

SELECTED FINANCIAL DATA DERIVED FROM THE FINANCIAL STATEMENTS

SELECTED FINANCIAL DATA	PLN thousand period from 6.10.2014 to 31.12.2015	EUR thousand period from 6.10.2014 to 31.12.2015
Net interest income	7 745	1 848
Net fees and commissions	(1 569)	(374)
Operating result	(17 235)	(4 112)
Profit / (Loss) before income tax	(17 235)	(4 112)
Net profit / (loss)	(13 973)	(3 334)
Earnings per share for the period – basic (in PLN/EUR)	(0.05)	(0.01)
Earnings per share for the period – diluted (in PLN/EUR)	(0.05)	(0.01)
Total net comprehensive income	(13 971)	(3 334)
Net cash flows from operating activities	(310 194)	(74 015)
Net cash flows from investing activities	(4 990)	(1 191)
Net cash flows from financing activities	330 000	78 740
Net cash flows	14 816	3 535

SELECTED FINANCIAL DATA	PLN thousand as at 31.12.2015	EUR thousand as at 31.12.2015
Total assets	791 485	185 729
Total equity	286 029	67 119
Share capital	300 000	70 398
Number of shares (in thousand)	300 000	300 000
Net asset value per share (in PLN/EUR)	0.95	0.22
Diluted number of shares (in thousand)	300 000	300 000
Diluted net asset value per share (in PLN/EUR)	0.95	0.22
Capital adequacy ratio	47.8%	47.8%
Basic funds (Tier 1)	282 811	66 364
Total own funds	282 811	66 364

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

- income statement, statement of comprehensive income and statement of cash flows items – the rate is calculated as the average of NBP exchange rates prevailing as at the last day of each month of the reporting period, i.e. EUR 1 = PLN 4.1910,
- statement of financial position items – the average NBP exchange rate as at 31 December 2015: EUR 1 = PLN 4.2615.



Bank Hipoteczny

Financial Statements
of PKO Bank Hipoteczny S.A.
for the period from 6 October 2014
to 31 December 2015

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**FINANCIAL STATEMENTS OF PKO BANK HIPOTECZNY SA
FOR THE PERIOD FROM 6 OCTOBER 2014 TO 31 DECEMBER 2015
(IN PLN THOUSAND)**



STATEMENT OF PROFIT OR LOSS

	Note	06.10.2014 - 31.12.2015
Interest income	3	7 808
Interest expense	3	(63)
Net interest income		7 745
Fee and commission income	4	891
Fee and commission expense	4	(2 460)
Net fees and commissions		(1 569)
Income from financial instruments measured at fair value	5	(1)
Foreign exchange result	6	(3)
Other operating income	7	119
Other operating expense	7	(55)
Net other operating income and expense		64
Impairment allowance and write-downs	8	(229)
General administrative expenses	9	(23 242)
Operating result		(17 235)
Profit / (Loss) before income tax		(17 235)
Income tax expense	10	3 262
Net profit / (loss)		(13 973)
Earnings per share for the period (PLN)		(0.05)
Diluted earnings per share for the period (PLN)		(0.05)
Weighted average number of shares during the period (in thousand)		300 000
Weighted average number of diluted shares during the period (in thousand)		300 000

STATEMENT OF COMPREHENSIVE INCOME

	Note	06.10.2014 - 31.12.2015
Net profit / (loss)		(13 973)
Other comprehensive income		2
Items that may be reclassified to the statement of profit or loss		2
Revaluation of financial assets available for sale		3
Deferred tax on revaluation of financial assets available for sale		(1)
Net gains on revaluation of financial assets available for sale		2
Items that may not be reclassified to the statement of profit or loss		-
Total net comprehensive income		(13 971)

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STATEMENT OF FINANCIAL POSITION

	Note	31.12.2015
ASSETS		
Cash and balances with the central bank	12	4
Amounts due from banks	13	14 812
Financial assets designated upon initial recognition at fair value through profit or loss	14	39 988
Loans and advances to customers	15	722 655
Investment securities available for sale	16	500
Intangible assets	17	3 176
Property, plant and equipment	18	647
Deferred income tax asset	10	3 261
Other assets	19	6 442
TOTAL ASSETS		791 485
LIABILITIES AND EQUITY		
Liabilities		
Amounts due to banks	20	469 298
Amounts due to customers	21	146
Mortgage bonds	22	29 933
Other liabilities	23	6 020
Provisions	24	59
TOTAL LIABILITIES		505 456
Equity		
Share capital	25	300 000
Revaluation reserve		2
Net loss for the period		(13 973)
TOTAL EQUITY		286 029
TOTAL LIABILITIES AND EQUITY		791 485
Capital adequacy ratio	39	47.8%
Net asset value (in PLN thousand)		286 029
Number of shares (in thousand)	25	300 000
Net asset value per share (in PLN)		0.95
Diluted number of shares (in thousand)		300 000
Diluted net asset value per share (in PLN)		0.95

STATEMENT OF CHANGES IN EQUITY

period from 6 October 2014 to 31 December 2015	Note	Share capital	Revaluation reserve	Net loss for the period	Total equity
As at 6 October 2014		-	-	-	-
Issue of series A shares	25	300 000	-	-	300 000
Total comprehensive income, including:					
Net profit/(loss)		-	-	(13 973)	(13 973)
Other comprehensive income		-	2	-	2
As at 31 December 2015		300 000	2	(13 973)	286 029

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STATEMENT OF CASH FLOWS

	Note	06.10.2014 - 31.12.2015
Cash flow from operating activities		
Profit / (Loss) before income tax		(17 235)
Adjustments:		(292 960)
Depreciation and amortization		670
Change in trading assets and financial assets designated upon initial recognition at fair value through profit or loss		(39 986)
Change in loans and advances to customers		(722 853)
Change in other assets and non-current assets held for sale		(6 442)
Change in amounts due to banks		469 298
Change in amounts due to customers		146
Change in amounts due to issue of mortgage bonds		(67)
Change in provisions and impairment allowances		257
Change in other liabilities		6 020
Other adjustments		(2)
Net cash flow from operating activities		(310 194)
Cash flow from investing activities		
Acquisition of investment securities available for sale		(497)
Acquisition of intangible assets and property, plant and equipment		(4 493)
Net cash flow from investing activities		(4 990)
Cash flows from financing activities		
Proceeds from issue of own shares		300 000
Proceeds from issue of mortgage bonds		30 000
Net cash flow from financing activities		330 000
Net cash flows		14 816
including exchange differences on cash and cash equivalents		-
Cash and cash equivalents at the beginning of the period		-
Cash and cash equivalents at the end of the period	29	14 816
therein restricted cash		-

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NOTES TO THE FINANCIAL STATEMENTS

1. General information

The financial statements of PKO Bank Hipoteczny Spółka Akcyjna ('PKO Bank Hipoteczny', 'the Bank') have been prepared for the period from 6 October 2014 to 31 December 2015. Due to the fact that the Bank started its activity on 6 October 2014 and extended the first financial year, the financial statements do not include comparative information. The Financial information have been presented in Polish zloty (PLN), rounded to thousands of zloty, unless indicated otherwise.

PKO Bank Hipoteczny located in Gdynia, 17 Jerzego Waszyngtona Street, 81-342 Gdynia (to 5 October 2015 located at 17/19/21 Kaszubski Square, 81-350 Gdynia) was registered on 24 October 2014 in the Gdansk-North District Court for Gdansk, 8th Commercial Division of the National Court Register. The Bank was registered under the KRS number 0000528469 and received a statistical REGON No. 222181030. The paid up share capital amounts to PLN 300 000 000.00.

Business activities of the Bank

PKO Bank Hipoteczny is a specialized bank that operates in terms of the Mortgage bond and mortgage banks Act dated 29 August 1997, the Commercial Companies Code and other generally applicable provisions of law, the principles of good banking practice and the Bank's Statute.

PKO Bank Hipoteczny SA specializes in granting mortgage loans for individuals and acquiring such loans. Based on the strategic cooperation with PKO Bank Polski SA, these loans are offered to retail customers through Poland's largest network of branches, brokers and agents. Sale of loans and their after-sales service, excluding risk management, is performed in terms of the outsourcing agreement with PKO Bank Polski SA, described in Note 30.1.

The main task of PKO Bank Hipoteczny SA is to issue mortgage bonds, which are intended to provide the primary source of financing of the mortgage loans granted by the Bank.

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

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

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

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

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

N	First Name Last Name	Function	Appointment Date	Resignation Date
1	Rafał Kozłowski	President of the Management Board	6.10.2014	-
2	Agnieszka Domaradzka	Vice-President of the Management Board	6.10.2014	31.3.2015
3	Bartłomej Śliwa	Vice-President of the Management Board	6.10.2014	13.8.2015
4	Jakub Niesłuchowski	Vice-President of the Management Board	1.4.2015	-
5	Marek Szcześniak	Vice-President of the Management Board	1.6.2015	-

On 26 August 2014 the Polish Financial Supervision Authority approved the first Management Board. Mr. Marek Szcześniak was approved as a member of the Management Board by the Polish Financial Supervision Authority, with effect from 13 August 2015.

On 6 October 2014, the Ordinary Shareholders' Meeting appointed the following persons as members of the Supervisory Board of PKO Bank Hipoteczny SA.

No	First Name Last Name	Function	Appointment Date	Resignation Date
1	Jakub Papierski	Chairman of the Supervisory Board	6.10.2014	-
2	Jacek Obłękowski	Deputy-Chairman of the Supervisory Board	6.10.2014	-
3	Piotr Alicki	Member of the Supervisory Board	6.10.2014	-
4	Piotr Mazur	Member of the Supervisory Board	6.10.2014	-
5	Artur Osytek	Member of the Supervisory Board	6.10.2014	-
6	Barbara Soares da Silva	Member of the Supervisory Board	6.10.2014	-

Approval of the Financial Statements

These financial statements, which were subject to review and were opined upon by the Audit and Finance and Risk Committees and were subject to evaluation by the Supervisory Board of the Bank on 24 February 2016, were accepted for publication by the Management Board on 19 February 2016.

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2. Summary of significant accounting policies

2.1. Statement of Compliance

These financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU), effective as at 31 December 2015, and with respect to matters not regulated by the above standards, in accordance with the accounting principles as set out in the Accounting Act dated 29 September 1994 (Official Journal from 2013, item 330 with amendments) and the respective implementing regulations issued on the basis thereof.

2.2. Going concern

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

2.3. Basis of preparation of the financial statement

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

Non-current assets are stated at cost less accumulated depreciation or amortization and impairment allowances.

Non-current assets (or groups of the above-mentioned assets) classified as held for sale are stated at the lower of their carrying amount and fair value less costs to sell.

2.4. Foreign currencies

2.4.1. Transactions and balances denominated in foreign currencies

Foreign currency transactions are translated into the functional currency using exchange rates prevailing at the dates of the transactions. At each reporting date items are translated using the following principles:

- 1) monetary assets denominated in foreign currency, using a closing rate, i.e. the average rate announced by the National Bank of Poland prevailing as at the reporting date,
- 2) non-monetary assets measured at historical cost in foreign currency, using the exchange rate as of the date of the transaction,
- 3) non-monetary assets measured at fair value in foreign currency are translated, using exchange rates prevailing as at the date of the determination of fair value.

Gains and losses from the foreign currency transactions and the carrying amount of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of profit or loss.

The financial statements are presented in Polish zloty, which is the functional and presentation currency of the Bank.

2.5. Financial assets and liabilities

2.5.1 Classification

The Bank classifies financial assets into the following categories: financial assets measured at fair value through profit or loss, financial assets available for sale, loans, advances and other receivables, financial assets held to maturity. Financial liabilities are classified as follows: financial liabilities measured at fair value through profit or loss and other financial liabilities. The Bank decides on the classification of its financial assets and financial liabilities at initial recognition.

2.5.1.1 Financial assets and liabilities designated as at fair value through profit or loss

Financial assets and financial liabilities designated as at fair value through profit or loss are financial assets and financial liabilities that meet either of the following conditions:

- 1) they are classified as held for trading. Financial assets or financial liabilities are classified as held for trading if they are acquired or incurred principally for the purpose of sale or repurchase in the near term, are a part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-making. Derivatives are also classified as held for trading except for derivatives that are designated and effective hedging instruments.
- 2) upon initial recognition they are classified as designated at fair value through profit or loss. The Bank may use this designation only when:
 - a) the designated financial asset or liability is a hybrid instrument which includes one or more embedded derivatives qualifying for separate recognition, and the embedded derivative financial instrument cannot significantly change the cash flows resulting from the host contract or its separation from the hybrid instrument is forbidden;
 - b) it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on a different basis;
 - c) a group of financial assets, financial liabilities or both is properly managed and its performance is evaluated on a fair value basis, in accordance with the written risk management principles or investment strategy of the Bank.

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

2.5.1.2 Financial assets available for sale

Financial assets available for sale are those non-derivative financial assets that are designated as available for sale or are not classified as financial assets:

- 1) designated by the Bank upon initial recognition as at fair value through profit or loss;
- 2) held to maturity;
- 3) those that meet the definition of loans and advances.

2.5.1.3 Loans, advances and other receivables

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

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

2.5.1.4 Financial assets held to maturity

Financial assets held to maturity are financial assets with fixed or determinable payments and fixed maturity that the Bank intends and is able to hold to maturity, excluding assets that the Bank designates as at fair value through profit or loss upon initial recognition, assets classified as available for sale and loans, advances and other receivables of the Bank.

2.5.1.5 Other financial liabilities

Other financial liabilities are financial liabilities other than those designated as at fair value through profit or loss which have the nature of a deposit, a loan or an advance received.

2.5.2 Accounting for transactions

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

2.5.3 Derecognition of financial instruments from the statement of financial position

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

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

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

- 1) if all the risks and rewards of ownership of the financial asset are substantially transferred, then the Bank derecognizes the financial asset from the statement of financial position,
- 2) if all the risks and rewards of ownership of the financial asset are substantially retained, then the financial asset continues to be recognized in the statement of financial position,
- 3) if substantially all the risks and rewards of ownership of the financial asset are neither transferred nor retained, the entity determines whether control of the financial asset has been retained. If the Bank has retained control, it continues to recognize the financial asset in the statement of financial position to the extent of its continuing involvement in the financial asset, if control has not been retained, then the financial asset is derecognized from the statement of financial position.

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

2.5.4 Valuation

When a financial asset or liability is initially recognized, it is measured at its fair value increased, in case of a financial asset or liability not designated at fair value through profit or loss, by transaction costs that are directly attributable to the acquisition or the issuance of the financial asset or liability.

The fair value is the price that would be received for the sale of an asset or paid for the transfer of a liability in a transaction carried out under regular conditions on the main (or most advantageous) market at the valuation date under current market conditions (i.e. exit price), regardless of whether this price is directly observable or estimated using another valuation technique.

Subsequent to initial recognition financial instruments are valued as follows:

2.5.4.1 Assets and financial liabilities measured at fair value through profit or loss

They are measured at fair value through profit or loss, to the line item: income from financial instruments measured at fair value.

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2.5.4.2 Financial assets available for sale

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

2.5.4.3 Loans, advances and investments held to maturity

They are measured at amortized cost using the effective interest method, less impairment losses. Loans and advances for which it is not possible to determine the schedule of future cash flows and therefore the effective interest rate, are measured at the principal due.

2.5.4.4 Other financial liabilities including liabilities resulting from the issue of securities

They are measured at amortized cost. If the time schedule of cash flows from a financial liability cannot be determined, and thus the effective interest rate cannot be determined reliably, the liability is measured at the amount equal to the principal due.

Debt instruments issued by the Bank are recognized as financial liabilities and measured at amortized cost.

2.5.5 Derivative instruments

2.5.5.1 Recognition and measurement

Derivative financial instruments are recognized at fair value from the trade date. A derivative instrument becomes an asset if its fair value is positive and it becomes a liability if its fair value is negative.

The valuation of these instruments includes the counterparty's credit risk and the Bank's own credit risk.

When the estimated fair value is lower or higher than the fair value as of the preceding reporting date (for transactions concluded in the reporting period – initial fair value), the Bank presents the difference in income from financial instruments designated at fair value through profit or loss or in foreign exchange result, as appropriate, with a corresponding adjustment to 'Derivative financial instruments'.

The result of the ultimate settlement of derivative instruments transactions is recognized in income from financial instruments designated at fair value through profit or loss or in the foreign exchange result.

The notional amounts of the underlying derivative instruments are recorded and disclosed from the date of the transaction until maturity.

2.5.6 Hedge accounting

In the period from 6 October 2014 to 31 December 2015 the Bank did not apply hedge accounting.

2.6. Offsetting financial instruments

Financial assets and liabilities are offset only if the Bank has a legally enforceable right to set-off the recognized amounts and intends to settle them on a net basis or simultaneously realize the particular asset and settle the liability.

2.7. Impairment of financial assets

2.7.1. Assets measured at amortized cost

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

Objective evidence that a financial asset or a group of financial assets is impaired includes information that comes to the attention of the Bank particularly about the following events:

- 1) significant financial difficulties of the issuer or the debtor,
- 2) breach of a contract by the issuer or the debtor, such as a default or a delinquency in contracted payments of interest or principal,
- 3) granting a concession by the lender to the issuer or the borrower, for economic or legal reasons relating to the borrower's financial difficulty, that the lender would not otherwise consider
- 4) high probability of bankruptcy or reorganization of the issuer or the debtor.

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

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

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

The present value of estimated cash flows related to the financial assets for which collateral is held takes, into account cash flows arising from acquiring the collateral, less acquisition and selling costs.

The following portfolio parameters are used in estimating impairment allowances, :

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

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

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

The Bank plans that the adopted methodology used for estimating impairment allowances will be further developed with the further the development of capacity to obtain data indicating impairment from the existing applications and information systems and those under development. As a consequence, new data obtained could influence the level of impairment allowances in the future.

The methodology and assumptions used in the estimates are reviewed on a regular basis to minimize the differences between the estimated and actual incurred losses.

2.7.2. Assets available for sale

At each reporting date, the Bank makes an assessment, whether there is objective evidence that a given financial asset classified to financial assets available for sale is impaired. If such evidence exists, the Bank determines the amounts of impairment allowances.

2.8. Leasing

The Bank is a party to operating lease agreements on the basis of which it accepts fixed assets for chargeable use over a period determined in the agreement. The Bank classifies lease contracts on the basis of the risks and rewards of ownership of the leased assets attributable to the lessor and the lessee.

Lease payments made under an operating lease and subsequent instalments are recognized in the statement of profit or loss as a cost on a straight-line basis over the term of the lease.

2.9. Property, plant and equipment and intangible assets

2.9.1. Intangible assets

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

2.9.1.1. Software

Acquired computer software licenses is capitalized in the amount of costs incurred on the purchase and preparation of the software for use, less accumulated amortization and impairment losses.

Further expenditure related to the maintenance of the computer software is recognized in profit or loss when incurred.

2.9.1.2. Other intangible assets

Other intangible assets acquired by the Bank are recognized at purchase price or cost to produce, less accumulated depreciation and impairment losses.

2.9.1.3. Development Costs

Development costs are recognized as intangible assets on condition that they are anticipated to generate future economic benefits and subject to meeting specific requirements and conditions, i.e. it is a possible and it is intended to complete and use the internally generated intangible asset, there are appropriate technical and financial resources to complete the development and to use the asset and it is possible to reliably measure the expenditure attributable to the intangible asset during its development which can be directly attributed to the development of the intangible asset.

2.9.2. Property, plant and equipment

Property, plant and equipment are recognized at purchase price or cost of production less accumulated depreciation and impairment losses, at the end of the reporting period.

2.9.3. Subsequent expenses

The carrying amount of items of property, plant and equipment and intangible assets is increased by additional expenditures incurred during their useful life, when:

- 1) it is probable that the Bank will receive future economic benefits which can be assigned to the particular item of property, plant and equipment or intangible asset (higher than initially assessed, for example, measured by useful life, improvement of service quality, maintenance costs),
- 2) the purchase price or the cost to produce the item of property, plant and equipment or intangible assets can be measured reliably.

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2.9.4. Depreciation/amortization and the useful life of property, plant and equipment and intangible assets

Depreciation/amortization is charged on all non-current assets, whose value decreases due to usage or passage of time, using the straight-line basis over the estimated useful life of the given asset. The adopted depreciation/amortization method and useful life of an asset are subject to reviews at least once a year.

In estimating useful lives of particular types of property, plant and equipment and intangible assets, following factors are considered:

- 1) expected physical wear and tear, estimated based on the average period of use observed to date, reflecting physical wear and tear rate, intensity of use etc.,
- 2) loss of utility due to technical or market obsolescence,
- 3) legal and other limitations regarding the use of the asset,
- 4) expected use of the asset estimated based on the expected production capacity or volume,
- 5) other factors affecting useful lives of such assets.

When the period of use of a given asset results from a contractual term, the useful life of such an asset is equal to the period defined in the contract. If the estimated useful life is shorter than the period defined in the contract, the estimated useful life is applied.

For non-financial fixed assets it is assumed that the residual value is nil, unless there is an obligation of a third party to buy back the asset, or if there is an active market which will continue to exist at the end of the asset's period of use and when it is possible to determine the value of the asset on this market.

Depreciation/amortization periods for basic groups of property, plant and equipment, investment properties and intangible assets applied by PKO Bank Hipoteczny SA:

Property, plant and equipment	Periods
Leaseholds improvements (buildings, premises)	10 years
Machinery and equipment	from 2 to 5 years
Computer hardware	3 years
Intangible assets	Periods
Software	from 2 to 5 years

2.9.5. Impairment allowances for non-financial non-current assets

At each reporting date, the Bank makes an assessment of whether there are any indicators of impairment of any non-financial non-current assets (or cash-generating units). If any such indicators are identified and annually for intangible assets which are not amortized, the Bank estimates the recoverable amount, which is the higher of the fair value less costs to sell or the value in use of the non-current asset (or cash-generating unit). If the carrying amount of an asset exceeds its recoverable amount, the Bank recognizes an impairment loss in the statement of profit or loss. Estimating the above-mentioned values requires assumptions, about, among others, future expected cash flows that the Bank may receive from the continued use or disposal of the non-current asset (or cash-generating unit). The adoption of different assumptions with respect to the value of future cash flows could affect the carrying amount of certain non-current assets.

If there are indications for impairment for a group of assets, which do not generate cash flows irrespective of other assets or asset groups, and the recoverable amount of a single asset included in common assets cannot be determined, the Bank determines the recoverable amount at the level of the cash-generating unit to which the asset belongs.

An impairment allowance is recognized if the carrying value of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognized in the statement of profit or loss.

Impairment allowances in respect of cash-generating units first and foremost decrease the goodwill relating to those cash-generating units (groups of units), and then they proportionally decrease the carrying value of other assets in the unit (group of units).

In respect of other assets, the impairment allowance may be reversed if there was a change in the estimates used to determine the recoverable amount. An impairment allowance may be reversed only to the extent to which the carrying value of an asset does not exceed its carrying value, less depreciation/amortization, had the impairment allowances have not been recognized.

2.10. Accruals and deferred income

This item comprises mainly fees and commissions accounted for on a straight line basis and other income received in advance, which will be recognized in the statement of profit or loss in future reporting periods. Accruals and deferred income are presented in the statement of financial position under 'Other liabilities'.

Prepayments and deferred costs relate to particular types of expenses which will be gradually recognized in the statement of profit or loss in future reporting periods, over the period to which the costs relate. Prepayments and deferred costs are presented in the statement of financial position under 'Other assets'.

2.11. Provisions

Provisions are liabilities of uncertain amount or timing of settlement. They are recognized when the Bank has a present obligation (legal or constructive) as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

If the effect of the time value of money is material, the amount of the provision is determined by discounting the forecasted future cash flows to their present value, using the discount rate before tax which reflects the current market assessments of the time value of money and the potential risk related to a given liability.

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The Bank recognizes provisions for legal claims from counterparties, customers and external institutions on obtaining information from its legal advisor of a high probability of an unfavorable outcome of the legal action, provisions for retirement benefits, provisions for liabilities and guarantees and other provisions.

Provisions for commitments of a financial nature are determined based on the expected exposure which will arise from the commitment. To determine the provision, the credit conversion factor (CCF) estimated for the portfolio of exposures with similar characteristics, is used. The CCF is then the basis for determining the amount of the provision, either by comparing it to the present value of expected future cash flows from the exposure, resulting from the commitment, determined individually or using the portfolio parameters estimated by statistical methods (a portfolio and collective basis).

All provisions are charged to the statement of profit or loss.

A detailed description of the accounting principles is presented in Note 2.7.1. 'Impairment of financial assets' - 'Assets measured at amortized cost' and Note 34.4. 'Provisions for off-balance sheet credit exposures.'

2.12. Employee benefits and the determination of provisions for employee benefits

According to the Labour Code (Kodeks Pracy), employees of PKO Bank Hipoteczny SA are entitled to retirement or pension benefits upon retirement or pension. The Bank periodically performs a valuation of provisions for future liabilities to employees.

The provision for retirement and pension benefits arising from the Labour Code is recognized individually for each employee on the basis of a periodical valuation. The basis for calculating these provisions are determined by the internal regulations of the entity. The calculation takes into account all retirement and pension benefits expected to be paid in the future. The provision is recognized on the basis of a list of persons including all the necessary details of employees, in particular the length of service, age and gender. The provisions are raised at the amount of future payments, and relate to the period ending at the reporting date.

The Bank recognizes provisions for future liabilities arising from compensation and severance payments made to those employees whose employment contracts are terminated for reasons independent of the employees and periodic settlements with respect to the employee remuneration costs incurred in the current period which will be paid in future periods, including bonuses and unused annual leave, taking into account all outstanding unused holiday days.

Employee benefits also comprise variable components of remuneration of persons in managerial positions, part of which is recognized as a liability due to cash-settled share-based payments.

2.13. Cost of external financing

Costs of external financing that can be directly attributed to the acquisition, construction or production of an asset, are capitalized by the Bank as part of the cost of the asset if it is probable that future economic benefits associated with the item will flow to the Bank, and that the purchase price or cost of production of the item can be measured reliably. Other external financing costs are charged to the statement of profit or loss during the financial period in which they are incurred.

2.14. Contingent liabilities for commitments

Within its operating activities, the Bank concludes transactions, which, at their conclusion are not recognized in the statement of financial position as assets or liabilities, however which give rise to contingent liabilities. A contingent liability is:

- 1) a possible obligation that arises from past events and whose existence will be confirmed only at the time of occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Bank,
- 2) a present obligation resulting from past events, but not recognized in the statement of financial position, because it is not probable that an outflow of cash or other assets will be required to fulfil the obligation, or the amount of the obligation cannot be estimated reliably.

For off-balance sheet commitments, provisions are recognized in accordance with IAS 37 for the exposed to the risk of the counterparty default. The most significant off balance-sheet commitments are unsettled loan commitments.

2.15. Equity

Equity constitutes capital and reserves recognized in accordance with binding legal regulations and the Bank's Statute.

2.15.1 Share capital

Share capital is stated at nominal value in accordance with the Bank's Statute and the Register of Entrepreneurs in the National Court Register.

2.15.2 Supplementary capital

Supplementary capital is recognized according to the Bank's Statute, from allocations made from net profits and from share premium less issue costs and it is accumulated to cover potential losses which might arise from the Bank's activities.

2.15.3 Revaluation reserve

The effects of the revaluation of financial assets available for sale net of the related deferred tax, the effective part of cash flow hedging resulting from hedge accounting net of the related deferred tax as well as actuarial gains and losses net of the amount of the related deferred tax are recognized in the revaluation reserve.

2.15.4 General banking risk fund

The general banking risk fund is created from net profit in accordance with the Banking Law dated 29 August 1997 (Journal of Laws of 2012, item 1376 with subsequent amendments) referred to as 'the Banking Law', and serves to cover unidentified risks of the Bank's operations.

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2.15.5 Other reserves

Other reserves are created from the allocation of net profits. They serve to cover potential losses.

2.16. Determination of a financial result

The Bank recognizes all significant expenses and income in accordance with the following principles: an accrual basis, the matching principle, policies for recognition and valuation of assets and liabilities, policies for recognition of impairment losses.

2.16.1 Interest income and expense

Interest income and expense comprise interest, including premiums and discounts in respect of financial instruments measured at amortized cost and instruments valued at fair value, with the exception of derivative financial instruments. Interest income and interest expense are recognized on an accrual basis using the effective interest rate method. Interest income, with respect to financial assets or a group of similar financial assets for which an impairment allowance was recognized, is accrued based on the present values of receivables (net of impairment allowances) using the current interest rate used to discount future cash flows for the purposes of determining impairment losses.

Interest income/expense in respect of derivative financial instruments is recognized in 'Net income from financial instruments at fair value through profit or loss' or 'Foreign exchange result'. Interest income also includes deferred fees and commissions received and paid, which are recognized in the carrying value of the financial instruments.

2.16.2 Fee and commission income and expense

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

Fee and commission expense also include deferred fees and commissions recognized on a straight-line basis, with respect to external financing received with an unspecified schedule of future cash flows for which the effective interest rate cannot be determined.

The Bank does not offer insurance products with credits and loans.

2.16.3 Income from financial instruments designated as at fair value

The result on financial instruments designated as at fair value through profit or loss includes gains and losses arising from the disposal of financial instruments classified as financial assets/liabilities as at fair value through profit or loss as well as the effect of their fair value measurement.

2.16.4 Income from investment securities

Income from investment securities include gains and losses arising from disposal of financial instruments classified as available for sale and held to maturity.

2.16.5 Foreign exchange result

The foreign exchange result comprise foreign exchange gains and losses, both realized and unrealized, resulting from daily revaluation of assets and liabilities denominated in foreign currency using the National Bank of Poland average exchange rates at the reporting date, and from the revaluation of outstanding derivatives.

The Bank presented monetary assets and liabilities, representing the statement of financial position and off-balance sheet foreign currency position, translated into Polish zloty using the average National Bank of Poland exchange rates prevailing for a given currency as at the reporting date. Realized and unrealized translation differences are recognized in the statement of profit or loss.

2.16.6 Other operating income and expense

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

2.17. Income tax

Income tax expense is classified as into current and deferred income tax. Current income tax is recognized in the statement of profit or loss. Deferred income tax, depending on the source of the temporary differences, is recognized in the statement of profit or loss or in 'other comprehensive income' in the statement of comprehensive income.

2.17.1 Current income tax

Current income tax is determined on the basis of the accounting profit before tax adjusted by non-taxable income, taxable income that does not constitute accounting income, non-tax deductible expenses and tax deductible costs which are not accounting costs, in accordance with applicable tax regulations. These items mainly include income and expenses relating to accrued interest receivable and payable, impairment allowances for receivables and provisions for off-balance sheet liabilities.

2.17.2 Deferred income tax

Deferred income tax is determined as the difference between the tax base and book value of assets and liabilities for financial reporting purposes. The Bank recognizes deferred income tax assets and liabilities. Deferred tax recognized in profit or loss is determined based on the change in the difference between the carrying values and tax values of assets and liabilities, which the applicable tax rate is applied. Deferred tax assets and deferred tax liabilities of the Bank are presented in the statement of financial position as assets or liabilities respectively. The change in the balance of the deferred tax liability and deferred tax asset is included in the obligatory charges to the net result ('Income tax

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expense' in the 'Statement of profit or loss'), except for the effects of the valuation of financial assets recognized in other comprehensive income, in relation to which changes in the deferred tax liability and deferred tax asset are also recognized in other comprehensive income. Deferred income tax is determined taking into account the balance of the deferred tax asset and deferred tax liability at the beginning and at the end of the reporting period.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or a part of the deferred income tax asset to be realized.

Deferred income tax assets and liabilities are measured using tax rates that are expected to apply in the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred income tax assets are offset against deferred income tax liabilities only when the enforceable legal entitlement to offset current tax receivables with current tax liabilities exists and deferred income tax is related to the same taxpayer and the same tax authority.

2.18. Critical estimates and judgments

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

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

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

The most significant areas in which the Bank applies estimates are presented below:

2.18.1 Impairment of loans and advances

A detailed description of the adopted accounting principles is presented in Note 2.7.1. '*Impairment of financial assets*' – '*Assets measured at amortized cost*'.

2.18.2 Valuation of derivatives and unlisted debt securities available for sale

The fair value of non-option derivatives is determined using valuation models based on discounted cash flows expected to be received from the given financial instrument. Options are valued using option pricing models. The variables and assumptions used in a valuation include, where available, data derived from observable markets. The fair value of derivatives includes the Bank's own credit risk as well as counterparty credit risk. With respect to the valuation of derivative instruments, adjustment are made to reflect counterparty credit risk CVA (credit value adjustment) and adjustment the Bank's own credit risk DVA (debt value adjustment). The process of calculating CVA and DVA adjustments includes the selection of the method of determining the credit risk spread of the counterparty or Bank (for example a market price method based on price quotations of liquid debt instruments issued by the counterparty, a method of spread implied from Credit Default Swap contracts), an estimation of the probability of default of the counterparty or the Bank and the recovery rate, and calculation of the CVA and DVA adjustments (advanced method, taking into consideration collateral or a simplified method).

The valuation techniques used by the Bank for non-option derivative instruments are based on yield curves based on available market data (deposit margins on the interbank market, IRS quotations). The Bank conducted a simulation to assess the potential influence of changes of the yield curves on the transaction valuation.

The Bank did not have any of non-option derivatives instruments as at 31 December 2015.

The fair value of debt securities not quoted on an active market is determined using valuation models based on discounted cash flows anticipated from that financial instrument.

Assumptions adopted for the fair value measurement are described in Note 31, 'Fair value of financial assets and liabilities'.

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2.19. Changes in Accounting Policies

Bank prepares its financial statements in accordance with International Financial Reporting Standards, as adopted by the European Union in form of EU Commission (the “EU Commission”) regulations.

1) Standards, Interpretations and amendments to published Standards as adopted by the EU that are not yet effective and have not as yet been adopted by the Bank.

Standard/ interpretation approved by the EU	Nature of impending change in accounting policy	Possible impact on financial statements	Effective date for periods beginning on or after that date
Amendments to IAS 19 <i>Employee Benefits</i> entitled <i>Defined Benefit Plans: Employee Contributions</i>	The amendments apply to contributions from employees or third parties to defined benefit plans. The objective of the amendments is to simplify the accounting for contributions that are independent of the number of years of employee service, for example, employee contributions that are calculated according to a fixed percentage of salary.	It is expected that the Amendment, when initially applied, will not have a material impact on the Bank’s financial statements.	1 February, 2015 (the IASB effective date is 1 July 2014). *
Improvements to IFRS 2010-2012	The <i>Improvements to IFRSs (2010-2012)</i> contains 8 amendments to 7 standards, with consequential amendments to other standards and interpretations.	None of these changes are expected to have a significant impact on the financial statements of the Bank.	1 February, 2015 (the IASB effective date is 1 July 2014). *
Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11 <i>Joint Arrangements</i>)	The Amendments provide guidance on the accounting for the acquisition of an interest in a joint operation that constitutes a business.	This standard will not impact the Bank.	1 January 2016
A Clarification of the Accepted Methods of Depreciation and Amortization (Amendments to IAS 16 <i>Property, Plant and Equipment</i> and IAS 38 <i>Intangible Assets</i>)	The Amendments clarify that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset.	The Bank does not expect the Amendments to have a material impact on its financial statements. The Bank does not use revenue-based depreciation and amortization methods.	1 January 2016
Improvements to IFRS 2012-2014	The <i>Improvements to IFRSs (2012-2014)</i> contains 4 amendments to standards, with consequential amendments to other standards and interpretations.	It is not expected that the Amendments will have a significant effect on the Bank’s financial statements.	1 January 2016
Disclosure initiative (Amendments to IAS 1 <i>Presentation of Financial Statements</i>)	Key guidelines included in the Amendments: <ul style="list-style-type: none"> • Clarification of materiality. • The order of notes to the financial statements is not prescribed. • Specific criteria are provided for presenting subtotals in the statement of financial position and in the statement of profit or loss and other comprehensive income, with additional reconciliation requirements for the statement of profit or loss and other comprehensive income. • The presentation in the statement of other comprehensive income of items of comprehensive income arising from joint ventures and associates accounted for using the equity method. 	It is not expected that the Amendments will have a significant effect on the Bank’s financial statements.	1 January 2016
Equity Method in Separate Financial Statements (Amendments to IAS 27 <i>Separate Financial Statements</i>)	The Amendments introduce an option to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements, in addition to the existing cost and fair value options.	The Bank does not expect the Amendments to have an impact on its financial statements	1 January 2016

* Due to the current reporting period of PKO Bank Hipoteczny having started on 6 October 2014, the changes have not been applied by the Bank.

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2) New standards and interpretations and amendments thereto, that have not as yet been adopted by the EU,

Standard/ interpretation not yet approved by the EU	Nature of impending change in accounting policy	Possible impact on financial statements	Effective date for periods beginning on or after that date
IFRS 9 <i>Financial Instruments (2014)</i>	The new Standard replaces the guidance included in IAS 39 <i>Financial Instruments: Recognition and Measurement</i> on the classification and measurement of financial assets, including the impairment model. IFRS 9 eliminates the existing IAS 39 categories of held to maturity, available for sale and loans and receivables used to classify financial assets.	It is expected that the new Standard, when initially applied, will have a significant impact on the financial statements. However, the Bank is not able to prepare an analysis of the impact it will have on the financial statements until the date of initial application.	1 January 2018
IFRS 14 <i>Regulatory deferral accruals</i>	The Standard applies to the activities subject to regulated prices and applies only to entities that, at the effective date of this Standard, do not prepare financial statements according to IFRS.	The Standard will not have any impact on the Bank.	1 January 2016 (The EU Commission decided not to endorse this interim standard in anticipation of the final standard)
IFRS 15 <i>Revenue from Contracts with Customers</i>	The Standard provides a framework that replaces existing revenue recognition guidance in IFRS. Specifically, it replaces IAS 18 <i>Revenue</i> , IAS 11 <i>Construction Contracts</i> and related interpretations. Under the new standard, entities will apply a five-step model to determine when to recognize revenue, and at what amount. The model specifies that revenue should be recognized when (or as) an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled. Depending on whether certain criteria are met, revenue is recognized: <ul style="list-style-type: none"> • over time, in a manner that depicts the entity's performance; or • at a point in time, when control of the goods or services is transferred to the customer. 	The change may have an impact on revenue recognized by the Bank and will require additional disclosures in financial statements. However, the entity is not able to prepare an analysis of the impact this will have on the financial statements until the date of initial application.	1 January 2018
Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 <i>Consolidated Financial Statements</i> and IAS 28 <i>Investments in Associates</i>)	The Amendments address the acknowledged inconsistency between the requirements in IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is contributed to an associate or a joint venture. While IAS 28 restricts gains and losses arising from contributions of non-monetary assets to an associate or a joint venture to the extent of the interest attributable to the other equity holders in the associate or joint venture, IFRS 10 requires full profit or loss recognition on the loss of control of the subsidiary.	The new Standard will not have any impact on the Bank.	1 January 2016
Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10 <i>Consolidated Financial Statements</i> , IFRS 12 <i>Disclosure of Interests in Other Entities</i> and IAS 28 <i>Investments in Associates and Joint Ventures</i>)	The amendments relate to financial reporting of investment entities.	The new Standard will not have any impact on the Bank.	1 January 2016

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IFRS 16 <i>Leases</i>	IFRS 16 supersedes IAS 17 <i>Leases</i> and related interpretations. The Standard eliminates the current dual accounting model for finance and operating lessees. The recognition of operating leases in the statement of financial position will result in the recognition of a new asset, the right to use the underlying asset, and a new liability, the obligation to make lease payments. The right-of-use asset will be depreciated and the liability will accrue interest. This will result in a front-loaded pattern of expense for most leases, even with constant annual rentals.	The Bank does not expect the Standard to have a significant impact on the financial statements of the Bank.	1 January 2019
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In conclusion, the Management Board does not expect that the adoption of the above-mentioned standards and interpretations will have a significant influence on the accounting policies applied by the Bank, with the exception of IFRS 9 and IFRS 15, the impact of which has not as yet been determined. The Bank intends to apply these changes in accordance with the periods indicated in the relevant standards and interpretations (without early adoption), subject to adoption by the EU.

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NOTES TO THE STATEMENT OF PROFIT OR LOSS

3. Interest income and expense

Interest income

	6.10.2014 - 31.12.2015
Interest income calculated using the effective interest rate method, with respect to financial assets, which are not valued at fair value through profit or loss, including:	5 671
Income from loans and advances to customers, of which:	2 602
from impaired loans	-
Income from deposits at banks	3 069
Other income, of which:	2 137
Income from financial assets designated upon initial recognition as at fair value through profit or loss	2 072
Income from financial assets held to maturity	65
Total	7 808

Interest expense

	6.10.2014 - 31.12.2015
Interest expense calculated using the effective interest rate method, with respect to financial assets, which are not valued at fair value through profit or loss, including:	(63)
Interest expense on loans	(20)
Expense on mortgage bonds	(43)
Total	(63)

4. Fee and commission income and expense

Fee and commission income

	6.10.2014 - 31.12.2015
Income from financial assets, which are not designated as at fair value through profit or loss, including:	891
Income from loans and advances to customers	891
Total	891

Fees for the valuation of real estate i.e. preparation of expert mortgage lending real estate valuation, are presented in the fee and commission income.

Fee and commission expense

	6.10.2014 - 31.12.2015
Fees and commissions for operating services provided by banks	(109)
Costs associated with mortgage bond issuance programs	(98)
Costs associated with own bond issuance program	(28)
Costs associated with received credit facilities	(123)
Preparation of expert mortgage lending real estate valuations by real estate appraisers	(1 964)
Administrative servicing of loans	(88)
Credit insurance costs	(50)
Total	(2 460)

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5. Income from financial instruments measured at fair value

	6.10.2014 - 31.12.2015
Derivative instruments:	-
including SWAP points	-
Debt securities	(1)
Total	(1)

6. Foreign exchange result

	6.10.2014 - 31.12.2015
Foreign exchange result:	(3)
including SWAP points	-
Total	(3)

7. Other operating income and expense

	6.10.2014 - 31.12.2015
Other operating income	
Sundry income	114
Other	5
Total	119

	6.10.2014 - 31.12.2015
Other operating expense	
Sundry expense	(55)
Other	(0)
Total	(55)

8. Impairment allowance and write-downs

	For the period from 6 October 2014 to 31 December 2015	Balance at the beginning of the period	Increases		Decreases		Balance at the end of the period	Net- impact on the statement of profit or loss
			Recognized during the period	Derecognition of assets and settlement	Reversed during the period			
Amounts due from banks		-	-	-	-	-	-	-
Loans and advances to customers measured at amortized cost		-	198	-	-	198	(198)	(198)
Non-financial sector		-	198	-	-	198	(198)	(198)
housing loans		-	198	-	-	198	(198)	(198)
Provision for loans commitments		-	31	-	-	31	(31)	(31)
Total		-	229	-	-	229	(229)	(229)

9. General administrative expenses

	6.10.2014 - 31.12.2015
Employee benefits	(15 374)
Overheads	(7 098)
Amortization and depreciation, including:	(670)
property, plant and equipment	(157)
intangible assets	(513)
Taxes and fees	(100)
Total	(23 242)

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Overheads

	6.10.2014 - 31.12.2015
Services in terms of contracts to perform activities specified in the banking law	(3 203)
Services performed in terms of other contracts	(516)
IT costs	(874)
Rental expense	(1 559)
Operating lease	(239)
Other	(707)
Total	(7 098)

Employee benefits

	6.10.2014 - 31.12.2015
Wages and salaries, including:	(13 355)
provision for variable remuneration components (Note 30.4)	(1 871)
provision for retirement and pensions benefits	(28)
Salary surcharges, including:	(1 658)
provision for surcharges for variable remuneration components (Note 30.4)	(375)
Other employee benefits	(361)
Total	(15 374)

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

10. Income tax expense

	6.10.2014 - 31.12.2015
Statement of profit or loss	
Current income tax expense	-
Deferred income tax related to origination and reversal of temporary differences	3 262
Tax expense in the income statement	3 262
Tax expense in other comprehensive income related to origination and reversal of temporary differences	(1)
Total	3 261

	6.10.2014 - 31.12.2015
Loss before income tax	(17 235)
Corporate income tax calculated using the enacted tax rate (19%) in force in Poland	3 275
Permanent differences between profit before income tax and taxable income, of which:	(13)
PFRON costs	(11)
other permanent differences	(2)
Income tax in the income statement	3 262
Effective tax rate	18.93%
Temporary difference related to deferred tax presented in the statement of profit or loss	3 262
Total current income tax expense in the statement of profit or loss	0

Accounts payable/receivable from current income tax

As at 31 December 2015, the Bank did not have either liabilities or receivables from in relation to current income tax.

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Deferred tax asset/liability

	Statement of financial position	Statement of profit or loss
	31.12.2015	6.10.2014 - 31.12.2015
Deferred tax liability		
Interest accrued on receivables from banks	0	0
Interest accrued on receivables from customers	191	191
Adjustments for straight-line and effective interest rate valuation	772	772
Deferred expenses	547	547
Difference between carrying amount and tax value of property, plant and equipment assets and intangible fixed assets	4	4
Valuation of securities:	1	0
recognized in statement of profit or loss	0	0
recognized in other comprehensive income	1	-
Gross deferred tax liability	1 515	1 514
Deferred income tax asset		
Interest accrued on receivables with respect to mortgage bonds	8	8
Impairment allowance on credit exposures	43	43
Other deductible temporary differences	699	699
Tax loss	4 026	4 026
Gross deferred income tax asset	4 776	4 776
Combined effect of temporary differences	3 261	3 262
Deferred income tax asset (presented in the statement of financial position)	3 261	
Net deferred tax impact on the statement of profit or loss		3 262

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

The Bank has presented the deferred tax assets arising from the recognition of provisions for operating costs in *Other deductible temporary differences*.

11. Profit/loss per share

Profit/loss per share

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

Profit/loss per share

	6.10.2014 - 31.12.2015
Profit / (loss) attributable to ordinary shareholders (in PLN thousand)	(13 973)
Weighted average number of ordinary shares during the period (in thousand)	300 000
Profit / (loss) per share (in PLN per share)	(0.05)

Diluted profit / loss per share

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

During the period ended on 31 December 2015, the Bank did not have instruments that could be dilutive in relation to the profit/loss per share.

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NOTES TO THE STATEMENT OF FINANCIAL POSITION

12. Cash and balances with the central bank

	31.12.2015
Current account in the central bank	4
Cash	-
Total	4

Obligatory reserve

As at 31 December 2015, the Bank maintained an obligatory reserve in the amount of PLN 0.

13. Amounts due from banks

	31.12.2015
Deposits with banks	9 000
Current accounts	5 812
Total	14 812
Impairment allowances on receivables	-
Net total	14 812

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

Cash and cash equivalents

Current amounts due from banks as well as other cash equivalents with maturities up to 3 months from the date of acquisition, amounting to PLN 14.812 thousand are treated as cash and cash equivalents in their entirety for the purposes of the statement of cash flows.

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

By carrying amount	31.12.2015
Debt securities	39 988
issued by central banks, NBP money market bills	39 988
Total	39 988

Debt securities by nominal value	31.12.2015
issued by central banks, NBP money market bills	40 000
The average yield on debt securities issued by central banks	1.523%

Change in financial instruments designated upon initial recognition as at fair value through profit or loss	31.12.2015
Balance at the beginning of the period	-
Translation differences	-
Increases	7 356 292
Decreases	(7 316 305)
Changes in fair value	1
Balance at the end of the period	39 988

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

As at 31 December 2015, the Bank did not have continuing involvement in any transferred financial assets that were derecognized from the financial statements as a whole. The Bank did not have any transferred financial instruments designated upon initial recognition as at fair value through profit or loss, that were not derecognized from the statement of financial position.

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

At 31 December 2015	up to 1 month	from 1 month to 3 months	from 3 months to 1 year	from 1 year to 5 years	over 5 years	Total
Debt securities issued by central banks, NBP money market bills	39 988	-	-	-	-	39 988
Total	39 988	-	-	-	-	39 988

15. Loans and advances to customers

	31.12.2015
Loans and advances to customers, gross, of which:	722 853
non-financial sector	722 853
housing	722 853
loans granted	294 663
purchased receivables	428 190
Impairment allowances on loans and advances	(198)
Loans and advances to customers, net	722 655

In December 2015 the Bank purchased a portfolio of mortgage housing loans in the amount of PLN 429 516 thousand based on the Framework Agreement Concerning the Sale of Debts with PKO Bank Polski SA signed with on 17 November 2015. The purchase price was based on market value estimated by an independent appraiser. The purchased debts were recognized on the dates of transfer to the Bank of the rights to the cash flows from individual portfolios, and all related liability for costs and economic risks, in terms of the respective agreements for the sale of debts. The purchase of debt portfolios has been financed by the liability described in Note 20. The Bank plans to refinance debt purchased portfolios primarily through the issuance of mortgage bonds.

Loans and advances to customers by method of determination of impairment allowances	31.12.2015
Assessed on an individual basis	-
Assessed on a portfolio basis, impaired	-
Assessed on a collective basis (IBNR)	722 853
Loans and advances to customers, gross	722 853
Impairment allowances on exposures assessed on an individual basis	-
Impairment allowances on exposures assessed on a portfolio basis	-
Impairment allowances on exposures assessed on a collective basis (IBNR)	(198)
Impairment allowances - total	(198)
Loans and advances to customers, net	722 655

A detailed description of changes in impairment losses are presented in note 8 'Net impairment allowance and write-downs'.

As at 31 December 2015 there were no impaired loans as well as the past due loans over 90 days.

As at 31 December 2015 the Bank did not have transferred financial assets that are excluded from the financial statements as a whole for which the Bank would maintain an exposure.

16. Investment securities available for sale

	31.12.2015
Debt securities available for sale, gross	500
issued by the State Treasury, treasury bonds	500
Impairment allowances on debt securities available for sale	-
Total net debt securities available for sale	500
Total net equity securities available for sale	-
Total net investment securities available for sale	500

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Debt securities by nominal value	31.12.2015
issued by the State Treasury, treasury bonds PLN	500
The average yield on debt securities issued by the State Treasury	1.964%

Change in investment securities available for sale	31.12.2015
Balance at the beginning of the period	-
Translation differences	-
Increases	497
Decreases	-
Change in fair value recognized in other comprehensive income	3
Balance at the end of the period	500

Bank Guarantee Fund

The Bank determined the Bank Guarantee Fund in accordance with Article 25 of the Act on the Bank Guarantee Fund dated 14 December 1994 (*Journal of Laws of 2009 No 84, item 711* with subsequent amendments). Due to the lack of guaranteed funds at the date of determination, the Fund as at 31 December 2015 amounted to PLN 0.

17. Intangible assets

Period from 6 October 2014 to 31 December 2015	Assets under construction	Software	Total
Cost at the beginning of the period	-	-	-
Purchases	3 039	650	3 689
Transfers	(3 039)	3 039	-
Cost at the end of the period	-	3 689	3 689
Accumulated amortization and impairment allowances for impairment losses at the beginning of the period	-	-	-
Amortization	-	(513)	(513)
Impairment allowances	-	-	-
Accumulated amortization and impairment allowances at the end of the period	-	(513)	(513)
Net carrying amount at the beginning of the period	-	-	-
Net carrying amount at the end of the period	-	3 176	3 176

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

A significant intangible asset from the Bank's point of view is the purchase of the Alnova license (central system) in of the amount of PLN 2 724 thousand.

As at 31 December 2015, there were no intangible assets to which the Bank's ownership were subject to restrictions and or that were pledged as collateral for liabilities.

18. Property, plant and equipment

Period from 6 October 2014 to 31 December 2015	Assets under construction	Leasehold improvements	Machinery and equipment	Other	Total
Cost of property, plant and equipment at the beginning of the period	-	-	-	-	-
Purchase	89	-	399	316	804
Transfers	(89)	28	1	60	-
Cost of property, plant and equipment at the end of the period	-	28	400	376	804
Accumulated depreciation and impairment allowances at the beginning of the period	-	-	-	-	-
Depreciation	-	-	(106)	(51)	(157)
Accumulated depreciation and impairment allowances at the end of the period	-	-	(106)	(51)	(157)
Net carrying amount at the beginning of the period	-	-	-	-	-
Net carrying amount at the end of the period	-	28	294	325	647

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

As at 31 December 2015, there were no items of property, plant and equipment to which the Bank ownership was subject to restriction or that were pledged as collateral for liabilities.

During the reporting period, in connection with the commencement of operations, the Bank acquired property, plant and equipment items required for conducting its business.

19. Other assets

	31.12.2015
Deferred expenses and prepayments, including:	3 241
deferred expenses associated with the current account revolving credit facility	1 700
deferred expenses associated with the bond issuance program	382
deferred expenses associated with the mortgage bonds issuance program	794
Other	365
Deferred commissions from loans granted, proportionally to undrawn principle	1 417
Settlements with respect to expert valuations	1 759
Social and legal settlements	13
Other	12
Total	6 442
of which financial assets	-

20. Amounts due to banks

	31.12.2015
Liabilities resulting from current account facility	39 782
Liabilities for the purchase of mortgage loans	429 516
Total	469 298

The Bank has presented the utilized part of the current account revolving credit facility in liability resulting from current account facility. On 29 October 2015, PKO Bank Hipoteczny SA and PKO Bank Polski SA, signed a Current Account Revolving Credit Agreement with a limit of PLN 900 million for the period of 3 years, which is being drawn in tranches. The interest rate was set at WIBOR3M + 70 bps per annum while the unused amount of a tranche is subject to a fee of 0.1% per annum.

Liabilities from the purchase of mortgage loans arose from the transaction concluded between PKO Bank Hipoteczny SA and PKO Bank Polski SA regarding the sale of mortgage loans secured in December 2015 in the amount of PLN 429 516 thousand, further described in Note 15. The maturity date of the liability resulting from these transactions is agreed upon by the parties in Debt Purchase Agreement for each transaction. For loans acquired in December 2015, the parties agreed that the payment is due no later than 8 months from the date of transfer. If the liability is not settled within 1 month from the date of transfer, the principle amount is subject to interest. The Bank plans to refinance the purchase of loan portfolios primarily through the issuance of mortgage bonds.

21. Amounts due to customers

	31.12.2015
Amounts due to customers	146
Loan overpayments	146
Total	146

22. Mortgage bonds

	31.12.2015
Mortgage bonds	
Financial instruments measured at amortized cost - mortgage bonds	29 933
Total	29 933

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31.12.2015

Mortgage bonds with maturity	
from 1 month to 3 months	-
from 3 months to 1 year	-
from 1 year to 5 years	29 933
Total	29 933

In 2015, the Bank issued mortgage bonds with a nominal value of PLN 30 000 thousand classified as liabilities measured at amortized cost. As at 31 December 2015 the issued mortgage bonds were assigned a rating granted by Moody's Investors Service of Aa3.

On 29 December 2015 bonds with a nominal value of PLN 30 000 thousand were admitted to trading on the regulated OTC (over the counter) market on Catalyst operated by BondSpot SA.

The total nominal value of issued mortgage bonds as at 31 December 2015 amounted to PLN 30 000 thousand.

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

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

The nominal value of loans entered in the register of security for mortgage bonds representing collateral for mortgage bond issues amounted to PLN 82 071 thousand as at 31 December 2015. No additional security has been used.

Mortgage bonds issued as at 31 December 2015

Mortgage bonds	Nominal value	Interest rates at 31.12.2015	Guarantee / security	Date of issue	Maturity
Mortgage bonds (PLN) Series 1	30 000	2.47%	The Register of security for mortgage bonds	11.12.2015	11.12.2020
Total	30 000				

Change in liabilities for mortgage bonds issued 31.12.2015

Balance at the beginning of the period	-
Increases, on account of:	29 933
issuance	30 000
accrued interest	43
valuation at amortized cost	(110)
translation differences	-
Decreases, on account of:	-
buybacks	-
settlement of interest	-
valuation at amortized cost	-
translation differences	-
Balance at the end of the period	29 933

23. Other liabilities

31.12.2015

Accounts payable	3 758
Other liabilities, including:	2 262
various creditors	1 954
social and legal settlements	308
Total	6 020
including financial liabilities	-

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24. Provisions

Period from 6 October 2014 to 31 December 2015	Provisions for retirement benefits	Provisions for loan commitments and guarantees granted	Total
As at 6 October 2015, including:	-	-	-
Short term provision	-	-	-
Long term provision	-	-	-
Increase/reassessment of provision	28	31	59
As at 31 December 2015, including:	28	31	59
Short term provision	-	-	-
Long term provision	28	31	59

25. Equity and shareholders of the Bank

	31.12.2015
Share capital	300 000
Revaluation reserve	2
Net loss for the period	(13 973)
Total equity	286 029

The only shareholder of the Bank as at 31 December 2015 is PKO Bank Polski SA.

The share capital of the Bank amounts to PLN 300 000 000 (three hundred million) and is divided into 300 000 000 (three hundred million) ordinary series A registered shares with a nominal value of PLN 1 (one) each.

The issued shares of PKO Bank Hipoteczny do not have preferential rights and have been fully paid-up.

The Bank is not listed on the Stock Exchange in Warsaw.

OTHER NOTES

26. Contingent liabilities and off-balance sheet liabilities received

26.1. Contractual commitments

As at 31 December 2015 the value of contractual commitments concerning intangible assets and property, plant and equipment amounted to PLN 0.

26.2. Loan commitments granted

by nominal value	31.12.2015
Credit lines and limits	
Mortgage loans to customers	173 479
Total	173 479
including: irrevocable loan commitments	-

Loan commitments granted by maturity as at 31 December 2015

	up to 1 month	from 1 month to 3 months	from 3 months to 1 year	from 1 year to 5 years	over 5 years	Total
Loan commitments granted	86 740	15 771	70 968	-	-	173 479
Total	86 740	15 771	70 968	-	-	173 479

Information on provisions for contingent financial liabilities is included in Note 24 'Provision'.

26.3. Guarantee liabilities granted

As at 31 December 2015, the Bank did not grant any guarantee liabilities.

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26.4. Off-balance sheet liabilities received

by nominal value	31.12.2015
Financial	160 218
Guarantees	-
Total liabilities received	160 218

Right to sell or pledge collateral established for the Bank

As at 31 December 2015 there was no collateral established for the Bank which the Bank was entitled to sell or encumber with another pledge in the event of fulfilment of all obligations by the owner of the collateral.

27. Litigation and claims

As at 31 December 2015 there were no litigations and claims.

28. Financial and operating lease contracts

Financial lease

The Bank has no liabilities and receivables with respect to financial leases.

Operating lease - lessee

Leasing contracts under which the lessor generally retains all the risks and rewards of ownership of the leased asset are classified as operating leases. Lease payments under operating leases are recognized as an expense in the statement of profit or loss on a straight-line basis over the useful life of the leased asset.

The definition of operating leases also are met by rental and lease agreements concluded by the Bank in the normal course of operations.

The Bank is a party to an operating lease agreement for a car fleet which have been transferred for use for a period of 44 months in exchange for lease payment. The agreement may not be terminated by the lessee.

The Bank is also a party to property rental agreements for the Bank's head office, office in Warsaw and backup center. The rental agreement for the head office was concluded for a period of 10 years, and other contracts for an indefinite period. The notice period for termination of these agreements is from 6 to 12 months.

The following table presents the irrevocable costs resulting from the operating lease of cars and property rental (including notice period).

Total amount of future lease payments under irrevocable operating lease for the period:	31.12.2015
For period:	
up to 1 year	1 551
from 1 year to 5 years	434
over 5 years	-
Total	1 985

Lease payments (including property rental agreements) recognized as an expense in the period from 6 October 2014 to 31 December 2015 amounted to 1.798 thousand PLN.

29. Supplementary information to the statement of cash flows

Cash and cash equivalents

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

	31.12.2015
Cash and balances with the Central Bank	4
Current receivables due from banks	5 812
Receivables from banks with original maturities up to 3 months	9 000
Total	14 816

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Cash flows from received interests

	31.12.2015
Interest income – received	
Interest income received from loans and advances granted	1 631
Interest income received from securities designated upon initial recognition as at fair value through profit or loss	2 070
Interest income received from securities designated as held-to-maturity	65
Interest income received from deposits	3 068
Other interest received (mainly interest income on current accounts, purchased debt, realized guarantees)	0
Total	6 834

30. Related party transactions

30.1. Equity related party transactions

31 December 2015

Entity	Purchase of property, plant and equipment	Unsettled fees for the sale of loans	Receivables	Liabilities
PKO Bank Polski S.A.	520	3 900	18 722	479 952
PKO BP Finat Sp. Z o.o.	-	-	-	14
Total		3 900	18 722	479 966

31 December 2015

Entity	Off-balance sheet liabilities granted	Off-balance sheet liabilities received
PKO Bank Polski S.A.	-	160 218
Total	-	160 218

For the period from 6 October 2014 to 31 December 2015

Entity	Total income	of which interest and fees	Total expenses	of which interest and fees
PKO Bank Polski S.A.	3 045	3 035	7 120	2 257
PKO BP Finat Sp. Z o.o.	-	-	147	-
PKO Bankowy Leasing Sp. Z o. o.	-	-	334	-
Qualia Residence sp. Z o. o.	-	-	2	-
Total	3 045	3 035	7 603	2 257

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

The Bank obtains funding from PKO Bank Polski SA in the form of current account revolving credit facility. Additionally, regarding the planned bond issue of the Bank, a *Bond Issue Program Agreement* in the amount of PLN 2 billion for a period of 4 years, as well as a *Guarantee agreement*, whereby the guarantor accepted the obligation to purchase the issuer's bonds on its own account, to the amount of PLN 500 million, were concluded with PKO Bank Polski SA on 30 September 2015.

On 17 November 2015 a *Framework Agreement* concerning the sale of debts was concluded with PKO Bank Polski SA. The acquisition of debt portfolio of secured mortgage loans was concluded in December 2015, on these terms. The transaction was financed by deferred payment. A detailed description is presented in Notes 15 and 20.

On 9 November 2015 the Bank concluded the *Program Agreement* for the establishment of the Bank's mortgage bonds issue program with PKO Bank Polski SA and Powszechna Kasa Oszczednosci Bank Polski SA, the Brokerage House Branch of PKO Bank Polski SA.

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

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

30.2. Personally related party transactions

As at 31 December 2015, three entities were related to the Bank through key management personnel of PKO Bank Hipoteczny or close family members of key management personnel.

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Between 6 October 2014 and 31 December 2015, no transactions were concluded with the abovementioned entities by the Bank.

30.3. Remuneration of PKO Bank Hipoteczny key management personnel

Short-term employee benefits

During the period from 6 October 2014 to 31 December 2015 the Management Board received the following remuneration:

First Name Last Name	Function	6.10.2014 – 31.12.2015
Management Board		
Rafał Kozłowski	President of the Management Board	938
Agnieszka Domaradzka	Vice-President of the Management Board	392
Bartłomiej Śliwa	Vice-President of the Management Board	568
Jakub Niesłuchowski	Vice-President of the Management Board	487
Marek Szcześniak	Vice-President of the Management Board	245
Total short-term employee benefits for the Management Board		2 630

Salary surcharges on the above mentioned remuneration for the period from 6 October 2014 to 31 December 2015 amounted to PLN 188 thousand.

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

Long-term employee benefits

During the period between 6 October 2014 and 31 December 2015 the Bank's Management Board was neither paid nor granted any long-term employee benefits in cash, or financial instrument i.e. phantom shares. The recognition of first variable salary components will take place in the first year after the assessment year i.e. in 2016.

Post-employment benefits

During the period from 6 October 2014 to 31 December 2015 the following post-employment benefits were paid on behalf of the Bank's Management Board:

First Name Last Name	Function	06.10.2014 – 31.12.2015
Management Board		
Agnieszka Domaradzka	Vice-President of the Management Board	460
Bartłomiej Śliwa	Vice-President of the Management Board	120
Total post-employment benefits for the Management Board		580

Termination Benefits

Benefits due to termination of employment were not paid during the period from 6 October 2014 to 31 December 2015.

Loans, advances, guarantees and other benefits provided by the Bank to management

During the period from 6 October 2014 to 31 December 2015 the Bank did not grant any loans, advances, guarantees or other benefits to management.

As at 4 December 2015, the Bank acquired a mortgage loan portfolio, which included a loan granted to one of the member of the Supervisory Board. On 31 December 2015 the carrying value of this loan amounted to PLN 283 thousand.

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

In order to fulfil the requirements of Resolution No 258/2011 of the Polish Financial Supervision Authority ("PFSA") dated 4 October 2011 on detailed principles for the functioning of the risk management systems and internal control systems and detailed terms of estimating internal capital by banks and reviewing the process of estimating and maintaining internal capital, and the principles for determining the variable salary components policy for key management personnel of the Bank, the Bank implemented:

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

The cited Policy, and Regulation issued on the basis thereof, describe the procedure for granting variable salary components, associated with the results and effects of work, to the above-mentioned persons. In accordance with the requirements of the cited resolution of the PFSA and in proportion as specified therein, the variable salary components are granted in the form of:

- non-deferred (in the first year after the calendar year subject to assessment),
- deferred (for the three years after the first year succeeding the calendar year subject to assessment),

However, both the non-deferred and deferred salary, is awarded in equal parts in cash and in the form of financial instrument, i.e. phantom shares (for which conversion into cash is carried out after an additional period of retention).

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As at 31 December 2015 the provision for variable salary components amounted to PLN 1 871 thousand, including PLN 989 thousand for the Bank's Management Board. The provision for surcharges related to variable salary components amounted to PLN 375 thousand as at 31 December 2015.

As at 31 December 2015 no variable salary components in terms of the above cited Policy and Regulations had been paid.

31. Fair value of financial assets and liabilities

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

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

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

The table below presents the classification of financial assets and liabilities presented in the financial statements at fair value classified into the 3 levels as at 31 December 2015:

Assets and liabilities measured at fair value as at 31.12.2015	Note	Carrying value	Level 1	Level 2	Level 3
			Prices quoted on active markets	Valuation techniques based on observable market data	Other valuation techniques
Financial instruments measured upon initial recognition at fair value through profit or loss	14	39 988	-	39 988	-
NBP money market bills		39 888	-	39 988	-
Investment securities available for sale	16	500	500	-	-
Treasury bonds		500	500	-	-
Financial assets measured at fair value – total:		40 488	500	39 888	-
Financial liabilities measured at fair value - total		-	-	-	-

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

Level 1: Prices quoted on the active markets:

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

Level 2: Valuation techniques based on observable market data

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

Assets and liabilities measured at fair value	Valuation method (technique)	Observable inputs
Financial instruments measured upon initial recognition at fair value through profit or loss		
NBP money market bills	Yield curve valuation method	Yield curves for money market bills are built based on market prices, money market data and the OIS (overnight index swap) transactions market.

Level 3: Other valuation techniques

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

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

During the period from 6 October 2014 to 31 December 2015, the Bank did not make any transfers between levels of fair value hierarchy for financial instruments measured at fair value.

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

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

Where there is no market value of financial instruments available, their fair values have been estimated with the use of various valuation techniques. The fair value of financial instruments was measured using a model based on estimates of the present value of future cash flows discounted using appropriate interest rates.

All model calculations include certain simplifying assumptions and are sensitive to those assumptions. Set out below is a summary of the main methods and assumptions used for estimating the fair values of financial instruments which are not carried at fair value.

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

- cash and balances with the Central Bank,
- amounts due from banks,
- loans and advances granted by the Bank to its customers (the entire portfolio was originated in 2015 or acquired in December 2015 at fair value),
- liabilities to banks,
- liabilities to customers,
- issued mortgage bonds.

	level of fair value hierarchy	valuation method	31.12.2015	
			carrying amount	fair value
Cash and balances with the central bank	n/a	value at cost to pay incl. impairment allowance	4	4
Amounts due from banks	3	discounted cash flows	14 812	14 812
Loans and advances to customers, incl. housing loans	3	discounted cash flows	722 655	722 655
Amounts due to banks	3	discounted cash flows	469 298	469 298
Amounts due to customers	3	discounted cash flows	146	146
Mortgage bonds	3	discounted cash flows	29 933	29 933

32. Business segments

During the reporting period, the Bank did not conduct segmented business activities.

OBJECTIVES AND PRINCIPLES OF RISK MANAGEMENT RELATED TO FINANCIAL INSTRUMENTS

33. Risk Management in PKO Bank Hipoteczny

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

33.1. Main principles of risk management

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

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

33.2. Elements of risk management process

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

- risk identification:
 - the identification of actual and potential sources of risk and estimation of the significance of their potential influence on the financial situation of the Bank. Within the risk identification process, types of risk perceived as significant to the Bank's activities are identified,
- risk measurement and assessment:

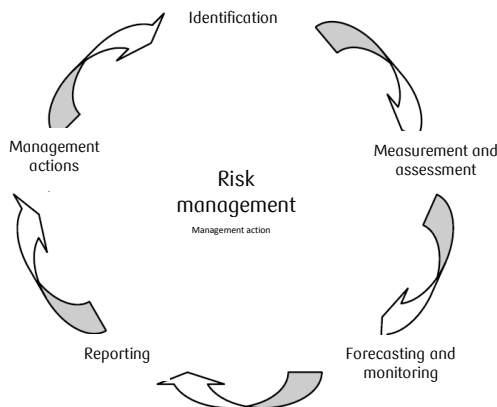
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risk measurement covering determination of risk assessment measures adequate to the type and significance of the risk, data availability and quantitative risk assessment by means of determined measures, as well as risk assessment aimed at identifying the scale or scope of risk, taking into account risk management objectives. Within risk measurement, stress-testing is conducted on the basis of assumptions providing a fair risk assessment,

- risk forecasting and monitoring:
preparing risk level forecasts and monitoring deviations from forecasts or adopted reference points (e.g. limits, thresholds, plans, measures from the previous period, recommendations and suggestions). Risk monitoring is performed with a frequency appropriate to the significance and volatility of a specific risk type,
- risk reporting:
periodically informing the authorities of the Bank about the results of risk measurement or risk assessment, actions taken and recommended actions. The scope, frequency and the form of reporting are adjusted to the management level of the recipients,
- management actions:
including, in particular, issuing internal regulations, establishing levels of risk tolerance, establishing limits and thresholds, issuing recommendations, making decisions about the use of tools supporting risk management, and taking action to maintain a defined level of risk. The objective of management actions is to direct the risk management process and risk levels

The risk management process is presented on the chart below:



33.3. The organization of risk management in the Bank

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

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

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

- 1) the first line of defense, which is functional internal control that ensures the use of risk control mechanisms and compliance of the activities with the generally applicable laws,
- 2) the second line of defense, which is the risk management system, including methods, tools, process and organization of risk management,
- 3) the third line of defense, which is internal audit.

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

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

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

The Risk Department is, in particular, responsible for the management of the following risk types: market, liquidity, credit, business, operational and the management of capital adequacy, including:

- identifying risk factors and sources,
- measuring, assessing, as well as monitoring and reporting risk levels on a regular basis,
- measuring and assessing capital adequacy,
- cooperating with supervisory authorities with respect to risk (BION, inspections, explanations, questionnaires, etc.)
- creating and implementing credit risk assessment methodologies,
- managing bad debts and performing effective actions for collection of these debts.

The Collateral Valuation Department is, in particular, responsible for the determination of the Mortgage-Lending Value of the Real Estates (BHWN).

The Credit Analysis Department is, in particular, responsible for the assessment of credit applications.

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

The Model Validation position is responsible, in particular, for:

- validation of risk models,
- implementation of an effective model risk management system within the Bank.

Risk management is supported by the following committees:

The Audit, Finance and Risk Committee ('the AFRC') – supporting the Supervisory Board

- monitors the integrity, adequacy and effectiveness of the risk management system, capital adequacy and implementation of the Bank's binding risk management policies in accordance with the Bank's Strategy,
- analyses and evaluates the application of strategic risk limits determined by PKO Bank Hipoteczny's Bank Risk Management Strategy,
- supports the Supervisory Board in the bank risk management process by formulating recommendations and making decisions concerning capital adequacy and the effectiveness of the risk monitoring system.

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

- makes decisions with respect to limits and thresholds for particular types of risks, issues related to transfer pricing, models and portfolio parameters used to determine impairment allowances and provisions as well as other significant financial and business risk models and their parameters,
- gives recommendations to the Management Board, among others, with regard to determining the structure of the Bank's assets and liabilities, managing different types of risks, equity and price policy,
- supports the Management Board in the process of managing assets and liabilities.

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

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

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

33.4. Identification of significant risk types

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

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

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

Based on quantitative and qualitative information, a periodic assessment of significance of particular types of risk is performed in the Bank. As a result of the assessment, each particular type of risk is classified as significant or insignificant. In particular, monitoring is conducted if significant changes in the scope or profile of the Bank's activities have occurred.

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

- 1) credit risk,
- 2) liquidity risk,
- 3) operational risk,
- 4) business risk,
- 5) risk of macroeconomic change,
- 6) modelling risk,
- 7) non-compliance risk.

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

- 1) currency risk,
- 2) interest rate risk.

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

34. Credit risk management

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

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

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

34.1. Measurement and assessment of credit risk

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

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

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

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

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

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

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

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

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

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

34.2. Impairment for loan exposures

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

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

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

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

34.3. Methods of estimating impairment

PKO Bank Hipoteczny currently applies two methods of estimating impairment:

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

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

34.4. Provisions for off-balance sheet loan exposures

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

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

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

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

34.5. Forecasting and monitoring of credit risk

34.5.1. Maximum exposure to credit risk

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

Maximum exposure to credit risk	31.12.2015
Cash, balances with the Central Bank	4
Amounts due from banks	14 812
Loans and advances to customers	722 655
Financial instruments designated upon initial recognition as at fair value through profit or loss	39 988
Investment securities available for sale	500
Total - exposure for balance recognized in the statement of financial position	777 959
Commitment to grant loans	173 479
Total off-balance sheet exposure	173 479

34.5.2. Amounts due from banks

The following table presents amounts due from banks.

Amounts due from banks	31.12.2015
Amounts not past due, not impaired	14 812
Gross total	14 812
Impairment allowances	-
Net total	14 812

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

34.5.3. Loans and advances to customers

The following table presents loans and advances to customers.

Loans and advances to customers	31.12.2015
Loans not past due, not impaired	722 853
Loans past due, not impaired	-
Impaired loans	-
Gross total	722 853
Allowances for loans not past due, not impaired	(198)
Allowances for loans past due, not impaired	-
Impaired loans	-
Net total	722 655

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

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Loans to customers, not impaired	31.12.2015
not past due	722 853
up to 30 days	-
from 31 to 60 days	-
from 61 to 90 days	-
Gross total	722 853

34.5.4. Forbearance practices

The Bank defines *forbearance* as actions aimed at changing contractual terms agreed with a debtor, caused by the debtor's difficult financial position (restructuring activities). The purpose of forbearance activities is to restore a debtor's ability to fulfil obligations to the Bank and to maximize the effectiveness of non-performing loan management, i.e. obtaining the highest recoveries while minimizing the costs of recoveries, which are very high in the event of execution proceedings.

Forbearance measures represent a change in payment terms which are individually agreed for each contract. Such changes may include:

- spreading the overdue due debt into instalments,
- changes to the repayment schedule,
- suspension of repayment,
- change in a repayment form (annuity instalments, decreasing instalments),
- change in interest rates,
- loans reduction,
- change in grace period.

As a result of concluding a forbearance agreement and the timely servicing thereof, the loans become current. Evaluating the ability of a debtor to fulfil the conditions of the forbearance agreement (debt repayment according to the agreed schedule) is an element of the forbearance process. Forbearance agreements are monitored on an on-going basis. The conclusion of a forbearance type agreement, changing the contractual conditions due to the financial difficulties of a debtor, is one of the individual impairment indicators and results in the necessity for recognition of an impairment allowance or provision in relation to the credit exposure.

Loans and advances cease to be subject of reporting on the status of forbearance if the following conditions are met simultaneously:

- timely settlement of at least 6 instalments from restructuring,
- at least 19 months have elapsed since the return of the debt to the unit, which delivered the application.

The timely settlement of the forborne exposures means settlement of each instalment with 30 days of due date as specified in the schedule of the restructuring agreement.

As at 31 December 2015 no forborne exposure were recognized in the Bank's portfolio.

34.5.5. Concentration of credit risk

PKO Bank Hipoteczny SA defines credit risk concentration as one arising from a significant exposure to:

- a single entity or group of entities whose repayment capacity depends on a common risk factor,
- a group of customers or credit portfolios exposed to one risk factor.

The Bank assesses the credit risk concentration on the basis of portfolio structure by analysis of the LTV ratio and geographical region.

Portfolio structure based on LTV ratio

Loans and advances to customers by LTV levels	31.12.2015
0% - 50%	175 415
51% - 60%	164 727
61% - 70%	172 249
71% - 80%	117 886
in excess of 80%	92 576
Gross total	722 853

Portfolio structure based on geographical region

Loans and advances to customers by geographical regions	31.12.2015
mazowiecki	263 152
małopolsko-świętokrzyski	85 829
dolnośląski	66 281
pomorski	61 829
wielkopolski	60 292
lubelsko-podkarpacki	45 337
śląsko-opolski	37 779
zachodnio-pomorski	33 472
łódzki	31 653
podlaski	16 913
kujawsko-pomorski	14 785
warmińsko-mazurski	5 531
Total	722 853

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Due to the specific nature of the Bank, its business model assumes credit risk concentration in the segment of loan exposures collateralized by real estates. Accordingly, the Bank places particular emphasis on the monitoring of collateral value. Therefore, minimum collateral conditions for transactions in terms of the collateral policy, pays a special role in relation to credit risk, including the establishment of mortgages that provide the highest possible level of recovery in the event that execution activities are necessary.

34.5.6. Collateral

The Bank's policies with respect to loan collateral and valuation thereof take into consideration the requirements of applicable laws: The Mortgage Bonds and Mortgage Banks Act, The Banking Law, and The Act on Land Registers and Mortgages. In addition, the suggestions and recommendations of the Polish Financial Supervision Authority, including Recommendations F, S and J, as well as internal bank regulations address the application of legal collateral.

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

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

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

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

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

34.6. Credit risk reporting

The Bank prepares monthly and quarterly credit risk reports. The reporting of credit risk specifically covers cyclical information on the risk exposure of the loan portfolio of the Bank.

34.7. Credit risk management

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

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

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

35. Market risk management

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

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

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

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

The significance of interest rate risk and currency risk is periodically assessed by PKO Bank Hipoteczny, which results from the business model of the Bank. The methodology for monitoring, as well as risk management tools will depend on the assessment of the significance of these risks.

In the current phase of the Bank's business, currency risk as well as interest rate risk were considered as non-significant and did not require coverage from internal capital.

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35.1. Measurement and assessment of market risk

35.1.1. Measurement of interest rate risk

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

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

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

The repricing gap shows the difference between the present value of assets and liabilities exposed to interest rate risk, subject to repricing in a given time horizon.

The repricing gap report in the table below presents the interest bearing assets and liabilities (responsive to changes in interest rates). Off-balance sheet transactions and the Bank's own funds, as well as receivables due from banks in form of current accounts were not included in the report.

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

(thb PLN)	0-1 month	1-3 months	3-6 months	6-12 months	1-2 years	2-5 years	> 5 years	Total
31.12.2015								
Interest bearing assets, of which	260 494	508 195	-	-	-	-	-	768 689
balance with Central Bank securities	-	-	-	-	-	-	-	-
amounts due from banks	40 488	-	-	-	-	-	-	40 488
amounts due from customers	9 000	-	-	-	-	-	-	9 000
	211 006	508 195	-	-	-	-	-	719 201
Interest bearing liabilities, of which	469 298	30 000	-	-	-	-	-	499 298
amounts due to banks	469 298	-	-	-	-	-	-	469 298
amounts due to customers issued mortgage bonds	-	30 000	-	-	-	-	-	30 000
Assets due to derivatives	-	-	-	-	-	-	-	-
Liabilities due to derivatives	-	-	-	-	-	-	-	-
Periodic Gap	(208 804)	478 195	-	-	-	-	-	
Cumulative Gap	(208 804)	269 391	269 391	269 391	269 391	269 391	269 391	

35.1.2. Measurement of currency risk

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

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

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

Currency position	31.12.2015
EUR	(41)
USD	1
CHF	-
GBP	-

35.2. Forecasting and monitoring of market risk

The exposure of PKO Bank Hipoteczny to market risk was within accepted limits as at 31 December 2015.

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

In relation to currency risk, the Bank closes all open currency positions on a current basis, and the control and reporting procedures implemented by the Bank significantly limit the impact of changes in exchange rates on the Bank's financial result, hence the currency risk as at 31 December 2015 was determined as insignificant.

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The utilization of market risk limits as at 31 December 2015 amounted to:

Kind of limit	Formula for calculation the limit	Limit	Level as at 31.12.2015	Usage
the Bank's sensitivity to interest rate risk	$\frac{\sum BPV_i \times 100}{\text{own funds}}$	1.00%	0.22%	22.32%
the Bank's sensitivity to currency risk	$\frac{\sum PW_i }{\text{own funds}}$	1.00%	0.01%	1.48%

where:

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

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

35.3. Market risk reporting

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

35.4. Management of market risk

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

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

The Bank monitors the level of significance of interest rate risk and currency risk and established thresholds, above which the type of market risk will be entered on the list of risks subject to coverage of internal capital.

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

36. Liquidity risk management

Liquidity risk is defined as the risk of the inability to settle obligations when due to the lack of liquid assets. Lack of liquidity may arise from an inappropriate structure of the statement of financial position, mismatch of cash flows, counterparty default, sudden withdrawal of funds by customers or other market events.

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

The Bank manages liquidity risk in order to maintain current, short-term, medium-term and long-term liquidity.

PKO Bank Hipoteczny's policy concerning liquidity is to maintain a portfolio of liquid securities and to increase stable sources of financing (in particular, from the issuance of mortgage bonds and funding from the parent entity). Money market instruments are also used in liquidity risk management.

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

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

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

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

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

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36.1. Measurement of the liquidity risk

The Bank makes use of the following liquidity risk measures:

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

36.2. Forecasting and monitoring of liquidity risk

The liquidity gaps in real terms as at 31 December 2015 are presented below. In up to 24 months, the cumulative liquidity gap in real terms of PKO Bank Hipoteczny indicates a positive values. This means a surplus of assets receivable, increased by estimated inflows from available limit in the current account over liabilities payable in the short and medium-term.

	a 'vista	0 - 1 month	1 - 3 months	3 - 6 months	6 - 12 months	12 - 24 months	24 - 60 months	over 60 months
31.12.2015								
Adjusted gap	5 670	211 731	4 743	5 837	12 289	26 454	(570 265)	303 541
Cumulative adjusted gap	5 670	217 401	222 144	227 981	240 270	266 724	(303 541)	-

The table below presents the Bank's liquidity surplus as at 31 December 2015.

Name of sensitivity measure	31.12.2015
Liquidity surplus up to 1 month	130 662

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

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

In the presented period the Bank monitored all liquidity standards specified in the PFSA's resolution 386/2008 dated 17 December 2008. The table below presents the liquidity standards as at 31 December 2015 and the average, minimum and maximum values since the beginning of the period.

	value at the end of period	average for the period	minimum for the period	maximum for the period	minimum supervisory level
31.12.2015					
M1	125 869	207 119	43 336	295 867	>0
M2	2.41	35.36	1.74	205.14	>1.0
M3	43.09	159.57	38.48	457.21	>1.0
M4	1.07	57.88	1.07	420.00	>1.0

The coverage ratio of 1 months net outflows (LCR) was inestimable as at 31 December 2015 due to no net outflows up to 1 month (denominator equals zero). As at 31 December 2015 liquid assets amounted PLN 40 012 thousand.

In the analyzed period the Bank did not exceed any of the liquidity standards. The high levels of the indicators presented in the analyzed period indicated excessive liquidity, which is appropriate for a bank commencing business.

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

The table below presents the assets and liabilities of the Bank assigned to the respective residual time bands determined by maturity of cash flows. Amount denominated in foreign currencies have been translated at the average Polish Central Bank exchange rate as at 31 December 2015.

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Assets and liabilities and equity by contractual maturity as at 31 December 2015.

	Up to 1 month	1-3 months	3 months- 1 year	1-5 years	Over 5 years	Total
Assets						
Cash balances with the Central Bank	4	-	-	-	-	4
Amounts due from banks	14 812	-	-	-	-	14 812
Amounts due from customers	2 153	4 776	18 146	112 131	585 449	722 655
Securities	39 988	-	-	500	-	40 488
Other assets	6 442	-	-	3 261	3 823	13 526
Total assets	63 399	4 776	18 146	115 892	589 272	791 485
Liabilities:						
Amounts due to banks	-	-	429 516	39 782	-	469 298
Amount due to customers	146	-	-	-	-	146
Mortgage bonds in issue	-	-	-	29 933	-	29 933
Equity	-	-	-	-	286 029	286 029
Other liabilities	6 079	-	-	-	-	6 079
Total liabilities	6 225	-	429 516	69 715	286 029	791 485

36.4. The contractual cash flows from transactions on derivative financial instruments by maturity

As at 31 December 2015 the Bank did not have any derivative transactions in its portfolio.

36.5. Concentration of funding sources

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

The business model of the Bank assumes that, after reaching the designated configuration of the statement of financial position the risk of concentration of funding sources will result from:

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

The following table presents the funding structure of the Bank as at 31 December 2015.

	31.12.2015
Equity	36.43%
Funds from the parent entity	59.76%
Issued mortgage bonds	3.81%
Issued bonds	0.00%
Total	100.00%

The share of parent company's funding amounted to 59.8% and was considered as significant. The mentioned level of this indicator is consistent with the financial plan at the present stage of Bank's business and is expected to gradually decrease with successive issues of mortgage and own bonds. Due to low share of external sources of funding concentration risk is assessed as acceptable.

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

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

- shock changes in market parameters on financial markets,
- the impact of marginal changes in market factors, as well as drops in prices on the property market on the anticipated losses on the mortgage loan portfolio,
- redemption of mortgage bonds resulting from the exceeding of regulatory standards,
- decrease of issue ratings,
- changes in key parameters affecting the liquidity level determined on the basis of the projected statement of financial position of the Bank.

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

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

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- the process of planning of the Bank's statement of financial position,
- the process of determining conditions resulting in the implementation of liquidity emergency plans of the Bank, which are presented at the meetings of the Management Board and the Supervisory Board of the Bank.

The tests of stress condition carried out on the basis of financial data of the Bank as at 31 December 2015 did not indicate any risk to the Bank's business due to the occurrence of hypothetical marginal market conditions. The Bank has a high capacity to outlast crisis situations due to a high proportion of equity in its financing structure, distant maturity dates of liabilities and a sufficient level of liquid assets.

36.7. Liquidity risk reporting

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

36.8. Management of liquidity risk

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

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

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

37. Operational risk management

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

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

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

In order to manage operational risk, the Bank gathers internal and external data about operational events, on business environment factors, results operational risk self-assessment, data on key indicators of operational risk (KRI) and data related to the quality of functional internal controls.

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

37.1. Measurement of operational risk

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

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

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

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

37.2. Forecasting and monitoring operational risk

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

The Bank regularly monitors, in particular:

- utilization of strategic tolerance limits and operational risk losses limits,
- effectiveness and timeliness of actions undertaken to reduce or transfer the operational risk,
- the KRI value,

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- results of operational risk self-assessment,
- results of stress-tests,
- operational events and their consequences.

37.3. Reporting of operational risk

Reporting on information concerning operational risk is performed for:

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

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

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

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

37.4. Management of operational risk

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

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

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

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

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

38. Compliance risk management

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

38.1. The objective of compliance risk management

The objective of compliance risk management is to:

- prevent the occurrence of instances of non-compliance and maintain the Bank's image as an institution acting in accordance with law and adopted standards of conduct, that is respected, fair and honest in the eyes of the shareholders, customers, employees, business partners and other market participants,
- prevent the possibility of the Bank losing its reputation or credibility due to failure to comply with or inappropriate application of the law, internal regulations and the Bank's implemented standards of conduct, including ethical standards,
- prevent the occurrence the risk of financial losses or legal sanction, which may be a result of a breach of the abovementioned regulations and standards of conduct.

38.2. Identification and evaluation of compliance risk

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

The identification and evaluation of compliance risk is carried out periodically by the so-called owners of internal processes, in cooperation with the Compliance, Security and Legal Office and in particular include:

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

38.3. Compliance risk monitoring

Compliance risk monitoring includes:

- 1) the results of the identification and assessment of compliance risk,
- 2) incidents of non-compliance, their causes and effects,
- 3) the following actions undertaken by the Bank:
 - compliance risk management,
 - implementation of recommendations from internal audits and functional and external controls,

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- adoption of new laws and standards of conduct,
 - implementation of the Compliance, Security and Legal Bureau's recommendations,
- 4) evaluation of the effectiveness of controls associated with compliance risk mitigation,
 - 5) selected areas related to the business specific to a mortgage bank subjected to periodical compliance verification by the Compliance, Security and Legal Bureau's.

38.4. Compliance risk reporting

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

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

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

39. Capital adequacy

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

The capital adequacy management consists of:

- Tier I: minimal capital requirements specified in law,
- Tier II: internal capital determined by the Bank's own models for the risks considered significant.

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

The primary regulations applicable in the process of the capital adequacy assessment process as at 31 December 2015 are:

- the Regulation (EU) No. 575/2013 of the European Parliament and of the Council dated 26 June 2013 on prudential requirements for credit institutions and investment firms, amending the Regulation (EU) No. 648/2012 (hereinafter referred to as the "CRR Regulation"),
- The Act dated 29 August 1997, the Banking Law,
- The Act dated 5 August 2015, on macroprudential supervision of the financial system and crisis management in the financial system.

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

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

- identifying and monitoring of all of significant risks,
- assessing internal capital to cover the individual risk types and total internal capital,
- monitoring, reporting, forecasting and limiting of capital adequacy,
- performing internal capital allocations to business segments and client segments in connection with profitability analyses,
- use of tools affecting the capital adequacy level (including: tools affecting the level of equity, the scale of equity reduction items and the level of the loan portfolio).

The Bank commenced operational activities on 1 April 2015 and since the beginning the level of capital adequacy remained on a safe level and was significantly above the regulatory limits. In the first year of its operations the banking supervisory limit for the total capital ratio amounted 15% in accordance with the Banking Law.

As at 31 December 2015 the Bank's total capital ratio amounted 47.8%.

39.1. Own funds for the purpose of capital adequacy

As at 31 December 2015 the own fund of the Bank for the purposes of capital adequacy were calculated in accordance with the provisions of the CRR Regulation.

The own funds of the Bank comprise only Tier 1 core capital.

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The Tier 1 core capital basic funds (so-called Common Equity Tier 1 or CET1) as at 31 December 2015 comprises of:

OWN FUNDS OF THE BANK	31.12.2015
Basic funds (Tier 1)	282 811
fundamental funds, of which:	300 002
share capital	300 000
other accumulated comprehensive income	2
adjustment of transition period	(1)
loss for the current financial year	(13 973)
intangible assets	(3 176)
additional adjustments to assets measured at fair value	(41)
Supplementary funds (Tier 2)	-
TOTAL OWN FUNDS	282 811

39.2. Requirements regarding own funds (Tier I)

In accordance with the CRR Regulation in force since 1 January 2014, the Bank calculates requirements in respect of own funds for the following risk types:

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

The total own capital requirement of the Bank as at 31 December 2015 consists of the capital requirements for the risks presented in points 1 and 4. The requirements presented in points 2, 3 and 5 as at 31 December 2015 amounted to zero due to lack of items covered by these requirements (no transactions and foreign currency positions that do not exceeds the limits).

The following table presents the Bank's own funds requirements for particular types of risks:

Capital requirements	31.12.2015
Credit risk	45 717
Market risk	-
Operational risk	1 618
Total capital requirements	47 335
Tier 1 basic capital ratio (CET1)	47.8%
Tier 1 capital ratio (T1)	47.8%
Total capital ratio (TCR)	47.8%

39.3. Internal capital (Tier II)

PKO Bank Hipoteczny calculates internal capital in accordance with:

- the CRR Regulation
- CRD Directive,
- the Banking Act.

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

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

- credit risk (including default risks),
- liquidity risk,
- operational risk,
- business risk (including strategy risk).

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

The Bank periodically monitors the significance of the individual risk types that relate to the Bank's activities.

The internal capital for covering the individual risk types is determined using the methods specified in the Bank's internal regulations.

The Bank adopts a prudent approach to the aggregation of risks and does not rely on the diversification effect. As at 31 December 2015, the proportion of the Bank's own funds to its internal capital remained on a level exceeding both the threshold set by the law and the Bank's internal limits.

**FINANCIAL STATEMENTS OF PKO BANK HIPOTECZNY SA
FOR THE PERIOD FROM 6 OCTOBER 2014 TO 31 DECEMBER 2015
(IN PLN THOUSAND)**



39.4. Disclosures (Tier III)

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

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

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

EVENTS AFTER THE REPORTING PERIOD

40. Events after the reporting period

On 26 January 2016 PKO Bank Hipoteczny acquired a further portfolio of mortgage loans from PKO Bank Polski S.A. in amount of PLN 251.279 thousand in terms of the Framework Agreement concerning the sale of debts concluded on 17 November 2015.

On 11 February 2016 PKO Bank Hipoteczny issued bonds with a total nominal value amounting to PLN 7.500 thousand. The bond issue was conducted under the Bond Issue Program established by PKO Bank Hipoteczny on 30 September 2015 for the issuance of the bonds up to PLN 2.000.000 thousand. The redemption date for the bonds was determined as 11 May 2016.

Signatures of all Members of the Management Board of the Bank

19.02.2016	Rafał Kozłowski	President of the Management Board	<i>Signed on the Polish original</i> (signature)
19.02.2016.	Jakub Niesłuchowski	Vice-President of the Management Board	<i>Signed on the Polish original</i> (signature)
19.02.2016.	Marek Szcześniak	Vice-President of the Management Board	<i>Signed on the Polish original</i> (signature)

Signature of the person responsible for bookkeeping

19.02.2016

Tomasz Rynkowski
Director, Chief Accountant

Signed on the Polish original

.....
(signature)