to 1 156 000 thousand PLN as at 31 December 2016.

Unsecured bonds issued as at 31 December 2016

Unsecured bonds	Nominal value (in PLN)	Interest	Issue date	Maturity date
OW020217-B15	30 000 000	discount paper	02.08.2016	02.02.2017
OW270217-B18	278 000 000	discount paper	12.08.2016	27.02.2017
OW270217-B25	150 000 000	discount paper	16.09.2016	27.02.2017
OW160117-B28	17 200 000	discount paper	10.10.2016	16.01.2017
OW200117-B30	30 700 000	discount paper	21.10.2016	20.01.2017
OW160117-B16	30 000 000	discount paper	28.10.2016	16.01.2017
OW160117-A16	13 300 000	discount paper	28.10.2016	16.01.2017
OW020217-B31	22 500 000	discount paper	09.11.2016	02.02.2017
OW200117-A20	27 800 000	discount paper	02.11.2016	20.01.2017
OW200117-B36	36 500 000	discount paper	24.11.2016	20.01.2017
OW200117-B38	28 000 000	discount paper	29.11.2016	20.01.2017
OW280417-BH	25 000 000	discount paper	02.11.2016	28.04.2017
OW310317-B39	123 100 000	discount paper	08.12.2016	31.03.2017
OW260517-B40	210 000 000	discount paper	08.12.2016	26.05.2017
OW310317A-B41	133 900 000	discount paper	16.12.2016	31.03.2017

Changes inliabilities from unsecured bonds issued	31.12.2016	31.12.2015
Balance at beginning of the period	-	-
Increase, on account of	**2 131 216**	-
issuance	2 122 206	-
accrued intrest/amortization of discount	9 010	-
Decrease, on account of	**(980 000)**	-
redemption	(980 000)	-
Balance at end of the period	**1 151 216**	-

25. Other liabilities

	31.12.2016	31.12.2015
Accounts payable	5 669	3 758
Other liabilities, including:	6 527	2 262
various creditors	4 558	1 954
social and legal settlements	1 969	308
Total	**12 196**	**6 020**

26. Provisions

Period from 1 January 2016 to 31 December 2016	Provisions for retirement benefits	Provisions for loan commitments and guarantees granted	Total
As at 1 January 2016, including:	**28**	**31**	**59**
Short term provision	-	-	-
Long term provision	**28**	**31**	**59**
Increase/reassessment of provision	32	58	**90**
Realease of provisions	-	(9)	**(9)**
As at 31 December 2016, including:	**60**	**80**	**140**
Short term provision	-	-	-
Long term provision	**60**	**80**	**140**

(IN PLN THOUSAND)

Period from 1 January 2015 to 31 December 2015	Provisions for retirement benefits	Provisions for loan commitments and guarantees granted	Total
As at 1 January 2015, including:	-	-	-
Short term provision	-	-	-
Long term provision	-	-	-
Increase/reassessment of provision	28	31	59
As at 31 December 2015, including:	28	31	59
Short term provision	-	-	-
Long term provision	28	31	59

27. Equity and shareholders of the Bank

	31.12.2016	31.12.2015
Share capital	800 000	300 000
Revaluation reserve	(17 961)	2
Profit / (Loss) from prior years	(13 973)	(1 377)
Net profit / (loss) for the year	13 224	(12 596)
Total Equity	**781 290**	**286 029**

The only shareholder of the bank on 31 December 2016 and 31 December 2015 was PKO Bank Polski SA.

In 2016, there were three issues of shares and the share capital was increased by a total of PLN 500 000 thousand.

Details regarding the issued shares of the Bank are presented in the table below.

Series	Type of shares	Number of shares	Nominal value One share (in PLN)	Value Series Nominal values (in PLN)	Date of adoption of the resolution by the General Meeting of Shareholders	Date of issue	Date of registration in the KRS
A	ordinary registered	300 000 000	1	300 000 000	06.10.2014	06.10.2014	24.10.2014
B	ordinary registered	200 000 000	1	200 000 000	14.03.2016	07.04.2016	22.04.2016
C	ordinary registered	200 000 000	1	200 000 000	01.07.2016	15.07.2016	28.07.2016
D	ordinary registered	100 000 000	1	100 000 000	28.10.2016	18.11.2016	01.12.2016
Total		**800 000 000**		**800 000 000**			

The share capital amounts to PLN 800 000 000 (eight hundred million) and is divided into 800 000 000 (eight hundred million) ordinary registered shares with a nominal value of PLN 1 (one) each. The issued shares of PKO Bank Hipoteczny SA do not have preferential rights and have been fully paid-up.

OTHER NOTES

28. Contingent liabilities and off-balance sheet liabilities received

28.1. Contractual commitments

As at 31 December 2016 and 31 December 2015 the value of contractual commitments concerning intangible assets and property, plant and equipment amounted to PLN 0.

28.2. Loan commitments granted

Nominal value	31.12.2016	31.12.2015
Credit lines and limits		
Mortgage loans for customers	611 793	173 479
Total	**611 793**	**173 479**
including: irrevocable loan commitments	-	-

(IN PLN THOUSAND)

Loan commitments granted by maturity as at 31 December 2016

	up to 1 month	from 1 month to 3 months	from 3 months to 1 year	from 1 year to 5 years	over 5 years	Total
Loan commitments granted	305 896	85 867	186 633	33 139	258	**611 793**
Total	**305 896**	**85 867**	**186 633**	**33 139**	**258**	**611 793**

Loan commitments granted by maturity as at 31 December 2015

	up to 1 month	from 1 month to 3 months	from 3 months to 1 year	from 1 year to 5 years	over 5 years	Total
Loan commitments granted	86 740	15 771	70 968	-	-	**173 479**
Total	**86 740**	**15 771**	**70 968**	**-**	**-**	**173 479**

Information on provisions for contingent financial liabilities is included in Note 26 '*Provision*'.

28.3 Guarantee liabilities granted

As at 31 December 2016 and as at 31 December 2015 the Bank did not grant any guarantee liabilities.

28.4.Off-balance sheet liabilities received

Nominal value	31.12.2016	31.12.2015
financial	390 199	160 218
guarantees	500 000	500 000
Total liabilities received	**890 199**	**660 218**

Financial off-balance sheet commitments received represent an established and available revolving current account credit facility, while off-balance sheet guarantee commitments received represent the amount of an available guarantee to underwrite unsecured bond issues.

Right to sell or pledge collateral established for the Bank

At 31 December 2016 and 31 December 2015 there was no collateral established for the Bank, which the Bank was entitled to sell or encumber with another pledge, in the event of fulfilment of all obligations by the owner of the collateral.

29. Litigation and claims

As at 31 December 2016, 31 December 2015 there were no litigations and claims.

30. Financial lease agreements and operating leases

Financial leasing

The Bank has no receivables and liabilities from financial leases.

Operating lease - lessee

Leasing contracts under which the lessor generally retains all the risks and rewards of ownership of the leased asset are classified as operating leases. Lease payments under operating leases are recognized as an expense in the statement of profit or loss on a straight-line basis over the useful life of the leased asset.

The definition of operating leases also are met by rental and lease agreements concluded by the Bank in the normal course of operations.

The Bank is a party to an operating lease agreement for a car fleet which have been transferred for use for a period of 44 months in exchange for lease payment. The agreement may not be terminated by the lessee.

The Bank is also a party to property rental agreements for the Bank's head office, office in Warsaw and backup center. The rental agreement for the head office was concluded for a period of 10 years, and other contracts for an indefinite period. The notice period for termination of these agreements is from 6 to 12 months.

The following table presents the irrevocable costs resulting from the operating lease of cars and property rental (including notice period).

Total amount of future lease payments under irrevocable operating lease for the period:	31.12.2016	31.12.2015
For period:		
up to 1 year	1 340	1 551
from 1 year to 5 years	133	434
over 5 years	-	-
Total	**1 473**	**1 985**

Lease payments (including property rental agreements) recognized as an expense in the period amounted in 2016 to 1 722 thousand PLN and in 2015 amounted to 1 361 thousand PLN.

(IN PLN THOUSAND)

31. Supplementary information to the statement of cash flows

Cash and cash equivalents

Cash and cash equivalents consist of: cash on accounts with the Central Bank, current amounts due from banks, as well as other cash equivalents with maturities up to 3 months from the date of acquisition.

	31.12.2016	31.12.2015
Cash and balances with the Central Bank	16 033	4
Current receivables due from banks	12 994	5 812
Receivables from banks with original maturities up to 3 months	-	9 000
Total	**29 027**	**14 816**

Cash flows from received and paid interests

Interest income – received	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Interest income received from loans and advances to customers	126 417	1 631	1 631
Interest income received from securities designated upon initial recognition as at fair value through profit and loss	1 209	2 070	2 070
Interest income received from securities designated as held-to-maturity	-	65	65
Interest income received from investment securities	153	-	-
Interest income received from deposits	26	1 887	3 068
Other interest received	34	0	0
Total	**127 839**	**5 653**	**6 834**

Interest expense - paid	01.01.2016 - 31.12.2016	01.01.2015 - 31.12.2015	06.10.2014 - 31.12.2015
Interest expense paid due to loan in current account	5 559	-	-
Interest expense/discounts paid due to issued mortgage covered bonds and unsecured bonds	16 636	-	-
Interest expense with respect to deferred payment due to loan portfolios purchased	26 509	-	-
Interest expense paid from CIRS	8 100		
Interest expense paid due to overdraft within the available limit	5	-	-
Other interest paid	94	-	-
Total	**56 903**	**-**	**-**

32. Related party transactions

32.1 Equity related party transactions

31 December 2016

ASSETS				
Entity	Purchase of property, plant and equipment an intangible assets	Unsettled fees for the sale of loans	Other receivables	including derivative instruments
PKO Bank Polski SA	3 400	24 967	43 674	27 808
Total	**3 400**	**24 967**	**43 674**	**27 808**

LIABILITIES					
Entity	Revolving loan in current account	Loan purchases	Mortgage covered bonds	Other liabilities	including derivative instruments
PKO Bank Polski SA	393 793	3 038 039	29 782	5 410	113
PKO BP Finat Sp. z o.o.	-	-	-	16	-
Total	**393 793**	**3 038 039**	**29 782**	**5 426**	**113**

(IN PLN THOUSAND)

OFF-BALANCE SHEET

Entity	Off-balance sheet liabilities granted	Off-balance sheet liabilities received
PKO Bank Polski SA	-	1 506 207
Total	**-**	**1 506 207**

For the period from 1 January 2016 to 31 December 2016

PROFIT OR LOSS

Entity	Total income	of which interest and fees	Total expenses	of which interest and fees	Result from financial instruments measured at fair value	Foreign exchange result
PKO Bank Polski SA	588	(169)	74 017	55 230	92	49 688
PKO BP Finat Sp. z o.o.	-	-	159	-		
PKO Leasing SA	-	-	310	-		
Total	**588**	**(169)**	**74 486**	**55 230**	**92**	**49 688**

31 December 2015

ASSETS

Podmiot	Purchase of property, plant and equipment an intangible assets	Unsettled fees for the sale of loans	Other receivables	including derivative instruments
PKO Bank Polski SA	520	3 900	18 722	-
Total	**520**	**3 900**	**18 722**	**-**

LIABILITIES

Entity	Revolving loan in current account	Loan purchases	Mortgage covered bonds	Other liabilities	including derivative instruments
PKO Bank Polski SA	39 782	429 516	9 949	705	-
PKO BP Finat Sp. z o.o.	-	-	-	14	-
Total	**39 782**	**429 516**	**9 949**	**719**	**-**

Podmiot	Off-balance sheet liabilities granted	Off-balance sheet liabilities received
PKO Bank Polski SA	-	660 218
Total	**-**	**660 218**

For the period from 1 January 2015 to 31 December 2015

PROFIT OR LOSS

Entity	Total income	of which interest and fees	Total expenses	of which interest and fees	Result from financial instruments measured at fair value	Foreign exchange result
PKO Bank Polski SA	3 045	3 035	7 120	2 257	-	-
PKO BP Finat Sp. z o.o.	-	-	147	-	-	-
PKO Leasing SA	-	-	334	-	-	-
Qualia Residence Sp. z o.o.	-		2	-	-	-
Total	**3 045**	**3 035**	**7 603**	**2 257**	**-**	**-**

The Bank holds current accounts and has been making deposits during the reporting period with PKO Bank Polski SA. In addition, the Bank cooperates strategically with PKO Bank Polski SA. Mortgage loan sales as well as after-sales servicing, excluding risk management, are carried out within the framework set out in the *Outsourcing agreement* with PKO Bank Polski SA dated 16 January 2015. Assistance is also provided with respect to support activities under this agreement.

The Bank also obtains funding from PKO Polish Bank SA in the form of a revolving current account credit facility. In addition, with respect of the Bank's bond issuance, on 30 September 2015, *the PKO Bank Hipoteczny Bond Issuance Program Agreement* was concluded with PKO Bank Polski SA for the Program amount of up to PLN 2 billion over a period of 4 years, as well as *the Guarantee Agreement* under which the guarantor assumes the obligation to acquire the Bonds of the Issuer for its own account up to the amount of PLN 500 million. On 26 October 2016 an annex to the *Agreement* was signed, in terms of which the guaranteed amount was increased to PLN 1 billion.

(IN PLN THOUSAND)

On 17 November 2015 *the Framework Agreement for the Sale of Receivables* was concluded with PKO Bank Polski SA. Purchases of debt portfolios of residential loans secured by mortgage are being realized on the basis thereof with effect from December 2015. A detailed description thereof is presented in Notes 16 and 21.

On 9 November 2015 the Bank concluded *the Program Agreement for the establishment of the Bank's Mortgage Bonds Issuance Program* with PKO Bank Polski SA and the Powszechna Kasa Oszczednosci Bank Polski SA Brokerage House Branch of PKO Bank Polski SA.

PKO Bank Polski also serves in the capacity of arranger and one of the dealers under *the. Program Agreement* concluded on 28 September 2016, in terms of which the Bank has conducted and will conduct international mortgage bond issues within the framework of the PKO Bank Hipoteczny Base Prospectus, approved by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.

Furthermore, as a part of equity related party transactions, PKO BP Finat Sp. z o.o. provides accounting services with respect to the Bank's own operations, as well as personnel and payroll services, while PKO Leasing SA provides vehicles within the framework of a lease agreement.

During the reporting period the Bank did not conclude significant transactions with related parties other than on an arm's length basis.

32.2. Personally related party transactions

As at 31 December 2016, four entities were related to the Bank through key management personnel of PKO Bank Hipoteczny or close family members of key management personnel, and as at 31 December 2015 – three entities.

Between 1 January and 31 December 2016 and between 6 October and 31 December 2015, no transactions were concluded with the abovementioned entities by the Bank.

32.3. Remuneration of PKO Bank Hipoteczny key management personnel

Short-term employee benefits

Purchase In the period from 1 January 2016 to 31 December 2016 and from 6 October 2014 to 31 December 2015 was paid to the Management Board for the following remuneration:

First Name Last Name	Function	01.01.2016 – 31.12.2016	06.10.2014 - 31.12.2015
Management Board			
Rafał Kozłowski	President of the Management Board	611	938
Agnieszka Domaradzka	Vice-President of the Management Board	-	392
Bartłomiej Śliwa	Vice-President of the Management Board	-	568
Jakub Niesłuchowski	Vice-President of the Management Board	515	487
Marek Szcześniak	Vice-President of the Management Board	476	245
Total short-term employee benefits for the Management Board		**1 602**	**2 630**

Surcharges on the above remuneration amounted to PLN 126 thousand for the period from 1 January 2016 to 31 December 2016 and PLN 188 thousand for the period from 6 October 2014 to 31 December 2015.

Members of the Supervisory Board do not receive remuneration in connection with the exercise of their functions.

Long-term employee benefits in the form of cash

Long-term benefits paid in cash have been granted to the Management Board for the first time during 2016.

First Name Last Name	Function	01.01.2016 – 31.12.2016	06.10.2014 - 31.12.2015
Management Board			
Rafał Kozłowski	President of the Management Board	130	-
Jakub Niesłuchowski	Vice-President of the Management Board	121	-
Marek Szcześniak	Vice-President of the Management Board	94	-
Total long-term employee benefits for the Management Board		**345**	**-**

Surcharges on the above remuneration for the period from 1 January 2016 to 31 December 2016 amounted to PLN 10 thousand.

Long-term employee benefits in the form of a financial instrument

Long-term benefits in the form of financial instruments, i.e. phantom shares, have been granted to the Management Board and key management personnel with a high impact on the risk profile of the Bank ("MRT" - Material Risk Takers) for the first time during 2016. The phantom shares were allocated based on the book value per share of the Bank as at 30 June 2016, i.e. PLN 0.9725. The amount due from the conversion to cash based on the per share book value of the Bank as at 31 December 2016 of non-deferred phantom shares and one third of the deferred phantom shares will be paid by the end of the second quarter of 2017.

	Number of shares				
	non-deferred 2017	deferred 2017	deferred 2018	deferred 2019	Total
Management Board	204 828	45 518	45 519	45 517	341 382
MRT	49 801	11 067	11 067	11 067	83 002
Total	**254 629**	**56 585**	**56 586**	**56 584**	**424 384**

(IN PLN THOUSAND)

Post-employment benefits

In the period from 1 January 2016 to 31 December 2016, post-employment benefits in the following amounts have been paid to the Management Board:

First Name Last Name	Function	01.01.2016 – 31.12.2016	06.10.2014 - 31.12.2015
Management Board			
Agnieszka Domaradzka	Vice-President of the Management Board	138	460
Bartłomiej Śliwa	Vice-President of the Management Board	54	120
Total post employment benefits for the Management Board		**192**	**580**

The table presents all paid post-employment benefits, including long-term employee benefits programs.

Benefits due to termination of employment

No benefits due to termination of employment were paid in the period from 1 January 2016 to 31 December 2016 and from 6 October 2014 to 31 December 2015.

Credits, loans, guarantees and other benefits provided by the Bank for management

The Bank did not grant loans, guarantees or other benefits to members of the management in the period from 1 January 2016 to 31 December 2016 and from 6 October 2014 to 31 December 2015.

On 4 December 2015, the Bank acquired a portfolio of residential loan receivables which included a loan to one of the members of the Supervisory Board. The carrying value of the loan amounted to PLN 271 thousand as at 31 December 2016 and PLN 283 thousand as at 31 December 2015.

32.4 The principles for determining the variable salary components for key management personnel of the Bank

In order to fulfil the requirements of Resolution No 258/2011 of the Polish Financial Supervision Authority ("PFSA") dated 4 October 2011 on detailed principles for the functioning of the risk management systems and internal control systems and detailed terms of estimating internal capital by banks and reviewing the process of estimating and maintaining internal capital, and the principles for determining the variable salary components policy for key management personnel of the Bank, the Bank implemented:

- the resolution of the Supervisory Board of the Bank concerning the Regulations for variable salary components for Management Board Members of PKO Bank Hipoteczny and the variable salary components Policy for PKO Bank Hipoteczny,
- the resolution of the Management Board of the Bank regarding the list of staff whose professional activities have a material impact on the risk profile of the entity, covered by the Regulations for variable salary components for management personnel of the Bank,
- directive of the President of the Management Board on the implementation of the Regulation on variable salary components for management personnel at the Bank.

The cited Policy, and Regulation issued on the basis thereof, describe the procedure for granting variable salary components, associated with the results and effects of work, to the above-mentioned persons. In accordance with the requirements of the cited resolution of the PFSA and in proportion as specified therein, the variable salary components are granted in the form of:

- non-deferred (in the first year after the calendar year subject to assessment),
- deferred (for the three years after the first year succeeding the calendar year subject to assessment),

however, both the non-deferred and deferred salary, is awarded in equal parts in cash and in the form of financial instrument, i.e. phantom shares (for which conversion into cash is carried out after an additional period of retention).

As at 31 December 2016 the provision for variable remuneration components amounted to 2 951 thousand PLN (as at 31 December 2015 1 871 thousand PLN), of which for the members of the Management Board in the amount of PLN 1 672 thousand PLN (as at 31 December 2015 989 thousand PLN). Provision for surcharges related to variable salary components amounted 243 thousand PLN as at 31 December 2016 (as at 31 December 2015 375 thousand PLN).

33. Fair value of financial assets and liabilities

33.1. Categories of fair value valuation of financial assets and liabilities measured at fair value in the statement of financial position

The Bank classifies particular components of financial assets and liabilities measured at fair value into the following categories:

- Level 1: Prices quoted on the active markets,
- Level 2: Valuation techniques based on observable market data,
- Level 3: Other valuation techniques.

The table below shows the breakdown of financial assets and liabilities presented in the financial statements at fair value broken down into 3 categories on 31 December 2016 and 31 December2015:

(IN PLN THOUSAND)

Assets and liabilities measured at fair value as at 31.12.2016	Note	Carrying value	Level 1	Level 2	Level 3
			Prices quoted on active markets	Valuation techniques based on observable market data	Other valuation techniques
Derivative financial instruments	14	27 808	-	27 808	-
CIRS		27 709	-	27 709	-
FX-Forward		99	-	99	-
Financial instruments measured upon initial recognition at fair value through profit or loss	15	79 987	-	79 987	-
NBP money market bills		79 987	-	79 987	-
Investment securities available for sale	17	203 019	203 019	-	-
Treasury bonds		203 019	203 019	-	-
Financial assets measured at fair value - total:		310 814	203 019	107 795	-
Derivative financial instruments	14	113	-	113	-
FX-Forward		113	-	113	-
Financial liabilities measured at fair value - total:		113	-	113	-

Assets and liabilities measured at fair value as at 31.12.2015	Note	Carrying value	Level 1	Level 2	Level 3
			Prices quoted on active markets	Valuation techniques based on observable market data	Other valuation techniques
Financial instruments measured upon initial recognition at fair value through profit or loss	15	39 988	-	39 988	-
NBP money market bills		39 988	-	39 988	-
Investment securities available for sale	17	500	500	-	-
Treasury bonds		500	500	-	-
Financial assets measured at fair value - total:		40 488	500	39 988	-
Financial liabilities measured at fair value - total:		-	-	-	-

Different methods of determining fair value are used depending on the classification of financial assets and liabilities within the hierarchy.

Level 1: Prices quoted on the active markets:

Financial assets and liabilities whose fair value is determined directly based on quoted prices (unadjusted) from active markets for identical assets and liabilities.

Level 2: Valuation techniques based on observable market data

Financial assets and liabilities whose fair value is determined with the use of valuation models where all significant input data is observable on the market directly (as prices) or indirectly (based on prices). The Bank classifies financial instruments for which there is no active market into that category:

Assets and liabilities measures at fair value	Valuation method (technique)	Observable inputs
Financial instruments measured upon initial recognition at fair value through profit or loss including:		
NBP money market bills	Yield curve valuation method	Yield curves for money market bills are built based on market prices, money market data and the OIS (overnight index swap) transaction market.
CIRS	Yield curve valuation method	Yield curves are built in relation to market rates, market data from money market, FRA transactions market (Forward Rate Agreement), IRS (Interest Rate Swap), basis swap and CDS transactions market (Credit Default Swap).
FX Forward	Yield curve valuation method	Yield curves are built in relation to market rates, market data from money market, FX-Forward transactions.

Level 3: Other valuation techniques

Financial assets and liabilities, whose fair value is determined with the use of valuation models, for which available input data is not derived from observable markets (unobservable input data).

Transfers of instruments between Level 1 and Level 2 occur depending on the availability of quotations in an active market at the end of the reporting period. Transfer from Level 2 to Level 3 occur when an observable factor in the valuation is superseded by one that is unobservable or in applying a new unobservable risk factor in the valuation, which also has a significant impact on the valuation of the instrument. Transfer from Level 3 to Level 2 occur when an unobservable factor in the valuation is superseded by one that is observable or when the impact of an unobservable factor on the valuation of the instrument ceases to be significant. Transfers between levels of fair value hierarchy occur as at the end of the reporting period.

(IN PLN THOUSAND)

In the period from 1 January 2016 to 31 December 2016. and from 6 October 2014 to 31 December 2015, there were no transfers between levels in the fair value hierarchy used in measuring fair value of financial instruments.

33.2. Financial assets and liabilities not presented at fair value in the statement of financial position

The Bank holds financial assets and liabilities which are not presented at fair value in the statement of financial position.

Market values are not available for the majority of financial instruments, therefore their fair values have been estimated with the use of various valuation techniques. The fair value of financial instruments was measured using a model based on estimates of the present value of future cash flows discounted using appropriate interest rates. All model calculations include certain simplifying assumptions and are sensitive to those assumptions. Set out below is a summary of the main methods and assumptions used for estimating the fair values of financial instruments which are not carried at fair value.

For certain groups of financial instruments it has been assumed that their carrying amount approximates their fair values, due to the lack of expected material differences between their carrying amount and their fair value in view of the features of these groups (for example, short term nature, high correlation with market parameters, short interest repricing periods, unique character of the instrument or short period from issue date). This applies to the following groups of financial instruments:

- cash and balances with the Central Bank,
- amounts due from banks,
- loans and advances to customers,
- liabilities to banks,
- liabilities to customers,
- mortgage covered bonds issued in PLN,
- unsecured bonds issued.

Due to the fact that the Bank issued mortgage bonds denominated in EUR with maturity of 5 years and 8 months, with a fixed interest rate for the term, the fair value was determined based on the price observed on the regulated market (stock exchange in Luxembourg).

	level of fair value hierarchy	valuation method	31.12.2016	
			carrying amount	fair value
Cash and balances with the Central Bank	n/a	value at cost to pay incl. impairment allowance	16 033	16 033
Amounts due from banks	3	discounted cash flows	12 994	12 994
Loans and advances to customers, including:			8 247 900	8 247 900
housing loans	3	discounted cash flows	8 247 900	8 247 900
Amounts due to banks	3	discounted cash flows	3 431 832	3 431 832
Amounts due to customers	3	discounted cash flows	1 549	1 549
Mortgage covered bonds	1, 3	discounted cash flows, regulated market	3 232 117	3 207 099
Unsecured bonds issued	3	discounted cash flows	1 151 216	1 151 216

	level of fair value hierarchy	valuation method	31.12.2015	
			carrying amount	fair value
Cash and balances with the Central Bank	n/a	value at cost to pay incl. impairment allowance	4	4
Amounts due from banks	3	discounted cash flows	14 812	14 812
Loans and advances to customers, incl.:			722 655	722 655
housing loans	3	discounted cash flows	722 655	722 655
Amounts due to banks	3	discounted cash flows	469 298	469 298
Amounts due to customers	3	discounted cash flows	146	146
Mortgage covered bonds	3	discounted cash flows	29 933	29 933

34. Business segments

During the reporting period, the Bank did not conduct segmented business activities.

OBJECTIVES AND PRINCIPLES OF RISK MANAGEMENT RELATED TO FINANCIAL INSTRUMENTS

35. Risk Management in PKO Bank Hipoteczny

Risk management is a key internal process within PKO Bank Hipoteczny. It aims at ensuring profitability of business activity, by ensuring control of risk level and maintaining it within the risk tolerance and system of limits applied by the Bank, in a changing macroeconomic and legal environment. The expected level of risk plays an important role in the planning process.

35.1. Main principles of risk management

Risk management within PKO Bank Hipoteczny is based on the following principles:

- the risk management process, including the loan process, is defined and regulated by strategies, policies and procedures adopted by the Management Board and Supervisory Board of PKO Bank Hipoteczny,

- the Bank manages all identified types of banking risks and performs an ICAAP (Internal Capital Adequacy Assessment Process) where in:
  - the risk management process is appropriate to the scale of the operations and to the significance, scale and complexity of a given risk and tailored to new risk factors and sources on a current basis,
  - the risk management methods (in particular the models and their assumptions) and the risk measurement systems are tailored to the scale and complexity of the risk, as well as periodically verified and validated,
- the organizational structure of risk management ensures the independence of the risk area, including real estate valuation and the credit decision making process from business activities,
- risk management is integrated with the planning and controlling systems and supports the implementation of the Bank's strategy in compliance with the risk management strategy, particularly in terms of risk tolerance levels,
- the risk management process is consistent with the principles of risk management of the PKO Bank Polski SA Group, including the application of group risk models, modified to reflect the nature of activities of PKO Bank Hipoteczny and approved by the adequate authorities of PKO Bank Hipoteczny.

35.2. Elements of risk management process

The process of risk management in PKO Bank Hipoteczny SA consists of the following elements:

- risk identification:

  the identification of actual and potential sources of risk and estimation of the significance of their potential influence on the financial situation of the Bank. Within the risk identification process, types of risk perceived as significant to the Bank's activities are identified,
- risk measurement and assessment:

  risk measurement covering determination of risk assessment measures adequate to the type and significance of the risk, data availability and quantitative risk assessment by means of determined measures, as well as risk assessment aimed at identifying the scale or scope of risk, taking into account risk management objectives. Within risk measurement, stress-testing is conducted on the basis of assumptions providing a fair risk assessment,
- risk control:

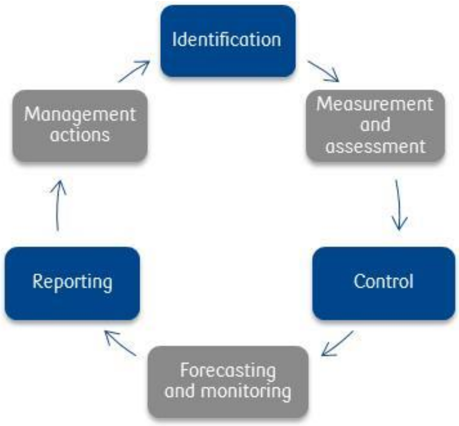
  determination of the tools used to diagnose or reduce the level of risk in specific areas of the Bank's activity. Risk control covers the determination of control mechanisms suited to the scale and complexity of the Bank's operations, in particular in the form of strategic tolerance limits for individual types of risks, which fulfillment is subject to monitoring, and in the event these are exceeded management actions are taken,
- risk forecasting and monitoring:

  preparing risk level forecasts and monitoring deviations from forecasts or adopted reference points (e.g. limits, thresholds, plans, measures from the previous period, recommendations and suggestions). Risk monitoring is performed with a frequency appropriate to the significance and volatility of a specific risk type,
- risk reporting:

  periodically informing the authorities of the Bank about the results of risk measurement or risk assessment, actions taken and recommended actions. The scope, frequency and the form of reporting are adjusted to the management level of the recipients,
- management actions:

  including, in particular, issuing internal regulations, establishing levels of risk tolerance, establishing limits and thresholds, issuing recommendations, making decisions about the use of tools supporting risk management, and taking action to maintain a defined level of risk. The objective of management actions is to direct the risk management process and risk levels.

The risk management process is presented on the chart below:



35.3. The organization of risk management in the Bank

The risk management process is supervised by the Supervisory Board of the Bank, which is informed on a regular basis about the risk profile of PKO Bank Hipoteczny and the most important activities undertaken with respect to risk management.

The Bank's Management Board is responsible for risk management, including supervising and monitoring of activities untaken by the Bank with respect to risk management. The Bank's Management Board takes the most important decisions affecting the risk profile of the Bank and adopts internal regulations concerning risk management.

The risk management process is conducted in three, mutually independent lines of defense:

1) the first line of defense, which is functional internal control that ensures the use of risk control mechanisms and compliance of the activities with the generally applicable laws,

2) the second line of defense, which is the risk management system, including methods, tools, process and organization of risk management,

3) the third line of defense, which is internal audit.

The independence of the lines of defense is achieved by preserving organizational independence in the following areas:

- the function of the second line of defense in creating systematic solutions is independent of the function of the first line of defense,
- the function of the third line of defense is independent of the functions of the first and second lines of defense,
- the function of managing compliance risk reports directly to the President of the Management Board.

PKO Bank Hipoteczny's organizational units responsible for risk management, within the scope of their competencies are:

The Risk Department is, in particular, responsible for the management of the following risk types: credit, concentration, liquidity, interest rate, currency, business, macroeconomic changes and the management of capital adequacy, including:

- identifying risk factors and sources,
- measuring, assessing, as well as monitoring and reporting risk levels on a regular basis,
- measuring and assessing capital adequacy,
- creating and implementing credit risk assessment methodologies,
- analysis of the real estate market and real estate valuation principles, including the principle for determining the mortgage lending value of real estates (BHWN)
- managing bad debts and performing effective actions for collection of these debts;
- cooperating with supervisory authorities with respect to risk (BION, inspections, explanations, questionnaires, etc.)

The Collateral Valuation Department is, in particular, responsible for the determination of the Mortgage-Lending Value of the Real Estates (BHWN).

The Credit Analysis Department is particularly responsible for the assessment of credit applications.

The Compliance, Security and Legal Bureau is, in particular, responsible for the direction of the non-compliance risk management system and identification of this risk within the Bank, in cooperation with the Bank's organizational units that develop internal regulations and supervising processes.

The position for operational risk is responsible, in particular, for the coordination of the operational risk management process, including the identification, measurement, assessment, control, monitoring and reporting, and for coordinating the realization of management actions with respect to operational risk.

The position for model validation is responsible in particular for validation of risk models and implementation of an effective model risk management system within the Bank.

The position for communication is responsible, in particular, for the development of the reputational risk management system and management of the Bank's risk.

Risk management is supported by the following committees:

The Audit, Finance and Risk Committee ('the AFRC') – supporting the Supervisory Board

- monitors the integrity, adequacy and effectiveness of the risk management system, capital adequacy and implementation of the Bank's binding risk management policies in accordance with the Bank's Strategy,
- analyses and evaluates the application of strategic risk limits determined by PKO Bank Hipoteczny's Bank Risk Management Strategy,
- supports the Supervisory Board in the bank risk management process by formulating recommendations and making decisions concerning capital adequacy and the effectiveness of the risk monitoring system.

The Assets & Liabilities Management Committee (the 'ALCO') – supporting the Management Board

- makes decisions with respect to limits and thresholds for particular types of risks, issues related to transfer pricing, models and portfolio parameters used to determine impairment allowances and provisions as well as other significant financial and business risk models and their parameters,
- gives recommendations to the Management Board, among others, with regard to determining the structure of the Bank's assets and liabilities, managing different types of risks, equity and price policy,
- supports the Management Board in the process of managing assets and liabilities.

The Credit Committee (the 'CC') – supporting the Management Board

- makes loan decisions with regard to significant individual credit exposures or formulates recommendations in this respect to the Management Board,
- makes decisions regarding approval of loans acquired by the Bank's,

- issues recommendations and makes decisions with respect to the management of troubled loans,
- supports the Management Board in credit risk management.

The ALCO, AFRC, the Management Board and the Supervisory Board are recipients of periodic reports concerning the specific risk types.

35.4. Identification of significant risk types

The significance of individual types of risk is established at the level of the Bank

In determining criteria for classifying a given type of risk as significant, the impact of the risk on the Bank's activities is considered and three types are distinguished:

- considered as permanently significant– actively managed,
- potentially significant – for which monitoring of significance is performed,
- other types of risk that are undefined or do not arise in the Bank (insignificant and unmonitored).

Based on quantitative and qualitative information, a periodic assessment of the significance of particular types of risk is performed by the Bank. As a result of the assessment, each particular type of risk is classified as significant or insignificant. In particular, monitoring is conducted if significant changes in the scope or profile of the Bank's activities have occurred.

The following types of risk are considered to be significant for the Bank:

1) credit risk,
2) liquidity risk, including financing risk
3) operational risk,
4) business risk,
5) risk of macroeconomic change,
6) risk of models,
7) capital risk, including excessive financial leverage,
8) compliance risk.

Additionally, the following types of risk were considered potentially significant by the Bank:

1) concentration risk,
2) interest rate risk,
3) currency risk,
4) residual risk,
5) reputational risk.

The Bank has defined and monitors significance criteria for the potentially significant risks. The fulfillment of those criteria will result in recognition of such risk as significant to the Bank.

The Bank's Risk Management Strategy has defined a number of strategic limits defining the appetite for different types of risk. The Bank regularly monitors these limits, and in 2016 none has been exceeded.

36. Credit risk management

Credit risk is defined as the risk of the occurrence of losses due to a counterparty's default on obligations to the Bank or as the risk of a decrease in economic value of amounts due to the Bank as a result of a deterioration of a counterparty's ability to service its obligations. The objective of credit risk management is to minimize losses on the loan portfolio as well as to minimize the risk of occurrence of impairment exposures, while maintaining an expected level of profitability and value of loan portfolio.

PKO Bank Hipoteczny has policies for credit risk management, which are aimed at proper risk assessment of credit transactions at the credit application phase and throughout the life of the transaction (monitoring), as well as appropriate safeguards by the use of suitable techniques for limiting credit risk.

The policies are executed by the Bank through the use of advanced credit risk management methods, both at the level of individual credit exposures and on the level of the entire loan portfolio of the Bank. These methods are verified and developed to ensure compliance with internal rating based requirements (IRB), i.e. an advanced credit risk measurement method.

36.1 Measurement and assessment of credit risk

PKO Bank Hipoteczny measures and assesses credit risk at the level of individual transaction and at the level of the entire portfolio.

Measurement and assessment of the risk of individual credit transactions is performed by PKO Bank Hipoteczny SA with the use of group risk models adjusted to nature of PKO Bank Hipoteczny's business and accepted by the adequate authorities of PKO Bank Hipoteczny SA. Group risk models used by PKO Bank Hipoteczny SA are also applied by PKO Bank Polski SA and are based on application and behavioral data, as well as data from Credit Information Department (BIK). The review (monitoring) of models and their validation are performed separately on the basis of the Bank's portfolio, PKO Bank Polski SA's portfolio as well as the combined portfolios of both banks.

The detailed principles and scope of cooperation within the PKO Banku Polskiego Group within the scope of group risk models are determined by the terms of the Outsourcing agreement with PKO Bank Polski SA described in Note 32.1.

In terms of the current credit process, as part of the risk assessment of individual credit transactions, the Bank assesses the credit risk in two dimensions, in respect of the customer's credit rating and creditworthiness. Creditworthiness is based on a review of the customer's financial situation, while credit rating involves a scoring assessment and evaluation of the client's credit history obtained from internal and external databases.

For mortgage loans acquired from PKO Bank Polski SA, the Bank also assesses the credit risk of transactions subject to purchase in accordance with the Bank's applicable assessment methodology for acquired loans. In particular the Bank assesses: the creditworthiness of the client in accordance with the data obtained at the time the loan was granted by PKO Bank Polski SA, a current assessment of behavioral scoring (based on a group scoring model), as well as current timeliness of settlement, excluding those loans that did not meet the criteria of the selected methodology.

Additionally, the purchased loan portfolios are valued by an independent third party in order to ensure an independent assessment of the value of acquired portfolios. In this valuation process an assessment of the cost of risk expected on specific loan portfolio is performed, which is reflected in the final price paid by the Bank for the respective loan portfolio.

In order to assess the level of credit risk at the portfolio level, the Bank uses the following credit risk measures and valuation methods:

- Probability of Default (PD),
- loss in the event of default (LGD)
- Expected Loss (EL),
- proportion and structure of impaired loans (according to IFRS),
- coverage ratio of impaired loans (according to IFRS) by allowances (coverage ratio),
- cost of risk,
- vintage analysis.

The portfolio credit risk measurement methods allow for, among others, the determination of the level of impairment allowances.

The Bank performs analysis and stress-tests regarding the influence of potential changes in macroeconomic condition on the quality of the Bank's loan portfolio. The test results are reported to the Bank's authorities. The abovementioned information enables the Bank to identify and take measures to limit the negative influence of unfavorable market conditions on the Bank's performance.

36.2. Impairment of loan exposures

PKO Bank Hipoteczny performs a monthly review of loan exposures in order to identify those that are threatened with impairment, to measure the impairment of loan exposures and to recognize impairment allowances or provisions.

Depending on whether an individual loan exposure has an identified impairment, an appropriate method of estimating the amount of allowance is applied. The events considered individual impairment triggers are, in particular, as follows:

- overdue repayment of principal or interest of more than 90 days,
- concluding a restructuring agreement or applying forbearance measures concerning debt repayment (an indicator of impairment is recognized, if the forbearance measures are granted due to legal or economic considerations stemming from the customers financial difficulties).

In determining the overdue period of a loan, the overdue amounts of principal and interest, exceeding defined thresholds, are taken into account.

36.3. Methods of estimating impairment

PKO Bank Hipoteczny currently applies two methods of estimating impairment:

- a portfolio approach applied to loans for which objective evidence of an indicator of individual impairment have been identified,
- a collective approach (IBNR) applied to loans for which objective evidence of individual impairment has not been identified and for which a possible loss has incurred but has not been reported.

Impairment allowance for loan exposures correspond to the difference between the carrying amount of the exposure and the present value of the expected future cash flows from a given exposure, estimated with the use of the group risk parameters.

36.4. Provisions for off-balance sheet loan exposures

Provision for off-balance sheet loan exposures are recognized in an amount equal to the resultant expected (possible to estimate) loss of economic benefits.

In determining provisions for off-balance sheet loan exposures, PKO Bank Hipoteczny uses a portfolio based method (if an exposure meets the criteria for an indicator of individual impairment) or a collective basis (if an exposure only fulfils the criteria for an indicator of collective impairment).

The provision is determined as the difference between the expected amount of the exposure in the statement of financial position, which will arise from the fulfilment of an off-balance sheet commitment (from the date of the assessment till the date overdue amounts are considered an impairment indicator) and the present value of the expected future cash flows obtained from the exposure in the statement of financial position arising from the fulfilment of the off-balance sheet commitment, estimated with use of the group risk parameters.

The loan portfolio structure and allowances for impairment of credit exposures of PKO Bank Hipoteczny are presented in Note 16 "Loans and advances to customers".

36.5. Forecasting and monitoring of credit risk

36.5.1. Maximum exposure to credit risk

The following table presents the Bank's maximum exposure to credit risk for balance recognized in the statement of financial position and off-balance sheet commitments, excluding collateral.

(IN PLN THOUSAND)

Maximum exposure to credit risk	31.12.2016	31.12.2015
Cash, balances with the Central Bank	16 033	4
Amounts due from banks	12 994	14 812
Loans and advances to customers	8 247 900	722 655
Financial instruments designated upon initial recognition as at fair value through profit or loss	79 987	39 988
Investment securities available for sale	203 019	500
Total - exposure for balance recognized in the statement of financial position	**8 559 933**	**777 959**
Commitment to grant loans	611 793	173 479
Total off-balance sheet exposure	**611 793**	**173 479**

36.5.2. Amounts due from banks

The following table presents amounts due from banks.

Amounts due from banks	31.12.2016	31.12.2015
Amounts not past due, not impaired	12 994	14 812
Gross total	**12 994**	**14 812**
Impairment allowances	-	-
Net total	**12 994**	**14 812**

The Bank has no overdue or impaired receivables from banks. Currently the Bank only engages in interbank transactions with PKO Bank Polski SA and assesses the credit risk arising from those transactions as significantly limited, and therefore did not recognize impairment allowances for losses incurred but not reported (IBNR).

36.5.3. Loans and advances to customers

The following table presents loans and advances to customers.

Loans and advances to customers	31.12.2016	31.12.2015
Loans not past due, not impaired	8 227 317	722 835
Loans past due, not impaired	22 342	-
Impaired loans	-	-
Gross total	**8 249 659**	**722 835**
Allowances for loans not past due, not impaired	(1 543)	(198)
Allowances for loans past due, not impaired	(216)	-
Impaired loans	-	-
Net total	**8 247 900**	**722 655**

The carrying amount of the loan portfolio that is not impaired, is presented below.

Loans to customers, not impaired	31.12.2016	31.12.2015
not past due	8 227 317	722 853
up to 30 days	21 263	-
from 31 to 60 days	1 079	-
from 61 to 90 days	-	-
Gross total	**8 249 659**	**722 853**

36.5.4. Forbearance

The Bank defines *forbearance* as actions aimed at changing contractual terms agreed with a debtor, caused by the debtor's difficult financial position (restructuring activities). The purpose of forbearance activities is to restore a debtor's ability to fulfil obligations to the Bank and to maximize the effectiveness of non-performing loan management, i.e. obtaining the highest recoveries while minimizing the costs of recoveries, which are very high in the event of execution proceedings.

Forbearance activities focus on changing the payment terms that are individually determined for each contract depending on the specificity of the problem. One of the elements of the forbearance process is the assessment of debtor's ability to comply with modified terms of the forbearance agreement (debt repayment on contractual dates). Changes to agreements may consist of:

- spreading the overdue due debt into instalments,
- changes to the repayment schedule,
- suspension of repayment,
- change in a repayment form (annuity instalments, decreasing instalments),

- change in interest rates,
- loans reduction,
- change in grace period.

Forborne agreements are monitored on the ongoing basis. As a result of timely service of the contract, the forborne debt becomes non-overdue Loan.

The conclusion of a forbearance type agreement, changing the contractual conditions due to financial difficulties of the debtor, is one of the individual impairment triggers and results in the recognition of impairment allowance or provision in relation to the credit exposure.

Loans and advances cease to be subject Forbearance when the conditions are met simultaneously:

- timely settlement of at least 6 instalments from restructuring,
- at least 19 months have elapsed since the return of the debt to the unit, which delivered the application.

The timely settlement of the forborne exposures means settlement of each instalment within 30 days of due date as specified in the schedule of the restructuring agreement.

As at 31 December 2016 and as at 31 December 2015 no forborne exposure were recognized in the Bank's portfolio.

36.5.5. Collateral

Due to the specialized nature of its business, the Bank pays particular attention to monitoring of the value of collateral. Therefore, a key role in establishing minimum transaction conditions is a collateral policy in terms of credit risk. The aim of the mortgage collateral policy is to appropriately secure the credit risk to which the Bank is exposed, including the establishment of mortgage collateral providing the highest possible level of recovery in the event of debt collection actions.

The Bank's policies with respect to loan collateral and valuation thereof take into consideration the requirements of applicable laws: The Mortgage Bonds and Mortgage Banks Act, The Banking Law, and The Act on Land Registers and Mortgages. In addition, the suggestions and recommendations of the Polish Financial Supervision Authority, including Recommendations F, S and J, as well as internal bank regulations address the application of legal collateral.

The Bank implemented and applies the Regulations on determining the mortgage lending value of real estates, approved by the Polish Financial Supervision Authority, issued in terms of the Mortgage Bonds and Mortgage Banks Act dated 29 August 1997, and taking into consideration Recommendation F's concerning the basic criteria used by the Polish Financial Supervision Authority for the approval of regulations on the mortgage lending value of real estate issued by mortgage banks.

The mortgage lending value of real estates (BHWN) is described as a value determined by the Bank, which in the opinion of the Bank reflects the level of risk associated with the property, as collateral for loans and is used to determine the upper limit of a granted or purchased loan secured by a mortgage on a specific property or in reaching a decision by the Bank as to whether the loan secured on the property may be acquired by the Bank.

PKO Bank Hipoteczny determines the BHWN on the basis of expert valuations of the mortgage lending value of property, which is carried out with due diligence and prudence, taking into account only those characteristics and expenditures necessary for construction of a property, that will be of a permanent nature and on the assumption of rationale exploitation will be possible to recover by any property holder. Assumptions and parameters used for the analysis, the mortgage lending value determination process and consequential proposed the mortgage lending value are documented in the expert valuation report prepared at a specified date. The expert valuation report takes into account the analysis and forecasts concerning specific parameters for a given property, that affect the credit risk assessment, as well as general factors such as: population development, unemployment rate, and local zoning plan.

The Bank accepts the following as a mandatory legal collateral for granted or acquired loans:

- highest priority mortgage on property registered in the land register,
- assignment of rights from the insurance policies against fire and other accidental causes for the mortgaged property.

36.6. Credit risk reporting

The Bank prepares monthly and quarterly reports on credit risk. Credit risk reporting includes regular information about the structure and scale of the risk exposure of the credit portfolio of the Bank. The reports are presented to the Assets and Liabilities Management Committee on a monthly basis and the Management Board and the Supervisory Board on a quarterly basis.

36.7. Credit risk management

Basic credit risk management tools used by the PKO Bank Hipoteczny include in particular:

- strategic and internal tolerance limits (portfolio approach),
- minimum transaction requirements (maximum LTV value, maximum loan amount, required collateral, value of individual loan compared to the BHWN),
- scoring system, including cut-offs (minimum number of points scored required for acceptance of a loan transaction),
- limits on credit exposures related to the Bank's clients – the limits defining the credit risk tolerance of the Bank as result of, among others, Recommendations S (such as, for example, the ratio of expenses due to credit and financial liabilities to client's income – DtI, which is accepted by the Supervisory Board),
- competence limits – defining the maximum level of credit decision-making powers with regard to the Bank's customers, the limits primarily depend on the level at which the credit decision is made (within the Bank's organizational structure),
- minimum credit margins, considering credit risk costs.

The Collateral policies as regards credit risk have a significant role in establishing minimum transaction terms in accordance with which a fundamental element limiting the credit losses related to customers' inability to settle obligations due to the Bank are secured mortgages on financed real estate. However the Bank applies the principle that it only accepts collateral as a loan support and not as a substitute for customers' ability to settle obligations due to the Bank.

(IN PLN THOUSAND)

37. Concentration risk management

Concentration risk is analyzed in the Bank in relation to lending and is defined as the excessive exposure of the Bank to:

- exposures to individual clients or groups of related clients,
- exposures subject to common or correlated risk factors

characterized by the potential to generate losses large enough to threaten the financial condition of the Bank or the ability to maintain its core operations or to lead to a significant change in the risk profile of the Bank.

As part of the management of concentration risk, the Bank performs cyclical risk identification, measurement, control, monitoring and reporting.

Given the high degree of dispersion of the Bank's portfolio in terms of exposure to individual clients, the Bank identifies and assesses the concentration risk by analyzing the structure of the portfolio in relation to significant risk factors (characteristics of exposure) from the point of view of credit risk and on this basis distinguishes groups of exposures to which excessive concentration is undesirable and in extreme conditions could generate losses in excess of the Bank's appetite for credit risk.

At PKO Bank Hipoteczny, measurement and control of concentration risk is performed by determining the volume of exposures that generate concentration risk and comparing those to reference limits set by the provisions established by law and internal limits.

Internal exposure limits are determined in relation to the size of the Bank's own funds and in relation to the total credit exposure of the Bank and reflect the appetite for credit risk adopted by the Bank, taking into account normal and extreme conditions.

The Bank mitigates concentration risk by using the following limits, the use of which is monitored and reported on a monthly basis:

- exposure limits to a single entity or group of entities related financially or organizationally,
- exposure limits to credit exposure for members of the Supervisory Board, Management Board and other managers as well as entities related financially or organizationally with them,
- exposure limits to credit exposures for customers generating income from commercial activity,
- exposure limits to credit exposures for customers with a DTI (debt to income) level in excess of 50%.

In the reporting period the Bank did not exceed any of the concentration limits.

Portfolio structure by DTI

Loans and advances to customers by DTI levels	31.12.2016	31.12.2015
0% - 50%	79%	74%
over 50%	21%	26%
Gross total	**100%**	**100%**

Portfolio structure based on LtV ratio

Loans and advances to customers by LtV levels	31.12.2016	31.12.2015
0% - 50%	31%	24%
51% - 60%	17%	23%
61% - 70%	19%	24%
71% - 80%	23%	16%
80%-90%	10%	13%
90%-100%	0%	0%
Total	**100%**	**100%**

The table includes the indexation of the market value of the property.

The Bank prepares monthly and quarterly reports on concentration risk. The reports are presented to the Committee of Assets and Liabilities Management on a monthly basis and the Management Board and the Supervisory Board on a quarterly basis.

38. Market risk management

The following market risk types were identified in PKO Bank Hipoteczny's business:

- interest rate risk defined as the risk of incurring losses on the Bank's statement of financial position and off-balance sheet items sensitive to interest rate fluctuations, as a result of changes in interest rates on the market,
- currency risk defined as the risk of incurring losses due to unfavorable exchange rate changes as a consequence of maintaining open currency positions in a given foreign currency.

The objective of interest rate risk management is to limit the risk of incurring possible losses arising from market interest rate changes to an acceptable level by appropriate structuring of the statement of financial position and off-balance sheet items, among others, by reducing repricing dates mismatch between assets and liabilities and off-balance sheet items.

The objective of currency risk management is to limit the risk of incurring possible losses arising from exchange rate fluctuations to an acceptable level by appropriate structuring of the statement of the financial position and off-balance sheet currency items with derivative instruments that hedge currency risk and/or interest rate risk.

According to business model of PKO Bank Hipoteczny the significance of interest rate risk and currency risk is periodically assessed by the Bank. The methodology of monitoring, as well as risk management tools depend on the assessment of the significance of these risks.

In the current phase of the Bank's business, currency risk as well as interest rate risk were considered as non-significant and did not require coverage from internal capital.

38.1. Measurement and assessment of market risk

38.1.1 Measurement of interest rate risk

In the process of interest rate risk management the Bank, in particular, uses interest income sensitivity (WDO), basis point value (BPV), stress tests and repricing gap reports.

The sensitivity of interest income (WDO) is a measure determining changes in interest income resulting from abrupt changes in interest rates and basis point value (BPV) is a measure determining the impact of such changes on the economic value of capital. These measures take into account the diversity of the repricing dates of individual interest positions in each of the selected time horizons.

Stress tests are used to estimate potential losses arising from maintaining the structure of the statement of financial position and off-balance sheet items under market conditions that cannot be described in a standard manner using statistical measures. The Bank uses hypothetical scenarios which are based on the arbitrary application of parallel shifts in interest rate curves by ±50 b.p., ±100 b.p. and ±200 b.p.

The repricing gap shows the difference between the present value of assets and liabilities exposed to interest rate risk, subject to repricing in a given time bucket, however items which are not valued at fair value (e.g. loans) are recognized at the value representing the basis for interest accrual.

The repricing gap report in the table below presents the interest bearing assets and liabilities and unrecognized exposures responsive to changes in interest rates. Exposures that are not sensitive to changes in interest rates, the Bank's own funds, receivables due from banks in the form of current accounts and overdraft within available limits were excluded from the report.

(thousand PLN)	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	> 5 years	Total
31.12.2016								
Interest bearing assets, of which	**2 963 311**	**5 537 893**	**797**	**1 942**	**5 671**	**642**	**-**	**8 510 256**
securities	285 501	-	-	-	-	-	-	285 501
amounts due from banks	-	-	-	-	-	-	-	-
amounts due from customers	2 677 810	5 537 893	797	1 942	5 671	642	-	8 224 755
Interest liabilities, of which	**1 969 574**	**3 399 478**	**235 000**	**-**	**-**	**-**	**2 212 000**	**7 816 052**
amounts due to banks	1 286 074	2 131 978	-	-	-	-	-	3 418 052
mortgage covered bonds issued	500 000	530 000	-	-	-	-	2 212 000	3 242 000
unsecured bonds issued	183 500	730 500	235 000	-	-	-	-	1 156 000
Assets due to derivatives	-	-	765	-	1 174	3 695	2 210 823	2 216 457
Liabilities due to derivatives	-	2 154 809	733	-	1 161	3 482	6 036	2 166 261
Periodic Gap	**993 737**	**(16 394)**	**(234 211)**	**1 942**	**5 684**	**855**	**(7 213)**	
Cumulative Gap	**993 737**	**977 343**	**743 132**	**745 074**	**750 758**	**751 613**	**744 400**	

(thousand PLN)	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	> 5 years	Total
31.12.2015								
Interest assets, of which	**260 494**	**508 195**	**-**	**-**	**-**	**-**	**-**	**768 689**
securities	40 488	-	-	-	-	-	-	40 488
amounts due from banks	9 000	-	-	-	-	-	-	9 000
amounts due from customers	211 006	508 195	-	-	-	-	-	719 201
Interest liabilities, of which	**469 298**	**30 000**	**-**	**-**	**-**	**-**	**-**	**499 298**
amounts due to banks	469 298	-	-	-	-	-	-	469 298
mortgage covered bonds issued	-	30 000	-	-	-	-	-	30 000
unsecured bonds issued	-	-	-	-	-	-	-	-
Assets due to derivatives	-	-	-	-	-	-	-	-
Liabilities due to derivatives	-	-	-	-	-	-	-	-
Periodic Gap	**(208 804)**	**478 195**	**-**	**-**	**-**	**-**	**-**	
Cumulative Gap	**(208 804)**	**269 391**	**269 391**	**269 391**	**269 391**	**269 391**	**269 391**	

38.1.2. Measurement of currency risk

In the process of currency risk management the Bank, in particular, uses individual and aggregated currency positions and stress-tests.

Stress-tests are used to estimate potential losses arising from currency positions under extraordinary conditions on the currency market that cannot be described in a standard manner using statistical measures. The Bank uses hypothetical scenarios – which assume a hypothetical appreciation or depreciation of currency rates (by 20 percent and 50 percent),

The value of currency positions for each currency is presented in the following table (in PLN thousands)

Currency position	31.12.2016	31.12.2015
EUR	0	(41)
USD	0	1
CHF	-	-
GBP	-	-

38.2. Forecasting and monitoring of market risk

The exposure of PKO Bank Hipoteczny SA to market risk was within accepted strategic and internal limits as at 31 December 2016 and 31 December 2015.

The interest rate risk was low and determined by the mismatch between repricing dates of interest rates for assets and liabilities of the Bank in the short term (up to 3 months).

In relation to currency risk, the Bank closes all open currency positions on a current basis, and the control and reporting procedures implemented by the Bank significantly limit the impact of changes in exchange rates on the Bank's financial result, hence the currency risk as at 31 December 2016, 31 December 2015 was determined as insignificant.

Market risk is perceived in the Bank as a potentially significant risk. The Bank will begin to asses internal equity after exceeding one of the below mentioned threshold.

Kind of limit	Formula for calculation the limit	Limit	31.12.2016		31.12.2015	
			Level	Usage	Level	Usage
the Bank's sensivity to interest rate risk	$\frac{\Sigma \lvert BPV_i \rvert \times 100}{\text{own funds}}$	1.00%	0.49%	49.34%	0.22%	22.32%
the Bank's sensivity tocurrency risk	$\frac{\Sigma \lvert PW_i \rvert \times 10\%}{\text{own funds}}$	0.10%	0.00%	0.00%	0.00%	1.48%

where:

BPV_i – is defined as the basis point value, which is expressed as the monetary value of the change in fair value of financial instrument, which arises out of a parallel shift of the yield curve by one basis point in currency 'i'

PW_i – is defined as the currency 'i' position denominated in PLN

38.3. Market risk reporting

The Bank prepares daily, weekly, monthly and quarterly market risk reports. Reports containing the information on market risk exposure and usage of available limits regarding the risk are presented to the Assets and Liabilities Management Committee on a monthly basis and to the Management Board and Supervisory Board on the quarterly basis.

38.4. Management of market risk

The main tools used in the management of market risk by PKO Bank Hipoteczny SA include:

- procedures for interest rate risk and currency risk management,
- limits and thresholds for market risk, among others, for price sensitivity and currency positions,
- defining allowable transaction types based on interest rates, as well as currency transactions.

The Bank monitors the level of significance of interest rate risk and currency risk the Bank established also thresholds, above which the type of market risk will be considered as significant type of risk and it will be subject to coverage of internal capital.

The Bank manages interest rate risk and currency risk respectively by adjusting the repricing dates structure, as well as the currency structure of assets and financing (natural hedging) and, if necessary applies hedging transactions (derivative transactions).

39. Liquidity risk management

Liquidity risk is defined as the risk of the inability to settle obligations when due to the lack of liquid assets. Lack of liquidity may arise from an inappropriate structure of the statement of financial position, mismatch of cash flows, counterparty default, sudden withdrawal of funds by customers, inability to rollover bonds or other market events.

The objective of liquidity risk management is to ensure the sufficient level of funds to settle present and future obligations (including potential obligations) when due, taking into account the nature of activities and requirements which may occur due to changes in market conditions, by structuring the statement of financial position and off-balance sheet liabilities.

(IN PLN THOUSAND)

The Bank manages liquidity risk in order to maintain current, short-term, medium-term and long-term liquidity. PKO Bank Hipoteczny's policy concerning liquidity is to maintain a portfolio of liquid securities and to increase stable sources of financing (in particular, from the issuance of mortgage covered bonds and funding from the parent entity). Money market instruments and unsecured bonds issued are also used in liquidity risk management and derivative transactions are used to manage currency mismatches.

The liquidity risk management is built into the risk management process described in Note 35.2.

The Supervisory Board of the Bank supervises the liquidity management policy and analyses reports concerning the Bank's liquidity, the Bank's liquidity risk exposure, the use of internal limits and consequences of liquidity risk management decisions. The Supervisory board is tasked with ensuring that the Management Board takes appropriate corrective actions on encountered problems, as well as approves the principles for conducting stress tests on liquidity.

The Management Board of the Bank supervises liquidity risk management, approves sets of strategic limits defining liquidity risk tolerance and at least once a year reviews, evaluates and potentially updates internal regulations (including the policies for stress testing), informing the Supervisory Board about the results of the assessment and implementation of liquidity risk management policies. The Management Board takes decisions about corrective actions, in particular in the state of heightened risk of loss of liquidity and accepts financial plans in accordance with separate internal regulations of the Bank regarding the annual planning process. In the event of potential liquidity problems, the Bank's Management Board promptly informs the Supervisory board about the Bank's liquidity, threats and actions taken, and supervises the review and financing possibilities test, performed at least annually, on which basis it assesses the possibility of obtaining short, medium and long-term financing.

The Assets and Liabilities Management Committee (ALCO) establishes internal limits on liquidity risk, verifies, at least once a year, the level of existing internal limits on liquidity risk, issues recommendations for actions for the purpose of maintaining an acceptable level of liquidity risk by the Bank and monitors liquidity risk on the basis of reports obtained. The ALCO also initiates action to protect Bank from liquidity risk, in particular, for the purpose of implementing the banking risk management strategy adopted by the Bank.

The Treasury Department is responsible for short-term operational liquidity management, and the Risk Department is responsible for the supervision of its actions, as well as the development of tools for risk measurement and control of compliance with limits.

39.1. Measurement of the liquidity risk

The Bank makes use of the following liquidity risk measures:

- the contractual, real term and stress test liquidity gap,
- liquidity surplus and survival horizon,
- supervisory liquidity measures:
  - M1 – short-term liquidity gap,
  - M2 – short-term liquidity ratio,
  - M3 – coverage ratio of non-liquid assets with own funds,
  - M4 – coverage ratio of non-liquid assets and assets with limited liquidity with own funds and stable external funds,
- short-term liquidity ratio:
  - LCR – coverage ratio of 1 months net outflows,
- robust financing ratio:
  - NSFR – net stable financing ratio,
- concentration of funding sources,
- tests of stressed conditions (liquidity stress-tests).

39.2. Forecasting and monitoring of liquidity risk

The liquidity gaps in real terms are presented below. In up to 12 months, the cumulative liquidity gap in real terms of PKO Bank Hipoteczny indicates a positive values. This means a surplus of assets receivable, increased by estimated inflows from available limit in the current account over liabilities payable in the short and medium–term.

	a'vista	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months
31.12.2016								
Adjusted gap	535 234	(115 135)	(32 488)	(12 778)	69 365	(4 778 710)	151 561	3 621 355
Cumulative adjustes gap	535 234	420 099	387 611	374 833	444 198	(4 334 512)	(4 182 951)	(561 596)
31.12.2015								
Adjusted gap	5 670	211 731	4 743	5 837	12 289	26 454	(570 265)	303 541
Cumulative adjustes gap	5 670	217 401	222 144	227 981	240 270	266 724	(303 541)	-

The liquidity gap in real terms includes the liabilities arising from deferred payment resulting from the Framework Agreement concerning the sale of debts signed with PKO Bank Polski SA (PLN 3 038 039 thousand as at 31 December 2016 and PLN 429 516 thousand as at 31 December 2015) which are treated by the Bank as a bridge financing that will be replaced by other financing sources such as mortgage covered bonds that are planned to be issued in the future. Although the contractual maturity of the deferred payment is shorter than 12 months, for the real terms liquidity gap analysis purposes it is classified into 12-24 months bucket according to the internal Bank regulations on liquidity risk management. In 2016 Bank changed the methodology of liquidity risk monitoring and incorporated granted loan commitments into liquidity gap in real terms for 2016.

(IN PLN THOUSAND)

The table below presents the Bank's liquidity surplus:

Name of sensitivity measure	31.12.2016	31.12.2015
Liquidity surplus* up to 1 month	415 573	130 662

* The Liquidity surplus is the gap between the most liquid assets and expected and potential liabilities which mature in a given period of time.

The positive liquidity surplus in a one month time horizon indicates a sufficient level of short-term liquidity.

In the presented period the Bank monitored all liquidity standards specified in the PFSA's resolution 386/2008 dated 17 December 2008. The table below presents the liquidity standards and the average, minimum and maximum values since the beginning of the period:

	value at the end of period	average for the period	minimum for the period	maximum for the period	the minimum supervisory level
31.12.2016					
M1	365 040	270 872	40 233	627 848	>0
M2	2.09	2.09	1.14	3.07	>1.0
M3	66.94	58.2	26.12	88.38	>1.0
M4	1.04	1.03	1.02	1.07	>1.0
31.12.2015					
M1	125 869	207 119	43 336	295 867	>0
M2	2.41	35.36	1.74	205.14	>1.0
M3	43.09	159.57	38.48	457.14	>1.0
M4	1.07	57.88	1.07	420.00	>1.0

The table below presents the Bank's liquidity coverage ratio to 1 month (LCR):

Name of measure	31.12.2016	31.12.2015
Net outflows for 1 month coverage ratio (LCR)	384%	nd.*
Supervisory limit of LCR ratio	70%	60%

* The coverage ratio of 1 months net outflows (LCR) was inestimable due to no net outflows up to 1 month (denominator equals zero).

In the analyzed period the Bank did not exceed any of the liquidity standards.

39.3. Statement of financial position maturity analysis of the Bank excluding derivative financial instruments

The table below presents the assets and liabilities of the Bank assigned to the respective residual time bands determined by maturity of cash flows. Amount denominated in foreign currencies have been translated at the average Polish Central Bank exchange rate as at the reporting date.

Assets and liabilities and equity by contractual maturity:

	up to 1 month	1-3 months	3 months - 1 year	1-5 years	over 5 years	Total
31.12.2016						
Assets						
Cash balances with the Central Bank	16 033	-	-	-	-	16 033
Amounts due from banks	12 994	-	-	-	-	12 994
Amounts due from customers	25 213	53 398	243 311	1 431 341	6 494 637	8 247 900
Securities	79 987	-	-	195 315	7 704	283 006
Other assets	14 380	-	-	2 440	5 892	22 712
Total assets	**148 607**	**53 398**	**243 311**	**1 629 096**	**6 508 233**	**8 582 645**
Liabilities						
Amounts due to banks	-	1 038 948	1 999 091	393 793	-	3 431 832
Amounts due to customers	1 549	-	-	-	-	1 549
Mortgage covered bonds	-	-	-	1 030 566	2 201 551	3 232 117
Unsecured bonds issued	183 326	734 801	233 089	-	-	1 151 216
Equity	-	-	-	-	781 290	781 290
Other liabilities	12 336	-	-	-	-	12 336
Total liabilities	**197 211**	**1 773 749**	**2 232 180**	**1 424 359**	**2 982 841**	**8 610 340**

(IN PLN THOUSAND)

	up to 1 month	1-3 months	3 months - 1 year	1-5 years	over 5 years	Total
31.12.2015						
Assets						
Cash balances with the Central Bank	4	-	-	-	-	4
Amounts due from banks	14 812	-	-	-	-	14 812
Amounts due from customers	2 153	4 776	18 146	112 131	585 449	722 655
Securities	39 988	-	-	500	-	40 488
Other assets	6 442	-	-	3 261	3 823	13 526
Total assets	**63 399**	**4 776**	**18 146**	**115 892**	**589 272**	**791 485**
Liabilities						
Amounts due to banks	-	-	429 516	39 782	-	469 298
Amounts due to customers	146	-	-	-	-	146
Mortgage covered bonds	-	-	-	29 933	-	29 933
Debt securities issued	-	-	-		-	-
Equity	-	-	-	-	286 029	286 029
Other liabilities	6 079	-	-	-	-	6 079
Total liabilities	**6 225**	**-**	**429 516**	**69 715**	**286 029**	**791 485**

39.4 Maturity of contractual cash flows from derivative financial instrument transactions

As at the date of these financial statements, the Bank had no net settled derivative transactions. Such transactions would include interest rate swap transactions and Non-Deliverable FX-Forwards.

Gross settled derivative financial instruments include:

- FX- forward currency transactions,
- Cross Currency IRS transactions (CIRS).

The following table shows the breakdown of contractual maturity, presenting the remaining contractual maturities analysed by categories of derivative financial instruments (inflows and outflows) for which the valuation at the reporting date was negative (liability) at 31 December 2016 year. As at 31 December 2015, the Bank was not a party to any derivative transactions.

31.12.2016	up to 1 month	over 1 month uop to 3 months	over 3 months uop to 1 year	over 1 year up to 5 years	over 5 years	Contractual value
Derivative financial instruments						
Inflows, including:	-	-	773	4 643	-	5 416
- hedging financial instruments	-	-	773	4 643	-	5 416
Outflows, including:	-	-	765	4 869	-	5 634
- hedging financial instruments	-	-	765	4 869	-	5 634

Amounts denominated in foreign currencies have been translated at the average exchange rate at 31 December 2016. The amounts presented include the undiscounted future cash flows arising from both the nominal and interest amounts (if applicable).

39.5. Concentration of funding sources

The Bank recognizes the risk of concentration of funding sources, as an element of liquidity risk, determined by circumstances under which the funding structure becomes susceptible to occurrence of individual events or single factors, such as sudden significant withdrawal of funds or insufficient access to new funding.

The business model of the Bank assumes that the risk of concentration of funding sources results from:

- a high proportion of mortgage bonds in the funding structure. Mortgage bonds are a stable source of funding, however the nature of their balloon redemptions causes that in most cases, at maturity, a further need for a new issue or alternative source of funding arises,
- funding from the parent entity,
- the issue of short-term unsecured bonds.

The following table presents the funding structure of the Bank:

	31.12.2016	31.12.2015
Equity	9.09%	36.43%
Funds from the parent entity	39.92%	59.76%
Mortgage covered bonds issued	37.6%	3.81%
Unsecured bonds issued	13.39%	0.00%
Total	**100.00%**	**100.00%**

The share of parent company's funding amounted to 39.9% as at 31 December 2016 whereas 59.8% as at 31 December 2015 and was significant. This level of indicator is consistent with the financial plan at this early stage of the Bank's operations and is expected to gradually reduce its level with successive issues of mortgage covered bonds and own unsecured bonds. The concentration risk is assessed as acceptable.

In order to reduce the concentration risk of funding sources, the Bank has implemented a system of internal limits, both a short-term (30-day) and longer, covering the issues undertaken by the Bank. In the analyzed period, none of these limits were exceeded.

39.6. Tests of stressed conditions (Liquidity stress-tests)

Tests of stressed conditions (liquidity stress-tests) present the impact of marginal market conditions on the liquidity of the Bank. Shock analyses are carried out on the basis of hypothetical scenarios of changes in the following factors:

- shock changes in market parameters on financial markets,
- the impact of marginal changes in market factors, as well as drops in prices on the property market on the anticipated losses on the mortgage loan portfolio,
- redemption of mortgage bonds resulting from the exceeding of regulatory standards,
- decrease of issue ratings,
- inability to roll over short-term issuances,
- changes in key parameters affecting the liquidity level determined on the basis of the projected statement of financial position of the Bank.

The results of tests of stress condition are used in particular in:

- monitoring of the Bank's exposure to liquidity risk in marginal conditions,
- the process of determining internal limits imposed on liquidity risk measures,
- control over liquidity maintenance, for each day for a period of 30 days,
- the process of planning of the Bank's statement of financial position,
- the process of determining conditions resulting in the implementation of liquidity emergency plans of the Bank,

and are presented at the meetings of the Management Board and the Supervisory Board of the Bank.

The tests of stress condition carried out on the basis of financial data of the Bank as at 31 December 2016 and 31 December 2015 did not indicate any risk to the Bank's business due to the occurrence of hypothetical marginal market conditions. The Bank has a high capacity to outlast crisis situations due to the balanced financing structure, distant maturity dates of liabilities and a sufficient level of liquid assets.

39.7. Liquidity risk reporting

The Bank prepares daily, weekly, monthly and quarterly liquidity risk reports. The reports, containing information on liquidity risk exposure and usage of available limits in relation to this risk, are presented to the Assets and Liabilities Management Committee on a monthly basis and to the Management Board and Supervisory Board on a quarterly basis.

39.8. Management of liquidity risk

The main tools for liquidity risk management in PKO Bank Hipoteczny SA are as follows:

- procedures for liquidity risk management, including and in particular emergency plans,
- limits and thresholds limiting liquidity risk (short, medium and long term),
- deposit, investment and derivative transactions, including structural currency transactions and transactions for sale or purchase of securities,
- transactions facilitating long-term financing of the lending activities.

The Bank places emphasis on matching cash flows on maturity of liabilities that are significant in terms of value (mortgage bonds redemptions).

40. Operational risk management

Operational risk is defined as the risk of occurrence of a loss due to non-compliance or unreliability of internal processes, people and systems or external events. Operational risk takes into account legal risk, however does not include reputational risk and business risk.

The objective of operational risk management is to enhance the security of the operational activities pursued by the Bank by improving effectiveness, tailoring of identification mechanisms to the profile and the scale of operations, assessing and measuring, limiting, monitoring and reporting of operational risk.

The process of operational risk management is realized at the level of the entire Bank and at the levels of each systematic operational risk management area. Systematic operational risk management involves the creation of solutions that serve to enable control over the level of operational risk by the Bank enabling the accomplishment of the Bank's objectives. Ongoing operational risk management is conducted by every employee of the Bank, within their responsibilities and tasks.

In order to manage operational risk, the Bank gathers internal and external data about operational events, on business environment factors, results operational risk self-assessment, data on key indicators of operational risk (KRI) and data related to the quality of functional internal controls.

Taking into account the scale of outsourcing and its potential impact on the operational risk profile, the Bank has prepared an appropriate risk management process related to allocation of task to external entities, including sales and after sales servicing and IT services. This risk management, carried out in different organizational units of the Bank, includes numerous components such as the introduction of a procedure for delegation of operations on behalf of the Bank, analysis and assessment of risk associated with the delegation of operations to external entities on behalf of the Bank, assessment of the reliability and financial position of service providers, creation of backup plans for the Bank and its suppliers (in particular, in the IT field), implementation of adequate safeguards of the interests of the Bank in outsourcing agreements, requirements for appropriate insurance coverage of the outsourcing counterparty, monitoring of proper execution of contracts and the outsourcing counterparty's position, including their periodic verification, recording of incidents and losses related to the realization of outsourced services.

40.1. Measurement of operational risk

Measurement of operational risk at the Bank aims at defining the scale of threats related to the existence of operational risk with the use of defined risk measures. The measurement of operational risk comprises:
- calculation of Key Risk Indicators (KRI),
- calculation of own funds requirement for operational risk under the BIA approach (BIA requirement),
- stress-tests,
- calculation of Bank's internal capital.

The operational risk self-assessment comprises identification and assessment of operational risk for the Bank's products, processes. The operational risk self-assessment is conducted at least annually and before the introduction of new or changed products, processes or applications by the Bank, with the use of:
- data collection on operational events,
- the results of inspections, actions and internal functional control,
- KRI.

40.2. Forecasting and monitoring operational risk

Monitoring of operational risk aims at controlling such risk and diagnosis of areas requiring management actions.

The Bank regularly monitors, in particular:
- utilization of strategic tolerance limits and operational risk losses limits,
- effectiveness and timeliness of actions undertaken to reduce or transfer the operational risk,
- the KRI value,
- results of operational risk self-assessment,
- results of stress-tests,
- operational events and their consequences.

40.3. Reporting of operational risk

Reporting on information concerning operational risk is performed for:
- the Bank's internal requirements, particularly of the Management Board, and the Supervisory Board,
- supervisory institutions,
- shareholders and financial markets.

Reporting for the Bank's internal purposes related to operational risk is performed on a quarterly basis. Quarterly reports contain, in particular, information on:
- the results of measurement and monitoring of operational risk,
- the operational risk profile of the Bank resulting from the process of identifying and assessing the threats to products, processes and applications of the Bank,
- operational risk level and tools applied in operational risk management,
- actions taken to reduce operational risk and the evaluation of the effectiveness of actions taken to reduce the operational risk level,
- recommendations, decision and suggestions of the Management Board.

The quarterly reports also include information on operational risks identified in relation to the activities outsourced by the Bank to external entities, including, in particular, PKO Bank Polski SA.

40.4. Management of operational risk

Management actions are taken when the level of self-assessed operational risk, KRI or adjusted operational risk reach an elevated or high level at the Bank.

If the risk level is elevated or high, the Bank uses the following approach:
- risk reduction – mitigating the impact of risk factors or consequences of its materialization,
- risk transfer – transfer of responsibility for covering potential losses to a third-party,
- risk avoidance – discontinuance of activities that generates risk or elimination the possibility of occurrence of a risk factor.

The operational risk management process is subject to internal control covering:
- review of strategy and processes for operational risk management,
- internal audit.

40.5. Incurred operating losses

In 2016, the Bank identified operational risk events, which represent operating losses for the total net amount of PLN 3 thousand.

In order to limit losses arising from operational risk, the Bank takes ad hoc and systematic actions. Ad hoc measures include a direct response to the identified risks, eliminating reversible irregularities and recovering losses.

41. Compliance risk management

At PKO Bank Hipoteczny compliance risk is defined as the risk of legal sanction, incurring financial losses or loss of reputation or credibility due to a failure of the Bank, the Bank's employees or entities acting on its behalf to comply with the provisions of law, internal regulations and market standards adopted by the Bank.

41.1 The objective of compliance risk management

The objective of compliance risk management is to:

- maintain the Bank's reputation as an institution acting in accordance with law and adopted market standards, that is respected, fair and honest, among customers, employees, business partners and other market participants,
- prevent the occurrence of financial losses or legal sanction and reputational loss, which may be a result of a breach of the law, internal regulations and market standards adopted by the Bank.

41.2. Identification and evaluation of compliance risk

The identification and evaluation of compliance risk is carried out on the basis of the methodology implemented in the PKO Bank Polski SA Group for identification and evaluation of compliance risk for internal processes.

The identification and evaluation of compliance risk is carried out periodically by the so-called owners of internal processes, in cooperation with the Compliance, Security and Legal Bureau and in particular include:

1) estimation of the potential intensity of non-compliance incidents in the form of:
   - financial losses, particularly in form of administrative penalties or damages,
   - loss of reputation or credibility.
2) conducting thorough assessment of compliance of processes with law, on the basis of information provided by internal control and internal audit, and formulated post-control recommendations and extent of their implementation.

41.3. Compliance risk monitoring

Compliance risk monitoring includes:

1) the results of the identification and assessment of compliance risk,
2) incidents of non-compliance, their causes and effects,
3) the following actions undertaken by the Bank:
   - compliance risk management,
   - implementation of recommendations from internal audits and functional and external controls,
   - adoption of new laws and standards of conduct,
   - implementation of the Compliance, Security and Legal Bureau's recommendations,
4) evaluation of the effectiveness of controls associated with compliance risk mitigation,
5) selected areas related to the business specific to a mortgage bank subjected to periodical compliance verification by the Compliance, Security and Legal Bureau's.

41.4. Compliance risk reporting

Reporting of information related to compliance risk of the Bank is conducted on a quarterly basis. The reports are addressed to: the Management Board, the Supervisory Board and the Supervisory Board's Audit, Finance and Risk Committee. Reports contain among others information on:

1) the results of identification and assessment of compliance risk,
2) the observed instances of non-compliance in the Bank and in the financial sector as a whole,
3) the most significant changes in the regulatory environment of the Bank, as well as circumstances resulting from the activities of external supervisory authorities,
4) the results of external controls carried out within the Bank,
5) the most important actions undertaken within compliance risk management and the implementation of recommendations arising from external controls.

The Bank has adopted a zero tolerance policy on compliance risk, which means that the Bank focuses its efforts on prevention of instances of materialization of this risk.

42. Capital adequacy

Capital adequacy is a process which objective is to ensure that, for a given level of risk tolerance, the level of risk assumed by the Bank associated with development of its business activities will be covered with capital held within a given time horizon. The process of managing capital adequacy comprises of, in particular, compliance with prevailing supervisory standards and the level of risk tolerance determined within the Bank, the process of capital planning, including of the policies regarding capital sourcing.

The capital adequacy management consists of:
- Pillar I: minimal capital requirements specified in law,
- Pillar II: internal capital, determined by the Bank's own models for the risks considered significant.

The objective of capital adequacy management is to maintain own funds at a level that is adequate to the scale and risk profile of the Bank's activities, with due regard to regulatory requirements.

The primary regulations applicable in the process of the capital adequacy assessment process as at 31 December 2016 are:

- the Regulation (EU) No. 575/2013 of the European Parliament and of the Council dated 26 June 2013 on prudential requirements for credit institutions and investment firms, amending the Regulation (EU) No. 648/2012 (hereinafter referred to as the "CRR Regulation"),
- The Act dated 29 August 1997, the Banking Law,
- The Act dated 5 August 2015, on macroprudential supervision of the financial system and crisis management in the financial system (hereinafter referred to as the 'Macroprudential Act').

(IN PLN THOUSAND)

The capital adequacy process is described in Directive 2013/36/EU of the European Parliament and of the Council dated 26 June 2013 on approval of the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (Referred to as 'CRD IV'). In contrast to the CRR Regulation and Macroprudential Act, which is binding directly, the CRD Regulation was implemented into national law by amendment of the Banking Law.

The process of managing the Bank's capital adequacy comprises:

- defining by the Bank of the capital adequacy targets and achieving them,
- identifying and monitoring of all of significant risks,
- assessing internal capital to cover the individual risk types and total internal capital,
- establishing internal limits with respect to capital adequacy,
- forecasting, monitoring, and reporting the level and structure of own capital and capital adequacy,
- capital contingency activities.

In 2016 and since the launch of operations, the level of capital adequacy remained at a safe level above the supervisory limits.

On 31 December 2016, the total capital ratio of the Bank was 17.1%.

42.1. Own funds for the purpose of capital adequacy

Bank's own funds for capital adequacy purposes, have been designated in accordance with the Banking Law and the CRR Regulation with implementing legislation.

The Bank's own funds consists entirely of core capital Tier I (CET 1). In determining own funds, the Bank makes use of the transitional provisions to take account of accumulated other comprehensive income in terms of unrealized gains and losses on instruments classified as available for sale.

The following table shows the structure of the Bank's own funds:

OWN FUNDS OF THE BANK	31.12.2016	31.12.2015
Core capital Tier 1 (CET1)	**780 265**	**282 811**
primary funds, of which:	799 754	300 002
share capital	800 000	300 000
other accumulated comprehensive income, excluding gains and losses on cash flow hedges	(246)	2
adjustment of transition period	(1)	(1)
accumulated profits/(losses)	(13 973)	(1 377)
loss for the current financial year	-	(12 596)
intangible assets	(5 312)	(3 176)
additional adjustments to assets measured at fair value	(203)	(41)
Tier 2 Supplementary funds	-	-
TOTAL OWN FUNDS	**780 265**	**282 811**

42.2. Capital Buffers

The CRD Directive, in particular on regulatory capital buffers, has been implemented into national law by adopting the Macroprudential Act and amendment of the Banking Law. The Macroprudential Act defines capital buffers that are applicable to banks with effect from January 2016.

With effect from 1 January 2016, the Bank was required to maintain an additional capital buffer to a level of 1.25% of the total risk exposure. A security buffer applies to all banks, and every year will be gradually increased to a final, permanent level equal to 2.5% (in 2019).

42.3. Financial Leverage

The risk of excessive financial leverage is defined as the susceptibility to risks due to financial leverage or contingent financial leverage that may require unintended corrective actions to business plans, including the forced sale of assets which could result in losses or result in the need to adjust the valuation of other assets.

Financial leverage is defined as the relative value, in relation to the Bank's own funds, of assets held by the Bank, contingent liabilities and commitments relating to payment or delivery or provided collateral, including liabilities arising from funds received, liabilities incurred, derivative contracts or repurchase agreements, however excluding liabilities which can be enforced only in the event of the liquidation of the Bank.

The Bank calculates financial leverage according to the CRR Regulation (amended Regulation 2015/62 EU[1]).

The financial leverage ratio is monitored on a monthly basis, whereas the Bank recognizes a ratio in excess of 5% to be safe and not requiring further action.

[1] Commission Delegated Regulation (EU) 2015/62 of 10 October 2014 amending Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to the leverage ratio.

(IN PLN THOUSAND)

The ratio amounted to:

Financial leverage	31.12.2016	31.12.2015
Leverage ratio (LR)	8.8%	29.9%

As of 31 December 2016 and 31 December 2015 leverage ratio remained above 3% i.e. the level recommended by Basel Committee.

42.4. Requirements regarding own funds (Pillar I)

42.4.1 General information

In accordance with the CRR Regulation, the Bank calculates requirements in respect of own funds for the following risk types:
1) in respect of credit risk – using the standardized method,
2) in respect of credit valuation adjustment (CVA) risk - using the standardized method,
3) in respect of settlement and delivery risk – using the standardized method,
4) in respect of operational risk– in accordance with the Base Indicator Approach (BIA)
5) in respect of market risk (only currency risk) - using basic methods.

At 31 December 2016 and 31 December 2015 the requirements for own funds with respect to the risks set out in points 2, 3 and 5 were zero, therefore the total requirement for own funds represented requirements for credit and operational risks, as set out in the table below:

Capital requirements	31.12.2016	31.12.2015
Credit risk	359 120	45 717
Operational risk	4 950	1 618
Total capital requirements	**364 070**	**47 335**
Tier 1 basic capital ratio (CET1)	**17.1%**	**47.8%**
Tier 1 capital ratio (T1)	**17.1%**	**47.8%**
Total capital ratio (TCR)	**17.1%**	**47.8%**

The following tables present the value of exposure, risk-weighted assets (RWA) and the requirements for own funds, analysed by exposure class:

31.12.2016	Gross exposure	Value of exposure*	Risk weighted assets	Requirements regarding own funds
Retail exposure**	3 966 230	3 686 806	2 765 104	221 208
Exposure secured by mortgages on real estate	4 895 222	4 868 628	1 704 020	136 322
Exposure to central governments or central banks	301 479	301 479	6 099	488
Exposure to institutions	208 098	208 098	-	-
Other exposures	13 774	13 774	13 774	1 102
TOTAL	**9 384 803**	**9 078 785**	**4 488 997**	**359 120**

31.12.2015	Gross exposure	Value of exposure*	Risk weighted assets	Requirements regarding own funds
Retail exposure**	763 755	686 736	515 052	41 204
Exposure secured by mortgages on real estate	132 578	122 644	42 925	3 434
Exposure to central governments or central banks	43 753	43 753	8 154	653
Exposure to institutions	16 571	16 571	-	-
Other exposures	5 329	5 329	5 329	426
TOTAL	**961 986**	**875 033**	**571 460**	**45 717**

* The value of recognized exposures and recognized equivalent liabilities and off-balance sheet transactions, taking into account adjustments for specific credit risk and CCF (Credit Conversion Factor - credit conversion factor).
** This results from part of the exposure that is not fully and completely secured, i.e. which exceeds a BHWN of 60% or is in a transitional period, i.e. until collateral is established.

42.4.2. Adjustments for credit risk

For the purposes of adjustments for specific credit risk, the Bank uses the impairment allowance, which was included in the Banks's Tier I capital in accordance with the CRR Regulation and the regulations implementing the Regulation.

The approach applied by the Bank to identify exposures are risk of impairment and methods of estimating impairment and provisions for off-balance sheet credit exposures are described in Note 36.2 "Impairment of loan exposures" and 36.3 "Methods of estimating impairment."

42.4.3. The use of credit risk mitigation techniques

The Bank uses mortgage collateral for the purposes of classification of exposures to grades of exposures secured by mortgages on real estate and the use of preferential risk weighting. Detailed information on the main types of collateral accepted by the Bank and the method of determining the banking mortgage value of the property is described in Note 36.5.5. "Collateral".

42.5. Internal capital (Pillar II)

Internal capital is defined as the estimated amount of capital required to cover all identified significant risks in the Bank's activities, as well as the effect of changes in the economic environment, taking into account the expected level of risk.

The internal capital in PKO Bank Hipoteczny SA is calculated to cover each of the significant risk types:

- credit risk,
- liquidity risk,
- operational risk,
- business risk.

Materialization of the risk of macroeconomic changes, capital risk, risk of models, compliance risk are reflected in the estimates of internal capital for covering the types of risk: credit, operational, liquidity and business.

The internal capital to cover the risks is determined in accordance with the methods set out in the Bank's internal regulations. The total internal capital is the sum of internal capital amount necessary to cover all significant risks for the Bank. Bank adopts a cautious approach to risk aggregation and does not use diversification effect.

At 31 December 2016 and 31 December 2015, the relation of equity to internal capital remained above the statutory limit and the Bank's internal limits.

In order to estimate the amount of capital necessary to conduct safe operations in the conditions of recession, the Bank carried out stress tests.

42.6. Disclosures (Pillar III)

The Bank annually discloses information concerning, in particular, risk management and capital adequacy in accordance with:

- The CRR Regulation and legislation implementing this Regulation,
- The Act dated 29 August 1997, the Banking Law,
- The Act dated 5 August 2015, on macroprudential supervision of the financial system and crisis management in the financial system.
- Recommendation M relating to operational risk management in banks, issued by the Financial Supervision Authority.
- Recommendation P relating to the management of financial liquidity of banks, that was issued by the Financial Supervision Commission.

Details of the scope of information disclosed, the method of its verification and publication are presented in PKO Bank Hipoteczny Capital Adequacy Information Policies and other information subject to disclosure, which are available on the Bank's website (www.pkobh.pl).

(IN PLN THOUSAND)

EVENTS AFTER THE REPORTING PERIOD

43. Events after the reporting period

In the period from 1 January 2017 until the date of these financial statements, i.e. to 28 February 2017, PKO Bank Hipoteczny SA acquired new portfolio of mortgage loans in the amount of PLN 552 104 thousand from PKO Bank Polski SA under the terms of the Framework Agreement concerning the sale of receivables concluded on 17 November 2015.

In the period from 1 January 2017 until the date of these financial statements, i.e. to 28 February 2017, PKO Bank Hipoteczny SA issued bonds with a total nominal value amounting to PLN 1 182 700 thousand, with the simultaneous maturity and redemption of bonds with a total nominal value amounting to PLN 664 000 thousand. The bond issue was conducted under the Bond Issue Program established by PKO Bank Hipoteczny SA on 30 September 2015 for the issuance of bonds of up to PLN 2 000 000 thousand . The bonds issued mature between the 4 April 2017 and 16 October 2017.

On 2 February 2017 the Bank issued EUR denominated mortgage covered bonds in the amount of EUR 25 000 thousand with maturity set at seven years from the date of issuance. These bonds were issued in a private placement. The issued bonds are listed on the Luxembourg Stock Exchange.

On 2 February 2017, the Bank concluded a current account revolving credit agreement with PKO Bank Polski, with a limit in the amount of PLN 1 500 000 thousand, which will be made available in tranches. The loan was granted for the period till 2 February 2020. On 28 February 2017, PLN 1 000 000 thousand was made available.

Signatures of all Members of the Management Board of the Bank

28 February 2017	Rafał Kozłowski	President of the Management Board	*Signed on the Polish original* .... (signature)
28 February 2017	Jakub Niesłuchowski	Vice-President of the Management Board	*Signed on the Polish original* .... (signature)
28 February 2017	Marek Szcześniak	Vice-President of the Management Board	*Signed on the Polish original* .... (signature)

Signature of the person responsible for bookkeeping

28 February 2017

Tomasz Rynkowski
Director, Chief Accountant

Signed on the Polish original
....
(signature)