

## SELECTED FINANCIAL DATA RELATING TO THE FINANCIAL STATEMENTS



SELECTED FINANCIAL DATA	in PLN'000		in EUR'000	
	period from 01.01.2019 to 31.12.2019	period from 01.01.018 to 31.12.2018	period from 01.01.2019 to 31.12.2019	period from 01.01.018 to 31.12.2018
Net interest income	316,665	249,486	73,612	58,470
Net fee and commission income	(5,888)	(4,785)	(1,369)	(1,121)
Operating profit	135,123	122,215	31,411	28,643
Profit before tax	135,123	122,215	31,411	28,643
Net profit	89,170	85,849	20,728	20,120
Net earnings per share - basic (in PLN/EUR)	0.06	0.07	0.01	0.02
Net earnings per share - diluted (in PLN/EUR)	0.06	0.07	0.01	0.02
Total net comprehensive income	163,271	178,630	37,954	41,864
Net cash used in operating activities	(4,390,657)	(4,966,322)	(1,020,656)	(1,163,918)
Net cash used in investing activities	(377,256)	5,436	(87,697)	1,274
Net cash used in financing activities	4,767,936	4,955,003	1,108,358	1,161,265
Total net cash flows	23	(5,883)	5	(1,379)

SELECTED FINANCIAL DATA	in PLN'000		in EUR'000	
	as at 31.12.2019	as at 31.12.2018	as at 31.12.2019	as at 31.12.2018
Total assets	27,253,301	22,103,134	6,399,742	5,140,264
Total equity	2,000,023	1,487,883	469,654	346,019
Share capital	1,611,300	1,295,000	378,373	301,163
Number of shares (in thousands)	1,611,300	1,295,000	1,611,300	1,295,000
Book value per share (in PLN/EUR)	1.24	1.15	0.29	0.27
Diluted number of shares (in thousands)	1,611,300	1,295,000	1,611,300	1,295,000
Diluted book value per share (in PLN/EUR)	1.24	1.15	0.29	0.27
Total capital ratio (TCR)	16.6%	15.2%	16.6%	15.2%
Common equity Tier 1 (CET1)	1,820,780	1,393,847	427,564	324,150
Total own funds	1,820,780	1,393,847	427,564	324,150

Selected consolidated financial statement items have been translated to EUR at the following foreign exchange rates	
items of the income statement, statement of comprehensive income and statement of cash flows items - the average of the NBP exchange rates prevailing as at the last day of each month of the reporting period	01.01.2019 - 31.12.2019 4.3018
	01.01.2018 - 31.12.2018 4.2669
items of the statement of financial position - the average NBP exchange rate as at the last day of the reporting period	31.12.2019 4.2585
	31.12.2018 4.3000

Financial statements  
of PKO Bank Hipoteczny SA  
for the year ended  
31 December 2019

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## INCOME STATEMENT

INCOME STATEMENT	Note	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Interest income, including:	6	862,413	667,595
Interest income recognized under the effective interest rate method		860,820	666,411
Income similar to interest income on instruments measured at fair value through profit or loss		1,593	1,184
Interest expense	6	(545,748)	(418,109)
<b>Net interest income</b>		<b>316,665</b>	<b>249,486</b>
Fee and commission income	7	15,495	14,769
Fee and commission expense	7	(21,383)	(19,554)
<b>Net fee and commission income</b>		<b>(5,888)</b>	<b>(4,785)</b>
Net gain/(loss) on financial instruments measured at fair value through profit or loss	8	65	89
Net foreign exchange gains / (losses)	9	(1,803)	(238)
Net gain / (loss) on modification	10	455	(439)
Net expected credit losses	11	(14,708)	(8,703)
Other operating income		499	613
Other operating expenses		(930)	(559)
<b>Net other operating income and expense</b>	12	<b>(431)</b>	<b>54</b>
Administrative expenses	13	(51,385)	(45,616)
Cost of regulatory charges	14	(24,745)	(6,868)
Tax on certain financial institutions	15	(83,102)	(60,765)
<b>Operating profit</b>		<b>135,123</b>	<b>122,215</b>
<b>Profit before tax</b>		<b>135,123</b>	<b>122,215</b>
Income tax expense	16	(45,953)	(36,366)
<b>Net profit</b>		<b>89,170</b>	<b>85,849</b>
Earnings per share - basic (PLN)	17	0.06	0.07
Earnings per share - diluted (PLN)	17	0.06	0.07
Weighted average number of ordinary shares during the period (in thousands)		1,495,022	1,222,123
Weighted average diluted number of ordinary shares during the period (in thousands)		1,495,022	1,222,123



## STATEMENT OF COMPREHENSIVE INCOME

STATEMENT OF COMPREHENSIVE INCOME	Note	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
<b>Net profit</b>		89,170	85,849
<b>Other comprehensive income</b>		74,101	92,781
<b>Items which may be reclassified to profit or loss</b>		74,101	92,781
Cash flow hedges (gross)		92,542	112,141
Deferred tax		(17,583)	(21,307)
Cash flow hedges (net)	20	74,959	90,834
Remeasurement of financial assets measured at fair value through other comprehensive income (gross)		(1,059)	2,404
Deferred tax		201	(457)
Remeasurement of financial assets measured at fair value through other comprehensive income (net)		(858)	1,947
<b>Total net comprehensive income</b>		163,271	178,630



## STATEMENT OF FINANCIAL POSITION

STATEMENT OF FINANCIAL POSITION	Note	31.12.2019	31.12.2018
<b>ASSETS</b>			
Cash and balances with the Central Bank	18	20	6
Amounts due from banks	19	31	22
measured at amortized cost		31	22
Derivative hedging instruments	20	173,275	168,289
Securities	21	1,240,161	842,965
measured at fair value through other comprehensive income		1,240,161	842,965
Loans and advances to customers	22	25,821,070	21,070,469
measured at amortized cost		25,821,070	21,070,469
Intangible assets	24	2,395	4,165
Property, plant and equipment	24	5,271	449
Other assets	25	11,078	16,769
<b>TOTAL ASSETS</b>		<b>27,253,301</b>	<b>22,103,134</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Liabilities</b>			
Amounts due to banks	26	4,811,259	4,292,286
measured at amortized cost		4,811,259	4,292,286
Derivative hedging instruments	20	46,084	15,254
Amounts due to customers	27	4,885	4,359
measured at amortized cost		4,885	4,359
Mortgage covered bonds issued	28	16,239,975	12,841,500
measured at amortized cost		16,239,975	12,841,500
Unsecured bonds issued	29	4,060,026	3,311,148
measured at amortized cost		4,060,026	3,311,148
Other liabilities	30	35,960	121,974
Current income tax liabilities	16	11,373	3,159
Deferred income tax provision	16	43,422	25,303
Provisions	31	294	268
<b>TOTAL LIABILITIES</b>		<b>25,253,278</b>	<b>20,615,251</b>
<b>Equity</b>			
Share capital	32	1,611,300	1,295,000
Supplementary capital		161,563	54,932
Accumulated other comprehensive income		137,990	63,889
Retained earnings		-	(11,787)
Net profit for the period		89,170	85,849
<b>TOTAL EQUITY</b>		<b>2,000,023</b>	<b>1,487,883</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>27,253,301</b>	<b>22,103,134</b>
Total capital ratio (TCR)	52	16.6%	15.2%
Book value (in PLN '000)		2,000,023	1,487,883
Number of shares (in thousands)	32	1,611,300	1,295,000
Book value per share (in PLN)		1.24	1.15
Diluted number of shares (in thousands)		1,611,300	1,295,000
Diluted book value per share (in PLN)		1.24	1.15

## STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2019	Note	Share capital	Supplementary capital	Accumulated other comprehensive income			Net profit for the period	Total equity
				Cash flow hedges	Financial assets measured at fair value through other comprehensive income	Retained earnings		
As at 31 December 2018		1,295,000	54,932	59,462	4,427	(11,787)	85,849	1,487,883
Issue of series I shares	32	100,000	-	-	-	-	-	100,000
Issue of series J shares	32	131,500	17,741	-	-	-	-	149,241
Issue of series K shares	32	84,800	14,828	-	-	-	-	99,628
Transfer of profit to retained earnings		-	-	-	-	85,849	(85,849)	-
Transfer of profit to equity		-	74,062	-	-	(74,062)	-	-
Total comprehensive income, including:		-	-	74,959	(858)	-	89,170	163,271
Net profit		-	-	-	-	-	89,170	89,170
Other comprehensive income		-	-	74,959	(858)	-	-	74,101
As at 31 December 2019	32	1,611,300	161,563	134,421	3,569	-	89,170	2,000,023

FOR THE YEAR ENDED 31 DECEMBER 2018	Note	Share capital	Supplementary capital	Accumulated other comprehensive income			Net profit for the period	Total equity
				Cash flow hedges	Financial assets measured at fair value through other comprehensive income	Retained earnings		
As at 31 December 2017		1,200,000	-	(31,372)	2,480	(749)	51,419	1,221,778
Changes due to IFRS 9 implementation		-	-	-	-	(11,787)	-	(11,787)
As at 1 January 2018 (restated)	32	1,200,000	-	(31,372)	2,480	(12,536)	51,419	1,209,991
Issue of series H shares	32	95,000	4,262	-	-	-	-	99,262
Transfer of profit to retained earnings		-	-	-	-	51,419	(51,419)	-
Transfer of profit to equity		-	50,670	-	-	(50,670)	-	-
Total comprehensive income, including:		-	-	90,834	1,947	-	85,849	178,630
Net profit		-	-	-	-	-	85,849	85,849
Other comprehensive income		-	-	90,834	1,947	-	-	92,781
As at 31 December 2018		1,295,000	54,932	59,462	4,427	(11,787)	85,849	1,487,883





## STATEMENT OF CASH FLOWS

STATEMENT OF CASH FLOWS	Note	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
<b>Cash flows from operating activities</b>			
Profit before tax		135,123	122,215
<b>Total adjustments:</b>		<b>(4,525,780)</b>	<b>(5,088,537)</b>
Depreciation charge		3,249	2,177
Interest on mortgage covered bonds issued, unsecured bonds issued and loans obtained		201,371	132,334
Change in derivative financial instruments (asset)		(4,986)	(167,951)
Change in loans and advances to customers (gross)		(4,765,054)	(5,051,060)
Change in other assets and right-of-use assets		4,935	460
Change in amounts due to banks		(21,880)	(188,873)
Change in derivative financial instruments (liability)		30,830	(202,523)
Change in amounts due to customers		526	2,260
Change in liabilities in respect of mortgage covered bonds issued		(106,181)	249,777
Change in liabilities in respect of bonds issued		72,690	59,338
Change in allowances for expected credit losses and provisions		14,479	8,642
Change in other liabilities, excluding liabilities in respect of unregistered issues of own shares		9,822	4,533
Income tax paid		(37,002)	(33,646)
Other adjustments (including changes in the measurement of securities and derivative instruments recognized in other comprehensive income)		71,421	95,995
<b>Net cash used in operating activities</b>		<b>(4,390,657)</b>	<b>(4,966,322)</b>
<b>Cash flows from investing activities</b>			
<b>Inflows from investing activities</b>		<b>641,620</b>	<b>195,325</b>
Disposal of and interest on securities measured at fair value through other comprehensive income		641,620	195,325
<b>Outflows on investing activities</b>		<b>(1,018,876)</b>	<b>(189,889)</b>
Acquisition of securities measured at fair value through other comprehensive income		(1,018,758)	(189,252)
Acquisition of intangible assets and property, plant and equipment		(118)	(637)
<b>Net cash used in investing activities</b>		<b>(377,256)</b>	<b>5,436</b>
<b>Cash flows from financing activities</b>			
Proceeds from issue of own shares and payments towards issue of own shares		248,869	199,262
Proceeds from issue of mortgage covered bonds		3,504,656	3,708,510
Proceeds from issue of bonds		7,624,688	7,771,985
Redemption of bonds issued		(6,948,500)	(6,948,200)
Proceeds from loans obtained		11,096,009	5,380,879
Proceeds from loans repaid		(10,555,156)	(5,025,099)
Repayment of interest on mortgage covered bonds issued, bonds issued and loans obtained		(201,371)	(132,334)
Payments of lease liabilities (IFRS 16)		(1,259)	
<b>Net cash used in financing activities</b>		<b>4,767,936</b>	<b>4,955,003</b>
<b>Total net cash flows</b>		<b>23</b>	<b>(5,883)</b>
Cash equivalents at the beginning of the period		28	5,911
<b>Cash equivalents at the end of the period</b>	36	<b>51</b>	<b>28</b>



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## NOTES TO THE FINANCIAL STATEMENTS

### 1. GENERAL INFORMATION

#### BANKING ACTIVITIES

PKO Bank Hipoteczny Spółka Akcyjna ("PKO Bank Hipoteczny SA", "Bank") with its registered office in Gdynia, ul. Jerzego Waszyngtona 17, 81-342 Gdynia, was entered in the Register of Businesses maintained by the District Court for Gdańsk-Północ in Gdańsk, 8th Business Department of the National Court Register, with the number KRS 0000528469, on 24 October 2014. The Bank was assigned the statistical number REGON 222181030. Its share capital as at 31 December 2019 was PLN 1,611,300,000 and was fully paid up.

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

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

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

#### INDICATION AS TO WHETHER THE BANK IS A PARENT OR KEY INVESTOR AND WHETHER IT PREPARES CONSOLIDATED FINANCIAL STATEMENTS

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

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

#### INFORMATION ON THE COMPOSITION OF THE BANK'S SUPERVISORY AND MANAGEMENT BOARDS

Due to the end of the term of office of the Supervisory Board on 29 March 2019, on that same day the General Shareholders' Meeting appointed the members of the Supervisory Board for a further four-year term of office.

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

No.	Name and surname	Position	Date of appointment	Date of dismissal / resignation / end of term
1	Jakub Papierski	Chairman of the Supervisory Board	06.10.2014	-
2	Piotr Mazur	Deputy Chairman of the Supervisory Board (to 29.03.2019)	06.10.2014	29.03.2019
3	Rafał Kozłowski	Member of the Supervisory Board (from 09.02.2018 to 17.04.2019) / Deputy Chairman of the Supervisory Board (from 17.04.2019 to 31.08.2019)	09.02.2018	31.08.2019
4	Paweł Metrycki	Member of the Supervisory Board (from 30.03.2019 to 07.10.2019) / Deputy Chairman of the Supervisory Board (from 07.10.2019)	30.03.2019	-
5	Justyna Borkiewicz	Member of the Supervisory Board	28.10.2016	-
6	Artur Kluczny	Member of the Supervisory Board (independent)	18.10.2017	31.08.2019
7	Lucyna Kopińska	Member of the Supervisory Board	01.09.2019	-
8	Mieczysław Król	Member of the Supervisory Board	28.10.2016	29.03.2019
9	Piotr Kwiecień	Member of the Supervisory Board (independent)	18.10.2017	-
10	Jadwiga Lesisz	Member of the Supervisory Board (independent)	01.09.2019	-
11	Dariusz Odzioba	Member of the Supervisory Board	01.09.2019	-
12	Jan Emeryk Rościszewski	Member of the Supervisory Board	18.10.2017	31.08.2019
13	Ilona Wołyniec	Member of the Supervisory Board	30.03.2019	-

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

No.	Name and surname	Position	Date of appointment	Date of dismissal / resignation / end of term
1	Paulina Strugała	President of the Management Board	16.04.2018	-
2	Piotr Kochanek	Vice-President of the Management Board	01.01.2019	-
3	Agnieszka Krawczyk	Vice-President of the Management Board	01.01.2018	-
4	Jakub Niesłuchowski	Vice-President of the Management Board	01.04.2015	28.02.2019

## 2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

The financial statements of the Bank cover the year ended 31 December 2019 and comprise the comparative data for the year ended 31 December 2018. The financial data is presented in thousands of Polish zlotys (PLN), rounded to a thousand, unless otherwise indicated.

### 2.1 STATEMENT OF COMPLIANCE

These financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) as at 31 December 2019, and in the areas not regulated by these standards, in accordance with the requirements of the Accounting Act of 29 September 1994 and implementing regulations issued on the basis of the said Act, and the requirements applicable to issuers of securities admitted or seeking admission to trading on the official stock exchange.

### 2.2 GOING CONCERN

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

### 2.3 BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

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

Property, plant and equipment and intangible assets are stated at cost, less accumulated depreciation/amortization and impairment allowances.

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

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

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

Estimates and assumptions made by the Bank are subject to reviews on an on-going basis. Adjustments to estimates are recognized in the periods in which the estimates were adjusted, provided that these adjustments only affect

a given period. If the adjustments affect both the period in which the adjustment was made and future periods, they are recognized in the period in which the adjustments were made and in future periods.

## 2.4 MANAGEMENT REPRESENTATION

The Management Board hereby represents that, to the best of its knowledge, these financial statements and the comparative data have been prepared in accordance with the applicable rules of accounting practice and give a true, fair and clear view of the Bank's financial position and results of operations.

## 2.5 APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements, having been reviewed with an opinion issued by the Audit and Finance Committee of the Supervisory Board and evaluated by the Supervisory Board on 7 February 2020, were approved by the Bank's Management Board for publication on 7 February 2020.

## 3. DESCRIPTION OF MAJOR ACCOUNTING POLICIES

The most important accounting policies, estimates and judgements applied when preparing these financial statements have been presented in the individual notes to the financial statements. These accounting policies were applied consistently in all the reporting periods presented, excluding changes relating to the implementation of IFRS 16 Leases.

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

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

STATEMENT OF FINANCIAL POSITION	Note	Accounting policies <sup>1)</sup>	Major estimates and judgments <sup>1)</sup>
Cash and balances with the Central Bank	18	Y	
Amounts due from banks	19	Y	
Derivative hedging instruments	20	Y	Y
Securities	21	Y	
Loans and advances to customers	22	Y	Y
Intangible assets	24	Y	Y
Property, plant and equipment, including right-of-use assets	24	Y	Y
Other assets	25	Y	
Amounts due to banks	26	Y	
Amounts due to customers	27	Y	
Mortgage covered bonds issued	28	Y	
Unsecured bonds issued	29	Y	
Other liabilities	30	Y	
Provisions	31	Y	Y
Equity	32	Y	

<sup>1)</sup> The letter Y indicates the presence of a particular accounting policy or major estimates and judgements.



### 3.1 FOREIGN CURRENCIES

#### 3.1.1. FUNCTIONAL CURRENCY AND CURRENCY OF PRESENTATION

The financial statements are presented in Polish zlotys (PLN), which are the Bank's functional currency and currency of presentation.

#### 3.1.2. TRANSACTIONS AND BALANCES IN FOREIGN CURRENCIES

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

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

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

### 3.2 ACCOUNTING FOR TRANSACTIONS

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

### 3.3 DERECOGNITION OF FINANCIAL INSTRUMENTS FROM THE STATEMENT OF FINANCIAL POSITION

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

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

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

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

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

### 3.4 CLASSIFICATION AND MEASUREMENT OF FINANCIAL INSTRUMENTS

#### 3.4.1. THE PRINCIPLES FOR CLASSIFICATION OF FINANCIAL INSTRUMENTS

The Bank classifies its financial assets to one of the following categories:

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





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

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

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

#### BUSINESS MODEL

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

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

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

#### ASSESSMENT OF THE CHARACTERISTICS RESULTING FROM CONTRACTUAL CASH FLOWS

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

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

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

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

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

#### CATEGORY OF MEASUREMENT OF FINANCIAL ASSETS AT AMORTIZED COST

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

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

The initial value of a financial asset measured at amortized cost is adjusted by all commissions and fees with an impact on its effective return which constitute an integral part of the effective interest rate on the asset (commissions and fees arising as a result of the Bank conducting activities which lead to the origination of the asset). Commissions

and fees which arise after the date of the financial asset being established lead to changes in future cash flow schedules generated by the assets.

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

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

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

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

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

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

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

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

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

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

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

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

1) held for trading – financial assets which:

- have been purchased mainly to sell or redeem in the foreseeable future; or
- upon initial recognition constitute part of a portfolio of specific financial instruments which are managed jointly and for which there is evidence that they currently generate short-term profits; or
- are derivative financial instruments (with the exception of derivatives which are financial guarantee agreements or designated and effective hedges);

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

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

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





### 3.4.2. CHANGE IN CLASSIFICATION OF FINANCIAL ASSETS

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

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

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

### 3.4.3. CHANGES IN THE ESTIMATED CONTRACTUAL CASH FLOWS – MODIFICATIONS

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

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

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

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

The adopted **QUALITATIVE CRITERIA** are as follows:

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

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

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

If the quantitative criterion (difference) exceeds 10%, the modification is considered material, however, if the quantitative criterion is not equal to or less than 10%, the modification is considered immaterial.



#### 3.4.4. MEASUREMENT OF PURCHASED OR ORIGINATED CREDIT IMPAIRED FINANCIAL ASSETS (POCI)

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

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

#### 3.4.5. GAINS/(LOSSES) ON DERECOGNITION OF FINANCIAL INSTRUMENTS NOT MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

Gains/(losses) on derecognition of financial assets and financial liabilities not measured at fair value through profit or loss (including gains or losses resulting from sale or significant modification) are recognized in "Gains/(losses) on derecognition of financial assets and financial liabilities not measured at fair value through profit or loss".

Net income/(expense) on insignificant modification of financial assets is recognized in "Net income/(expense) on modification".

Both the above-mentioned income statement items are presented by financial instrument:

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

### 4. CHANGES TO ACCOUNTING POLICIES

#### 4.1 IFRS 16 LEASES

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

The new standard introduced one model for accounting for leases in the lessee's accounts, consistent with the accounting for financial leases under IAS 17. According to IFRS 16, a contract is a lease or contains a lease if it transfers the right to use an identified asset for a given period in exchange for consideration.

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

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

Expenses relating to the use of leased assets which were previously charged to non-personnel costs are currently classified as depreciation and interest expense.

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

#### IMPACT OF IFRS 16 ON THE FINANCIAL STATEMENTS

As part of the IFRS 16 implementation project, analyses were conducted of all operating lease, rent and hire agreements. In addition, agreements for the purchase of services (external services costs incurred as part of operating activities) were analysed for the existence of the right of use of an identified asset.

As part of the project, the Bank amended its accounting policies and operational procedures as appropriate. Methodologies were developed and implemented for the correct identification of agreements which represent leases and for collecting the data necessary to accurately account for such transactions.



The Bank adopted the standard as of 1 January 2019. In accordance with the transitional provisions of IFRS 16, the new policies were adopted retrospectively. Consequently, the comparative data for the reporting year 2018 were not restated (modified retrospective approach).

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

#### RECOGNITION OF LEASE LIABILITIES

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

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

- fixed lease payments less any lease incentives due;
- variable lease payments that depend on market indices;
- amounts expected to be paid by the lessee as the guaranteed residual value;
- the price for exercising the purchase option if it is reasonably certain that it will be exercised;
- payments of penalties for terminating the lease, if the lessee is able to exercise an option to terminate the lease.

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

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

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

#### RECOGNITION OF RIGHT-OF-USE ASSETS

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

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

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

#### APPLICATION OF ESTIMATES

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

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

#### APPLICATION OF PRACTICAL EXPEDIENTS

Upon first-time application of IFRS 16, the Bank applied the following practical expedients permitted by the standard by applying a single discount rate to a portfolio of lease contracts with similar characteristics.

#### IMPACT ON THE STATEMENT OF FINANCIAL POSITION

The impact of applying, as at 1 January 2019, IFRS 16 on the recognition of additional financial liabilities and right-of-use assets is presented in the table below:

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

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

<b>OPERATING LEASE LIABILITIES</b>	5,297
<b>AS AT 31 DECEMBER 2018 (NOT DISCOUNTED)</b>	
Agreements whose assessment changed and are treated as service contracts since 1 January 2019	(56)
Impact of discount	(486)
Adjusted for the difference in the recognition of the extension/termination option, including notice period	672
<b>LEASE LIABILITIES</b>	5,427
<b>AS AT 1 JANUARY 2019</b>	

#### IMPACT ON THE INCOME STATEMENT

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

#### 4.2 OTHER AMENDMENTS TO THE PUBLISHED STANDARDS AND INTERPRETATIONS WHICH BECAME BINDING AS OF 1 JANUARY 2019

The implementation of new standards and interpretations and amendments thereto, which became binding on 1 January 2019, such as, among other things, changes to IFRS 9 *Financial Instruments*, IAS 28 *Investments in Associates and Joint Ventures*, IAS 19 *Employee Benefits*, IFRIC 23 *Uncertainty over Income Tax Treatments*, and Changes to IFRS 2015–2017, apart from IFRS 16 *Leases*, as described in chapter 4.1, did not have a material impact on these financial statements.

#### 4.3 NEW STANDARDS AND INTERPRETATIONS, AND AMENDMENTS THERETO, WHICH HAVE BEEN PUBLISHED AND HAVE BEEN APPROVED BY THE EUROPEAN UNION, BUT ARE NOT YET BINDING AND HAVE NOT BEEN APPLIED BY THE BANK

Changes to: IAS 1 *Presentation of Financial Statements*, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, IFRS 9 *Financial Instruments*, IAS 39 *Financial Instruments*, IFRS 7 *Financial Instruments: IAS Disclosures and References to the IFRS Conceptual Framework* should not have a material impact on the Bank's financial statements.

#### 4.4 NEW STANDARDS AND INTERPRETATIONS, AS WELL AS THEIR AMENDMENTS, WHICH WERE PUBLISHED AND HAVE NOT YET BEEN APPROVED BY THE EUROPEAN UNION

Changes to IFRS 3 *Business Combinations*, IAS 1 *Presentation of Financial Statements*, *Classification of liabilities as current and non-current*, and the implementation of IFRS 17 *Insurance Contracts* will not have a material impact on the Bank's financial statements.

## 5. EXPLANATION OF THE DIFFERENCES BETWEEN PREVIOUSLY PUBLISHED FINANCIAL STATEMENTS AND THESE FINANCIAL STATEMENTS

To better reflect the information in the condensed interim financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2019, the Bank made the following changes to recognition and presentation:

INCOME STATEMENT	01.01.2018 - 31.12.2018 before restatement	separate presentation of "Cost of regulatory charges"	01.01.2018 - 31.12.2018 restated
Administrative expenses	(52 484)	6 868	(45 616)
Cost of regulatory charges	-	(6 868)	(6 868)
<b>Total</b>	<b>(52 484)</b>	<b>-</b>	<b>(52 484)</b>



## NOTES TO THE INCOME STATEMENT

### 6. INTEREST INCOME AND EXPENSES

#### ACCOUNTING POLICIES

Interest income and expense includes interest, including premium and discount on financial instruments measured at amortized cost and instruments measured at fair value. Interest income and expense also includes fees and commission accrued using the effective interest rate method, accrued or paid, included in the measurement of a financial instrument.

Interest income and expenses are recognized on an accrual basis using the effective interest rate method, which discounts the estimated future cash flows throughout the expected useful life of a financial asset or financial liability to the gross carrying amount of a financial asset or amortized cost of a financial liability, with the exception of:

- purchased or originated credit-impaired financial assets (POCI). Interest income on these POCI assets is calculated on the net carrying amount using the effective interest rate adjusted by credit risk recognized over the life of the asset;
- financial assets which were not credit-impaired when they were purchased or originated, but which subsequently became credit-impaired financial assets. Interest income on such assets is calculated based on their net carrying amount using the original effective interest rate as at the date of recognition of indications of impairment of a given asset.

The calculation of the effective interest rate takes into account all commissions paid or received by the parties to the contract.

#### INTEREST AND EXPENSE ON THE SALE OF INSURANCE PRODUCTS LINKED TO LOANS AND ADVANCES

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

#### FINANCIAL INFORMATION

INTEREST INCOME	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
<b>Interest income recognized under the effective interest rate method, including:</b>	<b>860,820</b>	<b>666,411</b>
on financial instruments measured at amortized cost, including:	839,704	650,264
loans and advances to customers	839,611	650,216
amounts due from banks and on mandatory reserve	93	48
on instruments measured at fair value through other comprehensive income, including:	21,116	16,147
debt securities	21,116	16,147
<b>Income similar to interest income on instruments measured at fair value through profit or loss, including:</b>	<b>1,593</b>	<b>1,184</b>
hedging IRS transactions (net)	1,593	1,184
<b>Total</b>	<b>862,413</b>	<b>667,595</b>
including: interest income on impaired financial instruments	576	248



INTEREST EXPENSE	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
<b>Interest expense on financial instruments measured at amortized cost, including:</b>	<b>(331,445)</b>	<b>(268,615)</b>
loans received and overdraft facility used	(44,507)	(34,627)
deferred payment for acquisition of receivables	(43,473)	(52,370)
mortgage covered bonds issued	(161,784)	(122,061)
unsecured bonds issued	(81,523)	(59,557)
lease liabilities	(158)	
<b>Cost similar to interest expense on instruments measured at fair value through profit or loss, including:</b>	<b>(214,303)</b>	<b>(149,494)</b>
hedging CIRS transactions (net)	(214,303)	(149,494)
<b>Total</b>	<b>(545,748)</b>	<b>(418,109)</b>

## 7. FEE AND COMMISSION INCOME AND EXPENSE

### ACCOUNTING POLICIES

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

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

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

### FINANCIAL INFORMATION:

FEE AND COMMISSION INCOME	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Fees for property valuation	5,659	6,166
Fees for property inspection	2,573	2,634
Fees for full or partial early repayment of loans	5,503	4,676
Other	1,760	1,293
<b>Total</b>	<b>15,495</b>	<b>14,769</b>

FEE AND COMMISSION EXPENSE	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Preparation by property valuers of appraisal reports on Property Value for Mortgage Lending Purposes (BHWN)	(8,463)	(8,981)
Expenses related to bonds issuance programme	(4,151)	(3,542)
Expenses related to credit lines	(3,339)	(2,614)
Expenses related to mortgage covered bonds issuance programme	(1,219)	(1,164)
Loan insurance costs	(3,971)	(2,999)
Commission on other operating services	(213)	(225)
Costs of debt collection and intermediation in selling collateral	(27)	(29)
<b>Total</b>	<b>(21,383)</b>	<b>(19,554)</b>





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

### ACCOUNTING POLICIES AND CLASSIFICATION

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

The item also includes the ineffective part of cash flow hedges for hedging strategies using Interest Rate Swap (IRS) contracts.

### FINANCIAL INFORMATION

NET INCOME FROM FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Gain/loss on derivatives	65	89
Gain/loss on IRS derivative instruments before designation to hedge accounting	-	26
Gain/loss on IRS derivative instruments related to hedge ineffectiveness	65	63
<b>Total</b>	<b>65</b>	<b>89</b>

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

## 9. NET FOREIGN EXCHANGE GAINS/ (LOSSES)

### ACCOUNTING POLICIES AND CLASSIFICATION

Net foreign exchange gains/(losses) include foreign exchange gains and losses, both realized and unrealized, on the measurement of foreign currency assets and liabilities at the average exchange rates announced by the National Bank of Poland applicable as at the end of the reporting period, and on fair value measurement of derivative instruments, i.e. Cross Currency Interest Rate Swaps (CIRS) and Foreign Exchange Forwards (FX-Forward), including the ineffective part of cash flow hedges for hedging strategies where CIRS and FX Forwards contracts are hedging instruments.

### FINANCIAL INFORMATION

NET FOREIGN EXCHANGE GAINS / (LOSSES)	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Result on revaluation	34	(173)
Gain/loss on derivative instruments (CIRS, FX-Forward) before designation to hedge accounting	(388)	(1,375)
Gain/loss on derivative instruments (CIRS, FX-Forward) related to hedge ineffectiveness	(1,449)	1,310
<b>Total</b>	<b>(1,803)</b>	<b>(238)</b>

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

## 10. NET RESULT ON MODIFICATION

### ACCOUNTING POLICIES

The principles for recognition of the net income/(expense) on modification are described in Note 3.4 "Classification and measurement of financial instruments".





## FINANCIAL INFORMATION

NET RESULT ON MODIFICATION	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Financial instruments measured at amortized cost	455	(439)
<b>Total</b>	<b>455</b>	<b>(439)</b>

  

FINANCIAL ASSETS SUBJECT TO MODIFICATION	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Carrying amount at amortized cost before modification (Stage 2)	4,909	1,761
Gain/(loss) recognized on modification during the period (Stage 2)	7	5
Carrying amount at amortized cost before modification (Stage 3)	1,939	469
Gain/(loss) recognized on modification during the period (Stage 3)	(3)	(2)

The gross value of financial assets for which the loss was calculated over the entire life of the asset and which were subject to modifications since their initial recognition, for which the allowance for expected credit losses changed in the reporting period in an amount equal to 12-month expected credit losses, amounted to PLN 2,567 thousand as at 31 December 2019 and PLN 1,606 thousand as at 31 December 2018.

## 11. NET EXPECTED CREDIT LOSSES

### ACCOUNTING POLICIES

Accounting policies for recognizing net expected credit losses on specific items have been described in Notes 23 and 41.3, as appropriate. Net expected credit losses comprise allowances for loans and advances to customers and provisions for loan commitments granted recognized and released.

## FINANCIAL INFORMATION

NET EXPECTED CREDIT LOSSES	Note	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Net allowances on loans and advances to customers	23	(14,712)	(8,667)
Net provisions for loan commitments	31	4	(36)
<b>Total</b>		<b>(14,708)</b>	<b>(8,703)</b>

## 12. OTHER OPERATING INCOME AND EXPENSES

### ACCOUNTING POLICIES

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

## FINANCIAL INFORMATION

OTHER OPERATING INCOME	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Sundry income	485	606
Other	14	7
<b>Total</b>	<b>499</b>	<b>613</b>



OTHER OPERATING EXPENSE	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Sundry expenses	(396)	(517)
Other	(534)	(42)
<b>Total</b>	<b>(930)</b>	<b>(559)</b>

### 13. ADMINISTRATIVE EXPENSES

#### ACCOUNTING POLICIES

<b>EMPLOYEE BENEFITS</b>	<p>Employee benefits include costs of salaries and wages, and social insurance (including provisions for pension and disability benefits, described in detail in Note 31 "Provisions").</p> <p>In addition, the Bank also recognizes a provision for accrued costs attributable to the current period, to be paid in future periods, including bonuses and unused holiday pay, taking into account all outstanding unused holiday.</p> <p>Employee benefits also include a variable remuneration plan for the top management, which is recognized in part as a liability in respect payments based on the book value of shares, settled in cash. The plan is described in Chapter 6.5 of PKO Bank Hipoteczny SA Directors' Report for the year ended 31 December 2019.</p>
<b>OVERHEADS</b>	<p>These include, among other things: costs of services relating to supporting tasks and the costs of servicing loans under the Outsourcing Agreement (described in Note 37.1 "Transactions with entities related in terms of capital"), costs of external services resulting from other agreements, costs of renting properties and IT costs.</p>
<b>AMORTIZATION AND DEPRECIATION</b>	<p>Depreciation and amortization policies are described in details in Note 24 "Intangible assets and property, plant and equipment".</p>

#### FINANCIAL INFORMATION

ADMINISTRATIVE EXPENSES	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Employee benefits	(17,471)	(16,698)
Overheads	(30,665)	(26,741)
Amortization and depreciation, including:	(3,249)	(2,177)
property, plant and equipment	(221)	(252)
right-of-use assets, including:	(1,206)	
real estate	(1,018)	
cars	(188)	
intangible assets	(1,822)	(1,925)
<b>Total</b>	<b>(51,385)</b>	<b>(45,616)</b>

  

EMPLOYEE BENEFITS	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Wages and salaries, including:	(14,951)	(14,171)
provision for disability and retirement benefits	(30)	(53)
Salary surcharges	(1,961)	(1,657)
Other employee benefits	(559)	(870)
<b>Total</b>	<b>(17,471)</b>	<b>(16,698)</b>



OVERHEADS	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Services relating to supporting operations under Outsourcing Agreement <sup>1)</sup>	(3,861)	(3,192)
Servicing of loans granted and receivables purchased under Outsourcing Agreement <sup>1)</sup>	(19,957)	(15,939)
External services under other contracts	(2,558)	(2,623)
IT costs	(1,802)	(1,534)
Life- and non-life insurance costs	(375)	(282)
Rents and service charges		(1,855)
Car leases		(274)
Costs related to short-term lease contracts	(88)	
Costs related to lease contracts for low-value assets (other than short-term), non-deductible VAT expenses and service charges	(753)	
Other	(1,271)	(1,042)
<b>Total</b>	<b>(30,665)</b>	<b>(26,741)</b>

<sup>1)</sup> The Outsourcing Agreement is described in Note 37.1 "Transactions with entities related in terms of capital"

#### 14. COST OF REGULATORY CHARGES

COST OF REGULATORY CHARGES	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Contribution and payments to the Bank Guarantee Fund (BGF), including: resolution fund	(22,058)	(4,556)
Payments to Polish Financial Supervision Authority (PFSA)	(2,239)	(1,524)
Tax on civil law transactions (due to share capital increase)	-	(500)
Other taxes and charges	(448)	(288)
<b>Total</b>	<b>(24,745)</b>	<b>(6,868)</b>

#### 15. TAX ON CERTAIN FINANCIAL INSTITUTIONS

As of 1 February 2016, the Act of 15 January 2016 on tax on certain financial institutions came into force. For banks, the tax base is calculated as the surplus of total assets over PLN 4 billion as per the trial balance as at the end of each month. Banks are entitled to reduce the tax base by deducting, among other things, own funds and the value of Treasury securities held. The tax rate is 0.0366% per month and the tax is paid monthly by the 25th day of the month following the month to which the tax relates. The tax paid is not deductible for the purposes of corporate income tax. Tax on certain financial institutions amounted to PLN 83,102 thousand for 2019 and PLN 60,765 thousand for 2018.

#### 16. INCOME TAX EXPENSE

##### ACCOUNTING POLICIES

<b>RECOGNITION</b>	Corporate income tax comprises current and deferred tax. Current income tax is recognized in the income statement. Deferred tax is recognized in the income statement or other comprehensive income, depending on the source of the timing differences.
<b>CURRENT INCOME TAX EXPENSE</b>	Current income tax is calculated based on profit before tax determined in accordance with the accounting regulations, adjusted by income which is not taxable under the tax regulations, taxable income not recognized as income for accounting purposes, non-deductible costs and tax costs not recognized as costs for accounting purposes, in accordance with the relevant provisions of the tax law. These include, among other things, interest income and expense accrued to be received or paid, allowances for credit losses, provisions for liabilities, the cost of tax on certain financial institutions or payments to the BGF.



**DEFERRED INCOME TAX**

Deferred tax is recognized in the amount of the difference between the tax value of the assets and liabilities and their carrying amounts for the purpose of financial reporting. A change in the deferred tax provision and asset is charged to the profit or loss, with the exception of the effects of revaluation of financial assets measured at fair value through other comprehensive income and the valuation of hedging instruments recognized in other comprehensive income, where the changes in the balance of the deferred tax provision and asset are also recognized in other comprehensive income. When determining the deferred income tax, the amounts of the deferred tax provision and asset as at the beginning and end of the reporting period are taken into account.

The carrying amount of a deferred tax asset is reviewed as at each reporting date and is decreased to the extent that it has become improbable that a taxable profit will be generated in an amount sufficient for the deferred tax asset to be partially or fully realized.

Deferred income tax assets and provisions are measured using the tax rates which are expected to apply in the period in which the asset is realized or the provision released, determined on the basis of tax rates (and tax regulations) enacted or substantively enacted as at the end of the reporting period, or the rates which are certain to apply in the future.

The Bank offsets the deferred tax asset against the deferred tax provision solely when it has a legally enforceable title to offset the current income tax receivables and liabilities, and if the deferred income asset and provision relate to income taxes imposed by the same tax authorities on the same taxpayer.

**FINANCIAL INFORMATION**

INCOME TAX EXPENSE	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Current income tax expense	(45,216)	(33,299)
Deferred income tax due to temporary differences	(737)	(3,067)
<b>Income tax expense reported in the income statement</b>	<b>(45,953)</b>	<b>(36,366)</b>
Income tax reported in other comprehensive income due to temporary differences	(17,382)	(21,764)
<b>Total</b>	<b>(63,335)</b>	<b>(58,130)</b>

  

RECONCILIATION OF THE EFFECTIVE TAX RATE	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
<b>Profit / (loss) before income tax</b>	<b>135,123</b>	<b>122,215</b>
Corporate income tax calculated at the statutory tax rate in force in Poland (19%)	(25,673)	(23,221)
<b>Effect of permanent differences between profit before income tax and taxable income, including:</b>	<b>(20,035)</b>	<b>(13,145)</b>
tax on certain financial institutions	(15,789)	(11,545)
contributions to BGF	(4,191)	(866)
costs exceeding the limit set in Article 15e of the CIT Act	-	(607)
Tax on civil law transactions relating to share capital increase	-	(95)
PFRON (State Disabled Persons Fund) costs	(19)	(16)
impact of other permanent differences	(36)	(16)
<b>Effect of other timing differences between profit before income tax and taxable income, including adjustments of previous periods</b>	<b>(245)</b>	<b>-</b>
<b>Income tax expense reported in the income statement</b>	<b>(45,953)</b>	<b>(36,366)</b>
<b>Effective tax rate</b>	<b>34.01%</b>	<b>29.76%</b>



NET DEFERRED TAX ASSET / (PROVISION)	31.12.2018	Income statement	Other comprehensive income	31.12.2019
<b>Deferred tax provision</b>				
Interest accrued on loans and advances to customers	7,655	1,427	-	9,082
Interest accrued and discount on securities	727	836	-	1,563
Adjustment of loan portfolio valuation under straight-line and effective interest rate methods	19,575	5,619	-	25,194
Adjustment of own bonds issued valuation under straight-line and effective interest rate methods	3,586	(569)	-	3,017
Deferred costs	825	(6)	-	819
Difference between carrying amount and tax value of property, plant and equipment and intangible assets	5	1	-	6
Measurement of securities	1,038	-	(148)	890
Measurement of derivatives	22,590	661	17,625	40,876
<b>Gross deferred income tax provision</b>	<b>56,001</b>	<b>7,969</b>	<b>17,477</b>	<b>81,447</b>
<b>Deferred tax asset</b>				
Interest accrued on amounts due to banks	5,996	882	-	6,878
Interest accrued and discount on liabilities in respect of securities issued	11,201	2,195	-	13,396
Allowances for credit losses <sup>1</sup>	5,132	2,350	-	7,482
Expenses to be paid	1,639	246	-	1,885
Valuation of securities	-	-	53	53
Valuation of derivatives	6,730	1,539	42	8,311
Difference between depreciation of the right-of-use assets and the cost of financing the lease (IFRS 16)	-	20	-	20
<b>Deferred tax asset, gross</b>	<b>30,698</b>	<b>7,232</b>	<b>95</b>	<b>38,025</b>
<b>Net deferred income tax asset / (provision) (presented in the statement of financial position)</b>	<b>(25,303)</b>	<b>(737)</b>	<b>(17,382)</b>	<b>(43,422)</b>

## TAX GROUP

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

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

Due to PKO Bank Hipoteczny SA acceding to the PGK PKO Banku Polskiego SA tax group as of 1 January 2019, the current income tax liability shown in the table below as at 31 December 2019 is a liability to PKO Bank Polski SA which is the Parent.



## 17. EARNINGS PER SHARE

### METHODOLOGY

<b>BASIC EARNINGS PER SHARE</b>	Basic earnings per share are calculated based on the profit attributable to the Bank's ordinary shareholders by dividing the profit attributable to them by the weighted average number of ordinary shares during the period.
<b>DILUTED EARNINGS PER SHARE</b>	Diluted earnings per share are calculated based on the profit attributable to ordinary shareholders by dividing the profit attributable to them by the weighted average number of ordinary shares during the period, adjusted for the dilutive effect of all dilutive potential ordinary shares.

### FINANCIAL INFORMATION

EARNINGS PER SHARE	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Profit attributable to ordinary shareholders (in PLN thousand)	89,170	85,849
Weighted average number of ordinary shares during the period (in thousands)	1,495,022	1,222,123
Earnings per share (in PLN per share)	0.06	0.07

In 2019 and 2018 there were no instruments which would dilute the earnings per share. Therefore, the amount of diluted earnings per share corresponds to the amount of base earnings per share.

## NOTES TO THE STATEMENT OF FINANCIAL POSITION

### 18. CASH AND BALANCES WITH THE CENTRAL BANK

#### ACCOUNTING POLICIES

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

#### FINANCIAL INFORMATION

CASH AND BALANCES WITH THE CENTRAL BANK	31.12.2019	31.12.2018
Current account with the Central Bank	20	6
<b>Total</b>	<b>20</b>	<b>6</b>

#### MANDATORY RESERVE

In the period from 31 December 2019 to 30 January 2020 and from 31 December 2018 to 30 January 2019, the Bank maintained the mandatory reserve of PLN 10,226 thousand and PLN 0 thousand, respectively. As at 31 December 2019 and 31 December 2018, such interest rate on the mandatory reserve was 0.5%.

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

### 19. AMOUNTS DUE FROM BANKS

#### ACCOUNTING POLICIES

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

#### FINANCIAL INFORMATION:

AMOUNTS DUE FROM BANKS	31.12.2019	31.12.2018
<b>Measured at amortised cost</b>		
current accounts	31	22
<b>Total</b>	<b>31</b>	<b>22</b>

Information on exposures to credit risk relating to amounts due from banks is provided in Note 41 “Credit risk management”.

All amounts due from banks were classified to Stage 1 as at 31 December 2019 and 31 December 2018. In the periods ended on these dates there were no transfers of amounts due from banks between the stages.



## 20. DERIVATIVE HEDGING INSTRUMENTS

### ACCOUNTING POLICIES AND ESTIMATES AND JUDGMENTS

<p><b>THE USE OF HEDGE ACCOUNTING</b></p>	<p>The Bank decided to further apply the provisions of IAS 39 and did not apply IFRS 9 in respect of hedge accounting.</p> <p>In its operations, the Bank uses derivative instruments: CIRS, IRS, FX-Forward for hedging purposes only, in accordance with the risk management strategy described in more detail in Notes 45 and 46. All derivatives are designated for hedge accounting.</p> <p>The Bank applies hedge accounting when all the terms and conditions below have been met:</p> <ul style="list-style-type: none"> <li>▪ upon setting up the hedge, the purpose of risk management by the entity and the hedging strategy were officially established and documented. Such documentation contains an identification of the hedging instrument, the hedged item or transaction, the nature of the hedged risk, and the method used by the entity to assess the hedging instrument's effectiveness in compensating the risk of changes in the fair value of the hedged risk or the cash flows relating to the hedged risk;</li> <li>▪ the hedge is expected to be highly effective in compensating the changes in the fair value or cash flows resulting from the hedged risk, in accordance with the originally documented risk management strategy relating to this specific hedging relationship;</li> <li>▪ in the case of cash flow hedges, the planned hedged transaction must be highly probable and must be exposed to a risk of variability of cash flows which may, as a result, have an impact on the income statement;</li> <li>▪ the hedge effectiveness can be assessed reliably, i.e. the fair value or cash flows relating to the hedged item and resulting from the hedged risk and the fair value of the hedging instrument can be assessed reliably;</li> <li>▪ the hedge is regularly assessed and its high effectiveness is confirmed in all the reporting periods for which the hedge had been designated.</li> </ul>
<p><b>DISCONTINUATION OF HEDGE ACCOUNTING</b></p>	<p>The Bank discontinues the application of hedge accounting when:</p> <ul style="list-style-type: none"> <li>▪ a hedging instrument expires, is sold, terminated or exercised (replacing a hedging instrument with another hedging instrument or extending the validity of a hedging instrument is not treated as its expiry or termination, if such replacement or extension is a part of a documented hedging strategy adopted by the entity). In such cases, accumulated gains or losses associated with a hedging instrument, which were directly recognized in other comprehensive income over the period in which the hedge was effective, continue to be recognized as a separate item of other comprehensive income and credited or charged to profit or loss over the period in which the hedged item is recognized in profit or loss;</li> <li>▪ the hedge no longer meets the criteria of hedge accounting. In such cases, accumulated gains or losses associated with a hedging instrument, which were directly recognized in other comprehensive income over the period in which the hedge was effective, continue to be recognized as a separate item of other comprehensive income and credited or charged to profit or loss over the period in which the hedged item is recognized in profit or loss;</li> <li>▪ the planned transaction is no longer expected to be executed – in such cases, all accumulated gains or losses relating to the hedging instrument which were recognized directly in other comprehensive income over the period in which the hedge was effective, are recognized in profit or loss;</li> <li>▪ the hedging relationship has been invalidated.</li> </ul>
<p><b>FAIR VALUE HEDGES</b></p>	<p>The Bank does not apply fair value hedging.</p>
<p><b>CASH FLOW HEDGES</b></p>	<p>Cash flow hedges are hedges against cash flow volatility, which may be attributed to a specific type of risk associated with a recognized asset or liability (such as future payments of interest on floating-interest debt (or a part thereof)) or a highly probable planned transaction, and which could affect the income statement.</p> <p>Changes in the fair value of a derivative financial instrument designated as a cash flow hedge are recognized directly in other comprehensive income in respect of the portion constituting the effective portion of the hedge. The ineffective portion of the hedge is recognized in the</p>





	<p>income statement in the item “Net income from financial instruments designated at fair value” or “Foreign exchange gains (losses)”. Moreover, the amounts recognized directly in other comprehensive income are transferred to the income statement as “Net interest income” or “Net foreign exchange gain”, respectively, in the period or periods in which the impact of the hedged transaction is recognized in the income statement.</p> <p>The effectiveness tests comprise the valuation of hedging transactions, net of interest accrued and foreign exchange gains (losses) on the nominal value of the hedging transactions (in the case of CIRS and FX-Forward transactions).</p> <p>Hedge effectiveness is verified through the use of prospective and retrospective effectiveness tests. The tests are performed on a monthly basis.</p>
<b>POTENTIAL SOURCES OF INEFFECTIVENESS</b>	<p>The main sources of hedge ineffectiveness may include:</p> <ul style="list-style-type: none"> <li>▪ applying the CVA/DVA adjustment to the hedging instrument only;</li> <li>▪ the existence of minute differences in the structure and the basic parameters of hedging transactions and hedged items.</li> </ul> <p>The monthly tests show continuous high effectiveness of the hedging strategies applied.</p>
<b>ESTIMATES AND JUDGMENTS</b>	<p>The fair value of derivative instruments is determined using valuation models based on discounted future cash flows from a given financial instrument. The model variables and assumptions used for valuation purposes comprise, subject to availability, data from observable markets (e.g. deposit rates on the interbank market, foreign exchange rates, IRS transaction quotations).</p> <p>The fair value of derivatives includes the Bank’s own credit risk, DVA (debit value adjustment) as well as counterparty credit risk, CVA (credit value adjustment). The process of calculating CVA and DVA adjustments includes the selection of a method for determining the spread of the counterparty’s or the Bank’s credit risk (e.g. a market price method based on the continuous quotations of debt instruments issued by the counterparty, a method of spread implied from Credit Default Swap contracts), an estimation of the probability of default by the counterparty or the Bank and the recovery rate.</p>

#### TYPES OF HEDGING STRATEGIES APPLIED BY THE BANK

<b>STRATEGY 1</b>	<b>HEDGE OF THE VARIABILITY OF CASH FLOW 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</b>
<b>DESCRIPTION OF THE HEDGING RELATIONSHIP</b>	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.
<b>HEDGED RISK</b>	Forex and interest rate risk
<b>HEDGING INSTRUMENTS</b>	<ul style="list-style-type: none"> <li>▪ Cross-Currency Interest Rate Swap (CIRS) transactions in which the Bank pays a coupon based on a variable PLN rate and receives a coupon based on a fixed rate for the convertible currency. If PKO Bank Hipoteczny SA is declared bankrupt by the court, the CIRS transactions will automatically be extended by 12 months on the terms and conditions set on the transaction date;</li> <li>▪ an optional series of FX-Forward transactions in the convertible foreign currency serving as hedges of the FX exposures maturing on the dates of payment of coupons on the mortgage covered bonds in the foreign currency.</li> </ul>
<b>HEDGED ITEM</b>	<ul style="list-style-type: none"> <li>▪ part of the portfolio of the residential loans included in the cover pool of PLN covered bonds at floating rates. The interest rates on the loans are indexed by the 3M WIBOR rate. The mortgage loan margin is excluded from the hedge;</li> <li>▪ fixed-rate covered bonds issued in a foreign currency.</li> </ul>



**THE PERIOD IN WHICH CASH FLOWS ARE EXPECTED**

The period in which cash flows are expected to occur and when they are expected to affect the financial results: January 2020 – August 2024.

DERIVATIVE HEDGING INSTRUMENTS	NOMINAL VALUE OF DERIVATIVE HEDGING INSTRUMENTS	CARRYING AMOUNT/FAIR VALUE OF HEDGING INSTRUMENTS		INEFFECTIVE PORTION OF CASH FLOW HEDGES RECOGNIZED IN THE INCOME STATEMENT	CHANGE IN THE FAIR VALUE OF HEDGING INSTRUMENT SINCE DESIGNATION
		Assets	Liabilities		
31.12.2019					
CIRS EUR/PLN	fixed EUR	2,775,514	163,676	45,237	(1,423)
	float PLN	11,863,682			
FX forward	purchase EUR	2,852	382	847	(26)
	sale EUR	1,654			
31.12.2018					
CIRS EUR/PLN	fixed EUR	2,076,360	162,100	14,786	1,334
	float PLN	8,858,819			
FX forward	purchase EUR	2,173	237	468	(24)
	sale EUR	1,656			

The average fixed rate weighted with the nominal value for CIRS transactions amounted to 0.502% as at 31 December 2019, and 0.585% as at 31 December 2018.

HEDGED ITEMS	CARRYING AMOUNT OF HEDGED ITEMS	ITEM OF THE STATEMENT OF FINANCIAL POSITION	CHANGE IN THE FAIR VALUE OF HEDGED ITEMS SINCE DESIGNATION
31.12.2019			
floating rate PLN loans	11,863,682	Loans and advances to customers	(125,679)
fixed-rate mortgage covered bonds issued in a convertible currency	11,824,628	Mortgage covered bonds issued	
31.12.2018			
floating rate PLN loans	8,858,819	Loans and advances to customers	(150,942)
fixed-rate mortgage covered bonds issued in a convertible currency	8,930,571	Mortgage covered bonds issued	

**STRATEGY 2**

**HEDGING CASH FLOW VOLATILITY FROM CASH LOANS IN PLN WITH FLUCTUATING INTEREST RATES, RESULTING FROM THE RISK OF FLUCTUATIONS IN INTEREST RATES, USING IRS TRANSACTIONS**

<b>DESCRIPTION OF THE HEDGING RELATIONSHIP</b>	Elimination of the risk of cash flow fluctuations generated by the floating interest rate PLN loan portfolio resulting from the interest rate risk using IRS transactions in the period covered by the hedge;
<b>HEDGED RISK</b>	Interest rate risk;
<b>HEDGING INSTRUMENTS</b>	IRS transactions where the Bank pays coupons based on the floating 3M WIBOR rate, and receives coupons based on a fixed rate on the nominal value for which they were concluded;
<b>HEDGED ITEM</b>	A part of the portfolio of residential loans in PLN indexed to the WIBOR 3M floating rate. The mortgage loan margin is excluded from the hedge;
<b>THE PERIOD IN WHICH CASH FLOWS ARE EXPECTED</b>	The period in which cash flows are expected to occur and when they are expected to affect the financial results: January 2020 – August 2028.

DERIVATIVE HEDGING INSTRUMENTS	NOMINAL VALUE OF DERIVATIVE HEDGING INSTRUMENTS	CARRYING AMOUNT/FAIR VALUE OF HEDGING INSTRUMENTS		INEFFECTIVE PORTION OF CASH FLOW HEDGES RECOGNIZED IN THE INCOME STATEMENT	CHANGE IN THE FAIR VALUE OF HEDGING INSTRUMENT SINCE DESIGNATION
		Assets	Liabilities		
31.12.2019					
IRS PLN	PLN	325,000	9,217	-	9,430
31.12.2018					
IRS PLN	PLN	325,000	5,952	-	6,165

The average fixed rate weighted with the nominal value for IRS transactions amounted to 2.84% as at 31 December 2019 as well as at 31 December 2018.

	CARRYING AMOUNT OF HEDGED ITEMS	ITEM OF THE STATEMENT OF FINANCIAL POSITION	CHANGE IN THE FAIR VALUE OF HEDGED ITEMS SINCE DESIGNATION
31.12.2019			
floating rate PLN loans	325,000	Loans and advances to customers	(9,371)
31.12.2018			
floating rate PLN loans	325,000	Loans and advances to customers	(6,248)

#### FINANCIAL INFORMATION:

CARRYING AMOUNT / FAIR VALUE OF DERIVATIVES USED AS CASH FLOW HEDGES	31.12.2019		31.12.2018	
	Assets	Liabilities	Assets	Liabilities
IRS	9,217	-	5,952	-
CIRS	163,676	45,237	162,100	14,786
FX forward	382	847	237	468
<b>Total</b>	<b>173,275</b>	<b>46,084</b>	<b>168,289</b>	<b>15,254</b>

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

NOMINAL VALUE OF HEDGING INSTRUMENTS BY MATURITY AS AT 31 DECEMBER 2019	up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	over 5 years	Total
IRS						
PLN fixed-float	-	-	-	265,000	60,000	325,000
CIRS						
float PLN sale	-	-	-	11,863,682	-	11,863,682
fixed EUR purchase (original currency)	-	-	-	2,775,514	-	2,775,514
FX forward						
PLN sale	-	-	238	13,606	-	13,844
EUR purchase (original currency)	-	-	53	2,799	-	2,852
PLN purchase	507	-	2,747	4,388	-	7,642
EUR sale (original currency)	115	-	602	937	-	1,654



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

CHANGE IN OTHER COMPREHENSIVE INCOME ON CASH FLOW HEDGES AND INEFFECTIVE PORTION OF CASH FLOW HEDGES	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Accumulated other comprehensive income on cash flow hedges at the beginning of the period, gross	73,411	(38,730)
Gains / (Losses) recognized in other comprehensive income during the period	(233,934)	213,920
Amounts transferred from other comprehensive income to the income statement during the period	326,476	(101,779)
- interest income	(1,593)	(1,184)
- Interest expense	214,303	149,494
- net foreign exchange gains/(losses)	113,766	(250,089)
Accumulated other comprehensive income on cash flow hedges as at the end of the period, gross	165,953	73,411
Tax effect	(31,532)	(13,949)
Accumulated other comprehensive income on cash flow hedges as at the end of the period, net	134,421	59,462
Ineffective portion of cash flow hedges recognized in the income statement	(1,384)	1,373
Impact on other comprehensive income during the period, gross	92,542	112,141
Deferred tax on cash flow hedges	(17,583)	(21,307)
Impact on other comprehensive income during the period, net	74,959	90,834

## CALCULATION OF ESTIMATES

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

ESTIMATED CHANGE IN THE VALUATION AT A PARALLEL MOVE OF YIELD CURVES:	31.12.2019		31.12.2018	
	+50 b.p. scenario	-50 b.p. scenario	+50 b.p. scenario	-50 b.p. scenario
IRS	(4,024)	4,024	(5,273)	5,273
CIRS	(183,184)	183,184	(200,809)	200,809
FX forward	6	(6)	4	(4)

## 21. SECURITIES

### ACCOUNTING POLICIES

The debt securities' classification and measurement policies have been described in Note 3.4 "Classification and Measurement of Financial Instruments".



## FINANCIAL INFORMATION

SECURITIES	31.12.2019	31.12.2018
Measured at fair value through other comprehensive income	1,240,161	842,965
issued by the State Treasury, PLN Treasury bonds	1,240,161	842,965
<b>Total</b>	<b>1,240,161</b>	<b>842,965</b>

  

SECURITIES BY MATURITY	31.12.2019	31.12.2018
Issued by the State Treasury, PLN Treasury bonds		
up to 1 month	159,745	186,506
1 to 5 years	704,465	479,474
over 5 years	375,951	176,985
<b>Total</b>	<b>1,240,161</b>	<b>842,965</b>

  

SECURITIES BY NOMINAL VALUE AND AVERAGE YIELD	31.12.2019	31.12.2018
Issued by the State Treasury, PLN Treasury bonds	1,236,480	836,480
Average yield	1.79%	1.78%

Information on credit risk exposure in connection with securities is provided in Note 41 "Credit risk management".

The whole balance of securities as at 31 December 2019 and 31 December 2018 was classified in Stage 1. In the periods ended on these dates there were no transfers of securities between the stages.

## SECURITIES PUT UP AS COLLATERAL

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

As at 31 December 2019, the mandatory contribution to the bank resolution fund payable to the Bank Guarantee Fund ("BGF"), amounted to PLN 7,984 thousand, and the Bank held Treasury bonds with a carrying value of PLN 9,059 thousand as a cover for the contribution. As at 31 December 2018, the amounts were PLN 1,367 thousand and PLN 1,708 thousand respectively.

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

### COLLATERAL FOR MORTGAGE COVERED BONDS

The amount of additional collateral entered in the mortgage covered bonds cover pool maintained in the form of Treasury securities in PLN was PLN 250,000 thousand as at 31 December 2019 and PLN 251,000 as at 31 December 2018. The disclosure of assets in the mortgage covered bonds cover pool is described in Note 28.

## 22. LOANS AND ADVANCES TO CUSTOMERS

### ACCOUNTING POLICIES

The classification and measurement policies in respect of loans and advances to customers is described in Note 3.4 "Classification and measurement of financial instruments".

## FINANCIAL INFORMATION

LOANS AND ADVANCES TO CUSTOMERS	31.12.2019	31.12.2018
<b>Measured at amortised cost</b>		
Residential mortgage loans, gross, including:		
loans granted	25,863,796	21,098,742
receivables acquired	12,090,010	8,781,520
	13,773,786	12,317,222
Allowances for expected credit losses	(42,726)	(28,273)
<b>Loans and advances to customers, net</b>	<b>25,821,070</b>	<b>21,070,469</b>

In 2019 the Bank purchased, based on the Framework Agreement for the Sale of Receivables signed with PKO Bank Polski SA on 17 November 2015, receivables portfolios relating to residential mortgage loans amounting to PLN 2,745,544 thousand, and in 2018 – in the amount of PLN 2,524,086 thousand. The purchase price was determined on an arm's length basis, based on the valuation made by an independent expert. The receivables purchased were recognized on the transfer dates set in the Receivables Sale Agreements, on which the Bank acquired the rights to the cash flows from individual portfolios, and assumed all related liability for costs and economic risks in the constituent receivables. The purchase of the receivables portfolios was financed by the liability the nature of which is described in Note 26. The Bank ultimately refinances the purchased receivables portfolios primarily through issuing mortgage covered bonds.

Loans granted and receivables purchased that have been entered in the Bank's cover pool represent collateral for mortgage covered bonds issued, as described in Note 28.

Information about exposure to credit risk for loans and advances granted measured at amortized cost are described in Note 23 "Expected credit losses".

Information about the quality of the loan portfolio is presented in Note 41.4 "Forecasting and monitoring of credit risk".

## 23. EXPECTED CREDIT LOSSES

### ESTIMATES AND ASSESSMENTS

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

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

The methodology used for estimating expected credit losses and calculating impairment of credit exposures is described in Note 41.3 "Impairment of credit exposures".



FINANCIAL INFORMATION

ALLOWANCES FOR EXPECTED CREDIT LOSSES

FINANCIAL ASSETS AND ALLOWANCES FOR EXPECTED CREDIT LOSSES AS AT 31.12.2019	Assets with no significant increase in credit risk since initial recognition, gross (Stage 1)	Allowances for expected credit losses (Stage 1)	Assets with a significant increase in credit risk since initial recognition, but not credit-impaired, gross (Stage 2)	Allowances for expected credit losses (Stage 2)	Credit-impaired assets, gross (Stage 3)	Allowances for expected credit losses (Stage 3)	Total gross amount	Total allowances for expected credit losses
<b>Measured at fair value through OCI</b>								
securities	1,240,161	-	-	-	-	-	1,240,161	-
issued by the State Treasury, PLN Treasury bonds	1,240,161	-	-	-	-	-	1,240,161	-
<b>Total</b>	<b>1,240,161</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,240,161</b>	<b>-</b>
<b>Measured at amortized cost</b>								
amounts due from banks	31	-	-	-	-	-	31	-
loans and advances to customers	25,504,795	(9,333)	341,078	(25,895)	17,923	(7,498)	25,863,796	(42,726)
residential mortgage loans	25,504,795	(9,333)	341,078	(25,895)	17,923	(7,498)	25,863,796	(42,726)
loans granted	11,881,240	(5,283)	202,712	(16,334)	6,058	(2,951)	12,090,010	(24,568)
receivables acquired	13,623,555	(4,050)	138,366	(9,561)	11,865	(4,547)	13,773,786	(18,158)
other financial assets	217	-	-	-	-	-	217	-
<b>Total</b>	<b>25,505,043</b>	<b>(9,333)</b>	<b>341,078</b>	<b>(25,895)</b>	<b>17,923</b>	<b>(7,498)</b>	<b>25,864,044</b>	<b>(42,726)</b>

As at 31 December 2019 there were no purchased or originated credit-impaired assets (POCI).

LOAN COMMITMENTS AND PROVISIONS AS AT 31.12.2019	Nominal amount of loan commitments with no significant increase in credit risk since initial recognition (Stage 1)	Provisions for loan commitments (Stage 1)	Nominal amount of loan commitments with a significant increase in credit risk since initial recognition, but not credit-impaired (Stage 2)	Provisions for loan commitments (Stage 2)	Nominal amount of credit-impaired loan commitments (Stage 3)	Provisions for loan commitments (Stage 3)	Total nominal amount	Total provisions for loan commitments
<b>Loan commitments</b>	<b>482,236</b>	<b>(111)</b>	<b>450</b>	<b>(29)</b>	<b>-</b>	<b>-</b>	<b>482,686</b>	<b>(140)</b>

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

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

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



CHANGES IN THE GROSS AMOUNT OF FINANCIAL INSTRUMENTS AND CHANGES IN ALLOWANCES FOR EXPECTED CREDIT LOSSES

CHANGES IN GROSS CARRYING AMOUNTS OF FINANCIAL INSTRUMENTS IN 2019	Carrying amount, gross as at 31.12.2018	Increase due to origination or purchase	Changes due to disbursement of tranches	Decrease due to repayment / redemption	Changes due to insignificant modification, net	Decrease due to derecognition	Changes due to lengthening the loss recognition horizon from 12 months to period to maturity	Changes due to shortening the loss recognition horizon from period to maturity to 12 months	Decrease due to impairment in connection with a write-down	Transfers to stage 1 (S1)	Transfers to stage 2 (S2)	Transfers to stage 3 (S3)	Other changes	Carrying amount, gross as at 31.12.2019
<b>Measured at fair value through OCI</b>														
securities (stage 1 (S1))	842,965	1,018,758	-	(641,620)	-	-	-	-	-	-	-	-	20,058	1,240,161
<b>Total</b>	<b>842,965</b>	<b>1,018,758</b>	<b>-</b>	<b>(641,620)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>20,058</b>	<b>1,240,161</b>
<b>Measured at amortized cost</b>														
amounts due from banks (S1)	22	31	-	(22)	-	-	-	-	-	-	-	-	-	31
loans and advances to customers	21,098,742	6,013,866	786,092	(1,974,734)	455	(56,299)	(2,226)	(1,961)	(259)	-	-	-	120	25,863,796
residential mortgage loans	21,098,742	6,013,866	786,092	(1,974,734)	455	(56,299)	(2,226)	(1,961)	(259)	-	-	-	120	25,863,796
stage 1 (S1)	20,823,722	6,011,464	782,898	(1,948,478)	451	(55,121)	(2,226)	-	(4)	690,867	(798,193)	(585)	-	25,504,795
stage 2 (S2)	266,928	2,402	3,194	(24,943)	7	(1,178)	-	(1,961)	(11)	(690,867)	801,392	(13,885)	-	341,078
stage 3 (S3)	8,092	-	-	(1,313)	(3)	-	-	-	(244)	-	(3,199)	14,470	120	17,923
other financial assets (S1)	449	217	-	(449)	-	-	-	-	-	-	-	-	-	217
<b>Total</b>	<b>21,099,213</b>	<b>6,014,114</b>	<b>786,092</b>	<b>(1,975,205)</b>	<b>455</b>	<b>(56,299)</b>	<b>(2,226)</b>	<b>(1,961)</b>	<b>(259)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>120</b>	<b>25,864,044</b>

CHANGES IN ALLOWANCES FOR EXPECTED CREDIT LOSSES ON FINANCIAL ASSETS IN 2019	As at 31.12.2018	Increase due to origination or purchase	Changes due to changes in credit risk, including full repayment (net)	Changes due to insignificant modification, net	Decrease due to derecognition	Changes due to lengthening the loss recognition horizon from 12 months to period to maturity	Changes due to shortening the loss recognition horizon from period to maturity to 12 months	Decrease due to write-down	Transfers to stage 1 (S1)	Transfers to stage 2 (S2)	Transfers to stage 3 (S3)	Other changes	As at 31.12.2019
<b>Measured at fair value through OCI</b>													
securities (S1)	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Total</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Measured at amortized cost</b>													
amounts due from banks (S1)	-	-	-	-	-	-	-	-	-	-	-	-	-
loans and advances to customers	28,273	1,551	(2,446)	182	(68)	42,627	(27,134)	(259)	-	-	-	-	42,726
residential mortgage loans	28,273	1,551	(2,446)	182	(68)	42,627	(27,134)	(259)	-	-	-	-	42,726
stage 1 (S1)	7,108	1,490	694	140	(16)	42,627	-	(4)	1,806	(44,328)	(184)	-	9,333
stage 2 (S2)	17,979	61	(2,943)	33	(52)	-	(27,134)	(11)	(1,806)	44,507	(4,739)	-	25,895
stage 3 (S3)	3,186	-	(197)	9	-	-	-	(244)	-	(179)	4,923	-	7,498
other financial assets (S1)	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Total</b>	<b>28,273</b>	<b>1,551</b>	<b>(2,446)</b>	<b>182</b>	<b>(68)</b>	<b>42,627</b>	<b>(27,134)</b>	<b>(259)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>42,726</b>

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

**FINANCIAL STATEMENTS OF PKO BANK HIPOTECZNY SA**  
**FOR THE YEAR ENDED 31 DECEMBER 2019**  
**(IN PLN THOUSANDS)**



**Bank Hipoteczny**

CHANGES IN GROSS CARRYING AMOUNTS OF FINANCIAL INSTRUMENTS IN 2018	Carrying amount, gross as at 01/01/2018	Increase due to origination or purchase	Changes due to disbursement of tranches	Decrease due to repayment / redemption	Changes due to insignificant modification, net	Decrease due to derecognition	Changes due to lengthening the loss recognition horizon from 12 months to period to maturity	Changes due to shortening the loss recognition horizon from period to maturity to 12 months	Decrease due to impairment in connection with a write-down	Transfers to stage 1 (S1)	Transfers to stage 2 (S2)	Transfers to stage 3 (S3)	Other changes	Carrying amount, gross as at 31.12.2018
<b>Measured at fair value through OCI</b>														
securities (S1)	830,489	189,252	-	(195,325)	-	-	-	-	-					18,549
<b>Total</b>	<b>830,489</b>	<b>189,252</b>	<b>-</b>	<b>(195,325)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>					<b>18,549</b>
<b>Measured at amortized cost</b>														
amounts due from banks (S1)	5,350	22	-	(5,350)	-	-	-	-	-					22
loans and advances to customers	16,047,682	5,506,346	960,374	(1,372,458)	(439)	(39,047)	(1,324)	(2,387)	(101)					96
residential mortgage loans	16,047,682	5,506,346	960,374	(1,372,458)	(439)	(39,047)	(1,324)	(2,387)	(101)					96
stage 1 (S1)	15,876,720	5,501,941	958,745	(1,356,065)	(439)	(37,729)	(1,324)	-	(1)	416,779	(533,650)	(1,255)	-	20,823,722
stage 2 (S2)	168,115	4,405	1,629	(15,322)	2	(1,236)	-	(2,387)	(7)	(416,779)	534,724	(6,216)	-	266,928
stage 3 (S3)	2,847	-	-	(1,071)	(2)	(82)	-	-	(93)	-	(1,074)	7,471	96	8,092
other financial assets (S1)	99	449	-	(99)	-	-	-	-	-					449
<b>Total</b>	<b>16,053,131</b>	<b>5,506,817</b>	<b>960,374</b>	<b>(1,377,907)</b>	<b>(439)</b>	<b>(39,047)</b>	<b>(1,324)</b>	<b>(2,387)</b>	<b>(101)</b>					<b>96</b>

CHANGES IN ALLOWANCES FOR EXPECTED CREDIT LOSSES ON FINANCIAL ASSETS IN 2018	As at 01.01.2018	Increase due to origination or purchase	Changes due to credit risk, including full repayment (net)	Changes due to changes in insignificant modification, net	Decrease due to derecognition	Changes due to lengthening the loss recognition horizon from 12 months to period to maturity	Changes due to shortening the loss recognition horizon from period to maturity to 12 months	Decrease due to write-down	Transfers to stage 1 (S1)	Transfers to stage 2 (S2)	Transfers to stage 3 (S3)	Other changes	As at 31.12.2018
<b>Measured at fair value through OCI</b>													
securities (S1)	-	-	-	-	-	-	-	-	-				-
<b>Total</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>				<b>-</b>
<b>Measured at amortized cost</b>													
amounts due from banks (S1)	-	-	-	-	-	-	-	-	-				-
loans and advances to customers	19,707	1,869	(558)	(54)	(196)	31,040	(23,434)	(101)					28,273
residential mortgage loans	19,707	1,869	(558)	(54)	(196)	31,040	(23,434)	(101)					28,273
stage 1 (S1)	3,776	1,652	1,183	59	(11)	31,040	-	(1)	2,273	(32,435)	(428)	-	7,108
stage 2 (S2)	14,963	217	(1,798)	(47)	(160)	-	(23,434)	(7)	(2,273)	32,594	(2,076)	-	17,979
stage 3 (S3)	968	-	57	(66)	(25)	-	-	(93)	-	(159)	2,504	-	3,186
other financial assets (S1)	-	-	-	-	-	-	-	-					-
<b>Total</b>	<b>19,707</b>	<b>1,869</b>	<b>(558)</b>	<b>(54)</b>	<b>(196)</b>	<b>31,040</b>	<b>(23,434)</b>	<b>(101)</b>					<b>28,273</b>

## CALCULATION OF ESTIMATES

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

ESTIMATED CHANGE IN EXPECTED CREDIT LOSSES RESULTING FROM THE RISK PARAMETERS DETERIORATION OR IMPROVEMENT, INCLUDING: <sup>1</sup>	31.12.2019		31.12.2018	
	+10% scenario	-10% scenario	+10% scenario	-10% scenario
changes in the probability of default	3,173	(3,540)	2,200	(2,524)
changes in recovery rates	(9,206)	9,214	(7,202)	7,202

<sup>1</sup>(in plus – increase in allowances, in minus – decrease in allowances)

## FINANCIAL ASSETS IMPAIRED UPON INITIAL RECOGNITION – POCI

As at 31 December 2019 and 31 December 2018, the Bank had no purchased or originated credit-impaired assets (POCI).

## 24. INTANGIBLE ASSETS AND PROPERTY, PLANT AND EQUIPMENT

### ACCOUNTING POLICIES AND CLASSIFICATION

<b>INTANGIBLE ASSETS</b>	<p>Intangible assets comprise identifiable non-monetary assets, which do not have a physical form.</p> <p>Recognition of intangible assets:</p> <ul style="list-style-type: none"> <li>▪ software – computer software licences acquired are recognized at the amount of the costs incurred on their purchase and preparation for use, taking into account amortization and impairment.</li> <li>▪ other intangible assets acquired by the Bank are recognized at the purchase price or cost of manufacture less amortization and total impairment allowances;</li> <li>▪ the costs of completed development projects are recognized in intangible assets when economic benefits are obtained and specific conditions are satisfied, i.e. if there is a possibility and intention to complete and use the asset, appropriate technical and financial means are available to complete the work and use the asset, and the amount of expenditure incurred during development work, which can be allocated to the development of intangible assets, can be assessed reliably.</li> </ul>
<b>PROPERTY, PLANT AND EQUIPMENT</b>	<p>Property, plant and equipment is recognized at the end of a reporting period at the purchase price or cost of manufacture less depreciation and impairment.</p> <p>Right-of-use assets, which are measured at cost, are also presented in this category. The cost of a right-of-use asset includes:</p> <ul style="list-style-type: none"> <li>▪ the amount of the initial measurement of the lease liability;</li> <li>▪ any lease payments made at or before the commencement date, less any lease incentives received;</li> <li>▪ any initial direct costs incurred by the lessee in connection with concluding the lease agreement;</li> <li>▪ an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset or restoring the underlying asset.</li> </ul>
<b>EXPENDITURE</b>	The carrying amount of property, plant and equipment and intangible assets is increased by additional expenditure incurred over the period of their use.
<b>AMORTIZATION AND DEPRECIATION</b>	Amortization and depreciation is charged on all intangible assets and property, plant and equipment, including right-of-use assets, whose value decreases due to their use or lapse of time under the straight-line method over the estimated useful life of a given asset. The amortization/depreciation method and useful life are verified at least once a year.
<b>IMPAIRMENT ALLOWANCES ON</b>	At each balance sheet date, the Bank makes an assessment of whether there is objective evidence of impairment of any non-financial non-current assets (or cash-generating units). If



<p><b>NON-FINANCIAL NON-CURRENT ASSETS</b></p>	<p>any such evidence exists, and annually in the case of intangible assets which are not amortized and goodwill, the Group estimates the recoverable amount being the higher of the fair value less costs to sell or the value in use of a non-current asset (or a cash-generating unit); if the carrying amount of an asset exceeds its recoverable amount, the Group recognizes an impairment loss in the income statement. In order to estimate these amounts it is necessary to adopt assumptions concerning, among other things, the projected future cash flows that the Bank may obtain from further use or sale of a given non-current asset (or a cash-generating unit). Adopting different assumptions concerning the valuation of future cash flows could affect the carrying amount of non-current assets.</p> <p>If there are any indications of impairment of common assets, i.e. assets that do not generate cash inflows independently from other assets or groups of assets, and the recoverable amount of a single common asset cannot be established, the Bank determines the recoverable amount of the cash-generating unit to which a given asset belongs.</p> <p>This allowance is reversed if the estimations used to determine the recoverable amount change.</p>																
<p><b>ESTIMATES AND JUDGMENTS</b></p>	<p>The following factors are taken into account in estimating the useful lives of different types of property, plant and equipment and intangible assets:</p> <ul style="list-style-type: none"> <li>▪ expected wear and tear estimated based on the average periods of use recorded to date, reflecting the rate of wear and tear, intensity of use etc.;</li> <li>▪ technical or market obsolescence;</li> <li>▪ legal and other limitations on the asset's use;</li> <li>▪ expected utilization of an asset estimated based on the expected production capacity or volume;</li> <li>▪ other circumstances affecting the useful life of such assets.</li> </ul> <p>If the period of using an asset results from contractual provisions, its useful life corresponds to the period resulting from the contract.</p> <p>It is assumed that the residual value of property, plant and equipment and intangible assets is zero, unless a third party has made a commitment to purchase them or there is (and will continue to exist as at the end of their useful life) an active market for such assets and their value on that market can be estimated.</p>																
<p><b>AMORTIZATION AND DEPRECIATION PERIODS</b></p>	<p>Amortization and depreciation periods for the basic groups of intangible assets and property, plant and equipment applied by PKO Bank Hipoteczny SA:</p> <table border="1" data-bbox="427 1384 1508 1691"> <thead> <tr> <th data-bbox="427 1384 1214 1442">PROPERTY, PLANT AND EQUIPMENT</th> <th data-bbox="1214 1384 1508 1442">DEPRECIATION PERIODS</th> </tr> </thead> <tbody> <tr> <td data-bbox="427 1442 1214 1478">Leasehold improvements (buildings, premises)</td> <td data-bbox="1214 1442 1508 1478">10 years</td> </tr> <tr> <td data-bbox="427 1478 1214 1514">Plant and equipment</td> <td data-bbox="1214 1478 1508 1514">from 2 to 5 years</td> </tr> <tr> <td data-bbox="427 1514 1214 1550">Computer hardware</td> <td data-bbox="1214 1514 1508 1550">3 years</td> </tr> <tr> <td data-bbox="427 1550 1214 1585">Right-of-use assets</td> <td data-bbox="1214 1550 1508 1585">lease term <sup>1)</sup></td> </tr> <tr> <td data-bbox="427 1585 1214 1621"></td> <td data-bbox="1214 1585 1508 1621"></td> </tr> <tr> <th data-bbox="427 1621 1214 1657">INTANGIBLE ASSETS</th> <th data-bbox="1214 1621 1508 1657">AMORTIZATION PERIODS</th> </tr> <tr> <td data-bbox="427 1657 1214 1693">Software</td> <td data-bbox="1214 1657 1508 1693">from 2 to 5 years</td> </tr> </tbody> </table> <p><sup>1)</sup> In the case of agreements for unspecified periods – estimated period of use of the leased asset</p>	PROPERTY, PLANT AND EQUIPMENT	DEPRECIATION PERIODS	Leasehold improvements (buildings, premises)	10 years	Plant and equipment	from 2 to 5 years	Computer hardware	3 years	Right-of-use assets	lease term <sup>1)</sup>			INTANGIBLE ASSETS	AMORTIZATION PERIODS	Software	from 2 to 5 years
PROPERTY, PLANT AND EQUIPMENT	DEPRECIATION PERIODS																
Leasehold improvements (buildings, premises)	10 years																
Plant and equipment	from 2 to 5 years																
Computer hardware	3 years																
Right-of-use assets	lease term <sup>1)</sup>																
INTANGIBLE ASSETS	AMORTIZATION PERIODS																
Software	from 2 to 5 years																

## FINANCIAL INFORMATION

### INTANGIBLE ASSETS

FOR THE PERIOD FROM 1 JANUARY 2019 TO 31 DECEMBER 2019	Intangible assets under construction	Software	Total
Carrying amount as at the beginning of the period, gross	229	8,580	8,809
Purchase	45	7	52
Scrapping	-	(215)	(215)
Carrying amount as at the end of the period, gross	274	8,372	8,646
Accumulated amortization as at the beginning of the period	-	(4,644)	(4,644)
Amortization charge	-	(1,822)	(1,822)
Impairment allowance	-	-	-
Accumulated amortization as at the end of the period	-	(6,251)	(6,251)
Net carrying amount as at the beginning of the period	229	3,936	4,165
Net carrying amount as at the end of the period	274	2,121	2,395

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

### PROPERTY, PLANT AND EQUIPMENT

FOR THE PERIOD FROM 1 JANUARY 2019 TO 31 DECEMBER 2019	Leasehold improvements	Machinery and equipment	Right-of-use assets, including: real estate	cars	Other	Total
Carrying amount as at the end of the previous period, gross	34	894			403	1,331
Changes due to IFRS 16 implementation	-	-	5,361	66	-	5,427
Carrying amount as at the beginning of the period, gross	34	894	5,361	66	403	6,758
Purchase	-	66	-	-	-	66
Lease agreements concluded	-	-	-	684	-	684
Lease agreements – modification / indexation	-	-	72	-	-	72
Carrying amount as at the end of the period, gross	34	960	5,433	750	403	7,580
Accumulated depreciation as at the beginning of the period	(11)	(582)			(289)	(882)
Depreciation charge	(3)	(138)	(1,018)	(188)	(80)	(1,427)
Accumulated depreciation as at the end of the period	(14)	(720)	(1,018)	(188)	(369)	(2,309)
Net carrying amount as at the beginning of the period	23	312	5,361	66	114	5,876
Net carrying amount as at the end of the period	20	240	4,415	562	34	5,271

FOR THE PERIOD FROM 1 JANUARY 2018 TO 31 DECEMBER 2018	Leasehold improvements	Machinery and equipment	Right-of-use assets, including:		Other	Total
			real estate	cars		
Carrying amount as at the beginning of the period, gross	34	789			403	1,226
Purchase	-	131			-	131
Scrapping and sale	-	(26)			-	(26)
Carrying amount as at the end of the period, gross	34	894			403	1,331
Accumulated depreciation as at the beginning of the period	(6)	(441)			(209)	(656)
Depreciation charge	(5)	(167)			(80)	(252)
Scrapping and sale	-	26			-	26
Accumulated depreciation as at the end of the period	(11)	(582)			(289)	(882)
<b>Net carrying amount as at the beginning of the period</b>	<b>28</b>	<b>348</b>			<b>194</b>	<b>570</b>
<b>Net carrying amount as at the end of the period</b>	<b>23</b>	<b>312</b>			<b>114</b>	<b>449</b>

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

#### LEGAL LIMITATIONS RELATING TO THE BANK'S TITLE

In the years 2019 and 2018, there were no intangible assets or property, plant and equipment items to which the Bank's legal title would be limited or pledged as collateral for the Bank's liabilities.

## 25. OTHER ASSETS

#### ACCOUNTING POLICIES

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

#### FINANCIAL INFORMATION

OTHER ASSETS	31.12.2019	31.12.2018
Deferred costs and prepaid expenses, including:	7,656	7,456
deferred costs relating to the overdraft facilities	1,753	2,103
deferred costs relating to unsecured bonds issuance programme <sup>1)</sup>	891	290
deferred costs relating to mortgage covered bonds issuance programme <sup>1)</sup>	1,667	1,948
other	3,345	3,115
Deferred costs and commission relating to loans granted, proportionally to undrawn principal and adjustments of the commission income recognized	3,194	8,829
Settlements relating to appraisal reports on property value for mortgage lending purposes (MLV)	208	443
Settlements with the state budget	11	35
Other	9	6
<b>Total</b>	<b>11,078</b>	<b>16,769</b>
of which financial assets	217	449

<sup>1)</sup> Costs associated with issue programmes relate to the issue programmes as a whole and cannot be allocated to the individual issues carried out as part of the programmes.

## 26. AMOUNTS DUE TO BANKS

### ACCOUNTING POLICIES

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

### FINANCIAL INFORMATION

AMOUNTS DUE TO BANKS	31.12.2019	31.12.2018
<b>Measured at amortized cost</b>		
overdraft within the limit available	10,081	10,513
liability in respect of overdraft facilities	2,422,408	1,881,512
liability in respect of term loans	100,007	100,007
liability in respect of the purchase of receivables	2,278,763	2,300,254
<b>Total</b>	<b>4,811,259</b>	<b>4,292,286</b>

### LIABILITIES IN RESPECT OF LOANS

LENDER	Effective date of agreement	Maturity date	Amount of loan granted as at 31 December 2019	Amount of loan drawn as at 31 December 2019	Liability as at 31 December 2019
PKO Bank Polski SA	29.10.2015	29.10.2022	2 000 000	2 000 000	1 579 996
PKO Bank Polski SA	02.02.2017	03.02.2023	1 500 000	1 500 000	692 404
PKO Bank Polski SA	10.07.2019	08.07.2022	1 000 000	1 000 000	-
Another bank 1	10.06.2019	12.06.2020	150 000	150 000	150 008
Another bank 2	27.12.2018	28.12.2020	100 000	100 000	100 007
<b>Total</b>			<b>4 750 000</b>	<b>4 750 000</b>	<b>2 522 415</b>

LENDER	Effective date of agreement	Maturity date	Amount of loan granted as at 31 December 2018	Amount of loan drawn as at 31 December 2018	Liability as at 31 December 2018
PKO Bank Polski SA	29.10.2015	29.10.2021	1 500 000	1 400 000	828 580
PKO Bank Polski SA	02.02.2017	02.02.2020	1 500 000	1 500 000	902 924
Another bank 1	05.06.2017	10.06.2019	150 000	150 000	150 008
Another bank 2	27.12.2018	28.12.2020	100 000	100 000	100 007
<b>Total</b>			<b>3 250 000</b>	<b>3 150 000</b>	<b>1 981 519</b>

### LIABILITY IN RESPECT OF THE PURCHASE OF RECEIVABLES

The line "Liability in respect of the purchase of receivables" represents the liability arising from the purchase transactions of mortgage covered loan portfolios from PKO Bank Polski SA, as specified in Note 22. The maturity date of the liability resulting from the purchase of receivables is agreed by the parties in the Receivables Sale Agreement for each transaction. For receivables acquired in 2019, the parties agreed that the payment would be due no later than 18 months from the date of transfer (for receivables acquired in 2018 – no later than 12 months from the date of transfer). If the liability is not settled within one month of the date of transfer, the principal amount is subject to interest. The Bank ultimately refinances the purchased receivables portfolios primarily through issuing mortgage covered bonds. The liability resulting from the purchase of receivables at 31 December 2019 concerns portfolios purchased in 2019, whereas as at 31 December 2018 the liability concerned portfolios purchased from the second quarter of 2018.

## 27. AMOUNTS DUE TO CUSTOMERS

### ACCOUNTING POLICIES

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



## FINANCIAL INFORMATION

AMOUNTS DUE TO CUSTOMERS	31.12.2019	31.12.2018
<b>Measured at amortized cost</b>		
amounts due to retail customers- overpaid loans	4,885	4,359
<b>Total</b>	<b>4,885</b>	<b>4,359</b>

## 28. MORTGAGE COVERED BONDS ISSUED

### ACCOUNTING POLICIES

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

### FINANCIAL INFORMATION

MORTGAGE-COVERED BONDS ISSUED	31.12.2019	31.12.2018
<b>Measured at amortized cost</b>		
mortgage covered bonds, including issued under:		
International Mortgage Covered Bonds Issue Programme	16,239,975	12,841,500
National Mortgage Covered Bonds Issue Programme	11,847,023	8,949,417
	4,392,952	3,892,083
<b>Total</b>	<b>16,239,975</b>	<b>12,841,500</b>

  

REPAYMENT PERIOD OF LIABILITIES UNDER MORTGAGE COVERED BONDS ISSUED	31.12.2019	31.12.2018
3 months to 1 year	30,020	-
1 to 5 years	15,417,600	6,933,749
over 5 years	792,355	5,907,751
<b>Total</b>	<b>16,239,975</b>	<b>12,841,500</b>

On 10 June 2019 PKO Bank Hipoteczny SA, as the first bank in Poland, issued green mortgage covered bonds to finance residential mortgage loans that meet the energy effectiveness criteria. The energy effectiveness criteria developed by the Bank were approved by the International Climate Bonds Initiative Agency and are recommended as Low Carbon Building Criteria for housing properties in Poland. The Bank's green mortgage covered bonds have been certified by the Climate Bonds Initiative Agency as bonds that meet the highest international standards in terms of positive environmental impact. Proceeds from green mortgage covered bonds are used exclusively to finance new or re-finance existing long-term mortgage loans for residential real estate with high energy efficiency.

In 2019 the Bank carried out two issues of mortgage covered bonds denominated in PLN with a total value of PLN 500,000 thousand and three issues of mortgage covered bonds denominated in EUR with a value of EUR 700,000 thousand. However, in 2018, the Bank carried out five issues of mortgage covered bonds denominated in PLN with the total value of PLN 1,590,000 thousand and one issue of mortgage covered bonds denominated in EUR with a value of EUR 500,000 thousand. In 2019 and in 2018, the Bank did not redeem any mortgage covered bonds.

As at 31 December 2019 and 31 December 2018, the issued PLN and EUR mortgage covered bonds were rated by Moody's Investors Service at Aa3, i.e. the highest achievable by Polish securities. The limit for the ratings is the Polish country ceiling for debt instruments (i.e. the highest rating which can be obtained in Poland) which currently is at the level of Aa3.

The total nominal value of the issued mortgage covered bonds as at 31 December 2019 amounted to PLN 16,219,372 thousand, and as at 31 December 2018 - PLN 12,824,700 thousand.





## MORTGAGE COVERED BOND ISSUES AS AT 31 DECEMBER 2019

ISIN	Currency	Nominal value	Interest rate as at 31.12.2019	Rate +margin / fixed rate	Issue date	Maturity date	Quotation market
PLPKOHP00017	PLN	30,000	2.45%	WIBOR3M + 0.75 p.p.	11.12.2015	11.12.2020	Bondspot, WSE alternative market
PLPKOHP00025	PLN	500,000	2.37%	WIBOR3M + 0.65 p.p.	27.04.2016	28.04.2021	Bondspot, WSE alternative market
PLPKOHP00033	PLN	500,000	2.29%	WIBOR3M + 0.59 p.p.	17.06.2016	18.06.2021	Bondspot, WSE alternative market
XS1508351357	EUR	500,000	0.13%	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	0.63%	fixed rate	30.03.2017	24.01.2023	LuxSE, WSE alternative market
PLPKOHP00041	PLN	500,000	2.40%	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	2.30%	WIBOR3M + 0.60 p.p.	27.10.2017	27.06.2023	Bondspot, WSE alternative market
XS1709552696	EUR	54,000	0.47%	fixed rate	02.11.2017	03.11.2022	LuxSE
XS1795407979	EUR	500,000	0.75%	fixed rate	22.03.2018	24.01.2024	LuxSE, WSE alternative market
PLPKOHP00074	PLN	700,000	2.20%	WIBOR3M + 0.49 p.p.	27.04.2018	25.04.2024	Bondspot, WSE alternative market
PLPKOHP00082	PLN	100,000	2.04%	WIBOR3M + 0.32 p.p.	18.05.2018	29.04.2022	Bondspot, WSE alternative market
PLPKOHP00090	PLN	500,000	2.33%	WIBOR3M + 0.62 p.p.	27.07.2018	25.07.2025	Bondspot, WSE alternative market
PLPKOHP00108	PLN	60,000	3.49%	fixed rate	24.08.2018	24.08.2028	Bondspot, WSE alternative market
PLPKOHP00116	PLN	230,000	2.38%	WIBOR3M + 0.66 p.p.	26.10.2018	28.04.2025	Bondspot, WSE alternative market
XS1935261013	EUR	500,000	0.25%	fixed rate	28.01.2019	23.11.2021	LuxSE, WSE alternative market
XS1935261013( tranche 2)	EUR	100,000	0.25%	fixed rate	01.03.2019	23.11.2021	LuxSE, WSE alternative market
XS1508351357( tranche 2)	EUR	100,000	0.13%	fixed rate	08.03.2019	24.06.2022	LuxSE, WSE alternative market
PLPKOHP00132	PLN	250,000	2.31%	WIBOR3M + 0.60 p.p.	10.06.2019	30.09.2024	Bondspot, WSE alternative market
PLPKOHP00199	PLN	250,000	2.22%	WIBOR3M + 0.51 p.p.	2019-12-02	2024-12-02	Bondspot, WSE alternative market

## COLLATERAL FOR MORTGAGE COVERED BONDS

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

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

The nominal value of loans included in the cover pool and constituting collateral for issues of mortgage covered bonds as at 31 December 2019 stood at PLN 21,662,027 million. The amount of additional collateral entered in the mortgage covered bonds cover pool maintained in the form of Treasury securities in PLN was PLN 250,000 thousand. As at 31 December 2018 these amounts were PLN 16,947,730 thousand and PLN 251,000 respectively. The Bank's mortgage covered bonds cover pool also included CIRS and FX-Forward transactions hedging the currency and



interest-rate risk of issued mortgage covered bonds denominated in EUR and IRS transactions securing the interest rate risk of fixed rate mortgage covered bonds issued in PLN.

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

## 29. UNSECURED BONDS ISSUED

### ACCOUNTING POLICIES

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

### FINANCIAL INFORMATION

UNSECURED BONDS ISSUED	31.12.2019	31.12.2018
<b>Measured at amortized cost</b>		
unsecured bonds, including bonds issued under:		
Non-Public Bond Issue Programme	4,060,026	3,311,148
Public Bond Issue Programme	3,380,932	2,961,108
an individual agreement	328,148	-
	350,946	350,040
<b>Total</b>	<b>4,060,026</b>	<b>3,311,148</b>

REPAYMENT PERIOD OF LIABILITIES UNDER UNSECURED BONDS ISSUED	31.12.2019	31.12.2018
up to 1 month	796,324	384,312
1 to 3 months	652,153	454,191
3 months to 1 year	2,446,519	2,122,605
1 to 5 years	165,030	350,040
<b>Total</b>	<b>4,060,026</b>	<b>3,311,148</b>

### NON-PUBLIC BOND ISSUE PROGRAMME

In 2019, as part of the Non-Public Bond Issue Programme, the Bank issued 47,317 bonds with a total nominal value of PLN 7,370,100 thousand (i.e. 40,721 bonds with PLN 100,000 nominal value each and 6,596 bonds with PLN 500,000 nominal value each) and redeemed 69,485 bonds with PLN 100,000 nominal value each, i.e. with a total nominal value of PLN 6,948,500 thousand. The figures for 2018 were PLN 7,486,400 thousand (i.e. 74,864 bonds at PLN 100,000 nominal value each) and PLN 6,948,200 thousand (i.e. 69,482 bonds at PLN 100,000 nominal value each), respectively.

The above-mentioned issues of bonds are governed by the Bond Issue Programme Agreement concluded with PKO Bank Polski SA. In accordance with the Agreement, the nominal value of bonds issued and not yet redeemed is PLN 3,500,000 thousand. At the same time, under the Underwriting Agreement, PKO Bank Polski SA as the Underwriter shall be obliged to take up the issuer's bonds up to the amount of PLN 2,000,000 thousand.

As at 31 December 2019, the Bank's liability in respect of bonds issued as part of the Non-Public Bond Issue Programme had a nominal value of PLN 3,400,000 thousand, and as at 31 December 2018 its nominal value was PLN 2,978,400 thousand. As at 31 December 2019 PKO Bank Polski SA did not hold any bonds under the guarantee (PLN 54,100 thousand as at 31 December 2018).

### PUBLIC BOND ISSUE PROGRAMME

On 11 April 2019 the Bank established a Public Bond Issue Programme, and as at 31 May 2019, the Polish Financial Supervision Authority (PFSA) approved the Base Prospectus for the Issue of Bonds by PKO Bank Hipoteczny SA. In 2019, as part of the programme the Bank issued:

- one series of bonds with a value of PLN 161,500 thousand and maturity of 6 months, which were taken up by Biuro Maklerskie PKO Banku Polskiego SA (the Brokerage Office of PKO Bank Polski SA) as part of the underwriting service and subsequently sold to institutional investors;
- four series of bonds addressed primarily to retail investors with a total value of PLN 165,000 thousand and maturity of 2 years.

As at 31 December 2019, the Bank's liability in respect of bonds issued as part of the Public Bond Issue Programme amounted to PLN 326,500 thousand (nominal value); of this amount, the value of bonds issued as part of the underwriting service provided by the Brokerage Office of PKO Bank Polski SA was PLN 161,500 thousand.

#### BONDS ISSUED AS AT 31 DECEMBER 2019

Unsecured bonds issued under:	BONDS (code/ISIN)	Nominal value of 1 bond (in PLN)	Number of bonds	Nominal value (in PLN '000)	Currency	Interest rate	Issue date	Maturity date	Quotation market
Non-Public Bond Issue Programme	OW050220-186	100,000	1,020	102,000	PLN	zero coupon	05.02.2019	05.02.2020	GPW parallel market
	OW230120-198	500,000	1,268	634,000	PLN	zero coupon	23.07.2019	23.01.2020	
	OW210220-199	500,000	400	200,000	PLN	zero coupon	23.08.2019	21.02.2020	
	OW010420-200	500,000	1,800	900,000	PLN	zero coupon	02.10.2019	01.04.2020	
	OW080520-201	500,000	1,454	727,000	PLN	zero coupon	06.11.2019	08.05.2020	
	OW080620-202	500,000	1,674	837,000	PLN	zero coupon	06.12.2019	08.06.2020	
Public Bond Issue Programme	PLPKOHP00140	100	500,000	50,000	PLN	WIBOR3M + 0.60 p.p.	11.07.2019	12.07.2021	GPW parallel market
	PLPKOHP00157	100,000	1,615	161,500	PLN	WIBOR3M + 0.30 p.p.	10.07.2019	10.01.2020	
	PLPKOHP00165	100	450,000	45,000	PLN	WIBOR3M + 0.60 p.p.	28.08.2019	30.08.2021	
	PLPKOHP00173	100	400,000	40,000	PLN	WIBOR3M + 0.60 p.p.	17.10.2019	18.10.2021	
	PLPKOHP00181	100	300,000	30,000	PLN	WIBOR3M + 0.60 p.p.	18.12.2019	20.12.2021	
an individual agreement	PLPKOHP00124	1,000,000	350	350,000	PLN	variable	21.12.2018	21.02.2020	

### 30. OTHER LIABILITIES

#### ACCOUNTING POLICIES

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

## FINANCIAL INFORMATION

OTHER LIABILITIES	31.12.2019	31.12.2018
Expenses to be paid	9,767	8,506
Liabilities in respect of contribution to the Bank Guarantee Fund (BGF), including:	7,984	1,367
maintained in the form of payment commitments to the resolution fund	7,984	1,367
Other liabilities, including:	13,158	12,101
sundry creditors	5,295	5,882
settlements with the state budget, including:	7,863	6,219
liabilities in respect of tax on certain financial institutions	7,404	5,818
Liabilities in respect of payment for shares which have not yet been registered by the KRS Court Register	-	100,000
Lease liabilities	5,051	
<b>Total</b>	<b>35,960</b>	<b>121,974</b>
including financial liabilities	20,113	14,388

As at 31 December 2019 and 31 December 2018, the Bank had no overdue contractual liabilities.

## 31. PROVISIONS

### ACCOUNTING POLICIES

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

## FINANCIAL INFORMATION AND ESTIMATES

PROVISIONS FOR THE PERIOD FROM 1 JANUARY 2019 TO 31 DECEMBER 2019	Provision for disability and retirement benefits	Provisions for loan commitments	Total
<b>As at 1 January 2019, including:</b>	<b>124</b>	<b>144</b>	<b>268</b>
Short-term provision	-	144	144
Long-term provision	124	-	124
Increase/reassessment of provisions	30	207	237
Release/utilization	-	(211)	(211)
<b>As at 31 December 2019, including:</b>	<b>154</b>	<b>140</b>	<b>294</b>
Short-term provision	-	140	140
Long-term provision	154	-	154
<b>PROVISIONS FOR THE PERIOD FROM 1 JANUARY 2018 TO 31 DECEMBER 2018</b>			
<b>As at 31 December 2017, including:</b>	<b>84</b>	<b>54</b>	<b>138</b>
Short-term provision	-	54	54
Long-term provision	84	-	84
<b>Changes due to IFRS 9 implementation</b>	<b>-</b>	<b>54</b>	<b>54</b>
Short-term provision	-	54	54
<b>As at 1 January 2018, including:</b>	<b>84</b>	<b>108</b>	<b>192</b>
Short-term provision	-	108	108
Long-term provision	84	-	84
Increase/reassessment of provisions	53	133	186
Release/utilization	(13)	(97)	(110)
<b>As at 31 December 2018, including:</b>	<b>124</b>	<b>144</b>	<b>268</b>
Short-term provision	-	144	144
Long-term provision	124	-	124

## 32. EQUITY AND SHAREHOLDING STRUCTURE OF THE BANK

### ACCOUNTING POLICIES

#### EQUITY

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

Components of the Bank's equity:

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

## FINANCIAL INFORMATION:

EQUITY	31.12.2019	31.12.2018
Share capital	1,611,300	1,295,000
Supplementary capital	161,563	54,932
Accumulated other comprehensive income, including:	137,990	63,889
cash flow hedges	134,421	59,462
measurement of financial assets measured at fair value through other comprehensive income	3,569	4,427
Retained earnings / accumulated losses (loss resulting from IFRS 9 implementation)	-	(11,787)
Net profit for the period	89,170	85,849
<b>Total equity</b>	<b>2,000,023</b>	<b>1,487,883</b>

## SHAREHOLDING STRUCTURE

Series	Type of shares	Number of shares	Nominal value of 1 share (in PLN)	Series value at nominal value (in PLN)	Date of passing the resolution by the GSM	Issue date	Date of registration in the National Court Register
A	ordinary	300,000,000	1	300,000,000	06.10.2014	06.10.2014	24.10.2014
B	ordinary	200,000,000	1	200,000,000	14.03.2016	07.04.2016	22.04.2016
C	ordinary	200,000,000	1	200,000,000	01.07.2016	15.07.2016	28.07.2016
D	ordinary	100,000,000	1	100,000,000	28.10.2016	18.11.2016	01.12.2016
E	ordinary	150,000,000	1	150,000,000	21.03.2017	04.04.2017	12.04.2017
F	ordinary	150,000,000	1	150,000,000	28.06.2017	04.07.2017	11.09.2017
G	ordinary	100,000,000	1	100,000,000	18.10.2017	20.10.2017	16.11.2017
H	ordinary	95,000,000	1	95,000,000	13.08.2018	17.08.2018	08.10.2018
I	ordinary	100,000,000	1	100,000,000	19.12.2018	21.12.2018	21.02.2019
J	ordinary	131,500,000	1	131,500,000	07.03.2019	19.03.2019	16.05.2019
K	ordinary	84,800,000	1	84,800,000	27.06.2019	01.07.2019	20.08.2019
<b>Total</b>		<b>1,611,300,000</b>		<b>1,611,300,000</b>			

PKO Bank Polski SA was the Bank's sole shareholder as at 31 December 2019 and 31 December 2018.

On 21 February 2019, the issue of 100,000,000 I-series shares (issued on 21 December 2018) was registered with the National Court Register.

Furthermore in 2019, the following took place:

- 131,500,000 new J-series ordinary registered shares with a nominal value of PLN 1 each were issued and the shares were acquired for the issue price of PLN 1.14 per share. The share premium (less tax on civil law transactions and notarial fees) in the amount of PLN 17,741 thousand was recognized in supplementary capital. The issue was registered with the National Court Register on 16 May 2019.
- 84,800,000 new K-series ordinary registered shares with a nominal value of PLN 1 each were issued and the shares were acquired for the issue price of PLN 1.18 per share. The share premium (less tax on civil law transactions and notarial fees) in the amount of PLN 14,828 thousand was recognized in supplementary capital. The issue was registered with the National Court Register on 20 August 2019.

The Bank's share capital amounts to PLN 1,611,300,000 and comprises 1,611,300,000 ordinary registered shares with a nominal value of PLN 1 (one zloty) each. The PKO Bank Hipoteczny SA shares are non-preference shares and have been paid up in full.

The Bank did not pay dividend in 2019 or in 2018. The Bank's Management Board will propose to the Annual General Shareholders' Meeting crediting the profit for the year ended 31 December 2019 to supplementary capital.

## OTHER NOTES

### 33. CONTINGENT LIABILITIES GRANTED AND RECEIVED

#### 33.1 CONTRACTUAL COMMITMENTS

As at 31 December 2019 and 31 December 2018 the Bank had no contractual commitments relating to the purchase of intangible assets and property, plant and equipment.

#### 33.2 FINANCIAL LIABILITIES GRANTED

##### ACCOUNTING POLICIES

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

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

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

##### FINANCIAL INFORMATION

LOAN COMMITMENTS (CONTINGENT)	31.12.2019	31.12.2018
Undrawn residential mortgage loans (nominal value)		
residential mortgage loans to individuals	482,686	719,217
provisions for loan commitments	(140)	(144)
<b>Total, net</b>	<b>482,546</b>	<b>719,073</b>
including irrevocable loan commitments	-	-

Information on provisions for financial liabilities granted is provided in Note 31 "Provisions".

CONTINGENT LOAN COMMITMENTS AT NOMINAL VALUE, BY MATURITY	31.12.2019	31.12.2018
up to 1 month (inclusive)	149,633	186,997
1 to 3 months (inclusive)	121,617	179,128
3 months to 1 year (inclusive)	182,961	307,678
1 to 5 years (inclusive)	28,475	45,414
<b>Total</b>	<b>482,686</b>	<b>719,217</b>

#### 33.3 GUARANTEE COMMITMENTS GRANTED

PKO Bank Hipoteczny SA does not grant guarantee commitments.



### 33.4 CONTINGENT LIABILITIES RECEIVED

#### FINANCIAL INFORMATION:

CONTINGENT LIABILITIES AT THE NOMINAL VALUE	31.12.2019	31.12.2018
Contingent liabilities		
financial	2,230,566	1,171,420
guarantees	2,000,000	1,945,900
<b>Total</b>	<b>4,230,566</b>	<b>3,117,320</b>

The contingent financial liabilities received represent initiated and available revolving current account overdraft facilities, while guarantee commitments received represent the available underwriting guarantees to take up bond issues.

#### RIGHT TO SELL OR PLEDGE COLLATERAL ESTABLISHED FOR THE BANK

As at 31 December 2019 and 31 December 2018 no collateral was established for the Bank, which the Bank would be entitled to sell or re-pledge, in the event of fulfilling all obligations by the owner of the collateral.

### 34. LEGAL CLAIMS

As at 31 December 2019 and 31 December 2018 there were no legal claims.

### 35. INFORMATION ABOUT LEASES

#### ACCOUNTING POLICIES

##### LEASE – LESSEE

The Bank classifies contracts to lease contracts or contracts containing a lease if:

- It obtains the right to use an identified asset, and the supplier's right to substitute it with an alternative asset is insignificant; and
- It has the right to acquire substantially all economic rewards for exercising the right over the entire period of use, and
- It has the right to direct the use of an identified asset over the entire period of its use; where:
  - the Bank has the right to direct the use of an identified asset over the entire period of the lease; or
  - appropriate previous decisions were taken as to how and for what purpose the asset is used.

The Bank applies eliminations and does not recognize right-of-use assets or liabilities in respect of:

- short-term leases to which the Bank classifies contracts without a purchase option, concluded for a period no longer than 12 months from the inception of the lease, in particular contracts concluded for an unspecified period with a short (up to 12-month) notice period, without any significant penalties which are understood in particular as expenses incurred on leasehold improvements or costs of changing the location;
- low-value leases (an asset with a value below PLN 20,000 determined based on the value of a new asset, irrespective of the age of the leased asset), with the exception of leases of space.

The Bank measures its lease liabilities initially at the amount of the present value of outstanding lease payments as at that date:

- fixed lease payments less any lease incentives due;
- variable lease payments that depend on market indices;
- amounts expected to be paid by the lessee as the guaranteed residual value;
- the price for exercising the purchase option if it is reasonably certain that it will be exercised;
- payments of penalties for terminating the lease if the lessee is able to exercise an option to terminate the lease.

The lease payments do not include variable fees dependent on external factors.

After the initial recognition, the lease liabilities are measured by the Bank at amortized cost.



Remeasurement of the lease liability is recognized by the Bank as an adjustment to the right-of-use asset. If due to remeasurement the carrying amount of a right-of-use asset has been reduced to zero and the value of the lease liability is reduced further, the remaining portion of the remeasurement is recognized by the Bank as a gain or loss.

Right-of-use assets are initially measured by the Bank at cost, which comprises:

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

After initial recognition, the Bank recognizes a right-of-use asset at cost reduced by depreciation (straight-line) and impairment, and adjusts it for remeasurement of the lease liability.

The Bank discounts future lease payments using discount rates:

- calculated based on yield curves reflecting the cost of financing in a given currency;
- covering the tenor of the longest lease agreement measured and reflecting (for a given currency) the fixed market interest rate and the Bank's cost of financing;
- indicated on the curve for the maturity corresponding to half of the term of the lease agreement (in connection with the assumption that the lease payments are fixed).

The value of the marginal lending rate for leases is updated by the Bank on a quarterly basis.

The Bank applies the same discount rates to the portfolio of lease contracts for cars and properties, taking into account the impact of the security for the lease on the discount rate applied.

Lease payments in respect of short-term and low-value leases are recognized by the Bank as costs on a straight-line basis over the term of the lease. Differences between the amounts paid and those resulting from the straight-line accounting for costs are recognized in prepayments or accruals.

#### LEASES – LESSOR

The Bank does not conclude contracts in which it acts as the lessor.

#### FINANCIAL INFORMATION

LEASE AMOUNTS RECOGNIZED IN THE INCOME STATEMENT - LESSEE	01.01.2019 - 31.12.2019	
Depreciation of the right-of-use assets		
real estate		(1,206)
cars		(1,018)
Interest expense		(188)
Costs related to short-term lease contracts		(88)
Costs related to lease agreements in respect of low-value assets which are not short-term lease agreements, non-deductible VAT expenses and costs of service charges		(753)
<b>Total</b>		<b>(2,205)</b>

  

RIGHT-OF-USE ASSETS	31.12.2019	01.01.2019
Real estate	4,415	5,361
Cars	562	66
<b>Total</b>	<b>4,977</b>	<b>5,427</b>



OTHER LIABILITIES	31.12.2019	01.01.2019
Lease liabilities, by maturity:		
up to 1 month	5,051	5,427
1 to 3 months	111	93
3 months to 1 year	221	184
1 to 5 years	981	818
over 5 years	3,411	3,387
	327	945
<b>Total</b>	<b>5,051</b>	<b>5,427</b>

### 36. NOTES TO THE STATEMENT OF CASH FLOWS

#### CASH AND CASH EQUIVALENTS

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

#### FINANCIAL INFORMATION

Cash and cash equivalents	31.12.2019	31.12.2018
Cash and balances with the Central Bank	20	6
Amounts due from banks - current accounts	31	22
<b>Total</b>	<b>51</b>	<b>28</b>

As at 31 December 2019 and 31 December 2018 there were no cash and cash equivalents with restricted availability for use.

INTEREST INCOME - RECEIVED	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Interest income on loans and advances to customers	840,573	645,790
Interest received on securities measured at fair value through other comprehensive income	17,931	15,309
Interest received on CIRS	55,602	31,517
Interest received on IRS	9,221	7,129
Interest received on deposits	49	47
Other interest received	44	2
<b>Total</b>	<b>923,420</b>	<b>699,794</b>

INTEREST EXPENSE - PAID	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
Interest paid on overdraft facility	41,827	36,160
Interest paid on term loan	2,470	20
Interest paid on mortgage covered bonds issued	148,265	96,154
Discount and interest paid on bonds issued	72,679	57,403
Interest paid on a liability arising on acquisition of receivables	38,871	30,375
Interest paid on CIRS	267,046	188,633
Interest paid on IRS	7,640	6,541
Interest paid for exceeding the limit in a current account	167	149
Other interest paid	40	22
<b>Total</b>	<b>579,005</b>	<b>415,457</b>

RECONCILIATION OF ITEMS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION WITH THE CASH FLOW STATEMENT	Note	31.12.2018	In the statement of cash flows, presented in:			31.12.2019
			financing activities		operating activities	
			Incurred	Repaid	Other changes, including foreign exchange differences	
Amounts due to banks	26	4,292,286	11,096,009	(10,555,156)	(21,880)	4,811,259
overdraft within the limit available		10,513	-	-	(432)	10,081
liability in respect of overdraft facilities		1,881,512	11,096,009	(10,555,156)	43	2,422,408
liability in respect of term loans		100,007	-	-	-	100,007
liability in respect of the purchase of receivables		2,300,254	-	-	(21,491)	2,278,763
Mortgage covered bonds issued	28	12,841,500	3,504,656	-	(106,181)	16,239,975
Unsecured bonds issued	29	3,311,148	7,624,688	(6,948,500)	72,690	4,060,026
<b>Total</b>		<b>20,444,934</b>	<b>22,225,353</b>	<b>(17,503,656)</b>	<b>(55,371)</b>	<b>25,111,260</b>

## 37. RELATED-PARTY TRANSACTIONS

### 37.1 RELATED-PARTY TRANSACTIONS – CAPITAL LINKS

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

#### FINANCIAL INFORMATION

##### AS AT 31 DECEMBER 2019

ENTITY	ASSETS	
	Receivables	including derivatives
PKO Bank Polski SA	173,515	173,275
<b>Total</b>	<b>173,515</b>	<b>173,275</b>

ENTITY	LIABILITIES				
	Current account credit limits, overdrafts	Liabilities in respect of the purchase of receivables	Mortgage covered bonds and unsecured bonds	Other liabilities	including derivatives
PKO Bank Polski SA	2,282,481	2,278,763	62,416	57,897	46,084
PKO BP Finat Sp. z o.o.	-	-	-	19	-
PKO Leasing SA	-	-	-	577	-
PKO Towarzystwo Ubezpieczeń SA	-	-	-	31	-
PKO Życie Towarzystwo Ubezpieczeń SA	-	-	64,423	-	-
PKO VC -fizan	-	-	33,698	-	-
<b>Total</b>	<b>2,282,481</b>	<b>2,278,763</b>	<b>160,537</b>	<b>58,524</b>	<b>46,084</b>

ENTITY	Loan commitments	Contingent assets
PKO Bank Polski SA	-	4,230,566
<b>Total</b>	<b>-</b>	<b>4,230,566</b>

FOR THE PERIOD FROM 1 JANUARY 2019 TO 31 DECEMBER 2019

ENTITY	Total revenues	including interest and commissions	Total costs	of which interest and commission expense	Gain / (loss) on financial instruments measured at fair value	Net foreign exchange gains / (losses)
PKO Bank Polski SA	1,924	1,642	342,575	317,626	65	(115,511)
PKO BP Finat Sp. z o.o.	-	-	197	-	-	-
PKO Leasing SA	-	-	225	14	-	-
PKO Towarzystwo Ubezpieczeń SA	-	-	3,417	3,417	-	-
PKO Życie Towarzystwo Ubezpieczeń SA	-	-	25	25	-	-
PKO VC -fizan	-	-	713	713	-	-
<b>Total</b>	<b>1,924</b>	<b>1,642</b>	<b>347,152</b>	<b>321,796</b>	<b>65</b>	<b>(115,511)</b>

AS AT 31 DECEMBER 2018

ENTITY	ASSETS	
	Receivables	including derivatives
PKO Bank Polski SA	168,754	168,289
<b>Total</b>	<b>168,754</b>	<b>168,289</b>

ENTITY	LIABILITIES				
	Current account credit limits, overdrafts	Liabilities in respect of the purchase of receivables	Mortgage covered bonds and unsecured bonds	Other liabilities	including derivatives
PKO Bank Polski SA	1,742,017	2,300,254	137,491	122,185	15,254
PKO BP Finat Sp. z o.o.	-	-	-	18	-
PKO Leasing SA	-	-	-	50	-
PKO VC -fizan	-	-	34,675	-	-
<b>Total</b>	<b>1,742,017</b>	<b>2,300,254</b>	<b>172,166</b>	<b>122,253</b>	<b>15,254</b>

ENTITY	Loan commitments	Contingent assets
PKO Bank Polski SA	-	3,117,320
<b>Total</b>	<b>-</b>	<b>3,117,320</b>

FOR THE PERIOD FROM 1 JANUARY 2018 TO 31 DECEMBER 2018

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

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

The Bank also obtains financing from PKO Bank Polski SA in the form of revolving overdrafts:

- On 29 October 2015, PKO Bank Hipoteczny SA concluded a Current Account Revolving Credit Agreement with PKO Bank Polski SA with a limit of PLN 900,000 thousand, for a period of 3 years. By an annex to the Agreement, the amount of the limit was increased to PLN 2,000,000 thousand and the lending period was extended until 29 October 2022.
- On 2 February 2017, PKO Bank Hipoteczny SA concluded a Current Account Revolving Credit Agreement with PKO Bank Polski SA with a limit of PLN 1,500,000 thousand, for a period of 3 years; it was drawn in tranches. As a result of signing an annex on 18 December 2019, the period of utilization was extended to 3 February 2023, and as of 3 February 2020 the limit will amount to PLN 2,000,000 thousand.
- On 10 July 2019, PKO Bank Hipoteczny SA concluded a Current Account Revolving Credit Agreement with PKO Bank Polski SA with a limit of PLN 1,000,000 thousand, for a period of 3 years. The purpose of the loan is to finance the redemption of bonds issued under the Non-Public Programme. The Bank obtained this financing in connection with the obligation to register all non-public issues of securities and clear them with the Central Securities Depository of Poland, which has been binding since 1 July 2019, and makes it impossible to redeem and receive funds from a new issue ("roll-over") on the same day. As a result of an annex to the agreement signed on 18 December 2019, as of 1 January 2020 the limit was increased to PLN 2,500,000 thousand, the utilization period expires on 1 July 2022, and the loan (in addition to servicing the redemption of bonds issued under the Non-Public Bond Issue Programme) may also be used for repayment of liabilities in respect of the purchase of receivables or servicing the redemption of mortgage covered bonds.

As at 31 December 2019, all the loans described above were available in their total amounts.

On 30 September 2015, the Bank entered into a PKO Bank Hipoteczny Bond Issue Programme Agreement (the "Programme") with PKO Bank Polski SA for a Programme amount of up to PLN 2,000,000 thousand over a period of 4 years, as well as an Underwriting Agreement under which the underwriter assumes the obligation to take up the Issuer's Bonds for its own account up to the amount of PLN 2,000,000 thousand. As at 21 May 2018 the value of the programme with annexes was PLN 3,500,000 thousand. On 30 September 2019 the parties to the agreement extended it for another 4-year period. On 18 July 2019, the Bank signed the Issue Agent Agreement with the Brokerage Office Branch of PKO Bank Polski SA. On 18 December 2019, PKO Bank Hipoteczny signed a dealer agreement with PKO Bank Polski SA, on the basis of which PKO Bank Polski SA can be a dealer of bonds issued under the Non-Public Bond Issue Programme of PKO Bank Hipoteczny SA.

On 17 November 2015 A Framework Agreement for the Sale of Receivables was concluded with PKO Bank Polski SA. Based on the agreement, in 2019 the Bank continued to purchase portfolios of receivables under residential mortgage loans. Further details are available in Notes 22 and 26.

On 9 November 2015 the Bank concluded a Programme Agreement with PKO Bank Polski SA and the Brokerage Office Branch of PKO Bank Polski SA. On 30 August 2017, the parties signed an amendment agreement altering and

consolidating the Programme Agreement, under which the Brokerage Office of PKO Bank Polski is engaged by the Bank 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 conducts international mortgage bond issues within the framework of the PKO Bank Hipoteczny Base Prospectus, approved by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.

On 31 May 2019 the Bank concluded a Programme Agreement with PKO Bank Polski SA and the Brokerage Office Branch of PKO Bank Polski SA. concerning the programme for issuing bonds, established on 11 April 2019. PKO Bank Polski SA acts as an arranger and calculation agent and Dom Maklerski PKO Banku Polskiego SA acts as a dealer and firm commitment underwriter.

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

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

### 37.2 RELATED PARTY TRANSACTIONS – PERSONAL LINKS

As at 31 December 2019 ten entities were related to the Bank through key management personnel of PKO Bank Hipoteczny SA or close relatives of key management personnel. In 2019, the Bank had an active agreement with only one of these entities and made payments for the purchases of goods. However at as 31 December 2018, 12 entities were related to the Bank with which no mutual transactions were concluded in 2018.

### 37.3 BENEFITS FOR THE PKO BANK HIPOTECZNY SA KEY MANAGEMENT PERSONNEL

The principles for determining the variable remuneration components policy for key management personnel in the Bank are described in the PKO Bank Hipoteczny SA Directors' Report for the year ended 31 December 2019 (Chapter 6.5).

#### FINANCIAL INFORMATION

COST OF REMUNERATION OF THE BANK'S MANAGEMENT AND SUPERVISORY BOARDS	01.01.2019 - 31.12.2019	01.01.2018 - 31.12.2018
<b>Management Board of the Bank</b>		
Short-term employee benefits <sup>1)</sup>	2,025	2,356
Long-term benefits <sup>2)</sup>	188	237
Share-based payments settled in cash <sup>3)</sup>	469	594
Termination benefits in respect of service provision contracts	-	129
<b>Total</b>	<b>2,681</b>	<b>3,316</b>
<b>Supervisory Board of the Bank (independent members)</b>		
Short-term employee benefits <sup>1)</sup>	138	138
<b>Total</b>	<b>138</b>	<b>138</b>

<sup>1)</sup> Including members of the Management Board who ceased fulfilling their functions;

<sup>2)</sup> Short-term employee benefits comprise: remuneration, social insurance contributions, Employee Social Plans, other benefits and the provision for non-deferred variable remuneration components, which are settled within 12 months of the end of a reporting period;

<sup>3)</sup> Long-term benefits include provisions for deferred variable remuneration components granted in cash, which shall be payable more than 12 months after the end of the reporting period;

<sup>4)</sup> Share-based payments settled in cash comprise provisions for deferred variable remuneration components granted in the form of financial instruments, i.e. phantom shares. Phantom shares are converted into cash after the retention period.

PROVISION FOR VARIABLE REMUNERATION COMPONENTS	31.12.2019 (for 2016-2019)	31.12.2018 (for 2015-2018)
Management Board of the Bank <sup>1</sup>	2,037	2,754
Other MRT	2,808	2,151
<b>Total provision</b>	<b>4,845</b>	<b>4,905</b>

  

REMUNERATION PAID DURING THE YEAR	01.01.2019 - 31.12.2019 (for 2015-2018)	01.01.2018 - 31.12.2018 (for 2015-2017)
awarded in cash		
Management Board of the Bank <sup>1</sup>	515	731
Other MRT	975	850
awarded in the form of financial instruments		
Management Board of the Bank <sup>1</sup>	735	540
Other MRT	223	144
<b>Total remuneration paid</b>	<b>2,448</b>	<b>2,265</b>

<sup>1)</sup> Including members of the Management Board who ceased fulfilling their functions;

<sup>2)</sup> MRT – Material Risk Takers.

#### LOANS AND ADVANCES GRANTED BY THE BANK TO ITS MANAGEMENT

In the period from 1 January to 31 December 2019 and from 1 January to 31 December 2018, no loans or advances were granted to the Bank's Management

Under the Framework Agreement Concerning the Sale of Receivables entered into with PKO Bank Polski SA on 17 November 2015, the Bank purchased portfolios of mortgage residential loans comprising two loans granted to one of the members of the Bank's Supervisory Board. As at 31 December 2019 their carrying amount was PLN 621 thousand, and as at 31 December 2018: PLN 656 thousand. The interest rate and repayment terms are consistent with the arm's length principle.

### 38. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

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

##### ACCOUNTING POLICIES

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



## TRANSFERS

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

There were no transfers between the fair value hierarchy levels in 2019 and 2018.

## MEASUREMENT TECHNIQUES AND OBSERVABLE INPUT DATA

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

## FINANCIAL INFORMATION

ASSETS AND LIABILITIES MEASURED AT FAIR VALUE AS AT 31 DECEMBER 2019	Note	Carrying amount	Level 1	Level 2	Level 3
			Prices quoted on active markets	Valuation techniques based on observable market data	Other valuation techniques
Derivative hedging instruments	20	173,275	-	173,275	-
CIRS		163,676	-	163,676	-
FX forward		382	-	382	-
IRS		9,217	-	9,217	-
Securities	21	1,240,161	1,240,161	-	-
measured at fair value through other comprehensive income		1,240,161	1,240,161	-	-
<b>Total financial assets measured at fair value</b>		<b>1,413,436</b>	<b>1,240,161</b>	<b>173,275</b>	<b>-</b>
Derivative hedging instruments	20	46,084	-	46,084	-
CIRS		45,237	-	45,237	-
FX forward		847	-	847	-
IRS		-	-	-	-
<b>Total financial liabilities measured at fair value</b>		<b>46,084</b>	<b>-</b>	<b>46,084</b>	<b>-</b>



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

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

#### ACCOUNTING POLICIES

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

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

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

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

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

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



## FINANCIAL INFORMATION

ASSETS AND LIABILITIES NOT PRESENTED AT FAIR VALUE AS AT 31 DECEMBER 2019	fair value hierarchy level	valuation method	31.12.2019	
			carrying amount	fair value
Cash and balances with the Central Bank	N/A	amount of consideration due	20	20
Amounts due from banks	2	discounted cash flows	31	31
Loans and advances to customers, including:			25,821,070	25,138,514
residential mortgage loans	3	discounted cash flows	25,821,070	25,138,514
Other financial assets	3	amount of consideration due taking into account impairment	217	217
Amounts due to banks	2	discounted cash flows	4,811,259	4,811,259
Amounts due to customers	2	discounted cash flows	4,885	4,885
Mortgage covered bonds issued	1.2	discounted cash flows, quotations on a regulated market	16,239,975	16,452,033
Unsecured bonds issued	2	discounted cash flows	4,060,026	4,060,026
Other financial liabilities	3	amount of consideration due	20,113	20,113

FINANCIAL ASSETS AND LIABILITIES NOT PRESENTED AT FAIR VALUE AS AT 31 DECEMBER 2018	fair value hierarchy level	valuation method	31.12.2018	
			carrying amount	fair value
Cash and balances with the Central Bank	N/A	amount of consideration due	6	6
Amounts due from banks	2	discounted cash flows	22	22
Loans and advances to customers, including:			21,070,469	21,026,457
residential mortgage loans	3	discounted cash flows	21,070,469	21,026,457
Other financial assets	3	amount of consideration due taking into account impairment	449	449
Amounts due to banks	2	discounted cash flows	4,292,286	4,292,286
Amounts due to customers	2	discounted cash flows	4,359	4,359
Mortgage covered bonds issued	1.2	discounted cash flows, quotations on a regulated market	12,841,500	12,855,959
Unsecured bonds issued	2	discounted cash flows	3,311,148	3,311,148
Other financial liabilities	3	amount of consideration due	14,388	14,388

## 39. OPERATING SEGMENTS

In 2019 and 2018 the Bank did not analyse its operations by segments due to the specific nature of its operations.

## OBJECTIVES AND PRINCIPLES OF RISK MANAGEMENT

### 40. RISK MANAGEMENT IN PKO BANK HIPOTECZNY SA

Risk management at PKO Bank Hipoteczny SA is aimed at ensuring financial stability of the Bank, safeguarding the value and security of the mortgage covered bonds issued and to guarantee the safety of funds deriving from the issue of bonds and the other sources of financing the Bank's operations. The assumed level of risk plays an important role in the planning process.

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

Type of risk	Section
credit risk	41
concentration risk	42
residual risk	43
liquidity risk	44
interest rate risk	45
currency risk	46
models risk	47
operating risk	48
business risk	49
compliance risk	50
reputation risk	51
equity risk	52

#### 40.1 KEY RISK MANAGEMENT POLICIES

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

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



## RISK MANAGEMENT SYSTEM

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



### 40.2 COMPONENTS OF THE RISK MANAGEMENT SYSTEM

The process of risk management in PKO Bank Polski SA consists of the following stages:

#### RISK IDENTIFICATION

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

#### RISK MEASUREMENT AND ASSESSMENT

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

#### RISK CONTROL

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

#### RISK FORECASTING AND MONITORING

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

#### RISK REPORTING

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

#### MANAGEMENT ACTIONS

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

#### 40.3 RISK MANAGEMENT IN THE BANK

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

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

Risk is managed at three mutually complementary levels:

- the first level consists of organizational structures managing the product, organizing the sale of products and customer service as well as other organizational units carrying out operational tasks which generate risk, operating on the basis of internal regulations;
- the second level covers the activity of the compliance unit and the identification, measurement or assessment, control, monitoring and reporting of risk and the identified threats and irregularities – the tasks are carried out by specialized organizational units operating on the basis of the Bank's internal regulations. The purpose of these units is to create internal regulations defining the principles, methods, tools and procedures for risk management as well as measuring the effectiveness of operations;
- the third level is the activity of the internal audit unit performing independent audits of the components of the Bank's management system, including the risk management system and the internal control system. Internal audit functions separately from the first and second level.

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

- the function of the second level in creating systemic solutions is independent of the function of the first level;
- the function of the third level is independent of the functions of the first and second levels.

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

##### RISK BUREAU

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

- identifying risk factors and sources of risk;
- measuring, assessing, as well as periodic monitoring and reporting risk levels;
- measuring and assessing capital adequacy;
- collaborating with the regulator in the risk area (SREP, inspections, clarifications, questionnaires, etc.)
- analysing the property market, principles for property valuation, including the rules for determining the Mortgage Lending Value (BHWN);
- managing non-performing receivables and taking effective actions to collect those receivables.

##### COMPLIANCE TEAM IN THE COMPLIANCE, SECURITY AND LEGAL BUREAU

The Compliance Team, which is a separate internal unit of the Compliance, Security and Legal Bureau, is responsible in particular for developing the compliance risk management system and identifying, controlling and monitoring compliance risk in the Bank, as well as preparing reports and developing a system for managing reputation risk.

##### VALIDATION AND RISK CONTROL TEAM

The Validation and Risk Control Team is responsible, in particular, for ensuring the effectiveness of the Bank's operational risk management system, which includes the identification, measurement, monitoring, control and reporting of the risk, designing model risk management standards, and assessing the level of model risk, validating the models, cooperating in this respect with the model validations unit in PKO Bank Polski SA and for designing and monitoring the operation of systemic solutions for forming control functions in respect of processes considered to be significant for the internal control system, including maintaining the Control Function Matrix. The Team's responsibilities also include coordinating data quality management processes as well as supervising the security of IT systems.

Risk management is supported by the following committees:

#### **SUPERVISORY BOARD AUDIT AND FINANCE COMMITTEE (“AFC”)**

The Committee supports the Supervisory Board in particular by:

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

#### **SUPERVISORY BOARD RISK COMMITTEE (“RC”)**

The Committee supports the Supervisory Board in particular by:

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

#### **ASSETS AND LIABILITIES COMMITTEE (“ALCO”);**

The Committee supports the Supervisory Board in particular by:

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

#### **CREDIT COMMITTEE (“CC”)**

The Committee supports the Supervisory Board in particular by:

- supporting the functions that manage credit, concentration and residual risks, as well as the risk of the models measuring such risks;
- reviewing documents concerning the risks mentioned above, the profile and quality structure of the loan portfolio, impairment allowances on expected credit losses, acquisition of loan portfolios and the property market;
- taking decisions concerning the Bank’s operations, particularly regarding the risk measures and limits, the results of the valuation of risk models, the methodologies and models of calculating impairment allowances on expected credit losses, cut-offs used in the assessment of credit risk, loan receivables purchased by the Bank and individual loan transactions;

- presenting recommendations for the relevant governing bodies of the Bank, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of its competencies.

#### STRATEGY AND BUSINESS INITIATIVES COMMITTEE (“SBIC”)

The Committee supports the Management Board in particular by:

- supporting the functions that manage operational, reputation and compliance risks as well as the risk of the models measuring such risks;
- reviewing documents concerning the risks mentioned above, the directions of the Bank's development, the Bank's strategy and the IT strategy, initiatives connected with the pursuit of the Bank's strategy and the IT strategy, including analyses of operational risk, reviewing the product range, product profitability and the lending process;
- 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 units, members of the Bank's Management Board, project teams or task forces – within the scope of its competencies.

#### DATA QUALITY COMMITTEE (“DOC”)

The Committee supports the Management Board in particular by:

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

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

## 40.4 IDENTIFICATION OF MATERIAL RISKS

### MATERIALITY OF DIFFERENT RISKS

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

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

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

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

Risk types considered to be material:

- credit risk;
- liquidity risk, including financial risk;
- interest rate risk;
- operational risk;
- model risk.

Additionally, the Bank considered the following types of risk as subject to monitoring:

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



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

In the Risk Management Strategy the Bank has defined a number of strategic limits defining the appetite for different risks. The limits are regularly monitored. In 2019 and in 2018 none of the strategic limits was exceeded.

## 41. 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 deterioration in a counterparty's ability to service its obligations. The aim of credit risk management is to minimize losses in the loan portfolio as well as to minimize the risk of occurrence of impairment exposures, while maintaining the expected level of profitability and value of the loan portfolio.

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

The policies are pursued 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.

### 41.1 CREDIT RISK MEASUREMENT AND ASSESSMENT

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

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

The detailed principles and scope of cooperation within the PKO Bank Polski Group regarding the group risk models are laid down in the Outsourcing Agreement with PKO Bank Polski SA described in Note 37.1.

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

When purchasing receivables in respect of housing loans from PKO Bank Polski SA, the Bank also performs an assessment of the credit risks of the contracts to be purchased, in accordance with PKO Bank Hipoteczny S.A.'s methodology for assessing the 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 in accordance with the Internal Ratings-Based Approach - IRB) and the current timeliness of repayments, eliminating receivables which do not satisfy the methodology criteria from the transfer.

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

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

- probability of default – "PD";





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

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

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

The loan portfolio structure taking into account the PD parameters is presented in the table in Note 41.4.4.

## 41.2 CREDIT RISK CONTROL

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

## 41.3 IMPAIRMENT LOSS ON CREDIT EXPOSURES

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

In measuring impairment, the Bank applies IFRS 9, which is based on the concept of expected losses. The impairment model applies to financial assets which are not measured at fair value through profit or loss, and which comprise:

- debt instruments comprising credit exposures and securities;
- off-balance-sheet financial and guarantee exposures.

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

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

Expected loss is determined as the product of the following credit risk parameters: probability of default (PD), loss given default (LGD) and exposure at default (EAD); each of these parameters is a vector representing the number of months covering the expected credit loss horizon.

With regard to exposures classified to Stage 1, the Bank will use a maximum 12-month horizon of estimation of the expected loss, unless the maturity is shorter than 12 months. With Stage 2 exposures, the expected loss will be estimated in the time horizon until the loan matures. 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.

Material credit risk increase is determined taking into account probability of insolvency and its changes in relation to the level recorded at the initial recognition of the loan. In order to assess a material credit risk increase, the Bank uses a model based on the calculation of marginal PD, i.e. the probability of default in a given month. Such probability depends on the amount of time that has passed since the inception of the exposure. Therefore, it is possible to obtain a projection of changes in credit quality over the life of an exposure, which are characteristic of exposures to individuals. Marginal PD curves have been determined based on historical data. Marginal PD is assigned to individual exposures by scaling the curve determined at the portfolio level to the individual exposure/customer assessment obtained using application models (which use data from loan applications) and behavioural models. The Bank identifies material risk increases based on the comparison of probability of default curves over the lifetime of an exposure on initial recognition and on a given reporting date. For each reporting date, only those parts of the initial and current PD curve are compared which correspond to the period from the reporting date to the maturity of the loan. A comparison is based on average PD values over the life of the loan in the analysed period adjusted for present and forecasted macroeconomic ratios. The result of such comparison, referred to as  $\alpha$  statistical value is applied to a threshold value above which an increase in credit risk is considered material. A threshold value is determined based on historical relations between  $\alpha$  statistical value and the occurrence of default. In this process, the probability of the following events is reduced to a minimum:

- classifying an exposure which was not in default in the analysed period to the set of credit exposures with significantly increased credit risk (based on statistics) (type I error);
- not classifying an exposure which was in default in the analysed period to the set of credit exposures with significantly increased credit risk (based on statistics) (type II error).

According to data as at the end of 2019, a threefold or greater increase in PD in relation to the value at the moment of recognition in the books is an indication of a significant deterioration in credit quality. With respect to credit exposures for which the current risk of insolvency does not exceed the level reflected in the price of the financing granted, the results of a comparison of PD curves as at the date of initial recognition and as at the reporting date do not entail the recognition of a significant credit risk increase.

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

- restructuring actions introducing favourable conditions for debtors in financial hardship (forbearance);
- delays in repayment of a material amount of principal or interest exceeding 30 days;
- a significant increase in LTV;
- quarantine of exposures for which the indication of impairment ceased to exist in the last 3 months in Stage 2;
- petitioning for consumer bankruptcy by any of the co-borrowers;
- putting a credit exposure under the management of restructuring and debt collection units of the Bank.

Impairment premises of credit exposures comprise in particular:

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

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

In calculating the value of the ultimate expected loss, the Bank also considers the impact of macroeconomic scenarios on the respective parameters (PD, LGD). The methodology of calculation of the risk parameters includes back-testing of the dependence of the value of the parameters on macroeconomic conditions. Three macroeconomic scenarios developed on the basis of the PKO Bank Polski Group forecasts are used for the purpose of calculating expected loss (as in the identification of an indication of a material increase in credit risk) – a baseline scenario with an 80% probability and two alternative scenarios, each with a 10% probability. The scope of projected indicators include: the GDP growth rate, the unemployment rate, the 3M WIBOR rate, the property price index, and the NBP reference rate. The final expected loss is the average of expected losses in each scenario, weighted by the probability of the scenarios. The base scenario is based on base macroeconomic forecasts. The forecasts are prepared on the basis of quantitative models and adjusted for one-off events.

The Bank applies the low credit risk criterion in accordance with IFRS 9, which allows exposures considered to be at low credit risk to remain in Stage 1, irrespective of the scale of a relative deterioration in the credit quality since initial recognition. In accordance with IFRS 9, credit risk of a financial instrument is considered low when:

- the financial instrument has a low risk of default;
- the borrower has a strong capacity to meet its contractual cash flow obligations in the near term;
- adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations.

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

In 2019, the Bank made the following modifications to the impairment measurement model:

- updating the PD threshold over a 12-month horizon, below which the Bank does not identify indications of a material risk increase. The current level of this threshold depends on the year in which a loan was granted and it is equal to the average PD value over a 12-month horizon for all loans granted in a given year;
- a change in the approach to estimating risk parameters used in the model from quantitative to qualitative.

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

#### 41.4 CREDIT RISK FORECASTING AND MONITORING

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

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

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

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

##### 41.4.1 MAXIMUM EXPOSURE TO CREDIT RISK

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

MAXIMUM EXPOSURE TO CREDIT RISK	31.12.2019	31.12.2018
Derivative hedging instruments	173,275	168,289
<b>Total balance sheet exposure</b>	<b>173,275</b>	<b>168,289</b>

##### 41.4.2 AMOUNTS DUE FROM BANKS

AMOUNTS DUE FROM BANKS	31.12.2019	31.12.2018
Amounts not overdue, not impaired (counterparty rating A2)	31	22
<b>Total, gross</b>	<b>31</b>	<b>22</b>
Allowances for expected credit losses	-	-
<b>Total, net</b>	<b>31</b>	<b>22</b>

#### 41.4.3 SECURITIES

SECURITIES	31.12.2019	31.12.2018
Issued by the State Treasury, PLN Treasury bonds (rating A)	1,240,161	842,965
<b>Total, gross</b>	<b>1,240,161</b>	<b>842,965</b>
Allowances for expected credit losses	-	-
<b>Total, net</b>	<b>1,240,161</b>	<b>842,965</b>

#### 41.4.4 LOANS AND ADVANCES TO CUSTOMERS

The loan portfolio is characterized by low exposure to impaired loans and advances. At 31 December 2019, 88 impaired loans were recognized, and their share in the total loan portfolio amount was 0.07%, whereas as at 31 December 2018, 42 impaired loans were recognized, and their share in the total loan portfolio amount was 0.04%.

LOANS AND ADVANCES TO CUSTOMERS	31.12.2019	31.12.2018
Loans not overdue, not impaired	25,728,434	20,998,000
Loans overdue, not impaired	117,439	92,650
Loans impaired	17,923	8,092
<b>Total, gross</b>	<b>25,863,796</b>	<b>21,098,742</b>
Allowances for loans not overdue, not impaired	(27,212)	(19,205)
Allowances for loans overdue, not impaired	(8,016)	(5,882)
Allowances for loans impaired	(7,498)	(3,186)
<b>Total, net</b>	<b>25,821,070</b>	<b>21,070,469</b>

LOANS AND ADVANCES TO CUSTOMERS, NOT IMPAIRED	31.12.2019	31.12.2018
not past due	25,728,434	20,998,000
up to 30 days overdue	107,093	84,269
from 31 to 60 days overdue	8,406	6,922
from 61 to 90 days overdue	1,940	1,459
<b>Total, gross</b>	<b>25,845,873</b>	<b>21,090,650</b>

#### LOAN PORTFOLIO AND FINANCIAL LIABILITIES GRANTED BY PD RANGE

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

LOANS AND ADVANCES TO CUSTOMERS	31.12.2019			
	Stage 1	Stage 2	Stage 3	Total, gross
<0.01%	764,248	609	-	764,857
0.01% - 0.02%	3,329,464	2,525	-	3,331,989
0.02% - 0.05%	7,219,473	3,198	-	7,222,671
0.05% - 0.1%	6,027,817	2,188	-	6,030,005
0.1% - 0.3%	6,447,869	3,233	-	6,451,102
0.3% - 1.0%	1,517,342	85,740	-	1,603,082
1.0% - 10%	187,143	200,619	-	387,762
10% - 100%	11,439	42,966	17,923	72,328
<b>Total gross amount</b>	<b>25,504,795</b>	<b>341,078</b>	<b>17,923</b>	<b>25,863,796</b>



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

LOAN COMMITMENTS		31.12.2019			
PD RANGE	Stage 1	Stage 2	Stage 3	Total	
<0.01%	25,661	-	-	25,661	
0.01% - 0.02%	70,390	29	-	70,419	
0.02% - 0.05%	100,533	-	-	100,533	
0.05% - 0.1%	206,437	-	-	206,437	
0.1% - 0.3%	59,841	-	-	59,841	
0.3% - 1.0%	19,324	49	-	19,373	
1.0% - 10%	50	372	-	422	
10% - 100%	-	-	-	-	
<b>Total nominal amount</b>	<b>482,236</b>	<b>450</b>	<b>-</b>	<b>482,686</b>	

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

#### 41.4.5 FORBEARANCE PRACTICES

The Bank defines forbearance as actions aimed at changing the contractual terms agreed with a debtor, caused by the debtor's financial distress (restructuring activities introducing concessions that otherwise would not have been granted). The purpose of forbearance activities is to restore a debtor's ability to fulfil his obligations towards the Bank and to maximize the effectiveness of non-performing loan management, i.e. obtaining the highest recoveries while minimizing their costs.

Forbearance changes in repayment terms may consist in:

- dividing the debt due into instalments;
- changing the repayment scheme (annuities, degressive instalments);
- extending the loan period;
- changing the interest rate;
- changing the margin;

- reducing the amounts due.

As a result of signing and repaying the amounts due under a forbearance agreement on a timely basis, a non-performing loan becomes a performing loan.

The granting of forbearance concessions recognized as impairment triggers results in the recognition of a default event and the classification of the credit exposure to the impaired portfolio.

The inclusion of such exposures in the portfolio of serviced exposures (discontinuation of recognition of the forbearance agreement as an impairment trigger) takes place at least 12 months after the introduction of forbearance, provided that all payments in arrears and at least six scheduled payments have been made by the customer and, in the Bank's opinion, the current situation of the customer does not pose a threat to their compliance with the terms of the restructuring agreement.

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

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

Forborne exposures are monitored on a current basis. Due to the impairment trigger or a significant increase in credit risk identified in connection therewith, throughout the whole period of their recognition, allowances are recognized for these exposures in the amount of expected losses over the life horizon of the exposure.

EXPOSURES SUBJECT TO FORBEARANCE IN THE LOAN PORTFOLIO	31.12.2019	31.12.2018
Gross loans and advances to customers, including: subject to forbearance	25,863,796 4,469	21,098,742 2,420
Impairment allowances on loans and advances to customers, of which: on loans and advances to customers subject to forbearance	(42,726) (953)	(28,273) (801)
<b>Net loans and advances to customers, including: subject to forbearance</b>	<b>25,821,070 3,516</b>	<b>21,070,469 1,619</b>

## 41.5 CREDIT RISK REPORTING

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

## 41.6 CREDIT RISK MANAGEMENT ACTIONS

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

- strategic and internal (portfolio) risk tolerance limits;
- minimum transaction conditions (i.e. the maximum value of LTV, maximum loan amount, required down payment, required collateral, the amount of a single loan to MLV);
- the scoring system, including specific cut-off points based on the expected credit loss (the maximum value of the product of PD and LGD for a given customer over a 12-month horizon at which a loan transaction is acceptable);
- limits of the Bank's customers' loan exposures – limits defining the Bank's appetite for credit risk resulting, among other things, from Recommendation S (such as the ratio of the level of a customer's expenses due to servicing the credit and his/her financial liabilities to his/her income, i.e. Debt-to-Income (Dtl) ratio, acceptable to the Supervisory Board);
- competence limits – defining the maximum level of credit decision-making powers concerning the customers of the Bank; the amount of competence limits depends on the authority level at which the credit decision is made (within the Bank's organization);
- minimum loan margins, taking into account the costs of credit risk.



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

## 42. CONCENTRATION RISK MANAGEMENT

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

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

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

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

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

GROSS LOANS AND ADVANCES TO CUSTOMERS – CONCENTRATION RATIO	31.12.2019	31.12.2018
10 largest exposures	0.05%	0.06%
20 largest exposures	0.09%	0.10%
50 largest exposures	0.21%	0.24%
100 largest exposures	0.39%	0.45%

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

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

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

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

In the period ended 31 December 2019 or in any of the prior periods the Bank did not exceed any of the concentration limits.

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



### 43. RESIDUAL RISK MANAGEMENT

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

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

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

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

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

MLV is the value determined by the Bank, which in the Bank's opinion reflects the level of risk associated with the property serving as collateral for loans, and is used to determine the ceiling of a granted loan secured by a mortgage on a specific property or to reach a decision by the Bank as to whether the loan secured on the property may be acquired by the Bank.

PKO Bank Hipoteczny SA determines MLV on the basis of expert valuations of the mortgage lending value of property. Such valuations are carried out with due diligence and prudence. They take into account only those property characteristics and expenditures necessary for its construction which will be of a permanent nature and which any property holder will be able to obtain assuming rational exploitation. The expert valuation, made on a specified date, documents assumptions and parameters underlying the analysis, the process of determining the MLV and the resulting MLV proposal. The expert valuation report takes into account the analyses and forecasts concerning specific parameters for a given property that affect the credit risk assessment, as well as general factors such as: population growth, unemployment rate, and local zoning plans.

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

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

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

GROSS LOANS BY LTV BASED ON MARKET VALUATION	31.12.2019	31.12.2018
below 50%	34%	29%
51% - 60%	21%	18%
61% - 70%	22%	23%
71% - 80%	16%	21%
81% - 90%	7%	9%
<b>Total</b>	<b>100%</b>	<b>100%</b>
Average LTV based on market valuation	56%	59%

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

GROSS LOANS AND ADVANCES TO CUSTOMERS - BY GEOGRAPHICAL REGION	31.12.2019	31.12.2018
mazowiecki	23.7%	24.2%
śląsko-opolski	11.7%	11.3%
dolnośląski	10.7%	10.5%
wielkopolski	9.2%	9.4%
pomorski	8.2%	8.1%
małopolsko-świętokrzyski	8.1%	8.3%
lubelsko-podkarpacki	6.5%	6.8%
zachodnio-pomorski and lubuski	6.3%	6.2%
łódzki	4.9%	4.8%
kujawsko-pomorski	4.8%	4.7%
warmińsko-mazurski	3.4%	3.3%
podlaski	2.5%	2.4%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>

#### 44. LIQUIDITY RISK MANAGEMENT

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

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

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

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

The liquidity risk management is built into the risk management process described in Note 40.2.

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

The Bank's Management Board supervises liquidity risk management, and at least once a year reviews, evaluates and potentially updates internal regulations (including the policies for stress testing), informing the Supervisory Board about the results of the assessment and the implementation of liquidity risk management policies. The Management Board makes decisions about corrective actions, in particular in a situation of heightened risk of the loss of the Bank's liquidity. 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.

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

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

#### 44.1 LIQUIDITY RISK MEASUREMENT AND ASSESSMENT

The Bank applies the following liquidity risk measures:

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

The actualized liquidity gaps as at 31 December 2019 and as at 31 December 2018 are presented below.

LIQUIDITY GAP AS AT 31.12.2019	on demand	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months
Adjusted periodic gap	1,230,618	839,626	41,039	(1,899,778)	(1,777,819)	(5,084,028)	(11,893,775)	18,025,394
Adjusted cumulative periodic gap	1,230,618	2,070,244	2,111,283	211,505	(1,566,314)	(6,650,342)	(18,544,117)	(518,723)

As at 31 December 2019, in the bands up to 6 months, the cumulative adjusted liquidity gap has positive values, which means a surplus of maturing assets increased by estimated inflows from the available overdraft limit over mature liabilities in the short and medium term.

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

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

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

A liquidity surplus comprises liquid assets (consisting of the main part aimed at providing protection from the most acute crises and the supplementary part providing protection from less acute, but longer lasting crises) adjusted for net stress test flows (outflows less inflows) over a 30-day horizon.

SENSITIVITY MEASURE	31.12.2019	31.12.2018
Liquidity surplus in the horizon of up to 1 month (in PLN million)	1,606	1,452

The Bank monitors all mandatory liquidity standards specified in the Decision of the PFSA 386/2008 dated 17 December 2008. The values of liquidity standards binding as at 31 December 2019 and 31 December 2018, as well as the average, minimum and maximum values during the reporting period are shown in the following table:

31.12.2019	as at the end of the period	average during the period	minimum for the period	period high	regulatory minimum
M3	331.27	306.32	145.75	1,807.65	>1.0
M4	1.03	1.03	1.03	1.05	>1.0
31.12.2018	as at the end of the period	average during the period	minimum for the period	period high	regulatory minimum
M3	1,493.58	921.62	78.48	2,164.57	>1.0
M4	1.03	1.04	1.03	1.05	>1.0

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

SENSITIVITY MEASURE	31.12.2019	31.12.2018
Liquidity coverage ratio up to 1 month (LCR)	163%	1255%
LCR regulatory limit	100%	100%

#### 44.2 LIQUIDITY RISK CONTROL

The control of liquidity risk 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.

#### 44.3 LIQUIDITY RISK FORECASTING AND MONITORING

The liquidity risk exposure of PKO Bank Hipoteczny SA as at 31 December 2019 and 31 December 2018 was within the strategic and internal limits set. In the period ended 31 December 2019 and in the period ended 31 December 2018 the Bank did not exceed any of the standards nor any strategic or internal limits.

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

#### 44.4 LIQUIDITY GAP IN THE PRESENTATION OF CONTRACTUAL CASH FLOWS

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

31.12.2019	on demand	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months	Total
<b>Inflows</b>	<b>1,230,617</b>	<b>324,458</b>	<b>805,969</b>	<b>465,731</b>	<b>948,690</b>	<b>2,079,744</b>	<b>6,144,228</b>	<b>28,507,319</b>	<b>40,506,756</b>
securities	-	168,267	-	1,280	9,806	190,568	566,007	388,754	1,324,682
loans and advances to customers	-	156,191	305,969	464,451	938,884	1,889,176	5,578,221	28,118,565	37,451,457
credit lines	1,230,566	-	500,000	-	-	-	-	-	1,730,566
other	51	-	-	-	-	-	-	-	51
<b>Outflows</b>	<b>5,167</b>	<b>1,003,723</b>	<b>798,562</b>	<b>2,750,597</b>	<b>2,387,780</b>	<b>4,439,653</b>	<b>15,912,104</b>	<b>810,655</b>	<b>28,108,241</b>
amounts due to banks	5,167	10,370	9,780	162,269	2,186,462	276,384	4,046,808	-	6,697,240
mortgage covered bonds issued	-	40,967	12,601	27,360	112,319	3,967,011	11,864,800	810,655	16,835,713
unsecured bonds issued	-	797,728	654,564	2,464,978	2,028	168,279	-	-	4,087,577
disbursement of loan commitments	-	149,633	121,617	95,990	86,971	27,979	496	-	482,686
other	-	5,025	-	-	-	-	-	-	5,025
Inflows from hedging derivative instruments	-	30,274	873	6,883	34,275	2,626,435	9,417,809	8,370	12,124,919
Outflows on hedging derivative instruments	-	26,415	46,277	87,886	181,515	2,963,035	9,858,376	9,166	13,172,670
<b>Periodic gap</b>	<b>1,225,450</b>	<b>(675,406)</b>	<b>(37,997)</b>	<b>(2,365,869)</b>	<b>(1,586,330)</b>	<b>(2,696,509)</b>	<b>(10,208,443)</b>	<b>27,695,868</b>	<b>11,350,764</b>
<b>Cumulative gap</b>	<b>1,225,450</b>	<b>550,044</b>	<b>512,047</b>	<b>(1,853,822)</b>	<b>(3,440,152)</b>	<b>(6,136,661)</b>	<b>(16,345,104)</b>	<b>11,350,764</b>	

31.12.2018	on demand	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months	Total
<b>Inflows</b>	<b>1,171,448</b>	<b>313,705</b>	<b>244,439</b>	<b>373,354</b>	<b>760,153</b>	<b>1,694,468</b>	<b>4,852,822</b>	<b>23,000,979</b>	<b>32,411,368</b>
securities	-	191,172	-	1,280	5,985	169,036	335,428	181,920	884,821
loans and advances to customers	-	122,533	244,439	372,074	754,168	1,525,432	4,517,394	22,819,059	30,355,099
credit lines	1,171,420	-	-	-	-	-	-	-	1,171,420
other	28	-	-	-	-	-	-	-	28
<b>Outflows</b>	<b>5,496</b>	<b>627,320</b>	<b>656,458</b>	<b>4,103,379</b>	<b>926,399</b>	<b>2,200,035</b>	<b>8,770,547</b>	<b>5,992,147</b>	<b>23,281,781</b>
amounts due to banks	5,496	10,778	12,120	1,804,054	678,562	1,628,999	1,517,526	-	5,657,535
mortgage covered bonds issued	-	38,803	9,810	23,775	70,874	174,505	7,251,797	5,992,147	13,561,711
unsecured bonds issued	-	386,239	455,400	2,121,798	23,037	352,340	-	-	3,338,814
disbursement of loan commitments	-	186,996	179,128	153,752	153,926	44,191	1,224	-	719,217
other	-	4,504	-	-	-	-	-	-	4,504
<b>Inflows from hedging derivative instruments</b>	<b>-</b>	<b>27,913</b>	<b>882</b>	<b>5,017</b>	<b>27,011</b>	<b>63,510</b>	<b>4,699,897</b>	<b>4,451,008</b>	<b>9,275,238</b>
<b>Outflows on hedging derivative instruments</b>	<b>-</b>	<b>26,465</b>	<b>28,673</b>	<b>61,503</b>	<b>129,001</b>	<b>282,588</b>	<b>5,297,119</b>	<b>4,442,569</b>	<b>10,267,918</b>
<b>Periodic gap</b>	<b>1,165,952</b>	<b>(312,167)</b>	<b>(439,810)</b>	<b>(3,786,511)</b>	<b>(268,236)</b>	<b>(724,645)</b>	<b>(4,514,947)</b>	<b>17,017,271</b>	<b>8,136,907</b>
<b>Cumulative gap</b>	<b>1,165,952</b>	<b>853,785</b>	<b>413,975</b>	<b>(3,372,536)</b>	<b>(3,640,772)</b>	<b>(4,365,417)</b>	<b>(8,880,364)</b>	<b>8,136,907</b>	

#### 44.5 CONCENTRATION OF FUNDING SOURCES

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

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

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

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

STRUCTURE OF THE BANK'S FINANCING	31.12.2019	31.12.2018
Mortgage covered bonds issued	59.6%	58.1%
Funds from the parent entity	16.7%	18.7%
Unsecured bonds issued	14.9%	15.0%
Equity	7.3%	6.7%
Other	1.5%	1.5%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>

The share of funding raised from the Parent amounted to 16.7% as at 31 December 2019 and 18.7% as at 31 December 2018. Such level of the indicator is consistent with the financial plan at the current stage of the Bank's operations. The funding concentration risk is assessed as acceptable.

Seeking to reduce the concentration risk of funding sources, the Bank has implemented a system of internal limits, both in short-term and long-term horizons, according to the mortgage covered bond issues carried out by the Bank. In the period ended 31 December 2019 and 31 December 2018 none of these limits were exceeded.

#### 44.6 LIQUIDITY STRESS TESTS

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

- shock changes in market parameters on financial markets;

- the impact of extreme changes in market factors and of drops in prices on the property market on the anticipated losses on the residential loan portfolio;
- downrating of the Bank's counterparties and of the Bank;
- deterioration of the creditworthiness of borrowers;
- increase in the instability of funding sources;
- increased disbursements of mortgage loans granted;
- inability to roll over short-term bond issues or obtain new ones;
- inability to roll over covered bond issues or obtain new ones.

Stress test results are used in particular in:

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

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

The stress tests conducted on the basis of the Bank's financial data as at 31 December 2019 and as at 31 December 2018 did not indicate any risk to the Bank's business due to the occurrence of hypothetical stressed market conditions. Owing to the well-balanced funding structure, long maturities of most of its liabilities and a sufficient level of liquid assets, the Bank has a high ability to survive a liquidity crisis.

#### 44.7 LIQUIDITY RISK REPORTING

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

#### 44.8 LIQUIDITY RISK MANAGEMENT ACTIONS

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

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

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

### 45. 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 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 and off-balance sheet positions, among other things, in terms of the matching of the repricing periods.

#### 45.1 INTEREST RATE RISK MEASUREMENT AND ASSESSMENT

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



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

SENSITIVITY MEASURE	31.12.2019	31.12.2018
Sensitivity of interest income to a 100 b.p. shift in yield curve, in PLN'000	19,341	19,304
Sensitivity of economic value of equity (BPV), in PLN'000	2	49

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

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

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

31.12.2019	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months	Total
Assets, including:	8,997,175	16,188,124	1,722,523	3,928	6,544	25,274	-	26,943,568
securities	1,093,480	-	143,000	-	-	-	-	1,236,480
loans and advances to customers	7,903,695	16,188,124	1,579,523	3,928	6,544	25,274	-	25,707,088
Liabilities	(5,710,816)	(4,726,662)	(2,464,000)	-	(2,820,100)	(9,279,272)	(60,000)	(25,060,850)
amounts due to banks	(2,795,316)	(1,969,662)	-	-	-	-	-	(4,764,978)
mortgage covered bonds issued	(2,030,000)	(2,030,000)	-	-	(2,820,100)	(9,279,272)	(60,000)	(16,219,372)
unsecured bonds issued	(885,500)	(727,000)	(2,464,000)	-	-	-	-	(4,076,500)
Derivative instruments - assets	507	-	1,914	1,059	2,822,610	9,278,223	60,000	12,164,313
Derivative hedging instruments - liabilities	(4,232,621)	(7,956,551)	(1,775)	(1,028)	(3,780)	(13,816)	-	(12,209,571)
<b>Periodic gap</b>	<b>(945,755)</b>	<b>3,504,911</b>	<b>(741,338)</b>	<b>3,959</b>	<b>5,274</b>	<b>10,409</b>	<b>-</b>	<b>1,837,460</b>
<b>Cumulative gap</b>	<b>(945,755)</b>	<b>2,559,156</b>	<b>1,817,818</b>	<b>1,821,777</b>	<b>1,827,051</b>	<b>1,837,460</b>	<b>1,837,460</b>	
31.12.2018	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months	Total
Assets, including:	7,606,968	14,063,152	144,045	3,636	7,794	-	-	21,825,595
securities	693,480	-	143,000	-	-	-	-	836,480
loans and advances to customers	6,913,488	14,063,152	1,045	3,636	7,794	-	-	20,989,115
Liabilities	(3,642,594)	(5,357,824)	(2,119,700)	(18,500)	-	(4,797,200)	(4,467,500)	(20,403,318)
amounts due to banks	(1,227,794)	(3,022,424)	-	-	-	-	-	(4,250,218)
mortgage covered bonds issued	(2,030,000)	(1,530,000)	-	-	-	(4,797,200)	(4,467,500)	(12,824,700)
unsecured bonds issued	(384,800)	(805,400)	(2,119,700)	(18,500)	-	-	-	(3,328,400)
Derivative instruments - assets	435	-	1,202	295	2,040	4,799,644	4,466,738	9,270,354
Derivative hedging instruments - liabilities	(4,232,565)	(4,951,687)	(1,128)	(286)	(1,908)	(9,971)	(4,122)	(9,201,667)
<b>Periodic gap</b>	<b>(267,756)</b>	<b>3,753,641</b>	<b>(1,975,581)</b>	<b>(14,855)</b>	<b>7,926</b>	<b>(7,527)</b>	<b>(4,884)</b>	<b>1,490,964</b>
<b>Cumulative gap</b>	<b>(267,756)</b>	<b>3,485,885</b>	<b>1,510,304</b>	<b>1,495,449</b>	<b>1,503,375</b>	<b>1,495,848</b>	<b>1,490,964</b>	



## 45.2 INTEREST RATE RISK CONTROL

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

## 45.3 INTEREST RATE RISK FORECASTING AND MONITORING

The foreign exchange risk exposure of PKO Bank Hipoteczny SA as at 31 December 2019 and 31 December 2018 was within the strategic and internal limits set. Owing to effective mitigating activities, despite dynamically growing total assets, interest rate risk was relatively low and caused by the mismatch between the repricing dates of the interest rates on the Bank's assets and liabilities in the shortest repricing bands, i.e. up to 3 months.

## 45.4 INTEREST RATE RISK REPORTING

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

## 45.5 INTEREST RATE RISK MANAGEMENT ACTIONS

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

- procedures concerning the management of interest rate risk;
- internal limits on interest rate risk, among other things for basis point value sensitivity and net interest income sensitivity;
- specification of the permitted types of interest-rate based transactions;
- hedging interest risk with derivatives 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 an as needs basis, enters into hedging transactions (derivative contracts).

## 46. 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.

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

FOREIGN CURRENCY POSITION IN PLN '000	31.12.2019	31.12.2018
EUR	86	78
USD	4	2

The foreign exchange risk exposure of PKO Bank Hipoteczny SA as at 31 December 2019 and 31 December 2018 was within the strategic and internal limits set.

The Bank closes all open FX positions on an ongoing basis, and the control and reporting procedures implemented by the Bank significantly limit the impact of changes in exchange rates on the Bank's financial performance, hence the foreign exchange risk as at 31 December 2019 and as at 31 December 2018 was at a low level.



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

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

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

## 47. MODEL RISK MANAGEMENT

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

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

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

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

### 47.1 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.

### 47.2 MODEL RISK CONTROL

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

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

### 47.3 MODEL RISK FORECASTING AND MONITORING

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

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

### 47.4 MODEL RISK REPORTING

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

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



## 47.5 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.

## 48. OPERATIONAL RISK MANAGEMENT

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

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

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

In order to manage the operational risk, the Bank gathers internal and external data about operational events and the causes and consequences of their occurrence, data on the factors of the business environment, results of operational risk self-assessment, data on KRI and data related to the quality of internal controls.

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

### 48.1 OPERATIONAL RISK MEASUREMENT AND ASSESSMENT

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

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

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

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

### 48.2 OPERATIONAL RISK CONTROL

The aim of operational risk control is to strive to maintain the Bank's operational risk at an acceptable level.

The control of operational risk involves determining the risk limits appropriate for the scale and complexity of the Bank's operations, in particular strategic tolerance limits for operational risk and KRI limits, including threshold and critical values.

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

### 48.3 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.

### 48.4 OPERATIONAL RISK REPORTING

Operational risk information is reported for:

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

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

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

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

### 48.5 OPERATIONAL RISK MANAGEMENT ACTIONS

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

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

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

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

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

### 48.6 OPERATIONAL LOSSES INCURRED

In 2019, 16 operational risk incidents were disclosed at the Bank, which involved operational losses totalling PLN 486 thousand net whereas in 2018 there were 6 incidents with a financial loss of PLN 6 thousand.

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

#### 49. BUSINESS RISK MANAGEMENT

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

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

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

Control of business risk is intended to mitigate the adverse effect of internal and external factors on the financial position of the Bank. The purpose of business risk control is to maintain the Bank's business risk at an acceptable level adapted to the Bank's scale of operations, and its impact on the functioning and financial situation of the Bank in the form of strategic tolerance limits.

The aim of business risk monitoring is to determine whether its level after applying risk controls reflects the admissible level, and diagnosing the necessity of taking management actions and the areas in which it has to be taken.

Particular attention is paid to monitoring the strategic business risk tolerance limit.

Business risk is reported in the form of reports addressed to the Asset and Liability Committee, the Management Board and the Supervisory Board of the Bank.

Management actions consist in particular of:

- reviewing and revising the quarterly financial forecasts and financial plan 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.

#### 50. COMPLIANCE RISK MANAGEMENT

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

The aim of compliance risk management is to:

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

The identification of non-compliance risk includes determining the potential cases of lack of compliance that can occur in processes and products.

The estimation of non-compliance is carried out through:

- estimation of the potential severity of the occurrence of non-compliance risk in the form of:
  - financial losses, particularly in the form of administrative penalties or damages;
  - loss of reputation;
  - other legal sanctions

- estimation of the probability of non-compliance risk occurring.

Based on the compliance risk assessment, by compliance risk category, the overall level of compliance risk for a given process and the related product is determined.

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;
- in the event of non-compliance – the reasons for their arising and the consequences;
- the actions taken by the Bank as part of:
  - compliance risk management;
  - implementing the recommendations issued by internal auditors and external inspectors;
  - bringing the Bank to compliance with new legislation and standards of conduct;
  - fulfilling the Compliance Team's recommendations;
- effectiveness of the controls connected with the mitigation of compliance risk;
- results of compliance tests.

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

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

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

## 51. REPUTATION RISK MANAGEMENT

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

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

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

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

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

- information spread by the mass media;
- information disclosed by the Bank, in accordance with the Bank's internal regulations, concerning the Bank's information policies regarding contacts with investors and customers;
- 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, determining the severity of losses of reputation resulting from such events. The assessment of reputation risk includes the impact, credibility and the opinion-forming potential of the disclosure of an image-related event to the public.

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

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

Information about reputation risk is reported in the form of:

- semi-annual management reports addressed to the Management Board of the Bank;
- information on current events having a material impact on the Bank's reputation; should they occur, they should immediately be delivered to the President of the Management Board;
- information provided in the annual report on the execution of the risk management macroprocess at the Bank, addressed to the Management Board and the Supervisory Board.

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.

## 52. CAPITAL ADEQUACY AND THE MANAGEMENT OF CAPITAL RISK

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

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

Managing the Bank's capital adequacy covers:

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

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

The following constituted the legal basis of the capital adequacy assessment process as at 31 December 2019:

- 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");
- the Act of 29 August 1997 "Banking Law";
- The Act of 5 August 2015 on macroprudential supervision over the financial system and crisis management in the financial system ("Macroprudential Act");
- The Regulation of the Minister of Development and Finance of 25 May 2017 in respect of a higher risk weight for exposures secured with mortgages on residential property.

The process of assessing internal capital adequacy 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 has been implemented in Polish law by way of updating the Banking Law.

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



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

Capital risk is classified as a risk subject to monitoring. In 2019 and since the beginning of the Bank's operations, capital adequacy has remained at a safe level above the supervisory limits.

At 31 December 2019, the total capital ratio of the Bank amounted to 16.6% (as at 31 December 2018: 15.2%). Without taking account of the temporary solutions resulting from the implementation of IFRS 9, the total capital ratio of the Bank would have amounted to 16.5% (15.0% as at 31 December 2018).

## 52.1 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 Law and the CRR with implementing legislation.

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

BANK'S OWN FUNDS	31.12.2019	31.12.2018
Share capital	1,611,300	1,295,000
Supplementary capital	161,563	54,932
Retained earnings	-	(11,787)
Net profit for the period	89,170	85,849
Accumulated other comprehensive income - cash flow hedges	134,421	59,462
Accumulated other comprehensive income - financial assets measured at fair value through other comprehensive income	3,569	4,427
<b>Equity</b>	<b>2,000,023</b>	<b>1,487,883</b>
<b>Equity adjustments</b>	<b>(179,243)</b>	<b>(94,036)</b>
Net profit for the period	(89,170)	(85,849)
Current profit, included by permission from the PFSA	30,629	42,588
Accumulated other comprehensive income - cash flow hedges	(134,421)	(59,462)
Intangible assets	(2,395)	(4,165)
Adjustment to assets measured at fair value (AVA)	(1,360)	(949)
Adjustment relating to the transitional period for IFRS 9 implementation	17,474	13,801
<b>Own funds</b>	<b>1,820,780</b>	<b>1,393,847</b>

At 30 December 2019, the Bank's own funds, Tier I common equity capital and Tier I capital, without accounting for transitional solutions following from the implementation of IFRS 9, would have amounted to PLN 1,803,306 thousand, and to PLN 1,380,046 thousand as at 31 December 2018.

## 52.2 CAPITAL BUFFERS

In accordance with the Regulation of the Minister of Development and Finance of 1 September 2017 in respect of the systemic risk buffer (Official Journal 2017, item 1776), in 2019, the banks were required to maintain the equity ratios at the following levels:

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

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

- the systemic risk buffer of 2.5%;
- the counter-cyclical buffer of 0% for loan exposures in the territory of Poland;
- the buffer of other systemically important institutions set by the PFSA on a case by case basis;
- the systemic risk buffer of 3%.

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

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

### 52.3 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 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 in respect of funding received, commitments made, derivatives or repurchase agreements, but excluding obligations which can only be enforced during the liquidation of a Bank, compared to the Bank's own funds.

The Bank calculates financial leverage according to the CRR.

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

LEVERAGE	31.12.2019	31.12.2018
Leverage ratio (LR)	6.7%	6.3%

As at 31 December 2019 and as at 31 December 2018, the Bank's financial leverage ratio was above the 3% level resulting from Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 which shall apply from 28 June 2021.

As at 31 December 2019, the leverage ratio, without taking account of the transitional solutions resulting from the implementation of IFRS 9, would have amounted to 6.6%, whereas it was 6.2% as at 31 December 2018.

### 52.4 REQUIREMENTS REGARDING OWN FUNDS (PILLAR I)

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

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

At 31 December 2019 and as at 31 December 2018, the own fund requirements in respect of the risk of credit valuation adjustment, settlement and delivery, and market risk were nil, therefore, the total requirement in respect of own funds comprised the requirements in respect of credit and operational risk.

OWN FUNDS REQUIREMENTS	31.12.2019	31.12.2018
Credit risk	854,550	718,961
Operational risk	22,695	15,655
<b>Total own funds requirement</b>	<b>877,245</b>	<b>734,616</b>
Common equity Tier 1 capital ratio (CET1)	16.6%	15.2%
Tier 1 capital ratio (T1);	16.6%	15.2%
<b>Total capital ratio (TCR)</b>	<b>16.6%</b>	<b>15.2%</b>

## EVENTS AFTER THE END OF THE REPORTING PERIOD

### 53. EVENTS AFTER THE END OF THE REPORTING PERIOD

Not applicable.

ZAPISY BĘDĄ UZUPEŁNIANE DO DATY PODPISANIA SPRAWOZDANIA TJ. DO 07.02.2020 r.

Signatures of all Members of the Bank's Management Board

07.02.2020	Paulina Strugała	President of the Management Board	Signed on Polish original ..... (signature)
07.02.2020	Piotr Kochanek	Vice-President of the Management Board	Signed on Polish original ..... (signature)
07.02.2020	Agnieszka Krawczyk	Vice-President of the Management Board	Signed on Polish original ..... (signature)

Signature of the person responsible for the Bank's accounts

07.02.2020

Tomasz Rynkowski  
Director, the Bank's Chief Accountant

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