

SELECTED FINANCIAL DATA DERIVED FROM THE INTERIM CONDENSED FINANCIAL STATEMENTS

SELECTED FINANCIAL DATA	PLN thousand	PLN thousand	EUR thousand	EUR thousand
	period from 01.01.2017 to 30.06.2017	period from 01.01.2016 to 30.06.2016	period from 01.01.2017 to 30.06.2017	period from 01.01.2016 to 30.06.2016
Net interest income	62 227	19 450	14 651	4 440
Net fees and commissions	(2 078)	(2 308)	(489)	(527)
Operating result	34 030	635	8 012	145
Profit / (Loss) before income tax	34 030	635	8 012	145
Net profit / (Loss)	25 140	248	5 919	57
Earnings per share for the period - basic (in PLN / EUR)	0,03	0,00	0,01	0,00
Earnings per share for the period - diluted (in PLN / EUR)	0,03	0,00	0,01	0,00
Total net comprehensive income	17 177	240	4 044	55
Net cash flows from operating activities	(3 532 817)	(1 439 460)	(831 760)	(328 606)
Net cash flows from investing activities	(355 208)	(19 369)	(83 630)	(4 422)
Net cash flows from financing activities	3 866 616	1 445 475	910 349	329 980
Net cash flows	(21 409)	(13 354)	(5 042)	(3 049)

SELECTED FINANCIAL DATA	PLN thousand	PLN thousand	EUR thousand	EUR thousand
	as at 30.06.2017	as at 31.12.2016	at at 30.06.2017	at at 31.12.2016
Total assets	12 134 540	8 610 453	2 871 061	1 946 305
Total equity	948 467	781 290	224 410	176 603
Share capital	950 000	800 000	224 772	180 832
Number of shares (in thousand)	950 000	800 000	950 000	800 000
Net asset value per share (in PLN / EUR)	1,00	0,98	0,24	0,22
Diluted number of shares (in thousand)	950 000	800 000	950 000	800 000
Diluted net asset value per share (in PLN / EUR)	1,00	0,98	0,24	0,22
Capital adequacy ratio	16,7%	17,1%	16,7%	17,1%
Tier 1 capital (CET1)	944 303	780 265	223 424	176 371
Total own funds	944 303	780 265	223 424	176 371

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

- income statement, statement of comprehensive income and statement of cash flows items – the rate is calculated as the average of NBP exchange rates prevailing as at the last day of each month of the reporting period, i.e.: EUR 1 = PLN 4.2474 for the period from 1 January 2017 to 30 June 2017 and EUR 1 = PLN 4.3805 for the period from 1 January 2016 to 30 June 2016,
- statement of financial position items – the average NBP exchange rate as at 30 June 2017: EUR 1 = PLN 4.2265 and as at 31 December 2016: EUR 1 = PLN 4.4240.



Condensed Interim Financial Statements
of PKO Bank Hipoteczny SA
for the six-month period ended
30 June 2017

CONDENSED INTERIM FINANCIAL STATEMENTS OF
PKO BANK HIPOTECZNY SA FOR THE SIX-MONTH PERIOD
ENDED 30 JUNE 2017
(IN PLN THOUSAND)



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STATEMENT OF PROFIT OR LOSS

	Note	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016 ¹⁾
Interest income	2	165 499	36 327
Interest expense	2	(103 272)	(16 877)
Net interest income		62 227	19 450
Fee and commission income	3	5 056	2 359
Fee and commission expense	3	(7 134)	(4 667)
Net fees and commissions		(2 078)	(2 308)
Income from financial instruments measured at fair value	4	(240)	(4)
Foreign exchange result	5	6 503	(4)
Other operating income	6	410	157
Other operating expense	6	(395)	(130)
Net other operating income and expense		15	27
Impairment allowance and write-downs	7	(1 503)	(758)
General administrative expenses	8	(19 580)	(15 768)
Tax on financial institutions		(11 314)	-
Operating result		34 030	635
Profit / (Loss) before income tax		34 030	635
Income tax expense	9	(8 890)	(387)
Net profit / (loss)		25 140	248
¹⁾ Restated data (see Note 1.2.3)			
Earnings per share for the period (PLN)	10	0,03	0,00
Diluted earnings per share for the period (PLN)		0,03	0,00
Weighted average number of shares during the period (in thousand)	10	866 298	376 923
Weighted average number of diluted shares during the period (in thousand)		866 298	376 923

STATEMENT OF COMPREHENSIVE INCOME

	Note	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Net profit / (loss)		25 140	248
Other comprehensive income		(7 963)	(8)
Items that may be reclassified to the statement of profit or loss		(7 963)	(8)
Cash flow hedging, gross		(11 037)	-
Deferred tax on cash flow hedging		2 097	-
Net Cash flow hedging	13	(8 940)	-
Revaluation of financial assets available for sale		1 206	(10)
Deferred tax on revaluation of financial assets available for sale		(229)	2
Net gains on revaluation of financial assets available for sale		977	(8)
Items that may not be reclassified to the statement of profit or loss		-	-
Total net comprehensive income		17 177	240

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STATEMENT OF FINANCIAL POSITION

	Note	30.06.2017	31.12.2016
ASSETS			
Cash and balances with the central bank	11	22	16 033
Amounts due from banks	12	7 596	12 994
Financial derivative instruments	13	181	27 808
Financial assets designated upon initial recognition at fair value through profit or loss	14	-	79 987
Loans and advances to customers	15	11 538 579	8 247 900
Investment securities available for sale	16	563 126	203 019
Intangible assets	17	4 901	5 312
Property, plant and equipment	18	593	580
Deferred income tax asset	9	-	2 440
Other assets	19	19 542	14 380
TOTAL ASSETS		12 134 540	8 610 453
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to banks	20	3 031 312	3 431 832
Financial derivative instruments	13	103 617	113
Amounts due to customers	21	1 773	1 549
Mortgage covered bonds issued	22	6 116 818	3 232 117
Unsecured bonds issued	23	1 912 507	1 151 216
Other liabilities	24	16 145	12 196
Current income tax liabilities	9	1 502	-
Deferred income tax liabilities	9	2 217	-
Provisions	25	182	140
TOTAL LIABILITIES		11 186 073	7 829 163
Equity			
Share capital	26	950 000	800 000
Revaluation reserve		(25 924)	(17 961)
Profit / (Loss) from previous years		(749)	(13 973)
Net profit / (loss) for the period		25 140	13 224
TOTAL EQUITY		948 467	781 290
TOTAL LIABILITIES AND EQUITY		12 134 540	8 610 453
Capital adequacy ratio	41	16,7%	17,1%
Net assets value (in PLN thousand)		948 467	781 290
Number of shares (in thousand)	26	950 000	800 000
Net assets value per share (in PLN)		1,00	0,98
Diluted number of shares (in thousand)		950 000	800 000
Diluted net assets value per share (in PLN)		1,00	0,98

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STATEMENT OF CHANGES IN EQUITY

Period from 1 January 2017 to 30 June 2017	Note	Share capital	Revaluation reserve	Profit/ (Loss) from prior years	Undistributed profit / (loss)	Net profit/ (loss) for the period	Total equity
As at 1 January 2017	26	800 000	(17 961)	(13 973)	13 224	-	781 290
Distribution of profit/ (loss) / Distribution for the Profit/ (Loss) from prior years				13 224	(13 224)		
The issue of shares series E	26	150 000	-	-	-	-	150 000
Total comprehensive income, including:			(7 963)	-	-	25 140	17 177
Net profit/ (loss)			-	-	-	25 140	25 140
Revaluation reserve			(7 963)	-	-	-	(7 963)
As at 30 June 2017		950 000	(25 924)	(749)	-	25 140	948 467

Period from 1 January 2016 to 30 June 2016	Note	Share capital	Revaluation reserve	Profit/ (Loss) from prior years	Undistributed profit / (loss)	Net profit/ (loss) for the period	Total equity
As at 1 January 2016	26	300 000	2	-	(13 973)	-	286 029
The issue of shares series B	26	200 000	-	-	-	-	200 000
Distribution of profit/ (loss) / Distribution for the Profit/ (Loss) from prior years				(13 973)	13 973	-	-
Total comprehensive income, including:			(8)	-	-	248	240
Net profit/ (loss)			-	-	-	248	248
Revaluation reserve			(8)	-	-	-	(8)
As at 30 June 2016		500 000	(6)	(13 973)	-	248	486 269

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STATEMENT OF CASH FLOWS

	Note	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Cash flow from operating activities			
Profit/ (Loss) before income tax		34 030	635
Adjustments:		(3 566 847)	(1 440 095)
Depreciaton and amortization		617	586
Change in financial instruments designated upon initial recognition at fair value through profit or loss		80 000	(94 957)
Change in derivative financial instruments (asset)		27 628	-
Change in loans and advances to customers		(3 292 181)	(3 459 021)
Change in other assets		(9 074)	(2 767)
Change in amounts due to banks		(400 520)	2 108 488
Change in derivative financial instruments (liability)		103 503	-
Change in amounts due to customers		224	468
Change in amounts due to issued mortgage covered bonds		(87 857)	669
Change in amounts due to issued unsecured bonds		17 232	446
Change in provisions and impairment allowances		1 543	774
Change in other liabilities		3 950	5 269
Income tax paid		(864)	-
Other adjustments		(11 048)	(51)
Net cash flow from operating activities		(3 532 817)	(1 439 460)
Cash flow from investing activities			
Inflows from investing activities		1 854	4
Sale and interests from investment securities available for sale		1 854	4
Outflows from investing activities		(357 062)	(19 373)
Acquisition of investment securities available for sale		(356 843)	(16 122)
Acquisition of intangible assets and property, plant and equipment		(219)	(3 251)
Net cash flow from investing activities		(355 208)	(19 369)
Cash flow from financing activities			
Proceeds from issue of own shares		150 000	200 000
Proceeds from issue of mortgage covered bonds		2 987 047	1 000 000
Porceeds from issue of unsecured bonds		744 059	245 842
Interests in issued mortgage covered bonds and unsecured bonds		(14 490)	(367)
Net cash flow from financing activities		3 866 616	1 445 475
Net cash flows		(21 409)	(13 354)
Cash and cash equivalents at the beginning of the period		29 027	14 817
Cash and cash equivalents at the end of the period	29	7 618	1 462
therein restricted cash		-	-

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NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS

1. Introduction

1.1. General information

The condensed interim financial statements of PKO Bank Hipoteczny Spółka Akcyjna („PKO Bank Hipoteczny SA”, „the Bank”) have been prepared for the 6-month period ended 30 June 2017 and include the comparative information for the 6-month period ended 30 June 2016 (in relation to the statement of profit or loss, the statement of comprehensive income, the statement of cash flows and the statement of changes in equity) and the comparative information as at 31 December 2016 (in relation to statement of financial position). The financial information has been presented in Polish zloty (PLN), rounded to thousands of zloty, unless indicated otherwise.

PKO Bank Hipoteczny SA located in Gdynia, 17 Jerzego Waszyngtona Street, 81-342 Gdynia was registered on 24 October 2014 in the Gdansk-North District Court for Gdansk, 8th Commercial Division of the National Court Register under the KRS number 0000528469. The Bank received a statistical REGON No. 222181030. The share capital amounts to PLN 950 000 000.00 and was fully paid up.

Business activities of the Bank

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

PKO Bank Hipoteczny SA specialises in mortgage loans for individual clients and acquiring portfolios of such loans from PKO Bank Polski SA. The Bank acquires loans for its portfolio, based on the strategic relationship with PKO Bank Polski SA.

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

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

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

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

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

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

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

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

No.	First and Last Name	Function	Appointment Date to the Supervisory Board	Resignation Date
1	Jakub Papierski	Chairman of the Supervisory Board	06.10.2014	-
2	Piotr Mazur	Deputy-Chairman of the Supervisory Board	06.10.2014	-
3	Justyna Borkiewicz	Member of the Supervisory Board	28.10.2016	-
4	Mieczysław Król	Member of the Supervisory Board	28.10.2016	-
5	Adam Marciniak	Member of the Supervisory Board	28.10.2016	-
6	Artur Osytek	Member of the Supervisory Board	06.10.2014	-
7	Barbara Soares da Silva	Member of the Supervisory Board	06.10.2014	-

Approval of the Financial Statements

These condensed interim financial statements, which will be subject to a review of Audit and Finance Committee of the Supervisory Board on 25 August 2017, were approved by the Management Board for publication on 18 August 2017.

1.2. Summary of significant accounting policies

1.2.1. Statement of compliance

These condensed interim financial statements of the PKO Bank Hipoteczny SA have been prepared in accordance with IAS 34 Interim Financial Reporting (International Accounting Standards) as adopted by the European Union (EU).

The accounting policies and calculation methods applied in these condensed interim financial statements are consistent with those applied in preparation of the annual financial statements of the PKO Bank Hipoteczny SA for the period ended 31 December 2016.

These condensed interim financial statements for the 6-month period ended 30 June 2017 should be read together with the financial statement of the PKO Bank Hipoteczny SA for the period from 1 January 2016 to 31 December 2016 prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

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1.2.2. Critical estimates and judgements

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

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

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

The same estimation methods have been applied in these interim condensed financial statements as in the financial statements of the PKO Bank Hipoteczny SA for the period from 1 January 2016 to 31 December 2016. The most significant estimates made for the 6-month period ended 30 June 2017 relate to the estimation of impairment of financial assets, which were presented in Note 7.

1.2.3. Changes in presentation of financial statements

The Bank changed the presentation of cost related to the commissions for servicing loans granted as well as purchased receivables under the Outsourcing agreement with PKO Bank Polski SA that is described in Note 30.1. These costs were previously presented in the statement of profit or loss as *Fee and commission expenses*, and are now presented as *General administrative expenses*. The revised presentation better reflects the nature of the costs incurred by the Bank in respect of commission for servicing loans and purchased receivables as such expenses would be presented as general administrative expenses had the Bank serviced these loans as part of its operations. The table below presents the restatement of information presented in the previous financial statements for the period from 1 January 2016 to 30 June 2016:

	01.01.2016 - 30.06.2016 as previously reported	restatement	01.01.2016 - 30.06.2016 restated
Interest income	36 327	-	36 327
Interest expense	(16 877)	-	(16 877)
Net interest income	19 450	-	19 450
Fee and commission income	2 359	-	2 359
Fee and commission expense	(5 766)	1 099	(4 667)
Net fees and commissions	(3 407)	1 099	(2 308)
Income from financial instruments measured at fair value	(4)		(4)
Foreign exchange result	(4)		(4)
Other operating income	157		157
Other operating expense	(130)		(130)
Net other operating income and expense	27		27
Impairment allowance and write-downs	(758)		(758)
General administrative expenses	(14 669)	(1 099)	(15 768)
Tax on financial institutions	-		-
Operating result	635		635
Profit / (Loss) before income tax	635		635
Income tax expense	(387)		(387)
Net profit / (loss)	248		248

1.2.4. Changes in accounting policies

The introduction of new standards and interpretations, which came into force in 2016 and in the first half of 2017 had no significant impact on these financial statements.

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

IFRS 9 "FINANCIAL INSTRUMENTS"

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

Classification and Measurement:

IFRS 9 defines 3 measurement categories of financial instruments:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

During 2017, the second stage of the project is being carried out by the Bank, aimed at implementing the changes in the IT systems and applications, processes, procedures as well as in the financial reporting process.

Impairment

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

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

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

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

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

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

The expected increase of provisions, at initial recognition, due to the implementation of IFRS 9, will be recognized in Tier 1 basic capital (CET1), wherein it is expected that the negative influence on capital level will be spread over time for 5 years, according to the recommendation of European Commission.

Hedge accounting

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

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

During 2016, the Bank in cooperation with an external advisor to the PKO Bank Polski Group executed a gap analysis with respect to these requirements. As at the date of these financial statements the Bank has not yet decided whether to apply the new standard, or to continue to apply the provisions of IAS 39.

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NOTES TO THE STATEMENT OF PROFIT OR LOSS

2. Interest income and expense

Interest income

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Interest income calculated using the effective interest rate method, with respect to financial assets, which are not valued to fair value through profit and loss, including:	161 284	35 732
Income from loans and advances to customers, of which:	161 197	35 708
from impaired loans	9	-
Income from deposits with Banks and mandatory reserve	87	24
Other income, including:	4 215	595
Income from financial assets designated upon initial recognition at fair value through profit and loss	284	595
Income from investment securities	3 911	-
Income from hedging transactions IRS (net)	20	-
Total	165 499	36 327

Interest expense

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Interest expense calculated using the effective interest rate method, with respect to financial assets, which are not valued to fair value through profit and loss, including:	(70 285)	(16 877)
Interest expense on loans received and overdrafts within the limit	(11 698)	(2 156)
Interest expense with respect to deferred payment due to loan portfolios purchased	(20 334)	(11 057)
Interest expense with respect to mortgage covered bonds issued	(21 021)	(2 949)
Interest expense with respect to unsecured bonds issued	(17 232)	(715)
Other costs	(32 987)	-
Expense with respect to hedging transactions CIRS (net)	(32 987)	-
Total	(103 272)	(16 877)

3. Fee and commission income and expense

Fee and commission income

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Fee and commission income from loans and advances to customers, including:	5 056	2 359
fees for property valuations	2 543	1 700
Total	5 056	2 359

Fee and commission expense

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Fee and commissions for operating services provided by banks	(76)	(58)
Costs associated with mortgage covered bonds issuance programmes	(463)	(313)
Costs associated with unsecured bonds issuance programme	(1 168)	(118)
Costs associated with received credit facilities	(1 079)	(417)
Preparation of expert mortgage lending real estate valuations by real estate appraisers	(3 943)	(3 638)
Credit risk insurance costs	(405)	(123)
Total	(7 134)	(4 667)

4. Income from financial instruments measured at fair value

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Derivative instruments:	(239)	-
Derivative result of IRS before designation to hedge accounting	(239)	-
Debt securities	(1)	(4)
Total	(240)	(4)

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5. Foreign exchange result

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Derivative result of CIRS and FX-Forward before designation to hedge accounting	7 596	-
Derivative result of CIRS and FX-Forward in relation to hedge accounting ineffectiveness	(1 137)	-
Other foreign exchange result	44	(4)
Total	6 503	(4)

The hedge accounting ineffectiveness is mainly a result of changes in the value of credit and debt valuation adjustments (CVA/DVA).

6. Other operating income and expense

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Other operating income		
Sundry income	409	155
Other	1	2
Total	410	157

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Other operating expense		
Sundry expense	(377)	(127)
Other	(18)	(3)
Total	(395)	(130)

Sundry expenses for 6 months ended 30 June 2017 includes PLN 333 thousand of costs related to the valuation reports delivered by real estate appraisers for loans which could not be transferred to PKO Bank Hipoteczny SA. According to Debt Purchase Agreement such costs are incurred by PKO Bank Polski SA and thus are reinvoiced and presented in Sundry income. In the period of 6 months ended 30 June 2016 Sundry expenses amounted to PLN 96 thousand.

7. Impairment allowance and write-downs

For the period from 1 January 2017 to 30 June 2017	Balance at the beginning of the period	Increases		Decreases		Balance at the end of the period	Net-impact on the statement of profit and loss
		Recognized during the period	Derecognition of assets and settlement	Reversed during the period	Reversed during the period		
Amounts due from banks	-	-	-	-	-	-	-
Loans and advances to customers measured at amortized cost	1 759	2 951	-	1 450	3 260	(1 501)	
Non-financial sector	1 759	2 951	-	1 450	3 260	(1 501)	
housing loans	1 759	2 951	-	1 450	3 260	(1 501)	
Provision for loans commitments	80	18	-	16	82	(2)	
Total	1 839	2 969	-	1 466	3 342	(1 503)	

For the period from 1 January 2016 to 30 June 2016	Balance at the beginning of the period	Increases		Decreases		Balance at the end of the period	Net-impact on the statement of profit and loss
		Recognized during the period	Derecognition of assets and settlement	Reversed during the period	Reversed during the period		
Amounts due from banks	-	-	-	-	-	-	-
Loans and advances to customers measured at amortized cost	198	1 230	-	510	918	(720)	
Non-financial sector	198	1 230	-	510	918	(720)	
housing loans	198	1 230	-	510	918	(720)	
Provision for loans commitments	31	38	-	-	69	(38)	
Total	229	1 268	-	510	987	(758)	

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8. General administrative costs

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Employee benefits	(7 944)	(7 097)
Overheads	(8 805)	(5 791)
Amortization and depreciation, including:	(6 17)	(586)
property, plant and equipment	(124)	(112)
intangible assets	(493)	(474)
Taxes and fees, including:	(2 214)	(2 294)
tax on civil-law transactions	(1 500)	(1 000)
payment for Banking Guarantee Fund	(31)	(1 084)
payment for Financial Supervision Authority	(554)	(137)
Total	(19 580)	(15 768)

Employee benefits

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Wages and salaries, including:	(6 657)	(5 839)
provision for variable salary components	(1 214)	(892)
provision for retirement and pensions benefits	(40)	(16)
Salary surcharges, including:	(1 027)	(1 030)
provision for surcharges for variable remuneration components	(101)	(178)
Other employee benefits	(260)	(228)
Total	(7 944)	(7 097)

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

Overheads

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Servicing of granted loans and purchased receivables within Outsourcing agreement	(4 386)	(1 099)
Services in terms of supporting operations within Outsourcing agreement	(1 385)	(2 135)
External services performed in terms of other contracts	(933)	(610)
IT costs	(674)	(551)
Rental expense	(954)	(915)
Operating lease	(117)	(123)
Other	(356)	(358)
Total	(8 805)	(5 791)

9. Income tax expense

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Statement of profit or loss		
Current income tax expense	(2 366)	-
Deferred income tax related to origination and reversal of temporary differences	(6 524)	(387)
Tax expense in the income statement	(8 890)	(387)
Tax expense in other comprehensive income related to origination and reversal of temporary differences	1 868	2
Total	(7 022)	(385)

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Effective tax rate reconciliation

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Profit/ (loss) before income tax	34 030	635
Corporate income tax calculated using the enacted tax rate (19%) in force in Poland	(6 466)	(121)
Permanent differences between profit before income tax and taxable income, of which:	(2 453)	(266)
Bank Guarantee Fund prudential levy	(6)	(66)
tax on civil-law transactions	(285)	(190)
tax on financial institutions	(2 150)	-
PFRON costs	(8)	(6)
other permanent differences	(4)	(4)
Other differences between profit before income tax and taxable income, of which:	29	-
tax credit for new technologies	29	-
Income tax in the income statement	(8 890)	(387)
Effective tax rate	26,12%	60,97%
Temporary difference related to the deferred tax presented in the statement of profit or loss	(6 524)	(387)
Total current income tax expense in the statement of profit or loss	(2 366)	0

Accounts payable/receivable from current income tax

	30.06.2017	31.12.2016
Current income tax liabilities	1 502	-
Current income tax receivables	-	-

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Deferred tax assets/liability

	Statement of financial position		Statement of profit or loss	
	30.06.2017	31.12.2016	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Deferred tax liability				
Interest accrued on receivables from customers	3 791	2 838	953	1 161
Interest accrued and discount on securities	608	219	389	15
Adjustment for straight-line and effective interest rate valuation for loan portfolio	10 405	7 217	3 189	2 562
Adjustment for straight-line and effective interest rate valuation for own issued bonds	2 165	1 229	936	437
Deferred expenses	1 217	735	482	(79)
Difference between carrying amount and tax value of property, plant and equipment assets and intangible fixed assets	12	2	10	(2)
Valuation of securities:	174	0	(0)	0
recognized in statement of profit or loss	-	0	(0)	0
recognized in other comprehensive income	174	0	n/d	n/d
Valuation of derivatives	2 277	171	2 068	-
recognized in statement of profit or loss	2 228	160	2 068	-
recognized in other comprehensive income	49	11	n/d	n/d
Gross deferred tax liability	20 650	12 411	8 027	4 094
Deferred income tax asset				
Interest accrued on amounts due to banks	1 725	2 618	(893)	1 149
Interest accrued and discount on issued bonds	3 295	1 491	1 803	558
Impairment allowance on credit exposure	635	349	286	144
Provision for costs	1 587	1 089	498	452
Tax loss	2 361	4 723	(2 362)	1 403
Valuation of securities:	2	59	-	1
recognized in statement of profit or loss	-	-	-	1
recognized in other comprehensive income	2	59	n/d	n/d
Valuation of derivatives	8 828	4 522	2 171	-
recognized in statement of profit or loss	2 527	356	2 171	-
recognized in other comprehensive income	6 301	4 166	n/d	n/d
Gross deferred income tax asset	18 432	14 851	1 503	3 707
Combined effect of temporary differences	(2 217)	2 440	(6 524)	(387)
Deferred income tax asset (presented in the statement of financial position)		2 440		
Deferred income tax liability (presented in the statement of financial position)	(2 217)			
Net deferred tax impact on the statement of profit or loss			(6 524)	(387)

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

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

10. Profit per share

Profit per share

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

Profit per share

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Profit attributable to ordinary shareholders (in PLN thousand)	25 140	248
Weighted average number of ordinary shares during the period (in thousand)	866 298	376 923
Profit per share (in PLN per share)	0,03	0,00

Diluted profit per share

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

During the periods ended on 30 June 2017 and 30 June 2016, the Bank did not have instruments that could be dilutive in relation to the profit per share.

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NOTES TO THE STATEMENT OF FINANCIAL POSITION

11. Cash and balances with the central bank

	30.06.2017	31.12.2016
Current account in the Central Bank	22	16 033
Total	22	16 033

Obligatory reserve

As at 30 June 2017 and as at 31 December 2016, the Bank maintained an obligatory reserve in the amount of PLN 0 and PLN 15 507 thousand.

12. Amounts due from banks

	30.06.2017	31.12.2016
Deposits with banks	-	-
Current accounts	7 596	12 994
Total	7 596	12 994
Impairment allowances on receivables	-	-
Net total	7 596	12 994

Details of risks related to amounts due from banks are presented in the Note 34 'Credit risk management'.

Cash and cash equivalents

Current amounts due from banks as well as other cash equivalents with maturities up to 3 months from the date of acquisition, amounting to PLN 7 596 thousand as at 30 June 2017 and PLN 12 994 thousand as at 31 December 2016 are treated as cash and cash equivalents in their entirety for the purposes of the statement of cash flows.

13. Derivative hedging instrument

Since 2016, the Bank has been applying hedge accounting for cash flow hedges.

13.1. Cash flow hedges

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

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

Hedged risk – currency risk and interest rate risk.

Hedging instruments:

- a) **CIRS Transactions (Cross-Currency Interest Rate Swap)**, where the Bank pays coupons based on a variable rate in PLN, and receives a coupon based on a fixed rate appropriate for the foreign currency. In the event of notice of the bankruptcy of PKO Bank Hipoteczny SA by a court, an automatic extension of the CIRS for 12 months occurs under the terms agreed at the transaction date,
- b) **Series of FX-Forward** in foreign currency which hedge currency exposure, of maturity equivalent to the terms of payment of the coupon of the mortgage covered bonds in foreign currency (optional).

Hedged items:

- a) **mortgage loans** included in the cover pool, with variable interest rates in PLN. Interest rates on loans are indexed to the WIBOR 3M rate. The margin on the mortgage loans, in accordance with IAS 39, are excluded from hedging,
- b) **mortgage covered bonds issued** in a foreign currency at a fixed interest rate.

Periods of expected cash flows and in which an impact on the results is expected – from 1 January 2017 until 2 February 2024.

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

13.1.2. Hedging fluctuations in cash flows from variable rate loans in PLN caused by risk of changes in interest rates, using IRS transactions.

Purpose of hedging – eliminating the risk of cash flow variability generated by loan portfolio in PLN with variable rates, due to the risk of changes in interest rates throughout the hedging period.

Hedged risk – interest rate risk

Hedging instruments:

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IRS Transactions (Interest Rate Swap), where the Bank pays coupons based on a variable WIBOR 3M rate and receives a coupon based on a fixed rate calculated from the nominal amount of transaction.

Hedged items:

A part of the PLN loan portfolio indexed to the variable WIBOR 3M rate. The margin on the mortgage loans is excluded from hedging.

Periods of expected cash flows and in which an impact on the results is expected - from 1 July 2017 until 10 September 2021.

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

Type of instrument	Carrying value/fair value of derivative instruments representing cash flow hedges related to the interest rate and/ or exchange rate			
	30.06.2017		31.12.2016	
	Assets	Liabilities	Assets	Liabilities
IRS	-	1 552	-	-
CIRS	-	101 833	27 709	-
FX-Forward	181	232	99	113
Total	181	103 617	27 808	113

Type of instrument	The nominal value as at 30 June 2017					Total
	up to 1 month	from 1 month up to 3 months	from 3 months up to 1 year	from 1 year up to 5 years	over 5 years	
IRS						
PLN fixed-float	-	-	-	265 000	-	265 000
CIRS						
float PLN sale	-	-	-	2 154 809	2 239 403	4 394 212
fixed EUR purchase (original currency)	-	-	-	498 510	524 860	1 023 370
FX-Forward						
PLN sale	-	-	-	6 036	571	6 607
EUR purchase (original currency)	-	-	-	1 224	116	1 340
PLN purchase	-	-	1 260	4 141	-	5 401
EUR sale (original currency)	-	-	282	884	-	1 166

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

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	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Other comprehensive income from cash flow hedges		
Other comprehensive income at beginning of period, gross	(21 870)	-
Profit/(Loss) recognized in other comprehensive income during the period	(163 559)	-
Amount transferred during the period from other comprehensive income to the statement of profit or loss account	(152 522)	-
- interest income	20	-
- interest expense	(32 987)	-
- exchange result	(119 555)	-
Accumulated other comprehensive income at end of period gross	(32 907)	-
Tax effect	6 252	-
Accumulated other comprehensive income at end of period net	(26 655)	-
The ineffective portion of cash flow hedges recognized in the statement of profit or loss	(1 137)	-
Other comprehensive income for the period before tax	(11 037)	-
Deferred tax on cash flow hedges	2 097	-
Other comprehensive income for the period after tax	(8 940)	-

13.2. Fair value hedges

As at 30 June 2017, the Bank did not use fair value hedges.

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

	30.06.2017	31.12.2016
Debt securities by carrying amount		
Debt securities	-	79 987
issued by central banks, NBP money market bills	-	79 987
Total	-	79 987
Debt securities by nominal value		
issued by central banks, NBP money market bills	-	80 000
The average yield on debt securities issued by central banks	n/d	1,523%

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

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

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

15. Loans and advances to customers

	30.06.2017	31.12.2016
Loans and advances to customers, gross, of which:	11 541 839	8 249 659
non-financial sector	11 541 839	8 249 659
housing	11 541 839	8 249 659
loans granted	3 683 891	2 319 574
purchased receivables	7 857 948	5 930 085
Impairment allowances on loans and advances	(3 260)	(1 759)
Loans and advances to customers, net	11 538 579	8 247 900

In the first half of 2017, based on the Framework Agreement Concerning the Sale of Debts signed with PKO Bank Polski SA on 17 November 2015, the Bank purchased a portfolio of mortgage housing loans in the amount of PLN 2 230 355 thousand. The purchase price was based on market value estimated by an independent appraiser. The purchased debt were recognized on the dates of transfer to the Bank of the rights to the cash flows from individual portfolios, and all related liability for costs and economic risks, in terms of the respective agreements for the sale of debts. The purchase of debt portfolios has been initially financed by the liabilities described in Note 20. The Bank refinances debt purchased portfolios mainly through the issuance of mortgage covered bonds described in Note 22.

Loans granted and purchased receivables that are entered in the Bank's cover pool represent collateral for mortgage covered bonds issued by the Bank, described in Note 23.

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Loans and advances to customers by method of determination of impairment allowances	30.06.2017	31.12.2016
Assessed on an individual basis	-	-
Assessed on a portfolio basis, impaired	754	-
Assessed on a collective basis (IBNR)	11 541 085	8 249 659
Loans and advances to customers, gross	11 541 839	8 249 659
Impairment allowances on exposures assessed on an individual basis	-	-
Impairment allowances on exposures assessed on a portfolio basis	(199)	-
Impairment allowances on exposures assessed on a collective basis (IBNR)	(3 061)	(1 759)
Impairment allowances - total	(3 260)	(1 759)
Loans and advances to customers, net	11 538 579	8 247 900

A detailed description of changes in impairment allowances are presented in Note 7 'Net impairment allowance and write-downs'.

As at 30 June 2017 and 31 December 2016 the net value of the past due loans over 90 days amounted to PLN 445 thousand and PLN 0 respectively. Information about the quality of the loan portfolio were also presented in Note 34.5.3.

As at 30 June 2017 the Bank did not have transferred financial assets that are excluded from the financial statements as a whole for which the Bank would maintain an exposure.

16. Investment securities available for sale

	30.06.2017	31.12.2016
Debt securities available for sale, gross	563 126	203 019
issued by the State Treasury, treasury bonds PLN	563 126	203 019
Impairment allowances on debt securities available for sale	-	-
Total net debt securities available for sale	563 126	203 019
Total net equity securities available for sale	-	-
Total net investment securities available for sale	563 126	203 019

Debt securities by nominal value

issued by the State Treasury, treasury bonds PLN	559 480	201 980
The average yield on debt securities issued by the State Treasury	1,81%	1,74%

Bank Guarantee Fund

As at 30 June 2017, the Bank Guarantee Fund amounted to PLN 10.1 thousand and the Bank held assets in the amount of PLN 3 019.7 thousand to cover the fund. As at 31 December 2016 it was PLN 377.6 thousand and PLN 450.1 thousand respectively. On 30 June 2017 as well as on 31 December 2016, the Bank did not hold any funds that would be covered by the guarantee protection.

17. Intangible assets

Period from 1 January 2017 to 30 June 2017	Assets under construction	Software	Total
Gross carrying amount at the beginning of the period	2 670	4 145	6 815
Purchase	82	-	82
Transfers	-	-	-
Gross carrying amount at the end of the period	2 752	4 145	6 897
Accumulated amortization and impairment allowances for impairment losses at the beginning of the period	-	(1 503)	(1 503)
Amortization	-	(493)	(493)
Impairment allowances	-	-	-
Accumulated amortization and impairment allowances for impairment losses at the end of the period	-	(1 996)	(1 996)
Net carrying amount at the beginning of the period	2 670	2 642	5 312
Net carrying amount at the end of the period	2 752	2 149	4 901

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Period from 1 January 2016 to 30 June 2016	Assets under construction	Software	Total
Gross carrying amount at the beginning of the period	-	3 689	3 689
Purchase	2 670	456	3 126
Transfers	-	-	-
Gross carrying amount at the end of the period	2 670	4 145	6 815
Accumulated amortization and impairment allowances for impairment losses at the beginning of the period	-	(513)	(513)
Amortization	-	(474)	(474)
Impairment allowances	-	-	-
Accumulated amortization and impairment allowances for impairment losses at the end of the period	-	(987)	(987)
Net carrying amount at the beginning of the period	-	3 176	3 176
Net carrying amount at the end of the period	2 670	3 158	5 828

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

The Bank does not produce patents and licenses on its own.

At 30 June 2017 and 31 December 2016 there were no intangible assets to which the Bank's ownership were subject to restrictions and or that were pledged as collateral for liabilities.

18. Property, plan and equipment

Period from 1 January 2017 to 30 June 2017	Assets under construction	Leaseholds improvements	Machinery and equipment	Other	Total
Gross carrying amount of property, plant and equipment at the beginning of the period	-	34	534	397	965
Purchase	83	-	54	-	137
Transfers	(58)	-	58	-	-
Gross carrying amount of property, plant and equipment at the end of the period	25	34	646	397	1 102
Accumulated depreciation at the beginning of the period	-	(3)	(253)	(129)	(385)
Depreciation	-	(2)	(83)	(39)	(123)
Accumulated depreciation at the end of the period	-	(5)	(336)	(168)	(508)
Net carrying amount at the beginning of the period	-	31	281	268	580
Net carrying amount at the end of the period	25	29	310	229	593

Period from 1 January 2016 to 30 June 2016	Assets under construction	Leaseholds improvements	Machinery and equipment	Other	Total
Gross carrying amount of property, plant and equipment at the beginning of the period	-	28	400	376	804
Purchase	6	-	98	21	125
Transfers	(6)	6	-	-	-
Disposal or sale	-	-	(0)	-	(0)
Gross carrying amount of property, plant and equipment at the end of the period	-	34	498	397	929
Accumulated depreciation at the beginning of the period	-	(0)	(106)	(51)	(157)
Depreciation	-	(2)	(72)	(38)	(112)
Disposal or sale	-	-	0	-	0
Accumulated depreciation at the end of the period	-	(2)	(178)	(89)	(269)
Net carrying amount at the beginning of the period	-	28	294	325	647
Net carrying amount at the end of the period	-	32	320	308	660

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

At 30 June 2017 and 31 December 2016, there were no items of property, plant and equipment to which the Bank ownership was subject to restriction or that were pledged as collateral for liabilities.

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19. Other assets

	30.06.2017	31.12.2016
Deferred expenses and prepayments, including:	9 646	5 845
deferred expenses associated with the current account revolving credit facility	3 383	1 100
deferred expenses associated with the unsecured bond issuance program	872	528
deferred expenses associated with the mortgage covered bonds issuance programmes	2 152	2 239
other	3 239	1 978
Deferred commissions from loans granted, proportionally to undrawn principle	8 720	7 020
Settlements with respect to expert mortgage lending real estate valuations	1 115	1 190
Social and legal settlement	42	324
Other	19	1
Total	19 542	14 380

20. Amounts due to banks

	30.06.2017	31.12.2016
Liabilities resulting from current account facility	1 244 756	393 793
Liabilities for the purchase of mortgage loans	1 786 556	3 038 039
Total	3 031 312	3 431 832

Liabilities resulting from current account facility represent the utilized part of the current account revolving credit facility that are presented in the following table:

Creditor	Date of signing the agreement	Loan period	The amount of loan granted	The amount of loan available	Liabilities as at 30.06.2017
PKO Bank Polski S.A.	29.10.2015 r.	3 years	900 000	900 000	141 574
PKO Bank Polski S.A.	02.02.2017 r.	3 years	1 500 000	1 000 000	1 003 177
Other bank	05.06.2017 r.	1 year	100 000	100 000	100 005
			2 500 000	2 000 000	1 244 756

Liabilities from the purchase of mortgage loans arose from the transactions concluded between PKO Bank Hipoteczny SA and PKO Bank Polski SA regarding the sale of mortgage loans secured in the amount of PLN 1 786 556 thousand, further described in Note 15.

The maturity date of the liability resulting from these transactions is agreed upon by the parties in Debt Purchase Agreement for each transaction. For loans acquired in 2017, the parties agreed that the payment is due 12 months from the date of transfer. If the liability is not settled within 1 month from the date of transfer, the principle amount is subject to interest. The Bank refinances the purchase of loan portfolios primarily through the issuance of mortgage covered bonds. The liability for the purchase of mortgage loans is entirely related to portfolios acquired in 2017.

21. Amounts due to customers

	30.06.2017	31.12.2016
Amounts due to customers	1 773	1 549
Loan overpayments	1 773	1 549
Total	1 773	1 549

22. Mortgage covered bonds issued

	30.06.2017	31.12.2016
Mortgage covered bonds issued		
Financial instruments measured at amortized cost - mortgage covered bonds issued	6 116 818	3 232 117
Total	6 116 818	3 232 117

	30.06.2017	31.12.2016
from 1 year to 5 years	3 899 684	1 030 566
over 5 years	2 217 134	2 201 551
Total	6 116 818	3 232 117

In the first half of 2017, the Bank issued mortgage covered bonds in a nominal value of PLN 765 000 thousand and EUR 525 000 thousand classified as liabilities measured at amortized cost.

The total nominal value of issued mortgage covered bonds amounted to PLN 6 127 163 thousand at 30 June 2017.

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Mortgage covered bonds issued as at 30 June 2017

ISIN	Currency	Nominal value	Interest rates at 30.06.2017	Interest rate + margin	Date of issue	Maturity	Quotation market
PLPKOHP00017	PLN	30 000	2,48%	WIBOR3M + 0,75p.p.	11.12.2015	11.12.2020	Bondspot, parallel market WSE
PLPKOHP00025	PLN	500 000	2,38%	WIBOR3M + 0,65p.p.	27.04.2016	28.04.2021	Bondspot, parallel market WSE
PLPKOHP00033	PLN	500 000	2,32%	WIBOR3M + 0,59p.p.	17.06.2016	18.06.2021	Bondspot, parallel market WSE
XS1508351357	EUR	500 000	0,125%	fixed rate	24.10.2016	24.06.2022	LuxSE, WSE
XS1559882821	EUR	25 000	0,82%	fixed rate	02.02.2017	02.02.2024	LuxSE
XS1588411188	EUR	500 000	0,625%	fixed rate	30.03.2017	24.01.2023	LuxSE, WSE
PLPKOHP00041	PLN	500 000	2,42%	WIBOR3M + 0,69p.p.	28.04.2017	18.05.2022	Bondspot, parallel market WSE
PLPKOHP00058	PLN	265 000	2,69%	fixed rate	22.06.2017	10.09.2021	Bondspot, parallel market WSE

As at 30 June 2017 the issued mortgage covered bonds denominated in PLN and in EUR were assigned a rating by Moody's Investors Service of Aa3.

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 Polish National Bank, the European Central Bank, the governments and central banks of the Member States of the European Union, the Organization for Economic Cooperation and Development, with the exception of countries that are restructuring or restructured their foreign debt in the past 5 years, and the State Treasury,
- deposited with the National Bank of Poland,
- held in cash.

The nominal value of loans entered in the Bank's cover pool representing collateral for the mortgage covered bonds issued totaled PLN 8 156 480 thousand at 30 June 2017. The nominal value of additional collateral in the form of securities issued by the State Treasury amounted to PLN 134 000 thousand. As at 31 December 2016, these amounts were PLN 4 650 411 thousand and PLN 85 000 thousand respectively. The CIRS transactions hedging the currency risk of issued mortgage covered bonds denominated in EUR, the FX-Forward transactions hedging the currency risk of issued mortgage covered bonds denominated in EUR and the IRS transaction hedging the interest rate risk of mortgage covered bonds denominated in PLN issued based on a fixed rate, are also registered in the cover pool.

The Bank's cover pool did not contain asset-backed securities (ABS), which did not comply with paragraph 1 of Article 80 of the Guidelines (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (as amended) during the first half of 2017 and in 2016.

23. Unsecured bonds issued

	30.06.2017	31.12.2016
Unsecured bonds issued		
Financial instruments measured at amortized cost - bonds issued	1 912 507	1 151 216
Total	1 912 507	1 151 216
	30.06.2017	31.12.2016
Unsecured bonds issued by maturity		
up to 1 month	548 583	183 326
from 1 month up to 3 months	650 169	734 801
over 3 months up to 1 year	713 755	233 089
Total	1 912 507	1 151 216

During the first half of 2017, the Bank issued unsecured bonds with a nominal value of PLN 2 627 600 thousand and redeemed bonds with a total nominal value of PLN 1 862 900 thousand. Unsecured bonds issued are classified as liabilities measured at amortized cost.

The nominal value of the unsecured bonds outstanding amounted to PLN 1 920 700 thousand as at 30 June 2017.

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Unsecured bonds issued as at 30 June 2017

Unsecured bonds	Nominal value (in PLN)	Interest	Issue date	Maturity date
OW040417-B42	100 000	discount paper	04.01.2017	04.07.2017
OW070817-B53	52 000	discount paper	27.02.2017	07.08.2017
OW150917-B50	80 000	discount paper	07.02.2017	15.09.2017
OW150917-B51	420 000	discount paper	27.02.2017	15.09.2017
OW161017-B52	37 000	discount paper	27.02.2017	16.10.2017
OW161017-B56	210 000	discount paper	31.03.2017	16.10.2017
OW040717-B57	189 600	discount paper	04.04.2017	04.07.2017
OW161017-B58	160 000	discount paper	04.04.2017	16.10.2017
OW161017-B60	20 000	discount paper	28.04.2017	16.10.2017
OW070817-B68	21 000	discount paper	26.05.2017	07.08.2017
OW070817-B69	30 000	discount paper	26.05.2017	07.08.2017
OW210717-B61	88 000	discount paper	05.05.2017	21.07.2017
OW210717-B62	37 300	discount paper	05.05.2017	21.07.2017
OW210717-B63	30 000	discount paper	05.05.2017	21.07.2017
OW210717-B64	27 600	discount paper	12.05.2017	21.07.2017
OW210717-B65	40 000	discount paper	12.05.2017	21.07.2017
OW151117-B67	137 000	discount paper	26.05.2017	15.11.2017
OW151117-B66	30 000	discount paper	12.05.2017	15.11.2017
OW151217-B71	25 000	discount paper	09.06.2017	15.12.2017
OW290917-B73	49 800	discount paper	29.06.2017	29.09.2017
OW271217-B74	100 000	discount paper	29.06.2017	27.12.2017
OW130717-B75	36 400	discount paper	29.06.2017	13.07.2017
Total	1 920 700			

24. Other liabilities

	30.06.2017	31.12.2016
Accounts payable	8 250	5 669
Other liabilities, including:	7 895	6 527
various creditors	4 904	4 558
social and legal settlements	2 991	1 969
Total	16 145	12 196

25. Provisions

Period from 1 January 2017 to 30 June 2017	Provisions for retirement benefits	Provisions for loan commitments and guarantees granted	Total
As at 1 January 2017, including:	60	80	140
Short term provision	-	-	-
Long term provision	60	80	140
Increase/reassessment of provision	40	18	58
Release of provisions	-	(16)	(16)
As at 30 June 2017, including:	100	82	182
Short term provision	-	-	-
Long term provision	100	82	182

Period from 1 January 2016 to 30 June 2016	Provisions for retirement benefits	Provisions for loan commitments and guarantees granted	Total
As at 1 January 2016, including:	28	31	59
Short term provision	-	-	-
Long term provision	28	31	59
Increase/reassessment of provision	16	38	54
As at 30 June 2016, including:	44	69	113
Short term provision	-	-	-
Long term provision	44	69	113

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26. Equity and shareholders of the Bank

	30.06.2017	31.12.2016
Share capital	950 000	800 000
Revaluation reserve	(25 924)	(17 961)
Profit / (Loss) from prior years	(749)	(13 973)
Net profit / (loss) for the year	25 140	13 224
Total Equity	948 467	781 290

The only shareholder of the Bank on 30 June 2017 was PKO Bank Polski SA.

During the first half of 2017, there was one issue of shares and the share capital was increased by a total of PLN 150 000 thousand.

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

Series	Type of shares	Number of shares	Nominal value One share (in PLN)	Value Series Nominal values (in PLN)	Date of adoption of the resolution by the General Meeting of Shareholders	Date of issue	Date of registration in the KRS
A	ordinary register	300 000 000	1	300 000 000	06.10.2014	06.10.2014	24.10.2014
B	ordinary register	200 000 000	1	200 000 000	14.03.2016	07.04.2016	22.04.2016
C	ordinary register	200 000 000	1	200 000 000	01.07.2016	15.07.2016	28.07.2016
D	ordinary register	100 000 000	1	100 000 000	28.10.2016	18.11.2016	01.12.2016
E	ordinary register	150 000 000	1	150 000 000	21.03.2017	04.04.2017	12.04.2017
Total		950 000 000		950 000 000			

As at 30 June 2017 the share capital amounts to PLN 950 000 000 (nine hundred fifty million) and is divided into 950 000 000 (nine hundred fifty million) ordinary registered shares with a nominal value of PLN 1 (one) each. The issued shares of PKO Bank Hipoteczny SA do not have preferential rights and have been fully paid-up.

In addition, on 28 June 2017 the Extraordinary General Meeting of Shareholders adopted a resolution on increasing the share capital of PKO Bank Hipoteczny SA by the amount PLN 150 000 000, i.e. up to PLN 1 100 000 000 by the issue of 150 000 000 new ordinary shares of F series of nominal value of PLN 1 (one) each. All shares have been acquired and paid up by PKO Bank Polski SA on 4 July 2017. Till the date of Management Board approval of these financial statements to publication, the increase of shares has not been registered in the Register of Entrepreneurs of the National Court Register.

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OTHER NOTES

27. Contingent liabilities and off-balance sheet liabilities received

27.1. Contractual commitments

As at 30 June 2017 and as at 31 December 2016 the value of contractual commitments concerning intangible assets and property, plant and equipment amounted to PLN 0.

27.2. Loans commitments granted

Nominal value	30.06.2017	31.12.2016
Credit lines and limits		
Mortgage loans for customers	745 579	611 793
Total	745 579	611 793

Loan commitments granted by maturity as at 30 June 2017

	up to 1 month	from 1 month to 3 months	from 3 months to 1 year	from 1 year to 5 years	over 5 years	Total
Loan commitments granted	372 789	139 810	199 856	33 004	120	745 579
Total	372 789	139 810	199 856	33 004	120	745 579

Loan commitments granted by maturity as at 31 December 2016

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

Information on provisions for contingent financial liabilities is included in Note 25 'Provisions'.

27.3. Guarantee liabilities granted

As at 30 June 2017 and as at 31 December 2016 the Bank did not grant any guarantee liabilities.

27.4. Off-balance sheet liabilities received

Nominal value	30.06.2017	31.12.2016
financial guarantees	758 426	506 207
	1 963 600	1 000 000
Total liabilities received	2 722 026	1 506 207

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

Right to sell or pledge collateral established for the Bank

At 30 June 2017 and 31 December 2016 there was no collateral established for the Bank, which the Bank was entitled to sell or encumber with another pledge, in the event of fulfillment of all obligations by the owner of the collateral.

28. Litigation and claims

As at 30 June 2017 and as at 31 December 2016 there were no litigations and claims.

29. Supplementary information to the statement of cash flows

Cash and cash equivalents

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

Cash and cash equivalents	30.06.2017	31.12.2016
Cash and cash balances with the Central Bank	22	16 033
Current receivables due from banks	7 596	12 994
Total	7 618	29 027

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Bank Hipoteczny

Cash flows from received and paid interests

	01.01.2017 - 30.06.2017	01.01.2016 - 30.06.2016
Interest income - received		
Interest income received from loans and advances to customers	156 822	29 484
Interest income received from securities designated upon initial recognition as at fair value through profit and loss	291	512
Interest income received from investment securities	1 854	4
Interest income received from CIRS transactions	2 496	-
Interest income received from deposits	24	25
Other interest received	63	0
Total	161 550	30 025
Interest income - paid		
Interest income paid due to loan in current account	8 512	2 155
Interest expense / discounts paid due to issued mortgage covered bonds and unsecured bonds	27 090	540
Interest expense with respect to deferred payment due to loan portfolios purchased	28 219	5 009
Interest expense paid due to CIRS	28 704	-
Interest expense paid due to overdraft within the available limit	3	1
Other interest paid	0	0
Total	92 528	7 705

30. Related party transactions

30.1. Equity related party transactions

30 June 2017

ASSETS				
Entity	Purchase of property, plant and equipment and intangible assets	Unsettled fees for the sales of loans	Other receivables	including derivative instruments
PKO Bank Polski SA	3 275	43 150	13 201	181
Total	3 275	43 150	13 201	181

LIABILITIES					
Entity	Revolving loan in current account	Loan purchases	Mortgage covered bonds and unsecured bonds issued	Other liabilities	including derivative instruments
PKO Bank Polski SA	1 144 751	1 786 556	91 789	109 534	103 617
PKO BP Finat Sp. z o.o.	-	-	-	15	-
PKO Leasing SA	-	-	-	2	-
Total	1 144 751	1 786 556	91 789	109 552	103 617

30 June 2017

Entity	Off-balance sheet liabilities granted	Off-balance sheet liabilities received
PKO Bank Polski SA	-	2 722 026
Razem	-	2 722 026

for the period from 1 January 2017 to 30 June 2017

Entity	Total income *	of which interest and fees	Total expenses	of which interest and fees	Result from financial instruments measured at fair value	Foreign exchange result
PKO Bank Polski SA	(549)	(882)	78 917	72 076	(239)	(113 070)
PKO BP Finat Sp. z o.o.	-	-	91	-	-	-
PKO Leasing SA	-	-	156	-	-	-
Total	(549)	(882)	79 163	72 076	(239)	(113 070)

* Total income position concerns, among others, commissions paid to PKO Bank Polski SA for the sales of loans, accounted using the effective interest rate method and included in interest income.

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31 December 2016

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

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

31 December 2016

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

for the period from 1 January 2016 to 30 June 2016

Entity	Total income	of which interest and fees	Total expenses	of which interest and fees
PKO Bank Polski SA	130	35	22 044	18 869
PKO BP Finat Sp. z o.o.	-	-	78	-
PKO Leasing SA	-	-	158	-
Total	130	35	22 280	18 869

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

The Bank also obtains funding from PKO Bank Polski SA. On 29 October 2015, PKO Bank Hipoteczny SA concluded the Agreement for current account revolving credit facility with PKO Bank Polski SA, to the limit of PLN 900 million, for a 3-year period, which is disbursed in tranches. As at 30 June 2017 PLN 758 million was available within the facility. In addition, on 2 February 2017 PKO Bank Hipoteczny SA concluded the Agreement for current account revolving credit facility with PKO Bank Polski SA, to the limit of PLN 1 500 million, for a 3-year period, which is disbursed in tranches. As at 30 June 2017 the loan was available and disbursed in the amount of PLN 1 000 million.

On 30 September 2015, the *PKO Bank Hipoteczny SA Bond Issuance Program Agreement* was concluded with PKO Bank Polski SA for the Program amount of up to PLN 2 billion over a period of 4 years, as well as the *Guarantee Agreement* under which, due to the annexes signed, the guarantor assumes the obligation to acquire the Bonds of the Issuer for its own account up to PLN 2 billion. As at 30 June 2017, the value of the Program amounts to PLN 3 billion due to the signed annex.

On 17 November 2015 the *Framework Agreement for the Sale of Receivables* was concluded with PKO Bank Polski SA. Purchases of debt portfolios of residential loans secured by mortgage in the total value of PLN 2 230 355 thousand were realized on the basis thereof with effect in the first half of 2017. A detailed description thereof is presented in Notes 15 and 20.

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

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

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

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

30.2. Personally related party transactions

As at 30 June 2017, five entities were related to the Bank through key management personnel of PKO Bank Hipoteczny SA or close family members of key management personnel, and as at 31 December 2016 – four entities.

Between 1 January and 30 June 2017 and between 1 January and 31 December 2016, no transactions were concluded with the abovementioned entities by the Bank.

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30.3. Remuneration of PKO Bank Hipoteczny SA key management personnel

Benefits for the Supervisory Board

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

Received, due and potentially due benefits for the Management Board

	2017								
	Short-term employee benefit			Other long-term benefits - variable remuneration in cash ³			Total share-based payments settled in cash		
	Remuneration 01.01.2017-30.06.2017 ¹	Other received 01.01.2017-30.06.2017	Other due as at 30.06.2017 ²	Received in 01.01.2017-30.06.2017	Other due as at 30.06.2017	Potential as at 30.06.2017	Received in 01.01.2017-30.06.2017	Due as at 30.06.2017	Potential as at 30.06.2017
Management Board	1 061	-	546	-	44	350	240	-	749
Members of the Management Board that has not fulfilled their functions in 2017	-	-	-	-	1	2	5	-	2
Total remuneration for the Management Board	1 061	-	546	-	45	352	245	-	751

	2016								
	Short-term employee benefit			Other long-term benefits - variable remuneration in cash ³			Total share-based payments settled in cash		
	Remuneration 01.01.2016-30.06.2016 ¹	Other received 01.01.2016-30.06.2016	Other due as at 30.06.2016 ²	Received in 01.01.2016-30.06.2016	Other due as at 30.06.2016	Potential as at 30.06.2016	Received in 01.01.2016-30.06.2016	Due as at 30.06.2016	Potential as at 30.06.2016
Management Board	780	-	399	-	-	130	-	-	324
Members of the Management Board that has not fulfilled their functions in 2017	-	-	-	-	-	3	-	-	8
Total remuneration for the Management Board	780	-	399	-	-	133	-	-	332

¹⁾ Benefits include basic remuneration and medical care and company social benefits fund (ZFSS)

²⁾ Non-deferred component of variable remuneration (in cash form).

³⁾ Deferred component of variable remuneration (in cash form).

For the period from 1 January 2017 to 30 June 2017 the Management Board was granted short and long-term benefits in form of cash as well as in financial instrument, i.e. phantom shares. Accordingly, due to the fact that no basis for limitation of the amount for variable remuneration nor limitation of the reimbursements granted in 2015 were found, the long-term benefits were granted and share based payment due in 2017 were settled in cash.

Post-employment benefits

In the period from 1 January 2017 to 30 June 2017, no post-employment benefits were paid to the Management Board, whereas in the period from 1 January 2016 to 31 December 2016 the value of post-employment benefits amounted to PLN 138 thousand.

Benefits due to termination of employment

No benefits due to termination of employment were paid in the period from 1 January 2017 to 30 June 2017 and from 1 January 2016 to 30 June 2016.

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

The Bank did not grant loans, guarantees or other benefits to members of the management in the period from 1 January 2017 to 30 June 2017 and from 1 January 2016 to 30 June 2016.

On 4 December 2015, the Bank acquired a portfolio of residential loan receivables which included a loan to one of the members of the Supervisory Board. The carrying value of the loan amounted to PLN 265.7 thousand as at 30 June 2017.

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

As required by CRD IV, European Commission Delegated Commission Regulation (EU) No 604/2014 supplementing the European Parliament and Council Directive 2013/36 / EU on regulatory technical standards for quality criteria and appropriate quantitative criteria for determining the categories of employees whose activities have a significant impact on the institution's risk profile, and also according to the Regulation of

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the Minister of Economic Development and Finance dated 6 March 2017 related to the risk management system, internal control system, remuneration policy and the detailed way of estimating internal capital in banks, the Bank follows the following regulations determining the principles for setting variable salary components:

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

The Regulations describe the procedure for granting variable salary components, associated with the results and effects of work, to the members of the Management Board and the MRT. Variable salary components for the particular period (calendar year) are granted after the settlement bonus objectives. The maximum value of variable remuneration cannot exceed 100% of fixed salaries for the particular period. The variable salary components are granted and paid in the form of:

- non-deferred – 60% of variable salary (in the first year after the calendar year subject to assessment),
- deferred – 40% of the variable salary (for the three years after the first year succeeding the calendar year subject to assessment),

However, both the non-deferred and deferred salary, is awarded in equal parts in cash and in the form of financial instrument, i.e. phantom shares (for which conversion into cash is carried out after an additional period of retention), and in the case of deferred remuneration – after a deferral period. Each of the variable salary components can be decreased by using malus-type mechanism that decreases the amount of due variable salaries.

Provision for variable salary components	30.06.2017 (for years 2015-2017)	31.12.2016 (for years 2015-2016)
Management Board ¹	2 207	1 672
other Risk Takers (MRT)	1 653	1 279
Total provision	3 860	2 951
Remuneration paid during the year	01.01.2017 - 30.06.2017 (for years 2015-2016)	01.01.2016 - 30.06.2016 (for 2015)
granted in cash		
Management Board ¹	-	-
other Risk Takers (MRT)	-	-
granted in the form of financial instruments		
Management Board ¹	245	-
Remuneration paid during the year	60	-
Total amount paid	305	-

¹⁾ including the members of the Management Board that have ceased to fulfill their function

Provision for surcharges related to variable salary components amounted to PLN 330 thousand as at 30 June 2017 and to PLN 243 thousand as at 31 December 2016.

31. Fair value of financial assets and liabilities

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

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

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

The table below shows the breakdown of financial assets and liabilities presented in the financial statements at fair value broken down into 3 categories on 30 June 2017 and 31 December 2016:

Assets and liabilities measured at fair value as at 30.06.2017	Note	Carrying value	Level 1	Level 2	Level 3
			Prices quoted on active markets	Valuation techniques based on observable market data	Other valuation techniques
Derivative financial instruments	13	181	-	181	-
CIRS		-	-	-	-
FX-Forward		181	-	181	-
Financial instruments measured upon initial recognition at fair value through profit or loss	14	-	-	-	-
NBP money market bills		-	-	-	-
Investment securities available for sale	16	563 126	563 126	-	-
Treasury bonds		563 126	563 126	-	-
Financial assets measured at fair value - total:		563 307	563 126	181	-
Derivative financial instruments	13	103 617	-	103 617	-
CIRS		101 833	-	101 833	-
FX-Forward		232	-	232	-
IRS		1 552	-	1 552	-
Financial liabilities measured at fair value - total:		103 617	-	103 617	-

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Assets and liabilities measured at fair value as at 31.12.2016	Note	Carrying value	Level 1	Level 2	Level 3
			Prices quoted on active markets	Valuation techniques based on observable market data	Other valuation techniques
Derivative financial instruments	13	27 808	-	27 808	-
CIRS		27 709	-	27 709	-
FX-Forward		99	-	99	-
Financial instruments measured upon initial recognition at fair value through profit or loss	14	79 987	-	79 987	-
NBP money market bills		79 987	-	79 987	-
Investment securities available for sale	16	203 019	203 019	-	-
Treasury bonds		203 019	203 019	-	-
Financial assets measured at fair value - total:		310 814	203 019	107 795	-
Derivative financial instruments	13	113	-	113	-
FX-Forward		113	-	113	-
Financial liabilities measured at fair value - total:		113	-	113	-

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

Level 1: Prices quoted on the active markets:

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

Level 2: Valuation techniques based on observable market data

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

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

Level 3: Other valuation techniques

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

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

In the period from 1 January 2017 to 30 June 2017 and from 1 January 2016 to 31 December 2016, there were no transfers between levels in the fair value hierarchy used in measuring fair value of financial instruments.

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

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

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

For certain groups of financial instruments it has been assumed that their carrying amount approximates their fair values, due to the lack of expected material differences between their carrying amount and their fair value in view of the features of these groups (for example,

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short-term nature, high correlation with market parameters, short interest repricing periods, unique character of the instrument or short period from issue date). This applies to the following groups of financial instruments:

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

Due to the fact that the Bank issued mortgage covered bonds denominated in EUR with a fixed interest rate for the term, the fair value was determined based on the price observed on the regulated market (LuxSE).

	level of fair value hierarchy	valuation method	30.06.2017	
			carrying amount	fair value
Cash and balances with the Central Bank	n/a	value at cost to pay incl. impairment allowance	22	22
Amounts due from banks	3	discounted cash flows	7 596	7 596
Loans and advances to customers, including: housing loans	3	discounted cash flows	11 538 579	11 538 579
Amounts due to banks	3	discounted cash flows	3 031 312	3 031 312
Amounts due to customers	3	discounted cash flows	1 773	1 773
Mortgage covered bonds	1,3	discounted cash flows, regulated market	6 116 818	6 090 750
Unsecured bonds issued	3	discounted cash flows	1 912 507	1 912 507
			31.12.2016	
	level of fair value hierarchy	valuation method	carrying amount	fair value
Cash and balances with the Central Bank	n/a	value at cost to pay incl. impairment allowance	16 033	16 033
Amounts due from banks	3	discounted cash flows	12 994	12 994
Loans and advances to customers, including: housing loans	3	discounted cash flows	8 247 900	8 247 900
Amounts due to banks	3	discounted cash flows	3 431 832	3 431 832
Amounts due to customers	3	discounted cash flows	1 549	1 549
Mortgage covered bonds	1, 3	discounted cash flows, regulated market	3 232 117	3 207 099
Unsecured bonds issued	3	discounted cash flows	1 151 216	1 151 216

32. Business segments

During the reporting period, the Bank did not conduct segmented business activities. The whole Bank's business activity is perceived as one segment.



OBJECTIVES AND PRINCIPLES OF RISK MANAGEMENT RELATED TO FINANCIAL INSTRUMENTS

33. Risk Management in PKO Bank Hipoteczny

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

33.1. Main principles of risk management

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

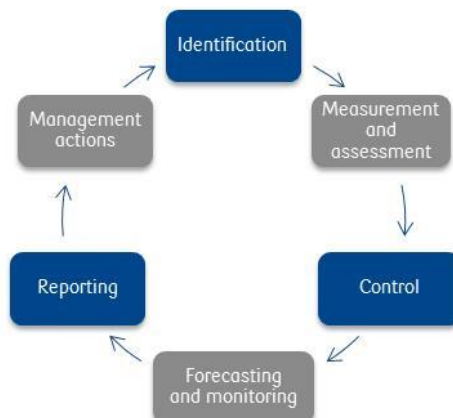
- the risk management process, including the loan process, is defined and regulated by strategies, policies and procedures adopted by the Management Board and Supervisory Board of PKO Bank Hipoteczny SA,
- the Bank manages all identified types of banking risks and performs an ICAAP (Internal Capital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

33.2. Elements of risk management process

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

- risk identification:
the identification of actual and potential sources of risk and estimation of the significance of their potential influence on the financial situation of the Bank. Within the risk identification process, types of risk perceived as significant to the Bank's activities are identified,
- risk measurement and assessment:
risk measurement covering determination of risk assessment measures adequate to the type and significance of the risk, data availability and quantitative risk assessment by means of determined measures, as well as risk assessment aimed at identifying the scale or scope of risk, taking into account risk management objectives. Within risk measurement, stress-testing is conducted on the basis of assumptions providing a fair risk assessment,
- risk control:
determination of the tools used to diagnose or reduce the level of risk in specific areas of the Bank's activity. Risk control covers the determination of control mechanisms suited to the scale and complexity of the Bank's operations, in particular in the form of strategic tolerance limits for individual types of risks, which fulfillment is subject to monitoring, and in the event these are exceeded management actions are taken,
- risk forecasting and monitoring:
preparing risk level forecasts and monitoring deviations from forecasts or adopted reference points (e.g. limits, thresholds, plans, measures from the previous period, recommendations and suggestions). Risk monitoring is performed with a frequency appropriate to the significance and volatility of a specific risk type,
- risk reporting:
periodically informing the authorities of the Bank about the results of risk measurement or risk assessment, actions taken and recommended actions. The scope, frequency and the form of reporting are adjusted to the management level of the recipients,
- management actions:
including, in particular, issuing internal regulations, establishing levels of risk tolerance, establishing limits and thresholds, issuing recommendations, making decisions about the use of tools supporting risk management, and taking action to maintain a defined level of risk. The objective of management actions is to direct the risk management process and risk levels.

The risk management process is presented on the chart below:



33.3. The organization of risk management in the Bank

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

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

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

- 1) the first line of defense, which is the risk exposure management in the core business activities, the framework of which is established by limits, rules of performance of control functions and compliance with the generally applicable laws, internal regulations of the Bank and market standards adopted by the Bank,
- 2) the second line of defense, which is the risk management system, including methods, tools, process and organization of risk management as well as the measurement of the effectiveness of business activity,
- 3) the third line of defense, which is internal audit.

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

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

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

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

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

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

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

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

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

Risk management is supported by the following committees:

The Risk Committee – supporting the Supervisory Board

- provides a comprehensive opinion on the Bank's current and future readiness to accept risk, strategic directions and risk assignments in the context of the Bank's Strategy and the circumstances arising from the macroeconomic situation and regulatory environment,
- monitors the compliance of the Bank's risk-taking policy with the Bank Strategy and financial plan,

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- monitors the integrity, adequacy and effectiveness of the risk management system, capital adequacy and implementation of the Bank's binding risk management policies in accordance with the Bank's Strategy,
- analyses the usage of strategic tolerance limits for risk determined by PKO Bank Hipoteczny SA Risk Management Strategy, develops appropriate guidelines and periodically verifies implementation of risk management strategy,
- supports the Supervisory Board in the risk management process by formulating opinions on capital adequacy, procedures of credit rating assessment, risk models and impairment measurement models.

The Audit and Finance Committee – supporting the Supervisory Board

- monitors and provides opinions in terms of adequacy and effectiveness of the internal control system, including internal audit, the risk management system and the non-compliance risk management.

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

- monitors and provides opinions with respect to tolerance limits and warning thresholds for particular risk types, the most important regulations of risk management and models and risk parameters including portfolio parameters used to determine impairment allowances and provisions,
- gives recommendations to the Management Board or to the Supervisory Board, among others, with regard to determining the structure of the Bank's assets and liabilities, managing different types of risks, equity and price policy.

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

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

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

33.4. Identification of significant risk types

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

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

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

Based on quantitative and qualitative information, a periodic assessment of the significance of particular types of risk is performed by the Bank. As a result of the assessment, each particular type of risk is classified to the appropriate category: significant risk/ potentially significant risk/non-significant risk. Monitoring and assessment of significance are also conducted in each significant change in the scope or profile of the Bank's activities has occurred.

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

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

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

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

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

The Bank's Risk Management Strategy has defined a number of strategic limits and internal warning limits defining the appetite for different types of risk. The Bank regularly monitors these limits, and during the period covered by the financial statements none of the strategic or warning limits have been exceeded.

34. Credit risk management

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

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

The proper implementation of the policies is provided by the effective credit risk management. These methods are verified and developed to ensure compliance with internal rating based requirements (IRB), i.e. an advanced credit risk measurement method. In the future, the Bank will seek to implement the IRB methods, after obtaining the appropriate consent of the supervisory authority.

34.1. Measurement and assessment of credit risk

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

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

The detailed principles and scope of cooperation within the PKO Bank Polski Group within the scope of group risk models are determined by the terms of the Outsourcing agreement with PKO Bank Polski SA described in Note 30.1.

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

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

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

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

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

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

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

34.2. Impairment of loan exposures

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

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

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

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

Identifying the condition for individual impairment in respect of mortgage exposure granted to a person or an individual implies the need to identify it for all mortgage exposures of the co-borrowers of that loan (individual and joint) unless other persons are obliged to repay these loans (as co-borrowers) in respect of which the Bank does not hold any exposures meeting the condition of individual impairment. Under this rule, both exposures are verified, i.e. of the Bank and PKO Bank Polski S.A.

34.3. Methods of estimating impairment

PKO Bank Hipoteczny SA currently applies two methods of estimating impairment:

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

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

34.4. Provisions for off-balance sheet loan exposures

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

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

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

The loan portfolio structure and allowances for impairment of credit exposures of PKO Bank Hipoteczny SA are presented in Note 15 "Loans and advances to customers".

34.5. Forecasting and monitoring of credit risk

34.5.1. Maximum exposure to credit risk

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

Maximum exposure to credit risk	30.06.2017	31.12.2016
Cash, balances with the Central Bank	22	16 033
Amounts due from banks	7 596	12 994
Loans and advances to customers	11 538 579	8 247 900
Financial instruments designated upon initial recognition as at fair value through profit or loss	0	79 987
Investment securities available for sale	563 126	203 019
Total - exposure for balance recognized in the statement of financial position	12 109 323	8 559 933
Commitment to grant loans	745 579	611 793
Total off-balance sheet exposure	745 579	611 793

34.5.2. Amounts due from banks

The following table presents amounts due from banks.

Amounts due from banks	30.06.2017	31.12.2016
Amounts not past due, not impaired	7 596	12 994
Gross total	7 596	12 994
Impairment allowances	-	-
Net total	7 596	12 994

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

34.5.3. Loans and advances to customers

The following table presents loans and advances to customers.

Loans and advances to customers	30.06.2017	31.12.2016
Loans not past due, not impaired	11 491 181	8 227 317
Loans past due, not impaired	49 904	22 342
Impaired loans	754	-
Gross total	11 541 839	8 249 659
Allowances for loans not past due, not impaired	(2 433)	(1 543)
Allowances for loans past due, not impaired	(628)	(216)
Impaired loans	(199)	-
Net total	11 538 579	8 247 900

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

Loans and advances to customers, not impaired	30.06.2017	31.12.2016
not past due	11 491 181	8 227 317
up to 30 days	47 844	21 263
from 31 to 60 days	1 718	1 079
from 61 to 90 days	343	-
Gross total	11 541 085	8 249 659

34.5.4. Forbearance

The Bank defines *forbearance* as actions aimed at changing contractual terms agreed with a debtor or an issuer, forced by the difficult financial position (restructuring activities). These are restructuring actions introducing facilities that otherwise would not be granted. The purpose of forbearance activities is to restore a debtor's ability to fulfil obligations to the Bank and to maximize the effectiveness of non-performing loan management, i.e. obtaining the highest recoveries while minimizing the costs of recoveries, which are very high in the event of execution proceedings.

Forbearance activities focus on changing the payment terms that are individually determined for each contract. Changes to agreements may consist of:

- spreading the overdue due debt into instalments,
- change in a repayment form (annuity instalments, decreasing instalments),
- extending of the lending period,
- change in interest rates,
- change in the credit margin,
- loans reduction.

As a result of signing and a timely service of forbearance agreement, the loan becomes undue. Forbearance involves evaluation of the ability of a debtor to fulfil the forbearance agreement conditions (debt repayment according to the agreed schedule).

Forbearance agreements are monitored on an on-going basis. If, as regards to the loan exposure the impairment is recognised, the impairment allowances are recognised to reflect identified loss.

Exposures with the status of forbearance, classified as non-performing, are included in the portfolio of performing exposures if the following conditions are met simultaneously:

- a debt does not meet individual impairment triggers and there is no impairment recognised,
- at least 12 months have elapsed from the conclusion of a forbearance agreement,
- forbearance agreement has covered the whole debt,
- a debtor has demonstrated the ability to fulfil the terms of the forbearance agreement.

Exposures cease to be subject of reporting with the forbearance status if the following conditions are met simultaneously:

- at least 24 months have elapsed from the date of including forborne exposition to the portfolio of performing loans (conditional period),
- at the end of the conditional period, discussed above, client does not have a debt overdue more than 30 days,
- timely repayment of at least 12 consecutive instalments occurred.

As at 30 June 2017 and as at 31 December 2016 no forborne exposures were recognized in the Bank's portfolio.

34.5.5. Collateral

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

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

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

The Bank's policies with respect to loan collateral and valuation thereof take into consideration the requirements of applicable laws: The Polish Covered Bonds Act, The Banking Law, and The Act on Land Registers and Mortgages. In addition, the suggestions and recommendations of the Polish Financial Supervision Authority, including Recommendations F, S and J, as well as internal bank regulations address the application of legal collateral. By developing the collateral policy, the Bank also takes into account the current and forecast situation on the real estate market, which is a subject of periodic analysis and monitored. In the event of worsening of market conditions and decreasing the market prices, the Bank has developed warning thresholds that starts additional actions increasing the Bank's security, in case the warning thresholds will be exceeded.

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

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

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

At least once a year, the Bank's Management Board verifies and sets the minimum values of obligatory adjustments used in the process of preparing the real estate valuations and determining the BHWN. The validity of the minimum adjustment from anticipated decreases in real estate prices is monitored quarterly. In the event of probability of significant changes on the real estate market, the Bank updates those minimum values of obligatory adjustments.

The Bank on a quarterly basis prepares the real estate market analysis, including macroeconomic conditions, price and demographics trends, the regulatory environment, real estate demand and supply data and then provides those analyses for experts preparing valuations and determining BHWN.

34.6. Credit risk reporting

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

34.7. Credit risk management

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

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

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

35. Concentration risk management

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

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

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

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

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

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

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

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

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

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

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Portfolio structure based on LtV ratio

Loans and advances to customers by LtV levels	30.06.2017	31.12.2016
0% - 50%	29%	31%
51% - 60%	16%	17%
61% - 70%	18%	19%
71% - 80%	23%	23%
80%-90%	14%	10%
90%-100%	0%	0%
Total	100%	100%

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

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

36. Market risk management

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

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

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

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

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

In the current phase of the Bank's business, currency risk as well as interest rate risk were considered as non-significant and did not require coverage from internal capital. It is a result of relatively low Bank's exposure to these risks. Low Bank's exposure to these risks is a result of appropriate management of the foreign currency position and the Bank's sensitivity to interest rate risk by using among others derivative transactions (IRS and CIRS) as part of hedge accounting.

36.1. Measurement and assessment of market risk

36.1.1. Measurement of interest rate risk

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

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

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

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

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

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(thousand PLN)	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	> 5 years	Total
30.06.2017								
Interest bearing assets, of which	4 303 803	7 750 309	1 936	2 768	4 855	-	-	12 063 671
securities	566 135	-	-	-	-	-	-	566 135
amounts due from banks	-	-	-	-	-	-	-	-
amounts due from customers	3 737 668	7 750 309	1 936	2 768	4 855	-	-	11 497 536
Interest liabilities, of which	1 630 768	4 123 167	719 000	-	-	2 378 250	2 218 913	11 070 098
amounts due to banks	581 868	2 440 367	-	-	-	-	-	3 022 235
issued	500 000	1 030 000	-	-	-	2 378 250	2 218 913	6 127 163
unsecured bonds issued	548 900	652 800	719 000	-	-	-	-	1 920 700
Assets due to derivatives	-	-	-	1 260	1 309	2 379 958	2 218 811	4 601 337
Liabilities due to derivatives	2 130 903	2 528 309	-	1 193	1 211	8 560	571	4 670 747
Periodic Gap	542 131	1 098 832	(717 064)	2 835	4 953	(6 852)	(673)	
Cumulative Gap	542 131	1 640 963	923 900	926 735	931 688	924 836	924 163	

(thousand PLN)	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	> 5 years	Total
31.12.2016								
Interest bearing assets, of which	2 963 311	5 537 893	797	1 942	5 671	642	-	8 510 256
securities	285 501	-	-	-	-	-	-	285 501
amounts due from banks	-	-	-	-	-	-	-	-
amounts due from customers	2 677 810	5 537 893	797	1 942	5 671	642	-	8 224 755
Interest liabilities, of which	1 969 574	3 399 478	235 000	-	-	-	2 212 000	7 816 052
amounts due to banks	1 286 074	2 131 978	-	-	-	-	-	3 418 052
issued	500 000	530 000	-	-	-	-	2 212 000	3 242 000
unsecured bonds issued	183 500	730 500	235 000	-	-	-	-	1 156 000
Assets due to derivatives	-	-	765	-	1 174	3 695	2 210 823	2 216 457
Liabilities due to derivatives	-	2 154 809	773	-	1 161	3 482	6 036	2 166 261
Periodic Gap	993 737	(16 394)	(234 211)	1 942	5 684	855	(7 213)	
Cumulative Gap	993 737	977 343	743 132	745 074	750 758	751 613	744 400	

36.1.2. Measurement of currency risk

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

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

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

Currency position	30.06.2017	31.12.2016
EUR	(2)	0
USD	0	0
CHF	-	-
GBP	-	-

36.2. Forecasting and monitoring of market risk

The exposure of PKO Bank Hipoteczny SA to market risk was within accepted strategic and internal limits as at 30 June 2017 and 31 December 2016.

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

In relation to currency risk, the Bank closes all open currency positions on a current basis, and the control and reporting procedures implemented by the Bank significantly limit the impact of changes in exchange rates on the Bank's financial result, hence the currency risk as at 30 June 2017, 31 December 2016 was determined as insignificant.

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

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Kind of limit	Formula for calculation the limit	Limit	30.06.2017		31.12.2016	
			Level	Usage	Level	Usage
the Bank's sensitivity to interest rate risk	$\frac{\sum BPV_i \times 100}{\text{own funds}}$	1.00%	0.446%	44.60%	0.493%	49.34%
the Bank's sensitivity to currency risk	$\frac{\sum PW_i \times 10\%}{\text{own funds}}$	0.10%	0.001%	1.04%	0.000%	0.00%

where:

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

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

During the period covered by the financial statements none of the abovementioned thresholds was exceeded.

36.3. Market risk reporting

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

36.4. Management of market risk

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

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

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

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

37. Liquidity and financing risk management

Liquidity and financing risk is defined as the risk of the inability to settle obligations when due to the lack of liquid assets. Lack of liquidity may arise from an inappropriate structure of the statement of financial position, mismatch of cash flows, counterparty default, inability to rollover or acquire new funds from issuing unsecured bonds and mortgage covered bonds or other market events.

The objective of liquidity risk management is to ensure the sufficient level of funds to settle present and future obligations (including potential obligations) when due, taking into account the nature of activities and requirements which may occur due to changes in market conditions, by structuring the statement of financial position and off-balance sheet liabilities in a way that ensures the appropriate amount of financial resources. The purpose of financing risk management is to diversify the Bank's funding sources in terms of their concentration of subject, instrument, market or maturity and to provide access to short, medium and long-term financing markets

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

The liquidity risk management is built into the risk management process described in Note 33.2.

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

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

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

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

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37.1. Measurement of the liquidity risk

The Bank makes use of the following liquidity risk measures:

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

37.2. Forecasting and monitoring of liquidity risk

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

	a'vista	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months
30.06.2017								
Adjusted gap	766 044	(33 881)	(69 286)	269	37 408	(4 073 974)	(3 397 315)	5 954 163
Cumulative adjusted gap	766 044	732 164	662 877	663 146	700 554	(3 373 420)	(6 770 735)	(816 572)
31.12.2016								
Adjusted gap	535 234	(115 135)	(32 488)	(12 778)	69 365	(4 778 710)	151 561	3 621 355
Cumulative adjusted gap	535 234	420 099	387 611	374 833	444 198	(4 334 512)	(4 182 951)	(561 596)

The liquidity gap in real terms includes the liabilities arising from deferred payment resulting from the Framework Agreement concerning the sale of debts signed with PKO Bank Polski SA (PLN 1 783 956 thousand as at 30 June 2017 and PLN 3 038 039 thousand as at 31 December 2016) which are treated by the Bank as a bridge financing that will be replaced by other financing sources such as mortgage covered bonds that are planned to be issued in the future. Although the contractual maturity of the deferred payment is shorter than 12 months, for the real terms liquidity gap analysis purposes it is classified into 12-24 months bucket according to the internal Bank regulations on liquidity risk management.

The table below presents the Bank's liquidity surplus:

Name of sensitivity measure	30.06.2017	31.12.2016
Liquidity surplus* up to 1 month	812 531	415 573

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

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

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

	value at the end of period	average for the period	minimum for the period	maximum for the period	the minimum supervisory level
30.06.2017					
M1	740 962	681 487	358 695	1 023 544	>0
M2	2.75	2.70	1.17	3.64	>1.0
M3	99.24	81.59	45.36	209.01	>1.0
M4	1.04	1.04	1.04	1.05	>1.0
31.12.2016					
M1	365 040	270 872	40 233	627 848	>0
M2	2.09	2.09	1.14	3.07	>1.0
M3	66.94	58.2	26.12	88.38	>1.0
M4	1.04	1.03	1.02	1.07	>1.0

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

Name of measure	30.06.2017	31.12.2016
Net outflows for 1 month coverage ratio (LCR)	280%	384%
Supervisory limit of LCR ratio	80%	70%

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

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

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

Assets and liabilities and equity by contractual maturity:

	up to 1 month	1-3 months	3 months - 1 year	1-5 years	over 5 years	Total
30.06.2017						
Assets						
Cash balances with the Central Bank	22	-	-	-	-	22
Amounts due from banks	7 596	-	-	-	-	7 596
Amounts due from customers	35 619	70 562	337 649	1 964 652	9 130 097	11 538 579
Securities	-	-	100 945	454 360	7 821	563 126
Other assets	19 542	-	-	-	5 494	25 036
Total assets	62 779	70 562	438 594	2 419 012	9 143 412	12 134 359
Liabilities						
Amounts due to banks	-	-	1 886 564	1 144 809	-	3 031 373
Amounts due to customers	1 773	-	-	-	-	1 773
Mortgage covered bonds	-	-	-	3 899 683	2 217 134	6 116 818
Unsecured bonds issued	548 584	650 177	713 745	-	-	1 912 507
Equity	-	-	-	-	948 467	948 467
Other liabilities	19 986	-	-	-	-	19 986
Total liabilities	570 343	650 177	2 600 309	5 044 493	3 165 601	12 030 924
31.12.2016						
Assets						
Cash balances with the Central Bank	16 033	-	-	-	-	16 033
Amounts due from banks	12 994	-	-	-	-	12 994
Amounts due from customers	25 213	53 398	243 311	1 431 341	6 494 637	8 247 900
Securities	79 987	-	-	195 315	7 704	283 006
Other assets	14 380	-	-	2 440	5 892	22 712
Total assets	148 607	53 398	243 311	1 629 096	6 508 233	8 582 645
Liabilities						
Amounts due to banks	-	1 038 948	1 999 091	393 793	-	3 431 832
Amounts due to customers	1 549	-	-	-	-	1 549
Mortgage covered bonds	-	-	-	1 030 566	2 201 551	3 232 117
Unsecured bonds issued	183 326	734 801	233 089	-	-	1 151 216
Equity	-	-	-	-	781 290	781 290
Other liabilities	12 336	-	-	-	-	12 336
Total liabilities	197 211	1 773 749	2 232 180	1 424 359	2 982 841	8 610 340

37.4. Maturity of contractual cash flows from derivative financial instrument transactions

As at the date of these financial statements, the Bank was a counterparty of the net settled interest rate swap transaction (IRS).

Gross settled derivative financial instruments include:

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

The following table shows the breakdown of contractual maturity, presenting the remaining contractual maturities analysed by categories of derivative financial instruments (inflows and outflows) for which the valuation at the reporting date was negative (liability) at 30 June 2017 and at 31 December 2016.

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30.06.2017	up to 1 month	over 1 month up to 3 months	over 3 months up to 1 year	over 1 year up to 5 years	over 5 years	Contractual value
Derivative financial instruments						
Inflows, including:	12910	13132	80 371	2 700 855	2 308 299	5 115 566
- hedging financial instruments	12910	13132	80 371	2 700 855	2 308 299	5 115 566
Outflows, including:	-	-	15 556	2 183 832	2 233 853	4 433 242
- hedging financial instruments	-	-	15 556	2 183 832	2 233 853	4 433 242
31.12.2016						
	up to 1 month	over 1 month up to 3 months	over 3 months up to 1 year	over 1 year up to 5 years	over 5 years	Contractual value
Derivative financial instruments						
Inflows, including:	-	-	773	4 643	-	5 416
- hedging financial instruments	-	-	773	4 643	-	5 416
Outflows, including:	-	-	765	4 869	-	5 634
- hedging financial instruments	-	-	765	4 869	-	5 634

Amounts denominated in foreign currencies have been translated at the average exchange rate at 30 June 2017 and at 31 December 2016. The amounts presented include the undiscounted future cash flows arising from both the nominal and interest amounts (if applicable).

37.5. Concentration of funding sources

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

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

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

The following table presents the funding structure of the Bank:

	30.06.2017	31.12.2016
Equity	7.9%	9.1%
Funds from the parent entity	24.4%	39.9%
Mortgage covered bonds issued	50.9%	37.6%
Unsecured bonds issued	15.9%	13.4%
Other	0.8%	-
Total	100.0%	100.0%

The share of parent company's funding amounted to 24.4% as at 30 June 2017 whereas 39.9% as at 31 December 2016 and was significant. This level of indicator is consistent with the financial plan and the early stage of the Bank's operations. It is expected to gradually reduce the share of financing from the parent entity, to external financing, in particular related to successive issues of mortgage covered bonds and own unsecured bonds.

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

The concentration risk is assessed as acceptable.

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

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

- shock changes in market parameters on financial markets,
- the impact of marginal changes in market factors, as well as drops in prices on the property market on the anticipated losses on the mortgage loan portfolio,
- redemption of mortgage covered bonds resulting from the exceeding of regulatory standards,
- inability to acquire new or to roll-over maturing unsecured bonds issued,
- inability to acquire new or to roll-over maturing mortgage covered bonds issued,
- necessity to take action to defend supervisory liquidity measures,
- decrease of issue ratings,
- changes in key parameters affecting the liquidity level determined on the basis of the projected statement of financial position of the Bank.

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

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

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

The tests of stress condition carried out on the basis of financial data of the Bank as at 30 June 2017 and 31 December 2016 did not indicate significant risk to the continuity and safety of the Bank's business. The tests indicate on the Bank's high resilience to unfavorable changes in the market conditions and confirm that the Bank has an ability to outlast crisis situations. Positive test results are the result of, among others, the balanced financing structure, distant and properly concentrated maturity dates of long-term liabilities and the adequate level of liquid assets.

37.7. Liquidity risk reporting

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

37.8. Management of liquidity risk

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

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

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

38. Operational risk management

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

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

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

In order to manage operational risk, the Bank gathers internal and external data about operational events, on business environment factors, results operational risk self-assessment, data on key indicators of operational risk (KRI) and data derived from the internal control system.

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

38.1. Measurement of operational risk

Measurement of operational risk at the Bank aims at defining the scale of threats related to the existence of operational risk with the use of defined risk measures. The measurement of operational risk comprises:

- calculation of Key Risk Indicators (KRI),
- calculation of own funds requirement for operational risk under the BIA approach (BIA requirement),
- stress-tests,
- calculation of Bank's internal capital.

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

- data collection on operational events,
- the results of inspections, actions and internal control,
- KRI.



38.2. Forecasting and monitoring operational risk

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

The Bank regularly monitors, in particular:

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

38.3. Reporting of operational risk

Reporting on information concerning operational risk is performed for:

- the Bank's internal requirements, particularly of the Management Board, and the Supervisory Board,
- supervisory institutions,
- shareholders and financial markets.

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

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

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

38.4. Management of operational risk

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

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

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

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

- review of strategy and processes for operational risk management,
- internal audit.

38.5. Incurred operating losses

During the period covered by the financial statements, the Bank identified operational risk events, which represent operating losses for the total net amount of PLN 116 thousand what constitutes 0.01% of own funds.

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

39. Compliance risk management

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

39.1. The objective of compliance risk management

The objective of compliance risk management is to:

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

39.2. Identification and evaluation of compliance risk

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

Identification of the compliance risk is determined by identifying the sources and factors of the compliance risk and by analyzing the possible relationships between this risk and the operational risk. Identification of the Bank's compliance risk relates to: existing or projected products, processes and internal regulations.

The evaluation of compliance risk in internal processes is carried out periodically by the so-called owners of internal processes, in cooperation

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with the Compliance Team and in particular include:

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

39.3. Compliance risk controlling and monitoring

As part of the compliance risk control, the Bank protects itself against the compliance risk or reduces this risk by introducing mechanisms for control of compliance risk and ensuring adherence to those rules.

Compliance risk monitoring includes:

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

39.4. Compliance risk reporting

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

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

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

40. Internal control system

The purpose of the Bank's internal control system is to support decision-making processes which contribute to ensuring:

- 1) effectiveness and efficiency of the Bank's operations,
- 2) reliability of financial reporting, administrative and accounting procedures and internal and external reporting,
- 3) compliance with the risk management principles,
- 4) compliance with generally applicable laws, internal regulations and market standards adopted by the Bank and also with recommendations of supervisory authorities.

The internal control system of PKO Bank Hipoteczny SA is composed of:

- 1) the control function,
- 2) compliance unit,
- 3) an independent internal audit unit.

In the event of deficiencies detected by the internal control system, the Bank takes appropriate improving, corrective and disciplinary actions to remove identified deficiencies.

In connection with the Regulation of the Minister of Economic Development and Finance dated 6 March 2017 related to the risk management system, internal control system, remuneration policy and the detailed way of estimating internal capital in banks, the Bank introduced the necessary changes to the internal control system. The changes aimed to implement a matrix of control functions that included control mechanisms in relevant processes and defined the responsibility for independent monitoring of control mechanisms. The Bank is also working on the implementation of the revised Recommendation H related to the internal control in banks.

41. Capital adequacy

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

The primary regulations applicable in the process of the capital adequacy assessment process as at 30 June 2017 are:

- the Regulation (EU) No. 575/2013 of the European Parliament and of the Council dated 26 June 2013 on prudential requirements for credit institutions and investment firms, amending the Regulation (EU) No. 648/2012 (hereinafter referred to as the "CRR Regulation"),

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- the Act dated 29 August 1997, the Banking Law,
- the Act dated 5 August 2015, on macroprudential supervision of the financial system and crisis management in the financial system (hereinafter referred to as the 'Macroprudential Act'),
- the Regulation of the Minister of Development and Finance of 6 March 2017 on the risk management system, the internal control system, the remuneration policy and a detailed method of estimating internal capital in banks.

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

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

The process of managing the Bank's capital adequacy comprises the process of estimating internal capital and the process of capital management, which in particular consist of:

- identifying and monitoring of all of significant risk, including criteria for the recognition of particular risks as significant,
- defining internal capital to cover the individual risk types, including total internal capital,
- risk control mechanisms in the area of estimating internal capital and maintaining the level of own funds at a level not lower than the estimated internal capital,
- stress-tests used in the process of determining internal capital,
- defining by the Bank the long-term capital targets and monitoring their realization,
- creation of capital plans and determination of preferred capital structure,
- organization of the capital increase process, including capital emergency procedures,
- defining dividend policy and assessing capital profitability.

During the period covered by the financial statements, the level of capital adequacy remained at a safe level above the supervisory limits. On 30 June 2017, the total capital ratio of the Bank was 16.7% and on 31 December 2016 17.1%.

41.1. Own funds for the purpose of capital adequacy

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

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

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

OWN FUNDS OF THE BANK	30.06.2017	31.12.2016
Common Equity Tier 1 capital (CET1)	944 303	780 265
primary funds, of which:	950 731	799 754
share capital	950 000	800 000
other accumulated comprehensive income, excluding gains and losses on cash flow hedges	731	(246)
adjustment of transition period	(184)	(1)
accumulated profits/(losses)	(750)	(13 973)
loss for the current financial year	-	-
intangible assets	(4 901)	(5 312)
additional value adjustments to assets measured at fair value	(593)	(203)
Tier 2 capital	-	-
TOTAL OWN FUNDS	944 303	780 265

41.2. Capital Buffers

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

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

41.3. Financial Leverage

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

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

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The Bank calculates financial leverage according to the CRR Regulation (amended Regulation 2015/62 EU¹).

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.

The ratio amounted to:

Financial leverage	30.06.2017	31.12.2016
Leverage ratio (LR)	7.6%	8.8%

As of 30 June 2017 and 31 December 2016 leverage ratio remained above 3% i.e. the level recommended by Basel Committee.

41.4. Requirements regarding own funds (Pillar I)

41.4.1. General information

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

- 1) in respect of credit risk - using the standardized method,
- 2) in respect of credit valuation adjustment (CVA) risk - using the standardized method,
- 3) in respect of settlement and delivery risk - using the standardized method,
- 4) in respect of operational risk - in accordance with the Base Indicator Approach (BIA)
- 5) in respect of market risk (only currency risk) - using basic methods.

At 30 June 2017 and 31 December 2016 the requirements for own funds with respect to the risks set out in points 2, 3 and 5 were zero, therefore the total requirement for own funds represented requirements for credit and operational risks, as set out in the table below:

Capital requirements	30.06.2017	31.12.2016
Credit risk	438 566	359 120
Operational risk	15 062	4 950
Total capital requirements	453 627	364 070
Common Equity Tier 1 capital ratio (CET1)	16.7%	17.1%
Tier 1 capital ratio (T1)	16.7%	17.1%
Total capital ratio (TCR)	16.7%	17.1%

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

30.06.2017	Gross exposure	Value of exposure ¹⁾	Risk weighted assets	Requirements regarding own funds
Exposure to central governments or central banks	563 148	563 148	-	-
Exposure to institutions	286 477	286 477	-	-
Retail exposure ²⁾	3 572 946	3 232 322	2 424 242	193 939
Exposure secured by mortgages on real estate	8 713 717	8 680 091	3 038 032	243 043
Exposure for default	754	742	778	62
Other exposures	19 020	19 020	19 020	1 522
TOTAL	13 156 062	12 781 800	5 482 072	438 566

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

¹⁾ The value of recognized exposures and recognized equivalent liabilities and off-balance sheet transactions, taking into account adjustments for specific credit risk and CCF (Credit Conversion Factor - credit conversion factor).

²⁾ This results from part of the exposure that is not fully and completely secured, i.e. which exceeds a BHWN of 80% or is in a transitional period, i.e. until collateral is established.

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

41.4.2. Adjustments for credit risk

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

The approach applied by the Bank to identify exposures are risk of impairment and methods of estimating impairment and provisions for off-balance sheet credit exposures are described in Note 34.2 "Impairment of loan exposures" and Note 34.3 "Methods of estimating impairment."

41.4.3. The use of credit risk mitigation techniques

The Bank uses mortgage collateral for the purposes of classification of exposures to grades of exposures secured by mortgages on real estate and the use of preferential risk weighting. Detailed information on the main types of collateral accepted by the Bank and the method of determining the banking mortgage value of the property is described in Note 34.5.5. "Collateral".

41.5. Internal capital (Pilar II)

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

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

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

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

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

At 30 June 2017 and 31 December 2016, the relation of equity to internal capital remained above the statutory limit and the Bank's internal limits.

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

41.6. Disclosures (Pilar III)

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

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

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

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EVENTS AFTER THE REPORTING PERIOD

42. Events after the reporting period

In the period from 1 July 2017 until the date of approval of the financial statements to publish by the Management Board, PKO Bank Hipoteczny SA acquired new portfolio of mortgage loans in the amount of PLN 967 593 thousand from PKO Bank Polski SA under the terms of the Framework Agreement concerning the sale of receivables concluded on 17 November 2015.

In the period from 1 January 2017 until the date of approval of the financial statements to publish by the Management Board, PKO Bank Hipoteczny SA carried out 11 bond issue with a total value amounting to PLN 772 900 thousand, with the simultaneous redemption of 12 bond issue with a total value amounting to PLN 658 900 thousand.

On 28 June 2017 the Extraordinary General Meeting of Shareholders adopted a resolution on increasing share capital of PKO Bank Hipoteczny SA by PLN 150 000 000, i.e. to PLN 1 100 000 000 by the issue of 150 000 000 new ordinary registered shares of F series of nominal value of PLN 1 each. All shares have been acquired and paid up by PKO Bank Polski SA on 4 July 2017. Till the date of Management Board approval of these financial statements to publication, the increase of shares has not been registered in the Register of Entrepreneurs of the National Court Register.

Signatures of all Members of the Management Board of the Bank

18.08.2017	Rafał Kozłowski	President of the Management Board	<i>Signed on the Polish original</i> (signature)
18.08.2017	Jakub Niesłuchowski	Vice-President of the Management Board	<i>Signed on the Polish original</i> (signature)
18.08.2017	Marek Szcześniak	Vice-President of the Management Board	<i>Signed on the Polish original</i> (signature)

Signature of the person responsible for bookkeeping

18.08.2017

Tomasz Rynkowski
Director, Chief Accountant

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