Bank Hipoteczny

PKO Bank Hipoteczny SA
Directors' Report
for the six-month period ended
30 June 2020

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1. INTRODUCTION

PKO Bank Hipoteczny SA (Bank) specializes in granting residential mortgage loans to individual customers and purchasing receivables in respect of such loans. The Bank purchases loans for its portfolio based on its strategic cooperation with PKO Bank Polski SA.

PKO Bank Hipoteczny SA is the leader of the Polish mortgage bank market in terms of total assets and the balance of residential mortgage loans. The Bank is Poland's largest issuer of covered bonds on Polish and international markets. It was the only Bank in Poland to carry out benchmark issues of EUR-denominated covered bonds, five issues in total as at 30 June 2020. The outstanding mortgage covered bonds issued by the Bank account for approximately 63% of the total value of outstanding mortgage covered bonds issued by Polish mortgage banks.

The Bank operates by granting both new residential mortgage loans and purchasing such loans from PKO Bank Polski SA. In the first half of 2020, the Bank's total assets exceeded PLN 27 billion, of which PLN 25.5 billion were a high quality portfolio of residential mortgage loans. This means that there was a 1% increase in total assets compared with the end of 2019, while at the same time maintaining the stability and safety of operations.

COVID-19 PANDEMIC

The Bank took action aimed at improving the safety of its customers and employees and ensuring prudent management of the Bank in connection with the COVID-19 pandemic.

- In March 2020, it was decided that most employees would work remotely.
- The Bank introduced special solutions for mortgage borrowers and allowed them to suspend the repayment of up to six consecutive loan instalments in 2020.
- The Bank enabled customers to suspend loan agreements in accordance with the Act on subsidizing interest on bank loans granted to entrepreneurs affected by COVID-19 and on a simplified procedure for approving composition arrangement in connection with COVID-19 (the co-called "Shield 4.0").
- The Bank recognized a provision relating to COVID-19 in respect of the forecasted deterioration in the quality of the loan portfolio in the financial statements for the first half of 2020.

The COVID-19 pandemic has an adverse impact on, among other things, economic activities in Poland and the functioning of financial markets. This will certainly have an adverse impact on the Bank's results in subsequent quarters. However, the Bank maintains good liquidity and capital levels, above the regulatory requirements.

It is uncertain and difficult to estimate how the COVID-19 pandemic will develop and continue to affect the Bank's operations; therefore, the Bank is monitoring the situation and adjusting its actions accordingly.

PKO BANK HIPOTECZNY SA'S STRATEGY FOR THE YEARS 2020–2022

In the first quarter of 2020, the Bank's Management Board adopted and the Supervisory Board approved the updated PKO Bank Hipoteczny SA strategy for the years 2020-2022.

The Strategy defines the following:

- the Bank' s mission and strategic objectives;
- the Bank's market position;
- the Bank's operating model;

- the strategic directions of the Bank's operations;
- the Bank's financial position in the years 2020–2022.

The Bank prepared the updated strategy for the years 2020-2022 taking into account the following circumstances:

a) the updated strategy of the PKO Bank Polski Group which redefined the role of PKO Bank Hipoteczny in the Group;
b) the time horizon of the new strategy prepared by PKO Bank Polski (the years 2020–2022) which made PKO Bank Hipoteczny SA extend its strategy horizon up to the year 2022;
c) changes in the regulatory environment, including mainly the new minimum requirement for own funds and eligible liabilities (MREL), which has a significant impact on the planned financing structure of the Group.

The Bank's strategic objectives defined in the new strategy include:

- diversification of financing sources of the Bank and the PKO Group through maintaining the ability to obtain long-term financing in the form of covered bonds for the purposes of mortgage lending;
- maintaining a safe level of risk in the Bank's operations, in particular with respect to the loan portfolio and capital ratios;
- making optimum use of the assets and competencies of PKO Bank Hipoteczny SA and PKO Bank Polski SA in order to achieve synergies within the PKO Group;
- issuing green mortgage covered bonds and taking action in the area of sustainable development.

The effects of the present epidemic situation on the macroeconomic position of Poland and the position of PKO Bank Hipoteczny SA may include a reduction in revenue streams, and increase in provisions and problems with access to financing. Consequently, the strategy will be reviewed and possibly updated annually, and the annual financial plans will be adjusted accordingly.

MORTGAGE COVERED BONDS ISSUED

The Bank did not issue any mortgage covered bonds in the first half of 2020. At the end June 2020, the Bank was the leader of the Polish mortgage bank market in terms of the balance of outstanding mortgage covered bonds and the balance of residential mortgage loans. The value of mortgage covered bonds issued by PKO Bank Hipoteczny and outstanding as at 30 June 2020 amounted to PLN 16.8 billion.

2. EXTERNAL OPERATING CONDITIONS

Macroeconomic environment
Residential real estate market
Residential mortgage loan market
Covered bond market
Regulatory and legal environment

2.1. MACROECONOMIC ENVIRONMENT

The Bank only operates in Poland.

Macroeconomic factors affecting the Polish economy in the first six months of 2020:

GROSS DOMESTIC PRODUCT

The GDP growth rate affects both the residential real estate market and the mortgage loan market. A sufficiently high GDP growth rate translates into new jobs and higher wages, and, consequently, into consumers' purchasing power and creditworthiness. The data published by the Central Statistical Office of Poland (GUS) in May 2020 show that annual economic growth continued in Q1 2020 (+2.0% y/y), with a slight quarterly drop in the seasonally adjusted GDP, due to very good economic results in the first two months of the year, with a positive contribution from consumption and investments. Restrictions introduced in mid-March to fight the pandemics contributed to a dramatic drop in economic activity and is likely to have led to the first recession in the economy since transformation (an estimated GDP drop of 8% y/y/ in Q2 2020). The lowest level of economic activity was reached in April, when drops in industrial production and retail sales exceeded 20% y/y. The data available show that economic activity has been strengthening since May, and the unprecedented deep recession is likely to be short.

UNEMPLOYMENT AND WAGES AND SALARIES

The labour market response to recession caused by the pandemic is mitigated by the operation of the Anti-crisis Shield and the Financial Shield of the Polish Development Fund. The rate of registered unemployment was 6.0% in May compared with 5.2% at the end of 2019 and 5.4% in March. Unemployment increased in spring, which is against the seasonal pattern, but the scale of the increase of approx. 120 thousand in Q2 2020 is not significant. The drop in employment in the enterprise sector (-3.2% y/y in May) is largely due to absences (child care and medical leave) and reductions in the number of working hours per post (with simultaneous subsidies to salaries under the Anti-crisis shield) rather than due to jobs being liquidated. Companies are protecting jobs, but at the expense of reducing wages and salaries – in the enterprise sector, wage growth decelerated to 1.2% y/y in May from 6.6% y/y in April. However, such a scenario is more favourable than redundancies from the point of view of reducing the depth of recession in 2020 and laying the foundations for economic recovery in 2021.

INFLATION

Price changes affect consumers' purchasing power and the level of interest rates. A high level of inflation, which is not offset with an increase in incomes, has an adverse effect on the creditworthiness of the banks' customers (lower real disposable incomes), which in turn has a negative effect on the amount of residential loans granted.

Throughout the first six months of 2020, CPI (Consumer Price Index) inflation exceeded the target of the National Bank of Poland: after reaching the maximum at 4.7% y/y in February, it dropped to 2.9% y/y/ in May. In June, CPI inflation increased to 3.3% y/y, and the base inflation rate (CPI net of food and energy) reached the highest level since 2001 of more than 4% y/y/. The increase in base inflation reflected mainly one-off factors. In subsequent months, the disinflationary effects of the crisis caused by the pandemic (a significant drop in demand) should lower inflation.

INTEREST RATES

The rapid deterioration in economic prospects and perturbations on the Polish financial market (including a decrease in the treasury bond market liquidity) prompted a response from the NBP Management Board and the Monetary

Policy Council (MPC). In coordination with fiscal measures, interest rates were significantly reduced and additional measures to support the economy were introduced. The reference rate was decreased by 140 b.p. in total, to a historic low of 0.1%. Among other measures, the introduction of the possibility to buy out Treasury bonds or securities guaranteed by the State Treasury has the strongest impact on the economy. As part of the quantitative easing (QE) program, the NBP purchased bonds (issued by the State Treasury, the Polish Development Fund and BGK) with a nominal value of PLN 96 billion by the end of June.

2.2. RESIDENTIAL REAL ESTATE MARKET

In the first quarter of 2020, the residential real estate market continued to grow strongly due to high consumer and investment demand. The upward trend in residential real estate prices in Poland has continued since 2014. In 2019, regardless of the deceleration of economic growth, prices of residential real estate accelerated to more than 10% y/y. A strong pace of price growth continued in Q1 2020. In Q2 2020, as a result of freezing the economy due to the coronavirus pandemic, which strengthened recessionary trends in the economy, the activity of the real estate market weakened, and the price growth halted. The data from the Bank's internal real estate prices database show that real estate prices stabilized in Q2 2020 at a level close to that recorded in the prior period. The condition of the real estate market in the second half of 2020 will depend on the epidemiological developments in Poland and abroad, and the pace of economic recovery after the crisis, including the effectiveness of the anti-crisis measures implemented.

NEW HOUSING MARKET

For the large part of Q2, restrictions to the movements of customers applied, and as a result, the level of sales on the primary housing market was 60% lower than the average quarterly sales for the last three years (2017-2019), according to JLL Reas. Consequently, the statistics of the housing units sold are based on a relatively small sample. It follows from information from real estate developers that so far, the prices of apartments have not been reduced, but some of the developers use price incentives for customers who decide to finalize the transaction more quickly. According to JLL Reas, the average prices of new apartments brought to sale are the best reflection of the developers' pricing policies. In Q2 2020, such prices maintained a clear upward trend in the Tri-city and Poznań; in Kraków they did not change compared with Q1 and decreased very slightly in Warsaw and Łódź, while in Wrocław, they dropped significantly. In several cities, it can also be seen that more expensive projects of high and very high standard have started to be introduced to the market. This offer seems to be addressed to the wealthiest customers who have large savings and are not afraid of the deteriorating economic situation during the pandemic. Such customers treat luxury real estate as investments in assets against the erosion of capital.

According to data published by Parkiet, in the group of 12 developer companies listed on the stock exchange, the economic freeze resulted in a drop in sales of 36% on average in Q2 2020, but due to high sales in the period preceding the pandemic (Q1 2020), the scale of the decrease in sales for the entire first half of the year was much lower and amounted to 18% on average, with 4 out of 12 companies recording growth. In the opinion of some developers, if no unexpected changes in circumstance occur in connection with the pandemic, the real estate development sector should end the year with sales lower by approximately 20–25% compared with pre-pandemic plans.

SECONDARY MARKET

The data from the Bank's internal real estate database show that the economic freeze due to the coronavirus pandemic resulted in limiting the activity of the residential real estate market participants in Q2 2020 and deceleration of the price growth. The median of transaction prices of residential real estate in June 2020 on the domestic secondary market was approximately 3% higher than the median for Q1 2020. A slight decrease in this period was noted in Warsaw (-2.6%) and in the segment of the top 10 cities[1] (-0.5%). In the segment of the top 6 cities,[2] prices grew by 1.6%, and in the segment of other urban counties[3] and in rural counties a growth of 4% was recorded.

[1] Białystok, Bydgoszcz, Katowice, Kielce, Lublin, Olsztyn, Opole, Rzeszów, Szczecin, Zielona Góra
[2] Kraków, Poznań, Wrocław, Gdańsk, Gdynia, Łódź
[3] All urban counties except Warsaw and the counties included in the top 10 large and top 10 medium-sized cities except Warsaw

The real estate market responds with some delay to economic changes and crises, so it is now difficult to clearly predict the depth of the price adjustment during the next 12 months. The market is reporting a large increase in the number of apartments being offered for sale. This must undoubtedly include the stock of apartments previously bought for investment purposes. Especially those customers who intended to offer short-term leases which stopped completely during the pandemic are being forced to change their strategy, i.e. switch to long-term leases, which may not be sufficiently profitable for some customers, or to sell the property in order to regain financial liquidity.

SUPPLY AND DEMAND ON THE REAL ESTATE MARKET

The economic freeze due to the coronavirus pandemic significantly slowed down activity in the residential construction segment. The number of building permits for the construction of apartments decreased by 27% compared with the corresponding period of the prior year, the number of apartments obtaining occupancy permits decreased by 22%, and the number of apartments whose construction began, by as much as 38%. However, a recovery could already be noted in May, associated with the gradual "unfreezing" of the economy. The number of building permits granted for the construction of apartments increased by 15% compared with the previous month, the number of apartments whose construction started by 10%, and the number of apartments obtaining occupancy permits increased by 20%.

The boom on the residential real estate market noted in Q1 2020 was stimulated by the continued strong demand, both for own housing needs and for investment purposes. Concerns and uncertainty associated with the unprecedented freeze of the economy due to the coronavirus pandemic resulted in the psychological effect of a sudden drop in consumers' moods, and therefore significantly decreased consumers' propensity to make important purchases. In April 2020, consumer economic activity indicators dropped to levels that had last been noted in 2001–2003. The current consumer confidence index fell to -36.4, and the leading consumer confidence index – to -47.7. In subsequent months, in line with the gradual unfreezing of successive economic sectors, consumer confidence started to improve and amounted to -19.4 (current consumer confidence index) and -23.9 (leading consumer confidence index) in June.

The situation on the residential real estate market in the coming months will depend on a number of factors, and the most important among these will be the pace of economic recovery after the present crisis, which will depend on the effectiveness of the measures implemented under the Anti-crisis Shield programme and also on the risk of the adverse impact of the effects of a potential second wave of the pandemic on the economy. The historically low level of interest rates after a series of three cuts by the Monetary Policy Council following the start of the pandemic will certainly be a positive stimulus for the residential real estate market.

2.3. RESIDENTIAL MORTGAGE LOAN MARKET

Based on NBP data, banks' receivables from residential mortgage loans in Poland were PLN 463.3 billion as at 31 May 2020, up 8.3% y/y. Loans denominated in Polish zloty were PLN 339.7 billion as at 31 May 2020 (73.3% of the Bank's total receivables from housing loans in Poland), up 12.0% y/y.

At the same time, in June 2020, the situation on the residential mortgage loan market could have stabilized somewhat after a significant weakening of the demand for residential mortgage loans during Q2 (as indicated by the data from Biuro Informacji Kredytowej (Credit Information Bureau). The time-consuming process of residential mortgage lending may mean that this demand drop may not yet be visible in the Q2 data and may be reflected in the statistics later during Q3. The increase in the volume of residential mortgage loans in May decelerated to 12.0% y/y from 12.5% y/y at the end of March. The gradual recovery of the economy from the pandemic trough means that the situation on the market of residential mortgage loans may slowly be returning to normal, which will be assisted by the record low interest rates and anti-crisis shield programmes which support household income.

2.4. COVERED BOND MARKET

As at 30 June 2020, four mortgage banks were operating in Poland, namely:

- PKO Bank Hipoteczny SA
- mBank Hipoteczny SA
- Pekao Bank Hipoteczny SA.
- ING Bank Hipoteczny SA

In the first half of 2020, Bank Millennium obtained a consent to form a mortgage bank within its Group.

The Polish covered bond market is relatively small and moderately liquid. At the end of June 2020, the total value of outstanding mortgage covered bonds issued by Polish mortgage banks amounted to about PLN 26.5 billion, i.e. PLN 2.3 billion more than at 30 June 2019. As at 30 June 2020, outstanding covered bonds issued by Polish banks corresponded to 5.8% of the amount of residential mortgage loans granted by banks.

PKO Bank Hipoteczny SA is the largest issuer of mortgage covered bonds in Poland. As at 30 June 2020, the value of outstanding mortgage covered bonds issued by PKO Bank Hipoteczny SA amounted to PLN 16.8 billion, which accounted for approx. 63% of the total value of outstanding mortgage covered bonds issued by Polish mortgage banks.

In the first six months of 2020, PKO Bank Hipoteczny SA did not carry out any issues of mortgage covered bonds.

2.5. REGULATORY AND LEGAL ENVIRONMENT

In the first six months of 2020, the following legal and regulatory solutions affecting the operations of PKO Bank Hipoteczny SA came into force:

SUPPORT TO BORROWERS	The Act of 4 July 2019 amending the act on support to borrowers in a difficult financial situation who incurred a residential mortgage loan and certain other acts – the Act has extended the possibility of obtaining support from the Borrowers Support Fund.
BANKRUPTCY LAW	The Act of 30 August 2019 amending the Bankruptcy Law and certain other acts – the Act has introduced a number of solutions facilitating consumer bankruptcy, including the introduction of three ways of consumer debt reduction, enabling debtors to conclude out-of-court composition arrangements with their creditors, the introduction of a quick sale of the entire bankruptcy estate.
DEMATERIALIZATION OF SHARES	The Act of 30 August 2019 amending the Commercial Companies Code and certain other acts – the Act has introduced mandatory dematerialization of shares of all joint stock companies; shares should be registered in a Shareholders' Register or in the securities depository. The Act entered into force in part on 1 January 2020, and will become fully effective starting from 1 March 2020.
COVID-19	The Act on subsidies to interest on bank loans granted to entrepreneurs affected by the effects of COVID-19 and on simplified composition arrangements in connection with COVID-19 – the Act imposes an obligation for banks to suspend the performance of loan agreements for 3 months for people who have lost jobs or another main source of income during the COVID-19 pandemic and submitted a respective application.

3. FINANCIAL RESULTS AND CAPITAL ADEQUACY

Key financial ratios of PKO Bank Hipoteczny SA
Statement of financial position of PKO Bank Hipoteczny SA
Income statement of PKO Bank Hipoteczny SA
Requirements regarding own funds (Pillar I)
Internal capital (Pillar II)
Disclosures (Pillar III)

3.1. KEY FINANCIAL RATIOS OF PKO BANK HIPOTECZNY SA

	30.06.2020	31.12.2019	30.06.2019
Total assets (PLN million)	27,494.7	27,253.3	25,955.0
ROA[4]	0.3%	0.4%	0.3%
ROE[5]	3.5%	5.0%	3.8%
Total capital ratio	17.5%	16.6%	15.2%
Leverage ratio (LR)	7.0%	6.7%	6.5%
Cost to income ratio (C/I)[6]	23.0%	24.6%	27.4%

3.2. STATEMENT OF FINANCIAL POSITION OF PKO BANK HIPOTECZNY SA

PLN million	30.06.2020	31.12.2019	30.06.2019
Cash and balances with the Central Bank	0.0	0.0	0.0
Amounts due from banks	0.0	0.0	0.0
Derivative hedging instruments	758.1	173.3	173.5
Securities	1,240.5	1,240.2	1,158.1
Loans and advances to customers	25,481.0	25,821.1	24,599.2
Other assets[7]	15.1	18.7	24.2
TOTAL ASSETS	**27,494.7**	**27,253.3**	**25,955.0**

PLN million	30.06.2020	31.12.2019	30.06.2019
Amounts due to banks	5,937.0	4,811.3	4,137.6
Derivative hedging instruments	0.8	46.1	48.5
Liabilities in respect of mortgage covered bonds issued	16,817.1	16,240.0	15,965.6
Liabilities in respect of bonds issued	2,557.6	4,060.0	3,830.8
Other liabilities and provisions[8]	119.6	95.9	116.6
Equity	2,062.6	2,000.0	1,855.9
TOTAL LIABILITIES AND EQUITY	**27,494.7**	**27,253.3**	**25,955.0**

[4]Annualized ratio expressed as the quotient of the net profit (loss) for the given period and the average level of assets at the beginning and end of the reporting period and of the interim monthly periods.
[5]Annualized ratio calculated by dividing the net profit (loss) for the given period by the average level of equity at the beginning and end of the reporting period and of the interim monthly periods.
[6]Annualized ratio excluding tax on certain financial institutions.
[7] Includes the following items of the statement of financial position: intangible assets, property, plant and equipment and other assets.
[8] Includes the following items of the statement of financial position: amounts due to customers, other liabilities, current tax liabilities, deferred income tax provision and provisions.

As at 30 June 2020, the total assets of PKO Bank Hipoteczny SA were PLN 27,494.7 million, which means it was similar to the level at the end of 2019 Residential mortgage loans were the key component of the Bank's assets. Their carrying amount, taking into account write-downs for expected credit losses recognized as at 30 June 2020, amounted to PLN 25,481.0 million, of which new loans amounted to PLN 12,270.5 million, whereas loans purchased from PKO Bank Polski SA amounted to PLN 13,210.5 million.

As far as liabilities are concerned, the share of covered bonds was 61% thereof as at the end of June 2020. The Bank did not carry out any issues of mortgage covered bonds in the first six months of 2020. On the other hand, due to the impact of the EUR/PLN exchange rate on the measurement of EUR-denominated mortgage covered bonds, the carrying amount of mortgage covered bonds as at the end of June 2020 amounted to PLN 16,817.1 million, 4% up compared to the end of 2019.

As at 30 June 2020, financial liabilities to PKO Bank Polski SA constituted a significant item of the Bank's equity and liabilities. They consisted of liabilities in the form of revolving credit lines, limited overdraft facilities, liabilities in respect of the purchase of receivables, liabilities in respect of the covered bonds and unsecured bonds acquired by PKO Bank Polski SA, other liabilities to PKO Bank Polski SA. Their total balance was PLN 5,748.9 million. Bonds issued by the Bank were also a significant source of funding the Bank's operations. As at 30 June 2020, they amounted to PLN 2,557.6 million, down 37% compared with the end of 2019. The decrease in the balance of bonds is due to the adverse impact of the COVID-19 pandemic on the functioning of the financial markets in Poland.

3.3. INCOME STATEMENT OF PKO BANK HIPOTECZNY SA

PLN million	01.01.2020 – 30.06.2020	01.01.2019 – 30.06.2019	Change y/y (PLN million)
Net interest income	173.2	150.3	22.9
Net fee and commission income	(1.3)	(2.4)	1.1
Net gain/(loss) on financial instruments measured at fair value through profit or loss	0.0	0.0	0.0
Net foreign exchange gains/ (losses)	5.6	(1.9)	7.5
Net income / (expense) on modification	(1.5)	0.4	(1.9)
Net allowances for expected credit losses	(19.6)	(5.7)	(13.9)
Net other operating income and expenses	(0.1)	0.0	(0.1)
Administrative expenses	(26.0)	(25.0)	(1.0)
Regulatory charges	(25.2)	(24.5)	(0.7)
Tax on certain financial institutions	(45.2)	(39.0)	(6.2)
Operating profit	**60.0**	**52.2**	7.8
Profit before tax	**60.0**	**52.2**	7.8
Income tax expense	(24.5)	(21.6)	(2.9)
Net profit	**35.5**	**30.6**	4.9

In the first six months of 2020, PKO Bank Hipoteczny SA generated net profit of PLN 35.5 million, up PLN 4.9 million compared with the corresponding period of 2019. The most important driver of this increase was the improvement in net interest income caused by an increase in the scale of the Bank's operations, with a limited increase in costs.

In 2020, the Bank calculated income tax expense using the tax rate that would be applicable to the expected profit before tax for the whole year, i.e. using the estimated average annual effective income tax rate applicable to income before tax in the interim period.

The calculation of the average annual effective income tax rate requires using a forecast of profit before tax for the entire reporting year and of permanent differences between carrying amounts and tax bases of assets and liabilities. The forecast annual effective tax rate used to calculate the income tax expense in the first six months of 2020 was 40.83%.

In the same period, the Bank generated interest income of PLN 429.7 million. It comprised primarily interest income from residential mortgage loans of PLN 416.7 million, and interest income from debt securities. In the same period,

the Bank incurred interest expense of PLN 256.4 million. Interest expense resulted mainly from covered bonds issued and the costs of hedging transactions. The related interest expense was PLN 171.6 million. In addition, the Bank incurred interest expense of PLN 45.6 million on loans received and the overdraft facility used, PLN 33.5 million on bonds issued and PLN 5.6 million on the liability in respect of the deferred payment for receivables purchased from PKO Bank Polski SA.

The Bank's turnover in the first half of 2020 (understood as the total value of interest income and fee and commission income) amounted to PLN 434.4 million. The realized turnover was generated entirely from the Bank's operations in Poland.

In the first half of 2020, the Bank incurred a net fee and commission loss of PLN 1.3 million. This item comprised, among other things, costs of expert valuations of the mortgage lending value of real estate (MLV), as prepared by real estate appraisers, in the amount of PLN 0.4 million, costs of the bond issue programme of PLN 1.2 million, costs of insuring loans of PLN 1.8 million, and costs of credit lines of PLN 1.8 million. The Bank also recognized fee and commission income from customers including, among other things, fees for real estate valuations and real estate inspections and commission for early full or partial loan repayments. The total fee and commission income amounted to PLN 4.7 million.

In the first half of 2020, the Bank incurred administrative expenses of PLN 26.0 million. Non-personnel expenses of PLN 17.1 million, including costs related to services rendered by PKO Bank Polski SA of PLN 14.1 million under an outsourcing agreement, were a significant component of administrative expenses. Costs of employee benefits, whose amount during the reporting period was PLN 7.3 million, were also a significant component of administrative expenses. The increase in administrative expenses compared with the corresponding period of 2019 was mainly caused by an increase in costs of services provided by PKO Bank Polski SA under an outsourcing agreement (up PLN +2.9 million), which resulted from an increase in the volume of loans in the Bank's balance sheet.

In 2020, the Bank also incurred regulatory expenses totalling PLN 25.2 million. The main item of such expenses was the contribution to the resolution fund of the Bank Guarantee Fund of PLN 22.5 million which means an increase of PLN 0.4 million compared to 2019.

Tax on certain financial institutions, which amounted to PLN 45.2 million in the reporting period, was a significant cost of the Bank's activities.

The Bank's costs resulting from write-downs in respect of credit losses amounted to PLN 19.6 million in the first half of 2020.

As at 30 June 2020, an additional write-down for expected deterioration in the quality of the loan portfolio of PLN 10.8 million was also recognized in connection with the COVID-19 pandemic. The Bank took into account, in particular, adverse macroeconomic scenarios which assume economic recession and an increase in unemployment as a baseline.

In the first half of 2020, there were no unusual events significantly affecting the Bank's operations

THE BANK'S FINANCING STRUCTURE

The table below shows the structure of the Bank's sources of financing:

	30.06.2020	31.12.2019
Equity	7.5%	7.3%
Funds from the parent entity	20.7%	16.7%
Mortgage covered bonds issued	61.2%	59.6%
Bonds issued	9.3%	14.9%
Other	1.3%	1.5%
Total	**100.0%**	**100.0%**

As at 30 June 2020 and 31 December 2019, the Bank did not have any liabilities in respect of which it had defaulted on contractual payments.

3.4. REQUIREMENTS REGARDING OWN FUNDS (PILLAR I)

GENERAL INFORMATION

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

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

At 30 June 2020, the own funds requirements concerning the credit valuation adjustment, settlement and delivery, and market risk were nil, therefore the total own funds requirement comprised the requirements for credit and operational risks.

Own funds requirements	30.06.2020	31.12.2019
Credit risk (PLN million)	824.6	854.5
Operational risk (PLN million)	35.2	22.7
Total own funds requirement (PLN million)	859.8	877.2
Common equity Tier 1 capital ratio (CET1)	17.5%	16.6%
Tier 1 capital ratio (T1);	17.5%	16.6%
Total capital ratio (TCR)	17.5%	16.6%

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

30.06.2020	Gross exposure	Exposure value[9]	Risk weighted assets (RWA)	Own funds requirement
Retail exposures[10]	3,392.8	3,303.4	2,477.6	198.2
Exposures secured by mortgages on real estate	22,320.2	22,280.4	7,798.1	623.9
Exposures to central governments or central banks	1,240.5	1,240.5	0.0	0.0
Exposures to institutions	1,381.0	1,381.0	0.0	0.0
Exposures in default	23.2	17.4	18.6	1.5
Other exposures	13.4	13.4	13.4	1.1
Total	**28,371.0**	**28,236.0**	**10,307.7**	**824.6**

[9] The value of balance-sheet exposures and the balance-sheet equivalent of contingent liabilities and transactions, taking into account specific credit risk adjustments and the CCF (Credit Conversion Factor).
[10] These result from that part of the exposure which is not fully and completely secured, i.e. which exceeds an MLV of 80% or is in a transitional period, i.e. until collateral has been put up.

31.12.2019	Gross exposure	Exposure value[12]	Risk weighted assets (RWA)	Own funds requirement
Retail exposures[13]	4,034.3	3,823.8	2,867.9	229.4
Exposures secured by mortgages on real estate	22,294.2	22,237.4	7,783.1	622.6
Exposures to central governments or central banks	1,240.2	1,240.2	0.0	0.0
Exposures to institutions	771.2	771.2	0.0	0.0
Exposures in default	17.9	13.6	14.8	1.2
Other exposures	16.1	16.1	16.1	1.3
Total	**28,373.9**	**28,102.3**	**10,681.9**	**854.5**

CREDIT RISK ADJUSTMENTS

For the purpose of specific credit risk adjustments, the Bank uses impairment loss, which was recognized in the Bank's Tier 1 capital in accordance with the CRR and the implementing legislation.

The approach applied by the Bank to identifying exposures at risk of impairment and methods for estimating write-downs for expected credit losses and provisions for financial liabilities granted are described in Note 41.3 "Impairment loss on credit exposures" of the financial statements of PKO Bank Hipoteczny SA as at and for the year ended 31 December 2019.

USE OF CREDIT RISK MITIGATION TECHNIQUES

The Bank uses mortgage collateral for the classification of exposures to classes of exposures secured by mortgages on real estate and the use of preferential risk weighting. Detailed information about the main types of collateral adopted by the Bank and the method of determining the mortgage lending value is presented in Note 43 "Residual risk management" of the financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2019.

3.5. INTERNAL CAPITAL (PILLAR II)

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

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

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

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

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

Structure of internal capital	30.06.2020	31.12.2019
To cover credit risk	89.0%	93.8%
To cover operational risk	3.8%	2.5%
To cover liquidity risk	2.2%	1.7%
To cover interest rate risk	4.8%	1.8%
To cover model risk	0.2%	0.2%
Total	100.0%	100.0%

As at 30 June 2020, the relationship between the Bank's own funds and internal capital remained above the statutory and internal limits.

In order to estimate the amount of capital necessary to operate safely in recessionary conditions, the Bank conducts regular stress tests.

3.6. Disclosures (Pillar III)

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

- risk management objectives and strategies;
- own funds for capital adequacy purposes;
- capital buffers;
- leverage ratio;
- capital requirements;
- credit risk adjustments;
- credit risk mitigation techniques used;
- remuneration policy for those categories of personnel whose professional activities have a material impact on the Bank's risk profile;
- the requirements referred to in Article 111a of the Banking Act and Recommendation H;
- operational risk in accordance with Recommendation M;
- liquidity risk management system and the liquidity position, in accordance with Recommendation P;
- the impact of implementing International Financial Reporting Standard 9 (IFRS 9) on capital adequacy.

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

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

4. BUSINESS OF PKO BANK HIPOTECZNY SA

Sales of residential mortgage loans under the agency model
Acquisition of receivables under residential mortgage loans
Structure of the residential mortgage loan portfolio
Covered bonds
Financial market operations
Bonds – Issue Programme Agreement concluded with PKO Bank Polski SA
Bonds – public programme
Bonds – other
Ratings of the Bank and its covered bonds

4.1. SALES OF RESIDENTIAL MORTGAGE LOANS UNDER THE AGENCY MODEL

PKO Bank Hipoteczny SA has been granting residential mortgage loans in Polish zloty since 1 April 2015. New residential mortgage loans are sold under the agency model, through Poland's largest network of branches, agents and intermediaries, organized by PKO Bank Polski SA. The Bank accepts apartments and single-family homes as collateral.

In the first half of 2020, in preparation for implementing the updated strategy for the years 2020-2022, the Bank limited sales of residential mortgage loans. This decision has no impact on the total sales of residential mortgage loans by the Group. Consequently, in the first six months of 2020, the Bank granted PLN 361.5 million worth of residential mortgage loans, 80% down compared with the first six months of 2019.

Towards the end of Q1 2020, in connection with the epidemiologic situation in Poland, the Bank introduced special solutions for mortgage borrowers and allowed them to suspend the repayment of up to three consecutive loan instalments in 2020. In Q2, the Bank extended the possibility of suspending the repayment of loans to up to six instalments. Moreover, the Bank adopted "Uniform rules for offering assistance tools by banks", which, in their nature, represent a non-legislative moratorium within the meaning of 10(a) of EBA Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis. Assistance measures introduced by the Bank consist in deferring the repayment of principal or principal and interest instalments. As requested by a customer in an application, for the period of up to six months. Further, on 24 June 2020, the Bank introduced the possibility of suspending the execution of an agreement under the "Shield 4.0" programme for customers having a mortgage loan from the Bank who lost their jobs or another main source of income.

In accordance with the provisions of Recommendation S of the Polish Financial Supervision Authority, the Bank grants loans for up to 80% of the real estate value. Where a low down payment insurance policy was used, the Bank approved loans for which this ratio was not higher than 90% until the end of Q1 2020. Moreover, in compliance with the Polish Mortgage Covered Bonds Act, the Bank only grants loans whose value in relation to the mortgage lending value of the real estate does not exceed 100%.

The following table shows the main criteria applied by PKO Bank Hipoteczny SA in the process of granting loans secured by mortgages.

CRITERIA	AGENCY MODEL
Loan amount/market value of the real estate	Max 80%[11]
Loan amount/mortgage lending value of the real estate	Max 100%
Legal title to the real estate	Ownership or perpetual usufruct
Loan collateral	Mortgage recorded as the first in Section IV of the Land and Mortgage Register
Currency	PLN
Purpose	Residential

[11] Until the end of Q1 2020, the Bank accepted granting loans for which this ratio did not exceed 90%, provided that the debt-financed required own contribution was insured.

In 2018-2019, the Bank was gradually introducing residential mortgage loans with interest based on the five-year fixed base interest rate. In 2020, the Bank has been working on the introduction of the option to switch to interest based on the five-year fixed base rate for all loan agreements, irrespective of their inception date.

Energy Efficient Mortgages Initiative

PKO Bank Hipoteczny SA and PKO Bank Polski SA were the first banks in Poland to join the Energy Efficient Mortgages (EEM) Initiative pilot project on 11 April 2019. The aim of the project is to develop standardized, pan-European solutions for residential mortgage loans granted for the financing of energy-efficient apartments and houses. This includes offering preference packages to encourage borrowers to buy energy efficient properties or to improve the energy efficiency of the existing buildings. In this way, banks would be encouraged to play a key role in stimulating climate change-related actions in the European construction sector.

4.2. Acquisition of receivables under residential mortgage loans

Purchase of receivables in respect of residential mortgage loans, on the basis of a framework agreement signed in 2015 with PKO Bank Polski SA is an important element of the business of PKO Bank Hipoteczny SA.

In the first six months of 2020, PKO Bank Hipoteczny SA acquired from PKO Bank Polski SA a portfolio of receivables for residential mortgage loans totalling PLN 154.0 million. The following table shows the main criteria applied by PKO Bank Hipoteczny SA in the process of acquiring residential mortgage loans.

Criteria	Pooling model
Loan amount/mortgage lending value of the real estate	Max 100%
Legal title to the real estate	Ownership or perpetual usufruct
Loan collateral	Mortgage recorded as the first in Section IV of the Land and Mortgage Register
Currency	PLN
Days past due or impairment indicators	None
Purpose	Residential

4.3. Structure of the residential mortgage loan portfolio

Portfolio structure by LtV

The structure of the gross portfolio of loans granted to customers in the statement of financial position of PKO Bank Hipoteczny SA according to the LtV ratio based on market valuation[12] and the LtV ratio based on the mortgage lending value is presented in the following tables.

Gross loans at LtV based on market valuation	30.06.2020	31.12.2019
below 50%	40%	34%
51% – 60%	23%	21%
61% – 70%	21%	22%
71% – 80%	12%	16%
80% – 90%	4%	7%
more than 90%	0%	0%
Total, gross	**100%**	**100%**
Average LtV based on market valuation	53.1%	56.2%

[12] The current level of LtV is determined based on the value of the real estate at the moment the loan and updated using statistical methods based on an analysis of the real estate market.

Gross loans at LtV based on MLV	30.06.2020	31.12.2019
below 50%	15%	15%
51% – 60%	10%	9%
61% – 70%	14%	13%
71% – 80%	20%	19%
80% – 90%	25%	25%
more than 90%	16%	19%
Total, gross	**100%**	**100%**
Average LtV based on MLV	71.3%	72.4%

In the first six months of 2020, the average LtV ratio based on the market valuation of the loan portfolio declined by 3.1 p.p. (a decline of 0.7 p.p. in the first six months of 2019), which was the result of a further rise in the market value of the real estate provided as collateral for the Bank's loans. For the LtV ratio based on MLV, this relationship is not observed to such an extent (a decline of 1.1 p.p.) because the mortgage lending value of the real estate did not need to be updated.

INTEREST ON LOANS

In 2019, the Bank changed its offer by replacing the WIBOR 3M reference rate with WIBOR 6M for the purposes of calculating interest rates on residential mortgage loans.

WIBOR 3M and WIBOR 6M are the main reference interest rates applied by the Bank to loans. In the first six months of 2020, the average value of these rates was 1.11% and 1.15%, respectively.

4.4. COVERED BONDS

The key objective of PKO Bank Hipoteczny SA is issuing mortgage covered bonds which are the main source of long-term financing for loans secured with real estate.

POLISH ISSUES OF MORTGAGE COVERED BONDS

From the beginning of its operations, PKO Bank Hipoteczny SA has issued thirteen series of Polish mortgage covered bonds, including two issues of green mortgage covered bonds.

The total value of outstanding mortgage covered bonds issued by PKO Bank Hipoteczny SA for the domestic market (at the nominal value) as at the end of June 2020 was PLN 4,385.0 million.

All series of domestic mortgage covered bonds issued are traded on the Warsaw Stock Exchange parallel market and on the BondSpot regulated market. They are also accepted in repo transactions by the National Bank of Poland.

Chart: Purchasers of domestic issues of PKO Bank Hipoteczny SA's covered bonds in the years 2015-2020

In the first six months of 2020, PKO Bank Hipoteczny SA did not carry out any issues of mortgage covered bonds.

Chart: Geographical distribution of purchasers of domestic issues of PKO Bank Hipoteczny SA's covered bonds in the years 2015-2020

PLN-denominated issues of mortgage covered bonds of PKO Bank Hipoteczny SA carried out to 30 June 2020:

Series	Mortgage covered bond number (ISIN)	Issue date	Maturity date	Value of series (PLN million)	Interest rate	Currency	Issue rating	Listing
1	PLPKOHP00017	11.12.2015	11.12.2020	30	WIBOR 3M +0.75%	PLN	Aa3	Bondspot, WSE parallel market
2	PLPKOHP00025	27.04.2016	28.04.2021	500	WIBOR 3M +0.65%	PLN	Aa3	Bondspot, WSE parallel market
3	PLPKOHP00033	17.06.2016	18.06.2021	500	WIBOR 3M +0.59%	PLN	Aa3	Bondspot, WSE parallel market
4	PLPKOHP00041	28.04.2017	18.05.2022	500	WIBOR3M +0.69%	PLN	Aa3	Bondspot, WSE parallel market
5	PLPKOHP00058	22.06.2017	10.09.2021	265	2.69%	PLN	Aa3	Bondspot, WSE parallel market
6	PLPKOHP00066	27.10.2017	27.06.2023	500	WIBOR3M +0.60%	PLN	Aa3	Bondspot, WSE parallel market
7	PLPKOHP00074	27.04.2018	25.04.2024	700	WIBOR3M +0.49%	PLN	Aa3	Bondspot, WSE parallel market
8	PLPKOHP00082	18.05.2018	29.04.2022	100	WIBOR3M +0.32%	PLN	Aa3	Bondspot, WSE parallel market
9	PLPKOHP00090	27.07.2018	25.07.2025	500	WIBOR3M +0.62%	PLN	Aa3	Bondspot, WSE parallel market
10	PLPKOHP00108	24.08.2018	24.08.2028	60	3.4875%	PLN	Aa3	Bondspot, WSE parallel market
11	PLPKOHP00116	26.10.2018	28.04.2025	230	WIBOR3M +0.66%	PLN	Aa3	Bondspot, WSE parallel market
12	PLPKOHP00132	10.06.2019	30.09.2024	250	WIBOR3M +0.60%	PLN	Aa3	Bondspot, WSE parallel market

13	PLPKOHP00199	02.12.2019	02.12.2024	250	WIBOR3M +0.51%	PLN	Aa3	Bondspot, WSE parallel market

INTERNATIONAL ISSUES OF MORTGAGE COVERED BONDS

From the beginning of its operations, PKO Bank Hipoteczny SA issued seven series of international mortgage covered bonds, including five benchmark issues and two private placement ones.

The total value of outstanding mortgage covered bonds issued by PKO Bank Hipoteczny SA for the international market (at nominal value) as at the end of June 2020 was EUR 2,779.0 million.

All series of international mortgage covered bonds issued are traded on the Luxembourg Stock Exchange and, except for series 2 and 5, on the parallel market of the Warsaw Stock Exchange. They have also been accepted in repo transactions by the European Central Bank.

In the first six months of 2020, PKO Bank Hipoteczny SA did not carry out any international issues of mortgage covered bonds.

Chart: Purchasers of EUR-denominated issues of PKO Bank Hipoteczny SA's covered bonds in the years 2016-2020

Chart: Geographical distribution of purchasers of EUR-denominated covered bonds of PKO Bank Hipoteczny SA's in the years 2016-2020

EUR-denominated issues of mortgage covered bonds of PKO Bank Hipoteczny SA carried out to June 2020:

Series	Mortgage covered bond number (ISIN)	Issue date	Maturity date	Value of series (EUR million)	Coupon	Price	Currency	Issue rating	Listing
1	XS1508351357	24.10.2016	24.06.2022	500	0.125%	99.702%	EUR	Aa3	LuxSE, WSE parallel market
2	XS1559882821	02.02.2017	02.02.2024	25	0.82%	100.00%	EUR	Aa3	LuxSE
3	XS1588411188	30.03.2017	24.01.2023	500	0.625%	99.972%	EUR	Aa3	LuxSE, WSE parallel market
4	XS1690669574	27.09.2017	27.08.2024	500	0.75%	99.906%	EUR	Aa3	LuxSE, WSE parallel market
5	XS1709552696	02.11.2017	03.11.2022	54	0.467%	100.00%	EUR	Aa3	LuxSE

6	XS1795407979	22.03.2018	24.01.2024	500	0.75%	99.892%	EUR	Aa3	LuxSE, WSE parallel market
7	XS1935261013	28.01.2019	23.11.2021	500	0.250%	99.933%	EUR	Aa3	LuxSE, WSE parallel market
7 tranche 2	XS1935261013	01.03.2019	23.11.2021	100	0.250%	100.145 %	EUR	Aa3	LuxSE, WSE parallel market
1 tranche 2	XS1508351357	08.03.2019	24.06.2022	100	0.125%	99.489%	EUR	Aa3	LuxSE, WSE parallel market

The funds raised from the issues of mortgage covered bonds have been used by PKO Bank Hipoteczny SA to grant residential mortgage loans and to acquire receivables for such loans from PKO Bank Polski SA.

The Covered Bond Label

On 6 February 2018, PKO Bank Hipoteczny, as the first issuer of covered bonds from Poland, joined The Covered Bond Label. The Covered Bond Label is a quality certificate, whose purpose is to build awareness among investors of the safety and high quality of assets such as mortgage covered bonds.

The Bank's details on the website of The Covered Bond Label are available at:

https://coveredbondlabel.com/issuer/161/

Green mortgage covered bonds

In Q2 2019, PKO Bank Hipoteczny SA published the Green Covered Bond Framework (GCBF). In June 2019, PKO Bank Hipoteczny SA, as the first issuer in Poland, received a certificate granted by the international agency Climate Bonds Initiative for green covered bonds that satisfy the highest international standards with respect to the criteria for financing low emission projects. Through its participation in the financing of environmentally-friendly housing projects, the Bank will be able to obtain access to additional sources of financing from issues of Green covered bonds.

The proceeds from Green covered bonds are used exclusively to provide full or partial financing or refinancing of new and/or existing projects which have been classified as green. Such bonds should satisfy the criteria set by the International Capital Market Association (ICMA), which are known as Green Bond Principles (GBP). The GBP are a set of guidelines concerning transparency, disclosure and reporting, which promote the consistency of the green bond market.

In June 2019, PKO Bank Hipoteczny SA obtained a second party opinion of a specialized, certified international institution Sustainalytics, which confirmed that the Bank's GCBF complies with the key GCB principles.

For more detailed information concerning green covered bonds issued by the Bank, please visit:

https://www.pkobh.pl/relacje-inwestorskie/zielone-listy-zastawne/

4.5. Financial market operations

PKO Bank Hipoteczny SA executes treasury transactions on the wholesale financial market. The purpose of the transactions is to manage liquidity (over short-, mid- and long-term time horizons) and the Bank's foreign-currency position. Additionally, the Mortgage Covered Bonds and Mortgage Banks Act imposes an obligation on PKO Bank Hipoteczny SA to mitigate the risk caused by fluctuations in exchange rates.

For the purpose of financing the granting of residential mortgage loans and purchase of receivables for residential mortgage loans granted by PKO Bank Polski SA, PKO Bank Hipoteczny SA issues mortgage covered bonds, bonds, and takes out credit lines and assumes liabilities for purchased receivables. However, in accordance with the Mortgage Covered Bonds and Mortgage Banks Act, the level of liabilities arising from the taking out of loans and advances (including liabilities for purchased receivables) and issuing bonds cannot exceed in aggregate six times the Bank's own funds.

In the Management Board's opinion, as at 30 June 2020, there were no indicators of a risk of late payment of the liabilities incurred by the Bank. In the first six months of 2020, the Bank did not exceed any of the liquidity limits. Details of the levels of the Bank's liquidity limits are provided in Note 32 "Liquidity risk management" to the financial statements of PKO Bank Hipoteczny SA for the six-month period ended 30 June 2020.

As far as the issue of EUR-denominated covered bonds is concerned, for the purpose of hedging interest-rate risk and foreign exchange risk, PKO Bank Hipoteczny SA entered into Cross-Currency Interest Rate Swap (CIRS) transactions, under which the Bank pays a coupon in PLN based on a variable interest rate, and receives a coupon based on a fixed interest rate for EUR. If a court declares PKO Bank Hipoteczny SA bankrupt, the CIRS transactions will automatically be extended by 12 months on the terms set on the transaction date and indicated in the Final Terms of issue of covered bonds. Additionally, the Bank has executed a series of FX-forward contracts, which constitute a hedge of currency exposure with maturities on the payment dates of the coupons for EUR-denominated covered bonds.

As far as the issue of fixed-interest rate covered bonds in PLN is concerned, the Bank entered into IRS transactions to hedge interest rate risk in 2017 and 2018. Under the IRS transactions, the Bank pays a coupon based on a floating PLN rate, and receives a coupon based on a fixed PLN rate.

4.6. Bonds – Issue Programme Agreement concluded with PKO Bank Polski SA

On 30 September 2015, PKO Bank Hipoteczny SA concluded an Issue Programme Agreement with PKO Bank Polski SA under which bonds are issued. In the first half 2020, the Bank issued a total of PLN 2,148.0 million worth of bonds under the programme. The balance of issued bonds was PLN 2,048.0 million as at 30 June 2020.

In Q1 2020, the amount of the Programme was increased from PLN 3,500.0 million to PLN 4,000.0 million.

The Bank intends to continue seeking short-term financing in the form of bond issues under this Programme.

4.7. Bonds – Public programme

In the first six months of 2020, PKO Bank Hipoteczny SA did not issue bonds under the Public Bond Issue Programme, but it redeemed bonds with a total nominal value of PLN 161.5 million.

The balance of issued bonds was PLN 165.0 million as at 30 June 2020. All series were admitted to and introduced to trading on a regulated market of the WSE (parallel market)

Series	Bond number (ISIN)	Issue date	Maturity date	Value of series (EUR million)	Coupon	Currency	Issue rating	Listing
1	PLPKOHP00140	11.07.2019	12.07.2021	50	WIBOR3M +0.60%	PLN	None	WSE parallel market
2	PLPKOHP00165	28.08.2019	30.08.2021	45	WIBOR3M +0.60%	PLN	None	WSE parallel market
3	PLPKOHP00173	17.10.2019	18.10.2021	40	WIBOR3M +0.60%	PLN	None	WSE parallel market

4	PLPKOHP00181	18.12.2019	20.12.2021	30	WIBOR3M +0.60%	PLN	None	WSE parallel market

4.8. Bonds– Other

In the first six months of 2020, PKO Bank Hipoteczny SA signed an agreement with a European financial institution for an issue of unsecured bonds based on a variable interest rate with a total nominal value of PLN 350.0 million and a redemption date on 24 February 2021 and redeemed unsecured bonds with a nominal value of PLN 350.0 million.

4.9. Ratings of the Bank and its covered bonds

As at the date of this Report, PKO Bank Hipoteczny SA had the following ratings assigned by Moody's:

	Rating	Outlook	Rating assignment/confirmation date
Long-term issuer rating	Baa1	Stable	19.12.2017
Short-term issuer rating	P-2	n/a	19.12.2017
Long-term counterparty risk rating	A3	n/a	18.06.2018
Short-term counterparty risk rating	P-2	n/a	18.06.2018
Long-term counterparty risk assessment (CR)	A3(cr)	n/a	19.12.2017
Short-term counterparty risk assessment (CR)	P-2(cr)	n/a	19.12.2017

As at the date of this Report, the covered bonds of PKO Bank Hipoteczny SA had the following ratings assigned by Moody's:

	Rating	Date of initial rating	Rating confirmation date
Covered bonds denominated in PLN	Aa3	08.09.2015	12.12.2015
Covered bonds denominated in EUR	Aa3	29.09.2016	24.10.2016

The rating assigned to the covered bonds of PKO Bank Hipoteczny SA is the highest rating achievable for Polish securities. The rating of Polish securities is limited by Poland's country ceiling[13] for debt instruments, which is currently Aa3.

[13] Maximum country rating for Poland.

5. INTERNAL OPERATING CONDITIONS

Qualified personnel
Lending process and cooperation with PKO Bank Polski SA
Internal control system
Risk management
Measurement of residential mortgage loan collaterals
The cover pool for mortgage covered bonds
Cover Pool Monitor
Statutory limits

5.1. QUALIFIED PERSONNEL

The Bank implements mechanisms and procedures to guarantee that personnel employed in the Bank have the highest qualifications in key business areas. The Bank constantly improves the qualifications of its employees, and makes every effort to ensure the stability of the personnel. These factors have an important influence on the implementation of the Bank's strategy and business goals and, consequently, on its operations and results of operations.

5.2. LENDING PROCESS AND COOPERATION WITH PKO BANK POLSKI SA

PKO Bank Hipoteczny SA acquires residential mortgage loans for its portfolio as part of its strategic cooperation with PKO Bank Polski. The banks work together under two models:

- agency model;
- pooling model.

The cooperation with PKO Bank Polski SA is governed in detail by an outsourcing agreement concluded on 16 January 2015. The agreement governs the scope of the cooperation and describes in detail the method of performing the outsourced functions, first and foremost in the area of offering and administering residential mortgage loans and performing support functions for PKO Bank Hipoteczny SA. Additionally, the agreement imposes obligations on PKO Bank Polski SA to properly perform the functions entrusted to it, as well as extensive reporting and control tasks on behalf of PKO Bank Hipoteczny SA.

On 17 November 2015, the Receivables Sale Framework Agreement was signed with PKO Bank Polski SA. On the basis thereof, the Bank has been acquiring portfolios of receivables for residential mortgage loans since December 2015.

PKO Bank Polski SA, as part of the regulatory approval process for establishing a mortgage bank before the PFSA, undertook to ensure that, if necessary and if PKO Bank Hipoteczny SA's capital or liquidity ratios fall below the level required by law or by other regulations of relevant domestic banking supervision authorities that are applicable to PKO Bank Hipoteczny SA, PKO Bank Polski SA will immediately provide PKO Bank Hipoteczny SA with appropriate financial support.

5.3. INTERNAL CONTROL SYSTEM

The internal control system in PKO Bank Hipoteczny SA is one of the elements of managing the Bank. The objective of the internal control system is to support the Bank's decision-making processes to ensure:

- effectiveness of the Bank's operations;
- reliability and accuracy of financial reporting, administrative and accounting procedures, and reliable internal and external reporting;
- compliance with the risk management policy;

- compliance of the Bank's operations with the generally applicable laws, internal regulations and market standards adopted by the Bank, taking into account regulatory recommendations.

The Bank's internal control system includes:

- the control function designed to ensure compliance with controls relating, in particular, to risk management; this function covers all business units which are responsible for carrying out the tasks assigned to this function;
- the compliance function, which, together with the business units, is responsible for identifying, assessing, controlling and monitoring the risk of the Bank's non-compliance with the generally applicable laws and with the Bank's internal regulations and market standards adopted by the Bank, taking into account regulatory recommendations, and for the submission of the relevant reports;
- the independent internal audit function to evaluate and assess, independently and objectively, the adequacy and effectiveness of the risk management system, the internal control system and corporate governance, except for the aspects relating to the internal audit function itself.

The internal control system is arranged at the Bank on three independent levels:

- the first level consists of organizational structures that perform risk-generating operational tasks and operate under internal regulations;
- the second level is composed of specialized organizational structures operating under applicable policies, methodologies and procedures. The purpose of such structures is to ensure that actions at the first level are properly designed and ensure effective functioning with respect to risk mitigation, support risk measurement and assessment, and ensure effectiveness of operations. This level comprises the activities of the compliance function, as well as identification, measurement or estimation, control, monitoring and reporting of risks material to the Bank, and identified threats and irregularities;
- the third level is internal audit, which carries out independent audits of elements of the Bank's management system, including the risk management system and the internal control system. The internal audit operates separately from, and can support the activities carried out by, the first and second level. The support involves consultation without affecting the decisions made.

The Bank's Management Board ensures the continuity of operation of the internal control system and proper cooperation of all business units within the internal control system in place. The Management Board also identifies corrective actions to be taken to remedy any irregularities identified by the internal control system, including specific corrective and disciplinary measures. The Bank's Management Board approves criteria for distinguishing the relevant processes taking into account the management strategy, the business model and the impact on the Bank's financial performance and capital adequacy, as well as risk appetite. The Bank's Management Board also approves the list of significant processes and their connection with the internal control system's objectives.

Supervision of the internal control system is exercised by the Supervisory Board with the support of the Audit and Finance Committee of the Bank's Supervisory Board. The Supervisory Board approves, in particular, the principles of operation of the internal control system and assesses the adequacy and effectiveness of the system. The Audit and Finance Committee supports the Supervisory Board by monitoring and reviewing the adequacy and effectiveness of the internal control system based on the reports obtained from compliance, internal audit and the control function matrix coordinator, as well as by reviewing draft resolutions of the Management Board in terms of the internal control system, the approval of which falls within the competence of the Supervisory Board.

In the first six months of 2020, the reporting within the internal control system and the remedial actions taken indicated that the internal control system in PKO Bank Hipoteczny SA was effective and commensurate with the business model and the scale of the Bank's operations.

5.4. RISK MANAGEMENT

The risk management process is a key process in PKO Bank Hipoteczny SA. Its purpose is to ensure control of the risk level in a changing macroeconomic and legal environment, and to ensure it is maintained within the risk tolerance established by the Bank and the system of limits that is in place. The assumed level of risk constitutes an important component of the planning and decision-making process.

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

- the Bank manages all identified types of risk associated with its operations;
- the process of risk management is commensurate with the scale of the Bank's operations and the materiality, scale and complexity of a given risk;
- the risk management process supports the execution of the Bank's management strategy, while maintaining compliance with the risk management strategy, in particular in the area of the risk tolerance level;
- the process of risk management is continuously adjusted to new factors and sources of risk;
- methods of risk management and risk measurement systems are adjusted to the scale and complexity of the Bank's operations and to the nature and size of the risk to which the Bank is exposed;
- methods of risk management are periodically reviewed and validated;
- risk management is integrated with planning and controlling processes;
- the risk level is regularly monitored and compared against the system of limits that apply in the Bank, while the Bank's management receives regular information on the level of risk;
- the risk management process is cohesive with the risk management principles in the PKO Bank Polski SA Group.

PKO Bank Hipoteczny SA identifies and manages the following types of risk:

MATERIAL RISKS	• Credit risk • Liquidity risk, including financing risk • Interest rate risk • Model risk • Operational risk
MONITORED RISKS	• Concentration risk • Residual risk • Currency risk • Business risk, including macroeconomic risk • Compliance risk • Reputation risk • Capital risk, including leverage risk

The significance of individual types of risk is defined at the level of the Bank. While determining the criteria of considering a certain risk to be material, the impact of such risk on the Bank's activities is taken into account. That there are three types of risk:

- material risks, which are subject to active management;
- monitored risks, for which the monitoring of materiality is performed;
- risks not identified in the Bank.

For monitored risks, PKO Bank Hipoteczny SA performs periodic monitoring of whether they should be designated as material. The Bank has defined materiality criteria; when they are met, a risk will be recognized as material.

In its Risk Management Strategy, the Bank has defined a number of strategic limits defining the tolerance for different risks. The Bank monitors these limits on an ongoing basis. In the first half of 2020, as well as during the whole period of the Bank's activities, none of them was exceeded.

A detailed description of the Bank's risk management objectives and methods is provided in the financial statements of PKO Bank Hipoteczny SA for the year ended 31 December 2019, in the chapter "Objectives and principles of risk management". It also includes important information on the level of financial risk in the Bank's operations, together with the methods of hedging significant types of planned transactions for which hedge accounting is applied. The objectives and principles of risk management did not change significantly in the first half of 2020.

5.5. MEASUREMENT OF RESIDENTIAL MORTGAGE LOAN COLLATERALS

PKO Bank Hipoteczny SA's policy concerning loan collaterals and their measurement is based on the provisions of the following acts:

- the Mortgage Covered Bonds and Mortgage Banks Act;
- the Act on Land and Mortgage Registers and Mortgage;
- the Banking Law.

Additionally, the question of loan collaterals is addressed by:

- the recommendations of the PFSA, including Recommendations F, S and J;
- the Bank's internal regulations.

The Bank has in place and applies the Rules for Setting the Mortgage Lending Value of Real Estate, approved (as amended) by the PFSA on 30 October 2017. The Rules take into account the provisions of Recommendation F concerning the basic criteria applied by the PFSA in approving rules for setting the mortgage lending value of real estate issued by mortgage banks.

The mortgage lending value of real estate (MLV) is the value determined by the mortgage bank which, in the Bank's opinion, reflects the level of risk associated with the real estate as the loan collateral. MLV is used to determine the maximum amount of a loan that can be secured by a mortgage on a given property, and to make a decision on whether a receivable secured by a particular property can be acquired by the Bank. The mortgage lending value of real estate is determined in a prudent manner, taking into consideration long-term parameters.

PKO Bank Hipoteczny SA determines the MLV on the basis of expert valuations of the mortgage lending value of property. Such valuations are carried out with due diligence and prudence. They take into account only those characteristics of the real estate and investments necessary for its construction which, assuming rational use, can be realized by any keeper of the property. In the expert opinion, prepared as at a specific date, the assumptions and parameters of the analysis are documented, as is the process of setting the MLV and the proposed MLV that results. The expert opinion takes into account analyses and forecasts concerning specific parameters for a given property, which influence the evaluation of credit risk, as well as factors of a general nature, e.g. population growth, the unemployment rate and urban development planning.

The process of setting the MLV is carried out in the Bank by a dedicated team.

In the agency model, the process of setting the mortgage lending value of real estate comprises three stages:

PREPARATION OF THE MLV EXPERT OPINION	Appraiser with appropriate experience and the ability to estimate bank risk in connection with securing residential mortgage loans or a dedicated organizational unit of the Bank – the Collateral Valuation Team at the Loan Office, based on the report from the inspection of the real estate prepared by a property valuation expert.
CONFIRMATION OF THE EXPERT OPINION	PKO Bank Polski SA under the Outsourcing Agreement, or a dedicated organizational unit of the Bank: the Collateral Valuation Team at the Loan Office
REVIEW OF AN EXPERT OPINION ON MLV AND DETERMINING THE MORTGAGE LENDING VALUE OF THE REAL ESTATE	A dedicated organizational unit of the Bank: the Collateral Valuation Team at the Loan Office

In the case of an acquisition of a receivable, the process of setting the mortgage lending value of real estate comprises four stages:

CONFIRMATION OF THE PROPERTY'S LEGAL STATUS	PKO Bank Polski SA, under the outsourcing agreement
INSPECTION PROTOCOL OF THE PROPERTY, TOGETHER WITH MARKET RESEARCH	Appraiser with appropriate experience and the ability to estimate bank risk in connection with securing residential mortgage loans
PREPARATION OF THE MLV EXPERT OPINION	A dedicated organizational unit of the Bank: the Collateral Valuation Team at the Loan Office
REVIEW OF AN EXPERT OPINION ON MLV AND DETERMINING THE MORTGAGE LENDING VALUE OF THE REAL ESTATE	A dedicated organizational unit of the Bank: the Collateral Valuation Team at the Loan Office

The processes of preparing an MLV expert opinion, reviewing the opinion and setting the mortgage lending value of a property described above are performed by two independent individuals.

5.6. THE COVER POOL FOR MORTGAGE COVERED BONDS

PKO Bank Hipoteczny SA maintains a cover pool for its mortgage covered bonds. The Bank includes in the cover pool receivables on residential mortgage loans secured with the first mortgage on the property, and rights and funds that constitute the basis for issuing mortgage covered bonds, as well as additional funds that constitute the excess to cover interest on mortgage covered bonds in circulation which is due in the following six months. The mortgage covered bonds are secured by loans secured by the highest priority mortgage. Certain bank funds can also constitute the basis for issuing mortgage covered bonds:

- funds invested in securities issued or guaranteed by the National Bank of Poland, the European Central Bank, governments and central banks of members of the European Union and/or the Organization for Economic Cooperation and Development, excluding countries that are restructuring or have restructured their foreign debt in the past 5 years;
- invested in the National Bank of Poland;
- funds held in cash.

The nominal value of loans included in the cover pool and constituting collateral for issues of mortgage covered bonds as at 30 June 2020 stood at PLN 22,665.6 million. The nominal value of the over-collateralization in the form of securities issued by the State Treasury, denominated in PLN, stood at PLN 250 million. As at 31 December 2019, these figures were PLN 21,622.0 million and PLN 250 million respectively. The cover pool also takes into account CIRS transactions hedging foreign exchange risk and the interest rate on EUR-denominated mortgage covered bonds, FX-Forward transactions hedging the foreign exchange risk of issued EUR-denominated mortgage covered bonds and IRS transactions hedging the interest rate risk of PLN-denominated mortgage covered bonds issued on a fixed-rate basis.

In the first half of 2020 and in previous years, the cover pool did not include asset-backed securities that do not meet the requirements described in paragraph 1 of Article 80 of Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (recast).

The method of managing the cover pool is laid out by:

- the Mortgage Covered Bonds and Mortgage Banks Act of 29 August 1997 (Journal of Laws of 2003, No 99, item 919 as amended);

- Resolution No. 633/2015 of the PFSA of 1 December 2015 on defining the form of a cover pool;
- Recommendation K of the PFSA of 9 February 2016 concerning the principles for maintaining the cover pool by mortgage banks.

The Cover Pool Monitor and the Deputy Cover Pool Monitor provide continuous supervision over the management of the cover pool.

The following table presents basic data on the Cover Pool as at 30 June 2020 and 31 December 2019:

	30.06.2020	31.12.2019
Total cover pool, including (PLN millions):	**22,915.6**	**21,912.0**
loans secured by mortgages (PLN millions)	*22,665.6*	*21,662.0*
other assets[14] (PLN millions)	*250.0*	*250.0*
Liquidity buffer[15] (PLN millions)	84.7	119.4
Nominal value of hedging transactions[16] (PLN millions)	12,732.71	12,156.2
Number of residential mortgage loans	120,877	115,978
Average value of a loan (PLN'000)	187.5	186.8
Average time since loan issuance (seasoning) (months)	51.2	48.1
Average maturity (months)	256.5	258.4
Average LtV (loan amount to market value)	51.3%	53.6%
Average loan to mortgage lending value of real estate	70.5%	71.0%
Over-collateralization[17]	39.5%	34.7%

5.7. Cover Pool Monitor

The purpose of the cover pool monitor is to ensure protection of the material interests of the holders of mortgage covered bonds. The Mortgage Covered Bonds and Mortgage Banks Act guarantees protecting the independence of the monitor and his deputy. Monitors are appointed by the PFSA, upon the request of the Bank's Supervisory Board, for a period of six years.

On 6 March 2015 the PFSA appointed the following cover pool monitor and deputy cover pool monitor for PKO Bank Hipoteczny SA:

	Position	Appointment date	Dismissal/ resignation date
Tadeusz Swat	Cover Pool Monitor	06.03.2015	-
Grzegorz Kędzia	Deputy Monitor	06.03.2015	-

[14] Article 18(3) of the Mortgage Covered Bonds and Mortgage Banks Act.
[15] Article 18(3a) of the Mortgage Covered Bonds and Mortgage Banks Act.
[16] The nominal value of the hedging transaction corresponds to the issue price of the covered bond.
[17] It includes the net value of hedging transactions but excludes NPL (Non-performing loans).

5.8. STATUTORY LIMITS

Acting under the Mortgage Covered Bonds and Mortgage Banks Act, PKO Bank Hipoteczny SA is obliged to monitor and comply with designated limits related to the operations of a mortgage bank.

The statutory limits and the level to which they have been met as of 30 June 2020 and as of 31 December 2019 were as follows:

Limit	Legal basis	Limit level	Actual level	
			30.06.2020	31.12.2019
Total value of receivables on loans secured by mortgages, and receivables on such loans acquired from other banks, in which the value exceeds 60% of the mortgage lending value, in proportion to the total value of receivables secured by mortgages	Article 13(1)	≤30.0%	18.0%	18.7%
Value of funds received from the issue of mortgage bonds designated for refinancing loans secured by mortgages or receivables on such loans acquired from other banks, in proportion to 80% of the mortgage lending value of particular residential properties that constitute the collateral	Article 14	≤100.0%	68.5%	65.5%
Total value of acquired shares in other entities, in proportion to the Bank's own funds	Article 15(1)(5)	≤10.0%	0.0%	0.0%
Total value of loans and advances taken out and bonds issued, in proportion to the Bank's own funds	Article 15(2)	≤600.0%[18]	452.2%	485.2%
Total value of loans and advances taken out and bonds issued, in proportion to the amount designated for refinancing of activities described in Article 12 of the Act, i.e. issuing loans secured and unsecured by mortgages, receivables acquired from other banks on loans granted by them and secured or unsecured by mortgages	Article 15(3)	≤100.0%	33.3%	34.2%
Total nominal value of mortgage covered bonds outstanding, in proportion to the Bank's own funds and general risk provision	Article 17	≤4000.0%	894.9%	890.1%
Total nominal value of receivables secured by mortgages and value of rights and additional funds of the Bank constituting the basis for issuing mortgage covered bonds, in proportion to the total value of outstanding mortgage covered bonds (taking into account hedging instruments)	Article 18(1)	≥110.0%	139.5%	134.7%
Total nominal value of receivables secured by mortgages constituting the basis for issuing mortgage covered bonds, in proportion to the total nominal value of mortgage covered bonds outstanding	Article 18(1)	≥85.0%	134.8%	133.5%
Interest expense on mortgage covered bonds outstanding (cumulative from the beginning of the financial year and on any given day), in proportion to interest income on receivables secured by mortgages and rights and additional funds constituting the basis for issuing mortgage covered bonds (cumulative from the beginning of the financial year and on any given day), taking into account hedging instruments	Article 18(2)	≤100.0%	28.5%	33.8%

[18] As of 1 April 2020 there was a change in the limit level arising from Article 15(2) according to which after five years from commencing operating activities by a mortgage bank, the value of the liabilities from loans and advances taken out and bonds issued may not exceed a total of six times the mortgage bank's own funds. Until 31 March 2020 the limit level was 1,000.0%.

Bank funds constituting the excess described in Article 18(3a) over the nominal value of interest on mortgage bonds outstanding due in the following 6 months	Article 18(3a)	≥100.0%	148.2%	149.2%
Value of receivables secured by mortgages established during the course of construction investments, in proportion to the total value of receivables secured by mortgages that constitute the basis for issuing mortgage covered bonds	first sentence of Article 23(1)	≤10.0%	7.7%	8.5%
Value of receivables secured by mortgages established on land designated for construction in accordance with development plans, in proportion to the value of receivable secured by mortgages established during the course of construction investments that constitute the basis for issuing mortgage covered bonds	second sentence of Article 23(1)	≤10.0%	0.0%	0.0%

PKO Bank Hipoteczny SA did not breach any of these limits during the entire period covered by this Report.

The Bank achieved positive results on the coverage test and liquidity test performed at the end of June 2020.

6. STRUCTURE AND GOVERNING BODIES OF PKO BANK HIPOTECZNY SA

Organizational structure of PKO Bank Hipoteczny SA
Powers of the governing bodies and committees of PKO Bank Hipoteczny SA
The Management Board of PKO Bank Hipoteczny SA
The Supervisory Board of PKO Bank Hipoteczny SA

6.1. ORGANIZATIONAL STRUCTURE OF PKO BANK HIPOTECZNY SA

The management of PKO Bank Hipoteczny SA is carried out on the basis of the organizational structure presented in the chart below and within the framework of the duties of the Bank's Governing Bodies, described in the following section of this chapter.

6.2. POWERS OF THE GOVERNING BODIES AND COMMITTEES OF PKO BANK HIPOTECZNY SA

The powers of the **General Shareholders' Meeting of the Bank** include in particular:

- appointing and dismissing members of the Supervisory Board and determining the principles for remunerating them and covering the costs related to the performance of a Supervisory Board member by the Bank;
- establishing the procedure for redemption of shares and the level of compensation for redeemed shares and granting consent to the purchase of the Bank's own shares for the purpose of redemption;
- creating and dissolving special funds created from net profit;
- adopting resolutions on issuing bonds convertible into shares or other instruments entitling the holder to purchase or take up shares in the Bank;
- adopting resolutions on the liquidation, disposal or lease of an enterprise of the Bank or a business unit of the Bank's enterprise, and establishing limited property rights over them;
- adopting resolutions on the settlement of claims for damages caused upon the establishment of the Bank, or by the exercise of management or supervision;
- granting consent to the Bank's taking up or purchasing, as permitted by the Act, as well as selling or encumbering shares in companies, redemption of the Bank's shares in the companies, and the Bank making contributions, additional contributions, acceding to and withdrawing from companies and granting consent to the purchase and sale of bonds or other securities convertible to shares;
- assessing whether the Bank's remuneration policy is conducive to its development and operating safety.
- authorizing disposal of non-current assets classified as intangible assets, property, plant & equipment or non-current investments, including their contribution to a company or a cooperative, if the market value of such assets exceeds 5% of the total assets as determined based on the most recent approved financial statements,

as well as providing such assets for use to another entity for a period exceeding 180 days in a calendar year, in a legal transaction, if the market value of such assets exceeds 5% of the total assets;

- granting consent for the purchase of non-current assets with a value exceeding PLN 100,000,000 or 5% of the total assets as determined based on the most recent approved financial statements.

The powers of the **Bank's Supervisory Board** include in particular:

- approving the Bank's annual financial plan and long-term development plans (in particular the Bank's strategy);
- approving the Bank's compliance policy;
- approving the Bank's management strategy, the risk management strategy, including the general level of risk at the Bank, the policy for estimating internal capital and capital management and reviewing the internal capital assessment strategies and procedures and capital management procedures;
- approving the assumptions underlying the introduction of a new product to the Bank's offer;
- approving the audit charter, the internal audit function's strategy, the annual and long-term internal audit plans and the principles for cooperation with the internal audit function at PKO Bank Polski SA and the statutory auditor;
- approving and periodically reviewing the general principles of the remuneration policy concerning persons whose professional activities significantly affect the Bank's risk profile;
- approving the operating principles of the internal control system, the criteria for determining the adequacy and effectiveness of the system and the principles for classifying irregularities discovered by the internal control system;
- approving the Management Board Rules;
- approving the Regulations for Setting the Mortgage Lending Value of Property, which take effect after approval by the PFSA;
- affirming the Code of Ethics and the Rules for Management of Conflicts of Interest;
- approving the framework organizational structure of the Bank, adjusted to the scale and profile of the risk taken on by the Bank;
- approving the results of reviews of exercising cooperation agreements with PKO Bank Polski SA;
- adopting the Supervisory Board Rules;
- appointing and dismissing, by secret ballot, individual members of the Management Board and determining the detailed rules and procedures for recruiting members of the Management Board;
- representing the Bank in agreements with members of the Management Board;
- approving the policy and procedure for selecting an audit firm responsible for auditing the Bank's financial statements and the policy for providing permitted non-audit services by the audit firm performing the audit, its related entities and members of its network;
- selecting an audit firm to conduct an audit or review of the Bank's financial statements;
- assessing the Directors' report on the Bank's activities and the financial statements for the previous financial year in terms of their consistence with the books of accounts and documents, and the actual state, and the proposals of the Management Board concerning the distribution of profit or the financing of losses and presenting, to the General Meeting, a written annual report on the results of these assessments;
- assessing the adequacy and effectiveness of the Bank's internal control system, including the control function, the compliance unit and the internal audit unit, as well as the adequacy and effectiveness of the risk management system;
- assessing the effectiveness of the Bank's compliance risk management;
- assessing the adequacy and effectiveness of the whistleblowing procedure and the ethical procedures and standards in force at the Bank;
- applying to the PFSA for consent to the appointment of two Management Board members, including the President of the Management Board and the Management Board member responsible for oversight over

managing material risk in the Bank's activities, and to entrusting the function of the Management Board member responsible for oversight over material risk in the Bank's activities to the appointed Board Member;

- applying to the PFSA for the appointment of the Bank's Cover Pool Monitor and his Deputy;
- granting consent to the appointment and dismissal of the compliance unit manager and the internal audit unit manager;
- granting consent to changing the Bank's registered office or location (address);
- assessing the functioning of the remuneration policy in the Bank and presenting a report on this area to the General Shareholders' Meeting;
- assessing the application by the Bank of the Principles of Corporate Governance for Supervised Institutions.

In the first half of 2020, the following **Supervisory Board committees** operated, whose powers included, in particular:

Audit and Finance Committee	• monitoring and expressing periodic opinions on the adequacy and effectiveness of the internal control system, the adequacy and effectiveness of the risk management system and internal audit, the effectiveness of the Bank's compliance risk management and the adequacy and effectiveness of the compliance unit, the application of the Corporate Governance Principles for Supervised Institutions, the adequacy and effectiveness of the whistleblowing policy and the ethical procedures and standards in force at the Bank; • developing the policy and procedures of selecting an audit firm, submitting to the Supervisory Board the recommendation of an audit firm to conduct an audit of the Bank's financial statements; • monitoring the process of financial reporting, including reviewing the Bank's periodic and annual financial statements and expressing opinions on them; • monitoring audit proceedings and the independence of the statutory auditor and the entity authorized to audit the financial statements; • giving opinions on Management Board resolutions relating to the internal control system, the approval of which is the responsibility of the Supervisory Board.
Risk Committee	• reviewing the Bank's overall current and future risk appetite, strategic risk directions and tasks in the context of the Bank's strategy and the conditions resulting from the macroeconomic situation and the regulatory environment, and, in particular, the risk management strategy developed by the Management Board and the Bank's acceptable overall risk level; • monitoring compliance of the Bank's policy in the area of taking on risk with the strategy and financial plan; • analysing periodic risk-related reports, including the utilization of strategic risk tolerance limits, and developing appropriate guidelines on the basis thereof, as well as reviewing periodically the implementation of the risk management strategy; • giving opinions on capital adequacy, creditworthiness evaluation principles, the risk measurement model, the impairment measurement model; • giving opinions on the principles of the information policy in the area of capital adequacy, managing capital adequacy, managing liquidity, operational and model risk and impairment measurement; • providing opinions on the draft Rules on setting the mortgage lending value of real estate.
Remuneration and Nomination Committee	• evaluating and conducting periodic reviews of nominations for key managerial positions in the Bank; • submitting, to the Supervisory Board, proposals relating to appropriate forms of contracts with members of the Bank's Management Board;

	• preparing opinions on the Code of Ethics and the Principles for Managing Conflicts of Interest; • preparing opinions on requests concerning the consent for a member of the Management Board to engage in competitive activities or to participate in a competing company as a shareholder of a civil law company, a sole proprietorship or as a member of a governing body of a capital company, or to participate in another competing legal person as a member of a governing body; • evaluating and performing periodic reviews, subject to the approval of the Supervisory Board, of the general principles of the policy for remunerating individuals whose actions have a material impact on the Bank's risk profile; • evaluating and monitoring the variable remuneration components of individuals whose activities have a significant impact on the Bank's risk profile, second-level risk management, the compliance unit manager and the internal audit unit manager; • reviewing detailed rules and procedures for recruiting members of the Bank's Management Board and assessing the suitability of members of the Bank's Management Board; • preparing and carrying out, with potential support from external, independent entities, the programme for raising the qualifications of members of the Supervisory Board.
COMMERCIAL COMMITTEE	• reviewing cooperation agreements concluded between PKO Bank Polski SA and the Bank; • providing opinions on material changes in the criteria for qualifying products for the Bank; • providing opinions on the premises of introducing a new product to the Bank's offer and the directions of changes in the Bank's product offer; • monitoring and supervising the outsourcing of internal processes.

The powers of the **Bank's Management Board** include, in particular:

- defining PKO Bank Hipoteczny SA's strategy, taking into account the risk of the operational risk and the strategy for managing the Bank;
- defining the risk management strategy, including defining the general level of risk at the Bank;
- setting the annual financial plan, including the conditions for its execution;
- adopting the Organizational Regulations of the Bank and the rules for segregation of duties;
- establishing and closing down standing Committees of the Bank and defining their powers;
- adopting the Management Board Rules;
- adopting the Regulations for setting the mortgage lending value of real estate;
- adopting the regulations for the use of special funds created from net profit;
- determining the operating principles of the internal control system, the criteria for determining the adequacy and effectiveness of the system and the principles for classifying irregularities discovered by the internal control system;
- approving the rules of the internal audit unit and the audit charter, defining the principles for cooperation of the internal audit function with the similar function at PKO BP SA and the statutory auditor, giving opinions on the internal audit function's strategy and the annual and long-term internal audit plans;
- approving the rules of the compliance unit, defining the principles for cooperation of the compliance function with the similar function at PKO BP and giving opinions on the annual operational plan of the compliance function;
- establishing the policy for estimating internal capital and capital management;
- establishing, restructuring and closing down branches and other organizational units of the Bank in Poland and abroad;
- making decisions on issues of covered bonds.

The Bank's Management Board established the following standing committees whose powers included in particular:

Asset and Liability Committee	• supporting the liquidity, interest rate, business – including macroeconomic, currency, capital – including leverage – risks, and the related risk of models and their measurement; • managing the Bank's capital adequacy; • examining materials on capital adequacy, equity, internal capital, stress tests, risks mentioned above, as well as tolerance limits for these risks; • making decisions regarding the Bank's operations, in particular as regards risk measures and limits as well as initiating capital and liquidity emergency actions; • issuing recommendations for the Bank's competent authorities, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of their competencies.
Credit Committee	• supporting the credit, concentration, residual and related model risk management functions; • examining materials on the risks mentioned above, the profile and quality structure of the loan portfolio, impairment losses on assets, acquisition of loan portfolios, the real estate market; • making decisions on the Bank's operations, in particular as regards risk measures and limits, risk model validation results, the methodology and models of calculating impairment losses on loan assets, cut-offs used as part of credit risk assessment, credit receivables purchased by the Bank, single loan transactions; • issuing recommendations for the Bank's competent authorities, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of their competencies.
Data Quality Committee	• determining the strategic directions of operations in the area of managing the quality of data and data architecture in the Bank, in the context of the Data Management System (DMS); • oversight over the functioning of the DMS, including evaluation of its efficiency and the operations of particular organizational units of the Head Office.
Strategy and Business Initiatives Committee	• supporting the operational, reputation, compliance and related model risk measurement functions; • examining materials on the risks mentioned above, directions of the Bank's development, the Bank's strategy and IT strategy, initiatives related to the implementation of the Bank's strategy and IT strategy together with the operational risk analysis, product offer, product profitability, lending process; • making decisions regarding the Bank's operations, in particular as regards managing the risks mentioned above, the related risk measurement models and the related risk measures and limits; • issuing recommendations for the Bank's competent authorities, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of their competencies.
Green Covered Bonds Committee	• supervising the process of issuing Green Covered Bonds, including defining the directions for changes in the principles for issuing the Green Covered Bonds and the assessment and selection of assets qualifying for financing with the Green Covered Bonds; • making decisions relating to the Bank's operations in the area of assessing and selecting qualified loans according to the methodology adopted by the Bank and adopting the principles for issuing the Green Covered Bonds in accordance with appropriate guidelines;

- issuing recommendations for the Bank's competent authorities, organizational units, members of the Bank's Management Board, project teams or task forces – within the scope of their competencies.

6.3. THE MANAGEMENT BOARD OF PKO BANK HIPOTECZNY SA

In the period from 1 January to 30 June 2020, the composition of the Management Board of PKO Bank Hipoteczny SA was as follows:

	Position	Position holding period
Paulina Strugała	President of the Management Board	16.04.2018 – to date
Agnieszka Krawczyk	Vice President of the Management Board	01.01.2018 – to date
Piotr Kochanek	Vice President of the Management Board	01.01.2019 – to date

On 28 March 2019 the Supervisory Board, after conducting qualifying procedures in respect of persons to be appointed to the Management Board appointed Ms Paulina Strugała, Ms Agnieszka Krawczyk and Mr Piotr Kochanek to a joint four-year term of office – as of the day following the date of the General Shareholders' Meeting which approved the financial statements for the year ended 31 December 2018.

On 18 March 2020, the Annual General Meeting granted a vote of approval to the President of the Management Board Ms Paulina Strugała, the Vice President of the Management Board Ms Agnieszka Krawczyk, and the Vice President of the Management Board Mr Piotr Kochanek.

The Bank's Supervisory Board has established the following internal division of key competencies within the Bank's Management Board:

PAULINA STRUGAŁA	**President of the Management Board** responsible for supervising compliance and reputation risk, the internal audit function, human resources management, communication and legal services
Other functions performed:	Chairperson of the Strategy and Business Initiatives Committee Chairperson of the Asset and Liability Committee
AGNIESZKA KRAWCZYK	**Vice President of the Management Board** responsible for supervising the development, creation and functioning of the product offer for individuals and business entities, as well as for coordinating activities in respect of sales of mortgage products in all distribution channels, supervising the acquisition of loan receivables, creating principles for and supervising the process of handling the loans granted and acquired, operation and effectiveness of IT resources, creating the principles for outsourcing and exercising the outsourcing, as well as supervising financial planning and financial control issues, accounting and financial reporting, issuing securities and obtaining the respective funds
Other functions performed:	Chairperson of the Green Covered Bonds Committee Deputy Chairperson of the Strategy and Business Initiatives Committee Member of the Credit Committee Member of the Asset and Liability Committee
PIOTR KOCHANEK	**Vice President of the Management Board** responsible for supervising the management of all risks relating to the Bank's operations except compliance risk and reputation risk, supervising restructuring and debt collection,

	supervising the lending decisions in respect of the credit risk and supervising the verification and assessment of real estate constituting collateral for loans granted or acquired
Other functions performed:	Chairperson of the Credit Committee Chairperson of the Data Quality Committee Deputy Chairperson of the Asset and Liability Committee Deputy Chairperson of the Green Covered Bonds Committee Member of the Strategy and Business Initiatives Committee

Other management functions of the Management Board members

	Position	Position holding period
Paulina Strugała	Member of the Supervisory Board of PKO BP Finat Sp. z o.o.	Throughout the reporting period
Agnieszka Krawczyk	Director of the Mortgage Banking Products Department at PKO Bank Polski SA, on a part-time (0.2 FTE) basis	Throughout the reporting period
Piotr Kochanek	Did not hold any additional Management Board or Supervisory Board member positions and did not occupy any other managerial positions	Throughout the reporting period

Recruitment policy concerning the selection of Management Board members and evaluation of Management Board members

The process of selecting and evaluating candidates for members of the Management Board in PKO Bank Hipoteczny SA is carried out by the Remuneration and Nominations Committee of the Bank's Supervisory Board. The Committee takes into consideration the guidelines of the European Banking Authority dated 21 March 2018 regarding evaluating the qualifications of members of a management body and persons performing key functions (the EBA guidelines) and the Regulation of the Minister of Development and Finance of 10 March 2017 on information and documents concerning the founders and the management board of the bank to be submitted to the PFSA. During the candidate selection process, the Committee takes into account PKO Bank Hipoteczny SA's profile, scope and scale of operations. During the evaluation of a candidate, the Committee also verifies whether the candidate's experience and knowledge will strengthen the abilities of the other members of the Bank's Management Board, and complement them, so as to ensure the coverage of all areas managed in the Bank. The examination of this criterion is to ensure diversification in the selection of members of the managing body, its purposes, tasks and area of operation.

Before their appointment, all members of the Management Board of PKO Bank Hipoteczny SA were subjected to an evaluation of their suitability, in accordance with the EBA guidelines.

The Members of the Management Board are subject to continuous evaluation by the Supervisory Board's Remuneration and Nominations Committee and the Supervisory Board, beginning from the moment of recruitment and continuing through their entire term of office. In addition, pursuant to Article 395 § 2(3) of the Commercial Companies Code, each year the Ordinary General Shareholders' Meeting grants each individual member of the Management Board a vote of approval. The granting of this vote of approval constitutes an evaluation of the Management Board members, which is independent of the approval of the Bank's Directors' Report by the General Shareholders' Meeting.

The process described above for appointments to perform functions on the Management Board and the positive evaluation of members of the Bank's Management Board confirms the proper performance of their duties, based on adequate knowledge, abilities and experience, in accordance with the requirements of art. 22aa of the Banking Law.

6.4. THE SUPERVISORY BOARD OF PKO BANK HIPOTECZNY SA

In the first half of 2020, the composition of the Supervisory Board of PKO Bank Hipoteczny SA was as follows:

	Position in the Supervisory Board	Appointment date	Dismissal/ resignation date	qualifications in finance	Independent member[19]	Audit and Finance Committee	Risk Committee	Remuneration and Nomination Committee	Commercial Committee
Jakub Papierski	Chairman	06.10.2014		✓				Ch	Ch
Justyna Borkiewicz	Member	28.10.2016		✓			M		
Piotr Kwiecień	Member	18.10.2017		✓	✓	Ch			M
Paweł Metrycki	Member Deputy Chairman	30.03.2019 07.10.2019	06.10.2019	✓		D	Ch		M
Ilona Wołyniec	Member	30.03.2019		✓			D	D	D
Lucyna Kopińska	Member	01.09.2019		✓					M
Jadwiga Lesisz	Member	01.09.2019		✓	✓	M			
Dariusz Odzioba	Member	01.09.2019		✓					

Ch – Chairman of the Committee; D – Deputy Chairman of the Committee; M – Member of the Committee

The composition of the Committees is presented as at 30 June 2020.

Pursuant to Article 395 § 2 (3) of the Commercial Companies Code each year the Annual General Shareholders' Meeting grants a vote of approval to each individual member of the Supervisory Board. Granting this vote of approval constitutes an evaluation of the Supervisory Board members, independent of the approval of the Supervisory Board's report on the Bank's operations by the General Shareholders' Meeting. On 18 March 2020, by resolution of the Annual General Shareholders' Meeting, all members of the Bank's Supervisory Board received a vote of approval for the period ended 31 December 2019.

The above confirms the proper performance of their duties by the members of the Supervisory Board, based on adequate knowledge, abilities and experience, in accordance with the requirements of art. 22aa of the Banking Law.

INFORMATION ON THE AUDIT AND FINANCE COMMITTEE

In the first half of 2020, the composition of the Audit and Finance Committee of PKO Bank Hipoteczny SA was as follows:

[19] In accordance with the Act on Registered Auditors, Registered Audit Companies and Public Oversight of 11 May 2017.

	Position in the Audit and Finance Committee	Appointment date	Dismissal / resignation date	Independent member[20]	Accounting and auditing knowledge and skills	Mortgage banking knowledge and skills
Piotr Kwiecień	Member of the Committee Committee Chairman	18.10.2017 07.10.2019		✓		
Paweł Metrycki	Committee Deputy Chairman	07.10.2019			✓	✓
Jadwiga Lesisz	Member of the Committee	07.10.2019		✓		

The Audit and Finance Committee met three times in the first half of 2020.

[20] In accordance with the Act on Registered Auditors, Registered Audit Companies and Public Oversight of 11 May 2017.

7. CORPORATE GOVERNANCE AND INFORMATION FOR INVESTORS

Representation on compliance with the rules for corporate governance
Entity authorized to audit financial statements
Other information

7.1. REPRESENTATION ON COMPLIANCE WITH THE RULES FOR CORPORATE GOVERNANCE

The Bank has adopted the Principles of Corporate Governance for Supervised Institutions, as issued by the PFSA, on the basis of the following decisions by the Bank's bodies:

- the Resolution of the Bank's Management Board of 15 December 2014 – in relation to the powers and duties of the Management Board, i.e. conducting the Bank's affairs and its representation, in accordance with the generally applicable laws and the Bank's Articles of Association;
- the Resolution of the Supervisory Board of 18 December 2014 – in relation to the powers and duties of the Supervisory Board, i.e. supervising the conduct of the Bank's affairs, in accordance with the generally applicable laws and the Bank's Articles of Association;
- the Resolution of the General Shareholders' Meeting of 22 December 2015 – in relation to the powers reserved for the General Meeting.

Pursuant to and to the extent arising from the aforementioned decisions, the Bank opted out of the following provisions of the Principles of Corporate Governance for Supervised Institutions:

- the provisions referring to the principles of cooperation and rights of multiple shareholders (§ 8(4), § 9(1) and (6), § 10(3), § 11(3) and § 31(3)), which are not applicable due to the fact that the Bank has only one shareholder;
- chapter 9, concerning the management of assets at the client's risk, because the Bank does not conduct operations in this area;
- the principle specified in § 22(1), concerning the independence of Supervisory Board members, manifesting itself primarily in the lack of direct and indirect links to the supervised institution, members of the management and supervisory bodies, significant shareholders and related parties; in addition, two members meeting the independence requirements set out in the Act of 11 May 2017 on statutory auditors, audit firms and public oversight were appointed members of the Bank's Supervisory Board. (Journal of Laws, item 1089 as amended).

In accordance with the requirement arising from § 27 of the Principles of Corporate Governance for Supervised Institutions, on 22 May 2020, the Supervisory Board evaluated the application of the said Principles in the Bank in 2019. The Supervisory Board positively evaluated the application of the Principles in the Bank confirming that the Principles adopted by the Bank and its authorities were applied adequately to the scale, nature of operations and the specific character of the Bank.

The text of the Principles is available on the website of the PFSA:

https://www.knf.gov.pl/knf/pl/komponenty/img/knf_140904_Zasady_ladu_korporacyjnego_22072014_38575.pdf

MAIN CHARACTERISTICS OF THE INTERNAL CONTROL SYSTEM IN RELATION TO THE PROCESS OF PREPARING THE FINANCIAL STATEMENTS

To ensure the reliability and accuracy of the financial reporting process, the Bank introduced a number of control mechanisms included in the reporting system and the internal regulation of this process. Such mechanisms involve, among other things, continued verification and reconciliation of reporting data with the books of account, subsidiary ledgers and other documents which provide the basis for the preparation of the financial statements.

The process of preparing the financial statements is verified regularly, in particular with regard to arithmetical correctness, technical analysis and reliability of information. In accordance with the internal regulations, the financial statements are approved by the Management Board of PKO Bank Hipoteczny SA and are subject to review by the Audit and Finance Committee appointed by the Supervisory Board of PKO Bank Hipoteczny SA and the

Supervisory Board of PKO Bank Hipoteczny SA. The annual financial statements are additionally assessed by the Supervisory Board of PKO Bank Hipoteczny SA.

The Director of the Finance and Accounting Office is responsible for ensuring compliance with controls with regard to financial reporting, while the internal audit function reviews and independently evaluates the adequacy and effectiveness of controls over the financial reporting processes and evaluates risk management in these processes, in accordance with the approved internal audit plans. No issues which would cast doubt on the reliability of the financial reporting have been observed so far as part of the internal audit operations.

LIST OF DIRECT OR INDIRECT HOLDERS OF SIGNIFICANT BLOCKS OF SHARES WITH AN INDICATION OF THE NUMBER OF SHARES HELD AND THE NUMBER OF VOTES CARRIED BY THESE SHARES

As at 30 June 2020 the share capital of PKO Bank Hipoteczny SA amounted to PLN 1,611,300,000 and comprised 1,611,300,000 shares with PLN 1 par value. The shares are paid up in full. The share capital did not change in relation to the end of 2019. The PKO Bank Hipoteczny SA shares are non-preference shares. The holders of PKO Bank Hipoteczny SA shares do not have any special control rights due to holding such shares. 100% of the shares of PKO Bank Hipoteczny SA are held by Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna.

Structure of the share capital of PKO Bank Hipoteczny SA as at 30 June 2020:

Series	Type of shares	Number of shares	Nominal value of one share	Number of votes at the GSM	Amount paid in for the shares
A	Ordinary registered shares	300,000,000	PLN 1	300,000,000	PLN 300,000,000.00
B	Ordinary registered shares	200,000,000	PLN 1	200,000,000	PLN 200,000,000.00
C	Ordinary registered shares	200,000,000	PLN 1	200,000,000	PLN 200,000,000.00
D	Ordinary registered shares	100,000,000	PLN 1	100,000,000	PLN 100,000,000.00
E	Ordinary registered shares	150,000,000	PLN 1	150,000,000	PLN 150,000,000.00
F	Ordinary registered shares	150,000,000	PLN 1	150,000,000	PLN 150,000,000.00
G	Ordinary registered shares	100,000,000	PLN 1	100,000,000	PLN 100,000,000.00
H	Ordinary registered shares	95,000,000	PLN 1	95,000,000	PLN 95,000,000.00
I	Ordinary registered shares	100,000,000	PLN 1	100,000,000	PLN 100,000,000.00
J	Ordinary registered shares	131,500 000	PLN 1	131,500 000	PLN 131,500,000.00
K	Ordinary registered shares	84,800,000	PLN 1	84,800,000	PLN 84,800,000.00
	TOTAL	1,611,300,000		1,611,300,000	PLN 1,611,300,000.00

Shareholder	30.06.2020		31.12.2019	
	Number of shares	Share in the number of votes at the GM	Number of shares	Share in the number of votes at the GM
Powszechna Kasa Oszczędności Bank Polski SA	1,611,300,000	100%	1,611,300,000	100%

DESCRIPTION OF THE RULES FOR APPOINTING AND DISMISSING MANAGERS

Members of the Management Board are appointed and dismissed by resolution of the Supervisory Board. When appointing Management Board members, the Supervisory Board determines the number of members. The appointment of two members of the Management Board, including the President and the member responsible for

risk, requires the consent of the Polish Financial Supervision Authority. The terms of office of members of the Management Board expire on the date when the General Shareholders' Meeting approves the financial statements for the last full financial year during which a member served, at the latest. Furthermore, the term of office of a Management Board member also expires as a result of his/her death, resignation or dismissal from the Management Board, as of the date of the event causing the expiration, unless the resolution on dismissal provides a different date of expiration. Management Board members may be dismissed before the end of their term of office at any time.

The Supervisory Board notifies the Polish Financial Supervision Authority of the composition of the Management Board and of any changes in the composition thereof immediately after its appointment or after any changes in the composition thereof. The Supervisory Board also notifies the Polish Financial Supervision Authority of the members of the Management Board who, as a result of the segregation of duties, shall be in charge of the risk management and the internal audit unit. The Supervisory Board notifies the PFSA of the intention to dismiss, and the reasons for dismissal of a member of the Management Board who, as a result of the segregation of duties, is in charge of risk management and the internal audit unit, immediately after the relevant item has been placed on the agenda of the Supervisory Board meeting.

Additional information on the powers of management are provided in Chapter 6, "Structure and Governing Bodies of PKO Bank Hipoteczny SA."

Description of authorizations to decide on share issues or redemptions

The powers of the General Shareholders' Meeting include adopting resolutions on establishing the share redemption method and the level of compensation for redeemed shares, approving the acquisition of the Bank's treasury shares for redemption, and approving the issue of bonds convertible into shares or other instruments giving the right to acquire or take up shares in the Bank.

Indication of any limitations on the transfer of ownership rights to the issuer's securities

There are no limitations on the transfer of ownership rights to the issuer's securities.

Principles for amending the Bank's Articles of Association

Amendments to the Bank's Articles of Association require a resolution of the General Shareholders' Meeting and must be entered in the Business Register of the National Court Register. To the extent specified in Article 34(2) of the Banking Law, an amendment to the Articles of Association requires the consent of the Polish Financial Supervision Authority.

Composition and changes during the last financial year, and a description of the operations of the management, supervisory and administrative bodies of the issuer and of their committees

Information concerning the description of the management, supervisory and administrative bodies of the issuer, their committees and their composition and changes during the last financial year is presented in Section 6, "Structure and Governing Bodies of PKO Bank Hipoteczny SA."

The General Shareholders' Meeting and relations with shareholders

The method of operation of the General Shareholders' Meeting and its key powers as well as a description of the shareholder rights and the method of their execution follow directly from the applicable laws and the Bank's Articles of Association. In consideration of the fact that all shares in the Bank's share capital are held by a single shareholder, i.e. PKO Bank Polski SA, the resolutions of the General Shareholders' Meeting are adopted without formally convening a General Shareholders' Meeting, in accordance with the principles arising from Article 405 of the Commercial Companies Code.

7.2. ENTITY AUTHORIZED TO AUDIT FINANCIAL STATEMENTS

On 27 February 2019 the Supervisory Board of PKO Bank Hipoteczny SA, based on § 18(1)(4) of the Bank's Articles of Association and the recommendation of the Audit and Finance Committee of the Supervisory Board, selected PricewaterhouseCoopers Polska spółka z ograniczoną odpowiedzialnością Audyt sp. k. as the entity authorized to audit and review the Bank's financial statements for the years 2020–2021.

PricewaterhouseCoopers Polska spółka z ograniczoną odpowiedzialnością Audyt sp. k. with its registered office in Warsaw at ul. Polna 11, is entered on the list of entities authorized to audit financial statements maintained by the Polish Chamber of Statutory Auditors, with the number 144.

On 26 April 2019, an agreement was signed by and between PKO Bank Hipoteczny SA and PricewaterhouseCoopers Polska spółka z ograniczoną odpowiedzialnością Audyt sp. k. for the performance of an audit and review of the financial statements for the years 2020–2021.

In accordance with the policy for selecting an audit firm to perform an audit of the Bank's financial statements, the Supervisory Board conducts an open tender procedure to commission an audit of the financial statements. The Audit and Finance Committee of the Bank's Supervisory Board makes a recommendation concerning the selection of the audit firm to the Supervisory Board. Unless it concerns renewing an existing audit contract, the recommendation contains at least two suggestions with justifications, and indicates the preferred firm. The Bank's Supervisory Board selects an audit firm based on the recommendation of the Audit and Finance Committee of the Bank's Supervisory Board. The offers made by audit firms are assessed based on transparent and non-discriminatory selection criteria.

In accordance with the policy for providing the Bank with permitted non-audit services by the audit firm conducting the audit, its related entities and members of its network, the provision of non-audit services by the audit firm conducting the audit, its related entities and members of its network to the Bank requires the approval of the Audit and Finance Committee of the Bank's Supervisory Board and the approval of the Audit Committee of the Supervisory Board of PKO Bank Polski SA.

7.3. OTHER INFORMATION

CHANGES IN THE HOLDING OF SHARES AND RIGHTS TO SHARES IN PKO BANK HIPOTECZNY SA BY INDIVIDUALS IN MANAGEMENT AND SUPERVISORY ROLES

In the first half of 2020 and in 2019, there were no changes in the holdings of shares and rights to shares in PKO Bank Hipoteczny SA by individuals in management and supervisory roles. 100% of the shares are held by PKO Bank Polski SA.

EVALUATION OF PKO BANK HIPOTECZNY SA'S FINANCIAL CREDIBILITY

On 27 March 2015, the Bank requested the rating agency Moody's Investors Service ("Moody's") to assign ratings to the Bank and to mortgage covered bonds issued by PKO Bank Hipoteczny SA.

On 7 September 2015, Moody's assigned Baa1/P-2 long- and short-term issuer ratings to PKO Bank Hipoteczny SA, with a stable outlook. On 19 December 2017, Moody's announced that the ratings had been maintained.

On 8 September 2015, Moody's assigned a long-term (P) rating (a provisional rating) of Aa3 to PKO Bank Hipoteczny SA's PLN-denominated mortgage covered bonds. This rating was confirmed by the agency on 11 December 2015, i.e. immediately after PKO Bank Hipoteczny SA conducted its first issue of mortgage covered bonds. The rating has been maintained for all issues of PLN-denominated covered bonds of PKO Bank Hipoteczny SA.

On 29 September 2016, Moody's assigned a long-term (P) rating (a provisional rating) of Aa3 to PKO Bank Hipoteczny SA's EUR-denominated mortgage covered bonds. This rating was confirmed by the agency on 24 October 2016, i.e. immediately after PKO Bank Hipoteczny SA conducted its first issue of EUR-denominated mortgage covered bonds. The rating has been maintained for all issues of EUR-denominated mortgage covered bonds of PKO Bank Hipoteczny SA.

The rating assigned to the mortgage covered bonds of PKO Bank Hipoteczny SA is the highest rating achievable for Polish securities. The limit for the ratings is the Polish country ceiling for debt instruments, which currently is at the level of Aa3.

On 18 June 2018, Moody's Investors Service assigned new counterparty risk ratings (CRR) to the Bank. The long-term counterparty risk rating was set at A3, and the short-term counterparty risk rating – at P-2. The new ratings were assigned in connection with the updating of the bank's rating methodology by the agency in June 2018. At the same time, new ratings were assigned to 32 other banks in Central and Eastern Europe. Counterparty risk ratings reflect an entity's ability to settle an unsecured portion of the counterparty's financial liabilities not related to a debt (CRR liabilities) and the expected financial losses in the case of failing to settle such liabilities.

Financial liabilities and guarantees granted

In the first half of 2020 PKO Bank Hipoteczny SA did not issue any guarantees.

Financial liabilities under residential mortgage loans granted and not disbursed as at 30 June 2020 stood at PLN 193.0 million, down by PLN 289.7 million compared to 31 December 2019.

Off-balance-sheet liabilities to related parties

In the first half of 2020 and in 2019, PKO Bank Hipoteczny SA did not grant any off-balance sheet liabilities to related parties.

Loans taken out and loan and guarantee agreements unrelated to the Bank's operations

In the first half of 2020 and in 2019, PKO Bank Hipoteczny SA did not take out any loans or enter into any loan or guarantee agreements unrelated to the Bank's operations.

Underwriting agreements and guarantees granted to subsidiaries

In the first half of 2020 and in 2019, PKO Bank Hipoteczny SA did not grant any guarantees to its subsidiaries.

Identification of pending proceedings before courts, arbitration bodies or public administration authorities

As at 30 June 2020, no proceedings were underway before courts, arbitration bodies or public administration bodies concerning liabilities or receivables whose value constituted at least 10% of PKO Bank Hipoteczny SA's equity.

Factors which will influence future financial performance over the horizon of at least one quarter

The ongoing COVID-19 pandemic has an adverse impact on economic activity, which translates into a deterioration in the customers' financial standing and, consequently, a decrease in their interest in residential mortgage loans and a deterioration in the repayment rate of the existing residential mortgage loans, which in turn may have an adverse impact on the quality of the loan portfolio.

The fact that the Monetary Policy Council decreased the interest rates to a historic low translated into a lower interbank WIBOR rate. For the borrowers, it means lower loan instalments, and for the banks – a negative impact on profitability and lower financial results.

However, the Bank maintains good liquidity and equity levels, above the regulatory requirements. In the Bank's opinion, the actions of the National Bank of Poland, including redemption of Treasury bonds, bill discount facility and repo operations may help the Bank to improve its liquidity.

Other significant factors and threats which may affect the Bank's results over at least the following quarter of 2020 include:

- the situation on the residential market in Poland;
- the situation on the residential mortgage loans market in Poland;

- legislative changes, including the changes to BRRD (MREL);
- the possibility and timing of further transfers to the Bank of portions of the portfolio of residential mortgage loans granted by PKO Bank Polski SA;
- the situation on the Polish and international financial market;
- investor demand for mortgage covered bonds and own bonds issued by the Bank.

INFORMATION ON LOAN GUARANTEES OR OTHER GUARANTEES ISSUED BY THE BANK OR ITS SUBSIDIARY – IN AGGREGATE TO A SINGLE ENTITY OR ITS SUBSIDIARY, IF THE TOTAL AMOUNT OF THE EXISTING GUARANTEES IS EQUIVALENT TO AT LEAST 10% OF THE ISSUER'S EQUITY

In the first half of 2020 and in 2019, PKO Bank Hipoteczny SA did not grant any loan or credit guarantees to a single entity or a subsidiary of such an entity with a total value equivalent to at least 10% of the Bank's equity.

INFORMATION ON AGREEMENTS FOR LOANS AND ADVANCES CONCLUDED AND TERMINATED DURING A FINANCIAL YEAR

On 8 May 2020, PKO Bank Hipoteczny SA concluded an annex to the medium-term agreement on the overdraft limit, extending the repayment period until 13 June 2021, with a maximum amount up to PLN 150 million.

On 18 March 2020, PKO Bank Hipoteczny SA and PKO Bank Polski SA concluded annex no 2 to the agreement on the revolving current account overdraft facility of 10 July 2019 increasing the limit from PLN 2,500 million to PLN 4,000 million. The Bank obtained this financing in order to reduce potential difficulties with refinancing of ongoing activities as a result of the COVID-19 pandemic.

Moreover, as at 30 June 2020 the Bank, had a liability in respect of purchase receivables of PLN 155.0 million resulting from purchasing, from PKO Bank Polski SA, of residential mortgage loan portfolios, as described in Note 15 to the condensed interim financial statements. The repayment date of the liability resulting from the purchase of receivables is agreed by the parties each time in the Receivables Sales Agreement. For receivables purchased in the first half of 2020, the parties agreed that payment would be due no later than 18 months from the date of transfer. If the liability is not settled within 1 month from the date of transfer, the principal amount will be increased by interest.

INFORMATION ON TRANSACTION(S) WITH RELATED PARTIES CONCLUDED BY THE ISSUER OR ITS SUBSIDIARY, IF MATERIAL AND NOT CONCLUDED ON AN ARM'S LENGTH BASIS

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

In the first half of 2020 and in 2019, PKO Bank Hipoteczny SA did not conclude any significant non-arm's length transactions with related parties.

INFORMATION ON CHANGES IN THE KEY PRINCIPLES OF MANAGING THE BANK'S ENTERPRISE

In the first half of 2020 and in 2019, there were no changes in the key principles of managing the Bank's enterprise in PKO Bank Hipoteczny SA.

FINANCIAL SUPPORT AGREEMENTS

PKO Bank Hipoteczny SA did not conclude financial support agreements with other entities subject to consolidated supervision operating within the same Group, or with closely related parties.

DEPOSITS AND GUARANTEES AND SURETIES ISSUED

PKO Bank Hipoteczny SA does not accept any deposits and does not grant any guarantees or sureties.

INFORMATION ON THE VALUE OF SECURITY ESTABLISHED ON THE ACCOUNTS OF ASSETS OF BORROWERS

In the first half of 2020 and in 2019, PKO Bank Hipoteczny SA did not set up any security on the borrower's accounts.

The value of collateral in respect of residential mortgage loans secured with real estate as at 30 June 2020 amounted to PLN 57.3 billion.

SUBSEQUENT EVENTS

On 14 July 2020, the PFSA granted its approval for amending the Articles of Association in accordance with the resolution of the Extraordinary General Shareholders' Meeting of PKO Bank Hipoteczny S.A. of 5 June 2020 in connection with changing the Bank's seat. The Bank's new seat will be Warsaw, and the address of its new registered office will be ul. Puławska15, 02-515 Warsaw. The Bank is currently preparing an application to the District Court Gdańsk-Północ in Gdańsk for registering the amendment to the Articles of Association in the Register of Businesses of the National Court Register.

8. Statement of the Management Board of PKO Bank Hipoteczny SA

The Management Board of PKO Bank Hipoteczny SA declares that, to the best of their knowledge:

- The condensed interim financial statements of PKO Bank Hipoteczny SA for the six-month period ended 30 June 2020 have been prepared in accordance with the applicable accounting policies and give a true, fair and clear view of the financial position of PKO Bank Hipoteczny SA and of the result of its operations;
- The PKO Bank Hipoteczny SA Directors' Report for the six-month period ended 30 June 2020 gives a true view of the development and achievements as well as of the position of PKO Bank Hipoteczny SA, including a description of the key risks and threats.

The Management Board of PKO Bank Hipoteczny SA declares that the entity authorized to audit the financial statements which conducted the review of the condensed interim financial statements of PKO Bank Hipoteczny SA for the six-month period ended 30 June 2020 was selected in compliance with the applicable law and that both the entity and the statutory auditor who conducted the review fulfilled the criteria for providing an unbiased and independent opinion on the condensed interim financial statements, in compliance with the applicable law and professional standards.

This PKO Bank Hipoteczny SA Directors' Report for the six-month period ended 30 June 2020 comprises 47 sequentially numbered pages.

Signatures of all Members of the Bank's Management Board

31 July 2020	Paulina Strugała	President of the Management Board	*signed with qualified electronic signature* ..... (signature)
31 July 2020	Piotr Kochanek	Vice President of the Management Board	*signed with qualified electronic signature* ..... (signature)
31 July 2020	Agnieszka Krawczyk	Vice President of the Management Board	*signed with qualified electronic signature* ..... (signature)