

PKO Bank Hipoteczny SA
Directors' Report
for the year ended 31 December 2019

This document is a translation of a document originally issued in Polish. The only binding version is the original Polish version.

PKO BANK HIPOTECZNY SA DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2019

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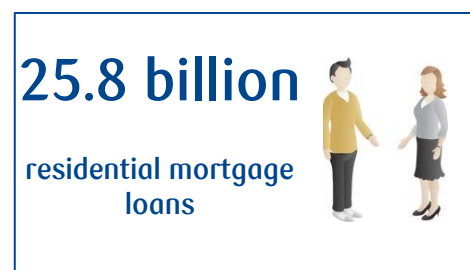
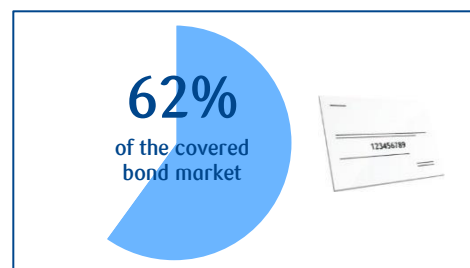
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1. INTRODUCTION

PKO Bank Hipoteczny SA (Bank) specializes in granting residential mortgage loans to individual customers and purchasing receivables in respect of such loans. The Bank purchases loans for its portfolio based on its strategic cooperation with PKO Bank Polski SA.

PKO Bank Hipoteczny SA is leader of the Polish mortgage bank market in terms of total assets and the balance of residential mortgage loans. The Bank is Poland's largest regular issuer of covered bonds on Polish and international markets. It was the only Bank in Poland to carry out benchmark issues of EUR-denominated covered bonds, five issues in total as at 31 December 2019. The outstanding mortgage covered bonds issued by the Bank account for more than two-thirds of the total value of outstanding mortgage covered bonds issued by Polish mortgage banks.

The Bank's fast growth was made possible by granting both new residential mortgage loans and the purchase of such loans from PKO Bank Polski SA. In 2019, the Bank's total assets exceeded PLN 27 billion, of which over PLN 25.8 billion were a high quality portfolio of residential mortgage loans. This means that there was a 23% increase in total assets compared with the end of 2018, while at the same time the stability and safety of operations was maintained.



STRATEGY OF PKO BANK HIPOTECZNY SA

In December 2016, the Management Board of PKO Bank Hipoteczny SA adopted, and the Supervisory Board of PKO Bank Hipoteczny SA approved, the strategy of PKO Bank Hipoteczny SA for the years 2017 to 2020.

The mission of the Bank is to responsibly promote the interests of its stakeholders by ensuring:

- for customers – loan products tailored to their needs, for the financing of real estate;
- for investors – long-term mortgage covered bonds providing a high level of safety.

PKO Bank Hipoteczny SA's strategy for the years 2017–2020 calls for:

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Diversification of sources of funding by obtaining long-term financing in the form of mortgage covered bonds, intended for real estate lending



Achieving and maintaining the leading position on the Polish market for mortgage covered bond issues while at the same time maintaining a high level of safety of such covered bonds



Establishing a centre of competence of the PKO Bank Polski SA Group in the area of real-estate valuation and residential loans, with the optimal use of PKO Bank Polski SA's assets, for the purpose of achieving synergies within the PKO Bank Polski SA Group.

In 2019, PKO Bank Hipoteczny SA pursued its strategy by building a portfolio of residential mortgage loans under the agency and pooling models in cooperation with PKO Bank Polski SA.

In 2019, PKO Bank Hipoteczny SA was the leader of the Polish mortgage bank market in terms of total assets and the balance of residential mortgage loans. In addition, in 2019 the Bank conducted five issues of mortgage covered bonds, including the first issue of green mortgage covered bonds in Poland.

In 2019 the Bank introduced a special residential mortgage loan offer based on preferential price terms for those customers submitting an energy performance certificate confirming the required energy-effectiveness of the purchased real estate. PKO Bank Hipoteczny SA and PKO Bank Polski SA were the first banks in Poland to join the Energy Efficient Mortgages (EEM) Initiative pilot project on 11 April 2019. The aim of the project is to develop standardized, European solutions for residential mortgage loans granted for the financing of energy-efficient apartments and houses.

At the same time, in 2019, the Bank worked on solutions facilitating the lending process – also for the needs of the PKO Bank Polski SA Group.

In connection with the binding minimum requirement for own funds and eligible liabilities (MREL) and the related change in the policy of the PKO Bank Polski Group in respect of the long-term financing structure, in 2020 the Bank is planning to limit both the level of covered bonds and of acquired assets.

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2. EXTERNAL OPERATING CONDITIONS

Macroeconomic environment Residential real estate market Residential mortgage loan market Covered bond market Regulatory and legal environment
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2.1. MACROECONOMIC ENVIRONMENT

The Bank only operates in Poland.

Macroeconomic factors affecting the Polish economy in 2019:

GROSS DOMESTIC PRODUCT

The GDP growth rate affects both the residential real estate market and the residential mortgage loan market. A sufficiently high GDP growth rate translates into new jobs and higher wages, and, consequently, into consumers' purchasing power and creditworthiness. The data published by the Central Statistical Office of Poland (GUS) in November 2019 show that Poland's GDP grew by 3.9% in Q3 2019 compared with Q3 2018. The forecast published by the European Commission in November 2019 stipulates a drop in the rate of GDP growth. According to the forecast, Poland's GDP will increase by 3.3% in 2020 and by another 3.3% in 2021. The steady GDP growth rate will have a favourable impact on the employment level and consumers' wages. As a result, it will contribute to generating an increased demand for residential loans granted by banks to finance residential real estate purchases.

UNEMPLOYMENT AND WAGES AND SALARIES

Based on the data published by GUS, the number of unemployed people registered with employment offices in Poland stood at 866.4 thousand at the end of December 2019, down 102.5 thousand, or 10.6%, compared with December 2018. The unemployment rate at the end of December 2019 was 5.2%, compared with 5.8% at the end of December 2018. The number of people employed at the end of the third quarter of 2019 was 16,619 thousand, up 0.01% y/y, according to GUS's Labour Force Survey (BAEL). Whereas, the average monthly wage in the enterprise sector in Q4 2019 was PLN 5,348.99, up 5.8% y/y, based on GUS data. The increase in the number of professionally active people and the increase in the wage level contribute to the development of the residential real estate market, and thus increases demand for residential mortgage loans.

INFLATION

Since May 2019, the CPI (Consumer Price Index) has been above the NBP inflation target (2.5% y/y). In December the CPI was 3.4% y/y, so it was close to the ceiling of acceptable deviations from the target. This is the highest inflation according to the CPI since 2012. The average annual CPI was 2.3% compared with 1.6% in 2018. The base inflation rate (CPI net of food and energy) accelerated from 0.8% y/y in January to over 3.0% y/y in December. Its visible growth trend reflected the growing tensions on the Polish labour market and changes in administered prices over the last years.

INTEREST RATES

Low interest rates translate into reduced credit costs and increased consumer creditworthiness. As at the date of this Report, the National Bank of Poland's (NBP) reference rate was 1.5%, the lowest on record. Maintaining interest rates at the current level may contribute to a further increase in the Bank's lending. It should also favourably influence the meeting of payment obligations by borrowers as and when they fall due.

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2.2. RESIDENTIAL REAL ESTATE MARKET

In 2019 the conditions on the residential market remained very good. The ongoing upward trend in real estate prices which began at the turn of 2013 and 2014 has continued uninterruptedly until now. Also in the third quarter of 2019 real estate prices increased due to high consumer and investor demand.

The current macroeconomic environment continues to contribute to the development of the real estate market. Growing wages and salaries accompanied by low interest rates and a lack of alternative attractive options for investing savings in times of growing inflation, accompanied by the constantly increasing value of real estate, create favourable conditions for perceiving the purchase of real estate as a good investment.

NEW HOUSING MARKET

According to RedNet data, in Q3 2019, the average price of a square metre of residential property sold on the primary market, on the six most liquid local markets,¹ was 10% higher than in the corresponding period of 2018.

The dynamically increasing prices of investment land contribute to the increase in the prices of residential real estate on the primary market. It follows from the dynamic increase in prices of real estate that the average value of land in the price of a square metre of residential properties increased during three quarters of 2019 from 13.3% to 13.8%. According to the Central Statistical Office (GUS) data the average cost of building a multi-family 4-storey building was 4% higher in September 2019 than in the corresponding month of 2018, and the cost of a single family house without a basement increased by 3.4% in the same period. Based on SEKOCENBUD's costing rates for Q3 2019, the cost of construction (excluding the price of land) of selected single and multi-family residential buildings grew by 6.1% to 9% per annum. However, it is worth mentioning that the pace of growth of investment land prices and construction costs decreased slightly in the third quarter compared to the first two quarters of 2019.

SECONDARY MARKET

It follows from the data for Q3 2019 that the pace of growth of average transaction prices on the secondary residential market dropped in Warsaw (+4% y/y, whereas in Q1 2019 it was +11% y/y) and in the segment of the six largest Polish cities excluding Warsaw² (+8% y/y, whereas in the previous three quarters it ranged from +10 to +11%), whereas in the segment of 10 medium-size cities³, prices increased by 13% in Q3 2019 compared with the corresponding period of the previous year (compared with a +12% increase y/y noted in the first two quarters of 2019). It follows from the Bank's internal real estate database that the pace of growth was even higher in the other urban county segment⁴ (+16% according to data for Q3 2019), whereas in the rural county segment the pace of growth in the first three quarters of the year was stable, at approx. +10% y/y.

SUPPLY AND DEMAND ON THE REAL ESTATE MARKET

GUS data for the third quarter of 2019 point to a continuation of an upward trend of investors' activity in the residential construction segment throughout the country. At the national level, in the first three quarters of 2019, 4% more permits for the construction of apartments were issued than in the corresponding period of 2018. The number of apartments whose construction started increased by 3%, and those commissioned for use increased by 12%. However, the growth trend was not the same for the whole real estate market. On the Warsaw market and in the 10 medium-size cities segment a drop in residential construction activity was noted, which in case of Warsaw, in view of the planning permissions issued, should be considered in relation to supply barriers, mainly the limited access to investment land, and in the 10 medium-size cities segment – in relation to the reaction to exceptionally large increases in 2018, when the number of residential constructions started increased by as much as 27%.

¹ Warsaw, Kraków, Poznań, Wrocław, Tricity, Łódź

² Kraków, Poznań, Wrocław, Gdańsk, Gdynia, Łódź

³ Białystok, Bydgoszcz, Katowice, Kielce, Lublin, Olsztyn, Opole, Rzeszów, Szczecin, Zielona Góra

⁴ All urban counties apart from Warsaw and the counties included in the six large cities segment and ten medium size cities segment.

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According to NBP data, in Q2 2019, the average availability of apartments in large cities (a measure defining the number of square metres of housing available for an average one-month salary in the enterprise sector based on the average transaction price of an apartment on the given market) was 0.82 sq. m. This is 0.33 sq. m more than the minimum level reported in Q3 2007. Since the beginning of 2014, there has been a horizontal trend in the level of this indicator, fluctuating at around 0.85 sq. m, which means that the rate of wage growth followed the rate of growth of residential real estate prices.

The good situation on the residential real estate market is supported by strong internal demand. Despite a deterioration in economic conditions unemployment is constantly dropping, wages increase at a rate of approx. 7% y/y, and additionally the 500 Plus benefits programme was expanded. In consequence, positive consumer sentiments prevail on the internal market, which is reflected in record levels of consumer confidence indices, both current and future, in Q3 2019. Record-high values are also reported for the indicator of consumer willingness to make major purchases, which is an element of the current consumer confidence index.

The strength of demand on the residential real estate market is also demonstrated by the structure of the developers' offer, in which, at the end of Q3 2019, the share of unsold finished apartments was only 9%.⁵ For example, before the beginning of the current long-term growth cycle on the residential real estate market this share was 39%.⁶ Currently, in the developers' offer properties to be built in the years 2020–2021 dominate, and the average pace of sales of the real estate offered by the developers' amounts to approx. 10 months. The above data confirms that in the current market conditions developers have no problems with the sale of the apartments built.

Residential property purchases are financed with household savings and residential mortgage loans. Based on NBP data, the estimated share of cash purchases of apartments on the primary market on the six most liquid local markets was 62% in Q2 2019. In the last three years, it ranged from 62–75%. Based on GUS data, household deposits have been steadily increasing, and, at the end of Q3 2019, they were 11% higher than in the previous year.

The impact of government schemes on the residential real estate market is now neutral. The Mieszkanie Plus (Apartment Plus) scheme, which is currently undergoing modification, has no significant impact on the real estate market now.

2.3. RESIDENTIAL MORTGAGE LOAN MARKET

Based on NBP data, banks' receivables from residential mortgage loans in Poland were PLN 443.2 billion at 31 December 2019, up 6.6% y/y. Loans denominated in PLN were PLN 323.1 billion as at 31 December 2019 (72.9% of the total banks' receivables from residential loans in Poland), up 12.3% y/y.

The total balance of residential mortgage loans in relation to gross domestic product expressed at market prices stood at 19.9% at the end of Q3 2019. That is significantly lower than the average for the European Union, which, according to 2018 data, was nearly 46.4%. This indicates a great potential for further growth of the residential loan market in Poland.

2.4. COVERED BOND MARKET

As at the end of December 2019, four mortgage banks were operating in Poland, namely:

- PKO Bank Hipoteczny SA,
- mBank Hipoteczny SA,
- Pekao Bank Hipoteczny SA,
- ING Bank Hipoteczny SA.

⁵ According to RedNet Property Group Sp. z o.o. data from the six most liquid local markets (Warsaw, Kraków, Poznań, Wrocław, Tricity, Łódź).

⁶ RedNet Property Group Sp. z o.o. data as at 31 December 2013.

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The Polish covered bond market is relatively small and moderately liquid. At the end of December 2019, the total value of outstanding covered bonds issued by Polish mortgage banks amounted to approx. PLN 26.0 billion, i.e. PLN 4.8 billion more than at 31 December 2018. As at 31 December 2019, outstanding covered bonds issued by Polish banks corresponded to 5.9% of the amount of mortgage loans granted by banks. For comparison, in 2018 this ratio was around 16.1% in Germany and around 3.3% in the Czech Republic.

PKO Bank Hipoteczny SA is the largest issuer of covered bonds in Poland. As at 31 December 2019, the value of outstanding covered bonds issued by PKO Bank Hipoteczny SA amounted to PLN 16.2 billion, which accounted for approx. 62% of the total value of outstanding covered bonds issued by Polish mortgage banks.

2.5. REGULATORY AND LEGAL ENVIRONMENT

In 2019, the following legal and regulatory solutions significantly affecting the operations of PKO Bank Hipoteczny SA came into force:

PERSONAL DATA	The Act on amendments to certain acts to ensure the application of Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data – the regulation has an impact on recruitment processes, employee relations and the process of handling loan applications.
BONDS ISSUE	The Act of 9 November 2018 on amendments to certain acts in connection with strengthening supervision over the financial market and protecting investors on that market – to a large extent in force as of 1 July 2019 – the act introduces material changes to the manner of issuing bonds.
THE BANK GUARANTEE FUND	The Act of 17 January 2019 on amending the Act on the Bank Guarantee Fund, the deposit guarantee system and mandatory restructuring, as well as certain other acts – the act excluded mortgage banks from the deposit guarantee system and adjusted the provisions of the Act – the Banking Law relating to the transfer of mortgage with reference to the sale of banking receivables.
CREDIT EXPOSURES	Regulation (EU) 2019/630 of the European Parliament and of the Council of 17 April 2019 amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures – the regulation amends the CRR in respect of the minimum loss coverage in respect of non-performing exposures, in respect of credit exposures granted after 26 April 2019.
REGISTERED AUDITORS	Recommendation L of the Polish Financial Supervision Authority (PFSA) dated 18 December 2018 on the role of registered auditors in contributing to the process of supervision over banks and savings and credit cooperatives – the regulation has an impact on the cooperation process between the audit participants.
PUBLIC OFFERINGS OR ADMITTING SECURITIES TO TRADING	On 21 July 2019 Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market became binding. The Regulation is aimed at standardizing the principles governing public offerings based on a prospectus within the EU. The Regulation introduces specific value thresholds for offerings, upon reaching which the issue of a prospectus becomes mandatory (approval and publication of a prospectus), and new types of prospectuses, and the summary in prospectuses is abbreviated.
PUBLIC OFFERINGS OR ADMITTING SECURITIES TO TRADING	The Act of 16 October 2019 on amending the Act on Public Offerings and on the conditions for introducing financial instruments to organized trading, and on public companies, and certain other acts – the act introduces the provisions of Regulation (EU) 2017/1129 of the European Parliament and of the Council to the Polish legal system – the act introduces a new definition of the public offering and new principles for offering securities.

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3. FINANCIAL RESULTS AND CAPITAL ADEQUACY

Key financial ratios of PKO Bank Hipoteczny SA
Statement of financial position of PKO Bank Hipoteczny SA
Income statement of PKO Bank Hipoteczny SA
Requirements regarding own funds (Pillar I)
Internal capital (Pillar II)
Disclosures (Pillar III)

3.1. KEY FINANCIAL RATIOS OF PKO BANK HIPOTECZNY SA

	31.12.2019	31.12.2018
Total assets (PLN million)	27,253.3	22,103.1
ROA ⁷	0.4%	0.4%
ROE ⁸	5.0%	6.6%
Total capital ratio	16.6%	15.2%
Leverage ratio (LR)	6.7%	6.3%
Cost to income ratio (C/I) ⁹	24.6%	21.5%

3.2. STATEMENT OF FINANCIAL POSITION OF PKO BANK HIPOTECZNY SA

PLN million	31.12.2019	31.12.2018
Cash and balances with the Central Bank	0.0	0.0
Amounts due from banks	0.0	0.0
Derivative hedging instruments	173.3	168.3
Securities	1,240.2	843.0
Loans and advances to customers	25,821.1	21,070.5
Other assets ¹⁰	18.7	21.3
TOTAL ASSETS	27,253.3	22,103.1

PLN million	31.12.2019	31.12.2018
Amounts due to banks	4,811.3	4,292.3
Derivative hedging instruments	46.1	15.3
Mortgage covered bonds issued	16,240.0	12,841.5
Unsecured bonds issued	4,060.0	3,311.1
Other liabilities and provisions ¹¹	95.9	155.0
Equity	2,000.0	1,487.9

⁷ Annualized ratio expressed as the quotient of the net profit (loss) for the given period and the average level of assets at the beginning and end of the reporting period and of the interim monthly periods.

⁸ Annualized ratio calculated by dividing the net profit (loss) for the given period by the average level of equity at the beginning and end of the reporting period and of the interim monthly periods.

⁹ Annualized ratio excluding tax on certain financial institutions.

¹⁰ Includes the following items of the statement of financial position: intangible assets, property, plant and equipment and other assets.

¹¹ Includes the following items of the statement of financial position: amounts due to customers, other liabilities, current tax liabilities, deferred tax liabilities, deferred income tax provision and provisions.

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TOTAL LIABILITIES AND EQUITY	27,253.3	22,103.1
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As at 31 December 2019, the total assets of PKO Bank Hipoteczny SA were PLN 27,253.3 million, up 23% compared with the end of 2018. Residential mortgage loans were the key component of the Bank's assets. Their carrying amount, taking into account write-downs for expected credit losses recognized as at 31 December 2019, amounted to PLN 25,821.1 million, of which new loans amounted to PLN 12,065.5 million, whereas loans purchased from PKO Bank Polski SA amounted to PLN 13,755.6 million.

As far as liabilities are concerned, the share of covered bonds rose to 60% thereof as at the end of December 2019. In 2019, PKO Bank Hipoteczny SA carried out:

- one benchmark issue of EUR-denominated covered bonds of EUR 500 million;
- two TAP issues of EUR-denominated covered bonds with a total value of EUR 200 million;
- two issue of PLN-denominated green covered bonds of PLN 500 million.

Therefore as at the end of December 2019, the carrying amount of mortgage covered bonds was PLN 16,240.0 million and was up 26% compared with the end of 2018.

As at 31 December 2019, financial liabilities to PKO Bank Polski SA were a significant item of the Bank's liabilities and equity. They consisted of liabilities in the form of revolving credit lines, limited overdraft facilities, liabilities in respect of the purchase of receivables, liabilities in respect of the covered bonds and unsecured bonds acquired by PKO Bank Polski SA and other liabilities to PKO Bank Polski SA. Their total balance was PLN 4,681.6 million. Short-term bonds issued by the Bank were also a significant source of funding the Bank's operations. Their balance as at 31 December 2019 was PLN 4,060.0 million, up 23% in relation to the end of 2018.

3.3. INCOME STATEMENT OF PKO BANK HIPOTECZNY SA

PLN million	01.01.2019 – 31.12.2019	01.01.2018 – 31.12.2018	Change y/y (PLN million)
Net interest income	316.7	249.5	67.2
Net fee and commission income	(5.9)	(4.8)	(1.1)
Net gain/(loss) on financial instruments measured at fair value through profit or loss	0.1	0.1	0.0
Net foreign exchange gains/ (losses)	(1.8)	(0.2)	(1.6)
Net income/(loss) on modification	0.4	(0.4)	0.8
Net expected credit losses	(14.7)	(8.7)	(6.0)
Net other operating income and expenses	(0.4)	0.1	(0.5)
Administrative expenses	(51.4)	(45.6)	(5.8)
Cost of regulatory charges	(24.8)	(6.9)	(17.9)
Tax on certain financial institutions	(83.1)	(60.8)	(22.3)
Operating profit	135.1	122.2	12.9
Profit before tax	135.1	122.2	12.9
Income tax expense	(45.9)	(36.4)	(9.5)
Net profit	89.2	85.8	3.4

In 2019, PKO Bank Hipoteczny SA generated net profit of PLN 89.2 million, up PLN 3.4 million compared with the year 2018. The most important driver of this increase was the improvement in net interest income caused by an increase in the scale of the Bank's operations, with a limited increase in costs.

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In the analysed period, the Bank generated interest income of PLN 862.4 million comprising primarily income from residential mortgage loans in the amount of PLN 839.6 million, and income from debt securities. In the same period, the Bank incurred interest expense of PLN 545.7 million. Interest expense resulted mainly from mortgage covered bonds issued and costs of hedging transactions. The related interest expense was PLN 376.1 million. The Bank also incurred, among other things, interest expense of PLN 44.5 million on loans and overdrafts received, interest expense of PLN 43.5 million on the liability for the deferred payment for receivables purchased from PKO Bank Polski SA, and interest expense of PLN 81.5 million on bonds issued.

The Bank's turnover in 2019 (understood as the total value of interest income and fee and commission income) amounted to PLN 877.9 million. The realized turnover was generated entirely from the Bank's operations in Poland.

In 2019, the Bank incurred a net fee and commission loss of PLN 5.9 million. This item comprised, among other things, costs of expert valuations of the mortgage lending value of real estate (MLV), as prepared by real estate appraisers, in the amount of PLN 8.5 million, costs of the bond issue programme of PLN 4.2 million, costs of insuring loans of PLN 4.0 million, and costs of credit lines of PLN 3.3 million. The Bank also recognized fee and commission income from customers for, among other things, real estate valuations performed by the Bank and for real estate inspections, as well as commission for early full or partial loan repayments. The total fee and commission income was PLN 15.5 million.

In 2019 the Bank incurred administrative expenses of PLN 51.4 million. Non-personnel expenses of PLN 30.7 million, including costs related to services rendered by PKO Bank Polski SA of PLN 23.8 million under an outsourcing agreement, were a significant component of administrative expenses. Costs of employee benefits, whose amount during the reporting period was PLN 17.5 million, were also a significant component of administrative expenses. The increase in administrative expenses compared with the corresponding period of 2018 was mainly caused by an increase in costs of services provided by PKO Bank Polski SA under an outsourcing agreement (up PLN +4.7 million), which resulted from an increase in the volume of loans in the Bank's balance sheet.

In 2019, the Bank also incurred regulatory expenses totalling PLN 24.7 million. The main item of such expenses was the contribution to the resolution fund of the Bank Guarantee Fund of PLN 22.1 million (PLN 17.6 million more than in 2018). The increase in the regulatory expenses adversely affected the Bank's profitability ratios.

Tax on certain financial institutions, which amounted to PLN 83.1 million in the reporting period, was a significant cost of the Bank's activities.

The Bank's costs resulting from write-downs in respect of credit losses amounted to PLN 14.7 million in 2019.

In 2019, there were no unusual events with a material effect on the Bank's operations.

THE BANK'S FINANCING STRUCTURE

The table below shows the structure of the Bank's sources of financing:

	31.12.2019	31.12.2018
Equity	7.3%	6.7%
Funds from the parent entity	16.7%	18.7%
Covered bonds issued	59.6%	58.1%
Unsecured Bonds issued	14.9%	15.0%
Other	1.5%	1.5%
Total	100.0%	100.0%

As at 31 December 2019 and as at 31 December 2018 the Bank did not have any liabilities in respect of which it had defaulted on contractual payments.

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3.4. REQUIREMENTS REGARDING OWN FUNDS (PILLAR I)

GENERAL INFORMATION

In accordance with CRR, the Bank calculates requirements in respect of own funds for the following risk types:

- credit risk – according to the standardized approach;
- credit valuation adjustment (CVA) risk – according to the standardized approach;
- settlement and delivery risk – according to the standardized approach;
- operational risk – using the Basic Indicator Approach (BIA);
- market risk (foreign-exchange risk only) – using basic methods.

At 31 December 2019, the own funds requirements concerning the credit valuation adjustment, settlement and delivery, and market risk were nil, therefore the total own funds requirement comprised the requirements for credit and operational risks.

Own funds requirements	31.12.2019	31.12.2018
Credit risk (PLN million)	854.5	719.0
Operational risk (PLN million)	22.7	15.6
Total own fund requirement (PLN million)	877.2	734.6
Common equity Tier 1 capital ratio (CET1)	16.6%	15.2%
Tier 1 capital ratio (T1)	16.6%	15.2%
Total capital ratio (TCR)	16.6%	15.2%

The tables below present the values of exposures, risk-weighted assets (RWA) and own funds requirements by exposure class:

31.12.2019	Gross exposure	Exposure value ¹²	Risk-weighted assets (RWA)	Own funds requirement
Retail exposures ¹³	4,034.3	3,823.8	2,867.9	229.4
Exposures secured by mortgages on real estate	22,294.2	22,237.4	7,783.1	622.6
Exposures to central governments or central banks	1,240.2	1,240.2	0.0	0.0
Exposures to institutions	771.2	771.2	0.0	0.0
Exposures in default	17.9	13.6	14.8	1.2
Other exposures	16.1	16.1	16.1	1.3
Total	28,373.9	28,102.3	10,681.9	854.5

¹² The value of balance-sheet exposures and the balance-sheet equivalent of contingent liabilities and transactions, taking into account specific credit risk adjustments and the CCF (Credit Conversion Factor).

¹³ These result from that part of the exposure which is not fully and completely secured, i.e. which exceeds an MLV of 80% or is in a transitional period, i.e. until collateral has been put up.

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31.12.2018	Gross exposure	Exposure value ¹²	Risk-weighted assets (RWA)	Own funds requirement
Retail exposures ¹³	3,985.8	3,658.9	2,744.2	219.5
Exposures secured by mortgages on real estate	17,824.0	17,768.4	6,218.9	497.5
Exposures to central governments or central banks	843.0	843.0	0.0	0.0
Exposures to institutions	729.1	729.1	0.0	0.0
Exposures in default	8.1	6.1	7.1	0.6
Other exposures	16.8	16.8	16.8	1.4
Total	23,406.8	23,022.3	8,987.0	719.0

CREDIT RISK ADJUSTMENTS

For the purpose of specific credit risk adjustments, the Bank uses impairment loss, which was recognized in the Bank's Tier 1 capital in accordance with the CRR and the implementing legislation.

The approach applied by the Bank to identifying exposures at risk of impairment and methods for estimating write-downs for expected credit losses and provisions for financial liabilities granted are described in Note 41.3 "Impairment loss on credit exposures" of the financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2019.

USE OF CREDIT RISK MITIGATION TECHNIQUES

The Bank uses mortgage collateral for the classification of exposures to classes of exposures secured by mortgages on real estate and the use of preferential risk weighting. Detailed information about the main types of collateral adopted by the Bank and the method of determining the mortgage lending value is presented in Note 43 "Residual risk management" of the financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2019.

3.5. INTERNAL CAPITAL (PILLAR II)

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

PKO Bank Hipoteczny SA regularly monitors the materiality of different risks involved in the Bank's operations.

The Bank separately assesses its internal capital for the following risks considered as material:

- credit risk;
- liquidity risk;
- operational risk;
- interest rate risk;
- model risk.

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 amounts necessary to cover all the risks material for the Bank. The Bank has adopted a prudent approach to risk aggregation and does not take advantage of the diversification effect.

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Structure of internal capital	31.12.2019	31.12.2018
To cover credit risk	93.8%	93.5%
To cover operational risk	2.5%	2.0%
To cover liquidity risk	1.7%	2.2%
To cover interest rate risk	1.8%	2.1%
To cover model risk	0.2%	0.2%
Total	100.0%	100.0%

As at 31 December 2019, the relationship between the Bank's own funds and internal capital remained above the statutory and internal limits.

In order to estimate the amount of capital necessary to operate safely in recessionary conditions, the Bank conducts regular stress tests.

3.6. DISCLOSURES (PILLAR III)

Considering the scale and specific nature of its operations, in the financial statements and in the Directors' Report the Bank discloses in particular the following information:

- risk management objectives and strategies;
- own funds for capital adequacy purposes;
- capital buffers;
- leverage ratio;
- capital requirements;
- credit risk adjustments;
- credit risk mitigation techniques used;
- remuneration policy for those categories of personnel whose professional activities have a material impact on the Bank's risk profile;
- the requirements referred to in Article 111a of the Banking Law and in Recommendation H;
- operational risk in accordance with Recommendation M;
- liquidity risk management system and the liquidity position, in accordance with Recommendation P;
- the impact of implementing International Financial Reporting Standard 9 (IFRS 9) on capital adequacy.

Being part of the PKO Bank Polski Group, the Bank also supplies information to the Parent for consolidation purposes.

Details of the disclosures made, the methods of their verification and publication are presented in the Information policy of PKO Bank Hipoteczny SA regarding capital adequacy and other information subject to disclosure, which is available on the Bank's website ("<http://www.pkobh.pl>").

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PKO BANK HIPOTECZNY SA DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2019

4. BUSINESS OF PKO BANK HIPOTECZNY SA

Sales of residential mortgage loans under the agency model
Acquisition of receivables under residential mortgage loans
Structure of the residential mortgage loan portfolio
Covered bonds
Financial market operations
Bonds – non-public programme
Bonds – public programme
Ratings of the Bank and its covered bonds

4.1. SALES OF RESIDENTIAL MORTGAGE LOANS UNDER THE AGENCY MODEL

PKO Bank Hipoteczny SA has been granting residential mortgage loans in Polish zloty since 1 April 2015. New residential mortgage loans are sold under the agency model, through Poland's largest network of branches, agents and intermediaries, organized by PKO Bank Polski SA. The Bank accepts apartments and single-family homes as collateral.

In 2019, the Bank granted PLN 3,749.4 million worth of residential mortgage loans, a small drop of 5.1% compared with 2018.

In accordance with Recommendation S of the PFSA, in 2019 the Bank granted only loans for which the loan-to-value ratio did not exceed 80%. Where a low down payment insurance policy was used, the Bank approved loans for which this ratio was not higher than 90%. Moreover, in compliance with the Polish Mortgage Covered Bonds and Mortgage Banks Act, the Bank only grants loans whose value in relation to the mortgage lending value of the real estate does not exceed 100%.

The following table shows the main criteria applied by PKO Bank Hipoteczny SA in the process of granting loans secured by mortgages.

CRITERIA	AGENCY MODEL
Loan amount/market value of the real estate	Max 80% ¹⁴
Loan amount/mortgage lending value of the real estate	Max 100%
Legal title to the real estate	Ownership or perpetual usufruct
Loan collateral	Mortgage recorded as the first in Section IV of the Land and Mortgage Register
Currency	PLN
Purpose	Residential

In 2019 the Bank introduced a special residential mortgage loan offer based on preferential price terms for those customers who would submit an energy performance certificate confirming the required energy-effectiveness of the purchased real estate.

In addition, in 2019 the Bank expanded its residential mortgage loan offer by loans with interest based on the five-year base interest rate, making it available to newly granted loans.

¹⁴ Where a low down payment insurance policy is used, the Bank approves loans for which this ratio is not higher than 90%.

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ENERGY EFFICIENT MORTGAGES INITIATIVE

PKO Bank Hipoteczny SA and PKO Bank Polski SA were the first banks in Poland to join the Energy Efficient Mortgages (EEM) Initiative pilot project on 11 April 2019. The aim of the project is to develop standardized, pan-European solutions for residential mortgage loans granted for the financing of energy-efficient apartments and houses. This includes offering preference packages to encourage borrowers to buy energy efficient properties or to improve the energy efficiency of the existing buildings. In this way, banks would be encouraged to play a key role in stimulating climate change-related actions in the European construction sector.

4.2. ACQUISITION OF RECEIVABLES UNDER MORTGAGE RESIDENTIAL MORTGAGE LOANS

Purchase of receivables in respect of residential mortgage loans, on the basis of a framework agreement signed in 2015 with PKO Bank Polski SA, is an important element of the business of PKO Bank Hipoteczny SA.

In 2019, PKO Bank Hipoteczny SA acquired a portfolio of receivables in respect of residential mortgage loans totalling PLN 2,745.5 million from PKO Bank Polski SA. The following table shows the main criteria applied by PKO Bank Hipoteczny SA in the process of acquiring residential mortgage loans.

CRITERIA	POOLING MODEL
Loan amount/mortgage lending value of the real estate	Max 100%
Legal title to the real estate	Ownership or perpetual usufruct
Loan collateral	Mortgage recorded as the first in Section IV of the Land and Mortgage Register
Currency	PLN
Days past due or impairment indicators	None
Purpose	Residential

4.3. STRUCTURE OF THE RESIDENTIAL MORTGAGE LOAN PORTFOLIO

PORTFOLIO STRUCTURE BY LTV

The structure of the gross portfolio of loans granted to customers in the statement of financial position of PKO Bank Hipoteczny SA according to the LTV ratio based on market valuation¹⁵ and the LTV ratio based on the mortgage lending value is presented in the following tables.

Gross loans by LTV based on market valuation	31.12.2019	31.12.2018
less than 50%	34%	29%
51% – 60%	21%	18%
61% – 70%	22%	23%
71% – 80%	16%	21%
80% – 90%	7%	9%
more than 90%	0%	0%
Total, gross	100%	100%
Average LTV based on market valuation	56.2%	58.7%

¹⁵ The current level of LTV is determined based on the value of the real estate as at the moment of granting the loan and updated using statistical methods based on an analysis of the real estate market.

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Gross loans by LtV based on MLV	31.12.2019	31.12.2018
less than 50%	15%	14%
51% – 60%	9%	10%
61% – 70%	13%	13%
71% – 80%	19%	18%
80% – 90%	25%	25%
more than 90%	19%	20%
Total, gross	100%	100%
Average LtV based on MLV	72.4%	72.7%

In 2019, the average LtV ratio based on the market valuation of the loan portfolio declined by 2.5 p.p. (in 2018 a decline of 1.6 p.p.), which was the result of a further rise in the market value of the real estate provided as loan collateral. For the LtV ratio based on MLV this relationship is not observed because the mortgage lending value of the real estate did not need to be updated.

INTEREST ON LOANS

In 2019, the Bank changed its offer by replacing the WIBOR 3M reference rate with WIBOR 6M for the purposes of calculating interest rates on residential mortgage loans.

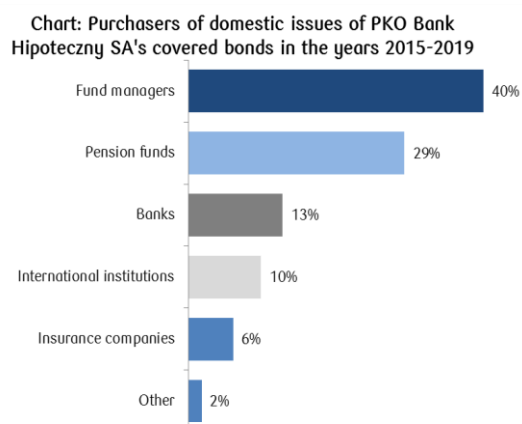
The main reference interest rate applied by the Bank to loans was WIBOR 6M, whose average value was 1.79% in 2019.

4.4. COVERED BONDS

The key objective of PKO Bank Hipoteczny SA is issuing mortgage covered bonds which are the main source of the long-term financing for loans secured with real estate.

POLISH ISSUES OF MORTGAGE COVERED BONDS

On 10 June 2019, PKO Bank Hipoteczny SA carried out its issue of Series 12 PLN-denominated covered bonds, which was yet another issue carried out under the firm commitment underwriting procedure.¹⁶ It was **the first issue of green mortgage covered bonds** secured exclusively with PLN-denominated high-quality residential loans carried out in Poland. The Bank offered securities of PLN 250 million to institutional investors. During the book-building process, the spread of Series 12 mortgage covered bonds was set at 0.60% above WIBOR 3M. The period from the date of issue to redemption of the mortgage covered bonds was set at 5 years, 3 months and 20 days, and the maturity date was set at 30 September 2024.



¹⁶ Firm commitment underwriting is a contract whereby the underwriter undertakes to purchase on its own account all or a part of securities in a given issue from the issuer or from the arranger; the securities are only offered to that entity to further sell them in a public offering.

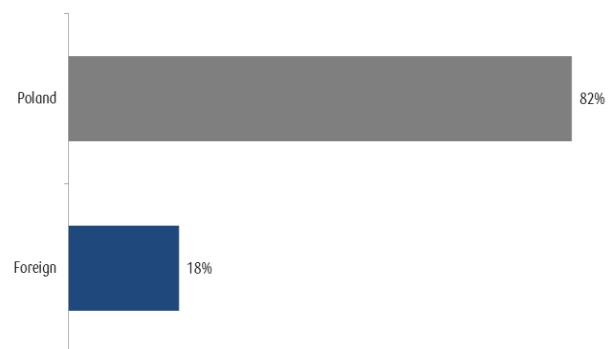
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The series 12 mortgage covered bonds of PKO Bank Hipoteczny SA were placed on the Warsaw Stock Exchange's parallel market and on the BondSpot OTC market on 24 June 2019; they have also been admitted to repo transactions by the National Bank of Poland.

On 2 December 2019, PKO Bank Hipoteczny SA carried out its issue of Series 13 PLN-denominated covered bonds, which was yet another issue carried out under the firm commitment underwriting procedure. It was the second issue of green mortgage covered bonds secured exclusively with PLN-denominated high-quality residential loans carried out in Poland. The Bank offered securities of PLN 250 million to institutional investors. During the book-building process, the spread of Series 13 mortgage covered bonds was set at 0.51% above WIBOR 3M. The period from the date of issue to redemption of the mortgage covered bonds was set at five years and the maturity date was set at 2 December 2024.

Chart: Geographical distribution of purchasers of domestic issues of PKO Bank Hipoteczny SA's covered bonds in the years 2015-2019



The series 13 mortgage covered bonds of PKO Bank Hipoteczny SA were placed on the Warsaw Stock Exchange's parallel market and on the BondSpot OTC market on 16 December 2019; they have also been admitted to repo transactions by the National Bank of Poland.

PLN-denominated issues of mortgage covered bonds of PKO Bank Hipoteczny SA carried out to 31 December 2019:

Series number	Mortgage covered bond number (ISIN)	Issue date	Maturity date	Value of series (PLN million)	Interest rate	Currency	Issue rating	Listing
1	PLPKOHP00017	11.12.2015	11.12.2020	30	WIBOR 3M+0.75%	PLN	Aa3	Bondspot, WSE parallel market
2	PLPKOHP00025	27.04.2016	28.04.2021	500	WIBOR 3M+0.65%	PLN	Aa3	Bondspot, WSE parallel market
3	PLPKOHP00033	17.06.2016	18.06.2021	500	WIBOR 3M+0.59%	PLN	Aa3	Bondspot, WSE parallel market
4	PLPKOHP00041	28.04.2017	18.05.2022	500	WIBOR 3M +0.69%	PLN	Aa3	Bondspot, WSE parallel market
5	PLPKOHP00058	22.06.2017	10.09.2021	265	2.69%	PLN	Aa3	Bondspot, WSE parallel market
6	PLPKOHP00066	27.10.2017	27.06.2023	500	WIBOR 3M +0.60%	PLN	Aa3	Bondspot, WSE parallel market
7	PLPKOHP00074	27.04.2018	25.04.2024	700	WIBOR 3M +0.49%	PLN	Aa3	Bondspot, WSE parallel market
8	PLPKOHP00082	18.05.2018	29.04.2022	100	WIBOR 3M +0.32%	PLN	Aa3	Bondspot, WSE parallel market
9	PLPKOHP00090	27.07.2018	25.07.2025	500	WIBOR 3M +0.62%	PLN	Aa3	Bondspot, WSE parallel market
10	PLPKOHP00108	24.08.2018	24.08.2028	60	3.4875%	PLN	Aa3	Bondspot, WSE parallel market
11	PLPKOHP00116	26.10.2018	28.04.2025	230	WIBOR 3M +0.66%	PLN	Aa3	Bondspot, WSE parallel market
12	PLPKOHP00132	10.06.2019	30.09.2024	250	WIBOR 3M +0.60%	PLN	Aa3	Bondspot, WSE parallel market
13	PLPKOHP00199	02.12.2019	02.12.2024	250	WIBOR 3M +0.51%	PLN	Aa3	Bondspot, WSE parallel market

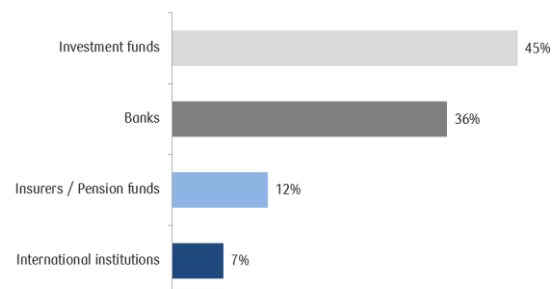
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INTERNATIONAL ISSUES OF MORTGAGE COVERED BONDS

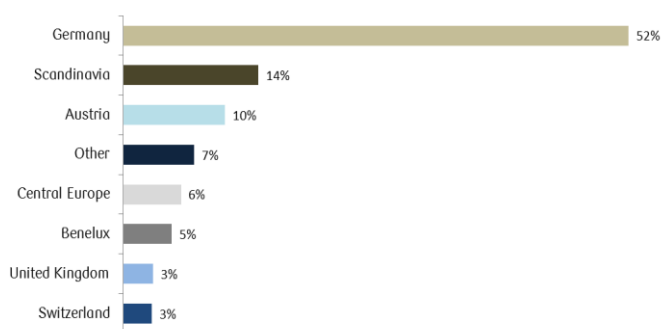
On 28 January 2019, PKO Bank Hipoteczny SA carried out its fifth benchmark issue of Series 7 EUR-denominated mortgage covered bonds. The Bank offered instruments with a value of EUR 500 million, based on the fixed interest rate, to institutional investors. During the book-building process, the spread was set at 0.274% (and the coupon at 0.250%). In the process, investors expressed interest in purchasing securities for a total of about EUR 1,080 million. The period from the date of issue to redemption of the mortgage covered bonds was set at 2 years, 9 months and 26 days, and the maturity date was set at 23 November 2021.

Chart: Purchasers of EUR-denominated issues of PKO Bank Hipoteczny SA's covered bonds in the years 2016-2019



Series 7 EUR-denominated mortgage covered bonds of PKO Bank Hipoteczny SA were listed on the Luxembourg Stock Exchange and the Warsaw Stock Exchange (parallel market) on 28 January 2019 and 25 February 2019 respectively. Since 28 January 2019, they have also been accepted in repo transactions by the European Central Bank.

Chart: Geographical distribution of purchasers of EUR-denominated covered bonds of PKO Bank Hipoteczny SA's in years 2016-2019



On 1 March 2019, PKO Bank Hipoteczny SA placed the first TAP¹⁷ mortgage covered bonds issue for series 7 benchmark issue in the nominal amount of EUR 100 million. The yield on mortgage covered bonds of this issue was determined at 0.197%, and the coupon at 0.250%. The instruments were assimilated with series 7 mortgage covered bonds, as a result of which the nominal value of the securities quoted on the Luxembourg Stock Exchange and in the Warsaw Stock Exchange parallel market increased to a total of EUR 600 million.

On 8 March 2019, PKO Bank Hipoteczny SA placed the second TAP mortgage covered bonds issue for series 1 benchmark issue in the nominal amount of EUR 100 million. The yield on mortgage covered bonds of this issue was determined at 0.281%, and the coupon at 0.125%. The instruments were assimilated with Series 1 mortgage covered bonds, as a result of which the nominal value of the securities quoted on the Luxembourg Stock Exchange and in the Warsaw Stock Exchange parallel market increased to a total of EUR 600 million.

On 8 March 2019, PKO Bank Hipoteczny SA placed the second TAP mortgage covered bonds issue for series 1 benchmark issue in the nominal amount of EUR 100 million. The yield on mortgage covered bonds of this issue was determined at 0.281%, and the coupon at 0.125%. The instruments were assimilated with Series 1 mortgage covered bonds, as a result of which the nominal value of the securities quoted on the Luxembourg Stock Exchange and in the Warsaw Stock Exchange parallel market increased to a total of EUR 600 million.

EUR-denominated issues of mortgage covered bonds of PKO Bank Hipoteczny SA carried out up to and including 31 December 2019:

Series number	Mortgage covered bond number (ISIN)	Issue date	Maturity date	Value of series (EUR million)	Coupon	Price	Currency	Issue rating	Listing
1	XS1508351357	24.10.2016	24.06.2022	500	0.125%	99.702%	EUR	Aa3	LuxSE, WSE parallel market
2	XS1559882821	02.02.2017	02.02.2024	25	0.82%	100.00%	EUR	Aa3	LuxSE

¹⁷ TAP – a procedure allowing issuers to offer bonds or debt securities from previous issues by increasing their nominal value.

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3	XS1588411188	30.03.2017	24.01.2023	500	0.625%	99.972%	EUR	Aa3	LuxSE, WSE parallel market
4	XS1690669574	27.09.2017	27.08.2024	500	0.75%	99.906%	EUR	Aa3	LuxSE, WSE parallel market
5	XS1709552696	02.11.2017	03.11.2022	54	0.467%	100.00%	EUR	Aa3	LuxSE
6	XS1795407979	22.03.2018	24.01.2024	500	0.75%	99.892%	EUR	Aa3	LuxSE, WSE parallel market
7	XS1935261013	28.01.2019	23.11.2021	500	0.250%	99.933%	EUR	Aa3	LuxSE, WSE parallel market
7 tranche 2	XS1935261013	01.03.2019	23.11.2021	100	0.250%	100.145 %	EUR	Aa3	LuxSE, WSE parallel market
1 tranche 2	XS1508351357	08.03.2019	24.06.2022	100	0.125%	99.489%	EUR	Aa3	LuxSE, WSE parallel market

The funds raised from the issues of mortgage covered bonds have been used by PKO Bank Hipoteczny SA to grant residential mortgage loans and to acquire receivables for such loans from PKO Bank Polski SA.

THE COVERED BOND LABEL

On 6 February 2018, PKO Bank Hipoteczny, as the first issuer of covered bonds from Poland, joined The Covered Bond Label. The Covered Bond Label is a quality certificate, whose purpose is to build awareness among investors of the safety and high quality of assets such as mortgage covered bonds.

The Bank's details on the website of The Covered Bond Label are available at:

<https://coveredbondlabel.com/issuer/161/>

GREEN MORTGAGE COVERED BONDS

In Q2 2019, PKO Bank Hipoteczny SA published the Green Covered Bond Framework (GCBF). In June 2019, PKO Bank Hipoteczny SA, as the first issuer in Poland, received a certificate granted by the international agency Climate Bonds Initiative for green covered bonds that satisfy the highest international standards with respect to the criteria for financing low emission projects. Through its participation in the financing of environmentally-friendly housing projects, the Bank will be able to obtain access to additional sources of financing from issues of Green covered bonds.

The proceeds from Green covered bonds are used exclusively to provide full or partial financing or refinancing of new and/or existing projects which have been classified as green. Such bonds should satisfy the criteria set by the International Capital Market Association (ICMA), which are known as Green Bond Principles (GBP). The GBP are a set of guidelines concerning transparency, disclosure and reporting, which promote the consistency of the green bond market.

In June 2019, PKO Bank Hipoteczny SA obtained a second party opinion of a specialized, certified international institution Sustainalytics, which confirmed that the Bank's GCBF complies with the key GCB principles.

For more detailed information concerning green covered bonds issued by the Bank, please visit:

<https://www.pkobh.pl/en/investor-relations/green-covered-bonds/>

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PKO BANK HIPOTECZNY SA DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2019

4.5. FINANCIAL MARKET OPERATIONS

PKO Bank Hipoteczny SA executes treasury transactions on the wholesale financial market. The purpose of the transactions is to manage liquidity (over short-, mid- and long-term time horizons) and the Bank's foreign-currency position. Additionally, the Mortgage Covered Bonds and Mortgage Banks Act imposes an obligation on PKO Bank Hipoteczny SA to mitigate the risk caused by fluctuations in exchange rates.

For the purpose of financing the granting of residential mortgage loans and purchase of receivables for residential mortgage loans granted by PKO Bank Polski SA, PKO Bank Hipoteczny SA issues covered bonds, bonds, and takes out lines of credit and assumes liabilities for purchased receivables. However, in accordance with the Mortgage Covered Bonds and Mortgage Banks Act, the level of liabilities arising from the taking out of loans and advances (including liabilities for purchased receivables) and issuing bonds cannot exceed in aggregate ten times the Bank's own funds over the first five years of operating activities or six times the Bank's own funds after that period.

In the Management Board's opinion, as at 31 December 2019, there were no indicators of a risk of late payment of the liabilities incurred by the Bank. In 2019, the Bank did not exceed any of the liquidity limits. Details of the levels of the Bank's liquidity limits are provided in Note 44 "Liquidity risk management" to the financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2019.

As far as the issue of EUR-denominated covered bonds is concerned, for the purpose of hedging interest-rate risk and foreign exchange risk, PKO Bank Hipoteczny SA entered into Cross-Currency Interest Rate Swap (CIRS) transactions, under which the Bank pays a coupon in PLN based on a variable interest rate, and receives a coupon based on a fixed interest rate for EUR. If a court declares PKO Bank Hipoteczny SA bankrupt, the CIRS transactions will automatically be extended by 12 months on the terms set on the transaction date and indicated in the Final Terms of issue of covered bonds. Additionally, the Bank has executed a series of FX-Forward contracts, which constitute a hedge of currency exposure with maturities on the payment dates of the coupons for EUR-denominated covered bonds.

As far as the issue of fixed-interest rate covered bonds in PLN is concerned, the Bank entered into IRS transactions to hedge interest rate risk in 2017 and 2018. Under the IRS transaction, the Bank pays a coupon based on a floating PLN rate, and receives a coupon based on a fixed PLN rate.

4.6. BONDS – NON-PUBLIC PROGRAMME

On 30 September 2015, PKO Bank Hipoteczny SA established a Non-Public Short-Term Bond Issue Programme. In 2019, the Bank issued a total of PLN 7,370.1 million worth of bonds under the programme. The balance of issued short-term bonds was PLN 3,400.0 million as at 31 December 2019. The Bank intends to continue seeking short-term financing in the form of short-term bond issues.

On 18 December 2018, PKO Bank Hipoteczny SA signed an agreement with a European financial institution for an issue of unsecured bonds based on a variable interest rate with a total nominal value of PLN 350.0 million and redemption date on 21 February 2020.

4.7. BONDS – PUBLIC PROGRAMME

On 11 April 2019, PKO Bank Hipoteczny SA established a Public Bond Issue Programme. On 31 May 2019 the PFSA approved the Base Bond Issue Prospectus of PKO Bank Hipoteczny SA:

As part of this programme, bonds with a total nominal value of PLN 326.5 million were subscribed for by 31 December 2019. All the series were admitted and introduced to trading on the WSE regulated market (the parallel market). The Bank intends to continue seeking financing under this programme.

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Series number	Bond number (ISIN)	Issue date	Maturity date	Value of series (EUR million)	Coupon	Currency	Issue rating	Listing
1	PLPKOHP00140	11.07.2019	12.07.2021	50	WIBOR 3M +0.60%	PLN	None	WSE parallel market
2	PLPKOHP00157	10.07.2019	10.01.2020	161.5	WIBOR 6M +0.30%	PLN	None	WSE parallel market
3	PLPKOHP00165	28.08.2019	30.08.2021	45	WIBOR 3M +0.60%	PLN	None	WSE parallel market
4	PLPKOHP00173	17.10.2019	18.10.2021	40	WIBOR3M +0.60%	PLN	None	WSE parallel market
5	PLPKOHP00181	18.12.2019	20.12.2021	30	WIBOR3M +0.60%	PLN	None	WSE parallel market

4.8. RATING OF THE BANK AND ITS COVERED BONDS

As at the date of this Report, PKO Bank Hipoteczny SA had the following ratings assigned by Moody's:

	Rating	Outlook	Rating assignment/confirmation date
Long-term issuer rating	Baa1	Stable	19.12.2017
Short-term issuer rating	P-2	n/a	19.12.2017
Long-term counterparty risk rating	A3	n/a	18.06.2018
Short-term counterparty risk rating	P-2	n/a	18.06.2018
Long-term counterparty risk assessment (CR)	A3(cr)	n/a	19.12.2017
Short-term counterparty risk assessment (CR)	P-2(cr)	n/a	19.12.2017

As at the date of this Report, the mortgage covered bonds of PKO Bank Hipoteczny SA had the following ratings assigned by Moody's:

	Rating	Date of initial rating	Rating confirmation date
Mortgage covered bonds denominated in PLN	Aa3	08.09.2015	12.12.2015
Mortgage covered bonds denominated in EUR	Aa3	29.09.2016	24.10.2016

The rating assigned to the covered bonds of PKO Bank Hipoteczny SA is the highest rating achievable for Polish securities. The limit for the ratings is the Polish country ceiling¹⁸ for debt instruments, which currently is at the level of Aa3.

¹⁸ Maximum country rating for Poland.

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5. INTERNAL OPERATING CONDITIONS

Qualified personnel Lending process and cooperation with PKO Bank Polski SA Internal control system Risk management Measurement of residential mortgage loan collaterals The cover pool for mortgage covered bonds Cover Pool Monitor Statutory limits

5.1. QUALIFIED PERSONNEL

The Bank implements tools and procedures to guarantee that personnel employed in the Bank have the highest qualifications in key business areas. The Bank constantly improves the qualifications of its employees, and makes efforts to ensure the stability of the personnel. These factors have an important influence on the implementation of the Bank's strategy and business goals and, consequently, on its operations and results of operations.

5.2. LENDING PROCESS AND COOPERATION WITH PKO BANK POLSKI SA

PKO Bank Hipoteczny SA acquires residential mortgage loans for its portfolio as part of its strategic cooperation with PKO Bank Polski. The banks work together under two models:

- agency model;
- pooling model.

The cooperation with PKO Bank Polski SA is governed in detail by an outsourcing agreement concluded on 16 January 2015. The agreement governs the scope of the cooperation and describes in detail the method of performing the outsourced functions, first and foremost in the area of offering and administering residential mortgage loans and performing support functions for PKO Bank Hipoteczny SA. Additionally, the agreement imposes obligations on PKO Bank Polski SA to properly perform the functions entrusted to it, as well as extensive reporting and control tasks on behalf of PKO Bank Hipoteczny SA.

On 17 November 2015, the Receivables Sale Framework Agreement was signed with PKO Bank Polski SA. On the basis thereof, the Bank has been acquiring portfolios of receivables for residential mortgage loans since December 2015.

PKO Bank Polski SA, as part of the regulatory approval process for establishing a mortgage bank before the PFSA, undertook to ensure that, if necessary and if PKO Bank Hipoteczny SA's capital or liquidity ratios fall below the level required by law or by other regulations of relevant domestic banking supervision authorities that are applicable to PKO Bank Hipoteczny SA, PKO Bank Polski SA will immediately provide PKO Bank Hipoteczny SA with appropriate financial support.

5.3. INTERNAL CONTROL SYSTEM

The internal control system in PKO Bank Hipoteczny SA is one of the elements of managing the Bank. The objective of the internal control system is to support the Bank's decision-making processes to ensure:

- effectiveness of the Bank's operations;
- reliability and accuracy of financial reporting, administrative and accounting procedures, and reliable internal and external reporting;

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- compliance with the risk management policy;
- compliance of the Bank's operations with the generally applicable laws, internal regulations and market standards adopted by the Bank, taking into account regulatory recommendations.

The Bank's internal control system includes:

- the control function designed to ensure compliance with controls relating, in particular, to risk management; this function covers all of the Bank's and the Head Office's business units which are responsible for carrying out the tasks assigned to this function;
- the compliance function, which, together with the Head Office's business units, is responsible for identifying, assessing, controlling and monitoring the risk of the Bank's non-compliance with the generally applicable laws and with the Bank's internal regulations and market standards adopted by the Bank, taking into account regulatory recommendations, and for the submission of the relevant reports;
- the independent internal audit function to evaluate and assess, independently and objectively, the adequacy and effectiveness of the risk management system, the internal control system, and corporate governance, except for the aspects relating to the internal audit function itself.

The internal control system is arranged at the Bank on three independent levels:

- the first level consists of organizational structures that perform risk-generating operational tasks and operate under internal regulations;
- the second level is composed of specialized organizational structures operating under applicable policies, methodologies and procedures. The purpose of such structures is to ensure that actions at the first level are properly designed and ensure effective functioning with respect to risk mitigation, support risk management and measurement, and ensure the effectiveness of operations. This level comprises the activities of the compliance function, as well as identification, measurement or estimation, control, monitoring and reporting of risks material to the Bank, and identified threats and irregularities;
- the third level is internal audit, which carries out independent audits of elements of the Bank's management system, including the risk management system and the internal control system. The internal audit operates separately from, and can support the activities carried out by the first and second level. The support involves consultation without affecting the decisions made.

The Bank's Management Board ensures the continuity of operation of the internal control system and proper cooperation of all business units within the internal control system in place. The Management Board also identifies corrective actions to be taken to remedy any irregularities identified by the internal control system, including specific corrective and disciplinary measures. The Bank's Management Board approves criteria for distinguishing the relevant processes taking into account the management strategy, the business model and the impact on the Bank's financial performance and capital adequacy, as well as risk tolerance. The Bank's Management Board also approves the list of significant processes and their connection with the internal control system's objectives.

Supervision of the internal control system is exercised by the Supervisory Board with the support of the Audit and Finance Committee of the Bank's Supervisory Board. The Supervisory Board approves, in particular, the principles of operation of the internal control system and assesses the adequacy and effectiveness of the system. The Audit and Finance Committee supports the Supervisory Board by monitoring and reviewing the adequacy and effectiveness of the internal control system based on the reports obtained from compliance, internal audit and the control function matrix coordinator, as well as by reviewing draft resolutions of the Management Board in terms of the internal control system, the approval of which falls within the competence of the Supervisory Board.

In 2019, the reporting within the internal control system and the remedial actions taken indicated that the internal control system in PKO Bank Hipoteczny SA was effective and commensurate with the business model and the scale of the Bank's operations.

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5.4. RISK MANAGEMENT

The risk management process is a key process in PKO Bank Hipoteczny SA. Its purpose is to ensure control of the risk level in a changing macroeconomic and legal environment, control of the risk level, and to ensure it is maintained within the risk tolerance established by the Bank and the system of limits that is in place. The assumed level of risk constitutes an important component of the planning and decision-making process.

Risk management in the Bank is based in particular on the following principles:

- the Bank manages all identified types of risk associated with its operations;
- the process of risk management is commensurate with the scale of the Bank's operations and the materiality, scale and complexity of a given risk;
- the risk management process supports the execution of the Bank's management strategy, while maintaining compliance with the risk management strategy, in particular in the area of the risk tolerance level;
- the process of risk management is continuously adjusted to new factors and sources of risk;
- methods of risk management and risk measurement systems are adjusted to the scale and complexity of the Bank's operations and to the nature and size of the risk to which the Bank is exposed;
- methods of risk management are periodically reviewed and validated;
- risk management is integrated with planning and controlling processes;
- the risk level is regularly monitored and compared against the system of limits that apply in the Bank, while the Bank's management receives regular information on the level of risk;
- the risk management process is cohesive with the risk management principles in the PKO Bank Polski SA Group.

PKO Bank Hipoteczny SA identifies and manages the following types of risk:

MATERIAL RISKS

- Credit risk
- Liquidity risk, including financing risk
- Interest rate risk
- Model risk
- Operational risk

MONITORED RISKS

- Concentration risk
 - Residual risk
 - Currency risk
 - Business risk, including macroeconomic risk
 - Compliance risk
 - Reputation risk
 - Capital risk, including leverage risk
-

The significance of individual types of risk is defined at the level of the Bank. While determining the criteria of considering a certain risk to be material, the impact of such risk on the Bank's activities is taken into account, provided that there are three types of risk:

- material risks, which are subject to active management;
- monitored risks, for which the monitoring of materiality is performed;
- other undefined risks or risks that do not exist in the Bank (immaterial or unmonitored).

For monitored risks, PKO Bank Hipoteczny SA performs periodic monitoring of whether they should be designated as material. The Bank has defined materiality criteria; when they are met, a risk will be recognized as material.

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In its Risk Management Strategy, the Bank has defined a number of strategic limits which define the tolerance for different risks. The Bank monitors these limits on an ongoing basis. In 2019, as well as during the whole period of the Bank's activities, none of them was exceeded.

A detailed description of the Bank's risk management objectives and methods is provided in the financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2019, in the chapter *Objectives and principles of risk management*. It also includes important information on the level of financial risk in the Bank's operations, together with the methods of hedging significant types of planned transactions for which hedge accounting is applied.

5.5. MEASUREMENT OF RESIDENTIAL MORTGAGE LOAN COLLATERALS

PKO Bank Hipoteczny SA's policy concerning loan collaterals and their measurement is based on the provisions of the following legal acts:

- the Mortgage Covered Bonds and Mortgage Banks Act,
- the Act on Land and Mortgage Registers and Mortgage,
- the Banking Law.

Additionally, the question of loan collaterals is addressed by:

- the recommendations of the PFSA, including Recommendations F, S and J,
- the Bank's internal regulations.

The Bank has in place and applies the Rules for Setting the Mortgage Lending Value of Real Estate, approved (as amended) by the PFSA on 30 October 2017. The rules take into account the provisions of Recommendation F concerning the basic criteria applied by the PFSA in approving rules for setting the mortgage lending value of real estate issued by mortgage banks.

The mortgage lending value of real estate (MLV) is the value determined by the mortgage bank which, in the Bank's opinion, reflects the level of risk associated with the real estate as the loan collateral. MLV is used to determine the maximum amount of a loan that can be secured by a mortgage on a given property, and to make a decision on whether a receivable secured by a particular property can be acquired by the Bank. The mortgage lending value of real estate is determined in a prudent manner, taking into consideration long-term parameters.

PKO Bank Hipoteczny SA determines the MLV on the basis of expert valuations of the mortgage lending value of property. Such valuations are carried out with due diligence and prudence. They take into account only those characteristics of the real estate and investments necessary for its construction which will be of a permanent nature and which, assuming rational use, can be realized by any keeper of the property. In the expert opinion, prepared as at a specific date, the assumptions and parameters of the analysis are documented, as is the process of setting the MLV and the proposed MLV that results. The expert opinion takes into account analyses and forecasts concerning specific parameters for a given property, which influence the evaluation of credit risk, as well as factors of a general nature, e.g. population growth, the unemployment rate and urban development planning.

The process of setting the MLV is carried out in the Bank by a dedicated team.

In the agency model, the process of setting the mortgage lending value of real estate comprises three stages:

PREPARATION OF THE MLV EXPERT OPINION	Appraiser with appropriate experience and the ability to estimate bank risk in connection with securing residential mortgage loans or a dedicated organizational unit of the Bank – the Collateral Valuation Team at the Loan Office, based on the report from the inspection of the real estate prepared by a property valuation expert.
CONFIRMATION OF THE EXPERT OPINION	PKO Bank Polski SA under the Outsourcing Agreement, or a dedicated organizational unit of the Bank: the Collateral Valuation Team at the Loan Office
REVIEW OF AN EXPERT OPINION ON MLV AND DETERMINING THE	A dedicated organizational unit of the Bank: the Collateral Valuation Team at the Loan Office

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MORTGAGE LENDING VALUE OF THE REAL ESTATE

In the case of an acquisition of a receivable, the process of setting the mortgage lending value of real estate comprises four stages:

CONFIRMATION OF THE PROPERTY'S LEGAL STATUS	PKO Bank Polski SA under the Outsourcing Agreement
INSPECTION PROTOCOL OF THE PROPERTY, TOGETHER WITH MARKET RESEARCH	Appraiser with appropriate experience and the ability to estimate bank risk in connection with securing mortgage loans
PREPARATION OF THE MLV EXPERT OPINION	A dedicated organizational unit of the Bank: the Collateral Valuation Team at the Loan Office
REVIEW OF AN EXPERT OPINION ON MLV AND DETERMINING THE MORTGAGE LENDING VALUE OF THE REAL ESTATE	A dedicated organizational unit of the Bank: the Collateral Valuation Team at the Loan Office

The processes of preparing an MLV expert opinion and setting the mortgage lending value of a property described above are performed by two independent individuals.

5.6. THE COVER POOL FOR MORTGAGE COVERED BONDS

PKO Bank Hipoteczny SA maintains a cover pool for its covered bonds. The Bank includes in the cover pool receivables on residential mortgage loans secured with the first mortgage on the property, and rights and funds that constitute the basis for issuing mortgage covered bonds, as well as additional funds that constitute the excess to cover interest on mortgage covered bonds in circulation which is due in the following six months. The mortgage covered bonds are secured by loans secured by the highest priority mortgage. Certain bank funds can also constitute the basis for issuing mortgage covered bonds:

- funds invested in securities issued or guaranteed by the National Bank of Poland, the European Central Bank, governments and central banks of members of the European Union and/or the Organization for Economic Cooperation and Development, excluding countries that are restructuring or have restructured their foreign debt in the past 5 years;
- invested in the National Bank of Poland;
- funds held in cash.

The nominal value of loans included in the cover pool and constituting collateral for issues of mortgage covered bonds as at 31 December 2019 stood at PLN 21,662.0 million. The nominal value of the over-collateralization in the form of securities issued by the State Treasury, denominated in PLN, stood at PLN 250 million. As at 31 December 2018, these figures were PLN 16,947.7 million and PLN 251 million respectively. The cover pool also takes into account CIRS transactions hedging foreign exchange risk and the interest rate risk on EUR-denominated mortgage-covered bonds, FX-Forward transactions hedging the foreign exchange risk of issued EUR-denominated mortgage covered bonds and an IRS transactions hedging the interest rate risk of PLN-denominated mortgage-covered bonds issued on a fixed-rate basis.

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In 2019 and in previous years, the cover pool did not include asset-backed securities that do not meet the requirements described in paragraph 1 of Article 80 of Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (recast).

The method of managing the cover pool is laid out by:

- the Mortgage Covered Bonds and Mortgage Banks Act of 29 August 1997 (Journal of Laws of 2003, No 99, item 919 as amended);
- Resolution No 633/2015 of the PFSA of 1 December 2015 on defining the form of a cover pool;
- Recommendation K of the PFSA of 9 February 2016 concerning the principles for maintaining the cover pool by mortgage banks;

The Cover Pool Monitor and the Deputy Cover Pool Monitor provide continuous supervision over the management of the cover pool.

The following table presents basic data on the Cover Pool as at 31 December 2019 and 31 December 2018:

	31.12.2019	31.12.2018
Total cover pool, including (PLN millions)	21,912.0	17,198.7
<i>loans secured by mortgages (PLN millions)</i>	21,662.0	16,947.7
<i>other assets¹⁹ (PLN millions)</i>	250.0	251.0
Liquidity buffer ²⁰ (PLN millions)	119.4	100.4
Nominal value of hedging transactions ²¹ (PLN millions)	12,156.2	9,262.7
Number of residential mortgage loans	115,978	92,561
Average value of a loan (PLN'000)	186.8	183.1
Average time since loan issuance (seasoning) (months)	48.1	44.9
Average maturity (months)	258.4	258.1
Average LtV (loan amount to market value)	53.6%	55.8%
Average loan to mortgage lending value of real estate	71.0%	71.2%
Over-collateralization ²²	34.7%	34.6%

5.7. COVER POOL MONITOR

The purpose of the cover pool monitor is to ensure protection of the interests of the holders of mortgage covered bonds. The Mortgage Covered Bonds and Mortgage Banks Act guarantees protecting the independence of the monitor and his deputy. Monitors are appointed by the PFSA, upon the request of the Bank's Supervisory Board, for a period of six years.

On 6 March 2015 the PFSA appointed the following cover pool monitor and deputy cover pool monitor for PKO Bank Hipoteczny SA:

	Position	Appointment date	Dismissal/ resignation date
Tadeusz Swat	Cover Pool Monitor	06.03.2015	-
Grzegorz Kędzia	Deputy Monitor	06.03.2015	-

¹⁹ Article 18 (3) of the Mortgage Covered Bonds and Mortgage Banks Act.

²⁰ Article 18 (3a) of the Mortgage Covered Bonds and Mortgage Banks Act.

²¹ The nominal value of the hedging transaction corresponds to the issue price of the covered bond.

²² It includes the net value of hedging transactions but excludes NPL (Non-performing loans).

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5.8. STATUTORY LIMITS

Acting under the Mortgage Covered Bonds and Mortgage Banks Act, PKO Bank Hipoteczny SA is obliged to monitor and comply with designated limits related to the operations of a mortgage bank.

The statutory limits and the level to which they have been met as of 31 December 2019 and as at 31 December 2018 were as follows:

Limit	Legal basis	Limit level	Actual level	
			31.12.2019	31.12.2018
Total value of receivables on loans secured by mortgages, and receivables on such loans acquired from other banks, in which the value exceeds 60% of the mortgage lending value, in proportion to the total value of receivables secured by mortgages	Article 13 (1)	≤30.0%	18.7%	18.7%
Value of funds received from the issue of mortgage bonds designated for refinancing loans secured by mortgages or receivables on such loans acquired from other banks, in proportion to 80% of the mortgage lending value of particular residential properties that constitute the collateral	Article 14	≤100.0%	65.5%	63.5%
Total value of acquired shares in other entities, in proportion to the Bank's own funds	Article 15 (1)(5)	≤10.0%	0.0%	0.0%
Total value of credits and loans taken out and bonds issued, in proportion to the Bank's own funds	Article 15 (2)	≤1000.0%	485.2%	551.3%
Total value of credits and loans taken out and bonds issued, in proportion to the amount designated for refinancing of activities described in Article 12 of the Act, i.e. issuing loans secured and unsecured by mortgages, receivables acquired from other banks on loans granted by them and secured or unsecured by mortgages	Article 15 (3)	≤100.0%	34.2%	36.5%
Total nominal value of mortgage covered bonds outstanding, in proportion to the Bank's own funds and general risk provision	Article 17	≤4000.0%	890.1%	920.7%
Total nominal value of receivables secured by mortgages and value of rights and additional funds constituting the basis for issuing mortgage covered bonds, in proportion to the total value of outstanding mortgage covered bonds (taking into account hedging instruments)	Article 18 (1)	≥110.0%	134.7%	134.6%
Total nominal value of receivables secured by mortgages constituting the basis for issuing mortgage covered bonds, in proportion to the total nominal value of mortgage covered bonds outstanding	Article 18 (1)	≥85.0%	133.5%	132.1%
Interest expense on mortgage covered bonds outstanding (cumulative from the beginning of the financial year and on any given day), in proportion to interest income on receivables secured by mortgages and rights and additional funds constituting the basis for issuing mortgage covered bonds (cumulative from the beginning of the financial year and on any given day), taking into account hedging instruments	Article 18 (2)	≤100.0%	33.8%	35.1%

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Bank funds constituting the excess described in Article 18(3a) over the nominal value of interest on mortgage bonds outstanding due in the following 6 months	Article 18 (3a)	$\geq 100.0\%$	149.2%	139.9%
Value of receivables secured by mortgages established during the course of construction investments, in proportion to the total value of receivables secured by mortgages that constitute the basis for issuing mortgage covered bonds	first sentence of Article 23 (1)	$\leq 10.0\%$	8.5%	8.6%
Value of receivables secured by mortgages established on land designated for construction in accordance with development plans, in proportion to the value of receivable secured by mortgages established during the course of construction investments that constitute the basis for issuing mortgage covered bonds	second sentence of Article 23 (1)	$\leq 10.0\%$	0.0%	0.0%

PKO Bank Hipoteczny SA did not breach any of these limits during the entire period covered by this Report.

The Bank achieved positive results on the coverage test and liquidity test performed at the end of December 2019.

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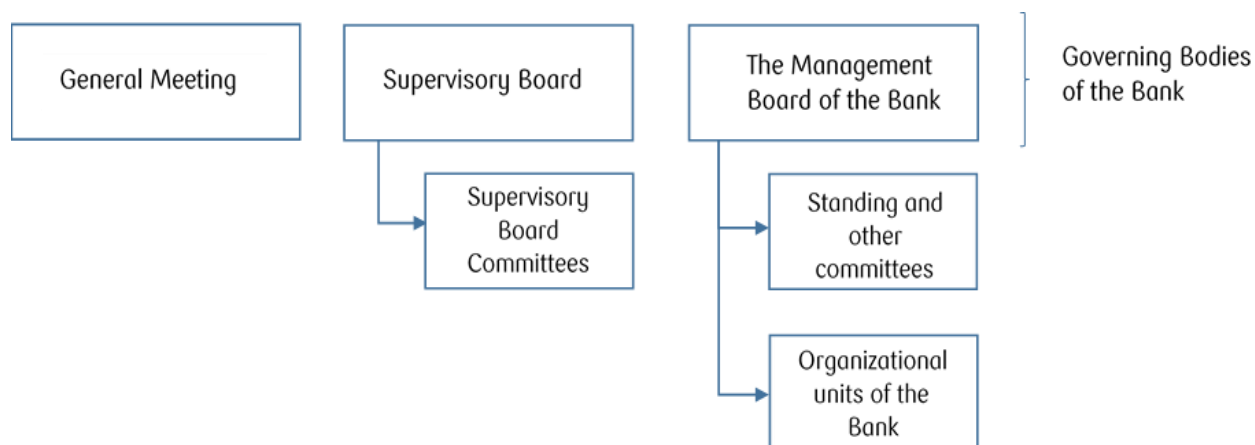
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6. STRUCTURE AND GOVERNING BODIES OF PKO BANK HIPOTECZNY SA.

Organizational structure of PKO Bank Hipoteczny SA
Powers of the governing bodies and committees of PKO Bank Hipoteczny SA
The Management Board of PKO Bank Hipoteczny SA
The Supervisory Board of PKO Bank Hipoteczny SA
Remuneration and human resource management policy
Benefits for the key management of PKO Bank Hipoteczny SA

6.1. ORGANIZATIONAL STRUCTURE OF PKO BANK HIPOTECZNY SA

The management of PKO Bank Hipoteczny SA is carried out on the basis of the organizational structure presented in the chart below and within the framework of the duties of the Bank's Governing Bodies, described in the following section of this chapter.



6.2. POWERS OF THE GOVERNING BODIES AND COMMITTEES OF PKO BANK HIPOTECZNY SA

The powers of the **General Shareholders' Meeting** of the Bank include in particular:

- appointing and dismissing members of the Supervisory Board and determining the principles for remunerating them and covering the costs related to the performance of a Supervisory Board member by the Bank;
- adopting resolutions on the settlement of claims for damages caused at the establishment of the Bank, or by the exercise of management or supervision;
- establishing the procedure for redemption of shares and the level of compensation for redeemed shares and granting consent to the purchase of the Bank's own shares for the purpose of redemption;
- creating and dissolving special funds created from net profit;
- adopting resolutions on issuing bonds convertible into shares or other instruments entitling the holder to purchase or take up shares in the Bank;
- adopting resolutions on the liquidation, disposal or lease of enterprises of the Bank or an organized part of the Bank's enterprises, and establishing limited property rights over them.
- assessing whether the Bank's remuneration policy is conducive to its development and operating safety.

The competencies of the **Bank's Supervisory Board** include in particular:

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- approving the Bank's annual financial plan and long-term development plans (in particular the Bank's strategy);
- approving the Bank's compliance policy;
- approving the Bank's management strategy, the risk management strategy, including the general level of risk at the Bank, the policy for estimating internal capital and capital management and reviewing the internal capital assessment strategies and procedures and capital management procedures;
- approving the assumptions underlying the introduction of a new product to the Bank's offer;
- approving the audit charter, the internal audit function's strategy, the annual and long-term internal audit plans and the principles for cooperation with the internal audit function at PKO Bank Polski SA and the statutory auditor;
- approving and periodically reviewing the general principles of the remuneration policy concerning persons whose professional activities significantly affect the Bank's risk profile;
- approving the Management Board Rules;
- approving the Regulations for Setting the Mortgage Lending Value of Property, which take effect after approval by the PFSA;
- affirming the Code of Ethics and the Rules for Management of Conflicts of Interest;
- approving the framework organizational structure of the Bank, adjusted to the scale and profile of the risk taken on by the Bank;
- approving the results of reviews of exercising cooperation agreements with PKO Bank Polski SA;
- adopting the Supervisory Board Rules;
- appointing and dismissing, by secret ballot, individual members of the Management Board;
- representing the Bank in agreements with members of the Management Board;
- approving the policy and procedure for selecting an audit firm responsible for auditing the Bank's financial statements and the policy for providing permitted non-audit services by the audit firm performing the audit, its related entities and members of its network;
- selecting an audit firm to conduct an audit or review of the Bank's financial statements;
- assessing the Directors' report on the Bank's activities and the financial statements for the previous financial year in terms of their consistency with the books of accounts and documents and the proposals of the Management Board concerning the distribution of profit or the off-setting of losses and presenting, to the General Shareholders' Meeting, a written annual report on the results of these assessments;
- applying to the PFSA for consent to the appointment of two members of the Management Board, including the President, and for the appointment of a member of the Management Board to supervise the management of risks material to the Bank's operations, and entrusting a member of the Bank's Management Board with the function of Management Board Member supervising the management of risks material to the Bank's operations;
- applying to the PFSA for consent to the appointment of a Bank cover pool monitor and deputy cover pool monitor;
- granting prior approval for the Bank to using the rights or incurring liabilities in instances indicated in the Bank's Articles of Association, and concluding agreements that exceed the normal scope of the Bank's operations, concluding transactions between the Bank and its shareholders or their related parties or members of the Bank's governing bodies in instances indicated in the Bank's Articles of Association;
- granting consent to changing the Bank's registered office or location (address);
- assessing the functioning of the remuneration policy in the Bank and presenting a report on this area to the General Shareholders' Meeting;
- assessing the application by the Bank of the Principles of Corporate Governance for Supervised Institutions.

In 2019, the following **Supervisory Board committees** operated:

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AUDIT AND FINANCE COMMITTEE

- monitoring and expressing periodic opinions on the adequacy and effectiveness of the internal control system, the adequacy and effectiveness of the risk management system and internal audit, the effectiveness of the Bank's compliance risk management and the adequacy of the compliance unit, the application of the Corporate Governance Principles for Supervised Institutions, the adequacy and effectiveness of the whistleblowing policy and the ethical procedures and standards in force at the Bank;
- developing the policy of selecting an audit firm, submitting to the Supervisory Board a recommendation of an audit firm to conduct an audit of the Bank's financial statements;
- monitoring the process of financial reporting, including reviewing the Bank's periodic and annual financial statements;
- monitoring financial audit proceedings and the independence of the statutory auditor and the entity authorized to audit the financial statements;
- giving opinions on Management Board resolutions relating to the internal control system, the approval of which is the responsibility of the Supervisory Board.

RISK COMMITTEE

- reviewing the Bank's overall current and future risk appetite, strategic risk directions and tasks in the context of the Bank's strategy and the conditions resulting from the macroeconomic situation and the regulatory environment, and, in particular, the risk management strategy developed by the Management Board and the Bank's acceptable overall risk level;
- monitoring compliance of the Bank's policy in the area of taking on risk with the strategy and financial plan;
- analysing periodic risk-related reports, including the utilization of strategic risk tolerance limits, and developing appropriate guidelines on the basis thereof, as well as reviewing periodically the implementation of the risk management strategy;
- giving opinions on capital adequacy, creditworthiness evaluation principles, the risk measurement model, the impairment measurement model;
- giving opinions on the principles of the information policy in the area of capital adequacy, managing capital adequacy, managing liquidity, operational and model risk and impairment measurement;
- providing opinions on the draft Rules on setting the mortgage lending value of real estate.

REMUNERATION AND NOMINATION COMMITTEE

- evaluating and conducting periodic reviews of nominations for key managerial positions in the Bank;
- submitting, to the Supervisory Board, proposals relating to appropriate forms of contracts with members of the Bank's Management Board;
- preparing opinions on the Code of Ethics and the Principles for Managing Conflicts of Interest;
- preparing opinions on requests concerning the consent for a member of the Management Board to engage in competitive activities or to participate in a competing company as a shareholder of a civil law company, a sole proprietorship or as a member of a governing body of a capital company, or to participate in another competing legal person as a member of a governing body;
- evaluating and performing periodic reviews, subject to the approval of the Supervisory Board, of the general principles of the policy for remunerating individuals whose actions have a material impact on the Bank's risk profile;

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| COMMERCIAL
COMMITTEE | <ul style="list-style-type: none">• evaluating and monitoring the variable remuneration components of individuals whose activities have a significant impact on the Bank's risk profile, second-level risk management, the compliance unit manager and the internal audit unit manager;• reviewing detailed rules and procedures for recruiting members of the Bank's Management Board and assessing the suitability of members of the Bank's Management Board;• preparing and carrying out, with potential support from external, independent entities, the programme for raising the qualifications of members of the Supervisory Board. <hr/> <ul style="list-style-type: none">• reviewing cooperation agreements concluded between PKO Bank Polski SA and the Bank;• providing opinions and approving product regulations, including the criteria for qualifying products for the Bank;• providing opinions on the price and discount policy;• monitoring and supervising the outsourcing of internal processes. |
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The powers of the Bank's Management Board include, in particular:

- defining PKO Bank Hipoteczny SA's strategy, taking into account the risk of the operational risk and the strategy for managing the Bank;
- setting the annual financial plan, including the conditions for its execution;
- adopting the Organizational Regulations of the Bank and the rules for segregation of duties;
- establishing and closing down standing Committees of the Bank and defining their powers;
- adopting the Management Board Rules;
- adopting the regulations for setting the mortgage lending value of real estate;
- adopting the regulations for the use of special funds created from net profit;
- determining the operating principles of the internal control system, the criteria for determining the adequacy and effectiveness of the system and the principles for classifying irregularities discovered by the internal control system;
- establishing, restructuring and closing down branches and other organizational units of the Bank in Poland and abroad;
- making decisions on issues of covered bonds.

The Bank's Management Board established the following standing committees:

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| ASSET AND LIABILITY
COMMITTEE | <ul style="list-style-type: none">• supporting the liquidity, interest rate, business – including macroeconomic, currency, capital – including leverage – risks, and the related risk of models and their measurement;• managing the Bank's capital adequacy;• examining materials on capital adequacy, equity, internal capital, stress tests, risks mentioned above, as well as tolerance limits for these risks;• making decisions regarding the Bank's operations, in particular as regards risk measures and limits as well as initiating capital and liquidity emergency actions;• issuing recommendations for the Bank's competent authorities, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of their competencies. |
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CREDIT COMMITTEE

- supporting the credit, concentration, residual and related model risk management functions;
- examining materials on the risks mentioned above, the profile and quality structure of the loan portfolio, impairment losses on assets, acquisition of loan portfolios, the real estate market;
- making decisions on the Bank's operations, in particular as regards risk measures and limits, risk model validation results, the methodology and models of calculating impairment losses on loan assets, cut-offs used as part of credit risk assessment, credit receivables purchased by the Bank, single loan transactions;
- issuing recommendations for the Bank's competent authorities, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of their competencies.

DATA QUALITY COMMITTEE

- determining the strategic directions of operations in the area of managing the quality of data and data architecture in the Bank, in the context of the Data Management System (DMS);
- oversight over the functioning of the DMS, including evaluation of its efficiency and the operations of particular organizational units of the Head Office.

STRATEGY AND BUSINESS INITIATIVES COMMITTEE

- supporting the operational, reputation, compliance and related model risk measurement functions;
- examining materials on the risks mentioned above, directions of the Bank's development, the Bank's strategy and IT strategy, initiatives related to the implementation of the Bank's strategy and IT strategy together with the operational risk analysis, product offer, product profitability, lending process;
- making decisions regarding the Bank's operations, in particular as regards managing the risks mentioned above, the related risk measurement models and the related risk measures and limits;
- issuing recommendations for the Bank's competent authorities, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of their competencies.

GREEN COVERED BONDS COMMITTEE

- supervising the process of issuing Green Covered Bonds, including defining the directions for changes in the principles for issuing the Green Covered Bonds and the assessment and selection of assets qualifying for financing with the Green Covered Bonds;
 - making decisions relating to the Bank's operations in the area of assessing and selecting qualified loans according to the methodology adopted by the Bank and adopting the principles for issuing the Green Covered Bonds in accordance with appropriate guidelines;
 - issuing recommendations for the Bank's competent authorities, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of their competencies.
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6.3. THE MANAGEMENT BOARD OF PKO BANK HIPOTECZNY SA

In the period from 1 January to 31 December 2019, the composition of the Management Board of PKO Bank Hipoteczny SA was as follows:

	Position	Position holding period
Paulina Strugała	President of the Management Board	16.04.2018 – to date
Agnieszka Krawczyk	Vice President of the Management Board	01.01.2018 – to date
Piotr Kochanek	Vice President of the Management Board	01.01.2019 – to date
Jakub Niesłuchowski	Vice President of the Management Board	01.04.2015 – 28.02.2019

Due to the resignation of Mr Marek Szcześniak as Vice President of the Management Board, the Supervisory Board of PKO Bank Hipoteczny SA appointed Mr Piotr Kochanek to the position of Vice President of the Management Board. Moreover, the Supervisory Board appointed Mr Piotr Kochanek to the position of Vice President of the Bank's Management Board responsible for managing material risk, on the condition that the PFSA grants the consent mentioned in Article 22b of the Banking Law. The PFSA unanimously granted such consent on 26 February 2019.

Mr Jakub Niesłuchowski resigned as Vice President of the Management Board and stepped down from this function on 28 February 2019.

On 28 March 2019 the Supervisory Board, after conducting qualifying procedures in respect of persons to be appointed to the Management Board appointed Ms Paulina Strugała, Ms Agnieszka Krawczyk and Mr Piotr Kochanek to a joint four-year term of office – as of the day following the date of the General Shareholders' Meeting which approved the financial statements for the year ended 31 December 2018.

On 29 March 2019 the Annual General Meeting granted a vote of approval to the President of the Management Board, Ms Paulina Strugała, the Vice President of the Management Board, Ms Agnieszka Krawczyk, and the Vice President of the Management Board Mr Piotr Kochanek.

The Bank's Supervisory Board has established the following internal division of key competencies within the Bank's Management Board:

PAULINA STRUGAŁA

President of the Management Board responsible for supervising compliance and reputation risk, the internal audit function, human resources management, communication and legal services

Other functions performed:

Chairperson of the Strategy and Business Initiatives Committee

Chairperson of the Asset and Liability Committee

AGNIESZKA KRAWCZYK

Vice President of the Management Board responsible for supervising the development, creation and functioning of the product offer for individuals and business entities, as well as for coordinating activities in respect of sales of mortgage products in all distribution channels, supervising the acquisition of loan receivables, creating principles for and supervising the process of handling the loans granted and acquired, operation and effectiveness of IT resources, creating the principles for outsourcing and exercising the outsourcing, as well as supervising financial planning and financial control

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issues, accounting and financial reporting, issuing securities and obtaining the respective funds

Other functions performed: Chairperson of the Green Covered Bonds Committee
Deputy Chairperson of the Strategy and Business Initiatives Committee
Member of the Credit Committee
Member of the Asset and Liability Committee

PIOTR KOCHANEK **Vice President of the Management Board** responsible for supervising the management of all risks relating to the Bank's operations except compliance risk and reputation risk, supervising restructuring and debt collection, supervising the lending decisions in respect of the credit risk and supervising the verification and assessment of real estate constituting collateral for loans granted or acquired

Other functions performed: Chairperson of the Credit Committee
Chairperson of the Data Quality Committee
Deputy Chairperson of the Asset and Liability Committee
Deputy Chairperson of the Green Covered Bonds Committee
Member of the Strategy and Business Initiatives Committee

OTHER MANAGEMENT FUNCTIONS OF THE MANAGEMENT BOARD MEMBERS

	Position	Position holding period
Paulina Strugała	Member of the Supervisory Board of PKO BP Finat Sp. o.o.	Throughout the reporting period
Agnieszka Krawczyk	Director of the Mortgage Banking Products Department at PKO Bank Polski SA, on a part-time (0.2 FTE) basis	Throughout the reporting period
Piotr Kochanek	Did not hold any additional Management Board or Supervisory Board member positions and did not occupy any other managerial positions	Throughout the reporting period

RECRUITMENT POLICY CONCERNING THE SELECTION OF MANAGEMENT BOARD MEMBERS AND EVALUATION OF MANAGEMENT BOARD MEMBERS

The process of selecting and evaluating candidates for members of the Management Board at PKO Bank Hipoteczny SA is carried out by the Remuneration and Nominations Committee of the Bank's Supervisory Board. The Committee takes into consideration the guidelines of the European Banking Authority dated 21 March 2018 regarding evaluating the qualifications of members of a management body and persons performing key functions (the EBA guidelines) and the Regulation of the Minister of Development and Finance of 10 March 2017 on information and documents concerning the founders and the management board of the bank to be submitted to the PFSA. During the candidate selection process, the Committee takes into account PKO Bank Hipoteczny SA's profile, scope and scale of operations. During the evaluation of a candidate, the Committee also verifies whether the candidate's experience and knowledge will strengthen the abilities of the other members of the Bank's Management Board, and

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complement them, so as to ensure the coverage of all areas managed in the Bank. The examination of this criterion is to ensure diversification in the selection of members of the managing body, its purposes, tasks and area of operation.

Before their appointment, all members of the Management Board of PKO Bank Hipoteczny SA were subjected to an evaluation of their suitability, in accordance with the EBA guidelines.

The Members of the Management Board are subject to continuous evaluation by the Supervisory Board's Remuneration and Nominations Committee and the Supervisory Board, beginning from the moment of recruitment and continuing through their entire term of office. In addition, pursuant to Article 395 § 2(3) of the Commercial Companies Code, each year the Ordinary General Shareholders' Meeting grants each individual member of the Management Board a vote of approval. The granting of this vote of approval constitutes an evaluation of the Management Board members, which is independent of the approval of the Bank's Directors' Report by the General Shareholders' Meeting.

The process described above for appointments to perform functions on the Management Board and the positive evaluation of members of the Bank's Management Board confirms the proper performance of their duties, based on adequate knowledge, abilities and experience, in accordance with the requirements of art. 22aa of the Banking Law.

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6.4. THE SUPERVISORY BOARD OF PKO BANK HIPOTECZNY SA

In 2019, the composition of the Supervisory Board of PKO Bank Hipoteczny SA was as follows:

	Position in the Supervisory Board	Appointment date	Dismissal/resignation date	qualifications in finance	Independent member ²³	Audit and Finance Committee	Risk Committee	Risk Committee Remuneration and Nomination Committee	Commercial Committee
Jakub Papierski	Chairman	06.10.2014		✓				CH	CH
Piotr Mazur	Deputy Chairman	06.10.2014	29.03.2019	✓			CH		D
Justyna Borkiewicz	Member	28.10.2016		✓			M		
Mieczysław Król	Member	28.10.2016	29.03.2019	✓			D	D	
Artur Kluczny	Member	18.10.2017	31.08.2019	✓	✓	CH			M
Piotr Kwiecień	Member	18.10.2017		✓	✓	M CH			M
Jan Emeryk Rościszewski	Member	18.10.2017	31.08.2019	✓					M
Rafał Kozłowski	Member Deputy Chairman	09.02.2018 30.03.2019	29.03.2019 31.08.2019	✓		D		D	M D
Paweł Metrycki	Member Deputy Chairman	30.03.2019 07.10.2019	06.10.2019	✓		D	CH		M
Ilona Wołyniec	Member	30.03.2019		✓			D	D	D
Lucyna Kopińska	Member	01.09.2019		✓					M
Jadwiga Lesisz	Member	01.09.2019		✓	✓	M			
Dariusz Odzioba	Member	01.09.2019		✓					

CH - Chairman of the Committee; D - Deputy Chairman of the Committee; M - Member of the Committee

The composition of the Committees is presented as at 31 December 2019.

Pursuant to Article 395 § 2 (3) of the Commercial Companies Code each year the Ordinary General Shareholders' Meeting grants a vote of approval to each individual member of the Supervisory Board. Granting this vote of

²³ In accordance with the Act on Registered Auditors, Registered Audit Companies and Public Oversight of 11 May 2017.

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approval constitutes an evaluation of the Supervisory Board members, independent of the approval of the Supervisory Board's report on the Bank's operations by the General Shareholders' Meeting. On 29 March 2019, by resolution of the Ordinary General Shareholders' Meeting, all members of the Bank's Supervisory Board received a vote of approval for the period ended 31 December 2018.

The process described above the positive evaluation of members of the Bank's Management Board confirms the proper performance of their duties, based on adequate knowledge, abilities and experience, in accordance with the requirements of Article 22aa of the Banking Law.

The Bank has a Policy on the Selection and Evaluation of Members of the Supervisory Board of PKO Bank Hipoteczny SA. The policy defines the criteria for suitability of the members of the Supervisory Board at the stage of their appointment and in the course of exercising their functions and governs the procedure for their evaluation. In accordance with this Policy, on 28 August 2019, the General Shareholders' Meeting evaluated the qualifications of a candidate for a member of the Supervisory Board.

INFORMATION ON THE AUDIT AND FINANCE COMMITTEE

In 2019, the composition of the Audit and Finance Committee of PKO Bank Hipoteczny SA was as follows:

	Position in the Audit and Finance Committee	Appointment date	Dismissal / resignation date	Independent member ²⁴	Accounting and auditing knowledge and skills	mortgage banking knowledge and skills
Artur Kluczny	Committee Chairman	20.10.2017	31.08.2019	✓		
Rafał Kozłowski	Committee Deputy Chairman	14.02.2018	31.08.2019		✓	✓
Piotr Kwiecień	Member of the Committee Chairman of the Committee	18.10.2017 07.10.2019		✓		
Paweł Metrycki	Committee Deputy Chairman	07.10.2019			✓	✓
Jadwiga Lesisz	Member of the Committee	07.10.2019		✓		

The Audit and Finance Committee met five times in 2019.

²⁴ In accordance with the Act on Registered Auditors, Registered Audit Companies and Public Oversight of 11 May 2017.

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6.5. REMUNERATION AND HUMAN RESOURCE MANAGEMENT POLICY

EMPLOYMENT LEVEL

As at 31 December 2019, 80 people were employed in PKO Bank Hipoteczny SA (79.75 FTEs). This means an increase of 13 employees compared with the end of 2018.

REMUNERATION POLICY

The Remuneration Policy of PKO Bank Hipoteczny SA, introduced by Order of the President of the Management Board, is the basic internal regulation in the remuneration policy. In accordance with the Order, Bank employees are entitled to the following remuneration components:

- basic salaries;
- bonuses and awards for special achievements in professional work;
- additional remuneration for working overtime and at night.

Basic salaries and additional benefits granted to employees are determined on the basis of an analysis of market remuneration in the banking sector. The remuneration policy of PKO Bank Hipoteczny SA is consistent with the principles of appropriate and effective risk management.

There is no employee share programme in place at the Bank.

BASIC SALARIES

The Bank assigns basic salaries in accordance with an internal system of salary levels. The levels are assigned based on an independent and objective scoring method. The positions are evaluated on an ongoing basis, in particular in the case of significant organizational changes at the Bank. The Bank engages specialist external entities to verify the adequacy of basic salaries by performing regular benchmark tests.

VARIABLE REMUNERATION

The Bank regulates the process of granting variable remuneration in the Rules and regulations for variable components of remuneration of persons holding managerial positions at the Bank, the Principles for employing and remunerating members of the Bank's Management Board and the Principles for granting bonuses to Bank employees.

The targets assigned are aimed at ensuring that the risk associated with the Bank's operations is taken into account. All targets result from target grids approved by the Bank's Management Board, which are cascaded down to the subordinates of the individual structures. MRT (Material Risk Takers) are additionally responsible for special projects aimed at executing the Bank's strategy.

MRTs, who have significant influence on the safety level and stable development of the Bank, are subject to additional remuneration restrictions. Variable remuneration components are granted to MRTs, including the Management Board members, for a particular appraisal year (calendar year) following the settlement of bonus targets in non-deferred and deferred form. In order to ensure that the results are sustainable, deferred variable remuneration components can be reduced if the Bank's financial results have deteriorated, the Bank incurred a loss or other variables deteriorated.

Moreover, half of the value of each component is payable in the form of a financial instrument linked to the carrying amount of the Bank's net assets. Bonus parametrization takes into account the Bank's situation and the market benchmarks of the financial sector. The Supervisory Board had rights to set bonus parameters for the Management

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Board (bonus indices, bonus adjustment indices, targets whose execution is rewarded with a bonus). The President of the Bank's Management Board had the same rights with respect to the MRTs and other employees.

In addition to the bonus system, an employee awards system functions in the Bank, as part of which an award fund is created, designated for individual discretionary awards for employees who achieve distinctive results in their professional work or for achievements as a result of which important outcomes are achieved for the Bank.

EMPLOYEE BENEFITS

EXTRA MEDICAL CARE	The Bank provides its employees with extra medical care (in addition to occupational medical care provided in accordance with the Labour Code). Different medical packages are assigned to specific job categories.
GROUP INSURANCE	The possibility of joining group insurance, which is paid for by the employees through the Bank.
MYBENEFIT CAFETERIA SYSTEM	Under this system, every employee of the Bank can manage the funds assigned to him/her from the Company Social Fund as he/she chooses.
EMPLOYEE PENSION SCHEME (PPE)	Possibility of joining the Employee pension scheme where the base premium is fully funded by the employer.

THE PRINCIPLES FOR REMUNERATING THE MANAGEMENT BOARD MEMBERS

On 23 August 2019 the Policy for employing and remunerating members of the Management Board of the Bank was adopted by Resolution of the Supervisory Board. Based on the said policy, the members of the Bank's Management Board are entitled to:

- fixed remuneration in the amount specified in the Supervisory Board resolution for each Management Board member separately;
- variable remuneration - additional remuneration granted and payable after the appraisal period, in particular in the form of bonuses, rewards for special achievements at work, severance pay (other than fixed remuneration and benefits granted based on the applicable laws).

The information on remuneration components and other benefits payable to Management Board members in the reporting period is presented in the financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2019 (Notes 37.3 and 37.4).

VARIABLE REMUNERATION COMPONENTS FOR MEMBERS OF THE MANAGEMENT BOARD AND MATERIAL RISK TAKERS (MRT)

In accordance with the requirements of CRD IV, i.e. Commission Delegated Regulation (EU) 604/2014 (as amended) supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile, as well as in connection with the Regulation of the Minister of Development and Finance of 6 March 2017 on the risk management system, the internal control system, the remuneration policy and detailed method of estimating internal capital in banks, the following policies and procedures laying down the principles of determining variable remuneration components are in force in the Bank:

- The Policy for employing and remunerating members of the Management Board of the Bank, adopted by Resolution of the Supervisory Board;

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- Principles of the remuneration policy concerning persons whose professional activities significantly affect the Bank's risk profile (MRT);
- The list of positions where professional activities have a significant impact on the institution's risk profile, adopted by Resolution of the Management Board (the MRT list);

The policy on variable remuneration components for Management Board members and MRTs as at 31 December 2019 was applicable to three Management Board members and 14 MRT positions.

Variable remuneration components are awarded for the purpose of achievement of objectives assigned as part of the Management by Objectives (MbO) system. Variable remuneration components for a given assessment period (a calendar year) are awarded after verification whether the objectives which entitle to a bonus have been met. The maximum amount of variable remuneration cannot exceed 50% of the fixed remuneration for a given assessment period.

Variable remuneration is awarded and paid in the following forms:

- in a non-deferred form – 60% of variable remuneration (in the first year after the assessment period);
- in a deferred form – 40% of variable remuneration (in equal instalments over the next three years after the first year following the assessment period).

Both non-deferred and deferred remuneration is granted in equal parts in cash and in the form of financial instruments (i.e. phantom shares) converted to cash after the retention period, and in the case of deferred remuneration – after the period of deferral).

Each of the accrued components of variable remuneration may be reduced as a consequence of:

- inadequate performance of the assigned professional duties;
- material non-compliance with the legal regulations;
- participation in activities which result in significant losses for the Bank or liability for such activities;
- violations of appropriate standards relating to the warranty of stable and prudent management of the Bank;
- material behaviours in respect of other employees and collaborators who violate the principles of community life.

For members of the Management Board, variable remuneration may only be assigned and paid provided that the Directors' Report and the financial statements for the previous financial year have been approved and the Management Board member has been granted a discharge in respect of his/her duties. Variable remuneration may be reduced by the Supervisory Board up to total deprivation of the right to such remuneration in the event that up to the date of payment (in particular within the last three years) a member of the Management Board was responsible for:

- a material violation of the duties following from the contract for services;
- inadequate performance of the professional duties assigned;
- material non-compliance with the legal regulations or customer service standards;
- participation in activities which resulted in significant losses for the Bank or liability for such activities;
- violations of appropriate standards relating to the warranty of stable and prudent management of the Bank;
- material behaviours in respect of the Bank's other employees and collaborators who violate the principles of community life.

A member of the Management Board is entitled to severance pay as a result of termination of his/her contract for services if he/she ceases to perform the functions of a Management Board member, in an amount equal to three times the permanent portion of remuneration on condition that the function of Management Board member was performed for at least twelve months before the termination of the contract; the period of performing a function on the Management Board includes a period of constant performance of the function directly before the date of

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concluding the management contract. A member of the Management Board is entitled to compensation in respect of the ban to engage in competitive activities over a period of six months after termination of the management contract, in the amount of 100% of the fixed portion of remuneration for providing managerial services, following from the contract for services, as at the date of its termination. A member of the Management Board is entitled to contributions to the Employee Pension Fund over a period of performing the duties of member of the Management Board, which are included in the fixed and variable components of remuneration and which are not included in the variable remuneration – if the bank is engaged in the Employee Pension Fund scheme; the amount of the contributions is the same as for the Bank's employees.

In 2019, none of the employees at PKO Bank Hipoteczny SA received total remuneration of at least EUR 1 million.

The policy on variable remuneration components for members of the Management Board and material risk takers is reviewed annually by the Internal Audit Office, the Remuneration and Nominations Committee of the Bank's Supervisory Board and by the Supervisory Board of PKO Bank Hipoteczny SA.

In the reporting period, 5 meetings of the Remuneration and Nomination Committee of the Supervisory Board of PKO Bank Hipoteczny SA were held.

AGREEMENTS BETWEEN THE BANK AND PERSONS HOLDING MANAGERIAL POSITIONS

According to the understanding of the provisions of § 2 (1) (30)(a) of the Regulation of the Minister of Finance of 29 March 2018 on current and periodical information to be reported by issuers of securities and the conditions for treating information required by the laws of a state other than a member state as equivalent, the persons managing the Bank are the Management Board members.

In 2019 each of the members of the Bank's Management Board performed their functions based on the contracts for providing management services concluded with the Bank, which determined – among other things – the terms and conditions relating to remuneration and the ban on performing competitive activities.

6.6. BENEFITS FOR THE KEY MANAGEMENT OF PKO BANK HIPOTECZNY SA

BENEFITS OF MEMBERS OF THE SUPERVISORY BOARD

In accordance with the Principles of remuneration for the Bank's Supervisory Board adopted by the General Shareholders' Meeting on 18 October 2017, updated on 5 July 2018, the members of the Supervisory Board of PKO Bank Hipoteczny SA do not receive remuneration for the functions performed. Independent members of the Supervisory Board are an exception; they receive monthly remuneration equal to the average monthly remuneration in the enterprise sector, without payments out of profit in the fourth quarter of 2016, announced by the President of the Central Statistical Office. The remuneration is increased by 10% if an independent member of the Supervisory Board participates in at least one standing committee of the Supervisory Board.

Benefits for independent members of the Supervisory Board (PLN'000)	01.01.2019 – 31.12.2019	01.01.2018 – 31.12.2018
Artur Kluczny	44	60
Piotr Kwiecień	49	60
Jadwiga Lesisz	15	-
Total	118	120

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BENEFITS FOR MEMBERS OF THE MANAGEMENT BOARD RECEIVED, RECEIVABLE AND POTENTIALLY RECEIVABLE

BENEFITS FOR MEMBERS OF THE MANAGEMENT BOARD	01.01.2019 - 31.12.2019					
	Short-term employee benefits		Other long-term benefits – variable remuneration in cash ²⁵		Share-based payments settled in cash	
	Remuneration 01.01.2019-31.12.2019 ²⁶	Other received 01.01.2019-31.12.2019	Received 01.01.2019-31.12.2019	Potentially receivable as at 31.12.2019	Received 01.01.2019-31.12.2019	Potentially receivable as at 31.12.2019
Paulina Strugała	613	65	-	43	-	108
Piotr Kochanek ²⁷	472	-	-	-	-	-
Agnieszka Krawczyk	478	71	-	47	-	119
Jakub Niesłuchowski	86	75	73	137	228	207
Members of the Management Board who have not performed their functions in 2019	-	70	161	246	507	306
Total benefits for members of the Management Board	1 649	281	234	473	735	740

BENEFITS FOR MEMBERS OF THE MANAGEMENT BOARD	01.01.2018 - 31.12.2018					
	Short-term employee benefits		Other long-term benefits – variable remuneration in cash		Share-based payments settled in cash	
	Remuneration 01.01.2018-31.12.2018 ²⁶	Other received 01.01.2018-31.12.2018	Received 01.01.2018-31.12.2018	Potentially receivable as at 31.12.2018	Received 01.01.2018-31.12.2018	Potentially receivable as at 31.12.2018
Paulina Strugała	434	-	-	-	-	-
Agnieszka Krawczyk	475	-	-	-	-	-
Jakub Niesłuchowski	517	188	42	92	160	213
Marek Szcześniak	468	190	39	93	170	216
Members of the Management Board who have not performed their functions in 2018	-	219	53	112	210	260
Total benefits for members of the Management Board	1 894	597	134	297	540	689

BENEFITS AFTER THE TERM OF THE CONTRACT FOR SERVICES

Both in the period from 1 January to 31 December 2019, and in the period from 1 January to 31 December 2018 no post-employment benefits were paid to members of the Management Board.

²⁵ The benefits comprise base salaries, additional payments for medical care and the Company Social Fund.

²⁶ Deferred component of variable remuneration (in cash).

²⁷ The values presented relate to the period of performing the function of member of the Management Board, i.e. values resulting from previous performance of functions of MRT ("Material Risk Taker") of a person who has not been member of the Management Board have not been included.

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BENEFITS IN RESPECT OF THE TERMINATION OF THE CONTRACT FOR SERVICES

In the period from 1 January to 31 December 2019 a benefit in respect of the termination of the contract for services was granted to Mr Marek Szcześniak of PLN 129 thousand, of which PLN 39 thousand was paid in the reporting period, of which PLN 39 thousand was paid in the reporting period. The remaining part will be paid in subsequent periods, in accordance with the principles for payment of variable remuneration components. In the period from 1 January to 31 December 2018 no benefits were paid in respect of terminating the employment relationship.

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7. CORPORATE GOVERNANCE AND INFORMATION FOR INVESTORS

Representation on compliance with the rules for corporate governance Entity authorized to audit financial statements Other information
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7.1. REPRESENTATION ON COMPLIANCE WITH THE RULES FOR CORPORATE GOVERNANCE

The Bank has adopted the Principles of Corporate Governance for Supervised Institutions, as issued by the PFSA, on the basis of the following decisions by the Bank's bodies:

- the Resolutions of the Bank's Management Board of 15 December 2014 – in relation to the powers and duties of the Management Board, i.e. conducting the Bank's affairs and its representation, in accordance with the generally applicable laws and the Bank's Articles of Association;
- the Resolutions of the Supervisory Board of 18 December 2014 – in relation to the powers and duties of the Supervisory Board, i.e. supervising the conduct of the Bank's affairs, in accordance with the generally applicable laws and the Bank's Articles of Association;
- the Resolutions of the General Shareholders' Meeting of 22 December 2015 – in relation to the powers reserved for the General Shareholders' Meeting.

Pursuant to and to the extent arising from the aforementioned decisions, the Bank opted out of the following provisions of the Principles of Corporate Governance for Supervised Institutions:

- the provisions referring to the principles of cooperation and rights of multiple shareholders (§ 8 (4), § 9 (1) and (6), § 10 (3), § 11 (3) and § 31 (3), which are not applicable due to the fact that the Bank has only one shareholder;
- chapter 9, concerning the management of assets at the customer's risk, because the Bank does not conduct operations in this area;
- the principle specified in § 22 (1), concerning the independence of Supervisory Board members, manifesting itself primarily in the lack of direct and indirect links to the supervised institution, members of the management and supervisory bodies, significant shareholders and related parties; in addition, on 18 October 2017 two members meeting the independence requirements set out in the Act of 11 May 2017 on statutory auditors, audit firms and public oversight were appointed members of the Bank's Supervisory Board. (Journal of Laws, item 1089 as amended).

In accordance with the requirement arising from § 27 of the Principles of Corporate Governance for Supervised Institutions, on 24 June 2019, the Supervisory Board evaluated the application of the said Principles in the Bank in 2018. The Supervisory Board positively evaluated the application of the Principles in the Bank confirming that the Principles adopted by the Bank and its authorities were applied adequately to the scale, nature of operations and the specific character of the Bank.

The text of the Principles is available on the website of the PFSA:

https://www.knf.gov.pl/knf/pl/komponenty/img/knf_140904_Zasady_ladu_korporacyjnego_22072014_38575.pdf

DIVERSITY POLICY

Diversity management at the Bank concerns all employees, the Bank's authorities and key managers. Diversity activities affect many aspects of the Bank's operations and are aimed at respecting other persons, equal treatment of the employees and making use of their potential. Diversity means that people are important regardless of their

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gender, age, health, sexual orientation, religion, marital status or country of origin. Therefore, the following solutions were implemented in the form of regulations, processes and HR policies:

- The Code of Ethics and the Rules and regulations of the Bank's operations concerning, among other things, preventing discrimination due to gender, age, disability, race, religion, nationality, political views, trade union membership, ethnicity, religion or sexual orientation, as well as due to employment for a specified or unspecified period or full- or part-time;
- When conducting recruitment projects, the Bank observes the principles of equal treatment during the hiring process and at work. The processes of selecting candidates are based on the principles of objectivity, and their individual stages follow the established patterns and principles.
- The Bank employs students and graduates from different types of universities and offers them development opportunities.
- Employee appraisal is performed every year based on a competence model, which covers general, leadership and job-specific competencies. As part of the periodic performance appraisal system, every employee determines his or her individual development plan during the interview with his/her superior.

DIVERSITY POLICY CONCERNING THE MANAGEMENT AND SUPERVISORY STAFF AS AT 31 DECEMBER 2019

Diversity management also concerns the PKO Bank Hipoteczny SA Supervisory Board and Management Board members and the key managers. The management and supervisory staff includes persons of different gender, age and experience.

Gender	Women	Men
Supervisory Board	4	4
Management Board	2	1
Key managers	8	6

Age	30 – 40 years	41 – 50 years	51 – 60 years	more than 60
Supervisory Board	-	5	3	-
Management Board	1	2	-	-
Key managers	5	9	-	-

Period of employment with PKO Bank Hipoteczny SA	Up to 1 year	1 – 5 years
Supervisory Board	5	3
Management Board	0	3
Key managers	3	11

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MAIN CHARACTERISTICS OF THE INTERNAL CONTROL SYSTEM IN RELATION TO THE PROCESS OF PREPARING THE FINANCIAL STATEMENTS

To ensure the reliability and accuracy of the financial reporting process, the Bank introduced a number of control mechanisms included in the reporting system and the internal regulation of this process. Such mechanisms involve, among other things, continued verification and reconciliation of reporting data with the books of account, subsidiary ledgers and other documents which provide the basis for the preparation of the financial statements.

The process of preparing the financial statements is verified regularly, in particular with regard to arithmetical correctness, technical analysis and reliability of information. In accordance with the internal regulations, the financial statements are approved by the Management Board of PKO Bank Hipoteczny SA and are subject to review by the Audit and Finance Committee appointed by the Supervisory Board of PKO Bank Hipoteczny SA. The annual and interim financial statements for the first half of the year are additionally assessed by the Supervisory Board of PKO Bank Hipoteczny SA.

The Director of the Finance and Accounting Office is responsible for ensuring compliance with controls with regard to financial reporting, while the internal audit function reviews and independently evaluates the adequacy and effectiveness of controls over the financial reporting processes and evaluates risk management in these processes, in accordance with the approved internal audit plans. No issues which would cast doubt on the reliability of the financial reporting have been observed so far as part of the internal audit operations.

LIST OF DIRECT OR INDIRECT HOLDERS OF SIGNIFICANT BLOCKS OF SHARES WITH AN INDICATION OF THE NUMBER OF SHARES HELD AND THE NUMBER OF VOTES CARRIED BY THESE SHARES

As at 31 December 2019, the share capital of PKO Bank Hipoteczny SA amounted to PLN 1,611.3 million and comprised 1,611,300,000 shares with PLN 1.00 par value. The shares are paid up in full. The share capital increased by PLN 316.3 million in relation to the end of 2018. The PKO Bank Hipoteczny SA shares are non-preference shares. The holders of PKO Bank Hipoteczny SA shares do not have any special control rights due to holding such shares. 100% of the shares of PKO Bank Hipoteczny SA are held by Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna.

Structure of the share capital of PKO Bank Hipoteczny SA:

Series	Type of shares	Number of shares	Nominal value of one share	Number of votes at the GSM	Amount paid in for the shares
A	Ordinary registered shares	300,000,000	PLN 1	300,000,000	PLN 300,000,000.00
B	Ordinary registered shares	200,000,000	PLN 1	200,000,000	PLN 200,000,000.00
C	Ordinary registered shares	200,000,000	PLN 1	200,000,000	PLN 200,000,000.00
D	Ordinary registered shares	100,000,000	PLN 1	100,000,000	PLN 100,000,000.00
E	Ordinary registered shares	150,000,000	PLN 1	150,000,000	PLN 150,000,000.00
F	Ordinary registered shares	150,000,000	PLN 1	150,000,000	PLN 150,000,000.00
G	Ordinary registered shares	100,000,000	PLN 1	100,000,000	PLN 100,000,000.00
H	Ordinary registered shares	95,000,000	PLN 1	95,000,000	PLN 95,000,000.00

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I	Ordinary registered shares	100,000,000	PLN 1	100,000,000	PLN 100,000,000.00
J	Ordinary registered shares	131,500,000	PLN 1	131,500,000	PLN 131,500,000.00
K	Ordinary registered shares	84,800,000	PLN 1	84,800,000	PLN 84,800,000.00
	TOTAL	1,611,300,000		1,611,300,000	PLN 1,611,300,000.00

Shareholder	31.12.2019		31.12.2018	
	Number of shares	Share in the number of votes at the GSM	Number of shares	Share in the number of votes at the GSM
Powszechna Kasa Oszczędności Bank Polski SA	1,611,300,000	100%	1,295,000,000	100%

DESCRIPTION OF THE RULES FOR APPOINTING AND DISMISSING MANAGERS

Members of the Management Board are appointed and dismissed by resolution of the Supervisory Board. When appointing Management Board members, the Supervisory Board determines the number of members. The appointment of two members of the Management Board, including the President and the member responsible for risk, requires the consent of the Polish Financial Supervision Authority. The terms of office of members of the Management Board expire on the date when the General Shareholders' Meeting approves the financial statements for the last full financial year during which a member served, at the latest. Furthermore, the term of office of a Management Board member also expires as a result of his/her death, resignation or dismissal from the Management Board, as of the date of the event causing the expiration, unless the resolution on dismissal provides a different date of expiration. Management Board members may be dismissed before the end of their term of office at any time.

The Supervisory Board notifies the Polish Financial Supervision Authority of the composition of the Management Board and of any changes in the composition thereof immediately after its appointment or after any changes in the composition thereof. The Supervisory Board also notifies the Polish Financial Supervision Authority of the members of the Management Board who, as a result of the segregation of duties, shall be in charge of the risk management and the internal audit unit. The Supervisory Board notifies the PFSA of the intention to dismiss, and the reasons for dismissal of a member of the Management Board who, as a result of the segregation of duties, is in charge of risk management and the internal audit unit, immediately after the relevant item has been placed on the agenda of the Supervisory Board meeting.

Additional information on the powers of management are provided in Chapter 6, *Structure and Governing Bodies of PKO Bank Hipoteczny SA*.

DESCRIPTION OF AUTHORIZATIONS TO DECIDE ON SHARE ISSUES OR REDEMPTIONS

The powers of the General Shareholders' Meeting include adopting resolutions on establishing the share redemption method and the level of compensation for redeemed shares, approving the acquisition of the Bank's treasury shares for redemption, and approving the issue of bonds convertible into shares or other instruments giving the right to purchase or take up shares in the Bank.

INDICATION OF ANY LIMITATIONS ON THE TRANSFER OF OWNERSHIP RIGHTS TO THE ISSUER'S SECURITIES

There are no limitations to the transfer of ownership rights to the issuer's securities.

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PRINCIPLES FOR AMENDING THE BANK'S ARTICLES OF ASSOCIATION

Amendments to the Bank's Articles of Association require a resolution of the General Shareholders' Meeting and must be entered in the Business Register of the National Court Register. To the extent specified in Article 34 (2) of the Banking Law, an amendment to the Articles of Association requires the consent of the Polish Financial Supervision Authority.

COMPOSITION AND CHANGES DURING THE LAST FINANCIAL YEAR, AND A DESCRIPTION OF THE OPERATIONS OF THE MANAGEMENT, SUPERVISORY AND ADMINISTRATIVE BODIES OF THE ISSUER AND OF THEIR COMMITTEES

Information concerning the description of the management, supervisory and administrative bodies of the issuer, their committees and their composition and changes during the last financial year is presented in Section 6, *Structure and Governing Bodies of PKO Bank Hipoteczny SA*.

THE GENERAL SHAREHOLDERS' MEETING AND RELATIONS WITH SHAREHOLDERS

The method of operation of the General Shareholders' Meeting and its key powers as well as a description of the shareholder rights and the method of their execution follow directly from the applicable laws and the Bank's Articles of Association. In consideration of the fact that all shares in the Bank's share capital are held by a single shareholder, i.e. PKO Bank Polski SA, the resolutions of the General Shareholders' Meeting are adopted without formally convening a General Shareholders' Meeting, in accordance with the principles arising from Article 405 of the Polish Commercial Companies Code.

7.2. ENTITY AUTHORIZED TO AUDIT FINANCIAL STATEMENTS

On 3 March 2017 the Supervisory Board of PKO Bank Hipoteczny SA, based on the recommendation of the Audit and Finance Committee of the Supervisory Board that complied with all the binding conditions, selected KPMG Audyt Spółka z ograniczoną odpowiedzialnością sp.k. as the entity authorized to audit and review the Bank's financial statements for the years 2017-2019.

KPMG Audyt Spółka z ograniczoną odpowiedzialnością sp. k. with its registered office in Warsaw, ul. Inflancka 4A ("KPMG") is entered on the list of entities authorized to audit financial statements maintained by the Polish Chamber of Statutory Auditors, with the number 3546. The Bank's Supervisory Board appointed the auditor authorized to audit and review financial statements in accordance with the applicable laws and occupational standards, on the basis of § 18(1)(4) of the Bank's Articles of Association.

On 19 June 2017, an agreement was signed by and between PKO Bank Hipoteczny SA and KPMG for the performance of an audit of the financial statements for the years ended 31 December 2017, 2018 and 2019, respectively, and on a review of the financial statements for the periods ended 30 June 2017, 2018 and 2019, respectively.

The following table presents the services provided by KPMG and the fees for such services:

Net fee of KPMG (PLN'000)	2019	2018
Audit of the financial statements	132.5	132.5
Review of the financial statements, audit and review of group packages	105.3	105.3
Other assurance services - attestation letters	250.0	250.0

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In 2019, the audit firm KPMG provided the Bank with permitted services other than audit, which related to the issue of attestation letters. The Audit and Finance Committee of the Bank's Supervisory Board assessed the audit firm's independence and approved the provision of such services.

In accordance with the policy for selecting an audit firm to perform an audit of the Bank's financial statements, the Supervisory Board conducts an open tender procedure to commission an audit of the financial statements. The Audit and Finance Committee of the Bank's Supervisory Board makes a recommendation concerning the selection of the audit firm to the Supervisory Board. Unless it concerns renewing an existing audit contract, the recommendation contains at least two suggestions with justifications, and indicates the preferred firm. The Bank's Supervisory Board selects an audit firm based on the recommendation of the Audit and Finance Committee of the Bank's Supervisory Board. The offers made by audit firms are assessed based on transparent and non-discriminatory selection criteria.

In accordance with the policy for providing the Bank with permitted non-audit services by the audit firm conducting the audit, its related entities and members of its network, the provision of non-audit services by the audit firm conducting the audit, its related entities and members of its network to the Bank requires the approval of the Audit and Finance Committee of the Bank's Supervisory Board and the approval of the Audit Committee of the Supervisory Board of PKO Bank Polski SA.

In accordance with the provisions of the Policy and Procedures for selecting the audit firm to audit the financial statements of the Bank, on 27 February 2019 the Supervisory Board of PKO Bank Hipoteczny SA, based on § 18 (1)(4) of the Bank's Articles of Association and in accordance with the recommendation of the Audit and Finance Committee of the Supervisory Board, selected PricewaterhouseCoopers Polska spółka z ograniczoną odpowiedzialnością Audyt sp. k. as the audit firm to audit and review the Bank's financial statements for the years 2020–2021. PricewaterhouseCoopers Polska spółka z ograniczoną odpowiedzialnością Audyt sp. k. with its registered office in Warsaw, ul. Polna 11 (PwC) is entered on the list of entities authorized to audit financial statements maintained by the Polish Council of Statutory Auditors, with the number 144.

On 26 April 2019, an agreement was signed by and between PKO Bank Hipoteczny SA and PwC to carry out an audit and review of the financial statements and the consolidation package of the Bank in the years 2020–2021.

7.3. OTHER INFORMATION

CHANGES IN THE HOLDING OF SHARES AND RIGHTS TO SHARES IN PKO BANK HIPOTECZNY SA BY INDIVIDUALS IN MANAGEMENT AND SUPERVISORY ROLES

In 2019 there were no changes in the holdings of shares and rights to shares of PKO Bank Hipoteczny SA by individuals in management and supervisory roles. 100% of the shares are held by PKO Bank Polski SA.

EVALUATION OF PKO BANK HIPOTECZNY SA'S FINANCIAL CREDIBILITY

On 27 March 2015, the Bank requested the rating agency Moody's Investors Service ("Moody's") to assign ratings to the Bank and to mortgage covered bonds issued by PKO Bank Hipoteczny SA.

On 7 September 2015, Moody's assigned Baa1/P-2 long- and short-term issuer ratings to PKO Bank Hipoteczny SA, with a stable outlook. On 19 December 2017, Moody's announced that the ratings had been maintained.

On 8 September 2015, Moody's assigned a long-term (P) rating (a provisional rating) of Aa3 to PKO Bank Hipoteczny SA's PLN-denominated mortgage covered bonds. This rating was confirmed by the agency on 11 December 2015, i.e. immediately after PKO Bank Hipoteczny SA conducted its first issue of mortgage covered bonds. The rating has been maintained for all issues of PLN-denominated mortgage covered bonds of PKO Bank Hipoteczny SA.

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On 26 September 2016, Moody's assigned a long-term (P) rating (a provisional rating) of Aa3 to PKO Bank Hipoteczny SA's PLN-denominated mortgage covered bonds. This rating was confirmed by the agency on 24 October 2016, i.e. immediately after PKO Bank Hipoteczny SA conducted its first issue of EUR-denominated mortgage covered bonds. The rating has been maintained for all issues of EUR-denominated mortgage covered bonds of PKO Bank Hipoteczny SA.

The rating assigned to the mortgage covered bonds of PKO Bank Hipoteczny SA is the highest rating achievable for Polish securities. The limit for the ratings is the Polish country ceiling for debt instruments, which currently is at the level of Aa3.

On 18 June 2018, Moody's Investors Service assigned new counterparty risk ratings (CRR) to the Bank. The long-term counterparty risk rating was set at A3, and the short-term counterparty risk rating – at P-2. At the same time, new ratings were assigned to 32 other banks in Central and Eastern Europe. The new ratings were assigned in connection with the updating of the bank's rating methodology by the agency in June 2018.

Counterparty risk ratings reflect an entity's ability to settle an unsecured portion of the counterparty's financial liabilities not related to a debt (CRR liabilities) and the expected financial losses in the case of failing to settle such liabilities.

SIGNIFICANT AND MATERIAL AGREEMENTS WITH THE CENTRAL BANK OR SUPERVISORY BODIES

In 2019 PKO Bank Hipoteczny SA did not conclude any significant or material agreements with the Central Bank or with supervisory bodies.

FINANCIAL LIABILITIES AND GUARANTEES GRANTED

In 2019 PKO Bank Hipoteczny SA did not issue any guarantees.

Financial liabilities under residential mortgage loans granted and not disbursed as at 31 December 2019 stood at PLN 482.7 million, down by PLN 236.5 million compared to 31 December 2018.

OFF-BALANCE-SHEET LIABILITIES TO RELATED PARTIES

In 2019, PKO Bank Hipoteczny SA did not grant any off-balance sheet liabilities to related parties.

LOANS TAKEN OUT AND LOAN AND GUARANTEE AGREEMENTS UNRELATED TO THE BANK'S OPERATIONS

In 2019, Bank Hipoteczny SA did not take out any loans or enter into any loan or guarantee agreements unrelated to the Bank's operations.

UNDERWRITING AGREEMENTS AND GUARANTEES GRANTED TO SUBSIDIARIES

On 31 May 2019, PKO Bank Hipoteczny SA signed a programme agreement with PKO Bank Polski SA (also acting through its Branch – the Brokerage House of PKO Bank Polski in Warsaw) in which it engaged the Brokerage House of PKO Bank Polski SA to act as its underwriter.

In 2019, PKO Bank Hipoteczny SA did not grant any guarantees to its subsidiaries.

IDENTIFICATION OF PENDING PROCEEDINGS BEFORE COURTS, ARBITRATION BODIES OR PUBLIC ADMINISTRATION AUTHORITIES

As at 31 December 2019, no proceedings were underway before courts, arbitration bodies or public administration authorities concerning liabilities or receivables whose value constituted at least 10% of PKO Bank Hipoteczny SA's equity.

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FACTORS WHICH WILL INFLUENCE FUTURE FINANCIAL PERFORMANCE OVER THE HORIZON OF AT LEAST ONE QUARTER

Among the significant factors and threats which may affect the Bank's results over the following quarter, the following should be mentioned:

- expected moderate slow-down of the global economy,
- the development of the residential market in Poland,
- the conditions on the residential mortgage loans market in Poland,
- legislative changes, including adjustments to Recommendation S, changes to BRRD (MREL),
- the possibility and timing of further transfers of portions of the portfolio of residential mortgage loans which had been granted by PKO Bank Polski SA to the Bank,
- the situation on the domestic and foreign mortgage covered bonds markets,
- investor demand for mortgage covered bonds issued by the Bank.

INFORMATION ON LOAN GUARANTEES OR OTHER GUARANTEES ISSUED BY THE BANK OR ITS SUBSIDIARY – IN AGGREGATE TO A SINGLE ENTITY OR ITS SUBSIDIARY, IF THE TOTAL AMOUNT OF THE EXISTING GUARANTEES IS EQUIVALENT TO AT LEAST 10% OF THE ISSUER'S EQUITY

In 2019 PKO Bank Hipoteczny SA did not grant any loan or credit guarantees to a single entity or a subsidiary of such an entity with a total value equivalent to at least 10% of the Bank's equity.

INFORMATION ON AGREEMENTS FOR LOANS AND ADVANCES CONCLUDED AND TERMINATED DURING A FINANCIAL YEAR

On 28 May 2019, PKO Bank Hipoteczny SA concluded a revolving loan agreement with an external financial institution of up to PLN 150 million until 12 June 2020. The loan was granted for the financing of the Bank's current activities. In accordance with the agreement, it was used on 10 June 2019 to repay a loan granted by the same external financial institution on 5 June 2017.

On 18 June 2019, PKO Bank Hipoteczny SA and PKO Bank Polski SA concluded annex no. 9 to the agreement on the revolving current account overdraft of 29 October 2015 increasing the limit from PLN 1,500 million to PLN 2,000 million and extending the financing period by three years, i.e. until 29 October 2022.

On 10 July 2019, the Bank concluded a current account revolving facility agreement with PKO Bank Polski SA, with a limit of PLN 1 billion for a period of three years. The loan is earmarked for servicing the redemption of bonds issued under the Non-Public Programme. The Bank acquired the funding in connection with the duty to register and settle all non-public issues of securities through the National Depository of Securities binding as of 1 July 2019. In effect, it is impossible to redeem and receive funds from a new issue (roll-over) on the same day.

On 18 December 2019, PKO Bank Hipoteczny SA and PKO Bank Polski SA concluded annex no. 1 to the agreement referred to above of 10 July 2019, increasing the limit from PLN 1,000 million to PLN 2,500 million as of 1 January 2020. At the same time, the funds from the loan may also be used for repayment of deferred liabilities on the purchase of receivables portfolios and for handling the redemption of mortgage covered bonds. As at 31 December 2019, PLN 1 billion of the facility was available.

On 18 December 2019, PKO Bank Hipoteczny SA and PKO Bank Polski SA concluded annex no. 9 to the agreement on the revolving current account overdraft facility of 2 February 2017 increasing the limit from PLN 1,500 million to PLN 2,000 million as of 3 February 2020, and extending the financing period until 3 February 2023. On 27 December 2018, PKO Bank Hipoteczny SA concluded a medium-term non-revolving loan agreement with an external financial institution for PLN 100 million for a period of 2 years.

Moreover, as at 31 December 2019 the Bank had a liability arising from acquired receivables of PLN 2,278.8 million resulting from the receivables portfolios acquired from PKO Bank Polski SA pertaining to residential mortgage loans, described in Note 26 to the financial statements. The maturity date of the liability resulting from the purchase of

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receivables is agreed each time by the parties in the Receivables Sales Agreement. For receivables purchased in 2019, the parties agreed that payment would be made no later than within 18 months from the transfer date. In the case of failing to settle the liability within one month from the transfer date, the price shall be increased by interest.

INFORMATION ON TRANSACTION(S) WITH RELATED PARTIES CONCLUDED BY THE ISSUER OR ITS SUBSIDIARY, IF MATERIAL AND NOT CONCLUDED ON AN ARM'S LENGTH BASIS

PKO Bank Polski SA and PKO Bank Polski SA Group entities are the Bank's related parties.

In 2019 PKO Bank Hipoteczny SA did not conclude any significant non-arm's length transactions with related parties.

INFORMATION ON CHANGES IN THE KEY PRINCIPLES OF MANAGING THE BANK'S ENTERPRISE

In 2019 there were no changes in the key principles of managing the Bank's enterprise in PKO Bank Hipoteczny SA.

FINANCIAL SUPPORT AGREEMENTS

PKO Bank Hipoteczny SA did not conclude financial support agreements with other entities subject to consolidated supervision operating within the same Group, or with closely related parties.

DEPOSITS AND GUARANTEES, AND SURETIES ISSUED

PKO Bank Hipoteczny SA does not accept any deposits and does not grant any guarantees or sureties.

INFORMATION ON THE VALUE OF SECURITY ESTABLISHED ON THE ACCOUNTS OR ASSETS OF BORROWERS

In 2019, PKO Bank Hipoteczny SA did not set up any security on the borrowers' accounts.

The value of collateral in respect of residential mortgage loans secured with real estate as at 31 December 2019 amounted to PLN 54.8 billion.

SUBSEQUENT EVENTS

In the period from 1 January 2020 to the date of signing this report no subsequent events occurred.

This document is a translation of a document originally issued in Polish. The only binding version is the original Polish version.

**PKO BANK HIPOTECZNY SA DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2019**

8. STATEMENT OF THE MANAGEMENT BOARD OF PKO BANK HIPOTECZNY SA

The Management Board of PKO Bank Hipoteczny SA declares that, to the best of their knowledge:

- the financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2019 have been prepared in accordance with the applicable accounting policies and give a true, fair and clear view of the financial position of PKO Bank Hipoteczny SA and of the result of its operations;
- the PKO Bank Hipoteczny SA Directors' Report for the year ended 31 December 2019 gives a true view of the development and achievements as well as of the position of PKO Bank Hipoteczny SA, including a description of the key risks and threats.

The Management Board of PKO Bank Hipoteczny SA declares that the entity authorized to audit the financial statements which conducted the audit of the financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2019 was selected in compliance with applicable law and that both the entity and the statutory auditor who conducted the audit fulfilled all the criteria for providing an unbiased and independent audit opinion on the financial statements, in compliance with applicable law and professional standards.

This PKO Bank Hipoteczny SA Directors' Report for the year ended 31 December 2019 comprises 56 sequentially numbered pages.

Signatures of all Members of the Bank's Management Board

7 February 2020	Paulina Strugała	President of the Management Board	<i>Signed on the Polish original</i> (signature)
7 February 2020	Piotr Kochanek	Vice President of the Management Board	<i>Signed on the Polish original</i> (signature)
7 February 2020	Agnieszka Krawczyk	Vice President of the Management Board	<i>Signed on the Polish original</i> (signature)