Bank Hipoteczny

SELECTED FINANCIAL DATA RELATING TO THE FINANCIAL STATEMENTS

Bank Hipoteczny

SELECTED FINANCIAL DATA	in PLN'000		in EUR'000	
	period from 01.01.2018 to 31.12.2018	period from 01.01.2017 to 31.12.2017	period from 01.01.2018 to 31.12.2018	period from 01.01.2017 to 31.12.2017
Net interest income	249,486	151,237	58,470	35,630
Net fee and commission income	(4,785)	(4,556)	(1,121)	(1,074)
Operating profit	122,215	71,395	28,642	16,820
Profit before income tax	**122,215**	**71,395**	**28,642**	**16,820**
Net profit	**85,849**	**51,419**	**20,120**	**12,114**
Earnings per share – basic (in PLN/EUR)	**0.07**	**0.05**	**0.02**	**0.01**
Earnings per share – diluted (in PLN/EUR)	**0.07**	**0.05**	**0.02**	**0.01**
Total net comprehensive income	**178,630**	**40,488**	**41,864**	**9,538**
Net cash used in operating activities	(4,966,322)	(8,069,444)	(1,163,914)	(1,901,063)
Net cash used in investing activities	5,436	(615,796)	1,274	(145,074)
Net cash used in financing activities	4,955,003	8,662,124	1,161,261	2,040,691
Total net cash flows	**(5,883)**	**(23,116)**	**(1,379)**	**(5,446)**

SELECTED FINANCIAL DATA	in PLN'000		in EUR'000	
	as at 31.12.2018	as at 31.12.2017	as at 31.12.2018	as at 31.12.2017
Total assets	22,103,134	16,902,594	5,140,264	4,052,505
Total equity	1,487,883	1,221,778	346,019	292,929
Share capital	1,295,000	1,200,000	301,163	287,708
Number of shares (in thousand)	1,295,000	1,200,000	1,295,000	1,200,000
Book value per share (in PLN/EUR)	1.15	1.02	0.27	0.24
Diluted number of shares (in thousand)	1,295,000	1,200,000	1,295,000	1,200,000
Diluted book value per share (in PLN/EUR)	1.15	1.02	0.27	0.24
Total capital ratio (TCR)	15.2%	15.2%	15.2%	15.2%
Common equity Tier 1 (CET1)	1,393,847	1,194,623	324,150	286,418
Total own funds	1,393,847	1,194,623	324,150	286,418

Selected financial statement items have been translated to EUR according to the following foreign exchange rates	31.12.2018	31.12.2017
items of the income statement, statement of comprehensive income and statement of cash flows items – the rate is calculated as the average of the NBP exchange rates prevailing as at the last day of each month of the reporting period	4.2669	4.2447
items of the statement of financial position – the average NBP exchange rate as at the last day of the reporting period	4.3000	4.1709

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

Bank Hipoteczny

Financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2018

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INCOME STATEMENT

INCOME STATEMENT	Note	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Interest income, including:	6	667,595	410,494
Interest income recognized under the effective interest rate method		666,411	409,657
Income similar to interest income on instruments measured at fair value through profit or loss		1,184	837
Interest expense	6	(418,109)	(259,257)
Net interest income		**249,486**	**151,237**
Fee and commission income	7	14,769	11,067
Fee and commission expense	7	(19,554)	(15,623)
Net fee and commission income		**(4,785)**	**(4,556)**
Net gain/(loss) in financial instruments measured at fair value through profit or loss	8	89	(265)
Net foreign exchange gains/(losses)	9	(238)	991
Net income/(expense) on modification	11	(439)	
Net credit losses	12	(8,703)	(3,283)
Other operating income	13	613	1,313
Other operating expenses	13	(559)	(1,296)
Net other operating income and expense		**54**	**17**
Administrative expenses	14	(52,484)	(41,047)
Tax on certain financial institutions	15	(60,765)	(31,699)
Operating profit		**122,215**	**71,395**
Profit before income tax		**122,215**	**71,395**
Income tax expense	16	(36,366)	(19,976)
Net profit		**85,849**	**51,419**
Earnings per share – basic (PLN)	17	0.07	0.05
Earnings per share – diluted (PLN)	17	0.07	0.05
Weighted average number of ordinary shares during the period (in thousand)		1,222,123	967,123
Weighted average diluted number of ordinary shares during the period (in thousand)		1,222,123	967,123

(IN PLN '000)

STATEMENT OF COMPREHENSIVE INCOME

STATEMENT OF COMPREHENSIVE INCOME	Note	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Net profit		**85,849**	**51,419**
Other comprehensive income		**92,781**	**(10,931)**
Items which may be reclassified to profit or loss		**92,781**	**(10,931)**
Cash flow hedges (gross)		112,141	(16,860)
Related tax		(21,307)	3,203
Cash flow hedges (net)	20	90,834	(13,657)
Unrealized net gains on available-for-sale financial assets (gross)			3,366
Related tax			(640)
Unrealized net gains on available-for-sale financial assets (net)			2,726
Remeasurement of financial assets measured at fair value through other comprehensive income (gross)		2,404	
Related tax		(457)	
Remeasurement of financial assets measured at fair value through other comprehensive income (net)		1,947	
Total net comprehensive income		**178,630**	**40,488**

STATEMENT OF FINANCIAL POSITION

STATEMENT OF FINANCIAL POSITION	Note	31.12.2018	31.12.2017
ASSETS			
Cash and balances with the Central Bank	18	6	561
Amounts due from banks	19	22	5,350
measured at amortized cost		22	5,350
Derivative hedging instruments	20	168,289	338
Securities	21	842,965	830,489
available for sale			830,489
measured at fair value through other comprehensive income		842,965	
Loans and advances to customers	22	21,070,469	16,042,473
measured at amortized cost		21,070,469	16,042,473
Intangible assets	25	4,165	5,584
Property, plant and equipment	25	449	570
Other assets	26	16,769	17,229
TOTAL ASSETS		**22,103,134**	**16,902,594**
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to banks	27	4,292,286	4,125,379
measured at amortized cost		4,292,286	4,125,379
Derivative hedging instruments	20	15,254	217,777
Amounts due to customers	28	4,359	2,099
measured at amortized cost		4,359	2,099
Mortgage covered bonds issued	29	12,841,500	8,883,213
measured at amortized cost		12,841,500	8,883,213
Unsecured bonds issued	30	3,311,148	2,428,025
measured at amortized cost		3,311,148	2,428,025
Other liabilities	31	121,974	17,441
Current income tax liabilities	16	3,159	3,507
Deferred income tax provision	16	25,303	3,237
Provisions	32	268	138
TOTAL LIABILITIES		**20,615,251**	**15,680,816**
Equity			
Share capital	33	1,295,000	1,200,000
Supplementary capital		54,932	-
Accumulated other comprehensive income		63,889	(28,892)
Retained earnings		(11,787)	(749)
Net profit for the period		85,849	51,419
TOTAL EQUITY		**1,487,883**	**1,221,778**
TOTAL LIABILITIES AND EQUITY		**22,103,135**	**16,902,594**
Total capital ratio (TCR)	53	15.2%	15.2%
Book value (in PLN thousand)		1,487,883	1,221,778
Number of shares (in thousand)	33	1,295,000	1,200,000
Book value per share (in PLN)		1.15	1.02
Diluted number of shares (in thousand)		1,295,000	1,200,000
Diluted book value per share (in PLN)		1.15	1.02

(IN PLN '000)

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2018	Note	Share capital	Supplementary capital	Accumulated other comprehensive income		Retained earnings	Net profit for the period	Total equity
				Cash flow hedges	Financial assets measured at fair value through OCI			
31 December 2017		1,200,000	-	(31,372)	2,480	(749)	51,419	1,221,778
Changes due to IFRS 9 implementation		-	-	-	-	(11,787)	-	(11,787)
As at 1 January 2018 (restated)	33	1,200,000	-	(31,372)	2,480	(12,536)	51,419	1,209,991
Issue of series H shares	33	95,000	4,262	-	-	-	-	99,262
Transfer from retained earnings	33	-	-	-	-	51,419	(51,419)	-
Transfer of the profit to equity		-	50,670	-	-	(50,670)	-	-
Total comprehensive income, of which:		-	-	90,834	1,947	-	85,849	178,630
Net profit for the year		-	-	-	-	-	85,849	85,849
Other comprehensive income		-	-	90,834	1,947	-	-	92,781
31 December 2018		**1,295,000**	**54,932**	**59,462**	**4,427**	**(11,787)**	**85,849**	**1,487,883**

FOR THE YEAR ENDED 31 DECEMBER 2017	Note	Share capital	Supplementary capital	Accumulated other comprehensive income		Retained earnings	Net profit for the period	Total equity
				Cash flow hedges	Financial assets measured at fair value through OCI			
31 December 2016		800,000	-	(17,715)	(246)	(13,973)	13,224	781,290
Transfer from retained earnings		-	-	-	-	13,224	(13,224)	-
Issue of series E shares	33	150,000	-	-	-	-	-	150,000
Issue of series F shares	33	150,000	-	-	-	-	-	150,000
Issue of series G shares	33	100,000	-	-	-	-	-	100,000
Total comprehensive income, of which:		-	-	(13,657)	2,726	-	51,419	40,488
Net profit for the year		-	-	-	-	-	51,419	51,419
Other comprehensive income		-	-	(13,657)	2,726	-	-	(10,931)
31 December 2017		**1,200,000**	**-**	**(31,372)**	**2,480**	**(749)**	**51,419**	**1,221,778**

(IN PLN '000)

STATEMENT OF CASH FLOWS

STATEMENT OF CASH FLOWS	Nota	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Cash flows from operating activities			
Profit before tax		**122,215**	**71,395**
Total adjustments and changes:		**(5,088,537)**	**(8,140,838)**
Amortization and depreciation		2,177	1,487
Interest on mortgage covered bonds issued and loans obtained		132,334	59,389
Change in securities designated at fair value through profit or loss upon initial recognition		-	80,000
Change in derivative financial instruments (asset)		(167,951)	27,471
Change in loans and advances to customers (gross)		(5,051,060)	(7,797,882)
Change in other assets		460	(2,851)
Change in amounts due to banks		(188,873)	(535,460)
Change in derivative financial instruments (liability)		(202,523)	217,664
Change in amounts due to customers		2,260	549
Change in mortgage covered bonds issued		249,777	(204,428)
Change in unsecured bonds issued		59,338	39,829
Change in allowances for expected credit losses		8,642	3,307
Change in other liabilities, excluding liabilities in respect of unregistered issues of own shares		4,533	5,245
Income tax paid		(33,646)	(8,229)
Other adjustments (including changes in the measurement of securities and derivative instruments recognized in other comprehensive income)		95,995	(26,929)
Net cash flows used in operating activities		**(4,966,322)**	**(8,069,444)**
Cash flows from investing activities			
Inflows from investing activities		**195,325**	**6,204**
Disposal of and interest on available-for-sale investment securities			6,204
Disposal of and interest on securities measured at fair value through other comprehensive income		195,325	
Outflows from investing activities		**(189,889)**	**(622,000)**
Acquisition of available-for-sale investment securities			(620,251)
Acquisition of securities measured at fair value through other comprehensive income		(189,252)	
Acquisition of intangible assets and property, plant and equipment		(637)	(1,749)
Net cash flows used in investing activities		**5,436**	**(615,796)**
Cash flows from financing activities			
Proceeds from issue of own shares and payments towards issue of own shares		199,262	400,000
Proceeds from issue of mortgage covered bonds		3,708,510	5,855,524
Proceeds from issue of unsecured bonds		7,771,985	6,141,581
Redemption of unsecured bonds issued		(6,948,200)	(4,904,600)
Proceeds from loans obtained		5,380,879	4,055,122
Proceeds from loans repaid		(5,025,099)	(2,826,114)
Interest on mortgage covered bonds issued and loans obtained		(132,334)	(59,389)
Net cash flows used in financing activities		**4,955,003**	**8,662,124**
Total net cash flows		**(5,883)**	**(23,116)**
Cash and cash equivalents at the beginning of the period		5,911	29,027
Cash and cash equivalents at the end of the period	37	**28**	**5,911**

NOTES TO THE FINANCIAL STATEMENTS – CONTENTS

(IN PLN '000)

NOTES TO THE FINANCIAL STATEMENTS

1. General Information

Banking Activities

PKO Bank Hipoteczny Spółka Akcyjna ("PKO Bank Hipoteczny SA", "Bank") with its registered office in Gdynia, ul. Jerzego Waszyngtona 17, 81-342 Gdynia, was entered in the Register of Businesses maintained by the District Court Gdańsk-Północ in Gdańsk, 8th Business Department of the National Court Register, with the number KRS 0000528469, on 24 October 2014. The Bank was assigned the statistical number REGON 222181030. Its share capital as at 31 December 2018 was PLN 1,295,000,000 and was fully paid up.

PKO Bank Hipoteczny SA is a specialized bank that operates on the basis of the Polish Covered Bonds and Mortgage Banks Act dated 29 August 1997, the Banking Act of 29 August 1997, the Commercial Companies Code and other generally applicable provisions of the law, the principles of good banking practice and the Bank's Statute.

The Bank specializes in granting mortgage loans for individuals and acquires receivables following from such loans from PKO Bank Polski SA. The Bank acquires loans for its portfolio based on strategic cooperation with PKO Bank Polski SA.

The Bank's principal business objective is to issue mortgage covered bonds, which are to serve as the primary source of long-term financing for the mortgage loans.

Indication whether the Bank is a Parent or Key Investor and whether it prepares consolidated financial statements

PKO Bank Hipoteczny SA is not a parent or a significant investor in associates and jointly controlled entities. Therefore, PKO Bank Hipoteczny SA does not prepare consolidated financial statements.

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

Composition of the Bank's Supervisory Board And Management Board

The following table presents the composition of the Supervisory Board of PKO Bank Hipoteczny SA during the period covered by the financial statements:

No.	Name and surname	Position	Date of appointment	Date of dismissal / resignation
1	Jakub Papierski	Chairman of the Supervisory Board	06.10.2014	-
2	Piotr Mazur	Deputy Chairman of the Supervisory Board	06.10.2014	-
3	Justyna Borkiewicz	Member of the Supervisory Board	28.10.2016	-
4	Artur Kluczny	Member of the Supervisory Board (independent)	18.10.2017	-
5	Rafał Kozłowski	Member of the Supervisory Board	09.02.2018	-
6	Mieczysław Król	Member of the Supervisory Board	28.10.2016	-
7	Piotr Kwiecień	Member of the Supervisory Board (independent)	18.10.2017	-
8	Jan Emeryk Rościszewski	Member of the Supervisory Board	18.10.2017	-
9	Bartosz Drabikowski	Member of the Supervisory Board	18.10.2017	15.01.2018

The following table presents the composition of the Management Board of PKO Bank Hipoteczny SA during the period covered by the financial statements:

No.	Name and surname	Position	Date of appointment	Date of dismissal / resignation
1	Paulina Strugała	President of the Management Board	16.04.2018	-
2	Agnieszka Krawczyk	Vice-President of the Management Board	01.01.2018	-
3	Jakub Niesłuchowski	Vice-President of the Management Board	01.04.2015	-
4	Marek Szcześniak	Vice-President of the Management Board	01.06.2015	26.11.2018

In connection with the resignation of Mr Rafał Kozłowski as President of the Management Board, on 28 December 2017, the Supervisory Board entrusted the organizational and procedural duties of the President of the Bank's Management Board to Mr Jakub Niesłuchowski with effect from 1 January 2018 until a new President of the

Management Board is appointed and appointed Ms Agnieszka Krawczyk Vice-President of the Bank's Management Board as of 1 January 2018.

On 4 April 2018 the Supervisory Board of PKO Bank Hipoteczny SA appointed Ms Paulina Strugała President of the Bank's Management Board as of 16 April 2018, on condition and as of the date of the Polish Financial Supervision Authority (PFSA) granting consent to her appointment as President of the Bank' Management Board. Until the PFSA granted its consent on 12 June 2018, Paulina Strugała performed the function of vice president of the Bank's Management Board and acted as President of the Board.

In connection with the resignation of Mr Marek Szcześniak as Vice-President of the Bank's Management Board as of 26 November 2018, on 12 December 2018, the Supervisory Board of Bank Hipoteczny SA appointed Mr Piotr Kochanek Vice-President of the Bank's Management Board with effect from 1 January 2019. In addition, the Supervisory Board decided to entrust Mr Piotr Kochanek management of material risks in the Bank's operations, subject to obtaining permission from the PFSA.

2. BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS

The financial statements of PKO Bank Hipoteczny Spółka Akcyjna cover the year ended 31 December 2018 and include comparative data for the year ended 31 December 2017. The financial data is presented in thousands of Polish zlotys (PLN), rounded to a thousand, unless otherwise indicated.

2.1 STATEMENT OF COMPLIANCE

These financial statements have been prepared in accordance with International Financial reporting Standards (IFRS) endorsed by the European Union as at 31 December 2018, and to the extent not governed by the said standards, in accordance with the requirements of the Accounting Act of 29 September 1994 and implementing regulations issued on the basis of the said Act, and the requirements applicable to issuers of securities admitted or seeking admission to trading on a market for official stock exchange listing.

2.2 GOING CONCERN

The financial statements have been prepared on the assumption of the Bank continuing its business activities in the foreseeable future (i.e. in the period of at least 12 months of the end of the reporting period). As at the date of signing these financial statements, the Management Board has not identified any facts or circumstances which would indicate any threats to the Bank's ability to continue as a going concern for at least 12 months of the end of the reporting period as a result of intended or forced discontinuing or significantly curtailing the Bank's existing operations.

2.3 BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS

In the financial statements, the concept of fair value was applied to financial assets and financial liabilities measured at fair value through profit or loss or through other comprehensive income, including derivative instruments, and to securities measured at fair value through other comprehensive income. Other components of financial assets and financial liabilities (including loans and advances) are reported at amortized cost, using the effective interest rate method, less allowances for expected credit losses in the case of financial assets.

Property, plant and equipment and intangible assets are stated at cost, less accumulated depreciation/amortization and impairment allowances. Property, plant and equipment classified as held for sale are stated at the lower of their book value and fair value less costs to sell.

The Bank recognized all items of costs and income in accordance with the accruals basis, the matching principle, the principles of recognition and measurement of assets and liabilities, and the recognition of impairment allowances.
Accounting policies applicable to individual items are presented in the notes to the statement of financial position and to the income statement.

When preparing the financial statements, the Bank makes certain estimates and adopts assumptions which directly affect the financial statements. The estimates and assumptions that are used by the Bank in determining the value of its assets and liabilities, as well as revenues and costs, are made based on historical data and other factors which are available and are considered to be proper in the given circumstances.

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

(IN PLN '000)

Estimates and assumptions made by the Bank are subject to reviews on an on-going basis. Adjustments to estimates are recognized in the periods in which the estimates were adjusted, provided that these adjustments only affect a given period. If the adjustments affect both the period in which the adjustment was made as well as future periods, they are recognized in the period in which the adjustments were made and in future periods.

2.4 APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements, having been reviewed with an opinion issued by the Audit and Finance Committee of the Supervisory Board on 21 February 2019 and evaluated by the Supervisory Board on 27 February 2019, were approved by the Bank's Management Board for publication on 27 February 2019.

3. DESCRIPTION OF MAJOR ACCOUNTING POLICIES

The most important accounting policies, estimates and judgements applied when preparing these financial statements have been presented in the Notes to the financial statements. The accounting policies were applied consistently in all the reporting periods presented, excluding changes relating to the implementation of IFRS 9.

The list of accounting policies and important estimates and judgments for specific items of the income statement and statement of financial position have been presented below.

INCOME STATEMENT	Note	Accounting policies[1)]	Major estimates and judgments[1)]
Interest income and expense	6	Y	
Fee and commission income and expense	7	Y	
Net gain/(loss) on financial instruments measured at fair value through profit or loss	8	Y	Y
net foreign exchange gains/(losses)	9	Y	Y
Gains/(losses) on derecognition of financial assets and financial liabilities not measured at fair value through profit or loss	10	Y	
Net income/(expense) on modification	11	Y	
Net credit losses	12	Y	Y
Net other operating income and expense	13	Y	
Administrative expenses	14	Y	Y
Tax on certain financial institutions	15	Y	
Income tax expense	16	Y	

STATEMENT OF FINANCIAL POSITION	Note	Accounting policies[1)]	Major estimates and judgments[1)]
Cash and balances with the Central Bank	18	Y	
Amounts due from banks	19	Y	
Derivative hedging instruments	20	Y	Y
Securities	21	Y	
Loans and advances to customers	22	Y	Y
Intangible assets	25	Y	Y
Property, plant and equipment	25	Y	Y
Other assets	26	Y	
Amounts due to banks	27	Y	
Amounts due to customers	28	Y	
Mortgage covered bonds issued	29	Y	
Unsecured bonds issued	30	Y	
Other liabilities	31	Y	
Provisions	32	Y	Y
Equity	33	Y	

[1)] Letter "Y" means an accounting policies and major estimates and judgements included in the Notes to the financial statements

3.1 FOREIGN CURRENCIES

FUNCTIONAL CURRENCY AND CURRENCY OF PRESENTATION

These financial statements are presented in Polish zloties which are the Bank's functional currency and the currency of presentation.

TRANSACTIONS AND BALANCES IN FOREIGN CURRENCIES

Transactions expressed in foreign currencies are translated into functional currency at the exchange rate applicable on the transaction date. At the end of each reporting period, the Bank translates:

- monetary items in foreign currencies – at the closing exchange rate, i.e. the average exchange rate announced by the National Bank of Poland applicable at the end of the reporting period;
- non-monetary items carried at historical cost in foreign currencies – using the exchange rate as at the date of the transaction;
- non-monetary items carried at fair value in foreign currencies – are translated using the exchange rates that existed when the fair values were determined.

Gains and losses resulting from the settlement of these transactions and the measurement of monetary assets and liabilities expressed in foreign currencies are recognized in the income statement.

3.2 RECOGNITION OF TRANSACTIONS IN THE BOOKS OF ACCOUNT

Financial assets and financial liabilities, including forward contracts which result in an obligation or a right to buy or sell a fixed quantity of specific financial instruments at a fixed price at a future date are recognized in the books of account as at the date of the contract being concluded, irrespective of the contractual settlement date.

3.3 DERECOGNITION OF FINANCIAL INSTRUMENTS

A financial asset is derecognized when contractual rights to cash flows from the financial assets expire or when the Bank transfers the financial assets to another entity. Such transfer takes place when the Bank:

- transfers contractual rights to cash flows from the financial asset, or
- retains contractual rights to cash flows from the financial assets but assumes a contractual obligation to transfer these cash flows to a third party.

When transferring a financial asset, the Bank makes an assessment of the extent to which it retains the risks and rewards of the ownership of the financial asset. In such a case:

- if the Bank transfers substantially all risks and rewards of ownership of a financial asset, the Bank excludes the financial asset from the statement of financial position;
- if the Bank retains substantially all risks and rewards of ownership of a financial asset, the Bank continues to present the financial asset in the statement of financial position;
- If the Bank neither transfers nor retains substantially all risks and rewards of ownership of a financial asset, the Bank determines whether or not it retained control over the financial asset. If control has been retained, the financial asset is recognized in the Bank's statement of financial position up to the amount resulting from permanent involvement. Otherwise, the financial asset is derecognized.

The Bank derecognizes a financial liability (or a part thereof) if and when it is no longer binding, i.e. when a contractual liability has been settled, annulled, or has expired.

4. IFRS 9 FINANCIAL INSTRUMENTS

IFRS 9 "Financial Instruments" was published in July 2014 and adopted for use in the European Union on 22 November 2016 by Regulation No. 2016/2067 of the European Commission. The standard is binding for financial statements prepared for periods beginning on or after 1 January 2018 (with the exception of insurance companies which may apply the standard as of 1 January 2021). The standard replaces IAS 39 "Financial Instruments: Recognition and Measurement". The classification and measurement of financial instruments, recognition and calculation of impairment and hedge accounting have changed.

4.1 Classification and Measurement

4.1.1. Policies for the classification of financial instruments

Following the application of IFRS 9, as of 1 January 2018 the Bank classifies its financial assets to one of the following categories:
- assets carried at amortized cost;
- assets measured at fair value through other comprehensive income;
- assets measured at fair value through profit or loss.

Classification as at the date of acquisition or arising of an asset depends on the business model adopted by the Bank to manage a given group of assets and the contractual characteristics of the cash flows from a single asset or group of assets. The Bank distinguishes the following business models:

- "held to collect" – a model according to which financial assets which were acquired or arose are held to benefit from contractual cash flows – a model typical for lending operations;
- "held to collect or sell" – a model according to which financial assets which after their acquisition or arising are held to benefit from contractual cash flows, but which may also be sold (a model typical for liquidity management);
- residual – other than the model "held to collect", and "held to collect or sell.

Financial instruments are classified at the moment of the first application of IFRS 9, i.e. as at 1 January 2018 and as at the moment of recognition of an instrument or its material modification. Changes in the classification of financial assets may result from changes in the business model. Changes in the model are conditioned by changes occurring inside or outside the Bank, or before or after the end of a given type of operation; therefore, such changes do not often occur.

Business model

Business models are selected at initial recognition of financial assets. It is selected at the level of particular groups of assets, in the context of the area of operations in connection with which the financial assets arose or were acquired, and is based, among other things, on:

- manner of assessing and reporting financial asset portfolio results;
- manner of managing those assets' risk and policies for remunerating asset managers.

In the business model "held to collect" sale of assets is incidental and may only be accomplished in the event of increased credit risk, changes in laws or regulations – to maintain the assumed regulatory capital level, on the terms and conditions described in the management strategies of such portfolios or on condition that the sale is close to maturity, in the event of a drop in credit rating below the level assumed for the given portfolio, material internal restructuring or acquiring another business, pursuing a crisis or repair plan and other unforeseeable factors on which the Bank has no influence.

Assessment of the characteristics resulting from contractual cash flows

Characteristics resulting from contractual cash flows are assessed by determining, on the basis of a qualitative SPPI test, whether the cash flows resulting from the asset constitute solely payments of principal and interest on the amount remaining to be repaid. Interest comprises the payment for the time value of money and the credit risk connected with the value of the remaining exposure during a specified period, and for other basic risks and costs related to granting the loan, as well as a profit margin.

The characteristics resulting from contractual cash flows have no impact on the classification of financial assets if:

- it would only have an insignificant impact on the contractual cash flows from the asset (*de minimis* feature);
- it has an impact on the contractual cash flows from the instrument only if an extremely rare, atypical and unlikely event occurs (non-genuine feature).

To determine this, the potential impact of characteristics resulting from contractual cash flows in each reporting period and throughout the life cycle of the financial instrument are taken into account.

SPPI tests are conducted for each financial asset in the model "held to collect" or "held to collect and sell" as at the date of initial recognition (including for material modifications after re-recognizing the financial asset) and as at the date of a change in the characteristics of contractual cash flows.

CATEGORY OF MEASUREMENT OF FINANCIAL ASSETS AT AMORTIZED COST

A financial asset (this relates to debt financial assets) is measured at amortized cost if the following conditions are jointly met:

- a financial asset is "held to collect";
- the contractual terms relating to the financial asset cause cash flows to arise in certain periods are solely payments of principal and interest (SPPI test).

The original value of an asset measured at amortized cost is adjusted by all commissions and fees with an impact on its effective return which constitute an integral part of the effective interest rate on the asset (commissions and fees arising as a result of the Bank conducting activities which lead to the asset arising). Commissions and fees which arise after the date of the financial asset being established lead to changes in future cash flow schedules generated by the assets.

The present value of this category of assets is determined using the effective interest rate described in subpar. 3.1.5, used to determine (accrue) interest income generated by the asset in the given period, on a current basis, adjusting it by allowances for expected credit losses.

Assets for which no future cash flow schedule may be determined, necessary to calculate the effective interest rate, are not measured at amortized cost. They are measured at the amount payable which also covers interest on the amounts due, taking into consideration allowances for expected credit losses. Commissions and fees related to those assets arising or decisive for their financial features have to be deferred over the life cycle of the asset on a straight-line basis and are included in fee and commission income.

The straight-line basis used to account for specific fees and commissions consists of their systematic transfer to income statement, in proportion to the life of the product. Systematic accounting for specific fees and commissions is done on a monthly basis.

CATEGORY OF MEASUREMENT OF FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

A financial asset (this relates to debt financial assets) is measured at amortized cost through other comprehensive income if the following conditions are jointly met:

- the financial asset is held in accordance with the business model aimed at both receiving contractual cash flows and selling the asset; and
- the contractual terms relating to the financial asset cause cash flows to arise in certain periods, which are only the result of repayment of the principal amount and the interest on the principal amount remaining to be repaid.

Financial assets measured at fair value through other comprehensive income are measured at fair value.

The effects of changes in the fair value of such financial assets, until derecognition or reclassification, are recognized in other comprehensive income, with the exception of interest income, net expected credit losses and foreign exchange gains and losses, which are recognized in the income statement. If a financial asset has been derecognized, accumulated gains and losses previously reported in other comprehensive income are reclassified from other comprehensive income to the income statement.

CATEGORY OF MEASUREMENT OF FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

If financial assets do not meet the qualification criteria set out above to be measured at amortized cost, or at fair value through other comprehensive income, they are classified to financial assets measured at fair value through profit or loss.

In addition, upon initial recognition, a financial asset may be irrevocably designated as measured at fair value through profit or loss (the option of measurement at fair value through profit or loss), provided that this will eliminate or significantly reduce inconsistency in the measurement or recognition (accounting mismatch). This option is available for debt instruments both under the "held to collect", and "held to collect and sell" models.

Pursuant to IFRS 9 assets measured at fair value through profit or loss are presented as follows:

1) held for trading – financial assets which:

- have been purchased mainly to sell or redeem in the foreseeable future; or
- upon initial recognition constitute part of a portfolio of specific financial instruments which are managed jointly and for which there is evidence that they currently generate short-term profits; or

- are derivative financial instruments (with the exception of derivatives which are financial guarantee agreements or designated and effective hedges);

2) financial assets not held for trading, mandatorily measured at fair value through profit or loss – financial assets which have not met the criterion of cash flow characteristics (the SPPI test) (irrespective of a business model);

3) financial assets designated at fair value through profit or loss at initial recognition (the option of measurement at fair value through profit or loss).

Gains or losses on a financial asset measured at fair value through profit or loss are recognized in the income statement.

4.1.2. CHANGE IN CLASSIFICATION OF FINANCIAL ASSETS

Financial assets may be reclassified only in the event of a change in the business model referring to an asset or a group of assets resulting from the start or discontinuation of a material part of operations. Such changes are incidental. Changes in classification are recognized prospectively, i.e. without changing the effects of fair value measurement, allowances or interest accrued, recognized to-date.

The following are not considered to be changes in the business model:

- changes in intentions related to concrete financial assets (even in the event of significant changes in market conditions);
- provisional disappearance of a specific financial assets market;
- transfer of financial assets between areas of operations using different business models.

In the event of reclassification of a financial asset from measured at amortized cost to measured at fair value through profit or loss, the fair value of the asset is determined as at the reclassification date. All gains and losses resulting from the difference between the previous recognition of a financial asset at amortized cost and its fair value are recognized in the income statement.

In the event of reclassification of a financial asset from measured at fair value through profit or loss to measured at amortized cost, the fair value of the asset becomes its new gross carrying amount as at the reclassification date. The effective interest rate is determined based on the fair value of an asset as at the reclassification date.

In the event of reclassification of a financial asset from measured at amortized cost to measured at fair value through other comprehensive income, the fair value of the asset is determined as at the reclassification date. All gains and losses resulting from the difference between the previous recognition of a financial asset at amortized cost and its fair value are recognized in other comprehensive income. The effective interest rate and the expected credit losses are not adjusted as a result of the reclassification.

In the event of reclassification of a financial asset from measured at fair value through other comprehensive income to measured at amortized cost, the asset is recognized at fair value as at the reclassification date. Accumulated gains or losses which had been recognized in other comprehensive income are derecognized from equity and adjusted based on the fair value of the financial asset as at the reclassification date. Therefore, the financial asset is measured as at the reclassification date as if it had always been measured at amortized cost. This adjustment relates to other comprehensive income and has no impact on the income statement, therefore, it is not a reclassification adjustment according to IAS 1. The effective interest rate and the expected credit losses are not adjusted as a result of this reclassification.

In the event of reclassification of a financial asset from measured at fair value through profit or loss to measured at fair value through other comprehensive income, the asset continues to be recognized at fair value. The effective interest rate is determined based on the fair value of an asset as at the reclassification date.

In the event of reclassification of a financial asset from measured at fair value through other comprehensive income to measured at fair value through profit or loss, the asset continues to be recognized at fair value. Accumulated gains or losses previously recognized in other comprehensive income are reclassified from equity to profit or loss in the form of a reclassification adjustment pursuant to IAS 1, as at the reclassification date.

4.1.3. CHANGE IN ESTIMATED CONTRACTUAL CASH FLOWS – MODIFICATIONS

A modification is a change in contractual flows of a financial asset based on an annexe to the respective contract. A modification may be material or immaterial. Changes in contractual flows resulting from meeting the contractual terms and conditions are not considered to be modifications.

If the cash flows resulting from a contract related to a financial asset are subject to renegotiation or any other modification, and the renegotiation or modification does not lead to derecognition of the given financial asset ("IMMATERIAL MODIFICATION") the gross carrying amount of the financial asset is recalculated and respective gains or losses on modification are recognized in the income statement. Adjustments to the carrying amounts of financial assets due to modifications are accounted for in net interest income/cost using the effective interest rate. The carrying amount of a financial asset is calculated as the present value of renegotiated or modified contractual cash flows discounted at the original effective interest rate of the financial asset (or effective interest rate adjusted by credit risk in the event of purchased or created impaired financial assets) or, if applicable (e.g. for gains or losses on hedges), at the updated effective interest rate. All the costs and fees incurred adjust the carrying amount of the modified financial asset and are amortized over the period to maturity of the modified financial asset.

In some situations renegotiation or modification of contractual cash flows related to a financial asset may lead to derecognition of the given financial asset. If the modification of a financial asset leads to its derecognition and then to the recognition of a modified financial asset, the modified financial asset is considered to be a new financial asset ("MATERIAL MODIFICATION"). The new asset is recognized at fair value and a new effective interest rate is calculated to be applied to the new asset. In the event that the characteristics of the modified new financial asset (after conclusion of the annexe) reflects the arm's length basis, the carrying amount of the financial asset constitutes its fair value.

The assessment of whether the given modification of financial assets is material or immaterial depends on the qualitative and quantitative criteria being met.

The adopted QUALITATIVE CRITERIA are as follows:

- change in debtor, with the exception of a change following from the debtor's death;
- introducing a contractual feature to the contract which leads to failing the cash flow characteristics test or removal of the feature;
- currency conversion;
- an increase in a debtor's exposure which includes the value of a capital increase and loan commitments exceeding 10% in relation to equity and loan commitments before the increase for each individual exposure.

If at least one of the criteria is present, a material modification occurs.

The adopted QUANTITATIVE CRITERION constitutes a 10% test consisting of analysing the changes in the contractual terms of a financial asset resulting in a difference arising between the amount of the future cash flows from the changes in the financial asset discounted using the effective interest rate and the amount of corresponding future cash flows from the original financial asset discounted using the same interest rate.

If the quantitative criterion (difference) exceeds 10%, the modification is considered material. The quantitative criterion does not apply to loans under restructuring (i.e. the modification is immaterial).

4.1.4. MEASUREMENT OF PURCHASED OR ORIGINATED CREDIT-IMPAIRED ASSETS (POCI)

IFRS 9 distinguishes a new category of purchased or originated credit-impaired assets (hereinafter "POCI").

POCI assets are debt financial assets measured at amortized cost and at fair value through other comprehensive income, i.e. loans and debt securities. Those assets are initially recognized in net amounts (net of impairment allowances) which reflect their fair value. Interest income on POCI assets is calculated on the net carrying amount using the effective interest rate adjusted by credit risk recognized over the life of the asset. Credit-risk adjusted effective interest rate is calculated in consideration of the future cash flows adjusted by the effect of credit risk recognized over the life of the asset. The change in estimates of future recoveries in further reporting periods is recognized as an impairment loss or revaluation gain in the income statement.

4.1.5. INTEREST INCOME

Interest income is calculated using the effective interest rate described used to determine (accrue) interest income generated by the asset in the given period, on the gross carrying amount of the financial asset, with the exception of:

- purchased or originated credit-impaired assets (see subpar. 4.1.4). With respect to those financial assets, the credit-risk adjusted effective interest rate is applied to the amount of amortized cost of the financial asset (net carrying amount) as of the moment of initial recognition (POCI assets).
- financial assets which are not POCI, which then became impaired. In respect of those financial assets the original effective interest rate is applied (i.e. from the moment of recognition of the impairment premises) to

determine the value of the financial assets at amortized cost (net carrying amount) in the following reporting periods.

4.1.6. Changes in classification and measurement in connection with the implementation of IFRS 9

In connection with the implementation of IFRS 9 from 1 January 2018:

- loans and advances to customers are measured at amortized cost, since the "held to collect" model applies to them and they meet the SPPI test;
- securities are measured at fair value through other comprehensive income, since the "held to collect and sell" model applies to them and they meet the SPPI test.

4.2 Impairment

In the area of impairment, the Bank applies IFRS 9, which is based on the concept of expected losses.

The impairment model applies to financial assets which are not measured at fair value through profit or loss, and which comprise:

- debt financial instruments in the form of credit exposures and securities;
- loan commitments and guarantee exposures.

In accordance with IFRS 9 impairment is measured as 12-month expected credit losses or perpetual expected credit losses. The time horizon of an expected loss depends on whether a significant increase in credit risk occurred since the moment of initial recognition. Therefore, financial assets are allocated to 4 stages.

IFRS 9 portfolio	Period of expected credit losses
Stage 1 (assets whose credit risk has not increased materially since initial recognition)	12-month expected credit losses
Stage 2 (assets whose credit risk has increased materially since initial recognition)	lifetime expected credit losses
Stage 3 (impaired assets)	
Stage 4 (purchased or originated impaired assets – POCI)	

The expected loss is calculated as the product of credit risk parameters: probability of default (PD), loss given default (LGD) and exposure at default (EAD). These parameters are estimated using the risk models applied by the PKO Bank Polski Group, tailored to the specific characteristics of the operations and the risk profile of PKO Bank Hipoteczny and approved by the competent governing bodies of the Bank.

With regard to exposures classified in Stage 1, the Bank will use a maximum 12-month horizon of estimation of the expected loss, unless the maturity is shorter than 12 months. With Stage 2 exposures, the expected loss will be estimated in the time horizon until maturity. In either case, the expected loss will be the sum total of the losses expected in the individual periods, discounted by the effective interest rate.

To assess the materiality of growth in the risk of mortgage exposures the Bank uses a model based on marginal PD, i.e. probability of default in a given month, calculated as of the moment of the initial recognition of the loan. This allows reflecting the differentiation of the loan quality characteristic for retail customers over the lifetime of the exposure. The Bank identifies material risk increases based on the comparison of probability of default curves over the lifetime of exposure on initial recognition and on a given reporting date. For each reporting date, only those parts of the initial and current PD curve are compared which correspond to the period from the reporting date to the maturity of the loan. The comparison is based on average PD probability values in the given period adjusted for current and forecast macroeconomic ratios.

Additionally, to assess the materiality of credit risk increases the Bank uses full quantitative and qualitative information, including information on:

- payment delinquencies exceeding 30 days;
- forbearance measures due to the borrower's financial distress;
- a borrower submitting a motion to a court to declare consumer bankruptcy.

Stage 2 also includes exposures for which an impairment trigger ceased to exist in the last 3 months.

Impairment premises of credit exposures comprise in particular:
- delays in repayment of a material amount of principal or interest exceeding 90 days;
- conclusion of a restructuring agreement or applying a relief in repayment of the debt for economic or legal reasons resulting from the customer's financial distress (until the debt is considered recoverable);
- the Bank giving notice and requesting immediate repayment of the loan;
- a court declaring consumer bankruptcy of a customer;
- so-called contamination of the loans, i.e. situations whereby impairment recognized on a loan exposure implicates the necessity of its recognition in all loan exposures in respect of housing loans of the relevant co-debtors – this premise requires checking both the Bank's and PKO Bank Polski SA's exposures.

In order to determine the value of assets at the time of default, the Bank determines the exposure at default parameter on the basis of future payments according to the repayment schedule and potential over- or underpayments.

In calculating the value of the ultimate expected loss, the Bank also considers the impact of macroeconomic scenarios on the respective parameters (PD, LGD). The methodology of calculation of the risk parameters includes back-testing of the dependence of the value of the parameters on macroeconomic conditions. Three macroeconomic scenarios developed on the basis of the PKO Bank Polski Group forecasts are used for the purpose of calculating expected loss (as in the identification of an indication of a material increase in credit risk) – a baseline scenario and two alternative scenarios. The scope of projected indicators include: the GDP growth rate, the unemployment rate, the 3M WIBOR rate, the property price index, and the NBP reference rate. The final expected loss is the average of expected losses in each scenario, weighted by the probability of the scenarios.

The Bank applies the low credit risk criterion in accordance with IFRS 9, which allows exposures considered low credit risk exposures to remain in Stage 1 irrespective of the scale of a relative deterioration in the credit quality since initial recognition. In accordance with IFRS 9, credit risk of a financial instrument is considered low when:
- the financial instrument has a low risk of default;
- the borrower has a strong capacity to meet its contractual cash flow obligations in the near term;
- adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations.

The Bank applies the low credit risk criterion to exposures to banks and exposures to the State Treasury and the National Bank of Poland.

Assessments of materiality of a credit risk increase and calculation of expected losses are both performed monthly in a dedicated computing environment.

In 2018, the Bank made one modification to the impairment measurement model by updating the threshold of PD below which the Bank does not identify indications of a material increase in credit risk. At present, the threshold is 0.3% in the 12-monthly horizon.

4.3 Hedge accounting

IFRS 9 increases the range of items that may be identified as hedged items, and also permits designating financial assets or financial liabilities at fair value through profit or loss as hedging instruments. It waives the requirement for retrospective measurement of hedge effectiveness as well as the previously existing limit of 80% – 125% (application of hedge accounting becomes conditional on the economic interdependence between the hedging instrument and the hedged item). In addition, the scope of required disclosures regarding the risk management strategy, cash flows arising from hedging transactions and the impact of hedge accounting on the financial statements was increased.

Due to the fact that the International Accounting Standards Board is still working on the standard with respect to portfolio-based hedge accounting (macro hedges), entities have a choice of applying hedge accounting provisions: they may either continue to apply IAS 39 or apply the new IFRS 9 standard with the exception of fair value macro hedges relating to interest rate risk.

The Bank chose to continue to follow the provisions of IAS 39 with regard to hedge accounting.

4.4 Disclosures and comparative data

In the Bank's opinion, the application of IFRS 9 requires a change in the presentation and the scope of disclosures concerning the area of financial instruments, including in the first year of application, when information about the opening balance and the restatements made is required. The Bank availed itself of the provisions of IFRS 9 concerning exemption from the restatement of comparable data for earlier periods with regard to the changes resulting from classification, measurement and impairment. Differences in the carrying amounts of financial assets and financial liabilities resulting from the application of IFRS 9 were recognized as part of the retained earnings in equity as at 1 January 2018.

(IN PLN '000)

4.5 Reconciliation of the items of the statement of financial positions between IAS 39 and IFRS 9 as at 1 January 2018

	Closing balance as at 31.12.2017 under IAS 39	Classification change	Measurement change	Opening balance as at 01.01.2018 under IFRS 9
ASSETS				
Cash and balances with the Central Bank	561	-	-	561
Amounts due from banks	5,350	-	-	5,350
measured at amortized cost	5,350	-	-	5,350
Derivative hedging instruments	338	-	-	338
Securities	830,489	-	-	830,489
available for sale	830,489	(830,489)	-	
measured at fair value through other comprehensive income		830,489	-	830,489
Loans and advances to customers at amortized cost	16,042,473	-	(14,498)	16,027,975
Intangible assets	5,584	-	-	5,584
Property, plant and equipment	570	-	-	570
Other assets	17,229	-	-	17,229
TOTAL ASSETS	**16,902,594**	**-**	**(14,498)**	**16,888,096**
LIABILITIES AND EQUITY				
Liabilities				
Amounts due to banks	4,125,379	-	-	4,125,379
Derivative hedging instruments	217,777	-	-	217,777
Amounts due to customers	2,099	-	-	2,099
Mortgage covered bonds issued	8,883,213	-	-	8,883,213
Unsecured bonds issued	2,428,025	-	-	2,428,025
Other liabilities	17,441	-	-	17,441
Current income tax liabilities	3,507	-	-	3,507
Deferred income tax provision	3,237	-	(2,765)	472
Provisions	138	-	54	192
TOTAL LIABILITIES	**15,680,816**	**-**	**(2,711)**	**15,678,105**
Equity				
Share capital	1,200,000	-	-	1,200,000
Accumulated other comprehensive income	(28,892)	-	-	(28,892)
Retained earnings	(749)	-	(11,787)	(12,536)
Net profit for the period	51,419	-	-	51,419
TOTAL EQUITY	**1,221,778**	**-**	**(11,787)**	**1,209,991**
TOTAL LIABILITIES AND EQUITY	**16,902,594**	**-**	**(14,498)**	**16,888,096**

The total impact of the implementation of IFRS 9 resulting from the change in the measurement of loans and advances to customers of PLN 14,498 thousand and an increase in provisions for expected losses on contingent loan commitments of PLN 54 thousand less the effect of deferred tax consisting of a decrease in the net deferred tax provision of PLN 2,765 thousand was recognized in retained earnings as at 1 January 2018.

(IN PLN '000)

4.6 CLASSIFICATION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES ACCORDING TO IFRS 9 ON FIRST APPLICATION

The impact of the implementation of IFRS 9 on the classification and measurement of financial assets as at 1 January 2018 is presented below.

	Classification under IAS 39	New classification under IFRS 9	Carrying amount under IAS 39 as at 31.12.2017	remeasurement[1]	New carrying amount under IFRS 9 as at 01.01.2018	impact of changes in accounting policies	
						on retained earnings	on other comprehensive income
Financial assets							
Cash and balances with the Central Bank	loans and receivables	measured at amortized cost	561	-	561	-	-
Amounts due from banks	loans and receivables	measured at amortized cost	5,350	-	5,350	-	-
Derivative hedging instruments	measured at fair value through profit or loss	measured at fair value through profit or loss	338	-	338	-	-
Securities	measured at fair value through profit or loss[2]	measured at fair value through OCI	-	-	-	-	-
Loans and advances to customers	loans and receivables	measured at amortized cost	16,042,473	(14,498)	16,027,975	(14,498)	-
Securities	available for sale	measured at fair value through other comprehensive income	830,489	-	830,489	-	-
Other (financial) assets	loans and receivables	measured at amortized cost	99	-	99		
Total financial assets			**16,879,310**	**(14,498)**	**16,864,812**	**(14,498)**	**-**

[1] Measurement change due to an increase in the gross carrying amount of PLN 141 thousand and an increase in impairment losses of PLN 14,639 thousand.
[2] As at 1 January 2018 the Bank did not have any securities measured at fair value through profit or loss.

The value of the financial liability items presented in the statement of financial position as at 31 December 2017 did not change as a result of the implementation of IFRS 9.

(IN PLN '000)

4.7 Disclosures concerning the reconciliation of the balance of impairment losses and provisions for contingent liabilities according to IAS 39 and IAS 37 and the opening balance of the impairment losses and provisions calculated according to IFRS 9

The following table presents the reconciliation of the closing balance of impairment losses according to IAS 39 and provisions for contingent liabilities according to IAS 37 at 31 December 2017 to the opening balance of the expected credit losses determined according to IFRS 9 at 1 January 2018.

	Classification under IAS 39	Classification under IFRS 9	As at 31.12.2017 (IAS 39)	As at 01.01.2018 (IFRS 9)
Loans and advances to customers	Impairment allowances		5,068	19,707
		Stage 1		3,776
		Stage 2		14,963
		Stage 3		968
		POCI		-
Loan commitments	Provisions for loan commitments granted		54	108
		Stage 1		69
		Stage 2		39
		Stage 3		-
		POCI		-

4.8 Quantification of the impact of IFRS 9 on own funds

The increase in impairment losses and provisions for financial commitments following the implementation of IFRS 9 at initial recognition were recognized in Common Equity Tier 1 (CET1) capital; the Bank chose to apply transitory solutions concerning the alleviation of the impact of the implementation of IFRS 9, which are specified in Regulation No. 2017/2395 of the European Parliament and the Council (UE) of 12 December 2017. Therefore, the impact on the Common Equity Tier 1 and on the Total Capital Ratio of the Bank was negligible, as it remained at 15.2% as at 1 January 2018. In connection with the above, the impact of the above on the Bank's Tier 1 capital and the total capital ratio, which remained at 15.2% as at 1 January 2018, was negligible. If transitional solutions were not applied, the common equity Tier 1 capital ratio, Tier 1 capital ratio and the total capital requirement would amount to 15.1%.

As at 31 December 2018, the Bank's own funds, common equity Tier 1 capital and Tier 1 capital, excluding the above transitional solutions, would amount to PLN 1,380,045 thousand, common equity Tier 1 capital, Tier 1 capital and total capital requirement would amount to 15.0%, and the leverage ratio would amount to 6.2%. After taking into account the transitional solutions, the Bank's own funds as at 31 December 2018 would amount to PLN 1,393,846 thousand, common equity Tier 1 capital, Tier 1 capital and total capital requirement would amount to 15.2%, and the leverage ratio would amount to 6.3%.

5. Other changes to accounting policies

5.1 Amendments to the published standards and interpretations which became binding as of 1 January 2018

The implementation of new standards and interpretations which became binding in 2018, apart from IFRS 9, as described in subpar. 4, did not have a material impact on these financial statements.

IFRS 15 "Revenue from contracts with customers"

IFRS 15 was adopted for use in all the Member States of the European Union on 22 September 2016 and applies to annual periods beginning on or after 1 January 2018.

IFRS 15 refers to fee and commission income and other fees generated by financial institutions, related – among other things – to servicing loans, asset management or fiduciary activities, which are not covered by IFRS 9.

Pursuant to this standard the Bank recognizes revenue in such a manner so as to reflect the transfer of the goods or services promised to a customer in an amount reflecting the consideration to which – in accordance with the entity's expectations – it will be entitled in return for the goods or services. The Bank applies this Standard in consideration of the terms and conditions of the contracts, and all material facts and circumstances.

The Bank has not identified contracts in respect of which the implementation of IFRS 15 would materially impact the financial statements.

5.2 New Standards and Interpretations, and amendments thereto, which have been published and have been approved by the European Union, but are not yet binding and have not been applied by the Bank

Several new standards and amendments to standards and interpretations have not yet become binding for the annual periods ending on 1 January 2018 and these have not been applied to these financial statements. From among the new standards and interpretations those referred to below will have an impact on the annual financial statements. The Bank intends to apply them for the periods for which they will be applicable for the first time, without taking advantage of an early application option.

IFRS 16"Leases"

The standard was published by the International Accounting Standards Board on 13 January 2016 and has been endorsed by the European Union. IFRS 16 is binding for the annual periods beginning on or after 1 January 2019. The new standard will replace the currently binding IAS 17 Leases. which is effective until the end of 2018, and Interpretation of the International Financial Reporting Interpretations Committee ("IFRIC") no. 4 and Interpretations of the Standing Interpretations Committee ("SIC") no. 15 and 27.

The new standard introduces one model for accounting for leases in the lessee's accounts, consistent with the accounting for financial leases under IAS 17. In accordance with IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The key difference between the definitions of a lease in IAS 17 and IFRS 16 is the requirement of control over the use of a specific asset being used, identified in an agreement expressly or implied. A transfer of right of use takes place where we have an identified asset from which a lessee has the right to practically all economic benefits, and where the lessee has control over the use of the asset in a given period.

If the definition of a lease is met, a right-of-use asset is recognized together with a corresponding lease liability determined in the amount of discounted future payments over the lease period, except for short-term lease contracts up to 12 months and lease agreements relating to assets immaterial in terms of their amounts.

Expenses relating to the use of leased assets which were previously charged to overheads shall now be classified as amortization cost and interest expense.

Right-of-use assets are amortized on a straight line basis, while lease liabilities are accounted for using the effective interest rate.

Impact of IFRS 16 on the financial statements

In the fourth quarter of 2018, the Bank finished the IFRS 16 implementation project.

Analyses were conducted of all operating lease, rent and hire agreements. In addition, agreements for the purchase of services (external services costs incurred as part of operating activities) were analysed for the existence of a right of use of an identified asset.

As part of the project, the Bank amended its accounting policies and operational procedures as appropriate. Methodologies were developed and implemented for the correct identification of agreements which represent leases and for collecting the data necessary to accurately account for such transactions. Moreover, the Bank implemented the necessary changes in its IT systems to enable them to collect and process the relevant data.

The Bank decided to adopt the standard as of 1 January 2019. In accordance with transitional provisions of IFRS 16, the new policies will be adopted retrospectively, with the cumulative effect of the initial application of the new standard being recognized in equity as at 1 January 2019. Consequently, the comparative data for the reporting year 2018 will not be restated (modified retrospective approach).

Specific adjustments resulting from the implementation of IFRS 16 are described below.

Recognition of lease liabilities

Upon adoption of IFRS 16, the Bank will recognize lease liabilities on agreements previously classified as operating leases in accordance with IAS 17. Such liabilities have been measured at the present value of the remaining lease payments at the date of initial application of IFRS 16, discounted using the interest rate as at 1 January 2019 calculated based on the Bank's incremental borrowing rate.

(IN PLN '000)

As at the date of initial recognition, lease payments taken into account in the measurement of the lease liability include the following types of payments for the right to use the underlying asset over the lease period:

- fixed lease payments less any lease incentives due;
- variable lease payments that depend on market indices;
- amounts expected to be paid in respect of the guaranteed residual value of a leased asset;
- the exercise price of a purchase option if it may be reasonably assumed to be exercised;
- payments of penalties for terminating the lease, if the lessee is able to exercise an option to terminate the lease.

In order to calculate discount rates for the purposes of IFRS 16, the Bank assumed that the discount rate should reflect the cost of financing which would have been incurred to purchase the leased asset. In order to estimate the discount rate, the Bank took into account the following parameters: the lease period and contractual currency, and the profitability of own debt securities issued by the Bank.

At 1 January 2019, the discount rates calculated by the Bank ranged from 2.07% to 4.21% (depending on the length of the lease period). All lease agreements concluded by the Bank are in PLN.

The Bank applied simplifications relating to short-term leases (below 12 months) and to agreements where the underlying asset is of low value (below PLN 20 thousand), and did not recognize financial liabilities and right-of-use assets for such leases. Lease payments are charged to costs on a straight-line basis over the period of the lease.

Recognition of the right-of-use assets

Right-of-use assets are measured at cost and presented in the statement of financial position together with assets owned by the Bank, including presentation of additional information in notes to the financial statements.

The cost of the right-of-use asset includes:

- the amount of the initial measurement of the lease liability;
- any lease payments made at or before the commencement date, less any lease incentives received;
- any initial direct costs incurred by the lessee in connection with concluding the lease agreement;
- an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset or restoring the underlying asset.

Application of estimates

The implementation of IFRS 16 required certain estimates and calculations which affect the measurement of the finance lease liabilities and right-of-use assets. They include, among others:

- identifying agreements covered by IFRS 16;
- identifying the lease term (including for agreements with an unspecified term or with an extension option);
- determining the interest rate to be applied for discounting future cash flows;
- determining depreciation rates.

Application of practical expedients

Upon first-time application of IFRS 16, the Bank applied the following practical expedients permitted by the standard:

- applying a single discounting rate to a portfolio of lease agreements with similar characteristics;
- operating lease agreements with a remaining lease term shorter than 12 months as at 1 January 2019 were treated as short-term leases.

Impact on the statement of financial position

The impact of IFRS 16 on the recognition of additional financial liabilities and right-of-use assets is presented in the table below:

IMPACT ON THE STATEMENT OF FINANCIAL POSITION	As at 31.12.2018 (IAS 17)	Effect of IFRS 16 implementation	As at 01.01.2019 (IFRS 16)
ASSETS			
Property, plant and equipment, of which:	449	5,427	**5,876**
right-of-use asset		5,427	**5,427**
LIABILITIES AND EQUITY			
Other liabilities, of which:	121,974	5,427	**127,401**
lease liabilities		5,427	**5,427**

(IN PLN '000)

Reconciliation of the difference between amounts of future lease payments under irrevocable operating leases disclosed in accordance with IAS 17 as at the end of 2018 and the lease liabilities recognized as at 1 January 2019, i.e. as at the date of the first application of IFRS 16 is presented below:

OPERATING LEASE LIABILITIES AS AT 31 DECEMBER 2018 (NOT DISCOUNTED)	**5,297**
Exclusion of short-term lease agreements	-
Exclusion of lease agreements for low value assets	-
Agreements whose assessment changed and are treated as service contracts since 1 January 2019	(56)
Impact of discount	(486)
Adjusted for the difference in the recognition of the extension/termination option, including notice period	672
LEASE LIABILITIES AS AT 1 JANUARY 2019	**5,427**

IMPACT ON EQUITY

Implementation of IFRS 16 has no impact on retained earnings and equity as at 1 January 2019 due to the fact that the right-of-use assets and lease liabilities were recognized in the same amounts.

IMPACT ON THE INCOME STATEMENT

Starting from 1 January 2019, there will be a change in the presentation of costs (rent will be replaced by depreciation and interest expense) and the timing of their recognition (costs relating to leases will be recognized faster due to the fact that interest expense will be recognized using the effective interest method which has not been applied previously).

IMPACT ON FINANCIAL RATIOS

Given the amount of the right-of-use assets and lease liabilities recognized as at 1 January 2019, it is estimated that the implementation of IFRS 16 will have a negligible impact on the financial ratios.

NEW STANDARDS AND INTERPRETATIONS, AND AMENDMENTS THERETO, WHICH HAVE BEEN PUBLISHED BUT HAVE NOT BEEN APPROVED BY THE EUROPEAN UNION

Amendments to IFRS 3, IFRS 9, IFRS 10, IAS 1, IAS 28 and IAS 19, improvements to IFRS 2015-2017 and implementation of IFRS 17 and IFRIC 23 will not have a material impact on the Bank's financial statements.

(IN PLN '000)

NOTES TO THE INCOME STATEMENT

6. Interest income and expense

Accounting policies

Interest income and expense includes interest, including premium and discount on financial instruments measured at amortized cost and instruments measured at fair value. Interest income and expense is recognized on the accruals basis and using the effective interest rate method.

Interest income and expense also includes fees and commission accrued using the effective interest rate method, accrued or paid, included in the measurement of a financial instrument.

Income and expense on the sale of insurance products linked to loans and advances

The Bank is not offering insurance products linked to loans and advances.

Financial information

INTEREST INCOME	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Interest income calculated under the effective interest rate method, including:	**666,411**	**409,657**
on financial instruments measured at amortized cost, including:	**650,264**	**399,599**
loans and advances to customers	650,216	399,457
amounts due from banks and on mandatory reserve	48	142
on instruments measured at fair value through other comprehensive income, including:	**16,147**	**10,058**
debt securities	16,147	10,058
Income similar to interest income on instruments measured at fair value through profit or loss, including:	**1,184**	**837**
debt securities	-	360
hedging IRS transactions (net)	1,184	477
Total	**667,595**	**410,494**
including: interest income on impaired financial instruments	248	52

INTEREST EXPENSE	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Interest income on financial instruments measured at amortized cost, including:	**(268,615)**	**(173,231)**
loans received and overdraft facility used	(34,627)	(27,802)
deferred payment for acquisition of receivables	(52,370)	(40,471)
mortgage covered bonds issued	(122,061)	(65,129)
unsecured bonds issued	(59,557)	(39,829)
Interest expense on instruments measured at fair value through profit or loss, including:	**(149,494)**	**(86,026)**
on hedging CIRS transactions (net)	(149,494)	(86,026)
Total	**(418,109)**	**(259,257)**

7. Fee and commission income and expense

Accounting policies

Fee and commission income is generally recognized on an accruals basis when the service has been provided.

Commission income includes one-off fees collected by the Bank for performing tasks not directly related to origination of loans, advances and other receivables.

Commission expense includes fees and commission accrued on a straight-line basis, paid in connection with the financing obtained by the Bank where the timing of the future cash flows is unspecified, for which the effective interest rate cannot be determined, and relating to issue programmes, as well as costs incurred by the Bank in connection with preparation by property valuers of appraisal reports on Property Value for Mortgage Lending Purposes (BHWN).

(IN PLN '000)

FINANCIAL INFORMATION

FEE AND COMMISSION INCOME	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Fees for property valuation	6,166	5,063
Fees for property inspection	2,634	2,066
Fees for full or partial early repayment of loans	4,676	3,127
Other	1,293	811
Total	**14,769**	**11,067**

FEE AND COMMISSION EXPENSE	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Preparation by property valuers of appraisal reports on Property Value for Mortgage Lending Purposes (BHWN)	(8,981)	(7,642)
Expenses related to unsecured bonds issuance programme	(3,542)	(2,632)
Expenses related to credit lines	(2,614)	(2,889)
Expenses related to mortgage covered bonds issuance programme	(1,164)	(982)
Loan insurance costs	(2,999)	(1,321)
Commission on other operating services	(225)	(145)
Costs of debt collection and intermediation in selling collateral	(29)	(12)
Total	**(19,554)**	**(15,623)**

8. NET RESULT ON FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

ACCOUNTING POLICIES AND CLASSIFICATION

Net result on financial instruments measured at fair value through profit or loss includes gains and losses arising on disposal of financial instruments classified as financial assets/liabilities measured at fair value through profit or loss (both those held for trading and designated as measured at fair value through profit or loss at initial recognition), and the effects of their remeasurement to the fair value.

The item also includes an ineffective part of cash flow hedges for hedging strategies where Interest Rate Swap (IRS) contracts are hedging instruments.

FINANCIAL INFORMATION

NET RESULT ON FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Gain/(loss) on derivatives	89	(264)
Gain/(loss) on IRS derivative instruments before designation to hedge accounting	26	(240)
Gain/(loss) on IRS derivative instruments related to hedge ineffectiveness	63	(24)
Gain/(loss) on debt instruments	-	(1)
Total	**89**	**(265)**

The Bank concludes and maintains IRS derivative instruments solely for hedging purposes.

9. NET FOREIGN EXCHANGE GAINS/(LOSSES)

ACCOUNTING POLICIES AND CLASSIFICATION

Net foreign exchange gains/(losses) include foreign exchange gains and losses, both realized and unrealized, on measurement of foreign currency assets and liabilities at average exchange rates announced by the National Bank of Poland applicable as at the end of the reporting period, and on fair value measurement of derivative instruments, i.e.

(IN PLN '000)

Cross Currency Interest Rate Swaps (CIRS) and Foreign Exchange Forwards (FX-Forward), including the ineffective part of cash flow hedges for hedging strategies where CIRS and FX Forwards contracts are hedging instruments.

FINANCIAL INFORMATION

NET FOREIGN EXCHANGE GAINS/(LOSSES)	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Result on revaluation	(173)	294
Gain/(loss) on derivative instruments (CIRS, FX-Forward) before designation to hedge accounting	(1,375)	5,767
Gain/(loss) on derivative instruments (CIRS, FX-Forward) related to hedge ineffectiveness	1,310	(5,070)
Total	**(238)**	**991**

The Bank concludes and maintains CIRS and FX Forward derivative instruments solely for hedging purposes.

10. GAINS/(LOSSES) ON DERECOGNITION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES NOT MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

ACCOUNTING POLICIES AS OF 1 JANUARY 2018

Gains or losses on derecognition of financial instruments not measured at fair value through profit or loss (including on sale or material modification) is presented broken down by accounting portfolios:

- measured at fair value through other comprehensive income;
- measured at amortized cost.

FINANCIAL INFORMATION

In 2018 the net result on derecognition of financial assets and liabilities not measured at fair value through profit or loss was PLN 0.

11. NET RESULT ON MODIFICATION

ACCOUNTING POLICIES AS OF 1 JANUARY 2018

The net result on the modification of financial assets is presented broken down by financial instruments:

- measured at amortized cost;
- measured at fair value through other comprehensive income;
- measured at fair value through profit or loss.

Issues related to modifications have been described in Note 4 "IFRS 9 Financial instruments". In the item "Net result on modification" the net result on immaterial modification is presented, whereas the net result on material modification is presented under "Net result on derecognition of financial instruments not measured at fair value through profit or loss".

FINANCIAL INFORMATION

NET RESULT ON MODIFICATION	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Financial instruments measured at amortized cost	(439)	
Total	**(439)**	

(IN PLN '000)

FINANCIAL ASSETS SUBJECT TO MODIFICATION	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Carrying amount at amortized cost before modification (Stage 2)	1,761	
Gain/(loss) recognized on modification	5	
Carrying amount at amortized cost before modification (Stage 3)	469	
Gain/(loss) recognized on modification	(2)	

The gross value of financial assets for which lifetime expected losses were calculated and which had been modified after 1 January 2018 and were classified to Stage 1 after modification amounted to PLN 1,606 thousand as at 31 December 2018.

12. NET CREDIT LOSSES

ACCOUNTING POLICIES

Accounting policies for recognizing net credit losses have been described for specific items in Notes 4.2, 23 and 34.2, as appropriate. Net credit losses comprise allowances for loans and advances to customers and provisions for loan commitments granted recognized and released.

FINANCIAL INFORMATION

NET CREDIT LOSSES	Note	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Net allowances on loans and advances to customers	23, 24	(8,667)	(3,309)
Net provisions for loan commitments	23, 24	(36)	26
Total		**(8,703)**	**(3,283)**

13. OTHER OPERATING INCOME AND EXPENSES

ACCOUNTING POLICIES

Other operating income and expenses include income and expenses not directly associated with banking activities.

FINANCIAL INFORMATION

OTHER OPERATING INCOME	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Sundry income	606	1,308
Other	7	5
Total	**613**	**1,313**

OTHER OPERATING EXPENSE	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Sundry expenses	(517)	(1,250)
Other	(42)	(46)
Total	**(559)**	**(1,296)**

Sundry expenses for 2018 include PLN 403 thousand relating to inspection reports provided by property valuers in respect of properties for which the receivables could not have been purchased by PKO Bank Hipoteczny SA. In accordance with terms and conditions of the receivable purchase agreements, these costs are borne to PKO Bank Polski SA and, consequently, were re-invoiced and presented as sundry income. In 2017, they amounted to PLN 1,150 thousand.

(IN PLN '000)

14. Administrative expenses

Accounting policies

Employee benefits	Employee benefits include costs of salaries and wages and social insurance (including contributions to pension and disability benefits, described in detail in Note 32 "Provisions"). In addition, the Bank recognizes a provision for future liabilities in respect of severance pay for employees whose employment contracts will be terminated, charged to costs of salaries and wages, and accrued costs attributable to the current period, to be paid in future periods, including bonuses and holiday pay, taking into account all outstanding unused holiday. Employee benefits also include a variable remuneration plan for the top management, which is recognized in part as a liability in respect payments based on the book value of shares, settled in cash. The variable remuneration plan is described in Note 38.4 "The principles for determining the variable remuneration components policy for key management personnel in the Bank".
Overheads	These include, among others: costs of services relating to supporting tasks and the costs of servicing loans under the Outsourcing Agreement (described in Note 38.1 "Transactions with entities related in terms of capital"), costs of external services resulting from other agreements, costs of renting properties and IT costs. Lease payments made under operating leases and subsequent lease instalments are charged to the income statement on a straight line basis over the period of the lease.
Depreciation and amortization	Depreciation and amortization policies are described in details in Note 25 "Intangible assets and property, plant and equipment".
Taxes and charges	These include, among others, the following items: tax on civil law transactions, payments to the Bank Guarantee Fund (BGF) and to the Polish Financial Supervision Authority (PFSA).

Financial information

ADMINISTRATIVE EXPENSES	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Employee benefits	(16,698)	(16,063)
Overheads	(26,741)	(20,622)
Amortization and depreciation, including:	(2,177)	(1,487)
property, plant and equipment	(252)	(271)
intangible assets	(1,925)	(1,216)
Taxes and fees, including:	(6,868)	(2,875)
Tax on civil law transactions (due to share capital increase)	(500)	(2,000)
Contribution to the BGF Resolution Fund	(4,556)	(31)
Payments to the PFSA	(1,524)	(583)
Total	**(52,484)**	**(41,047)**

EMPLOYEE BENEFITS	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Wages and salaries, of which:	(14,171)	(13,748)
provision for disability and retirement benefits	(53)	(24)
Salary surcharges	(1,657)	(1,690)
Other employee benefits	(870)	(625)
Total	**(16,698)**	**(16,063)**

(IN PLN '000)

OVERHEADS	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Services relating to supporting operations under Outsourcing Agreement[1)]	(3,192)	(2,812)
Servicing of loans granted and receivables purchased under Outsourcing Agreement[1)]	(15,939)	(10,644)
External services under other contracts	(2,623)	(2,037)
IT costs	(1,534)	(1,537)
Rents and service charges	(2,083)	(1,943)
Car leases	(274)	(246)
Other	(1,096)	(1,403)
Total	**(26,741)**	**(20,622)**

[1)] The Outsourcing Agreement is described in Note 38.1 "Transactions with entities related in terms of capital"

15. Tax on certain financial institutions

On 1 February 2016, the Act on tax on certain financial institutions of 15 January 2016 came into force. For banks, the tax base is calculated as the surplus of total assets over PLN 4 billion as per the trial balance as at the end of each month. Banks are entitled to reduce the tax base by deducting, among other things, own funds and the value of Treasury securities held. The tax rate is 0.0366% per month and the tax is paid monthly by the 25th day of the month following the month to which the tax relates. The tax paid is not tax deductible for the purposes of corporate income tax. Tax on certain financial institutions amounted to PLN 60,765 thousand for 2018 and PLN 31,699 thousand for 2017.

16. Income tax expense

Accounting policies

Recognition	Income tax expense comprises current and deferred tax. Current income tax expense is recognized in the income statement. Deferred tax is recognized in the income statement or other comprehensive income, depending on the source of the timing differences.
Current income tax expense	Current income tax is calculated based on profit before tax determined in accordance with the accounting regulations, adjusted by income which is not taxable under the tax regulations, taxable income not recognized as income for accounting purposes, non-deductible costs and tax costs not recognized as costs for accounting purposes, in accordance with the relevant provisions of the tax law. These include, among other things, interest income and expense accrued to be received or paid, allowances for credit losses, provisions for liabilities, the cost of tax on certain financial institutions or payments to the BGF.
Deferred income tax	Deferred income tax is recognized as the difference between the tax bases of assets and liabilities and their carrying amounts. A change in the deferred tax provision and asset is charged to the profit or loss, with the exception of the effects of revaluation of financial assets measured at fair value through other comprehensive income and the valuation of the hedging instruments recognized in other comprehensive income, where the changes in the balance of the deferred tax provision and asset are also recognized in other comprehensive income. When determining the deferred income tax, the amounts of the deferred tax provision and asset as at the beginning and end of the reporting period are taken into account. The carrying amount of a deferred tax asset is reviewed as at each reporting date and is decreased to the extent it has become less probable that a taxable profit will be generated in an amount sufficient for the deferred tax asset to be partially or fully realized. Deferred income tax assets and provisions are measured using the tax rates, which are expected to apply in the period in which the asset is realized or the provision released, determined on the basis of tax rates (and tax regulations) enacted or substantively enacted as at the end of the reporting period, or the rates which are certain to apply in the future. The Bank offsets the deferred tax asset against the deferred tax provision solely when it has a

(IN PLN '000)

legally enforceable title for an offset of the current income tax receivables and liabilities, and if the deferred income asset and provision relate to income taxes imposed by the same tax authorities on the same taxpayer.

FINANCIAL INFORMATION

INCOME TAX EXPENSE	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Current income tax expense	(33,299)	(11,735)
Deferred income tax due to temporary differences	(3,067)	(8,241)
Income tax reported in the income statement	**(36,366)**	**(19,976)**
Income tax reported in other comprehensive income due to temporary differences	(21,764)	2,564
Total	**(58,130)**	**(17,412)**

RECONCILIATION OF THE EFFECTIVE TAX RATE	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Profit / (loss) before income tax	**122,215**	**71,395**
Corporate income tax calculated at the statutory tax rate in force in Poland (19%)	(23,221)	(13,565)
Effect of non-deductible differences and between profit before income tax and taxable income, of which:	**(13,145)**	**(6,440)**
tax on certain financial institutions	(11,545)	(6,023)
fees to the BGF	(866)	(6)
costs exceeding the limit set in Article 15e of the CIT Act	(607)	-
Tax on civil law transactions relating to share capital increase	(95)	(380)
PFRON (State Disabled Persons Fund) costs	(16)	(15)
impact of other permanent differences	(16)	(16)
Effect of other timing differences between profit before income tax and taxable income, including new technologies tax relief	**-**	**29**
Income tax expense reported in the income statement	**(36,366)**	**(19,976)**
Effective tax rate	**29.76%**	**27.98%**
Temporary difference resulting from deferred tax reported in the income statement	(3,067)	(8,241)
Total current Income tax expense reported in the income statement	**(33,299)**	**(11,735)**

CURRENT INCOME TAX LIABILITIES	31.12.2018	31.12.2017
Current income tax liabilities	3,159	3,507

Current income tax liabilities were paid within the statutory deadline.

(IN PLN '000)

NET DEFERRED TAX ASSETS/LIABILITIES	31.12.2017	Impact of adjustment due to IFRS 9 adoption recognized in retained earnings	Income statement	Other comprehensive income	31.12.2018
Deferred tax provision					
Interest accrued on loans and advances to customers	5,735	27	1,893	-	7,655
Interest accrued and discount on securities	565	-	162	-	727
Adjustment of loan portfolio valuation under the straight-line and effective interest rate methods	13,470	-	6,105	-	19,575
Adjustment of own bonds issued valuation under straight-line and effective interest rate methods	2,205	-	1,381	-	3,586
Deferred costs	1,060	-	(235)	-	825
Difference between carrying amount and tax value of property, plant and equipment and intangible assets	10	-	(5)	-	5
Valuation of securities	619	-	-	419	1,038
Valuation of derivatives	5,623	-	3,451	13,516	22,590
Gross deferred income tax provision	**29,287**	**27**	**12,752**	**13,935**	**56,001**
Deferred tax asset					
Interest accrued on amounts due to banks	2,144	-	3,852	-	5,996
Interest accrued and discount on liabilities in respect of securities issued	6,280	-	4,921	-	11,201
Allowances for credit losses	952	2,792	1,388	-	5,132
Expenses to be paid	1,637	-	2	-	1,639
Tax loss	2,362	-	(2,362)	-	-
Valuation of securities	38	-	-	(38)	-
Valuation of derivatives	12,637	-	1,884	(7,791)	6,730
Gross deferred tax asset	**26,050**	**2,792**	**9,685**	**(7,829)**	**30,698**
Net deferred income tax asset / (provision) (presented in the statement of financial position)	**(3,237)**	**2,765**	**(3,067)**	**(21,764)**	**(25,303)**

Tax Group

Based on the contract dated 5 November 2018 PKO Bank Polski SA, as the parent company, jointly with its two subsidiaries: PKO Bank Hipoteczny SA and PKO Leasing SA, created the Podatkowa Grupa Kapitałowa Powszechnej Kasy Oszczędności Banku Polskiego Spółki Akcyjnej Tax Group ("PGK PKO Banku Polskiego SA"). The contract was registered by the Head of the Second Mazovian Tax Office in Warsaw. PGK PKO Banku Polskiego SA was established for three tax years. The first tax year began on 1 January 2019.

A tax group is an institution of the tax law stipulated in the provisions of the Corporate Income Tax Act. Its creation means that the income of the Tax Group companies will be consolidated for corporate income tax purposes and that solutions will be available facilitating the application of other, in particular operational, regulations of the Corporate Income Tax Act, dedicated specifically to Tax Groups.

17. Earnings per share

Methodology

Basic earnings per share	Basic earnings per share are calculated based on the profit attributable to the Bank's ordinary shareholders by dividing the profit attributable to then by the weighted average number of ordinary shares during the period.
Diluted earnings per share	Diluted earnings per share are calculated based on the profit attributable to ordinary shareholders by dividing the profit attributable to them by the weighted average number of ordinary shares during the period, adjusted for the dilutive effect of .all dilutive potential ordinary shares.

Financial information

EARNINGS PER SHARE	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Profit attributable to ordinary shareholders (in PLN thousand)	85,849	51,419
Weighted average number of ordinary shares during the period (in thousand)	1,222,123	967,123
Earnings per share (in PLN per share)	0.07	0.05

In 2018 and 2017 there were no instruments which would dilute the earnings per share. Therefore, the amount of diluted earnings per share corresponds to the amount of base profit per share.

(IN PLN '000)

NOTES TO THE STATEMENT OF FINANCIAL POSITION

18. Cash and balances with the Central Bank

Accounting policies

"Cash and balances with the Central Bank" comprise amounts in the current account and deposits with the Central Bank, measured at amounts due which include any interest on these amounts.

Financial information

CASH AND BALANCES WITH THE CENTRAL BANK	31.12.2018	31.12.2017
Current account with the Central Bank	6	561
Total	**6**	**561**

Mandatory reserve

In the period from 31 December 2018 to 30 January 2019 and from 30 November 2017 to 1 January 2018, the Bank maintained the mandatory reserve of PLN 0 thousand and PLN 670 thousand, respectively. Funds in the mandatory reserve account bear interest equal to 0.9 of the reference rate. As at 31 December 2018 and 31 December 2017, such interest rate was 1.35%.

During the day, the Bank may use the funds deposited in the mandatory reserve account for current cash settlements on the basis of an instruction submitted to the National Bank of Poland, but the Bank must ensure that the monthly average balance is maintained on the account at an appropriate level consistent with the declared mandatory reserve.

19. Amounts due from banks

Accounting policies

Amounts due from banks are financial assets measured at amortized cost using the effective interest rate method, net of allowances for expected credit losses. If the timing of future cash flows and, consequently, the effective interest rate, cannot be determined for a receivable, it is measured at the amount due.

Financial information

AMOUNTS DUE FROM BANKS	31.12.2018	01.01.2018	31.12.2017
Measured at amortized cost			
current accounts	22	5,350	5,350
Total	**22**	**5,350**	**5,350**

Information on exposures to credit risk relating to amounts due from banks is provided in Note 42 "Credit risk management".

All amounts due from banks were classified to Stage 1 as at 1 January 2018 and 31 December 2018. During the year ended 31 December 2018, there were no transfers between stages for amounts due from banks.

20. Derivative hedging instruments

Accounting policies, estimates and assessments

The use of hedge accounting	The Bank decided to further apply the provisions of IAS 39 and did not apply IFRS 9 in respect of hedge accounting. In its operations, the Bank uses derivative instruments: CIRS, IRS, FX-Forward for hedging purposes only, in accordance with the risk management strategy described in more detail in Notes 46 and 47. All derivatives shall be designated for hedge accounting. The Bank applies hedge accounting when all the terms and conditions below have been met:

	▪ upon setting up the hedge, the hedging relationship, the purpose of risk management by the entity and the hedging strategy were officially established and documented. Such documentation shall contain identification of the hedging instrument, the hedged item or transaction, the nature of the hedged risk, and the method used by the entity to assess the hedging instrument's effectiveness in compensating the risk of changes in the fair value of the hedged risk or the cash flows relating to the hedged risk; ▪ the hedge is expected to be highly effective in compensating the changes in the fair value or cash flows resulting from the hedged risk, in accordance with the originally documented risk management strategy relating to this specific hedging relationship; ▪ in the case of cash flow hedges, the planned hedged transaction must be highly probable and must be exposed to a risk of variability of cash flows which may, as a result, have an impact on the income statement; ▪ the hedge effectiveness can be assessed reliably, i.e. the fair value or cash flows relating to the hedged item and resulting from the hedged risk and the fair value of the hedging instrument can be assessed reliably; ▪ the hedge is regularly assessed and its high effectiveness is confirmed in all the reporting periods for which the hedge had been designated.
DISCONTINUATION OF HEDGE ACCOUNTING	The Bank discontinues the application of hedge accounting when: ▪ a hedging instrument expires, is sold, terminated or executed (replacing a hedging instrument with another hedging instrument or extending the validity of a hedging instrument is not treated as its expiry or termination, if such replacement or extension is a part of a documented hedging strategy adopted by the entity). In such cases, accumulated gains or losses associated with a hedging instrument, which were directly recognized in other comprehensive income over the period in which the hedge was effective, continue to be recognized as a separate item of other comprehensive income and credited or charged to profit or loss over the period in which the hedged item is recognized in profit or loss; ▪ the hedge no longer meets the criteria of hedge accounting. In such cases, accumulated gains or losses associated with a hedging instrument, which were directly recognized in other comprehensive income over the period in which the hedge was effective, continue to be recognized as a separate item of other comprehensive income and credited or charged to profit or loss over the period in which the hedged item is recognized in profit or loss; ▪ the planned transaction is no longer expected to be executed – in such cases, all accumulated gains or losses relating to the hedging instrument which were recognized directly in other comprehensive income over the period in which the hedge was effective, are recognized in profit ot loss; ▪ the hedging relationship has been invalidated.
FAIR VALUE HEDGES	The Bank does not apply fair value hedging.
CASH FLOW HEDGES	Cash flow hedges are hedges against cash flow volatility, which may be attributed to a specific type of risk associated with a recognized asset or liability (such as future payments of interest on floating-interest debt (or a part thereof)) or a highly probable planned transaction, and which could affect the income statement. Changes in the fair value of a derivative financial instrument designated as a cash flow hedge are recognized directly in other comprehensive income in respect of the portion constituting the effective portion of the hedge. The ineffective portion of the hedge is recognized in the income statement in the item "Net income from financial instruments designated at fair value" or "Foreign exchange gains (losses)". Moreover, the amounts recognized directly in other comprehensive income are transferred to the income statement as "Net interest income" or "Net foreign exchange gain", respectively, in the period or periods in which the impact of the hedged transaction is recognized in the income statement. The effectiveness tests comprise the valuation of hedging transactions, net of interest accrued and foreign exchange gains (losses) on the nominal value of the hedging transactions (in the case of CIRS and FX-Forward transactions). Hedge effectiveness is verified through the use of prospective and retrospective effectiveness tests. The tests are performed on a monthly basis.

POTENTIAL SOURCES OF INEFFECTIVENESS	The main sources of hedge ineffectiveness may include: ▪ applying the CVA/DVA adjustment to the hedging instrument only; ▪ the existence of minute differences in the structure and the basic parameters of hedging transactions and hedged items. The monthly tests show continuous high effectiveness of the hedging strategies applied.
ESTIMATES AND JUDGEMENTS	The fair value of derivative instruments is determined using valuation models based on discounted future cash flows from a given financial instrument. The model variables and assumptions used for valuation purposes comprise, subject to availability, data from observable markets (e.g. deposit rates on the interbank market, foreign exchange rates, IRS transaction quotations). The fair value of derivatives includes the Bank's own credit risk, DVA (debit value adjustment) as well as counterparty credit risk, CVA (credit value adjustment). The process of calculation of CVA and DVA adjustments includes the selection of a method for determining the spread of the counterparty's or the Bank's credit risk (e.g. a market price method based on the continuous price quotations of debt instruments issued by the counterparty, a method of spread implied from Credit Default Swap contracts), an estimation of the probability of default by the counterparty or the Bank and the recovery rate.

TYPES OF HEDGING STRATEGIES USED BY THE BANK

STRATEGY 1	HEDGE OF THE VARIABILITY OF CASH FLOWS GENERATED BY MORTGAGE LOANS IN PLN DUE TO CHANGES IN THE REFERENCE INTEREST RATES AND BY MORTGAGE COVERED BONDS DENOMINATED IN A CONVERTIBLE FOREIGN CURRENCY DUE TO CHANGES IN THE EXCHANGE RATE, USING CIRS AND FX-FORWARD HEDGING INSTRUMENTS
OUTLINE OF THE HEDGING TRANSACTION	Elimination of the variability of cash flows generated by mortgage loans in PLN due to changes in the reference interest rates and by mortgage covered bonds denominated in a convertible foreign currency due to changes in the exchange rate, using CIRS hedging instruments and a series of FX-Forward transactions in the foreign currency serving as hedges of the FX exposures maturing on the dates of payment of coupons on the mortgage covered bonds in the foreign currency.
HEDGED RISK	Forex and interest rate risks.
HEDGING INSTRUMENTS	▪ Cross-Currency Interest Rate Swap (CIRS) transactions in which the Bank pays a coupon based on a variable PLN rate and receives a coupon based on a fixed rate for the convertible currency. If PKO Bank Hipoteczny SA is declared bankrupt by the court, the CIRS transactions will automatically be extended by 12 months on the terms and conditions set on the transaction date; ▪ an optional series of FX-Forward transactions in the convertible foreign currency serving as hedges of the FX exposures maturing on the dates of payment of coupons on the mortgage covered bonds in the foreign currency.
HEDGED ITEM	▪ part of the portfolio of the home loans included in the cover pool of PLN covered bonds at floating rates. The interest rates on the loans are indexed by the 3M WIBOR rate. The mortgage loan margin is excluded from the hedge; ▪ fixed-rate covered bonds issued in a foreign currency.
THE PERIOD IN WHICH CASH FLOWS ARE EXPECTED	The period in which cash flows are expected to occur and affect the financial results: January 2019 – August 2024.

(IN PLN '000)

HEDGING DERIVATIVE INSTRUMENTS	NOMINAL VALUE OF HEDGING DERIVATIVE INSTRUMENTS		CARRYING AMOUNT/FAIR VALUE OF HEDGING INSTRUMENTS		INEFFECTIVE PORTION OF CASH FLOW HEDGES RECOGNIZED IN THE INCOME STATEMENT	CHANGE IN THE FAIR VALUE OF THE HEDGING INSTRUMENT SINCE DESIGNATION
			Assets	Liabilities		
31.12.2018						
CIRS EUR/PLN	fixed EUR	2,076,360	162,100	14,786	1,334	143,605
	float PLN	8,858,819				
FX forward	purchase EUR	2,173	237	468	(24)	
	sale EUR	1,656				
31.12.2017						
CIRS EUR/PLN	fixed EUR	1,576,900	-	217,009	(5,070)	(220,539)
	float PLN	6,757,590				
FX forward	purchase EUR	1,733	338	391	-	
	sale EUR	1,558				

The average fixed rate weighted with the nominal value for CIRS transactions amounted to 0.585% as at 31 December 2018, and 0.527% as at 31 December 2017.

HEDGED ITEMS	CARRYING AMOUNT OF HEDGED ITEMS	ITEM IN THE STATEMENT OF FINANCIAL POSITION	CHANGE IN THE FAIR VALUE THE HEDGED ITEMS SINCE DESIGNATION
31.12.2018			
variable interest loans in PLN	8,858,819	Loans and advances to customers	(150,942)
fixed-interest mortgage covered bonds issued in a convertible currency	8,930,571	Mortgage covered bonds issued	
31.12.2017			
variable interest loans in PLN	6,757,590	Loans and advances to customers	216,957
fixed-interest mortgage covered bonds issued in a convertible currency	6,577,822	Mortgage covered bonds issued	

STRATEGY 2	HEDGES AGAINST FLUCTUATIONS IN CASH FLOWS FROM FLOATING INTEREST RATE LOANS IN PLN, RESULTING FROM THE RISK OF CHANGES IN INTEREST RATES, USING IRS TRANSACTIONS
DESCRIPTION OF THE HEDGING RELATIONSHIP	Elimination of the risk of cash flow fluctuations generated by floating interest rate PLN loan portfolio resulting from the risk of changes in interest rates in the period covered by the hedge using IRS transactions.
HEDGED RISK	Interest rate risk.
HEDGING INSTRUMENTS	IRS (Interest Rate Swap) transactions where the Bank pays coupons based on floating 3M WIBOR rate, and receives coupons based on a fixed rate on the nominal value for which they were concluded.
HEDGED ITEM	A part of the portfolio of home loans in PLN indexed to the WIBOR 3M floating rate. The margin on mortgage loans is excluded from hedging.
THE PERIOD IN WHICH CASH FLOWS ARE EXPECTED	The period in which cash flows are expected to occur and affect the financial results: January 2019 – August 2028.

HEDGING DERIVATIVE INSTRUMENTS	NOMINAL VALUE OF HEDGING DERIVATIVE INSTRUMENTS		CARRYING AMOUNT/FAIR VALUE OF HEDGING INSTRUMENTS		INEFFECTIVE PORTION OF CASH FLOW HEDGES RECOGNIZED IN THE INCOME STATEMENT	CHANGE IN THE FAIR VALUE OF THE HEDGING INSTRUMENT SINCE DESIGNATION
			Assets	Liabilities		
31.12.2018						
IRS PLN	PLN	325,000	5,952	-	63	6,165
31.12.2017						
IRS PLN	PLN	265,000	-	377	(24)	(165)

The average fixed rate weighted with the nominal value for IRS transactions amounted to 2.84% as at 31 December 2018, and 2.69% as at 31 December 2017.

HEDGED ITEMS	CARRYING AMOUNT OF HEDGED ITEMS	ITEM IN THE STATEMENT OF FINANCIAL POSITION	CHANGE IN THE FAIR VALUE THE HEDGED ITEMS SINCE DESIGNATION
31.12.2018			
variable interest loans in PLN	325,000	Loans and advances to customers	(6,248)
31.12.2017			
variable interest loans in PLN	265,000	Loans and advances to customers	114

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CARRYING AMOUNT / FAIR VALUE OF DERIVATIVE INSTRUMENTS DESIGNATED AS CASH FLOW HEDGES	31.12.2018		31.12.2017	
	Assets	Liabilities	Assets	Liabilities
IRS	5,952	-	-	377
CIRS	162,100	14,786	-	217,009
FX forward	237	468	338	391
Total	**168,289**	**15,254**	**338**	**217,777**

The Bank concludes and maintains derivative instruments exclusively for hedging purposes.

NOMINAL VALUE OF HEDGING INSTRUMENTS BY MATURITY AS AT 31 DECEMBER 2018	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
IRS						
PLN fixed-float	-	-	-	265,000	60,000	**325,000**
CIRS						
float PLN sale	-	-	-	4,514,349	4,344,470	**8,858,819**
fixed EUR purchase (original currency)	-	-	-	1,052,370	1,023,990	**2,076,360**
FX forward						
PLN sale	-	-	-	6,607	4,122	**10,729**
EUR purchase (original currency)	-	-	-	1,340	833	**2,173**
PLN purchase	435	-	1,497	5,731	-	**7,663**
EUR sale (original currency)	101	-	329	1,226	-	**1,656**

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NOMINAL VALUE OF HEDGING INSTRUMENTS BY MATURITY AS AT 31 DECEMBER 2017	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
IRS						
PLN fixed-float	-	-	-	265,000	-	**265,000**
CIRS						
float PLN sale	-	-	-	2,383,445	4,374,145	**6,757,590**
fixed EUR purchase (original currency)	-	-	-	552,510	1,024,390	**1,576,900**
FX forward						
PLN sale	-	-	-	6,036	2,549	**8,585**
EUR purchase (original currency)	-	-	-	1,224	509	**1,733**
PLN purchase	86	-	1,438	5,364	325	**7,213**
EUR sale (original currency)	20	-	323	1,149	66	**1,558**

ACCUMULATED OTHER COMPREHENSIVE INCOME ON CASH FLOW HEDGES AND IMPACT ON OTHER COMPREHENSIVE INCOME	31.12.2018	31.12.2017
Accumulated other comprehensive income on cash flow hedges as at the beginning of the period, gross	(38,730)	(21,870)
Gains / (Losses) recognized in other comprehensive income during the period	213,920	(333,532)
Amounts transferred from other comprehensive income to the income statement during the period	(101,779)	316,672
- interest income	(1,184)	(477)
- Interest expense	149,494	86,026
- net foreign exchange gains/(losses)	(250,089)	231,123
Accumulated other comprehensive income on cash flow hedges as at the end of the period, gross	73,411	(38,730)
Tax effect	(13,949)	7,358
Accumulated other comprehensive income on cash flow hedges as at the end of the period, net	**59,462**	**(31,372)**
Ineffective portion of cash flow hedges recognized in the income statement	**1,373**	**(5,094)**
Impact on other comprehensive income during the period, gross	112,141	(16,860)
Deferred tax on cash flow hedges	(21,307)	3,203
Impact on other comprehensive income during the period, net	**90,834**	**(13,657)**

CALCULATION OF ESTIMATES

The Bank conducted a simulation to assess the potential impact of changes in the yield curves on the transaction value.

ESTIMATED CHANGE IN THE VALUATION AT A PARALLEL MOVE OF YIELD CURVES:	31.12.2018		31.12.2017	
	+50 b.p. scenario	-50 b.p. scenario	+50 b.p. scenario	-50 b.p. scenario
IRS	(5,273)	5,273	(4,151)	4,151
CIRS	(200,809)	200,809	(173,196)	173,196
FX forward	4	(4)	4	(4)

21. SECURITIES

ACCOUNTING POLICIES AS OF 1 JANUARY 2018

As of 1 January 2018 the Bank classifies debt securities to the following categories:

- Financial assets measured at fair value through profit or loss:
  - financial instruments held for trading;
  - financial assets not held for trading, measured at fair value through profit or loss on a mandatory basis;

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  - financial assets designated to be measured at fair value through profit or loss at initial recognition.
- Financial assets measured at fair value through other comprehensive income.
- Financial assets are measured at amortized cost.

The debt securities' classification and measurement policies have been described in Note 4 "IFRS 9 Financial instruments".

Accounting policies until 31 December 2017

Until 31 December 2017 the Bank classified debt securities to the following categories:

- financial instruments held for trading;
- financial instruments designated at fair value through profit or loss;
- investment securities available for sale;
- investment securities held to maturity.

Respective policies have been described in detail in the annual Financial Statements of PKO Bank Hipoteczny SA for the year ended 31 December 2017.

Financial information

SECURITIES	31.12.2018	01.01.2018	31.12.2017
Available -for-sale investment securities, including:			830,489
issued by the State Treasury, PLN Treasury bonds			830,489
Measured at fair value through other comprehensive income	842,965	830,489	
issued by the State Treasury, PLN Treasury bonds	842,965	830,489	
Total	**842,965**	**830,489**	**830,489**

SECURITIES BY MATURITY	31.12.2018	31.12.2017
Issued by the State Treasury, PLN Treasury bonds		
up to 1 month	186,506	100,797
1 to 5 years	479,474	614,160
over 5 years	176,985	115,532
Total	**842,965**	**830,489**

SECURITIES BY NOMINAL VALUE AND AVERAGE YIELD	31.12.2018	31.12.2017
Issued by the State Treasury, PLN Treasury bonds	836,480	826,480
Average yield	1.78%	1.81%

Information on credit risk exposure in connection with securities is provided in Note 42 "Credit risk management".

The whole balance of securities as at 1 January 2018 and 31 December 2018 was classified in Stage 1. There were no transfers of securities between the stages in the year ended 31 December 2018.

Securities put up as collateral

Deposit Guarantee Fund

As at 31 December 2018, the Deposit Guarantee Fund (hereinafter: "DGF") amounted to PLN 17 thousand, and the Bank held Treasury bonds with a carrying value of PLN 20 thousand to cover the DGF. As at 31 December 2017, these amounts were PLN 10 thousand and PLN 20 thousand respectively. As at 31 December 2018 and 31 December 2017, the Bank did not maintain any deposits covered by the guarantee.

FUNDS SECURING LIABILITIES IN RESPECT OF CONTRIBUTIONS TO THE BANK GUARANTEE FUND

As at 31 December 2018, the contribution to the bank resolution fund, which is contributed as an obligation to pay to the Bank Guarantee Fund ("BGF"), amounted to PLN 1,367 thousand, and the Bank held Treasury bonds with a carrying value of PLN 1,708 thousand to cover the contribution. As at 31 December 2017, the Bank did not held any Treasury bonds for the purposes of covering the BGF contribution in the form of an obligation to pay.

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Such funds are treated as assets pledged as collateral for own liabilities, they cannot be pledged or encumbered in any way, are excluded from judicial or administrative enforcement proceedings and do not form part of the estate in bankruptcy.

COLLATERAL FOR MORTGAGE COVERED BONDS

The amount of additional collateral entered in the covered bonds cover pool maintained in the form of Treasury securities in PLN was PLN 251,000 thousand as at 31 December 2018 and 31 December 2017. The disclosure of assets in the covered bonds cover pool is described in Note 29.

22. LOANS AND ADVANCES TO CUSTOMERS

ACCOUNTING POLICIES AS OF 1 JANUARY 2018

As of 1 January 2018 the Bank classifies loans and advances to customers to the following categories:

- measured at amortized cost;
- measured at fair value through other comprehensive income;
- measured at fair value through profit or loss.

The classification and measurement policies in respect of loans and advances to customers have been described in Note 4 "IFRS 9 Financial instruments".

ACCOUNTING POLICIES UNTIL 31 DECEMBER 2017

The respective policies have been described in detail in the annual financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2017.

FINANCIAL INFORMATION

LOANS AND ADVANCES TO CUSTOMERS	31.12.2018	01.01.2018	31.12.2017
Measured at amortized cost			
Housing loans, gross, including:	21,098,742	16,047,682	16,047,541
loans granted	8,781,520	5,251,257	5,251,206
acquired receivables	12,317,222	10,796,425	10,796,335
Impairment allowances (IAS 39)			(5,068)
Allowances for expected credit losses (IFRS 9)	(28,273)	(19,707)	
Housing loans, net	**21,070,469**	**16,027,975**	**16,042,473**

In 2018 the Bank purchased, based on the Framework Agreement for the Sale of Receivables signed with PKO Bank Polski SA on 17 November 2015, mortgage covered housing loan receivables portfolios in the amount of PLN 2,524,086 thousand, and in 2017 - in the amount of PLN 5,553,538 thousand. The purchase price was determined on an arm's length basis, based on the valuation made by an independent expert. The receivables purchased were recognized on the transfer dates set in the Receivables Sale Agreements, on which the Bank acquired the rights to the cash flows from individual portfolios, and assumed all related liability for costs and economic risks in the constituent receivables. The purchase of the receivable portfolios was financed by the liability the nature of which is described in Note 27. The Bank ultimately refinances the purchased receivable portfolios primarily through issuing mortgage covered bonds.

Loans granted and receivables purchased that have been entered in the Bank's cover pool represent collateral for mortgage covered bonds issued, as described in Note 29.

Information about the quality of the loan portfolio is also presented in Note 42.4 "Forecasting and monitoring of credit risk".

Information relating to credit risk exposure in respect of loans and advances to customers measured at amortized cost have been described for 2018 in Note 23 "Expected credit losses" and for 2017 in Note 24 "Impairment allowances in respect of financial assets – in accordance with IAS 39".

23. Expected credit losses

Estimates and assessments binding as of 1 January 2018

The allowance for expected credit losses is recognized in the financial statements as follows:

- Financial assets measured at amortized cost: the allowance decreases the gross carrying amount of the financial asset; changes in the allowance are recognized in the income statement;
- Off-balance sheet liabilities of a credit nature and financial guarantees: the allowance is presented as a provision in liabilities; changes in allowances are recognized in the income statement;
- Financial instruments measured at fair value through other comprehensive income: the carrying amount of an asset carried at fair value is additionally decreased by the amount of the allowances; measurement changes are however each time divided into the component related to impairment – recognized in the income statement – and the component related to other fair value measurement changes – recognized in other comprehensive income.

A detailed description of changes in the area of impairment binding as of 1 January 2018 and related to the implementation of IFRS 9 has been described in Note 4 "IFRS 9 Financial instruments".

Financial information

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ALLOWANCES FOR EXPECTED CREDIT LOSSES

FINANCIAL ASSETS AND ALLOWANCES FOR EXPECTED CREDIT LOSSES AS AT 31.12.2018	Assets with no significant increase in credit risk since initial recognition, gross (Stage 1)	Allowances for expected credit losses (Stage 1)	Assets with a significant increase in credit risk since initial recognition, but not credit impaired, gross (Stage 2)	Allowances for expected credit losses (Stage 2)	Credit-impaired assets, gross (Stage 3)	Allowances for expected credit losses (Stage 3)	Total gross amount	Total allowances for expected credit losses
Measured at fair value through OCI								
securities	842,965	-	-	-	-	-	842,965	-
issued by the State Treasury, PLN Treasury bonds	842,965	-	-	-	-	-	842,965	-
Total	842,965	-	-	-	-	-	842,965	-
Measured at amortized cost								
amounts due from banks	22	-	-	-	-	-	22	-
loans and advances to customers	20,823,722	(7,108)	266,928	(17,979)	8,092	(3,186)	21,098,742	(28,273)
housing loans	20,823,722	(7,108)	266,928	(17,979)	8,092	(3,186)	21,098,742	(28,273)
loans granted	8,636,038	(3,480)	143,432	(10,730)	2,050	(922)	8,781,520	(15,132)
acquired receivables	12,187,684	(3,628)	123,496	(7,249)	6,042	(2,264)	12,317,222	(13,141)
other financial assets	449	-	-	-	-	-	449	-
Total	20,824,193	(7,108)	266,928	(17,979)	8,092	(3,186)	21,099,213	(28,273)

As at 31 December 2018 there were no purchased or originated credit-impaired assets (POCI).

LOAN COMMITMENTS AND PROVISIONS AS AT 31.12.2018	Nominal amount of loan commitments with no significant increase in credit risk since initial recognition (Stage 1)	Provisions for loan commitments (Stage 1)	Nominal amount of loan commitments with a significant increase in credit risk since initial recognition, but not credit impaired (Stage 2)	Provisions for loan commitments (Stage 2)	Nominal amount of credit-impaired loan commitments (Stage 3)	Provisions for loan commitments (Stage 3)	Total nominal amount	Total provisions for loan commitments
Loan commitments	717,808	(103)	1,409	(41)	-	-	719,217	(144)

(IN PLN '000)

FINANCIAL ASSETS AND ALLOWANCES FOR EXPECTED CREDIT LOSSES AS AT 01.01.2018	Assets with no significant increase in credit risk since initial recognition, gross (Stage 1)	Allowances for expected credit losses (Stage 1)	Assets with a significant increase in credit risk since initial recognition, but not credit-impaired, gross (Stage 2)	Allowances for expected credit losses (Stage 2)	Credit-impaired assets, gross (Stage 3)	Allowances for expected credit losses (Stage 3)	Total gross amount	Total allowances for expected credit losses
Measured at fair value through OCI								
securities	830,489	-	-	-	-	-	830,489	-
issued by the State Treasury, PLN Treasury bonds	830,489	-	-	-	-	-	830,489	-
Total	830,489	-	-	-	-	-	830,489	-
Measured at amortized cost								
amounts due from banks	5,350	-	-	-	-	-	5,350	-
loans and advances to customers	15,876,720	(3,776)	168,115	(14,963)	2,847	(968)	16,047,682	(19,707)
housing loans	15,876,720	(3,776)	168,115	(14,963)	2,847	(968)	16,047,682	(19,707)
loans granted	5,186,117	(1,127)	64,063	(7,777)	1,078	(412)	5,251,258	(9,316)
acquired receivables	10,690,603	(2,649)	104,052	(7,186)	1,769	(556)	10,796,424	(10,391)
other financial assets	99	-	-	-	-	-	99	-
Total	15,882,169	(3,776)	168,115	(14,963)	2,847	(968)	16,053,131	(19,707)

As at 1 January 2018 there were no purchased or originated credit-impaired assets (POCI).

LOAN COMMITMENTS AND PROVISIONS AS AT 01.01.2018	Nominal amount of loan commitments with no significant increase in credit risk since initial recognition (Stage 1)	Provisions for loan commitments (Stage 1)	Nominal amount of loan commitments with a significant increase in credit risk since initial recognition, but not credit impaired, gross (Stage 2)	Provisions for loan commitments (Stage 2)	Nominal amount of credit-impaired loan commitments (Stage 3)	Provisions for loan commitments (Stage 3)	Total nominal amount	Total provisions for loan commitments
Loan commitments	682,135	(69)	797	(39)	-	-	682,932	(108)

(IN PLN '000)

TRANSFERS BETWEEN IMPAIRMENT STAGES FOR FINANCIAL ASSETS AND FINANCIAL LIABILITIES GRANTED

FINANCIAL ASSETS AS AT 31.12.2018 – TRANSFERS BETWEEN STAGES	Carrying amount, gross								Impairment allowances								
	AMOUNTS NOT SUBJECT TO TRANSFER IN THE PERIOD	Transfers between Stage 1 (S1) and Stage 2 (S2)		Movements between Stage 2 (S2) and Stage 3 (S3)		Transfers between Stage 1 (S1) and Stage 3 (S3)		TOTAL CARRYING AMOUNT, GROSS	AMOUNTS NOT SUBJECT TO TRANSFER IN THE PERIOD	Transfers between Stage 1 (S1) and Stage 2 (S2)		Movements between Stage 2 (S2) and Stage 3 (S3)		Transfers between Stage 1 (S1) and Stage 3 (S3)		TOTAL ALLOWANCES	TOTAL, NET
		from S1 to S2	from S2 to S1	from S2 to S3	from S3 to S2	from S1 to S3	from S3 to S1			from S1 to S2	from S2 to S1	from S2 to S3	from S3 to S2	from S1 to S3	from S3 to S1		
Measured at fair value through OCI																	
securities	842,965	-	-	-	-	-	-	**842,965**	-	-	-	-	-	-	-	-	**842,965**
issued by the State Treasury, PLN Treasury bonds	842,965	-	-	-	-	-	-	**842,965**	-	-	-	-	-	-	-	-	**842,965**
Measured at amortized cost																	
amounts due from banks	22	-	-	-	-	-	-	**22**	-	-	-	-	-	-	-	-	22
loans and advances to customers	20,777,724	212,386	102,110	2,951	556	3,015	-	**21,098,742**	(12,950)	(12,821)	(562)	(980)	(13)	(947)	-	**(28,273)**	**21,070,469**
housing loans	20,777,724	212,386	102,110	2,951	556	3,015	-	**21,098,742**	(12,950)	(12,821)	(562)	(980)	(13)	(947)	-	**(28,273)**	**21,070,469**
loans granted	8,622,121	120,189	38,259	951	-	-	-	**8,781,520**	(6,656)	(8,067)	(259)	(150)	-	-	-	**(15,132)**	**8,766,388**
acquired receivables	12,155,603	92,197	63,851	2,000	556	3,015	-	**12,317,222**	(6,294)	(4,754)	(303)	(830)	(13)	(947)	-	**(13,141)**	**12,304,081**
other financial assets	449	-	-	-	-	-	-	**449**	-	-	-	-	-	-	-	-	449
Total financial assets	**21,621,160**	**212,386**	**102,110**	**2,951**	**556**	**3,015**	-	**21,942,178**	**(12,950)**	**(12,821)**	**(562)**	**(980)**	**(13)**	**(947)**	-	**(28,273)**	**21,913,905**

Transfers between impairment stages are presented in the gross carrying amount and amount of allowance as at 31 December 2018. In the case of loans and advances to customers, which changed stages a number of times, the movement was presented as a transfer from the stage to which they belonged as at 1 January 2018 or upon initial recognition to the impairment stage to which they belonged as at 31 December 2018.

LOAN COMMITMENTS AS AT 31.12.2018 – TRANSFERS BETWEEN STAGES	Nominal value of loan commitments								Provisions								
	AMOUNTS NOT SUBJECT TO TRANSFER IN THE PERIOD	Transfers between Stage 1 (S1) and Stage 2 (S2)		Movements between Stage 2 (S2) and Stage 3 (S3)		Transfers between Stage 1 (S1) and Stage 3 (S3)		TOTAL NOMINAL VALUE	AMOUNTS NOT SUBJECT TO TRANSFER IN THE PERIOD	Transfers between Stage 1 (S1) and Stage 2 (S2)		Movements between Stage 2 (S2) and Stage 3 (S3)		Transfers between Stage 1 (S1) and Stage 3 (S3)		TOTAL PROVISIONS	TOTAL, NET
		from S1 to S2	from S2 to S1	from S2 to S3	from S3 to S2	from S1 to S3	from S3 to S1			from S1 to S2	from S2 to S1	from S2 to S3	from S3 to S2	from S1 to S3	from S3 to S1		
Loan commitments																	
housing loans to individuals	717,808	1,409	-	-	-	-	-	719,217	(103)	(41)	-	-	-	-	-	**(144)**	719,073

(IN PLN '000)

CHANGES IN GROSS CARRYING AMOUNT OF FINANCIAL INSTRUMENTS

CHANGES IN GROSS CARRYING AMOUNTS OF FINANCIAL INSTRUMENTS	Carrying amount, gross as at 01.01.2018	Increase due to granting and purchasing loans	Decrease due to derecognition	Changes due to disbursement of tranches and repayments	Changes due to modification without derecognition, net	Decrease due to impairment in connection with a write-down[1]	Changes due to lengthening the loss recognition horizon from 12 months to lifetime	Changes due to shortening the loss recognition horizon from lifetime to 12 months	Other adjustments	Carrying amount, gross as at 31.12.2018
Measured at fair value through OCI										
securities	830,489	189,252	-	(195,325)	-	-	-	-	18,549	**842,965**
Total	830,489	189,252	-	(195,325)	-	-	-	-	18,549	**842,965**
including: assets measured on a group basis	830,489	189,252	-	(195,325)	-	-	-	-	18,549	**842,965**
Measured at amortized cost										-
amounts due from banks	5,350	-	-	(5,328)	-	-	-	-		**22**
loans and advances to customers	16,047,682	5,622,777	(301,247)	(338,288)	68,986	(100)	2,460	(3,528)	-	**21,098,742**
housing loans	16,047,682	5,622,777	(301,247)	(338,288)	68,986	(100)	2,460	(3,528)	-	**21,098,742**
other financial assets	99	449	-	(99)	-	-	-	-	-	**449**
Total	**16,053,131**	**5,623,226**	**(301,247)**	**(343,715)**	**68,986**	**(100)**	**2,460**	**(3,528)**	-	**21,099,213**
including: assets measured on a group basis	16,053,032	5,622,777	(301,247)	(343,616)	68,986	(100)	2,460	(3,528)	-	21,098,764

[1] The Bank writes down a part of the penalty interest it does not expect to recover.

CHANGES IN ALLOWANCES FOR EXPECTED CREDIT LOSSES

CHANGES IN ALLOWANCES FOR EXPECTED CREDIT LOSSES ON FINANCIAL ASSETS	As at 01.01.2018	Increase due to granting and purchasing loans	Decrease due to derecognition	Changes due to changes in credit risk (net)	Changes due to modification without derecognition	Decrease of impairment allowances due to write-down	Changes due to lengthening the loss recognition horizon from 12 months to lifetime	Changes due to shortening the loss recognition horizon from lifetime to 12 months	Other adjustments	As at 31.12.2018
Measured at fair value through OCI										
securities	-	-	-	-	-	-	-	-	-	-
Total	-	-	-	-	-	-	-	-	-	-
including: assets measured on a group basis	-	-	-	-	-	-	-	-	-	-
Measured at amortized cost										
loans and advances to customers	19,707	4,041	(373)	2,243	619	(100)	10,339	(8,203)	-	28,273
housing loans	19,707	4,041	(373)	2,243	619	(100)	10,339	(8,203)	-	28,273
other financial assets	-	-	-	-	-	-	-	-	-	-
Total	**19,707**	**4,041**	**(373)**	**2,243**	**619**	**(100)**	**10,339**	**(8,203)**	-	**28,273**
including: assets measured on a group basis	**19,707**	**4,041**	**(373)**	**2,243**	**619**	**(100)**	**10,339**	**(8,203)**	-	**28,273**

The gross carrying amount as at 31 December 2018 of the portfolios of receivables acquired in 2018 amounted to PLN 2,425,999 thousand, and the allowance recorded for such portfolios amounted to PLN 1,682 thousand.

(IN PLN '000)

CALCULATION OF ESTIMATES

The Bank performed a simulation of allowances for expected credit losses resulting from a deterioration or improvement in risk parameters.

ESTIMATED CHANGE IN IMPAIRMENT ALLOWANCES ON EXPECTED CREDIT LOSSES RESULTING FROM THE RISK PARAMETERS DETERIORATION OR IMPROVEMENT, OF WHICH:[1]	31.12.2018		01.01.2018	
	+10% scenario	-10% scenario	+10% scenario	-10% scenario
changes in the probability of default	2,200	(2,524)	1,679	(1,885)
changes in recovery rates	(7,202)	7,202	(5,575)	5,575

[1] (in plus – an increase in allowances; in minus – a decrease in allowances)

FINANCIAL ASSETS IMPAIRED UPON INITIAL RECOGNITION - POCI

As at 31 December 2018 and 1 January 2018, the Bank had no purchased or originated credit-impaired assets (POCI).

24. ALLOWANCES ON IMPAIRMENT OF FINANCIAL ASSETS – COMPARATIVE DATA IN ACCORDANCE WITH IAS 39

ESTIMATES AND ASSESSMENTS BINDING UNTIL 31 DECEMBER 2017

Respective accounting policies have been described in detail in the annual financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2017.

FINANCIAL INFORMATION

IMPAIRMENT ALLOWANCES ON LOANS AND ADVANCES – RECONCILIATION OF MOVEMENTS FOR PERIOD FROM 1 JANUARY 2017 TO 31 DECEMBER 2017	As at the beginning of the period	INCREASE	DECREASE	As at the end of the period	Net increase - impact on the income statement
		Recognized during the period	Reversed during the period		
Amounts due from banks	-	-	-	-	-
Loans and advances to customers at amortized cost	1,759	7,509	4,200	5,068	(3,309)
Non-financial sector	1,759	7,509	4,200	5,068	(3,309)
housing loans	1,759	7,509	4,200	5,068	(3,309)
Provisions for loan commitments	80	18	44	54	26
Total	**1,839**	**7,527**	**4,244**	**5,122**	**(3,283)**

25. INTANGIBLE ASSETS AND PROPERTY, PLANT AND EQUIPMENT

ACCOUNTING POLICIES AND ESTIMATES

INTANGIBLE ASSETS

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

Recognition of intangible assets:

- software – computer software licenses acquired are recognized at the amount of the costs incurred on their purchase and preparation for use, taking into account amortization and impairment. Any subsequent expenditure on the maintenance of computer software is recognized in costs when incurred;
- other intangible assets acquired by the Bank are recognized at the purchase price or cost of manufacture less amortization and total impairment allowances;
- the costs of completed development projects are recognized in intangible assets when

	economic benefits are obtained and specific conditions are satisfied, i.e. if there is a possibility and intention to complete and use the asset, appropriate technical and financial means are available to complete the work and use the asset and the amount of expenditure incurred during development work, which can be allocated to the development of intangible assets, can be assessed reliably.
PROPERTY, PLANT AND EQUIPMENT	Property, plant and equipment is recognized at the end of a reporting period at the purchase price or cost of manufacture less depreciation and impairment.
EXPENDITURE	The carrying amount of property, plant and equipment and intangible assets is increased by additional expenditure incurred over the period of their use.
AMORTIZATION AND DEPRECIATION	Amortization and depreciation is charged on all intangible assets and property, plant and equipment whose value decreases due to their use or lapse of time under the straight-line method over the estimated useful life of a given asset. The amortization/depreciation method and useful life are verified at least once a year.
IMPAIRMENT OF NON-FINANCIAL NON-CURRENT ASSETS	At the end of each reporting period the Bank assesses whether there are any indications of impairment of any non-financial non-current assets (or cash-generating units). When such indications are recognized and each year in the case of intangible assets which are not amortized, the Bank estimates the recoverable amount, which is the higher of the following two amounts: the fair value less costs to sell and the value in use of the non-current asset (or the cash-generating unit), and if the carrying amount of the asset exceeds its recoverable amount, the Bank recognized an impairment allowance in the income statement. In order to estimate these amounts it is necessary to adopt assumptions concerning, among other things, the projected future cash flows that the Bank may obtain from further use or sale of a given non-current asset (or a cash-generating unit). Adopting different assumptions concerning the valuation of future cash flows could affect the carrying amount of non-current assets. If there are any indications of impairment of common assets, i.e. assets that do not generate cash inflows independently from other assets or groups of assets, and the recoverable amount of a single common asset cannot be established, the Bank determines the recoverable amount of the cash-generating unit to which a given asset belongs. This allowance is reversed if the estimations used to determine the recoverable amount have changed.
ESTIMATES AND JUDGEMENTS	The following factors are taken into account in estimating the useful lives of different types of property, plant and equipment and intangible assets: ▪ expected wear and tear estimated based on the average periods of use recorded to date, reflecting the rate of wear and tear, intensity of use etc.; ▪ technological or market obsolescence; ▪ legal and other restrictions of the asset's use; ▪ expected utilization of an asset estimated based on the expected production capacity or volume; ▪ other circumstances affecting the useful life of such assets. If the period of using an asset results from contractual provisions, its useful life corresponds to the period resulting from the contract. If the estimated useful life is shorter than the period resulting from the contract, the estimated useful life is taken into account. It is assumed that the residual value of property, plant and equipment and intangible assets is zero, unless a third party has made a commitment to purchase them or there is (and will continue to exist as at the end of their useful life) an active market for such assets and their value on that market can be estimated.
AMORTIZATION AND DEPRECIATION PERIODS	Amortization and depreciation periods for the basic groups of intangible assets and property, plant and equipment applied by PKO Bank Hipoteczny SA:

(IN PLN '000)

PROPERTY, PLANT AND EQUIPMENT	DEPRECIATION PERIODS
Leasehold improvements	10 years
Machinery and equipment	from 2 to 5 years
Computer hardware	3 years
INTANGIBLE ASSETS	**AMORTISATION PERIODS**
Software	from 2 to 5 years

FINANCIAL INFORMATION

INTANGIBLE ASSETS

FOR THE PERIOD FROM 1 JANUARY 2018 TO 31 DECEMBER 2018	Intangible assets under construction	Software	Total
Carrying amount as at the beginning of the period, gross	-	8,303	**8,303**
Purchase	459	47	**506**
Transfers	(230)	230	**-**
Carrying amount as at the end of the period, gross	229	8,580	**8,809**
Accumulated amortization as at the beginning of the period	-	(2,719)	**(2,719)**
Amortization charge	-	(1,925)	**(1,925)**
Accumulated amortization as at the end of the period	-	(4,644)	**(4,644)**
Carrying amount as at the beginning of the period, net	**-**	**5,584**	**5,584**
Net carrying amount as at the end of the period	**229**	**3,936**	**4,165**

FOR THE PERIOD FROM 1 JANUARY 2017 TO 31 DECEMBER 2017	Intangible assets under construction	Software	Total
Carrying amount as at the beginning of the period, gross	2,670	4,145	**6,815**
Purchase	1,488	-	**1,488**
Transfers	(4,158)	4,158	**-**
Carrying amount as at the end of the period, gross	-	8,303	**8,303**
Accumulated amortization as at the beginning of the period	-	(1,503)	**(1,503)**
Amortization charge	-	(1,216)	**(1,216)**
Accumulated amortization as at the end of the period	-	(2,719)	**(2,719)**
Carrying amount as at the beginning of the period, net	**2,670**	**2,642**	**5,312**
Net carrying amount as at the end of the period	**-**	**5,584**	**5,584**

PROPERTY, PLANT AND EQUIPMENT

FOR THE PERIOD FROM 1 JANUARY 2018 TO 31 DECEMBER 2018	Property, plant and equipment under construction	Leasehold improve-ments	Machinery and equipment	Other	Total
Carrying amount as at the beginning of the period, gross	-	34	789	403	**1,226**
Purchase	-	-	131	-	**131**
Transfery	-	-	-	-	**-**
Scrapping and sale	-	-	(26)	-	**(26)**
Carrying amount as at the end of the period, gross	-	34	894	403	**1,331**
Accumulated depreciation as at the beginning of the period	-	(6)	(441)	(209)	**(656)**
Depreciation charge	-	(5)	(167)	(80)	**(252)**
Scrapping and sale	-	-	26	-	**26**
Accumulated depreciation as at the end of the period	-	(11)	(582)	(289)	**(882)**
Net carrying amount as at the beginning of the period	**-**	**28**	**348**	**194**	**570**
Net carrying amount as at the end of the period	**-**	**23**	**312**	**114**	**449**

(IN PLN '000)

FOR THE PERIOD FROM 1 JANUARY 2017 TO 31 DECEMBER 2017	Property, plant and equipment under construction	Leasehold improve-ments	Machinery and equipment	Other	Total
Carrying amount as at the beginning of the period, gross	-	34	534	397	**965**
Purchase	83	-	172	6	**261**
Transfers	(83)	-	83	-	-
Carrying amount as at the end of the period, gross	-	34	789	403	**1,226**
Accumulated depreciation as at the beginning of the period	-	(3)	(253)	(129)	**(385)**
Depreciation charge	-	(3)	(188)	(80)	**(271)**
Accumulated depreciation as at the end of the period	-	(6)	(441)	(209)	**(656)**
Net carrying amount as at the beginning of the period	-	**31**	**281**	**268**	**580**
Net carrying amount as at the end of the period	-	**28**	**348**	**194**	**570**

The item "Other" comprises mainly the Bank's furniture.

Legal limitations relating to the Bank's title

In the years 2018 and 2017, there were no intangible assets or property, plant and equipment items to which the Bank's legal title would be limited or pledged as collateral for the Bank's liabilities.

26. Other assets

Accounting policies

Financial assets recognized in this item are measured at amounts due, including interest on such assets (if any) and taking into account allowances for expected credit losses. Non-financial assets are measured in accordance with the principles applicable to the specific categories of assets recognized in this item.

Financial information

OTHER ASSETS	31.12.2018	31.12.2017
Deferred costs and prepaid expenses, including:	7,456	9,085
deferred costs relating to the overdraft facility	2,103	2,583
deferred costs relating to unsecured bonds issuance programme[1)]	290	684
deferred costs relating to mortgage covered bonds issuance programme [1)]	1,948	2,309
other prepaid expenses	3,115	3,509
Deferred costs and commission relating to loans granted, proportionally to undrawn principal	8,829	7,946
Settlements relating to appraisal reports on Property Value for Mortgage Lending Purposes (BHWN)	443	66
Settlements under the public law	35	99
Other	6	33
Total	**16,769**	**17,229**
of which financial assets	449	99

[1)] Costs associated with issue programmes relate to the issue programmes as a whole and cannot be allocated to the individual issues executed as part of the programmes.

27. Amounts due to banks

Accounting policies

Amounts due to banks are measured at amortized cost using the effective interest rate method. If a schedule of future cash flows cannot be determined for a financial liability (and, therefore, the effective interest rate cannot be determined), the liability is measured at the amount due.

(IN PLN '000)

FINANCIAL INFORMATION

AMOUNTS DUE TO BANKS	31.12.2018	31.12.2017
Measured at amortized cost		
overdraft within the limit available	10,513	-
liabilities in respect of overdraft facilities	1,881,512	1,627,461
liabilities in respect of term loans	100,007	-
liability in respect of the purchase of receivables	2,300,254	2,497,918
Total	**4,292,286**	**4,125,379**

LIABILITIES IN RESPECT OF LOANS

LENDER	Date of agreement	Maturity date	Amount of loan granted	Amount of loan drawn	Liability as at 31 December 2018	Liability as at 31 December 2017
PKO Bank Polski SA	29.10.2015	29.10.2021	1,500,000	1,400,000	828,580	-
PKO Bank Polski SA	02.02.2017	02.02.2020	1,500,000	1,500,000	902,924	1,477,453
Another bank 1	05.06.2017	10.06.2019	150,000	150,000	150,008	150,008
Another bank 2	27.12.2018	28.12.2020	100,000	100,000	100,007	-
Total			**3,250,000**	**3,150,000**	**1,981,519**	**1,627,461**

LIABILITY IN RESPECT OF THE PURCHASE OF RECEIVABLES The line "Liability in respect of the purchase of receivables" represents the liability arising from the transactions of purchase of mortgage-backed housing loan portfolios from PKO Bank Polski SA, as specified in Note 22. The maturity date of the liability resulting from the purchase of receivables is agreed by the parties in the Receivables Sale Agreement for each transaction. For receivables acquired in 2018, the parties agreed that the payment would be due no later than 12 months from the date of transfer. If the liability is not settled within 1 month from the date of transfer, the principal amount is subject to interest. The Bank ultimately refinances the purchased receivable portfolios primarily through the issue of mortgage covered bonds. The liability resulting from the purchase of receivables at 31 December 2018 concerns portfolios purchased as of the second quarter of 2018, whereas as at 31 December 2017 the liability concerned portfolios purchased in the fourth quarter of 2017.

28. AMOUNTS DUE TO CUSTOMERS

ACCOUNTING POLICIES

Due to the fact that the repayment schedule cannot be determined, amounts due to customers are measured at amounts due. Amounts due comprise loan overpayments only. The Bank does not accept deposits.

FINANCIAL INFORMATION

AMOUNTS DUE TO CUSTOMERS	31.12.2018	31.12.2017
Measured at amortized cost		
amounts due to retail customers- overpaid loans	4,359	2,099
Total	**4,359**	**2,099**

29. MORTGAGE COVERED BONDS ISSUED

ACCOUNTING POLICIES

Liabilities in respect of covered bonds issued are measured at amortized cost using the effective interest rate method.

FINANCIAL INFORMATION

(IN PLN '000)

MORTGAGE COVERED BONDS ISSUED	31.12.2018	31.12.2017
Measured at amortized cost		
covered bonds	12,841,500	8,883,213
Total	**12,841,500**	**8,883,213**

REPAYMENT PERIOD OF MORTGAGE COVERED BONDS ISSUED	31.12.2018	31.12.2017
1 to 5 years	6,933,749	4,102,528
over 5 years	5,907,751	4,780,685
Total	**12,841,500**	**8,883,213**

Mortgage covered bonds issued as at 31 December 2018

ISIN	Currency	Nominal value	Interest rate as at 31.12.2018	Rate +margin/fixed rate	Issue date	Maturity	Quotation market
PLPKOHP00017	PLN	30,000	2.47%	WIBOR3M + 0.75 p.p.	11.12.2015	11.12.2020	Bondspot, WSE alternative market
PLPKOHP00025	PLN	500,000	2.37%	WIBOR3M + 0.65 p.p.	27.04.2016	28.04.2021	Bondspot, WSE alternative market
PLPKOHP00033	PLN	500,000	2.31%	WIBOR3M + 0.59 p.p.	17.06.2016	18.06.2021	Bondspot, WSE alternative market
XS1508351357	EUR	500,000	0.13%	fixed rate during the period	24.10.2016	24.06.2022	LuxSE, WSE alternative market
XS1559882821	EUR	25,000	0.82%	fixed rate during the period	02.02.2017	02.02.2024	LuxSE
XS1588411188	EUR	500,000	0.63%	fixed rate during the period	30.03.2017	24.01.2023	LuxSE, WSE alternative market
PLPKOHP00041	PLN	500,000	2.41%	WIBOR3M + 0.69 p.p.	28.04.2017	18.05.2022	Bondspot, WSE alternative market
PLPKOHP00058	PLN	265,000	2.69%	fixed rate during the period	22.06.2017	10.09.2021	Bondspot, WSE alternative market
XS1690669574	EUR	500,000	0.75%	fixed rate during the period	27.09.2017	27.08.2024	LuxSE, WSE alternative market
PLPKOHP00066	PLN	500,000	2.32%	WIBOR3M + 0.60 p.p.	27.10.2017	27.06.2023	Bondspot, WSE alternative market
XS1709552696	EUR	54,000	0.47%	fixed rate during the period	02.11.2017	03.11.2022	LuxSE
XS1795407979	EUR	500,000	0.75%	fixed rate during the period	22.03.2018	24.01.2024	LuxSE, WSE alternative market
PLPKOHP00074	PLN	700,000	2.21%	WIBOR3M + 0.49 p.p.	27.04.2018	25.04.2024	Bondspot, WSE alternative market
PLPKOHP00082	PLN	100,000	2.04%	WIBOR3M + 0.32 p.p.	18.05.2018	29.04.2022	Bondspot, WSE alternative market
PLPKOHP00090	PLN	500,000	2.34%	WIBOR3M + 0.62 p.p.	27.07.2018	25.07.2025	Bondspot, WSE alternative market
PLPKOHP00108	PLN	60,000	3.49%	fixed rate during the period	24.08.2018	24.08.2028	Bondspot, WSE alternative market
PLPKOHP00116	PLN	230,000	2.38%	WIBOR3M + 0.66 p.p.	26.10.2018	28.04.2025	Bondspot, WSE alternative market

In 2018 the Bank carried out 5 issues of covered bonds denominated in PLN with a total value of PLN 1,590,000 thousand and one issue of covered bonds denominated in EUR with a value of EUR 500,000 thousand. In 2017, the Bank carried out 3 issues of covered bonds denominated in PLN with the total value of PLN 1,265,000 thousand and 4 issues of covered bonds denominated in EUR with a value of EUR 1,079,000 thousand. The Bank did not redeem any covered bonds in 2018 and in 2017.

As at 31 December 2018 and 31 December 2017 the issued PLN- and EUR-mortgage covered bonds were rated by Moody's Investors Service at Aa3, i.e. the highest achievable by Polish securities. The limit for the ratings is the Polish country ceiling for debt instruments, which currently is at the level of Aa3.

(IN PLN '000)

The total nominal value of the issued mortgage covered bonds as at 31 December 2018 amounted to PLN 12,824,700 thousand, and as at 31 December 2017 - PLN 8,880,851 thousand.

Securing the mortgage covered bonds

The mortgage covered bonds are secured by loans secured by the highest priority mortgage. Additionally, the basis for the issue of mortgage covered bonds may also be the Bank's own funds:

- invested in securities issued or guaranteed by the National Bank of Poland, the European Central Bank, the governments and central banks of the Member States of the European Union, the Organization for Economic Cooperation and Development, with the exception of countries that are having or have had their foreign debt restructured in the past 5 years;
- invested in the National Bank of Poland;
- held in cash.

The nominal value of loans entered in the Bank's cover pool representing collateral for the covered bonds issued totalled PLN 16,947,730 thousand at 31 December 2018, whereas the nominal value of additional collateral in the form of PLN-denominated securities issued by the State Treasury amounted to PLN 251,000 thousand. As at 31 December 2017 it amounted to PLN 11,103,708 thousand and PLN 251,000 thousand respectively. The Bank's covered bonds cover pool also included CIRS and FX-Forward transactions hedging the currency and interest-rate risk of issued covered bonds denominated in EUR and IRS transactions securing the interest rate risk of fixed rate mortgage covered bonds issued in PLN.

In the first half of 2018 and in the previous years the Bank's covered bonds cover pool did not include asset-backed securities (ABS), which do not meet the requirements specified in paragraph 1 of Article 80 of the 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).

30. Unsecured bonds issued

Accounting policies

Liabilities in respect of bonds issued are measured at amortized cost using the effective interest rate method.

Financial information

UNSECURED BONDS ISSUED	31.12.2018	31.12.2017
Measured at amortized cost		
bonds	3,311,148	2,428,025
Total	**3,311,148**	**2,428,025**

REPAYMENT PERIOD OF UNSECURED BONDS ISSUED	31.12.2018	31.12.2017
up to 1 month	384,312	364,083
1 to 3 months	454,191	1,048,540
3 months to 1 year	2,122,605	1,015,402
1 to 5 years	350,040	-
Total	**3,311,148**	**2,428,025**

In 2018 the Bank issued bonds of a total nominal value of PLN 7,836,400 thousand and redeemed bonds of a total nominal value of PLN 6,948,200 thousand, whereas in 2017 it was PLN 6,188,800 thousand and PLN 4,904,600 thousand respectively.

The nominal value of the bonds issued as at 31 December 2018 amounted to PLN 3,328,400 thousand, and as at 31 December 2017 it amounted to PLN 2,440,200 thousand.

(IN PLN '000)

BONDS ISSUED AS AT 31 DECEMBER 2018

BONDS	Nominal value	Interest rate	Issuance date	Maturity
OW080219-123	4,000	discount paper	09.02.2018	08.02.2019
OW230119-155	262,000	discount paper	23.07.2018	23.01.2019
OW080819-157	14,200	discount paper	08.08.2018	08.08.2019
OW050419-162	722,800	discount paper	21.09.2018	05.04.2019
OW230119-163	18,700	discount paper	21.09.2018	23.01.2019
OW050419-166	55,000	discount paper	01.10.2018	05.04.2019
OW050419-167	10,000	discount paper	05.10.2018	05.04.2019
OW090519-168	40,000	discount paper	16.10.2018	09.05.2019
OW090519-169	604,900	discount paper	22.10.2018	09.05.2019
OW050219-170	23,400	discount paper	22.10.2018	05.02.2019
OW251019-171	4,300	discount paper	26.10.2018	25.10.2019
OW240119-172	50,000	discount paper	26.10.2018	24.01.2019
OW190205-173	119,800	discount paper	13.11.2018	05.02.2019
OW130219-174	68,000	discount paper	15.11.2018	13.02.2019
OW220219-175	182,000	discount paper	21.11.2018	22.02.2019
OW100619-176	233,000	discount paper	21.11.2018	10.06.2019
OW100619-177	150,000	discount paper	17.12.2018	10.06.2019
OW240119-178	54,100	discount paper	17.12.2018	24.01.2019
OW190319-179	58,200	discount paper	19.12.2018	19.03.2019
OW100619-180	204,000	discount paper	21.12.2018	10.06.2019
OW260619-181	100,000	discount paper	28.12.2018	26.06.2019
PLPKOHP00124	350,000	floating	21.12.2018	21.02.2020

As at 31 December 2018, the guarantee described in Note 38.1 covered the bonds issued with a nominal value of PLN 54,100 thousand, and as at 31 December 2017 - PLN 15,100 thousand.

31. OTHER LIABILITIES

ACCOUNTING POLICIES

LIABILITIES	The liabilities recognized in this item are measured at the amounts due including interest, if any. Non-financial liabilities are measured in accordance with the principles of measurement applicable to the specific categories of liabilities recognized in this item.
COSTS PAYABLE	The Bank recognizes accruals in respect of future payments in justified, reliably estimated amounts that are necessary to fulfil the present obligation as at the end of the reporting period. The Bank also recognizes accruals in respect of costs which are attributable to the current period, but will be incurred in the next period, including bonuses and unused holiday, taking into account all outstanding days of holiday.

(IN PLN '000)

FINANCIAL INFORMATION

OTHER LIABILITIES	31.12.2018	31.12.2017
Expenses to be paid	8,506	8,534
Liabilities in respect of contribution to the Bank Guarantee Fund, including:	1,367	-
maintained in the form of payments commitments to the Resolution Fund	1,367	-
Other, including:	12,101	8,907
sundry creditors	5,882	4,438
liabilities under the public law, including:	6,219	4,469
liabilities in respect of tax on certain financial institutions	5,818	3,991
Liabilities in respect of payment for series "I" shares which have not yet been registered by the National Court Register	100,000	-
Total	**121,974**	**17,441**
of which financial liabilities	14,388	12,972

As at 31 December 2018 and 31 December 2017, the Bank had no overdue contractual liabilities.

32. PROVISIONS

ACCOUNTING POLICIES

THE PRINCIPLES FOR RECORDING PROVISIONS	Provisions are liabilities whose amount or date of payment are uncertain. Provisions are created when the Bank has a current (legal or constructive) obligation resulting from past events and fulfilling this obligation is likely to cause an outflow of economic benefits whose amount can be estimated reliably. If the effect of the time value of money is material, the amount of the provision is determined by discounting the forecast future cash flows to their present value, using the gross discount rate reflecting the current market assessments of the time value of money and the potential risk related to a given obligation. All provisions are charged to the income statement.
PROVISIONS FOR LEGAL CLAIMS	The Bank recognizes provisions for disputes with counterparties, customers and third parties after being informed by a legal counsel about the high probability of losing a court case or administrative proceedings. Such provisions are recognized in the amount of the expected outflow of economic benefits.
PROVISIONS FOR DISABILITY AND RETIREMENT BENEFITS	In accordance with the Labour Code, the employees of PKO Bank Hipoteczny SA are entitled to disability or retirement benefits upon their retirement or obtaining a qualification for disability pension. The Bank periodically calculates provisions for employee benefits. Provisions for disability and retirement benefits resulting from the Labour Code are recognized for every employee individually based on periodical valuations. The calculation takes into account all retirement and disability benefits which may be payable in the future. The provision is recognized based on a list of employees containing all the necessary details, in particular the length of service, age and gender.
PROVISIONS FOR FINANCIAL AND GUARANTEE LIABILITIES GRANTED	A provision for financial liabilities granted is recognized in the amount of expected credit losses. The provision is determined using portfolio parameters estimated with the use of statistical methods, based on historical observations of exposures with the same characteristics, defining the marginal probability of occurrence of impairment indications and the level of expected loss in the event of occurrence of an impairment indication in the consecutive months of the period from the reporting date to the expected loss horizon.

(IN PLN '000)

FINANCIAL INFORMATION AND ESTIMATES

PROVISIONS FOR THE PERIOD FROM 1 JANUARY 2018 TO 31 DECEMBER 2018	Provision for disability and retirement benefits	Provisions for financial liabilities granted	Total
As at 31 December 2017, of which:	**84**	**54**	**138**
Long-term provisions	84	54	138
Changes due to IFRS 9 implementation	**-**	**54**	**54**
Long-term provisions	-	54	54
As at 1 January 2018, of which:	**84**	**108**	**192**
Long-term provisions	84	108	192
Increase/reassessment	53	133	186
Release/utilization	(13)	(97)	(110)
As at 31 December 2018, of which:	**124**	**144**	**268**
Short-term provisions	-	144	144
Long-term provisions	124	-	124

PROVISIONS FOR THE PERIOD FROM 1 JANUARY 2017 TO 31 DECEMBER 2017	Provision for disability and retirement benefits	Provisions for financial liabilities granted	Total
As at 1 January 2017, of which:	**60**	**80**	**140**
Long-term provisions	60	80	140
Increase/reassessment	24	(26)	(2)
Release	-	-	-
As at 31 December 2017, of which:	**84**	**54**	**138**
Long-term provisions	84	54	138

33. THE BANK'S EQUITY AND SHAREHOLDING STRUCTURE

ACCOUNTING POLICIES

EQUITY

Equity comprises the capital and funds created by the Bank in accordance with the applicable laws and the Articles of Association.

Components of the Bank's equity:

- the share capital is recognized in the nominal amount presented in the Articles of Association and entered in the business register;
- the supplementary capital is created from profit and share premiums less share issue costs and it is earmarked for offsetting the losses that may occur in connection with the Bank's operations;
- the accumulated other comprehensive income comprises the amounts resulting from valuation of financial assets measured at fair value through other comprehensive income and the effective portion of cash flow hedges and the related deferred tax amounts;
- the reserves are created from net profit. The reserves are created solely for the purpose of offsetting potential losses.

(IN PLN '000)

FINANCIAL INFORMATION

EQUITY	31.12.2018	31.12.2017
Share capital	1,295,000	1,200,000
Supplementary capital	54,932	-
Accumulated other comprehensive income, of which:	63,889	(28,892)
cash flow hedges	59,462	(31,372)
valuation of available-for-sale financial assets		2,480
valuation of financial assets measured at fair value through other comprehensive income	4,427	
Retained earnings (loss resulting from IFRS 9 implementation)	(11,787)	(749)
Net profit for the period	85,849	51,419
Total equity	**1,487,884**	**1,221,778**

SHAREHOLDING STRUCTURE

Series	Type of shares	Number of shares	Nominal value of 1 share (in PLN)	Series value at nominal value (in PLN)	Date of adoption of the resolution by the GSM	Issue date	Date of registration in the National Court Register
A	Ordinary	300,000,000	1	300,000,000	06.10.2014	06.10.2014	24.10.2014
B	Ordinary	200,000,000	1	200,000,000	14.03.2016	07.04.2016	22.04.2016
C	Ordinary	200,000,000	1	200,000,000	01.07.2016	15.07.2016	28.07.2016
D	Ordinary	100,000,000	1	100,000,000	28.10.2016	18.11.2016	01.12.2016
E	Ordinary	150,000,000	1	150,000,000	21.03.2017	04.04.2017	12.04.2017
F	Ordinary	150,000,000	1	150,000,000	28.06.2017	04.07.2017	11.09.2017
G	Ordinary	100,000,000	1	100,000,000	18.10.2017	20.10.2017	16.11.2017
H	Ordinary	95,000,000	1	95,000,000	13.08.2018	17.08.2018	08.10.2018
Total		**1,295,000,000**		**1,295,000,000**			

PKO Bank Polski SA was the Bank's sole shareholder as at 31 December 2018 and 31 December 2017.

In 2018, 95,000,000 new H-series ordinary registered shares with a nominal value of PLN 1 (one zloty) each were issued. The shares were acquired for the issue price of PLN 1.05 per share. The share premium (less tax on civil law transactions and notarial fees) in the amount of PLN 4,262 thousand was recognized in supplementary capital. The issue was registered with the National Court Register on 8 October 2018.

The Bank's share capital amounts to PLN 1,295,000,000 and comprises 1,295,000,000 (one billion two hundred and ninety-five million) ordinary registered shares with a nominal value of PLN 1 (one zloty) each. The PKO Bank Hipoteczny SA shares are non-preference shares and have been paid up in full.

Furthermore, on 19 December 2018 the Extraordinary General Shareholders' Meeting passed a resolution on increasing the share capital of PKO Bank Hipoteczny by PLN 100,000,000, i.e. up to the amount of PLN 1,395,000,000, by issuing 100,000,000 new I-series ordinary registered shares with a nominal value of PLN 1 (one zloty) each. The issue price for each I-series share amounted to PLN 1. The shares were acquired and paid for by PKO Bank Polski SA. As at 31 December 2018, the capital increase was not registered in the business register of the National Court Register, and the liability in respect of the payment made for the shares is presented in Note 31 "Other liabilities".

The Bank did not pay dividend in 2018 or in 2017. The Bank's Management Board will propose to the Annual General Shareholders' Meeting that the profit for the year ended 31 December 2018 is used for offsetting accumulated losses and the remaining part is credited to the supplementary capital.

(IN PLN '000)

OTHER NOTES

34. CONTINGENT LIABILITIES GRANTED AND RECEIVED

34.1 CONTRACTUAL COMMITMENTS

As at 31 December 2018 and 31 December 2017 the Bank had no contractual commitments relating to the purchase of intangible assets and property, plant and equipment.

34.2 LOAN COMMITMENTS

ACCOUNTING POLICIES

As part of its operations, the Bank concludes transactions that are not initially recognized in the statement of financial position as assets or liabilities, but give rise to contingent liabilities. A contingent liability is:

- a potential obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Bank;
- a current obligation that arises from past events, but is not recognized in the statement of financial position, because an outflow of cash or other assets for the purpose of fulfilling the obligation is not likely, or the amount of the liability cannot be estimated reliably.

Loan commitments relate to loans that have been granted but not yet disbursed.

FINANCIAL INFORMATION

LOAN COMMITMENTS (CONTINGENT)	31.12.2018	01.01.2018	31.12.2017
undrawn housing loans (nominal value)			
housing loans to individuals	719,217	682,932	682,932
provisions under IAS 37			(54)
provisions under IFRS 9	(144)	(108)	
Total, net	**719,073**	**682,824**	**682,878**
of which irrevocable loan commitments	-	-	-

Information on provisions on financial liabilities granted is provided in Note 32 "Provisions".

34.3 GUARANTEE COMMITMENTS GRANTED

PKO Bank Hipoteczny SA does not grant guarantee commitments.

34.4 CONTINGENT ASSETS

FINANCIAL INFORMATION

CONTINGENT ASSETS BY NOMINAL VALUE	31.12.2018	31.12.2017
Contingent assets		
financial	1,171,420	927,200
guarantees	1,945,900	1,984,900
Total	**3,117,320**	**2,912,100**

The contingent liabilities received of a financial nature represent initiated and available revolving current account overdraft facilities, while guarantee commitments received represent the available guarantees to underwrite unsecured bond issues.

(IN PLN '000)

THE RIGHT TO SELL OR RE-PLEDGE COLLATERAL ESTABLISHED FOR THE BANK

As at 31 December 2018 and 31 December 2017 no collateral was established for the Bank, which the Bank would be entitled to sell or re-pledge, in the event of fulfilling all obligations by the owner of the collateral.

35. LEGAL CLAIMS

As at 31 December 2018 and 31 December 2017 there were no legal claims.

36. FINANCE AND OPERATING LEASE AGREEMENTS

ACCOUNTING POLICIES

Lease agreements according to which the lessor retains substantially all the risks and rewards of ownership are classified as operating leases. Rental and lease agreements concluded by the Bank as part of its normal operating activities also meet the definition of operating lease.

The Bank is a party to operating lease agreements on the basis of which it accepts fixed assets for use at a charge over a specified period. The Bank classifies lease agreements based on the proportion in which the risks and rewards of ownership of the leased asset are divided between the lessor and the lessee.

Lease payments under an operating lease and subsequent lease instalments are recognized as an expense in the income statement on a straight-line basis over the lease term.

The Bank is a party to an operating lease agreement for a fleet of cars that were provided for use for a period of 44 months in exchange for the payment of lease instalments. The agreement cannot be terminated by the lessee.
The Bank is also a party to rental agreements for the properties in which the Bank's registered office, the Warsaw office and the supplementary centre are located. The rental agreement for the registered office has been concluded for a period of 10 years, and the other agreements – for unspecified periods. The notice periods under these agreements are between 6 and 12 months.

FINANCIAL INFORMATION

TOTAL FUTURE LEASE PAYMENTS UNDER IRREVOCABLE OPERATING LEASES, NET	31.12.2018	31.12.2017
For the contractual period of:		
up to 1 year	1,165	1,217
from 1 to 5 years	3,006	2,964
over 5 years	1,127	1,822
Total	**5,297**	**6,002**

The lease payments (including the payments under the real estate rental agreements) recognized as the costs of the current period amounted to PLN 1,342 thousand in 2018 and PLN 1,385 thousand in 2017 (net).

37. NOTES TO THE STATEMENT OF CASH FLOWS

CASH AND CASH EQUIVALENTS

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

FINANCIAL INFORMATION

Cash and cash equivalents	31.12.2018	31.12.2017
Cash and balances with the Central Bank	6	561
Amounts due from banks - current accounts	22	5,350
Total	**28**	**5,911**

As at 31 December 2018 and 31 December 2017 there were no cash and cash equivalents with restricted availability for use.

(IN PLN '000)

INTEREST INCOME – RECEIVED	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Interest income on loans and advances to customers	645,790	386,277
Interest / discount on securities designated at fair value through profit or loss upon initial recognition	-	367
Interest received on securities measured at fair value through other comprehensive income	15,309	
Interest received on investment securities available for sale		8,232
Interest received on CIRS	31,517	2,496
Interest received on IRS	7,129	1,562
Interest received on deposits	47	75
Other interest received	2	67
Total	**699,794**	**399,076**

INTEREST EXPENSE – PAID	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Interest paid on overdraft facility	36,160	23,134
Interest paid on term loan	20	-
Interest paid on mortgage covered bonds issued	96,154	36,254
Interest paid on bonds issued	57,403	34,522
Interest paid on a liability arising on acquisition of receivables	30,375	47,628
Interest paid on CIRS	188,633	89,110
Interest paid on IRS	6,541	2,913
Interest paid for exceeding the limit in a current account	149	6
Other interest paid	22	1
Total	**415,457**	**233,568**

RECONCILIATION OF ITEMS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION WITH THE CASH FLOW STATEMENT	Note	31.12.2017	In the statement of cash flows, presented in: financing activities		operating activities	31.12.2018
			Incurred	Repaid	Other changes, including foreign exchange differences	
Amounts due to banks	27	**4,125,379**	**5,380,879**	**(5,061,279)**	**(152,693)**	**4,292,286**
overdraft within the limit available		-	-	-	10,513	10,513
liability related to overdraft facilities		1,627,461	5,280,879	(5,061,259)	34,431	1,881,512
liability related to term loans		-	100,000	(20)	27	100,007
liability in respect of the purchase of receivables		2,497,918	-	-	(197,664)	2,300,254
Mortgage covered bonds issued	29	**8,883,213**	**3,708,510**	**(96,154)**	**345,931**	**12,841,500**
Unsecured bonds issued	30	**2,428,025**	**7,771,985**	**(6,948,200)**	**59,338**	**3,311,148**
Total		**15,436,617**	**16,861,374**	**(12,105,633)**	**252,576**	**20,444,934**

38. Related party transactions

38.1 Related party transactions

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

(IN PLN '000)

FINANCIAL INFORMATION

AS AT 31 DECEMBER 2018

ENTITY	ASSETS	
	Receivables	including due to derivative instruments
PKO Bank Polski SA	171,355	168,289
Total	**171,355**	**168,289**

ENTITY	LIABILITIES				
	Overdraft facility	Purchase of receivables	Mortgage covered bonds and unsecured bonds	Other liabilities	including due to derivative instruments
PKO Bank Polski SA	1,742,017	2,300,254	131,960	122,185	15,254
PKO BP Finat Sp. z o.o.	-	-	-	18	-
PKO Leasing SA	-	-	-	50	-
PKO VC -fizan	-	-	34,675	-	-
Total	**1,742,017**	**2,300,254**	**166,635**	**122,253**	**15,254**

ENTITY	Loan commitments	Contingent assets
PKO Bank Polski SA	-	3,117,320
Total	**-**	**3,117,320**

FOR THE PERIOD FROM 1 JANUARY 2018 TO 31 DECEMBER 2018

ENTITY	Total income	of which interest and commission income	Total expenses	of which interest and commission expense	Net result on financial instruments measured at fair value	Net foreign exchange gains/(losses)
PKO Bank Polski SA	1,633	1,231	273,257	252,074	89	250,073
PKO BP Finat Sp. z o.o.	-	-	193	-	-	-
PKO Leasing SA	-	-	400	-	-	-
PKO Towarzystwo Ubezpieczeń SA	-	-	1,994	1,994	-	-
Qualia Sp. z o.o.	-	-	524	524	-	-
PKO VC -fizan	-	-	14	14	-	-
Total	**1,633**	**1,231**	**276,382**	**254,606**	**89**	**250,073**

AS AT 31 DECEMBER 2017

ENTITY	ASSETS	
	Receivables	including due to derivative instruments
PKO Bank Polski SA	9,070	338
Total	**9,070**	**338**

(IN PLN '000)

ENTITY	LIABILITIES				
	Overdraft facility	Purchase of receivables	Mortgage covered bonds and unsecured bonds	Other liabilities	including due to derivative instruments
PKO Bank Polski SA	1,477,453	2,497,918	58,441	223,178	217,777
PKO BP Finat Sp. z o.o.	-	-	-	17	-
PKO Leasing SA	-	-	-	1	-
Total	**1,477,453**	**2,497,918**	**58,441**	**223,195**	**217,777**

ENTITY	Loan commitments	Contingent assets
PKO Bank Polski SA	-	2,912,100
Total	**-**	**2,912,100**

FOR THE PERIOD FROM 1 JANUARY 2017 TO 31 DECEMBER 2017

ENTITY	Total income	of which interest and commission income	Total expenses	of which interest and commission expense	Net result on financial instruments measured at fair value	Net foreign exchange gains/(losses)
PKO Bank Polski SA	2,179	1,029	183,413	168,177	(264)	(230,398)
PKO BP Finat Sp. z o.o.	-	-	184	-	-	-
PKO Leasing SA	-	-	324	-	-	-
Total	**2,179**	**1,029**	**183,921**	**168,177**	**(264)**	**(230,398)**

The Bank holds current accounts and made deposits with PKO Bank Polski SA during the reporting period. In addition, the Bank cooperates strategically with PKO Bank Polski SA. Housing loan sales as well as after-sales servicing, excluding risk management, internal audit and control, are carried out within the framework of the Outsourcing Agreement with PKO Bank Polski SA dated 16 January 2015. Assistance is also provided with respect to support activities under this agreement.

The Bank also obtains financing from PKO Bank Polski SA. On 29 October 2015, PKO Bank Hipoteczny SA concluded with PKO Bank Polski SA a Current Account Revolving Credit Agreement with a limit of PLN 900,000 thousand for a period of 3 years. By an annex to the Agreement, the amount of the limit was increased to PLN 1,500,000 thousand and the lending period was extended until 29 October 2021. As at 31 December 2018, PLN 1,400,000 thousand of the facility was available. Furthermore, on 2 February 2017, PKO Bank Hipoteczny SA concluded with PKO Bank Polski SA a Current Account Revolving Credit Agreement with a limit of PLN 1,500,000 thousand for a period of 3 years, which was drawn in tranches. As at 31 December 2018, PLN 1,500,000 thousand of the facility was available.

On 30 September 2015, the Bank entered into a PKO Bank Hipoteczny Bond Issuance Programme Agreement (the "Programme") with PKO Bank Polski SA for a Programme amount of up to PLN 2,000,000 thousand over a period of 4 years, as well as an Underwriting Agreement under which the underwriter assumes the obligation to take up the Issuer's Bonds for its own account up to the amount of PLN 2,000,000 thousand. As at 31 December 2018, in connection with the signed annexes, the Programme amount was PLN 3,500,000 thousand, compared with PLN 3,000,000 thousand as at 31 December 2017.

On 17 November 2015 A Framework Agreement for the Sale of Receivables was concluded with PKO Bank Polski SA. Based on the agreement, in 2018 the Bank continued to purchase portfolios of receivables under mortgage-backed housing loans. Further details are available in Notes 22 and 27.

On 9 November 2015 the Bank concluded a Programme Agreement with PKO Bank Polski SA and the Powszechna Kasa Oszczednosci Bank Polski SA Brokerage House Branch of PKO Bank Polski SA. On 30 August 2017, the parties signed an amendment agreement altering and consolidating the Programme Agreement, under which the Brokerage House of PKO Bank Polski is engaged by the Bank as a firm-commitment underwriter.

(IN PLN '000)

PKO Bank Polski also plays the role of the arranger and dealer under the Programme Agreement of 28 September 2016, under which the Bank conducts international mortgage bond issues within the framework of the PKO Bank Hipoteczny Base Prospectus, approved by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.

Furthermore, as a part of transactions with parties related by equity, PKO BP Finat Sp. z o.o. provides accounting services with respect to the Bank's general administration, as well as personnel and payroll services, while PKO Leasing SA provides vehicles under a lease agreement, and PKO Towarzystwo Ubezpieczeniowe SA insures the Bank's credit risk.

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

38.2 Personally-related party transactions

As at 31 December 2018, 12 entities were related to the Bank through key management personnel of PKO Bank Hipoteczny SA or close relatives of key management personnel, whereas at 31 December 2017 it was 11 entities.

In the period from 1 January to 31 December 2018 and from 1 January to 31 December 2017, no mutual transactions were concluded by the Bank with such entities.

38.3 Benefits for PKO Bank Hipoteczny SA key management personnel

Benefits for members of the Supervisory Board

Pursuant to the Remuneration policy of the members of the Supervisory Board of the Bank adopted by the General Meeting of Shareholders on 18 October 2018, updated on 5 July 2018, the members of the Supervisory Board of PKO Bank Hipoteczny SA do not receive any compensation for performing their duties. An exception here are independent members of the Supervisory Board, who receive monthly remuneration equal to the average monthly remuneration in the corporate sector, without profit sharing schemes in the fourth quarter of the year 2016, as announced by the Chairman of the Central Statistical Office. The remuneration is increased by 10% when an independent member of the Supervisory Board sits on at least one standing committee of the Supervisory Board.

BENEFITS FOR INDEPENDENT MEMBERS OF THE SUPERVISORY BOARD	01.01.2018 - 31.12.2018	01.01.2017 - 31.12.2017
Artur Kluczny	60	7
Piotr Kwiecień	60	7
Total	**120**	**14**

Benefits for members of the Management Board paid, due and potentially due

BENEFITS FOR THE MANAGEMENT BOARD MEMBERS	01.01.2018 -31.12.2018					
	Short-term employee benefits		Other long-term benefits - variable remuneration paid in cash[2]		Share-based payments settled in cash	
	Remuneration 01.01.2018 - 31.12.2018[1]	Other received 01.01.2018- 31.12.2018	Received 01.01.2018-31.12.2018	Contingent, due as at 31.12.2018	Received 01.01.2018-31.12.2018	Contingent, due 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 did not perform their functions in 2018	-	219	53	112	210	260
Total benefits for the Management Board	**1,894**	**597**	**134**	**297**	**540**	**689**

(IN PLN '000)

BENEFITS FOR THE MANAGEMENT BOARD MEMBERS	01.01.2017 -31.12.2017					
	Short-term employee benefits		Other long-term benefits - variable remuneration paid in cash[2]		Share-based payments settled in cash	
	Remuneration 01.01.2017 to - 31.12.2017[1]	Other received 01.01.2017-31.12.2017	Received 01.01.2017-31.12.2017	Contingent, due as at 31.12.2017	Received 01.01.2017-31.12.2017	Contingent, due as at 31.12.2017
Rafał Kozłowski	612	203	18	137	98	291
Jakub Niesłuchowski	514	165	16	108	87	224
Marek Szcześniak	516	178	10	105	55	233
Members of the Management Board who did not perform their functions in 2017	-	-	1	2	5	2
Total benefits for the Management Board	**1,642**	**546**	**45**	**352**	**245**	**750**

1) The benefits comprise the basic salary, a health care allowance, and an allowance from the Company Social Fund.
2) Deferred variable salary component (in cash).

POST-EMPLOYMENT BENEFITS

In the period from 1 January to 31 December 2018 and from 1 January to 31 December 2017, no post-employment benefits were paid to the Bank's Management Board.

TERMINATION BENEFITS

In the period from 1 January to 31 December 2018 and from 1 January to 31 December 2017, no termination benefits were paid.

LOANS AND ADVANCES GRANTED BY THE BANK TO ITS MANAGEMENT

In the period from 1 January to 31 December 2018 and from 1 January to 31 December 2017, no loans or advances were granted to the Bank's Management.

Under the Framework Agreement Concerning the Sale of Receivables entered into with PKO Bank Polski SA on 17 November 2015, the Bank purchased portfolios of mortgage-backed home loans comprising two loans granted to one of the members of the Bank's Supervisory Board. As at 31 December 2018 their carrying amount was PLN 656 thousand, and as at 31 December 2017: PLN 690 thousand. The interest rate and repayment terms are consistent with the arm's length principle.

38.4 POLICIES FOR DETERMINING THE VARIABLE SALARY COMPONENT POLICY OF KEY MANAGEMENT PERSONNEL IN THE BANK

Pursuant to the requirements of CRD IV, Commission Delegated Regulation (EU) No. 604/2014 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, and in connection with the Regulation of the Minister of Development and Finance of 6 March 2017 in respect of the risk management system, internal control system, remuneration policy and the specific method of assessing internal capital in banks, the following regulations setting the rules for determining variable salary components are in force in the Bank:

- Policies for employing and remunerating members of the Management Board of the Bank, enacted by resolution of the Bank's Supervisory Board;
- A list of job positions of staff whose professional activities have a material impact on the risk profile of the entity, enacted under a Management Board resolution;
- Rules of Variable Salary Components For Material Risk Takers (MRT) of the Bank, enacted under a Decree of the President of the Management Board.

The Policies and rules specify the procedure for granting performance-based variable salary components to members of the Management Board and the MRTs. The variable salary components for a given appraisal period (calendar year) are granted after the bonus targets are accounted for.

Variable salary components are awarded and paid in the following forms:

- non-deferred, at the rate of 60% of the variable salary component (in the first year following the calendar year of the appraisal);

(IN PLN '000)

- deferred, at the rate of 40% of the variable salary component (in equal parts in the three subsequent years following the calendar year of the appraisal).

Both the non-deferred and deferred salary are awarded in equal parts in cash and in the form of a financial instrument (i.e. phantom shares), which is converted into cash after an additional period of retention – after the deferral period. Each variable salary component may be reduced by applying a malus solution reducing the payable variable salary component.

FINANCIAL INFORMATION

PROVISION FOR VARIABLE REMUNERATION COMPONENTS	31.12.2018 (for 2015-2018)	31.12.2017 (for 2015-2017)
Management Board of the Bank[1]	2,754	2,748
Other MRT	2,151	1,770
Total provision	**4,905**	**4,518**

REMUNERATION PAID DURING THE YEAR	01.01.2018 - 31.12.2018 (for 2015-2017)	01.01.2017 - 31.12.2017 (for 2015-2016)
awarded in cash		
Management Board of the Bank[1]	731	591
Other MRT	850	808
awarded in the form of financial instruments		
Management Board of the Bank[1]	540	245
Other MRT	144	60
Total remuneration paid	**2,265**	**1,704**

[1)] including Members of the Management Board who were recalled

39. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

39.1 CATEGORIES OF FAIR VALUE MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES MEASURED AT FAIR VALUE IN THE STATEMENT OF FINANCIAL POSITION

ACCOUNTING POLICIES

CLASSIFICATION OF FINANCIAL ASSETS AND LIABILITIES	Individual financial assets and liabilities measured at the fair value are classified by the Bank to the following categories: Level 1: Prices quoted on active markets; Level 2: Measurement techniques based on observable market data; Level 3: Other measurement techniques. Depending on the category to which assets and liabilities are classified, different fair value measurement methods are applied.
LEVEL 1 PRICES QUOTED ON ACTIVE MARKETS	Financial assets and liabilities whose fair value is measured directly on the basis of prices quoted on active markets for identical assets or liabilities (unadjusted). The Bank classifies to this category financial instruments for which there is an active market and whose fair value is determined based on the market purchase price. Securities are measured based on Bondspot fixing.
LEVEL 2 MEASUREMENT TECHNIQUES BASED ON OBSERVABLE MARKET DATA	Financial assets and liabilities whose fair values are measured using measurement models, if all significant inputs are observable on the market either directly (as prices) or indirectly (on the basis of prices). The Bank classifies to this category the financial assets for which there is no active market, i.e. derivative instruments: CIRS, IRS and FX-Forward.
LEVEL 3 OTHER MEASUREMENT TECHNIQUES	Financial assets and liabilities whose fair values are measured using measurement models, if inputs are not based on observable market data (unobservable inputs). The Bank did not have any instruments classified to this category.

(IN PLN '000)

TRANSFERS	Transfers of instruments between Level 1 and Level 2 are based on the availability of quotations from an active market as at the end of a reporting period. Instruments are transferred from Level 2 to Level 3 if an observable factor is replaced in the measurement with an unobservable one or if a new unobservable risk factor having a significant effect on the measurement of an instrument is applied. Instruments are transferred from Level 3 to Level 2 if an unobservable factor is replaced in the measurement with an observable one or if a the effect of an unobservable factor on the measurement is no longer significant. There were no transfers between the fair value hierarchy levels in 2018 and 2017.

MEASUREMENT TECHNIQUES AND OBSERVABLE INPUT DATA

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE	Measurement techniques	Observable inputs
CIRS	The discounted future cash flows model based on the yield curves.	Yield curves are constructed based on market rates, money market data, and transaction markets for FRA (forward rate agreements), IRS (interest rate swap), basis swap and CDS (credit default swap) quotations.
IRS	The discounted future cash flows model based on the yield curves.	Yield curves are constructed based on market rates, money market data, and transaction markets for FRA (forward rate agreements), IRS (interest rate swap).
FX forward	The discounted future cash flows model based on the yield curves.	Yield curves are constructed based on market rates, money market data, and FX-Forward transaction market.

FINANCIAL INFORMATION

ASSETS AND LIABILITIES MEASURED AT FAIR VALUE AS AT 31 DECEMBER 2018	Note	Carrying amount	Level 1 Prices quoted on active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
Derivative financial instruments	20	168,289	-	168,289	-
CIRS		162,100	-	162,100	-
FX forward		237	-	237	-
IRS		5,952		5,952	
Securities	21	842,965	842,965	-	-
measured at fair value through other comprehensive income		842,965	842,965	-	-
Total financial assets measured at fair value		**1,011,254**	**842,965**	**168,289**	-
Derivative financial instruments	20	15,254	-	15,254	-
CIRS		14,786	-	14,786	-
FX forward		468	-	468	-
Total financial liabilities measured at fair value		**15,254**	-	**15,254**	-

ASSETS AND LIABILITIES MEASURED AT FAIR VALUE AS AT 31 DECEMBER 2017	Note	Carrying amount	Level 1 Prices quoted on active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
Derivative financial instruments	20	338	-	338	-
FX forward		338	-	338	-
Securities	21	830,489	830,489	-	-
available-for-sale investment securities		830,489	830,489	-	-
Total financial assets measured at fair value		**830,827**	**830,489**	**338**	-
Derivative financial instruments	20	217,777	-	217,777	-
CIRS		217,009	-	217,009	-
FX forward		391	-	391	-
IRS		377	-	377	-
Total financial liabilities measured at fair value		**217,777**	-	**217,777**	-

(IN PLN '000)

39.2 Financial assets and liabilities not presented at fair value in the Statement of Financial Position

Accounting policies

The Bank has some financial instruments which are not presented at the fair value in the statement of financial position.

Market values are unavailable for most financial instruments, therefore, the fair values are estimated based on a number of measurement techniques. The fair values of financial instruments are determined using a model based on estimating the present value of future cash flows by discounting the cash flows using the appropriate discount rates. The model calculations include certain simplifications and are sensitive to the assumptions adopted.

The summary of the main methods and assumptions used to estimate the fair values of financial instruments which are not measured at the fair value are presented below.

In the case of some groups of financial instruments, due to a lack of expected significant differences between their carrying amount and the fair value, resulting from the characteristics of those groups (e.g. short-term nature, high correlation with market parameters, short periods of rate overstatement, unique nature of an instrument or a short period from the issue date), it was assumed that the carrying amount of the instrument approximates its fair value. This applies to the following groups of financial instruments:

- cash and balances with the Central Bank;
- amounts due from banks;
- amounts due to banks;
- amounts due to customers;
- floating interest rate covered bonds in PLN issued;
- bonds issued.

The fair value of covered bonds issued in EUR and PLN, whose interest rate was fixed throughout the period, was determined based on the price observed on a regulated market (the Luxembourg stock exchange for EUR-denominated covered bonds and the Warsaw stock exchange for PLN-denominated covered bonds).

The model used with respect to loans and advances to customers without recognized impairment was based on the estimated present values of future cash flows, which were discounted using current interest rates taking into account the amount of credit risk margin and real repayment deadlines resulting from loan agreements. The current margin levels were determined for transactions concluded in the last quarter ended with a balance sheet date. In the case of loans with recognized impairment it is assumed that the fair value is equal to the carrying amount.

Financial information

ASSETS AND LIABILITIES NOT PRESENTED AT FAIR VALUE AS AT 31 DECEMBER 2018	level of fair value hierarchy	valuation method	31.12.2018	
			carrying amount	fair value
Cash and balances with the Central Bank	n/a	at amounts due	6	6
Amounts due from banks	2	discounted cash flows	22	22
Loans and advances to customers, including:			21,070,469	21,026,457
housing loans	3	discounted cash flows	21,070,469	21,026,457
Other financial assets	3	at amount due less impairment allowance	449	449
Amounts due to banks	2	discounted cash flows	4,292,286	4,292,286
Amounts due to customers	2	discounted cash flows	4,359	4,359
Mortgage covered bonds issued	1,2	discounted cash flows, quotations on a regulated market	12,841,500	12,855,959
Unsecured bonds issued	2	discounted cash flows	3,311,148	3,311,148
Other financial liabilities	3	at amounts due	14,388	14,388

(IN PLN '000)

ASSETS AND LIABILITIES NOT PRESENTED AT FAIR VALUE AS AT 31 DECEMBER 2017	level of fair value hierarchy	valuation method	31.12.2017	
			carrying amount	fair value
Cash and balances with the Central Bank	n/a	at amounts due	561	561
Amounts due from banks	2	discounted cash flows	5,350	5,350
Loans and advances to customers, including:			16,042,473	16,042,473
housing loans	3	discounted cash flows	16,042,473	16,042,473
Other financial assets	3	at amount due less impairment allowance	99	99
Amounts due to banks	2	discounted cash flows	4,125,379	4,125,379
Amounts due to customers	2	discounted cash flows	2,099	2,099
Mortgage covered bonds issued	1,2	discounted cash flows, quotations on a regulated market	8,883,213	8,891,406
Unsecured bonds issued	2	discounted cash flows	2,428,025	2,428,025
Other financial liabilities	3	at amounts due	12,972	12,972

40. Operating segments

In 2018 and 2017 the Bank did not analyse its operations by segments due to the specific nature of its operations.

(IN PLN '000)

RISK MANAGEMENT OBJECTIVES AND POLICIES

41. Risk management in PKO Bank Hipoteczny SA

Risk management in PKO Bank Hipoteczny SA is aimed at ensuring effective control of risks and maintaining them within the risk tolerance limits adopted by the Bank in a changing macroeconomic and legal environment, taking into account business profitability. The assumed level of risk plays an important role in the planning process.

The Bank has identified the following types of risks which are managed:

Type of risk	Section
credit risk	42
concentration risk	43
residual risk	44
liquidity risk	45
interest rate risk	46
foreign exchange risk	47
model risk	48
operational risk	49
business risk	50
compliance risk	51
reputation risk	52
capital risk	53

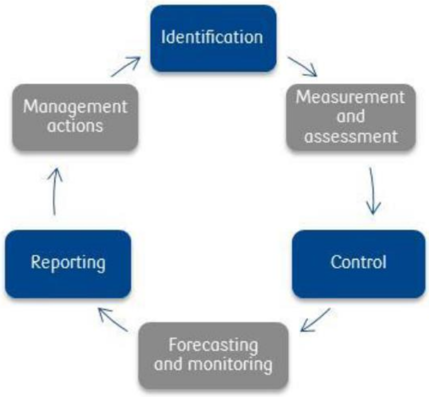
41.1 Key risk management policies

Risk management in PKO Bank Hipoteczny SA is based in particular on the following policies:

- the risk management process, including the lending process, is defined and regulated by strategies, policies and procedures adopted by the Management Board and approved by the Supervisory Board of PKO Bank Hipoteczny SA;
- the Bank manages all identified types of banking risks and performs an ICAAP (Internal Capital Adequacy Assessment Process), where:
  a) the risk management process is appropriate to the scale of the operations and to the significance, scale and complexity of a given risk and tailored to new risk factors and sources of risk as they emerge;
  b) the risk management methods, models and risk measurement systems are tailored to the scale and complexity of the risk, and periodically verified and validated;
- the organizational structure of risk management ensures the independence of the risk function, including the real estate valuation and the credit decision making processes from business activities;
- risk management is integrated with the planning and controlling systems and supports the pursuit of the Bank's strategy in compliance with the risk management strategy, in particular in terms of risk tolerance levels;
- the risk management process is consistent with the principles of risk management of the PKO Bank Polski SA Group, including the application of group risk models, modified to reflect the nature of activities of PKO Bank Hipoteczny SA and approved by the adequate authorities of PKO Bank Hipoteczny SA.

RISK MANAGEMENT SYSTEM

The risk management system of PKO Bank Hipoteczny SA covers the following components:



41.2 COMPONENTS OF THE RISK MANAGEMENT SYSTEM

The risk management system of PKO Bank Hipoteczny SA comprises the following components:

RISK IDENTIFICATION

Risk identification consists of identifying actual and potential sources of risk and assessing the materiality of their potential influence on the given type of risk and on the financial position of the Bank. As part of the risk identification process, material types of risk for the Bank's activities are identified. The different risks assessments are reviewed at least once a year for their materiality.

RISK MEASUREMENT AND ASSESSMENT

Risk measurement covers defining risk measures adequate to the type and materiality of the risk, data availability and quantitative risk assessment by means of set measures, and risk assessment covers identifying the scale of risk, taking into account risk management goals. Stress tests are carried out as part of risk measurement, with a view to determining the potential impact of adverse changes in the Bank's environment and operations on its financial position.

RISK CONTROL

Risk control consists of determining the tools to be used to diagnose or mitigate the level of risk in specific areas of the Bank's activity. Risk control comprises determining risk controls appropriate for the scale and complexity of the Bank's operations, in particular in the form of strategic tolerance limits for individual types of risks subject to monitoring, and in the event that these are exceeded, management actions are taken.

RISK FORECASTING AND MONITORING

Risk forecasting and monitoring consists of preparing forecasts and monitoring deviations from forecasts or adopted reference points (e.g. limits, thresholds, plans, measures from the previous period, recommendations) and stress testing. Risk monitoring is performed with a frequency appropriate to the materiality and volatility of a specific risk type.

RISK REPORTING

Risk reporting consists of regularly informing the authorities of the Bank about the results of risk measurement, actions taken and recommended actions. The scope, frequency and the form of reporting are adjusted to the management level of the recipients.

MANAGEMENT ACTIONS

The management actions taken by the Bank comprise in particular enacting internal regulations, specifying the risk tolerance level, establishing limits and thresholds, issuing recommendations, taking decisions, including about the use of tools supporting risk management. The objective of management actions is to shape the risk management system and risk levels.

41.3 Risk management in the Bank

Risk management is overseen by the Bank's Supervisory Board, which is informed on a regular basis about the risk profile of PKO Bank Hipoteczny SA and about the most important actions undertaken with respect to risk management.

The Bank's Management Board is responsible for risk management, including supervising and monitoring actions taken by the Bank concerning risk management. The Bank's Management Board takes key decisions affecting the risk profile of the Bank and adopts internal regulations concerning risk management.

Risk is managed at three independent lines of defence:

- the first line of defence, which consists primarily of managing risk exposure in the core business, whose framework comprises: limits set on the basis of pertinent internal regulations of the Bank with embedded controls, the rules of exercising control functions and ensuring compliance of the activities with the generally applicable laws, internal regulations of the Bank and the market standards adopted by the Bank;
- the second line of defence, which consists of identifying, measuring and assessing, monitoring, controlling and reporting risks material to the Bank, reporting identified threats and irregularities, formulating internal regulations which define the rules, methods, tools and procedures of risk management, and effectiveness measurement;
- the third line of defence, which is the internal audit function that performs independent audits of key components of the risk management system embedded in the Bank's operations.

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

- the function of the second line of defence in creating systemic solutions is independent of the function of the first line of defence;
- the function of the third line of defence is independent of the function of the first and second lines of defence;
- the function of compliance risk management, which is a part of the second line of defence, reports to the President of the Management Board.

The following organizational segments of PKO Bank Hipoteczny SA are responsible for risk management to the extent of the powers vested in them:

Risk Measurement Bureau

The Risk Measurement Bureau is responsible for the management of the following risks: credit risk (on a portfolio basis), concentration risk, liquidity risk, interest rate risk, foreign exchange risk, business risk, including macroeconomic changes risk, operational risk, and the management of capital adequacy, including:

- identification of risk factors and sources of risk;
- measuring, assessing, as well as periodic monitoring and reporting risk levels;
- measuring and assessing capital adequacy;
- collaboration with the regulator in the risk area (SREP, inspections, clarifications, questionnaires, etc.).

Credit Risk, IT and Outsourcing Bureau

The Credit Risk, IT and Outsourcing Bureau is responsible for the management of the following risks in particular: credit and residual risks, for analyses of the property market, the rules of property valuation, including the rules for determining the Property Value for Mortgage Lending Purposes (BHWN). The Credit Risk, IT and Outsourcing Bureau is also in charge of administering non-performing loans and taking effective action to recover such receivables.

Compliance Team in the Compliance, Security and Legal Bureau

The Compliance Team, which is a separate internal segment of the Compliance, Security and Legal Bureau, is responsible in particular for developing the compliance risk management system and identifying compliance risk in the Bank, in cooperation with the organizational segments of the Head Office designing internal legislation and process flows. The Compliance Team is also responsible for the assessment, control, monitoring and reporting of compliance risk.

Model Validation Officer

The Model Validation Officer is responsible in particular for the management of model risk, validation of risk models and cooperation in this regard with the model validation unit at PKO Bank Polski SA.

Communications Officer

The Communications Officer is responsible in particular for the development of the reputation risk management system and the management of this risk in the Bank.

Risk management is supported by the following committees:

Supervisory Board Audit and Finance Committee ("AFC")

The Committee supports the Supervisory Board in particular by:

- monitoring and periodically expressing its opinions on: the adequacy and effectiveness of internal controls; the adequacy and effectiveness of the risk management system; the degree of effectiveness of compliance risk management in the Bank; the application of corporate governance principles to supervised institutions, the internal audit and compliance principles; the adequacy and effectiveness of whistleblowing procedures (i.e. anonymous reporting of violations of the law and the ethical procedures and standards in place at the Bank);
- developing a policy for selecting an audit firm, recommending an audit firm that would audit the Bank's financial statements to the Supervisory Board;
- monitoring the financial reporting process, including reviewing the interim and annual financial statements of the Bank;
- monitoring the audit performance and independence of the registered auditor and the audit firm;
- expressing its opinions on the principles of operation of the internal control system which are subject to Supervisory Board approval.

Supervisory Board Risk Committee ("RC")

The Committee supports the Supervisory Board in particular by:

- reviewing the whole current and future readiness of the Bank for taking risk, strategic directions and tasks concerning risk in the context of the Bank's business strategy and the conditions resulting from the macroeconomic situation and the regulatory environment, and in particular the risk management strategy prepared by the Management Board and the Bank's acceptable general risk level;
- monitoring the conformity of the Bank's risk-taking policy with the strategy and the financial plan;
- analysing periodic risk reports, including the utilization of strategic risk tolerance limits and developing relevant guidelines on their basis, as well as periodic reviews of pursuance of the risk management strategy;
- issuing opinions about capital adequacy, the rules of evaluation of creditworthiness, the risk measurement models, the impairment model;
- reviewing the principles of the disclosure policy regarding capital adequacy, capital adequacy management, liquidity risk, operational risk, model risk, and impairment measurement risk.

Assets & Liabilities Management Committee ("ALCO")

The Committee supports the Bank's Management Board in particular by:

- supporting the functions managing the liquidity risk, interest rate risk, macroeconomic changes risk, foreign exchange risk and capital risk as well as the risk of the models measuring such risks;
- managing the Bank's capital adequacy;
- reviewing documents concerning capital adequacy, equity, internal capital, stress testing, the risks mentioned above and the risk tolerance limits for those risks;
- taking decisions concerning the Bank's operations, particularly regarding the risk measures and limits, and launching capital and liquidity emergency measures;
- presenting recommendations for the relevant governing bodies of the Bank, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of its competencies.

Credit Committee ("CC")

The Committee supports the Bank's Management Board in particular by:

- supporting the functions that manage credit, concentration and residual risks, as well as the risk of the models measuring such risks;
- reviewing documents concerning the risks mentioned above, the profile and quality structure of the loan portfolio, impairment losses on assets, acquisition of loan portfolios and the property market;

- taking decisions concerning the Bank's operations, particularly regarding the risk measures and limits, the results of the valuation of the risk models, the methodologies and models of calculation of impairment losses on credit assets, cut-offs used in the assessment of credit risk, loan receivables purchased by the Bank and individual loan transactions;
- presenting recommendations for the relevant governing bodies of the Bank, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of its competencies.

Strategy and Business Initiatives Committee ("SBIC")

The Committee supports the Bank's Management Board in particular by:

- supporting the functions that manage business, operational, reputational and compliance risks as well as the risk of the models measuring such risks;
- reviewing documents concerning the risks mentioned above, the directions of the Bank's development, the Bank's strategy and the IT strategy, initiatives connected with the pursuit of the Bank's strategy and the IT strategy, including analyses of operational risk, reviewing the product range, product profitability and the lending process;
- taking decisions concerning the Bank's operations, particularly regarding the management of these risks and the models of risk measurement, as well as the risk measures and limits;
- presenting recommendations for the relevant governing bodies of the Bank, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of its competencies.

Data Quality Committee ("DQC")

The Committee supports the Bank's Management Board in particular by:

- defining the strategic directions of data quality and data architecture management operations at the Bank in the context of the Data Management System ("DMS");
- supervising the DMS operations, which includes assessing its effectiveness and the operations of the individual Head Office organizational units.

The Committees, Management Board and Supervisory Board are recipients of regular reports concerning the different types of risk.

41.4 Identification of material risks

Materiality of different risks

The materiality of different risks is established on the basis of the review of the Bank's operations.

In determining the materiality criteria for the different risks, the impact of the risk on the Bank's operations is taken into account and three types of risks are recognized:

- material risks – subject to active management;
- risks subject to monitoring– which are monitored for materiality;
- other risks which have not been defined or do not arise in the Bank (immaterial and unmonitored).

The materiality evaluation of the different risks is performed periodically on the basis of quantitative and qualitative data. First and foremost, the evaluation results in defining all the risks existing in the Bank and then the risks are classified to one of the two categories: material risk or risk subject to monitoring. The materiality evaluation is also performed whenever a major change occurs in the scope or profile of the Bank's operations.

Risk types considered to be material:

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

Additionally, the following types of risk are considered potentially material by the Bank:

- concentration risk;
- foreign exchange risk;
- residual risk;

- business risk, including risk of macroeconomic changes;
- compliance risk;
- reputational risk;
- capital risk, including risk of excessive leverage.

The Bank has defined and monitors materiality criteria for the risks that are subject to monitoring. The fulfilment of these criteria will result in the recognition of such risk as material to the Bank.

In the Risk Management Strategy the Bank has defined a number of strategic limits defining the appetite for different risks. The limits are regularly monitored. In 2018 and in 2017 none of the strategic limits was exceeded.

42. Credit risk management

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

PKO Bank Hipoteczny SA has policies for credit risk management, which are aimed at the proper risk assessment of loan transactions at the loan application stage and throughout the life of the transaction (monitoring), as well as proper safeguarding of risk by applying appropriate credit risk mitigation techniques.

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

42.1 Credit risk measurement and assessment

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

The measurement and assessment of the risk of individual loan transactions is performed by PKO Bank Hipoteczny SA with the use of group risk models adapted to the specificity of PKO Bank Hipoteczny's business and approved by the relevant governing bodies of PKO Bank Hipoteczny SA. The group risk models used by PKO Bank Hipoteczny SA are based on application data, behavioural data and data from the Credit Information Bureau. The review (monitoring) of the models and their validation are performed separately based on the Bank's portfolio, PKO Bank Polski SA's portfolio as well as the combined portfolios of both banks.

The detailed principles and scope of cooperation within the PKO Bank Polski Group regarding the group risk models are laid down in the Outsourcing agreement with PKO Bank Polski SA described in Note 38.1.

In the lending process, as part of the risk assessment of an individual loan transaction, the Bank assesses the customer's creditworthiness on a qualitative and quantitative basis as well as evaluating the collateral. The qualitative assessment of creditworthiness means the review of all the available customer information originating from internal and external sources of information, as well as the assessment of certain socio-demographic features describing the customer from the perspective of statistical risk as a debtor. The quantitative assessment consists of investigating the customer's financial position in order to determine if the customer has adequate funds to pay his dues on time, including those arising from the requested loan. Creditworthiness is assessed, among other things, based on the documentation supplied by the customer, which is verified for completeness, authenticity and consistency with the facts and the legal status. The assessment of the collateral, particularly the property value for mortgage-lending purposes, consists of verifying the criteria determining the acceptability and effectiveness of the collateral as a possible source of recovery of the receivable.

When purchasing receivables in respect of housing loans from PKO Bank Polski SA, the Bank also performs an assessment of the credit risks of the contracts to be purchased, in accordance with the Bank's methodology of assessment of purchased receivables. In particular, the Bank assesses: the customer's creditworthiness at the time PKO Bank Polski SA granted the loan to be transferred, the current behavioural scoring (based on the group's scoring model) and the current timeliness of repayments, eliminating from the transfer receivables which do not satisfy the methodology criteria.

In addition, the purchased portfolios are measured by an independent third party to guarantee an unbiased valuation of the portfolios to be acquired. As part of the valuation, the costs of risk anticipated with regard to the given receivables portfolio are also assessed and are reflected in the final price which the Bank pays for the portfolio.

In order to determine the credit risk at portfolio level, the Bank uses the following risk measurement and assessment methods:

- probability of default – "PD";
- loss given default – "LGD";
- expected credit loss – "ECL";
- share and structure of non-performing loans – "NPL";
- coverage ratio – "CR";
- risk costs – "RC";
- vintage analyses.

The portfolio credit risk measurement methods enable, among other things, to determine the level of provisions for expected credit losses.

The Bank performs analyses and stress-tests regarding the influence of potential changes in macroeconomic conditions on the quality of the Bank's loan portfolio. The test results reported to the Bank's governing bodies enable them to identify and take measures to mitigate the risks related to the business conducted.

The loan portfolio structure taking into account the PD parameters is presented in the table in Note 42.4.4.

42.2 Credit risk control

The control of credit risk consists of defining tools for measuring the level of credit risks and applying risk controls to mitigate the level of credit risk, both in the lending processes and at portfolio level. The key credit risk control are strategic credit risk tolerance limits. The Bank monitors the level of credit exposure towards its customers or groups of related customers within the meaning of the Banking Act, setting competency limits representing the maximum level of credit decision-making powers.

42.3 Impairment loss on credit exposures

PKO Bank Hipoteczny SA performs monthly reviews of credit exposures in order to identify those that are at risk of impairment or whose credit risk has increased significantly since the initial recognition, to measure the impairment of credit exposures and to set up provisions for expected credit losses.

During the reporting period, the Bank assessed impairment of credit exposures in accordance with IFRS 9. The measurement method and the criteria for classification to the different stages are described in more detail in Note 4.2 "Impairment".

The structure of the loan portfolio and the amount of provisions for expected credit losses of PKO Bank Hipoteczny SA are shown in the tables in Note 23 "Expected credit losses".

42.4 Credit risk forecasting and monitoring

PKO Bank Hipoteczny SA monitors credit risk at the level of individual transactions and at the level of the entire portfolio.

The monitoring of credit risk at the level of individual loan transactions is governed by the Bank's policies concerning, among other things, the early monitoring of delays in the payment of dues.

The monitoring of credit risk at the portfolio level consists of:

- monitoring the level of the portfolio credit risk taking into account the identified sources of credit risk and an analysis of the consequences and measures applied as part of systemic management;
- recommending remedial actions if an increased level of credit risk is detected.

(IN PLN '000)

42.4.1 Maximum exposure to credit risk

The following table presents the maximum exposure to credit risk with respect to financial instruments covered by the provisions of IFRS 7 to which the requirements of IFRS 9 relating to impairment do not apply.

MAXIMUM EXPOSURE TO CREDIT RISK	31.12.2018	01.01.2018
Derivative hedging instruments	168,289	338
Balance sheet exposure - total	**168,289**	**338**

42.4.2 Amounts due from banks

AMOUNTS DUE FROM BANKS	31.12.2018	01.01.2018
Amounts not overdue, not impaired (counterparty rating A2)	22	5,350
Total, gross	22	5,350
Allowances for expected credit losses	-	-
Total, net	**22**	**5,350**

42.4.3 Securities

SECURITIES	31.12.2018	01.01.2018
Issued by the State Treasury, PLN Treasury bonds (rating A)	842,965	830,489
Total, gross	842,965	830,489
Allowances for expected credit losses	-	-
Total	**842,965**	**830,489**

42.4.4 Loans and advances to customers

The loan portfolio is characterized by low exposure to impaired, overdue loans and advances. At 31 December 2018, 42 impaired loans were recognized, and their share in the total loan portfolio amount was 0.04%, whereas as at 31 December 2017, 13 impaired loans were recognized, and their share in the total loan portfolio amount was 0.02%.

The significantly higher amount of impairment allowances as at 31 December 2018 compared with 31 December 2017 results, to a large extent, from implementing IFRS 9. The respective disclosures are included in Note 4.7 "Disclosures concerning the reconciliation of the balance of impairment losses and provisions for contingent liabilities according to IAS 39 and IAS 37 and the opening balance of the impairment losses and provisions calculated according to IFRS 9".

LOANS AND ADVANCES TO CUSTOMERS	31.12.2018	01.01.2018
Loans not overdue, not impaired	20,998,000	15,982,738
Loans overdue, not impaired	92,650	62,097
Loans impaired	8,092	2,847
Total, gross	**21,098,742**	**16,047,682**
Allowances for loans not overdue, not impaired	(19,205)	(16,279)
Allowances for loans overdue, not impaired	(5,882)	(2,460)
Allowances for loans impaired	(3,186)	(968)
Total, net	**21,070,469**	**16,027,975**

(IN PLN '000)

LOANS AND ADVANCES TO CUSTOMERS, NOT IMPAIRED	31.12.2018	01.01.2018
not past due	20,998,000	15,982,738
overdue up to 30 days	84,269	57,543
overdue between 31 and 60 days	6,922	3,764
overdue between 61 and 90 days	1,459	790
Total, gross	**21,090,650**	**16,044,835**

Loan portfolio and financial liabilities granted by PD range

The PD parameter presented in the following tables defines the probability of default over a 12-month horizon:

LOANS AND ADVANCES TO CUSTOMERS	31.12.2018				
PD range	Stage 1	Stage 2	Stage 3	POCI	Total, gross
<0.01%	1,092,324	625	-	-	**1,092,949**
0.01% - 0.02%	2,880,865	1,438	-	-	**2,882,303**
0.02% - 0.05%	5,577,867	2,817	-	-	**5,580,684**
0.05% - 0.1%	4,672,304	2,070	-	-	**4,674,374**
0.1% - 0.3%	5,077,344	3,424	-	-	**5,080,768**
0.3% - 1.0%	1,201,972	74,853	-	-	**1,276,825**
1.0% - 10%	312,451	150,920	-	-	**463,371**
10% - 100%	8,595	30,781	8,092	-	**47,468**
Razem wartość brutto	**20,823,722**	**266,928**	**8,092**	-	**21,098,742**

LOANS AND ADVANCES TO CUSTOMERS	01.01.2018				
PD range	Stage 1	Stage 2	Stage 3	POCI	Total, gross
<0.01%	2,142,132	589	-	-	**2,142,721**
0.01% - 0.02%	3,113,668	797	-	-	**3,114,465**
0.02% - 0.05%	4,657,612	861	-	-	**4,658,473**
0.05% - 0.1%	3,144,074	1,684	-	-	**3,145,758**
0.1% - 0.3%	2,281,846	2,522	-	-	**2,284,368**
0.3% - 1.0%	416,339	26,242	-	-	**442,581**
1.0% - 10%	120,062	131,665	-	-	**251,727**
10% - 100%	987	3,755	2,847	-	**7,589**
Total, gross	**15,876,720**	**168,115**	**2,847**	-	**16,047,682**

LOAN COMMITMENTS	31.12.2018				
PD range	Stage 1	Stage 2	Stage 3	POCI	Total, gross
<0.01%	131,526	-	-	-	**131,526**
0.01% - 0.02%	122,745	-	-	-	**122,745**
0.02% - 0.05%	118,025	-	-	-	**118,025**
0.05% - 0.1%	250,835	110	-	-	**250,945**
0.1% - 0.3%	79,044	-	-	-	**79,044**
0.3% - 1.0%	15,633	995	-	-	**16,628**
1.0% - 10%	-	304	-	-	**304**
10% - 100%	-	-	-	-	-
Total nominal value	**717,808**	**1,409**	-	-	**719,217**

(IN PLN '000)

LOAN COMMITMENTS	01.01.2018				
PD range	Stage 1	Stage 2	Stage 3	POCI	Total, gross
<0.01%	205,593	-	-	-	**205,593**
0.01% - 0.02%	96,144	486	-	-	**96,630**
0.02% - 0.05%	277,627	-	-	-	**277,627**
0.05% - 0.1%	55,737	-	-	-	**55,737**
0.1% - 0.3%	40,576	-	-	-	**40,576**
0.3% - 1.0%	6,458	76	-	-	**6,534**
1.0% - 10%	-	235	-	-	**235**
10% - 100%	-	-	-	-	**-**
Total nominal value	**682,135**	**797**	**-**	**-**	**682,932**

42.4.5 FORBEARANCE PRACTICES

The Bank defines forbearance as actions aimed at changing the contractual terms agreed with a debtor, caused by the debtor's financial distress. The purpose of forbearance activities is to restore a debtor's ability to fulfil his obligations towards the Bank and to maximize the effectiveness of non-performing loan management, i.e. obtaining the highest recoveries while minimizing their costs.

Forbearance involves changing the payment terms that are individually determined for each contract. Such changes may consist, among other things, of:

- dividing the overdue debt into instalments;
- modifying the repayment schedule;
- changing the repayment formula (annuity instalments, decreasing instalments);
- changing the interest rate;
- changing the margin;
- reducing the amounts due.

As a result of timely servicing of the forbearance agreement the due becomes a non-matured receivable. The assessment of the possibilities of the debtor's non-defaulting on an out-of-court settlement agreement (repayment of the debt in pre-determined periods) is an element of the forbearance process. Forbearance agreements are monitored on a current basis.

Forborne exposures classified to Stage 3 are reclassified to the Stage 2 exposures when the following conditions are jointly met:

- the receivable does not meet the premises of impairment;
- at least 12 months passed since the conclusion of the restructuring agreement;
- the forbearance agreement covers the whole debt;
- the debtor has demonstrated his ability to fulfil the conditions of the forbearance agreement.

Exposures cease to satisfy the criteria of forborne exposure when the following conditions are jointly met:

- at least 24 months have lapsed since the forborne exposure was included in the services exposures portfolio (probation period);
- at the end of the probation period mentioned above, the customer does not have any debt owed to the Bank overdue by more than 30 days;
- at least 12 instalments have been repaid in the expected amounts.

(IN PLN '000)

EXPOSURES SUBJECT TO FORBEARANCE IN THE LOAN PORTFOLIO	31.12.2018	01.01.2018
Gross loans and advances to customers, including:	21,098,742	16,047,682
subject to forbearance	2,420	878
Impairment allowances on loans and advances to customers, of which:	(28,273)	(19,707)
subject to forbearance	(801)	(271)
Net loans and advances to customers, including:	**21,070,469**	**16,027,975**
subject to forbearance	**1,619**	**607**

42.5 Credit risk reporting

Monthly and quarterly credit risk reports are prepared in the Bank. Credit risk reporting involves periodical reporting on the structure and scale of risk exposure of the Bank's loan portfolio. Reports are submitted to the Credit Committee on a monthly basis and to the Bank's Management Board, the Supervisory Board Risk Committee and the Supervisory Board on a quarterly basis.

42.6 Credit risk management actions

The basic credit risk management tools used by PKO Bank Hipoteczny SA comprise in particular:

- strategic and internal (portfolio) risk tolerance limits;
- minimum transaction conditions (i.e. the maximum value of LTV, maximum loan amount, required down payment, required collateral, the amount of a single loan to BHWN);
- a scoring system, including specific cut-off points (the minimum number of score points making it possible to accept the loan transaction);
- limits of loan exposures of Bank customers – limits defining the Bank's appetite for credit risk resulting, among other things, from Recommendation S (such as the level of the relationship between the expenses of servicing the liabilities in respect of credit and the financial nature to customer's income, i.e. Debt-to-Income (DtI) ratio, acceptable to the Supervisory Board);
- competence limits – defining the maximum level of credit decision-making powers concerning the customers of the Bank; the amount of competence limits depends on the authority level at which the credit decision is made (within the Bank's organization);
- minimum loan margins, taking into account the costs of credit risk.

A key role in establishing minimum transaction conditions is played by the collateral policy. It is executed by setting up mortgages on the financed properties, and its main purpose is to limit credit losses resulting from the customers' inability to repay their liabilities to the Bank. At the same time, the Bank follows the overriding principle that collateral is only accepted as a loan support instrument and may not be used as a substitute for the customer's ability to pay his/her dues.

43. Concentration risk management

Concentration risk is analysed in the Bank in relation to lending and is defined as the Bank's excessive exposure to:

- exposures to individual customers or groups of related customers;
- exposures subject to common or correlated risk factors;
- characterized by the potential to generate losses large enough to threaten the financial standing of the Bank or the ability to conduct its core operations or to lead to a significant change in the Bank's risk profile.

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

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

(IN PLN '000)

The following table presents the loans and advances exposure concentrations measured with the share of largest exposures in the Bank's total loan portfolio.

LOANS AND ADVANCES TO CUSTOMERS, GROSS – CONCENTRATION RATIO	31.12.2018	31.12.2017
10 largest exposures	0.06%	0.08%
20 largest exposures	0.10%	0.15%
50 largest exposures	0.24%	0.32%
100 largest exposures	0.45%	0.60%

Measurement and control of the concentration risk in PKO Bank Hipoteczny SA are performed by determining the amount of exposure, which generates the risk of concentration, and comparing the amount to the set limits resulting from legal regulations and internal limits.

Internal limits of exposure are determined in respect of the Bank's own funds and the Bank's total credit exposure, and reflect the Bank's credit risk appetite taking into consideration both normal and stress conditions.

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

- exposure limits to a single entity or group of entities related financially or organizationally;
- limits of concentration of internal receivables;
- exposure limits to credit exposures for customers generating income from a commercial activity;
- exposure limits to credit exposures for customers with a DtI ratio of over 50%.

In the period ended 31 December 2018 and in the period ended 31 December 2017 the Bank did not exceed any of the concentration limits.

Monthly and quarterly concentration risk reports are prepared in the Bank. The reports are submitted to the Credit Committee on a monthly basis and to the Bank's Management Board, the Supervisory Board Risk Committee and the Supervisory Board on a quarterly basis.

44. Residual risk management

Residual risk is a risk arising from the effectiveness of the credit risk mitigation techniques used being lower than assumed by the Bank.

The aim of residual risk management is to ensure the effectiveness of the credit risk mitigation techniques and eliminate the risk connected with the use of loan collateral.

In view of the above and considering the specialist nature of its business, the Bank attaches particular importance to the monitoring of the collateral value. Therefore a key role in determining the minimum transaction conditions is played by the credit risk collateral policy. The mortgage policy is aimed at properly securing the credit risk to which the Bank is exposed, including the establishment of mortgage collateral affording the highest possible recovery rates in the event of the need for debt recovery activities.

The Bank's policy regarding loan collateral and collateral valuation takes into account the provisions of the following statutory acts: the Banking Act, the Polish Covered Bonds and Mortgage Banks Act, the Act on Land and Mortgage Registers and Mortgage. In addition, the matter of collateral is also addressed by the guidelines and recommendations of the Polish Financial Supervision Authority, including Recommendations F, S, and J, and the provisions of internal regulations of the Bank.

The Bank has enacted and follows the Rules for Determining the Property Value for Mortgage Lending Purposes approved by the Polish Financial Supervision Authority, issued on the basis of the Polish Covered Bonds and Mortgage Banks Act of 29 August 1997, taking into account Recommendation F concerning the basic criteria applied by the Polish Financial Supervision Authority in approving the rules of determination of the property value for mortgage lending purposes enacted by mortgage banks.

The Property Value for Mortgage Lending Purposes (pol. bankowo-hipoteczna wartość nieruchomości ("BHWN")) is the value determined by the Bank, which in the Bank's opinion reflects the level of risk associated with the property serving as collateral for loans, and is used to determine the ceiling of a granted or purchased loan secured by a mortgage on a specific property or to reach a decision by the Bank as to whether the loan secured on the property may be acquired by the Bank.

(IN PLN '000)

PKO Bank Hipoteczny SA determines the BHWN 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 property characteristics and expenditures necessary for its construction, which will be of a permanent nature and which any property holder will be able to obtain assuming rational exploitation. The expert valuation, made on a specified date, documents assumptions and parameters underlying the analysis, the process of determining the BHWN and the resulting BHWN proposal. The expert valuation report takes into account the analyses and forecasts concerning specific parameters for a given property that affect the credit risk assessment, as well as general factors such as: population growth, unemployment rate, and local zoning plans.

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

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

The following table presents the concentration ratio for the portfolio of loans and advances measured in terms of LtV based on market valuation.

GROSS LOANS BY LTV BASED ON MARKET VALUATION	31.12.2018	31.12.2017
below 50%	29%	28%
51% - 60%	18%	16%
61% - 70%	23%	21%
71% - 80%	21%	23%
80% - 90%	9%	12%
over 90%	0%	0%
Total	**100%**	**100%**
Average LTV based on market valuation	58.7%	60.3%

The following table presents the concentration ratio for the portfolio of loans and advances by geographical region in which the real estate put up as collateral for the loan is located.

LOANS AND ADVANCES TO CUSTOMERS, GROSS – BY GEOGRAPHICAL REGION	31.12.2018	01.01.2018
mazowiecki	24.2%	23.7%
śląsko-opolski	11.3%	11.4%
dolnośląski	10.5%	10.1%
wielkopolski	9.4%	9.4%
małopolsko-świętokrzyski	8.3%	8.6%
pomorski	8.1%	7.8%
lubelsko-podkarpacki	6.8%	7.3%
zachodnio-pomorski	6.2%	6.1%
łódzki	4.8%	4.9%
kujawsko-pomorski	4.7%	4.8%
warmińsko-mazurski	3.3%	3.4%
podlaski	2.4%	2.5%
Total	**100.0%**	**100.0%**

45. LIQUIDITY RISK MANAGEMENT

Liquidity risk is the risk of the inability to settle Bank's obligations when due as a result of the lack of liquid assets. Liquidity risk comprises funding risk, which is a risk of the inability to renew the required funding resources or the loss of access to new sources of funding.

Lack of liquidity may arise from an inappropriate structure of the statement of financial position, mismatch of cash flows, counterparty default, customers' sudden realization of contingent commitments, the inability to roll over bonds or other market events.

The aim of liquidity risk management is to ensure a sufficient level of funds to settle present and future obligations (including potential obligations) when due, taking into account the nature of activities and requirements which may occur due to changes in market conditions. The Bank maintains a proper liquidity level by appropriate structuring of the statement of financial position and financial liabilities granted.

(IN PLN '000)

The Bank manages liquidity risk in order to maintain current, short-term, medium-term and long-term liquidity. The fundamental rule of the liquidity policy of PKO Bank Hipoteczny SA is to maintain an appropriate portfolio of liquid securities, to ensure appropriate liquidity supporting tools and to increase stable sources of funding (in particular, from the issuance of mortgage covered bonds). Money market instruments and unsecured bonds issued are also used in liquidity risk management.

The liquidity risk management is built into the risk management process described in Note 41.2.

The Bank's Supervisory Board oversees the liquidity management policy and reviews reports concerning the Bank's liquidity, the Bank's liquidity risk exposure, the utilization of internal limits and the consequences of liquidity risk management decisions. The Supervisory Board approves a set of strategic limits which determine liquidity risk tolerance and the rules of stress-testing with regard to liquidity.

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

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

The Treasury Bureau is responsible for the operational management of short-term liquidity and the Risk Measurement Bureau deals with overseeing this activity and with developing risk management tools and checking the observance of the limits.

45.1 LIQUIDITY RISK MEASUREMENT AND ASSESSMENT

The Bank applies the following liquidity risk measures:

- contractual, actualized and stress-test liquidity gap;
- liquidity surplus and survival horizon;
- regulatory liquidity measures:
  - M3 – Non-liquid assets to own funds;
  - M4 – Non-liquid assets and assets with limited liquidity to own funds and stable external funds ratio;
- short-term liquidity measure:
  - Liquidity coverage ratio (LCR) - the coverage ratio of net outflows up to 1 month;
- the concentration of funding sources;
- the liquidity stress tests.

The actualized liquidity gaps as at 31 December 2018 and as at 31 December 2017 are presented below.

LIQUIDITY GAP AS AT 31.12.2018	on demand	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months
Adjusted periodic gap	1,171,448	393,495	(45,787)	(1,760,766)	(397,478)	(4,098,827)	(5,517,552)	9,610,867
Adjusted cumulative periodic gap	1,171,448	1,564,943	1,519,156	(241,610)	(639,088)	(4,737,915)	(10,255,467)	(644,600)

As at 31 December 2018, in the bands up to 3 months, the cumulative adjusted liquidity gap has positive values, which means a surplus of maturing assets increased by estimated inflows from available overdraft limit over mature liabilities in the short and medium term.

LIQUIDITY GAP AS AT 31.12.2017	on demand	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months
Adjusted periodic gap	933,111	20,105	(20,132)	(104,202)	(677,924)	(4,214,887)	(3,453,207)	6,652,686
Adjusted cumulative periodic gap	933,111	953,216	933,084	828,882	150,958	(4,063,929)	(7,517,136)	(864,450)

The liquidity surplus is determined with account taken of outflows of funds under stress conditions. The survival horizon means the time during which the Bank will see a surplus of inflows over outflows under stress conditions.

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

A liquidity surplus comprises:

- basic liquidity surplus, consisting of items acquirable within 7 days. The basic part of the liquidity surplus comprises:
  - liquid assets;
  - inflows and outflows over a horizon of up to 7 days (inclusive);
  - additional stress-test outflows over a horizon of up to 7 days (inclusive).
- supplementary liquidity surplus, consisting of items acquirable from 8 to 30 days. The supplementary part of the liquidity surplus comprises
  - inflows and outflows over a horizon of 8 to 30 days;
  - additional stress-test outflows over a horizon of 8 to 30 days.

SENSITIVITY MEASURE	31.12.2018	31.12.2017
Liquidity surplus in the horizon of up to 1 month (in PLN million)	1,452	1,135

Liquidity surplus is defined as the difference between the sum of the most liquid assets and the unconditional stand-by credit facility, and the expected and potential liabilities which mature in a given time band.

The Bank monitors all liquidity standards specified in the Resolution of the PFSA 386/2008 dated 17 December 2008. The values of liquidity standards binding as at 31 December 2018 and the average, minimum and maximum values during the reporting period are shown in the following table:

31.12.2018	as at the end of the period	average during the period	minimum for the period	period high	regulatory minimum
M3	1,493.58	921.62	78.48	2,164.57	>1.0
M4	1.03	1.04	1.03	1.05	>1.0

31.12.2017	as at the end of the period	average during the period	minimum for the period	period high	regulatory minimum
M3	202.77	131.89	45.36	899.76	>1.0
M4	1.03	1.04	1.03	1.05	>1.0

The liquidity coverage ratio (LCR) of net outflows up to 1 month is shown in the following table:

SENSITIVITY MEASURE	31.12.2018	31.12.2017
Liquidity coverage ratio (LCR)	1255%	2520%
LCR regulatory limit	100%	100%

45.2 LIQUIDITY RISK CONTROL

The control of liquidity consists of determining strategic tolerance limits appropriate for the scale and complexity of the Bank, and internal liquidity risk limits for short-, medium-, and long-term liquidity, which are monitored, and if overrun, the Bank initiates management actions.

(IN PLN '000)

45.3 LIQUIDITY RISK FORECASTING AND MONITORING

The liquidity risk exposure of PKO Bank Hipoteczny SA as at 31 December 2018 and 31 December 2017 was within the strategic and internal limits set. In period ended 31 December 2018 and in the period ended 31 December 2017 the Bank did not exceed any of the standards nor any strategic or internal limits.

The Bank regularly reviews the business assumptions which may have a material effect on the projections of liquidity risk measures. Forecasts of the basic liquidity risk measures are prepared periodically and on an on-going basis and these are juxtaposed with the internal limits.

45.4 LIQUIDITY GAP IN THE PRESENTATION OF CONTRACTUAL CASH FLOWS

Liquidity gap in the presentation of contractual cash flows is a mismatch between the inflows and outflows classified in a given range. In the calculation of liquidity gap relating to cash flows the Bank takes into account all instruments concluded as at the balance sheet date. An increase in the amount of loans granted or rolling over of financing for a consecutive period is not taken into account. It is assumed that the funds available under the existing credit lines will be utilized.

31.12.2018	on demand	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months	Total
Inflows	1,171,448	330,069	244,439	373,354	759,740	1,693,151	4,807,427	23,000,979	32,380,607
securities	-	190,767	-	1,280	5,572	167,719	290,033	181,920	837,291
loans and advances to customers	-	122,533	244,439	372,074	754,168	1,525,432	4,517,394	22,819,059	30,355,099
credit lines	1,171,420	-	-	-	-	-	-	-	1,171,420
other	28	16,769	-	-	-	-	-	-	16,797
Outflows	5,496	688,391	656,458	4,103,379	926,399	2,200,035	8,770,547	5,992,147	23,342,852
amounts due to banks	5,496	10,778	12,120	1,804,054	678,562	1,628,999	1,517,526	-	5,657,535
mortgage covered bonds issued	-	38,803	9,810	23,775	70,874	174,505	7,251,797	5,992,147	13,561,711
unsecured bonds issued	-	386,239	455,400	2,121,798	23,037	352,340	-	-	3,338,814
disbursement of loan commitments	-	186,996	179,128	153,752	153,926	44,191	1,224	-	719,217
other	-	65,575	-	-	-	-	-	-	65,575
Inflows due to hedging derivative instruments	-	27,913	882	5,017	27,011	63,510	4,699,897	4,451,008	9,275,238
Outflows due to hedging derivative instruments	-	26,465	28,673	61,503	129,001	282,588	5,297,119	4,442,569	10,267,918
Periodic gap	1,165,952	(356,874)	(439,810)	(3,786,511)	(268,649)	(725,962)	(4,560,342)	17,017,271	8,045,075
Cumulative gap	1,165,952	809,078	369,268	(3,417,243)	(3,685,892)	(4,411,854)	(8,972,196)	8,045,075	

(IN PLN '000)

31.12.2017	on demand	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months	Total
Inflows	933,111	214,415	184,689	282,504	577,525	1,358,078	3,852,899	17,331,511	24,734,732
securities	-	106,133	-	832	4,550	195,616	396,735	124,016	827,882
loans and advances to customers	-	91,052	184,689	281,672	572,975	1,162,462	3,456,164	17,207,495	22,956,509
credit lines	927,200	-	-	-	-	-	-	-	927,200
other	5,911	17,230	-	-	-	-	-	-	23,141
Outflows	5,453	582,141	1,313,169	1,235,395	3,728,142	181,197	5,878,142	4,828,883	17,752,522
amounts due to banks	5,453	-	70,122	80,230	3,508,502	57,384	1,547,538	-	5,269,229
mortgage covered bonds issued	-	13,712	9,797	14,451	46,324	90,441	4,330,185	4,828,883	9,333,793
unsecured bonds issued	-	364,500	1,052,500	984,100	39,100	-	-	-	2,440,200
disbursement of loan commitments	-	177,507	180,750	156,614	134,216	33,372	419	-	682,878
other	-	26,422	-	-	-	-	-	-	26,422
Inflows due to hedging derivative instruments	-	10,882	855	4,875	23,014	43,393	2,431,567	4,321,756	6,836,342
Outflows due to hedging derivative instruments	-	13,134	28,388	43,437	88,706	194,873	3,043,169	4,542,702	7,954,409
Periodic gap	927,658	(369,978)	(1,156,013)	(991,453)	(3,216,309)	1,025,401	(2,636,845)	12,281,682	5,864,143
Cumulative gap	927,658	557,680	(598,333)	(1,589,786)	(4,806,095)	(3,780,694)	(6,417,539)	5,864,143	

45.5 Concentration of funding sources

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

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

- a high proportion of covered bonds in the funding structure (covered bonds are a stable source of funding, however the balloon nature of their redemption causes further need for a new issue or alternative source of funding to arise at redemption in most cases);
- funding supplied by the parent;
- issue of short-term unsecured bonds.

The table below presents the structure of the Bank's funding sources:

STRUCTURE OF THE BANK'S FINANCING	31.12.2018	31.12.2017
Equity	6.7%	7.2%
Funds from the parent entity	18.7%	23.6%
Issues of mortgage covered bonds	58.1%	52.6%
Issues of unsecured bonds	15.0%	14.4%
Other	1.5%	2.2%
Total	**100.0%**	**100.0%**

The share of funding raised from the parent entity amounted to 18.7% as at 31 December 2018 (23.6% as at 31 December 2017). Such level of the indicator is consistent with the financial plan at the current stage of the Bank's operations and is expected to gradually decrease with successive issues of covered bonds and own unsecured bonds. The funding concentration risk is assessed as acceptable.

Seeking to reduce the concentration risk of funding sources, the Bank has implemented a system of internal limits, both in short-term and long-term horizons, according to the mortgage covered bond issues carried out by the Bank. In the period ended 31 December 2018 and 31 December 2017 none of these limits were exceeded.

45.6 Liquidity stress tests

Liquidity stress tests present the impact of stressed market conditions on the level of the Bank's liquidity. Shock analyses are carried out on the basis of scenarios involving hypothetical changes in the following factors:

- shock changes in market parameters on financial markets;
- the impact of extreme changes in market factors, as well as drops in prices on the property market on the anticipated losses on the housing loan portfolio;
- downrating of the Bank's counterparties and of the Bank;
- inability to roll over short-term bond issues or obtain new ones;
- inability to roll over covered bond issues or obtain new ones.

Stress test results are used in particular in:

- monitoring the Bank's exposure to liquidity risk under stressed conditions;
- the process of setting internal limits for liquidity risk measures;
- controlling liquidity maintenance, for each day of the 30-day time band;
- the process of planning the Bank's statement of financial position;
- the process of determining conditions triggering the implementation of liquidity emergency plans of the Bank.

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

The stress tests conducted on the basis of the Bank's financial data as at 31 December 2018 and as at 31 December 2017 did not indicate any risk to the Bank's business due to the occurrence of hypothetical stressed market conditions. Owing to the well-balanced funding structure, long maturities of most of its liabilities and a sufficient level of liquid assets, the Bank has a high ability to survive a liquidity crisis.

45.7 LIQUIDITY RISK REPORTING

The Bank prepares reports concerning liquidity risk on a daily, weekly, monthly and quarterly basis. Reports containing information about the exposure to liquidity risk and information about the utilization of the liquidity risk limits are submitted to the ALCO committee on a monthly basis and to the Management Board and the Supervisory Board of the Bank on a quarterly basis.

45.8 LIQUIDITY RISK MANAGEMENT ACTIONS

The risk management system of PKO Bank Hipoteczny SA comprises the following components:

- procedures for liquidity risk management, including in particular emergency plans;
- internal limits limiting liquidity risk;
- deposit and derivative transactions, including structural currency transactions and transactions for sale or purchase of securities;
- unconditional liquidity support instruments obtained from PKO Bank Polski SA;
- transactions ensuring long-term funding of the lending activity.

The Bank pays particular attention to matching the timing of cash flows upon the maturity of material liabilities (redemption of covered bonds).

46. INTEREST RATE RISK MANAGEMENT

The operations of PKO Bank Hipoteczny SA are exposed to interest rate risk, which is defined as the risk of loss on balance sheet items and off-balance sheet positions, sensitive to movements in the interest rates, as a result of changes in the market interest rates.

The aim of interest rate risk management is to limit any potential losses incurred due to changes in the market interest rates to an acceptable level by the proper shaping of the structure of the balance sheet items and off-balance sheet positions, among other things, in terms of the matching of the repricing periods.

Interest rate risk is recognized as a material risk, which results from the Bank's business model.

46.1 INTEREST RATE RISK MEASUREMENT AND ASSESSMENT

In the process of interest rate risk management, the Bank uses the net interest income sensitivity (NIIS) measure, the Basis Point Value (BPV) measure, stress tests and repricing gap reports.

The net interest income sensitivity (NIIS) measure is a measure determining the change in net interest income arising from a sudden change in the interest rates while the Basis Point Value (BPV) measure is a measure illustrating the impact of such a change on the economic value of capital. The measures allow for the diversification of the repricing periods of individual interest items in each subsequent time band.

(IN PLN '000)

Stress tests are used to estimate potential losses resulting from the maintained structure of the balance sheet and off-balance sheet positions in the event of the occurrence of the hypothetical scenarios within which parallel shifts in interest rate curves by ±50 bps, ±100 bps and ±200 bps are arbitrarily assumed. Reversed stress test scenarios are also adopted, assuming a drop of the Bank's financial result to PLN 0 and a loss of the Bank's economic value of 1% of its equity.

The repricing gap presents the difference between the current value of the assets and liabilities exposed to interest rate risk, which are repriced within the given time band, where positions which are not marked-to-market (e.g. loans) are recognized in the amounts serving as the basis for interest accrual.

The repricing gap report presented below includes assets and liabilities as financial liabilities granted which are sensitive to changes in interest rates. They do not include contingent liabilities which are insensitive to interest rate risk, the Bank's own funds, deposits from banks in the form of current account balances and current account overdrafts.

31.12.2018	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
Assets	7,614,779	14,063,152	144,689	3,636	7,794	-	-	21,834,050
securities	702,749	-	143,644	-	-	-	-	846,393
loans and advances to customers	6,912,030	14,063,152	1,045	3,636	7,794	-	-	20,987,657
Liabilities	(3,642,594)	(5,357,824)	(2,119,700)	(18,500)	-	(4,797,200)	(4,467,500)	(20,403,318)
amounts due to banks	(1,227,794)	(3,022,424)	-	-	-	-	-	(4,250,218)
mortgage covered bonds issued	(2,030,000)	(1,530,000)	-	-	-	(4,797,200)	(4,467,500)	(12,824,700)
unsecured bonds issued	(384,800)	(805,400)	(2,119,700)	(18,500)	-	-	-	(3,328,400)
Derivative instruments – assets	435	-	1,202	295	2,040	4,799,644	4,466,738	9,270,354
Derivative instruments – liabilities	(4,232,565)	(4,951,687)	(1,128)	(286)	(1,908)	(9,971)	(4,122)	(9,201,667)
Periodic gap	(259,945)	3,753,641	(1,974,937)	(14,855)	7,926	(7,527)	(4,884)	1,499,419
Cumulative gap	(259,945)	3,493,696	1,518,759	1,503,904	1,511,830	1,504,303	1,499,419	

31.12.2017	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
Assets	5,981,946	10,723,756	93,663	3,768	6,235	-	-	16,809,368
securities	738,153	-	92,288	-	-	-	-	830,441
loans and advances to customers	5,243,793	10,723,756	1,375	3,768	6,235	-	-	15,978,927
Liabilities	1,014,500	6,546,596	984,100	39,100	-	2,575,679	4,275,173	15,435,147
amounts due to banks	150,000	3,964,096	-	-	-	-	-	4,114,096
mortgage covered bonds issued	500,000	1,530,000	-	-	-	2,575,679	4,275,173	8,880,851
unsecured bonds issued	364,500	1,052,500	984,100	39,100	-	-	-	2,440,200
Derivative instruments - assets	86	-	1,174	265	1,604	2,578,329	4,275,075	6,856,533
Derivative instruments – liabilities	2,130,986	4,891,687	1,094	253	1,472	9,357	2,826	7,037,675
Periodic gap	2,836,547	(714,527)	(890,358)	(35,321)	6,368	(6,707)	(2,923)	1,193,079
Cumulative gap	2,836,547	2,122,020	1,231,662	1,196,341	1,202,709	1,196,002	1,193,079	

46.2 Interest rate risk control

The control of interest rate risk involves determining risk limits appropriate for the scale and complexity of the Bank's operations, in particular strategic tolerance limits for interest rate risk, which are subject to monitoring, and in the event these are exceeded management actions are taken.

(IN PLN '000)

46.3 Interest rate risk forecasting and monitoring

The interest rate risk exposure of PKO Bank Hipoteczny SA as at 31 December 2018 and 31 December 2017 was within the strategic and internal limits set. Owing to effective mitigating activities, despite dynamically growing total assets, interest rate risk was relatively low and caused by the mismatch between the repricing dates of the interest rates on the Bank's assets and liabilities in the shortest repricing bands, i.e. up to 3 months.

46.4 Interest rate risk reporting

The Bank prepares reports concerning liquidity risk on a daily, weekly, monthly and quarterly basis. Reports containing information about the exposure to interest rate risk and information about the utilization of the interest rate risk limits are submitted to the ALCO committee on a monthly basis and to the Management Board and the Supervisory Board of the Bank on a quarterly basis.

46.5 Interest rate risk management actions

The basic interest rate risk management tools used by PKO Bank Hipoteczny SA comprise in particular:

- procedures concerning the management of interest rate risk;
- internal limits on interest rate risk, among other things for basis point value sensitivity and net interest income sensitivity;
- specification of the permitted types of interest-rate based transactions;
- hedging interest risk with derivatives tansactions;
- the proper selection of transaction parameters making it possible to apply natural hedges between assets and liabilities.

The Bank manages interest rate risk by matching the repricing structure of the assets and funding sources (natural hedging) and, on an as needs basis, enters into hedging transactions (derivative contracts).

47. Foreign exchange risk management

The operations of PKO Bank Hipoteczny SA are exposed to foreign exchange risk, which is defined as the risk of loss due to changes in the foreign exchange rates generated by the maintenance of open positions in various currencies.

The aim of foreign exchange risk management is to limit any potential losses incurred due to changes in the exchange rates to an acceptable level by the proper shaping of the currency structure of the balance sheet items and contingent liabilities, and the use of derivative instruments.

At the present stage of operations of the Bank, foreign exchange risk has been deemed to be potentially material and not requiring to be covered with internal capital.

In the process of foreign exchange risk management the Bank uses individual and aggregate FX positions and stress tests. Stress tests are used to estimate the potential loss on the positions taken in foreign currencies in the event of an extraordinary situation in the FX market. The Bank uses hypothetical scenarios – which assume a hypothetical appreciation or depreciation of currency rates (20 per cent and 50 per cent).

FOREIGN CURRENCY POSITION	31.12.2018	31.12.2017
EUR	78	32
USD	2	1

The foreign exchange risk exposure of PKO Bank Hipoteczny SA as at 31 December 2018 and 31 December 2017 was within the strategic and internal limits set.

The Bank closes all open FX positions on an ongoing basis, and the control and reporting procedures implemented by the Bank significantly limit the impact of changes in exchange rates on the Bank's financial performance, hence the foreign exchange risk as at 31 December 2018 and as at 31 December 2017 was at a low level.

The Bank prepares reports concerning foreign exchange risk on a daily, weekly, monthly and quarterly basis. Reports containing information about the exposure to foreign exchange risk and information about the utilization of the foreign exchange risk limits are submitted to the ALCO committee on a monthly basis and to the Management Board and the Supervisory Board of the Bank on a quarterly basis.

The basic foreign exchange rate risk management tools used by PKO Bank Hipoteczny SA comprise in particular:

- procedures concerning the management of foreign exchange risk;
- limits and thresholds on foreign exchange risk, among others on foreign exchange positions;
- specification of the permitted types of foreign exchange transactions.

48. Model risk management

Model risk is the risk of losses resulting from wrong business decisions made on the basis of the models used.

The aim of the management of model risk is to mitigate the risk of losses resulting from a wrong business decision made on the basis of the models used by way of a properly defined and implemented model management process.

All models of significance for the Bank are subject to a process of regular and impartial validation by the Bank's validation function.

The model risk management process in PKO Bank Hipoteczny SA is consistent with the solutions of the PKO Bank Polski Group.

48.1 Model risk measurement and assessment

Identification of model risk consists in particular of:

- collecting information about the models in use and those to be implemented;
- periodical determination of significance of the models.

The assessment of model risk is aimed at determining the scale of threats connected with the existence of model risk. The assessment is carried out at the level of a single model as well as on an aggregate basis for the whole Bank.

48.2 Model risk control

The aim of the model risk control is to maintain the aggregate assessment of model risk at a level acceptable to the Bank. The control of model risk consists of defining mechanisms for probing the model risk level and the risk mitigation tools.

The tools used for diagnosing model risk include in particular a strategic limit of model risk tolerance and model risk thresholds.

48.3 Model risk forecasting and monitoring

The aim of model risk monitoring is to diagnose the areas requiring management action. The following in particular are monitored as part of the model risk monitoring process:

- updating the model risk level;
- evaluating the utilization of the strategic limit of model risk tolerance and the values of the model risk thresholds;
- verifying the status of implementation and evaluation of the effectiveness of the model risk mitigating actions.

48.4 Model risk reporting

The results of monitoring are presented in periodic reports for the Management Board and the Supervisory Board containing a comprehensive assessment of model risk, particularly:

- information about the utilization of the strategic limit of model risk;
- information about the level of model risk;
- the model risk map;
- the status of implementation of the recommendations issued after model reviews or validation;
- suggested management actions to mitigate the model risk.

48.5 MODEL RISK MANAGEMENT ACTIONS

The aim of management actions is to develop the model risk management process and shape the risk level, in particular by setting acceptable risk levels and making decisions about the use of risk management supporting tools.

49. OPERATIONAL RISK MANAGEMENT

Operational risk is defined as the risk of the occurrence of a loss due to non-compliance or failed internal processes, people and systems or external events. Operational risk includes legal risk, but not reputational risk and business risk. Operational risk is classified as a material risk.

The aim of operational risk management is to enhance the security of the operational activities pursued by the Bank by enhancing effective mechanisms of identification, assessment and measurement, limitation, monitoring of and reporting on operational risk tailored to the profile and the scale of operations.

The process of operational risk management is realized at the level of the entire Bank and at the level of each systemic operational risk management area. Systemic operational risk management involves the creation of solutions which enable the Bank to exercise control over the level of operational risk so that it can accomplish its goals. Ongoing operational risk management is conducted by every employee of the Bank, within their responsibilities and tasks.

For the purpose of managing operational risk, the Bank gathers internal and external data about operational incidents, on business environment factors, the results of operational risk self-assessment, data on key risk indicators in respect of operational risk (KRI) and data related to the quality of internal control.

Taking into account the scale of outsourcing and its potential impact on the operational risk profile, the Bank has prepared a risk management process related to the outsourcing of services, including sales and after sales servicing, and IT services. The management of this risk, carried out by different organizational units of the Bank, includes numerous components, such as the introduction of procedures of outsourcing services for the Bank, analysing and assessing the risk associated with the outsourcing of services by the Bank, assessing the reliability and financial position of the service providers, developing contingency plans for the Bank and its service providers (in particular, in the IT field), implementing adequate safeguards of the Bank's interests in outsourcing agreements, requirements for an appropriate insurance coverage by insourcers, monitoring the proper execution of contracts and the insourcers' position, including their periodic verification, recording incidents and losses related to the realization of services by insourcers.

49.1 OPERATIONAL RISK MEASUREMENT AND ASSESSMENT

Operational risk is measured in order to determine the scale of threats connected with the existence of operational risk using set risk measures. Operational risk measurement covers:

- determining the strategic operational risk tolerance limits;
- calculating key risk indicators (KRI);
- calculating the own funds requirement for operational risk under the BIA approach (BIA requirement);
- stress testing;
- calculating internal capital.

The operational risk self-assessment includes the identification and assessment of operational risk in relation to the Bank's processes. The operational risk self-assessment is conducted once a year and before the introduction of new or changed products, processes or applications used by the Bank, with the use of:

- data collected on operational incidents;
- results of inspections, proceedings and functional internal control;
- KRIs.

49.2 OPERATIONAL RISK CONTROL

The aim of operational risk control is to strive to maintain the Bank's operational risk at an acceptable level.
The control of operational risk involves determining the risk limits appropriate for the scale and complexity of the Bank's operations, in particular strategic tolerance limits for operational risk and KRI limits, including threshold and critical values.

The strategic operational risk tolerance limit are set by the Management Board and approved by the Supervisory Board.

49.3 Operational risk forecasting and monitoring

The aim of operational risk monitoring is to control operational risk and diagnose the areas requiring management action.

In particular, the Bank regularly monitors:

- the utilization of strategic tolerance limits and operational risk loss limits;
- the effectiveness and timeliness of actions undertaken to reduce or transfer the operational risk;
- the values of the KRIs;
- the results of operational risk self-assessment;
- the results of stress test;
- operational incidents and their consequences.

49.4 Operational risk reporting

Operational risk information is reported for:

- the Bank's internal purposes, in particular: the Management Board and the Supervisory Board;
- supervisory and regulatory bodies;
- the shareholders and the financial market.

Reporting for the Bank's internal purposes related to operational risk is performed on a quarterly basis. Quarterly reports contain, in particular, information about:

- the results of the measurement and monitoring of operational risk;
- the operational risk profile of the Bank resulting from the process of identifying and assessing the threats to products, processes and applications of the Bank;
- the level of operational risk and the tools applied in operational risk management;
- the actions taken to limit operational risk and the evaluation of the effectiveness of the actions taken to reduce the operational risk level;
- recommendations, decision and suggestions of the Management Board.

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

49.5 Operational risk management actions

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

If the risk level is elevated or high, the Bank uses the following approach:

- risk reduction – mitigating the impact of the risk factors or the consequences of its materialization;
- risk transfer – the transfer of responsibility for covering potential losses to a third-party;
- risk avoidance – discontinuance of activities that generate risk or eliminate the possibility of occurrence of a risk factor.

The operational risk management process is subject to internal control including:

- a review of the strategy and the process of operational risk management;
- internal audit.

49.6 Operational losses incurred

In 2018, 6 operational risk incidents were disclosed at the Bank, which involved operational losses for the total net amount of PLN 6 thousand. In 2017, it was PLN 117 thousand.

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

50. Business risk management

Business risk is a risk of failing to achieve the assumed financial targets, including a risk of losses, resulting from adverse changes in the business environment, wrong decisions made, incorrect implementation of decisions made or failing to take proper action in response to changes occurring in the business environment. It also takes into account a risk of macroeconomic changes (a risk of deterioration in the Bank's financial position due to an adverse effect of changing macroeconomic conditions).

Identification of business risk consists of recognizing and defining actual as well as potential factors which result from the current or contemplated business operations of the Bank and may adversely affect the Bank's financial position, the occurrence or the volume of the Bank's income and expenses.

Business risk is measured in order to determine the scale of threats connected with the existence of business risk using specified risk measures.

The purpose of business risk control is to maintain the Bank's business risk at an acceptable level. The control of business risk involves setting risk controls in the form of business risk tolerance limits, adequate to the scale and complexity of the Bank's operations, and reviewing them on a regular basis.

The aim of business risk forecasting is to define the expected scenario of changes in the income and expense items.

The aim of business risk monitoring is to diagnose the areas requiring management action.

The following in particular are monitored as part of the business risk monitoring process:

- a strategic business risk tolerance limit;
- deviations of the forecast business risk from the actual one.

Business risk is reported in the form of periodic reports addressed to the Strategy and Business Initiative Committee, the Management Board and the Supervisory Board of the Bank.

Management actions consist in particular of:

- reviewing and revising the quarterly financial forecasts taking into account measures aimed at mitigating the level of business risk in line with the set limits;
- monitoring the level of the strategic business risk tolerance limit.

51. Compliance risk management

Compliance risk is defined at PKO Bank Hipoteczny SA as the risk of legal sanctions, incurring financial losses or the loss of reputation as a result of failure on the part of the Bank, the Bank's employees or entities acting on its behalf to comply with the provisions of the law, internal regulations and the market standards adopted by the Bank.

The aim of compliance risk management is to:

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

The identification and evaluation of compliance risk is carried out on the basis of the methodology implemented in the PKO Bank Polski SA Group for identification and evaluation of compliance risk and is performed by way of defining the sources and factors giving rise to compliance risk and analysing potential links between compliance risk and operational risks.

The assessment of compliance risk is carried out periodically by the owners of internal processes, in cooperation with the Compliance Team and in particular includes:

- estimation of the potential severity of the consequences non-compliance cases in the form of:
    - financial losses, particularly in the form of administrative penalties or damages;
    - loss of reputation;

  - other legal sanctions;
- using information about the findings of external inspections and internal audits, formulated recommendations and the extent of their implementation.

In an assessment, the nature and the potential scale of losses are determined and it is indicated how compliance risk can be mitigated or eliminated.

As part of compliance risk control, the Bank protects itself from or mitigates the risk by implementing compliance risk controls and ensuring that they are observed.

The following is covered by compliance risk monitoring:

- the results of compliance risk identification and assessment;
- the actions taken by the Bank as part of:
  - compliance risk management;
  - implementing the recommendations issued by internal auditors and external inspectors;
  - bringing the Bank to compliance with new legislation and standards of conduct;
  - fulfilling the Compliance Team's recommendations;
- effectiveness of the controls connected with the mitigation of compliance risk;
- selected areas connected with the specific nature of operations of a mortgage bank, subject to periodic compliance testing by the Compliance Team.

Reporting of information related to compliance risk of the Bank is conducted on a quarterly basis. The recipients of the reports are: The Management Board, the Supervisory Board and the Supervisory Board Audit and Finance Committees. Quarterly reports contain, in particular, information about:

- the results of compliance risk identification and assessment;
- the observed cases of non-compliance in the Bank and in the financial sector;
- the most significant changes in the regulatory environment of the Bank, as well as circumstances resulting from the activities of external supervisory and regulatory authorities;
- the results of external inspections carried out within the Bank;
- the most important actions undertaken as part of compliance risk management and the implementation of recommendations arising from external inspections.

The activities of the Compliance Team are based on an annual plan approved by the Bank's Supervisory Board. The report on the pursuit of the plan, and supplementary and summary information to the quarterly reports are presented to the Management Board, the Supervisory Board, and the Audit and Finance Committee on an annual basis.

52. Reputation risk management

Reputation risk is understood as the risk of deterioration of reputation among customers, counterparties, investors, supervisory and regulatory authorities and the general public, as a result of business decisions made by the Bank, operating incidents, and instances of non-compliance or other events.

The objective of managing the reputation risk is to protect the Bank's reputation by counteracting reputational losses and limiting the negative impact of image-related events on the Bank's reputation.

Identification of the reputation risks covers the developments observed in the Bank's internal processes and its external environment, particularly:

- image-related events;
- factors related to the business environment, i.e. quantitative and qualitative information, including in particular data describing the Bank and its external environment, which suggest the existence of reputation risk.

Collecting information about image-related events includes identified negative information content about the Bank, leading to the deterioration of its reputation, such as:

- information spread by the mass media;
- information disclosed by the Bank;
- evaluations of auditing firms, analytical institutions and external supervisory and regulatory authorities;
- public protests and demonstrations.

An assessment of reputation risk involves evaluating the impact of image-related events on the Bank's reputation, and in particular, quantifying and determining the severity of losses of reputation. The assessment of reputation risk includes the impact, credibility and the opinion-forming potential of the disclosure of an image-related event to the public.

Controlling reputation risk involves determining the risk controls appropriate for the scale and complexity of the Bank's operations, in the form of an internal tolerance limit for reputation risk.

Monitoring reputation risk consists of regular assessments of the values of the reputation risk measures compared with the adopted threshold values.

Information about reputational risk is reported in the form of:

- semi-annual management reports addressed to the Management Board of the Bank;
- ad hoc information on current events having a material impact on the Bank's reputation, delivered to the President of the Management Board;
- information provided at the request of the external supervisory and regulatory authorities.

Based on the specific level of reputation risk management actions are taken which may cover:

- an analysis of the reasons for the given risk occurring;
- assessment of the effects of such a level of risk occurring;
- preparation of proposed management actions aimed at reducing the level of reputation risk or justification of the lack of the need to take such action, e.g. in the event of incidental extraordinary events occurring.

53. CAPITAL ADEQUACY AND THE MANAGEMENT OF CAPITAL RISK

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

Capital risk is the risk of failing to arrange an adequate level and structure of own funds or the inability to ensure an adequate level of equity given the business risk borne by the Bank, necessary to cover unexpected losses and satisfy regulatory requirements, making it possible for the Bank to continue independent operations. Capital risk includes the risk of excessive leverage, i.e. the risk resulting from vulnerability to threats due to financial leverage or conditional financial leverage, which may necessitate taking involuntary action modifying business plans, including the forced sale of assets which could lead to losses or to the need to adjust the valuation of other assets.

Managing the Bank's capital adequacy covers:

- Pillar I: minimum capital requirements specified in the legislation;
- Pillar II: internal capital, determined by means of the Bank's own models for the risks considered material.

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

The following constituted the legal basis of the capital adequacy assessment process as at 31 December 2018:

- Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 ("CRR Regulation");
- the Act of 29 August 1997 "Banking Act";
- The Act of 5 August 2015 on macroprudential supervision over the financial system and crisis management in the financial system ("Macroprudential Act");
- The Regulation of the Minister of Development and Finance of 25 May 2017 in respect of a higher risk weight for exposures secured with mortgages on residential property.

The capital adequacy process is described in Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC ("CRD IV"). The CRD Directive has been implemented in Polish law by way of updating the Banking Act.

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

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

Capital risk is classified as a risk subject to monitoring. In 2018 and since the beginning of the Bank's operations, capital adequacy remained at a safe level above the supervisory limits.

At 31 December 2018, the total capital ratio of the Bank amounted to 15.2% (as at 31 December 2017: 15.2%).

53.1 Own funds for the purpose of capital adequacy

The Bank's own funds for capital adequacy purposes have been calculated in accordance with the Banking Act and the CRR with implementing legislation.

The Bank's own funds consist entirely of core Tier 1 capital (CET 1). In determining its own funds, the Bank makes use of the transitional provisions following from the implementation of IFRS 9.

BANK'S OWN FUNDS	31.12.2018	01.01.2018	31.12.2017
Share capital	1,295,000	1,200,000	1,200,000
Supplementary capital	54,932	-	-
Retained earnings	(11,787)	38,883	(749)
Net profit for the period	85,849	-	51,419
Accumulated other comprehensive income - hedge accounting	59,462	(31,372)	(31,372)
Accumulated other comprehensive income - available-for-sale securities			2,480
Accumulated other comprehensive income - securities measured through other comprehensive income	4,427	2,480	
Equity	**1,487,883**	**1,209,991**	**1,221,778**
Equity adjustments	(94,036)	(15,289)	(27,155)
Retained earnings before approval	-	(51,419)	-
Net profit for the period	(85,849)	-	(51,419)
Current profit, included by permission from the PFSA	42,588	-	-
Accumulated other comprehensive income - hedge accounting	(59,462)	31,372	31,372
Intangible assets	(4,165)	(5,584)	(5,584)
Adjustment to assets measured at fair value (AVA)	(949)	(871)	(871)
Transitional period adjustment[1)]			(653)
Adjustment relating to the transitional period for IFRS 9 implementation	13,800	11,213	
Total own funds	**1,393,847**	**1,194,702**	**1,194,623**

[1)] Transitional provisions to account for cumulative other comprehensive income in respect of unrealized gains and losses on financial instruments included in the portfolio of securities measured at the fair value through other comprehensive income.

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53.2 Capital buffers

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

With effect from 1 January 2016, the Bank was required to maintain an additional capital buffer at the level of 1.25% of the total risk exposure. The conservation buffer is mandatory for all banks, and is phased in gradually increasing every year to the target level of 2.5% (in 2019).

Due to the fact that 1 January 2018 marked the effective date for the Regulation of the Minister of Development and Finance of 1 September 2017 in respect of the systemic risk buffer (Official Journal 2017, 1776), in 2018, the banks were required to maintain the equity ratios at the following levels:

- Total capital ratio (TCR) = 8% + an add-on + the combined buffer requirement;
- Tier 1 capital ratio (T1) = 6% + 75%*add-on + the combined buffer requirement;
- Core Tier 1 capital ratio (CET1) = 4.5% + 56%*add-on + the combined buffer requirement,

where the add-on means the requirement specified in Article 138 (1) (2a) of the Banking Act and the combined buffer requirement is the sum total of the mandatory buffers, i.e.

- the conservation buffer of 1.875% (2.5% from 2019);
- the counter-cyclical buffer of 0% for loan exposures on the territory of Poland;
- the buffer of other systemically important institution set by the PFSA on a case by case basis;
- the systemic risk buffer of 3%.

PKO Bank Hipoteczny SA has not been recognized as another systemically important institution by the PFSA and therefore it is not required to satisfy the applicable additional capital requirements.

The Bank is also not required to satisfy the requirements specified in Article 138 (1) 2a of the Banking Act (add-on).

53.3 Financial leverage

The risk of excessive leverage is defined as the risk resulting from vulnerability to risks because of financial leverage or conditional financial leverage, which may necessitate taking involuntary action modifying business plans, including forced sale of assets which could result in losses or result in the need to adjust the valuation of other assets.

Financial leverage is defined as the relative size of a Bank's assets, off-balance sheet obligations and contingent obligations to pay or to deliver, or to provide collateral, including obligations from received funding, made commitments, derivatives or repurchase agreements, but excluding obligations which can only be enforced during the liquidation of a Bank, compared to the Bank's own funds.

The Bank calculates financial leverage according to the CRR Regulation.

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

LEVERAGE	31.12.2018	31.12.2017
Leverage ratio	6.3%	6.9%

As at 31 December 2018 and as at 31 December 2017, the Bank's financial leverage ratio was above the 3% level recommended for banks by the Basel Committee.

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53.4 Requirements regarding own funds (Pillar I)

In accordance with the CRR Regulation, 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– according to the basic indicator approach (BIA);
- market risk (foreign exchange risk only) – according to basic methods.

At 31 December 2018 and as at 31 December 2017, the own fund requirements in respect of the risk of credit valuation adjustment, settlement and delivery, and market risk were nil, therefore, the total requirement in respect of own funds comprised the requirements in respect of credit and operational risk.

OWN FUNDS REQUIREMENTS	31.12.2018	01.01.2018	31.12.2017
Credit risk	718,961	611,678	611,860
Operational risk	15,655	15,655	15,062
Total requirements for own funds	**734,616**	**627,333**	**626,922**
Common equity Tier 1 capital ratio (CET1)	15.2%	15.2%	15.2%
Tier 1 capital ratio (T1)	15.2%	15.2%	15.2%
Total capital ratio (TCR)	**15.2%**	**15.2%**	**15.2%**

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SUBSEQUENT EVENTS

54. EVENTS AFTER THE END OF THE REPORTING PERIOD

In the period from 1 January 2019 to the date of signing of these financial statements, PKO Bank Hipoteczny SA acquired another portfolio of receivables in respect of mortgage-secured housing loans in the amount of PLN 861,072 thousand under the Framework Agreement for Sale of Receivables signed on 17 November 2015 with PKO Bank Polski SA.

On 28 January 2019, PKO Bank Hipoteczny issued covered bonds denominated in EUR with a value of EUR 500,000 thousand and with a redemption period of 2 years and 10 months from the date of issue. The fixed interest over the period of issue is 0.250%. The covered bonds were purchased by investors for a price amounting to 99.933% of the nominal value. The covered bonds issued are quoted on the stock exchanges in Luxembourg and in Warsaw. Subsequently, on 25 February 2019, PKO Bank Hipoteczny executed a tap transaction by issuing the second tranche with a nominal value of EUR 100,000 thousand. The issue date of the second tranche was set on 1 March 2019.

On 21 February 2019, the share capital of PKO Bank Hipoteczny was increased by PLN 100,000,000 to PLN 1,395,000,000 due to the registration of I-series shares in the business register of the National Court Register.

On 22 February 2019, Mr Jakub Niesłuchowski resigned as Vice-President of the Bank's Management Board with effect from 28 February 2019.

On 26 February 2019, the Polish Financial Supervision Authority granted its consent to the appointment of Mr Piotr Kochanek to the position of member of the Management Board of PKO Bank Hipoteczny SA responsible for supervising the management of material risk for the Bank's activities.

Signatures of all Management Board Members

27.02.2019	Paulina Strugała	President of the Management Board	*Signed on Polish original* .... (signature)
27.02.2019	Piotr Kochanek	Vice-President of the Management Board	*Signed on Polish original* .... (signature)
27.02.2019	Agnieszka Krawczyk	Vice-President of the Management Board	*Signed on Polish original* .... (signature)
27.02.2019	Jakub Niesłuchowski	Vice-President of the Management Board	*Signed on Polish original* .... (signature)

Signature of the person in charge of maintaining the accounting records

27.02.2019

Tomasz Rynkowski
Director, the Bank's Chief Accountant

Signed on Polish original
....
(signature)