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Bank Hipoteczny

SELECTED FINANCIAL DATA RELATING TO THE FINANCIAL STATEMENTS

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SELECTED FINANCIAL DATA	in PLN'000 period from 01/01/2018 to 30/06/2018	in PLN'000 period from 01/01/2017 to 30/06/2017	in EUR'000 period from 01/01/2018 to 30/06/2018	in EUR '000 period from 01/01/2017 to 30/06/2017
Net interest income	119,559	62,227	28,201	14,651
Net fee and commission income	(2,314)	(2,078)	(546)	(489)
Operating profit	60,889	34,030	14,363	8,012
Profit before income tax	**60,889**	**34,030**	**14,363**	**8,012**
Net profit	**42,588**	**25,140**	**10,046**	**5,919**
Earnings per share – basic (in PLN/EUR)	**0.04**	**0.03**	**0.01**	**0.01**
Earnings per share – diluted (in PLN/EUR)	**0.04**	**0.03**	**0.01**	**0.01**
Total net comprehensive income	**82,894**	**17,177**	**19,553**	**4,044**
Net cash flows used in operating activities	(3,205,746)	(3,532,817)	(756,169)	(831,760)
Net cash flows used in investing activities	(1,759)	(355,208)	(415)	(83,630)
Net cash flows used in financing activities	3,323,841	3,866,616	784,026	910,349
Total net cash flows	**116,279**	**(21,409)**	**27,428**	**(5,042)**

SELECTED FINANCIAL DATA	in PLN'000 as at 30/06/2018	in PLN'000 as at 31/12/2017	in EUR'000 as at 30/06/2018	in EUR'000 as at 31/12/2017
Total assets	20,267,678	16,902,594	4,646,845	4,052,505
Total equity	1,292,885	1,221,778	296,424	292,929
Share capital	1,200,000	1,200,000	275,128	287,708
Number of shares (in thousand)	1,200,000	1,200,000	1,200,000	1,200,000
Book value per share (in PLN/EUR)	1.08	1.02	0.25	0.24
Diluted number of shares (in thousand)	1,200,000	1,200,000	1,200,000	1,200,000
Diluted book value per share (in PLN/EUR)	1.08	1.02	0.25	0.24
Total capital ratio (TCR)	14.2%	15.2%	14.2%	15.2%
Common equity Tier 1 (CET1)	1,249,017	1,194,623	286,367	286,418
Total own funds	1,249,017	1,194,623	286,367	286,418

Selected financial statement items have been translated to EUR according to the following foreign exchange rates:

- items of the income statement, statement of comprehensive income and statement of cash flows items – the rate is calculated as the average of the NBP exchange rates prevailing as at the last day of each month of the reporting period, i.e. EUR 1 = PLN 4.2395 for the period from 1 January 2018 to 30 June 2018 and EUR 1 = PLN 4.2474 for the period from 1 January 2017 to 30 June 2017;
- items of the statement of financial position – the average NBP exchange rate as at 30 June 2018: EUR 1 = PLN 4.3616 and as at 31 December 2017: EUR 1 = PLN 4.1709.

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Bank Hipoteczny

Condensed interim financial statements of PKO Bank Hipoteczny SA for the six-month period ended 30 June 2018

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INCOME STATEMENT

	Note	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Interest income, including:	5	306,882	165,499
Interest income recognised under the effective interest rate method		298,361	161,284
Income similar to interest income on instruments measured at fair value through profit or loss		468	304
Interest expense	5	(187,381)	(103,272)
Net interest income		**119,501**	**62,227**
Fee and commission income	6	6,916	5,056
Fee and commission expense	6	(9,230)	(7,134)
Net fee and commission income		**(2,314)**	**(2,078)**
Net gain / (loss) on financial instruments measured at fair value through profit or loss	7	24	(240)
Net foreign exchange gains	8	3,990	6,503
Gains / (losses) on derecognition of financial assets and financial liabilities not measured at fair value through profit or loss	9	-	
Net income / (expense) on modification	10	(257)	
Net credit losses	11	(4,445)	(1,503)
Other operating income	12	302	410
Other operating expenses	12	(301)	(395)
Net other operating income and expense		**1**	**15**
Administrative expenses	13	(28,241)	(19,580)
Tax on certain financial institutions		(27,427)	(11,314)
Operating profit		**60,832**	**34,030**
Profit before income tax		**60,832**	**34,030**
Income tax expense	14	(18,244)	(8,890)
Net profit		**42,588**	**25,140**
Earnings per share – basic (PLN)	15	0.04	0.03
Earnings per share – diluted (PLN)	15	0.04	0.03
Weighted average number of ordinary shares during the period (in thousand)		1,200,000	866,298
Weighted average diluted number of ordinary shares during the period (in thousand)		1,200,000	866,298

STATEMENT OF COMPREHENSIVE INCOME

	Note	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Net profit		**42,588**	**25,140**
Other comprehensive income		**40,306**	**(7,963)**
Items which may be reclassified to profit or loss		**40,306**	**(7,963)**
Cash flow hedges (gross)		47,051	(11,037)
Related tax		(8,940)	2,097
Cash flow hedges (net)	18	38,111	(8,940)
Unrealised net gains on available-for-sale financial assets (gross)			1,206
Related tax			(229)
Unrealised net gains on available-for-sale financial assets (net)			977
Remeasurement of financial assets measured at fair value through other comprehensive income (gross)		2,710	
Related tax		(515)	
Remeasurement of financial assets measured at fair value through other comprehensive income (net)		2,195	
Total comprehensive income		**82,894**	**17,177**

STATEMENT OF FINANCIAL POSITION

	Note	30.06.2018	31.12.2017
ASSETS			
Cash and balances with the Central Bank	16	18	561
Amounts due from banks	17	122,172	5,350
measured at amortised cost		122,172	5,350
Derivative hedging instruments	18	214,720	338
Securities	19	842,727	830,489
available for sale			830,489
measured at fair value through other comprehensive income		842,727	
Loans and advances to customers	20	19,065,845	16,042,473
measured at amortised cost		19,065,845	16,042,473
Intangible assets	23	4,772	5,584
Property and equipment	23	544	570
Other assets	24	16,880	17,229
TOTAL ASSETS		**20,267,678**	**16,902,594**
LIABILITIES AND EQUITY			
Liabilities			
Amounts due to banks	25	3,858,350	4,125,379
measured at amortised cost		3,858,350	4,125,379
Derivative hedging instruments	18	246	217,777
Amounts due to customers	26	3,051	2,099
measured at amortised cost		3,051	2,099
Mortgage covered bonds issued	27	12,167,940	8,883,213
measured at amortised cost		12,167,940	8,883,213
Unsecured bonds issued	28	2,898,978	2,428,025
measured at amortised cost		2,898,978	2,428,025
Other liabilities	29	27,992	17,441
Current income tax liabilities	14	3,699	3,507
Deferred income tax liabilities	14	14,266	3,237
Provisions	30	271	138
TOTAL LIABILITIES		**18,974,793**	**15,680,816**
Equity			
Share capital	31	1,200,000	1,200,000
Supplementary capital		50,670	-
Accumulated other comprehensive income		11,414	(28,892)
Retained earnings		(11,787)	(749)
Net profit for the period		42,588	51,419
TOTAL EQUITY		**1,292,885**	**1,221,778**
TOTAL LIABILITIES AND EQUITY		**20,267,678**	**16,902,594**
Total capital ratio (TCR)	51	14.2%	15.2%
Book value (in PLN thousand)		1,292,885	1,221,778
Number of shares (in thousand)	31	1,200,000	1,200,000
Book value per share (in PLN)		1.08	1.02
Diluted number of shares (in thousand)		1,200,000	1,200,000
Diluted book value per share (in PLN)		1.08	1.02

STATEMENT OF CHANGES IN EQUITY

for 6 months ended 30 June 2018	Note	Share capital	Supplementary capital	Accumulated other comprehensive income	Retained earnings	Net profit for the period	Total equity
As at 31 December 2017		1,200,000	-	(28,892)	(749)	51,419	1,221,778
Changes due to IFRS 9 implementation		-	-	-	(11,787)	-	(11,787)
As at 1 January 2018		1,200,000	-	(28,892)	(12,536)	51,419	1,209,991
Transfer of profit to retained earnings		-	-	-	51,419	(51,419)	-
Transfer of profit to equity		-	50,670	-	(50,670)	-	-
Total comprehensive income, of which:		-	-	40,306	-	42,588	82,894
Net profit		-	-	-	-	42,588	42,588
Other comprehensive income		-	-	40,306	-	-	40,306
As at 30 June 2018	31	**1,200,000**	**50,670**	**11,414**	**(11,787)**	**42,588**	**1,292,885**

for 6 months ended 30 June 2017	Note	Share capital	Supplementary capital	Accumulated other comprehensive income	Retained earnings	Net profit for the period	Total equity
As at 1 January 2017		800,000	-	(17,961)	(13,973)	13,224	781,290
Transfer of profit to retained earnings		-	-	-	13,224	(13,224)	-
Issue of series E shares	31	150,000	-	-	-	-	150,000
Total comprehensive income, of which:		-	-	(7,963)	-	25,140	17,177
Net profit		-	-	-	-	25,140	25,140
Other comprehensive income		-	-	(7,963)	-	-	(7,963)
As at 30 June 2017	31	**950,000**	**-**	**(25,924)**	**(749)**	**25,140**	**948,467**

STATEMENT OF CASH FLOWS

	Note	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Cash flows from operating activities			
Profit before tax		**60,832**	**34,030**
Total adjustments and changes:		**(3,266,635)**	**(3,566,847)**
Amortisation and depreciation		1,122	617
Change in securities designated at fair value through profit or loss upon initial recognition		-	80,000
Change in derivative financial instruments (asset)		(214,382)	27,628
Change in loans and advances to customers		(3,042,265)	(3,292,181)
Change in other assets		(7,704)	(9,074)
Change in amounts due to banks		(267,029)	(400,520)
Change in derivative financial instruments (liability)		(217,531)	103,503
Change in amounts due to customers		952	224
Change in mortgage covered bonds issued		404,264	(87,857)
Change in unsecured bonds issued		27,575	17,232
Change in allowances for expected credit losses		4,474	1,543
Change in other liabilities		10,552	3,950
Income tax paid		(13,712)	(864)
Other adjustments (including changes in the measurement of securities and derivative instruments recognised in other comprehensive income)		47,049	(11,048)
Net cash flows used in operating activities		**(3,205,803)**	**(3,532,817)**
Cash flows from investing activities			
Inflows from investing activities		**187,777**	**1,854**
Disposal of and interest on available-for-sale investment securities			1,854
Disposal of and interest on securities measured at fair value through other comprehensive income		187,777	
Outflows from investing activities		**(189,536)**	**(357,062)**
Acquisition of available-for-sale investment securities			(356,843)
Acquisition of securities measured at fair value through other comprehensive income		(189,251)	
Acquisition of intangible assets and property and equipment		(285)	(219)
Net cash flows used in investing activities		**(1,759)**	**(355,208)**
Cash flows from financing activities			
Proceeds from issue of own shares		-	150,000
Proceeds from issue of mortgage covered bonds		2,918,510	2,987,047
Proceeds from issue of unsecured bonds		3,751,378	2,606,959
Redemption of unsecured bonds issued		(3,308,000)	(1,862,900)
Repayment of interest on mortgage covered bonds issued		(38,047)	(14,490)
Net cash flows used in financing activities		**3,323,841**	**3,866,616**
Total net cash flows		**116,279**	**(21,409)**
Cash and cash equivalents at the beginning of the period		5,911	29,027
Cash and cash equivalents at the end of the period	34	**122,190**	**7,618**

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NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS

1. General Information

Banking Activities

PKO Bank Hipoteczny Spółka Akcyjna ("PKO Bank Hipoteczny SA", "Bank", "Company") with its registered office in Gdynia, ul. Jerzego Waszyngtona 17, 81-342 Gdynia, was entered to the Register of Businesses maintained by the District Court Gdańsk-Północ in Gdańsk, 8th Business Department of the National Court Register, with the number KRS 0000528469, on 24 October 2014. The Bank was assigned the statistical number REGON 222181030. Its share capital as at 30 June 2018 was PLN 1,200,000,000 and was fully paid up.

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

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

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

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

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

Composition of the Bank's Supervisory Board And Management Board

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

No.	Name and surname	Position	Date of appointment	Date of dismissal / resignation
1	Jakub Papierski	Chairman of the Supervisory Board	06/10/2014	-
2	Piotr Mazur	Deputy Chairman of the Supervisory Board	06/10/2014	-
3	Justyna Borkiewicz	Member of the Supervisory Board	28/10/2016	-
4	Artur Kluczny	Member of the Supervisory Board (independent)	18/10/2017	-
5	Rafał Kozłowski	Member of the Supervisory Board	09/02/2018	-
6	Mieczysław Król	Member of the Supervisory Board	28/10/2016	-
7	Piotr Kwiecień	Member of the Supervisory Board (independent)	18/10/2017	-
8	Jan Emeryk Rościszewski	Member of the Supervisory Board	18/10/2017	-
9	Bartosz Drabikowski	Member of the Supervisory Board	18/10/2017	15/01/2018

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

No.	Name and surname	Position	Date of appointment	Date of dismissal / resignation
1	Paulina Strugała	President of the Management Board	16/04/2018	-
2	Agnieszka Krawczyk	Vice-President of the Management Board	01/01/2018	-
3	Jakub Niesłuchowski	Vice-President of the Management Board	01/04/2015	-
4	Marek Szcześniak	Vice-President of the Management Board	01/06/2015	-

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

2. Basis of preparation of the condensed interim financial statements

The condensed interim financial statements of PKO Bank Hipoteczny Spółka Akcyjna cover the six months ended 30 June 2018 and include corresponding figures for the six months ended 30 June 2017 (with reference to the income statement, statement of comprehensive income, statement of cash flows and statement of changes in equity) and corresponding figures as at 31 December 2017 (with reference to the statement of financial position). The financial data is presented in thousands of Polish zlotys (PLN), rounded to a thousand, unless otherwise indicated.

These condensed interim financial statements of PKO Bank Hipoteczny SA were prepared in accordance with the requirements of International Accounting Standard 34 "Interim financial reporting", as adopted by the European Union.

The accounting policies and calculation methods used to prepare these condensed interim financial statements comply with the policies binding for the financial year ended 31 December 2017 with the exception of the changes following from IFRS 9 "Financial instruments" which came into force as of 1 January 2018 as described in Section 3. The impact of IFRS 15 "Revenue from contracts with customers", also applied since 1 January 2018, on the Bank's operations was not material.

The policies which have not changed have been described in the annual financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2017.

The condensed interim financial statements for 6 months of 2018 do not cover all the information and disclosures required in the annual financial statements and they should be read together with the annual financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2017 prepared in accordance with the International Financial Reporting Standards as adopted by the European Union.

Approval of the financial statements

These condensed interim financial statements subject to a review and opinion of the Audit and Finance Committee of the Supervisory Board on 22 August 2018, were approved by the Bank's Management Board for publication on 16 August 2018.

3. IFRS 9 Financial Instruments

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

3.1 Classification and Measurement

3.1.1. Policies for the classification of financial instruments

Following the application of IFRS 9, as of 1 January 2018 the Bank classifies its financial assets to one of the following categories:

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

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

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

Financial instruments are classified at the moment of the first application of IFRS 9, i.e. as at 1 January 2018 and as at the moment of recognition of an instrument or its material modification. Changes in the classification of financial assets may result from changes in the business model or failure to pass the Solely Payments of Principal and Interest test (SPPI test). Changes in the model are conditioned by changes occurring inside or outside the Bank, or before or after the end of a given type of operations; therefore, such changes do not occur often. Failing to pass the SPPI test is the result of a change in the characteristics of contractual cash flows which cause the returns from an instrument not to reflect exclusively the value of the principal and interest.

Business model

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

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

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

Assessment of the characteristics resulting from contractual cash flows

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

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

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

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

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

Category of measurement of financial assets at amortised cost

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

- a financial asset is "held to collect";
- the contractual terms relating to the financial asset cause cash flows to arise in certain periods, which are only the result of repayment of the principal amount and the interest on the principal amount remaining to be repaid (passed SPPI test).

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

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

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

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

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

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

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

Financial assets measured at fair value through other comprehensive income are measured fair value net of allowances for expected credit losses.

The effects of adjustments to the fair value of those financial assets until their derecognition or reclassification are recognised in other comprehensive income, with the exception of interest income, impairment gains or losses in respect of expected credit losses and foreign exchange gains or losses recognised in the profit or loss. If a financial asset is derecognised, the accumulated gains or losses previously recognised in other comprehensive income are reclassified from other comprehensive income to profit or loss in the form of a reclassification adjustment.

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

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

Additionally, at initial recognition, a financial asset may be classified as measured at fair value through profit or loss (option to measure at fair value through profit or loss) if this eliminates or significantly reduces inconsistency of measurement or recognition (accounting mismatch). This option is available for debt instruments both under the "held to collect", and "held to collect and sell" models.

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

1) held for trading – financial assets which:
   - they have been purchased mainly to sell or redeem in the foreseeable future; or
   - upon initial recognition they constitute part of a portfolio of specific financial instruments which are managed jointly and for which there is evidence that they currently generate short-term profits; or
   - are derivative financial instruments (with the exception of derivatives which are financial guarantee agreements or designated and effective hedges);
2) financial assets not held for trading have to be measured at fair value through profit or loss - financial assets which have not passed the cash flow characteristics test (irrespective of the business model);
3) financial assets designated to be measured at fair value through profit or loss (option to measure at fair value through profit or loss).

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

3.1.2. CHANGE IN CLASSIFICATION OF FINANCIAL ASSETS

Financial assets may be reclassified only in the event of a change in the business model referring to an asset or a group of assets resulting from the start or discontinuation of a material part of operations. Such changes are

incidental. Changes in classification are recognised prospectively, i.e. without changing the effects of fair value measurement, i.e. allowances or interest accrued, recognised to-date.

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

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

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

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

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

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

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

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

3.1.3. Change in estimated contractual cash flows - Modifications

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

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

In some situations renegotiation or modification of contractual cash flows related to a financial asset may lead to derecognition of the given financial asset. If the modification of a financial asset leads to its derecognition and then to the recognition of a modified financial asset, the modified financial asset is considered to be a new financial asset ("**Material modification**"). The new asset is recognised at fair value and a new effective interest rate is calculated to

be applied to the new asset. In the event that the characteristics of the modified new financial asset (after conclusion of the annexe) reflects the arm's length basis, the carrying amount of the financial asset constitutes its fair value.

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

The adopted **Qualitative criteria** are as follows:

- change in debtor, with the exception of a change following from the debtor's death;
- introducing a contractual feature to the contract which leads to failing the cash flow characteristics test or removal of the feature;
- currency conversion.

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

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

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

3.1.4. Measurement of purchased or originated credit-impaired assets (POCI)

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

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

3.1.5. Interest income

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

- purchased or originated credit-impaired assets (see subpar. 3.1.4). With respect to those financial assets, the credit-risk adjusted effective interest rate is applied to the amount of amortised cost of the financial asset (net carrying amount) as of the moment of initial recognition (POCI assets).
- financial assets which are not POCI, which then became impaired. In respect of those financial assets the original effective interest rate is applied (i.e. from the moment of recognition of the impairment premises) to determine the value of the financial assets at amortised cost (net carrying amount) in the following reporting periods.

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

In connection with the implementation of IFRS 9 as of 1 January 2018 the Bank changed its approach to recognising the liquidity portfolio of money market bills, thus far classified according to IAS 39 as financial instruments designated upon initial recognition at fair value through profit or loss, will now, according to IFRS 9, according to the "held to collect and sell" model be recognised at fair value through other comprehensive income. As at 1 January 2018 there were no money bills in the Bank's liquidity portfolio.

3.2 Impairment

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

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

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

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

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

Expected losses are determined as the product of credit risk parameters: probability of default (PD), loss given default (LGD) and exposure at default (EAD).

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

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

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

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

Impairment triggers for credit exposures comprise in particular:

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

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

In calculating the value of the ultimate expected loss, the Bank also considers the impact of macroeconomic scenarios on the respective parameters (PD, LGD). The methodology of calculation of the risk parameters includes back-testing of the dependence of the value of the parameters on macroeconomic conditions. Three macroeconomic

scenarios developed on the basis of the Group are used for the purpose of calculating expected loss (as in case of identification of an indication of a significant increase in credit risk) – a baseline scenario and two alternative scenarios. The scope of projected indicators include: the GDP growth rate, the unemployment rate, the 3M WIBOR rate, the property price index, and the NBP reference rate. The final expected loss is the average of expected losses in each scenario, weighted by the probability of the scenarios.

Both the process of evaluation of the significance of risk increase and the process of calculation of the expected loss are conducted on a monthly basis in the dedicated calculation environment.

3.3 Hedge accounting

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

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

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

3.4 Disclosures and comparative data

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

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

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

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

3.6 Classification of financial assets and financial liabilities according to IFRS 9 as at first application

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

	Classification under IAS 39	New classification under IFRS 9	Carrying amount under IAS 39 as at 31.12.2017	remeasurement[1)]	New carrying amount under IFRS 9 as at 01.01.2018	impact of changes in accounting policies	
						on retained earnings	on other comprehensive income
Financial assets							
Cash and balances with the Central Bank	loans and receivables	measured at amortised cost	561	-	561	-	-
Amounts due from banks	loans and receivables	measured at amortised cost	5,350	-	5,350	-	-
Derivative hedging instruments	measured at fair value through profit or loss	measured at fair value through profit or loss	338	-	338	-	-
Securities	measured at fair value through profit or loss[2)]	measured at fair value through other comprehensive income	-	-	-	-	-
Loans and advances to customers	loans and receivables	measured at amortised cost	16,042,473	(14,498)	16,027,975	(14,498)	-
Securities	available for sale measured at fair value through other comprehensive income	measured at fair value through other comprehensive income	830,489	-	830,489	-	-
Total financial assets			**16,879,211**	**(14,498)**	**16,864,713**	**(14,498)**	**-**

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

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

3.7 Disclosures concerning the reconciliation of the balance of impairment losses and provisions for loan commitments according to IAS 39 and IAS 37 and the opening balance of the impairment losses and provisions calculated according to IFRS 9

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

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

3.8 Quantification of the impact of IFRS 9 on own funds

The increase in impairment losses and provisions for loan commitments following the implementation of IFRS 9 at initial recognition was recognised in Common Equity Tier 1 (CET1) capital; the Bank chose to apply transitory provisions concerning the alleviation of the impact of the implementation of IFRS 9, which are specified in Regulation No. 2017/2395 of the European Parliament and the Council (UE) of 12 December 2017. Therefore, the impact on the Common Equity Tier 1 and on the Total Capital Ratio of the Bank was negligible, as it remained at 15.2% as at 1 January 2018. Without applying above mentioned transitory provisions Common Equity Tier I ratio, Tier I ratio and the total capital ratio woud be at the level of 15.1%.

As at 30 June 2018 the Bank' own funds, the Tier I Common Equity and Tier I capital without accounting for the transitory provisions would amount to PLN 1,237,804 thousand, Common Equity Tier I ratio, Tier I ratio and the total capital ratio: 14.0%, and the leverage ratio: 6.1%. After accounting for the said transitional provisions, the Bank's own funds amounted to PLN 1,249,017 thousand, the Common Equity Tier I ratio, Tier I ratio and the total capital ratio: 14.2%, and the leverage ratio: 6.1%.

4. Other changes to accounting policies

4.1 Amendments to the published standards and interpretations which became effective as of 1 January 2018

The implementation of new Standards and Interpretations which became effective in 2018, apart from IFRS 9, as described in subpar. 3, did not have a material impact on these condensed interim financial statements.

IFRS 15 "Revenue from contracts with customers"

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

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

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

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

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

Several new Standards and amendments to Standards and Interpretations have not yet become effective for the annual periods ending on 31 December 2018 and these have not been applied to these condensed interim financial statements. From among the new Standards and Interpretations those referred to below will have an impact on the annual financial statements. The Bank intends to apply them for the periods for which they will be applicable for the first time.

IFRS 16 "Leases"

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

The Bank is party to operating lease agreements, which are currently not recognised in the statement of financial position, however, their value is not significant. Therefore, it is estimated that implementation of the new Standard will not lead to a significant increase in total assets, and total equity and liabilities.

4.3 New Standards and Interpretations, and amendments thereto, which have been published but have not been approved by the European Union

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

NOTES TO THE INCOME STATEMENT

5. Interest income and expense

INTEREST INCOME ON:	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Interest income recognised under the effective interest rate method, including:	**306,414**	**165,195**
on financial instruments measured at amortised cost, including:	**298,361**	**161,284**
loans and advances to customers	298,328	161,197
amounts due from banks and on mandatory reserve	33	87
on instruments measured at fair value through other comprehensive income, including:	**8,053**	**3,911**
debt securities	8,053	3,911
Income similar to interest income on instruments measured at fair value through profit or loss, including:	**468**	**304**
debt securities	-	284
hedging IRS transactions (net)	468	20
Total	**306,882**	**165,499**
including: interest income on impaired financial instruments	92	9

INTEREST EXPENSE ON:	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
financial instruments measured at amortised cost, including:	**(117,603)**	**(70,285)**
loans received and overdraft facility used	(14,817)	(11,698)
deferred payment for acquisition of receivables	(25,752)	(20,334)
mortgage covered bonds issued	(49,459)	(21,021)
unsecured bonds issued	(27,575)	(17,232)
Instruments measured at fair value through profit or loss, including:	**(69,778)**	**(32,987)**
hedging CIRS transactions (net)	(69,778)	(32,987)
Total	**(187,381)**	**(103,272)**

6. Fee and commission income and expense

FEE AND COMMISSION INCOME	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Fee and commission income on loans and advances to customers including:	6,916	5,056
fees for property valuation	2,951	2,543
fees for property inspection	1,185	860
fees for full or partial early repayment of loans	2,162	1,320
Total	**6,916**	**5,056**

FEE AND COMMISSION EXPENSE	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Preparation by property valuers of appraisal reports on Property Value for Mortgage Lending Purposes (BHWN)	(4,461)	(3,943)
Expenses related to unsecured bonds issuance programme	(1,754)	(1,168)
Expenses related to credit lines	(1,106)	(1,079)
Expenses related to mortgage covered bonds issuance programme	(599)	(463)
Loan insurance costs	(1,234)	(405)
Commission on transactional services provided by banks	(76)	(76)
Total	**(9,230)**	**(7,134)**

7. Net result on financial instruments measured at fair value through profit or loss

NET RESULT ON FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Financial instruments held for trading	**24**	**(240)**
derivatives	24	(239)
Gain/loss on IRS derivative instruments before designation to hedge accounting	-	(239)
Gain/loss on IRS derivative instruments related to hedge ineffectiveness	24	-
debt instruments	-	(1)
Total	**24**	**(240)**

The Bank concludes and maintains Interest Rate Swap (IRS) derivative contracts exclusively for hedging purposes.

8. Net foreign exchange gains

NET FOREIGN EXCHANGE GAINS	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Result on revaluation	(879)	44
Gain/loss on derivative instruments (CIRS, FX-Forward) before designation to hedge accounting	(1,376)	7,596
Gain/loss on derivative instruments (CIRS, FX-Forward) related to hedge ineffectiveness	6,245	(1,137)
Total	**3,990**	**6,503**

The Bank concludes and maintains Cross Currency Interest Rate Swap (CIRS) and Foreign Exchange Forward (FX-Forward) contracts exclusively for hedging purposes.

9. Net result on derecognition of financial instruments not measured at fair value through profit or loss

Accounting policies as of 1 January 2018

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

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

Financial information

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

10. Net result on modification

Accounting policies as of 1 January 2018

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

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

Issues related to modifications have been described in Note 3 "IFRS 9 Financial instruments". In the item "Net result on modification" the net result on immaterial modification is presented, whereas the net result on material modification is presented under "Net result on derecognition of financial instruments not measured at fair value through profit or loss".

NET RESULT ON MODIFICATION	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Financial instruments measured at amortised cost	(257)	
Total	**(257)**	

11. Net credit losses

NET CREDIT LOSSES	Note	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Net allowances on loans and advances to customers	21, 22	(4,395)	(1,501)
Net provisions for loan commitments granted	21, 22	(50)	(2)
Total		**(4,445)**	**(1,503)**

12. Other operating income and expense

OTHER OPERATING INCOME	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Sundry income	301	409
Other	1	1
Total	**302**	**410**

OTHER OPERATING EXPENSE	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Sundry expenses	(268)	(377)
Other	(33)	(18)
Total	**(301)**	**(395)**

13. Administrative expenses

ADMINISTRATIVE EXPENSES	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Employee benefits	(8,007)	(7,944)
Overheads	(12,727)	(8,805)
Amortisation and depreciation, including:	(1,122)	(617)
property and equipment	(134)	(124)
Intangible assets	(988)	(493)
Taxes and fees, including:	(6,385)	(2,214)
Tax on civil law transactions (due to share capital increase)	-	(1,500)
contribution to BGF Resolution Fund	(4,556)	(31)
fees to PFSA	(1,690)	(554)
Total	**(28,241)**	**(19,580)**

EMPLOYEE BENEFITS	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Wages and salaries, of which:	(6,726)	(6,657)
provision for disability and retirement benefits	(29)	(40)
Salary surcharges	(1,005)	(1,027)
Other employee benefits	(276)	(260)
Total	**(8,007)**	**(7,944)**

OVERHEADS	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Services relating to supporting operations under Outsourcing Agreement[1)]	(1,471)	(1,385)
Servicing of loans granted and receivables purchased under Outsourcing Agreement[1)]	(7,537)	(4,386)
External services under other contracts	(1,352)	(933)
IT costs	(742)	(674)
Rents	(1,019)	(954)
Operating leases	(133)	(117)
Other	(473)	(356)
Total	**(12,727)**	**(8,805)**

[1)] The Outsourcing Agreement was described in Note 35.1 "Equity-related party transactions"

14. Income tax expense

INCOME TAX EXPENSE	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Current income tax expense	(13,905)	(2,366)
Deferred income tax due to temporary differences	(4,339)	(6,524)
Income tax reported in the income statement	**(18,244)**	**(8,890)**
Income tax reported in other comprehensive income due to temporary differences	(9,455)	1,868
Total	**(27,698)**	**(7,022)**

RECONCILIATION OF THE EFFECTIVE TAX RATE	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Profit before income tax	**60,832**	**34,030**
Corporate income tax calculated at the statutory tax rate in force in Poland (19%)	(11,558)	(6,466)
Effect of non-deductible expenses and tax-exempt income, of which:	**(6,686)**	**(2,453)**
tax on certain financial institutions	(5,211)	(2,150)
fees to BGF	(866)	(6)
costs exceeding the limit set in Article 15e of the CIT Act	(596)	-
tax on civil law transactions relating to share capital increase	-	(285)
PFRON (State Disabled Persons Fund) costs	(8)	(8)
impact of other permanent differences	(5)	(4)
Effect of other differences between profit before income tax and taxable income, including new technologies tax relief	-	**29**
Income tax expense reported in the income statement	**(18,244)**	**(8,890)**
Effective tax rate	**29.99%**	**26.12%**
Temporary difference resulting from deferred tax reported in the income statement	(4,339)	(6,524)
Total current income tax expense reported in the income statement	**(13,905)**	**(2,366)**

CURRENT INCOME TAX LIABILITIES	30.06.2018	31.12.2017
Current income tax liabilities	3,699	3,507

Current income tax liabilities were paid before the statutory deadline.

NET DEFERRED TAX ASSETS/LIABILITIES	31.12.2017	Impact of adjustment due to IFRS 9 adoption	Income statement	Other compre-hensive income	30.06.2018
Deferred tax liabilities					
Interest accrued on loans and advances to customers	5,735	27	763	-	6,525
Interest accrued and discount on securities	565	-	1,622	-	2,187
Adjustment of loan portfolio valuation under straight-line and effective interest rate methods	13,470	-	2,822	-	16,292
Adjustment of own bonds issued valuation under straight-line and effective interest rate methods	2,205	-	141	-	2,346
Deferred costs	1,060	-	(259)	-	801
Difference between carrying amount and tax value of property and equipment and intangible assets	10	-	(1)	-	9
Valuation of securities	619	-	59	477	1,155
Valuation of derivatives	5,623	-	2,299	4,466	12,388
Gross deferred tax liabilities	**29,287**	**27**	**7,446**	**4,943**	**41,703**
Deferred tax assets					
Interest accrued on amounts due to banks	2,144		466	-	2,610
Interest accrued and discount on liabilities in respect of securities issued	6,280		2,918	-	9,198
Impairment allowances on loan exposures	952	2,792	656	-	4,400
Accruals	1,637		424	-	2,061
Tax loss	2,362		(2,362)	-	-
Valuation of securities	38		-	(38)	-
Valuation of derivatives	12,637		1,005	(4,474)	9,168
Gross deferred tax assets	**26,050**	**2,792**	**3,107**	**(4,512)**	**27,437**
Net deferred tax assets / (liabilities) (presented in the statement of financial position)	**(3,237)**	**2,765**	**(4,339)**	**(9,455)**	**(14,266)**

15. Earnings per Share

EARNINGS PER SHARE	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Profit attributable to ordinary shareholders (in PLN thousand)	42,588	25,140
Weighted average number of ordinary shares during the period (in thousand)	1,200,000	866,298
Earnings per share (in PLN per share)	0.04	0.03

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

NOTES TO THE STATEMENT OF FINANCIAL POSITION

16. Cash and balances with the Central Bank

CASH AND BALANCES WITH THE CENTRAL BANK	30.06.2018	31.12.2017
Current account with the Central Bank	18	561
Total	**18**	**561**

17. Amounts due from banks

AMOUNTS DUE FROM BANKS	30.06.2018	31.12.2017
Measured at amortised cost		
current accounts	122,172	5,350
Total	**122,172**	**5,350**

As at 30 June 2018 funds from the deposit securing the settlements of hedging instruments shown in Note 25 were maintained in the current account.

The risk related to amounts due from banks is described in Note 39 "Credit risk management".

18. Derivative hedging instruments

Accounting policies

The Bank decided to further apply the provisions of IAS 39 and did not apply IFRS 9 in respect of hedge accounting.

Types of hedging strategies used by the Bank

Strategy 1	Hedge of volatility of cash flows from mortgage loans in PLN due to changes in the reference interest rates and by mortgage covered bonds denominated in a convertible foreign currency due to changes in the exchange rate, using CIRS and FX-Forward hedging instruments
Outline of the hedging transaction	Elimination of the volatility of cash flows generated by mortgage loans in PLN due to changes in the reference interest rates and by mortgage covered bonds denominated in a convertible foreign currency due to changes in the exchange rate, using CIRS hedging instruments and a series of FX-Forward transactions in the foreign currency serving as hedges of the FX exposures maturing on the dates of payment of coupons on the mortgage covered bonds in the foreign currency.
Hedged risk	Forex and interest rate risks.
Hedging instruments	▪ Cross-Currency Interest Rate Swap (CIRS) transactions in which the Bank pays a coupon based on a variable PLN rate and receives a coupon based on a fixed rate for the convertible currency. If PKO Bank Hipoteczny SA is declared bankrupt by the court, the CIRS transactions will automatically be extended by 12 months on the terms and conditions set on the transaction date. ▪ an optional series of FX-Forward transactions in the convertible foreign currency serving as hedges of the FX exposures maturing on the dates of payment of coupons on the mortgage covered bonds in the foreign currency.
Hedged item	▪ part of the portfolio of the mortgage loans included in the cover pool of PLN covered bonds at floating rates. The interest rates on the loans are indexed by the 3M WIBOR rate. The mortgage loan margin is excluded from the hedge; ▪ fixed-rate mortgage covered bonds issued in a foreign currency.

	▪ The period in which cash flows are expected to occur and in which an impact on profit or loss should be expected: July 2018 – August 2024.

HEDGED ITEMS AS AT 30.06.2018	HEDGING DERIVATIVE INSTRUMENTS	NOMINAL VALUE OF HEDGING DERIVATIVE INSTRUMENTS		CARRYING AMOUNT/FAIR VALUE OF HEDGING INSTRUMENTS		INEFFECTIVE PORTION OF CASH FLOW HEDGES RECOGNISED IN THE INCOME STATEMENT
				Assets	Liabilities	
variable interest loans in PLN and fixed interest mortgage covered bonds in convertible currencies	CIRS EUR/PLN	fixed EUR	9,056,252	209,640	-	6,245
		float PLN	8,858,818			
	FX forward	buy EUR	9,477	164	246	0
		sell EUR	7,486			

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

HEDGED ITEMS AS AT 30.06.18	HEDGING DERIVATIVE INSTRUMENTS	NOMINAL VALUE OF HEDGING DERIVATIVE INSTRUMENTS		CARRYING AMOUNT/FAIR VALUE OF HEDGING INSTRUMENTS		INEFFECTIVE PORTION OF CASH FLOW HEDGES RECOGNISED IN THE INCOME STATEMENT
				Assets	Liabilities	
variable interest loans in PLN	IRS PLN	PLN	265,000	4,916	-	24

FINANCIAL INFORMATION

CARRYING AMOUNT / FAIR VALUE OF DERIVATIVE INSTRUMENTS DESIGNATED AS CASH FLOW HEDGE	30.06.2018		31.12.2017	
	Assets	Liabilities	Assets	Liabilities
IRS	4,916	-	-	377
CIRS	209,640	-	-	217,009
FX forward	164	246	338	391
Total	**214,720**	**246**	**338**	**217,777**

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

ACCUMULATED OTHER COMPREHENSIVE INCOME ON CASH FLOW HEDGES AND IMPACT ON OTHER COMPREHENSIVE INCOME	30.06.2018	30.06.2017
Accumulated other comprehensive income on cash flow hedges as at the beginning of the period, gross	(38,730)	(21,870)
Gains / (Losses) recognised in other comprehensive income during the period	355,793	(163,559)
Amounts transferred from other comprehensive income to the income statement during the period	308,742	(152,522)
- interest income	468	20
- Interest expense	(69,778)	(32,987)
- net foreign exchange gains/(losses)	378,052	(119,555)
Accumulated other comprehensive income on cash flow hedges as at the end of the period, gross	8,321	(32,907)
Tax effect	(1,582)	6,252
Accumulated other comprehensive income on cash flow hedges as at the end of the period, net	**6,739**	**(26,655)**
Ineffective portion of cash flow hedges recognised in the income statement	**6,269**	**(1,137)**
Impact on other comprehensive income during the period, gross	47,051	(11,037)
Deferred tax on cash flow hedges	(8,940)	2,097
Impact on other comprehensive income during the period, net	**38,111**	**(8,940)**

19. Securities

Accounting policies as of 1 January 2018

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

- Financial assets measured at fair value through profit or loss:
  - financial instruments held for trading;
  - financial assets not held for trading, measured at fair value through profit or loss on a mandatory basis;
  - financial assets designated to be measured at fair value through profit or loss at initial recognition.
- Financial assets measured at fair value through other comprehensive income.
- Financial assets are measured at amortized cost.

The debt securities' classification and measurement policies have been described in Note 3 "IFRS 9 Financial instruments".

Accounting policies until 31 December 2017

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

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

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

FINANCIAL INFORMATION

SECURITIES	30.06.2018	31.12.2017
Available-for-sale investment securities, including:		830,489
issued by the State Treasury, PLN Treasury bonds		830,489
Measured at fair value through other comprehensive income	842,727	
issued by the State Treasury, PLN Treasury bonds	842,727	
Total	**842,727**	**830,489**

SECURITIES BY MATURITY	30.06.2018	31.12.2017
Issued by the State Treasury, PLN Treasury bonds		
up to 1 month	-	100,797
1 to 3 months	-	-
3 months to 1 year	187,027	-
1 to 5 years	479,037	614,160
over 5 years	176,663	115,532
Total	**842,727**	**830,489**

SECURITIES BY NOMINAL VALUE AND AVERAGE YIELD	30.06.2018	31.12.2017
Issued by the State Treasury, PLN Treasury bonds	836,480	826,480
Average yield	1.80%	1.81%

20. Loans and advances to customers

Accounting policies as of 1 January 2018

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

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

The classification and measurement policies in respect of loans and advances to customers have been described in Note 3 "IFRS 9 Financial instruments".

Accounting policies until 31 December 2017

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

FINANCIAL INFORMATION

LOANS AND ADVANCES TO CUSTOMERS	30.06.2018	01.01.2018	31.12.2017
Measured at amortised cost			
Housing loans, gross, including:	19,089,947	16,047,682	16,047,541
loans granted	6,886,826	5,251,257	5,251,206
acquired receivables	12,203,121	10,796,425	10,796,335
Impairment allowances (IAS 39)			(5,068)
Allowances for expected credit losses (IFRS 9)	(24,102)	(19,707)	
Housing loans, net	**19,065,845**	**16,027,975**	**16,042,473**

In the first half of 2018 the Bank purchased, based on the Framework Agreement for the Sale of Receivables signed with PKO Bank Polski SA on 17 November 2015, mortgage covered housing loan receivables portfolios in the amount

of PLN 1,880,968 thousand. The purchase price was determined on an arm's length basis, based on the valuation made by an independent expert. The receivables purchased were recognised on the transfer dates set in the Receivables Sale Agreements, on which the Bank acquired the rights to the cash flows from individual portfolios, and assumed all related liability for costs and economic risks in the constituent receivables. The purchase of the receivable portfolios was financed by the liability the nature of which is described in Note 25. The Bank ultimately refinances the purchased receivable portfolios primarily through issuing covered bonds.

Loans granted and receivables purchased that have been entered in the Bank's cover pool Register represent collateral for mortgage covered bonds issued, as described in Note 27.

Information about the quality of the loan portfolio is also presented in Note 39.4 "Forecasting and monitoring of credit risk".

Information relating to credit risk exposure in respect of loans and advances to customers measured at amortised cost have been described for 2018 in Note 21 "Expected credit losses" and for 2017 in Note 22 "Impairment allowances in respect of financial assets – in accordance with IAS 39".

21. Expected credit losses

Estimates and assessments effective as of 1 January 2018

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

- Financial assets measured at amortised cost: the allowance decreases the gross carrying amount of the financial asset; changes in the allowance are recognised in the income statement;
- Loan commitments and financial guarantees: the allowance is presented as a provision in liabilities; changes in allowances are recognised in the income statement;
- Financial instruments measured at fair value through other comprehensive income: the carrying amount of an asset carried at fair value is not decreased by the amount of the allowances; measurement changes are however each time divided into the component related to impairment – recognised in the income statement – and the component related to other fair value measurement changes – recognised in other comprehensive income.

A detailed description of changes in the area of impairment effective as of 1 January 2018 and related to the implementation of IFRS 9 has been described in Note 3 "IFRS 9 Financial instruments".

ALLOWANCES FOR EXPECTED CREDIT LOSSES

FINANCIAL ASSETS AND ALLOWANCES FOR EXPECTED CREDIT LOSSES AS AT 30.06.2018	Assets with no significant increase in credit risk since initial recognition (Stage 1), gross	Allowances for expected credit losses (Stage 1)	Assets with a significant increase in credit risk since initial recognition, but not credit-impaired, gross (Stage 2)	Allowances for expected credit losses (Stage 2)	Credit-impaired assets, gross (Stage 3)	Allowances for expected credit losses (Stage 3)	Total gross amount	Total allowances for expected credit losses
Measured at fair value through other comprehensive income								
securities	842,727	-	-	-	-	-	842,727	-
issued by the State Treasury, PLN Treasury bonds	842,727	-	-	-	-	-	842,727	-
Total	842,727	-	-	-	-	-	842,727	-
Measured at amortised cost								
amounts due from banks	122,172	-	-	-	-	-	122,172	-
loans and advances to customers	18,890,438	(8,038)	195,192	(13,994)	4,317	(2,070)	19,089,947	(24,102)
housing loans	18,890,438	(8,038)	195,192	(13,994)	4,317	(2,070)	19,089,947	(24,102)
Total	19,012,610	(8,038)	195,192	(13,994)	4,317	(2,070)	19,212,119	(24,102)

As at 30 June 2018 there were no purchased or originated credit-impaired assets (POCI).

FINANCIAL ASSETS AND ALLOWANCES FOR EXPECTED CREDIT LOSSES AS AT 01.01.2018	Assets with no significant increase in credit risk since initial recognition (Stage 1), gross	Allowances for expected credit losses (Stage 1)	Assets with a significant increase in credit risk since initial recognition, but not credit-impaired, gross (Stage 2)	Allowances for expected credit losses (Stage 2)	Credit-impaired assets, gross (Stage 3)	Allowances for expected credit losses (Stage 3)	Total gross amount	Total allowances for expected credit losses
Measured at fair value through other comprehensive income								
securities	830,489	-	-	-	-	-	830,489	-
issued by the State Treasury, PLN Treasury bonds	830,489	-	-	-	-	-	830,489	-
Total	830,489	-	-	-	-	-	830,489	-
Measured at amortised cost								
amounts due from banks	5,350	-	-	-	-	-	5,350	-
loans and advances to customers	15,876,720	(3,776)	168,115	(14,963)	2,847	(968)	16,047,682	(19,707)
housing loans	15,876,720	(3,776)	168,115	(14,963)	2,847	(968)	16,047,682	(19,707)
Total	15,882,070	(3,776)	168,115	(14,963)	2,847	(968)	16,053,032	(19,707)

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

TRANSFERS BETWEEN STAGES FOR FINANCIAL ASSETS AND LOAN COMMITMENTS

FINANCIAL ASSETS AS AT 30.06.2018 – TRANSFERS BETWEEN STAGES	Carrying amount, gross								Impairment allowances								
	AMOUNTS NOT SUBJECT TO TRANSFER IN THE PERIOD	Transfers between Stage 1 (S1) and Stage 2 (S2)		Transfers between Stage 2 (S2) and Stage 3 (S3)		Transfers between Stage 1 (S1) and Stage 3 (S3)		TOTAL GROSS AMOUNT	AMOUNTS NOT SUBJECT TO TRANSFER IN THE PERIOD	Transfers between Stage 1 (S1) and Stage 2 (S2)		Transfers between Stage 2 (S2) and Stage 3 (S3)		Transfers between Stage 1 (S1) and Stage 3 (S3)		TOTAL IMPAIRMENT ALLOWANCES	TOTAL, NET
		from S1 to S2	from S2 to S1	from S2 to S3	from S3 to S2	from S1 to S3	from S3 to S1			from S1 to S2	from S2 to S1	from S2 to S3	from S3 to S2	from S1 to S3	from S3 to S1		
Measured at fair value through other comprehensive income																	
securities	842,727	-	-	-	-	-	-	842,727	-	-	-	-	-	-	-	-	842,727
issued by the State Treasury, PLN Treasury bonds	842,727	-	-	-	-	-	-	842,727	-	-	-	-	-	-	-	-	842,727
Measured at amortised cost																	
amounts due from banks	122,172	-	-	-	-	-	-	122,172	-	-	-	-	-	-	-	-	122,172
loans and advances to customers	18,880,989	119,375	87,771	1,524	288	-	-	19,089,947	(15,253)	(7,577)	(625)	(588)	(59)	-	-	(24,102)	19,065,845
housing loans	18,880,989	119,375	87,771	1,524	288	-	-	19,089,947	(15,253)	(7,577)	(625)	(588)	(59)	-	-	(24,102)	19,065,845
Total financial assets	19,845,888	119,375	87,771	1,524	288	-	-	20,054,846	(15,253)	(7,577)	(625)	(588)	(59)	-	-	(24,102)	20,030,744

LOAN COMMITMENTS AS AT 30.06.2018 – TRANSFERS BETWEEN STAGES	Nominal value of loan commitments								Provisions								
	AMOUNTS NOT SUBJECT TO TRANSFER IN THE PERIOD	Transfers between Stage 1 (S1) and Stage 2 (S2)		Transfers between Stage 2 (S2) and Stage 3 (S3)		Transfers between Stage 1 (S1) and Stage 3 (S3)		TOTAL NOMINAL VALUE	AMOUNTS NOT SUBJECT TO TRANSFER IN THE PERIOD	Transfers between Stage 1 (S1) and Stage 2 (S2)		Transfers between Stage 2 (S2) and Stage 3 (S3)		Transfers between Stage 1 (S1) and Stage 3 (S3)		TOTAL PROVISIONS	TOTAL, NET
		from S1 to S2	from S2 to S1	from S2 to S3	from S3 to S2	from S1 to S3	from S3 to S1			from S1 to S2	from S2 to S1	from S2 to S3	from S3 to S2	from S1 to S3	from S3 to S1		
Loan commitments																	
housing loans to individuals	783,271	1,061	327	-	-	-	-	784,659	(130)	(28)	-	-	-	-	-	(158)	784,501

CHANGES IN ALLOWANCES FOR EXPECTED CREDIT LOSSES

CHANGES IN ALLOWANCES FOR EXPECTED CREDIT LOSSES ON FINANCIAL ASSETS	Impairment allowances / provisions for financial assets as at 31.12.2017 (IAS 39)	Changes due to IFRS 9 implementation	As at 01.01.2018	Increase due to origination and purchase	Decrease due to derecognition	Changes due to changes in credit risk (net)	Changes due to modification without derecognition	As at 30.06.2018
Measured at amortised cost								
amounts due from banks	-	-	-	-	-	-	-	
loans and advances to customers	5,068	14,639	19,707	1,242	(270)	3,405	18	24,102
housing loans	5,068	14,639	19,707	1,242	(270)	3,405	18	24,102
Total allowances	**5,068**	**14,639**	**19,707**	**1,242**	**(270)**	**3,405**	**18**	**24,102**
Loan commitments	54	54	108	93	(42)	-	(1)	158
housing loans to individuals	54	54	108	93	(42)	-	(1)	158
Total provisions for loan commitments	**54**	**54**	**108**	**93**	**(42)**	**-**	**(1)**	**158**

PURCHASED OR ORIGINATED CREDIT-IMPAIRED ASSETS – POCI AT INITIAL RECOGNITION

As at 30 June 2018 and as at 1 January 2018 the Bank had no purchased or originated credit-impaired financial assets (POCI).

22. ALLOWANCES ON IMPAIRMENT OF FINANCIAL ASSETS – IN ACCORDANCE WITH IAS 39

ESTIMATES AND ASSESSMENTS EFFECTIVE UNTIL 31 DECEMBER 2017

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

FINANCIAL INFORMATION

IMPAIRMENT ALLOWANCES ON LOANS AND ADVANCES – RECONCILIATION OF MOVEMENTS FOR PERIOD FROM 1 JANUARY 2017 TO 30 JUNE 2017	As at 01.01.2017	INCREASE	DECREASE		As at 30.06.2017	Net increase - impact on the income statement
		Recognised during the period	Reversed during the period	Derecognition of assets and settlements		
Loans and advances to customers measured at amortised 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)
Provisions for loan commitments	80	18	16	-	82	(2)
Total	**1,839**	**2,969**	**1,466**	**-**	**3,342**	**(1,503)**

23. INTANGIBLE ASSETS AND PROPERTY AND EQUIPMENT

INTANGIBLE ASSETS	30.06.2018	31.12.2017
Intangible assets under development	133	-
Software	4,639	5,584
Total	**4,772**	**5,584**

PROPERTY AND EQUIPMENT	30.06.2018	31.12.2017
Leasehold improvements	26	28
Equipment	364	348
Other	154	194
Total	**544**	**570**

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

24. Other assets

OTHER ASSETS	30.06.2018	31.12.2017
Deferred costs and prepaid expenses, including:	7,306	9,085
deferred costs relating to the overdraft facility	1,783	2,583
deferred costs relating to unsecured bonds issuance programme[1)]	486	684
deferred costs relating to mortgage covered bonds issuance programme [1)]	1,944	2,309
other prepaid expenses	3,093	3,509
Deferred costs and commission relating to loans granted, proportionally to undrawn principal	9,278	7,946
Settlements relating to appraisal reports on Property Value for Mortgage Lending Purposes (BHWN)	281	66
Settlements under the public law	7	99
Other	8	33
Total	**16,880**	**17,229**
of which financial assets	289	99

[1)] Costs related to issue programs relate to complete issue programs and cannot be allocated to particular issuances conducted under the programs.

25. Amounts due to banks

AMOUNTS DUE TO BANKS	30.06.2018	31.12.2017
Measured at amortised cost		
overdraft within the limit available	20,436	-
liabilities in respect of overdraft facilities	1,505,846	1,627,461
liability due to purchase of receivables	2,205,682	2,497,918
deposit accepted as collateral for settlement of hedging derivatives	126,386	-
Total	**3,858,350**	**4,125,379**

Liabilities in respect of overdraft facilities

LENDER	Date of agreement	Maturity date	Amount of loan granted	Amount of loan drawn	Liability as at 30 June 2018
PKO Bank Polski SA	29/10/2015	29/10/2018	900,000	900,000	-
PKO Bank Polski SA	02/02/2017	02/02/2020	1,500,000	1,500,000	1,405,841
Another bank	05/06/2017	10/06/2019	100,000	100,000	100,005
Total			**2,500,000**	**2,500,000**	**1,505,846**

Liability in respect of the purchase of receivables

The line "Liability due to purchase of receivables" represents the liability arising from the transactions of purchase of mortgage-backed housing loan portfolios from PKO Bank Polski SA, as specified in Note 20. The maturity date of the liability resulting from the purchase of receivables is agreed by the parties in the Receivables Sale Agreement for each transaction. For receivables acquired in 2018, the parties agreed that the payment would be due no later than 12 months from the date of transfer. If the liability is not settled within 1 month from the date of transfer, the principal amount is subject to interest. The Bank ultimately refinances the purchased receivable portfolios primarily through the issuance of mortgage covered bonds. The liability resulting from the purchase of receivables at 30 June 2018 concerns in whole portfolios purchased starting from the fourth quarter of 2017.

26. Amounts due to customers

AMOUNTS DUE TO CUSTOMERS	30.06.2018	31.12.2017
Measured at amortised cost		
amounts due to retail customers, overpaid loans	3,051	2,099
Total	**3,051**	**2,099**

27. Mortgage covered bonds issued

MORTGAGE COVERED BONDS ISSUED	30.06.2018	31.12.2017
Measured at amortised cost		
mortgage covered bonds	12,167,940	8,883,213
Total	**12,167,940**	**8,883,213**

REPAYMENT PERIOD OF MORTGAGE COVERED BONDS ISSUED	30.06.2018	31.12.2017
1 to 5 years	6,992,390	4,102,528
over 5 years	5,175,550	4,780,685
Total	**12,167,940**	**8,883,213**

Mortgage covered bonds issued as at 30 June 2018

ISIN	Currency	Nominal value	Interest rate as at 30.06.2018	Rate +margin	Issue date	Maturity	Quotation market
PLPKOHP00017	PLN	30,000	2.45%	WIBOR3M + 0.75 p.p.	11/12/2015	11/12/2020	Bondspot, WSE alternative market
PLPKOHP00025	PLN	500,000	2.35%	WIBOR3M + 0.65 p.p.	27/04/2016	28/04/2021	Bondspot, WSE alternative market
PLPKOHP00033	PLN	500,000	2.29%	WIBOR3M + 0.59 p.p.	17/06/2016	18/06/2021	Bondspot, WSE alternative market
XS1508351357	EUR	500,000	0.125%	fixed rate during the period	24/10/2016	24/06/2022	LuxSE, WSE alternative market
XS1559882821	EUR	25,000	0.82%	fixed rate during the period	02/02/2017	02/02/2024	LuxSE
XS1588411188	EUR	500,000	0.625%	fixed rate during the period	30/03/2017	24/01/2023	LuxSE, WSE alternative market
PLPKOHP00041	PLN	500,000	2.39%	WIBOR3M + 0.69 p.p.	28/04/2017	18/05/2022	Bondspot, WSE alternative market
PLPKOHP00058	PLN	265,000	2.69%	fixed rate during the period	22/06/2017	10/09/2021	Bondspot, WSE alternative market
XS1690669574	EUR	500,000	0.75%	fixed rate during the period	27/09/2017	27/08/2024	LuxSE, WSE alternative market
PLPKOHP00066	PLN	500,000	2.30%	WIBOR3M + 0.60 p.p.	27/10/2017	27/06/2023	Bondspot, WSE alternative market
XS1709552696	EUR	54,000	0.47%	fixed rate during the period	02/11/2017	03/11/2022	LuxSE
XS1795407979	EUR	500,000	0.75%	fixed rate during the period	22/03/2018	24/01/2024	LuxSE, WSE alternative market
PLPKOHP00074	PLN	700,000	2.19%	WIBOR3M + 0.49 p.p.	27/04/2018	25/04/2024	Bondspot, WSE alternative market
PLPKOHP00082	PLN	100,000	2.02%	WIBOR3M + 0.32 p.p.	18/05/2018	29/04/2022	Bondspot, WSE alternative market

In the first half of 2018 the Bank carried out 3 issues of mortgage covered bonds totalling PLN 800,000 thousand and EUR 500,000 thousand, and in the first half of 2017 4 issues of mortgage covered bonds totalling PLN 765,000 thousand, and EUR 525,000 thousand.

As at 30 June 2018 the issued PLN- and EUR-mortgage covered bonds were rated by Moody's Investors Service at Aa3, i.e. the highest achievable by Polish securities. The limit for the ratings is the Polish country ceiling for debt instruments, which currently is at the level of Aa3.

The total nominal value of the issued mortgage covered bonds as at 30 June 2018 amounted to PLN 12,162,766 thousand, and as at 31 December 2017: PLN 8,880,851 thousand.

SECURING THE MORTGAGE COVERED BONDS

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

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

The nominal value of loans entered in the Bank's cover pool representing collateral for the covered bonds issued totalled PLN 14,208,383 thousand at 30 June 2018, whereas the nominal value of additional collateral in the form of securities issued by the State Treasury amounted to PLN 251,000 thousand. As at 31 December 2017 it amounted to PLN 11,103,708 thousand and PLN 251,000 thousand respectively. The Bank's covered bonds cover pool also included CIRS and FX-Forward transactions hedging the currency risk of issued covered bonds denominated in EUR and an IRS transaction securing the interest rate risk of fixed rate mortgage covered bonds issued in PLN.

In the first half of 2018 and in the previous years the Bank's covered bonds cover pool did not include asset-backed securities (ABS), which do not meet the requirements specified in paragraph 1 of Article 80 of the Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (recast).

28. UNSECURED BONDS ISSUED

UNSECURED BONDS ISSUED	30.06.2018	31.12.2017
Measured at amortised cost		
bonds	2,898,978	2,428,025
Total	**2,898,978**	**2,428,025**

REPAYMENT PERIOD OF UNSECURED BONDS ISSUED	30.06.2018	31.12.2017
up to 1 month	403,337	364,083
1 to 3 months	1,005,841	1,048,540
3 months to 1 year	1,489,800	1,015,402
Total	**2,898,978**	**2,428,025**

In the first half of 2018 the Bank issued bonds of a total nominal value of PLN 3,783,200 thousand and redeemed bonds of a total nominal value of PLN 3,308,000 thousand, whereas in the first half of 2017 it was PLN 2,627,600 thousand and PLN 1,862,900 thousand respectively.

The nominal value of the bonds issued as at 30 June 2018 amounted to PLN 2,915,400 thousand, and as at 31 December 2017 to PLN 2,440,200 thousand.

Unsecured bonds issued as at 30 June 2018

BONDS	Nominal value	Interest rate	Issuance date	Maturity
OW161018-B99	15,000	discount paper	16/10/2017	16/10/2018
OW261018B103	4,100	discount paper	26/10/2017	26/10/2018
OW301018B105	20,000	discount paper	02/11/2017	30/10/2018
OW230718-120	191,000	discount paper	23/01/2018	23/07/2018
OW080219-123	4,000	discount paper	09/02/2018	08/02/2019
OW101218-125	4,100	discount paper	19/02/2018	10/12/2018
OW210918-128	746,000	discount paper	15/03/2018	21/09/2018
OW011018-129	40,000	discount paper	29/03/2018	01/10/2018
OW060718-131	52,500	discount paper	05/04/2018	06/07/2018
OW221018-132	619,500	discount paper	16/04/2018	22/10/2018
OW060718-133	30,000	discount paper	16/04/2018	06/07/2018
OW080818-135	163,000	discount paper	07/05/2018	08/08/2018
OW211118-136	195,000	discount paper	15/05/2018	21/11/2018
OW160718-137	130,200	discount paper	16/05/2018	16/07/2018
OW310818-139	49,000	discount paper	21/05/2018	31/08/2018
OW171218-141	250,000	discount paper	25/05/2018	17/12/2018
OW211118-142	35,000	discount paper	29/05/2018	21/11/2018
OW130918-145	32,000	discount paper	13/06/2018	13/09/2018
OW211218-147	70,000	discount paper	20/06/2018	21/12/2018
OW220818-148	20,000	discount paper	22/06/2018	22/08/2018
OW211218-149	145,000	discount paper	25/06/2018	21/12/2018
OW281218-150	100,000	discount paper	27/06/2018	28/12/2018

29. Other liabilities

OTHER LIABILITIES	30.06.2018	31.12.2017
Expenses to be paid	10,733	8,534
Liabilities due to contribution to the Bank Guarantee Fund	4,556	-
Other, including:	12,703	8,907
sundry creditors	6,823	4,438
liabilities under the public law, including:	5,880	4,469
liability in respect of tax on certain financial institutions	5,198	3,991
Total	**27,992**	**17,441**
of which financial liabilities	17,556	12,972

As at 30 June 2018 and as at 31 December 2017 the Bank had no liabilities in respect of which it would be in contractual default.

The item "Liabilities in respect of contributions to the Bank Guarantee Fund" includes liabilities in respect of the contribution calculated by the Bank Guarantee Fund (BGF) for the fund of mandatory restructuring for 2018, payable/contributed in the form of commitment to pay by 19 July 2018.

30. Provisions

Accounting policies

Provisions for loan commitments and guarantees

Provisions for loan commitments are set up in an amount equivalent to the respective expected (estimable) loss of economic benefits. In setting up the provision, portfolio parameters are used which are estimated using statistical methods based on historical observations of exposures with the same characteristics, determining the marginal probability of impairment triggers arising, the average level of utilisation of loan commitments and the expected loss

in the event of impairment triggers arising in consecutive months of the period from the reporting date to the horizon of the calculation of the expected loss.

FINANCIAL INFORMATION

PROVISIONS FOR THE PERIOD FROM 1 JANUARY 2018 TO 30 JUNE 2018	Provision for disability and retirement benefits	Provisions for loan commitments	Total
As at 31 December 2017, of which:	**84**	**54**	**138**
Long-term provisions	84	54	138
Changes due to IFRS 9 implementation	**-**	**54**	**54**
Long-term provisions	-	54	54
As at 1 January 2018, of which:	**84**	**108**	**192**
Long-term provisions	84	108	192
Increase/reassessment	29	92	121
Release	-	(42)	(42)
As at 30 June 2018, of which:	**113**	**158**	**271**
Long-term provisions	113	158	271

PROVISIONS FOR THE PERIOD FROM 1 JANUARY 2017 TO 30 JUNE 2017	Provision for disability and retirement benefits	Provisions for loan commitments	Total
As at 1 January 2017, of which:	**60**	**80**	**140**
Long-term provisions	60	80	140
Increase/reassessment	40	18	58
Release	-	(16)	(16)
As at 30 June 2017, of which:	**100**	**82**	**182**
Long-term provisions	100	82	182

31. The Bank's equity and shareholding structure

EQUITY	30.06.2018	31.12.2017
Share capital	1,200,000	1,200,000
Supplementary capital	50,670	-
Accumulated other comprehensive income, of which:	11,414	(28,892)
cash flow hedges	6,739	(31,372)
valuation of available-for-sale financial assets		2,480
valuation of financial assets measures at fair value through other comprehensive income	4,675	
Retained earnings	(11,787)	(749)
Net profit for the period	42,588	51,419
Total equity	**1,292,885**	**1,221,778**

SHAREHOLDING STRUCTURE

Series	Type of shares	Number of shares	Nominal value of 1 share (in PLN)	Series value at nominal value (in PLN)	Date of adoption of the resolution by the GSM	Issue date	Date of registration in the National Court Register
A	Ordinary registered	300,000,000	1	300,000,000	06/10/2014	06/10/2014	24/10/2014
B	Ordinary registered	200,000,000	1	200,000,000	14/03/2016	07/04/2016	22/04/2016
C	Ordinary registered	200,000,000	1	200,000,000	01/07/2016	15/07/2016	28/07/2016
D	Ordinary registered	100,000,000	1	100,000,000	28/10/2016	18/11/2016	01/12/2016
E	Ordinary registered	150,000,000	1	150,000,000	21/03/2017	04/04/2017	12/04/2017
F	Ordinary registered	150,000,000	1	150,000,000	28/06/2017	04/07/2017	11/09/2017
G	Ordinary registered	100,000,000	1	100,000,000	18/10/2017	20/10/2017	16/11/2017
Total		**1,200,000,000**		**1,200,000,000**			

PKO Bank Polski SA was the Bank's sole shareholder as at 30 June 2018 and as at 31 December 2017.

As at 30 June 2018 the Bank's share capital amounted to PLN 1,200,000,000 and comprised 1,200,000,000 (one billion two hundred million) ordinary registered shares with a nominal value of PLN 1 (one) each. The issued shares of PKO Bank Hipoteczny SA are not preferred shares and they have been fully paid up.

OTHER NOTES

32. Loan commitments and contingent assets

32.1. Contractual commitments

As at 30 June 2018 and 31 December 2017 the Bank had no contractual commitments relating to the purchase of intangible assets and property and equipment.

32.2. Loan commitments

LOAN COMMITMENTS (CONTINGENT)	30.06.2018	01.01.2018	31.12.2017
undrawn housing loans (nominal value)			
housing loans to individuals	784,659	682,932	682,932
provisions under IAS 37			(54)
provisions under IFRS 9	(158)	(108)	
Total, net	**784,501**	**682,824**	**682,878**
of which irrevocable loan commitments	-	-	-

Information on provisions on loan commitments is provided in Note 30 "Provisions".

32.3. Guarantees granted

PKO Bank Hipoteczny SA does not grant guarantee commitments.

32.4. Contingent assets

Financial information

CONTINGENT ASSETS BY NOMINAL VALUE	30.06.2018	31.12.2017
Contingent assets		
financial	997,200	927,200
guarantees	2,000,000	1,984,900
Total	**2,997,200**	**2,912,100**

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

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

As at 30 June 2018 and as at 31 December 2017 no collateral was established for the Bank, which the Bank would be entitled to sell or re-pledge, in the event of fulfilling all obligations by the owner of the collateral.

33. Legal claims

As at 30 June 2018 and 31 December 2017 there were no legal claims.

34. Notes to the statement of cash flows

Cash and cash equivalents

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

Financial information

Cash and cash equivalents	30.06.2018	31.12.2017	30.06.2017
Cash and balances with the Central Bank	18	561	22
Current amounts due from banks	122,172	5,350	7,596
Total	**122,190**	**5,911**	**7,618**

INTEREST INCOME – RECEIVED	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Interest received on loans and advances to customers	296,397	156,822
Interest / discount received on securities designated at fair value through profit or loss upon initial recognition	-	291
Interest / discount received on securities designated at fair value through other comprehensive income upon initial recognition	7,761	
Interest received on investment securities available for sale		1,854
Interest received on CIRS	15,476	2,496
Interest received on IRS	-	-
Interest received on deposits	31	24
Other interest received	2	63
Total	**319,667**	**161,550**

INTEREST EXPENSE – PAID	01/01/2018 - 30/06/2018	01/01/2017 - 30/06/2017
Interest paid on overdraft facility	16,386	8,512
Interest / discount paid on mortgage covered bonds and unsecured bonds issued	63,317	27,090
Interest paid on a liability due to purchase of receivables	21,686	28,219
Interest paid on CIRS	83,615	28,704
Interest paid on IRS	3,089	-
Interest paid for exceeding the limit of a current account	34	3
Other interest paid	13	-
Total	**188,140**	**92,528**

35. Related party transactions

35.1 Related party transactions

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

FINANCIAL INFORMATION

AS AT 30 JUNE 2018

ENTITY	ASSETS			
	Purchase of property and equipment and intangible assets	Unsettled commission on origination of loans and fair value adjustment on purchased receivables	Other receivables	including due to derivative instruments
PKO Bank Polski SA	3,501	83,759	339,480	214,720
Total	**3,501**	**83,759**	**339,480**	**214,720**

ENTITY	LIABILITIES				
	Overdraft facility, overdraft and margin deposit accepted	Purchase of receivables	Mortgage covered bonds and unsecured bonds	Other liabilities	including due to derivative instruments
PKO Bank Polski SA	1,552,663	2,205,682	32,668	8,496	246
PKO BP Finat Sp. z o.o.	-	-	-	17	-
PKO Leasing SA	-	-	-	2	-
PKO Towarzystwo Ubezpieczeń SA	-	-	-	16	-
Total	**1,552,663**	**2,205,682**	**32,668**	**8,531**	**246**

ENTITY	Loan commitments	Contingent assets
PKO Bank Polski SA	-	2,997,200
Total	**-**	**2,997,200**

FOR THE PERIOD FROM 1 JANUARY 2018 TO 30 JUNE 2018

ENTITY	Total income	of which interest and commission income*	Total expenses	of which interest and commission expense	Net result on financial instruments measured at fair value	Net foreign exchange gains
PKO Bank Polski SA	(1,833)	(2,045)	128,615	117,951	24	382,965
PKO BP Finat Sp. z o.o.	-	-	96	-	-	-
PKO Leasing SA	-	-	186	-	-	-
PKO Towarzystwo Ubezpieczeń SA	-	-	680	680	-	-
Total	**(1,833)**	**(2,045)**	**129,577**	**118,631**	**24**	**382,965**

*The negative amount of interest and commission income results from commission for intermediation services in respect of sales of loans, paid to PKO Bank Polski SA, which constitutes part of the amortised cost and is accounted for in interest income.

As at 31 December 2017

ENTITY	ASSETS			
	Purchase of property and equipment and intangible assets	Unsettled commission on origination of loans and fair value adjustment on purchased receivables	Other receivables	including due to derivative instruments
PKO Bank Polski SA	4,134	61,733	9,070	338
Total	**4,134**	**61,733**	**9,070**	**338**

ENTITY	LIABILITIES				
	Overdraft facility	Purchase of receivables	Mortgage covered bonds and unsecured bonds	Other liabilities	including due to derivative instruments
PKO Bank Polski SA	1,477,453	2,497,918	58,441	223,178	217,777
PKO BP Finat Sp. z o.o.	-	-	-	17	-
PKO Leasing SA	-	-	-	1	-
Total	**1,477,453**	**2,497,918**	**58,441**	**223,197**	**217,777**

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

For the period from 1 January 2017 to 30 June 2017

ENTITY	Total income	of which interest and commission income	Total expenses	of which interest and commission expense	Net result on financial instruments measured at fair value	Net foreign exchange losses
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)**	**79,164**	**72,076**	**(239)**	**(113,070)**

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

The Bank is also provided with funding by PKO Bank Polski SA. On 29 October 2015 PKO Bank Hipoteczny SA and PKO Bank Polski SA signed a Current Account Revolving Credit Agreement with a limit of PLN 900 million for a period of 3 years, which was drawn in tranches. As at 30 June 2018, PLN 900 million of the facility was available. Furthermore, on 2 October 2017, PKO Bank Hipoteczny SA and PKO Bank Polski SA signed a Current Account Revolving Credit Agreement with a limit of PLN 1,500 million for a period of 3 years, which was drawn in tranches. As at 30 June 2018 and as at 31 December 2017, PLN 1,500 million of the facility was available.

On 30 September 2015, the Bank entered into a PKO Bank Hipoteczny Bond Issuance Programme Agreement with PKO Bank Polski SA for a Programme amount of up to PLN 2 billion over a period of 4 years, as well as an Underwriting Agreement under which the underwriter assumes the obligation to take up the Issuer's Bonds for its own account up to the amount of PLN 2 billion. As at 30 June 2018, in connection with the signed annexes, the Programme amount was PLN 3.5 billion, compared with PLN 3 billion as at 31 December 2017.

On 17 November 2015 A Framework Agreement for the Sale of Receivables was concluded with PKO Bank Polski SA. Based on the agreement, in 2018 the Bank continued to purchase portfolios of receivables under mortgage-backed housing loans. Further details are available in Notes 20 and 25.

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

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

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

During the reporting period and in the first half of 2017 the Bank did not conclude transactions with related parties other than on an arm's length basis.

35.2 Personally-related party transactions

As at 30 June 2018, 12 entities were related to the Bank through key management personnel of PKO Bank Hipoteczny SA or close relatives of key management personnel, whereas at 31 December 2017 it was 11 entities.

During the reporting period and in the first half of 2017 no mutual transactions were concluded by the Bank with such entities.

35.3 Benefits for PKO Bank Hipoteczny SA key management personnel

BENEFITS FOR KEY MANAGEMENT PERSONNEL	30.06.2018	30.06.2017
Independent members of the Supervisory Board	63	-
Management Board of the Bank [1)]	1,530	981
Total	**1,592**	**981**

[1)] Benefits for Management Board of the Bank include benefits paid to Management Board members who did not perform their functions in the first half of 2018 and in the first half of 2017 respectively.

36. Fair value of financial assets and liabilities

36.1 Categories of fair value measurement of financial assets and financial liabilities measured at fair value in the Statement of Financial Position

Accounting policies

Measurement techniques and observable input data

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

Financial information

ASSETS AND LIABILITIES MEASURED AT FAIR VALUE AS AT 30 JUNE 2018	Note	Carrying amount	Level 1 Prices quoted on active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
Derivative financial instruments	18	214,720	-	214,720	-
CIRS		209,640	-	209,640	-
FX forward		164	-	164	-
IRS		4,916		4,916	
Securities	19	842,727	842,727	-	-
measured at fair value through other comprehensive income		842,727	842,727	-	-
Financial assets measured at fair value		**1,057,447**	**842,727**	**214,720**	**-**
Derivative financial instruments	18	246	-	246	-
FX forward		246	-	246	-
Financial liabilities measured at fair value		**246**	**-**	**246**	**-**

ASSETS AND LIABILITIES MEASURED AT FAIR VALUE AS AT 31 DECEMBER 2017	Note	Carrying amount	Level 1 Prices quoted on active markets	Level 2 Valuation techniques based on observable market data	Level 3 Other valuation techniques
Derivative financial instruments	18	338	-	338	-
FX forward		338	-	338	-
Securities	19	830,489	830,489	-	-
available-for-sale investment securities		830,489	830,489	-	-
Financial assets measured at fair value		**830,827**	**830,489**	**338**	**-**
Derivative financial instruments	18	217,777	-	217,777	-
CIRS		217,009	-	217,009	-
FX forward		391	-	391	-
IRS		377	-	377	-
Financial liabilities measured at fair value		**217,777**	**-**	**217,777**	**-**

In the first half of 2018 and in the first half of 2017 there were no transfers between the different levels of fair value hierarchy.

36.2 Financial assets and liabilities not measured at fair value in the Statement of Financial Position

ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE AS AT 30 JUNE 2018	level of fair value hierarchy	valuation method	30.06.2018	
			carrying amount	fair value
Cash and balances with Central Bank	n/a	at amounts due	18	18
Amounts due from banks	3	discounted cash flows	122,172	122,172
Loans and advances to customers, including:			19,065,845	19,065,845
housing loans	3	discounted cash flows	19,065,845	19,065,845
Other financial assets	3	at amount due less impairment allowance	289	289
Amounts due to banks	3	discounted cash flows	3,858,350	3,858,350
Amounts due to customers	3	discounted cash flows	3,051	3,051
Mortgage covered bonds issued	1,3	discounted cash flows, quotations on a regulated market	12,167,940	12,209,349
Unsecured bonds issued	3	discounted cash flows	2,898,978	2,898,978
Other financial liabilities	3	at amounts due	17,556	17,556

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

37. Operating segments

In the reporting period and in the period ended 30 June 2017 the Bank did not analyse its operations by segments due to the specific nature of its operations (ie. one operating segment).

GOALS AND PRINCIPLES OF RISK MANAGEMENT

38. Risk management in PKO Bank Hipoteczny SA

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

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

Type of risk	Note
credit risk	39
concentration risk	40
residual risk	41
liquidity risk	42
interest rate risk	43
foreign exchange risk	44
business risk	45
macroeconomic changes risk	46
model risk	47
operational risk	48
compliance risk	49
reputational risk	50
capital risk, including leverage risk	51

38.1 Main principles of risk management policies

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

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

RISK MANAGEMENT SYSTEM

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

38.2 COMPONENTS OF THE RISK MANAGEMENT SYSTEM

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

RISK IDENTIFICATION

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

RISK MEASUREMENT AND ASSESSMENT

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

RISK CONTROL

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

RISK FORECASTING AND MONITORING

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

RISK REPORTING

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

MANAGEMENT ACTIONS

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

38.3 Risk management in the Bank

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

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

Risk is managed at three independent lines of defence:

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

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

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

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

Risk Measurement Bureau

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

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

Credit Risk, IT and Outsourcing Bureau

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

Compliance Team in the Compliance, Security and Legal Bureau

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

Model Validation Officer

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

Communications Officer

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

Risk management is supported by the following committees:

Supervisory Board Audit and Finance Committee ("AFC")

The Committee supports the Supervisory Board in particular by monitoring and periodically expressing its opinions on:

- the adequacy and effectiveness of internal controls, including internal audit;
- the adequacy and effectiveness of the risk management system;
- the degree of effectiveness of compliance risk management in the Bank, and the adequacy and effectiveness of the compliance unit.

Supervisory Board Risk Committee ("RC")

The Committee supports the Supervisory Board in particular by:

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

Assets & Liabilities Management Committee ("ALCO")

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

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

Credit Committee ("CC")

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

- supporting the functions that manage credit, concentration and residual risks, as well as the risk of the models measuring such risks;
- reviewing documents concerning the risks mentioned above, the profile and quality structure of the loan portfolio, impairment losses on assets, acquisition of loan portfolios and the property market;
- making decisions concerning the Bank's operations, particularly regarding the risk measures and limits, the results of the valuation of the risk models, the methodologies and models of calculation of impairment losses on credit assets, cut-offs used in the assessment of credit risk, loan receivables purchased by the Bank and individual loan transactions;
- presenting recommendations for the relevant governing bodies of the Bank, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of its competencies.

Strategy and Business Initiatives Committee ("SBIC")

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

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

Data Quality Committee ("DQC")

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

- determining the operating directions in respect of data quality management;
- reviewing materials regarding data management in the Bank, in particular reports and periodic information concerning the quality of data and operating plans in this respect;
- making decisions relating to data management in the Bank, including those concerning the development directions of the data management system, assessment of the system's functioning and prioritising actions concerning its further development;
- presenting recommendations for the relevant governing bodies of the Bank, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of its competencies.

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

38.4 Identification of material risks

Materiality of different risks

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

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

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

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

Risk types considered to be material:

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

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

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

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

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

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

39. Credit risk management

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

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

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

39.1 Credit risk measurement and assessment

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

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

The detailed principles and scope of cooperation within the PKO Bank Polski Group regarding the group risk models are laid down in the Outsourcing agreement with PKO Bank Polski SA described in Note 35.1.

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

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

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

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

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

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

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

39.2 Credit risk control

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

39.3 Impairment loss on credit exposures

PKO Bank Hipoteczny performs monthly reviews of loan exposures in order to identify those that are at risk of impairment, to measure the impairment of loan exposures and to record respective allowances.

During the reporting period, the Bank assessed impairment of credit exposures in accordance with IFRS 9. The measurement method is described in more detail in Note 3.2 "Impairment".

The structure of the loan portfolio and the amount of allowances for expected credit losses of PKO Bank Hipoteczny SA are shown in Note 39.4.3 "Loans and advances to customers.

39.4 Credit risk forecasting and monitoring

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

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

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

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

39.4.1 Maximum exposure to credit risk

MAXIMUM EXPOSURE TO CREDIT RISK	30.06.2018	31.12.2017
Cash and balances with Central Bank	18	561
Amounts due from banks	122,172	5,350
Loans and advances to customers	19,065,845	16,042,473
Hedging derivatives	214,720	338
Securities	842,727	830,489
Other financial assets	289	99
Total, balance sheet exposure	**20,245,771**	**16,879,310**
Loan commitments	784,659	682,932
Total, off-balance sheet exposure	**784,659**	**682,932**

39.4.2 Amounts due from banks

AMOUNTS DUE FROM BANKS	30.06.2018	31.12.2017
Amounts not overdue, not impaired (counterparty rating A2)	122,172	5,350
Total, gross	122,172	5,350
Allowances for expected credit losses	-	-
Total, net	**122,172**	**5,350**

39.4.3 Loans and advances to customers

The loan portfolio is characterised by low exposure to impaired and overdue loans and advances. At 30 June 2018, 22 impaired loans were recognised, and their share in the total loan portfolio was 0.02%, whereas as at 31 December 2017, 13 impaired loans were recognised, and their share in the total loan portfolio was 0.02%.

The significantly higher amount of impairment allowances as at 30 June 2018 compared with 31 December 2017 results, to a large extent, from implementing IFRS 9. The respective disclosures are included in Note 3.7 "Disclosures concerning the reconciliation of the balance of impairment losses and provisions for loan commitments according to IAS 39 and IAS 37 and the opening balance of the impairment losses and provisions calculated according to IFRS 9".

LOANS AND ADVANCES TO CUSTOMERS	30.06.2018	31.12.2017
Loans not overdue, not impaired	19,025,142	15,982,619
Loans overdue, not impaired	60,488	62,088
Loans impaired	4,317	2,834
Total, gross	**19,089,947**	**16,047,541**
Allowances for loans not overdue, not impaired	(17,906)	(3,157)
Allowances for loans overdue, not impaired	(4,125)	(1,050)
Allowances for loans impaired	(2,071)	(861)
Total, net	**19,065,845**	**16,042,473**

LOANS AND ADVANCES TO CUSTOMERS, NOT IMPAIRED	30.06.2018	31.12.2017
not past due	19,025,142	15,982,619
up to 30 days	53,980	57,536
from 31 to 60 days	4,565	3,763
from 61 to 90 days	1,943	789
Total, gross	**19,085,630**	**16,044,707**

LOANS AND ADVANCES TO CUSTOMERS, NOT IMPAIRED - PERCENTAGE STRUCTURE	30.06.2018	31.12.2017
not past due	99.69%	99.62%
up to 30 days	0.28%	0.36%
from 31 to 60 days	0.02%	0.02%
from 61 to 90 days	0.01%	0.00%
Total, gross	**100.00%**	**100.00%**

39.4.4 Forbearance practices

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

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

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

As a result of timely servicing of the forbearance agreement the due becomes a non-matured receivable. The assessment of the possibilities of the debtor's non-defaulting on an out-of-court settlement agreement (repayment of the debt in pre-determined periods) is an element of the forbearance process. Forbearance agreements are monitored on a current basis. If impairment is identified on the loan exposures covered by such agreements, impairment losses are recognised, reflecting the identified loss.

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

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

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

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

EXPOSURES SUBJECT TO FORBEARANCE IN THE LOAN PORTFOLIO	30.06.2018	31.12.2017
Loans and advances to customers, including:	19,089,947	16,047,541
subject to forbearance	903	872
Impairment allowances on loans and advances to customers, of which:	(24,102)	(5,068)
subject to forbearance	(506)	(218)
Net loans and advances to customers, including:	**19,065,845**	**16,042,473**
subject to forbearance	**397**	**654**

39.5 Credit risk reporting

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

39.6 Credit risk management actions

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

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

A key role in establishing minimum transaction conditions is played by the collateral policy in terms of credit risk; according to the policy, the key element limiting credit losses resulting from a customers' default in respect of the Bank are mortgages on the financed properties, though the Bank follows the overriding principle that collateral is only accepted as a loan support instrument and may not be used as a substitute for the customer's ability to pay his dues.

40. Concentration risk management

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

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

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

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

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

LOANS AND ADVANCES TO CUSTOMERS, GROSS - CONCENTRATION	30.06.2018	31.12.2017
10 largest exposures	0.07%	0.08%
20 largest exposures	0.12%	0.15%
50 largest exposures	0.28%	0.32%
100 largest exposures	0.51%	0.60%

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

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

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

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

In the period covered by these condensed interim financial statements and in the period ended 30 June 2017 the Bank did not exceed any of the concentration limits.

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

41. Residual risk management

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

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

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

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

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

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

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

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

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

42. Liquidity risk management

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

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

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

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

The liquidity risk management is built into the risk management process described in Note 38.2.

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

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

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

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

42.1 LIQUIDITY RISK MEASUREMENT AND ASSESSMENT

The Bank applies the following liquidity risk measures:

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

The actualised liquidity gaps as at 30 June 2018 and as at 31 December 2017 are presented below. In the bands up to 12 months, the cumulative adjusted liquidity gap has positive values, which means a surplus of maturing assets increased by estimated inflows from available overdraft limit over mature liabilities in the short and medium term.

LIQUIDITY GAP 30.06.2018	on demand	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months
Adjusted periodic gap	1,119,385	6,756	(38,702)	(833,954)	263,366	(5,824,910)	(4,401,981)	9,122,003
Adjusted cumulative periodic gap	1,119,385	1,126,141	1,087,439	253,485	516,851	(5,308,059)	(9,710,040)	(588,037)

LIQUIDITY GAP 31.12.2017	on demand	0-1 month	1-3 months	3-6 months	6-12 months	12-24 months	24-60 months	over 60 months
Adjusted periodic gap	933,111	20,105	(20,132)	(104,202)	(677,924)	(4,214,887)	(3,453,207)	6,652,686
Adjusted cumulative periodic gap	933,111	953,216	933,083	828,882	150,958	(4,063,929)	(7,517,136)	(864,450)

The adjusted liquidity gap includes the liabilities with deferred payment terms resulting from the receivables purchase agreements with PKO Bank Polski SA (PLN 2,195 million as at 30 June 2018 and PLN 2,491 million as at 31 December 2017) which are treated by the Bank as bridge financing that will eventually be replaced by other funding sources such as covered bonds to be issued in the future.

SENSITIVITY MEASURE	30.06.2018	31.12.2017
Liquidity surplus* in the horizon of up to 1 month (in PLN million)	1,106	1,135
Survival horizon without external aid (days)	143	297

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

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

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

A liquidity surplus comprises:

- basic liquidity surplus, consisting of items acquirable within 7 days; and
- supplementary liquidity surplus, consisting of items acquirable from 7 to 30 days.

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

30.06.2018	value at end of period	average during the period	period low	period high	regulatory minimum
M3	1,488	598	78	2,165	>1.0
M4	1.05	1.04	1.03	1.05	>1.0

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

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

SENSITIVITY MEASURE	30.06.2018	31.12.2017
Liquidity coverage ratio (LCR)	1664%	2520%
LCR regulatory limit	100%	100%

42.2 Liquidity risk control

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

42.3 Liquidity risk forecasting and monitoring

The liquidity risk exposure of PKO Bank Hipoteczny SA as at 30 June 2018 and 31 December 2017 was within the strategic and internal limits set. In the reporting period and in the period ended 30 June 2017 the Bank did not exceed any of the standards nor any strategic or internal limits.

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

42.4 Concentration of funding sources

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

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

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

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

STRUCTURE OF THE BANK'S FINANCING	30.06.2018	31.12.2017
Equity	6.4%	7.2%
Funds from the parent entity	18.5%	23.6%
Issues of mortgage covered bonds	60.1%	52.6%
Issues of unsecured bonds	14.3%	14.4%
Other	0.7%	2.2%
Total	**100.0%**	**100.0%**

The share of funding raised from the parent entity amounted to 18.5% as at 30 June 2018 (23.6% as at 31 December 2017). Such level of the indicator is consistent with the financial plan at the current stage of the Bank's operations and is expected to gradually decrease with successive issues of covered bonds and own unsecured bonds. The funding concentration risk is assessed as acceptable.

Seeking to reduce the concentration risk of funding sources, the Bank has implemented a system of internal limits, both in short-term and long-term horizons, according to the mortgage covered bond issues carried out by the Bank. During the reporting period and in the period ended 30 June 2017 none of these limits was exceeded.

42.5 Liquidity stress tests

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

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

Stress test results are used in particular in:

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

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

The stress tests conducted on the basis of the Bank's financial data as at 30 June 2018 and as at 31 December 2017 did not indicate any risk to the Bank's business due to the occurrence of hypothetical stressed market conditions. Owing to the well-balanced funding structure, long maturities of most of its liabilities and a sufficient level of liquid assets, the Bank has a high capacity to survive a liquidity crisis.

42.6 Liquidity risk reporting

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

42.7 Liquidity risk management actions

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

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

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

43. Interest rate risk management

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

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

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

43.1 Interest rate risk measurement and assessment

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

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

Stress tests are used to estimate potential losses resulting from the maintained structure of the balance sheet and off-balance sheet positions in the event of the occurrence of the hypothetical scenarios within which parallel shifts in interest rate curves by ±50 bps, ±100 bps and ±200 bps are arbitrarily made.

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

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

30.06.2018	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Total
Assets, including:	**6,930,802**	**12,756,695**	**146,777**	**3,492**	**7,667**	**-**	**-**	**19,845,433**
securities	699,510	-	143,204	-	-	-	-	842,714
loans and advances to customers	6,231,292	12,756,695	3,573	3,492	7,667	-	-	19,002,719
Liabilities, including:	**2,056,149**	**5,885,345**	**1,497,700**	**4,000**	**-**	**4,862,126**	**4,470,640**	**18,775,960**
amounts due to banks	352,449	3,345,345	-	-	-	-	-	3,697,794
amounts due to customers	-	-	-	-	-	-	-	-
mortgage covered bonds issued	1,300,000	1,530,000	-	-	-	4,862,126	4,470,640	12,162,766
unsecured bonds issued	403,700	1,010,000	1,497,700	4,000	-	-	-	2,915,400
Derivative instruments – assets	-	265	-	1,637	2,033	4,864,529	4,470,193	9,338,657
Derivative instruments – liabilities	4,232,131	4,891,952	-	1,584	1,935	10,019	4,412	9,142,033
Periodic gap	**642,522**	**1,979,663**	**(1,350,923)**	**(455)**	**7,765**	**(7,616)**	**(4,859)**	
Cumulative gap	**642,522**	**2,622,185**	**1,271,262**	**1,270,807**	**1,278,572**	**1,270,956**	**1,266,097**	

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

43.2 Interest rate risk control

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

43.3 Interest rate risk forecasting and monitoring

The interest rate risk exposure of PKO Bank Hipoteczny SA as at 30 June 2018 and 31 December 2017 was within the strategic and internal limits set. Owing to effective mitigating activities, despite dynamically growing total assets, interest rate risk was relatively low and caused by the mismatch between the repricing dates of the interest rates on the Bank's assets and liabilities in the shortest repricing bands, i.e. up to 3 months.

43.4 Interest rate risk reporting

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

43.5 Interest rate risk management actions

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

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

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

44. Foreign exchange risk management

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

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

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

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

FOREIGN CURRENCY POSITION	30.06.2018	31.12.2017
EUR	57.9	31.6
USD	1.7	0.7

The foreign exchange risk exposure of PKO Bank Hipoteczny SA as at 30 June 2018 and 31 December 2017 was within the strategic and internal limits set.

The Bank closes all open FX positions on an ongoing basis, and the control and reporting procedures implemented by the Bank significantly limit the impact of changes in exchange rates on the Bank's financial performance, hence the foreign exchange risk as at 30 June 2018 and as at 31 December 2017 was at a low level.

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

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

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

45. Business risk management

Business risk, also understood as strategic risk, is a risk of failing to achieve the assumed financial targets, including a risk of losses, resulting from adverse changes in the business environment, wrong decisions made, incorrect implementation of decisions made or failing to take proper action in response to changes occurring in the business environment. Business risk is considered a material risk and the aim of business risk management is to keep the risk at an acceptable level.

45.1 Business risk identification and measurement

Identification consists of recognising and defining actual as well as potential factors which result from the current or contemplated business operations of the Bank and may adversely affect the Bank's financial position, the occurrence or the volume of the Bank's income and expenses. Business risk is identified by reviewing selected items of the income statement. Business risk is measured in order to determine the scale of threats connected with the existence of business risk using set risk measures. The measurement of business risk involves the calculation of internal capital.

45.2 Business risk control

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

The control of business risk involves setting risk controls in the form of business risk tolerance limits, including threshold and critical values, adequate to the scale and complexity of the Bank's operations, and reviewing them on a regular basis.

45.3 Business risk forecasting and monitoring

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

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

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

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

45.4 Business risk reporting

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

45.5 Business risk management actions

Management actions consist in particular of:

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

46. Macroeconomic changes risk management

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

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

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

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

As part of the management of macroeconomic changes risk, the Bank, among other things:

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

47. Model risk management in the Bank

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

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

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

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

47.1 Model risk measurement and assessment

Identification of model risk consists in particular of:

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

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

47.2 Model risk control

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

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

47.3 Model risk forecasting and monitoring

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

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

47.4 Model risk reporting

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

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

47.5 Model risk management actions

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

48. Operational risk management

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

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

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

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

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

48.1 Operational risk measurement and assessment

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

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

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

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

48.2 Operational risk control

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

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

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

48.3 Operational risk forecasting and monitoring

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

In particular, the Bank regularly monitors:

- the utilization of strategic tolerance limits and operational risk loss limits;

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

48.4 Operational risk reporting

Operational risk information is reported for:

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

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

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

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

48.5 Operational risk management actions

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

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

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

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

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

48.6 Operational losses incurred

In the first half of 2018, one operational risk incident was disclosed by the Bank, which involved operational losses for the total net amount of PLN 5 thousand. In the first half of 2017, operational incidents generated operational losses totalling PLN 116 thousand.

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

49. Compliance risk management

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

The aim of compliance risk management is to:

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

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

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

- estimation of the potential severity of the consequences non-compliance cases in the form of:
  - financial losses, particularly in the form of administrative penalties or damages;
  - loss of reputation;
  - other legal sanctions.
- using information about the findings of external inspections and internal audits, formulated recommendations and the extent of their implementation.

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

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

The following is covered by compliance risk monitoring:

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

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

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

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

50. Reputation risk management

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

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

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

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

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

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

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

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

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

Information about reputational risk is reported in the form of:

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

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

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

51. Capital adequacy and the management of capital risk

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

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

Managing the Bank's capital adequacy covers:

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

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

The following constituted the legal basis of the capital adequacy assessment process as at 30 June 2018:

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

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

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

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

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

At 30 June 2018, the total capital ratio of the Bank amounted to 14.2% (as at 31 December 2017: 15.2%).

51.1 Own funds for the purpose of capital adequacy

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

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

BANK'S OWN FUNDS	30.06.2018	01.01.2018	31.12.2017
Share capital	1,200,000	1,200,000	1,200,000
Supplementary capital	50,670		-
Retained earnings	(11,787)	38,883	(749)
Net profit for the period	42,588	-	51,419
Accumulated other comprehensive income - hedge accounting	6,739	(31,372)	(31,372)
Accumulated other comprehensive income - available-for-sale securities			2,480
Accumulated other comprehensive income - securities measured at fair value through other comprehensive income	4,675	2,480	
Equity	**1,292,885**	**1,209,991**	**1,221,778**
Equity adjustments	(43,868)	(15,289)	(27,155)
Retained earnings before approval	-	(51,419)	-
Net profit for the period	(42,588)	-	(51,419)
Accumulated other comprehensive income - hedge accounting	(6,739)	31,372	31,372
Intangible assets	(4,772)	(5,584)	(5,584)
Adjustment to assets measured at fair value (AVA)	(982)	(871)	(871)
Transitional period adjustment[1)]			(653)
Adjustment relating to the transitional period for IFRS 9 implementation	11,213	11,213	
Own funds	**1,249,017**	**1,194,702**	**1,194,623**

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

51.2 Capital buffers

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

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

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

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

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

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

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

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

51.3 Financial leverage

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

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

The Bank calculates financial leverage according to the CRR Regulation.

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

LEVERAGE	30.06.2018	31.12.2017
Leverage ratio	6.1%	6.9%

As at 30 June 2018 and as at 31 December 2017, the Bank's financial leverage ratio was above the 3% level recommended for banks by the Basel Committee.

51.4 Requirements regarding own funds (Pillar I)

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

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

At 30 June 2018 and as at 31 December 2017, the own fund requirements for credit valuation adjustment risk, settlement and delivery risk and market risk were nil, therefore, the total requirement for own funds comprised the requirements for credit and operational risk.

OWN FUNDS REQUIREMENTS	30.06.2018	01.01.2018	31.12.2017
Credit risk	690,218	611,678	611,860
Operational risk	15,655	15,655	15,062
Total own funds requirement	**705,874**	**627,333**	**626,922**
Common equity Tier 1 capital ratio (CET1)	14.2%	15.2%	15.2%
Tier 1 capital ratio (T1)	14.2%	15.2%	15.2%
Total capital ratio (TCR)	**14.2%**	**15.2%**	**15.2%**

SUBSEQUENT EVENTS

52. Events after the end of the reporting period

In the period from 1 July 2018 to the date of approval of these financial statements, i.e. 16 August 2018 PKO Bank Hipoteczny SA issued bonds in the total nominal value of PLN 675,600 thousand while bonds with a total nominal value of PLN 566,700 thousand matured and were redeemed. The bonds were issued under the bond issue scheme up to the amount of PLN 3,500,000 thousand as determined by PKO Bank Hipoteczny SA on 30 September 2015. The bonds are to be redeemed between 14 September 2018 and 8 August 2019.

In the period from 1 July 2018 to the date of approval of these financial statements PKO Bank Hipoteczny SA purchased, based on the Framework Agreement for the Sale of Receivables signed with PKO Bank Polski SA on 17 November 2015, mortgage covered housing loan receivables portfolio in the amount of PLN 393,668 thousand.

On 13 August 2018 the Extraordinary General Meeting passed a resolution on increasing the share capital of PKO Bank Hipoteczny by PLN 95,000,000, i.e. to PLN 1,295,000,000 by issuing 95,000,000 new ordinary registered H-series shares with a nominal value of PLN 1 (one) each. Share issue price of each H-series share was PLN 1.05. The shares were taken up by PKO Bank Polski SA. Until the date of the Management Board's approval of the financial statements for publication, the shares were not paid up and the capital increase has not been registered in the Register of Businesses of the National Court Register.

On 13 July 2018 PKO Bank Hipoteczny SA concluded an annex to the medium-term revolving credit facility dated 5 June 2017 with an external financial institution, increasing the limit by PLN 50,000 thousand, to PLN 150,000 thousand.

On 19 July 2018 PKO Bank Hipoteczny SA concluded an annex to the Renewable Current Account Credit Agreement with PKO Bank Polski SA, according to which the limit was increased from PLN 900,000 thousand to PLN 1,500,000 thousand and the financing period was extended by 3 years, i.e. to 29 October 2021. The additional limit will be provided in tranches.

On 27 July 2018 PKO Bank Hipoteczny SA issued mortgage covered bonds denominated in PLN, with a total nominal value of PLN 500,000 thousand and a 7 year period to redemption as of the issue date. Variable interest was determined at WIBOR 3 M + 0.62 p.p. margin. The mortgage covered bonds were purchased by investors at a price equal to the nominal value. The bonds are quoted on the Warsaw Stock Exchange.

Signatures of all Members of the Bank's Management Board

16.08.2018	Paulina Strugała	President of the Management Board	*Signed on the Polish original* ..... (signature)
16.08.2018	Agnieszka Krawczyk	Vice-President of the Management Board	*Signed on the Polish original* ..... (signature)
16.08.2018	Jakub Niesłuchowski	Vice-President of the Management Board	*Signed on the Polish original* ..... (signature)
16.08.2018	Marek Szcześniak	Vice-President of the Management Board	*Signed on the Polish original* ..... (signature)

Signature of the person in charge of maintaining accounting records

16.08.2018

Tomasz Rynkowski
Director, the Bank's Chief Accountant

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