BVR

Consolidated Financial Statements 2018

of the Volksbanken Raiffeisenbanken
Cooperative Financial Network

Ratings	Fitch Ratings (network rating)	Standard & Poor's
Long-term issuer default rating	AA–	AA–
Short-term issuer default rating	F1+	A–1+
Support rating	5	*)
Outlook	Stable	Stable
Individual rating	aa–	aa–

*) Standard & Poor's does not provide this kind of rating.

Volksbanken Raiffeisenbanken Cooperative Financial Network	2018 € million	2017 € million	Change (percent)
Financial performance			
Net interest income	18,368	18,638	–1.4
Net fee and commission income	6,816	6,491	5.0
Gains and losses on financial and commodities activities[1]	–574	854	>100
Net income from insurance business[2]	863	1,283	–32.7
Loss allowances	–151	–576	–73.8
Profit before taxes	7,771	8,916	–12.8
Net profit	5,402	6,073	–11.0
Net assets			
Loans and advances to banks	18,800	19,967[6]	–5.8
Loans and advances to customers	794,916	761,880	4.3
Financial assets held for trading	37,500	38,107	–1.6
Investments	239,083	243,732	–1.9
Loss allowances	–8,988	–7,363	22.1
Investments held by insurance companies	99,855	95,431	4.6
Remaining assets	112,011	91,562[7]	22.3
Financial position			
Deposits from banks	119,300	113,065	5.5
Deposits from customers	842,420	801,031	5.2
Debt certificates issued including bonds	56,111	64,807	–13.4
Financial liabilities held for trading	42,451	36,760	15.5
Insurance liabilities	93,252	89,324	4.4
Remaining liabilities	31,939	33,891	–5.8
Equity	107,704	104,438	3.1
Total assets/total equity and liabilities	**1,293,177**	**1,243,316**	**4.0**
Volume of business[3]	**1,724,917**	**1,662,773**	**3.7**
Profitability/efficiency			
Cost/income ratio (percent)	69.5	65.3	
Return on equity (percent)[4]	7.3	8.8	
Average equity	106,071	101,504	
Return on capital employed (percent)[5]	0.4	0.5	
Regulatory capital ratios			
Tier 1 capital ratio (percent)	13.6	13.4	
Total capital ratio (percent)	15.8	16.0	
Common equity Tier 1 capital ratio incl. sec. 340f HGB reserves (percent)	15.5	15.4	
Employees as at reporting date	**176,583**	**179,598[8]**	**–1.7**

(See back inside cover for footnotes 1–8)

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Consolidated Financial Statements 2018

of the Volksbanken Raiffeisenbanken
Cooperative Financial Network

Inhalt

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In brief

In 2018, the Volksbanken Raiffeisenbanken Cooperative Financial Network generated a profit before taxes of €7.8 billion. The performance of the traditional banking business was encouragingly stable, with further growth in the deposit-taking and lending businesses. Significant volatility in the capital markets at the end of the year meant that profit before taxes for 2018 as a whole was down by €1.1 billion compared with the very healthy figure reported for 2017. Since then, prices in the capital markets have of course rallied.

The annual consolidated financial statements of the Cooperative Financial Network, prepared in accordance with International Financial Reporting Standards (IFRS), provide information on the 2018 financial year of the 875 local cooperative banks, Sparda banks, PSD banks, and other cooperative specialized institutions as well as the DZ BANK Group. Net interest income fell slightly during the reporting period, decreasing by €270 million to €18.4 billion. The Cooperative Financial Network was able to mitigate the impact of much of this reduction in net interest income – a key component of its earnings – with growth in the volume of lending. The rise in net fee and commission income also more than offset the decrease. Supported by the local cooperative banks, net fee and commission income climbed by 5 percent or €325 million to €6.8 billion. This growth was driven not only by payments processing but also by the brokerage business for real estate and by investment advice, two areas of investment that customers are increasingly turning to in the low-interest-rate environment. Loss allowances amounted to a net addition of just €151 million in 2018.

Administrative expenses rose by a moderate 1.1 percent to €18.1 billion. Income taxes amounted to €2.4 billion, which meant that the tax expense recognized was down by almost €0.5 billion. After taxes, the Cooperative Financial Network's net profit for 2018 came to €5.4 billion.

In its customer business, the Cooperative Financial Network in 2018 again played to its strengths of focusing on values and on customers. Loans and advances to retail customers and to small and medium-sized corporate customers rose by 4.3 percent to €794.9 billion, while deposits increased by 5.2 percent to €842.4 billion. There was again brisk demand for personal home loans, while sight deposits remained customers' preferred choice in view of the low level of interest rates. The Cooperative Financial Network's consolidated total assets grew by 4.0 percent to €1.29 trillion.

Management Report 2018

General Information about the Volksbanken Raiffeisenbanken Cooperative Financial Network

Structure, business model, and features of the IPS*

This management report supplements the consolidated financial statements of the Volksbanken Raiffeisenbanken Cooperative Financial Network.

The Volksbanken Raiffeisenbanken Cooperative Financial Network consists of 875 cooperative banks (2017: 915), the DZ BANK Group, Münchener Hypothekenbank eG, the BVR protection scheme, and BVR Institutssicherung GmbH as consolidated entities. The consolidated cooperative banks include Deutsche Apotheker- und Ärztebank eG, the Sparda banks, the PSD banks, and specialized institutions such as BAG Bankaktiengesellschaft.

The cooperative banks and Münchener Hypothekenbank eG are the legally independent, equally ranked parent entities of the Cooperative Financial Network, whereas the other banking groups and entities are consolidated as subsidiaries.

The Volksbanken Raiffeisenbanken Cooperative Financial Network's institutional protection scheme (IPS) is set up as a dual cooperative scheme that comprises the BVR protection scheme and BVR Institutssicherung GmbH.

The principles and methods of the institutional protection scheme are outlined in more detail in the combined opportunity and risk report.

Definition of the main operating segments

The definitions of the operating segments referred to in the Annual Report – Retail Customers and SMEs, Central Institution and Major Corporate Customers, Real Estate Finance, and Insurance – can be found in the notes to the consolidated financial statements starting on page 69.

*Institutional Protection Scheme.

Management Report 2018

Business Performance

Economic conditions

The pace of growth in the German economy slowed markedly in 2018. Adjusted for inflation, gross domestic product (GDP) rose by 1.4 percent year on year, compared with 2.2 percent in 2017.

Factors on both the demand side and the supply side contributed to this weakening of growth. On the one hand, companies increasingly faced supply-side shortages, primarily of workers and intermediate goods. Moreover, manufacturing was impacted by one-off factors such as strikes, a severe flu epidemic in the early part of 2018, and a backlog of new car registrations (caused by problems with the new Worldwide Harmonised Light Vehicles Test Procedure, WLTP), which weighed heavily on macroeconomic output in the second half of the year. On the other hand, global trade lost some of its momentum compared with the previous year, which took its toll on demand.

The main reasons for the slower pace of global trade were that global economic growth had peaked and trade relations had deteriorated. The latter was predominantly due to the US government's trade policy, with US President Donald Trump progressively imposing new tariffs on the import of various products, including steel and aluminum. The affected trading partners – above all China, but also European countries – responded with retaliatory tariffs of their own. Nevertheless, Germany's economic growth was only slightly dented by the trade disputes, not least because domestic demand carried on expanding robustly.

Spending on capital equipment, for example, continued to go up thanks to higher capacity utilization in the manufacturing sector and because funding terms remained extremely favorable. Construction investment also maintained its growth trajectory, even though shortages of workers became increasingly evident. Rising spending, both by consumers and the state, continued to be an important source of support for macroeconomic expansion. By contrast, foreign trade notionally decreased economic growth, because the increase in imports far outweighed the moderate growth of exports.

In 2018, consumer prices were up by 1.8 percent compared with the previous year and thus rose at a slightly stronger rate than in 2017 (up by 1.5 percent). The main drivers of this overall trend were prices for energy and food, which went up at a disproportionately strong rate due to higher crude oil prices and a poor harvest.

The labor market remained in fundamentally good health, with the number of people in work in Germany climbing by 572,000 year on year to reach 44.8 million.

The number of people out of work continued to fall. Germany's Federal Employment Agency had 2.3 million people registered as unemployed on its books, which was 193,000 fewer than in 2017. The unemployment rate dropped by 0.5 percentage points to 5.2 percent.

In 2018, the European Central Bank (ECB) gradually began to move away from ultra-expansionary monetary policy. It closed its bond-buying program (quantitative easing) at the end of the year but left key interest rates at their historically low levels. The ECB's main refinancing rate for eurozone financial institutions remained at 0.0 percent, while the deposit rate was still in negative territory at minus 0.4 percent.

Volksbanken Raiffeisenbanken Cooperative Financial Network

Business situation

In a difficult market environment shaped by the ECB's long-standing policy of low interest rates and the continuation of fierce competition, combined with the influence of demanding regulatory requirements, the Volksbanken Raiffeisenbanken Cooperative Financial Network had yet another successful year in 2018. Profit before taxes amounted to €7,771 million, which fell short of the excellent prior-year figure of €8,916 million. With its focus on value creation and customers, the regionally oriented business model of the Cooperative Financial Network nevertheless again proved robust and reliable in these difficult operating conditions. This was clearly demonstrated by the fact that the Cooperative Financial Network's core operating business generated a very stable level of income that was on a par with 2017. The decrease was largely attributable to turmoil in the capital markets at the end of 2018 and the related falls in securities prices.

In 2018, the cooperative banks generated strong and stable growth in their lending business with retail and corporate customers. Overall, lending to retail and corporate customers increased by 5.5 percent, which was only just short of the 2017 growth rate of 5.6 percent. The main driver of this sustained growth in the lending business was again brisk customer demand for long-term home loans, which was supported by low interest rates on loans, rising incomes, and the positive trends in the labor market. The cooperative banks slightly increased their share of the retail customer market once again compared with the previous year. Their share of the corporate customer market was also a little higher. The Cooperative Financial Network's deposit-taking business continued to see stable and granular growth, contributing to the funding of its expanding lending business.

Equity advanced by 3.2 percent to €107.7 billion (December 31, 2017: €104.4 billion). This figure underlines the sustainability and future viability of the Cooperative Financial Network. The sound level of capital adequacy provides the Cooperative Financial Network with a sufficient risk buffer while, at the same time, enabling it to seize opportunities for expanding its lending business with retail and corporate customers.

The vitality and financial stability of the Cooperative Financial Network's business model, with its strong market position in retail and corporate banking, have been rewarded with capital market ratings of AA– from rating agencies Standard & Poor's and FitchRatings. These ratings are encouraging when viewed in comparison with the rest of the sector and emphasize the extraordinary strength of the Cooperative Financial Network by European and international comparison.

The continued popularity of the Cooperative Financial Network in the market was once again clearly demonstrated in 2018 by the sustained growth of its membership. It attracted a further 45,000 members in 2018, both retail and corporate, taking the total membership of the cooperative banks to 18.6 million as at December 31, 2018. Over the past ten years, the Cooperative Financial Network's membership base has grown by 2.3 million.

Financial performance

Net interest income again decreased slightly year on year to reach €18,368 million in 2018 (2017: €18,638 million). This figure was primarily influenced by the low-interest-rate policy of the ECB and the resulting deterioration of margins. The cooperative banks' net interest income – the biggest source of income for the Cooperative Financial Network – declined by just 0.8 percent, from €15,917 million in 2017 to €15,783 million in 2018.

Net fee and commission income improved by 5.0 percent, from €6,491 million in 2017 to €6,816 million in 2018. This was primarily due to a rise in fee and commission income and a simultaneous fall in fee and commission expense.

The Cooperative Financial Network's **gains and losses on trading activities** decreased to a net gain of €461 million, which was €248 million lower than the prior-year figure of €709 million. Most of this change was accounted for by gains and losses on trading activities in the DZ BANK Group.

Gains and losses on investments deteriorated significantly to a net loss of €913 million (2017: net loss of €144 million). This decrease largely resulted from higher write-downs on securities than in the previous year.

Loss allowances, which were determined in accordance with IFRS 9 for the first time in 2018, amounted to a net addition of €151 million (2017: net addition of €576 million).

Other gains and losses on valuation of financial instruments declined from a net gain of €289 million in 2017 to a net loss of €122 million in the reporting year, predominantly due to the widening of credit spreads. By contrast, the previous year had seen a narrowing of these credit spreads.

The **net income from insurance business** comprises premiums earned, gains and losses on investments held by insurance companies and other insurance company gains and losses, insurance benefit payments, and insurance business operating expenses. In 2018, this figure decreased by 32.7 percent to €863 million (2017: €1,283 million). This year-on-year change was attributable to a significant fall in gains and losses on investments held by insurance companies and other insurance company gains and losses.

Despite the objective of reducing **administrative expenses**, they rose slightly in the year under review, by 1.1 percent or €195 million, to €18,079 million (2017: €17,884 million). The bulk of the administrative expenses were attributable to staff expenses, which came to €10,076 million (2017: €10,137 million), and general and administrative expenses, which amounted to €7,011 million (2017: €6,793 million).

Income taxes amounted to €2,369 million in 2018 (2017: €2,843 million), with most of this amount €2,731 million (2017: €2,649 million) attributable to current income taxes. This underscores the particular importance of the Cooperative Financial Network for Germany's regional authorities, given that it is one of the largest municipal tax payers.

Net profit after tax fell by 11.0 percent to €5,402 million in 2018, compared with €6,073 million in 2017.

The Cooperative Financial Network's **cost/income ratio** came to 69.5 percent in 2018 (2017: 65.3 percent).

Financial position

The consolidated **total assets** of the Volksbanken Raiffeisenbanken Cooperative Financial Network had risen by €49.9 billion to €1,293.2 billion as at December 31, 2018 (December 31, 2017: €1,243.3 billion). The **volume of business** increased from €1,662.8 billion in 2017 to €1,724.9 billion in the reporting year.

Of the total assets before consolidation, 62.1 percent was attributable to the cooperative banks (December 31, 2017: 61.7 percent) and 34.9 percent to the DZ BANK Group (December 31, 2017: 35.3 percent). As had also been the case at the end of 2017, the remaining 3.0 percent was attributable to Münchener Hypothekenbank, the BVR protection scheme, and BVR Institutssicherung GmbH.

On the **assets** side of the balance sheet, loans and advances to customers grew by €33.0 billion or 4.3 percent to €794.9 billion (December 31, 2017: €761.9 billion). As in previous years, this rise in 2018 was predominantly attributable to the cooperative banks, whose loans and advances to customers rose by 5.5 percent and thus kept pace with the excellent 2017 growth rate of 5.6 percent. The main driver of this sustained growth in the lending business was again brisk demand for long-term home loans, which was well supported by persistently low interest rates on loans, rising incomes, and the positive trends in the labor market.

Financial assets held for trading contracted by €0.6 billion or 1.6 percent to €37.5 billion as at December 31, 2018 (December 31, 2017: €38.1 billion). This decline in financial assets held for trading resulted largely from a decrease in derivatives (positive fair values) of €1.5 billion, in shares and other variable-yield securities of €0.4 billion, and in loans and advances of €0.5 billion. These decreases were partly offset by an increase in bonds and other fixed-income securities, which were up by 19.7 percent or €1.8 billion to €10.8 billion.

Investments fell sharply, by €4.6 billion, to €239.1 billion as at December 31, 2018 (December 31, 2017: €243.7 billion). The principle reason was a €5.0 billion reduction in the portfolio of securities.

Financial performance

	2018 € million	2017 € million	Change (percent)
Net interest income	18,368	18,638	–1.4
Net fee and commission income	6,816	6,491	5.0
Gains and losses on trading activities	461	709	–35.0
Gains and losses on investments	–913	–144	>100.0
Loss allowances	–151	–576	–73.8
Other gains and losses on valuation of financial instruments	–122	289	>100.0
Net income from insurance business	863	1,283	–32.7
Administrative expenses	–18,079	–17,884	1.1
Other net operating income	528	110	>100.0
Profit before taxes	**7,771**	**8,916**	**–12.8**
Income taxes	–2,369	–2,843	–16.7
Net profit	**5,402**	**6,073**	**–11.0**

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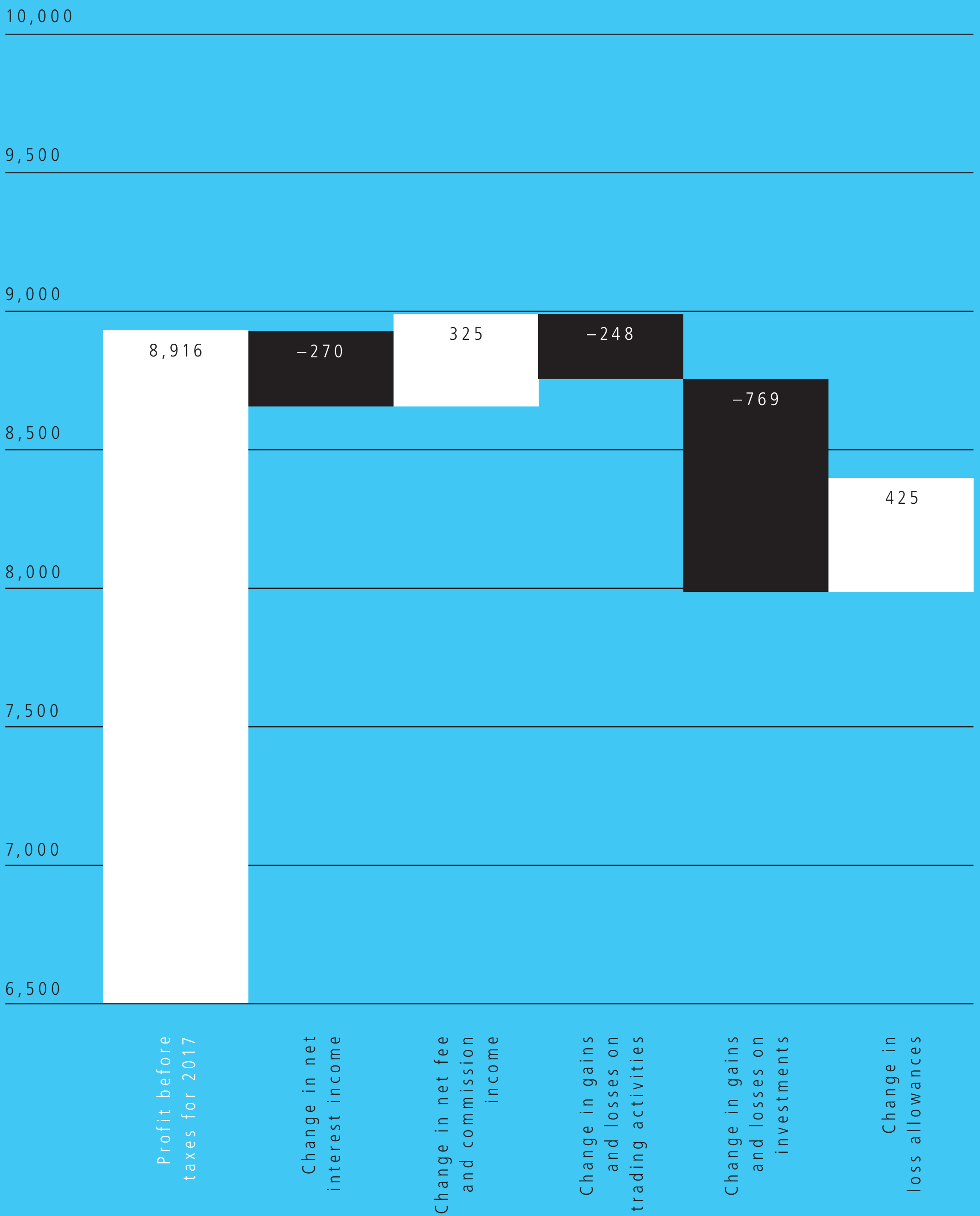
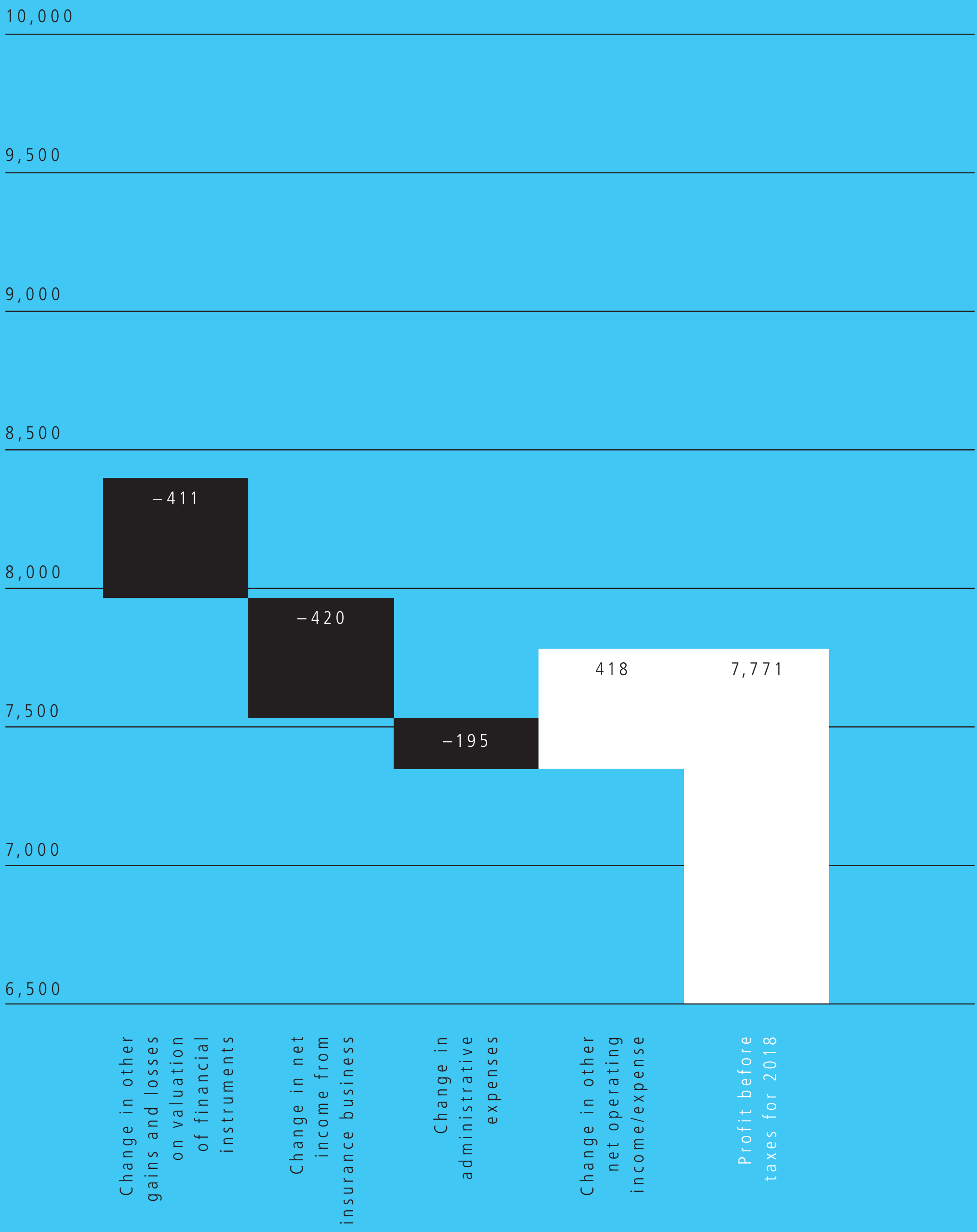
Breakdown of change in profit before taxes by income statement item

€ million



15


10,000
9,500
9,000
8,500
8,000
7,500
7,000
6,500
−411
−420
−195
418
7,771
Change in other gains and losses on valuation of financial instruments
Change in net income from insurance business
Change in administrative expenses
Change in other net operating income/expense
Profit before taxes for 2018

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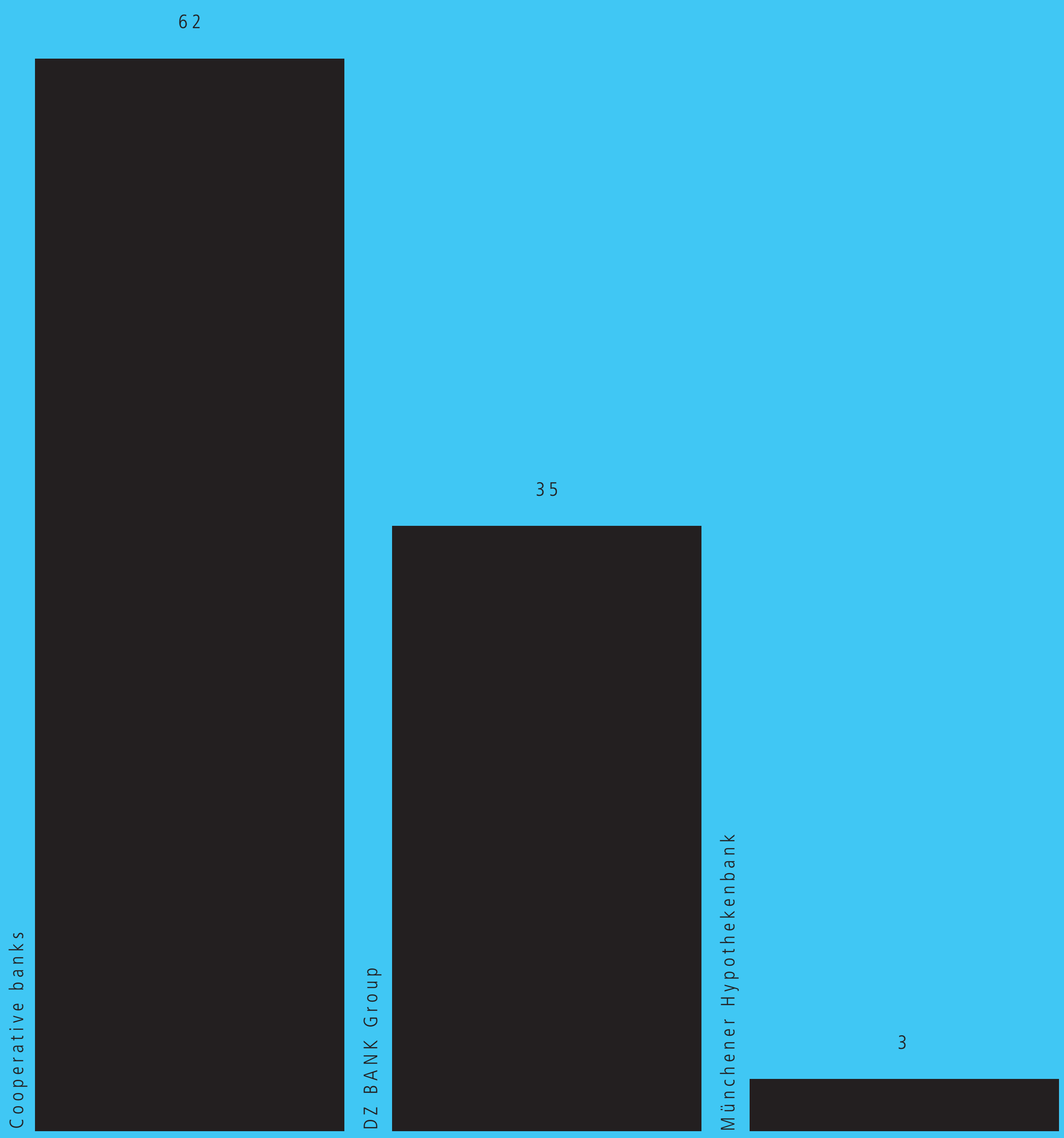
Breakdown of the total assets held in the Volksbanken Raiffeisenbanken Cooperative Financial Network as at December 31, 2018

Percent



This was partly offset by a small rise in equity investments. Investments held by insurance companies went up by €4.4 billion year on year. This rise was due, in particular, to an increase in fixed-income securities of €4.0 billion and in registered bonds of €0.3 billion.

On the **equity and liabilities** side of the balance sheet, deposits from customers again grew markedly, rising from €801.0 billion as at December 31, 2017 to €842.4 billion as at December 31, 2018. Deposits from banks also increased, by 5.5 percent, to reach €119.3 billion (December 31, 2017: €113.1 billion).

Financial liabilities held for trading rose by €5.7 billion or 15.5 percent to €42.5 billion (December 31, 2017: €36.8 billion). This was largely due to the 55.4 percent increase to €20.3 billion in the volume of bonds issued including share- and index- and other debt certificates issued (December 31, 2017: €13.0 billion). Conversely, derivatives (negative fair values) declined by €0.7 billion to €16.1 billion and liabilities by €1.3 billion to €5.0 billion.

The Cooperative Financial Network was again able to report a robust level of equity, which advanced by 3.2 percent to €107.7 billion (December 31, 2017: €104.4 billion). The main reason for this rise was the appropriation of profits generated in 2018 to boost reserves. This growth strengthens the Cooperative Financial Network and gives it scope to continue expanding the lending business and to invest for the future.

Capital adequacy and regulatory ratios

The disclosures relating to own funds and capital requirements are based on the outcome of the extended aggregated calculation in accordance with article 49 (3) of the Capital Requirements Regulation (CRR) in conjunction with article 113 (7) CRR.

The consolidation carried out as part of the extended aggregated calculation demonstrates that by far the greatest proportion of the consolidated own funds consists of the own funds of the cooperative banks. The growth in own funds therefore arises primarily from the profits generated by the cooperative banks and network institutions. Rights issues by the network institutions are for the most part subscribed internally and consolidated within the Cooperative Financial Network.

Due to the exclusion of internal exposures within the network in accordance with article 113 (7) CRR, risk-weighted exposure amounts are generally not consolidated. Consolidation measures primarily include directly and indirectly held own funds instruments within the Cooperative Financial Network and therefore particularly affect equity investments of cooperative banks and subordinate receivables due to them from the network institutions, especially from DZ BANK AG. The amounts are consolidated in the relevant own funds categories.

The impact of consolidation on the level of the risk-weighted exposure amounts is therefore negligible, whereas own funds decrease. The method by which the consolidation is carried out results in a total capital ratio for the Cooperative Financial Network that is lower than the corresponding ratio for the sum of all cooperative banks.

The Cooperative Financial Network's Tier 1 capital ratio increased again to stand at 13.6 percent as at the end of 2018 (December 31, 2017: 13.4 percent). If the reserves pursuant to section 340f of the German Commercial Code (HGB) are classified as Tier 1 capital, the Tier 1 capital ratio was unchanged year on year at 15.6 percent. At 15.8 percent, the regulatory total capital ratio was down slightly compared with a year earlier (December 31, 2017: 16.0 percent), due in large part to the effect of regulatory transitional provisions. Overall, the Cooperative Financial Network's own funds increased by €4.0 billion to €101.7 billion. The rise in own funds was largely attributable to the retention of profits from 2017 by the cooperative banks.

As at December 31, 2018, risk-weighted assets stood at €642.4 billion, which was up by €30.9 billion year on year (see the table on page 19). This increase was predominantly due to the growth of loans and advances in customer-related business. In total, credit risk exposures made up 89.6 percent of risk-weighted assets. The banks in the Cooperative Financial Network primarily use the Standardized Approach to credit risk to determine their regulatory capital requirements. Some institutions also apply internal ratings-based (IRB) approaches, including the DZ BANK Group, Münchener Hypothekenbank eG, and Deutsche Apotheker- und Ärztebank eG.

Using Tier 1 capital (including reserves in accordance with section 340f HGB and applying the new CRR provisions in full) as the capital basis, the leverage ratio was 7.8 percent as at December 31, 2018 (December 31, 2017: 7.7 percent). This ratio underlines the sound capital adequacy of the Cooperative Financial Network.

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Breakdown of risk-weighted assets

€ million

	Dec. 31, 2018	Dec. 31, 2017	Change (percent)
Credit risk			
of which Standardized Approach to credit risk			
of which corporates	174,537	157,653	10.7
of which retail business	128,375	122,107	5.1
of which secured by mortgages on immovable property	83,224	79,159	5.1
Total under the Standardized Approach to credit risk	***473,191***	***447,637***	***5.7***
of which IRB approaches			
of which corporates	43,786	42,808	2.3
of which retail business	22,516	20,300	10.9
of which equity investments	22,368	21,561	3.7
Total under IRB approaches	***102,071***	***99,368***	***2.7***
Total credit risk	**575,454**	**547,241**	**5.2**
Total market risk	**12,927**	**11,184**	**15.6**
Total operational risk	**50,884**	**49,853**	**2.1**
Total other exposures (including CVAs)	**3,087**	**3,212**	**−3.9**
Total	**642,352**	**611,490**	**5.0**

Operating segments of the Volksbanken Raiffeisenbanken Cooperative Financial Network

The operating segments 'Retail Customers and SMEs' and 'Central Institution and Major Corporate Customers' were previously called 'Retail' and 'Bank'. Their composition has not changed.

Retail Customers and SMEs operating segment (2017: 'Retail')

The **net interest income** generated by the Retail Customers and SMEs operating segment amounted to €16,321 million in 2018 and was therefore again lower than the prior-year amount (2017: €16,489 million). In the Retail Customers and SMEs operating segment, volume growth only partly offset the sustained negative effects of the ECB's low-interest-rate policy. The volume of LuxCredit foreign currency lending was almost at the level of the prior year. Net interest income from consumer finance business rose once again thanks to a significant consumer propensity to buy goods and services and take on finance, fueled by the stability of the German economy along with low interest rates and rising real wages.

Net fee and commission income rose significantly, advancing from €6,646 million in 2017 to €6,918 million in the year under review. Net fee and commission income in the Retail Customers and SMEs operating segment in 2018 was once again primarily influenced by income from payments processing and strong customer demand in the securities and funds business. As a result of the sustained period of low interest rates, retail investors are increasingly turning to investment products backed by real estate and tangible assets to supplement their interest-related investments. The volume-related income contribution generated from the average assets under management was one of the key factors in the increase in net fee and commission income in the Retail Customers and SMEs operating segment. However, income from performance-related management fees and from real estate fund transaction fees fell short of the amounted generated in 2017. The contribution to income from the fund services business also improved a little year on year, whereas the volume of assets under management relating to high-net-worth clients was down slightly.

Gains and losses on trading activities in the Retail Customers and SMEs operating segment declined year on year, amounting to a net gain of €195 million (2017: net gain of €213 million). Gains and losses on trading activities are derived from trading in financial instruments, gains and losses on trading in foreign exchange, foreign notes and coins, and precious metals business, and gains and losses on commodities trading.

The level of **gains and losses on investments** deteriorated by a substantial €956 million to a net loss of €1,130 million in the reporting year (2017: net loss of €174 million), mainly due to write-downs on securities and lower realized gains on the sale of funds in own-account investing activities.

Loss allowances, which were determined in accordance with IFRS 9, amounted to a net addition of €232 million in 2018 (2017: net reversal of €95 million).

In terms of costs, there were further efforts to make the Cooperative Financial Network even more efficient. Overall, it was not possible to further reduce **administrative expenses** in the Retail Customers and SMEs operating segment and they amounted to €15,386 million in the year under review (2017: €15,245 million). The main influences on this segment's administrative expenses were appointments to new and vacant positions and average pay rises, although there was a mitigating effect from people leaving – mainly due to retirement. Capital expenditure on the cooperative banks' digitalization initiative and spending on the standardization of IT banking processes impacted on costs, too. However, this investment is strengthening the Cooperative Financial Network's future competitiveness. Increased expenses for external research services and higher costs for IT and marketing in the consumer finance business also pushed up administrative expenses in the Retail Customers and SMEs operating segment during the reporting year. For these reasons, a further reduction in administrative expenses was not possible in 2018.

As a result of the factors described above, the **profit before taxes** of the Retail Customers and SMEs operating segment fell from €8,088 million in 2017 to €6,208 million in 2018. Accordingly, the cost/income ratio increased by 2.6 percentage points to 68.2 percent (2017: 65.6 percent).

Central Institution and Major Corporate Customers operating segment (2017: 'Bank')

The **net interest income** of the Central Institution and Major Corporate Customers operating segment declined again, by €154 million, to €1,371 million in 2018 (2017: €1,525 million).

The Cooperative Financial Network's corporate banking business has been pivotal in supporting the sustained economic upturn that began some years ago. Over the past few years, the volume of lending has consistently grown at a much faster rate than that of the market as a whole, enabling a sharp rise in the network's share of the corporate customer lending market. Although economic growth slowed in 2018, the German economy remains robust and is thus making a key contribution to net interest income in the Central Institution and Major Corporate Customers operating segment. At the same time, however, the increasingly challenging competitive environment continues to put pressure on credit margins. Both digitalization and the shift in customer behavior are intensifying the need for innovation and optimization in corporate banking. The sound capital and liquidity position of the majority of large and medium-sized companies enables them to meet their capital investment requirements from their own cash flows or reserves rather than take out loans.

Net interest income also decreased in the money and capital markets business due to portfolio contraction resulting from the shortening of the duration of own-account investments. The adverse impact of subordinated capital diminished as a consequence of the decrease in liabilities-side business.

In the transport finance business, the prior year had been significantly affected by special accelerated depreciation allowances on assets subject to operating leases. The international transport industry again experienced overcapacity within some segments of the international maritime shipping market in 2018, resulting in sharply falling freight rates and considerable downward pressure on ship prices. Even though shipyards continue to offer attractive prices, ordering activity was fairly sluggish. Supply and demand may therefore need to be realigned. Further orders for new vessels could jeopardize the recovery.

The leasing business saw an increase in net interest income in 2018, mainly due to a sharp rise in the volumes of the digital products 'VR Smart flexibel' and 'VR Smart express'. This offset a slight drop in the non-core business, which is being scaled back in accordance with the strategy. The non-core business includes real estate leasing, centralized settlement, IT leasing, hire purchase and leasing business with a value of more than €750,000, and factoring and international business.

Net fee and commission income in the Central Institution and Major Corporate Customers operating segment came to €550 million in 2018 and was therefore slightly higher than in the previous year (2017: €519 million). The principal sources of net fee and commission income are service fees in corporate banking, capital markets business, and transaction banking. As well as guarantees, these encompass international business, securities issuance business, payments processing, and securities custody. In 2018, net fee and commission income from lending in the transport finance business was on a par with 2017. The levels in the asset management and advice business also changed only minimally.

Gains and losses on trading activities in the Central Institution and Major Corporate Customers operating segment came to a net gain of €267 million in 2018, down by €218 million compared with the net gain of €485 million in 2017. The deterioration of gains and losses on trading activities was predominantly attributable to market-price-related measurement losses, specifically spread-induced measurement losses in interest-rate and fixed-income trading.

Key influences on capital markets during the year under review were the aforementioned continuation of the ECB's program of quantitative easing and the four interest-rate hikes by the Fed described earlier. The weakening of economic growth that was discernible in Germany and the eurozone in 2018, far-reaching geopolitical changes, and the trade disputes between the United States and China had a detrimental impact on export-dependent sectors of the economy and led to far more volatile stock market prices.

The level of **gains and losses on investments** improved from a net loss of €17 million in 2017 to a net gain of €195 million in the reporting year as a result of gains from the disposal of securities in the liquidity pool. Some of these gains were offset by losses arising from the termination of hedges in the context of portfolio fair value hedge accounting.

In the transport finance business, the figure for the prior year had notably been affected by impairment losses recognized in respect of equity-accounted entities. The figure for 2018 predominantly comprised gains on the sale of an equity-accounted investment.

Loss allowances, which were determined in accordance with IFRS 9 for the first time in 2018, amounted to a net reversal of €70 million in the reporting year compared with a net addition of €693 million in 2017. This positive trend was predominantly due to borrowers' rating improvements and successful restructuring and recovery measures, but also to the generally lower loss allowance requirement in the transport finance business.

Other gains and losses on valuation of financial instruments deteriorated to a net loss of €79 million in 2018 (2017: net loss of €10 million) as a result of market conditions. This decrease was mainly attributable to IFRS-related measurement effects relating to hedge accounting and to interest-rate-related measurements of cross-currency swaps.

Administrative expenses went down by €25 million to €1,944 million in the period under review (2017: €1,969 million). In 2017, this item had still been adversely affected by merger-related expenses in connection with the migration of data. The Central Institution and Major Corporate Customers operating segment was able to make savings on its staff expenses in 2018 due to reduced expenditure on variable remuneration. These savings were partly offset by higher expenses for the bank levy and by increased project-related consultancy and IT expenses.

Profit before taxes in the Central Institution and Major Corporate Customers operating segment climbed by €524 million year on year to €431 million (2017: loss of €93 million) due to the factors described above. The cost/income ratio rose from 76.6 percent in 2017 to 84.3 percent in the reporting year.

Real Estate Finance operating segment

The **net interest income** of the Real Estate Finance operating segment amounted to €1,423 million in 2018 (2017: €1,492 million) and was again adversely affected by the sustained low level of interest rates in the capital markets. In the case of loans issued under advance or interim financing arrangements, the Cooperative Financial Network's Real Estate Finance operating segment managed, at the same time, to strengthen its non-collective income base in terms of volume on the back of a marked expansion in business over the last few years and despite a fall in average returns. Thanks to expansion of the portfolio, this growth more than offset the decline in income from home savings loans and other building loans. The increased customer demand for home savings bears testimony to the particular merits of home savings, which enable customers to enjoy steady capital growth irrespective of economic conditions. The German investment market for commercial real estate also made an encouraging contribution in 2018, although it did not quite match the income generated in 2017. The high prices of real estate assets in prime locations encouraged German investors to invest in properties at sites outside the major cities. The increase in the level of competition in previous years, combined with higher demand caused by pressure from investors in Germany and abroad, led to a further rise in the prices of commercial real estate and in prices in the market for commercial investments in housing in the year under review. Higher tax receipts for local authorities resulted in growth in the public-sector business as well in 2018.

The net expense traditionally reported for this operating segment under **net fee and commission income** dropped by €12 million to a net expense of €110 million (2017: net expense of €122 million). This improvement was due to a fall in fees and commissions not directly attributable to the conclusion of a home savings contract. The substantial growth in home savings and home finance underscores the marked preference among German citizens for personal pension arrangements based on home ownership.

The level of **gains and losses on investments** in the Real Estate Finance operating segment declined, by €19 million, to reach a net gain of €6 million (2017: net gain of €25 million). Gains and losses on investments consist of gains and losses on securities and gains and losses on investments in subsidiaries and equity investments.

The net reversal posted under **loss allowances** in the Real Estate Finance operating segment decreased from €12 million in 2017 to €2 million in the year under review.

Other gains and losses on valuation of financial instruments in the Real Estate Finance operating segment deteriorated significantly year on year, amounting to a net loss of €16 million in 2018 (2017: net gain of €292 million). This decrease was mainly caused by a widening of credit spreads on bonds from the peripheral countries of the eurozone in the mortgage lending business, whereas credit spreads had narrowed in 2017.

Administrative expenses rose to €885 million in 2018 (2017: €804 million). This increase was mainly due to additional expenses for consultancy and IT costs in relation to strategic projects as well as measures to enhance the Real Estate Finance operating segment.

Profit before taxes in the Real Estate Finance operating segment fell by a substantial €451 million to €477 million in the reporting year (2017: €928 million). The performance of the Real Estate Finance operating segment, as outlined above, meant that the cost/income ratio rose to 65.1 percent (2017: 46.7 percent).

Insurance operating segment

Net premiums earned went up by €816 million to €15,997 million (2017: €15,181 million), reflecting the integral position held by the R+V subgroup within the Cooperative Financial Network. This exceeded the level of premiums earned in 2017 by 5.4 percent. Gross premiums written increased by 5.2 percent to €16,133 million in the year under review (2017: €15,338 million), also surpassing the excellent level of premiums written in 2017.

Premium income in the life insurance and health insurance business grew by a total of 3.2 percent to €7,868 million. In the life insurance business, premiums rose markedly, by 2.9 percent, to €7,273 million. This growth was predominantly attributable to higher one-off premiums, particularly in the Neue Garantien and bAV (occupational pensions) product lines, whereas premiums from products in the classic and unit-linked businesses declined. In the health insurance business, net premiums earned rose by 6.3 percent to €595 million. The year-on-year growth in the full health insurance and other supplementary insurance lines was particularly encouraging. On the other hand, the occupational health insurance and private long-term care insurance lines contracted.

In the non-life insurance business, premium income grew by 4.8 percent to €5,788 million, with most of this growth being generated from vehicle insurance and corporate liability insurance business.

Premium income from the inward reinsurance business rose by 15.1 percent to €2,341 million. The business in Europe performed well on the whole, with particularly strong growth in the United Kingdom. Business was also encouraging in Asia, whereas other regions registered a decrease in premiums.

Gains and losses on investments held by insurance companies and other insurance company gains and losses declined by 62.0 percent to a net gain of €1,342 million (2017: net gain of €3,531 million). At the end of the year under review, the level of long-term interest rates was slightly below the corresponding level at the end of the previous year. At the same time, the significant widening of spreads on interest-bearing securities had an adverse impact on this item during the year under review. Equities markets relevant to R+V did worse during the course of 2018 than they had in the prior year. In 2018, movements in exchange rates between the euro and various currencies were noticeably more favorable overall than in the previous year.

Overall, these trends in the reporting year essentially resulted in a €1,695 million deterioration in unrealized gains and losses to a net loss of €1,297 million (2017: net gain of €398 million), a €1,195 million deterioration in the contribution to earnings from the derecognition of investments to a loss of €21 million (2017: gain of €1,174 million), and a fall of €121 million in current income and expense to income of €2,346 million (2017: income of €2,467 million). On the other hand, foreign exchange gains and losses improved significantly, by €838 million, to a net gain of €181 million (2017: net loss of €657 million) and the balance of depreciation, amortization, impairment losses, and reversals of impairment losses improved by €91 million to a net expense of €50 million (2017: net expense of €141 million).

Owing to the inclusion of provisions for premium refunds (particularly in the life insurance and health insurance business) and claims by policyholders in the fund-linked life insurance business, the change in the level of gains and losses on investments held by insurance companies also affected the 'insurance benefit payments' line item presented below.

Net insurance benefit payments decreased by 7.2 percent from €15,312 million in 2017 to €14,208 million in 2018. At the companies offering personal insurance, the changes in insurance benefit payments were in line with the change in premium income and in gains and losses on investments held by insurance companies and other insurance company gains and losses. An amount of €305 million (2017: €827 million) was added to the supplementary change-in-discount-rate reserve. The 'corridor method' for calculating the supplementary change-in-discount-rate reserve was introduced in accordance with the German Regulation for Amending the Regulation on the Principles Underlying the Calculation of the Premium Reserve (DeckRV), which came into force on October 23, 2018. This method changed the procedure for determining the reference discount rate in order to restrict excessive changes under the previous rules. The corridor method was applied retrospectively for the whole of 2018 for those R+V Group companies offering personal insurance that were affected.

The non-life insurance business had to absorb expenses arising from storms Friederike and Burglind of around €90 million and from storms Wilma and Yvonne of around €50 million during the reporting year. Overall, the level of natural peril losses was within the anticipated claims budget.

In the inward reinsurance business, the net claims ratio was considerably lower than in the previous year. Notable natural disaster events included the Camp Fire in California, Typhoons Jebi and Trami in Japan, and Hurricane Michael in Florida, which together gave rise to a total expense of €149 million.

Insurance business operating expenses went up by 4.9 percent to €2,721 million (2017: €2,595 million) in the course of ordinary business activities in all divisions, with a particularly sharp rise in the non-life and inward reinsurance segments.

As a result of the factors described above, **profit before taxes** for the reporting year fell by €382 million to €413 million (2017: €795 million).

Management Report 2018

Human Resources Report and Sustainability Report

Human resources report

The financial sector faces huge challenges as a result of far-reaching changes in its environment. The transformation into a digital world, a shift in customers' expectations, and the transition to an information society with the postulate 'life-long learning' all place new demands on employees and managers, including in the Cooperative Financial Network. Moreover, there have been changes among employees across all age groups about what they expect from their immediate working environment.

It is increasingly recognized that the digital transformation can only be effective if the implementation of new technologies is accompanied by a fundamental cultural shift at the individual banks. This cultural evolution starts with the broad-based use of digital media but also encompasses internal communications and necessitates both a revised approach to management and increased flexibility in terms of working hours and location. From a human resources perspective, banking of the future at the cooperative banks will require employees and managers to be well-versed in the use of digital applications, to be open to the opportunities of digitalization, and to practice a measured risk culture when it comes to dealing with these new areas. A high level of willingness to embrace change at every level and having the necessary organizational structures in place are crucial if the individual bank is to successfully equip itself for the future.

In this process, the cooperative banks are supported by a comprehensive range of products and services from the cooperative associations, academies, and service providers. Specially designed professional development activities are available for employees, managers, and members of boards of managing directors that help to equip them for this upcoming transformation.

Human resources activities at the level of the individual cooperative banks also need to change. The focus is not only on improving the efficiency of human resources work by deploying suitable IT tools but also on sharing the work more widely with HR service providers within the Cooperative Financial Network and, in particular, on increasing the HR expertise of staff in the department. For this reason, the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken e.V. (BVR) [National Association of German Cooperative Banks] launched a project relating to human resources work of the future in 2018. The objectives of the project are as follows:

– Formulation of a new strategic blueprint for future human resources work so that the cooperative banks can continue to cater to the changing requirements faced by their workforce

– Incorporation of the products and services of the cooperative HR service providers into this strategic blueprint for future human resources work

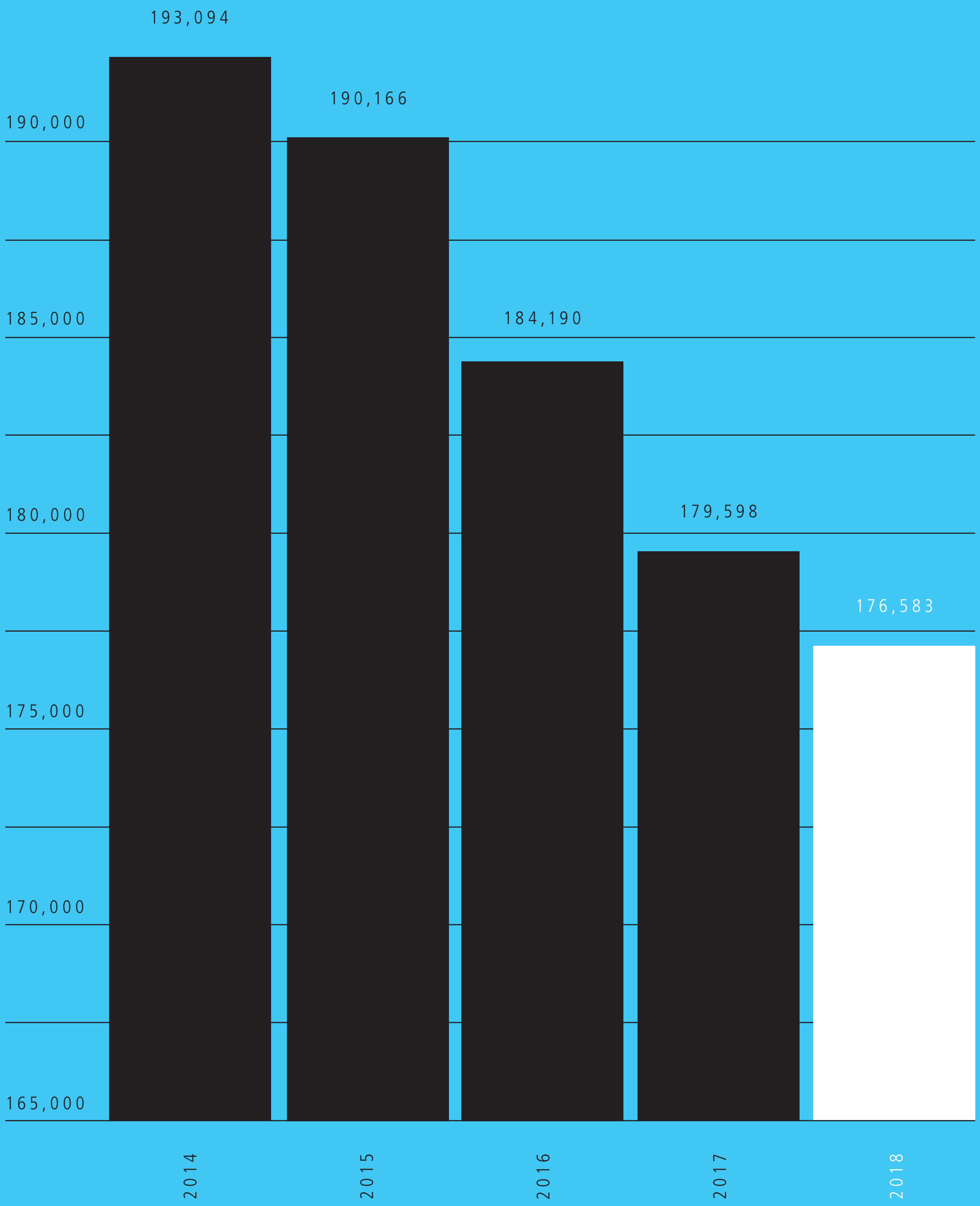
If a cooperative bank's workforce is to be a key factor in the information society, then human resources activities will also take on a fundamental role by making an invaluable contribution to the institution's efforts to equip itself for the future.

Another vital factor for the future is the ability of individual cooperative banks to recruit and retain well qualified young people. The 'next' initiative for trainees has been enhanced in order to provide the member institutions with effective support in this process. In 2018, five trainees were again selected for the 'next' ambassador team to act as authentic proponents of the local cooperative banks' traineeship programs. The career websites were also revised in 2018, while the hashtag @wirsindnext ('we are next') has been launched for use on social media. Two new digital platforms enable contact between all trainees and with trainers and marketing managers across Germany. At the next Drehmoment ('next turning point') event, trainees from across Germany met with experts in banking, training, education, and work for the first time, participating in workshops to gain fresh motivation and develop ideas for the future. The popularity of the local cooperative banks as a trainer and employer was confirmed when they were included in the Trendence institute's 2018/2019 ranking of the most sought-after employers for school-leavers for the 13th time in succession.

Although a traineeship in banking continues to be highly regarded as an entry-level qualification, significant changes are taking place. The ratio of trainees to other employees fell slightly, although it remains at a high level compared with other sectors. At the end of the year, the ratio stood at 6.3 percent (December 31, 2017: 6.8 percent; see chart on page 30). The decrease is partly due to the lack of suitably qualified applicants and forward-looking HR planning. The reorganization of the workforce was also reflected in the number of employees, which decreased slightly in the reporting year to 176,583 (December 31, 2017: 179,598; see chart on page 28).

Currently, around 90 percent of all traineeships in the cooperative banks are banking traineeships. In view of the digital revolution, however, HR planning is increasingly focusing on other occupations too. This includes traineeships in dialog marketing, IT and, since August 2018, a traineeship in the newly recognized occupation 'e-commerce'. The proportion of employees with a degree rose from 8.0 percent to 8.4 percent in 2018 (see chart on page 31). For the seventh time in a row, the local cooperative banks were ranked among 'Germany's top 100 employers' by the trendence Absolventenbarometer. This survey asked around 14,000 students approaching their final exams about their ideal employer and their career goals.

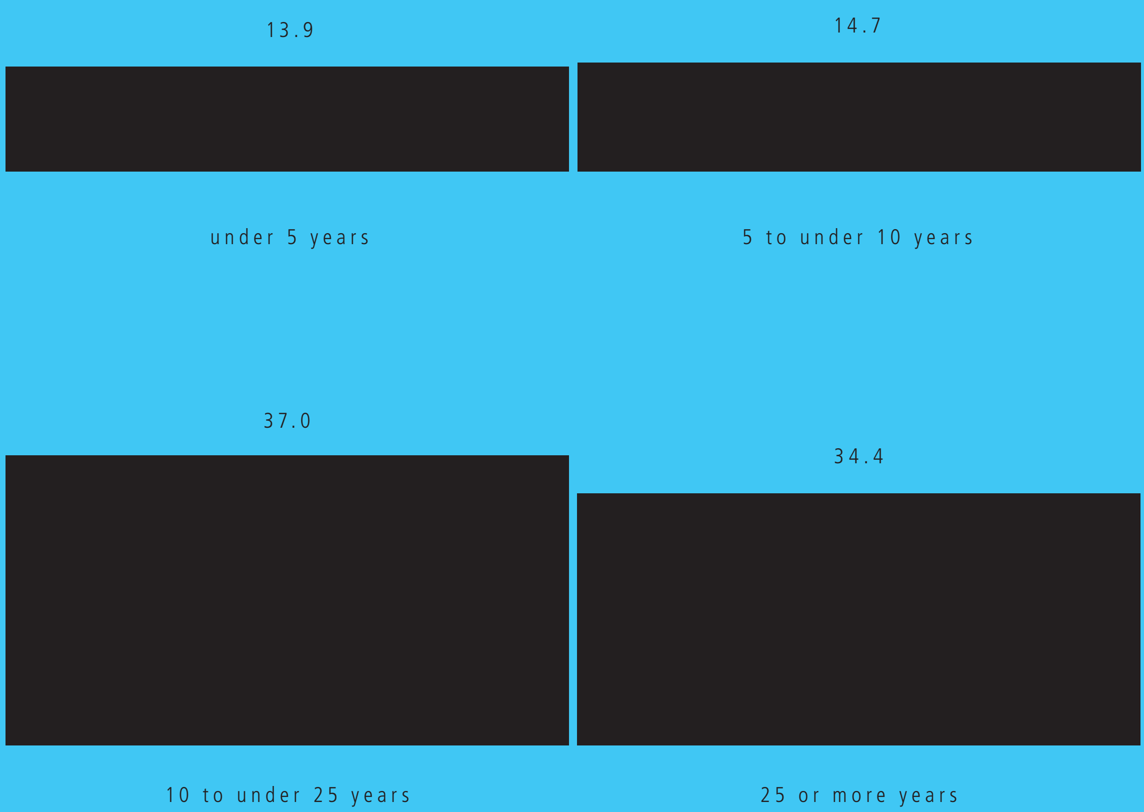
Number of employees*



* Volksbanken Raiffeisenbanken Cooperative Financial Network

Years of service*

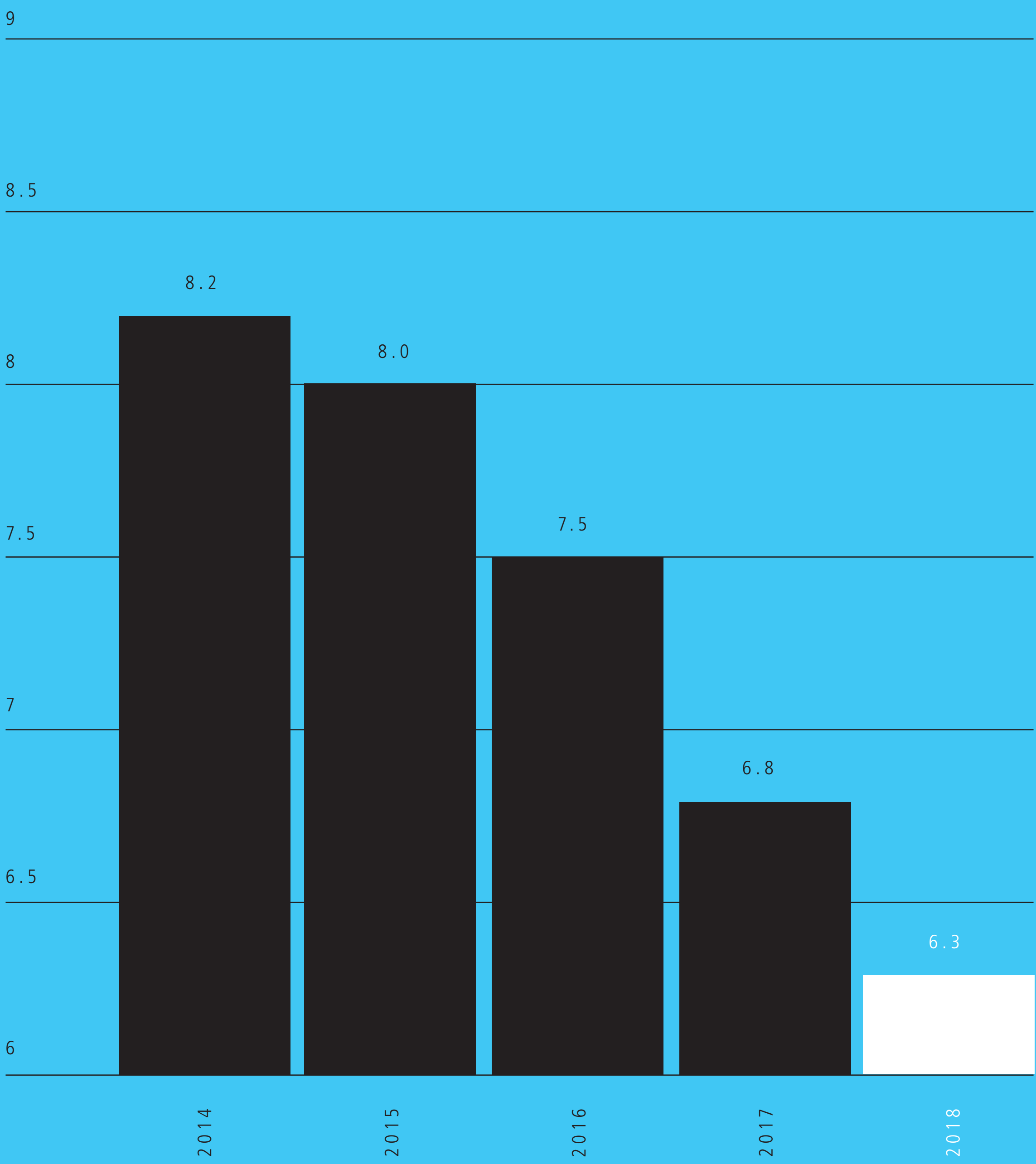
Percent



* Cooperative banks and DZ BANK AG

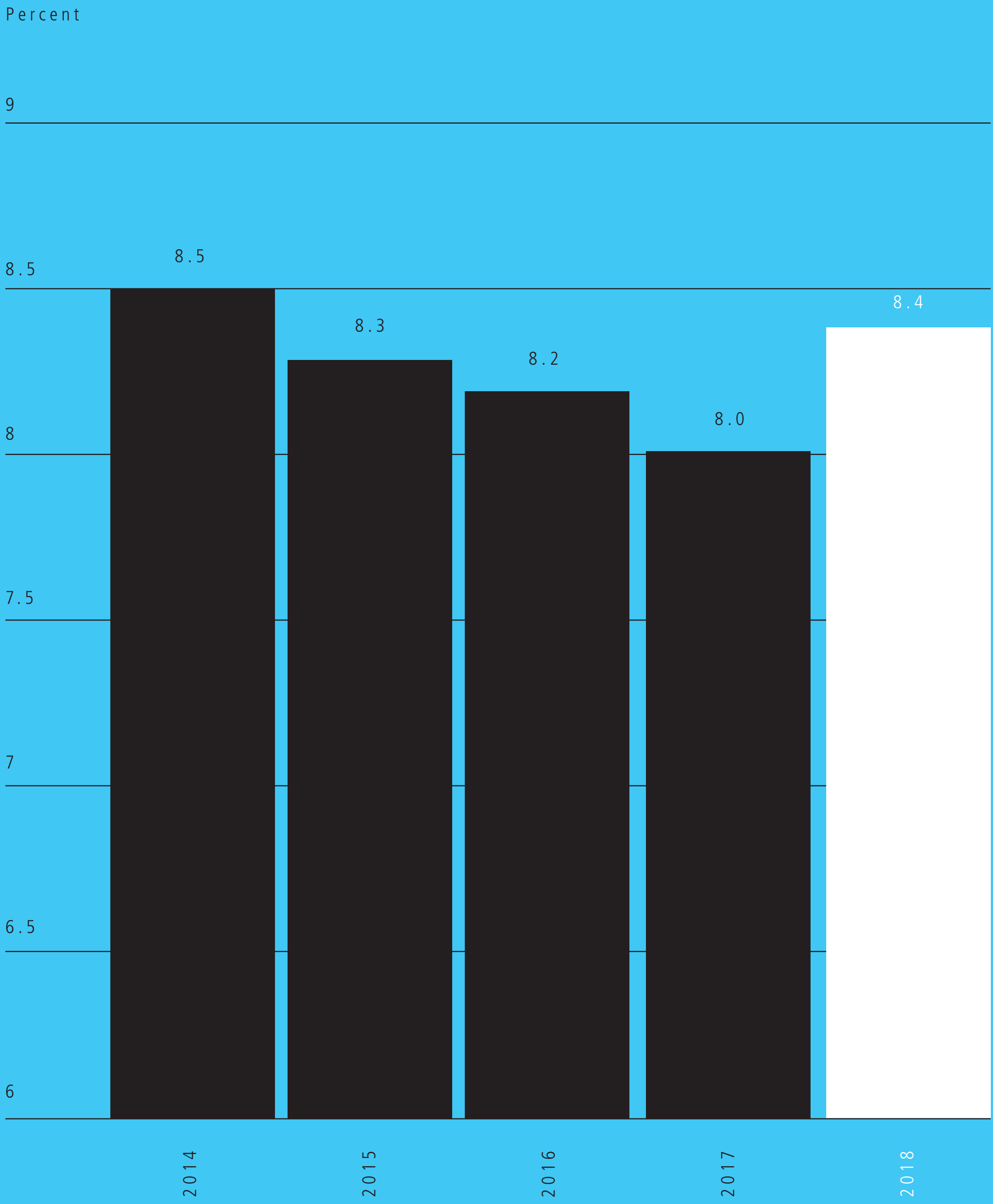
Ratio of trainees to other employees*

Percent



* Cooperative banks and DZ BANK AG

Proportion of employees with a degree*



* Cooperative banks and DZ BANK AG

Sustainability report

For many years, the idea of sustainability has been a guiding light for politicians, businesspeople, and environmentalists. One of the most widely used definitions of the term sustainability is the one developed by the United Nations in 1987: "Sustainable development is development that meets the needs of the present generation without compromising the ability of future generations to meet their own needs." According to this definition, sustainable development refers both to the present and to the future. The Cooperative Financial Network promotes sustainable development from an economic, social, and environmental perspective.

Owners: achieving more together

The identity principle is what makes the cooperative different from all other types of company structure. Its members are also its owners and customers. More than half of its customers have proactively decided to become a member. The cooperative banks have 18.6 million members across Germany. The cooperative banking remit to provide development finance entails collaboration in a spirit of partnership aimed at mutual benefit. It also defines the ethical business context: According to section 1 of the German Cooperative Act (GenG), the nature of the business has to be oriented to the long-term success of its members. Partnership, self-responsibility, and helping people to help themselves are thus part of the cooperative DNA.

Cooperative advocacy, along with the annual general meeting or general assembly of representatives and the supervisory board (whose members are businesspeople from the region), ensures opportunities for involvement in the democratic process and encourages dialog within society on economic, social, and environmental issues. At the same time, the local cooperative banks learn from the collaboration with their cooperative governing bodies, adopt business innovations, and embrace changing requirements in order to put their business models on an efficient footing for the future in line with market needs.

Regional responsibility

In accordance with their remit to provide development finance, the cooperative banks independently align the nature of their business to the long-term success of their members and customers, taking a grass-roots democracy approach. A responsible business policy with a strong focus on members and on the common good is thus an integral element of their corporate strategy. For more than 170 years, they have been supporting, encouraging, and advising local people and companies through their financial services and playing a vital role for the real economy through responsible lending. They operate and do business on the basis of mutuality: Each cooperative bank belongs to its members, who benefit from the strength and solidarity of a powerful community. Moreover, an annual dividend enables members to share directly in the business success of the cooperative banks.

The local cooperative banks have always adhered to the principle of sustainability and pass on their economic success to the regions in which they operate. They play a proactive role in the economic, social, and cultural development of their local area. They effectively expand their cooperative network structure through donations, sponsorship, and the voluntary activities of their employees in the community. At the same time, the remit to provide development finance defines the sustainable value creation process at the core of their day-to-day business. The combination of commercial viability and corporate responsibility underpins their regional strength, which they continually develop and expand.

In the challenging times created by the digital transformation and social change, the cooperative movement's strengths of customer proximity and regional roots are needed more than ever before. The cooperative banks are updating their values-based business model for the future, in dialog with their members and for their benefit.

Corporate social responsibility (CSR)

Every year, the BVR conducts a survey of all member institutions in order to record the Germany-wide CSR data of the Cooperative Financial Network. This provides tangible proof of how the many different engagement activities in the regions combine to create a force to be reckoned with at national level and highlights the particular contribution that the cooperative banks make to society (CSR reports of the local cooperative banks). The entities of the DZ BANK Group have also established various products, concepts, and processes that are based on environmental, social, and ethical criteria.

The latest figures for 2018 show that the Volksbanken Raiffeisenbanken Cooperative Financial Network is constantly stepping up its activities as a corporate citizen. The local cooperative banks and their specialized institutions provided financial assistance totaling €145.2 million to people in Germany. Donations from the Volksbanken Raiffeisenbanken and other cooperative banks reached €97.7 million and local communities benefited from sponsorship worth €36.7 million; income from charitable foundations added a further €10.8 million. This ever stronger commitment, not just in 2018 but also in the years before, reflects the healthy financial results of the Cooperative Financial Network. This shows that good financial performance is not an end in itself but leads to more being done for local needs.

Furthermore, the foundation assets of the Volksbanken Raiffeisenbanken Cooperative Financial Network amounted to €318 million at the end of 2018. This sum has been rising steadily for years. This total volume of foundation assets has more than doubled in recent years. To put that into context, the equivalent amount at the end of 2009 was only €125 million. Support for charitable foundations is a particularly sustainable form of social engagement. Reflecting the sustainability and long-term orientation of the 875 cooperative banks' business philosophy, this commitment to charitable foundations represents a very durable way of backing local projects.

Management Report 2018

Combined Opportunity and Risk Report

Principles

The following description of the risk management system is based on the structure and functional principles of the Cooperative Financial Network's institutional protection scheme at a primary level, but also takes into account the risk management of the individual institutions as a secondary element. In this context, risk management at the level of the protection scheme is mainly focused on preventing individual institutions from getting into difficulties.

Risk reporting covers all entities in the scope of consolidation for the purposes of commercial law. The scope of consolidation for the consolidated financial statements therefore goes beyond the companies consolidated for regulatory purposes and is not limited to the members of the protection scheme.

Risk management in a decentralized organization

The BVR protection scheme and BVR Institutssicherung GmbH ensure the stability of the entire Cooperative Financial Network and confidence in the creditworthiness of all its members. Both schemes together, and each in its respective functions and area of responsibility, form the backbone of risk management in the Cooperative Financial Network.

Institutional protection scheme of the Cooperative Financial Network

BVR protection scheme (BVR-SE)

BVR-SE is Germany's and the world's oldest deposit guarantee fund for banks and is financed entirely without government support. Since its creation in the 1930s in the wake of the global economic and banking crisis, it has always ensured that all affiliated banks have been able to meet their financial obligations, particularly with regard to the deposits of retail customers. BVR-SE is regulated and monitored by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) [German Federal Financial Supervisory Authority].

Since the German Deposit Insurance Act (EinSiG) came into effect on July 3, 2015, when it became necessary to establish a legally recognized deposit insurance scheme, BVR-SE has been continued as an additional voluntary bank-protection scheme in accordance with section 2 (2) and section 61 EinSiG.

The main and unchanged aims of BVR-SE are to ensure stability by averting imminent financial difficulties or eliminating any such existing problems at the affiliated institutions and to prevent any negative impact on confidence in the Cooperative Financial Network. So that it can provide the necessary support in securing these aims, BVR-SE has access to a guarantee fund that is funded by contributions from the member banks. If necessary, the institutions will also support each other with additional funding (guarantee obligations).

In 2018, BVR-SE met, without qualification, all its responsibilities as a bank-protection scheme in accordance with the articles of association. A total of 885 institutions of the Cooperative Financial Network belonged to BVR-SE as at December 31, 2018 (December 31, 2017: 926 members). The decrease stemmed solely from mergers within the Cooperative Financial Network.

BVR Institutssicherung GmbH (BVR-ISG)

BVR-ISG is an officially recognized deposit guarantee scheme and, since July 1, 2015, has been operating an institutional protection scheme within the meaning of article 113 (7) of Regulation (EU) No. 575/2013 for CRR credit institutions that has been approved by the regulator. By operating the institutional protection scheme, BVR-ISG satisfies its responsibility under its articles of association to avert or eliminate imminent or existing financial difficulties in its member institutions. To this end, BVR-ISG will initiate any preventive or restructuring action, as required. Where, in accordance with section 10 EinSiG, BaFin identifies a compensation event in relation to a CRR credit institution that is a member of the BVR-ISG protection scheme, BVR-ISG will compensate the customers of the credit institution concerned in accordance with sections 5 to 16 EinSiG. BVR-ISG thus fulfills the statutory requirements regarding deposit protection for customers.

Together, BVR-ISG and BVR-SE form the Cooperative Financial Network's dual protection scheme. The members of the BVR-ISG protection scheme are those CRR credit institutions that also belong to the BVR and are affiliated to BVR-SE. As at December 31, 2018, the membership comprised 883 CRR credit institutions (December 31, 2017: 924), which is all of the banks in the Cooperative Financial Network that are authorized in Germany by BaFin.

Under section 50 (1) EinSiG, BVR-ISG is subject to supervision by BaFin and to monitoring by the Bundesrechnungshof (BRH) [German Federal Court of Audit] with regard to its responsibilities to compensate depositors in accordance with sections 5 to 16 EinSiG and with regard to funding and target funding levels in accordance with sections 17 to 19 EinSiG.

To the extent possible under EinSiG, BVR-ISG's organizational and decision-making structures match the proven organizational and decision-making structures of BVR-SE. Dual employment contracts and a service agreement are in place so that BVR-ISG's day-to-day business operations can be carried out by the BVR employees who perform the corresponding functions for BVR-SE. Given the long-established successful operation of BVR-SE, this ensures that BVR-ISG can properly carry out its duties as an institutional protection scheme (including classification, collection of contributions, etc.). BVR-ISG has also engaged a third-party service provider to carry out the processing of potential compensation procedures, although such procedures have as yet never been required, nor are any currently identifiable.

The focus of the activities of BVR-ISG in 2018 was on fulfilling its responsibilities as defined by law, the articles of association, and regulatory requirements. The activities centered on the risk-based collection of contributions, which is compliant with the relevant guidance of the European Banking Authority (EBA), the management of funds, extensive operational stress tests, and preparations for the IPS recovery plan in accordance with the Minimum Requirements for the Design of Recovery Plans (MaSan). BVR-ISG can look back on a highly successful year, having not had to take any action to protect depositors or banks or pay any compensation in accordance with section 145 of the German Bank Recovery and Resolution Act (SAG) at any time in 2018.

Risk identification and analysis

Basic structures

The Cooperative Financial Network is a decentralized organization made up of legally independent institutions that are linked – through BVR-SE – by their liability. This decentralized element is in contrast with banking groups that have a parent company at the top of a hierarchical structure. Consequently, the power to make business decisions lies with each individual institution and its independent Board of Managing Directors and Supervisory Board. This decentralized structure determines the focus of risk management for BVR-SE. The focus is above all on overall analysis of the financial risk carriers – i.e. the institutions – rather than on isolated analysis of individual risk types and their scope. This fundamental methodological approach ensures that, in establishing that each individual institution's financial position and risk position are appropriate and its financial performance is adequate, the entire system – i.e. the entire Cooperative Financial Network – as a unit can be considered to be on a sound economic footing.

BVR-SE has reliable systems for identifying and classifying risks and for monitoring the risks of all its members and of the institutional protection scheme as a whole. Risks are rated on the basis of BVR-SE's classification system, which was implemented in 2003. The aim of this rating process, which is based on the annual financial statements, is to obtain an all-round, transparent view of the financial position, financial performance, and risk position of all members. Rating a bank in accordance with the classification system provides the basis for determining the risk-adjusted guarantee fund contributions of BVR-SE and is also the starting point for preventive management.

The results of the classification are supplemented by further analysis and data, in particular evaluations of the data collected as part of an annual comparative analysis. This is a data pool that the BVR compiles from data collected from its member institutions and is predominantly based on information from the institutions' accounting and reporting systems. The data from the annual comparative analysis forms the basis for analyses that use key risk indicators to identify and examine particular abnormalities. In addition, BVR-SE prepares special analyses on specific issues and specific risks, such as determining the impact of sustained low interest rates.

In accordance with its risk-oriented mode of operation, BVR-SE performs individual bank analyses on institutions of major financial significance to the protection scheme as a whole. In doing so, the protection scheme is applying the concept used to analyze large banks, taking into account the risks resulting from the size category of the affiliated institutions.

To assess BVR-SE's risk-bearing capacity, probabilities of default are determined on the basis of various stress scenarios and Monte Carlo simulations are used to calculate the possible restructuring amounts. This involves carrying out scenario-specific classifications on the basis of different assumptions (e.g. interest-rate changes, declining credit ratings in the customer lending business).

Classification process and contributions to the BVR protection scheme

The classification system uses eight key figures relating to financial position, financial performance, and risk position to assign the banks to one of the nine credit rating categories, which range from A++ to

D. The classification system is based on quantitative key figures, most of the data for which is taken from the banks' audited annual financial statements and audit reports. BVR-SE receives this data electronically from the regional auditing association responsible for the individual bank.

All institutions covered by BVR-SE are included in the classification system. Only a small number of institutions are not included, notably those that are rated separately by an external rating company, e.g. DZ BANK AG and its subsidiaries as well as Münchener Hypothekenbank eG.

The classification process in 2018 was based on an analysis of data from the 2017 financial statements. There was another year-on-year improvement in the class distribution that was attributable to a further small boost to the risk position, a virtually unchanged level of net assets, and a slightly poorer financial performance across the network as a whole. Adjusted for non-recurring items, net interest income went down only slightly, whereas net fee and commission income rose and the cost/income ratio held more or less steady. Loss allowances for loans and advances were exceptionally low, as had been the case in previous years. There was a slight drop in the proportion of unsecured lending classed as loans with a high probability of default or as non-performing loans (NPLs).

The net profit generated was used to strengthen the financial position, in particular Tier 1 capital.

For the institutions that are also members of BVR-ISG, the 2018 rate for contributions to the guarantee fund of the protection scheme was set at 0.036 percent of the assessment basis (unchanged on 2017), taking account of any individual discounts or surcharges resulting from the classification. For the other member institutions, the contribution rate was 0.0828 percent of the assessment basis.

Risk management and monitoring

Preventive management

The aim of preventive management is to identify and counteract adverse economic trends at an early stage, thereby helping to prevent the need for supporting measures. Data and other information from the banks that might be affected is analyzed and, following additional discussions with the management of these banks, appropriate measures are agreed that are aimed at stabilizing and improving their business performance.

The results of the classification process provide the basis for BVR-SE's systematic preventive management. Preventive management is used whenever a bank is classified as B– or lower on the basis of its annual financial statements. In addition, other key figures and data have increasingly been used over the past few years so that any anomalies at institutions can be identified at an early stage. In 2018, this data included multi-year planning information from the banks' reporting systems, all of which was made available to BVR-SE.

Before the prevention phase, the monitoring of conspicuous institutions is playing an ever more significant role in the early analysis of institutions. In 2018, the monitoring once again also included institutions that were not showing any particular indications of risk but that could potentially represent a major risk simply because of the size of their balance sheet. This underpins the long-term trend of shifting the focus of BVR-SE's work away from restructuring and toward end-to-end preventive management that also includes monitoring.

Restructuring management

As before, the work of BVR-SE in restructuring member institutions is aimed at ensuring that these institutions' annual financial statements are able to receive an unqualified auditors' opinion, which it does by providing restructuring assistance. The next stage is to contractually agree appropriate measures in order to ensure that the bank's business regains its future viability while accommodating the interests of all members of the Cooperative Financial Network.

The 'Manual for future-proof bank management – guidelines for reorganizing and restructuring cooperative banks', which was revised in 2017, forms the basis for providing restructuring assistance and carrying out restructuring measures. The principles documented in the manual provide affected banks with guidance on re-establishing competitive structures, e.g. through recovery, and describe concepts for restoring their fundamental profitability. The aim is for the banks to complete this restructuring phase within no more than five years. BVR-SE's manual is also specifically aimed at banks undergoing preventive measures and any institutions that have themselves identified the need for reorganization.

BVR-SE continued to perform well in the year under review in terms of its restructuring activities. Once again, no new first-time support measures were required in 2018. Costs were therefore incurred solely in connection with legacy cases, where risks already covered had become acute or loss allowances were recognized in BVR-SE's annual financial statements. As BVR-SE also focused on dealing with and finalizing legacy cases in 2018, the level of restructuring activity fell to an almost immaterial level in the reporting year. The total restructuring amounts in need of protection were not only significantly lower than expected, they were also – on a net basis – again far smaller than the repayments under debtor warrant obligations and other guarantee release obligations. This meant that the capital base of the dual cooperative institutional protection scheme (comprising BVR-SE and BVR-ISG) was strengthened once again in 2018 and, as planned, the statutory guarantee fund resources at its disposal could be expanded yet again.

Outlook for the BVR protection scheme and BVR Institutssicherung GmbH

In financial terms, BVR-SE expects the cooperative banks' performance to be unchanged or to weaken slightly in 2019. At present, there is no sign of any scenarios that might present a material threat to the stability of BVR-SE. Particularly in view of the slowing German economy, however, an increase in the level of support and assistance provided by BVR-SE cannot – for the first time in five years – be ruled out in 2019. In light of this potential adverse development, BVR-SE plans to strengthen its guarantee fund capital in the next few years.

Against this backdrop, the BVR Association Council decided in November 2018 to increase the contribution rate for 2019. The rate for contribution to BVR-SE's guarantee fund was set at 0.05 percent of the assessment basis for the institutions that are also members of the BVR-ISG protection scheme (2017: 0.036 percent). For the other member institutions, the contribution rate was raised from 0.0828 percent to 0.0924 percent of the assessment basis.

This year, BVR-ISG again faces the task of implementing regulatory requirements, such as preparing recovery plans within the meaning of sections 12 to 20 SAG. It is also likely that new disclosure requirements will arise as a result of indirect and sectoral supervision by the ECB, in particular broader and stricter requirements at the level of the Cooperative Financial Network. BVR-SE expects yet more issues to emerge in this regard, involving international institutions such as the European Single Resolution Board (SRB), the EBA, and the European Commission. Such issues could affect BVR-SE and/or BVR-ISG. The EBA is due to carry out extensive activities in connection with the regular review of the EU Deposit Guarantee Schemes Directive (DGSD), which was scheduled for 2019 back in 2014. BVR-ISG will be supporting these activities by participating in a number of the EBA task force's working groups.

Capital management

Regulatory capital management

The consolidated financial statements of the Cooperative Financial Network provide a comprehensive overview of the main capital ratios, particularly the consolidated regulatory capital ratios. These capital ratios are calculated in accordance with the provisions of the CRR using the extended aggregated calculation pursuant to article 49 (3) CRR in conjunction with article 113 (7) CRR. Information concerning the regulatory capital ratios relates to the reporting date of December 31, 2018 and does not include the retention of the profits reported in the 2018 annual financial statements. Profit is retained after the individual institution's relevant committees have given their approval. This retention of profits will significantly strengthen the capital base still further in 2019.

The Tier 1 capital ratio improved to 13.6 percent (December 31, 2017: 13.4 percent). If the reserves pursuant to section 340f of the German Commercial Code (HGB) are classified as Tier 1 capital, the Tier 1 capital ratio was unchanged year on year at 15.6 percent. The Cooperative Financial Network's regulatory total capital ratio was 15.8 percent as at December 31, 2018 (December 31, 2017: 16.0 percent). Overall, regulatory own funds increased by €4.0 billion to €101.7 billion. The rise in own funds was largely attributable to the retention of profits from 2017 by the cooperative banks, which was reflected in the ratios as at December 31. The Cooperative Financial Network's capital is predominantly held by the cooperative banks.

The total risk exposure as at December 31, 2018 amounted to €642.4 billion (December 31, 2017: €611.5 billion). This 5.1 percent increase was driven by growth in the customer lending business, in both the retail and the corporate banking segments.

BVR-SE analyzes the regulatory capital ratios of each member bank on an ongoing basis. The institutions themselves are responsible for fulfilling the regulatory requirements at all times, including in respect of bank-specific SREP surcharges (e.g. for interest-rate risk, other material risks, and/or stress test results). As shown by the chart on page 44/45, the capital adequacy of the individual institutions in the Cooperative Financial Network was at a healthy level as at the reporting date of December 31, 2018. This had also been the case as at December 31, 2017.

The Cooperative Financial Network has healthy capital adequacy thanks to equity of €107.7 billion (December 31, 2017: €104.4 billion). It has continually boosted its level of capital in recent years by retaining profit. This trend substantiates the Cooperative Financial Network's sustainable business model with its broad diversification of sources of risk and income.

The leverage ratio, which is calculated for the Cooperative Financial Network on a pro forma basis, came to 6.9 percent as at December 31, 2018 (December 31, 2017: 6.8 percent). This is further proof of the above-average capital adequacy of the Cooperative Financial Network. The ratio is calculated for the Cooperative Financial Network by applying the requirements (adjusted appropriately) of article 429 CRR. This was based on Tier 1 capital as determined in the extended aggregated calculation in accordance with article 49 (3) CRR, which is adjusted for all internal Tier 1 capital positions within the joint liability scheme of the Cooperative Financial Network. The risk exposures were determined by aggregating the individual leverage ratio submissions of all the member banks and adjusting them for material internal exposures within the joint liability scheme. This approach factors in the zero weighting given to internal exposures within the network, which will be implemented for the member institutions when CRR II is introduced. If the reserves pursuant to section 340f HGB are classified as Tier 1 capital and the pertinent CRR I provisions are applied in full, the leverage ratio was 7.8 percent (December 31, 2017: 7.7 percent). The leverage ratio total exposure increased by 4.2 percent year on year, rising to €1,269.8 billion.

Economic capital management

Risk capital management is a core task at each individual institution. Pursuant to the Minimum Requirements for Risk Management (MaRisk), it must be structured according to the complexity, scope of business activities, and size of the bank. The banks receive procedural support through the VR Control concepts and VR Control software.

Risk capital management is influenced by two factors: firstly the business necessity of optimally allocating risk capital to various risk categories while taking account of risk/reward considerations and, secondly, the new requirements of the Internal Capital Adequacy Assessment Process (ICAAP). The BVR drew up the necessary integrated concept in the VR Control update project, and it will be made available to the banks in 2019.

At a business management level, the interest-rate and credit risk categories – usually the main risk categories for the cooperative banks – are included in the optimization calculation. According to the basic concept of capital market theory, where there are given risk/return figures in each class and each correlation, combinations can be found that ensure an optimum ratio in the overall portfolio at overall bank level.

Alongside these business considerations, the banking regulator has supplemented risk measurement in Pillar I with its own Supervisory Review and Evaluation Process (SREP) and worked out a system of bank-specific surcharges for interest-rate risk and other material risks as well as a stress scenario surcharge. The surcharges were again at a manageable level for the banks in 2018, and the surcharges for other material risks fell sharply compared with 2017.

The proportionality of the individual institutions is taken into account when managing risk-bearing capacity in connection with risk capital management. The German banking regulator has comprehensively redrafted the 2011 prudential paper on the supervisory assessment of bank-internal capital adequacy concepts and, with the aim of harmonization, adapted it to the principle of significant institutions (SIs). The new concept for risk-bearing capacity consists of both a normative perspective (capital planning) and an economic perspective that is based on complete risk modelling from a value-based perspective.

This new concept means a change of method for the institutions, because more than 99 percent of them previously took a going-concern approach using HGB results. To help them with this change, the BVR has – as part of its remit to act as a catalyst and provide technical guidance – put in place various support services designed to equip the banks to tackle the challenges that they will face going forward. Cooperative banks, auditing associations, the computing center, and DZ BANK were involved in drawing up the concept. Alongside the project, an impact analysis was conducted at a number of banks. It confirmed their resilience, including under the new approach.

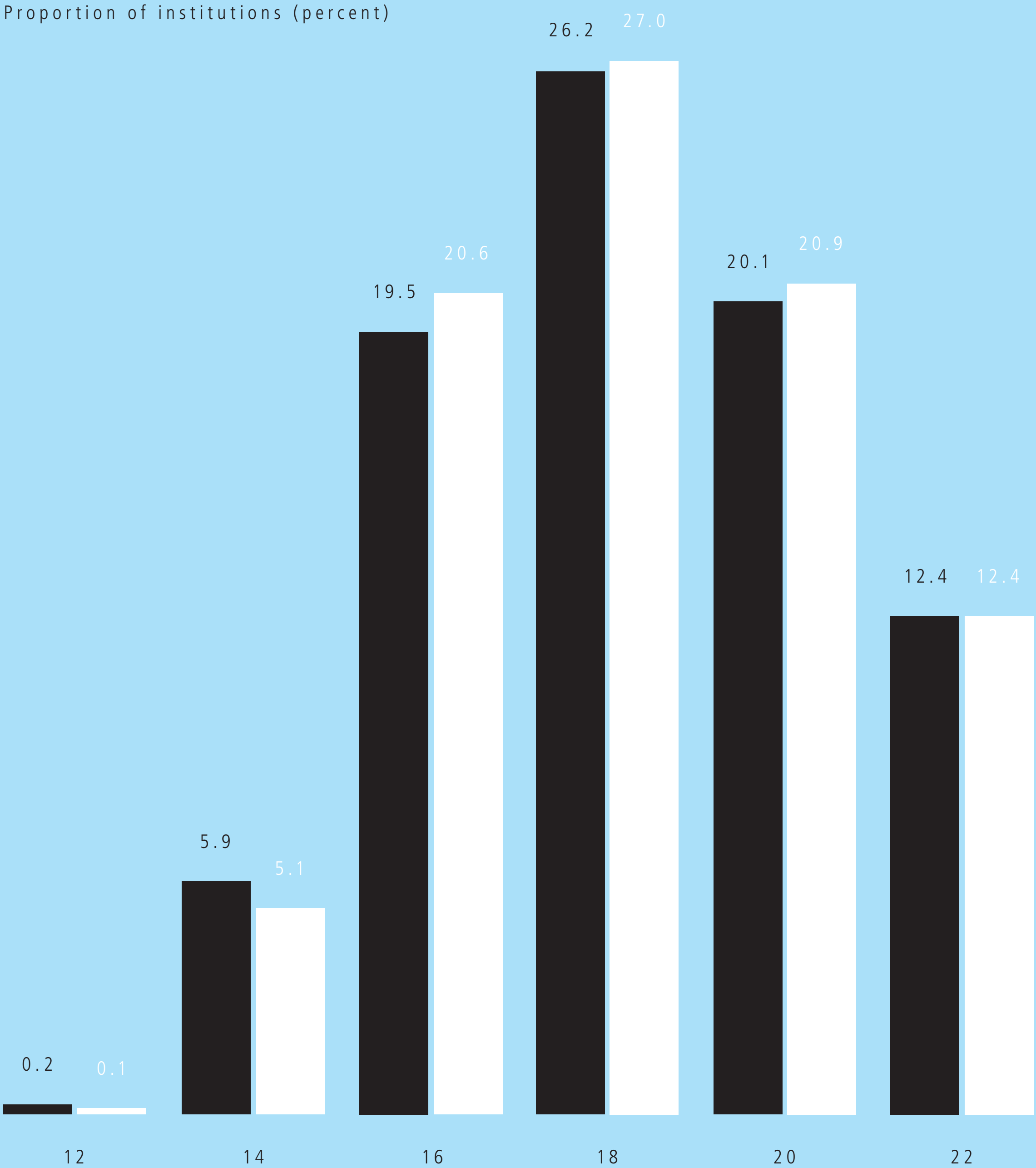
The new concept provides the basis for the necessary IT-based implementation support and should enable the banks to carry out the required calculations using their existing IT tools. Full implementation of the new guidelines will take some time and, after the banks' experts have studied them in detail, there will be an initial trial phase before the banks switch to the new calculation. The banking regulator specifically stated in an annex to the guidelines that there is a time-limited option to continue with the old going concern model during transition to the new concept.

Credit ratings of the Cooperative Financial Network

The high credit ratings of the Cooperative Financial Network remained stable and unchanged in 2018. Credit rating agencies Standard & Poor's and FitchRatings have each given the Cooperative Financial Network a rating of AA–. The credit ratings are based on the economic strength of the Cooperative Financial Network. This can be seen from the individual ratings, which are all at an identical level. The rating agencies point to the consistently successful business model focused on retail and corporate banking as the reason for their positive assessment. The funding of the business model is based on customer deposits, so it is structurally secured for the long term. Liquidity is ensured at all times by means of an extensive and highly diversified portfolio of marketable securities, combined with the cash pooling that takes place within the Cooperative Financial Network. Capital adequacy is also judged to be above average in terms of quantity and quality. The rating agencies recognize the ability and note the propensity of the Cooperative Financial Network to build up capital from its own resources by retaining profits. The granular credit structure and proportion of mortgages in the retail business are the hallmarks of the overall high level of quality in the customer lending business. BVR-SE is seen by the rating agencies as an important connecting link and a crucial element of the risk management system within the Cooperative Financial Network.

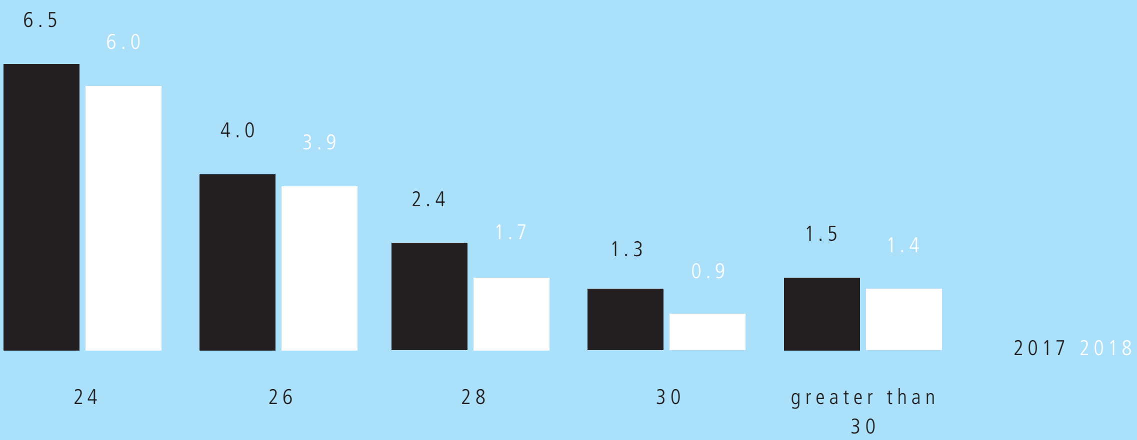
Distribution of total capital ratios in the Cooperative Financial Network*

Proportion of institutions (percent)



Total capital ratio up to ... percent

*As at December 31, 2018.


6.5
6.0
4.0
3.9
2.4
1.7
1.3
0.9
1.5
1.4
2017 2018
24
26
28
30
greater than 30

Credit risk, market risk, liquidity risk, and operational risk

Credit risk

Credit risk in the customer business is the most important risk category in the cooperative banks. To assess the creditworthiness of individual borrowers, the cooperative banks use the relevant segment-specific VR rating systems, which are validated centrally on an ongoing basis in accordance with high market standards. The vast majority of the banks, particularly when analyzing risk-bearing capacity, use portfolio models to measure risk at portfolio level. These models are also constantly reviewed at both overall model level and parameter level.

The Cooperative Financial Network's strategy focuses on the profit-oriented assumption of risk, while taking its level of equity into consideration and pursuing a risk-conscious lending policy. The cooperative banks are conservative in their lending decisions. Their knowledge of customers plays a central role, as does the capacity of customers to meet their obligations. Overall, the Cooperative Financial Network's customer lending business has a granular credit structure and a high proportion of mortgages. The granularity and extensive regional diversification of the Cooperative Financial Network's business activities limit the formation of risk clusters.

The Cooperative Financial Network registered significant growth in its lending business in 2018. Loans and advances to customers increased by 4.3 percent year on year. Once again, long-term home finance was a key growth driver. Home finance lending by the cooperative banks benefited from the favorable economic conditions. The combination of low interest rates, a healthy level of employment, and rising household incomes fueled strong demand for real-estate loans. However, residential real-estate prices in Germany continued to go up in 2018. On average across all 401 municipal and rural administrative districts, prices for purchasing residential properties for own use rose by 5.9 percent (2017: 5.4 percent). The price rises were geographically well distributed in 2018, with increases in both urban and rural areas.

To help the member institutions to monitor the regional markets, the BVR teamed up with vdpResearch GmbH to develop a concept for measuring market volatility in individual postal code areas: BVR real-estate market monitoring. The measurements from BVR real-estate market monitoring provide additional regional information to complement the German Banking Industry Committee's market volatility concept. This enables the cooperative banks to determine the geographical areas forming their relevant markets and better comply with regulatory requirements.

The growth in corporate banking was predominantly driven by lending to service sector companies, the construction sector, and further processing companies. Because of their regional roots, the local cooperative banks have also established a strong foothold in the renewable energies market and provide financial support to companies in relation to projects for increased energy efficiency and for power generation from renewable sources.

Loss allowances decreased to €151 million in 2018 (2017: €576 million). This year-on-year fall was due to the reduced recognition of loss allowances for legacy exposures in ship and offshore financing. Loss allowances remained low at 0.02 percent of the volume of loans and advances to customers and banks (total volume: €813,716 million). As at December 31, 2018, the Cooperative Financial Network's NPL ratio (non-performing loans as a proportion of the total lending volume) stood at 1.7 percent (December 31, 2017: 2.0 percent). This encouraging decrease in the NPL ratio was attributable to contraction of the volume of NPLs and a rise in the total lending volume. In summary, the cooperative banks operate a healthy lending business overall.

Market risk

Interest-rate risk has a significant influence on the banks' financial performance. Due to the persistently low interest rates, the Cooperative Financial Network's net interest income reduced by 1.4 percent in 2018. As in prior years, the largest proportion of net interest income was generated from the net interest margin contribution in the customer business. Given the persistently low level of interest rates and growing competition for deposits, the banks expect interest margins to be narrower in the future. There is also still the risk that funding costs will rise when interest rates in the financial markets start to climb again.

Along with credit risk, interest-rate risk – a category of market risk – plays an important role for most of the cooperative banks. The cooperative banks regularly measure and limit this risk with regard to their risk-bearing capacity. A distinction is made between interest-margin risk and valuation risk. Interest-margin risk is the risk of net interest income falling short of the expected or budgeted figure. Valuation risk is influenced by unexpected price volatility during the holding period. For the purpose of determining the shortfalls/volatility, parcIT provides generic interest-rate scenarios (VR interest-rate scenarios) centrally that are derived from time series. They contain not only parallel shifts but also rotations of the yield curve. The banks could face huge challenges if either the current low level of interest rates continues or there is a rapid and significant rise in interest rates. Supervisory authorities are factoring this problem into appropriate regulatory activities. For example, the Basel Committee on Banking Supervision published its new ‘Interest-rate risk in the banking book’ standard in 2016, which came into force in 2018. The EBA published its new ‘Guidelines on the management of interest-rate risk arising from non-trading book activities’ in 2018, which came into force on June 30, 2019. They introduce an early-warning indicator, for which there is a six-month transitional period. One aspect common to both the Basel standard and the EBA guidelines is that, although they continue to provide for the modeling of interest-rate risk in the banking book in Pillar II, they place greater emphasis on the quality and consistency of the management of interest-rate risk in institutions. If the internal management does not satisfy the requirements of supervisors, they can require an institution to use a standard model as described in the new Basel standard. Circular 9/2018 (BA) is being redrafted in 2019 and will take account of the aforementioned new requirements set out in the EBA guidelines.

BVR-SE monitors the appropriateness of the member institutions’ level of interest-rate risk, for example by using simulations to calculate net interest income. These simulations show that the local cooperative banks will continue to generate an adequate level of income going forward, not least as a result of the control mechanisms that they have in place.

Liquidity risk

For many years, the Cooperative Financial Network has had a reliable liquidity structure that is deemed crisis-resistant. The loan to deposit ratio of the Cooperative Financial Network is 94 percent. The basis for this lies in the diversifying, risk-mitigating effect created by the stable business structure of the banks, which tends to be divided into small units, and, in particular, in the institutions’ traditional method of obtaining funding through customer deposits. Customers therefore recognize and reward the effectiveness of the institutional protection provided by BVR-SE and BVR-ISG, which particularly aim to safeguard deposits.

The cooperative banks transfer surplus liquidity from their customer deposits to the central institution, DZ BANK. On the one hand, this gives DZ BANK indirect access to a stable source of funding based on retail deposits. On the other, cooperative banks requiring liquidity can obtain it from their central institution. DZ BANK thus pools the liquidity surpluses of the individual institutions and is able to balance out the structural differences in the individual cooperative banks’ liquidity levels. In its role as the cooperative central institution, DZ BANK ensures cash pooling within the network of cooperative banks and specialized service providers.

Each cooperative bank manages its own liquidity and the accompanying risk. In doing so, they make sure that they comply with the regulatory liquidity coverage ratio (LCR) and net stable funding ratio

(NSFR). They have business management tools at their disposal that enable the bank-specific parameterization of the funding matrices using the banks' own behavior-based assumptions and the calculation of a transaction-based liquidity price that can then be factored into their contribution costing as appropriate. The individual cooperative banks are thus able to establish and manage an appropriate level of liquidity adequacy.

With the BVR taking a leading role, the necessary plans were drawn up and then signed off by the relevant committees in 2018. A systemic rollout to support the concept is taking place in 2019.

The degree to which a bank is able to guarantee its ability to meet its payment obligations in the short term is measured using the LCR. Banks are required to maintain a sufficiently high level of liquidity. As at December 31, 2018, the median LCR of all cooperative institutions was 165.7 percent (December 31, 2017: 161.3 percent).

Operational risk

The systems and internal processes implemented by the cooperative banks aim to reduce operational risks that can lead to losses resulting from the inadequacy or failure of internal processes, people, or systems or as a consequence of external events.

A variety of measures are taken to address operational risk, including clear procedural instructions, separation of functions, the use of standardized contract templates that have been reviewed by a legal expert, and the appointment of security, compliance, data protection, and anti-money-laundering officers. In addition, business continuity plans for failure of technical equipment and unexpected staff absences are in place.

Internal control processes ensure that material operational risks are identified, analyzed, and assessed on a regular basis. The institutions can use guidelines to conduct a systematic risk assessment in keeping with market standards. Any loss event is recorded in a database. Based on the outcome of the loss event analysis, internal procedures are adjusted and preventive safeguards implemented as necessary.

Operational risk is measured in consideration of the business model of the individual institution. The dominant method is quantification by means of a plausible lump sum or based on historical loss event data, sometimes supplemented by value-at-risk approaches. Based on the analysis, the limits set by the institutions as part of their individual risk management are regularly met.

Opportunities and opportunity management

Customer membership is a distinctive feature of the cooperative banks' business model and one that is ideally suited to conveying the values of the cooperative idea. It offers the cooperative banks the opportunity to distinguish themselves from rival banking groups. The cooperative banks' distinctive characteristics are reflected in their continued ability to reach a wide range of customers. Strong customer retention results in measurable economic benefits, e.g. income growth for the cooperative banks and the protection of their market share.

Even in the digital age, the business model of the cooperative banks puts people and their wishes and objectives first. In the years ahead, the digitalization initiative launched by the Cooperative Financial Network in the retail and corporate banking businesses will enable it to proactively adapt to the changes in the competitive environment resulting from the digital revolution. The aim is to forge ahead with digitalizing the cooperative banks' products and services and offer all of the touchpoints that customers want (local branches as well as online and mobile banking).

Measures derived from the KundenFokus (customer focus) project have been implemented and there has been capital expenditure in connection with the digitalization initiative. This allows the Cooperative Financial Network to take account of the changes in customer behavior and to adjust and strengthen the overall business model accordingly. The focus is on the comprehensive omnichannel presence and thus the implementation of efficient processes at all levels. Nonetheless, personal contact remains a key component of the customer relationship, alongside high-quality advice and the possibility for customers to choose how they would like to communicate with their bank. The Cooperative Financial Network is therefore establishing efficient customer touchpoints and giving its members integrated access to all information and services through all the relevant channels – whether in branch or via digital media.

Digitalization, with its increasing influence on members' behavior, also offers the banks potential to improve their cost structure in the medium term. By marketing new digital payment services, such as contactless payments, paydirekt, and Kwitt, and implementing an online inquiry process for all of the main products, banks are able to address customer needs and attract new customers. This also enables them to target young, tech-savvy customers and members.

Consumer spending is expected to be boosted further by the positive trends in employment and disposable income. This will stabilize demand for banking products and services. Given the current low level of interest rates, the cooperative banks will continue tapping into potential in the real estate business. Should there be a sustained rise in interest rates, opportunities will open up in connection with the sale of interest-bearing financial products.

Management Report 2018

Outlook

Real economy and banking industry

Germany's economy has been turning noticeably gloomier since summer 2018. This is due not only to the more challenging global economic conditions but also to two one-off factors. Firstly, introduction of the new Worldwide Harmonised Light Vehicles Test Procedure (WLTP) resulted in a backlog of new car registrations. Secondly, the exceptionally dry summer led to low water levels in Germany's rivers and canals, causing disruptions for ship transport. The disappearance of these one-off factors should enable the overall economy to pick up again in the first half of 2019. The BVR's model-based estimates show that the economy is unlikely to slip into recession. However, economic growth is expected to remain muted for the time being. This can be seen from important sentiment indicators, such as the ifo Business Climate Index, which have not staged much of a recovery from their downturn last year, despite the brightening situation at the start of 2019.

In its latest economic main scenario (dated June 2019), the BVR predicts that, adjusted for inflation, GDP will rise by 0.8 percent in 2019. Growth is therefore expected to be significantly weaker than in 2018. As was the case last year, rising consumer spending and capital expenditure will remain the main growth drivers. These two types of spending will be underpinned by factors such as the continued increase in employment, (in many cases) rapidly rising income levels, the sustained health of the construction industry, and expansionary fiscal policy measures introduced by the German government. However, foreign trade is likely to hold back the increase in GDP, as exports will probably grow at a slower rate than imports. Consumer prices are predicted to rise by 1.4 percent.

As at June 2019, the downside risks for the economy are considerably greater than the prospects of an upturn. The risks primarily emanate from the global situation and are predominantly political in nature. If, for example, the US government imposes new tariffs on vehicles imported from the EU, there is likely to be a severe impact on German foreign trade. It is also unclear whether the weakness of the German automotive industry, which took a heavy toll on the country's economic growth in the second half of 2018, was solely caused by the one-off effect of introducing the WLTP. Structural factors were possibly at play too, and their effect could be compounded during the forecast period. Furthermore, the dispute between the United States and China flared up again in spring 2019, with new punitive tariffs and other trade restrictions being imposed. The dispute could escalate further, triggering a significant slowdown in the global economy. It is also conceivable that the weakness that is emerging in the United States and China turns out to be much more pronounced than assumed in the baseline scenario. The Iran dispute might lead to far higher oil prices and weigh down on the economy. Another significant source of uncertainty is the direction of economic policy in Italy. The country's size and very high government debt, as well as the ongoing risks in its banking sector, pose a real danger to the economic growth and financial stability of the eurozone as a whole. Moreover, the risk of a no-deal 'hard' Brexit is higher than it has ever been. If one or more of these downside risks were to materialize, demand for German exports would fall, which in turn would take its toll on capital expenditure and consumer spending in Germany. The country's economy might then stop growing and could even slip into a recession.

The European Central Bank has adjusted its forward guidance and, after its council meeting on June 6, 2019, announced that it expected the key interest rate to remain at its current level until at least the middle of 2020. A new program of targeted longer-term refinancing operations, which was announced in March 2019 and will start in September 2019, has put monetary policy on an expansionary footing again. At the beginning of the second half of June, ECB President Mario Draghi raised the prospect of further loosening measures in the event that inflation does not remain close to the monetary policy target. Consequently, and given that German government bonds remain in demand as a safe haven, yields on Bunds with long maturities will probably remain very low by historical standards.

A number of the macroeconomic scenarios outlined above also affect the outlook for the banking industry. As well as the absence of interest-rate rises in 2019, the main factors at play are the potential political arrangements for Brexit, the negative impact of Italy's economic policy on Italian government bonds, and uncertainties surrounding the tariffs to be imposed by the US government and by China. The ongoing difficulties in respect of income from interest-earning business will continue to be affected by the level of interest rates in the eurozone, which is not appropriate to the economic conditions, and margins will again be significantly squeezed over the course of 2019. These difficulties are still being mitigated at present by the low number of insolvencies among companies and individuals across Germany and by the country's sustained economic upturn, albeit at a diminishing rate. From the current perspective, no significant increase in the need to recognize loss allowances for loans and advances is expected in 2019. The extent of fair value gains and losses in the securities portfolio depends heavily on possible market turmoil, which is also significantly influenced by the aforementioned political risks.

In 2019, banks are continuing to address this still-growing pressure on earnings and the highly adverse impact of regulatory requirements by taking steps to improve their efficiency with the aim of reducing costs. There will continue to be mergers for economic reasons, and reviews of the appropriateness of the branch networks remain on the agenda. The main driver here continues to be changing customer behavior, with people increasingly accessing banking products online. Advancing digitalization will also further reduce the number of employees needed in the financial sector. As before, however, the banks will attempt to hold their position against competitors by aiming for an even greater focus on customer requirements, for example by expanding their digital offering in the context of omnichannel banking. Competition with fintechs and bigtechs will continue to intensify, especially given the forays into the market observed in Germany.

A very rapid rise in interest rates poses a genuine threat for the banking industry, even though banks have generally strengthened their capital adequacy. The European sovereign debt crisis and uncertainties in foreign policy and foreign trade could still have a negative impact. Although the short-term effects currently seem modest, the longer-term risks of these uncertainties for international trade and cross-border investment should not, from the current perspective, be underestimated. Levels of fee and commission income will be heavily influenced by potential shifts in market share between traditional competitors and fintechs/bigtechs.

Volksbanken Raiffeisenbanken Cooperative Financial Network

Since the financial crisis, the financial sector has faced considerable pressure in terms of both adjustment and costs caused by the need to comply with regulatory reforms – involving higher capital requirements and changes to regulatory systems – and implement structural change to adapt to competitive conditions.

In addition to the new regulatory environment, new competitors with approaches based on the use of data and technology are presenting the financial sector with the challenge of scrutinizing its existing business models, adapting them as required, and substantially improving its efficiency by digitalizing business processes and IT processes. The resulting capital investment is initially likely to lead to substantial costs before the anticipated profitability gains can be realized.

Moreover, the outlook for the Cooperative Financial Network shows that the environment of low interest rates will continue to dominate business performance and that the aforementioned challenges will have an adverse impact.

The expected growth in parts of the global economy should provide a boost for the financial performance of the Cooperative Financial Network. It is important, however, not to forget the negative factors for global economic growth resulting not only from Brexit but also from possible trade restrictions. These factors could also depress the heavily export-oriented German economy.

These challenges may thus limit the growth of the Cooperative Financial Network's income and thus its latitude for accumulating capital in 2019. Nevertheless, the Cooperative Financial Network is expected to generate a satisfactory level of earnings overall this year by exploiting market opportunities in its core business areas and, at the same time, actively managing costs. This should enable it to further strengthen its reserves.

Net interest income, particularly in the Retail Customers and SMEs operating segment, will remain under pressure in 2019, primarily as a consequence of the persistently low interest rates.

The Cooperative Financial Network anticipates that net fee and commission income will hold steady in 2019. Any lasting uncertainty in capital and financial markets could have a negative impact on confidence among retail and institutional investors, thereby depressing net fee and commission income.

In 2019, gains and losses on trading activities, which are particularly influenced by those of the Central Institution and Major Corporate Customers operating segment, are expected to be at a much better level than in 2018. Customer-driven capital markets business may again provide impetus in 2019. The main prerequisite for a steady level of net gains under gains and losses on trading activities continues to be a stable financial and capital markets environment.

Net gains under gains and losses on investments in 2019 are predicted to make a modest contribution to profit before taxes because the non-recurring items recognized in 2018 will not be repeated.

Loss allowances will probably return to their normal level in 2019 and should be in line with the lending portfolio and the planned volume of new business. The low number of insolvencies among companies and individuals across Germany and the continuation of a moderate economic upturn indicate that there is no significant increase in risk factors. Nonetheless, uncertain political and macroeconomic developments could have a detrimental impact on loss allowances.

Other gains and losses on valuation of financial instruments are expected to follow a positive trend in 2019. Volatility in capital markets and the widening of credit spreads on securities from government issuers could have an adverse impact on the forecast improvement in these gains and losses.

Net income from insurance business is expected to rise in 2019. Based on the prediction of steady gains and losses on investments held by insurance companies, it is currently assumed that a further increase in gross premiums in the different divisions will lead to a higher level of net income from insurance business overall. Exceptional events in financial and capital markets, changes in underwriting practices, or potential changes in the regulatory requirements faced by insurers may adversely affect the level of net income expected to be earned from insurance business.

Administrative expenses are projected to rise again slightly in 2019. This is primarily due to expenses in connection with the digitalization initiative that will only pay off in the years ahead in the form of productivity increases. Provided that costs continue to be tightly managed and given that income is expected to rise, the cost/income ratio will probably improve.

A compelling business model, supported by sound risk-bearing capacity, is one of the stand-out features of the Cooperative Financial Network. The strong support from members and customers, combined with strong capital ratios, enables the Cooperative Financial Network to seize any opportunities for growth that present themselves and thus to successfully maintain its outstanding market position in a challenging regulatory environment.

Consolidated Financial Statements 2018

of the Volksbanken Raiffeisenbanken Cooperative Financial Network

Income statement for the period January 1 to December 31, 2018

	Note no.	2018 € million	2017 € million
Net interest income	2.	18,368	18,638
Interest income and current income and expense		*23,659*	*25,227*
Interest expense		*–5,291*	*–6,589*
Net fee and commission income	3.	6,816	6,491
Fee and commission income		*7,989*	*7,811*
Fee and commission expenses		*–1,173*	*–1,320*
Gains and losses on trading activities	4.	461	709
Gains and losses on investments	5.	–913	–144
Loss allowances	6.	–151	–576
Other gains and losses on valuation of financial instruments	7.	–122	289
Premiums earned	8.	15,997	15,181
Gains and losses on investments held by insurance companies and other insurance company gains and losses	9.	1,246	3,447
Insurance benefit payments	10.	–14,208	–15,312
Insurance business operating expenses	11.	–2,172	–2,033
Administrative expenses	12.	–18,079	–17,884
Other net operating income	13.	528	110
Profit before taxes		**7,771**	**8,916**
Income taxes	14.	–2,369	–2,843
Net profit		**5,402**	**6,073**
Attributable to:			
Shareholders of the Cooperative Financial Network		5,305	5,958
Non-controlling interests		97	115

Statement of comprehensive income for the period January 1 to December 31, 2018

€ million	2018
Net profit	**5,402**
Other comprehensive income/loss	**–453**
Items that may be reclassified to the income statement	***–444***
Gains and losses on debt instruments measured at fair value through other comprehensive income	–655
Gains and losses on cash flow hedges	–5
Exchange differences on currency translation of foreign operations	25
Gains and losses on hedges of net investments in foreign operations	–6
Income taxes	197
Items that will not be reclassified to the income statement	***–9***
Gains and losses on equity instruments for which the fair value OCI option has been exercised	–8
Gains and losses in relation to financial liabilities for which the fair value option has been exercised, attributable to changes in own credit risk	35
Gains and losses arising from remeasurements of defined benefit plans	–42
Income taxes	6
Total comprehensive income	**4,949**
Attributable to:	
Shareholders of the Cooperative Financial Network	4,915
Non-controlling interests	34

Comparative information in accordance with IAS 39

	2017 € million
Net profit	**6,073**
Other comprehensive income/loss	**–208**
Items that may be reclassified to the income statement	***–53***
Gains and losses on available-for-sale financial assets	–26
Gains and losses on cash flow hedges	20
Exchange differences on currency translation of foreign operations	–43
Gains and losses on hedges of net investments in foreign operations	23
Share of other comprehensive income/loss of joint ventures and associates accounted for using the equity method	–12
Income taxes relating to components of other comprehensive income/loss	–15
Items that will not be reclassified to the income statement	***–155***
Gains and losses arising on remeasurements of defined benefit plans	–231
Income taxes relating to components of other comprehensive income/loss	76
Total comprehensive income	**5,865**
Attributable to:	
Shareholders of the Cooperative Financial Network	5,759
Non-controlling interests	106

Balance sheet as at December 31, 2018

Assets	Note no.	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Cash and cash equivalents	15.	75,169	63,669[1]
Loans and advances to banks	16.	18,800	19,967[2]
Loans and advances to customers	16.	794,916	761,880
Hedging instruments (positive fair values)	17.	883	1,096
Financial assets held for trading	18.	37,500	38,107
Investments	19.	239,083	243,732
Loss allowances	20.	–8,988	–7,363
Investments held by insurance companies	21.	99,855	95,431
Property, plant and equipment, and investment property	22.	12,241	11,731
Income tax assets	23.	4,359	2,980
Other assets	24.	19,359	12,086
Total assets		**1,293,177**	**1,243,316**

1 Adjustment by €+31,075 million due to change in presentation.
2 Adjustment by €-31,075 million due to change in presentation.

Equity and liabilities	Note no.	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Deposits from banks	25.	119,300	113,065
Deposits from customers	25.	842,420	801,031
Debt certificates issued including bonds	26.	56,111	64,807
Hedging instruments (negative fair values)	17.	5,962	7,086
Financial liabilities held for trading	27.	42,451	36,760
Provisions	28.	12,365	12,562
Insurance liabilities	29.	93,252	89,324
Income tax liabilities	23.	1,408	1,183
Other liabilities	30.	9,464	8,874
Subordinated capital	31.	2,740	4,186
Equity	32.	107,704	104,438
Equity of the Cooperative Financial Network		105,176	101,783
Subscribed capital		*12,332*	*11,930*
Capital reserves		*722*	*722*
Retained earnings		*85,954*	*81,446*
Reserves from other comprehensive income		*863*	*1,727*
Unappropriated earnings		*5,305*	*5,958*
Non-controlling interests		2,528	2,655
Total equity and liabilities		**1,293,177**	**1,243,316**

Statement of changes in equity

€ million	Subscribed capital	Capital reserves	Equity earned by the Cooperative Financial Network	Reserves from other comprehensive income	Equity of the Cooperative Financial Network	Non-controlling interests	Total equity
Equity as at Jan. 1, 2017	**11,443**	**696**	**81,963**	**1,784**	**95,886**	**2,683**	**98,569**
Net profit	–	–	5,958	–	5,958	115	6,073
Other comprehensive income/loss	–	–	–156	–43	–199	–9	–208
Total comprehensive income	**–**	**–**	**5,802**	**–43**	**5,759**	**106**	**5,865**
Issue and repayment of equity	487	26	–	–	513	–1	512
Changes in the scope of consolidation	–	–	14	–14	–	–	–
Acquisition/disposal of non-controlling interests	–	–	39	–	39	–80	–41
Dividends paid	–	–	–414	–	–414	–53	–467
Equity as at Dec. 31, 2017	**11,930**	**722**	**87,404**	**1,727**	**101,783**	**2,655**	**104,438**

€ million	Subscribed capital	Capital reserves	Equity earned by the Cooperative Financial Network	Reserves from other comprehensive income	Equity of the Cooperative Financial Network	Non-controlling interests	Total equity
Equity as at Dec. 31, 2017	**11,930**	**722**	**87,404**	**1,727**	**101,783**	**2,655**	**104,438**
First-time application of IFRS 9 in the consolidated financial statements	–	–	–991	–487	–1,478	–18	–1,496
Adjusted equity as at Jan. 1, 2018	**11,930**	**722**	**86,413**	**1,240**	**100,305**	**2,637**	**102,942**
Net profit	–	–	5,305	–	5,305	97	5,402
Other comprehensive income/loss	–	–	–23	–367	–390	–63	–453
Total comprehensive income	**–**	**–**	**5,282**	**–367**	**4,915**	**34**	**4,949**
Issue and repayment of equity	402	–	–	–	402	–9	393
Changes in the scope of consolidation	–	–	–11	12	1	4	5
Acquisition/disposal of non-controlling interests	–	–	–16	11	–5	–92	–97
Reclassifications within equity	–	–	33	–33	–	–	–
Dividends paid	–	–	–442	–	–442	–46	–488
Equity as at Dec. 31, 2018	**12,332**	**722**	**91,259**	**863**	**105,176**	**2,528**	**107,704**

The composition of equity is detailed in Note 32.

Statement of cash flows

	2018 € million	2017 € million
Net profit	**5,402**	**6,073**
Non-cash items included in net profit and reconciliation to cash flows from operating activities		
Depreciation, amortization, impairment losses, and reversal of impairment losses on assets, and other non-cash changes in financial assets and liabilities	3,637	−1,390
Non-cash changes in provisions	92	−546
Changes in insurance liabilities	3,928	7,732
Other non-cash income and expenses	1,581	239
Gains and losses on the disposal of assets and liabilities	38	124
Other adjustments (net)	−18,641	−16,122
Subtotal	**−3,963**	**−3,890**
Cash changes in assets and liabilities arising from operating activities		
Loans and advances to banks and customers	−38,380	−23,643[1]
Other assets from operating activities	−1,338	200
Derivative hedging instruments (positive and negative fair values)	−1,070	−617
Financial assets and financial liabilities held for trading	6,792	3,944
Deposits from banks and customers	48,128	36,961
Debt certificates issued including bonds	−8,597	−6,111
Other liabilities from operating activities	28	−1,690
Interest, dividends and operating lease payments received	25,778	26,808
Interest paid	−5,979	−8,022
Income taxes paid	−2,735	−1,637
Cash flows from operating activities	**18,664**	**22,303**
Proceeds from the sale of investments	18,920	20,184
Proceeds from the sale of investments held by insurance companies	23,658	20,224
Payments for acquisitions of investments	−15,671	−12,629
Payments for acquisitions of investments held by insurance companies	−30,488	−25,778
Net payments for acquisitions of property, plant and equipment, and investment property (excl. assets subject to operating leases)	−1,141	−1,525

	2018 € million	2017 € million
Net payments for acquisitions of intangible non-current assets	–245	–40
Changes in the scope of consolidation	2	7
Cash flows from investing activities	**–4,965**	**443**
Proceeds from capital increases by shareholders of the Cooperative Financial Network	402	513
Dividends paid to shareholders of the Cooperative Financial Network	–442	–414
Dividends paid to non-controlling interests	–46	–53
Other payments to non-controlling interests	–9	–1
Net change in cash and cash equivalents from other financing activities (including subordinated capital)	–2,104	–705
Cash flows from financing activities	**–2,199**	**–660**
Cash and cash equivalents as at January 1	**63,669**	**41,583**[2]
Cash flows from operating activities	18,664	22,303[3]
Cash flows from investing activities	–4,965	443
Cash flows from financing activities	–2,199	–660
Cash and cash equivalents as at December 31	**75,169**	**63,669**[4]

1 Adjustment by €+14,913 million due to change in presentation.
2 Adjustment by €+16,162 million due to change in presentation.
3 Adjustment by €+14,913 million due to change in presentation.
4 Adjustment by €+31,075 million due to change in presentation.

The statement of cash flows shows the changes in cash and cash equivalents during the financial year. Cash and cash equivalents consist of cash on hand, balances with central banks and other government institutions. The cash reserve does not include any financial investments with maturities of more than three months at the date of acquisition. Changes in cash and cash equivalents are broken down into operating, investing and financing activities.

Cash flows from operating activities comprise cash flows mainly arising in connection with the revenue-generating activities of the Cooperative Financial Network or other activities that cannot be classified as investing or financing activities. Cash flows related to the acquisition and disposal of non-current assets are allocated to investing activities. Cash flows from financing activities include cash flows arising from transactions with equity owners and from other borrowings to finance business activities.

Notes to the consolidated financial statements

A General disclosures

Explanatory information on the consolidated financial statements

The consolidated financial statements of the Volksbanken Raiffeisenbanken Cooperative Financial Network prepared by the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR) [National Association of German Cooperative Banks] are based on the significant financial reporting principles set out in the annex. The cooperative shares and share capital of the local cooperative banks are held by their members. The local cooperative banks own the share capital of DZ BANK either directly or through intermediate holding companies. The Cooperative Financial Network does not qualify as a corporate group as defined by the International Financial Reporting Standards (IFRS), the German Commercial Code (HGB) or the German Stock Corporation Act (AktG).

These consolidated financial statements have been prepared for informational purposes and to present the business development and performance of the Cooperative Financial Network, which is treated as a single economic entity in terms of its risks and strategies. In addition, the financial statements were prepared in order to comply with the provisions set out in article 113(7)(e) of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (Capital Requirements Regulation – CRR). These consolidated financial statements are not a substitute for analysis of the consolidated entities' financial statements.

The underlying data presented in these consolidated financial statements is provided by the separate and consolidated financial statements of the entities in the Cooperative Financial Network and also includes data from supplementary surveys of the local cooperative banks. The consolidated financial statements of DZ BANK included in these consolidated financial statements have been prepared on the basis of IFRS as adopted by the European Union.

The financial year corresponds to the calendar year. The consolidated entities have generally prepared their financial statements on the basis of the financial year ended December 31, 2018. There is one subsidiary (2017: 1 subsidiary) included in the consolidated financial statements with a different reporting date for its annual financial statements. With 47 exceptions (2017: 40 exceptions), the separate financial statements of the entities accounted for using the equity method are prepared using the same balance sheet date as that of the consolidated financial statements.

In the interest of clarity, some items on the face of the income statement and the balance sheet have been aggregated and are explained by additional disclosures.

Information as regards the significant financial reporting principles can be found in the annex to the consolidated financial statements.

Change in accounting policies

As at January 1, 2018, the rules of IFRS 9 Financial Instruments replaced the rules of IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 includes the requirements for the substantially revised subject areas of classification and measurement of financial instruments, accounting for impairment of financial instruments as well as hedge accounting. The modified implementation of these rules in the consolidated financial statements is described in the Annex "Significant Financial Reporting Principles" in the section "Financial instruments."

Upon the transition to IFRS 9 in the consolidated financial statements, changes in presentation were introduced in relation to various elements of the consolidated financial statements. The major changes in presentation are described in the following section in the order of their occurrence in the consolidated financial statements:

In order to reduce the increased complexity of the presentation of the components of reserves from other comprehensive income caused by the introduction of IFRS 9, these components will be combined and presented in one single column in the statement of changes in equity. The individual equity components are presented in the disclosures on equity in Note 32.

In contrast to the previous procedure applicable under IAS 39, the loss allowance determined in accordance with IFRS 9 is reported within all of the balance sheet items on a gross basis in the consolidated financial statements for financial instruments of the category "financial assets measured at amortized cost," except for the balance sheet item "Investments held by insurance companies." Accordingly, financial instruments are also presented on a gross basis within the balance sheet item "Investments" in accordance with IFRS 9. As a consequence, the loss allowance for financial assets measured at amortized cost is reported in the balance sheet below the line item "Investments." Accordingly, the loss allowance is presented in the income statement below the item "Gains and losses on investments." The loss allowance for financial instruments of the category "Financial assets measured at fair value through other comprehensive income" is reported in equity as part of the changes in reserves from other comprehensive income.

The modified retrospective application of IFRS 9 had the following effects on the balance sheet items of the consolidated financial statements as at the date of first-time application January 1, 2018:

The first-time application of the IFRS 9 rules led to a reduction in equity after taxes by €1,496 million as at the date of first-time application January 1, 2018. Of that amount, a decrease of €991 million was attributable to retained earnings, a decrease of €487 million to the reserve from other comprehensive income and a decrease of €18 million to non-controlling interests. The reduction in equity primarily results from the increase in loss allowances by €2,340 million. The reason for this is the assessment of expected credit losses over the entire lifetime as required under IFRS 9.

Assets	Dec. 31, 2017 € million	Adjustment amount	Jan. 1, 2018 € million
Cash and cash equivalents	63,669[1]	–	63,669
Loans and advances to banks	19,967[2]	189	20,156
Loans and advances to customers	761,880	743	762,623
Hedging instruments (positive fair values)	1,096	−18	1,078
Financial assets held for trading	38,107	−1,019	37,088
Investments	243,732	−657	243,075
Loss allowances	−7,363	−2,340	−9,703
Investments held by insurance companies	95,431	2.021	97,452
Property, plant and equipment, and investment property	11,731	–	11,731
Income tax assets	2,980	719	3,699
Other assets	12,086	665	12,751
Total assets	**1,243,316**	**303**	**1,243,619**

1 Adjustment by €+31,075 million due to change in presentation.
2 Adjustment by €−31,075 million due to change in presentation.

Equity and liabilities	Dec. 31, 2017 € million	Adjustment amount	Jan. 1, 2018 € million
Deposits from banks	113,065	61	113,126
Deposits from customers	801,031	–131	800,900
Debt certificates issued including bonds	64,807	–683	64,124
Hedging instruments (negative fair values)	7,086	275	7,361
Financial liabilities held for trading	36,760	540	37,300
Provisions	12,562	68	12,630
Insurance liabilities	89,324	1,694	91,018
Income tax liabilities	1,183	93	1,276
Other liabilities	8,874	–107	8,767
Subordinated capital	4,186	–11	4,175
Equity	104,438	–1,496	102,942
Equity of the Cooperative Financial Network	101,783	–1,478	100,305
Subscribed capital	*11,930*	–	*11,930*
Capital reserves	*722*	–	*722*
Retained earnings	*81,446*	*–991*	*80,455*
Reserves from other comprehensive income	*1,727*	*–487*	*1,240*
Unappropriated earnings	*5,958*	–	*5,958*
Non-controlling interests	2,655	–18	2,637
Total equity and liabilities	**1,243,316**	**303**	**1,243,619**

Scope of consolidation

The consolidated financial statements comprise, as consolidated entities, 875 cooperative banks (2017: 915) as well as all companies included in the consolidated financial statements of DZ BANK, Münchener Hypothekenbank eG (MHB), the BVR protection scheme, and BVR Institutssicherung GmbH. The consolidated cooperative banks include Deutsche Apotheker- und Ärztebank eG, the Sparda banks, the PSD banks, and specialized institutions such as BAG Bankaktiengesellschaft.

The cooperative banks and MHB are the legally independent, horizontally structured parent entities of the Cooperative Financial Network, whereas the other companies and the DZ BANK Group are consolidated as subsidiaries. The cooperative central institution and a total of 390 subsidiaries (2017: 434) have been consolidated in the DZ BANK Group. Further information on the shareholdings can be found in the list of shareholdings included in the annual report of the DZ BANK Group.

The consolidated financial statements include 20 joint ventures between a consolidated entity and at least one other non-network entity (2017: 21) and 44 associates (2017: 44) over which a consolidated entity has significant influence, that are accounted for using the equity method.

Volksbanken Raiffeisenbanken
Cooperative Financial Network

Local cooperative banks
(parent entities of the Cooperative Financial Network)

Cooperative banks:
Local cooperative banks, Sparda banks, PSD banks, Deutsche Apotheker- und Ärztebank eG and specialized institutions

Münchener Hypothekenbank eG

DZ BANK Group

Central institution:
DZ BANK AG

Specialized service providers:
Subsidiaries of DZ BANK AG

Protection scheme of BVR and BVR Institutssicherung GmbH

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B Selected disclosures of interests in other entities

Investments in subsidiaries

Share in the business operations of the Cooperative Financial Network attributable to non-controlling interests

DZ BANK AG Deutsche Zentral-Genossenschaftsbank (DZ BANK) and its subsidiaries are included together in the consolidated financial statements as a subgroup. DZ BANK is focused on its customers and owners, the local cooperative banks, as central institution, commercial bank and holding company. The objective of this focus is to sustainably expand the position of the Cooperative Financial Network as one of the leading bancassurance groups.

The shares of DZ BANK, with its headquarters in Frankfurt/Main, Germany, are held by the cooperative banks and by MHB, with ownership interests amounting to 94.6 percent (2017: 94.5 percent). The remaining shares of 5.4 percent (2017: 5.5 percent) are attributable to shareholders that are not part of the Cooperative Financial Network. The prorata share in net profit attributable to non-controlling interests amounted to €97 million (2017: €115 million). The carrying amount of non-controlling interests amounted to €2,528 million (2017: €2,655 million). In the financial year under review, the dividend payment made to non-controlling interests amounts to €46 million (2017: €53 million).

Nature and extent of significant restrictions

National regulatory requirements, contractual provisions, and provisions of company law restrict the ability of the DZ BANK Group companies included in the consolidated financial statements to transfer assets within the group. Where restrictions can be specifically assigned to individual line items on the balance sheet, the carrying amounts of the assets and liabilities subject to restrictions on the balance sheet date are shown in the following table:

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Assets	**85,850**	**81,559**
Loans and advances to customers	2,689	2,812
Investments	5	5
Investments held by insurance companies	83,152	78,738
Other assets	4	4
Liabilities	**140,359**	**132,474**
Deposits from banks	1,793	1,776
Deposits from customers	59,996	56,642
Provisions	1,072	983
Insurance liabilities	77,498	73,073

Nature of the risks associated with interests in consolidated structured entities

Risks arising from interests in consolidated structured entities largely result from loans to fully consolidated funds within the DZ BANK Group, some of which are extended in the form of junior loans.

Interests in joint arrangements and investments in associates

Nature, extent and financial effects of interests in joint arrangements
The carrying amount of individually immaterial joint ventures accounted for using the equity method totaled €462 million as at the balance sheet date (2017: €522 million).

Aggregated financial information for joint ventures accounted for using the equity method that individually are not material:

	2018 € million	2017 € million
Share of profit/loss from continuing operations	76	83
Share of other comprehensive income/loss	–8	–36
Share of total comprehensive income	68	47

Nature, extent and financial effects of interests in associates
The carrying amount of individually immaterial associates accounted for using the equity method totaled €288 million as at the balance sheet date (2017: €315 million).

Aggregated financial information for associates accounted for using the equity method that individually are not material:

	2018 € million	2017 € million
Share of profit/loss from continuing operations	5	–44
Share of other comprehensive income/loss	–	6
Share of total comprehensive income	5	–38

Interests in unconsolidated structured entities

Structured entities are entities that have been designed so that voting rights or similar rights are not the dominant factor in deciding who controls the entity. The Cooperative Financial Network mainly distinguishes between the following types of interests in unconsolidated structured entities, based on their design and the related risks; these entities largely concern companies of the DZ BANK Group:

- Interests in investment funds issued by the Cooperative Financial Network,
- Interests in investment funds not issued by the Cooperative Financial Network,
- Interests in securitization vehicles,
- Interests in asset-leasing vehicles

Interests in investment funds issued by the Cooperative Financial Network
The interests in the investment funds issued by the Cooperative Financial Network largely comprise investment funds issued by entities in the Union Investment Group in accordance with the contractual form model without voting rights and, to a lesser extent, those that are structured as a company with a separate legal personality. Furthermore, DVB Bank SE makes subordinated loans available to fully consolidated funds for the purpose of transport finance. In turn, these funds make subordinated loans or direct equity investments available to unconsolidated entities.

The maximum exposure of the investment funds issued and managed by the Cooperative Financial Network is determined as a gross value, excluding deduction of available collateral, and amounts to €8,855 million as at the reporting date (2017: €10,051 million). These investment fund assets resulted in losses of €85 million (2017: losses of €77 million) as well as income of €2,192 million (2017: €1,984 million).

Interests in investment funds not issued by the Cooperative Financial Network

The interests in the investment funds not issued by the Cooperative Financial Network above all comprise investment funds managed by entities in the Union Investment Group within the scope of their own decision-making powers that have been issued by entities outside the Cooperative Financial Network and parts of such investment funds. Their total volume amounted to €37,405 million (2017: €37,852 million). Moreover, loans to investment funds are extended in order to generate interest income. In addition, there are investment funds issued by entities outside the Cooperative Financial Network in connection with unit-linked life insurance of the R+V Group (R+V) amounting to €7,244 million (2017: €7,498 million) that, however, do not result in a maximum exposure.

The maximum exposure arising of the investment funds not issued by the Cooperative Financial Network is determined as a gross value, excluding deduction of available collateral, and amounts to €4,493 million as at the reporting date (2017: €4,022 million). Income generated from these investment funds in the financial year 2018 amounted to €154 million (2017: €133 million).

Interests in securitization vehicles

The interests in securitization vehicles are interests in vehicles where the Cooperative Financial Network involvement goes beyond that of an investor.

The material interests in securitization vehicles comprise the two multiseller asset-backed commercial paper (ABCP) programs: CORAL and AUTOBAHN. DZ BANK acts as sponsor and program agent for both programs. It is also the program administrator for AUTOBAHN.

The maximum exposure of the interests in securitization vehicles in the Cooperative Financial Network is determined as a gross value, excluding deduction of available collateral, and amounts to €3,895 million as at the reporting date (2017: €3,983 million). Income generated from these interests in the financial year 2018 amounted to €48 million (2017: €56 million).

Interests in asset-leasing vehicles

The interests in asset-leasing vehicles comprise shares in limited partnerships and voting rights, other than the shares in limited partnerships, in partnerships established by VR LEASING for the purpose of real estate leasing (asset-leasing vehicles), in which the asset, and the funding occasionally provided by the DZ BANK Group, are placed.

The actual maximum exposure of the interests in asset-leasing vehicles in the Cooperative Financial Network is determined as a gross value, excluding deduction of available collateral, and amounts to minus €4 million (2017: minus €13 million) as at the reporting date. As in the previous year, interest income and current income and expense generated from these interests amounted to €5 million.

C Income statement disclosures

1. Information on operating segments

Financial year 2018 € million	Retail Customers and SMEs[1]	Central Institution and Major Corporate Customers[2]	Real Estate Finance	Insurance	Other/ Consolidation	Total
Net interest income	16,321	1,371	1,423	–	–747	18,368
Net fee and commission income	6,918	550	–110	–	–542	6,816
Gains and losses on trading activities	195	267	1	–	–2	461
Gains and losses on investments	–1,130	195	6	–	16	–913
Loss allowances	–232	70	2	–	9	–151
Other gains and losses on valuation of financial instruments	–34	–79	–16	–	7	–122
Premiums earned	–	–	–	15,997	–	15,997
Gains and losses on investments held by insurance companies and other insurance company gains and losses	–	–	–	1,342	–96	1,246
Insurance benefit payments	–	–	–	–14,208	–	–14,208
Insurance business operating expenses	–	–	–	–2,721	549	–2,172
Administrative expenses	–15,386	–1,944	–885	–	136	–18,079
Other net operating expense/income	274	1	56	3	194	528
Profit/loss before taxes	**6,926**	**431**	**477**	**413**	**–476**	**7,771**
Cost/income ratio (percent)	68.2	84.3	65.1	–	–	69.5

Financial year 2017 € million	Retail Customers and SMEs[1]	Central Institution and Major Corporate Customers[2]	Real Estate Finance	Insurance	Other/ Consolidation	Total
Net interest income	16,489	1,525	1,492	–	–868	18,638
Net fee and commission income	6,646	519	–122	–	–522	6,491
Gains and losses on trading activities	213	485	11	–	–	709
Gains and losses on investments	–174	–17	25	–	22	–144
Loss allowances	95	–693	12	–	10	–576
Other gains and losses on valuation of financial instruments	20	–10	292	–	–13	289
Premiums earned	–	–	–	15,181	–	15,181
Gains and losses on investments held by insurance companies and other insurance company gains and losses	–	–	–	3,531	–84	3,447
Insurance benefit payments	–	–	–	–15,312	–	–15,312
Insurance business operating expenses	–	–	–	–2,595	562	–2,033
Administrative expenses	–15,245	–1,969	–804	–	134	–17,884
Other net operating expense/income	44	67	22	–10	–13	110
Profit/loss before taxes	**8,088**	**–93**	**928**	**795**	**–802**	**8,916**
Cost/income ratio (percent)	65.6	76.6	46.7	–	–	65.3

1 The operating segment “Retail Customers and SMEs” was previously named “Retail.” The segment’s composition has not changed.
2 The operating segment “Central Institution and Major Corporate Customers” was previously named “Bank.” The segment’s composition has not changed.

Definition of operating segments
The Volksbanken Raiffeisenbanken Cooperative Financial Network is founded on the underlying principle of decentralization. It is based on the local cooperative banks, whose business activities are supported by DZ BANK and by specialized service providers within the cooperative sector. These specialized service providers are integrated into DZ BANK. The main benefit derived by the cooperative banks from their collaboration with these specialized services providers and DZ BANK is that they can offer a full range of financial products and services.

The operating segment “Retail Customers and SMEs” (2017: “Retail”) covers private banking and activities relating to asset management. The segment focuses on retail clients. It mainly includes cooperative banks as well as the DZ PRIVATBANK, TeamBank AG Nürnberg (TeamBank) and Union Investment Group.

The operating segment “Central Institution and Major Corporate Customers” (2017: “Bank”) combines the activities of the Cooperative Financial Network in the corporate customers, institutional customers and capital markets businesses. The operating segment focuses on corporate customers. It essentially comprises DZ BANK, the VR LEASING Group and DVB Bank Group.

The Real Estate Finance operating segment encompasses the buildings society operations, mortgage banking, and real estate business. The entities allocated to this operating segment include the Bausparkasse Schwäbisch Hall Group (BSH), Deutsche Genossenschafts-Hypothekenbank AG (DZ HYP), and MHB.

Insurance operations are reported under the Insurance operating segment. This operating segment consists solely of R+V.

Other/Consolidation contains the BVR protection scheme (BVR-SE) as well as BVR Institutssicherung GmbH (BVR-ISG), whose task is to avert impending or existing financial difficulties faced by member institutions by taking preventive action or implementing restructuring measures. This operating segment also includes intersegment consolidation items.

Presentation of the disclosures on operating segments
The information on operating segments presents the interest income generated by the operating segments and the associated interest expenses on a netted basis as net interest income.

Intersegment consolidation
The adjustments to the figure for net interest income resulted largely from the consolidation of dividends paid within the Cooperative Financial Network.

The figure under Other/Consolidation for net fee and commission income relates specifically to the fee and commission business transacted between the cooperative banks, TeamBank, BSH, and R+V.

The figure under Other/Consolidation for administrative expenses includes the contributions paid to BVR-SE and BVR-ISG by member institutions of the Cooperative Financial Network.

The remaining adjustments are largely attributable to the consolidation of income and expenses.

2. Net interest income

	2018 € million	2017 € million
Interest income and current income and expense	**23,659**	**25,227**
Interest income from	***22,463***	***23,929***
Lending and money market business	21,222	22,204
of which: Building society operations	1,044	1,032
Finance leases	113	126
Fixed-income securities	2,080	2,456
Other assets	–541	–624
Financial assets with a negative effective interest rate	–298	–107
Current income from	***1,113***	***1,197***
Shares and other variable-yield securities	973	1,168
Investments in subsidiaries and equity investments	141	92
Operating leases	–1	–63
Income / loss from using the equity method for	***38***	***41***
Investments in joint ventures	24	40
Investments in associates	14	1
Income from profit-pooling, profit-transfer and partial profit-transfer agreements	***45***	***60***
Interest expense	**–5,291**	**–6,589**
Interest expense on	***–5,058***	***–6,279***
Deposits from banks and customers	–4,530	–5,336
of which: Building society operations	–828	–822
Debt certificates issued including bonds	–820	–993
Subordinated capital	–172	–224
Other liabilities	130	172
Financial liabilities with a positive effective interest rate	334	102
Other interest expense	***–233***	***–310***
Total	**18,368**	**18,638**

The interest income from other assets and the interest expense on other liabilities result from gains and losses on the amortization of fair value changes of the hedged items in portfolio hedges of interest-rate risk. Owing to the current low level of interest rates in the money markets and capital markets, there may be a negative effective interest rate for financial assets and a positive effective interest rate for financial liabilities.

3. Net fee and commission income

	2018 € million	2017 € million
Fee and commission income	**7,989**	**7,811**
Securities business	3,499	3,609
Asset management	423	397
Payments processing including card processing	2,746	2,627
Lending business and trust activities	174	158
Financial guarantee contracts and loan commitments	171	173
International business	132	129
Building society operations	31	25
Other	813	693
Fee and commission expenses	**–1,173**	**–1,320**
Securities business	–342	–481
Asset management	–121	–124
Payments processing including card processing	–215	–243
Lending business	–55	–97
Financial guarantee contracts and loan commitments	–22	–17
International business	–24	–28
Building society operations	–69	–60
Other	–325	–270
Total	**6,816**	**6,491**

4. Gains and losses on trading activities

	2018 € million	2017 € million
Gains and losses on trading in financial instruments	179	217
Gains and losses on trading in foreign exchange, foreign notes and coins, and precious metals	104	311
Gains and losses on commodities trading	178	181
Total	**461**	**709**

5. Gains and losses on investments

	2018 € million	2017 € million
Gains and losses on securities	–1,034	–239
Gains and losses on investments in subsidiaries and equity investments	121	95
Total	**–913**	**–144**

6. Loss allowances

	2018 € million	2017 € million
Additions	–3,453	–2,636
Reversals	3,061	1,881
Directly recognized impairment losses	–110	–155
Recoveries on loans and advances previously impaired	232	289
Other	18	–
Changes in the provisions for loan commitments, provisions for financial guarantee contracts and other provisions for loans and advances	101	45
Total	**–151**	**–576**

7. Other gains and losses on valuation of financial instruments

	2018 € million	2017 € million
Gains and losses from hedge accounting	**–21**	**–27**
Fair value hedges	–22	–27
Ineffectiveness of hedges of net investments in foreign operations	1	–
Gains and losses on derivatives held for purposes other than trading	**–53**	**–15**
Gains and losses on financial instruments designated as at fair value through profit or loss	**–37**	**331**
Gains and losses from contingent consideration in business combinations	**–11**	**–**
Total	**–122**	**289**

8. Premiums earned

	2018 € million	2017 € million
Net premiums written	**16,009**	**15,235**
Gross premiums written	16,133	15,338
Reinsurance premiums ceded	–124	–103
Change in provision for unearned premiums	**–12**	**–54**
Gross premiums	–7	–59
Reinsurers' share	–5	5
Total	**15,997**	**15,181**

9. Gains and losses on investments held by insurance companies and other insurance company gains and losses

	2018 € million	2017 € million
Interest income and current income	2,411	2,521
Administrative expenses	–150	–131
Gains and losses on valuation and disposals as well as from additions to and reversals of loss allowances	–1,187	773
Other gains and losses of insurance companies	172	284
Total	**1,246**	**3,447**

The net amount of additions to and reversals of loss allowances recorded in the fiscal year was €1 million.

10. Insurance benefit payments

	2018 € million	2017 € million
Expenses for claims	**–10,742**	**–10,138**
Gross expenses for claims	–10,786	–10,161
Reinsurers' share	44	23
Changes in benefit reserve, reserve for premium refunds, and in other insurance liabilities	**–3,466**	**–5,174**
Changes in gross provisions	–3,483	–5,171
Reinsurers' share	17	–3
Total	**–14,208**	**–15,312**

Claims rate trend for direct non-life insurance business including claim settlement costs

Gross claims provisions in direct business and payments made against the original provisions:

€ million	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
At the end of the year	4,551	4,276	4,173	3,856	3,634	3,901	3,345	3,341	3,324	2,953	2,704
1 year later	–	4,142	4,103	3,767	3,523	3,847	3,336	3,359	3,135	2,901	2,623
2 years later	–	–	4,046	3,682	3,457	3,769	3,247	3,279	3,160	2,763	2,527
3 years laterr	–	–	–	3,647	3,389	3,731	3,220	3,254	3,139	2,756	2,533
4 years later	–	–	–	–	3,382	3,696	3,189	3,241	3,122	2,756	2,505
5 years later	–	–	–	–	–	3,691	3,198	3,250	3,139	2,768	2,513
6 years later	–	–	–	–	–	–	3,126	3,183	3,080	2,710	2,469
7 years later	–	–	–	–	–	–	–	3,172	3,065	2,685	2,466
8 years later	–	–	–	–	–	–	–	–	3,060	2,680	2,449
9 years later	–	–	–	–	–	–	–	–	–	2,680	2,447
10 years later	–	–	–	–	–	–	–	–	–	–	2,449
Settlements	**–**	**134**	**127**	**209**	**252**	**210**	**219**	**169**	**264**	**273**	**255**

Net claims provisions in direct business and payments made against the original provisions:

€ million	2018	2017	2016	2015	2014	2013	2012	2011	2010
At the end of the year	4,518	4,255	4,110	3,827	3,574	3,669	3,313	3,298	3,254
1 year later	–	4,118	4,050	3,736	3,460	3,613	3,300	3,317	3,056
2 years later	–	–	3,994	3,655	3,393	3,533	3,211	3,236	3,077
3 years later	–	–	–	3,624	3,331	3,490	3,180	3,208	3,057
4 years later	–	–	–	–	3,361	3,465	3,139	3,194	2,939
5 years later	–	–	–	–	–	3,670	3,166	3,191	3,049
6 years later	–	–	–	–	–	–	3,095	3,144	2,957
7 years later								3,134	2,981
8 years later								–	2,977
Settlements	**–**	**137**	**116**	**203**	**213**	**–1**	**218**	**164**	**277**

Claims rate trend for inward reinsurance business

Gross claims provisions in inward reinsurance business and payments made against the original provisions:

€ million	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Gross provisions for claims outstanding	**3,642**	**3,197**	**2,718**	**2,433**	**1,976**	**1,710**	**1,506**	**1,409**	**1,190**	**892**	**712**
Cumulative payments for the year concerned and prior years											
1 year later	–	852	569	622	464	481	385	463	437	282	232
2 years later	–	–	852	867	783	685	630	640	632	399	347
3 years later	–	–	–	1,022	919	897	764	345	739	468	410
4 years later	–	–	–	–	1,026	987	930	891	856	516	447
5 years later	–	–	–	–	–	1,051	996	1,029	922	588	475
6 years later	–	–	–	–	–	–	1,035	1,072	1,043	626	528
7 years later	–	–	–	–	–	–	–	1,103	1,067	652	555
8 years later	–	–	–	–	–	–	–	–	1,090	658	574
9 years later	–	–	–	–	–	–	–	–	–	684	585
10 years later	–	–	–	–	–	–	–	–	–	–	597
Gross provisions for claims outstanding and payments made against the original provision											
At the end of the year	3,642	3,197	2,718	2,433	1,976	1,710	1,506	1,409	1,190	892	712
1 year later	–	3,392	2,654	2,434	2,157	1,840	1,593	1,536	1,401	1,026	779
2 years later	–	–	2,561	2,271	2,004	1,859	1,569	1,472	1,343	872	765
3 years later	–	–	–	2,224	1,915	1,779	1,628	1,014	1,338	826	696
4 years later	–	–	–	–	1,887	1,720	1,580	1,528	1,360	837	680
5 years later	–	–	–	–	–	1,699	1,550	1,501	1,396	858	691
6 years later	–	–	–	–	–	–	1,536	1,486	1,379	870	709
7 years later	–	–	–	–	–	–	–	1,481	1,368	876	719
8 years later	–	–	–	–	–	–	–	–	1,354	873	725
9 years later	–	–	–	–	–	–	–	–	–	864	725
10 years later	–	–	–	–	–	–	–	–	–	–	723
Settlements	**–**	**–195**	**157**	**209**	**89**	**11**	**–30**	**–72**	**–164**	**28**	**–11**

Net claims provisions in inward reinsurance business and payments made against the original provisions:

€ million	2018	2017	2016	2015	2014	2013	2012	2011	2010
Net provisions for claims outstanding	**3,639**	**3,193**	**2,710**	**2,428**	**1,970**	**1,695**	**1,491**	**1,389**	**1,164**
Cumulative payments for the year concerned and prior years									
1 year later		851	567	622	464	473	383	461	432
2 years later		–	849	866	782	677	620	636	625
3 years later		–	–	1,020	918	888	754	333	729
4 years later		–	–	–	1,025	978	919	878	839
5 years later		–	–	–	–	1,042	985	1,016	904
6 years later		–	–	–	–	–	1,024	1,059	1,025
7 years later		–	–	–	–	–	–	1,090	1,049
8 years later		–	–	–	–	–	–	–	1,071
Net provisions for claims outstanding and payments made against the original provision									
At the end of the year	3,639	3,193	2,710	2,428	1,970	1,695	1,491	1,389	1,164
1 year later		3,388	2,648	2,429	2,152	1,827	1,576	1,519	1,377
2 years later		–	2,555	2,267	1,999	1,845	1,554	1,454	1,321
3 years later		–	–	2,219	1,911	1,766	1,612	997	1,314
4 years later		–	–	–	1,883	1,708	1,566	1,510	1,337
5 years later		–	–	–	–	1,687	1,536	1,484	1,372
6 years later		–	–	–	–	–	1,522	1,470	1,357
7 years later		–	–	–	–	–	–	1,464	1,346
8 years later		–	–	–	–	–	–	–	1,332
Settlements		**–195**	**155**	**209**	**87**	**8**	**–31**	**–75**	**–168**

11. Insurance business operating expenses

	2018 € million	2017 € million
Gross expenses	−2,193	−2,049
Reinsurers' share	21	16
Total	**−2,172**	**−2,033**

12. Administrative expenses

	2018 € million	2017 € million
Staff expenses	−10,076	−10,137
General and administrative expenses	−7,011	−6,793
Depreciation/amortization and impairment losses	−992	−954
Total	**−18,079**	**−17,884**

13. Other net operating income

	2018 € million	2017 € million
Gains and losses on non-current assets classified as held for sale and disposal groups	2	126
Other operating income	1,266	979
Other operating expenses	−740	−995
Total	**528**	**110**

14. Income taxes

	2018 € million	2017 € million
Current tax expense	–2,731	–2,649
Income from/expense on deferred taxes	362	–194
Total	**–2,369**	**–2,843**

Current taxes in relation to the German limited companies are calculated using an effective corporation tax rate of 15.825 percent based on a corporation tax rate of 15 percent plus the solidarity surcharge. The effective rate for trade tax is 14.35 percent based on an average trade tax multiplier of 410 percent. The tax rates correspond to those for the previous year.

Deferred taxes must be calculated using tax rates expected to apply when the tax asset or liability arises. The tax rates used are therefore those that are valid or have been announced for the periods in question as at the balance sheet date.

	2018 € million	2017 € million
Profit before taxes	**7,771**	**8,916**
Notional rate of income tax of the Cooperative Financial Network (in percent)	30,175	30,175
Income taxes based on notional rate of income tax	**–2,345**	**–2,690**
Tax effects	**–24**	**–153**
Tax effects of tax-exempt income and non-tax deductible expenses	22	192
Tax effects of different tax types, different trade tax multipliers, and changes in tax rates	14	–8
Tax effects of different tax rates in other countries	–20	–74
Current and deferred taxes relating to prior reporting periods	32	–3
Change in deferred tax assets due to valuation adjustments	3	–92
Other tax effects	–75	–168
Total	**–2,369**	**–2,843**

The table shows a reconciliation from notional income taxes to recognized income taxes based on application of the current tax law in Germany.

D Balance sheet disclosures

15. Cash and cash equivalents

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Cash on hand	8,102	7,672
Balances with central banks	67,067	55,997[1]
Total	**75,169**	**63,669**

1 Adjustment by €+31,075 million due to change in presentation.

16. Loans and advances to banks and customers

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Loans and advances to banks	**18,800**	**19,967**
Repayable on demand	***8,419***	***8,931***[1]
Other loans and advances	***10,381***	***11,036***
Mortgage loans and other loans secured by mortgages on real estate	60	60
Local authority loans	5,814	6,783
Finance leases	–	22
Other loans and advances	4,507	4,171
Loans and advances to customers	**794,916**	**761,880**
Mortgage loans and other loans secured by mortgages on real estate	325,468	308,329
Local authority loans	31,699	34,889
Home savings loans advanced by building society	45,454	41,005
Finance leases	2,017	2,918
Other loans and advances	390,278	374,739

1 Adjustment by €–31,075 million due to change in presentation.

17. Hedging instruments (positive and negative fair values)

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Derivatives (positive fair values)	**883**	**1,096**
for fair value hedges	883	1,086
for cash flow hedges	–	8
for hedges of net investments in foreign operations	–	2
Derivatives (negative fair values)	**5,962**	**7,086**
for fair value hedges	5,962	7,083
for cash flow hedges	–	3

18. Financial assets held for trading

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Derivatives (positive fair values)	**15,647**	**17,101**
Interest-linked contracts	13,773	14,749
Currency-linked contracts	1,194	813
Share- and index-linked contracts	403	256
Credit derivatives	225	367
Other contracts	52	916
Securities	**11,790**	**10,429**
Bonds and other fixed-income securities	10,788	9,013
Shares and other variable-yield securities	1,002	1,416
Loans and advances	**9,714**	**10,242**
Inventories and trade receivables	**349**	**334**
Other assets held for trading	**–**	**1**
Total	**37,500**	**38,107**

19. Investments

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Securities	**234,813**	**239,819**
Bonds and other fixed-income securities	171,621	179,296
Shares and other variable-yield securities	63,192	60,523
Investments in subsidiaries	**1,618**	**1,471**
Equity investments	**2,652**	**2,442**
Investments in joint ventures	462	525
Investments in associates	289	318
Other shareholdings	1,901	1,599
Total	**239,083**	**243,732**

20. Loss allowances

Loss allowances for loans and advances to banks

	Stage 1 € million	Stage 2 € million	Stage 3 € million	POCI € million	Total € million
Balance as at Jan. 1, 2018	**202**	**16**	**22**	**–**	**240**
Additions	15	12	3	–	30
Reversals	–17	–14	–22	–	–53
Balance as at Dec. 31, 2018	**200**	**14**	**3**	**–**	**217**

Loss allowances for loans and advances to customers	Stage 1 € million	Stage 2 € million	Stage 3 € million	POCI € million	Total € million
Balance as at Jan. 1, 2018	**955**	**1,903**	**6,389**	**11**	**9,258**
Additions	310	798	2,159	18	3,285
Utilizations	–	–1	–1,129	–	–1,130
Reversals	–461	–337	–2,024	–25	–2,847
Other changes	149	–211	74	–1	11
Balance as at Dec. 31, 2018	**953**	**2,152**	**5,469**	**3**	**8,577**

Loss allowances for investments	Stage 1 € million	Stage 2 € million	Stage 3 € million	POCI € million	Total € million
Balance as at Jan. 1, 2018	**57**	**125**	**24**	**–**	**206**
Additions	41	86	1	–	128
Utilizations	–	–	–1	–	–1
Reversals	–31	–102	–8	–	–141
Other changes	–1	2	1	–	2
Balance as at Dec. 31, 2018	**66**	**111**	**17**	**–**	**194**

Comparative information in accordance with IAS 39	Specific loan loss allowance € million	Portfolio loan loss allowance € million	Total € million
Balance as at Jan. 1, 2018	**6,530**	**990**	**7,520**
Additions	2,410	226	2,636
Utilizations	–795	–1	–796
Reversals	–1,589	–305	–1,894
Changes in the scope of consolidation	–28	–	–28
Other changes	–79	4	–75
Balance as at Dec. 31, 2018	**6,449**	**914**	**7,363**

21. Investments held by insurance companies

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Investment property	2,842	2,539
Investments in subsidiaries, joint ventures and associates	776	715
Mortgage loans	9,307	9,142
Promissory notes and loans	7,083	7,342
Registered bonds	9,076	8,800
Other loans	653	721
Variable-yield securities	9,186	9,276
Fixed-income securities	48,764	44,808
Derivatives (positive fair values)	168	299
Loss allowances	–4	
Deposits with ceding insurers and other investments	294	240
Assets related to unit-linked contracts	11,710	11,549
Total	**99,855**	**95,431**

In the previous year, the loss allowance was not presented separately, but deducted from the individual items.

22. Property, plant and equipment, and investment property

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Land and buildings	6,693	6,756
Office furniture and equipment	1,361	1,403
Assets subject to operating leases	72	138
Investment property	258	254
Other fixed assets	3,857	3,180
Total	**12,241**	**11,731**

23. Income tax assets and liabilities

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Income tax assets	**4,359**	**2,980**
Current income tax assets	909	896
Deferred tax assets	3,450	2,084
Income tax liabilities	**1,408**	**1,183**
Current income tax liabilities	856	813
Deferred tax liabilities	552	370

	Deferred tax assets Dec. 31, 2018 € million	Deferred tax assets Dec. 31, 2017 € million	Deferred tax liabilities Dec. 31, 2018 € million	Deferred tax liabilities Dec. 31, 2017 € million
Tax loss carryforwards	39	103		
Loans and advances to banks and customers	130	51	350	139
Financial assets and liabilities held for trading, and hedging instruments (positive and negative fair values)	634	525	197	20
Investments	298	298	249	518
Loss allowances	900		2	
Investments held by insurance companies	123	53	641	676
Deposits from banks and customers	277	374	239	198
Debt certificates issued including bonds	151	46	4	6
Provisions	2,151	2,138	50	38
Insurance liabilities	78	75	195	399
Other balance sheet items	192	182	148	137
Total (gross)	**4,973**	**3,845**	**2,075**	**2,131**
Netting of deferred tax assets and deferred tax liabilities	−1,523	−1,761	−1,523	−1,761
Total (net)	**3,450**	**2,084**	**552**	**370**

Deferred tax assets and liabilities are recognized for temporary differences in respect of the balance sheet items shown in the table as well as for tax loss carryforwards.

In the previous year, the loss allowance, which is reported separately in the year under review, was included in loans and advances to banks and customers.

24. Other assets

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Other assets held by insurance companies	3,372	3,090
Goodwill	59	58
Other intangible assets	551	463
Prepaid expenses	184	162
Other receivables	3,560	3,485
Non-current assets and disposal groups classified as held for sale	7,133	84
Fair value changes of the hedged items in portfolio hedges of interest-rate risk	4,000	4,128
Residual other assets	500	616
Total	**19,359**	**12,086**

The breakdown of other assets held by insurance companies is as follows:

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Intangible assets	**140**	**151**
Reinsurers' share of insurance liabilities	**139**	**168**
Provision for unearned premiums	6	11
Benefit reserves	36	60
Provisions for claims outstanding	97	97
Loans and advances	**1,650**	**679**
Receivables arising out of direct insurance operations	450	305
Receivables arising out of reinsurance operations	271	294
Other receivables	929	80
Credit balances with banks, checks and cash on hand	**409**	**110**
Residual other assets	**1,036**	**1,982**
Property, plant and equipment	379	387
Prepaid expenses	34	31
Remaining assets held by insurance companies	623	1,564
Loss allowances	**−2**	
Total	**3,372**	**3,090**

In the previous year, the loss allowance was not presented separately, but deducted from the individual items.

25. Deposits from banks and customers

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Deposits from banks	**119,300**	**113,065**
Repayable on demand	10,733	7,664
With agreed maturity or notice period	108,567	105,401
Deposits from customers	**842,420**	**801,031**
Savings deposits and home savings deposits	***246,029***	***242,345***
Savings deposits with agreed notice period of three months	177,790	175,547
Savings deposits with agreed notice period of more than three months	8,242	10,156
Home savings deposits	59,997	56,642
Other deposits from customers	***596,391***	***558,686***
Repayable on demand	488,884	450,264
With agreed maturity or notice period	107,507	108,422

26. Debt certificates issued including bonds

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Bonds issued	**43,110**	**47,696**
Mortgage Pfandbriefe	33,737	30,390
Public-sector Pfandbriefe	2,683	3,548
Other bonds	6,690	13,758
Other debt certificates issued	**13,001**	**17,111**
Total	**56,111**	**64,807**

27. Financial liabilities held for trading

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Derivatives (negative fair values)	**16,080**	**16,813**
Interest-linked contracts	12,100	13,848
Currency-linked contracts	1,975	871
Share- and index-linked contracts	1,853	742
Credit derivatives	74	77
Other contracts	78	1,275
Short positions	**1,102**	**617**
Bonds issued including share- and index- and other debt certificates	**20,250**	**13,028**
Liabilities	**4,966**	**6,255**
Liabilities from commodities transactions and commodity lending	**53**	**47**
Total	**42,451**	**36,760**

28. Provisions

	Dec. 31, 2018 € million
Provisions for defined benefit plans	7,407
Provisions for loan commitments	222
Provisions for financial guarantee contracts	137
Other provisions for loans and advances	39
Provisions relating to building society operations	1,072
Residual provisions	3,488
Total	**12,365**

Comparative information in accordance with IAS 39	Dec. 31, 2017 € million
Provisions for defined benefit plans	7,630
Provisions for loans and advances	419
Provisions relating to building society operations	983
Residual provisions	3,530
Total	**12,562**

Funding status of defined benefit obligations	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Present value of defined benefit obligations not funded by plan assets	6,831	6,924
Present value of defined benefit obligations funded by plan assets	2,732	2,722
Present value of defined benefit obligations	**9,563**	**9,646**
less fair value of plan assets	−2,158	−2,016
Defined benefit obligations (net)	**7,405**	**7,630**
Recognized surplus	2	–
Provisions for defined benefit plans	**7,407**	**7,630**

Changes in the present value of the defined benefit obligations	2018 € million	2017 € million
Present value of defined benefit obligations as at Jan. 1	**9,646**	**9,464**
Current service cost	109	136
Interest expense	169	165
Pension benefits paid including plan settlements	–354	–353
Past service cost	–	–2
Actuarial gains (–)/losses (+)	–34	243
Other changes	27	–7
Present value of defined benefit obligations as at Dec. 31	**9,563**	**9,646**

Changes in plan assets	2018 € million	2017 € million
Fair value of plan assets as at Jan. 1	**2,016**	**1,239**
Interest income	37	24
Contributions to plan assets	231	814
Pension benefits paid	–69	–65
Return on plan assets (excluding interest income)	–65	14
Other changes	8	–10
Fair value of plan assets as at Dec. 31	**2,158**	**2,016**

Actuarial assumptions used for defined benefit obligations	Dec. 31, 2018 (percent)	Dec. 31, 2017 (percent)
Weighted discount rate	1.75	1.75
Weighted salary increase	1.98	1.99
Weighted pension increase	1.92	1.93

29. Insurance liabilities

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Provision for unearned premiums	1,171	1,169
Benefit reserve	61,709	58,670
Provision for claims outstanding	12,079	11,064
Provision for premium refunds	8,283	8,446
Other insurance liabilities	64	68
Reserve for unit-linked insurance contracts	9,946	9,907
Total	**93,252**	**89,324**

Change in provision for unearned premiums	2018 € million	2017 € million
Balance as at Jan. 1	**1,169**	**1,119**
Additions	1,235	1,235
Utilizations/reversals	–1,228	–1,176
Changes attributable to currency translation	–5	–9
Balance as at Dec. 31	**1,171**	**1,169**

Change in benefit reserve	2018 € million	2017 € million
Balance as at Jan. 1	**58,670**	**55,167**
Additions	5,876	6,255
Interest component	1,045	1,067
Utilizations/reversals	–3,882	–3,818
Changes attributable to currency translation	–	–1
Balance as at Dec. 31	**61,709**	**58,670**

Supplementary change-in-discount-rate reserves totaling €3,306 million have been recognized for policies with a discount rate in excess of the reference rate specified in the German Regulation on the Principles Underlying the Calculation of the Premium Reserve (DeckRV) (December 31, 2017: €2,998 million).

Change in the provision for claims outstanding	2018 € million	2017 € million
Balance as at Jan. 1	**11,064**	**10,071**
Claims expenses	6,650	6,175
less payments	–5,630	–5,078
Changes attributable to currency translation	–5	–104
Balance as at Dec. 31	**12,079**	**11,064**

Change in the provision for premium refunds	2018 € million	2017 € million
Balance as at Jan. 1	**8,446**	**8,918**
Adjustments due to first-time application of IFRS 9	1,694	
Balance as at Jan. 1 adjusted	**10,140**	**8,918**
Additions	878	672
Utilizations/reversals	–705	–1,290
Changes resulting from unrealized gains and losses on investments (through other comprehensive income)	–1,488	–136
Changes resulting from other remeasurements (through profit or loss)	–542	316
Changes attributable to currency translation	–	–34
Balance as at Dec. 31	**8,283**	**8,446**

The breakdown of maturities for insurance liabilities is shown in the following tables:

Balance as at December 31, 2018	≤ 1 year € million	> 1 year – 5 years € million	> 5 years € million	Indefinite € million
Provision for unearned premiums	950	166	55	–
Benefit reserve	1,810	6,178	13,050	40,671
Provision for claims outstanding	4,388	4,301	3,390	–
Provision for premium refunds	833	644	713	6,093
Other insurance liabilities	41	13	7	3
Total	**8,022**	**11,302**	**17,215**	**46,767**
Balance as at December 31, 2017				
Provision for unearned premiums	1,011	124	34	–
Benefit reserve	1,677	6,601	13,258	37,134
Provision for claims outstanding	4,764	3,608	2,692	–
Provision for premium refunds	763	632	754	6,297
Other insurance liabilities	46	14	5	3
Total	**8,261**	**10,979**	**16,743**	**43,434**

30. Other liabilities

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Other liabilities of insurance companies	5,806	5,464
Other liabilities and accruals	2,462	2,318
Liabilities included in disposal groups classified as held for sale	281	–
Fair value changes of the hedged items in portfolio hedges of interest-rate risk	329	335
Residual other liabilities	586	757
Total	**9,464**	**8,874**

The breakdown of other liabilities held by insurance companies is as follows:

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Residual provisions	**373**	**354**
Provisions for employee benefits	336	317
Provisions for share-based payment transactions	2	1
Other provisions	35	36
Payables and residual other liabilities	**5,433**	**5,110**
Subordinated capital	87	85
Deposits received from reinsurers	43	75
Payables arising out of direct insurance operations	1,500	1,465
Payables arising out of reinsurance operations	342	269
Debt certificates issued including bonds	30	30
Deposits from banks	580	596
Derivatives (negative fair values)	11	39
Liabilities from capitalization transactions	2,086	1,861
Other liabilities	120	199
Residual other liabilities	634	491
Total	**5,806**	**5,464**

31. Subordinated capital

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Subordinated liabilities	2,566	3,774
Profit-sharing rights	161	391
Share capital repayable on demand	13	21
Total	**2,740**	**4,186**

32. Equity

Breakdown of subscribed capital

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Cooperative shares	12,085	11,672
Share capital	178	178
Capital of silent partners	69	80
Total	**12,332**	**11,930**

The capital reserves comprise the amounts by which the notional value of the shares of the corporations included in the consolidated financial statements was exceeded upon the issuance of the shares.

Retained earnings contain the undistributed equity earned by the companies included in the consolidated financial statements as well as the gains and losses arising on remeasurements of defined benefit plans after taking into account deferred taxes.

Reserves from other comprehensive income consist of the following items:

€ million	No reclassification to the income statement Reserve from equity instruments for which the fair value OCI option has ben exercised	No reclassification to the income statement Reserve from gains and losses on financial liabilities for which the fair value option has been exercised, attributable to changes in own credit risk	Reclassification to the income statement Reserve from debt instruments measured at fair value through other comprehensive income	Reclassification to the income statement Revaluation reserve	Reclassification to the income statement Cash flow hedge reserve	Reclassification to the income statement Currency translation reserve
Equity as at Jan. 1, 2017				**1,720**	**−10**	**74**
Other comprehensive income/loss				−30	15	−28
Total comprehensive income				**−30**	**15**	**−28**
Changes in the scope of consolidation				−14	–	–
Equity as at Dec. 31, 2017				**1,676**	**5**	**46**
First-time application of IFRS 9 in the consolidated financial statements	465		724	−1,676		
Adjusted equity as at Jan. 1, 2018	**465**		**724**	**–**	**5**	**46**
Other comprehensive income/loss	1	22	−413		−5	28
Total comprehensive income	**1**	**22**	**−413**		**−5**	**28**
Changes in the scope of consolidation	–	–	–		1	11
Acquisition/disposal of non-controlling interests	5	–	6		–	–
Reclassifications within equity	−33	–	–		–	–
Equity as at Dec. 31, 2018	**438**	**22**	**317**		**1**	**85**

E Financial instruments disclosures

The table shows the disclosures on the fair value of financial instruments included in the published annual reports of the DZ BANK Group. For all other companies included in the consolidated financial statements, the fair value was deemed to be equivalent to the carrying amount.

33. Fair value of financial instruments

	Carrying amount Dec. 31, 2018 € million	Fair value Dec. 31, 2018 € million	Carrying amount Dec. 31, 2017 € million	Fair value Dec. 31, 2017 € million
Assets				
Cash and cash equivalents	67,067	67,067	55,997[4]	55,997[4]
Loans and advances to banks[1]	18,583	20,471	19,948[5]	21,198[5]
Loans and advances to customers[1]	786,339	788,727	754,536	756,447
Hedging instruments (positive fair values)	883	883	1,096	1,096
Financial assets held for trading[2]	37,151	37,151	37,773	37,773
Investments[1,3]	238,138	239,950	242,889	243,064
Investments held by insurance companies[1,2,3]	85,009	85,562	81,086	81,936
Other assets[2]	8,897	8,366	7,575	7,849
Equity and liabilities				
Deposits from banks	119,300	121,346	113,065	114,502
Deposits from customers	842,420	843,600	801,031	802,258
Debt certificates issued including bonds	56,111	56,264	64,807	64,849
Hedging instruments (negative fair values)	5,962	5,962	7,086	7,086
Financial liabilities held for trading[2]	42,398	42,398	36,713	36,713
Other liabilities[2]	2,878	2,745	2,653	2,542
Subordinated capital	2,740	2,839	4,186	4,365

1 Carrying amounts less loss allowances (in the previous year, the loss allowance for investments, and for investments held by insurance companies was not reported separately).
2 Fair values and carrying amounts are only disclosed for financial instruments.
3 Excluding investments in joint ventures and in associates.
4 Adjustment by €+31,075 million due to change in presentation
5 Adjustment by €–31,075 million due to change in presentation

34. Maturity analysis

Balance as at December 31, 2018	≤ 3 months € million	> 3 months – 1 year € million	> 1 year € million	Indefinite € million
Loans and advances to banks	8,314	1,821	12,959	270
Loans and advances to customers	39,739	60,927	688,932	20,658
Deposits from banks	34,241	10,278	80,128	790
Deposits from customers	701,225	20,448	64,861	60,400
Debt certificates issued including bonds	9,240	5,843	44,407	–
Balance as at December 31, 2017				
Loans and advances to banks	25,818	3,858	25,622	553
Loans and advances to customers	36,444	57,180	666,093	19,531
Deposits from banks	31,076	10,266	80,021	680
Deposits from customers	660,963	19,084	70,079	57,023
Debt certificates issued including bonds	12,252	7,869	45,840	236

The contractual maturities shown in the table do not match the estimated actual cash inflows and cash outflows.

F Other disclosures

35. Capital requirements and regulatory indicators

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Total capital	**101,671**	**97,680**
Tier 1 capital	87,272	82,191
of which: Common Equity Tier 1	86,746	81,463
Additional Tier 1 capital	526	728
Tier 2 capital	14,399	15,489
Total risk exposure	**642,352**	**611,490**
Common Equity Tier 1 capital ratio (percent)	13.5	13.3
Tier 1 capital ratio (percent)	13.6	13.4
Total capital ratio (percent)	15.8	16.0
Common Equity Tier 1 capital ratio incl. reserves pursuant to Section 340f HGB (percent)[1]	15.5	15.4
Tier 1 capital ratio incl. reserves pursuant to Section 340f HGB (percent)[1]	15.6	15.6
Leverage ratio (percent)[2]	6.9	6.8
Leverage ratio incl. reserves pursuant to Section 340f HGB (percent)[1,3]	7.8	7.7

1 The balance of reserves pursuant to Section 340f HGB is based on the financial statements data of the institutions included as at the balance sheet date before additions and reversals within the scope of the 2018 and 2017 financial statements.
2 Disclosure of the leverage ratio of the bank-specific protection system using the transitional definition for Tier 1 capital pursuant to article 429 (2) CRR in conjunction with article 499 (1) CRR.
3 Disclosure of ratio after full introduction of the new CRR provisions, subject to the assumption of full reclassification and inclusion of reserves pursuant to Section 340f HGB as Tier 1 capital from a business point of view.

The disclosures refer to the bank-specific protection system (Cooperative Financial Network) and the relevant reporting date. The disclosures in relation to own funds and capital requirements are based on the results of the extended aggregated calculation (being implemented) in accordance with article 49 (3) CRR in conjunction with article 113 (7) CRR.

36. Financial guarantee contracts and loan commitments

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Financial guarantee contracts	19,636	18,436
Loan commitments	87,811	75,634
Total	**107,447**	**94,070**

The amounts shown for financial guarantee contracts and loan commitments are the nominal values of the respective exposure.

37. Trust activities

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Trust assets	**923**	**1,468**
of which: trust loans	52	477
Trust liabilities	**923**	**1,468**
of which: trust loans	52	477

38. Asset management by the Union Investment Group

	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Fund assets	**284,649**	**286,295**
Other types of asset management	**50,083**	**49,833**
Unit-linked asset management	1,687	1,489
Institutional asset management	9,961	9,654
Advisory and outsourcing	38,435	38,690
Accounts managed by third parties	**–11,362**	**–12,209**
Total	**323,370**	**323,919**

As at the balance sheet date, the Union Investment Group (through Union Asset Management Holding AG) had total assets under management of €323,370 million (December 31, 2017: €323,919 million). The fund assets comprise equity funds, fixed-income funds, money market funds, mixed funds, other securities funds, capital preservation funds, real estate funds, alternative investment funds and hybrid funds issued by Union Investment Group.

In addition, Union Investment Group has assets under management within the scope of institutional asset management, unit-linked asset management, and advisory and outsourcing. The fund volume of funds that have been issued by Union Investment Group but whose portfolio management has been outsourced is shown as a deduction. The definition of assets under management is based on the aggregate statistics from the Federal Association of German Fund Management Companies (BVI), Frankfurt/Main.

39. Leases

Finance leases with the Cooperative Financial Network as lessor	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Gross investment	**2,164**	**3,203**
Up to 1 year	711	1,007
More than 1 year and up to 5 years	1,330	1,929
More than 5 years	123	267
Less unearned finance income	**–144**	**–263**
Net investment	**2,020**	**2,940**
Less present value of unguaranteed residual values	**–42**	**–57**
Present value of minimum lease payment receivables	**1,978**	**2,883**
Up to 1 year	642	882
More than 1 year and up to 5 years	1,225	1,763
More than 5 years	111	238

As at the balance sheet date, the accumulated allowance for uncollectable minimum lease payments at lessor companies amounted to €20 million (December 31, 2017: €26 million).

The DVB Bank Group and the VR LEASING Group are active as finance lessors in the Cooperative Financial Network. The entities in the DVB Bank Group primarily enter into leases for ships and ship containers. Entities in the VR LEASING Group mainly enter into equipment leases with their customers.

40. Changes in the contract portfolios held by Bausparkasse Schwäbisch Hall

	Not allocated Number of contracts € million	Not allocated, Home savings sum € million	Allocated, Number of contracts € million	Allocated, Home savings sum € million	Total, Number of contracts € million	Total, Home savings sum € million
Balance as at Dec. 31, 2017	**7,808,225**	**281,261**	**653,931**	**17,698**	**8,462,156**	**298,959**
Additions in 2018 as a result of						
New contracts (redeemed contracts)[1]	523,070	26,736	–	–	523,070	26,736
Transfers	21,056	637	676	17	21,732	654
Allocation waivers and cancellations	6,553	261	–	–	6,553	261
Splitting	151,242	–	32	–	151,274	–
Allocations and acceptance of allocations	–	–	355,026	9,056	355,026	9,056
Other	68,737	2,326	21	1	68,758	2,327
Total	**770,658**	**29,960**	**355,755**	**9,074**	**1,126,413**	**39,034**
Disposals in 2018 as a result of						
Allocations and acceptance of allocations	–355,026	–9,056	–	–	–355,026	–9,056
Reductions	–	–856	–	–	–	–856
Termination	–316,174	–8,294	–299,989	–7,807	–616,163	–16,101
Transfers	–21,056	–637	–676	–17	–21,732	–654
Pooling[1]	–64,302	–	–1	–	–64,303	–
Expiration	–	–	–120,072	–3,041	–120,072	–3,041
Allocation waivers and cancellations	–	–	–6,553	–261	–6,553	–261
Other	–68,737	–2,326	–21	–1	–68,758	–2,327
Total	**–825,295**	**–21,169**	**–427,312**	**–11,127**	**–1,252,607**	**–32,296**
Net addition/disposal	–54,637	8,791	–71,557	–2,053	–126,194	6,738
Balance as at Dec. 31, 2018	**7,753,588**	**290,052**	**582,374**	**15,645**	**8,335,962**	**305,697**

1 Including increases.

Volume of unredeemed contracts	Number of contracts € million	Home savings sum € million
Contracts signed prior to Jan. 1, 2018	45,700	2,742
Contracts signed in 2018	177,479	11,915

41. Changes in the allocation assets of Bausparkasse Schwäbisch Hall

	2018 € million
Additions	
Amounts carried forward from 2017 (surplus)	
Amounts not yet disbursed	55,106
Additions in 2018	
Savings deposits (including credited residential construction bonuses)	9,251
Repayable amounts (including credited residential construction bonuses)[1]	1,159
Interest on home savings deposits	690
Total	**66,206**
Withdrawals	
Withdrawals in 2018	
Amounts allocated (if disbursed)	
Home savings deposits	5,183
Home savings loans	1,028
Repayment of deposits on non-allocated home savings contracts	1,482
Surplus of additions	
(Amounts not yet disbursed) at the end of 2018[2]	58,513
Total	**66,206**

1 Amounts repaid are the portion of the loan principal actually repaid.
2 The surplus amounts allocated include:
a) undisbursed home savings deposits from allocated home savings contracts: €93 million.
b) undisbursed home savings loans from funds allocated: €3,174 million.

42. Cover statement for the mortgages and local authority loans extended by the mortgage banks DZ HYP and MHB

	Mortgage Pfandbriefe Dec. 31, 2018 € million	Mortgage Pfandbriefe Dec. 31, 2017 € million	Public-sector Pfandbriefe Dec. 31, 2018 € million	Public-sector Pfandbriefe Dec. 31, 2017 € million
Ordinary cover	**57,419**	**53,757**	**20,810**	**23,367**
Loans and advances to banks	25	28	214	489
of which: Mortgage loans	25	28	–	–
Local authority loans	–	–	214	489
Loans and advances to customers	57,248	53,582	16,962	18,624
of which: Mortgage loans	57,248	53,582	53	57
Local authority loans	–	–	16,909	18,567
Investments consisting of bonds and other fixed-income securities	–	–	3,634	2,577
Property, plant and equipment	146	147	–	1,677
Extended cover	**1,687**	**2,253**	**106**	**132**
Loans and advances to banks	–	–	36	17
Investments consisting of bonds and other fixed-income securities	1,687	2,253	70	115
Total cover	**59,109**	**56,010**	**20,916**	**23,499**
Pfandbriefe requiring cover	**−53,839**	**−50,360**	**−17,578**	**−20,289**
Nominal excess cover	**5,267**	**5,650**	**3,338**	**3,210**
Present value of excess cover	**9,098**	**9,312**	**4,039**	**3,879**
Risk-related present value of excess cover	**8,544**	**8,257**	**3,529**	**3,416**

The present value of excess cover is higher than the nominal excess cover because it includes an interest component.

Maturity structure of mortgage Pfandbriefe and public-sector Pfandbriefe in issue	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Mortgage Pfandbriefe	**53,839**	**50,360**
≤ 6 months	2,549	1,919
> 6 months und ≤ 12 months	2,692	1,799
> 12 months und ≤ 18 months	2,173	2,023
> 18 months und ≤ 2 years	2,086	2,718
> 2 years und ≤ 3 years	3,463	3,630
> 3 years und ≤ 4 years	4,457	3,458
> 4 years und ≤ 5 years	4,390	4,482
> 5 years und ≤ 10 years	17,863	17,316
> 10 years	14,166	13,015
Public-sector Pfandbriefe	**17,578**	**20,289**
≤ 6 months	690	716
> 6 months und ≤ 12 months	1,322	1,941
> 12 months und ≤ 18 months	1,005	637
> 18 months und ≤ 2 years	1,023	1,370
> 2 years und ≤ 3 years	1,265	2,091
> 3 years und ≤ 4 years	753	1,285
> 4 years und ≤ 5 years	992	798
> 5 years und ≤ 10 years	4,769	4,788
> 10 years	5,759	6,663

Fixed-interest periods of cover assets	Dec. 31, 2018 € million	Dec. 31, 2017 € million
Mortgage Pfandbriefe	**56,106**	**56,010**
≤ 6 months	2,186	2,799
> 6 months und ≤ 12 months	2,320	2,304
> 12 months und ≤ 18 months	2,208	2,170
> 18 months und ≤ 2 years	2,549	2,183
> 2 years und ≤ 3 years	4,967	4,841
> 3 years und ≤ 4 years	5,446	5,069
> 4 years und ≤ 5 years	5,121	5,031
> 5 years und ≤ 10 years	20,537	19,812
> 10 years	13,772	11,801
Public-sector Pfandbriefe	**20,916**	**23,499**
≤ 6 months	1,054	1,110
> 6 months und ≤ 12 months	1,114	902
> 12 months und ≤ 18 months	970	917
> 18 months und ≤ 2 years	654	988
> 2 years und ≤ 3 years	1,358	1,721
> 3 years und ≤ 4 years	1,173	1,381
> 4 years und ≤ 5 years	1,117	1,246
> 5 years und ≤ 10 years	5,093	5,896
> 10 years	8,383	9,338

57 properties were in forced administration as at the reporting date (December 31, 2017: 85). The mortgage loans held as cover include past-due payments for interests to be paid in the amount of €1 million (December 31, 2017: € 1 million).

43. Board of Managing Directors of the BVR

Marija Kolak (President)
Gerhard Hofmann
Dr. Andreas Martin

Berlin, July 4, 2019

National Association of German Cooperative Banks
BVR

Board of Managing Directors

Marija Kolak Gerhard Hofmann Dr. Andreas Martin

Annex:
Significant Financial Reporting Principles

Basis of preparation of the consolidated financial statements

The consolidated financial statements of the Volksbanken Raiffeisenbanken Cooperative Financial Network for the period from January 1 to December 31, 2018, prepared by the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken e.V. (BVR), has to be prepared for a specific purpose pursuant to the financial reporting principles set out below. They have been prepared for informational purposes and to present the business development and performance of the Cooperative Financial Network, which is treated as a single economic entity in terms of its risks and strategies. In addition, the financial statements were prepared in compliance with the provisions set out in article 113(7)(e) of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (Capital Requirements Regulation – CRR).

The consolidated financial statements have to include the following components:

- Income statement for the period from January 1 to December 31, 2018 (pursuant to IAS 1.81 A, IAS 1.81 B and IAS 1.82 (b) to IAS 1.105)
- Statement of comprehensive income for the period from January 1 to December 31, 2018 (pursuant to IAS 1.81 A, IAS 1.81 B and IAS 1.82 (b) to IAS 1.105)
- Balance sheet as at December 31, 2018 (pursuant to IAS 1.54 to IAS 1.80A)
- Statement of changes in equity for the period from January 1 to December 31, 2018 (pursuant to IAS 1.106 to IAS 1.110)
- Statement of cash flows for the period from January 1 to December 31, 2018 (pursuant to IAS 7.1 to IAS 7.47)
- Explanatory information on the consolidated financial statements
- Management report including risk report for the period from January 1 to December 31, 2018

The consolidated financial statements have to include prior year comparatives. The consolidated financial statements have to be prepared in euro. Unless stated otherwise, all amounts have to be shown in millions of euros (€ million). All figures have to be rounded to the nearest whole number.

Scope of consolidation

Regardless of whether consolidation criteria are met under other national or international financial reporting principles, the consolidated financial statements have to include as consolidated entities all cooperative banks existing as at the reporting date (the local cooperative banks, Sparda banks, PSD banks, Deutsche Apotheker- und Ärztebank eG as well as specialized institutions) as well as all companies included in the IFRS consolidated financial statements of DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt/Main (DZ BANK), Münchener Hypothekenbank eG (MHB), the BVR protection scheme, and BVR Institutssicherung GmbH.

Procedures of consolidation

The consolidated subsidiaries generally have to prepare their financial statements on the basis of a financial year ended December 31.

Similar to IFRS 3.4 et seq. in conjunction with IFRS 10, business combinations have to be accounted for using the purchase method by offsetting the acquisition cost of a subsidiary against the share of the equity that is attributable to the parent entities and remeasured at fair value on the relevant date when control is acquired. This eliminates the multiple gearing of eligible own funds and any inappropriate creation of own funds for regulatory purposes between the consolidated entities listed above. Any positive difference has to be recognized as goodwill under other assets and is subject to an annual impairment test in accordance with IAS 36.80-108. Any negative goodwill has to be recognized immediately in profit or loss. Any share of subsidiaries' net assets not attributable to the parent entities has to be reported as non-controlling interests within equity.

Interests in joint ventures and investments in associates in accordance with IFRS 11.4-19 have to be accounted for using the equity method pursuant to IAS 28.3 and reported under investments.

Assets and liabilities as well as income and expenses arising within the Cooperative Financial Network have to be offset against each other. Gains and losses arising from transactions between entities within the Cooperative Financial Network have to be eliminated.

Financial instruments

Financial instruments have to be designated upon initial recognition to the categories set out below if their characteristics and intended use meet the criteria of the relevant category. The following categories have been defined:

Financial assets measured at fair value through profit or loss (fair value PL)
Financial assets that are not measured at amortized cost or at fair value through other comprehensive income have to be classified as "financial assets measured at fair value through profit or loss." Apart from those financial instruments that are allocated to the "Other" business model or that do not meet the cash flow criterion set out in IFRS 9.B.4.1.2C, financial instruments have to be allocated to the following sub-categories of the category "financial instruments measured at fair value through profit or loss":

Financial assets mandatorily measured at fair value through profit or loss
The subcategory "financial assets mandatorily measured at fair value through profit or loss" has to comprise financial assets that are acquired for the purpose of selling them in the near term. To this end, these financial assets must be 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-taking, or must be derivatives, except for derivatives that are designated hedging instruments in effective hedging relationships.

The primary financial instruments held by cooperative banks in the trading portfolio under commercial law have to be allocated to this category.

Contingent considerations in a business combination
Contingent considerations classified by the acquirer in a business combination as financial assets have to be allocated to this subcategory.

Financial assets designated as at fair value through profit or loss (fair value option)
Financial assets may be assigned to the subcategory "financial assets designated as at fair value through profit or loss" by exercising the fair value option, provided that the application of this option eliminates or significantly reduces measurement or recognition inconsistencies (accounting mismatches).

Any changes in the fair value of instruments allocated to the category "financial assets designated as at fair value through profit or loss" have to be recognized in profit or loss.

Financial assets measured at fair value through other comprehensive income (fair value OCI)
A financial asset has to be assigned to this subcategory if it is held in accordance with a business model aimed both at collecting contractual cash flows and at selling financial assets. Moreover, the contractual terms of the financial asset must give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Because of the cash flow criterion, only financial assets in the form of debt instruments may be allocated to this category. These financial assets have to be measured at fair value. Interest income, loss allowances, and currency translation effects must be recognized in profit or loss. However, any differences between the amortized cost and the fair value have to be recognized in other comprehensive income. The amounts recognized in other comprehensive income must be reclassified to the income statement upon derecognition (so-called "recycling").

In addition, financial instruments have to be allocated to this category upon the exercise of the irrevocable option to designate equity instruments as "financial assets designated as at fair value through other comprehensive income" (fair value OCI option) upon initial recognition. Changes in fair value have to be recognized in other comprehensive income, except in the case of dividends that do not constitute repayment of capital. The cumulative other comprehensive income must not be recycled subsequently to the income statement, e.g. due to derecognition of the instrument. After derecognition of these equity instruments, the cumulative other comprehensive income has to be reclassified to retained earnings. The general fair value OCI option can only be exercised for equity instruments that are not held for trading and do not constitute contingent consideration recognized by the acquirer in a business combination pursuant to IFRS 3.58.

Financial assets measured at amortized cost (AC)
A financial asset has to be assigned to this category if it is held in accordance with a business model aimed at holding financial assets for the purpose of collecting contractual cash flows and the contractual

terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Because of the cash flow criterion, only financial assets in the form of debt instruments may be allocated to this category. Financial assets included in this category have to be measured at amortized cost. Interest income, loss allowances, and currency translation effects must be recognized in profit or loss.

Financial debt instruments of the cooperative banks that are not held in the trading portfolio under commercial law have to be allocated to this category.

Financial liabilities measured at fair value through profit or loss (fair value PL)
Financial liabilities that are not measured at amortized cost have to be classified as “financial liabilities measured at fair value through profit or loss”. This category has to be broken down into the following subcategories:

<u>Financial liabilities mandatorily measured at fair value through profit or loss</u>
The subcategory “financial liabilities mandatorily measured at fair value through profit or loss” has to include financial liabilities that are acquired for the purpose of selling them in the near term. To this end, these financial liabilities must be 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-taking, or must be derivatives, except for derivatives that are designated hedging instruments in effective hedging relationships.

<u>Contingent considerations in a business combination</u>
Contingent considerations classified by the acquirer in a business combination as financial liabilities have to be allocated to this subcategory.

<u>Financial liabilities designated as at fair value through profit or loss (fair value option)</u>
Financial liabilities may be designated to the “financial instruments designated as at fair value through profit or loss” subcategory by exercising the fair value option, provided that the application of this option eliminates or significantly reduces measurement or recognition inconsistencies (accounting mismatches), the financial liabilities are managed as a portfolio on a fair value basis, or they include one or more embedded derivatives required to be separated from the host contract.

In the case of financial liabilities designated as at fair value through profit or loss, any net gain or loss resulting from the changes in the fair value of the financial liability attributable to the changes in that liability’s credit risk has to be recorded in other comprehensive income. The rest of the change in the fair value of this liability has to be recognized in profit or loss. The amounts recognized in other comprehensive income have to be reclassified to retained earnings on derecognition of the relevant financial liability.

Financial liabilities measured at amortized cost (AC)
For measurement subsequent to initial recognition, all financial liabilities have to be categorized generally as “financial liabilities measured at amortized cost,” except in the following cases:

Financial liabilities measured at fair value through profit or loss, financial liabilities that arise when a transfer of a financial asset does not satisfy the condition for derecognition or accounting treatment is based on a continuing involvement, financial guarantee contracts, loan commitments with an interest rate below the market interest rate, and contingent consideration recognized by the acquirer in a business combination pursuant to IFRS 3.39 et seqq.

In accordance with IAS 32.15-32, shares in partnerships have to be classified normally as debt instruments. Given their subordinated status compared with the liabilities of the partnerships concerned, non-controlling interests in this case have to be reported as subordinated capital. Profit attributable to non-controlling interests has to be recognized under other liabilities, provided that the resulting liability is not of a subordinated nature. Non-controlling interests in partnerships have to be classified as “share capital repayable on demand” and have to be assigned to the “financial liabilities measured at amortized cost” category.

This category also has to include liabilities under compensation payment obligations owed to non-controlling interests in consolidated subsidiaries. These liabilities arise if DZ BANK or some other entity controlled by DZ BANK has concluded a profit transfer agreement with a subsidiary in accordance with section 291 (1) of the German Stock Corporation Act (AktG) under which there are non-controlling interests. Liabilities under compensation payment obligations have to be recognized at the amount of the discounted obligation.

In addition, this category has to include liabilities from capitalization transactions that are not designated as unit-linked insurance products. There is no significant transfer of insurance risk in these transactions and they do not therefore satisfy the criteria for an insurance contract under IFRS 4 Appendix A. As a consequence, such transactions need to be treated as financial instruments in accordance with the above-mentioned principles.

Other financial instruments
Other financial instruments have to comprise insurance-related financial assets and financial liabilities, receivables and liabilities arising from finance leases, or liabilities from financial guarantee contracts.

Insurance-related financial assets and financial liabilities as well as receivables and liabilities from finance leases have to be recognized and measured pursuant to the principles set out in this section and in the sections entitled “Insurance business” or “Leases,” respectively.

Liabilities from financial guarantee contracts within the DZ BANK Group have to be recognized by the guarantor at fair value at the time the commitment is made. The fair value normally has to correspond to the present value of the consideration received for issuing the financial guarantee contract. The obligation has to be subsequently measured at the higher of a provision recorded and the original amount less any amortization recognized subsequently. Nevertheless, financial guarantee contracts or loan commitments may not be recognized as liabilities at the cooperative banks.

Initial recognition and derecognition of financial assets and financial liabilities
Derivatives have to be initially recognized on the trade date. Regular way purchases and sales of non-derivative financial assets have to be generally recognized and derecognized using settlement date accounting. In the case of consolidated investment funds and the issue of certain securities, the financial instruments have to be recognized on the trade date.

All financial instruments have to be measured at fair value on initial recognition. In the case of financial assets or financial liabilities not measured at fair value through profit or loss, transaction costs directly attributable to the acquisition of the financial asset or issue of the financial liability concerned have to be added or deducted on initial recognition.

Financial assets have to be derecognized if the contractual rights to the cash flows from the financial assets have expired or these rights have been transferred to third parties, and substantially no risks or rewards of ownership in the financial assets remain. If the criteria for derecognizing financial assets are not satisfied, the transfer to third parties has to be recognized as a secured loan. Financial liabilities have to be derecognized when the contractual obligations have been settled, extinguished or have expired.

Loss allowances for financial assets
Loss allowances are only recognized for financial assets that represent debt instruments. In contrast, equity instruments do not fall within the scope of the impairment provisions set out in IFRS 9. Loss allowances have to be recognized for the following financial assets:

– Financial assets of the category “financial assets measured at amortized cost”
– Financial assets (only debt instruments) of the category “financial assets measured at fair value through other comprehensive income”
– Undrawn loan commitments where there is a current legal obligation to extend credit (irrevocable loan commitments), to the extent that these are not measured at fair value through profit or loss
– Financial guarantee contracts, to the extent that these are not measured at fair value through profit or loss
– Lease receivables that fall within the scope of IAS 17
– Trade receivables and contract assets that fall within the scope of IFRS 15

Expected losses have to be determined using a three-stage approach:

– Stage 1: All financial assets have to be assigned to Stage 1 upon initial recognition, with the exception of financial assets that are purchased or originated credit-impaired assets (POCI). Due to the cooperative banks’ business model, the POCI rules must not be applied in this context. The 12-month expected credit losses represent the minimum measurement amount for loss allowances regarding Stage 1 assets. Discounting must not be applied for cooperative banks.

– Stage 2: As at each reporting date, assets have to be allocated to Stage 2 if their credit risk has increased significantly since initial recognition, but where there is no objective evidence of impairment. For these assets, the loss allowances have to be measured at the amount of the lifetime expected credit losses. Cooperative banks have to assess the relevant assets by similar risk classes; discounting is not applicable. The stages have to be defined on the basis of the rating grade allocation.

  It has to be assumed that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument concerned is determined to have low credit risk at the reporting date (so-called low credit risk exemption). The application of the low credit risk exemption for loans and, hence, also for promissory note loans is excluded in the consolidated financial statements. Provided that historical probabilities of default for financial instruments were not available without undue effort and, to that extent, there is no original estimate of the probability of default over the remaining term, financial instruments have to be assigned to Stage 2 if the current credit assessment no longer meets the criteria for a rating equivalent to investment grade.

– Stage 3: Financial assets that are classified as credit-impaired have to be assigned to Stage 3 accordingly. The loss allowance for these assets has to be measured at the amount of the lifetime expected credit losses or, for cooperative banks, at the amount of the specific valuation allowance or the specific valuation allowance assessed on a portfolio basis, both of which determined in accordance with the German Commercial Code (HGB). Financial assets are classified as credit-impaired upon the occurrence of one or more events that have a negative effect on the expected future cash flows of the financial asset or when they are deemed defaulted in accordance with Article 178 of the Capital Requirements Regulation (CRR).

Financial assets that are subject to the impairment provisions set out in IFRS 9.5.5 have to be reviewed at each reporting date whether one or more events have occurred that have a negative effect on the expected future cash flows of the relevant financial asset.

Purchased or originated credit-impaired (POCI) financial assets have to be recognized, upon initial recognition, at their carrying amount reduced by lifetime expected credit losses and have to be amortized, accordingly, using a risk-adjusted effective interest rate. At the reporting date, only the cumulative changes in lifetime expected credit losses since initial recognition have to be recorded as a loss allowance. There is no transfer between individual stages for these assets. The modification rules set out in IFRS 9.5.4.3 have to be applied, except for non-substantial modification at the cooperative banks.

Embedded derivatives
An embedded derivative is a component of a hybrid contract that also includes a non-derivative financial instrument (host contract), with the effect that some of the cash flows of the combined financial instrument vary in a way similar to those of a standalone derivative. A derivative that is attached to a financial instrument but is contractually transferable independently of that instrument, or has a different counterparty, is not an embedded derivative, but a separate financial instrument.

If a hybrid contract contains a host contract that is a financial asset, the categorization rules for financial assets have to be applied to the entire hybrid contract.

If a hybrid contract contains a host contract that is a financial liability, an embedded derivative has to be separated from the host contract and accounted for separately if:
– the economic characteristics and risks of the derivative are not closely related to the economic characteristics and risks of the host contract;
– a separate instrument with the same terms would meet the definition of a derivative, and
– the hybrid contract is not measured at fair value through profit or loss.
If these conditions are not met, the embedded derivative may not be separated from the host contract. When an embedded derivative is separated, the host contract has to be accounted for in accordance with the measurement principles presented regarding financial instruments. If a contract includes one or more embedded derivatives and the host contract is not a financial asset, the entire hybrid contract can

be categorized as measured at fair value through profit or loss. This is not the case where embedded derivatives only have an insignificant impact on the contractually specified cash flows or, upon initial comparison with similar hybrid instruments, it is evident without – or with only minor – analysis that separation of the embedded derivative is not permitted.

Hedge accounting

Fair value hedges
A fair value hedge is intended to ensure that changes in the fair value of the hedged item are offset by countervailing changes in the fair value of the hedging instrument. Changes in the fair value of the hedged item attributable to the hedged risk and changes in the fair value of the hedging instrument have to be recognized in profit or loss. Risks must be hedged by designating hedges either on an individual or on a portfolio basis.

Hedged items categorized as “financial assets measured at amortized cost”, “financial liabilities measured at amortized cost”, or finance lease receivables have to be measured in accordance with the general measurement principles for these financial instruments. The values have to be adjusted for the change in fair value attributable to the hedged risk. Hedged items categorized as “financial assets at fair value through other comprehensive income” have to be measured at fair value, although only changes not attributable to the hedged changes in fair value have to be recognized in other comprehensive income. Interest income and interest expense arising from hedged items or hedging instruments have to be recognized under net interest income.

If the fair value is hedged against interest-rate risks on a portfolio basis, the cumulative changes in fair value attributable to the hedged risk have to be reported on the balance sheet under fair value changes of the hedged items in portfolio hedges of interest-rate risk, either under other assets or other liabilities depending on whether the portfolio comprises financial assets or financial liabilities.

In fully effective hedges, the changes in fair value attributable to the hedged risk offset each other over the lifetime of the hedging relationship. Any changes in fair value recognized in the carrying amount of the hedged items have to be amortized through profit or loss not later than by the time the hedge has been terminated.

Cooperative banks may only designate hedging relationships on a portfolio basis.

Cash flow hedges
Hedging instruments have to be measured at fair value. Changes in fair value attributable to the effective portion of the hedge have to be recognized in other comprehensive income. Changes in fair value attributable to the ineffective portion of the hedge have to be recognized in profit or loss. Hedged items have to be recognized and measured in accordance with the general principles for the relevant measurement category. At the end of a hedging relationship, any changes in fair value recognized in other comprehensive income must be reclassified to profit or loss on the date on which the hedged items or transactions are also recognized in profit or loss.

Hedges of net investments in foreign operations
Hedges of net investments in foreign operations have to be accounted for in the same way as cash flow hedges.

Currency translation

All monetary assets and liabilities, together with unsettled spot transactions, have to be translated at the closing rate into the relevant functional currency of the consolidated entity. Cash in foreign currency has to be translated using the buying rate for cash on the balance sheet date. The translation of non-monetary assets and liabilities has to be based on the way in which these assets and liabilities are measured. If non-monetary assets are measured at amortized cost, they have to be translated using the historical exchange rate. Non-monetary assets measured at fair value have to be translated at the closing rate. Income, expenses, gains, and losses have to be translated on the date they are recognized either in profit or loss or in other comprehensive income.

If the functional currency of companies included in the consolidated financial statements is different from the reporting currency (euros), all assets and liabilities have to be translated at the exchange rate at the reporting date. Equity has to be translated at the historical rate. Income and expenses have to be translated at average rates. Any differences arising from currency translation have to be reported in the currency translation reserve.

Insurance business

General information on the accounting treatment of insurance business
Insurance contracts have to be recognized in accordance with the requirements of IFRS 4.13-35. Capitalization transactions have to be classified as financial instruments and are recognized in accordance with the mentioned principles. Service contracts are subject to the revenue recognition requirements specified in IFRS 15.31-45.

Insurance business in the Cooperative Financial Network is generally reported under specific insurance items on the face of the income statement and balance sheet.

Financial assets and financial liabilities
Financial assets and financial liabilities held or entered into in connection with insurance operations have to be accounted for and measured in accordance with the financial reporting principles for financial instruments. Financial assets and financial liabilities have to be reported under investments held by insurance companies, other assets held by insurance companies, and other liabilities of insurance companies. Loss allowances on financial assets recognized under investments and other assets held by insurance companies have to be deducted from the assets' carrying amounts. The net presentation method applies for the items “Investments held by insurance companies” and “Other assets held by insurance companies,” while the gross presentation method applies for loss allowances in the notes to the balance sheet items.

Other liabilities of insurance companies have to include the benefit obligations under capitalization transactions for which no material insurance risk is assumed when the policy is concluded. They have to be reported under liabilities from capitalization transactions. The underlying financial instruments in these transactions have to be reported as part of assets related to unit-linked contracts under investments held by insurance companies.

Investment property
The investment property included in the investments held by insurance companies has to be measured at amortized cost in accordance with the cost model. Non-interest-bearing, low-interest or forgivable loans have to be recognized in the same way as government grants. The amount of financial assistance as well as any government grants have to be deducted when the carrying amount of the asset is identified and then have to be recognized in profit or loss over the period covered by the assistance or grant by means of a reduced depreciation charge.

Recoverable amounts of real estate have to be determined in the context of impairment tests pursuant to the provisions of IFRS 13.27-33. For this purpose, standard valuation methods have to be used that are based on the requirements of the German Real Estate Valuation Regulation (ImmoWertV), the German Real Estate Valuation Guidelines (WertR 2006), and the German Building Code (BauGB). Accordingly, the current value of real estate has to be determined by using the sales comparison approach, income approach, or cost approach and taking into account the provisions of any relevant contracts.

Any expenditure that increases value and extends the useful life of real estate or results in a significant improvement in the fabric of a building has to be capitalized. Maintenance and repair costs have to be expensed as incurred.

Insurance liabilities
Insurance liabilities have to be recognized and measured in accordance with the provisions of the German Comercial Code HGB and other German accounting rules applicable to insurance companies. Insurance liabilities have to be shown before the deduction of the share of reinsurers, which is reported as an asset.

Provision for unearned premiums
The provision for unearned premiums has to cover premiums that have already been collected but that relate to future periods.

The provision for unearned premiums from direct non-life insurance operations has to be calculated from the gross premiums using the 360-day system. Calculation of non-transferable income components has to be based on the letter from the Bundesministerium der Finanzen (BMF) [German Federal Ministry of Finance], dated April 30, 1974.

Unearned premiums from life insurance have to be calculated taking into account the starting date and maturity date of each individual policy after deduction of non-transferable premium components.

The proportion of the provision for unearned premiums relating to ceded insurance business has to be calculated as specified in the individual reinsurance contracts.

Benefit reserve
The purpose of the benefit reserve is to ensure that guaranteed entitlements to future insurance benefits can be satisfied on a permanent basis. Guaranteed entitlements for insured persons in respect of life insurance and casualty insurance with premium refund as well as the provision for increasing age in health insurance have to be reported under the benefit reserve.

The benefit reserve for life insurance and casualty insurance with premium refund has to be generally calculated on the basis of individual policies taking into account starting dates in accordance with approved business plans and the principles declared to the relevant regulatory authorities. The prospective method has to be used for life insurance (except for unit-linked insurance products and account management arrangements) and for casualty insurance (with the exception of premium-based policies that started prior to 1982). The retrospective method has to be used for other types of insurance. Negative benefit reserves on an individual policy basis have to be recognized with an amount of zero.

The assumptions used in calculations are determined in accordance with current recommendations issued by the Deutsche Aktuarvereinigung e.V., Cologne, (DAV) [German Actuarial Association] and the regulator and in accordance with other national statutory provisions and regulations. The interest rates are generally determined by the legally prescribed maximum discount rates. The calculation assumptions apply from the date on which the policy is written until the policy expires.

For policies entered into before or in 2014, calculation of the benefit reserve had to be based on the Zillmer method. Following the introduction of the German Life Insurance Reform Act (LVRG), zillmerizing does not have to be applied to most new business entered into since 2015. In particular, zillmerizing does not have to be applied to subsidized pension insurance policies under the German Personal Pension Plan Act (AVmG) or to pension insurance policies under reinsured pension plans.

The benefit reserve implicitly has to include administrative expenses for contracts with ongoing payment of premiums. A provision for administrative costs has to be recognized to cover premium-free years under insurance policies, fully paid-up insurance, and some legacy insurance commitments.

In health insurance, benefit reserves have to be computed prospectively on an individual policy basis using the technical parameters for calculating rates. Negative benefit reserves have to be offset against positive benefit reserves. The parameters for the computation of the reserves involve, in particular, assumptions regarding rates of return on investment, mortality, cancellations, and costs.

When the benefit reserves are prospectively calculated, the parameters used have to be generally retained throughout the term of the policy. If the actuarial analyses conducted once a year reveal that the level of cover offered is inadequate in terms of either biometric parameters or discount rate, appropriate adjustments have to be made. The biometric parameters used in such computations are based primarily on the mortality and invalidity tables published by the DAV.

Since 2011, supplementary change-in-discount-rate reserves have had to be recognized for policies with a discount rate in excess of the reference rate. For new policies, this requirement results from the provisions of the German Regulation on the Principles Underlying the Calculation of the Premium Reserve (DeckRV). A supplementary change-in-discount-rate reserve has to be recognized for policies with a discount rate in excess of the reference rate specified in the DeckRV. In the 2018, the German Federal Ministry of Finance (Bundesministerium der Finanzen, BMF) modified the procedure for determining this reference rate to soften an overly strong dynamic of the previous arrangements. This results in a modest increase in the supplementary change-in-discount-rate reserves for new business compared with previous years. Subject to the approval of BaFin, the supplementary change-in-discount-rate reserve has to be increased for existing policies. Entity-specific probabilities for cancellation and lump-sum payments have had to be used since 2016.

Provision for claims outstanding
The provision for claims outstanding has to include benefit obligations arising from claims in which it is not yet possible to reliably determine the amount and/or the timing of the payment. The provision has to be recognized for claims that have already been reported and also for insured events that have

occurred but have not yet been reported. It has to include both internal and external expenses as well as the cost of settling claims.

The provision for claims outstanding in direct non-life insurance business has to be determined on a case-by-case basis for all known claims. Recourse claims, excess proceeds, and claims under loss sharing agreements have to be netted. Based on claims reports in previous years, an additional claims provision has to be recognized for claims that occur or are caused before the balance sheet date but have not yet been reported by this date. Statistical estimates have to be used in this measurement. The provision for claims outstanding may not be discounted, except in the case of the pension benefits reserve. The provisions for claims settlement expenses, which are also included in this item, have to be calculated in accordance with the requirements set out in the coordinated regulations issued by the German federal states on February 2, 1973 and in accordance with the flat-rate calculation method (including claims incurred but not reported, IBNR) developed by the Gesamtverband der Deutschen Versicherungswirtschaft e. V., Berlin, (GDV) [German Insurance Association]. Under these arrangements, internal costs likely to be incurred in connection with the settlement of future claims have to be projected using an overall rate applied to the present level of expenses.

The provision for claims outstanding as regards life insurance and pension funds has to be determined on a case-by-case basis. The provision has to be recognized for claims that have already been incurred and reported by the balance sheet date, but have not yet been settled.

A provision for settlement expenses has to be recognized in an amount equivalent to 1 percent of the claims provision to cover claims incurred and reported by the balance sheet date (excluding maturing policies) and also IBNR losses.

In health insurance, the provision for claims outstanding has to be determined on the basis of the costs paid out in the financial year in connection with claims during the year. The calculation has to be based on claims experience over the previous 3 financial years. Recourse claims have to be deducted from the provision for claims outstanding, as are reimbursements due under the German Act on the Reform of the Pharmaceuticals Market (AMNOG). The recognized provision includes the costs of settling claims, calculated in accordance with tax rules. The reinsurers' share of the provision has to be determined in accordance with reinsurance agreements. Where appropriate, provisions for claims outstanding have to be recognized on a case-by-case basis for claims relevant to reinsurance.

Provision for premium refunds
The provision for premium refunds has to include obligations not yet due for settlement on the balance sheet date relating to premium refunds to insured parties. It has to include amounts allocated to policyholders under statutory or contractual arrangements for bonuses and rebates. In addition, the provision for premium refunds has to include provisions resulting from time-restricted cumulative recognition and measurement differences between items in the financial statements prepared in accordance with these significant financial reporting principles and those prepared in accordance with HGB. In the case of measurement differences recognized in other comprehensive income, such as unrealized gains and losses on available-for-sale financial assets, corresponding expenses for deferred premium refunds have to be recognized in other comprehensive income; otherwise, changes in the provision are recognized in profit or loss.

The expenses for deferred premium refunds in the non-life insurance business have to be recognized in an amount equivalent to 90 percent of the difference between the carrying amounts for items in the financial statements prepared in accordance with HGB and those in the financial statements prepared in accordance with the significant financial reporting principles, net of deferred taxes.

The provision for premium refunds related to life insurance policies and pension funds has to be recognized to cover the entitlement of policyholders to profit-related premium refunds. Funds earmarked in this way are therefore made available for future allocation of bonuses to policyholders on an individual policy basis. Within the overall provision for premium refunds, a distinction has to be made between provisions attributable to bonuses already declared but not yet allocated (including participation in valuation reserves in accordance with HGB), the funding used to finance future terminal bonuses, and the free provision for premium refunds. The expenses for deferred premium refunds have to be recognized in an amount equivalent to 90 percent of the difference between the carrying amounts for items in the financial statements prepared in accordance with HGB and those in the financial statements prepared in accordance with the significant financial reporting principles, net of deferred taxes.

The provision for premium refunds related to health insurance has to include amounts allocated to policyholders under statutory or contractual arrangements for bonuses and rebates. The expenses for deferred premium refunds have to be recognized in an amount equivalent to 80 percent of the difference between the carrying amounts for items in the financial statements prepared in accordance with HGB and those in the financial statements prepared in accordance with the significant financial reporting principles, net of deferred taxes.

Other insurance liabilities

Other insurance liabilities relating to non-life insurance have to include obligations arising from membership of the Verein Verkehrsopferhilfe e.V. (VOH) [road casualty support organization], Berlin, in line with the object of this organization and the provision for unearned premiums under dormant vehicle insurance policies, the provision being determined on an individual policy basis. The cancellation provision has to be calculated on the basis of past experience. The provision for onerous contracts is calculated on the basis of prior-year figures and a forecast of other insurance gains and losses, taking into account interest income and residual maturities.

Other insurance liabilities for life insurance have to be computed on the basis of individual policies from premiums that are already due but have yet to be paid and have not yet been included in the life insurance liabilities to the extent that the investment risk is borne by the policyholders.

Other insurance liabilities for health insurance have to contain a cancellation provision. The cancellation provision has to be recognized to take account of expected losses and was calculated on the basis of empirical values relating to the premature loss, not previously accounted for, of the negative portions of the provision for increasing age in health insurance.

Reinsurance business

In the case of reinsurance business, the insurance liabilities have to be recognized in accordance with the requirements specified by the ceding insurers. If no such details are available as at the reporting date, the provision for the financial year has to be estimated. The critical factors in estimating the provision are the contractual terms and conditions and the pattern of this business to date. In a few instances, loss provision details provided by ceding insurers are deemed to be too low based on experience; in such cases, appropriate increases have to be applied, the increases having been determined in accordance with prudent business practice, actuarial calculation methods, and past experience.

Reserve for unit-linked insurance contracts

The reserve for unit-linked insurance contracts is an item largely corresponding to assets related to unit-linked contracts. This item has to be used to report policyholders' entitlements to their individual investment fund units where the related investments arise out of contracts to be reported in accordance with IFRS 4. The reserve has to be measured at fair value on the basis of the underlying investments. Gains and losses on the fund assets have to result in corresponding changes on the equity and liabilities side of the balance sheet.

Adequacy test for insurance liabilities

Insurance liabilities must be regularly reviewed and subjected to an adequacy test. The adequacy test determines, on the basis of a comparison with estimated future cash flows, whether the carrying amount of insurance liabilities needs to be increased.

To review the insurance liabilities in the health insurance companies, a regular comparison has to be made between the present values of estimated future insurance benefits and costs, on the one hand, and the present values of estimated future premium payments on the other.

Leases

A lease has to be classified as a finance lease if substantially all the risks and rewards incidental to the ownership of an asset are transferred from the lessor to the lessee. If the risks and rewards remain substantially with the lessor, the lease is an operating lease.

Cooperative Financial Network as lessor

If a lease is classified as a finance lease, a receivable due from the lessee must be recognized. The receivable has to be measured at an amount equal to the net investment in the lease at the inception of the lease. Lease payments have to be apportioned into payment of interest and repayment of principal. The interest portion has to be recognized as interest income on an accrual basis.

If a lease is classified as an operating lease, the lessor retains beneficial ownership of the leased asset. These leased assets have to be reported as assets. The leased assets have to be measured at cost less depreciation and any impairment losses. Unless another systematic basis is more representative of the pattern of income over time, lease income has to be recognized in profit or loss on a straight-line basis over the term of the lease and has to be included in the current income from operating leases reported under net interest income.

Cooperative Financial Network as lessee
If a lease is classified as a finance lease, the leased asset must be recognized as an asset at the lower of fair value and the present value of the minimum lease payments. A liability of an equivalent amount also has to be recognized. The interest expenses have to be recognized on an accrual basis.

Expenses incurred under operating leases have to be amortized on an accrual basis over the term of the leases and reported as administrative expenses.

Income

Interest and dividends received
Interest income has to be accrued and recognized in the relevant period.

Premiums and discounts have to be allocated over the expected life of financial instruments. Any additional directly attributable transaction costs also have to be recorded on an accrual basis and amortized over the term when these are directly connected with the acquisition or sale of a financial asset or a financial liability. Such costs include sales charges directly associated with the origination of home savings contracts.

Interest income and interest expense arising in connection with derivatives that were not entered into for trading purposes or are used to hedge financial instruments designated as at fair value through profit or loss have to be reported under net interest income. Interest income and interest expense on overnight money and fixed-term deposits arranged between different organizational units for economic management purposes and timing effects from currency swaps used for economic management of net interest income have to be recognized under net interest income and under gains and losses on trading activities, depending on their economic classification.

In contrast to interest income, current income does not have to be recorded on an accrual basis but has to be recognized in its full amount at the date of realization. Dividends have to be recognized as soon as a legal entitlement to the payment of such a dividend is established.

Revenue from contracts with customers
Revenue from contracts with customers has to be recognized when the underlying services have been performed, it is probable that the economic benefits will flow to the group, and the amount of revenue can be reliably measured. Performance obligations are mainly satisfied at a point in time. Some of the performance obligations are satisfied over time on a pro-rated basis as the services are provided; the same applies to the property development business where performance obligations are satisfied gradually upon the completion of the individual construction phases.

Fee and commission income from the securities business, from payments processing including card processing as well as fee and commission income from the lending business and trust activities have to be recognized immediately after the provision of the service.

In the case of performance-related management fees, income has to be recognized when the contractually agreed performance criteria have been satisfied.

The distinction of fee and commission income between IFRS 9 and IFRS 15 is based on whether fees and commissions are a material part of the effective interest rate. Fees and commissions that represent an integral component of the effective interest rate do not fall within the scope of IFRS 15 and are therefore accounted for in accordance with IFRS 9.

Insurance business
For each insurance contract, gross premiums written have to be calculated pro rata temporis for an exact number of days based on the actual start date of the insurance. These premiums have to comprise all amounts that become due in the financial year in connection with insurance premiums, premium

installments, and one-off premiums for direct insurance and reinsurance business. Premiums for unit-linked life insurance, except capitalization transactions without policyholder participation, also have to be recognized as gross premiums written.

The components of premiums covering administration fees have to be reported pro rata temporis as income in the income statement. In the case of index-linked policies and service contracts, additional administration charges, fees, and commissions have to be deferred and apportioned over the relevant periods in line with the service performed.

Cash and cash equivalents

Cash on hand and balances with central banks have to be recognized as cash and cash equivalents.

Cash on hand has to comprise euros and other currencies measured at face value or translated at the buying rate. Balances with central banks also comprise deposit facilities payable on demand. Balances with central banks as well as public-sector debt securities and bills have to be assigned to the "Financial assets measured at amortized cost" category. Interest income on cash and cash equivalents has to be recognized as interest income from lending and money market business.

Loans and advances to banks and customers

All receivables attributable to registered debtors that are categorized as "financial assets measured at amortized cost," "financial assets measured at fair value through profit or loss," or "financial assets measured at fair value through other comprehensive income" or for which the fair value option is exercised have to be recognized as loans and advances to banks and customers. In addition to fixed-term receivables and receivables payable on demand in connection with lending, lease, and money market business, loans and advances to banks and customers have to include promissory notes and registered bonds.

Loans and advances to banks and customers have to be measured at amortized cost. In fair value hedges, the carrying amounts of hedged receivables have to be adjusted by the change in the fair value attributable to the hedged risk. The resulting hedge adjustments to the carrying amount have to be recognized within other gains and losses on valuation of financial instruments under gains and losses from hedge accounting. To avoid or significantly reduce accounting mismatches, certain loans and advances have to be designated as "financial assets measured at fair value through profit or loss." Finance lease receivables are recognized and measured in accordance with the requirements for the accounting treatment of leases.

Interest income on loans and advances to banks and customers has to be recognized as interest income from lending and money market business. This also includes gains and losses on the sale of loans and advances to banks and customers classified as "financial assets measured at amortized cost" and the amortization of hedge adjustments to the carrying amounts arising on the accounting for fair value hedges. Gains and losses on the valuation of loans and advances designated as at fair value through profit or loss have to be shown under the same item as part of other gains and losses on valuation of financial instruments.

Hedging instruments (positive and negative fair values)

The carrying amounts of financial instruments designated as hedging instruments in effective and documented hedging relationships have to be reported under either "Hedging instruments (positive fair values)" or "Hedging instruments (negative fair values)."

These financial instruments have to be measured at fair value. Changes in the fair value of hedging instruments used in fair value hedges between two reporting dates have to be recognized in the income statement as an element of other gains and losses on valuation of financial instruments under gains and losses from hedge accounting. If the hedged item is an equity instrument in which changes in fair value are recognized in other comprehensive income, the changes in the fair value of the hedging instruments also have to be recognized in other comprehensive income.

In the case of financial instruments used for cash flow hedges or hedges of net investments in foreign operations, changes in fair value attributable to the effective portion of the hedges must be recognized in other comprehensive income. These changes have to be shown in the cash flow hedge reserve or in the currency translation reserve as part of equity. Changes in fair value attributable to the ineffective portion of hedges have to be included in other gains and losses on valuation of financial instruments under gains and losses from hedge accounting.

Financial assets and financial liabilities held for trading

Financial assets and financial liabilities held for trading have to comprise solely financial assets and financial liabilities that are held for trading.

Derivatives with positive fair values have to be classified as financial assets held for trading if they were entered into for trading purposes or, despite being intended to be used as hedges, do not meet the requirements for an accounting treatment as hedging instruments.

The procedure for classifying derivatives with negative fair values as financial liabilities held for trading has to be the same as that used for financial assets held for trading.

Financial instruments reported as financial assets or financial liabilities held for trading always have to be measured at fair value through profit or loss. Gains and losses on valuation, interest income and expense, and dividends arising from financial assets and financial liabilities held for trading have to be recognized under gains and losses on trading activities, provided that there is an actual intent to trade the instruments concerned.

Gains and losses on the valuation of derivative financial instruments entered into for hedging purposes, but not recognized under hedge accounting criteria, have to be recognized under other gains and losses on valuation of financial instruments as gains and losses on derivatives held for purposes other than trading. If, to avoid accounting mismatches, hedged items are classified as “financial instruments designated as at fair value through profit or loss”, the valuation gains and losses on the related derivatives concluded for hedging purposes have to be recognized under gains and losses on financial instruments designated as at fair value through profit or loss. Interest income and interest expense arising in connection with derivatives that were not entered into for trading purposes or are used to hedge financial instruments designated as at fair value through profit or loss have to be reported under net interest income.

Investments

The following have to be recognized as investments: bearer bonds and other fixed-income securities, shares and other variable-yield securities, and other bearer or registered shareholdings in entities where there is no significant influence, provided that these securities or shares are not held for trading purposes. Investments also have to include investments in non-consolidated subsidiaries as well as investments in joint ventures and associates.

Investments have to be recognized initially at fair value. Joint ventures and associates accounted for using the equity method in accordance with IAS 28.10-19 have to be recorded at cost upon initial recognition. These investments have to be subsequently measured in accordance with the principles applicable to the relevant measurement category. In the case of investments in joint ventures and associates, the equity method has to be used generally for subsequent measurement.

Loss allowances on investments have to be reported either as a separate line item on the assets side of the balance sheet or in reserves from other comprehensive income.

Interest and any investment premiums or discounts amortized over the maturity of the investment have to be recognized under net interest income. Dividends derived from equity instruments have to be recognized as current income under net interest income. Gains or losses on investments accounted for using the equity method also have to be reported under net interest income. Loss allowances and reversals of allowances as well as gains and losses realized on the sale of investments in associates and in joint ventures accounted for using the equity method have to be included in gains and losses on investments.

Loss allowances

Loss allowances for loans and advances to banks and customers and investments measured at amortized cost or designated as finance leases have to be reported as a separate line item on the assets side of the balance sheet. Additions to loss allowances for these balance sheet items, and any reversals of such allowances, have to be recognized under loss allowances in the income statement.

Loss allowances for investments held by insurance companies and other assets held by insurance companies measured at amortized cost have to be netted with the carrying amounts of these assets. Additions to loss allowances for these balance sheet items, and any reversals of such allowances, have to be recognized under gains and losses on investments held by insurance companies and other insurance company gains and losses in the income statement.

Loss allowances for loans and advances to banks and customers, for investments, and for investments held by insurance companies that are measured at fair value through other comprehensive income do not have to be reported on the assets side of the balance sheet but instead in reserves from other comprehensive income. Additions to allowances for losses on loans and advances to banks and customers as well as for investments, and any reversals of such allowances have to be recognized in the income statement under loss allowances. Additions to loss allowances for investments held by insurance companies, and any reversals of such allowances, have to be recognized under gains and losses on investments held by insurance companies and other insurance company gains and losses in the income statement.

The recognition of loss allowances also covers changes in the provisions for loan commitments, provisions for financial guarantee contracts, and other provisions for loans and advances. Any additions to, or reversals of, provisions for loan commitments and financial guarantee contracts and other provisions for loans and advances are also recognized in profit or loss under loss allowances.

Property, plant and equipment, and investment property

Property, plant and equipment, and investment property have to comprise land and buildings, office furniture and equipment with an estimated useful life of more than one year used by the Cooperative Financial Network. This item also has to include assets subject to operating leases. Investment property has to include real estate held for the purposes of generating rental income or capital appreciation.

Property, plant and equipment, and investment property have to be measured at cost less cumulative depreciation and impairment losses in subsequent reporting periods.

Depreciation and impairment losses on property, plant and equipment, and investment property have to be recognized as administrative expenses. Reversals of impairment losses are reported under other net operating income.

Income tax assets and liabilities

Current and deferred tax assets have to be shown under the income tax assets balance sheet item; current and deferred tax liabilities have to be reported under the income tax liabilities balance sheet item. Current income tax assets and liabilities have to be recognized in the amount of any expected refund or future payment.

Deferred tax assets and liabilities have to be recognized for temporary differences between the carrying amounts recognized in the consolidated financial statements and those of assets and liabilities recognized in the financial statements for tax purposes. Deferred tax assets also have to be recognized in respect of as yet unused tax loss carryforwards, provided that utilization of these loss carryforwards is sufficiently probable. Deferred tax assets have to be measured using the national and company-specific tax rates expected to apply at the time of realization.

Deferred tax assets and liabilities do not have to be discounted. Where temporary differences arise in relation to items recognized directly in other comprehensive income, the resulting deferred tax assets and liabilities also have to be recognized in other comprehensive income. Current and deferred tax income and expense to be recognized through profit or loss has to be reported under income taxes in the income statement.

Other assets

Other assets comprise intangible assets and assets held for sale.

Intangible assets have to be recognized at cost. In the subsequent measurement of software, acquired customer relationships, and other intangible assets with a finite useful life, carrying amounts have to be reduced by cumulative amortization and cumulative impairment losses. Goodwill and other intangible assets with an indefinite useful life do not have to be amortized, but are subject to an impairment test at least once during the financial year in accordance with IAS 36.7-57.

Non-current assets held for sale have to include assets or groups of assets and liabilities for which a sale is planned and where the carrying amount is recovered principally through a sale transaction rather than through their continuing use. Therefore, they need to be classified as held for sale if the criteria set out below are satisfied.

To be classified as held for sale, the assets or disposal groups must be available for immediate sale in their present condition subject only to terms that are usual and customary for sales of such assets or disposal groups, and it must be highly probable that a sale will take place. A sale is deemed to be highly probable if there is a commitment to a plan to sell the asset or disposal group, an active program to locate a buyer and complete the plan has been initiated, the asset or disposal group is being actively marketed for sale at a price that is reasonable in relation to the current fair value, and a sale is expected to be completed within one year of the date on which the asset or disposal group is classified as held for sale.

Assets classified as held for sale have to be measured at the lower of carrying amount and fair value less costs to sell. The assets do no longer have to be depreciated from the date on which they are classified as held for sale.

Assets and disposal groups classified as held for sale have to be shown on the balance sheet under other assets as non-current assets and disposal groups classified as held for sale and in other liabilities as liabilities included in disposal groups classified as held for sale. Gains and losses arising on measurement as well as gains and losses on the sale of these assets or disposal groups that do not belong to a discontinued operation have to be recognized in the income statement under other net operating income. If the assets or disposal groups belong to discontinued operations, all gains and losses arising from these assets and disposal groups must be shown separately as profit/loss from discontinued operations.

Deposits from banks and customers

All liabilities attributable to registered creditors not classified as "financial liabilities measured at fair value through profit or loss" have to be recognized as deposits from banks and customers.

Deposits from banks and customers have to be measured at amortized cost. Where deposits from banks and customers are designated as a hedged item in an effective fair value hedge, the carrying amount has to be adjusted for any change in the fair value attributable to the hedged risk. If, to avoid or significantly reduce accounting mismatches, the fair value option is applied for deposits from banks and customers, the liabilities have to be measured at fair value as at the balance sheet date.

Interest expense on deposits from banks and customers have to be recognized separately under net interest income. Interest expense also includes gains and losses on early repayment and on the amortization of hedge adjustments to carrying amounts due to fair value hedges. Hedge adjustments to the carrying amount due to fair value hedges have to be reported within other gains and losses on valuation of financial instruments under gains and losses from hedge accounting. If liabilities are designated as at fair value through profit or loss, the gains and losses on valuation have to be recognized under the same item as part of other gains and losses on valuation of financial instruments.

Debt certificates issued including bonds

Debt certificates issued including bonds cover issued Pfandbriefe, other bonds and other debt certificates evidenced by paper for which transferable bearer certificates have been issued.

Debt certificates issued including bonds and gains and losses on these certificates have to be measured and recognized in the same way as deposits from banks and customers.

Provisions

Provisions are liabilities in which the amounts or due dates are uncertain. Provisions have to be recognized for present obligations arising out of past events, in which it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and the amount of the obligation can be reliably estimated.

The provisions have to be recognized and measured based on the best estimate of the present value of their anticipated utilization, taking into account risks and uncertainties associated with the issues concerned as well as future events.

Provisions for defined benefit plans
Where a commitment is made to defined contribution plans, fixed contributions have to be paid to external pension providers. The amount of the contributions and the income earned from the pension assets determine the amount of future pension benefits. The risks arising from the obligation to pay such benefits in the future lie with the pension provider. No provisions have to be recognized for these indirect pension commitments. The contributions paid have to be recognized as pension and other post-employment benefit expenses under administrative expenses.

Under a defined benefit plan, the employer promises a specific benefit and bears all the risks arising from this commitment. Defined benefit obligations have to be measured on the basis of the projected unit credit method. The measurement depends on various actuarial assumptions. These have to include, in particular, assumptions about long-term salary and pension trends and average life expectancy. Assumptions about salary and pension trends have to be based on past trends and take account of expectations about future labor market trends. Generally accepted biometric tables (2018 G mortality tables published by Professor Dr. Klaus Heubeck) have to be used to estimate average life expectancy. The discount rate used to discount future payment obligations must correspond to an appropriate market interest rate for high-quality fixed-income corporate bonds with a maturity equivalent to that of the defined benefit obligations. The discount rate depends on the obligation structure (duration) and must be determined using a portfolio of high-quality corporate bonds that must satisfy certain criteria in terms of quality and volume (outstanding face value). One of the notable quality criteria is an average AA rating from Moody's Investors Service, New York, Standard & Poor's, New York, Fitch Ratings, New York/London, and DBRS, Toronto. Bonds with existing call options in the form of embedded derivatives do not have to be included in this process. The defined benefit obligations of the cooperative banks and of MHB have to be based on the principles set out above, applying a typical underlying benefit commitment.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions regarding the defined benefit obligations, and gains and losses arising from the remeasurement of plan assets and reimbursement rights have to be recognized in other comprehensive income in the reporting period in which they occur.

Provisions for loan commitments and provisions for financial guarantee contracts
Provisions for loan commitments and provisions for financial guarantee contracts are recognized at the amount of the loss allowance for expected credit losses on the basis of the same model used for financial assets.

Other provisions for loans and advances
Other provisions for loans and advances have to factor in the usual sector-specific level of uncertainty. The underlying assumptions and estimates used have to include figures based on past experience as well as expectations and forecasts relating to future trends and developments.

Provisions relating to building society operations
Provisions relating to building society operations have to be recognized to cover the payment of any bonuses that may have been agreed in the terms and conditions of home savings contracts. These bonuses may take the form of a reimbursement of some of the sales charges or interest bonuses on deposits.

Residual provisions
The residual provisions have to include, among others, additional provisions for employee benefits, such as provisions for other long-term employee benefits (e.g. for semi-retirement arrangements, Altersteilzeit), provisions for termination benefits (e.g. early retirement arrangements) and provisions for short-term employee benefits.

Residual provisions also have to include provisions for restructuring measures as well as provisions for risks arising from ongoing legal disputes. Provisions for risks arising from ongoing legal disputes have to be recognized when it is more likely than not that the relevant legal dispute will result in a payment obligation. The recognized amount is based on the potential resulting losses.

Subordinated capital

Subordinated capital has to comprise all debt instruments in bearer or registered form that, in the event of insolvency or liquidation, are repaid only after settlement of all unsubordinated liabilities but before distribution to shareholders of any proceeds from the insolvency or liquidation.

Subordinated capital and gains and losses on this capital have to be measured and recognized in the same way as deposits from banks and customers.

Equity

Equity has to represent the residual value of the Cooperative Financial Network's assets minus its liabilities. Cooperative shares of the independent local cooperative banks and capital of silent partners have to be treated as economic equity in the consolidated financial statements and have to be recognized as equity. Equity thus has to comprise subscribed capital – consisting of cooperative shares or share capital and capital of silent partners – plus capital reserves of the local cooperative banks. In addition, equity earned by the Cooperative Financial Network, reserves from other comprehensive income, additional equity components as well as non-controlling interests in the equity of consolidated companies also have to be included.

Trust activities

Trust activities are defined as business transacted on one's own behalf for a third-party account. Assets and liabilities held as part of trust activities do not satisfy the criteria for recognition on the balance sheet.

Income and expenses arising from trust activities have to be recognized as fee and commission income or as fee and commission expenses. Income and expenses resulting from the passing-through and administration of trust loans have to be netted and have to be included in the fee and commission income earned from lending and trust activities.

Explanatory information on the consolidated financial statements

The consolidated financial statements must include explanatory information in accordance with the following prerequisites:

- The disclosures required in accordance with IFRS 12 “Disclosure of Interests in Other Entities” have to be made;
- Disclosure of a segment report in accordance with IFRS 8.5-19 “Operating Segments”;
- Further explanations and breakdowns of the material components of income statement and balance sheet items;
- Presentation of the changes in the development of loss allowances (balance sheet and income statement; reconciliation of opening balance to closing balance);
- Reconciliation in accordance with IAS 12.81c to present the relationship between notional income taxes and recognized income taxes, based on application of the current tax law in Germany;
- Changes in the present value of defined benefit obligations as well as changes in plan assets in accordance with IAS 19.140;
- Disclosures on financial instruments in accordance with IFRS 7.25 and IFRS 7.39a;
- Disclosures on capital requirements and regulatory indicators:
  - The disclosures have to refer to the institutional protection system (cooperative joint liability scheme). The disclosures in relation to own funds and capital requirements have to be based on the information of the extended aggregated calculation in accordance with article 49 (3) CRR in conjunction with article 113 (7) CRR (“EAC”).
  - As at December 31, 2018, the presentation of the leverage ratio of the bank-specific protection system of the Cooperative Financial Network has to comply with the requirements set out in article 429 CRR. Tier 1 capital has to be used as the capital measure pursuant to the extended aggregated calculation in accordance with article 49 (3) CRR, adjusted by any Tier 1 capital items of the members of the bank-specific protection system held internally within the Cooperative Financial Network. The exposure values have to be determined by aggregating the individual figures reported for the leverage ratio of all member institutions and adjusted by material items held internally within the Cooperative Financial Network.
  - The cooperative banks and Münchener Hypothekenbank have to be included on an individual basis using the respective reports. DZ BANK has to be taken into account based on its own reporting on a consolidated basis.

The report submitted by the DZ BANK Group has to be based on the regulatory scope of consolidation.
  - The underlying report forms of the members of the Institutional Protection Scheme (IPS) as at December 31, 2018 have to comply with the Commission Implementing Regulation (EU) No. 680/2014, which was amended by Commission Implementing Regulation (EU) No. 2016/428 to the amendments of Delegated Regulation (EU) No. 2015/62 dated October 10, 2014.
- Breakdowns of the composition of financial guarantee contracts and loan commitments, trust activities, asset management of Union Investment Group, changes in the contract portfolios as well as changes in the allocation assets of Bausparkasse Schwäbisch Hall, cover statement for the mortgages and local authority loans extended by the mortgage banks;
- Disclosures on leases in accordance with IAS 17.47;
- A list of the members of BVR's Board of Managing Directors;
- The signing of the consolidated financial statements by the Board of Managing Directors, including the signature date.

Management report including risk report

The principles set out in section 315 (1) sentences 1 to 4 HGB have to be complied with in the preparation of the management report including risk report. Performance indicators within the meaning of section 315 (3) HGB have to be disclosed accordingly. The relevant non-financial performance indicators have to be presented in the section “Human resources report”. The risk report has to present the disclosures pursuant to section 315 (2) sentence 1 No. 1 HGB, based on a corresponding application for the Volksbanken Raiffeisenbanken Cooperative Financial Network taken as a whole and has to fulfill the purpose of a bank-specific protection system. In addition, a presentation has to be made in relation to the material opportunities and of the risk management in the Cooperative Financial Network and, in connection with the report on expected developments, an outlook has to be provided about the development of major elements of the income statement.

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1 Gains and losses on trading activities, gains and losses on investments, other gains and losses on valuation of financial instruments.
2 Premiums earned, gains and losses on investments held by insurance companies and other insurance company gains and losses, insurance benefit payments, insurance business operating expenses.
3 Total assets including financial guarantee contracts and loan commitments, trust activities, and assets under management in the Union Investment Group.
4 Ratio of profit before taxes to average equity.
5 Ratio of net profit to total assets.
6 Amount reduced by €31,075 million due to reporting changes.
7 Amount increased by €31,075 million due to reporting changes.
8 Number increased by 2,350: employees working on commodities activities.

BVR