Bank Hipoteczny

HIGHLIGHTS OF THE FINANCIAL STATEMENTS

HIGHLIGHTS OF THE FINANCIAL STATEMENTS	PLN thousand 01/01/2017 - 31/12/2017	PLN thousand 01/01/2016 - 31/12/2016	EUR thousand 01/01/2017 - 31/12/2017	EUR thousand 01/01/2016 - 31/12/2016
Net interest income	151,237	63,599	35,630	14,535
Net fee and commission income	(4,556)	(3,636)	(1,074)	(831)
Net operating income	71,395	18,260	16,820	4,173
Profit / (loss) before income tax	**71,395**	**18,260**	**16,820**	**4,173**
Profit / (loss) for the year	**51,419**	**13,224**	**12,114**	**3,022**
Earnings per share – basic (in PLN / EUR)	**0.05**	**0.02**	**0.01**	**0.01**
Earnings per share – diluted (in PLN / EUR)	**0.05**	**0.02**	**0.01**	**0.01**
Total net comprehensive income	**40,488**	**(4,739)**	**9,538**	**(1,083)**
Net cash flows from operating activities	(6,863,570)	(4,570,020)	(1,616,974)	(1,044,409)
Net cash flows from investing activities	(615,796)	(204,827)	(145,074)	(46,810)
Net cash flows from financing activities	7,456,250	4,789,058	1,756,602	1,094,467
Total net cash flows	**(23,116)**	**14,211**	**(5,446)**	**3,248**

HIGHLIGHTS OF THE FINANCIAL STATEMENTS	PLN thousand as at 31/12/2017	PLN thousand as at 31/12/2016	EUR thousand as at 31/12/2017	EUR thousand as at 31/12/2016
Total assets	16,902,594	8,610,453	4,052,505	1,946,305
Total equity	1,221,778	781,290	292,929	176,603
Share capital	1,200,000	800,000	287,708	180,832
Number of shares (thousand)	1,200,000	800,000	1,200,000	800,000
Net assets value per share (PLN/EUR)	1.02	0.98	0.24	0.22
Diluted number of shares (thousand)	1,200,000	800,000	1,200,000	800,000
Diluted net assets value per share (PLN/EUR)	1.02	0.98	0.24	0.22
Capital adequacy ratio	15.2%	17.1%	15.2%	17.1%
Tier 1 capital (CET1)	1,194,623	780,265	286,418	176,371
Total own funds	1,194,623	780,265	286,418	176,371

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

- items of the income statement, the statement of comprehensive income and the statement of cash flows items – the rate is calculated as the average of NBP exchange rates prevailing as at the last day of each month of the reporting period, i.e. EUR 1 = PLN 4.2447 for 2017 and EUR 1 = PLN 4.3757 for 2016,
- items of the statement of financial position – the average NBP exchange rate during the period from 1 January 2017 to 31 December 2017: EUR 1 = PLN 4.1709 and during the period from 1 January 2016 to 31 December 2016: EUR 1 = PLN 4.4240.

Bank Hipoteczny

Financial Statements of PKO Bank Hipoteczny SA for the year ended 31 December 2017

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PROFIT AND LOSS ACCOUNT

STATEMENT OF PROFIT OR LOSS	Note	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Interest income	5	410,494	143,031
Interest expense	5	(259,257)	(79,432)
Net interest income		**151,237**	**63,599**
Fee and commission income	6	11,067	6,461
Fee and commission expense	6	(15,623)	(10,097)
Net fee and commission income		**(4,556)**	**(3,636)**
Net result on financial instruments measured at fair value	7	(265)	1
Net foreign exchange result	8	991	(836)
Other operating income	9	1,313	887
Other operating expense	9	(1,296)	(842)
Other operating income and expense, net		**17**	**45**
Net impairment loss and provisions	10	(3,283)	(1,610)
General administrative expenses	11	(41,047)	(34,979)
Tax on certain financial institutions	12	(31,699)	(4,324)
Net operating income		**71,395**	**18,260**
Profit before income tax		**71,395**	**18,260**
Income tax expense	13	(19,976)	(5,036)
Net profit		**51,419**	**13,224**
Earnings per share – basic (PLN / EUR)	14	0.05	0.02
Earnings per share – dilluted (PLN / EUR)	14	0.05	0.02
Weighted average number of shares during the period (thousand)		967,123	533,060
Weighted average diluted number of shares during the period (thousand)		967,123	533,060

STATEMENT OF COMPREHENSIVE INCOME

	Note	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Net profit		**51,419**	**13,224**
Other comprehensive income		**(10,931)**	**(17,963)**
Items that may be reclassified to profit or loss		**(10,931)**	**(17,963)**
Cash flow hedge, gross		(16,860)	(21,870)
Tax on cash flow hedge		3,203	4,155
Cash flow hedge, net	17	(13,657)	(17,715)
Revaluation of financial assets available for sale, gross		3,366	(306)
Tax on revaluation of financial assets available for sale		(640)	58
Revaluation of financial assets available for sale, net		2,726	(248)
Items that may not be reclassified to profit or loss		-	-
Total net comprehensive income		**40,488**	**(4,739)**

STATEMENT OF FINANCIAL POSITION

	Note	31/12/2017	31/12/2016
ASSETS			
Cash and balances with Central Bank	15	561	16,033
Amounts due from banks	16	5,350	12,994
Derivative hedging instruments	17	338	27,808
Financial instruments designated upon initial recognition as at fair value through profit or loss	18	-	79,987
Loans and advances to customers	19	16,042,473	8,247,900
Investment securities available for sale	20	830,489	203,019
Intangible assets	21	5,584	5,312
Property, plant and equipment	21	570	580
Deferred tax assets	13	-	2,440
Other assets	22	17,229	14,380
TOTAL ASSETS		**16,902,594**	**8,610,453**
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to banks	23	4,125,379	3,431,832
Derivative hedging instruments	17	217,777	113
Amounts due to customers	24	2,099	1,549
Mortgage covered bonds issued	25	8,883,213	3,232,117
Unsecured bonds issued	26	2,428,025	1,151,216
Other liabilities	27	17,441	12,196
Current tax liabilities	13	3,507	-
Deferred tax liabilities	13	3,237	-
Provisions	28	138	140
TOTAL LIABILITIES		**15,680,816**	**7,829,163**
Shareholders' equity			
Share capital	29	1,200,000	800,000
Revaluation reserve		(28,892)	(17,961)
Retained earnings		(749)	(13,973)
Net profit for the period		51,419	13,224
TOTAL EQUITY		**1,221,778**	**781,290**
TOTAL LIABILITIES AND EQUITY		**16,902,594**	**8,610,453**
Capital adequacy ratio	50	15.2%	17.1%
Net assets value (PLN thousand)		1,221,778	781,290
Number of shares (thousand)	29	1,200,000	800,000
Net assets value per share (PLN/EUR)		1.02	0.98
Diluted number of shares (thousand)		1,200,000	800,000
Diluted net assets value per share (PLN/EUR)		1.02	0.98

(PLN THOUSAND)

Bank Hipoteczny

STATEMENT OF CHANGES IN EQUITY

FOR THE PERIOD FROM 1 JANUARY 2017 TO 31 DECEMBER 2017	Note	Share capital	Revaluation reserve	Retained earnings	Undistributed net profit / (loss)	Net profit for the period	Total equity
1 January 2017		800,000	(17,961)	(13,973)	13,224	-	781,290
Profit distribution / Transfer to retained earnings				13,224	(13,224)		-
Issue of series E shares	29	150,000	-	-	-	-	150,000
Issue of series F shares	29	150,000	-	-	-	-	150,000
Issue of series G shares	29	100,000	-	-	-	-	100,000
Total comprehensive income, including:		-	(10,931)	-	-	51,419	40,488
Net profit		-	-	-	-	51,419	51,419
Other comprehensive income		-	(10,931)	-	-	-	(10,931)
31 December 2017		**1,200,000**	**(28,892)**	**(749)**	**-**	**51,419**	**1,221,778**

FOR THE PERIOD FROM 1 JANUARY 2016 TO 31 DECEMBER 2016	Note	Share capital	Revaluation reserve	Retained earnings	Undistributed net profit / (loss)	Net profit for the period	Total equity
1 January 2016		300,000	2	-	(13,973)	-	286,029
Profit distribution / Transfer to retained earnings				(13,973)	13,973		-
Issue of series B shares	29	200,000	-	-	-	-	200,000
Issue of series C shares	29	200,000	-	-	-	-	200,000
Issue of series D shares	29	100,000	-	-	-	-	100,000
Total comprehensive income, including:		-	(17,963)	-	-	13,224	(4,739)
Net profit		-	-	-	-	13,224	13,224
Other comprehensive income		-	(17,963)	-	-	-	(17,963)
31 December 2016		**800,000**	**(17,961)**	**(13,973)**	**-**	**13,224**	**781,290**

(PLN THOUSAND)

STATEMENT OF CASH FLOWS

	Note	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Cash flows from operating activities			
Profit / (loss) before income tax		71,395	18,260
Total adjustments:		**(6,934,965)**	**(4,588,280)**
Depreciation / amortisation		1,487	1,223
Change in financial instruments designated upon initial recognition as at fair value through profit or loss		80,000	(39,981)
Change in derivative hedging instruments (assets)		27,471	1,145
Change in loans and advances to customers		(7,797,882)	(7,526,805)
Change in other assets		(12,908)	(9,234)
Change in amounts due to banks		693,548	2,962,534
Change in derivative hedging instruments (liabilities)		217,664	(111)
Change in amounts due to customers		549	1,403
Change in amounts due to mortgage covered bonds issued		(168,173)	9,072
Change in amounts due to unsecured bonds issued		39,829	4,671
Change in provisions and impairment allowances		3,307	1,642
Change in other liabilities		5,245	6,176
Income tax expense		(8,229)	-
Other adjustments (including changes in measurement of securities and derivative hedging instruments recognised in other comprehensive income)		(16,872)	(15)
Net cash flow from operating activities		**(6,863,570)**	**(4,570,020)**
Cash flows from investing activities			
Proceeds from investing activities		**6,204**	**60**
Disposal and interest on investment securities available for sale		6,204	60
Expenditure in investing activities		**(622,000)**	**(204,887)**
Acquisition of investment securities available for sale		(620,251)	(201,589)
Acquisition of intangible assets and property, plant and equipment		(1,749)	(3,298)
Net cash flow from investing activities		**(615,796)**	**(204,827)**
Cash flows from financing activities			
Proceeds from issue of own shares		400,000	500,000
Proceeds from issue of mortgage covered bonds		5,855,524	3,154,809
Proceeds from issue of unsecured bonds		6,141,581	2,126,545
Redemption of unsecured bonds		(4,904,600)	(980,000)
Payment of interest on debt securities issued		(36,255)	(12,296)
Net cash flows from financing activities		**7,456,250**	**4,789,058**
Net increase (decrease) in cash and cash equivalents		**(23,116)**	**14,211**
Cash and cash equivalents at 1 January		29,027	14,816
Cash and cash equivalents at 31 December	33	**5,911**	**29,027**

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NOTES TO THE FINANCIAL STATEMENTS

1. General Information

Business activities of the Bank

PKO Bank Hipoteczny Spółka Akcyjna ("PKO Bank Hipoteczny SA", "Bank", "Company") with the registered office in Gdynia, 17 Jerzego Waszyngtona Street, 81-342 Gdynia was registered on 24 October 2014 in the Gdansk-North District Court for Gdansk, 8th Commercial Division of the National Court Register under the KRS number 0000528469. The Bank was assigned the statistical REGON number 222181030. Its share capital amounts to PLN 1,200,000,000.00 and was fully paid up

PKO Bank Hipoteczny is a specialised bank that operates in terms of the Polish Covered Bonds Act dated 29 August 1997, the Commercial Companies Code and other generally applicable provisions of law, the principles of good banking practice and the Bank's Statute.

The Bank specialises in granting mortgage loans for individuals and acquires receivables following from such loans form PKO Bank Polski SA. The Bank acquires loans for its portfolio, in terms of the strategic cooperation with PKO Bank Polski SA.

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

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

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

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

Composition of the Supervisory Board and the Management Board of the Bank

The following table presents the composition of the Supervisory Board of PKO Bank Hipoteczny SA during the reporting period:

No.	Name	Function	Date appointed into Supervisory Board	Date recalled / resigned
1	Jakub Papierski	Chairman of the Supervisory Board	06/10/2014	-
2	Piotr Mazur	Vice Chairman of the Supervisory Board	06/10/2014	-
3	Justyna Borkiewicz	Member of the Supervisory Board	28/10/2016	-
4	Mieczysław Król	Member of the Supervisory Board	28/10/2016	-
5	Adam Marciniak	Member of the Supervisory Board	28/10/2016	17/10/2017
6	Artur Osytek	Member of the Supervisory Board	06/10/2014	17/10/2017
7	Barbara Soares da Silva	Member of the Supervisory Board	06/10/2014	17/10/2017
8	Bartosz Drabikowski	Member of the Supervisory Board	18/10/2017	15/01/2018
9	Artur Kluczny	Member of the Supervisory Board (independent)	18/10/2017	-
10	Piotr Kwiecień	Member of the Supervisory Board (independent)	18/10/2017	-
11	Jan Emeryk Rościszewski	Member of the Supervisory Board	18/10/2017	-

The following table presents the composition of the Management Board of PKO Bank Hipoteczny SA during the reporting period:

No.	Name	Function	Date appointed into Management Board	Date recalled / resigned
1	Rafał Kozłowski	President of the Management Board	06/10/2014	31/12/2017
2	Jakub Niesłuchowski	Vice President of the Management Board	01/04/2015	-
3	Marek Szcześniak	Vice President of the Management Board	01/06/2015	-

Following the resignation of Mr Rafał Kozłowski, on 28 December 2017, the Supervisory Board of PKO Bank Hipoteczny SA appointed Ms Agnieszka Krawczyk as Vice President of the Management Board effective from 1 January 2018 and instructed Mr Jakub Niesłuchowski to act in the capacity of President of the Management Board of the Company in regard to organizational and administrative matters until the appointment of the President of the Management Board of the Company.

2. Basis of preparation of the financial statements

The financial statements of PKO Bank Hipoteczny Spółka Akcyjna cover the year ended 31 December 2017 and contains comparative data for the year ended 31 December 2016. The financial information has been presented in Polish zloty (PLN), rounded to thousands of zloty, unless indicated otherwise.

2.1 Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union, effective as at 31 December 2017 and with respect to matters not regulated by the above standards, in accordance with the accounting principles as set out in the Accounting Act dated 29 September 1994 and the respective implementing regulations issued on the basis thereof, as well as on the basis of requirements pertinent to issuers of securities admitted to or being the subject of application for admission to trading on a regulated stock exchange market.

2.2 Going concern

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

2.3 Basis of preparation of the financial statements

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

Non-current assets are stated at cost less accumulated depreciation or amortization and impairment loss. Items of property, plant and equipment classified as held for sale are stated at the lower of their carrying amount and fair value less costs to sell.

The Bank recognises all material items of income and expenses according to the principles of accruals, matching, recognition and measurement of assets and liabilities and recording impairment loss on assets and liabilities. The accounting principles pertaining to specific items have been presented in the relevant notes to the statement of profit or loss.

In preparation of the financial statements, the Bank makes certain estimates and assumptions directly influencing both the financial statements and the notes contained therein. Such estimates and assumptions adopted by the Bank for the reporting of the values of assets and liabilities as well as income and expenses are based on available historical data and a number of other factors that are deemed to be reasonable under the circumstances.

Assumptions about the future and the available data serve the purpose of estimating the carrying amounts of the assets and liabilities which cannot be unequivocally determined with the use of other sources. In making estimates, the Bank considers the causes and sources of uncertainty predicted at the end of the reporting period. The actual results may differ from the estimates.

The assumptions and estimates made by the Bank are reviewed on an on-going basis. Revisions to the accounting estimates are recognised in the period when the estimate is revised, provided that such an estimation affects only that period. However, if the revisions affect both the current and future periods, they are recognised in the period of the revision and in future periods.

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2.4 APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements, subject to a review and opinion by the Audit and Finance Committee of the Supervisory Board on 27 February 2018 and evaluation by the Supervisory Board on 2 March 2018, were approved by the Management Board for publication on 20 February 2018.

3. SIGNIFICANT ACCOUNTING POLICIES

The key accounting principles as well as the estimates and judgements applied in preparation of these statements have been presented in the relevant notes. The principles have been applied consistently in all the presented years. Presented below is a specification of the accounting principles and major estimates and judgement for the respective items of the statement of profit or loss and the statement of financial position.

STATEMENT OF PROFIT OR LOSS	Note	Accounting Principles [1]	Major estimates and judgements [1]
Interest income and expense	5	Y	
Fee and commission income and expense	6	Y	
Net result on financial instruments measured at fair value	7	Y	Y
Net foreign exchange income	8	Y	Y
Other operating income and expense, net	9	Y	
Net impairment loss and provisions	10	Y	Y
General administrative expenses	11	Y	
Income tax expense	13	Y	Y

STATEMENT OF FINANCIAL POSITION	Note	Accounting Principles [1]	Major estimates and judgements [1]
Cash and balances with Central Bank	15	Y	
Loans and advances to banks	16	Y	
Derivative hedging instruments	17	Y	Y
Financial instruments designated upon initial recognition as at fair value through profit or loss	18	Y	Y
Loans and advances to customers	19	Y	Y
Investment securities available for sale	20	Y	Y
Intangible assets	21	Y	Y
Property, plant and equipment	21	Y	Y
Other assets	22	Y	
Deposits from banks	23	Y	
Deposits from customers	24	Y	
Mortgage covered bonds issued	25	Y	
Unsecured bonds issued	26	Y	
Other liabilities	27	Y	
Provisions	28	Y	
Equity	29	Y	

[1] The letter Y means that the accounting policy or major estimates or judgments are applied

3.1 FOREIGN CURRENCIES

FUNCTIONAL CURRENCY AND PRESENTATION CURRENCY

The financial statements are presented in the Polish zloty (PLN), which is the functional currency and the presentation currency in the bank.

TRANSACTIONS AND BALANCES IN FOREIGN CURRENCIES

Transactions in foreign currencies are translated into the functional currency at the rates prevailing at the transaction date. At the end of each reporting period, the Bank translates:

- cash items in foreign currencies at the closing exchange rate, i.e. the average rate quited by the National Bank of Poland at the end of the reporting period,

- non-monetary items measured at historical cost stated in a foreign currency at the exchange rate from the transaction date,
- non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.

The translation gain or loss arising on the accounting of the transactions and the book valuation of monetary assets and liabilities in foreign currencies is recognised in profit or loss, respectively.

3.2 Recognition of transactions

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

3.3 Derecognition of financial instruments from the statement of financial position

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

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

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

- if substantially all the risks and rewards of ownership of the financial asset are transferred, then the Bank derecognises the financial asset from the statement of financial position,
- if substantially all the risks and rewards of ownership of the financial asset are retained, then the financial asset continues to be recognised in the statement of financial position,
- if substantially all the risks and rewards of ownership of the financial asset are neither transferred nor retained, the entity determines whether control of the financial asset has been retained.

If the Bank has retained control, it continues to recognize the financial asset in the statement of financial position to the extent of its continuing involvement in the financial asset. As appropriate, if control has not been retained, then the financial asset is derecognised from the statement of financial position.

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

4. Changes in accounting principles

4.1 Amendments to the published standards and interpretations which took effect as of 1 January 2017

The introduction of new Standards and Interpretations which took effect in 2017 did not have a material impact on these financial statements.

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

A number of new Standards, amendments to the Standards and Interpretations are not yet applicable to the annual periods ended 31 December 2017 and they were not applied to these financial statements. Out of the new Standards or the amendments to the Standards and Interpretations, the ones presented below will have a material impact on the financial statements. The Bank intends to apply them to the periods for which they will be mandatory for the first time.

IFRS 9 Financial Instruments

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

Classification and measurement

IFRS 9 defines 3 measurement categories of financial instruments:

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

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

The test of the business model establishes whether a given instrument is maintained to obtain contractual cash flows or to realize fair value changes before the maturity date. Therefore, due to the enactment of IFRS 9, the Bank recognises the following business models:

- held to collect ("H2C"),
- held to collect and sell ("H2C&S"),
- residual model - sale, i.e. other than H2C or H2C&S ("S").

A cash flows characteristics test determines if contractual cash flows are solely payments of the principal and interest, which are understood as payment for the time value of money and the risk connected with the value of the exposure during the period (solely payments of principal and interest, or "SPPI").

Debt-related financial assets which have been classified into the H2C model, if they satisfied the SPPI test, are measured at amortised cost, whereas those classified into the H2C&S model are measured at fair value through other comprehensive income.

If debt-related financial assets are classified into the residual model or do not meet the above criteria, they are measured at FVP&L.

It is possible to measure instruments classified into the H2C and H2C&S business models at FVP&L if such measurement eliminates a measurement or recognition inconsistency ("accounting mismatch").

Financial instruments are classified as at the first adoption of IFRS 9, that is at 1 January 2018, and upon the recognition or modification of the financial instrument. Reclassification is only possible in the event of a material change in the business model and it should be conducted rarely.

In the case of equity-related assets, instruments held for trading or instruments serving as payment in a business combination are measured at FVP&L, whereas in regard to other assets, the Bank has the option to choose the measurement category of either FVP&L or FVOCI. In the case of FVOCI, a change in the fair value is recognised in other comprehensive income, except for dividends, which are recognised in profit for the period. The changes in fair value recognised in other comprehensive income will never be subject to transfer to profit or loss - this is a difference compared with the corresponding measurement of financial assets available for sale under the currently effective IAS 39. However, such measurement may be transferred within the shareholders' equity category.

The table shows the principal measurement methods (✓) concerning the respective types of financial assets and the measurement method in the event of the negative outcome of the SPPI test or the exercising of the option of a different measurement model.

Measurement category	Debt instruments business model:			Equity instruments	Derivative instruments
	H2C	H2C&S	Residual - S		
Amortised cost	✓				
FVOCI		✓		Exercise of FVOCI measurement option	
FVP&L	Negative SPPI test result or option exercised due to accounting mismatch.		✓	✓	✓

Financial liabilities are measured in accordance with the current rules set in IAS 39, except for the obligation to recognise part of the fair value measurement resulting from changes in one's own credit risk in other comprehensive income - in regard to the financial liabilities in whose case the fair value measurement option was selected.

Due to the implementation of IFRS 9 from 1 January 2018, the Bank has changed its approach to:

- recognition of the liquidity portfolio of money market bills, thus far classified according to IAS 39 as financial instruments designated upon initial recognition as at fair value through profit or loss, in the case of which the change in the fair value measurement will now, according to IFRS 9, be recognised in other comprehensive income,
- recognition of the gain/loss on a modification of cash flows from loans granted and receivables purchased, which has been recognised over time using the effective interest method through the term remaining to maturity, whereas according to IFRS 9 it fill be recognised in profit or loss on a one-off basis upon the modification, and the measurement change will be calculated at the original effective interest rate.

In addition, IFRS 9 identifies a new category of impaired assets purchased or originated, which will be measured using the effective interest method taking into account the credit risk throughout the instruments life (so called purchased or originated credit-impaired financial assets, or "POCI"). At the date of transition to IFRS 9, the Bank had no assets which would qualify for this category.

Impairment

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

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

IAS 39 portfolio	IFRS 9 portfolio	Period of expected loan losses
Non-impaired portfolio (IBNR)	Stage 1 (assets whose credit risk has not increased materially since initial recognition)	12-month expected loan losses
	Stage 2 (assets whose credit risk has increased materially since initial recognition)	lifetime expected loan losses
Impaired portfolio	Impaired loans among which loans impaired upon initial recognition (POCI) will be recognised	lifetime expected loan losses

In order to evaluate the materiality of the increase in credit risk regarding mortgage-backed exposures, the Bank will use a model based on the calculation of the marginal PD, meaning the probability of default during a specified month (calculated from the moment of loan origination). This way it will be possible to reflect the diversity of credit quality during the life of the exposure, characteristic of retail customers. The Bank will identify a material increase in risk by comparing PD curves during the exposure life horizon upon initial recognition and at the reporting date. For each reporting date, only the parts of the original and the present PD curve which correspond to the time from the reporting date until the loan maturity will be compared. The comparison is based on the values of average PD during the period of analysis, as adjusted by the current and forecast macroeconomic indicators.

In addition, the Bank will evaluate the materiality of the increase in credit risk using complete qualitative and quantitative information, including among other things information about:

- payment delinquencies exceeding 30 days,
- forbearance measures due to the borrower's financial distress,
- unavailability of the credit risk rating of an exposure upon initial recognition, which prevents an evaluation if credit risk has increased,
- grace period on exposures in Stage 2, in whose case the impairment indication disappeared during the past 3 months.

In regard to exposures classified in Stage 1, the Bank will use a maximum 12-month horizon of estimation of the expected loss. 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. The expected loss for a given period will be determined as the product of the credit risk parameters: probability of default (PD), loss given default (LGD) and exposure at default (EAD). All of these parameters will be estimated at the end of each month from the reporting date until the loan maturity date.

In order to determine the value of assets at the time of default, the Bank will determine 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 will also consider 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 Group will be used for the purpose of calculation of expected loss (just like in the case of identification of an indication of a material increase in credit risk) - a baseline scenario and two alternative scenarios. The scope of projected indicators will include the GDP growth rate, the unemployment rate, the WIBOR 3M rate, the property price index, the NBP reference rate. The final expected loss will be the average of the expected losses in each scenario, weighted by the probability of the scenarios.

Both the process of evaluation of the materiality of risk growth and the process of calculation expected loss will be conducted on a monthly basis at the individual exposure level.

HEDGE ACCOUNTING

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

Due to the fact that the work on the standard is still in progress 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.

DISCLOSURES AND COMPARABLE DATA

In the Bank's opinion, the application of IFRS9 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 will be required. The Bank intends to take advantage of the provisions of IFRS 9 concerning the 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 will be recognised as part of the retained earnings in th shareholders' equity at 1 January 2018.

(PLN THOUSAND)

RECONCILIATION OF THE ITEMS OF THE STATEMENT OF FINANCIAL POSITIONS BETWEEN IAS 39 AND IFRS 9 AT 1 JANUARY 2018

The following table presents the reconciliation of items of the financial statements according to IAS 39 and IFRS 9 as at 1 January 2018.

	Closing balance 31/12/2017	Measurement change	Opening balance 01/01/2018
ASSETS			
Cash and balances with Central Bank	561	-	561
Amounts due from banks	5,350	-	5,350
Derivative hedging instruments	338	-	338
Financial instruments designated upon initial recognition as at fair value through profit or loss	-	-	-
Loans and advances to customers	16,042,473	(14,498)	16,027,975
Investment securities available for sale	830,489	-	830,489
Intangible assets	5,584	-	5,584
Property, plant and equipment	570	-	570
Deferred tax assets	-	-	-
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 tax liabilities	3,507	-	3,507
Deferred tax liabilities	3,237	(2,765)	472
Provisions	138	54	192
TOTAL LIABILITIES	**15,680,816**	**(2,711)**	**15,678,105**
Shareholders' equity			
Share capital	1,200,000	-	1,200,000
Revaluation reserve	(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 by PLN 14,498 thousand and an increase in the provisions for expected losses on contingent loan commitments by PLN 54 thousand, less the effect of deferred tax consisting of a decrease in the net deferred tax provision by PLN 2,765 thousand was recognised in retained earnings at 1 January 2018.

(PLN THOUSAND)

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

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

	Classification according to IAS 39	New classification according to IFRS 9	New carrying amount according to IAS 39 as at 31/12/2017	reclassifi-cations	measurement change[1)]	New carrying amount according to IFRS 9 as at 01/01/2018	impact of the change in the accounting policies	
							on the retained earnings	and other comprehensive income
Financial assets								
Cash and balances with Central Bank	loans and receivables	at amortised cost	561	-	-	561	-	-
Amounts due from banks	loans and receivables	at amortised cost	5,350	-	-	5,350	-	-
Derivative hedging instruments	at fair value through profit or loss	at fair value through profit or loss	338	-	-	338	-	-
Financial instruments designated upon initial recognition as at fair value through profit or loss	at fair value through profit or loss	at fair value through other comprehensive income	-	-	-	-	-	-
Loans and advances to customers	loans and receivables	at amortised cost	16,042,473	-	(14,498)	16,027,975	(14,498)	-
Investment securities available for sale	available for sale	at fair value through other comprehensive income	830,489	-	-	830,489	-	-
Financial assets, total			**16,879,211**	-	**(14,498)**	**16,864,713**	**(14,498)**	-

[1)] Measurement change due to an increase in the gross carrying amount by PLN 141 thousand and an increase in impairment losses by PLN 14,639 thousand.

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

(PLN THOUSAND)

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 transition from 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 loan losses determined according to IFRS 9 at 1 January 2018.

	Classification IAS 39	Classification IFRS 9	As at 12/31/2017 (IAS 39)	As at 01/01/2018 (IFRS 9)
Amounts due from banks	Impairment loss		-	
		Stage 1		-
		Stage 2		-
		Stage 3		-
		POCI		-
Loans and advances to customers	Impairment loss		5,068	
		Stage 1		3,776
		Stage 2		14,963
		Stage 3		968
		POCI		-
Contingent liabilities granted	Provisions for loan commitements		54	
		Stage 1		69
		Stage 2		39
		Stage 3		-
		POCI		-

QUANTIFICATION OF THE IMPACT OF IFRS ON OWN FUNDS

The increase in the impairment losses and provisions following the implementation of IFRS 9 will, at initial recognition, will be recognised in Common Tier 1 (CET1) capital, though 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, an impact on the Common Tier 1 and the Total Capital Ratio of the Bank was negligible, as it stayed at 15.2% at 1 January 2018.

IFRS 16 "LEASES"

The effective date of the standard is 1 January 2019. The new standard will replace the current IAS 17. Under the new standard, lessees are obliged to recognize the right to use an asset and the liability (the obligation to pay for that right, that is, financing) as assets and liabilities for all lease agreements (and not, as previously, only for finance leases). An exception here are short-term lease agreement with a term of up to 12 months and leases for low value items.

The Bank is a party to operating lease agreements, which are currently not recognised in the statement of financial position, yet their value is not significant. Thus, it is estimated that the new standard will not lead to a major increase in the balance sheet total.

OTHER CHANGES:

Changes to IFRS 15, IFRS 14 (connected with IFRS 9) will not affect the financial statements of the Bank.

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

Changes to IFRS 10, IFRS 2, IAS 28 and IAS 40, amendments to IFRS 2014-2016 and to IFRS 2015-2017 as well as the introduction of IFRS 17 and IFRS 14 will not have a material influence on the financial statements of the Bank.

(PLN THOUSAND)

NOTES TO THE STATEMENT OF PROFIT OR LOSS

5. INTEREST INCOME AND EXPENSE

ACCOUNTING PRINCIPLES

Interest income and interest expenses comprise interest, including premium and discount on financial instruments measured at amortised cost and instruments measured at fair value, except for derivatives, classified as held for trading. Interest income and interest expenses are recognised on an accrual basis using the effective interest method. Interest income, with respect to financial assets or a group of similar financial assets for which an impairment loss was recognised, is accrued based on the present values of receivables (net of impairment losses) using the current interest rate used to discount future cash flows for the purposes of determining impairment losses.

Interest income and interest expenses in respect of derivative financial instruments held for trading is recognised in 'Net result on financial instruments measured at fair value' or 'Net foreign exchange result.

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

INCOME AND EXPENSE DUE TO SALE OF INSURANCE PRODUCTS TIED WITH LOANS AND ADVANCES

The Bank does not offer any insurance products tied with loans and advances

FINANCIAL INFORMATION

INTEREST INCOME	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Interest income calculated using the effective interest rate method on financial assets not measured at fair value through profit or loss, including:	**399,599**	**140,521**
Income on loans and advances to customers, including:	399,457	140,461
impaired loans	52	-
Income on bank placements and mandatory reserve kept	142	60
Other income, including:	**10,895**	**2,510**
Income on financial assets designated upon initial recognition as at fair value through profit or loss	360	1,160
Income on investment securities available for sale	10,058	1,350
Income on IRS hedging transactions (net)	477	-
Total	**410,494**	**143,031**

INTEREST EXPENSE	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Interest expense calculated using the effective interest rate method on financial liabilities not measured at fair value through profit and loss, including:	**(173,231)**	**(71,117)**
Expense on loans received and overdraft facility used	(27,795)	(5,564)
Expense on deferred payment for purchase of receivables	(40,471)	(40,288)
Expense on covered bonds issued	(65,129)	(16,255)
Expense on unsecured bonds issued	(39,829)	(9,010)
Other expenses	**(86,026)**	**(8,315)**
Expense on CIRS hedging transactions (net)	(86,026)	(8,315)
Total	**(259,257)**	**(79,432)**

6. FEE AND COMMISSION INCOME AND EXPENSE

ACCOUNTING PRINCIPLES

Fee and commission income is generally recognised on an accrual basis at the time when the related service is performed.

(PLN THOUSAND)

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

Fee and commission expenses also include deferred fees and commissions recognised on a straight-line basis, paid with respect to external funding raised with an unspecified schedule of future cash flows for which the effective interest rate cannot be determined, and connected with issue programmes.

FINANCIAL INFORMATION

FEE AND COMMISSION INCOME	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Income on loans and advances to customers, including:	11,067	6,461
due to payment for property valuation	5,063	4,085
Total	**11,067**	**6,461**

FEE AND COMMISSION EXPENSE	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Preparation by property valuers of appraisal reports on Property Value for Mortgage Lending Purposes (BHWN)	(7,642)	(7,185)
Expenses related to unsecured bonds issuance programme	(2,632)	(799)
Expenses related to credit lines	(2,890)	(973)
Expenses related to covered bonds issuance programmes	(982)	(641)
Loan insurance costs	(1,321)	(386)
Commission on transactional services of banks	(145)	(113)
Costs of debt collection and intermediation in sale of collateral	(12)	-
Total	**(15,623)**	**(10,097)**

7. NET RESULT ON FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

ACCOUNTING PRINCIPLES AND CLASSIFICATION

Net result on financial instruments measured at fair value through profit or loss includes gains and losses arising from the disposal of financial instruments classified as financial assets/liabilities at fair value through profit or loss (whether held for trading and designated at initial recognition as at at fair value through profit or loss) as well as the effect of their fair value measurement.

The ineffective part of the cash flow volatility hedge (IRS) is also recognised in this line.

FINANCIAL INFORMATION

NET RESULT ON FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Derivative instruments	(264)	-
Gain/loss on IRS derivative instruments prior to designation to hedge accounting	(240)	-
Gain/loss on IRS derivative instruments due to ineffectiveness of hedge accounting	(24)	-
Debt instruments	(1)	1
Total	**(265)**	**1**

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

(PLN THOUSAND)

8. NET FOREIGN EXCHANGE RESULT

ACCOUNTING PRINCIPLES AND CLASSIFICATION

The net foreign exchange result comprises foreign exchange gains and losses, both realised and unrealised, resulting from the revaluation of assets and liabilities denominated in foreign currencies using the National Bank of Poland average exchange rates at the end of the reporting period, and from the fair value measurement of the outstanding derivatives (FX-Forward and CIRS), including the ineffective part of hedge accounting.

FINANCIAL INFORMATION

NET FOREIGN EXCHANGE RESULT	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Net foreign exchange result	294	(17)
Gain/loss on derivative instruments (CIRS, FX-Forward) prior to designation to hedge accounting	5,767	(911)
Gain/loss on derivative instruments (CIRS, FX-Forward) due to ineffectiveness of hedge accounting	(5,070)	92
Total	**991**	**(836)**

The Bank enters into and maintains CIRS and FX-Forward derivative instruments solely for hedging purposes.

What has the major impact on the ineffectiveness of hedge accounting are changes in the value of the counterparty credit risk and own credit risk (CVA/DVA).

9. OTHER OPERATING INCOME AND EXPENSE

ACCOUNTING PRINCIPLES

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

FINANCIAL INFORMATION

OTHER OPERATING INCOME	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Sundry income	1,308	878
Other	5	9
Total	**1,313**	**887**

OTHER OPERATING EXPENSE	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Sundry expenses	(1,250)	(829)
Other	(46)	(13)
Total	**(1,296)**	**(842)**

Sundry expenses of 2017 include PLN 1,150 thousand of costs of property inspection reports supplied by property expert valuers for loans which could not be transferred to PKO Bank Hipoteczny SA. According to the terms and conditions of the receivables purchase agreement, these costs are to be borne by PKO Bank Polski and so they will be re-invoiced, which is shown in sundry income. In 2016, the relevant amount was PLN 757 thousand.

(PLN THOUSAND)

10. Net impairment loss and provisions

Accounting principles

The accounting principles concerning the recognition of net impairment loss and provisions are specified for the relevant lines in Notes 16, 19 and 28, as as appropriate. The net impairment loss and provisions comprises impairment losses and provisions recognised and reversed.

Financial information

NET IMPAIRMENT LOSS AND PROVISIONS	Note	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Net impairment loss on loans and advances to banks	16	-	-
Net impairment loss on loans and advances to customers	19	(3,309)	(1,561)
Net provision for loans commitments	28	26	(49)
Total		(3,283)	(1,610)

11. General administrative expenses

Accounting principles

Employee benefits	Employee benefits comprise the cost of wages and salaries and social insurance (including costs of premiums for retirement and disability benefits, which are specified in Note 28 “Provisions”). The Bank recognises a provision, charged to the cost of salaries, for future liabilities arising from compensation and severance payments made to those employees whose employment contracts are terminated, and periodic settlements with respect to the costs incurred in the current period which will be paid in future periods, including bonuses and unused annual leave, taking into account all outstanding unused annual leave days. Employee benefits also comprise variable salary components of key management personnel, part of which is recognised as a liability due to cash-settled share-based payments based on the shares book value. The programme is described in Note 34.4 “Rules of formulation of the variable salary component policy of key management personnel in the Bank”.
Overheads	The following items are recognised, among others: cost of support services and loan administration supplied on the basis of the Outsourcing Agreement (described in Note 34.1 “Transactions with parties related by equity”), costs of services purchased under other agreements, costs of property lease and IT expenses. Lease charges under operating leases and later lease payments are recognised as expenses in the statement of profit or loss on a straight-line basis during the term of the lease.
Depreciation and amortisation	The principles of depreciation and amortisation are specified in Note 21 „Intangible assets and property, plant and equipment”.
Taxes and charges	What is recognised in this line are the following: civil transaction tax, charges for the Bank Guarantee Fund (BGF) and the Polish Financial Supervision Authority (PFSA).

(PLN THOUSAND)

FINANCIAL INFORMATION

GENERAL ADMINISTRATIVE EXPENSES	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Employee benefits	(16,063)	(13,781)
Overheads	(20,622)	(13,287)
Amortization and depreciation, including:	(1,487)	(1,223)
property, plant and equipment	(271)	(233)
intangible assets	(1,216)	(990)
Taxes and fees, including:	(2,875)	(6,688)
Tax on civil law transactions (due to increase of share capital)	(2,000)	(2,500)
BGF charges	(31)	(3,951)
PFSA charges	(583)	(82)
Total	**(41,047)**	**(34,979)**

EMPLOYEE BENEFITS	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Wages and salaries, including:	(13,748)	(12,107)
provision for retirement and disability benefits	(24)	(32)
Salary surcharges	(1,690)	(1,275)
Other employee benefits	(625)	(399)
Total	**(16,063)**	**(13,781)**

OVERHEADS	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Services in terms of supporting operations under Outsourcing Agreement	(2,812)	(3,517)
Servicing of granted loans and purchased receivables under Outsourcing Agreement	(10,644)	(4,085)
Services purchased under other contracts	(2,037)	(1,497)
IT expenses	(1,537)	(1,209)
Rental expenses	(1,943)	(1,840)
Operating leases	(246)	(243)
Other	(1,403)	(896)
Total	**(20,622)**	**(13,287)**

12. TAX ON CERTAIN FINANCIAL INSTITUTIONS

1 February 2016 marked the effective date for the Act of 15 January 2016 on tax on certain financial institutions. The tax base in the case of banks is the surplus of the entity's total assets over PLN 4 billion resulting from the trial balance at the end of every month. The banks are entitled to reduce the tax base by, among other things, the amount of the own funds and the value of the Treasury securities held. The tax rate is 0.0366% per month and the tax is payable monthly by the 25th day of the month following the month for which it is due. The tax is not deductible for the purposes of the Corporate Income Tax. The cost of the tax on certain financial institutions for 2017 amounted to PLN 31,699 thousand, while for 2016 PLN 4,324 thousand.

(PLN THOUSAND)

13. INCOME TAX EXPENSE

Accounting principles
Financial information:
- Income tax expense
- Reconciliation of effective tax rate
- Current tax liability/asset
- Deferred tax assets/liabilities, net

ACCOUNTING PRINCIPLES

RECOGNITION	Income tax expense is classified as into current and deferred income tax. Current tax is recognised in the statement of profit or loss. Deferred tax, depending on the source of the temporary differences, is recognised in the statement of profit or loss or in 'other comprehensive income'.
CURRENT TAX	Current tax is determined on the basis of the accounting profit before tax adjusted by non-taxable income, taxable income that does not constitute accounting income, non-tax deductible expenses and tax deductible costs which are not accounting costs, in accordance with applicable tax regulations. These items mainly include income and expenses relating to accrued interest receivable and payable, impairment loss on receivables and provisions for liabilities.
DEFERRED TAX	Deferred tax is recognised as the difference between the tax value and the book value of assets and liabilities. A change in the balance of the deferred tax liability and deferred tax asset is included in the obligatory charges to the net result, except for the effects of the valuation of financial assets available for sale and the valuation of hedging instruments recognised in other comprehensive income, in relation to which changes in the deferred tax liability and deferred tax asset are also recognised in other comprehensive income. Deferred tax is determined taking into account the value of the deferred tax asset and the deferred tax liability at the beginning and at the end of the reporting period. The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or a part of the deferred tax asset to be realised. Deferred tax assets and liabilities are measured using tax rates that are expected to apply in the period when the asset is realised or the liability is settled, based on the tax rates (and tax laws) which are in effect at the end of the reporting period or which are certain to be effective in the future. The Bank only compensates deferred tax assets against deferred tax liabilities when it has an enforceable legal title to set off deferred tax assets against deferred tax liabilities and the deferred tax is related to the same taxpayer and the same tax authority.

INCOME TAX EXPENSE	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Current income tax expense	(11,735)	-
Deferred income tax related to origination and reversal of temporary differences	(8,241)	(5,036)
Tax expense reported in the statement of profit or loss	**(19,976)**	**(5,036)**
Tax expense reported in the other comprehensive income related to origination and reversal of temporary differences	2,564	4,213
Total	**(17,412)**	**(823)**

(PLN THOUSAND)

RECONCILIATION OF EFFECTIVE TAX RATE	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Profit/ (loss) before income tax	**71,395**	**18,260**
Corporate income tax expense at the statutory tax rate (19%) in force in Poland	(13,565)	(3,469)
Permanent differences between profit before income tax and taxable income, of which:	**(6,440)**	**(1,567)**
BGF charges	(6)	(241)
Tax on civil-law transactions related to increase of share capital	(380)	(475)
Tax on certain financial institutions	(6,023)	(822)
PFRON costs	(15)	(13)
other permanent differences	(16)	(16)
Permanent differences between profit before income tax and taxable income, including new technology tax benefit	**29**	-
Tax expense reported in the statement of profit or loss	**(19,976)**	**(5,036)**
Effective tax rate	**27.98%**	**27.58%**
Temporary difference resulting from deferred tax reported in the statement of profit or loss	(8,241)	(5,036)
Total current income tax expense in the statement of profit or loss	**(11,734)**	-

CURRENT TAX LIABILITIES/ASSETS	31/12/2017	31/12/2016
Current tax liabilities	3,507	-
Current tax assets	-	-

The current tax liability was settled within the statutory time limit.

NET DEFERRED TAX ASSETS/LIABILITIES	31/12/2016	Statement of profit or loss	Other comprehensive income	31/12/2017
Deferred tax liabilities				
Interest accrued on loans and advances to customers	2,838	2,897	-	5,735
Interest accrued and discount on securities	219	346	-	565
Adjustment for straight-line and effective interest rate valuation of loan portfolio	7,217	6,253	-	13,470
Adjustment for straight-line and effective interest rate valuation of own bonds issued	1,229	976	-	2,205
Deferred expenses	735	325	-	1,060
Difference between carrying amount and tax value of property, plant and equipment and intangible assets	2	8	-	10
Valuation of securities	0	(0)	619	619
Valuation of derivative instruments	171	4,960	492	5,623
Gross deferred tax liabilities	**12,411**	**15,765**	**1,111**	**29,287**
Deferred tax assets				-
Interest accrued on deposits from banks	2,618	(474)	-	2,144
Interest accrued and discount on issued bonds	1,491	4,789	-	6,280
Impairment loss on credit exposure	349	603	-	952
Provision for costs	1,089	548	-	1,637
Tax loss	4,723	(2,361)	-	2,362
Valuation of securities	59	-	(21)	38
Valuation of derivative instruments	4,522	4,419	3,696	12,637
Gross deferred tax assets	**14,851**	**7,524**	**3,675**	**26,049**
Deferred tax assets / (liabilities) (presented in the statement of financial position)	**2,440**	**(8,241)**	**2,564**	**(3,237)**

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

14. EARNINGS PER SHARE

METHODOLOGY

BASIC EARNINGS PER SHARE	Basic earnings per share are calculated on the basis of the profit attributable to ordinary shareholders of the Bank divided by the weighted average number of ordinary shares during the period.
DILUTED EARNINGS PER SHARE	Diluted earnings per share are calculated on the basis of the profit attributable to ordinary shareholders of the Bank divided by the weighted average number of ordinary shares during the period, adjusted for the effects of all dilutive potential ordinary shares.

FINANCIAL INFORMATION

EARNINGS PER SHARE	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Earnings attributable to ordinary shareholders (PLN thousand)	51,419	13,224
Weighted average number of ordinary shares during the period (thousand)	967,123	533,060
Earnings per share (PLN/share)	0.05	0.02

Neither in 2017 nor in 2016 were there any instruments diluting the earnings per share. Therefore, the value of diluted earnings per share matches the value of basic earnings per share.

(PLN THOUSAND)

NOTES TO THE STATEMENT OF FINANCIAL POSITION

15. CASH AND BALANCES WITH CENTRAL BANK

ACCOUNTING PRINCIPLES

The line "Cash and balances with Central Bank" comprises cash recognised in the nominal value as well as the funds held in the current account and deposits with the Central Bank measured at the due amount, including any interest accrued on the funds.

FINANCIAL INFORMATION

CASH AND BALANCES WITH CENTRAL BANK	31/12/2017	31/12/2016
Current account with Central Bank	561	16,033
Cash	-	-
Total	**561**	**16,033**

MANDATORY RESERVE

At 31 December 2017 and 31 December 2016, the Bank maintained a mandatory reserve in the amount of PLN 670 thousand and PLN 15,507 thousand, respectively. The mandatory reserve account carries interest at 0.9 of the reference rate. At 31 December 2017 and 31 December 2016, the interest rate amounted to 1.35%.

The Bank is allowed to use the funds held in the mandatory reserve accounts during the day for current monetary settlements on the basis of instructions given to the National Bank of Poland, but it is required to maintain an appropriate average monthly balance of the account, as per the mandatory reserve declaration.

16. AMOUNTS DUE FROM BANKS

ACCOUNTING PRINCIPLES

Amounts due from banks are financial assets measured at amortised cost using the effective interest method, less any impairment loss. If it is not possible to determine the schedule of future cash flows for a specific loan or advance, and therefore determine the effective interest rate, the loan or advance is measured as the amount due for payment.

FINANCIAL INFORMATION

AMOUNTS DUE FROM BANKS	31/12/2017	31/12/2016
Deposits with banks	-	-
Current accounts	5,350	12,994
Total, gross	**5,350**	**12,994**
Impairment allowances	-	-
Total, net	**5,350**	**12,994**

The risks involved in loans and advances to banks are described in Note 38 "Credit risk management".

17. DERIVATIVE HEDGING INSTRUMENTS

Accounting principles
Types of hedging strategies applied by the Bank.
Financial information
The carrying amount/fair value of of derivative instruments serving as cash flow hedges
Nominal value of hedging instruments by term to maturity at 31 December 2017
Nominal value of hedging instruments by term to maturity at 31 December 2016
Change in other comprehensive income due to cash flow hedges

ACCOUNTING PRINCIPLES

APPLICATION OF HEDGE ACCOUNTING

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

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

DISCONTINUATION OF HEDGE ACCOUNTING

The Bank discontinues hedge accounting when:

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

FAIR VALUE HEDGE ACCOUNTING

The Bank does not apply fair value hedge accounting.

CASH FLOW HEDGES

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

Changes in the fair value of a derivative financial instrument designated as a cash flow hedge are recognised directly in other comprehensive income in respect of the portion constituting the effective portion of the hedge. The ineffective portion of a hedge is recognised in the statement of profit or loss as ‘Net result on financial instruments at fair value’ or ‘Net foreign exchange result’. In addition, amounts recognised directly in other comprehensive income are transferred to the statement of profit or loss as ‘Net interest income’ or ‘Net foreign exchange result’ in the same period or periods in which the hedged position is recognised in the statement of profit or loss.

	Effectiveness tests involve the valuation of hedging transactions, net of the accrued interest and the translation differences on the nominal value of the hedging transactions (with respect to CIRS and FX-Forward transactions). The effectiveness of a hedge is reviewed by prospective and retrospective effectiveness testing. Tests are performed on a monthly basis.

TYPES OF HEDGING STRATEGIES APPLIED 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	FX risk and interest rate risk
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 be automatically extended by 12 months on the terms and conditions set on the transaction date, ▪ an optional 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 ITEM	▪ part of the portfolio of the mortgage loans included in the cover pool of PLN covered bonds at floating rates. The interest rates on the loans are indexed by the WIBOR 3M rate. The mortgage loan margin is excluded from the hedge, ▪ fixed-rate mortgage covered bonds issued in a foreign currency.
PERIOD IN WHICH CASH FLOWS ARE EXPECTED TO OCCUR	The period in which cash flows are expected to occur and in which one should expect an impact on profit or loss: January 2018 - August 2024.

STRATEGY 2	HEDGE OF THE VARIABILITY OF FLOATING-RATE PLN LOANS RESULTING FROM INTEREST RATE RISK, USING IRS TRANSACTIONS
OUTLINE OF THE HEDGING TRANSACTION	Elimination of the variability of cash flows generated by the floating-rate PLN loan portfolio due to the risk of changes in the interest rates during the period of the hedge.
HEDGED RISK	Interest rate risk
HEDGING INSTRUMENTS	Interest Rate Swap (IRS) transactions in which the Bank pays a coupon based on the variable WIBOR 3M rate and is paid a coupon based on a fixed rate in relation to the nominal amount for which it was made.
HEDGED ITEM	Part of the portfolio of PLN-denominated loans indexed by the variable WIBOR 3M rate. The mortgage loan margin is excluded from the hedge.
PERIOD IN WHICH CASH FLOWS ARE EXPECTED TO OCCUR	The period in which cash flows are expected to occur and in which one should expect an impact on profit or loss: January 2018 - September 2021.

(PLN THOUSAND)

FINANCIAL INFORMATION

BOOK VALUE/FAIR VALUE OF DERIVATIVE INSTRUMENTS HEDGING CASH FLOWS DUE TO VIARIABLE INTEREST RATES AND/OR FX-RATES	31/12/2017		31/12/2016	
	Assets	Liabilities	Assets	Liabilities
IRS	-	377	-	-
CIRS	-	217,009	27,709	-
FX-Forward	338	391	99	113
Total	**338**	**217,777**	**27,808**	**113**

The Bank enters into and maintains derivative instruments solely for hedging purposes.

NOTIONAL VALUE OF HEDGING INSTRUMENTS BY TERM TO MATURITY 31 DECEMBER 2017	less than 1 month	1 to 3 months	3 months to 1 year	1 year to 5 years	over 5 years	Total
IRS						
PLN fixed-float	-	-	-	265,000	-	**265,000**
CIRS						
PLN float 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**

NOTIONAL VALUE OF HEDGING INSTRUMENTS BY TERM TO MATURITY 31 DECEMBER 2016	less than 1 month	1 to 3 months	3 months to 1 year	1 year to 5 years	over 5 years	Total
IRS						
PLN fixed-float	-	-	-	-	-	**-**
CIRS						
PLN float sale	-	-	-	-	2,154,809	**2,154,809**
fixed EUR purchase (original currency)	-	-	-	-	498,510	**498,510**
FX-Forward						
PLN sale	-	-	-	-	6,036	**6,036**
EUR purchase (original currency)	-	-	-	-	1,224	**1,224**
PLN purchase	-	-	765	4,869	-	**5,634**
EUR sale (original currency)	-	-	175	1,049	-	**1,224**

(PLN THOUSAND)

REVALUATION RESERVE DUE TO CASH FLOW HEDGES AND IMPACT ON OTHER COMPREHENSIVE INCOME	31/12/2017	31/12/2016
Revaluation reserve due to cash flow hedges at 1 January, gross	(21,870)	-
Gain/(Loss) recognized in other comprehensive income during the period	(333,532)	20,413
Amount transferred during the period from other comprehensive income to the statement of profit or loss	(316,672)	42,283
- interest income	477	-
- interest expense	(86,026)	(8,315)
- net foreign exchange result	(231,123)	50,598
Revaluation reserve due to cash flow hedges at 31 December, gross	(38,730)	(21,870)
Tax effect	7,358	4,155
Revaluation reserve due to cash flow hedges at 31 December, net	**(31,372)**	**(17,715)**
Ineffective portion of cash flow hedges recognized in the statement of profit or loss	**(5,094)**	**92**
Impact on other comprehensive income for the period, gross	(16,860)	(21,870)
Deferred tax on cash flow hedges	3,203	4,155
Impact on other comprehensive income for the period, net	**(13,657)**	**(17,715)**

18. FINANCIAL INSTRUMENTS DESIGNATED UPON INITIAL RECOGNITION AS AT FAIR VALUE THROUGH PROFIT OR LOSS

ACCOUNTING PRINCIPLES

The Bank classifies a financial instruments in this category when:

- it is a compound instrument containing one or more embedded derivative instruments eligible for separate recognition and the embedded derivative instrument considerably changes the cash flows originating from the underlying agreement or the separation of the derivative instrument is prohibited,
- such a qualification of the instrument eliminates or considerably reduces any inconsistency in measurement or recognition (e.g. accounting mismatch due to the different method of measurement of assets or liabilities or different recognition of related gains or losses),
- a group of financial instruments is appropriately managed and their performance is measured at fair value, in line with documented principles of risk management or the Bank's investment strategy.

The Bank has an investment policy according to which portfolios of financial assets classified as held for trading and financial assets designated upon initial recognition at fair value through profit or loss are managed separately.

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

FINANCIAL INFORMATION

FINANCIAL INSTRUMENTS DESIGNATED UPON INITIAL RECOGNITION AS AT FAIR VALUE THROUGH PROFIT OR LOSS	31/12/2017	31/12/2016
NBP money market bills	-	79,987
Total	-	**79,987**

FINANCIAL INSTRUMENTS DESIGNATED UPON INITIAL RECOGNITION AS AT FAIR VALUE THROUGH PROFIT OR LOSS BY MATURITY	31/12/2017	31/12/2016
less than 1 month	-	79,987
Total	-	**79,987**

At 31 December 2017 and 31 December 2016 the Bank did not have any transferred financial assets that were derecognised from the financial statements as a whole, in which the Bank has maintained continuing exposure. Likewise, the Bank did not have any transferred financial instruments designated upon initial recognition as at fair value through profit and loss which were not derecognised from the statement of financial position.

19. LOANS AND ADVANCES TO CUSTOMERS

ACCOUNTING PRINCIPLES

CLASSIFICATION AND MEASUREMENT OF LOANS AND ADVANCES

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

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

Upon initial recognition, a financial asset is measured at fair value increased by transaction costs if directly attributable to the acquisition or issue of the financial asset.

Subsequently, loans and advances are measured at amortised cost using the effective interest method, with account taken of impairment loss. In regard to the loans and advances in whose case it is not possible to determine the schedule of future cash flows, and therefore determine the effective interest rate, the loan or advance is measured as the amount due for payment.

ESTIMATES AND JUDGEMENTS - IMPAIRMENT LOSSES

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

The Bank treats information about the following events in particular as objective indication that a financial asset or a group of financial assets is impaired:

- significant financial distress of the debtor,
- a breach of contract by the debtor, such as default or delinquency in payment of interest or the principal amount,
- a concession made by the Bank to the debtor which Bank would not otherwise have considered but for the financial distress of the debtor,
- highly probable bankruptcy or other financial reorganisation of the debtor.

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

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

(PLN THOUSAND)

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

The calculation of the present value of estimated cash flows related to the financial asset for which collateral is held takes into account cash flows arising from the exercising of the collateral, less exercise and selling costs.

The following portfolio parameters are used in the estimation of losses:

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

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

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

The methodology and the assumptions based on which estimations are made are subject to regular reviews in order to reduce any differences between the estimated and the actual losses.

Note 4.2 presents the principles of estimation of expected loan losses, which will be applied from 1 January 2018 due to the IFRS 9 coming into effect.

FINANCIAL INFORMATION

LOANS AND ADVANCES TO CUSTOMERS, GROSS	31/12/2017	31/12/2016
Non-financial sector, of which:	16,047,541	8,249,659
housing loans, of which:	16,047,541	8,249,659
loans granted	5,251,206	2,319,574
receivables purchased	10,796,335	5,930,085
Impairment allowances	(5,068)	(1,759)
Loans and advances to customers, net	**16,042,473**	**8,247,900**

LOANS AND ADVANCES TO CUSTOMERS BY METHOD OF CALCULATION OF IMPAIRMENT LOSS	31/12/2017	31/12/2016
Assessed individually	-	-
impaired	-	-
not impaired	-	-
Assessed on a portfolio basis, impaired	2,834	-
Assessed collectively (IBNR)	16,044,707	8,249,659
Loans and advances to customers, gross	**16,047,541**	**8,249,659**
Impairment allowances on exposures assessed individually		-
Impairment allowances on exposures assessed on a portfolio basis	(861)	-
Impairment allowances on exposures assessed collectively (IBNR)	(4,207)	(1,759)
Impairment allowances - total	(5,068)	(1,759)
Loans and advances to customers, net	**16,042,473**	**8,247,900**

(PLN THOUSAND)

IMPAIRMENT ALLOWANCES ON LOSS AND ADVANCES - RECONCILIATION OF MOVEMENTS FROM 1 JANUARY 2017 TO 31 DECEMBER 2017	Value at 1 January	INCREASE	DECREASE		Value at 31 December	Net loss - impact on profit and loss
		Recognised during period	Reversal during period	Write-off of assets and settlement		
Loans and advances to banks	-	-	-	-	-	-
Loans and advances to customers measured 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)
Provision for loans commitments	80	18	44	-	54	26
Total	**1,839**	**7,527**	**4,244**	-	**5,122**	**(3,283)**

IMPAIRMENT ALLOWANCES ON LOSS AND ADVANCES - RECONCILIATION OF MOVEMENTS FROM 1 JANUARY 2016 TO 31 DECEMBER 2016	Value at 1 January	INCREASE	DECREASE		Value at 31 December	Net loss - impact on profit and loss
		Recognised during period	Reversal during period	Write-off of assets and settlement		
Loans and advances to banks	-	-	-	-	-	-
Loans and advances to customers measured at amortized cost	198	3,003	1,442	-	1,759	(1,561)
Non-financial sector	198	3,003	1,442	-	1,759	(1,561)
housing loans	198	3,003	1,442	-	1,759	(1,561)
Provision for loans commitments	31	58	9	-	80	(49)
Total	**229**	**3,061**	**1,451**	-	**1,839**	**(1,610)**

In 2017, based on the Framework Agreement Concerning the Sale of Receivables entered into with PKO Bank Polski SA on 17 November 2015, Bank purchased portfolios of mortgage-backed housing loans in the amount of PLN 5,553,538 thousand, while in 2016 portfolios in the amount of PLN 5,751,707 thousand. The purchase price was determined on an arm's length basis in reliance on the valuation by an independent appraiser. The receivables purchased were recognised on the transfer dates set in the Receivable 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 receivable portfolios was financed by the liability the nature of which is described in Note 23. The Bank ultimately refinances the purchased receivable portfolios primarily through the issuance of covered bonds.

Loans granted and receivables purchased that are entered in the Bank's cover pool represent collateral for mortgage covered bonds issued, which is stated in Note 25.

Information about the quality of the loan portfolio is also presented in Note 38.6.3.

20. INVESTMENT SECURITIES AVAILABLE FOR SALE

ACCOUNTING PRINCIPLES

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

At the end of each reporting period, the Bank assesses whether there is any objective indication of impairment of any financial asset classified as a financial asset available for sale. If such indication exists, the Bank determines the amounts of impairment losses.

(PLN THOUSAND)

Financial information

INVESTMENT SECURITIES AVAILABLE FOR SALE	31/12/2017	31/12/2016
Debt securities available for sale, gross	830,489	203,019
issued by the State Treasury, PLN Treasury bonds	830,489	203,019
Impairment allowances	-	-
Total debt securities available for sale, net	**830,489**	**203,019**
Total equities securities available for sale, net	-	-
Total investment securities available for sale, net	**830,489**	**203,019**

INVESTMENT SECURITIES AVAILABLE FOR SALE BY MATURITY	31/12/2017	31/12/2016
less than 1 month	100,797	-
1 month to 3 months	-	-
3 months to 1 year	-	-
1 year to 5 years	614,260	195,315
over 5 years	115,432	7,704
Total	**830,489**	**203,019**

Guaranteed Deposit Protection Fund

At 31 December 2017, the Guaranteed Deposit Protection Fund ("GDPF") amounted to PLN 10.1 thousand and the Bank maintained assets of PLN 20.2 thousand to cover the GDPF. At 31 December 2016, the respective amounts were: PLN 377.5 thousand and PLN 450.1 thousand. At 31 December 2017 and 31 December 2016, the Bank did not hold any deposits that would be covered by the guarantee protection.

21. Intangible assets and property, plant and equipment

Accounting principles

Intangible assets

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

Recognition of intangible assets:

- software - software licences purchased are capitalised in the amount of costs incurred on the purchase and preparation of the software for use, less accumulated amortization and impairment losses. Subsequent expenses on the maintenance of computer software are reported as cost when incurred,
- other intangible assets purchased by the Bank are carried at cost less accumulated amortization and impairment losses,
- development costs are recognised as intangible assets provided that they are expected to generate future economic benefits and subject to meeting specific requirements and conditions, i.e. it is possible and intended to complete and use the internally generated intangible asset, there are appropriate technical and financial resources to complete the development and to use the asset and it is possible to

	reliably measure the expenditure attributable to the intangible asset during its development which can be directly attributed to the development of the intangible asset.
PROPERTY, PLANT AND EQUIPMENT	Property, plant and equipment is reported at cost less accumulated depreciation and impairment losses, at the end of the reporting period.
ASSETS UNDER CONSTRUCTION	The carrying amount of property, plant and equipment and of intangible assets is increased by additional expenses incurred during their useful life.
DEPRECATION AND AMORTIZATION	Depreciation/amortization is charged on all non-current assets, whose value decreases due to usage or passage of time, using the straight-line basis over the estimated useful life of the given asset. The adopted depreciation/amortization method and useful life of an asset are subject to reviews at least once a year.
IMPAIRMENT LOSS ON NON-FINANCIAL NON-CURRENT ASSETS	At the end of each reporting period, the Bank makes an assessment whether there is any indication of impairment of any non-financial non-current assets (or cash-generating units). If any such indication is identified and annually for intangible assets which are not amortised, the Bank estimates the recoverable amount, which is the higher of the fair value less costs to sell or the value in use of the non-current asset (or cash generating unit), and if the carrying amount of an asset exceeds its recoverable amount, the Bank recognises an impairment loss in the statement of profit or loss. Estimating the above-mentioned values requires assumptions, about, among others, future cash flows which the Bank may reasonably expect to receive from the continued use or disposal of the non-current asset (or cash-generating unit). The adoption of different assumptions with respect to the value of future cash flows could affect the carrying amount of certain non-current assets. If there is an indication of impairment of shared assets, which are assets not generating cash flows irrespective of other assets or asset groups, and the recoverable amount of a single asset included in shared assets cannot be determined, the Bank determines the recoverable amount at the level of the cash-generating unit to which the asset belongs. The impairment loss is reversed where a change occurred in the estimations serving to determine the recoverable amount.
ESTIMATES AND JUDGEMENTS	When assessing the economic useful lives of the different types of property, plant and equipment and intangible assets, the following factors are considered: ▪ expected physical wear and tear, estimated based on the average useful lives observed to date, reflecting physical wear and tear rate, intensity of use etc., ▪ loss of usefulness due to technical or market obsolescence, ▪ legal and other limitations regarding the use of the asset, ▪ expected use of the asset estimated based on the expected production capacity or volume, ▪ other factors affecting useful lives of such assets. Where the period of use of a given asset results from a contractual term, the useful life of such an asset is equal to the period defined in the contract. If the estimated useful life is shorter than the period defined in the contract, the estimated useful life is applied. For non-financial fixed assets it is assumed that the residual value is nil, unless there is an obligation of a third party to buy back the asset, or if there is an active market which will continue to exist at the end of the asset's period of use and when it is possible to determine the value of the asset on this market.

(PLN THOUSAND)

DEPRECIATION/ AMORTIZATION PERIODS

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

PROPERTY, PLANT AND EQUIPMENT	DEPRECIATION PERIODS
Leaseholds improvements (buildings, premises)	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 2017 TO 31 DECEMBER 2017	Intangible assets under construction	Software	Total
Gross carrying amount at 1 January	2,670	4,145	**6,815**
Purchase	1,488	-	**1,488**
Transfers	(4,158)	4,158	**-**
Gross carrying amount at 31 December	(0)	8,303	**8,303**
Accumulated amortisation and impairment allowances at 1 January	-	(1,503)	**(1,503)**
Amortisation	-	(1,216)	**(1,216)**
Impairment loss	-	-	**-**
Accumulated amortisation and impairment allowances at 31 December	-	(2,719)	**(2,719)**
Net carrying amount at 1 January	**2,670**	**2,642**	**5,312**
Net carrying amount at 31 December	**(0)**	**5,584**	**5,584**

FOR THE PERIOD FROM 1 JANUARY 2016 TO 31 DECEMBER 2016	Intangible assets under construction	Software	Total
Gross carrying amount at 1 January	-	3,689	**3,689**
Purchase	2,670	456	**3,126**
Transfers	-	-	**-**
Gross carrying amount at 31 December	2,670	4,145	**6,815**
Accumulated amortisation and impairment allowances at 1 January	-	(513)	**(513)**
Amortisation	-	(990)	**(990)**
Impairment loss	-	-	**-**
Accumulated amortisation and impairment allowances at 31 December	-	(1,503)	**(1,503)**
Net carrying amount at 1 January	**-**	**3,176**	**3,176**
Net carrying amount at 31 December	**2,670**	**2,642**	**5,312**

What was a significant intangible asset from the Bank's point of view in 2017 were outlays on the adaptation of the Central System Module dedicated to support Cover pool register in the amount of PLN 1,133 thousand. As the adaptation work was completed, the module was commissioned for use.

(PLN THOUSAND)

PROPERTY, PLANT AND EQUIPMENT

FOR THE PERIOD FROM 1 JANUARY 2017 TO 31 DECEMBER 2017	Property, plant and equipment under construction	Leaseholds improvements	Machinery and equipment	Other	Total
Gross carrying amount of property, plant and equipment at 1 January	-	34	534	397	965
Purchase	83	-	172	6	261
Transfers	(83)	-	83	-	-
Disposal or sale	-	-	-	-	-
Gross carrying amount of property, plant and equipment at 31 December	-	34	789	403	1,226
Accumulated depreciation at 1 January	-	(3)	(253)	(129)	(385)
Depreciation	-	(3)	(188)	(80)	(271)
Disposal or sale	-	-	-	-	-
Accumulated depreciation at 31 December	-	(6)	(441)	(209)	(656)
Net carrying amount at 1 January	-	31	281	268	580
Net carrying amount at 31 December	-	28	348	194	570

FOR THE PERIOD FROM 1 JANUARY 2016 TO 31 DECEMBER 2016	Property, plant and equipment under construction	Leaseholds improvements	Machinery and equipment	Other	Total
Gross carrying amount of property, plant and equipment at 1 January	-	28	400	376	804
Purchase	6	-	144	21	171
Transfers	(6)	6	-	-	-
Disposal or sale	-	-	(10)	-	(10)
Gross carrying amount of property, plant and equipment at 31 December	-	34	534	397	965
Accumulated depreciation at 1 January	-	(0)	(106)	(51)	(157)
Depreciation	-	(3)	(152)	(78)	(233)
Disposal or sale	-	-	5	-	5
Accumulated depreciation at 31 December	-	(3)	(253)	(129)	(385)
Net carrying amount at 1 January	-	28	294	325	647
Net carrying amount at 31 December	-	31	281	268	580

The line ‘Other’ mainly represents the value of the furniture in the Bank’s offices.

(PLN THOUSAND)

22. Other assets

Accounting principles

Financial assets presented in this line are measured at amount due for payment, including any interest accrued on such assets, taking into account impairment losses. Non-financial assets are measured according to the rules of measurement appropriate for the specific categories of assets included in this line.

Financial information

OTHER ASSETS	31/12/2017	31/12/2016
Deffered expenses and accrued income, including:	9,085	5,845
deffered expenses associated with the overdraft facility	2,583	1,100
deffered expenses related to unsecured bonds issuance programme	684	528
deffered expenses related to covered bonds issuance programmes	2,309	2,239
other	3,509	1,978
Deffered commissions from loans granted, proportionally to undrawn principal	7,946	7,020
Settlements with respect to expert valuations of Property Value for Mortgage Lending Purposes	66	1,190
Statutory settlements	99	324
Other	33	1
Total	**17,229**	**14,380**

23. Amounts due to banks

Accounting principles

Amounts due to banks are measured at amortised costs using the effective interest method. If it is not possible to determine the schedule of future cash flows for a specific liability and therefore determine the effective interest rate, the liability is measured as the amount due for payment.

Financial information

AMOUNTS DUE TO BANKS	31/12/2017	31/12/2016
Liability related to overdraft facilities	1,627,461	393,793
Liability due to the purchase of receivables	2,497,918	3,038,039
Total	**4,125,379**	**3,431,832**

Liability related to overdraft facilities

LENDER	Agreement date	Financing period	Amount of loan granted	Amount made available	Outstanding at 31 December 2017
PKO Bank Polski SA	29/10/2015	3 years	900,000	900,000	-
PKO Bank Polski SA	02/02/2017	3 years	1,500,000	1,500,000	1,477,453
Other bank	05/06/2017	1 year	150,000	150,000	150,008
Total			**2,550,000**	**2,550,000**	**1,627,461**

Liability due to the purchase of receivables

The line 'Liability due to 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 19. The maturity date of the liability resulting from the purchase of receivables is agreed upon by the parties in the Receivable Sale Agreement for each transaction. For receivables acquired in 2017, 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 refinances the purchased receivable portfolios primarily through the issuance of mortgage covered bonds. The liability resulting from the purchase of receivables at 31 December 2017 concerns in whole portfolios purchased in the fourth quarter of 2017.

(PLN THOUSAND)

24. Amounts due to customers

Accounting principles

As it is impossible to determine the schedule, amounts due to customers are measured as the amount required to pay.

Financial information

AMOUNTS DUE TO CUSTOMERS	31/12/2017	31/12/2016
Amounts due to customers	2,099	1,549
Loan overpayments	2,099	1,549
Total	**2,099**	**1,549**

25. Mortgage covered bonds issued

Accounting principles

Liabilities due to mortgage covered bonds issued are measured at amortised costs using the effective interest method.

Financial information

MORTGAGE COVERED BONDS ISSUED	31/12/2017	31/12/2016
Financial instruments measured at amortized cost - mortgage covered bonds issued	8,883,213	3,232,117
Total	**8,883,213**	**3,232,117**

PERIOD OF REPAYMENT OF LIABILITIES UNDER MORTGAGE COVERED BONDS ISSUED	31/12/2017	31/12/2016
from 1 year to 5 years	4,102,528	1,030,566
over 5 years	4,780,685	2,201,551
Total	**8,883,213**	**3,232,117**

(PLN THOUSAND)

MORTGAGE COVERED BONDS IN ISSUE AT 31 DECEMBER 2017

ISIN	Currency	Nominal value	Interest rate at 31/12/2017	Interest rate + margin	Issue date	Maturity date	Quotation market
PLPKOHP00017	PLN	30,000	2.48%	WIBOR3M + 0.75 p.p.	11/12/2015	11/12/2020	Bondspot, WSE alternative market
PLPKOHP00025	PLN	500,000	2.38%	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	0.125%	fixed rate	24/10/2016	24/06/2022	LuxSE, WSE alternative market
XS1559882821	EUR	25,000	0.82%	fixed rate	02/02/2017	02/02/2024	LuxSE
XS1588411188	EUR	500,000	0.625%	fixed rate	30/03/2017	24/01/2023	LuxSE, WSE alternative market
PLPKOHP00041	PLN	500,000	2.42%	WIBOR3M + 0.69 p.p.	28/04/2017	18/05/2022	Bondspot, WSE alternative market
PLPKOHP00058	PLN	265,000	2.69%	fixed rate	22/06/2017	10/09/2021	Bondspot, WSE alternative market
XS1690669574	EUR	500,000	0.75%	fixed rate	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	0.467%	fixed rate	02/11/2017	03/11/2022	LuxSE

In 2017, the Bank carried out 7 issues of mortgage covered bonds totalling PLN 1,265,000 thousand and EUR 1,079,000 thousand.

As at 31 December 2017, the mortgage covered bonds denominated in PLN and in EUR issued by the Bank were assigned a long-term rating by Moody's Investors Service of Aa3, i.e. the highest achievable by Polish securities. The rating of Polish securities is limited by the country ceiling of Poland for debt instruments, currently at Aa3.

The total nominal value of covered bonds in issue at 31 December 2017 was PLN 8,880,851 while at 31 December 2016 PLN 3,242,000 thousand.

COLLATERAL COVERING 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, and by the State Treasury,
- deposited with 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 totaled PLN 11,103,708 thousand at 31 December 2017, whereas the nominal value of additional collateral in the form of securities issued by the State Treasury amounted to PLN 251,000 thousand. The respective figures at 31 December 2016 were PLN 4,650,411 thousand and PLN 85,000. The Bank's covered bonds cover pool also included CIRS and FX-Forward transactions hedging the currency risk of issued covered bonds denominated in EUR and an IRS transaction securing the interest rate risk of fixed rate mortgage covered bonds issued in PLN.

In 2017 and the previous years, the Bank's cover pool did not contain asset-backed securities (ABS) which did not comply with Article 80(1) of Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (recast).

(PLN THOUSAND)

26. Unsecured bonds issued

Accounting principles

Liabilities due to unsecured bonds issued are measured at amortised costs using the effective interest method.

Financial information

UNSECURED BONDS ISSUED	31/12/2017	31/12/2016
Financial instruments measured at amortized cost - unsecured bonds issued	2,428,025	1,151,216
Total	**2,428,025**	**1,151,216**

PERIOD OF REPAYMENT OF LIABILITIES UNDER UNSECURED BONDS ISSUED	31/12/2017	31/12/2016
less than 1 month	364,083	183,326
from 1 month up to 3 months	1,048,540	734,801
over 3 months up to 1 year	1,015,402	233,089
Total	**2,428,025**	**1,151,216**

In 2017, the Bank issued unsecured bonds of the total nominal value of totalling PLN 6,188,800 thousand. Unsecured bonds issued are classified as liabilities measured at amortised cost

The nominal amount of the unsecured bonds in issue at 31 December 2017 was PLN 2,440,200 thousand.

Unsecured bonds in issue at 31 December 2017

UNSECURED BONDS	Nominal value	Interest rate	Issue date	Redemption date
OW230118-B86	45,500	discount paper	07/08/2017	23/01/2018
OW150318-B90	642,200	discount paper	15/09/2017	15/03/2018
OW050318-B92	50,000	discount paper	29/09/2017	05/03/2018
OW230118-B93	23,600	discount paper	29/09/2017	23/01/2018
OW050318-B95	100,000	discount paper	02/10/2017	05/03/2018
OW160418-B96	30,000	discount paper	12/10/2017	16/04/2018
OW160418-B98	515,000	discount paper	16/10/2017	16/04/2018
OW161018-B99	15,000	discount paper	16/10/2017	16/10/2018
OW050218-B100	88,000	discount paper	20/10/2017	05/02/2018
OW230118-B101	162,800	discount paper	20/10/2017	23/01/2018
OW050218-B102	50,000	discount paper	25/10/2017	05/02/2018
OW261018-B103	4,100	discount paper	26/10/2017	26/10/2018
OW150218-B104	49,800	discount paper	02/11/2017	15/02/2018
OW301018-B105	20,000	discount paper	02/11/2017	30/10/2018
OW150518-B106	187,000	discount paper	15/11/2017	15/05/2018
OW230118-B108	117,500	discount paper	01/12/2017	23/01/2018
OW250618-B110	25,000	discount paper	15/12/2017	25/06/2018
OW090118-B111	15,100	discount paper	15/12/2017	09/01/2018
OW050418-B112	37,100	discount paper	20/12/2017	05/04/2018
OW200618-B113	30,000	discount paper	20/12/2017	20/06/2018
OW250618-B114	60,000	discount paper	20/12/2017	25/06/2018
OW270618-B115	100,000	discount paper	27/12/2017	27/06/2018
OW290318-B116	72,500	discount paper	29/12/2017	29/03/2018

(PLN THOUSAND)

27. Other liabilities

Accounting principles

Liabilities	Liabilities in this line are measured at amount due for payment, including any interest accrued on such liabilities. Non-financial liabilities are measured according to the rules of measurement appropriate for the specific categories of liabilities included in this line.
Accounts payable	The Bank establishes provisions for future payments in a reasonable, reliably assessed necessary to satisfy a present liability at the end of the reporting period. The Bank also recognises a provision for future liabilities arising from compensation and severance payments made to those employees whose employment contracts are terminated for reasons not attributable to employees, and periodic settlements with respect to the costs incurred in the current period which will be paid in future periods, including bonuses and unused annual leave, taking into account all outstanding unused annual leave days.

Financial information

OTHER LIABILITIES	31/12/2017	31/12/2016
Accounts payable	8,534	5,669
Other liabilities, including:	8,907	6,527
sundry creditors	4,438	4,558
statutory liabilities, of which:	4,469	1,969
tax on certain financial institutions	3,991	1,332
Total	**17,441**	**12,196**

28. Provisions

Accounting principles

Rules of recognition of provisions	Provisions are liabilities of uncertain amount or timing of settlement. They are recognised when the Bank has a present obligation (legal or constructive) as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. If the effect of the time value of money is material, the amount of the provision is determined by discounting the forecasted future cash flows to their present value, using the discount rate before tax which reflects the current market assessments of the time value of money and the potential risk related to a given liability. All provisions are recognised in the statement of profit or loss.
Provisions for litigation	The Bank recognises provisions for disputes with counterparties, customers and external institutions upon being informed by its legal advisor of a high probability of an unfavorable outcome of the legal action or administrative proceedings.
Provision for retirement and disability benefits	According to the Labour Code (Kodeks Pracy), the employees of PKO Bank Hipoteczny SA are entitled to retirement and disability benefits upon retirement or exercising the disability entitlement. The Bank periodically performs a valuation of provisions for future liabilities to employees. The provision for retirement and disability benefits prescribed in the Labour Code is

	recognised for every employee on the basis of a periodical valuation. The basis for calculating these provisions are determined by the internal regulations of the entity. The calculation takes into account all retirement and disability benefits expected to be paid in the future. The provision is recognised on the basis of a list of individuals including all the necessary details of employees, in particular the length of service, age and gender. The recognised provisions are equal to the amount of future payments, and relate to the period until the end of the reporting period. The Bank recognises a provision for future liabilities arising from compensation and severance payments made to those employees whose employment contracts are terminated for reasons not attributable to employees, and periodic settlements with respect to the costs incurred in the current period which will be paid in future periods, including bonuses and unused annual leave, taking into account all outstanding unused annual leave days.
PROVISION FOR COMMITMENTS OF FINANCIAL AND GUARANTEE NATURE	Provisions for commitments of a financial nature are determined based on the expected exposure which will arise from the commitment. To this end, the credit conversion factor (CCF) estimated for the portfolio of exposures with similar characteristics is used. The CCF is then the basis for determining the amount of the provision, either by comparing it to the present value of expected future cash flows from the exposure, resulting from the commitment, determined individually or using the portfolio parameters estimated by statistical methods (a portfolio and collective basis).

FINANCIAL INFORMATION

PROVISIONS FOR THE PERIOD FROM 1 JANUARY 2017 TO 31 DECEMBER 2017	Provision for retirement and disability benefits	Provision for loans commitments	Total
Balance at 1 January 2017, of which:	60	80	140
Short-term provision	-	-	-
Long-term provision	60	80	140
Increase/reassessment of provision	24	(26)	(2)
Reversal	-	-	-
Balance at 31 December 2017, of which:	**84**	**54**	**138**
Short-term provision	-	-	-
Long-term provision	84	54	138

PROVISIONS FOR THE PERIOD FROM 1 JANUARY 2016 TO 31 DECEMBER 2016	Provision for retirement and disability benefits	Provision for loans commitments	Total
Balance at 1 January 2016, of which:	28	31	59
Short-term provision	-	-	-
Long-term provision	28	31	59
Increase/reassessment of provision	32	58	90
Reversal	-	(9)	(9)
Balance at 31 December 2016, of which:	**60**	**80**	**140**
Short-term provision	-	-	-
Long-term provision	60	80	140

(PLN THOUSAND)

29. BANK'S EQUITY AND SHAREHOLDING STRUCTURE

ACCOUNTING PRINCIPLES

SHAREHOLDERS' EQUITY	Shareholders' equity is comprised of capital and reserves recognised in accordance with the applicable legislation and the Articles of Association of the Bank. Shareholders' equity: ▪ share capital is stated at nominal value in accordance with the Articles of Association of the Bank and the Register of Entrepreneurs in the National Court Register, ▪ supplementary capital is established from profit appropriations and from share premium less issue costs and it serves to cover potential losses which might arise from the Bank's activities, ▪ revaluation reserve includes the results of valuation of financial assets available for sale and the pertinent tax amount, the effective portion of the cash flow hedge in hedge accounting and the pertinent tax amount, ▪ reserves are established from profit appropriations. Reserves are solely meant for covering potential losses.

FINANCIAL INFORMATION

SHAREHOLDERS' EQUITY	31/12/2017	31/12/2016
Share capital	1,200,000	800,000
Revaluation reserve	(28,892)	(17,961)
Retained earnings	(749)	(13,973)
Net profit for the period	51,419	13,224
Total equity	**1,221,778**	**781,290**

SHAREHOLDING STRUCTURE

Series	Type of shares	Number of shares	Nominal value of 1 share (PLN)	Series value at nominal value (PLN)	Date of adoption of the resolution by the General Meeting of Shareholders	Issue date	National Court Register registration date
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
Total		**1,200,000,000**		**1,200,000,000**			

PKO Bank Polski SA was the sole shareholder of the Bank at 31 December 2017 and 31 December 2016.

In 2017, there were 3 issues of shares and the share capital was increased by the total of PLN 400,000 thousand.

The share capital of the Bank amounts to PLN 1,200,000,000 and is divided into 1,200,000,000 (one billion, two hundred million) ordinary bearer shares with the nominal value of PLN 1 (one) each. The issued shares of PKO Bank Hipoteczny SA are not preferred shares and they have been fully paid up.

(PLN THOUSAND)

OTHER NOTES

30. CONTINGENT LIABILITIES GRANTED AND RECEIVED

30.1. CONTRACTUAL COMMITMENTS

At 31 December 2017 and 31 December 2016, the value of contractual commitments concerning intangible assets and property, plant and equipment amounted to PLN 0.

30.2. LOAN COMMITMENTS GRANTED

ACCOUNTING PRINCIPLES

As part of its operating activities, the Bank enters into transactions, which, at their conclusion are not recognised in the statement of financial position as assets or liabilities, yet which give rise to contingent liabilities. A contingent liability is:

- a possible obligation arising from past events, whose existence will be confirmed only at the time of occurrence or non-occurrence of one or more uncertain future events which are not wholly controllable by the Bank,
- a present obligation resulting from past events, but not recognised in the statement of financial position, because it is not probable that an outflow of cash or other assets will be required to settle such an obligation, or the amount of the obligation cannot be estimated reliably.

Provisions are also recognised for contingent commitments granted which are exposed to the risk of counterparty's default. Contingent liabilities granted concern granted but undrawn loans.

FINANCIAL INFORMATION

LOAN COMMITMENTS GRANTED AT NOMINAL VALUE	31/12/2017	31/12/2016
Credit limits and credit lines		
housing loans for customers	682,932	611,793
Total	**682,932**	**611,793**
including irrevocable loan commitments	-	-

LOAN COMMITMENTS GRANTED BY MATURITY	31/12/2017	31/12/2016
up to and including 1 month	341,466	305,896
1 month to and including 3 months	122,128	85,867
3 months to and including 1 year	196,507	186,633
1 year to and including 5 years	22,831	33,139
over 5 years	-	258
Total	**682,932**	**611,793**

For information about provisions made for contingent liabilities of a financial nature, go to Note 28 "Provisions".

30.3. GUARANTEE COMMITMENTS GRANTED

PKO Bank Hipoteczny SA does not make any guarantee commitments.

(PLN THOUSAND)

30.4. Contingent liabilities received

Financial information

CONTINGENT COMMITMENTS RECEIVED AT NOMINAL VALUE	31/12/2017	31/12/2016
Contingent commitments received		
financial	927,200	506,207
guarantees	1,984,900	1,000,000
Total	**2,912,100**	**1,506,207**

The contingent liabilities received of a financial nature represent an established and available revolving current account credit facility, while guarantee commitments received represent the amount of an available guarantee to underwrite unsecured bond issues.

Right to sell or re-pledge collateral established for the Bank

At 31 December 2017 and 31 December 2016 there was no collateral established for the Bank, which the Bank was entitled to sell or re-pledge, in the event of fulfilment of all obligations by the owner of the collateral.

31. Litigations and claims

At 31 December 2017 and 31 December 2016, there were no litigations and claims.

32. Finance leases and operating leases

Accounting principles

Leasing contracts under which the lessor generally retains all the risks and rewards of ownership of the leased asset are classified as operating leases. The definition of operating lease is also satisfied by the contract of lease entered into by the Bank in the regular course of business.

The Bank is a party to operating lease agreements under which it takes the use of non-current assets for the agreed term in consideration of a fee. The basis of classification of lease agreements by the Bank is the extent to which he risks and rewards of ownership of the leased asset are attributable to the lessor and to the lessee.

Lease charges under operating leases and later lease payments are recognised as expenses in the statement of profit and loss on a straight-line basis during the term of the lease.

The Bank is a party to an operating lease agreement for a car fleet which has been handed over for use for a period of 44 months in exchange for lease payment. The agreement may not be terminated by the lessee.
The Bank is also a party to property rental agreements for the Bank's head office, office in Warsaw and backup center. The rental agreement for the head office was concluded for a term of 10 years, and other contracts for an indefinite term. The notice period for termination of these agreements is from 6 to 12 months.

Financial information

TOTAL AMOUNT OF FUTURE LEASE PAYMENTS UNDER IRREVOCABLE OPERATING LEASE	31/12/2017	31/12/2016
For notice period:		
to 1 year	1,266	1,340
from 1 year to 5 years	89	133
over 5 years	-	-
Total	**1,354**	**1,473**

Lease payments (including property lease agreements) recognised as an expense during the period amounted to PLN 1,703 thousand in 2017 and to PLN 1,722 thousand in 2016.

(PLN THOUSAND)

33. NOTES TO THE STATEMENT OF CASH FLOWS

CASH AND CASH EQUIVALENTS

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

FINANCIAL INFORMATION

Cash and cash equivalents	31/12/2017	31/12/2016
Cash and balances with Central Bank	561	16,033
Amounts due from banks, current	5,350	12,994
Total	**5,911**	**29,027**

INTEREST INCOME – RECEIVED	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Interest received on loans and advances to customers	386,277	126,417
Interest received on financial instruments designated upon initial recognition as at fair value through profit or loss	367	1,209
Interest received on investment securities	8,232	153
Interest received on CIRS transactions	2,496	-
Interest received on IRS transactions	1,562	-
Interest received on term deposits	75	26
Other interest received	67	34
Total	**399,076**	**127,839**

INTEREST EXPENSE - PAID	01/01/2017 - 31/12/2017	01/01/2016 - 31/12/2016
Interest paid due to overdraft facilities	23,134	5,559
Interest /discounts paid due to mortgage covered bonds and unsecured bonds issued	70,776	16,636
Interest paid due to deferred payment	47,628	26,509
Interest paid due to CIRS transactions	89,110	8,100
Interest paid due to IRS transactions	2,913	-
Interest paid due to unauthorised overdraft	6	5
Other interest paid	1	94
Total	**233,568**	**56,903**

34. RELATED PARTY DISCLOSURES

34.1 TRANSACTIONS WITH PARTIES RELATED BY EQUITY

FINANCIAL INFORMATION

AT 31 DECEMBER 2017

ENTITY	ASSETS			
	Acquisition of intangible assets and property, plant and equipment	Unsettled loan sale commission	Other receivables	including under derivative instruments
PKO Bank Polski SA	4,134	61,733	9,070	338
Total	**4,134**	**61,733**	**9,070**	**338**

(PLN THOUSAND)

ENTITY	LIABILITIES				
	Overdraft facility	Purchase of receivables	Mortgage covered bonds and unsecured bonds	Other liabilities	including under derivative instruments
PKO Bank Polski SA	1,477,453	2,497,918	58,441	223,251	217,777
PKO BP Finat Sp. z o.o.	-	-	-	17	-
PKO Leasing SA	-	-	-	1	-
Total	**1,477,453**	**2,497,918**	**58,441**	**223,267**	**217,777**

ENTITY	Contingent commitments granted	Contingent commitments received
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	including fee and commission expense	Total expense	including fee and commission expense	Net result on financial instruments measured at fair value	Net foreign exchange result
PKO Bank Polski SA	(302)	(1,452)	183,998	168,177	(264)	(230,398)
PKO BP Finat Sp. z o.o.	-	-	184	-	-	-
PKO Leasing SA	-	-	324	-	-	-
Total	**(302)**	**(1,452)**	**184,507**	**168,177**	**(264)**	**(230,398)**

At 31 December 2016

ENTITY	ASSETS			
	Acquisition of intangible assets and property, plant and equipment	Unsettled loan sale commission	Other receivables	including under derivative instruments
PKO Bank Polski SA	3,400	24,967	43,674	27,808
Total	**3,400**	**24,967**	**43,674**	**27,808**

ENTITY	LIABILITIES				
	Overdraft facility	Purchase of receivables	Mortgage covered bonds and unsecured bonds	Other liabilities	including under derivative instruments
PKO Bank Polski SA	393,793	3,038,039	29,782	5,410	113
PKO BP Finat Sp. z o.o.	-	-	-	16	-
Total	**393,793**	**3,038,039**	**29,782**	**5,426**	**113**

(PLN THOUSAND)

ENTITY	Contingent commitments granted	Contingent commitments received
PKO Bank Polski SA	-	1,506,207
Total	**-**	**1,506,207**

FOR THE PERIOD FROM 1 JANUARY 2016 TO 31 DECEMBER 2016

ENTITY	Total income	including fee and commission income	Total expense	including fee and commission expense	Net result on financial instruments measured at fair value	Net foreign exchange result
PKO Bank Polski SA	588	(169)	74,017	55,230	92	49,688
PKO BP Finat Sp. z o.o.	-	-	159	-	-	-
PKO Leasing SA	-	-	310	-	-	-
Total	**588**	**(169)**	**74,486**	**55,230**	**92**	**49,688**

The Bank holds current accounts and made deposits during the reporting period with PKO Bank Polski SA. In addition, the Bank cooperates strategically with PKO Bank Polski SA. Mortgage loan sales as well as after-sales servicing, excluding internal control and risk management functions, 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 is also provided funding by PKO Bank Polski SA. On 29 October 2015, PKO Bank Hipoteczny SA and PKO Bank Polski SA, signed a Current Account Revolving Credit Agreement with a limit of PLN 900 million for the period of 3 years, which was drawn in tranches. At 31 December 2017, PLN 900 million of the facility was available. Furthermore, on 2 October 2017, PKO Bank Hipoteczny SA and PKO Bank Polski SA, signed a Current Account Revolving Credit Agreement with a limit of PLN 1,500 million for the period of 3 years, which was drawn in tranches. At 31 December 2017, PLN 1,500 million of the facility was available.

On 30 September 2015, the Bank entered into a PKO Bank Hipoteczny Bond Issuance Programme Agreement with PKO Bank Polski SA for the Programme amount of up to PLN 2 billion over a period of 4 years, as well as the Underwriting Agreement under which the underwriter assumes the obligation to take up the Bonds issued by the Issuer for its own account up to the amount of PLN 2 billion. At 31 December 2017, the Programme amount was PLN 3 billion, due to an amendment agreement.

On 17 November 2015 A Framework Agreement for the Sale of Receivables was concluded with PKO Bank Polski SA. Based on the agreement, the Bank purchased portfolios of receivables under mortgage-backed home loans totalling PLN 5,553,538 thousand. Further details are available in Notes 19 and 23.

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 harmonising the Programme Agreement, under which the Brokerage House of PKO Bank Polski is engaged as a firm-commitment underwriter.

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

Furthermore, as a part of 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.

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

(PLN THOUSAND)

34.2 Transactions with parties related personally

At 31 December 2017, 11 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 2016 – 4 entities.

During the period from 1 January to 31 December 2017 and from 1 January to 31 December 2016, no transactions were concluded by the Bank with such entities.

34.3 Remuneration of PKO Bank Hipoteczny SA key management personnel

Benefits for the Supervisory Board Members

According to the Remuneration policy of the members of the Supervisory Board of the Company approved by the General Meeting of Shareholders on 18 October 2018, the members of the Supervisory Board of PKO Bank Hipoteczny SA do not receive any compensation in consideration of their duties. An exception here are independent members of the Supervisory Board, who receive a monthly compensation equal to the average monthly compensation in the corporate sector, without profit sharing schemes in the fourth quarter of the preceding year, as announced by the Chairman of the Central Office of Statistics. The compensation is increased by 10% when the independent member of the Supervisory Board sits on at least one standing committee of the Supervisory Board.

BENEFITS FOR INDEPENDENT SUPERVISORY BOARD MEMBERS	31/12/2017	31/12/2016
Artur Kluczny	7	-
Piotr Kwiecień	7	-
Total provision	14	-

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

BENEFITS FOR THE MANAGEMENT BOARD	2017								
	Short-term employee benefits			Other long-term employee benefits - variable salary in cash form[3]			Share-based payments settled in cash		
	Compensation 01/01/2017-31/12/2017 [1]	Other received 01/01/2017-31/12/2017	Other compensation due at 31/12/2017 [2]	Received 01/01/2017-31/12/2017	Other due at 31/12/2017	Potentially due at 31/12/2017	Received 01/01/2017-31/12/2017	Due at 31/12/2017	Potentially due 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 who did not perform their duties in 2017	-	-	-	1	-	2	5	-	2
Total benefits for the Management Board	1,642	546	-	45	-	352	245	-	750

(PLN THOUSAND)

BENEFITS FOR THE MANAGEMENT BOARD	2016								
	Short-term employee benefits			Other long-term employee benefits - variable salary in cash form[3]			Share-based payments settled in cash		
	Compensation 01/01/2016-31/12/2016 [1]	Other received 01/01/2016-31/12/2016	Other compensation due at 31/12/2016 [2]	Received 01/01/2016-31/12/2016	Other due at 31/12/2016	Potentially due at 31/12/2016	Received 01/01/2016-31/12/2016	Due at 31/12/2016	Potentially due at 31/12/2016
Rafał Kozłowski	611	130	-	-	-	53	-	-	135
Jakub Niesłuchowski	515	121	-	-	-	47	-	-	119
Marek Szcześniak	476	94	-	-	-	30	-	-	75
Members who did not perform their duties in 2016	-	192	-	-	-	3	-	-	7
Total benefits for the Management Board	1,602	537	-	-	-	133	-	-	336

1) The benefits comprise the basic salary, health care allowance from Company Welfare Fund.
2) Non-deferred variable salary component (in cash).
3) Deferred variable salary component (in cash).

During the period from 1 January to 31 December 2017, the Management Board of the Bank were granted short - and long-term employee benefits for 2016, in the form of cash and a financial instrument, i.e. phantom shares. At the same time, as there were no grounds for limiting the variable salary components nor for reducing amounts payable, granted for 2015 and for 2016, the Management Board members were paid both long-term cash benefits and benefits on the basis of phantom shares potentially due in 2017, as well as the short-term employee benefits due in 2017.

POST-EMPLOYMENT BENEFITS

During the period from 1 January to 31 December 2017, the Management Board members were not paid any post-employment benefits, while during the period from 1 January to 31 December 2016, PLN 192 thousand was paid.

TERMINATION BENEFITS

During the period from 1 January to 31 December 2017 and from 1 January to 31 December 2016, no benefits due to termination of employment were paid.

LOANS, ADVANCES, GUARANTEES AND OTHER BENEFITS PROVIDED BY THE BANK FOR MANAGEMENT

During the period from 1 January to 31 December 2017 and from 1 January to 31 December 2016, the Bank issued no loans, guarantee or other advances to its 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 Supervisory Board of the Bank. At 31 December 2017, their carrying amount was PLN 690 thousand.

34.4 THE RULES OF FORMULATION OF THE VARIABLE SALARY COMPONENT POLICY OF KEY MANAGEMENT PERSONNEL IN THE BANK

According to the requirements of CRD IV directive, 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 assessment of internal capital in banks, the following regulations setting the rules of determination of variable salary components are effective in the Bank:

Rules of variable salary components for the members of the Management Board of PKO Bank Hipoteczny SA, enacted under a Supervisory Board resolution,

List of job titles of staff whose professional activities have a material impact on the risk profile of the entity, covered by the Rules of Variable Salary Components for Key Management Personnel of the Bank, 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.

(PLN THOUSAND)

The Rules specify the procedure for granting performance-based variable salary components linked to the members of the Management Board and the MRTs. Variable salary components for a given appraisal period (calendar year) are granted after the bonus targets are accounted for. The maximum amount of the variable salary component may not exceed 100% of the fixed salary payable for the appraisal period in question.

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

However, both the non-deferred and deferred salary are awarded in equal parts in cash and in the form of financial instrument (i.e. phantom shares), for which conversion into cash is carried out after an additional period of retention - 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 SALARY COMPONENTS	31/12/2017 (for 2015-2017)	31/12/2016 (for 2015-2016)
Management Board[1]	2,748	1,672
other MRTs	1,770	1,279
Total provision	**4,518**	**2,951**

COMPENSATION PAID DURING THE YEAR	01/01/2017 - 31/12/2017 (for 2015-2016)	01/01/2016 - 31/12/2016 (for 2015)
granted in cash		
Management Board[1]	591	-
other MRTs	808	-
awarded in financial instruments		
Management Board[1]	245	-
other MRTs	60	-
Total paid	**1,704**	-

1) including the members of the Management Board who were recalled

35. FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

35.1 CATEGORIES OF FAIR VALUE MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES CARRIED AT FAIR VALUE IN THE STATEMENT OF FINANCIAL POSITION

ACCOUNTING PRINCIPLES

CLASSIFICATION OF FINANCIAL ASSETS AND FINANCIAL	The Bank classifies particular components of financial assets and financial liabilities measured at fair value into the following categories: Level 1: Quoted prices in active markets,

LIABILITIES	Level 2: Measurement techniques based on observable market data, Level 3: Other measurement techniques. Different fair value measurement techniques are used depending on the classification of financial assets and financial liabilities within the hierarchy.
LEVEL 1 QUOTED PRICES IN ACTIVE MARKETS	Financial assets and financial liabilities whose fair value is measured directly based on quoted prices (unadjusted) from active markets for identical assets and liabilities.
LEVEL 2 MEASUREMENT TECHNIQUES BASED ON OBSERVABLE MARKET DATA	Financial assets and liabilities whose fair value is measured with the use of valuation models where all significant input data is observable in the market directly (as prices) or indirectly (based on prices). The Bank classifies financial instruments for which there is no active market into that category.
LEVEL 3 OTHER MEASUREMENT TECHNIQUES	Financial assets and liabilities, whose fair value is measured with the use of valuation models, for which available input data is not derived from observable markets (unobservable input data).
TRANSFERS	Transfers of instruments between Level 1 and Level 2 occur depending on the availability of quotations in an active market at the end of the reporting period. A transfer from Level 2 to Level 3 occurs when an observable factor in the valuation is superseded by one that is unobservable or in applying a new unobservable risk factor in the valuation, which also has a significant impact on the valuation of the instrument. A transfer from Level 3 to Level 2 occurs when an unobservable factor in the valuation is superseded by one that is observable or when the impact of an unobservable factor on the valuation of the instrument ceases to be significant. Transfers between levels of fair value hierarchy occur as at the end of the reporting period. For the period from 1 January 2017 to 31 December 2017 there were no transfers between the levels of the fair value hierarchy used in the fair value measurement of financial instruments.

MEASUREMENT TECHNIQUES AND OBSERVABLE INPUT DATA

FINANCIAL INSTRUMENTS DESIGNATED UPON INITIAL RECOGNITION AS AT FAIR VALUE THROUGH PROFIT OR LOSS	Measurement methods (techniques)	Observable input data
NBP money market bills	Measured using the yield curve method	The yield curve for money market bills is based on market prices, data from the money market and the OIS (Overnight index swap) transactions market.
CIRS	Measured using the yield curve method	The yield curves are constructed based on market prices, data from the money market, the FRA (Forward rate agreement) and the IRS (Interest Rate Swap) transactions market, basis swaps and CDS (Credit Default Swap) quotations.
IRS	Measured using the yield curve method	The yield curves are constructed based on market prices, data from the money market and FRA (Forward rate agreement) and IRS (Interest Rate Swap) transactions market.
FX-Forward	Measured using the yield curve method	The yield curves are constructed based on market prices, data from the money market and the FX Forward transactions market.

(PLN THOUSAND)

FINANCIAL INFORMATION

ASSETS AND LIABILITIES MEASURED AT FAIR VALUE AT 31 DECEMBER 2017	Note	Carrying amount	Level 1 Quoted prices in active markets	Level 2 Measurement techniques based on observable market data	Level 3 Other measurement techniques
Derivative hedging instruments	17	338	-	338	-
CIRS		-	-	-	-
FX-Forward		338	-	338	-
Financial instruments designated upon initial recognition as at fair value through profit or loss	18	-	-	-	-
NBP money market bills		-	-	-	-
Investment securities available for sale	20	830,489	830,489	-	-
Treasury bonds		830,489	830,489	-	-
Total financial assets measured at fair value:		**830,827**	**830,489**	**338**	-
Derivative financial instruments	17	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**	-

ASSETS AND LIABILITIES MEASURED AT FAIR VALUE AT 31 DECEMBER 2016	Note	Carrying amount	Level 1 Quoted prices in active markets	Level 2 Measurement techniques based on observable market data	Level 3 Other measurement techniques
Derivative hedging instruments	17	27,808	-	27,808	-
CIRS		27,709	-	27,709	-
FX-Forward		99	-	99	-
Financial instruments designated upon initial recognition as at fair value through profit or loss	18	79,987	-	79,987	-
NBP money market bills		79,987	-	79,987	-
Investment securities available for sale	20	203,019	203,019	-	-
Treasury bonds		203,019	203,019	-	-
Total financial assets measured at fair value:		**310,814**	**203,019**	**107,795**	-
Derivative financial instruments	17	113	-	113	-
FX-Forward		113	-	113	-
Total financial liabilities measured at fair value:		**113**	-	**113**	-

35.2 FINANCIAL ASSETS AND FINANCIAL LIABILITIES NOT PRESENTED AT FAIR VALUE IN THE STATEMENT OF FINANCIAL POSITION

ACCOUNTING PRINCIPLES

Some of financial assets and liabilities are not presented at fair value in the statement of financial position.

Market values are unavailable for most financial instruments, hence fair values are estimated by means of a number of measurement techniques. The fair value of financial instruments was measured using a model based on estimates of the present value of future cash flows discounted using appropriate interest rates. All model calculations include certain simplifying assumptions and are sensitive to those assumptions.

Set out below is a summary of the main methods and assumptions used for estimating the fair values of financial instruments which are not carried at fair value.

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

(PLN THOUSAND)

- cash and balances with Central Bank,
- loans and advances to banks,
- loans and advances to customers,
- deposits from banks,
- deposits from customers,
- floating-rate PLN-denominated covered bonds issued,
- unsecured bonds issued.

In connection with the issue of covered bonds in EUR and PLN the interest rate on which is fixed in the period, the fair value was measured on the basis of the price observed in a regulated market (Luxembourg exchange for covered bonds in EUR and the Warsaw Stock Exchange for covered bonds in PLN).

FINANCIAL INFORMATION

FINANCIAL ASSETS AND LIABILITIES NOT PRESENTED AT FAIR VALUE AT 31 DECEMBER 2017	fair value hierarchy level	measurement technique	31/12/2017	
			carrying amount	fair value
Cash and balances with Central Bank	n/a	value at cost incl. impairment allowance	561	561
Amounts due from banks	3	discounted cash flows	5,350	5,350
Loans and advances to customers, of which:			16,042,473	16,042,473
housing loans	3	discounted cash flows	16,042,473	16,042,473
Amounts due to banks	3	discounted cash flows	4,125,379	4,125,379
Amounts due to customers	3	discounted cash flows	2,099	2,099
Mortgage covered bonds issued	1, 3	discounted cash flows, quotations in a regulated market	8,883,213	8,891,406
Unsecured bonds issued	3	discounted cash flows	2,428,025	2,428,025

FINANCIAL ASSETS AND LIABILITIES NOT PRESENTED AT FAIR VALUE AT 31 DECEMBER 2016	fair value hierarchy level	measurement technique	31/12/2016	
			carrying amount	fair value
Cash and balances with Central Bank	n/a	value at cost incl. impairment allowance	16,033	16,033
Amounts due from banks	3	discounted cash flows	12,994	12,994
Loans and advances to customers, of which:			8,247,900	8,247,900
housing loans	3	discounted cash flows	8,247,900	8,247,900
Amounts due to banks	3	discounted cash flows	3,431,832	3,431,832
Amounts due to customers	3	discounted cash flows	1,549	1,549
Mortgage covered bonds issued	1, 3	discounted cash flows, quotations in a regulated market	3,232,117	3,207,099
Unsecured bonds issued	3	discounted cash flows	1,151,216	1,151,216

36. SEGMENT REPORTING

During the reporting period, the bank did not conduct business on the basis of different segments.

(PLN THOUSAND)

GOALS AND PRINCIPLES OF RISK MANAGEMENT

37. RISK MANAGEMENT IN PKO BANK HIPOTECZNY SA

Risk management in PKO Bank Hipoteczny SA is aimed at ensuring control of the risk level and maintaining it within the risk tolerance and system of 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:

Risk type	Chapter
credit risk	38
concentration risk	39
residual risk	40
liquidity risk	41
interest rate risk	42
foreign exchange risk	43
business risk	44
macroeconomic changes risk	45
model risk	46
operational risk	47
compliance risk	48
reputation risk	49
capital risk, including leverage risk	50

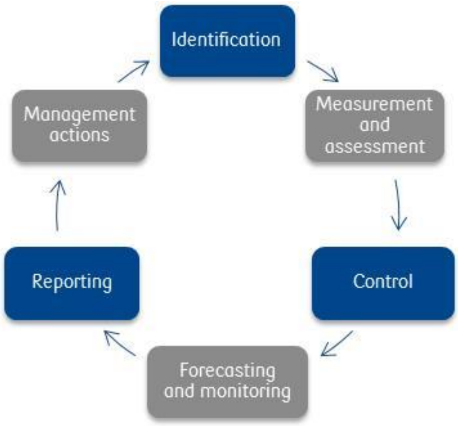
37.1 MAIN PRINCIPLES OF RISK MANAGEMENT

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

- the risk management process, including the credit process, is defined and regulated by strategies, policies and procedures adopted by the Management Board and 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 (in particular the models and their assumptions) and the risk measurement systems are tailored to the scale and complexity of the risk, as well as periodically verified and validated,
- the organizational structure of risk management ensures the independence of the risk 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 implementation 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 in PKO Bank Hipoteczny SA comprises the following components:



37.2 COMPONENTS OF THE RISK MANAGEMENT SYSTEM

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

RISK IDENTIFICATION

The risk identification consists of identification of actual and potential sources of risk and estimation of the significance of their potential influence on the financial situation 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 OR ASSESSMENT

Risk measurement covers determination of risk assessment 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 the 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 the determination of 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 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 regular 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 undertaken by the Bank comprise in particular enacting internal regulations, specifying the risk tolerance, establishing limits and thresholds, issuing recommendations, making decisions, including about the use of tools supporting risk management. The objective of management actions is to direct the risk management process and risk levels.

37.3 ORGANIZATION OF RISK MANAGEMENT IN THE BANK

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

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

Risk management is performed on the basis of three independent lines of defence:

- the first line of defense, which consists of first of all the management of risk exposure in the core business, whose framework is built of: 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 defense, which consists of identification, measurement and assessment, monitoring, controlling and reporting material risks for the Bank, reporting identified threats and irregularities, formulating internal regulations defining the rules, methods, tools and procedures of risk management, and the effectiveness measurement,
- the third line of defense, which is internal audit performing independent audits of key components of the risk management system embedded in the Bank's operations.

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

- the function of the second line of defense in creating systemic solutions is independent of the function of the first line of defense,
- the function of the third line of defense is independent of the functions of the first and second lines of defense,
- the function of compliance risk management has a direct reporting line to the President of the Management Board.

The following are the organizational segments of the Head Office of PKO Bank Hipoteczny SA 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 portfolio basis), concentration risk, liquidity risk, interest rate risk, foreign exchange risk, business risk, operational risk, macroeconomic changes 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 of determination of Property Value for Mortgage Lending Purposes (BHWN). The Credit Risk, IT and Outsourcing Bureau is also in charge of administration of bad 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 for developing the compliance risk management system and identification of 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 for the management of model risk, validation of risk models and cooperating in this regard with the model validation unit in PKO Bank Polski SA.

COMMUNICATIONS OFFICER

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

Risk management is aided by the following committees:

Supervisory Board Audit and Finance Committee ("AFC")

The Committee supports the Supervisory Board by monitoring and formulating opinions about:

- adequacy and effectiveness of the internal control system, including internal audit,
- adequacy and effectiveness of the risk management system,
- the extent of effectiveness of the management of compliance risk by the Bank and the adequacy and effectiveness of the compliance team.

Supervisory Board Risk Committee ("RC")

The Committee supports the Supervisory Board by:

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

Assets & Liabilities Management Committee ("ALCO")

The Committee supports the Management Board 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 of 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,
- making 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 segments, members of the Management Board, project teams or task forces - within the scope of its competencies.

Credit Committee ("CC")

The Committee supports the Management Board by:

- supporting the functions managing the credit, concentration and residual risk 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,
- making 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 segments, members of the Management Board, project teams or task forces - within the scope of its competencies.

Strategy and Business Initiatives Committee ("SBIC")

The Committee supports the Management Board by:

- supporting the functions managing the 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 pursuance of the Bank's strategy and the IT strategy, including analyses of operational risk, reviewing the product range, product profitability and the credit process,

- making 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 segments, members of the Management Board, project teams or task forces - within the scope of its competencies.

The Committees, the Management Board and the Supervisory Board are the recipient of periodic reports on the respective risk types.

37.4 Identification of meterial risks

Materiality of different risks

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

In setting 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 recognised:

- material risks - subject to active management,
- potentially material risks - 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. Firstly, 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 potentially material risk. 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,
- business risk,
- model risk.

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

- concentration risk,
- foreign exchange risk,
- residual risk,
- macroeconomic changes risk,
- compliance risk,
- reputation risk,
- capital risk, including risk of excessive leverage.

The Bank has defined and monitors materiality criteria for the potentially material risks. The fulfillment of these criteria will result in recognition of such risk as material to the Bank.

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

38. 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 of 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 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 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.

38.1 Credit risk measurement and assessment

PKO Bank Hipoteczny SA measures and assesses credit risk at the level of individual transaction 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 date from the Credit Information Bureau. The review (monitoring) of the models and their validation are performed separately on the basis of the Bank's portfolio, PKO Bank Polski SA's portfolio as well as the combined portfolios of both banks.

The detailed principles and scope of cooperation within the PKO Bank Polski Group regarding the group risk models are laid down in the Outsourcing agreement with PKO Bank Polski SA described in Note34.1.

In the current credit process, as part of the risk assessment of a 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 point of view of statistical risk of 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 the ones arising from the requested loan. Creditworthiness is assessed, among other things, on the basis of the documentation supplied by the customer, which is verified for completeness, authenticity and consistency with the facts and the legal situation. 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 under home loans from PKO Bank Polski SA, the Bank also performs the 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 punctuality of repayments, eliminating from the transfer the receivables which do not satisfy the methodology criteria.

In addition, the purchased portfolios are valuated by an independent third party in order to guarantee an unbiased valuation of the portfolios to be acquired. As part of the valuation, the risks costs expected in regard of the receivables portfolio in question are also assessed and are reflected in the final price which the Bank pays for the portfolio.

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

- probability of default (PD),
- loss given default (LGD),
- expected loss (EL),
- the share and structure of non-performing loans (NPL),
- coverage ratio (CR),
- risk costs (RC),
- vintage analyses.

The portfolio credit risk measurement methods make it possible, among others, to determine of the level of impairment losses.

The Bank performs analyses and stress-tests regarding the influence of potential changes in macroeconomic condition 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 risk related to the business conducted.

38.2 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 credit processes and at the 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 in the sense of the Banking Act, setting decision-making limits representing the maximum level of credit decision-making powers.

38.3 Impairment loss on credit exposures

PKO Bank Hipoteczny performs monthly reviews of loan exposures in order to identify those that are at risk of impairment, to measure the impairment of loan exposures and to recognize impairment losses or provisions.

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

- delinquency in the repayment of the principal or payment of interest of more than 90 days,
- concluding a restructuring agreement or applying forbearance measures concerning debt repayment (the indication of impairment is recognised, if the customer is granted forbearance measures due to legal or economic considerations stemming from the customers financial distress).

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

38.4 Impairment assessment approaches

During the reporting period, the Bank assessed the impairment of credit exposures in accordance with IAS39, applying two measurement approaches:

- a portfolio approach applied to loans for which an objective indication of individual impairment has been identified,
- a collective approach (IBNR) applied to loans for which no objective indication of individual impairment has been identified and for which a possible loss has incurred but has not been reported.

An impairment loss for loan exposures is the difference between the carrying amount of the exposure and the present value of the expected future cash flows from the exposure, estimated with the use of the group's risk parameters.

38.5 Provisions for loan commitments

Provisions for loan commitments made are recognised in an amount counterbalancing the expected (possible to estimate) loss of economic benefits.

In determining provisions, the Bank uses a portfolio based method (if the exposure meets the criteria for an indicator of individual impairment) or a collective method (if the exposure satisfies the criteria of collective impairment).

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

The loan portfolio structure and allowances for impairment of credit exposures of PKO Bank Hipoteczny SA are presented in Note 38.6.3 "Loans and advances to customers".

38.6 Risk forecasting and monitoring

PKO Bank Hipoteczny SA monitors credit risk at the level of individual transaction 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:

(PLN THOUSAND)

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

38.6.1 MAXIMUM CREDIT RISK EXPOSURE

MAXIMUM CREDIT RISK EXPOSURE	31/12/2017	31/12/2016
Cash and balances with Central Bank	561	16,033
Amounts due from banks	5,350	12,994
Loans and advances to customers	16,042,473	8,247,900
Derivative hedging instruments	338	27,808
Financial instruments designated upon initial recognition as at fair value through profit or loss	-	79,987
Investment securities available for sale	830,489	203,019
Balance sheet exposure, total	**16,879,211**	**8,587,741**
Loan commitments	682,932	611,793
Off- balance sheet exposure, total	**682,932**	**611,793**

38.6.2 LOANS AND ADVANCES TO BANKS

AMOUNTS DUE FROM BANKS	31/12/2017	31/12/2016
Not overdue, not impaired amounts due from banks	5,350	12,994
Total, gross	5,350	12,994
Impairment allowance	-	-
Total, net	**5,350**	**12,994**

38.6.3 LOANS AND ADVANCES TO CUSTOMERS

The loan portfolio is characterised by good quality. At 31 December 2017, 13 of impaired loans were recognised, and their share in the total loan portfolio amount was 0.02%.

LOANS AND ADVANCES TO CUSTOMERS	31/12/2017	31/12/2016
Not overdue, not impaired loans and advances	15,982,619	8,227,317
Overdue, not impaired loans and advances	62,088	22,342
Impaired loans and advances	2,834	-
Total, gross	**16,047,541**	**8,249,659**
Impaiment allowance for not overdue, not impaired loans and advances	(3,157)	(1,543)
Impaiment allowance for overdue, not impaired loans and advances	(1,050)	(216)
Impaiment allowance for impaired loans and advances	(861)	-
Total, net	**16,042,473**	**8,247,900**

(PLN THOUSAND)

NOT IMPAIRED LOANS AND ADVANCES TO CUSTOMERS	31/12/2017	31/12/2016
not overdue	15,982,619	8,227,317
to 30 days	57,536	21,263
from 31 to 60 days	3,763	1,079
from 61 to 90 days	789	-
Total, gross	**16,044,707**	**8,249,659**

38.6.4 Forbearance

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 the costs of recoveries.

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, reducing instalments),
- changing the interest rate,
- changing the margin,
- reducing the debt.

As a result of timely service of the agreement, the forborne debt becomes a non-overdue receivable. One of the components of the forbearance process is the evaluation if the debtor is able to fulfil the conditions of the forbearance agreement (pay the debt on the agreed dates). Forbearance agreements are monitored on the ongoing basis. If impairment is identified on the loan exposures covered by such agreements, impairment losses are recognised, reflecting the identified loss.

Forborne exposures classified as non-performing are included in the performing loan portfolio when the following conditions are jointly met:

- the receivable does not satisfy the individual impairment condition and no impairment is recognised,
- at least 12 months have lapsed from the conclusion of the forbearance 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:

- 24 months have lapsed since the forborne exposure was included in the performing 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.

VALUE OF EXPOSURES SUBJECT TO FORBEARANCE IN CREDIT PORTFOLIO	31/12/2017	31/12/2016
Gross loans and advances to customers, of which:	16,047,541	8,249,659
subject to forbearance	872	-
Impairment loss on loans and advances to customers, of which:	(5,068)	(1,759)
subject to forbearance	(218)	-
Net loans and advances to customers, of which:	**16,042,473**	**8,247,900**
subject to forbearance	**654**	-

38.7 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 Management Board and the Supervisory Board of the Bank on a quarterly basis.

38.8 Credit risk management actions

The principal tools of credit risk management in PKO Bank Hipoteczny SA include 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 related to the servicing of obligations of credit and financial nature to customer's income, i.e. Debt-to-Income (DtI) ratio, acceptable to the Supervisory Board),
- decision-making limits - defining the maximum level of credit decision-making powers concerning the customers of the Bank; the amount of decision-making powers 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 in terms of credit risk; according to the policy, the key element limiting loan losses resulting from the customers' inability to pay their obligations to the Bank are mortgages on the financed properties, though 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 customer's ability to pay his dues.

39. Concentration risk management

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

- exposures to individual customers or groups of related customers,
- exposures subject to common or correlated risk factors,
- characterised 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 risk profile of the Bank.

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

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

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

Internal exposure limits are determined in relation to the size of the Bank's own funds and in relation to the total credit exposure of the Bank and reflect the appetite for credit risk adopted by the Bank, taking into account normal and 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 DtI ratio of over 50%.

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

Monthly and quarterly concentration risk reports are prepared in the Bank. Reports are submitted to the Credit Committee on a monthly basis and to the Management Board and the Supervisory Board of the Bank on a quarterly basis.

40. 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 specialised 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 collateral 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: Banking Act, Polish Covered Bonds Act, 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 policies of the bank.

The Bank has enacted and follows the Rules of Determination of the Property Value for Mortgage Lending Purposes approved by the Polish Financial Supervision Authority, issued on the basis of the Polish Covered Bonds Act dated 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 opinion of the Bank reflects the level of risk associated with the property serving as collateral for loans and is used to determine the upper limit of a granted or purchased loan secured by a mortgage on a specific property or in reaching a decision by the Bank as to whether the loan secured on the property may be acquired by the Bank.

PKO Bank Hipoteczny 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 construction of the property 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 tentative 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 plan.

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.

41. Liquidity risk management

Liquidity risk is the risk of inability to settle Bank's obligations when due as a result the lack of liquid assets. Liquidity risk comprises funding risk, which is a risk of the loss of funding sources used and the inability to roll over maturing funding or the loss of access to new sources of funding.

Lack of liquidity may arise from an inappropriate structure of the balance sheet, mismatch of cash flows, counterparty default, customers' sudden realisation of off-balance sheet obligations, inability to roll over bonds or other market events.

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

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 a portfolio of liquid securities and to increase stable sources of funding (in particular, from the issuance of mortgage covered bonds and funding from the parent entity). Money market instruments and unsecured bonds issued are also used in liquidity risk management. Derivative transactions are used to manage any currency mismatches.

The liquidity risk management is built into the risk management process described in Note 37.2.

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

The Management Board of the Bank 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 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.

41.1 LIQUIDITY RISK MEASUREMENT AND ASSESSMENT

The Bank applies the following liquidity risk measures:

- contractual, actualised and stress-test liquidity gap,
- liquidity surplus and survival horizon,
- regulatory liquidity measures
  - M1 – short-term liquidity gap,
  - M2 – short-term liquidity ratio,
  - 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,
- stable funding measure:
  - Net Stable Funding Ratio (NSFR) – the net stable funding ratio,
- the concentration of funding sources outlined in Note 41.6.
- the liquidity stress tests outlined in Note 41.7.

The M1 and M2 liquidity measures ceased to apply from 1 January 2018.

(PLN THOUSAND)

The actualised liquidity gaps in are presented below. In the bands up to 12 months, the cumulative adjusted liquidity gap terms has positive values, which means a surplus of maturing assets increased by estimated inflows from available overdraft limit over mature liabilities in a short and medium term:

LIQUIDITY GAP 31/12/2017	at sight	0 - 1 month	1 - 3 months	3 - 6 months	6 - 12 months	12 - 24 months	24 - 60 months	> 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	933,083	828,882	150,958	(4,063,929)	(7,517,136)	(864,450)
LIQUIDITY GAP 31/12/2016	**at sight**	**0 - 1 month**	**1 - 3 months**	**3 - 6 months**	**6 - 12 months**	**12 - 24 months**	**24 - 60 months**	**> 60 months**
Adjusted periodic gap	535,234	(115,135)	(32,488)	(12,778)	69,365	(4,778,710)	151,561	3,621,355
Adjusted cumulative periodic gap	535,234	420,099	387,611	374,833	444,198	(4,334,512)	(4,182,951)	(561,596)

The adjusted liquidity gap includes the liabilities arising from deferred payment resulting from the receivables purchase agreements with PKO Bank Polski SA (PLN 32,497,918 thousand as at 31 December 2017) which are treated by the Bank as a bridge financing that will eventually be replaced by other funding sources such as covered bonds to be issued in the future. Their contractual maturities classified in the bands up to 12 months is actualised for the 12-24 month band, in accordance with the Bank's liquidity risk management principles.

NAME OF SENSITIVITY MEASURE	31/12/2017	31/12/2016
Liquidity surplus* within 1-month horizon	1,134,465	415,573
Survival horizon without external aid (days)	297	77

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

A positive liquidity surplus in a one-month time horizon indicates a sufficient level of short-term liquidity. The liquidity surplus comprises a basic liquidity surplus, consisting of items which can be raised within 7 days and supplementary liquidity surplus, made up of items which can be raised within 7 to 30 days. 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 surplus of inflows over outflows under stress conditions.

In 2017, the Bank monitored all the liquidity standards specified in the PFSA's resolution 386/2008 dated 17 December 2008. The table below presents the liquidity standards and the average, minimum and maximum values since the beginning of the period:

31/12/2017	value at 31 December	average value during the period	period low	period high	regulatory minimum
M1	1,055,150	851,942	358,695	1,312,716	>0
M2	3.54	3.01	1.17	4.18	>1.0
M3	202.77	131.89	45.36	899.76	>1.0
M4	1.03	1.04	1.03	1.05	>1.0

31/12/2016	value at 31 December	average value during the period	period low	period high	regulatory minimum
M1	365,040	270,872	40,233	627,848	>0
M2	2.09	2.09	1.14	3.07	>1.0
M3	66.94	58.20	26.12	88.38	>1.0
M4	1.04	1.03	1.02	1.07	>1.0

(PLN THOUSAND)

The liquidity coverage ratio (LCR) is presented in the table below:

NAME OF SENSITIVITY MEASURE	31/12/2017	31/12/2016
Liquidity coverage ratio (LCR)	2520%	384%
LCR regulatory limit	100%	70%

41.2 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.

41.3 Liquidity risk forecasting and monitoring

The liquidity risk exposure of PKO Bank Hipoteczny SA at 31 December 2017 was within the strategic and internal limits set. During the reporting period, the Bank did not exceed any of the liquidity 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.

41.4 Maturity analysis of the Bank's statement of financial position excluding derivative instruments

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

Assets and liabilities by contractual maturity:

31/12/2017	to and including 1 month	over 1 month to and including 3 months	over 3 months to and including 1 year	over 1 year to and including 5 years	over 5 years	Total
Assets						
balances with Central Bank	561	-	-	-	-	561
amounts due from banks	5,350	-	-	-	-	5,350
loans and advances to customers	48,377	101,996	464,290	2,698,285	12,729,525	16,042,473
securities	100,797	-	-	614,160	115,532	830,489
other assets	17,229	-	-	-	6,154	23,383
Total assets	**172,314**	**101,996**	**464,290**	**3,312,445**	**12,851,211**	**16,902,256**
Liabilities						
amounts due to banks	-	-	2,647,926	1,477,453	-	4,125,379
amounts due to customers	2,099	-	-	-	-	2,099
mortgage covered bonds issued	-	-	-	4,102,528	4,780,685	8,883,213
unsecured bonds issued	364,083	1,048,540	1,015,402	-	-	2,428,025
equity	-	-	-	-	1,221,778	1,221,778
other liabilities	24,323	-	-	-	-	24,323
Total liabilities	**390,505**	**1,048,540**	**3,663,328**	**5,579,981**	**6,002,463**	**16,684,818**

(PLN THOUSAND)

31/12/2016	to and including 1 month	over 1 month to and including 3 months	over 3 months to and including 1 year	over 1 year to and including 5 years	over 5 years	Total
Assets						
balances with Central Bank	16,033	-	-	-	-	16,033
amounts due from banks	12,994	-	-	-	-	12,994
loans and advances to customers	25,213	53,398	243,311	1,431,341	6,494,637	8,247,900
securities	79,987	-	-	195,315	7,704	283,006
other assets	14,380	-	-	2,440	5,892	22,712
Total assets	**148,607**	**53,398**	**243,311**	**1,629,096**	**6,508,233**	**8,582,645**
Liabilities						
amounts due to banks	-	1,038,948	1,999,091	393,793	-	3,431,832
amounts due to customers	1,549	-	-	-	-	1,549
mortgage covered bonds issued	-	-	-	1,030,566	2,201,551	3,232,117
unsecured bonds issued	183,326	734,801	233,089	-	-	1,151,216
equity	-	-	-	-	781,290	781,290
other liabilities	12,336	-	-	-	-	12,336
Total liabilities	**197,211**	**1,773,749**	**2,232,180**	**1,424,359**	**2,982,841**	**8,610,340**

41.5 Maturity of contractual cash flows from derivative transactions

At the date of preparation of the financial statements, the Bank was a party to net-settled derivative IRS transactions.

The table below presents a review of the contractual maturities and shows terms to maturity broken down by the different categories of net-settled derivative instruments (inflows and outflows).

NET-SETTLED DERIVATIVE INSTRUMENTS 31/12/2017	to and including 1 month	over 1 month to and including 3 months	over 3 months to and including 1 year	over 1 year to and including 5 years	over 5 years	contractual value
Derivative instruments - liabilities						
- IRS transactions regarding which undiscounted future net cash flows are presented, including due to:	-	(1,531)	2,244	497	-	-
- derivative hedging instruments	-	(1,531)	2,244	497	-	-

In 2016, the Bank was nat a party to net-settled derivative IRS transactions.

Derivative instruments gross-settled by the Bank include:

- FX-Forward,
- Cross Currency Interest Rate Swaps (CIRS).

The table below presents a review of the contractual maturities and shows terms to maturity broken down by the different categories of gross-settled derivative instruments (inflows and outflows).

GROSS-SETTLED DERIVATIVE INSTRUMENTS 31/12/2017	to and including 1 month	over 1 month to and including 3 months	over 3 months to and including 1 year	over 1 year to and including 5 years	over 5 years	Contractual value
outflow, including due to:	13,134	26,858	127,258	3,206,997	4,542,100	7,916,347
derivative hedging instruments	13,134	26,858	127,258	3,206,997	4,542,100	7,916,347
inflow, including due to:	10,882	855	20,760	2,443,418	4,321,153	6,797,068
derivative hedging instruments	10,882	855	20,760	2,443,418	4,321,153	6,797,068

(PLN THOUSAND)

DERIVATIVE INSTRUMENTS SETTLED IN GROSS AMOUNTS 31/12/2016	to and including 1 month	over 1 month to and including 3 months	over 3 months to and including 1 year	over 1 year to and including 5 years	over 5 years	Contractual value
outflow, including due to:	-	12,166	40,056	243,280	2,195,886	2,491,389
derivative hedging instruments	-	12,166	40,056	243,280	2,195,886	2,491,389
inflow, including due to:	-	-	3,378	20,571	2,214,749	2,238,699
derivative hedging instruments	-	-	3,378	20,571	2,214,749	2,238,699

Amounts denominated in foreign currencies have been translated at the average Polish Central Bank exchange rate as at 31 December 2017. The disclosed amounts include undiscounted future cash flows both in terms of the principal amounts and interest (if applicable).

41.6 Concentration of funding sources

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

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

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

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

FUNDING STRUCTURE OF THE BANK	31/12/2017	31/12/2016
Shareholders' equity	7.2%	9.1%
Funds from parent entity	23.6%	39.9%
Issues of mortgage covered bonds	52.6%	37.6%
Issues of unsecured bonds	14.4%	13.4%
Other	2.2%	-
Total	**100.0%**	**100.0%**

The share of funding raised from the parent entity amounted to 23.5% 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 (30-day) and longer time horizons, covering the issues carried out by the Bank. During the reporting period, none of these limits was exceeded.

41.7 Liquidity stress tests

Liquidity stress tests present the impact of stressed market conditions on the level of the Bank's liquidity. Stress tests 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 home loan portfolio,
- downrating of the Bank's counterparties and of the Bank,
- inability to roll over short-term issues,
- inability to roll over covered bond issues.

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 balance sheet,
- the process of determining conditions triggering in the implementation of liquidity emergency plans of the Bank,

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

The stress tests conducted on the basis of the Bank's financial data 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 capacity to survive a liquidity crisis.

41.8 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 utilisation 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.

41.9 LIQUIDITY RISK MANAGEMENT ACTIONS

The main tools of liquidity risk management in PKO Bank Hipoteczny SA are:

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

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

42. 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 recognised as a material risk, which results from the bank's business model.

42.1 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 the repricing gap reports.

The net interest income sensitivity (NIIS) measure is a measure determining the change in the 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.

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 occurrence of the hypothetical scenarios within which parallel shifts in interest rate curves by ±50 bps, ±100 bps and ±200 bps are arbitrarily made.

(PLN THOUSAND)

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

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

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, of which:	**5,981,946**	**10,723,756**	**93,663**	**3,768**	**6,235**	-	-	**16,809,368**
balances with Central Bank	-	-	-	-	-	-	-	-
investment securities	738,153	-	92,288	-	-	-	-	830,441
amounts due from banks	-	-	-	-	-	-	-	-
loans and advances to customers	5,243,793	10,723,756	1,375	3,768	6,235	-	-	15,978,927
Liabilities, of which:	**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
deposits from customers	-	-	-	-	-	-	-	-
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
Assets due to derivatives	86	-	1,174	265	1,604	2,578,329	4,275,075	6,856,533
Liabilities due to derivatives	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)**	
Cumulative gap	**2,836,547**	**2,122,020**	**1,231,662**	**1,196,341**	**1,202,709**	**1,196,002**	**1,193,079**	

31/12/2016	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	> 5 years	Total
Assets, of which:	2,963,311	5,537,893	797	1,942	5,671	642	-	8,510,256
investment securities	285,501	-	-	-	-	-	-	285,501
amounts due from banks	-	-	-	-	-	-	-	-
loans and advances to customers	2,677,810	5,537,893	797	1,942	5,671	642	-	8,224,755
Liabilities, of which:	1,969,574	3,399,478	235,000	-	-	-	2,212,000	7,816,052
amounts due to banks	1,286,074	2,131,978	-	-	-	-	-	3,418,052
mortgage covered bonds issued	500,000	530,000	-	-	-	-	2,212,000	3,242,000
unsecured bonds issued	183,500	737,500	235,000	-	-	-	-	1,156,000
Assets due to derivatives	-	-	765	-	1,174	3,695	2,210,823	2,216,457
Liabilities due to derivatives	-	2,154,809	773	-	1,161	3,482	6,036	2,166,261
Periodic gap	**993,737**	**(16,394)**	**(234,211)**	**1,942**	**5,684**	**855**	**(7,213)**	
Cumulative gap	**993,737**	**977,343**	**743,132**	**745,074**	**750,758**	**751,613**	**744,400**	

42.2 INTEREST RATE RISK CONTROL

The control of interest rate risk involves the determination of 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.

42.3 INTEREST RATE RISK FORECASTING AND MONITORING

The interest rate risk exposure of PKO Bank Hipoteczny SA at 31 December 2017 was within the strategic and internal limits set. Following a review of the materiality of risks, given the rapidly growing balance sheet total and and increased complexity of the Bank's balance sheet, interest rate risk was found to be material. However, owing to effective mitigating activities, interest rate risk was relatively low and caused by the mismatch between the repricing dates of the interest rates on assets and liabilities of the bank in the shortest repricing bands, i.e. up to 3 months.

(PLN THOUSAND)

42.4 INTEREST RATE RISK REPORTING

The Bank prepares reports concerning interest rate risk on a daily, weekly, monthly and quarterly basis. Reports containing information about the exposure to interest rate risk and information about the utilisation 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.

42.5 INTEREST RATE RISK MANAGEMENT ACTIONS

The main tools of interest rate risk management in PKO Bank Hipoteczny SA are as follows:

- procedures concerning the management of interest rate risk,
- limits and thresholds 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,
- 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 a needs basis, enters into hedging transactions (derivative contracts).

43. 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 as potentially material and not requiring to be covered with internal capital.

In the process of management of foreign exchange risk, 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 even of an extraordinary situation in the FX market. The Bank uses hypothetical scenarios – which assume a hypothetical appreciation or depreciation of currency rates (by 20 per cent and 50 per cent).

FX POSITION	31/12/2017	31/12/2016
EUR	31.6	0.3
USD	0.7	0.1
CHF	-	-
GBP	-	-

The foreign exchange risk exposure of PKO Bank Hipoteczny SA at 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 at 31 December 2017 was immaterial.

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 utilisation 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 main tools for the management of foreign exchange risk in PKO Bank Hipoteczny SA are as follows:

- procedures concerning the management of foreign exchange risk,

- limits and thresholds on foreign exchange risk, among other on foreign exchange positions,
- specification of the permitted types of foreign exchange transactions.

44. Business risk management

Business risk, also understood as strategic risk, is a risk of failure to achieved 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 failure to take proper action in response to changes occurring in the business environment. Business risk is considered as material risk and the aim of business risk management is to keep the risk at an acceptable level.

44.1 Business risk identification and measurement

Identification consists of recognising 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 identified by reviewing selected items of the statement of profit or loss. Business risk is measured in order to determine the scale of threats connected with the existence of business risk using set risk measures. The measurement of business risk involves the calculation of internal capital.

44.2 Business risk control

The aim of control of business risk is to strive 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, including threshold and critical values, adequate to the scale and complexity of the Bank's operations, and reviewing them on a periodic basis.

44.3 Business risk forecasting and monitoring

The aim of business risk forecasting is to define the expected scenario of changes in the income end expense items. A forecast also includes the assessment of internal capital.

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

The monitoring of business risk consists in particular of:

- a strategic business risk tolerance limit,
- the level of internal capital,
- deviations of the forecast business risk from the actual one.

44.4 Business risk reporting

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.

44.5 Business risk management actions

Management actions consist in particular of:

- reviewing and revising quarterly financial forecast 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.

45. Macroeconomic changes risk management

Macroeconomic risk is a risk of deterioration of the Bank's financial standing as a result of an adverse impact of a change in the macroeconomic conditions.

The aim of macroeconomic changes risk management is to identify the macroeconomic factors exerting substantial influence on the Bank's operations and to take action to mitigate the adverse impact of potential changes in the macroeconomic situation on the Bank's financial standing.

Macroeconomic changes risk is considered as potentially material. The risk materialises indirectly in other risks affecting the Bank's operations in:

- credit losses,
- losses incurred as a result of adverse changes in the market situation (changes in property prices, interest rates, foreign exchange rates),
- a drop in the Bank's liquidity level,
- losses incurred as a result of materialisation of operational risk,
- other losses.

As part of management of macroeconomic changes risk, the Bank:

- defines scenarios of potential macroeconomic changes and the risk factors having the greatest influence on the Bank's financial position,
- uses risk measures based on the result of comprehensive stress tests, determined in relation to adopted norms (e.g. limit levels) or the result of the baseline scenario,
- determines the acceptable level of the macroeconomic changes risk aligned with the scale of the Bank's business and its impact on the Bank's operation and financial position,
- assesses the Bank's sensitivity to macroeconomic changes,
- prepares managerial reporting on macroeconomic changes risk,
- takes necessary actions concerning the development or updating of internal policies.

46. Model risk management

Model risk is a risk of losses as a result of wrong business decision 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 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.

46.1 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.

46.2 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 and model risk thresholds.

46.3 Model risk forecasting and monitoring

The aim of model risk monitoring is to diagnose the areas requiring management action. Model risk monitoring includes in particular:

- updating the model risk level,

- evaluation of utilisation of the strategic limit of model risk and the values of the model risk thresholds,
- verification of the status of implementation and evaluation of the effectiveness of the model risk mitigating actions.

46.4 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 utilisation 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.

46.5 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.

47. OPERATIONAL RISK MANAGEMENT

Operational risk is defined as the risk of 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 realised 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 of operational risk (KRI) and data related to the quality of functional internal control.

Taking into account the scale of outsourcing and its potential impact on the operational risk profile, the Bank has prepared an appropriate risk management process related to the 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 the Bank, assessment of the reliability and financial position of the service providers, creation of contingency plans for the Bank and its service providers (in particular, in the IT field), implementation of adequate safeguards of the interests of the Bank in outsourcing agreements, requirements for an appropriate insurance coverage of the outsourcing counterparty, monitoring of proper execution of contracts and the outsourcing counterparty's position, including their periodic verification, recording of incidents and losses related to the realization of services by outsourced service providers.

47.1 OPERATIONAL RISK MEASUREMENT AND ASSESSMENT

The Bank measures operational risk in order to determine the scale of threats connected with the existence of operational risk using set risk measures. The measurement of operational risk involves:
- calculation of key risk indicators (KRI),
- calculation of the own funds requirement for operational risk under the BIA approach (BIA requirement),
- stress testing,
- calculation of internal capital.

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

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

47.2 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 the determination of risk limits appropriate for the scale and complexity of the Bank's operations, in particular strategic operational risk tolerance limits and KRI limits, along with threshold and critical values.

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

47.3 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.

47.4 Operational risk reporting

Operational risk information is reported for:

- internal purposes of the Bank, particularly: of 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.

47.5 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 elimination 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.

47.6 Operational losses incurred

In 2017, certain operational risk events were uncovered in the Bank, which involved operational losses for the total net amount of PLN 117 thousand.

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

48. Compliance risk management

Compliance risk is defined at PKO Bank Hipoteczny 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 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 sanction and and cases of reputation loss, 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 for internal processes 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 identification and evaluation of compliance risk is carried out periodically by the so-called owners of internal processes, in cooperation with the ComplianceTeam and in particular includes:

- estimation of the potential severity of the consequences non-compliance cases in the form of:
  - financial losses, particularly in form of administrative penalties or damages,
  - the 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,
- cases of non-compliance - their causes and consequences,
- the actions taken by the Bank as part of:
  - compliance risk management,
  - the implementation of the recommendations issued by internal auditors and external inspectors,
  - bringing the Bank to compliance with new legislation and standards of conduct,
  - the fulfilment of the Compliance Team's recommendations,
- the 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.

The 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 Committee. Reports contain, among other things, 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 Bank has adopted a zero tolerance policy on compliance risk, which means that the Bank focuses its efforts on prevention from compliance risk materialisation.

49. Reputation risk management

The 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 events, 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 reputation of the Bank.

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

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

A control of reputation risk involves the determination of 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 of 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 managment 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.

50. 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 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 of the policies regarding capital sourcing.

Capital risk is the risk of failure to arrange for the adequate level and structure of own funds or the inability to ensure the adequate level of equity given the business risk borne by the Bank, necessary to cover unexpected losses and satisfying the regulatory requirements making it possible for the Bank to continue operating by itself. Capital risk includes the risk of excessive leverage, i.e. the risk resulting from vulnerability to threats 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.

The capital adequacy management consists of:

- 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 2017:

- 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"),
- Banking Act of 29 August 1997 "Banking Act",
- Act of 5 August 2015 on macroprudential supervision over the financial system and crisis management in the financial system ("Macroprudential Act"),
- 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 the Polish law by way of updating the Banking Act.

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

- defining and achieving the capital adequacy targets desired by the Bank,
- identification and monitoring of 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 potentially material risk. In 2017 and since the start of the Bank's operations, the capital adequacy remained at a safe level above the supervisory limits.

At 31 December 2017, the total capital ratio of the Bank amounted to 15.2%.

50.1 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 Regulation with implementing legislation.

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

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BANK'S OWN FUNDS	31/12/2017	31/12/2016
Share capital	1,200,000	800,000
retained earnings	(749)	(13,973)
profit for the year	51,419	13,224
other comprehensive income - hedge accounting	(31,372)	(17,715)
other comprehensive income - available for sale	2,480	(246)
Shareholders' equity	**1,221,778**	**781,290**
Equity adjustments	(27,155)	(1,025)
profit for the year	(51,419)	(13,224)
other comprehensive income - hedge accounting	31,372	17,715
intangible assets	(5,584)	(5,312)
adjutments to assets measured at fair value (AVA)	(871)	(203)
transitional period adjustment	(653)	(1)
Own funds	**1,194,623**	**780,265**

50.2 Capital buffer

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 will be 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 recognised as other 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).

50.3 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 Bank's own funds.

The Bank calculates financial leverage according to the CRR Regulation.

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

FINANCIAL LEVERAGE	31/12/2017	31/12/2016
Leverage ratio (LR)	6.9%	8.8%

At 31 December 2017, the financial leverage ratio of the Bank was above the 3% level recommended for the banks by the Basel Committee.

50.4 Requirements regarding own funds (Pillar I)

50.4.1 General information

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 standardised approach,
- credit valuation adjustment (CVA) risk – according to the standardised approach,
- settlement and delivery risk – according to the standardised approach,
- operational risk– according to the basic indicator approach (BIA),
- market risk (foreign exchange risk only) – according to basic methods.

At 31 December 2017, the own funds requirements concerning the risk of credit valuation adjustment, settlement and delivery and market risk were zero, therefore the total requirement for own funds was comprised of the requirements for credit and operational risk.

REQUIREMENTS REGARDING OWN FUNDS	31/12/2017	31/12/2016
Credit risk	611,860	359,120
Operational risk	15,062	4,950
Total own funds requirement	626,922	364,070
Common Equity Tier 1 capital ratio (CET1)	15.2%	17.1%
Tier 1 capital ratio (T1)	15.2%	17.1%
Total capital ratio (TCR)	**15.2%**	**17.1%**

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

31/12/2017	Gross exposure	Exposure value[1)]	Risk-weighted assets	Own funds requirement
Retail exposures[2)]	5,043,011	4,730,680	3,548,010	283,841
Exposures secured by mortgages on immovable property	11,684,628	11,654,251	4,078,988	326,319
Exposures to central governments or central banks	831,050	831,050	-	-
Exposures to institutions	455,113	455,113	-	-
Exposures in default	2,834	2,817	3,511	281
Other items	17,733	17,733	17,733	1,419
Total	**18,034,368**	**17,691,644**	**7,648,242**	**611,860**

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31.12.2016	Gross exposure	Exposure value[1)]	Risk-weighted assets	Own funds requirement
Retail exposures[2)]	3,966,230	3,686,806	2,765,104	221,208
Exposures secured by mortgages on immovable property	4,895,222	4,868,628	1,704,020	136,322
Exposures to central governments or central banks	301,479	301,479	6,099	488
Exposures to institutions	208,098	208,098	-	-
Exposures in default	-	-	-	-
Other items	13,774	13,774	13,774	1,102
Total	**9,384,803**	**9,078,785**	**4,488,997**	**359,120**

[1)] The value of balance-sheet exposures and the balance-sheet equivalent of off-balance sheet obligations and contingent obligations, taking into account specific credit risk adjustments and CCF (Credit Conversion Factor).
[2)] These result from part of the exposure that is not fully and completely secured, i.e. which exceeds a BHWN of 80% or is in a transitional period, i.e. until collateral is established.

50.4.2 Credit risk adjustments

For the purposes of specific credit risk adjustments, the Bank uses impairment loss, which was included in the Banks's core Tier 1 capital in accordance with the CRR Regulation and the implementing legislation.

The approach applied by the Bank to identify exposures at risk of impairment and methods of estimating impairment loss and provisions for off-balance sheet credit exposures are described in Note38.3 "Impairment of loan exposures" and 38.4 “Impairment assessment approaches."

50.4.3 Use of credit risk mitigation techniques

The Bank uses mortgage collateral for the purposes of classification of exposures to classes of exposures secured by mortgages on immovable property and the use of preferential risk weighting. Detailed information about the main types of collateral accepted by the Bank and the method of determining the property value for mortgage lending purposes is described in Note 40 “Residual risk management".

50.5 Internal capital (Pillar II)

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

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

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

- credit risk,
- liquidity risk,
- operational risk,
- business risk,
- model risk,
- interest rate risk.

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

At 31 December 2017, the relationship between the Bank’s own funds and internal capital remained above the statutory and the internal limits.

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

50.6 Disclosures (Pillar III)

Considering the scale and the specific nature of the Bank's operations, the Bank discloses, in the financial statements and the Management Report, information about:

- the objectives and strategies to manage risk,
- own funds for the purpose of capital adequacy,
- capital buffers,
- leverage ratio,
- capital requirements,
- credit risk adjustments,
- use of credit risk mitigation techniques,
- remuneration policy for those categories of staff whose professional activities have a material impact on Bank's risk profile,
- the requirements referred to in Article 111a of the Banking Act and Recommendation H,
- operational risk in accordance with Recommendation M,
- the liquidity risk management system and the liquidity position in accordance with Recommendation P.

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

Details of the disclosures made, the methods of verification and publication of the disclosures concerning capital adequacy and other information subject to disclosure are presented in the "Information Policy of PKO Bank Hipoteczny SA", which is available on the Bank's website (www.pkobh.pl).

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EVENTS AFTER THE REPORTING PERIOD

51. EVENTS AFTER THE REPORTING PERIOD

During the period from 1 January 2018 to the date of signing of these financial statements, i.e. 20 February 2018, PKO Bank Hipoteczny SA conducted issues of unsecured bonds of the total nominal value of PLN 734,100 thousand, while at the same time unsecured bonds of the total nominal value of PLN 552,300 thousand matured and were redeemed. The unsecured bonds issues were conducted under the Bond Issue Programme established by PKO Bank Hipoteczny SA on 30 September 2015 for the issuance of bonds of up to PLN 3,000,000 thousand. The issued bonds mature for redemption between 13 March 2018 and 8 February 2019.

On 15 January 2018, Mr Bartosz Drabikowski handed in his resignation from the position of member of the Supervisory Board as of 15 January 2018.

On 9 February 2018, the Extraordinary General Meeting of the Bank appointed Mr Rafał Kozłowski into the Supervisory Board of the Bank as of 9 February 2018.

Signatures of all the Members of the Management Board

20/02/2018	Jakub Niesłuchowski	acting President of the Management Board Vice President of the Management Board	*Signed on the Polish original* .... (signature)
20/02/2018	Agnieszka Krawczyk	Vice President of the Management Board	*Signed on the Polish original* .... (signature)
20/02/2018	Marek Szcześniak	Vice President of the Management Board	*Signed on the Polish original* .... (signature)

Signature of the person in charge of accounting

20/02/2018

Tomasz Rynkowski
Director, Chief Accountant of the Bank

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