COMMERZBANK
Finance & Covered Bond S.A.

COMMERZBANK
Group

Annual Report 2018

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Management Report

1 Management Report

Economic conditions in 2018

The world economy enjoyed above-average growth once again in 2018, but with strong regional divergences. In China, growth slowed due to the tighter economic policy. Overall, though, Asian emerging markets kept up the high pace of growth seen in 2017.

In the USA, 2018 growth was much higher than in 2017 at an estimated 2.9%. Unemployment is now below 4%. Against this backdrop, the Federal Reserve decided to raise key interest rates by a further 100 basis points to 2.25%–2.50% and continued to slowly run down its holdings of securities.

In the eurozone, however, the upturn slowed noticeably in 2018. At 1.8%, growth was a good 0.5 percentage points lower than in 2017. One reason for this was the feeble rise in exports, especially to China. In the second half, the economy was also hurt by the difficult situation in the auto industry. Despite the growth slowdown, the situation in the labour market continued to improve significantly. The unemployment rate fell from 8.6% at the end of 2017 to 7.9% in December 2018, almost back to the low level seen before the financial crisis started. Greater competition for staff is now apparent in wages. So far, however, climbing wages have not fed through to higher inflation.

The core inflation rate, i.e. the year-on-year rate of the consumer price index excluding highly volatile food and energy prices, continues to fluctuate around 1%.
The ECB stopped its bond purchasing programme at the year-end. It will, though, reinvest all proceeds from maturing securities.

Germany's economic growth also weakened significantly in 2018 (1.5%) versus 2017 (2.2%), but the growth was still sufficient to reduce unemployment further. Seasonally adjusted unemployment at the start of 2019 was 5.0%, a new low since German reunification. The main brakes on the economy were weaker foreign demand and the difficult situation in the auto industry.

Financial markets were unsettled by ongoing rate hikes by the Federal Reserve and the trade conflict between the USA and China. Stock prices were down sharply and the dollar appreciated considerably. Despite rising interest rates in the USA, at 0.3% the yield on 10-year German government bonds at the end of 2018 was lower than at the start of the year.

Future economic situation in 2019

The global economy looks set to grow somewhat slower in 2019. The greatest risk comes from China, where the economy has clearly lost momentum. In addition, the trade dispute with the USA is weighing on the outlook for the Chinese economy. As in previous years, politicians are likely to prevent a collapse in the economy that could place political and social stability at risk. The government has already taken countermeasures and provided relief to individuals and companies through tax cuts. Monetary policy has also been loosened. If the actions taken so far prove insufficient, more are likely to follow.

The upturn in the USA will probably continue in 2019. There are no signs of excesses where a correction might drive the economy into a recession. However, the interest rate hikes and declining momentum from financial policy will probably lead to a more moderate pace of expansion. But the US economy is set to grow by 2.5% in 2019, again faster than production potential. The already low unemployment rate will decline further. This is likely to strengthen underlying inflation slightly. The US Federal Reserve will probably not raise its benchmark rates any further in 2019. The biggest risk to the US economy comes from politics. The dispute between Republicans and Democrats, who have held a majority in the House of Representatives since the elections in November 2018, and the trade dispute with China are causing uncertainty.

The table below is based on Commerzbank forecasts and illustrates the real changes in the gross domestic product of the regions in question.

Real gross domestic product - change from previous year	2018	2019	2020
USA	2.9 %	2.5 %	1.8 %
Eurozone	1.8 %	1.4 %	1.6 %
Germany	1.5 %	1.2 %	2.0 %
Central and Eastern Europe	3.0 %	1.6 %	2.2 %

The figures for 2019 and 2020 are all Commerzbank forecasts.

In the eurozone the upturn noticeably slowed in 2018. However, the economy is unlikely to slip into recession. Thus domestic demand continues to be driven by the ECB's expansive monetary policy. The ECB terminated its bond buying programme at the end of the year. But that does not mean the end of loose monetary policy. The ECB deposit rate is likely to remain at -0.4% for a considerable time. Low interest rates are making the still high debt levels of many companies and households more sustainable.

The economic environment should also brighten slightly as the Chinese economy stabilises. Despite a pick-up in economic growth in the course of the year, however, the average rate for 2019 will only be growth of just under 1.4%.

The planned UK departure from the EU is likely to have only a temporary impact on the economy in the eurozone. The economy is unlikely to slip into recession. This applies even in the event that the EU and the UK fail to agree a withdrawal agreement. Both sides will be keen to minimise the economic turbulence.

After a weak second half in 2018, the German economy is likely to gain speed again over the course of 2019. The main support for the economy will be investment, which remains robust. However, consumption and exports should provider stronger boosts again as the year progresses. For the year as a whole we expect growth of 1.2%, after 1.5% last year.

It is worthy of note, however, that unit labour costs at German companies have been rising faster than in the rest of the currency union for several years now. And in the property market, low interest rates are still driving up prices, especially in the major cities.

The end of interest rate hikes in the USA and the continuation of the ECB's highly expansive monetary policy will shape the financial markets in 2019. Even after the end of the ECB bond purchase programme the yield of 10-year German government bonds will not rise signifi-

cantly. Not only because there is no prospect of a genuine cycle of rate hikes, but because the ECB will be reinvesting the bonds that mature.

It will therefore hold just under one-third of government bonds for a long time to come, permanently pushing down the maturity premium on them. The euro will probably tend to appreciate against the dollar in 2019. This is not a matter of euro strength, but rather the dollar weakness that is likely as the end of the Federal Reserve's cycle of rate hikes draws nearer. Equity markets should recover from last year's setback in 2019, once it becomes apparent that there is no threat of a global recession. The persistently loose monetary policy is also supportive of equity valuations.

The table below is based on Commerzbank forecasts and illustrates the change in exchange rates:

Exchange rates	31.12.2018	31.12.2019	31.12.2020
Euro/US dollar	1.15	1.24	1.32
Euro/Sterling	0.90	0.89	0.92
Euro/Swiss franc	1.13	1.17	1.20

The figures for 2019 and 2020 are all Commerzbank forecasts.

Significant events

There were no other events of particular significance in the financial year 2018.

Net assets and financial position

Liquidity was maintained throughout 2018. During the year, the Bank complied with its obligations to the Banque Centrale du Luxembourg (BCL) in respect of minimum reserves and the equity and liquidity requirements imposed by the banking supervisor (SREP requirements).

Commerzbank Finance & Covered Bond S.A. is not currently planning to issue any new Lettres de gage. Future funding requirements are being reduced by the sale of assets and covered by repo transactions and internal, unsecured refinancing transactions.

Capital

Including reserves and regulatory deductions, the Bank's Common Equity Tier 1 capital amounts to €979m (31 December 2017: €2,049m). Together with the eligible Tier 2 capital, the Bank has a total regulatory capital base of €990m (31 December 2017: €2,062m). As at 31 December 2018, the capital adequacy ratio under CRR/CRD IV (CoRep) was 37.10% (31 December 2017: 67.09%).

Areas of activity

As a financial institution with a special banking licence, Commerzbank Finance & Covered Bond S.A. is entitled to carry on all activities specified in Art. 12-2 of the Luxembourg Law on Lettres de Gage of 21 November 1997 as most recently amended, including agency business and the issue of fiduciary notes as accessory business. The Bank conducted no other types of business as defined by law during 2018. The Bank only does business with counterparties within the Group when it comes to any transactions affecting liquidity.

Public-sector loans

Total lending to customers was reduced by a nominal €583.1m over the course of the year from a nominal €9,246.9m as at the end of 2017 to €8,663.8m as at 31 December 2018. This amount includes around €105m in scheduled maturities and around €591m in sales. Added to this were partial repayments and contrary currency effects.

The Bank is exposed to risks arising from the current level of public-sector debt, albeit to a substantially lesser extent than in previous years. As at 31 December 2018 the Bank had an exposure of a nominal €1,731.3m (31 December 2017: €2,042.4m) to GIIPS countries; this was comprised of exposure to the Republic of Italy (€1,101.2m), to the Kingdom of Spain (€392.3m) and to the Republic of Portugal (€237.8m). Further details may be found in the credit risk report (section 6.3.4).

Both this and other upheavals on the capital markets gave rise to the difference between carrying amount and lower market value of €610.5m for financial instruments in the category "financial assets - amortised cost".

The Bank applies the Commerzbank Group's certified rating procedure, which is subject to constant review, recalibration and validation. The internal rating system indicates that the proportion of assets in the total loan portfolio with a rating of AA- or better rose from 36.0% as at 31 December 2017 to 37.3% as at 31 December 2018. Compared to the previous year, the proportion of investment grade exposures (as rated using the internal system) increased from 89.6% to 94.2% as at 31 December 2018.

Lending policy

Commerzbank Finance & Covered Bond S.A. is a legally independent bank under the global functional leadership of Group Treasury, in whose strategy it is integrated and to which it reports. At the Bank's request, the CSSF has approved the complete exemption of risks in respect of Group entities when calculating large exposures, in accordance with 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. This exemption is also valid under CRR/CRD IV.

Internal Governance

Commerzbank Finance & Covered Bond S.A. has complied with all the requirements imposed on it by the current version of circular CSSF 12/552, within the bounds of the proportionality principle. The qualifications of the members of the Board of Directors and the management were examined and confirmed. The Board of Directors and management have drawn up guidelines to make the work of their key functions transparent and prevent conflicts of interest.

The internal governance policy compiled by Commerzbank Finance & Covered Bond S.A. brings together the circulars of relevance to the Bank and prevents redundancies.

Declaration on corporate governance

Responsible corporate governance constitutes an essential element of how Commerzbank Finance & Covered Bond S.A. sees itself. That is why we expressly support the principles of good governance.

The Bank has the processes and control systems required to compile financial information. Accounting is outsourced under service level agreements to Commerzbank AG, Luxembourg branch, whose Finance department performs the relevant functions.

Transactions are entered in the IT system on a daily basis. The required general ledgers and order books are maintained. The chart of accounts is designed to meet the Bank's requirements and enable accounts to be accurately allocated in accordance with the reporting templates for credit institutions. Internal accounts are reconciled regularly. Automated and standardised processes applied throughout the Group are used for most valuations.

In addition to daily closing balances, monthly balances are also generated, largely by automated processes but with manual adjustments in some areas.

Weekly internal reports are generated to keep management informed about the Bank's financial position and earnings performance. These reports are based on the transaction data stored in the IT system and prepared in line with information requirements.

The Bank furthermore forms part of the Commerzbank Group, which is supervised by BaFin, Deutsche Bundesbank and the European Central Bank in its entirety and is therefore subject to the corporate governance requirements governing credit institutions. The declaration on corporate governance is included in the annual financial statements of the Commerzbank Group and published on the homepage of Commerzbank AG.

The internal control system

Commerzbank Finance & Covered Bond S.A.'s internal control system is based on the methodology of Commerzbank AG and hence derived from the international "COSO I" framework developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). It aims to ensure: a) the effectiveness and efficiency of business processes, b) compliance with laws and regulations currently in force and c) the reliability of financial reporting.

It includes the three lines of defence required for an effective control system, as defined by the latest version of CSSF Circular 12/552.
Internal Audit reviews the appropriateness and efficiency of central administration, management and risk management. It supports management in optimising business activities in order to minimise the associated risks.

It conducts regular audits as required by law and internal rules, examining

- compliance with laws, regulations and CSSF requirements
- the effectiveness and efficiency of internal controls
- the organisation of the administration and accounting functions
- the separation of functions and the conduct of business
- the recording of transactions and the accuracy and meaningfulness of financial statements
- the maintenance of liquidity reserves and capital adequacy
- appropriate risk management
- the efficiency of the compliance and risk control functions
- Key functions

Appointments to the key functions of Chief Risk Officer, Chief Compliance Officer and Chief Internal Auditor are permanent and for an unlimited period. Commerzbank Finance & Covered Bond S.A. has outsourced the function of Chief Internal Auditor, while the two other functions remain in-house. All three function holders possess the required competences and enjoy direct access to the Board of Directors, the CSSF and the auditors and regularly, at least once a year, submit summary reports regarding their function and their activities.

Risk measurement

Commerzbank Finance & Covered Bond S.A.'s internal governance regulations, which cover in particular strategies and policies applicable to equity and liquidity reserves, must clearly reflect the whole range of its various risks. The Bank determines in particular its capacity for all the risks it takes on.

Authority to determine the methods and parameters for the risk measurement programmes rests with Commerzbank AG. It is, however, ensured that Commerzbank Finance & Covered Bond S.A. has a full overview of all its risks.

The Board of Directors sets internal limits. It assigns internal "sub-limits" (e.g. product, currency, etc.) to the Managing Directors of Commerzbank Finance & Covered Bond S.A., which are monitored on a day-to-day basis. Levels and channels for escalation have been put in place. Further information may be found in the risk report (section 6, notes).

Personnel report

As at the end of the financial year 2018 Commerzbank Finance & Covered Bond S.A. had 11 employees (31 December 2017: 12 employees), 5 of whom were female and 6 male (31 December 2017: 5 female and 7 male).

Commerzbank Finance & Covered Bond S.A. has implemented CSSF circular 2010/437 "Guidelines on remuneration policy in the financial sector". Allowing for the requirements of its organisational structure, the Bank has adopted in full the remuneration system of Commerzbank AG, which has been agreed with the German Federal Financial Supervisory Authority (BaFin) and the Financial Market Stabilisation Fund (SoFFin).

Organisation

Both the Board of Directors and the Managing Directors of Commerzbank Finance & Covered Bond S.A. are responsible for the internal control and risk management system used in the financial reporting process.

The allocation of responsibilities is set out clearly in Commerzbank Finance & Covered Bond S.A.'s business allocation plan.

The Board of Directors of Commerzbank Finance & Covered Bond S.A. oversees the accounting process and ensures it complies with current legislation, guidelines and regulations. As required by regulations, Group Audit produces summary reports during the year regarding audit work and the material findings emerging from it.

The Asset Liability Management, Credit Risk Management and Analytics & Regulatory Issues departments are permanent features of the Bank's structure. In the past, in the interests of ensuring operational stability, essential functionalities were outsourced to the Commerzbank Group underlaid by service level agreements. The work done is regularly reviewed and evaluated as part of outsourcing controlling. This process also considers any further cascading outsourcings. Where necessary, all organisational changes are agreed with the regulator.

Service level agreements have been under continual development. The Bank has no subsidiaries or branches.

Commerzbank Finance & Covered Bond S.A., together with other Luxembourg companies belonging to the Commerzbank Group, has constituted a tax group for corporate and business tax purposes since 2011. The parent company is the Luxembourg branch of Commerzbank AG.
No treasury shares were acquired during the year under review and Commerzbank Finance & Covered Bond S.A. held no treasury shares as at the reporting date.

Earnings performance

At the end of the reporting period, net interest and commission income was €207.3m, after €–2.4m in the previous year. In 2017, this item included net interest income from swaps (€–210.4m), which the Bank in 2018 (€–178.3m) reports under net income from assets at fair value through profit and loss. In loan loss provisions, allocations from valuation allowances on bonds led to expenses of €1.2m (31 December 2017: €0.6m). However, due to the first-time application of the new IFRS 9 standard this figure cannot be compared with the previous year's. Net commission income was €8.2m, compared with €6.0m the previous year. Net income from hedge accounting was €–3.5 million (31 December 2017: €–8.4 million).

In the financial year 2018, the Bank reported expenditures of €–117.5m (31 December 2018: €–70.6 million) under net income from assets and liabilities at fair value through profit and loss. In this context, starting from this financial year interest on derivative hedging instruments amounting to €–178.3m (31 December 2017: €–210.4m) has been reported under "Net income from financial assets and liabilities at fair value through profit and loss" instead of under net interest income. Other income from financial instruments was €2.1m (31 December 2017: expenditure of €–2.0m). The Bank's operating expenses rose by 1.1% to €24.9m (31 December 2017: €24.6m).

Overall, the positive trend of the total of net interest income and net income from financial assets and liabilities at fair value through profit and loss in particular resulted in a positive result before taxes of €+60.9m (31 December 2017: €–105.2m).

Profit after taxes amounted to €+64.5m (31 December 2017: €–83.6m).

Total assets

The Bank's total assets fell to €12.1bn, down €–1.7bn (–12.3%) compared with the opening balance according to IFRS 9 as at 1 January 2018.

Proposal for appropriation of profit

The approval of the balance sheet as at 31 December 2018 and the statement of comprehensive income for 2018 will be proposed to the Annual General Meeting, which is scheduled on 24 April 2019, together with the transferal to retained earnings, of the net income of 2018, amounting at €64,463,113.49.

Summary of business performance in 2018

The Board of Directors has taken note of the business performance of Commerzbank Finance & Covered Bond S.A. taking into account the challenging market environment in 2018.

Report on events after the reporting period and outlook and opportunities report

Report on events after the reporting period

In January 2019, the Bank decided to sell a portfolio of loans to British local authorities, which was reported under the "Financial assets - mandatorily fair value P&L" balance-sheet item, with a carrying amount of €2,592.3m as at 31 December 2018, to Commerzbank AG. The disposal did not result in a material gain or loss on disposals in 2019.

Outlook and opportunities report

The outlook and opportunities report covers expectations and forecasts for the future. These forward-looking statements are founded on planning assumptions and estimates derived from all the information available to the Bank as of the date on which the annual financial statements for 2018 were finalised.

Commerzbank Finance & Covered Bond S.A. accepts no obligation to revise these statements in the light of either new information or future events. Forward-looking statements are always subject to risks and uncertainties. Therefore, actual results and performance may differ substantially from those forecast now. Such differences may result above all from changes to the general economic situation and the competitive situation, as well as from developments on the international capital markets. The Bank's results may also be affected by defaults on the part of borrowers or counterparties to transactions, changes to legislation in Luxembourg and abroad, especially regarding tax rules, as well as other risks, some of which are set out in detail in the risk report.

Forecast

The reduction in risk-weighted assets (RWA) may have an impact on the trend in key management figures. However, lower ratings in the portfolio and the associated increase in impairments may have an adverse effect on capital ratios. Interest income will fall permanently as a consequence of the reduced portfolio volume. The agency business is expected to continue generating stable commission income in future and the repurchase of liabilities may have positive effects which could, however, have a negative impact on future results. Future sales may result in further charges, and this may be reflected in the income from financial investments. Commerzbank Finance & Covered Bond S.A. takes this into account where disposals appear sensible as part of managing the portfolio with an awareness of risk and in such a way as to preserve capital. Write-downs on lending cannot be completely ruled out. Measurement effects in net trading income may result in volatility. Operating expenses are expected to remain at the same level as last year. Risks arising from changed conditions and the sovereign debt crisis will continue to have an impact on the Bank's business operations into the future.

Acknowledgements

The Bank wishes to thank all employees, managers and governing bodies of Commerzbank Finance & Covered Bond S.A., not forgetting of course all the employees at Commerzbank Group who work for it. Their constructive and loyal cooperation has helped Commerzbank Finance & Covered Bond S.A. to achieve the demanding objectives set over the past year.

Particularly under the extraordinary circumstances under which it finds itself, the Board of Directors does not take this sort of great dedication for granted.

Luxembourg, 11 April 2019

The Board of Directors

Auditors' opinion

2 Auditors' opinion

To the Board of Directors
Commerzbank Finance & Covered Bond S.A.

Report on the audit of the annual financial statements

Audit opinion

We have audited the annual financial statements of Commerzbank Finance & Covered Bond S.A. (hereinafter "the Company") consisting of the balance sheet as at 31 December 2018, the statement of comprehensive income, the statement of changes in equity and the cash flow statement for the financial year ending on this date together with the notes including a summary of the main accounting methodologies.

In our opinion based on the findings of our audit, the enclosed annual financial statements comply with the International Financial Reporting Standards (IFRS) as applied in the European Union and give a true and fair view of the net assets and financial position of the Company as at 31 December 2018 as well as the earnings performance and cash flows for the financial year ended on that date.

Basis for the audit opinion

We carried out our audit of the annual financial statements in accordance with EU Regulation 537/2014, the Law on Audit Activities (the "Law dated 23 July 2016") and the International Standards on Auditing ("ISA") as adopted for Luxembourg by the Commission de Surveillance du Secteur Financier ("CSSF"). Our responsibility for the financial statements pursuant to EU Regulation 537/2014, the Law dated 23 July 2016 and the ISA Standards is described in detail in the section entitled "Responsibility of the auditor".

We are independent from the Company in accordance with the "International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants" ("IESBA Code") adopted for Luxembourg by the CSSF together with the professional standards of conduct with which we must comply within the scope of the audit of the annual financial statements and we have fulfilled all other professional requirements in accordance with these standards of conduct. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance to the audit of the annual financial statements for the current period under review. These matters were addressed in the context of the audit of the annual financial statements as a whole, and in forming the audit opinion thereon, and we do not provide a separate audit opinion on these matters.

Below, we describe what we consider to be the key audit matters:

1. Calculation of the loss provisions for financial instruments not in default (stage allocation)

a) Description of the matter
The Company holds claims and fixed-interest securities with a carrying amount of €8,576m, which are measured at amortised cost. This corresponds to 71.2% of total assets.

Information on the financial instruments measured at amortised cost is included in the notes under 5.3, 5.4, 5.14 in the section "Summary of accounting and measurement methods", under 8.2 and 8.6 in the section "Notes to the balance sheet" and under 9.20 "Fair value of financial instruments".

Since 1 January 2018 the financial instruments have been measured according to the rules of IFRS 9 for the first time. This involves replacing the incurred loss model under IAS 39 with an expected loss model.
Impairments of financial instruments not in default are taken into account depending on the changes in the default risk since the initial recognition date, either in the amount of the expected 12-month credit loss (stage 1) or in the amount of the credit losses expected over the term (stage 2) to the extent that the default risk of the financial instrument has deteriorated significantly.

In this context, the criteria for deriving a significant deterioration of the default risk (stage 2 assignment), in particular, provide some discretionary scope. Against the backdrop of the initial setting of the criteria for deriving a significant deterioration in the default risk (hereinafter also referred to as "stage allocation"), the associated discretionary scope and the volume of financial instruments not in default for which a provision for risks is to be set aside pursuant to IFRS 9, we view the calculation of the provision for losses for financial instruments not in default (stage allocation) as a key audit matter.

b) Our audit approach
To audit the criteria for determining a significant deterioration in the default risk, we assessed the stage allocation model devised by the Company and its significant assumptions for financial instruments not in default for their conformity with IFRS 9.

We assessed the appropriateness and operating effectiveness of selected controls over stage allocation. Due to the fact that the Company does not transact any new business, these included in particular the procedures and controls in place for loan monitoring (determination of the current default risk).

We performed substantive analytical procedures based on a data excerpt from the credit portfolio, analysing the original credit risk stored in the relevant data for anomalies. We also obtained an understanding of stage 2 allocation based on qualitative and quantitative criteria.

2. Measurement of promissory note loans to British authorities

a) Description of the matter
The Company issued promissory note loans to British local authorities with a carrying amount of €2,592m, which the Board of Directors assigned to the residual business model and are recognised under the balance sheet item “Financial assets – Mandatorily Fair Value P&L”

Information is included in the notes under 5.3, 5.4, 5.14 in the section “Summary of accounting and measurement methods”, under 8.5 in the section “Notes to the balance sheet” and under 9.20 “Fair value of financial instruments”.

There is substantial discretionary scope in the measurement of the promissory note loans at fair value, particularly where they have a long maturity. Changes in the assumptions can result in fair value calculations differing considerably from each other. Due to the existing discretionary scope, the measurement of loans to British local authorities constitutes a key audit matter.

b) Our audit approach
We looked at the procedures and processes used in the measurement process and assessed the appropriateness and operating effectiveness of the controls used.

We gained an understanding of the methodology of the measurement model used by the Company and examined it in accordance with the requirements set out in IFRS 13. We assessed the appropriateness of the inputs in the measurement model on the basis of both data available within the Company and externally available data. In this process, we assessed in particular the appropriateness of the spread premiums used by the Bank and of the yield curve used for discounting.

We gained an understanding of the calculatory accuracy of the method used to establish the fair value.

At the reporting date we performed a full subsequent measurement for the promissory note loans to British local authorities and assessed the appropriateness of the Bank’s values on this basis.

Further Information

The Board of Managing Directors is responsible for the further information. Further information includes information contained in the management report and in the declaration on corporate governance but not the annual financial statements or our auditor’s opinion on them.

Our audit opinion on the annual financial statements does not cover the further information and we give no assurance of any kind in respect thereof.

Our responsibility in relation to the auditing of the annual financial statements is to read the further information and on that basis assess whether there is any material inconsistency with the annual financial statements or the insights gained in the course of the audit or whether the further information appears otherwise to be materially misrepresented. Should

we conclude from the work done by us that the further information contains material misstatements, we are obliged to make a report to that effect. We have nothing to report on this point.

Responsibility of the Board of Directors

The Board of Directors is responsible for the preparation and proper presentation of the annual financial statements in accordance with the IFRS as applicable in the European Union and the internal controls which the Board of Directors regards as necessary to facilitate the preparation of annual financial statements free from material misrepresentations, whether intended or unintended.

In preparing the annual financial statements, the Board of Directors is responsible for assessing the Company’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors intends to liquidate the Company or suspend business operations or has no other realistic alternative but to do so.

Responsibility of the auditor for the annual financial statements

The objective of our audit is to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misrepresentations – whether intended or unintended – and to issue an auditor's opinion on this which contains our audit opinion. Reasonable assurance corresponds with a high level of assurance, but is not a guarantee that an audit conducted in accordance with EU Regulation 537/2014, the law dated 23 July 2016 and the ISAs adopted for Luxembourg by the CSSF will always detect a material misrepresentation, if one exists. Misrepresentations can arise from error or fraud and are considered material if, individually or in the aggregate, they could reasonably be expected to influence economic decisions of users taken on the basis of these annual financial statements.

We use our best judgement and take a critical approach within the scope of an audit of financial statements in accordance with EU Regulation 537/2014, the law dated 23 July 2016 and the ISAs adopted for Luxembourg by the CSSF. Furthermore:

- We identify and assess the risk of material misrepresentations in the annual financial statements resulting from error or fraud, plan and conduct audit procedures as a response to these risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinion. The risk of not detecting a material misrepresentations resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- We obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control.

- We evaluate the appropriateness of the accounting policies used by the Board of Directors, accounting estimates and the corresponding information in the Notes.

- We draw conclusions about the appropriateness of the Board of Directors’ use of the

going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's opinion to the related disclosures in the annual financial statements or, if such disclosures are inadequate, to modify our audit opinion. These conclusions are based on the audit evidence obtained up to the date of the auditor's opinion. However, future events or conditions may cause the Company to cease to continue as a going concern.

- We assess the overall presentation, structure and contents of the annual financial statements, including the information in the Notes, and we evaluate whether they accurately represent the underlying transactions and events.

We communicate with those charged with governance regarding multiple matters, including the planned scope and timing of the audit, significant audit findings and any significant deficiencies in the internal control system that we identify during our audit.

We have provided those charged with governance with a statement that we have complied with the relevant requirements regarding independence and communicated to them all relationships and other matters that may reasonably be thought to bear on our independence and, if relevant, the related safeguards.

With regard to the matters communicated to those charged with governance, we identify those matters that were of greatest significance to the audit of the consolidated financial statements of the current period under review as the key audit matters. We describe these matters in our report unless the law or other regulations preclude public disclosure of the matter.

Report on further legal and regulatory obligations

We were appointed as auditors by the extraordinary general meeting of shareholders on 26 September 2017 subject to regulatory approval, which the European Central Bank granted on 11 December 2017. The uninterrupted term of our mandate, including previous extensions and reappointments, is one year.

The Management Report is consistent with the financial statements and has been drafted in accordance with the requirements of the law.

The declaration on corporate governance is the responsibility of the Board of Directors. The information required according to Article 70bis (1) (c) and (d) of the amended law dated 17 June 1992 on the annual financial statements and consolidated financial statements of banks subject to Luxembourg law is consistent with the annual financial statements and has been drafted in accordance with the current requirements of the law.

We confirm that we have not rendered any prohibited non-audit services as defined by EU Regulation 537/2014 and that we remained independent of the Company during the performance of the audit.

Other matters

The Company's annual financial statements for the financial year ended on 31 December 2017 were audited by another auditor, who issued an unmodified audit opinion on these annual financial statements on 15 March 2018.

Other

The declaration on corporate governance includes the information required on account of Article 70bis (1) of the amended law dated 17 June 1992 governing the annual financial statements and consolidated financial statements of banks subject to Luxembourg law.

Ernst & Young
Société anonyme
Auditors

Luxemburg, 11. April 2019

Christian Brüne

Annual financial statements of Commerzbank Finance & Covered Bond S.A.

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All details in this Annual Report are derived from information and business performance figures of Commerzbank Finance & Covered Bond S.A. (CFCB) as at 31 December 2018.

Unless otherwise indicated, all amounts are shown in thousands of euros (€ thousand).

Due to rounding, slight deviations may occur in totals and calculations of percentages.

3 Annual financial statements of Commerzbank Finance & Covered Bond S.A.

Statement of comprehensive income

in €000	Notes	1.1.-31.12.2018	1.1.-31.12.2017[1]	Change in €000	Change in %
Interest income accounted for using the effective interest method		291,106	425,094	–133,989	–31.5
Interest income accounted for not using the effective interest method		87,045	0	87,045	n/a
Interest income	7.1	378,151	425,094	–46,944	–11.0
Interest expenses	7.1	179,015	224,599	–45,584	–20.3
Net interest income	**7.1**	**199,136**	**200,495**	**–1,359**	**>100**
Risk result/loan loss provisions	7.2, 7.3	1,205	–567	1,772	>100
Net interest income after loan loss provisions	**7.2, 7.3**	**197,931**	**201,062**	**–3,131**	**>100**
Commission income	7.4	8,765	6,751	2,014	29.8
Commission expenses	7.4	573	713	–140	–19.6
Net commission income	**7.4**	**8,192**	**6,038**	**2,154**	**35.7**
Net income from hedge accounting	7.5	–3,519	–8,419	4,899	58.2
Net income from financial assets and liabilities measured at fair value through profit and loss	7.5	-117,463	-280,936	163,473	-66.4
Gain or loss on disposal of financial assets – amortised cost	7.6, 7.7	1,079	54	1,025	>100
Other sundry profit or loss on disposal of financial instruments	7.6, 7.7	1,016	-606	1,622	>-100
Other profit or loss from financial instruments / Net investment income	7.6, 7.7	2,096	-552	2,648	>100
Operating expenses	7.8, 7.9, 7.10, 7.11, 7.12, 9.5	24,883	24,602	282	1.1
Other net income	7.13	-1,473	2,201	-3,674	>-100
Operating profit/loss		**60,880**	**-105,208**	**166,088**	**>100**
Taxes on income	7.14	-3,583	-21,564	17,981	>100
Surplus/shortfall for the year		**64,463**	**-83,644**	**148,107**	**>100**
Change from remeasurement of defined benefit plans not recognised in the income statement		34	77	-43	>100
Items not recyclable through profit or loss		**34**	**77**	**-43**	**>100**
Change in revaluation reserve					
before taxes		0	56,004	-56,004	>100
Taxes		0	-14,567	14,567	>100
Items recyclable through profit or loss		**0**	**41,438**	**-41,438**	**>100**
Other comprehensive income		**34**	**41,514**	**-41,481**	**>100**
Total comprehensive income		**64,497**	**-42,129**	**106,626**	**>100**

[1] Previous year's figures restated see Note 5.2

The Notes are an integral part of these financial statements.

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Balance sheet

Assets in €000	Notes	31.12.2018	1.1.2018[1]	Change in %	31.12.2017
Cash reserve	5.7, 8.1	5,263	105,326	–95.0	105,326
Financial assets – Amortised Cost	5.4, 5.8, 5.14, 8.2, 8.6	8,576,147	9,515,285	–9.9	n/a
Financial assets – Loans and Receivables	5.5, 5.9, 5.14, 8.3, 8.7	n/a	n/a	n/a	12,701,655
Financial assets – Available for Sale	5.5, 5.10, 5.14, 8.4	n/a	n/a	n/a	864,155
Financial assets – Mandatorily Fair Value P&L	5.4, 5.11, 8.5	2,633,044	3,176,822	–17.1	n/a
Financial assets – Held for Trading	5.4, 5.5, 5.12, 8.8	338,301	380,881	–11.2	403,744
Positive fair values of derivative hedging instruments	5.6, 5.13, 8.9	486,614	574,124	–15.2	574,124
Intangible assets	5.16, 8.10, 8.11	6,682	10,024	–33.3	10,024
Fixed assets	5.16, 8.10, 8.11	32	32	0.0	32
Deferred tax assets	5.17, 8.12	0	0	0.0	20,422
Other assets	8.13	6,640	25,877	–74.3	25,877
Total		**12,052,723**	**13,788,370**	**–12.6**	**14,705,358**

Liabilities in €000	Notes	31.12.2018	1.1.2018[1]	Change in %	31.12.2017
Financial liabilities – Amortised Cost	5.5, 5.18, 9.1	8,301,251	9,067,195	–8.4	9,067,195
Financial liabilities – Held for Trading	5.4, 5.5, 5.12, 9.2	1,433,076	2,295,419	–37.6	213,291
Negative fair values of derivative hedging instruments	5.6, 5.13, 9.3	1,091,038	1,255,240	–13.1	3,337,367
Provisions	5.19, 9.4, 9.5, 9.6	10,490	7,678	36.6	7,678
Current tax liabilities	5.17, 9.7	20,655	27,948	–26.1	27,948
Other liabilities	9.8	1,284	4,459	–71.2	4,459
Equity	5.20, 9.9	1,194,928	1,130,432	5.7	2,047,419
Subscribed capital	5.20, 9.9	235,000	235,000	0.0	235,000
Capital reserve	5.20, 9.9	1,859,000	1,859,000	0.0	1,859,000
Retained earnings	5.20, 9.9	–963,535	–963,568	0.0	206,503
Revaluation reserve	5.20, 9.9	0	0	0.0	–169,439
Surplus/shortfall for the year	5.20, 9.9	64,463	0	>100	–83,644
Total		**12,052,723**	**13,788,370**	**–12.6**	**14,705,358**

[1] This column shows the values of the opening balance according to IFRS 9 as at 1 January 2018.

For the reconciliation of the carrying amounts and equity with the application of IFRS 9, reference is made to the information in Note 5.3.

The Notes are an integral part of these financial statements.

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Statement of changes in equity

in €000	Notes	Subscribed capital	Capital reserve	Retained earnings	Revaluation reserve	IAS 19 reserve	Surplus/ shortfall for the year	Total
Balance as at 1.1.2017		**235,000**	**859,000**	**149,872**	**–210,877**	**–2,255**	**58,810**	**1,089,549**
Net income for the year	5.20, 9.9						–83,644	–83,644
Capital allocation	5.20, 9.9		1,000,000					1,000,000
Transfer to retained earnings	5.20, 9.9			58,810			–58,810	0
Change in revaluation reserve	5.20, 9.9				41,438			41,438
Change in IAS 19 reserve	5.20, 9.9					77		77
Balance as at 31.12.2017		**235,000**	**1,859,000**	**208,681**	**–169,439**	**–2,179**	**–83,644**	**2,047,419**
Change due to the first-time application of IFRS 9	5.3			–1,086,427	169,439			–916,988
Balance as at 1.1.2018		**235,000**	**1,859,000**	**–877,746**	**0**	**–2,179**	**–83,644**	**1,130,432**
Net income for the year	5.20, 9.9						64,463	64,463
Capital allocation	5.20, 9.9							0
Withdrawal from retained earnings	5.20, 9.9			–83,644			83,644	0
Change in revaluation reserve	5.20, 9.9							0
Change in IAS 19 reserve	5.20, 9.9					34		34
Balance as at 31.12.2018		**235,000**	**1,859,000**	**–961,390**	**0**	**–2,145**	**64,463**	**1,194,928**

The Notes are an integral part of these financial statements.

Cash flow statement

in €000	Notes	31.12.2018	31.12.2017
Surplus/shortfall for the year		**64,463**	**–83,644**
Non-cash positions in net income for the year and reconciliation with cash flow from operating activities:			
Write-downs, depreciation, write-ups on financial assets, intangible assets, changes in provisions and net changes due to hedge accounting		27,927	–439,395
Change in other non-cash positions:		–906,033	–150,746
Net gain or loss on the sale of financial assets and liabilities	7.6	–2,096	6,103
Other adjustments		–13,530	–8,836
Sub-total		**–829,269**	**–676,518**
Changes to assets and liabilities from operating activities after adjustment for non-cash positions:			
Financial assets – Amortised Cost			
Financial assets – Mandatorily Fair Value P&L	8.2, 8.3, 8.4, 8.5	1,463,544	3,054,458
Other assets from operating activities	8.10, 8.11, 8.13	27,294	–196
Financial liabilities – amortised cost	9.1	–765,945	–3,286,465
Other liabilities from operating activities	9.6, 9.7, 9.8	–10,738	–1,520
Interest received	7.1	404,194	486,273
Interest paid	7.1	–390,664	–477,437
Taxes on income received		1,521	0
Cash flow from operating activities		**–100,063**	**–901,405**
Cash flow from investing activities		**0**	**0**
Proceeds from capital increases		0	1,000,000
Cash flow from financing activities		**0**	**1,000,000**
Cash and cash equivalents as at 1.1.	8.1	**105,326**	**6,731**
Cash flow from operating activities		–100,063	–901,405
Cash flow from financing activities		0	1,000,000
Cash and cash equivalents as at 31.12.	8.1	**5,263**	**105,326**

The presentation was adjusted to the IFRS 9 presentation. The reclassifications are set out in the following table.

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in €000	31.12.2017 old structure		1.1.-31.12.2017 new structure	in €000
Surplus/shortfall for the year	**–83,644**		**-83,644**	
Non-cash positions in net income for the year and reconciliation with cash flow from operating activities:				Non-cash positions in net income for the year and reconciliation
• Write-downs, depreciation, write-ups on receivables fixed and other assets, changes in provisions and net changes due to hedge accounting	–439,395		-439,395	• Write-downs, depreciation, write-ups on financial assets, intangible assets, changes in provisions and • Change in other non-cash positions: • Net gain or loss on the sale of assets and liabilities
• Change in other non-cash positions	–150,746		-150,746	• Other adjustments
• Net gain or loss on the sale of fixed and other assets	6,103		6,103	• Net gain or loss on the sale of fixed and other assets
• Other adjustments	–8,836		-8,836	• Other adjustments
Sub-total	**–676,518**		**-676,518**	Sub-total
Changes to assets and liabilities from operating activities after adjustment for non-cash positions:				Changes to assets and liabilities from operating activities after adjustment for non-cash positions:
• Claims on banks – Loans and Receivables	254,198	–254,198	0	• Financial assets – Amortised Cost,
• Claims on customers – Loans and Receivables	345,616	2,708,842	3,054,458	• Financial assets – Mandatorily Fair Value P&L
• Available-for-sale financial investments	73,195	–73,195	0	• Other assets from operating activities
• Financial investments loans and receivables and other assets from operating activities	253,448	–253,644	-196	• Financial investments loans and receivables and other assets from operating activities
• Liabilities to banks other liabilities	–1,899,661	–1,386,804	-3,286,465	• Financial liabilities – Amortised Cost
• Liabilities to customers other liabilities	–307,415	307,415	0	• Liabilities to customers other liabilities
• Securitised liabilities other liabilities	–1,079,389	1,079,389	0	• Securitised liabilities
• Other liabilities from operating activities	–1,520		-1,520	• Other liabilities from operating activities
• Interest received	486,273		486,273	• Interest received
• Interest paid	–477,437		-477,437	• Interest paid
Cash flow from operating activities	**–3,029,210**		**-901,405**	**Cash flow from operating activities**
Proceeds from disposals of • Financial assets	2,127,805	–2,127,805	0	Proceeds from disposals of • Financial assets
Cash flow from investing activities	**2,127,805**		**0**	**Cash flow from investing activities**
Proceeds from capital increases	1,000,000		1,000,000	Proceeds from capital increases
Cash flow from financing activities	**1,000,000**		**1,000,000**	**Cash flow from financing activities**
Cash and cash equivalents at the end of the previous period	**6,731**		**6,731**	**Cash and cash equivalents as at 1.1.**

in €000	31.12.2017 old structure		1.1.-31.12.2017 new structure	in €000
Cash flow from operating activities	–3,029,210		-901,405	Cash flow from operating activities
Cash flow from investing activities	2,127,805		0	Cash flow from investing activities
Cash flow from financing activities	1,000,000		1,000,000	Cash flow from financing activities
Cash and cash equivalents at the end of the reported period	**105,326**	**0**	**105,326**	**Cash and cash equivalents as at 31.12.**

The Notes are an integral part of these financial statements.

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4 Notes on the separate financial statements for Commerzbank Finance & Covered Bond S.A.

4.1 Legal background

Commerzbank Finance & Covered Bond S.A. (hereinafter also referred to as CFCB or Bank) was established as a "Europäische Hypothekenbank der Deutschen Bank" (European mortgage bank of Deutsche Bank) on 24 April 1989 according to deed no. 529/89, as announced on 20 July 1989 in the public gazette of the Grand Duchy of Luxembourg under C, number 200, and is recorded as a "Societé Anonyme" in the Commercial Register of Luxembourg District Court under register number B 30.469. The Bank was granted a special banking licence (no. 356/99) by the Luxembourg Ministry of Finance on 23 September 1999 to issue covered bonds under Luxembourg law. As at 31 August 2012 the Bank was renamed Hypothekenbank Frankfurt International S.A. (HFI).

Commerzbank AG as the ultimate parent holds 100% of the shares in the Bank, which was established on 1 September 2014 – with retroactive effect in accounting terms to 1 January 2014 – by the merger of Erste Europäische Pfandbrief- und Kommunalkreditbank Aktiengesellschaft in Luxemburg (EEPK) with Hypothekenbank Frankfurt International S.A. (HFI) while retaining its name, EEPK.

As part of the reorientation of Commerzbank's operations in Luxembourg, EEPK was renamed as Commerzbank Finance & Covered Bond S.A. with legal effect on 15 February 2016. Publication took place in the public gazette of the Grand Duchy of Luxembourg on 8 February 2016 under C, number 342 and on 31 May 2016 under C, number 1559.

4.2 Object of the Bank

The object of the company is to conduct all such business as is permitted to a Pfandbrief bank by Art. 12-1 to 12-12 of the Law on the Financial Sector of 5 April 1993 as most recently amended. The Bank is thus authorised to issue Lettres de gage (covered bonds under Luxembourg law) and conduct related secondary and ancillary business.

4.3 Compliance Statement

Commerzbank Finance & Covered Bond S.A. is a credit institution with its registered office in Luxembourg, Grand Duchy of Luxembourg. The annual financial statements as at 31 December 2018 were prepared in conformity with Regulation (EC) No. 1606/2002 (the IAS Regulation) of the European Parliament and Council of 19 July 2002, with the Law on 17 June 1992 on annual financial statements and consolidated financial statements of banks subject to Luxembourg law and with other regulations on the adoption of certain international accounting standards based on the International Accounting Standards (IAS) adopted and published by the International Accounting Standards Board (IASB) and the International Financial Reporting Standards (IFRS) as interpreted by the International Financial Reporting Interpretations Committee (IFRIC). All standards and interpretations which are mandatory within the EU in 2018 have been applied.

4.4 Date of release for publication

The annual financial statements for the year ending on 31 December 2018 were released by the Board of Directors on 11 April 2019.

5 Summary of accounting and measurement methods

5.1 Initially applicable, revised and new standards

5.1.1 Standards to be applied for the first time

In the financial year 2018, the Bank implemented all new and revised standards and interpretations which required initial mandatory application as at 1 January 2018 and which had already been endorsed into European law, if they were relevant for the Bank. All amendments to the standards have been taken into account in accordance with the applicable transitional provisions. The relevant and significant new standards for the Bank are presented in the following section.

The following standards and IFRIC had to be applied for the first time during the year under review:

- IFRS 9 Financial instruments;
- IFRS 15 Revenue from Contracts with Customers;
- IFRIC 22 Foreign Currency Transactions and Advance Consideration.

IFRIC 22 does not apply to the Bank.

We set out below the impact of the standards that apply to the Bank for the first time where they are relevant for the Bank's annual financial statements:

IFRS 9

The IASB published an extensively revised new version of IFRS 9 Financial Instruments in July 2014, which affected not only IFRS 9 but also other standards (particularly IFRS 7 and IAS 1). This was transposed into European law in November 2016. The standard must be applied in the EU for financial years beginning on or after 1 January 2018. The previous standard for the accounting treatment of financial instruments (IAS 39) has largely been replaced.

CFCB's reported equity declined by €0.9bn as compared with IAS 39, mainly as a result of measurement effects in connection with the required reclassifications. In this connection, it is particularly the reclassification of loans to British authorities, now measured at fair value through profit or loss, which led to a reduction in equity.

Note 5.3 of this Annual Report contains the reconciliation tables between IAS 39 and IFRS 9 for the balance sheet, equity and loan loss provisions as at 1 January 2018.

In connection with hedge accounting the Bank has continued to apply the provisions of IAS 39.

The application of the amendments to IFRS 9 regarding the early repayment of loans, which were endorsed into European law in March 2018, clarifies the SPPI compliance of these interest and principal payments. These amendments do not have any impact on the Bank's financial statements.

IFRS 15

IFRS 15 Revenue from Contracts with Customers has introduced a principles-based five-step framework dealing with the nature, amount and timing of revenues and cash flows arising from a contract with a customer. It replaces IAS 11 and 18, IFRIC 13, 15 and 18 and SIC-31. The standard also requires extensive qualitative and quantitative disclosures on contracts, performance obligations and significant judgements and estimates. It was transposed into European law in October 2016. The standard must be applied in the EU for financial years beginning on or after 1 January 2018.

The application of IFRS 15 had no impact on CFCB's financial statements as at 31 December 2018.

5.1.2. Revised standards

Moreover, the following standards were revised where amendments required initial mandatory application in the financial year 2018:

- Amendments to IFRS 2: classification and measurement of share-based payment transactions;
- Amendments to IAS 40: Transfers of Investment Property;
- Annual Improvements (2014–2016 Cycle) to IFRS 1 and IAS 28;

The Amendments to IAS 40 and the Annual Improvements (2014–2016 Cycle) do not apply to the Bank.

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Amendments to IFRS 2

The IASB published an amendment to IFRS 2 "Share-based Payment", which relates to three main areas:

- The impact of the conditions for exercise on the accounting for cash-settled share-based payment transactions that include a performance condition;
- the classification of share-based payment transactions with net settlement features for the retention of taxes
- the accounting of cash-settled share-based transactions in the event of modifications of share-based payment transactions from cash-settled to equity-settled.

On initial adoption, businesses must apply the amendment without amending prior reporting periods. Retroactive application is permitted, however, if this option is used for all three amendment areas and additional requirements are met. The accounting treatment of cash-settled share-based payment transactions applied by the Bank corresponds to the approach specified in the amendments. In addition, the Bank does not have any share-based payment transactions with net settlement features for the retention of taxes and has not made any amendments to the conditions of the share-based payment transactions.

As a result, these amendments have no impact on the Bank's annual financial statements.

5.1.3 New standards

EU endorsement obtained

The IASB has published the following standards and interpretations which were transposed into EU law as part of the comitology procedure but which did not require initial mandatory application in the financial year 2018.

The Bank intends to apply the new and amended standards and interpretations from the date of its mandatory application but not earlier.

- IFRS 16 Leases:
- IFRIC 23 Uncertainty over Income Tax Treatments;
- Amendments to IFRS 9: Prepayment features with negative compensation;
- Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures;
- Annual Improvements (2015–2017 Cycle): IFRS 3 Business Combinations – Previously Held Interests in a Joint Operation;
- Annual Improvements (2015–2017 Cycle): IFRS 11 Joint Arrangements – Previously Held Interests in a Joint Operation;
- Annual Improvements (2015–2017 Cycle): IAS 12 Income Taxes – Income Tax Consequences of Payments on Instruments Classified as Equity;
- Annual Improvements (2015–2017 Cycle): IAS 23 Borrowing Costs – Capitalisation of Borrowing Costs;
- Amendments to IAS 19: Plan Amendment, Curtailment or Settlement;

The new standards generally applicable to the Bank together with amendments to standards and their impact are set out below. The standards and amendments not presented are not applicable to the Bank and do not therefore have an impact on the annual financial statements.

IFRS 16

The new standard IFRS 16 Leases, published in January 2016, will replace IAS 17 and the related interpretations IFRIC 4, SIC-15 and SIC-27. The change was transposed into EU law in the fourth quarter of 2017.

Under IFRS 16 all leases with a term of over twelve months must be recognised on the lessee's balance sheet together with the associated contractual obligations. Leases involving low-value assets are an exception. The lessee will in future recognise a right-of-use asset and a lease liability, which represents the obligation to make the lease payments. IFRS 16 adopts the criteria of IAS 17 for the classification of finance and operating leases by the lessor.

The standard also contains further provisions on recognition, on the information in the notes and on sale-and-leaseback transactions. IFRS 16 will become effective for financial years beginning on or after 1 January 2019. CFCB will make use of the simplified provisions regarding low-value leases and short-term leases.

Commerzbank AG launched a Group-wide project under the responsibility of Group Finance at the end of 2017 to prepare for the new requirements, in which all subsidiaries were involved. The necessary analyses were performed together with experts from the Real Estate Management and Contract Management divisions. The results were included in business specifications and will be incorporated into the Group-wide accounting guidelines by 2019. The IT implementation for the correct calculation of the new balance-sheet positions was completed in July 2018, and tests were successfully completed in mid-November 2018 with a Group-wide survey and coordination. CFCB was also involved in the tests.

An impact on the Group financial statements resulted from liabilities and right-of-use assets that must now be recognised, particularly in connection with the leased property and to a smaller extent in connection with car leases.

An analysis by CFCB has shown that, as an initial adoption effect as at 1 January 2019, total assets will increase by less than €1m. Instead of the previously recognised operating expenses, the income statement will in the future show deprecation on the recognised rights of use and interest-related expenses from the unwinding of the discount on leasing liabilities. The initial adoption of IFRS 16 will have no more than an insignificant impact on the surplus for the year.

IFRIC 23

On 7 June 2017, IFRIC Interpretation 23 (Uncertainty over Income Tax Treatments) was published. This interpretation aims to clarify the recognition and measurement of income taxes in accordance with IAS 12 when uncertainty prevails regarding the treatment for income tax purposes. The IFRIC interpretation must be applied for reporting periods beginning on or after 1 January 2019. Certain transitional relief measures may be used, however. We do not expect this to have any material impact on the Bank's financial statements.

Amendments to IFRS 9 Prepayment Features with Negative Compensation

The amendments to IFRS 9 Prepayment Features with Negative Compensation were published in October 2017. According to IFRS 9, a debt instrument can be measured at amortised cost or classified at fair value in other net income within equity if the contractually agreed cash flows merely consist of interest and principal payments on the outstanding capital amount ("SPPI criterion") and the debt instrument is held as part of a business model which corresponds to this classification. The amendments to IFRS 9 clarify that a financial asset fulfils the SPPI criterion regardless of the event or circumstance which prompts early termination of the contract and regardless of the contractual party which receives or makes appropriate payment for early termination of the contract.

The amendments must be adopted retroactively on 1 January 2019 for the first time. Earlier adoption is permitted.

Due to its narrow scope of application, this amendment standard has no impact on the annual financial statements.

EU endorsement outstanding:

The IASB has published the following standards and interpretations which did not require initial mandatory application in the financial year 2018. These standards and interpretations have so far not been recognised by the EU and are not applied by the Bank.

- IFRS 17 Insurance Contracts;
- revised Conceptual Framework and update of cross-references in the IFRS;
- Amendments to IFRS 3 Definition of a Business;
- Amendments to IAS 1 and IAS 8: Definition of Material.

The new standards generally applicable to the Bank but not yet transposed into EU law together with amendments to standards and their impact are set out below. The standards and amendments not presented are not applicable to the Bank and do not therefore have an impact on the annual financial statements.

The Bank intends to apply the new and amended standards and interpretations from the date of its mandatory application but not earlier:

Conceptual Framework and update of cross-references in the IFRS

In March 2018 the IASB presented a revised Conceptual Framework which is not subject to the endorsement process. Updates were also made to cross-references in the IFRS to the Conceptual Framework or reproductions from the Conceptual Framework which may have an impact on currently applied accounting and measurement methods which were developed in the context of IAS 8 and are subject to the endorsement process.

The amendments must be adopted prospectively on 1 January 2020 for the first time. Earlier application is permitted provided that all amendments are applied. The Bank does not expect any impact on its annual financial statements.

Amendments to IAS 1 and IAS 8 Definition of Material

October 2018 saw the publication of amendments to IAS 1 and IAS 8 regarding the definition of material. They state that information is material if omitting, misstating or obscuring

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it could reasonably expected to influence decisions that the primary users make. The new definition of material uses the obscuring of information as a measure for materiality in the notes.

The amendments must be applied prospectively for the first time for financial years beginning on 1 January 2020. The Bank does not expect any impact on its annual financial statements.

5.2 Significant principles and uncertainties in estimates

The IFRS financial statements as at 31 December 2018 include the additional national details (Notes and Management Report) required by the Law of 17 June 1992 on the financial statements of banks subject to Luxembourg law (version as at May 2016). The financial statements comprise the statement of comprehensive income, the balance sheet, the cash flow statement, the statement of changes in equity and the Notes. The internal evaluations carried out by the Board of Directors and the Managing Directors do not consider individual segments, which is why there is no segment reporting in the separate financial statements. Commerzbank Finance & Covered Bond S.A. is an independent bank within the Commerzbank Group which is assigned to Group Treasury (GM-T).

The reporting and functional currency of the financial statements is the euro. Unless otherwise indicated, all amounts are shown in thousands of euro. The financial year is the calendar year. The German edition of the Annual Report is the authoritative version.

Significant principles

Uniform accounting and measurement methods explained in the notes below are used throughout the Bank in preparing the financial statements.
The financial statements are based on the going concern principle. Financial assets and liabilities are generally measured at amortised cost, unless a different form of measurement is required by IFRS standards. This applies in particular to certain financial instruments classified in accordance with IFRS 9.

Income and expenses are accounted for on an accrual basis; they are recognised in the income statement for the period to which they are attributable in economic terms. Interest from all contractual agreements relating to financial assets or liabilities is reported in net interest income on an accrual basis and, for derivatives, in net income from financial assets and liabilities at fair value. We have reported negative interest separately in net interest income (see Note 7.1). Dividend income is only recognised where a corresponding legal entitlement exists. The Bank recognises commission income and expenses based on the accounting treatment of the associated financial instruments and on the nature of the activity. Commission income for services which are performed over a certain period is recognised on an accrual basis. Fees which are associated with the completion of a particular service are recognised at the time of completion of the service. Performance-related fees are recognised when the performance criteria are met.

Borrowing costs that are directly attributable to the acquisition, construction or production of a significant tangible or intangible asset are capitalised in the balance sheet, provided that a period of at least 12 months is required to prepare the asset for its intended use.

In Note 9.13.4 the reconciliation of gross amounts before netting to net amounts after netting, as well as the amounts for existing netting rights that do not meet the accounting criteria for netting are presented separately for all financial assets and liabilities carried on the balance sheet that are already netted in accordance with IAS 32.42, and are subject to an enforceable, bilateral master netting agreement or a similar agreement but are not netted in the balance sheet. For the netting agreements, we conclude master agreements with our counterparties, e.g. 1992 ISDA Master Agreement (Multicurrency – Cross Border) and German Master Agreement for Financial Futures. By means of such netting agreements, the positive and negative fair values of the derivatives contracts included under a master agreement can be offset against one another. This netting process reduces the credit risk to a single net claim on the party to the contract (close-out netting).

Note 9.14 contains a breakdown of all balance-sheet items into short-term and long-term items. This note also reports cash flows for all financial instruments with contractual due dates.

Monetary assets and liabilities denominated in foreign currencies are translated at the spot mid-rate on the reporting date. Realised expenses and income are generally translated using the spot rate applying on the date of realisation.

The expenses and income resulting from the translation of items in the balance sheet are fundamentally recognised in the net income from financial assets and liabilities measured at fair value through profit and loss.

Non-monetary items are translated using the current rate method. Gains and losses on the translation of profits or losses on non-monetary items are recognised either in equity or profit or loss depending on the way the net gain or loss is recognised.

Uncertainties in estimates

The financial statements include values which are determined, as permitted, on the basis of estimates and assumptions.

The estimates and judgements used are based on past experience and other factors, such as planning and, based on current estimates, expectations or forecasts of future events. The assumptions and parameters underlying the estimates we have made are based on the exercise of appropriate judgement by the Board of Directors. This applies in particular to the appropriate selection and use of parameters, assumptions and modelling techniques when valuing financial instruments for which there are no market prices and no comparative parameters observable on the market. Where differing valuation models lead to a range of different potential values, the Board of Directors uses its judgement to determine the choice of the model to be used.

The estimates and judgements themselves and the underlying estimation methods and judgement factors are reviewed on a regular basis and compared with actual events. The Board of Directors regards the parameters used as reasonable and appropriate. Nonetheless, the actual outturns may differ from the estimates in the instances listed below.
Uncertainties in estimates may arise, for example, in the derivation of fair value or the expected cash flows of financial instruments, and in connection with impairments of loans and securities and the recognition of provisions for off-balance-sheet lending exposures (in particular the analysis of the overall economic conditions and the determination of the expected cash flows including the recognition, level and timing of the realisation of collateral (see risk report)).

Uncertainties also exist regarding the calculation of pension obligations. Pension obligations are measured based on the projected-unit-credit method for defined benefit pension plans. In measuring such obligations, assumptions have to be made, in particular regarding the discount rate, the long-term rate of increase in salaries and pensions, and average life expectancy. Changes in the underlying assumptions from year to year and divergences from the actual annual effects are reported as remeasurements without effect on income in retained earnings (see Note 9.5 on the impact of changes in parameters).

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Adjustments

Since 2018, the Bank has followed the approach of the Commerzbank Group in the recognition of interest income and interest expense (see Note 7.1).

Accordingly, for the comparable 2017 figures the following reclassifications took place:

(A) Reclassification of net interest income on derivatives:

Interest income and expenses from derivatives are now recorded under net income from financial assets and liabilities measured at fair value through profit and loss.

(B) Reclassification of realised profit or loss from financial liabilities at amortised cost:

Net income from the repurchase of liabilities measured at cost, which was previously recognised in interest income and expenses, is now reported under other net gain or loss from financial instruments.

The table below shows the changes between the old and the new structure in the comprehensive income statement. All the changes presented had no impact on total comprehensive income.

in €000	1.1.-31.12.2017 old structure	(A)	(B)	1.1.-31.12.2017 new structure
Interest income	426,544		-1,450	425,094
Interest expenses	434,957	-210,358		224,599
Net interest income	**–8,414**	**210,358**		**200,495**
Risk result/loan loss provisions	–567			–567
Net interest income after loan loss provisions	**–7,847**			**201,062**
Commission income	6,751			6,751
Commission expenses	713			713
Net commission income	**6,038**			**6,038**
Net income from hedge accounting	–8,419			–8,419
Net income from financial assets and liabilities measured at fair value through profit and loss	-70,578	-210,358		-280,936
Gain or loss on disposal of financial assets – amortised cost	54			54
Other sundry profit or loss on disposal of financial instruments	-2,055		1,450	-606
Other profit or loss from financial instruments/ Net investment income	-2,002		1,450	-552
Operating expenses	24,602			24,602
Other net income	2,201			2,201
Operating profit/loss	**-105,208**	**0**	**0**	**–105,208**
Taxes on income	-21,564			–21,564
Surplus/shortfall for the year	**-83,644**	**0**	**0**	**–83,644**

The presentation in Note 7.10.2 was adjusted because the expenses in connection with the Commerzbank Incentive Plan did not constitute expenses for share-based payments in the previous year because the specified threshold was not met.

5.3 Application of IFRS 9

The Bank has been applying IFRS 9 since 1 January 2018 in the version adopted by the European Union. The Bank has not restated the prior-year figures because this is not required when applying the new standard for the first time. A reconciliation of the carrying amounts and of equity can be found at the end of this section.

General classification and measurement

The application of IFRS 9 requires the reporting entity to classify all assets and liabilities defined as financial instruments under IAS 32. This classification aims to enable the user of the financial statements to make a better assessment of the amount, timing and uncertainty of future cash flows. Fundamentally, all financial instruments must be recognised at their fair value on the date of acquisition. This acquisition principle applies regardless of the financial instrument's classification.

IFRS 9 sets out four types of subsequent measurement, which depend on the respective business model and the fulfilment of the SPPI criterion (solely payment of principal and interest):

- measurement at amortised cost (AC)
- fair value through other comprehensive income with recycling (FVOCImR)
- fair value through other comprehensive income without recycling (FVOCIoR)
- fair value through profit or loss (FVPL)

The management has allocated the financial assets to one of the business models set out below, based on how the financial assets are managed to generate cash flows:

- Business model: "Hold to collect": receipt of contractual cash flows with only rare or immaterial sales activities;
- Business model: "Hold to collect and sell" Receipt of cash flows through holding and also through sales.
- Residual business model: all portfolios that are not allocated to the "hold to collect" or "hold to collect and sell" business model. These include primarily trading portfolios and portfolios managed on a fair-value basis. The receipt of contractually agreed cash flows is of minor importance; the main objective is instead to maximise cash flows through purchases and sales.

The second criterion for classifying financial assets is the characteristics of their cash flows. When assessing these cash flows, the crucial consideration is whether they are solely unleveraged interest and principal payments on the outstanding capital, i.e. the SPPI criterion. In principle, a financial instrument is SPPI-compliant only if its contractual cash flows are equivalent to those of a simple loan, i.e. a basic lending arrangement.

The allocation to the business model can be made on a portfolio basis, whereas the SPPI criterion must always be assessed for each individual financial instrument that was allocated to the "hold to collect" or "hold to collect and sell" business model.

Measurement at amortised cost (AC) requires that the financial asset has cash flows which correspond to the SPPI criterion and that it has been allocated to a portfolio with the "hold to collect" business model. The associated bookings correspond in principle to the previous IAS 39 fair value category of loans and receivables (LaR).

A financial asset is measured at fair value through other comprehensive income with recycling (FVOCImR) if its cash flows also correspond to the SPPI criterion and it has been allocated to a portfolio with the "hold to collect and sell" business model. The associated accounting therefore corresponds fundamentally to the previous IAS 39 fair value category of available-for-sale (AfS).
The subsequent measurement at fair value with recognition of the value fluctuation in the income statement (FVPL) is required if either the financial asset has not been allocated to a portfolio with one of the aforementioned business models or its cash flows are not SPPI-compliant. This measurement category is therefore subsidiary in nature. A reporting distinction is made in this measurement category between financial instruments held for trading purposes (HfT) and other financial instruments requiring recognition at fair value with the resulting value fluctuation being recorded in the income statement (mFVPL). Besides the fair value option (FVO), there is also the possibility of voluntarily allocating financial assets on acquisition to the mFVPL category if accounting mismatches can be avoided.

The methodology for measuring financial assets is based on the allocation of the asset to one of the following three groups

Derivatives:

Financial instruments for which the allocation criteria have not changed as compared with IAS 39. As derivatives do not have fixed redemption amounts, subsequent measurement at

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amortised cost is not possible. They must always be measured at fair value, with the fluctuation in value being recorded in the income statement. If derivatives are not used for hedge accounting, they must always be allocated to the trading portfolio (HfT).

Equity instruments:
Financial instruments which correspond to the definition of equity under IAS 32 for the issuing entity. As they represent only a proportional right, and not a right to receive a fixed redemption amount, the SPPI criterion is not fulfilled and measurement at amortised cost is therefore precluded. However, an irrevocable decision can be made when the equity instrument is acquired to instead measure the instrument based on the FVOCI-without- recycling method. All value fluctuations are recognised in other comprehensive income and are not reported in the income statement upon the disposal of the financial instrument (without recycling). This option is not available for financial instruments that have been acquired for trading purposes or as conditional payment for the acquisition of a company. In these cases, similar to all other equity instruments, they must be measured at mFVPL. Dividends are recognised in the income statement under dividend income where a corresponding legal entitlement exists, unless a portion of the cost of acquiring the financial asset is recovered by the dividend. In this case, profits are recognised in other net income. Equity instruments classified at fair value in other net income within equity are not tested for impairment.

Debt instruments:
All financial instruments not considered to be derivatives as defined in IFRS 9 or equity as defined under IAS 32 are subsequently measured based on the business model of the portfolio to which the financial instrument was allocated upon acquisition and on the contractual cash flows of the financial instrument (fulfilment of SPPI criterion). In addition, in the case of an accounting mismatch there is the possibility of voluntarily applying the fair value option.

Debt instruments on the asset side of the balance sheet may thus be accounted for in one of the following ways:

- Subsequent measurement at amortised cost is required if the financial instrument is held only to realise the contractually agreed cash flows ("hold to collect" business model) and, in addition, the contractually agreed cash flows are exclusively interest and principal payments as defined under IFRS 9 (SPPI compliance).
- Subsequent measurement at fair value with recognition of the change in value in other comprehensive income with recycling (FVOCImR) is required if the financial instrument is allocated to a portfolio with the "hold to collect and sell" business model and, in addition, the contractually agreed cash flows are only interest and principal payments, and are thus SPPI-compliant. Upon disposal of the financial instrument, the cumulative valuation fluctuations that have been recognised in other comprehensive income (OCI) are then recognised in the income statement (recycling).
- The subsequent measurement at fair value with recognition of the value fluctuation in the income statement (FVPL) is required if the financial asset has been allocated to a portfolio with the residual business model.

As a rule, financial liabilities must be measured at amortised cost. In addition, it is possible to apply the fair value option in order to prevent an accounting mismatch if the financial liability forms part of a portfolio managed on a fair value basis or if the financial liability includes an embedded derivative.

If the fair value option is applied to financial liabilities, remeasurement effects deriving from own credit spread are always reported in other comprehensive income.

Financial liabilities held for trading and all derivatives must be reported in the balance sheet in a separate line item and measured at fair value through profit or loss.

Impairment

IFRS 9 changes the rules on the accounting treatment of expected default risk (provisions). Unlike in IAS 39, provisions are not recognised only when a specific loss event occurs. Instead, for every financial instrument measured at AC or FVOCImR, the credit loss expected over the next 12 months must be recognised as a provision on initial recognition (Stage 1). If the credit risk increases significantly, but the borrower is not yet in default (Stage 2), a provision must be recognised for the full lifetime expected credit losses unless the financial instrument has been allocated a rating in the investment grade range (see section 6). The LECL based on individual cash flow estimates is also the foundation for recognising impairments or provisions for financial instruments in default (Stage 3).

For further details on impairment see Note 5.14.

Hedge Accounting

The improvements for hedge accounting contained in IFRS 9 aim to achieve further harmonisation between the accounting treatment of hedging relationships and (economic) risk management. As a result of the option provided in the standard, a decision was made to apply the previous IAS 39 regulations.

For further details on hedge accounting see Note 5.6.

Effects resulting from the initial application of IFRS 9

The significant effects from the application of IFRS 9 Financial Instruments as at 1 January 2018 are presented below.

The Bank was involved in the project on IFRS 9 that had been set up within the Commerzbank Group. The project has involved the analysis of the new requirements applicable to methodology, data procurement and processes, with support from experts from the Finance, Risk and IT divisions. The results of these analyses were described in detail in technical concepts and incorporated into the Group-wide accounting guidelines.

The Board of Directors allocated the financial assets to a business model based on how the financial assets held under the business model in question are actually managed. The object of the Bank is to conduct all such business as is permitted to a Pfandbrief bank by the Law on the Financial Sector of 5 April 1993 as most recently amended. The Bank focuses on the public finance and public sector lending business with loans and promissory note loans to public borrowers in countries in the EEA and OECD. As a rule, subjecting its assets to a buy-and-hold strategy is intrinsic to the business model of a covered bond bank.

In view of this, as at 1 January 2018 the Board of Directors allocated a significant portion of the assets (€8.5bn nominal) to the "hold to collect" business model and thus measured them at amortised cost. A smaller portion of the portfolio (equivalent to €2.1bn nominal) was allocated to the residual business model and is therefore measured at mFVPL. This essentially relates to loans to British local authorities, which are referred to as LOBO loans (lender's option - borrower's option). One of the key features of these loans is the lender's option to change the interest rate at the end of a specific term. Another feature is that the borrower subsequently has the right to reject the new interest rate, linked with the early repayment of the loan without the calculation of break funding costs.

If derivatives are not used for hedge accounting, they must always be allocated to the trading portfolio (HfT).
The impact of initial application on equity was €–0.9bn, comprising both reclassification and remeasurement effects.
The significant individual effect of €–1.1bn comes from the classification of the loans to British authorities (LOBO loans), which were allocated to the residual business model and consequently measured at mFVPL. The changed allocation of securitised debt instruments which are assigned to category LAR or AfS pursuant to IAS 39 and to category AC under IFRS 9 resulted in a value-enhancing effect of €229m as at 1 January 2018.

The securitised debt instruments assigned to the LAR category as at 31 December 2007 in this connection were assigned to the AfS category on initial recognition and subsequently reclassified to the LAR category in accordance with the provisions of IAS 39.50.

The change in the provision methodology had a negative effect of around €20m.

The above-mentioned effects work out to contrary effects for deferred tax assets amounting to €0.2bn. Even taking into account the participation in the tax group with Commerzbank AG, Luxembourg branch, we do not expect to generate sufficient profits in the coming five years to use recognised deferred tax assets. Consequently, no deferred tax assets were recognised overall in the context of the switch to IFRS 9 as at 1 January 2018. This resulted in a negative effect of €20m.

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Reconciliation of the carrying amounts and equity with the application of IFRS 9

The following tables contain reconciliations of the carrying amounts as at 31 December 2017 based on IAS 39 regulations to the new carrying amounts as at 1 January 2018 in accordance with IFRS 9.

Balance-sheet assets in €000	Presentation IAS 39	Carrying amount IAS 39 31.12.2017	Presentation IFRS 9	Reclassification	Remeasurement	Carrying amount IFRS 9 1.1.2018
Cash on hand and cash on demand	**LAR**	**105,326**	**AC**			**105,326**
Financial assets – LAR						
Loans and receivables						
	LAR	1,604,504	AC		20,320	1,624,824
	LAR	4,234,364	mFVPL	22,863	-1,125,322	3,131,905
Securitised debt instruments						
	LAR	6,815,417	AC		107,236	6,922,652
	LAR	47,371	mFVPL		-2,454	44,917
Financial assets – AFS						
Securitised debt instruments						
	AFS	864,155	AC		103,655	967,809
Financial assets – HFT						
Derivatives	HFT	403,744	HFT	-22,863		380,881
Positive fair values of derivative hedging instruments		574,124				574,124
Intangible assets		10,024				10,024
Fixed assets		32				32
Deferred tax assets		20,422			-20,422	0
Other assets		25,877				25,877
Total		**14,705,358**		**0**	**-916,988**	**13,788,370**

The amount reported in the reclassification column relates to embedded derivatives in connection with the above-mentioned LOBO loans, which are recognised at fair value according to IFRS 9.
In the wake of the initial adoption of IFRS 9, financial instruments amounting to €864m were reclassified from AfS to AC because the "hold to collect" business model applies to them. Had these instruments not been reclassified upon adoption of IFRS 9 as at 1 January 2018, this would have resulted in a fair value change of €–60m in the financial year 2018, which would have been recognised in other comprehensive income (revaluation reserve). The carrying amount as at 31 December 2018 is €945m. The fair value as at 31 December 2018 is €797m.

The initial application of IFRS 9 has the following impact on the liabilities side:

Balance-sheet liabilities in €000	Presentation IAS 39	Carrying amount IAS 39 31.12.2017	Presentation IFRS 9	Reclassification	Remeasurement	Carrying amount IFRS 9 1.1.2018
Financial liabilities – amortised cost						
Deposits	AC	7,015,068	AC			7,015,068
Bonds and notes issued	AC	2,052,127	AC			2,052,127
Financial liabilities – HFT						
Derivatives and other trading liabilities	HFT	213,291	HFT	2,082,127		2,295,418
Negative fair values of derivative hedging instruments		3,337,367		–2,082,127		1,255,240
Provisions		7,678				7,678
Current tax liabilities		27,948				27,948
Deferred tax liabilities						
Other liabilities		4,459				4,459
Equity		2,047,419			–916,988	1,130,432
Subscribed capital		235,000				235,000
Capital reserve		1,859,000				1,859,000
Retained earnings		206,503			–1,086,427	–879,924
Revaluation reserve		–169,439			169,439	0
Shortfall for the year		–83,644				–83,644
Total		**14,705,358**		**0**	**–916,988**	**13,788,370**

The reclassification effects relate to derivatives that served primarily to hedge loans to British local authorities against interest rate risks and the allocation of the hedged loans to the mFVPL category which no longer fulfil the requirements for hedging instruments.

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Equity has changed as follows:

As at 31.12.2017 in €000	Presentation IAS 39	Presentation IFRS 9	Retained earnings	Revaluation reserve
As at 31.12.2017				
Financial assets				
	AFS	AC	–322	103,977
	LAR	mFVPL	–1,128,262	486
	LAR	AC	3,015	124,541
Deferred taxes			39,141	–59,564
As at 1.1.2018 (IFRS 9)			**–1,086,427**	**169,439**

Reconciliation of risk provisioning

The initial adoption of IFRS 9 and of the new system for calculating provisions for losses led to an overall effect of €20.0m, as follows:

in €000	Presentation IAS 39	Presentation IFRS 9	Loan loss provisions and securities impairments IAS 39 31.12.2017	Reclassification	Remeasurement	Loan loss provisions- IFRS 9 1.1. 2018	of which Stage 1	of which Stage 2	of which Stage 3	of which POCI
On-balance-sheet loan loss provisions										
Financial assets – LAR										
	LAR	AC	686		2,543	3,229	498	2,731		
	LAR	mFVPL	101	-101						
Cumulative net measurement gain or loss Securities										
Financial assets – LAR										
	LAR	AC	2,576		17,304	19,881	3,260	16,620		
	LAR	mFVPL	31	-31						
Financial assets – AFS										
	AFS	AC			322	**322**	322			
Total			**3,394**	**-132**	**20,169**	**23,432**	**4,080**	**19,351**	**0**	**0**

5.4 Financial assets and liabilities in accordance with IFRS 9

General classification and measurement

Under IFRS 9 all financial investments and liabilities – including financial derivatives – must be recognised in the balance sheet. A financial instrument is a contract that simultaneously gives rise to a financial asset for one entity and a financial liability or equity instrument for another. On initial recognition, financial instruments are measured at amortised cost, which usually corresponds to fair value. For financial instruments that are not measured at fair value through profit and loss, directly attributable transaction costs are included as acquisition-related costs. In accordance with IFRS 13, fair value is defined as the exit price, i.e. the price that the market participant would receive for the sale of an asset or pay to transfer a liability in an orderly transaction. The fair value is a price observed on an active market (mark-to-market) or determined using valuation models (mark-to-model). The relevant inputs for the valuation model are either observed directly on the market or, if not observable on the market, are estimates made by experts.

Depending on their respective category, financial instruments are recognised in the balance sheet subsequently either at (amortised) cost or fair value.

a) Recognition and derecognition of financial instruments

A financial asset or financial liability is generally recognised in the balance sheet when the Bank becomes a party to the contractual provisions of the financial instrument. For regular-way spot purchases or sales of financial assets in the cash market the trading and settlement dates normally differ. These ordinary spot purchases or sales may be recognised using either trade date or settlement date accounting. Regular-way spot purchases or sales of financial assets are recognised and derecognised on the settlement date.

The derecognition rules of IFRS 9 are based both on the concept of risks and rewards and on the concept of control. However, when deciding whether an asset qualifies for derecognition, the evaluation of the transfer of the risks and rewards of ownership takes precedence over the evaluation of the transfer of control. If the risks and rewards are transferred only partially and control over the asset is retained, the continuing involvement approach is used. The financial asset continues to be recognised to the extent of the Group's continuing involvement, and special accounting policies apply. The extent of the continuing involvement is the extent to which the Bank continues to be exposed to changes in the value of the transferred asset. A financial liability (or part of a financial liability) is derecognised when it is extinguished, i.e. when the obligations arising from the contract are discharged or cancelled or expire. The repurchase of own debt instruments is also a transfer of financial liabilities that qualifies for derecognition. Any differences between the carrying value of the liability (including discounts and premiums) and the purchase price are recognised in profit or loss; if the asset is sold again at a later date a new financial liability is recognised at cost equal to the price at which the asset was sold. Differences between this cost and the repayment amount are allocated over the term of the debt instrument.

Some amendments of contractual terms and conditions between borrowers and the Bank, for example as a consequence of forbearance measures or restructuring, can lead to derecognition. A substantial modification of the contractual terms and conditions of a financial instrument between an existing borrower and the Bank leads to the derecognition of the original financial asset and the recognition of a new financial instrument.

In quantitative terms, an amendment of the contractual terms and conditions is regarded as substantive if the present value of the cash flows discounted at the original effective interest rate under the new contractual terms and conditions varies by at least 10% from the discounted net present value of the residual cash flows of the original debt instrument.

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b) Classification of financial instruments and their measurement

The Bank classifies financial assets and financial liabilities in accordance with the applicable IFRS 9 categories:

Financial assets

- Amortised Cost (AC)
- Fair Value OCI (FVOCI)
- Fair Value Option (FVO)
- Mandatorily Fair Value P&L (mFVPL)
- Held for Trading (HFT)

Financial liabilities

- Amortised Cost (AC)
- Fair Value Option (FVO)
- Held for Trading (HFT)

The Bank subdivides the IFRS 9 categories into the following classes:

Financial assets

- Loans and receivables
- Securitised debt instruments
- Derivatives that do not qualify for hedge accounting (non-cover pool derivatives)
- Derivatives that qualify for hedge accounting

Financial liabilities

- Deposits
- Bonds and notes issued
- Derivatives that do not qualify for hedge accounting (non-cover pool derivatives)
- Derivatives that qualify for hedge accounting
- Financial guarantees

As well as irrevocable lending commitments

c) Net gains or losses

Net gains or losses include fair value measurements recognised in profit or loss, foreign currency effects, impairments, impairment reversals, gains realised on disposal, subsequent recoveries on written-down financial instruments and changes recognised in the revaluation reserve classified in the respective IFRS 9 categories. The components are detailed in the condensed statement of comprehensive income and in the notes on net interest income, risk result, gain or loss from financial assets and liabilities measured at fair value through profit and loss and other net gain or loss from financial instruments.

d) Financial guarantees

A financial guarantee is a contract that requires the issuer to make specified payments that reimburse the holder for a loss they incur because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. This may include, for example, bank guarantees. If the Bank is the guarantee holder, the financial guarantee is not recognised in the financial statements and only taken into consideration when determining an impairment of a guaranteed asset.

As the issuer, the Bank recognises the liability arising from a financial guarantee at inception. Initial measurement is at fair value at the time of recognition. In general terms, the fair value of a financial guarantee contract at inception is zero because for contracts in line with market conditions the value of the premium agreed normally corresponds to the value of the guarantee obligation (net method). As part of subsequent measurement, provisions are set aside for expected credit losses.

e) Embedded derivatives

Embedded derivatives are derivatives that are integrated into primary financial instruments.

Under IAS 39, derivatives that are embedded in financial assets, liabilities and non-financial host contracts were treated as standalone derivatives and measured at fair value if they met the definition of a derivative and if their economic characteristics and risks were not closely related to those of the host contract.

In accordance with IFRS 9, since 1 January 2018 we have separated only those derivatives that are embedded in financial liabilities and non-financial host contracts. Under IFRS 9, financial assets are assessed in their entirety. As a result, the host contract is no longer accounted for separately from the embedded derivative. Instead, financial assets are classified based on the business model and their contractual terms and conditions.

The separation must be made for financial liabilities in the financial statements if the following three conditions are met:

- The economic characteristics and risks of the embedded derivative are not closely related to those of the host contract.
- A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative under IFRS 9.
- The primary financial liability is not measured at fair value through profit or loss.

In this case, the embedded derivative to be separated is regarded as part of the held-for-trading category and is recognised at fair value. Changes on remeasurement are recognised in the gain or loss from financial assets and liabilities measured at fair value through profit and loss. The host contract is accounted for and measured applying the rules of the category to which the financial instrument is assigned.

If the above three conditions are not cumulatively met, the embedded derivative is not shown separately and the hybrid financial instrument or structured product is measured as a whole in accordance with the general provisions of the category to which the financial liability is assigned.

5.5 Financial assets and liabilities in accordance with IAS 39

General classification and measurement

In accordance with IAS 39 all financial assets and liabilities – which also include derivative financial instruments – had to be recognised in the balance sheet. A financial instrument is a contract that simultaneously gives rise to a financial asset for one entity and a financial liability or equity instrument for another. On initial recognition, financial instruments were measured at amortised cost, which generally corresponds to fair value. For financial instruments that are not measured at fair value through profit and loss, directly attributable transaction costs were included as acquisition-related costs. In accordance with IFRS 13, fair value is defined as the exit price, i.e. the price that the market participant would receive for the sale of an asset or pay to transfer a liability in an orderly transaction. The fair value is a price observed on an active market (mark-to-market) or determined using valuation models (mark-to-model). The relevant inputs for the valuation model are either observed directly on the market or are estimates made by experts. Depending on their respective category, financial instruments are recognised in the balance sheet subsequently either at (amortised) cost or fair value.

a) Recognition and derecognition of financial instruments

A financial asset or financial liability is generally recognised in the balance sheet when the Bank becomes a party to the contractual provisions of the financial instrument. For ordinary spot purchases or sales of financial assets in the cash market the trading and settlement dates normally differ. These ordinary spot purchases or sales may be recognised using either trade date or settlement date accounting. Regular-way spot purchases or sales of financial assets are recognised and derecognised on the settlement date.

The derecognition rules of IAS 39 were based both on the concept of risks and rewards and on the concept of control. However, when deciding whether an asset qualified for derecognition, the evaluation of the transfer of the risks and rewards of ownership took precedence over the evaluation of the transfer of control. If the risks and rewards were transferred only partially and control over the asset was retained, the continuing involvement approach was used. This means that the financial asset was recognised to the extent of the Group's continuing involvement and special accounting policies applied. The extent of the continuing involvement was the extent to which the Group was exposed to the risk of changes in the value of the transferred asset. A financial liability (or part of a financial liability) was derecognised when it was extinguished, i.e. when the obligations arising from the contract were discharged or cancelled or expired. The repurchase of own debt instruments was also a transfer of financial liabilities that qualified for derecognition. Any differences between the carrying value of the liability (including discounts and premiums) and the purchase price were recognised in profit or loss; if the asset was sold again at a later date a new financial liability was recognised at cost equal to the price at which the asset was sold. Differences between this cost and the repayment amount were allocated over the term of the debt instrument.

Some amendments of contractual terms and conditions, for example as a consequence of forbearance measures or restructuring, between borrowers and the Bank could lead to derecognition. A substantial modification of the contractual terms and conditions of a financial instrument between an existing borrower and the Bank led to the derecognition of

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the original financial asset and the recognition of a new financial instrument.

b) Categorisation of financial assets and liabilities and their measurement

The Bank classified its financial assets and financial liabilities in accordance with the applicable IFRS 39 categories:

Financial assets

- Loans and Receivables
- Available for Sale
- fair value option
- Held for Trading

Financial liabilities

- Amortised Cost
- fair value option
- Held for Trading

c) Net gains or losses

Net gains or losses included fair value measurements recognised in profit or loss, currency translation effects, impairments, impairment reversals, gains realised on disposal, subsequent recoveries on written-down financial instruments and changes recognised in the revaluation reserve classified in the respective IAS 39 categories. The components were detailed in the condensed statement of comprehensive income and in the notes on net interest income, loan loss provisions, other realised profit or loss, gain or loss from financial assets and liabilities measured at fair value through profit and loss and other net gain or loss from financial instruments.

d) Embedded derivatives

Embedded derivatives are derivatives that are integrated into primary financial instruments. These include, for example, reverse convertible bonds (bonds that may be repaid in the form of equities) or bonds with index-linked interest payments. Under certain conditions, the embedded derivative must be accounted for separately from the original host contract as a non-cover pool derivative. Such a separation had to be made if the following three conditions were met:

- The economic characteristics and risks of the embedded derivative were not closely related to those of the host contract.
- A separate instrument with the same terms as the embedded derivative would have met the definition of a derivative under IAS 39;
- the hybrid (combined) contract was not measured at fair value through profit or loss.

In this case, the embedded derivative to be separated was regarded as part of the held-for-trading category and was recognised at fair value. Changes on remeasurement were recognised in the gain or loss from financial assets and liabilities measured at fair value through profit and loss.

The host contract was accounted for and measured applying the rules of the category to which the financial instrument was assigned. If the above three conditions were not met cumulatively, the embedded derivative was not shown separately and the hybrid financial instrument (structured product) was measured as a whole in accordance with the general provisions of the category to which the financial instrument was assigned.

5.6 Hedge accounting

The improvements for hedge accounting contained in IFRS 9 aim to achieve further harmonisation between the accounting treatment of hedging relationships and (economic) risk management. As a result of the option provided in the standard, a decision was made to apply the previous IAS 39 regulations.

IAS 39 contains comprehensive rules on accounting for hedges, i.e. on the accounting treatment of hedging instruments (derivatives in particular) and the underlying transactions hedged by them. The general rule is that derivatives are classified as trading transactions (trading assets or liabilities) and measured at fair value, with the measurement result reported in net trading income.

Where derivatives are demonstrably used to hedge risks other than from trading, IAS 39 permits the use of hedge accounting, subject to certain conditions. Under IAS 39, hedges may be recognised in the form of fair value hedges or cash flow hedges. At present, the Bank only uses micro fair value hedge accounting.
On executing a transaction, the Bank documents the hedge between instrument and underlying, the risk(s) it is intended to manage and the strategy on which the hedge is based. The full fair value of the derivatives designated as hedging instruments is reported as a non-current asset or liability if the residual term of the underlying transactions hedged is longer than twelve months, and a current asset or liability where it is shorter than twelve months.

Fair value hedge accounting

IAS 39 prescribes the use of hedge accounting for derivatives which serve to hedge the fair value of assets or liabilities recognised in the balance sheet. The Bank's issuing and lending business is particularly subject to such a market value risk where fixed-interest financial instruments are involved. At present, only interest rate swaps are used to hedge these risks. In line with the regulations for fair value hedge accounting, financial derivatives used for hedging purposes are recognised at fair value under the balance-sheet items "Positive market values of derivative hedging instruments" and "Negative fair values of derivative hedging instruments". Changes in measurement are reported in the statement of comprehensive income as "net income from hedge accounting". Any changes in the fair value of the hedged asset or hedged liability resulting from an opposite move in the hedged risk are reported and likewise recognised as "net income from hedge accounting" in the statement of comprehensive income.

Fair value hedge accounting for interest rate risk can take the form either of a micro fair value hedge or a portfolio fair value hedge:

- In micro fair value hedge accounting an underlying transaction is linked with one or more hedging transactions in a hedging relationship. If they change in value, the carrying amounts of individual hedged and hedging transactions are adjusted through profit or loss.
- In a portfolio fair value hedge, interest rate risks are hedged at the portfolio level. What is hedged is not individual transactions or groups of transactions with a similar risk structure, but rather an amount of underlying fixed-interest transactions in a portfolio grouped by maturity bands.

Only micro fair value hedge accounting is used within the Bank. Hedges are dissolved once the criteria for the use of hedge accounting are no longer met. In this event, any hedge adjustments from the moment of dissolution of the hedge are released over the remaining term of the underlying transaction.

Application of the hedge accounting rules contained in IAS 39 is subject to the condition that there must be evidence of an effective hedge throughout the period of the hedge. Effectiveness of the fair value hedge means the relationship between the change in fair value of the hedged underlying transaction and the change in fair value or cash flow of the hedging instrument. If these changes offset each other almost fully, a high degree of effectiveness exists.

Proof of effectiveness requires, on the one hand, that a high degree of effectiveness can be expected from a hedge in the future (prospective effectiveness), and, on the other, that when a hedge exists, it must be regularly demonstrated that it was highly effective during the period under review (retrospective effectiveness). Both retrospective and prospective effectiveness must be within a range of 0.8 to 1.25. The Bank uses regression analysis for the prospective effectiveness test of micro fair value hedge accounting. The changes in fair value of the hedged transaction and the hedging instrument are determined by means of historical simulations, while the actual changes in fair value are used for the retrospective effectiveness test.

Within micro fair value hedge accounting, the causes of ineffective hedging lie primarily in the risk contained in the measurement of the fair value of the hedging instruments – mainly interest rate swaps – which cannot be used in determining the fair value of the hedged item. As a result, the changes in fair value of the respective hedging instrument are not fully offset by the changes in fair value of the hedged item, even though the hedging relationship is fully hedged economically. The most significant risk in this context is the underlying risk.

5.7 Cash reserve

The Bank's cash reserve is made up of cash on hand and credit balances with central banks. These are reported at their nominal value.

5.8 Financial assets – Amortised Cost

If the contractually agreed cash flows of a financial assets merely constitute interest and principal payments (i.e. they are SPPI-compliant) and the asset was allocated to the "hold to collect" business model, the asset is measured at amortised cost. The carrying amount of these financial instruments is reduced by the loan loss provision (see Note 8.6).

Interest payments for these financial instruments are recognised in net interest income according to maturity, and pre-

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miums and discounts are recognised through the income statement in net interest income over the life of the liability.

5.9 Financial assets – Loans and Receivables

Non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market were assigned to this category in the previous year in accordance with IAS 39. This was true regardless of whether they were originated by the Bank or acquired in the secondary market. An active market existed if quoted prices were readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represented actual and regularly occurring market transactions on an arm's length basis. Measurement of these assets was at amortised cost. If there was impairment, this was recognised in profit or loss when determining the amortised cost. Premiums and discounts were recognised in net interest income over the life of the asset.

For securities, impairments were recognised in the same way as for lending business (see Annual Report 2017, Note 5.16). Impairment of these financial instruments was included in loan loss provisions and deducted directly from the balance-sheet item. If the indicators for impairment of given securities ceased to apply or no longer suggested an impairment, the impairment of the securities in question was reversed through profit or loss, but to no more than the level of amortised cost. Similarly, an improved risk environment could lead to the reversal of an impairment that was previously recognised at the portfolio level.

5.10 Financial assets – Available for Sale

In accordance with IAS 39, this category comprised all non-derivative financial assets not assigned to one of the other categories or designated for the category "Financial assets – available for sale". The securities concerned were interest-bearing. Available-for-sale assets primarily comprised fixed-income securities that were traded on an active market but which the Bank did not intend to sell in the short term. They were measured at fair value. Where the fair value could not be ascertained from active market data, the measurement was generally carried out using comparative and indicative prices from pricing service providers or other banks (lead managers) or using internal measurement procedures (net present value or option price models).

5.11 Financial assets – Mandatorily Fair Value P&L

This item includes financial instruments that are allocated to the residual business model and not reported in financial assets – held for trading.
In addition, transactions allocated to the "hold to collect" and "hold to collect and sell" business model are included here if they are not SPPI-compliant.

5.12 Financial assets and liabilities – Held for trading

This category includes interest-rate related derivative financial instruments (derivatives that do not qualify for hedge accounting) as well as other trading portfolios allocated to the residual business model and held for trading.

Irrespective of the type of product, these financial assets are measured at fair value through profit or loss. The fair value changes of the transaction in question are thus reported through profit and loss in the income statement. Where the fair value cannot be ascertained from active market data, the measurement is generally carried out on the basis of comparative and indicative prices from pricing service providers or other banks (lead managers) or internal measurement procedures (net present value or option price models).
Interest income and expenses and gains or losses on measurement and disposal from these financial instruments are recorded in the income statement under net income from financial assets and liabilities measured at fair value through profit and loss.

5.13 Positive and negative fair values of derivative hedging instruments

This item shows derivative financial instruments that are used for hedging purposes and qualify for micro fair value hedge accounting. The hedging instruments are measured at fair value. Measurement gains or losses on fair value hedges from hedge accounting are reported under net income from hedge accounting in the statement of comprehensive income.

In 2017, interest income and interest expenses from derivative hedging instruments were still reported under net interest income. Starting in 2018, we have brought our reporting of interest income and interest expenses to the methodology used in the Commerzbank Group. We now recognise this interest under net income from financial assets and liabilities measured at fair value through profit and loss. The effects from the separate reporting are presented in Note 5.2 in the section "Adjustments".

5.14 Credit risks and credit losses

Authority to determine the methods and parameters for the risk measurement programmes rests with Commerzbank AG. It is, however, ensured that Commerzbank Finance & Covered Bond S.A. has a full overview of all its risks.

Risk management at Commerzbank Finance & Covered Bond S.A. is methodologically and organisationally integrated within the Commerzbank Group. The various risks are managed using a framework of guidelines, structured limits and a holistic risk management system, all of which are standard throughout the company. For the purpose of the quantitative measurement, monitoring and control of specific risks, the Group uses established systems and control mechanisms, which are regularly reviewed and adapted to current business trends.

In managing its risks, Commerzbank Finance & Covered Bond S.A. uses the methodologies and systems established in the Commerzbank Group. This is reflected in the close integration of the Bank's local risk functions with their Group counterparts.

Principles and measurements in accordance with IFRS 9

IFRS 9 stipulates that impairments for credit risks from loans and securities that are not recognised at fair value through profit or loss must be recognised using a 3-stage model based on expected credit losses. The following financial assets are generally included in the scope of this impairment model:

- financial assets in the form of loans and advances as well as securitised debt instruments measured at amortised cost;
- financial assets in the form of loans and advances as well as securitised debt instruments measured at fair value through other comprehensive income (FVOCImR);
- lease receivables;
- irrevocable lending commitments which under IFRS 9 are not measured at fair value through profit or loss;
- financial guarantees within the scope of IFRS 9 that are not measured at fair value through profit or loss.

The Bank determines the impairment using a 3-stage model based on the following requirements:

In **Stage 1**, as a rule all financial instruments are recognised if their risk of a loan loss (hereinafter default risk) has not risen significantly since their initial recognition. In addition, Stage 1 includes all transactions with limited default risk as at the reporting date for which the Bank utilises the option provided for in IFRS 9 to refrain from making an assessment about a significant increase in the default risk. A limited default risk exists for all financial instruments with an investment grade internal credit rating as at the financial reporting date (corresponds to a Commerzbank rating of 2.8 or better). An impairment must be recognised for financial instruments in Stage 1 in the amount of the expected credit loss over the next 12 months (12-month ECL).

Stage 2 includes those financial instruments with default risk that has risen significantly since their initial recognition and which, as at the financial reporting date, cannot be classified as transactions with limited default risk. Impairments in Stage 2 are recognised in the amount of the financial instrument's lifetime expected credit loss (LECL).

Financial instruments that are classified as impaired as at the reporting date are allocated to

Stage 3. The Bank's criterion for this classification is the definition of a default in accordance with Art. 178 of the Capital Requirements Regulation (CRR). This approach is consistent because the ECL calculation also uses statistical risk parameters derived from the Basel IRB approach, which are modified to meet the requirements of IFRS 9. The following events can be indicative of a customer default:

- Imminent insolvency (over 90 days past due);
- The Bank is assisting the customer in its financial rescue/restructuring measures, with or without restructuring contributions;
- The Bank has demanded immediate repayment of its claims;
- The customer is in insolvency proceedings.

The LECL is likewise used as the value of the required impairment for Stage-3 financial instruments in default. Apart from the fact that only loans which meet the definition of default can be allocated to Stage 3, stages 2 and 3 also differ regarding the recognition of interest income. In Stage 2 (as in Stage 1) interest and impairments are recognised separately and interest income is calculated on the basis of the gross carrying amount. By contrast, in Stage 3 interest income is

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calculated on the basis of amortised cost (i.e. based on the gross carrying amount after deducting provisions for losses).

When determining the LECL in Stage 3, the Bank distinguishes in principle between significant and insignificant cases. The amount of the LECL for insignificant transactions (volumes up to €5m) is determined based on statistical risk parameters. The LECL for significant transactions (volumes greater than €5m) is the expected value of the losses derived from individual expert assessments of future cash flows based on several potential scenarios and their probability of occurrence. The scenarios and probabilities are based on assessments by recovery and resolution specialists. For each scenario – whether it is a continuation or sale scenario – the timing and amount of the expected future cash flows are estimated. Both the customer-specific and the macroeconomic situation are taken into account (for example currency restrictions, currency value fluctuations, commodity price developments), as well as the sector environment, with a view to the future. The estimate is also based on external information. Sources include indices (e.g. World Corruption Index), forecasts (e.g. by the IMF), information from global associations of financial service providers (e.g. the Institute of International Finance) and publications from rating agencies and auditing firms.

If there is no longer a default criterion, the financial instrument recovers and is no longer allocated to Stage 3. After recovery, a new assessment is made based on the updated rating information to see if the default risk has increased significantly since initial recognition in the balance sheet, and the instrument is allocated to Stage 1 or Stage 2 accordingly.

Financial instruments which when initially recognised are already considered impaired as per the aforementioned definition (purchased or originated credit-impaired, or POCI) are handled outside the 3-stage impairment model and are therefore not allocated to any of the three stages. The initial recognition is based on fair value without recording an impairment, using an effective interest rate that is adjusted for creditworthiness. The impairment recognised in subsequent periods equals the cumulative change in the LECL since the initial recognition in the balance sheet. The LECL remains the basis for the measurement, even if the value of the financial instrument has risen.

Receivables are written off and derecognised from the balance sheet as soon as they become uncollectible. Firstly, uncollectibility may arise in the settlement process based on various objective criteria. These can be, for example, completed insolvency proceedings without further prospect of payments. Secondly, loans are generally regarded as (partially) uncollectible at the latest by 720 days after their due date, and are (partially) written down to the recoverable amount within the framework of existing loan loss provisions. Such a (partial) write-down has no direct impact on ongoing debt collection measures.

Calculation of the expected credit loss in accordance with IFRS 9

The Bank calculates the LECL as the probability-weighted, unbiased and discounted expected value of future loan losses over the total residual maturity of the respective financial instrument, i.e. the maximum contractual term (including any renewal options) during which the Bank is exposed to credit risk. The 12-month ECL used for the recognition of impairments in Stage 1 is the portion of the LECL that results from default events which are expected to occur within twelve months following the end of the reporting period.

The ECL for Stage 1 and Stage 2 as well as for insignificant financial instruments in Stage 3 is determined on an individual transaction basis taking into account statistical risk parameters. These parameters have been derived from the Basel IRB approach and modified to meet the requirements of IFRS 9. The significant main parameters used in this determination include the:

- customer-specific probability of default (PD);
- loss given default (LGD); and the
- exposure at default (EaD).

The Bank derives the PD by applying an internal ratings procedure, which is based on the respective customer group. The determination includes a wide variety of qualitative and quantitative variables, which are taken into account or weighted based on the respective procedure. The allocation of the PD ranges to the internal rating categories and the reconciliation to external ratings can be found in the master scale contained in the risk report.

The LGD is the forecasted loss given default as a percentage of the exposure at default (EaD), taking into account collateral and the capital recovery potential on the unsecured portion. The Bank's estimates, which are made specifically for different types of collateral and customer groups, are determined using both observed historical portfolio data and diverse external information, such as indices and data regarding the development of purchasing power.

The EaD is the expected loan utilisation as at the default date, taking into account a (partial) drawing of open lines.

All risk parameters used from the Bank's internal models have been adjusted to meet the specific requirements of IFRS 9, and the forecast horizon has been extended accordingly to cover the entire term of the financial instruments. For example, the forecast for the change in the exposure over the entire term of the financial instrument therefore also includes, in particular, contractual and statutory termination rights.

As a rule, the Bank estimates the risk parameters specific to IFRS 9 based not only on historical default information but also, in particular, on the current economic environment (point-in-time perspective) and forward-looking information. This assessment primarily involves reviewing the effects which the Bank's macroeconomic forecasts will have regarding the amount of the ECL, and including these effects in the determination of the ECL. A baseline scenario is used for this purpose which relies on the respective applicable consensus (forecasts of different banks on significant macroeconomic factors, such as GDP growth and the unemployment rate). This baseline scenario is then supplemented with additional macroeconomic parameters that are relevant for the model. The transformation of the macroeconomic baseline scenario into the effects on the risk parameters is based on statistically derived models. If needed, these models are supplemented with expert-based assumptions. Potential effects from non-linear correlations between different macroeconomic scenarios and the ECL are corrected using a separately determined adjustment factor.

All parameters used when determining the ECL are regularly validated by an independent unit (usually once a year). If needed, they are adjusted accordingly.

Assessment of a significant increase in default risk

Commerzbank AG's rating systems, which are also used for the Bank, combine into the PD all available quantitative and qualitative information relevant for forecasting the default risk. This metric is based primarily on a statistical selection and weighting of all available indicators. In addition, the PD adjusted in accordance with IFRS 9 requirements takes into account not only historical information and the current economic environment, but also, in particular, forward-looking information such as the forecast for the development of macroeconomic conditions.

As a consequence, the Bank uses the PD only as a frame of reference for assessing whether the default risk of a financial instrument has risen significantly since the date of its initial recognition. By anchoring the review of the relative transfer criterion in the robust processes and procedures of the Bank's Group-wide credit-risk-management framework (in particular, early identification of credit risk, controlling of overdrafts and the re-rating process), the Bank ensures that a significant increase in the default risk is identified in a reliable and timely manner based on objective criteria. For cases with an overdraft that exceeds 30 days, it has been demonstrated that this trigger is already covered by the ratings and/or the rating process. No such overdrafts were in existence as at the reporting date, however.

For further information on the Bank's processes and procedures as well as governance in credit risk management, please refer to the explanatory information in the risk report (section 6).

The review to determine whether the default risk as at the financial reporting date has risen significantly since the initial recognition of the respective financial instrument is performed as at the end of the reporting period. This review compares the observed probability of default over the residual maturity of the financial instrument (lifetime PD) against the lifetime PD over the same period as expected on the date of initial recognition.

Thresholds are set using a statistical procedure in order to determine whether an increase in the PD compared with the initial recognition date is "significant". These thresholds, which are differentiated by rating models, represent a critical degree of variance compared with the average development of the PD. In order to ensure an economically sound assignment of the stage, transaction-specific factors are taken into account, including the extent of the PD at the initial recognition date, the term to date and the remaining term of the transaction.

Financial instruments are retransferred from Stage 2 to Stage 1 if at the end of the reporting period the default risk is no longer significantly elevated compared with the initial recognition date. The relevant rating information determines whether a retransfer back to a stage with a lower credit risk takes place.

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Provisions for on- and off-balance-sheet loan losses in accordance with IAS 39

The particular risks in on- and off-balance-sheet lending business has been addressed by the recognition of specific loan loss provisions (SLLPs) and general loan loss provisions (GLLPs).

When determining provisioning levels, a fundamental distinction was drawn between those claims which are in default and those which are not. All claims which are in default under the Basel 3 regulations were identified as in default or non-performing. The following events can be indicative of a customer default:

- Imminent insolvency (over 90 days past due).
- The Bank is assisting in the financial rescue/restructuring measures of the customer with or without restructuring contributions.
- The Bank has demanded immediate repayment of its claims;
- The customer is in insolvency proceedings.

For claims which are in default, we recognised specific loan loss provisions in accordance with uniform standards. The net present value of the expected future cash flows was used to calculate both the specific valuation allowances as well as specific loan loss provisions (SLLPs). In addition to the expected payments from the borrower the cash flows included the expected proceeds from realising collateral and other recoverable cash flows. The loan loss provision or valuation allowance was therefore equal to the difference between the carrying value of the loan and the net present value of all the expected cash flows. The increase in the net present value over time using the original effective interest rate (unwinding) was recognised as interest income. If the reason for the impairment ceased to apply, it was reversed through profit or loss.
In the case of non-defaulted claims, the Bank set aside a portfolio loan loss provision (PLLP) on the basis of internal parameters.

Where the total loan loss provision related to claims recognised on the balance sheet, it was deducted directly from the respective asset item. However, the provision for losses in off-balance-sheet business (e.g. contingent liabilities and irrevocable lending commitments) was shown under provisions for lending business.

Uncollectable portions of claims were likewise written down against previously recognised loan loss provisions. Amounts recovered on claims written off were recognised in the income statement under loan loss provisions

5.15 Transferred financial assets and collateral pledged for own liabilities

Repo transactions combine the spot purchase or sale of securities with their forward sale or repurchase, the counterparty being identical in both cases. Securities sold under repurchase agreements (spot sale) continue to be recognised and measured in the balance sheet in accordance with the underlying category as part of the securities portfolio. The securities are not derecognised, as all risks and rewards associated with the ownership of the security sold under the repurchase agreement were retained. The same risks and opportunities that apply to non-transferred financial assets thus also apply to financial assets that have been transferred but not derecognised.
Securities lending transactions are concluded with other banks in order to meet delivery commitments or to enable the Bank to effect securities repurchase agreements. These transactions are reported in a similar manner to genuine repurchase transactions. Securities lent remain in the Bank's securities portfolio and are classified and measured according to the rules of IFRS 9. Borrowed securities do not appear in the balance sheet, nor are they valued. In securities lending transactions, the counterparty credit risk can be avoided by obtaining collateral, which may be provided in the form of cash, for example. Collateral furnished for a securities lending transaction is referred to as "cash collateral out" and collateral received as "cash collateral in". In addition, cash collaterals are deposited or received as collateral in connection with derivative transactions.

5.16 Fixed and intangible assets

Fixed assets are shown at acquisition or production cost. Acquisition costs comprise expense directly attributable to the purchase. Where such assets are subject to wear and tear, they are depreciated on a straight-line basis over their expected useful life.
Fixed assets are depreciated over their expected useful life as follows:

	Impairment Rate	Method
Office furniture and equipment	20 %	linear
IT (hardware)	25 %	linear

Fixed assets are tested for impairments if events or changed circumstances suggest that an impairment might have occurred. In such situations, the impairment test under IAS 36 is carried out. Unscheduled write-downs are carried out where the impairment can be expected to be permanent. If the reasons for the write-down cease to apply, it is reversed up to no more than the amortised cost of acquisition or production.

For reasons of materiality, acquisition costs of low-value assets are recognised directly as administrative expense during the period. Interest on debt used to fund fixed assets is not capitalised. Maintenance work on fixed assets is recorded as administrative expense in the financial year in which it is carried out. Depreciation is reported as administrative expense. Gains and losses from the sale of fixed assets are reported under other net income in the statement of comprehensive income.

The Bank recognises an acquired customer base as intangible assets, at amortised cost. Due to its finite useful economic life, the customer base is written off on a straight-line basis over its prospective useful life. The assets are also reviewed at every reporting date to determine whether the carrying amount exceeds the amount recoverable. If so, an impairment is recognised. The acquired customer base is written down over 4.5 years.

5.17 Taxes

Current tax assets and liabilities are calculated using the currently applicable tax rates at which payment is made to, or reimbursement received from, the tax authority concerned.

Deferred tax assets and liabilities are recognised to reflect differences between the IFRS carrying amounts of assets or liabilities and their taxable value (liability method), where these are likely to result in increases or reductions in future taxes on income (temporary differences). In addition, deferred tax assets are recognised for both tax loss carryforwards and unused tax credits, subject to the applicable conditions being met.
Commerzbank Finance & Covered Bond S.A., together with other Luxembourg companies belonging to the Commerzbank Group, has, since 2011, constituted a tax group for corporation and business tax purposes. Its parent company is the Luxembourg branch of Commerzbank AG. To compensate for the tax effects resulting from this tax group, the companies participating in it have entered into an apportionment agreement, which is also the basis for the accounting treatment.
The measurement of deferred taxes is based on income tax rates set as at 31 December 2018 and applicable upon realisation of the temporary differences. Deferred tax assets are recognised only if it is probable that taxable profits will arise in the same tax unit or tax group in future. Tax assets and liabilities may not be discounted. Depending on the treatment on the underlying situation, deferred tax assets and liabilities are recognised and carried forward either under taxes on income in the income statement or directly in equity in the relevant equity item. The Bank classifies deferred tax items in the balance sheet as non-current.

Deferred income tax assets and liabilities are netted if there is a right to net current taxes on income and the deferred tax assets and liabilities relate to taxes on income levied by the same fiscal authority on the same taxable entity.

Tax income and expense are reported as taxes on income in the statement of comprehensive income and broken down in the Notes into current and deferred tax assets and liabilities in the financial year. Other taxes not dependent on income are shown under other net operating income. Current and deferred income tax assets and liabilities are reported in the balance sheet as asset and liability items respectively.

The distinctions between current and deferred tax assets and between current and deferred tax liabilities are explained in Notes 8.12 und 9.7.

Reported equity declined by €0.9bn as part of the adoption of IFRS 9. Deferred tax assets of €0.2bn were recognised on this amount. Even taking into account the participation in the tax group with Commerzbank AG, Luxembourg branch, we do not expect to generate sufficient profits in the coming five years to use recognised deferred tax assets. Consequently, no deferred tax assets were recognised in the context of the switch to IFRS 9 as at 1 January 2018.

5.18 Financial liabilities – Amortised Cost

As a rule, financial liabilities must be subsequently measured at amortised cost. We have detailed the exceptions to this general classification in the above items within Notes 5.3 and

5.4. Deposits essentially include cash due on demand and time deposits.

Under other debt instruments issued we also report subordinated securitised and non-securitised issues which, in the event of an insolvency or liquidation, are only repaid once all non-subordinated creditors have been satisfied.

5.19 Provisions

A provision must be recognised if on the reporting date, as the result of an event in the past, a current legal or factual obligation has arisen, an outflow of resources to meet this obligation is likely and it is possible to make a reliable estimate of the amount of this obligation. For that reason, provisions are made for liabilities of an uncertain amount to third parties and anticipated losses arising from pending transactions in the amount of the claims expected.
The amount recognised as a provision represents the best possible estimate of the expense required to meet the current obligation as at the reporting date. This estimate takes account of risks and uncertainties. If the interest rate effect is material, provisions are recognised at net present value.
Allocations to the different types of provisions are made through various items in the statement of comprehensive income. Provisions for lending business are charged to loan loss provisions. Other provisions are generally recognised as administrative expense.

5.19.1 Provisions for pensions and similar commitments

Occupational pension provision for active and former employees and their survivors is based on various schemes (defined benefit and defined contribution plans).

Under a defined contribution plan, employees acquire an entitlement to a pension from an external pension scheme on the basis of contributions made. The Bank helps to fund this by paying a fixed contribution to external pension providers.

In this case, the amount of present and future pension benefits is determined by the contributions paid and the income generated by associated assets. The IFRS accounting rules for defined contribution plans are applied to such indirect schemes, so the contributions to the external pension provider are recognised as personnel expenses. No provisions are created.

There are also obligations arising out of entitlements to pensions and current benefits under the defined benefit plans operated by the Bank, based on a direct pension commitment on its part, where the level of the pension payment is predefined and dependent on factors such as age, salary level and length of service. As IAS 19 accounting principles for defined benefit pension plans apply to these pension schemes, provisions are recognised. The pension expenses recorded under personnel costs for direct pension commitments is made up of several components: First, from the service cost, which represents the entitlements earned by members during the financial year, and secondly from the interest cost on the net present value of the pension obligations, since the moment at which the pension obligations have to be met has moved closer by one period. Moreover, the amount of pension expense is influenced by the change in actuarial gains or losses not previously recognised in profit or loss. Where direct pension commitments have been changed, resulting in a change to the obligation to pay benefits, past service cost or income is reported.

With defined benefit plans, pension obligations and similar obligations (age-related short-time working, early retirement, long service awards) are calculated annually by an independent actuary using the projected unit credit method. In performing this calculation, the actuary draws not only on biometric assumptions (e.g. the Heubeck mortality tables) but also and in particular on an up-to-date market interest rate on prime long-term corporate bonds, fluctuation and career trends and expected rates of increase in salaries and pensions.

Actuarial gains and losses are reported immediately in equity and to their full amount.

At the same time, past service costs resulting from retrospective plan changes are reported immediately and in full through profit or loss. As a consequence of these changes, the netting of pension obligations and plan assets leads to the full net pension obligation being shown in the financial statements. In addition, where pension obligations are funded from plan assets, the amended IFRS requires net interest costs to be determined. This is the interest applied to the net liabilities or net assets (the defined benefit obligation less fair value of the plan assets) using a consistent interest rate.

Apart from the usual pension plan risks such as inflation risks and biometric risks the Bank has no discernible unusual risks.

5.19.2 Restructuring provisions

Restructuring provisions are recognised if the Bank has a detailed formal restructuring plan and has already begun implementing this plan or has announced the main details of the restructuring. The detailed plan sets out the costs associated with the restructuring and the period over which the restructuring is to be carried out. The detailed plan must be communicated in such a way that those affected can expect it to be put into effect.

5.19.3 Employee remuneration plans

1. Description of the Commerzbank Incentive Plan (CIP)

The Commerzbank Incentive Plan (CIP), which was first launched in 2011, sets out the detailed rules for variable remuneration and applies to the entire Commerzbank Group. Accordingly, CFCB is also part of this programme. The CIP is an equity-settled plan with a cash settlement option for the employer, which falls within the scope of IFRS 2.

Under the CIP, employees designated as risk takers can receive parts of their individual variable remuneration as a cash component and a stock component, linked to the performance of the Commerzbank share. The variable remuneration consists of a short-term incentive (STI) and, in the case of risk takers whose variable remuneration exceeds the risk taker limit, a long-term incentive (LTI).

A risk-taker is an employee whose activities have a significant impact on the Bank's overall risk profile. The criteria include the function carried out by the employee, the group to which the employee belongs and whether certain requirements determined by the Bank are met. Depending on the employee's hierarchical level and the risk relevance of their role, the Bank designates what kind of risk taker the employee is: "risk taker I" or "risk taker II". Risk taker I status applies to employees whose role entails a higher risk relevance.

The risk taker limit is the amount up to which the payment of a risk taker's entire variable remuneration for a financial year as a cash STI payment is tolerated by the supervisory authorities, subject to general salary levels in the banking sector. For risk takers whose variable remuneration does not exceed the risk taker limit, and for employees without risk taker status (non-risk takers), variable remuneration is paid entirely as STI in cash rather than shares. Only if the risk taker limit is exceeded is the variable remuneration divided up into STI and LTI components subject to the CIP rules applying to these components. No risk taker exceeded the limit during the year under review.

The following rules apply once the risk taker limit has been exceeded:

For the risk taker I category, the STI component is 40% and the LTI component is 60% of the potential variable remuneration. 50% of both the STI and LTI are paid in shares.
For the risk taker II category, the STI component is 60% and the LTI component is 40% of the potential variable remuneration. 50% of both the STI and LTI are paid in shares.

An individual's variable remuneration is determined on the basis of the results of their annual target attainment meeting (performance appraisal I), which is held in the first three months of the following financial year. The number of Commerzbank shares granted is set at the same time as the variable remuneration for both the STI and the LTI. If risk takers receive share-based remuneration components, the number of Commerzbank shares is calculated by dividing 50% of the euro amounts in the STI and the LTI by the subscription price. If there are any fractional amounts the number of shares is rounded up.
The subscription price for the variable remuneration set until the financial year 2018 is the simple arithmetic average of the Xetra closing prices of the Commerzbank share on all trading days during the reference period (December of the previous year and January and February of the next year). For the variable remuneration that has been set from the financial year 2019 onwards, the reference period for the subscription price is the month of January of the year following the financial year.

Under the rules of the share-based remuneration components Commerzbank has the right to make a payment in cash rather than in shares. Use is made of this option as a rule. In the STI, the shares, or the optional cash settlement, were subject to a six-month lockup ("retention period"), for the variable remuneration set until the financial year 2018.
From the financial year 2019, the retention period will be at least 12 months. This means that in the future the share component of the STI of the financial year will be paid out in April of the second following financial year (n+2) instead of in October of the following financial year (n+1).

In the LTI, variable remuneration set for the financial years up to and including 2018 may be acquired at the earliest after the expiry of a three-year deferral period, provided there are no other grounds under performance appraisal II to block the allocation. Starting from the financial year 2019, risk taker I

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can acquire it at the earliest after five years and risk taker II at the earliest after three years.

Performance appraisal II is held after the end of the deferral period and consists of a review of the underlying performance appraisal I and fulfilment of individual and Group-specific qualitative targets during the deferral period. In the LTI, if a claim arises, the shares or the optional cash settlement are also subject to a retention period, as in the STI. Until now the LTI has been paid out in October of the fourth year after the underlying financial year.

The payment of variable remuneration which is set from the 2019 financial year onwards will be made after completion of the performance appraisal II for risk taker I, for LTI Cash in November of the sixth year (n+6), and for LTI Equity in October of the seventh year (n+7). For risk taker II, LTI cash will be paid in November of the fourth year (n+4) and LTI equity in October of the fifth year (n+5).

In the event of a cash settlement of the share component the cash amount is calculated on the basis of the simple arithmetic average of Xetra closing prices of the Commerzbank share on all trading days during the reference period. The reference period for entitlement to variable remuneration set until the 2018 financial year is the month of September preceding the due date of the respective share-based remuneration components.
The reference period for entitlement from the financial year 2019 onwards is the last full calendar month preceding the end of the retention period of the respective share-based remuneration components.

If Commerzbank has paid dividends or carried out capital actions during the term of the CIP, then, for equity components with variable remuneration set until the financial year 2018, an additional cash amount equal to the dividend per share, or a cash settlement for the capital action, will be paid out when the STI and LTI components mature. From the financial year 2019 onwards, no entitlement to compensation for dividends or subscription rights paid or granted to shareholders arises in the deferral period, unlike the retention period.

The various remuneration components are estimated in the underlying financial year on the basis of budget forecasts, and provisions are recognised proportionally over the lifetime of the plans. Moreover, regular reviews, revaluations based on movements in the share price and/or adjustments of the amounts are carried out throughout the lifetime of the CIP.

The changes to the remuneration entitlement in the three-year retention period are treated as non-vesting conditions.

Accounting and valuation of share-based payment and bonus plans

The CIP is accounted for under the rules of IFRS 2 – Share-based Payment and IAS 19 – Employee Benefits. A distinction is made between share-based remuneration payments settled in the form of equity instruments and those settled in cash. For both types of remuneration, however, the grant of share-based payments has to be recognised at fair value in the annual financial statements.

2. Accounting
Equity-settled share-based remuneration transactions:
The fair value of share-based remuneration payments settled in the form of equity instruments is recognised as personnel expense and reflected within equity in retained earnings. The fair value is determined on the date on which the rights are granted. If rights cannot be exercised because the conditions for exercise are not met due to market conditions, no change is made to the amounts already recognised in equity.

However, if rights cannot be exercised because other conditions for exercise are not met (service and non-market conditions), the amounts already recognised in equity are adjusted through profit or loss.

Cash-settled share-based remuneration transactions:

The portion of the fair value of share-based remuneration payments settled in cash that relates to services performed up to the date of measurement is recognised as personnel expense while at the same time being recorded as a provision. The fair value is recalculated on each reporting date up to and including the settlement date. Any change in the fair value of the obligation must be recognised through profit or loss. On the date of settlement, therefore, the provision must correspond as closely as possible to the amount payable to the eligible employees.

The provisions fluctuate on each subsequent reporting date in parallel with the performance of the Commerzbank Aktiengesellschaft share price. This affects the portion of the share-based variable remuneration that was determined using an average price for the Commerzbank share. The price itself is determined as the average Xetra closing price of the months of January and February plus December of the previous year.

If Commerzbank Aktiengesellschaft pays dividends during the vesting period, a cash payment equal to the dividend, or cash compensation for a capital action, will be paid out for each CIP and share award at the payout date in addition to the payout value. Provisions are recognised for these payments if applicable.

Personnel expenses are spread over the three financial years, which form the basis for the achievement of individual targets.

Measurement
The provision for the Commerzbank Incentive Plan is measured by multiplying the number of shares earned by participants by the closing price of the Commerzbank share on 31 December of the year under review. The expense for the allocations to the provisions can also be recognised over the vesting period of four years, depending on the remuneration plan.

Expenses relating to employee remuneration plans in connection with the Commerzbank Incentive Plan were incurred in 2018 only in the form of a cash settlement (see Note 7.10.2).

5.20 Equity

According to IFRS, equity constitutes a residual interest in the assets of an undertaking after deduction of all its obligations or claims and is not capable of being cancelled by the provider of capital.

5.21 Irrevocable lending commitments

Irrevocable lending commitments are obligations potentially giving rise to a credit risk in future. These include obligations to grant loans (e.g. lines externally notified to customers), to buy securities or provide financial guarantees or acceptances.

Provisions for risks in respect of irrevocable lending commitments are included in provisions for loan losses. No irrevocable lending commitments existed as at 31 December 2018, only a contingent liability towards the Single Resolution Board.

5.22 Leases

Under IAS 17, a lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership to the lessee. Leases where the lessor bears substantially all the risks and rewards are classified as finance leases. The net present value of the lease payments is central to determining the risks and rewards of the lease. If the net present value is at least equal to the amount invested into the leased asset, the lease is classified as a finance lease. If the risks and rewards of ownership remain substantially with the lessor (an operating lease), the asset will continue to be recognised on its balance sheet. Leased assets are shown at acquisition or production cost, less depreciation over their useful economic lives and/or impairments. The Bank has no financial leases; its obligations on the basis of operating leases are explained in Note 9.10 and relate to properties and motor vehicles.

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6 Risk Report

6.1 Central administration, internal governance and risk management

The duties imposed by the current version of circular CSSF 12/552 are an established fact of life and day-to-day business practice at Commerzbank Finance & Covered Bond S.A. The key functions are in place and guidelines on them have been published for internal use. The process is reviewed annually.

The Bank complies in full with its requirements within the bounds of the proportionality principle.

6.2 Risk strategy

Risk management at Commerzbank Finance & Covered Bond S.A. is methodologically and organisationally integrated within the Commerzbank Group. The various risks are managed using a framework of guidelines, structured limits and a holistic risk management system, all of which are standard throughout the company. For the purpose of the quantitative measurement, monitoring and control of specific risks, the Group uses established systems and control mechanisms, which are regularly reviewed and adapted to current business trends.

6.3 Risk-oriented overall bank management

6.3.1 Risk management organisation

The Bank defines risk as the danger of possible losses or profits foregone due to internal or external factors. In risk management, a fundamental distinction is drawn between those risks that are quantifiable – i.e. usually measurable in the annual financial statements or in regulatory capital requirements – and those that are not quantifiable, such as reputational risk.

Risk management operations are the direct responsibility of the relevant Managing Director, who is also a member of the Board of Directors. This manager is responsible for the application of the risk policy principles adopted by the Board of Directors to address quantifiable risks, and reports to the Board of Directors on the Bank's overall risk position at least twice a year.

6.3.2 Integration into the Group

In managing its risks, Commerzbank Finance & Covered Bond S.A. collaborates very closely with the risk functions of the Commerzbank Group and, as a result, uses the methodologies and systems established in the Group.

Due to this close integration in the Group risk functions, the decision-making with regard to management parameters, e.g. the limits, takes place in close consultation between Commerzbank Finance & Covered bonds S.A., its governing bodies and the governing bodies of the Commerzbank Group.

6.3.3 Risk-bearing capacity

Risk-bearing capacity analysis is a key part of overall bank management and Commerzbank Finance & Covered Bond S.A.'s Internal Capital Adequacy Assessment Process (ICAAP).

The objective is to determine a level of capital adequacy appropriate to the Bank's risk position. To this end, Commerzbank Finance & Covered Bond S.A. uses Commerzbank AG's risk-bearing capacity concept. Risk-bearing capacity is monitored using a "gone concern" approach which seeks primarily to protect unsubordinated lenders. The intention is that this objective should be achieved even in the event of extraordinarily high losses from an unlikely extreme event. The gone concern approach is supplemented by elements aimed at ensuring the institution's continuing existence ("going concern" perspective).

To this end, as part of the risk-bearing capacity calculation, the economic capital requirements are compared against the economic risk coverage potential.

The quantification of the economic risk coverage potential is based on a differentiated view of the accounting values of assets and liabilities and involves economic valuations of certain balance-sheet items, e.g. hidden liabilities.

The economic capital requirement is quantified using the internal economic capital model. The model's confidence level of 99.91% (holding period of one year) is in line with the underlying gone concern assumptions and ensures the economic risk-bearing capacity concept is internally consistent. Economic capital makes allowance for all the types of risk at Commerzbank Finance & Covered Bond S.A. that are classified as material and quantifiable in the annual risk inventory. It therefore also comprises risks that are not included in the regulatory requirements for banks' capital adequacy.

The quantifiable risks in the economic capital model can be divided into default risk, reserve risk, market risk, operational risk and (although not shown separately in the table below) business risk. Business risk is considered as a deductible amount in risk coverage potential.

The results of the risk-bearing capacity calculation are shown using the risk-bearing capacity ratio (RBC ratio), showing the economically required capital in relation to the risk coverage potential.

Risk-bearing capacity CFCB in €bn	31/12/2018	31/12/2017
Economic risk coverage potential[1]	**0.50**	**0.53**
Economically required capital	**1.37**	**1.35**
of which: for credit risk[2]	0.68	0.70
of which: for market risk	0.69	0.65
of which: for OpRisk	0.00	0.00
of which: diversification effects	0.00	0.00
RBC ratio[3]	**37%**	**40%**

[1] Including deductible amounts for business risk.
[2] Credit risk incl. reserve risk
[3] RBC ratio = economic risk coverage potential/economically required capital

The RBC ratio decreased from 40% in the prior year to 37% as at 31 December 2018. The minimum risk-bearing capacity is deemed to be met as long as the RBC ratio is higher than 100%.

As the economic capital requirement cannot at present be covered by the economic risk coverage potential, the Bank is relying on its regulatory risk-bearing capacity, which is assured. The shortfall in economic capacity is underwritten by the letter of comfort given by Commerzbank AG in respect of Commerzbank Finance & Covered Bond S.A.'s liabilities.

The Bank's regulatory risk-bearing capacity is assured.

The Bank conducts monthly specific stress tests to show the risk-bearing capacity required in relation to liquidity. In the stress test, the Bank must have sufficient liquidity to last for a horizon of one month, a period termed the Survival Period. This was the case throughout the year under review.

The Bank has taken various steps to comply with risk capacity requirements on a stand-alone basis.

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6.3.4 Credit risk

Default risk

Default risk refers to the risk of losses due to defaults by counterparties and to changes in this risk. Under the heading of default risk, Commerzbank Finance & Covered Bond S.A. lists not only credit default and third-party debtor risk but also counterparty, issuer, settlement and replacement risk, as well as country and transfer risk.

Rating systems

As part of the check to be carried out on the creditworthiness of every borrower, the Bank assigns an internal rating (a reconciliation of internal ratings to external ones is provided in the attached master scale). It also calculates a loss given default (LGD) using various parameters including collateral and market value, recovery ratio and realisation period. In view of the Bank's integration into the Group-wide limit and management system, rating, further development, validation and monitoring are carried out by Commerzbank AG.

Commerzbank Master Scale

COMMERZBANK

Commerzbank AG Rating	PD / EL Mid-point [%]	PD / EL Range[1] [%]	S&P Scale[2]		Credit Quality Steps In Accordance With Article 136 CRR[3]	
1.0	0.0000	0.0000	AAA	AAA	I	Investment grade
1.2	0.0147	0.0001 - 0.0190	AA+			
1.4	0.0248	0.0191 - 0.0319	AA. AA-	AA		
1.6	0.0412	0.0320 - 0.0525	A+, A			
1.8	0.0671	0.0526 - 0.0847	A-	A	II	
2.0	0.1071	0.0848 - 0.1339				
2.2	0.1675	0.1340 - 0.2073				
2.4	0.2567	0.2074 - 0.3144	BBB+			
2.6	0.3851	0.3145 - 0.4665	BBB	BBB	III	
2.8	0.5654	0.4666 - 0.6775	BBB-			
3.0	0.8120	0.6776 - 0.9621	BB+			Sub-investment grade
3.2	1.1401	0.9622 - 1.3355	BB			
3.4	1.5644	1.3356 - 1.8110	BB-	BB	IV	
3.6	2.0965	1.8111 - 2.3979				
3.8	2.7426	2.3980 - 3.0982				
4.0	3.5000	3.0983 - 3.9039				Non-investment grade
4.2	4.3545	3.9040 - 4.8571	B+			
4.4	5.4177	4.8572 - 6.0430	B			
4.6	6.7405	6.0431 - 7.5184		B	V	
4.8	8.3862	7.5185 - 9.3541	B-			
5.0	10.4338	9.3542 - 11.6380				
5.2	12.9812	11.6381 - 14.4794	CCC+	CCC		
5.4	16.1507	14.4795 - 18.0147	CCC, CCC-		VI	
5.6	20.0940	18.0148 - 22.4131	CC, C	CC, C		
5.8	47.3425	22.4132 - 99.9999				
6.1	100	> 90 days past due	D			Default
6.2		Imminent insolvency				
6.3		Restructuring with recapitalisation / partial waiving of claims				
6.4		Cancellation without insolvency				
6.5		Insolvency				

Comments:
[1] after rounding to the nearest decimal number having 4 digits behind the decimal point.
[2] Mapping can only be indicative, since observed default rates may differ among portfolios and fluctuate over time.
[3] CRR = Capital Requirements Regulation (EU) No. 575/2013

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In Group Management Treasury's collaboration with Commerzbank AG, the latter's rating procedure for states (sovereigns), sub-sovereigns and banks is used.

Credit risk management
Commerzbank Finance & Covered Bond S.A. is directly integrated in the Commerzbank Group's overall bank management concept. To manage and limit default risk, the following risk parameters are used: exposure at default (EaD), loss at default (LaD), expected loss (EL), risk density (EL/EaD), credit value at risk (CVaR = economically required capital for credit risk with a confidence level of 99.91% and a holding period of one year), risk-weighted assets and "all-in" for bulk risk. Stress scenarios are modelled on the basis of the credit value at risk (CVaR) of the loan portfolio model, both regularly and as and when required.

Taking economic capital as a fundamental concept makes it possible to ensure that the concentration of risks in clusters, countries, target groups and produces is limited.

The table below sets out a geographical breakdown of the Bank's nominal volume by country.

Country Nominal in €m	31.12.2018 in €m	Proportion %	31.12.2017 in €m	Proportion %
United States of America	4,188	48.3	4.240	45.9
Great Britain	2,013	23.2	2.256	24.4
Italy	1,101	12.7	1.140	12.3
Canada	446	5.2	431	4.7
Spain[1]	392	4.5	463	5.0
Portugal	238	2.7	439	4.7
Supranational	193	2.2	184	2.0
Japan	93	1.1	93	1.0
Gesamt	**8.664**	**100.0**	**9.247**	**100.0**

[1] incl. EIF guaranteed exposure

The collateral held by Commerzbank Finance & Covered Bond S.A. to minimise credit risk is mainly in the form of guarantees given by public bodies in respect of that part of the portfolio that does not directly constitute sovereign risk.

Public finance
The portfolio of Commerzbank Finance & Covered Bond S.A. includes international state financing and financing for financial institutions. The public finance business focuses on the governments of national governments, provinces, federal states, regions, cities and municipalities in EU member states and OECD countries, as well as supranational institutions and a small proportion of covered bonds. The product groups to which it is exposed are bonds and loans/promissory note loans.

Broken down by product group, bonds made up approximately 78.2% (around €6.775bn nominal) and loans/promissory note loans approximately 21.8% (around €1.889bn nominal) of the overall portfolio as at 31 December 2018. As at 31 December 2017, bonds made up approximately 76.3% (around €7.1bn nominal) and promissory note loans approximately 23.7% (around €2.2bn nominal).

Overall, the hidden liabilities within financial assets classed – amortised cost, resulting from the difference between carrying amount and fair value – amounted to €610.5m (31 December 2017: €1,574.8m).

Credit exposure on the reporting date amounted to €8,664m nominal (31 December 2017: €9,247m) and, according to an internal ratings classification (cb1.0 – cb2.8) of 94.2% (31 December 2017: 89.6%) was investment grade (external rating AAA to BBB–). A total of around 59.8% (31 December 2017: 43.9%) can be regarded as of very good quality (internal rating cb1.0 – cb1.8).

Ongoing portfolio reduction resulted in a change to the debtor structure, which was consequently reflected in the rating breakdown.

Nominal exposure	31.12.2018 in €m	31.12.2018 in %	31.12.2017 in €m	31.12.2017 in %
cb1.0	0	0.0	83	0.9
cb1.2	2,567	29.6	2,456	26.6
cb1.4	668	7.7	791	8.6
cb1.6	586	6.8	427	4.6
cb1.8	1,357	15.7	299	3.2
cb2.0	901	10.4	2,351	25.4
cb2.2	159	1.8	104	1.1
cb2.4	107	1.2	90	1.0
cb2.6	219	2.5	351	3.8
cb2.8	1,600	18.5	1,334	14.4
>cb2.8	499	5.8	961	10.4
Gesamt	**8,664**	**100.0**	**9,247**	**100.0**

It also includes securities and loans in the regions of Europe, North America and Asia, and positions guaranteed by public bodies. European government bonds are used to secure an amount of US$250m due from a bank, which was taken over from Commerzbank International S.A., Luxembourg, in 2016.

6.3.5 Market price risk

Commerzbank Finance & Covered Bond S.A. defines market risk as the possibility of losses of economic value in its portfolio potentially resulting from changes to market prices. The main sub-risk types are general market risk (interest rates, exchange rates, basis risk, volatility) and specific market risk (credit spreads).

The Bank measures its market risk on the basis of the value at risk (VaR) concept, using Commerzbank AG's systems and methodologies.

VaR quantifies the potential loss from financial instruments due to changed market conditions within a set time horizon and at a specific probability. For internal management purposes, a confidence level of 97.5% and a holding period of one day are assumed. The value at risk concept makes it possible to compare risks over a variety of portfolios and/or business areas. It enables many positions to be aggregated, taking account of correlations between different assets. This ensures a consistent view of market risk at all times.

Value-at-Risk (VaR 97.5 % / 1D) in €m	2018	2017
Year-end	**11.9**	**13.0**
Minimum	8.3	12.8
Maximum	18.3	21.7
Average	11.2	17.7
Median	11.4	17.4

The table above shows Commerzbank Finance & Covered Bond S.A.'s limited VaR. The key figure at the end of the year under review was below the previous year's level.

The limited VaR of Commerzbank Finance & Covered Bond S.A. was subject to considerable fluctuation during the year (also see maximum/minimum as the following chart). The key driver in this regard was the Bank's adoption of IFRS 9 together with the methodological changes this entailed, particularly in January and August. Moreover, towards the end of the year a gradual increase in the credit spread risks of assets in pounds sterling against the backdrop of Brexit was a driving force behind the slight rise in VaR.

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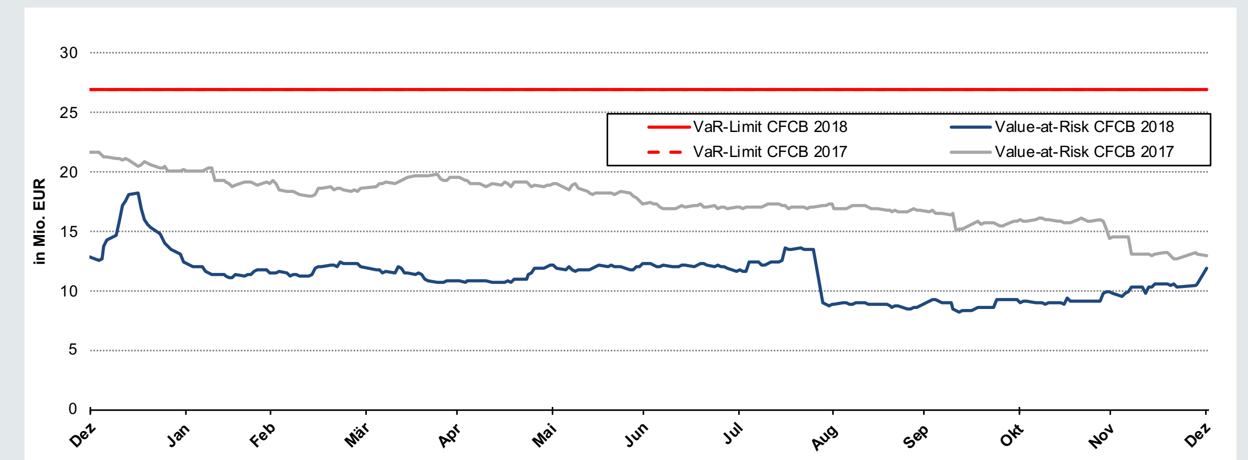
Change in value at risk in 2018

Commerzbank Finance & Covered Bond S.A. Value at Risk: 31 December 2017 – 31 December 2018



Risks arising from extreme market conditions are simulated and limited using Group-wide market risk stress tests. The main drivers of market risk are credit spread risk and interest and basis risk in the banking book.

Credit spread sensitivities are as follows as at 31 December 2018:

Credit spread sensitivities Rating 31.12.2018	CS01 limit in €000	CS01 in €000	Utilisation in %
AAA or lower	–14,500	–9,894	68
AA or lower	–13,500	–9,546	71
A or lower	–11,000	–7,815	71
Below A	–2,800	–1,769	63

Credit spread sensitivities Rating 31.12.2017	CS01 limit in €000	CS01 in €000	Utilisation in %
AAA or lower	–14,500	–11,951	82
AA or lower	–13,500	–11,540	85
A or lower	–11,000	–9,578	87
Below A	–2,800	–2,027	72

The exposure of all credit spread sensitivities of all securities fell from €–12.0m as at the end of 2017 to €–9.9m as at the end of 2018.

As required by the regulator for a bank with only a banking book, Commerzbank Finance & Covered Bond S.A. also quantifies the effects of interest rate change shocks on the economic value of its portfolio. The Bank uses a number of stress scenarios, including two for sudden and unexpected changes in interest rates (+/– 200 basis points as "standard shock"). The outcome of the +200 basis points scenario would be a potential change in value of €+28.6m as at 31 December 2018 (31 December 2017: €+29m), while the –200 basis points scenario would result in a potential change in value of €– 34.6m (31 December 2017 €– 35m) as at the same date (assuming a 0% floor). Based on current interest rate levels the floor stipulated by the regulators results in an improvement versus the scenario without floor of around €+10m.

6.3.6 Liquidity risk

The Bank defines liquidity risk in a narrower sense as the risk of being unable to meet its payment obligations on a day-to-day basis. In a broader sense, liquidity risk describes the risk that future payments cannot be funded for the full amount, in the required currency or at standard market conditions, as and when they are due.

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The Bank uses the liquidity gap profile (LGP) – the liquidity risk methodology of Commerzbank AG – to manage liquidity risk. In addition, Commerzbank Finance & Covered Bond S.A. is fully involved in the management and monitoring of liquidity risks across the Group.

The liquidity gap profile is limited overall and for each significant currency. In 2018 the liquidity gap profile (overall) was within the set limit at all times. The liquidity coverage ratio (LCR) is calculated as the ratio of liquid assets to net liquidity outflows under stressed conditions. It is used to measure whether a bank has a large enough liquidity buffer to independently withstand any potential imbalance between inflows and outflows of liquidity under stressed conditions over a period of 30 calendar days. Following an introductory period, a minimum ratio of 100% has had to be observed since 1 January 2018. The Bank significantly exceeded the stipulated minimum ratio on every reporting date in 2018.

6.3.7 Operational risk

The risk of losses resulting from the inappropriateness or failure of internal procedures and systems, the human element or external events is defined as operational risk. The definition also covers legal risk, but not reputational or strategic risk.

Commerzbank Finance & Covered Bond S.A. is integrated into Commerzbank AG's operational risk management system for the purpose of complying with the requirements of the Group and the regulator. This means it is also integrated into Commerzbank AG's system for collecting loss data and the other main elements of its operational risk management approach. All quantitative and qualitative requirements for managing operational risks, including the associated steering mechanisms, have been met.

Commerzbank Finance & Covered Bond S.A. calculates its capital adequacy using Commerzbank AG's advanced measurement approach (AMA) and an allocation formula.

As at 31 December 2018, the capital allocated by the Bank to operational risk amounted to €0.95m (31 December 2017: €0.6m).

Outsourcing

Given its small size, the Bank does not have an in-house internal audit department. During the year under review, the functions of internal audit at the Bank were performed by the Group Audit department (GM Audit) of Commerzbank AG under a service level agreement, as in the previous year. The CSSF approved the outsourcing in a letter dated 20 March 2003.

In order to meet the Minimum Requirements for Risk Management (MaRisk), the divisions responsible for central credit risk management at Commerzbank AG process applications for loans, prepare loan documentation, use appropriate systems to compile ratings and perform the related functions, on behalf of Commerzbank Finance & Covered Bond S.A.

The Bank has outsourced invoicing/accounting, settlement/payments, IT, organisation and security, compliance and law and risk controlling within the Group.

Service level agreements to this effect have been concluded and are subject to regular review as part of the monitoring of outsourcing. The departments remaining within the Bank are Asset Liability Management (ALM), Credit Risk Management (CRM) and Analytics & Regulatory Issues (ARI).

The monitoring and ongoing quantification of outsourcing risks as part of operational risk is accomplished by integrating the Bank in the Group-wide outsourcing policy, the processes established for this purpose and the methods and procedures defined for it.

Other risks

To meet the requirements of pillar 2 of the Basel framework, an integrated approach to risk that also includes unquantifiable risk categories is necessary. All the risk types set out below are likewise subject to a Group-wide qualitative control and monitoring process.

Human resources risk

Within the Commerzbank Group, human resources risk is divided into four categories:

- **Adjustment risk**
  All employees must have the knowledge, experience and skills required to perform their task and duties and discharge their responsibilities. This is ensured on an ongoing basis by appropriate training and continuous professional development.

- **Motivation risk**
  Systems of remuneration and incentivisation must be constructed in such a way that they do not result in conflicts of interest and false incentives, especially among senior management.

- **Departure risk**
  The absence or departure of staff must not result in long-term disruption to the conduct of business. The criteria governing appointments, especially to senior positions, must be specified.

- **Supply risk**
  The quality and number of staff recruited must be appropriate to requirements, specifically in terms of its business operations, strategy and risk situation.

Business strategy risk

Business strategy risk is the risk of negative influences on the achievement of strategic goals as a result of changes in market and competitive, capital market requirements, banking regulation and policy or inadequate implementation of Group strategy and/or inconsistent performance by the business areas. Commerzbank Finance & Covered Bond S.A. aligns itself with Commerzbank AG's Group strategy. Material changes and developments are detected by means of ongoing observation and continuing analysis of the market and competitive environment in Germany and other countries and the requirements of regulators and the capital markets, with the measures to secure the company's long-term success being derived from these.

Reputational risk

Commerzbank Finance & Covered Bond S.A. manages reputational risk in accordance with the Group's guidelines. A company's reputation is becoming more and more crucial in today's competitive environment. This is attributable not least to the effects of the financial crisis and to the associated loss of confidence in banks, as well as to the influence of reports in the media and elsewhere. The Bank is aware of its responsibility in this regard. As the sum of its stakeholders' perceptions, Commerzbank Finance & Covered Bond S.A.'s reputation is of significant value and needs to be protected, as a good reputation is an indicator of, among other things, trustworthiness, a commitment to values and an awareness of corporate responsibility. Commerzbank Finance & Covered Bond S.A. avoids business policy measures and transaction with inherent tax or legal risks or that are in breach of business policy as expressed in its articles of association or other public statements.

Compliance risk

The monitoring of compliance with relevant laws, regulations and internal rules and adherence to standards and codes of conduct customary on the market in the course of business operations is carried out by the local Chief Compliance Officer, who works closely with Group Compliance at Commerzbank AG. The objective is to identify at an early stage compliance risks with potential to jeopardise the company's integrity and hence its success, prevent them if at all possible, manage them, or resolve them appropriately in the interests of all parties.

6.4 Summary

Risks of significance in terms of the overall assessment of Commerzbank Finance & Covered Bond S.A. have been reported. There is no indication of any other risk criteria or circumstances that might put the continued existence of the Bank at risk. The possibility of further impairments, notably within the US sub-portfolio, cannot be entirely ruled out, but there is at present no evidence of any need for them.

6.5 Disclaimer

The risk measurement methods and models used at Commerzbank Finance & Covered Bond S.A., which form the basis for the calculation of the figures shown are state of the art and based on banking sector practice. The results produced by the risk models are suitable for managing the Bank. The measurement approaches are regularly reviewed by risk control and internal audit, external auditors and the supervisory authorities. Despite being carefully developed and regularly monitored, models cannot cover all the influencing factors that have an impact in reality or illustrate their complex behaviour and interactions. These limits to risk modelling apply particularly in extreme situations. Supplementary stress tests and scenario analyses can show only examples of the risks to which a portfolio may be exposed in extreme market situations; stress testing of all imaginable scenarios is not feasible. Stress tests cannot therefore offer a final estimate of the maximum loss should an extreme event occur.

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7 Notes on the comprehensive income statement

7.1 Net interest income

in €000	2018	2017[1]
Interest income accounted for using the effective interest method	**291,105**	**425,094**
Interest income Amortised Cost from loans and receivables	12,619	n/a
Interest income Amortised Cost from securitised debt instruments	279,173	n/a
Interest income Loans and Receivables from loans and receivables	n/a	135,699
Interest income Loans and Receivables from securitised debt instruments	n/a	244,319
Interest income Available for Sale from securitised debt instruments	n/a	40,913
Profit from the sale of loans and receivables	n/a	4,849
Negative interest on financial instruments held as assets	–687	–685
Interest income accounted for not using the effective interest method	**87,045**	**0**
Interest income Mandatorily Fair Value P&L from loans and receivables	87,045	n/a
Interest income Mandatorily Fair Value P&L from securitised debt instruments	0	n/a
Interest expenses – Amortised Cost	**179,015**	**224,599**
Securitised liabilities	49,478	73,745
Deposits and repos	133,863	156,688
Other interest expenses	123	121
Negative interest on financial instruments held as liabilities	–4,449	–5,955
Total	**199,136**	**200,495**

[1] Previous year's figure restated see Note 5.2

All interest income and interest expense – including interest related income and expense – are reported in this item, provided they do not result from the held-for-trading portfolio or from derivative hedging instruments.

7.2 Risk result

The risk result contains changes to provisions recognised in the income statement for on- and off-balance-sheet financial instruments for which the IFRS 9 impairment model is to be applied. This also includes reversals of loss provisions when derecognition occurs because of scheduled redemptions, write-ups and amounts recovered on claims written-down and direct write-downs not resulting from a substantial modification. Changes to provisions for losses recognised in the income statement for certain off-balance-sheet financial instruments which do not constitute financial guarantees within the meaning of IFRS 9 are also included.

There were no write-ups, amounts recovered on claims written down and direct write-downs not resulting from a substantial modification during the financial year.

Due to the adoption of IFRS 9, this item is not comparable with the item loan loss provisions stated in the Annual Report 2017 (Note 7.3).

in €000	2018	2017
Allocation to loan loss provisions	1,307	n/a
Reversals of loan loss provisions	–102	n/a
Write-ups on claims written-down	0	n/a
Total	**1,205**	**n/a**

7.3 Loan loss provisions

In the financial year 2017 this item included provisions for losses in on- and off-balance-sheet business. With the adoption of IFRS 9 the item now forms part of the risk result. It cannot compared with the previous year.

in €000	2018	2017
Allocation to loan loss provisions	n/a	2
Reversals of loan loss provisions	n/a	-568
Write-ups on claims written-down	n/a	0
Total	**n/a**	**-567**

In this connection we also refer to the information in Note 8.7.

7.4 Net commission income

in €000	2018	2017
Commission income	**8,765**	**6,751**
Services transactions	7,801	6,609
Other income	964	143
Commission expenses	**573**	**713**
Securities business	436	537
Lending and guarantee transactions	128	146
Services transactions	9	31
Net commission income	**8,192**	**6,038**
Securities business	–436	–537
Lending and guarantee transactions	–128	–146
Services transactions	8,756	6,721
Total	**8,192**	**6,038**

We report income from agency business under net commission income. This includes annual processing fees for the management of loans and/or collateral. They are received on payment. Furthermore, it records expenses from the covered bond business (essentially custody fees).

7.5 Net income from financial assets and liabilities measured at fair value through profit and loss and net income from hedge accounting

The item net income from financial assets and liabilities measured at fair value through profit and loss contains the net gain or loss from financial instruments in the held-for-trading category and the net gain or loss from financial instruments in the mandatorily fair value P&L category.
The net gain or loss from financial instruments in the held-for-trading category illustrates the Bank's net trading income and is reported as the net balance of expenses and income.

This item therefore includes:
- interest income and interest expenses from derivatives;
- net remeasurement gain or loss from remeasurements to fair value;
- net gain or loss from derivative financial instruments;
- net gain or loss from fair value adjustments (Credit Valuation Adjustment/CVA, Debit Valuation Adjustment/DVA, Funding Valuation Adjustment/FVA) (CVA, DVA, FVA)

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The net gain or loss from financial instruments in the mandatorily fair value P&L category contains only net measurement gains or losses and realised profit or loss.

Expenses and income are each presented on a net basis.

Net income from hedge accounting shows measurement gains or losses on effective hedges under hedge accounting.

in €000	2018	2017[1]
Net income from hedge accounting micro fair value hedges	**–3,519**	**–8,419**
Valuation hedging derivatives	68,006	63,136
Valuation hedged items	–71,525	–71,555

in €000	2018	2017[1]
Net income from financial assets and liabilities measured at fair value through profit and loss	**–117,463**	**–280,936**
Net income derivatives not qualifying for hedge accounting	148,510	–68,074
Net interest income derivatives	–178,280	–210,358
Profit or loss from financial instruments – Mandatorily Fair Value P&L	–88,870	n/a
Net income from currency transactions	1,176	–2,504

[1] Previous year's figures restated see Note 5.2

Net income from hedge accounting results in full from hedge ineffectiveness.

7.6 Other net gain or loss from financial instruments

This item contains the gain or loss on disposals of financial assets in the amortised cost category as well as the gain or loss from the repurchase of financial liabilities in the amortised cost category.

The result from the disposal of financial assets in the amortised cost category includes effects from sales of financial instruments measured at amortised cost that are not triggered by a change in credit rating.

The disposal of financial liabilities in the amortised cost category results in a net realised profit or loss, which arises directly from the difference between the sale price and amortised costs on the day of disposal.

in €000	2018	2017
Realised profit or loss from financial liabilities – Amortised Cost	**1,016**	**n/a**
Gains on disposals	1,016	n/a
Losses on disposals	0	n/a
Gain or loss on disposal of financial assets Amortised Cost	**1,079**	**n/a**
Gains on disposals	1,609	n/a
Losses on disposals	–530	n/a
Total	**2,096**	n/a

The net gain or loss from the sale of financial instruments (amortised cost) in the amount of €1,079 thousand resulted when the Bank sold securities and promissory note loans from the liquidity portfolio (amortised cost) as part of permitted portfolio measures and repayments of securities and loans.

No derecognition of financial assets – amortised cost took place in 2018 or 2017.

7.7 Net investment income

Net investment income in 2017 covered gains or losses on the disposal and remeasurement of securities categorised as loans and receivables and available-for-sale.

in €000	2018	2017[1]
Net gain or loss from interest-bearing business		
in the available-for-sale category	**n/a**	**–2,055**
Losses on disposals	n/a	–2,055
in the loans and receivables category	**n/a**	**54**
Gains on disposals	n/a	1,179
Losses on disposals	n/a	–3,225
Net remeasurement gain or loss	n/a	2,100
Repayment financial liabilities	**n/a**	**1,450**
Total	**n/a**	**–552**

[1] Previous year's figures restated see Note 5.2

7.8 Operating expenses

Operating expenses were €24,883 thousand (31 December 2017: €24,602 thousand) and included personnel expenses of €1,350 thousand (31 December 2017: €1,483 thousand), administrative expenses of €20,192 thousand (31 December 2017: €19,777 thousand) and well as amortisation of intangible assets of €3,341 thousand (31 December 2017: €3,341 thousand). These expenses are broken down as follows:

7.9 Personnel expenses

in €000	2018	2017
Wages and salaries	1,136	1,237
Social security contributions	143	160
Expenses for pensions and similar employee benefits	72	86
Total	**1,350**	**1,483**

Expenses for pensions and similar employee benefits are shown in Note 9.5.

7.10 Staff numbers, directors' and officers' remuneration, employee remuneration plans

7.10.1 Staff numbers and directors' and officers' remuneration

The average number of staff during the financial years stood at 12 employees, made up, as at 31 December 2018, as follows:

Employees (number)	2018	2017
CEO	2	2
Senior executives	1	1
Salaried employees	9	10
Total	**12**	**13**

As at 31 December 2018, the Bank had 11 employees, 5 of whom were female and 6 male.

in €000	2018	2017
Payments to active officers	**357**	**335**
of which CEO and senior staff	357	335
of which BoD	0	0
Pension expenses	**18**	**19**
of which CEO and senior staff	18	19
of which BoD	0	0
Advances, loans, contingent liabilities	0	0
of which CEO and senior staff	0	0
of which BoD	0	0

In 2018, managers and executive were paid a total of €357 thousand. Expenditure in 2018 on pension provision for the persons mentioned above amounted to €18 thousand. Pension obligations in respect of former members of management and their survivors as at 31 December 2018 amounted to €4,090 thousand. Members of the Board of Directors received no remuneration.

The payments received by managers and executives were summarised on the basis of the data protection provisions applicable in Luxembourg.

7.10.2 Employee remuneration plans

Expenses relating to the Commerzbank Incentive Plan (CIP, see 5.19.3) were incurred in 2018, as in previous years, in connection with services already rendered by employees (including the general management).

They were as follows:

in €000	2018	2017
Commerzbank Incentive Plan	66	157

Provisions for the Commerzbank Incentive Plan are as follows:

in €000	2018	2017
Provisions	94	159

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7.11 Administrative expenses

in €000	2018	2017
Occupancy expenses	153	135
Expenditure on consultancy services, other operating expenses and expenses required to comply with company law	1,051	646
Expenditure on advertising, public relations and representation	8	27
Personnel-related operating expenses	27	37
Workplace and information expenses	271	191
European Bank Levy	2,994	3,474
Service charged within Group	15,504	15,161
Other non-personnel expenses	184	107
Total	**20,192**	**19,777**

The fee paid to the auditor in the financial year is made up in detail (excl. VAT) as follows:

Auditors' fees in €000 (excl. VAT)	2018	2017
Audit of financial statements	124	162
Other audit services	65	81
Total	**189**	**243**

7.12 Amortisation of intangible assets

in €000	2018	2017
Intangible assets	3,341	3,341
Total	**3,341**	**3,341**

Amortisation on the acquired customer base in connection with the agency business is shown under this heading.

7.13 Other net operating income

in €000	2018	2017
Income from reversals of provisions	1,811	1,660
Sundry other operating income	36	986
Total other operating income	**1,847**	**2,646**
Other taxes	3,320	1
Other operating expenses	0	445
Total other operating expenses	**3,320**	**445**
Total other net operating income	**–1,473**	**2,201**

Other operating income and expenses include items that cannot be assigned to other headings in the statement of comprehensive income. Other taxes show expenses for wealth tax.

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7.14 Taxes on income

The breakdown of taxes on income was as follows:

in €000	2018	2017
Current taxes on income	3,583	6,034
Tax expense or income for the current year	0	6,034
Tax expense/income for previous years	3,583	0
Deferred taxes on income	0	15,531
Tax expense or income due to change in temporary differences and loss carryforwards	0	15,531
Total	**3,583**	**21,564**

In consequence of the establishment of the income tax group with effect from 1 January 2011, the taxable income of Commerzbank Finance & Covered Bond S.A. is allocated to Commerzbank AG, Luxembourg branch, in its capacity as parent company of the group.

The actual income of €3,583m includes the contribution of a tax refund from the income tax group. The deferred tax in 2017 resulted from a change to temporary differences. Even taking into account the participation in the tax group with Commerzbank AG, Luxembourg branch, we do not expect to generate sufficient profits in the coming five years to use deferred tax assets. Consequently, no deferred tax assets have been recognised as at 31 December 2018. The correction was made as part of the initial adoption of IFRS 9 and is shown in Note 5.3.

The tax rate applicable as at 31 December 2018 was 26.01%. This is made up of a corporation tax rate including Labour Fund premium of 19.26% and a trade tax rate of 6.75%.

The following reconciliation shows the relationship between net pre-tax profit according to IFRS and tax expense in the financial year. Calculated income tax was ascertained by multiplying pre-tax profit by the local tax applicable in the financial year, which was 26.01%.

in €000	2018	2017
Pre-tax profit or loss under IFRS	**60,880**	**–105,208**
Expected tax rate	26.01%	27.08%
Calculated income tax expense in financial year	**–15,835**	**28,490**
Tax effects		
a.) from previous years' taxes recognised in the financial year	3,583	0
b.) from tax-free income	0	0
c.) from temporary differences between values recognised for tax purposes and those recognised for IFRS purposes	0	15,531
d.) tax effect from tax group	15,835	–22,457
e.) from other differences	0	0
Taxes on income	**3,583**	**21,564**

The effective tax rate is –5.88%.

The following deferred taxes have been recognised directly in equity under the relevant heading:

in €000	2018	2017
Current taxes on income	**0**	**0**
Deferred taxes on income	**0**	**60,330**
Revaluation reserve	0	59,564
Application of IAS 19	0	766
Total	**0**	**60,330**

7.15 Net income

Net gains consists of measurements at fair value, impairments, impairment reversals, realised gains on disposal, recoveries on written-down financial instruments.

in €000	2018	2017
Net income from		
Financial assets and liabilities Held for trading and derivative hedging instruments	–32,113	–217,800
Financial assets Loans and Receivables and Available for Sale	n/a	209,875
Financial assets – Amortised Cost	297,132	n/a
Financial assets – Mandatorily Fair Value P&L	–1,824	n/a
Financial liabilities – Amortised Cost	–184,151	–76,016

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8 Notes to the balance sheet (assets)

8.1 Cash reserve

in €000	31.12.2018	31.12.2017
Balances with central banks	5,263	105,326
Total	**5,263**	**105,326**

8.2 Financial assets – Amortised Cost

If the contractually agreed cash flows of a financial assets merely constitute interest and principal payments (i.e. they are SPPI-compliant) and the asset was allocated to the "hold to collect" business model, the asset is measured at amortised cost. The carrying amount of these financial instruments is reduced by any loan loss provision (see Note 8.6).

Interest payments for these financial instruments are recognised in net interest income. Premiums and discounts are recognised through the income statement in net interest income over the life of the liability.

in €000	31.12.2018	31.12.2017
Securitised debt instruments	**7,520,733**	**n/a**
Banks	240,926	n/a
Other financial corporations	2,347,809	n/a
Corporate clients	133,772	n/a
General governments	4,798,227	n/a
Loans and receivables	**1,055,414**	**n/a**
Banks	963,873	n/a
General governments	91,541	n/a
Total	**8,576,147**	**n/a**

8.3 Financial assets – Loans and Receivables

Non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market were assigned to this category in the previous year in accordance with IAS 39. This was true regardless of whether they were originated by the Bank or acquired in the secondary market. An active market existed if quoted prices were readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represented actual and regularly occurring market transactions on an arm's length basis. Measurement of these assets was at amortised cost. If there was impairment, this was deducted through profit or loss. Premiums and discounts were recognised in net interest income over the life of the asset.

This item also included securitised debt instruments which were originally assigned to category AfS on acquisition and subsequently allocated to the Loans and Receivables category pursuant to the rules of IFRS 39.50. For further details see Note 5.3.

For the financial instruments included in this position, impairments were recognised in the same way as for lending business (see Annual Report 2017, Notes 5.11 and 8.4). Impairment of these financial instruments was included in loan loss provisions and deducted directly from the balance-sheet item. If the indicators for impairment of given securities ceased to apply or no longer suggested an impairment, the impairment of the securities in question was reversed through profit or loss, but to no more than the level of amortised cost. Similarly, an improved risk environment could lead to the reversal of an impairment that was previously recognised at the portfolio level.

in €000	31.12.2018	31.12.2017
Securitised debt instruments	**n/a**	**6,862,787**
Banks	n/a	231,972
Other financial corporations	n/a	2,293,264
Corporate clients	n/a	132,248
General governments	n/a	4,205,303
Loans and receivables	**n/a**	**5,838,868**
Banks	n/a	1,486,920
General governments	n/a	4,351,948
Total	**n/a**	**12,701,655**

8.4 Financial assets – Available for Sale

In accordance with IAS 39, this category comprised all non-derivative financial assets not assigned to one of the other categories or designated for the category "Financial assets – available for sale". The securities were concerned were interest-bearing. Available-for-sale assets primarily comprised fixed-income securities that were traded on an active market but which the Bank did not intend to sell in the short term.

They were measured at fair value. Where the fair value could not be ascertained from active market data, the measurement was generally carried out on the basis of comparative and indicative prices from pricing service providers or other banks (lead managers) or with the help of internal measurement procedures (net present value or option price models).

in €000	31.12.2018	31.12.2017
Securitised debt instruments	**n/a**	**864,155**
General governments	n/a	864,155
Total	**n/a**	**864,155**

8.5 Financial assets – mandatorily fair value P&L

This item includes financial instruments that are allocated to the residual business model and not reported in financial assets – held for trading. In addition, transactions allocated to the "hold to collect" and "hold to collect and sell" business model are included here if they are not SPPI-compliant.

in €000	31.12.2018	31.12.2017
Loans and receivables	**2,598,191**	**n/a**
General governments	2,598,191	n/a
Securitised debt instruments	**34,853**	**n/a**
Other financial corporations	34,853	n/a
Total	**2,633,044**	**n/a**

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8.6 Credit risks and credit losses

For the principles and the valuation of credit risks, the calculation of expected credit loss and an assessment of a significant increase in the default risk we refer to Note 5.14.

in €000	As at 01.01.2018	Net additions/ reversals	Utilisation	Exchange rate changes/ re-classifications	As at 31.12.2018
Value adjustment for risks from financial assets					
Financial assets – Amortised Cost	**23,432**	**1,205**	**0**	**226**	**24,863**
Loans and receivables	3,229	–102	0	0	3,127
Securitised debt instruments	20,203	1,307	0	226	21,736
Provisions for indemnity agreements	**0**	**0**	**0**	**0**	**0**
Total	**23,432**	**1,205**	**0**	**226**	**24,863**

The breakdown into the stages is as follows:
Value adjustment for risks from loans and advances

in €000	Stage 1	Stage 2	Stage3	POCI	Total
Balance as at 1.1.2018	**498**	**2,731**	**0**	**0**	**3,229**
New business	**0**	**0**	**0**	**0**	**0**
Changes in positions resulting from stage transfers	**0**	**0**	**0**	**0**	**0**
in Stage 1	0	0	0	0	0
in Stage 2	0	0	0	0	0
in Stage 3	0	0	0	0	0
Disposals	**0**	**0**	**0**	**0**	**0**
Changes of parameters/models	**100**	**–203**	**0**	**0**	**–103**
Utilisation	**0**	**0**	**0**	**0**	**0**
Exchange rate changes/Reclassification/Unwinding	**0**	**0**	**0**	**0**	**0**
Provisions for indemnity agreements	**0**	**0**	**0**	**0**	**0**
Total	**598**	**2,529**	**0**	**0**	**3,127**

Value adjustment for risks from debt instruments

in €000	Stage 1	Stage 2	Stage3	POCI	Total
Balance as at 1.1.2018	**3,069**	**17,134**	**0**	**0**	**20,203**
New business	**30**	**0**	**0**	**0**	**30**
Changes in positions resulting from stage transfers	**1**	**–4,219**	**0**	**0**	**–4,219**
in Stage 1	1	0	0	0	1
in Stage 2	0	–4,219	0	0	–4,219
in Stage 3	0	0	0	0	0
Disposals	**–120**	**0**	**0**	**0**	**–120**
Changes of parameters/models	**361**	**5,255**	**0**	**0**	**5,616**
Utilisation	**0**	**0**	**0**	**0**	**0**
Exchange rate changes/Reclassification/Unwinding	**509**	**–283**	**0**	**0**	**226**
Total	**3,849**	**17,886**	**0**	**0**	**21,736**

The change in value adjustments shown is based on the change in the portfolio of relevance for the value adjustments set out below.

in €000	31.12.2018	Net change	01.01.2018
Loans and receivables	**1,058,541**	**–569,512**	**1,628,053**
Stage 1	1,020,731	–533,710	1,554,441
Stage 2	37,810	–35,802	73,612
Stage 3	0	0	0
Securitised debt instruments	**7,542,469**	**–368,195**	**7,910,664**
Stage 1	7,218,491	–342,870	7,561,360
Stage 2	323,978	–25,326	349,304
Stage 3	0	0	0
Total	**8,601,010**	**–937,707**	**9,538,717**

The carrying amounts of the financial assets for which value adjustments have been made are allocated to the rating classes as follows:

In €000 Rating grades	12m ECL	ECL Lifetime	POCI	Total
Loans and receivables	**1,020,731**	**37,810**	**0**	**1,058,541**
1.0 – 1.8	658,392	0	0	658,392
2.0 – 2.8	324,839	0	0	324,839
3.0 – 3.8	37,500	37,810	0	75,310
4.0 – 4.8	0	0	0	0
5.0 – 5.8	0	0	0	0
6.1 – 6.5	0	0	0	0
Securitised debt instruments	**7,218,491**	**323,978**	**0**	**7,542,469**
1.0 – 1.8	3,999,188	0	0	3,999,188
2.0 – 2.8	2,724,578	0	0	2,724,578
3.0 – 3.8	494,726	298,596	0	793,322
4.0 – 4.8	0	5,810	0	5,810
5.0 – 5.8	0	19,572	0	19,572
6.1 – 6.5	0	0	0	0
Total	**8,239,222**	**361,788**	**0**	**8,601,010**

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8.7 Provisions for on- and off-balance-sheet loan losses in accordance with IAS 39

As at the reporting date of 31 December 2017, provisions for loan losses were recognised in accordance with the provisions of IAS 39. For the principles and methodologies regarding the valuation of credit risks, the calculation of expected credit loss and an assessment of a significant increase in the default risk we refer to Note 5.14.

in €000	Wertberichtigungen für Einzelrisiken 2017	Wertberichtigungen für Portfoliorisiken 2017	Wertberichtigungen gesamt 2017
As at 1.1.	**0**	**4,626**	**4,626**
Allocations	**0**	**279**	**279**
Disposals	**0**	**1,511**	**1,511**
of which reversals	0	1,511	1,511
Exchange rate changes/ reclassifications	**0**	**0**	**0**
As at 31.12.	**0**	**3,394**	**3,394**

The portfolio valuation allowances for claims on banks totalled €311 thousand, those for claims on customers €477 thousand and those for financial investments €2,607 thousand.

Allocations to and reversals of provisions for loan losses on claims recognised in profit and loss resulted in a gain of €567 thousand. Allocations to and reversals of provisions for financial investments resulted in a gain of €665 thousand. There were no unwinding effects.

8.8 Financial assets – Held for Trading

Financial assets – Held for Trading reports derivative financial instruments (derivatives that do not qualify for hedge accounting).
Irrespective of the type of product, these financial assets are measured at fair value through profit or loss. The fair value changes of the transaction in question are thus recognised in the income statement through profit or loss. Where the fair value cannot be ascertained from active market data, the measurement is generally carried out using comparative and indicative prices from pricing service providers or other banks (lead managers) or with the help of internal measurement procedures (net present value or option price models).
Interest income and expenses and gains or losses on measurement and disposal from these financial instruments are recorded in the income statement under net income from financial assets and liabilities measured at fair value through profit and loss. The impact in the presentation of the comprehensive income statement is presented in Note 5.2.

in €000	31.12.2018	31.12.2017
Positive fair values of derivative financial instruments (without hedge accounting)		
Interest-rate-related transactions	141,879	172,899
Currency-related transactions	196,423	230,845
Total	**338,301**	**403,744**

8.9 Positive fair values of derivative hedging instruments

This item shows derivative financial instruments used for hedging purposes and qualifying for hedge accounting. The instruments are measured at fair value.

in €000	31.12.2018	31.12.2017
Positive fair values of effective fair value hedges	**486,614**	**574,124**

8.10 Fixed and intangible assets

in €000	31.12.2018	31.12.2017
Intangible assets	6,682	10,024
Total	**6,682**	**10,024**

The carrying value of the agency business customer base acquired in 2016 is reported as intangible assets.

in €000	31.12.2018	31.12.2017
Office furniture and equipment	32	32
Total	**32**	**32**

The figure of €32 thousand reported under office furniture and equipment refers to works of art which have not been subject to depreciation.

8.11 Changes in fixed and intangible assets

Changes in intangible assets in 2018 were as follows:

in €000	2017
Acquisition and production costs	**15,314**
As at 1.1.2017	**15,314**
Additions	0
Disposals	0
As at 31.12.2017	15,314
Depreciation and amortisation	
As at 1.1.2017	1,949
Planned depreciation and amortisation in the financial year	3,341
Disposals	0
As at 31.12.2017	**5,290**
Carrying amount as at 31.12.2017	**10,024**

in €000	2018
Acquisition and production costs	**15,314**
As at 1.1.2018	**15,314**
Additions	0
Disposals	0
As at 31.12.2018	15,314
Depreciation and amortisation	
As at 1.1.2018	5,290
Planned depreciation and amortisation in the financial year	3,341
Disposals	0
As at 31.12.2018	**8,632**
Carrying amount as at 31.12.2018	**6,682**

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Changes in fixed assets in 2018 were as follows:

in €000	2017
Acquisition and production costs	**184**
As at 1.1.2017	**184**
Additions	0
Disposals	0
As at 31.12.2017	184
Depreciation and amortisation	
As at 1.1.2017	152
Planned depreciation and amortisation in the financial year	0
Disposals	0
As at 31.12.2017	**152**
Carrying amount as at 31.12.2017	**32**

in €000	2018
Acquisition and production costs	**184**
As at 1.1.2018	**184**
Additions	0
Disposals	0
As at 31.12.2018	184
Depreciation and amortisation	
As at 1.1.2018	152
Planned depreciation and amortisation in the financial year	0
Disposals	0
As at 31.12.2018	**152**
Carrying amount as at 31.12.2018	**32**

8.12 Tax assets

Deferred income tax liabilities represent the potential income tax reliefs arising from temporary differences between the values assigned to assets and liabilities in the consolidated balance sheet in accordance with IFRS and their values for tax accounting purposes in accordance with the local tax regulations.

Deferred tax claims have been treated as assets only in so far as business performance figures and the business environment make it probable that taxable income at the level of the tax group will be sufficient within the planning period.

Deferred income tax assets and liabilities are netted if there is a right to net current taxes on income and the deferred tax assets and liabilities relate to taxes on income levied by the same fiscal authority on the same taxable entity. The Bank has unused tax loss carryforwards of €410.4m, which expire 17 years after the date on which they arose and for which no deferred tax assets nor any impairments of existing deferred tax assets were recognised due to the limited planning horizon and the resulting insufficient probability of their being utilised.

For the unrecognised deferred tax assets please refer to Note 5.17.

€000	31.12.2018	31.12.2017
Current tax assets	**0**	**0**
Deferred tax assets	**0**	**20,422**
Tax assets recognised in income statement	0	–39,908
Tax assets not recognised in income statement	0	60,330
Total	**0**	**20,422**

Deferred tax assets were recognised in connection with the following items:

€000	2018	2017
Fair values of derivative hedging instruments	269,383	407,239
Financial assets and liabilities Held for trading	335,833	26,947
Financial assets Loans and Receivables and Available for Sale	n/a	59,564
Provisions	822	851
Financial liabilities – amortised cost	117,946	134,007
Other balance-sheet items	0	1,035
Sub-total	**723,984**	**629,642**
unrecognised deductible temporary differences	–84,006	0
Total	**639,977**	**629,642**
Netting	639,977	609,220
Total after netting	**0**	**20,422**

8.13 Other assets

The other assets item mainly comprises receivables from the tax group amounting to €6,034 thousand (31 December 2017: €24,518 thousand), a receivable from the Single Resolution Fund amounting to €514 thousand (31 December 2017: €514 thousand) and other receivables of €92 thousand (31 December 2017: €846 thousand).

8.14 Subordinated assets

The portfolio contained no subordinated assets either as at 31 December 2018 or as at 31 December 2017.

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9 Notes to the balance sheet (liabilities)

9.1 Financial liabilities – Held for Trading

€000	31.12.2018	31.12.2017
Deposits	**7,090,099**	**7,015,068**
Banks	5,760,754	5,649,119
Other financial corporations	1,311,670	1,349,820
Corporate clients	1,653	10
General governments	16,022	16,118
Securitised liabilities	**1,211,152**	**2,052,127**
Covered bonds	1,211,152	2,052,127
Total	**8,301,251**	**9,067,195**

9.2 Financial liabilities – Held for Trading

This position reports derivative financial instruments (derivatives that do not qualify for hedge accounting).

€000	31.12.2018	31.12.2017
Negative fair values from derivatives financial instruments (no hedge accounting)		
Interest-rate-related derivative transactions	1,321,455	155,345
Currency-related derivative transactions	111,622	57,947
Total	**1,433,076**	**213,291**

9.3 Negative fair values of derivative hedging instruments

Derivative instruments held for purposes other than trading, used for effective hedging and with a negative fair value are reported under this balance-sheet item. The financial instruments are measured at fair value.

€000	31.12.2018	31.12.2017
Negative fair values of effective fair value hedges	1,091,038	3,337,367
Total	**1,091,038**	**3,337,367**

9.4 Provisions

in €000	31.12.2018	31.12.2017
Provisions for pensions and similar commitments	6,521	6,622
Other provisions	3,969	1,055
Total	**10,490**	**7,678**

9.5 Provisions for pensions and similar commitments

Pension obligations are calculated annually by independent actuaries using the projected unit credit method:

in €000	2018	2017
Calculatory interest rate	1.9%	1.9%
Change in salaries	2.5%	2.5%
Adjustment to pensions	1.5%	1.5%

The changes in the pension obligations were as follows:

in €000	2018	2017
Pension obligations as at 1 January	**6,622**	**6,825**
Service cost	19	22
Interest cost	124	121
Pension payments	–210	–242
Change in actuarial gains/losses	–34	–104
Experience adjustments	–34	–2
Adjustments in financial assumptions	0	–102
Other changes (changes to exchange rates, reclassifications, changes to the plan)	0	0
Pension obligations as at 31 December	**6,521**	**6,622**

The expenses for pensions and other employee benefits consist of the following components:

in €000	2018	2017
Service cost	19	22
Interest cost	124	121
Amortisation of actuarial gains (–) / or losses (+)	0	0
Expenses for defined benefit plans	**143**	**143**
Expenses for defined contribution plans	29	31
Other pension benefits (age-related short-time working, early retirement)	0	0
Other expenses for pensions and similar employee benefits	24	33
Expenses for pensions and similar employee benefits	**196**	**207**

In 2019, expenses for defined benefit plans are expected to total €139 thousand.

The sensitivity analysis shown here reflects the changes in an assumption; the other assumptions remain unchanged from the original calculation, i.e. potential correlation effects between the individual assumptions are not taken into account. The effects of the assumption changes on the net present value of the pension obligations were determined using the same methods – in particular, the projected unit credit method – as used for the measurement of pension obligations in the financial statements.

A change in the corresponding assumptions as at 31 December 2018 would have the following effects:

in €000	31.12.2018	31.12.2017
Interest rate sensitivity		
Discount rate +50bps	-453	-476
Discount rate – 50bps	506	533
Salary change sensitivity		
Adjustment to pensions +50bps	10	10
Adjustment to pensions –50bps	-9	-11
Pension adjustment sensitivity		
Adjustment to pensions +50bps	424	436
Adjustment to pensions –50bps	-386	-396
Mortality rate (life expectancy) change sensitivity		
Reduction in mortality of 10%[1]	121	116

[1] Corresponds to the change in life expectancy of around one year.

The weighted average duration of pension obligations as at 31 December 2018 was 14.9 years (compared with 15.5 years as at 31 December 2017).

9.6 Other provisions

in €000	Provisions for the personnel area	Restructuring provisions	Other provisions	Total
As at 1.1.2017	**244**	**549**	**2,345**	**3,138**
Allocation	190	0	0	190
Utilisation	169	0	594	763
Release	99	0	1,411	1,510
As at 31.12.2017	**166**	**549**	**340**	**1,055**
As at 1.1.2018	**166**	**549**	**340**	**1,055**
Allocation	145	0	3,315	3,460
Utilisation	119	44	42	204
Release	92	0	250	342
As at 31.12.2018	**101**	**505**	**3,363**	**3,969**

Provisions for special human resources payments have been recognised. Service anniversary payments, which have also been provisioned, are by their nature long-term and the provisions for them will progressively be used up over future periods.

The provisions recognised for the restructuring measures are associated with the task of winding up and cover future HR-related liabilities and liabilities arising out of rental agreements. There were no new allocations in 2018.

There was no discounting on the grounds that, apart from the provisions for service anniversaries/restructuring, the terms generally extend over no more than one year. The discounting effect on provisions for service anniversaries would not be significant. Restructuring provisions are reviewed annually and are therefore not discounted.

The allocations to the remaining other provisions in the financial year mainly relate to a provision for wealth tax.

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9.7 Tax liabilities

Provisions for taxes on income are potential tax liabilities which have not yet been formally assessed. Deferred tax liabilities represent the potential income tax charge arising from temporary differences between the values assigned to assets and liabilities in the consolidated balance sheet in accordance with IFRS and their values for tax accounting purposes in accordance with the local tax regulations.

in €000	31.12.2018	31.12.2017
Current tax liabilities	**20,655**	**27,948**
Provisions for income tax	20,655	27,948
realised after more than twelve months	20,655	27,948
Deferred tax liabilities	**0**	**0**
Tax liabilities recognised in income statement	0	0
Total	**20,655**	**27,948**

Deferred income tax assets and liabilities are netted if there is a right to net current taxes on income and the deferred tax assets and liabilities relate to taxes on income levied by the same fiscal authority on the same taxable entity.

Deferred tax liabilities were recognised in connection with the following items:

in €000	2018	2017
Fair values of derivative hedging instruments	116,611	24,367
Financial assets and liabilities Held for trading	14,886	133,656
Financial assets Loans and Receivables and Available for Sale	n/a	419,707
Financial assets – Amortised Cost and Mandatorily Fair Value	481,185	n/a
Other balance-sheet items	27,296	31,491
Total	**639,977**	**609,220**
Netting	639,977	609,220
Total after netting	**0**	**0**

9.8 Other liabilities

in €000	31.12.2018	31.12.2017
Accrued and deferred items	12	11
Other liabilities	1,272	4,448
Total	**1,284**	**4,459**

Other liabilities mainly comprise taxes and social contributions payable in the amount of €893 thousand (31 December 2017: €1,284 thousand). Trade payables amounting to €373 thousand (31 December 2017: €331 thousand) and liabilities from the tax group of €6 thousand (31 December 2017: €2,833 thousand) are also reported under this item.

Of the other liabilities, €1,266 thousand after due within one year and €6 thousand after more than one year.

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9.9 Notes on equity

in €000	31.12.2018	31.12.2017
Subscribed capital	235,000	235,000
Capital reserve	1,859,000	1,859,000
Retained earnings	–963,535	206,503
Revaluation reserve	0	–169,439
Surplus/shortfall for the year	64,463	–83,644
Equity	**1,194,928**	**2,047,419**

The sole shareholder is Commerzbank AG.

As at 31 December 2018, the share capital, being subscribed and fully paid up, was divided into 235,000 (31 December 2017: 235,000) registered shares with a nominal value of €1,000 each.

The capital reserve, amounting to €1,859,000 thousand, is made up of capital contributions from shareholders amounting to €1,322,863 thousand in earlier years and the absorption into the capital reserve, on the merger of former EEPK with former HFI in 2014, of the equity of former EEPK, which totalled €536,137 thousand.

Retained earnings consist of the statutory reserves and other retained earnings. From the shortfall for 2017, €–83,644 thousand was allocated to other retained earnings. As at 31 December 2018, reserves required by law amounted to €23,500 thousand (31 December 2017: €23,500 thousand) and are subject to a limit on distribution. The other retained earnings, of €–987,035 thousand (31 December 2017: €+183,003 thousand) comprise the Bank's reinvested profits and transitory items resulting from the application of the amended IAS 19 (€2,145 thousand (31 December 2017: €2,179 thousand) after deferred tax). We also report the initial adoption effect of IFRS 9 amounting to €–916,988 thousand under this item, as well as the effect of the release of the revaluation reserve totalling €169,439.

The return on capital, calculated as net profit divided by total assets, is 0.54%.

9.10 Other financial commitments

Commerzbank Finance & Covered Bond S.A. is the lessee in a number of operating leases. As at 31 December 2018, various operating leases, none of which can be terminated, were in place for business premises leased by the parent company and other fixed assets (motor vehicles) used for the Bank's business operations. The main leases incorporate extension options and exit clauses in line with market conditions for commercial real estate, together with adjustment clauses which tie changes in the lease payment to the cost-of-living index. The minimum obligations arising out of leases not capable of being terminated for other fixed assets will generate expenses of €159 thousand in the financial year 2019 and expenses of €396 thousand in the financial years 2020 to 2023.

in €000	2018	2019	2020 up to 2023	> 2023	Total 2018 onwards
Office space	147	144	359	0	503
Other fixed assets	18	15	37	0	52

The operating leases give rise to no restrictions on future dividend payments or leveraging on the part of the Bank.

For the financial guarantees we refer to Note 9.21.

9.11 The Bank's foreign currency position

The following assets and liabilities in foreign currencies were recognised as at 31 December 2018:

in €000	USD	CHF	GBP	Other	Total 31.12.2018	Total 31.12.2017
Cash reserve	0	0	0	0	0	0
Financial assets – Amortised Cost	5,528,140	903	61,062	11,583	5,601,688	n/a
Financial assets – Loans and Receivables	n/a	n/a	n/a	n/a	n/a	212,432
Financial assets – Available for Sale	n/a	n/a	n/a	n/a	n/a	4,212,621
Financial assets – Mandatorily Fair Value P&L	5,907	0	2,592,284	0	2,598,191	n/a
Positive fair values of hedging instruments	53,494	115,187	0	5,049	173,729	197,966
Financial assets – Held for Trading	285,687	19,298	2,498	238	307,721	381,140
Financial investments	n/a	n/a	n/a	n/a	n/a	5,367,191
Other balance-sheet items	38	0	0	35	73	0
Foreign currency assets	**5,873,266**	**135,388**	**2,655,844**	**16,905**	**8,681,402**	**10,371,349**
Financial liabilities – Amortised Cost	2,994,424	838,704	1,377,194	55,579	5,265,900	5,627,954
Negative fair values of hedging instruments	450,413	0	26,668	1,661	478,742	2,679,769
Financial Assets – Held for Trading	214,901	49,171	1,189,051	5,064	1,458,187	236,599
Other liabilities	0	0	0	0	0	0
Foreign currency liabilities	**3,659,738**	**887,874**	**2,592,912**	**62,304**	**7,202,829**	**8,544,321**

The open balance-sheet positions are matched by corresponding forward foreign exchange contracts or currency swaps with matching maturities

9.12 Derivatives

The following tables show the Bank's transactions in derivatives as at the reporting date.

A derivative is a financial instrument with a value determined by an "underlying asset", which may, for example, be an interest rate, foreign exchange rate or bond price. The financial instrument requires either no initial net investment or an initial investment that is smaller than would be required for other types of contract expected to have a similar response to changes in market conditions. Settlement is at a future date.

The derivatives transactions involve OTC derivatives, where the nominal amount, maturity and price are agreed individually between the Bank and its counterparties.

The nominal amount shows the volume traded by the Bank. However, the positive and negative fair values listed in the table are the expenses which would be incurred by the Bank or the counterparty to replace the contracts originally executed with transactions of an equivalent financial value. From the Bank's point of view, a positive fair value thus indicates the maximum potential counterparty-specific default risk present from derivative transactions on the balance-sheet date.

In order to minimise both the economic and regulatory credit risk arising from these instruments, the Bank enters into master agreements (bilateral netting agreements) with its counterparties (such as the ISDA Master Agreement).

By concluding such netting agreements, the positive and negative fair values of the derivatives contracts included under a master agreement can be offset against one another, and the future regulatory risk add-ons for these products can be reduced.

This netting process reduces the credit risk to a single net claim on the party to the contract (close-out netting).

For both regulatory reports and the internal measurement and monitoring of credit commitments, such risk-mitigating techniques are used only where they are regarded as enforceable in the jurisdiction in question if the counterparty should become insolvent.

Similar to the master agreements are the collateral agreements (e.g. the Credit Support Annex), which Commerzbank Finance & Covered Bond S.A. enters into with its counterparties to secure the net claim or liability remaining after netting (receiving or providing security). As a rule, this collateral management reduces credit risk by means of prompt (usually daily or weekly) measurement and adjustment of the customer exposure.

9.13 Derivatives – further details

The following list shows the nominal amounts and fair values of derivatives broken down by interest rate-based contracts, currency-based contracts and contracts subject to other price risks, and the maturity structure of these transactions. The fair values are the sum totals of the positive and negative amounts per contract and are shown without deducting collateral and without taking account of any netting agreements, since these work on a cross-product basis. The nominal amount represents the gross volume of all sales and purchases. The maturity dates listed for the transactions are based on the term to maturity of the contracts and not the maturity of the underlying.

9.13.1 Maturity breakdown of derivatives

	Nominal values / Residual terms						Fair values	
2017 in €000	Due on demand	up to 3 months	3 months up to 1 year	over 1 year up to 5 years	over 5 years	Total 31.12.2017	Positive 31.12.2017	Negative 31.12.2017
Foreign-currency-based forward transactions not capable of being used for hedge accounting								
OTC products								
Foreign exchange spot and forward contracts	0	1,228,546	0	0	0	1,228,546	9,647	3,371
Interest rate / currency swaps	0	15,767	25,042	1,218,454	258,309	1,517,571	221,198	54,576
Total	**0**	**1,244,313**	**25,042**	**1,218,454**	**258,309**	**2,746,117**	**230,845**	**57,947**
Interest-based forward transactions								
OTC products								
Interest rate swaps not capable of being used for hedge accounting		5,636	1,286	296,408	2,616,997	2,920,326	172,899	155,345
Interest rate swaps, used as hedging derivatives	0	37,113	845,115	1,461,642	4,605,061	6,948,931	574,124	3,337,367
Other interest rate contracts not capable of being used for hedge accounting	0	0	0	0	0	0	0	0
Total	**0**	**42,749**	**846,400**	**1,758,051**	**7,222,057**	**9,869,258**	**747,023**	**3,492,712**
Total pending forward transactions	**0**	**1,287,062**	**871,442**	**2,976,505**	**7,480,366**	**12,615,374**	**977,868**	**3,550,658**

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	Nominal values / Residual terms						Fair values	
2018 in €000	Due on demand	up to 3 months	3 months up to 1 year	over 1 year up to 5 years	over 5 years	Total 31.12.2018	Positive 31.12.2018	Negative 31.12.2018
Foreign-currency-based forward transactions not capable of being used for hedge accounting								
OTC products								
Foreign exchange spot and forward contracts	0	968,288	0	0	0	968.288	10.642	5.139
Interest rate / currency swaps	0	18,963	53,951	1,249,241	193,129	1,515,285	185,781	106,483
Total	**0**	**987,252**	**53,951**	**1,249,241**	**193,129**	**2,483,573**	**196,423**	**111,622**
Interest-based forward transactions								
OTC products								
Interest rate swaps not capable of being used for hedge accounting		60,587	58,824	480,657	2,278,973	2,879,042	137,316	1,321,455
Interest rate swaps, used as hedging derivatives	0	123,567	121,742	1,361,670	3,844,958	5,451,938	486,614	1,091,038
Other interest rate contracts not capable of being used for hedge accounting	0	0	0	73,000	0	73,000	4,563	0
Total	**0**	**184,154**	**180,567**	**1,915,328**	**6,123,932**	**8,403,980**	**628,493**	**2,412,493**
Total pending forward transactions	**0**	**1,171,406**	**234,518**	**3,164,569**	**6,317,061**	**10,887,553**	**824,915**	**2,524,115**

9.13.2 Counterparty breakdown of derivatives

The table below shows the positive and negative fair values of the Bank's derivative business broken down by counterparty. The Bank conducts derivative transactions with credit and financial institutions with excellent credit ratings based in an OECD country.

	Fair values		Fair values	
in €000	positive 31.12.2018	negative 31.12.2018	positive 31.12.2017	negative 31.12.2017
OECD banks	820,353	2,288,492	977,868	3,289,406
OECD financial institutions	4,563	235,623	0	261,252
Total	**824,915**	**2,524,115**	**977,868**	**3,550,658**

9.13.3 Use of financial derivatives

The following table shows how financial derivatives are used. Derivatives are used for hedging purposes. The applicable criteria are described in the accounting and measurement methods (Note 5.13).

	Fair values		Fair values	
in €000	positive 31.12.2018	negative 31.12.2018	positive 31.12.2017	negative 31.12.2017
Hedging instruments not qualified for being used for hedge accounting	338,301	1,433,076	403,744	213,291
Derivatives used as hedging instruments	486,614	1,091,038	574,124	3,337,367
for micro fair value hedge accounting	486,614	1,091,038	574,124	3,337,367
Total	**824,915**	**2,524,115**	**977,868**	**3,550,658**

The fair values of the derivatives used as hedging instruments for micro fair value hedge accounting are included in the balance-sheet items positive fair values of derivative hedging instruments and negative fair values of derivative hedging instruments.

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The above hedging transactions are used to hedge the following assets and liabilities as part of micro fair value hedge accounting.

in €000	Carrying amount 31.12.2018	Cumulative carrying amount adjustment 31.12.2018	Carrying amount 31.12.2017	Cumulative carrying amount adjustment 31.12.2017
Financial assets – Amortised Cost	**4,863,791**	**1,065,785**	**8,365,881**	**2,983,886**
Loans and receivables	0	0	4,141,443	2,099,417
Securitised debt instruments	4,863,791	1,065,785	4,224,438	884,469
Financial assets – Fair Value OCI	**0**	**0**	**864,155**	**345,453**
Securitised debt instruments	0	0	864,155	345,453
Financial liabilities – Amortised Cost	**2,423,015**	**453,463**	**3,307,705**	**519,190**
Deposits and other financial liabilities	1,327,490	289,675	1,383,473	312,778
Securitised liabilities	1,095,525	163,788	1,924,232	206,412

9.13.4 Information on netting of financial instruments

We set out below the reconciliation of gross amounts before netting to net amounts after netting, as well as the amounts for existing netting rights that do not meet the accounting criteria for netting are presented separately for all financial assets and liabilities carried on the balance sheet that are already netted in accordance with IAS 32.42, and are subject to an enforceable, bilateral master netting agreement or a similar agreement but are not netted in the balance sheet. For the netting agreements, we conclude master agreements with our counterparties, e.g. 1992 ISDA Master Agreement (Multicurrency – Cross Border) and German Master Agreement for Financial Futures. By means of such netting agreements, the positive and negative fair values of the derivatives contracts included under a master agreement can be offset against one another. This netting process reduces the credit risk to a single net claim on the party to the contract (close-out netting).

2017 in €000	Derivatives Positive market values	Derivatives Negative market values
Gross amount before balance-sheet netting	**2,691,002**	**3,580,698**
Netting recorded in the balance sheet	**0**	**0**
Netting not recorded in the balance sheet	**695,486**	**1,694,715**
From master netting agreements not yet recognised	531,461	725,533
from cash collateral	164,025	969,182
Values in the balance sheet without netting agreement	**1,995,516**	**1,885,983**

2018 in €000	Derivatives Positive market values	Derivatives Negative market values
Gross amount before balance-sheet netting	**824,916**	**2,549,398**
Netting recorded in the balance sheet	**0**	**0**
Netting not recorded in the balance sheet	**595,655**	**1,346,019**
From master netting agreements not yet recognised	448,324	609,767
from cash collateral	147,331	736,252
Values in the balance sheet without netting agreement	**229,261**	**1,203,379**

9.14 Maturity breakdown

The residual term is defined as the period of time between the reporting date and the date on which the claim or liability falls contractually due.

Maturities of assets and liabilities

The Bank divides all assets and liabilities into current and non-current as set out below. Please refer to Note 9.13.1 for the breakdown of the nominal value of derivatives. The Bank defines the residual term or date of anticipated performance or settlement as current if the period between the reporting date and the maturity date is less than one year. Financial instruments in trading assets and liabilities without contractual maturity dates, the cash reserve, assets and liabilities held for sale, and actual taxes on income, are generally classified as current. However, the Bank generally classifies fixed assets as non-current. When it comes to the breakdown of other assets and liabilities, an estimate of the main items is made.

Expected cash flows are as follows:

31.12.2017 in €000	due on demand	Residual term up to 3 months	Residual term 3 months to 1 year	Residual term 1 year to 5 years	Residual term over 5 years	Total
Loans and receivables	971,499	647,702	114,303	440,429	5,091,880	**7,265,813**
Securitised debt instruments	0	108,000	284,907	2,097,064	7,116,513	**9,606,484**
Positive fair values from derivatives	0	5,016	23,051	183,780	672,780	**884,627**
Deposits	-174,596	-2,160,534	-1,195,833	-3,004,487	-1,069,770	**-7,605,219**
Securitised liabilities	0	-12,884	-879,548	-1,078,100	-926,595	**-2,897,128**
Subordinated liabilities	0	0	-750	-7,786	-10,736	**-19,272**
Negative fair values from derivatives	0	-159	-476	-197,592	-3,294,790	**-3,493,017**

31.12.2018 in €000	due on demand	Residual term up to 3 months	Residual term 3 months to 1 year	Residual term 1 year to 5 years	Residual term over 5 years	Total
Claims on customers	744,997	272,839	70,997	364,545	4,401,792	**5,855,170**
Securitised debt instruments	0	360,137	367,516	2,482,052	6,922,719	**10,132,423**
Positive fair values from derivatives	0	5,899	12,376	157,764	591,073	**767,112**
Deposits	-213,711	-233,885	-1,025,804	-2,862,785	-1,431,204	**-5,767,389**
Securitised liabilities	0	-93,861	-86,425	-918,185	-934,363	**-2,032,834**
Subordinated liabilities	0	0	-750	-7,520	-10,252	**-18,522**
Negative fair values from derivatives	0	-171	-3,539	-244,262	-2,222,964	**-2,470,936**

9.15 Repo and reverse repo transactions, securities lending transactions and cash collaterals

Repo transactions combine the spot purchase or sale of securities with their forward sale or repurchase, the counterparty being identical in both cases. Securities sold under repurchase agreements (spot sale) continue to be recognised and measured in the balance sheet in accordance with the underlying category as part of the securities portfolio. The securities are not derecognised as we retain all risks and opportunities connected with the ownership of the security sold under the repurchase agreement. The same risks and opportunities that apply to non-transferred financial assets thus also apply to financial assets that have been transferred but not derecognised. The money received from repo transactions where Commerzbank Finance & Covered Bond S.A. is the borrower (i.e. where it is under an obligation to take the

securities back) is shown in the balance sheet as a liability to banks or customers.

We conclude securities lending transactions with other banks in order to meet delivery commitments or to enable the Bank to effect securities repurchase agreements. We report these transactions in a similar manner to securities repurchase transactions. Securities lent remain in our securities portfolio and are classified and measured according to the rules of IFRS 9.

Borrowed securities do not appear in the balance sheet, nor are they valued. In securities lending transactions, the counterparty credit risk can be avoided by obtaining collateral, which may be provided in the form of cash, for example. Collateral furnished for a lending transaction is referred to as "cash collateral out" and collateral received as "cash collateral in". In addition, cash collateral is deposited or received in connection with derivative transactions.
In repo transactions, the Bank sells or purchases securities with the obligation to repurchase or return them.

The repo and securities lending transactions executed up to the reporting date and the cash collaterals received or paid broke down as follows:

in €000	31.12.2018	31.12.2017
Repurchase agreements as borrower		
Financial liabilities – Amortised Cost	1,387,537	953,983
Cash collaterals received		
Financial liabilities – Amortised Cost	147,331	164,025
Total	**1,534,868**	**1,118,009**
Cash collaterals paid		
Financial assets – Amortised Cost	741,082	954,642
Total	**741,082**	**954,642**

Assets were transferred as collateral for the following liabilities from genuine repurchase agreements where the Bank is the borrower.

in €000	31.12.2018	31.12.2017
Financial liabilities – Amortised Cost	1,387,537	953,983

The following assets were transferred as collateral for the above liabilities:

in €000	31.12.2018	31.12.2017
Financial assets – Amortised Cost		
Carrying amount of securities transferred	1,388,558	1,091,497

Securities lent in securities lending transactions:

in €000	31.12.2018	31.12.2017
Financial assets – Amortised Cost		
Carrying amount of securities transferred	892,103	3,531,620

The collateral was provided to borrow under securities repurchase agreements (repos). The transactions were carried out on standard market terms for securities lending and repo transactions.

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9.16 Maximum credit risk

The maximum credit risk exposure under IFRS 7 – excluding collateral or other credit enhancements – is equal to the carrying amounts after impairments of the relevant assets in each class, or the nominal values of irrevocable lending commitments. The table below shows the carrying amounts or nominal values of financial instruments with a potential default risk:

in €000	31.12.2018	31.12.2017
Financial assets – Amortised Cost	8,576,147	n/a
Loans and receivables	1,055,414	n/a
Securitised debt instruments	7,520,733	n/a
Financial assets – Loans and Receivables	n/a	12,701,655
Loans and receivables	n/a	6,862,787
Securitised debt instruments	n/a	5,838,868
Financial assets – Available for Sale	n/a	864,155
Loans and receivables	n/a	0
Securitised debt instruments	n/a	864,155
Financial assets – Mandatorily Fair Value P&L	2,633,044	n/a
Loans and receivables	34,853	n/a
Securitised debt instruments	2,598,191	n/a
Financial assets – Held for Trading	338,301	403,744
Derivatives	338,301	403,744
Positive fair values of derivative hedging instruments	486,614	574,124
Contingent liabilities	514	519
Total	**12,034,620**	**14,544,196**

The maximum credit risk exposures listed above are not part of internal credit risk management, as credit risk management also takes account of collateral, probabilities of default and other economic factors. These amounts are therefore not representative of the Bank's assessment of its actual credit risk.
For the fair value of the derivatives the Bank has received collateral in the form of cash collaterals amounting to €147,331 thousand (2017: €164,025 thousand). See also Note 9.15.

9.17 Regulatory capital requirements

The Bank uses the standard approach for credit and market risk to determine its capital adequacy; authorisation to do so has been confirmed by the regulator, the CSSF. Operational risk is determined using the advanced approach.

The Bank's regulatory capital as at 31 December 2018 was €990m (31 December 2017: €2,062m) and its overall ratio 37.10% (31 December 2017: 67.09%). Capital adequacy is determined by application of Regulation (EU) 575/2013.

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Regulatory capital in €000	31.12.2018	Change	31.12.2017
Tier 1 capital			
Subscribed capital	235,000	0	235,000
Reserves	895,465	–1,170,038	2,065,503
Result carried forward	0	0	0
Shortfall for the year	0	0	0
Deductions from tier 1 capital	–151,709	99,414	–251,123
Total tier 1 capital	**978,756**	**–1,070,624**	**2,049,380**
Tier 2 (supplementary) capital			
Subordinated loans	11,421	–925	12,346
Positive revaluation reserve			
Deductions from tier 2 capital			
Total tier 2 capital	**11,421**	**–925**	**12,346**
Total equity	**990,177**	**–1,071,549**	**2,061,726**
Own funds requirements			
from credit risk	203,894	–29,487	233,381
from CVA RCC	8,647	–3,265	11,912
from operational risks	950	382	568
Total own funds requirements	**213,492**	**–32,369**	**245,861**
Equity coefficient	**37.10**	**–29.98**	**67.09**

Own funds requirements in €000	31.12.2018	Change	31.12.2017
Credit risk positions			
Exposure class			
Claims on central government and central banks	140,829	–29,089	169,918
Claims on institutions	13,324	–724	14,048
Claims on companies	2,879	–306	3,185
Securitisation positions	45,302	1,754	43,548
Other assets (other loan obligations)	1,559	–1,123	2,682
CVAs	8,647	–3,265	11,912
Operational risk	950	382	568
Own funds requirements (total)	**213,492**	**-32,369**	**245,861**

9.18 Leverage ratio

The CRD IV/CRR has introduced the leverage ratio as a tool and indicator for quantifying the risk of excessive leverage. The leverage ratio shows the ratio of Tier 1 capital to leverage exposure, consisting of the non-risk-weighted assets plus off-balance-sheet positions. The way in which exposure to derivatives, securities financing transactions and off-balance-sheet positions is calculated is laid down by regulators. The leverage ratio at the end of financial year 2018 was calculated on the basis of the CRR as revised in January 2015. The leverage ratio, as a non-risk-sensitive key indicator, is a supplementary key indicator of risk-based capital adequacy.

Avoiding the risk of excessive leverage is an integral part of the Bank's management of its balance sheet. Quarterly regulatory reporting to the CSSF takes place on the basis of regulatory requirements.

The ratio as at 31 December 2018 stood at 8.52%.

9.19 Liquidity coverage ratio

The liquidity coverage ratio (LCR) is the regulatory minimum liquidity ratio. It is a measure of the near-term solvency of the Bank under a predetermined stress scenario. Based on the requirements of the Basel Committee, the EU Commission set out the legal foundation for the LCR in the Capital Requirements Regulation (CRR) and in Regulation (EU) No. 575/2013, in conjunction with Delegated Regulation EU/2015/61 (D–REG).

The ratio itself is defined as the relationship between high quality liquid assets (HQLA) and net liquidity outflows (NLOs) within a 30-day period. It has been reported to the supervisory authorities in this form since 30 September 2016. Under the CRR, a minimum value of 100% has to be complied with since 1 January 2018. The Bank has integrated the LCR into its internal liquidity risk model as a binding secondary condition, and the change in the LCR is monitored regularly.

The ratio as at 31 December 2018 stood at 228%.

9.20 Fair value of financial instruments

9.20.1 Determination of fair value

This note provides more information on the determination of fair values of financial instruments which are not recognised at fair value in the balance sheet, but for which a fair value has to be stated under IFRS 7.

The methods used to determine the fair values of financial instruments reported in the balance sheet at their fair values are set out in the accounting and measurement methods, Note 5.4 and in the section "Fair Value Hierarchy" (Note 9.20.2) below.

The nominal value of financial instruments that fall due on demand is taken as their fair value. These instruments include the cash reserve and claims on and liabilities due on demand.

Direct market prices are not available for loans or for financial investments reclassified as financial assets – Amortised Cost as part of the initial adoption of IFRS 9 as there are no organised markets on which such financial instruments are traded. The fair value of these instruments is calculated using mathematically accepted measurement procedures and up- to-date parameters derived from observation of the market.

Loans and financial investments reclassified as financial assets – Amortised Cost as part of the initial adoption of IFRS 9 are measured using a discounted cash flow model with parameters based on a risk-free yield curve, credit spreads, and a fixed premium to cover liquidity spreads and administration and equity costs. The fair value of liabilities is also determined using a risk-free yield curve, with Commerzbank AG's credit spread and a premium for administration costs applied separately. Market credit spreads for public and registered Lettres de gage and loans received are also used.

The fair value of securitised and subordinated liabilities is generally determined by reference to listed market prices. A number of different factors, including current market interest rates and the credit rating of the Commerzbank Group, are taken into account in determining fair value. If no quoted prices are available, fair values are calculated using mathematical measured models (discounted cash flows, option price models) that are themselves based on yield curves, volatilities, own credit spreads, etc.

The table below compares the fair values of the balance-sheet items with their carrying amounts, taking into account recognised loan loss provisions:

	Fair value		Carrying amount	
Assets in €000	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Cash reserve	**5,263**	**105,326**	**5,263**	**105,326**
Financial assets – Amortised Cost	**7,965,606**	**n/a**	**8,576,147**	**n/a**
Loans and receivables	1,055,919	n/a	1,055,414	n/a
Securitised debt instruments	6,909,687	n/a	7,520,733	n/a
Financial assets – Loans and Receivables	**n/a**	**11,126,817**	**n/a**	**12,701,655**
Loans and receivables	n/a	4,729,448	n/a	5,838,868
Securitised debt instruments	n/a	6,397,369	n/a	6,862,787
Financial assets – Available for Sale	**n/a**	**864,155**	**n/a**	**864,155**
Securitised debt instruments	n/a	864,155	n/a	864,155
Financial assets – Mandatorily Fair Value P&L	**2,633,044**	**n/a**	**2,633,044**	**n/a**
Loans and receivables	2,598,191	n/a	2,598,191	n/a
Securitised debt instruments	34,853	n/a	34,853	n/a
Financial assets – Held for Trading	**338,301**	**403,744**	**338,301**	**403,744**
Derivatives	338,301	403,744	338,301	403,744
Positive fair values of derivative hedging instruments	**486,614**	**574,124**	**486,614**	**574,124**

	Fair value		Carrying amount	
Liabilities in €000	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Financial liabilities – Amortised Cost	**8,080,122**	**8,929,499**	**8,301,251**	**9,067,195**
Deposits	6,957,040	6,939,179	7,090,099	7,015,068
Securitised liabilities	1,123,082	1,990,320	1,211,152	2,052,127
Financial Assets – Held for Trading	**1,433,076**	**213,291**	**1,433,076**	**213,291**
Derivatives	1,433,076	213,291	1,433,076	213,291
Negative fair values of derivative hedging instruments	**1,091,038**	**3,337,367**	**1,091,038**	**3,337,367**

When netted, the difference between carrying amount and fair value across all items as at 31 December 2018 is €–389.4m (31 December 2017: €–1,437.1m).

9.20.2 Fair value hierarchy

Under IFRS 13, financial instruments are assigned to the three levels of the fair value hierarchy as follows:

Level 1:
Financial instruments where the fair value is based on quoted prices for identical financial instruments in an active market.

Level 2:
Financial instruments where no quoted prices are available for identical instruments in an active market and the fair value is established using valuation techniques which rely on observable market parameters.

Level 3:
Financial instruments where valuation techniques are used that incorporate at least one material input for which there is insufficient observable market data and where at least this input has a more than insignificant impact on the fair value.

With respect to the methods of model-based measurements (level 2 and level 3) relevant for banks, IFRS 13 recognises the market approach and the income approach. The market approach relies on measurement methods that draw on information about identical or comparable assets and liabilities.

The income approach reflects current expectations about future cash flows, expenses and income. The income approach may also include option price models. These valuations are subject to the Board of Directors' judgement to a greater extent. Market data or third-party inputs are relied on to the greatest possible extent, and company-specific inputs to a limited degree.

Valuation models must be consistent with accepted economic methodologies for pricing financial instruments and must incorporate all factors that market participants would consider appropriate in setting a price. The fair values that can be realised at a later date may fundamentally deviate from the estimated fair values. All fair values are subject to the Commerzbank

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Group's internal controls and procedures, which set out the standards for independently verifying or validating fair values. These controls and procedures are carried out and coordinated by the Independent Price Verification (IPV) Group within the finance function of Commerzbank AG. The models, inputs and resulting fair values are reviewed regularly by senior management and the risk function.

Disclosure obligations
The respective disclosure requirements regarding these financial instruments are set out in IFRS 7 and IFRS 13. For example, they require explanatory statements on the valuation techniques applied and the inputs used for levels 2 and 3, as well as quantitative disclosures on unobservable inputs (level 3). The reporting entity must also provide the date of, reasons for and information about reclassifications between fair value hierarchy levels, reconciliations between the opening and closing balances for level 3 portfolios as at the respective reporting dates, and unrealised gains and losses. In addition, sensitivities for the unobservable inputs (level 3) are to be presented, and information on the day one profit or loss is to be provided.

Under IFRS 13, the fair value of an asset is the amount for which it could be sold between knowledgeable, willing, independent parties in an arm's length transaction. The fair value therefore represents an exit price. The fair value of a liability is defined as the price at which the debt could be transferred to a third party as part of an orderly transaction.

The measurement of liabilities must also take account of the Bank's own credit spread. If third parties provide security for our liabilities (e.g. guarantees), this security is not taken into account in the valuation of the liability, as the Bank's repayment obligation remains the same.

IFRS 9 requires that all financial instruments be measured at fair value upon initial recognition. This is usually the transaction price. If a portion relates to something other than the financial instrument being measured, fair value is estimated using a valuation method.

In the tables below, the financial instruments reported in the balance sheet at fair value are grouped according to the IFRS 9 measurement categories and by class.

Financial assets in €000	Level I	Level II	Level III	Total 31.12.2018	Total 31.12.2017
Cash reserve	**0**	**5,263**	**0**	**5,263**	**105,326**
Financial assets – Amortised Cost	**1,079,225**	**6,886,381**	**0**	**7,965,606**	**n/a**
Loans and receivables	0	1,055,919	0	1,055,919	n/a
Securitised debt instruments	1,079,225	5,830,462	0	6,909,687	n/a
Financial assets – Loans and Receivables	**n/a**	**n/a**	**n/a**	**n/a**	**11,126,817**
Loans and receivables	n/a	n/a	n/a	n/a	4,729,448
Securitised debt instruments	n/a	n/a	n/a	n/a	6,397,369
Positive fair values of derivative hedging instruments	**0**	**486,614**	**0**	**486,614**	**574,124**
Financial assets – Held for Trading	**0**	**338,301**	**0**	**338,301**	**403,744**
Derivatives	0	338,301	0	338,301	403,744
Available-for-sale financial investments	**n/a**	**n/a**	**n/a**	**n/a**	**864,155**
Securitised debt instruments	n/a	n/a	n/a	n/a	864,155
Financial assets – Mandatorily Fair Value P&L	**0**	**34,853**	**2,598,191**	**2,633,044**	**n/a**
Loans and receivables	0	0	2,598,191	2,598,191	n/a
Securitised debt instruments	0	34,853	0	34,853	n/a
Total	**1,079,225**	**7,751,412**	**2,598,191**	**11,428,828**	**13,074,165**

Financial liabilities in €000	Level I	Level II	Level III	Total 31.12.2018	Total 31.12.2017
Financial liabilities – Amortised Cost	**0**	**8,080,122**	**0**	**8,080,122**	**8,929,499**
Deposits	0	6,957,040	0	6,957,040	6,939,179
Securitised liabilities	0	1,123,082	0	1,123,082	1,990,320
Negative fair values of derivative hedging instruments	**0**	**1,091,038**	**0**	**1,091,038**	**3,337,367**
Financial Assets – Held for Trading	**0**	**1,433,076**	**0**	**1,433,076**	**213,291**
Derivatives	0	1,433,076	0	1,433,076	213,291
Total	**0**	**10,604,237**	**0**	**10,604,237**	**12,480,157**

A reclassification to a different level occurs where a financial instrument is reclassified from one level of the 3-level valuation hierarchy to another. This may be caused, for example, by market changes that impact on the input factors used to value the financial instrument. The Bank reclassifies items at the end of the reporting period. In 2018, as in 2017, no reclassifications were carried out.

The changes in financial instruments in the level 3 category and recognised at fair value were as follows:

in €000	Financial assets – Mandatorily Fair Value P&L
Fair value as at 1.1.2018	**3,131,905**
Gains or losses recognised in income statement during the period	–90,601
Sales	**0**
Redemptions	–443,113
Fair value as at 31.12.2018	**2,598,191**

In 2017, no level 3 financial instruments were recognised at fair value.

9.20.3 Sensitivity analysis

Where the value of financial instruments is based on unobservable input parameters (level 3), the precise level of these parameters at the reporting date may be derived from a range of reasonable possible alternatives at the discretion of the Board of Directors. In preparing the financial statements, appropriate levels for these unobservable input parameters are chosen which are consistent with existing market evidence and in line with the Group's valuation control approach. The purpose of this disclosure is to illustrate the potential impact of the relative uncertainty in the fair values of financial instruments with valuations based on unobservable input parameters (level 3). Interdependencies frequently exist between the parameters used to determine level 3 fair values. Such interdependencies are accounted for by means of correlation parameters insofar as they have a significant effect on the fair values in question. If a valuation model uses several parameters, the choice of one parameter may restrict the range of possible values the other parameters may take. So, by definition, this category will contain more illiquid instruments, instruments with longer-term maturities and instruments where sufficient independent observable market data is difficult to obtain. The purpose of this information is to illustrate the main unobservable input parameters for level 3 financial instruments and subsequently present various inputs on which the key input parameters were based.

The main unobservable input parameters for level 3 and the key related factors may be summarised as follows:

Internal rate of return (IRR):
The IRR is defined as the discount rate that sets the net present value of all future cash flows from an instrument equal to zero. For bonds, for example, the IRR depends on the current bond price, the nominal value and the duration.

Credit spread:
The credit spread is the yield spread (premium or discount) between securities that are identical in all respects except for their respective credit quality. The credit spread represents the excess yield above the benchmark reference instrument that compensates for the difference in creditworthiness between the instrument and the benchmark. Credit spreads are quoted in terms of the number of basis points above (or below) the quoted benchmark. The wider (higher) the credit spread in relation to the benchmark, the lower the instrument's creditworthiness, and vice versa for narrower (lower) credit spreads.
The following material, non-observable input parameters were used for the valuation of our level 3 financial instruments:

in €000	Assets 31.12.2018	Valuation technique	Significant unobservable input parameters
Loans and receivables	**2,598,191**	**Discounted-Cashflow-Modell**	**Credit Spread**

A range between 70 and 120 basis points was used for the credit spread.

The table below shows the impact on the income statement of reasonable parameter estimates on the edges of these ranges for instruments in level 3 of the fair value hierarchy. The selected parameters lie at the extremes of their range of reasonable possible alternatives. In practice, however, it is unlikely that all unobservable parameters would simultaneously lie at the extremes of their range of reasonable possible alternatives.
Consequently, the estimates provided are likely to exceed the actual uncertainty in the fair values of these instruments. The purpose of these figures is not to estimate or predict future changes in fair value. To this end, the unobservable parameters on the market (here: credit spread) were adjusted by 10 basis points by independent valuation experts.

in €000	Positive effects on income statement	Negative effects on income statement	Changed parameters
Loans and receivables	**51,319**	**–49,805**	**Credit Spread**

9.21 Off-balance-sheet liabilities

The residual terms of contingent liabilities and irrevocable lending commitments were as follows:

in €000	31.12.2018	31.12.2017
from guarantees and indemnity agreements	0	5
Other warranties	514	514
Total	**514**	**519**

The item other warranties relates to the irrevocable payment obligation which the Single Resolution Board (SRB) granted following approval of the Bank's application for the provision of a security to partially settle the amount of the bank levy. The residual terms of the contingent liabilities are as follows:

in €000	31.12.2018	31.12.2017
due on demand	0	5
up to three months	0	0
three months to one year	0	0
one year to five years	0	0
over five years	514	514
Total	**514**	**519**

9.22 Details of material transactions with related parties and persons

IAS 24 defines related parties as persons and companies capable of being influenced by Commerzbank Finance & Covered Bond S.A., capable of exercising influence over it, or under the influence of another of the Bank's related parties.

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In the course of its ordinary activities, Commerzbank Finance & Covered Bond S.A. enters into business relationships with related parties, both persons and companies. Persons in key positions are defined as members of the Board of Managing Directors and the Supervisory Board of Commerzbank AG, the Board of Directors of Commerzbank Finance & Covered Bond S.A., members of their families, and companies controlled by these persons.

Related parties are the parent company, its parent and affiliated companies and their subsidiaries. The transactions were executed on normal market terms.
Furthermore, Commerzbank AG has issued a letter of comfort for CFCB ensuring, except in the case of political risks, that the Bank is able to meet its contractual liabilities (see also Note 6.3.3).

The table below shows the carrying amounts of claims on and liabilities to related parties and persons in key positions.

2017 in €000	**related parties**	**related persons**
Financial assets – Amortised Cost	315,418	-
Positive fair values of derivative hedging instruments	287,751	-
Financial assets – Held for Trading	243,710	-
Other assets	24,518	-
Assets in relation to related parties and persons	**871,397**	**-**
Financial liabilities – Amortised Cost	5,489,132	-
Negative fair values of derivative hedging instruments	2,033,068	-
Financial Assets – Held for Trading	120,012	-
Other liabilities	2,833	-
Liabilities to related parties and persons	**7,645,046**	**-**

2018 in €000	**related parties**	**related persons**
Financial assets – Amortised Cost	169,470	-
Positive fair values of derivative hedging instruments	244,415	-
Financial assets – Held for Trading	203,909	-
Other assets	6,034	-
Assets in relation to related parties and persons	**623,827**	**-**
Financial liabilities – Amortised Cost	5,619,423	-
Negative fair values of derivative hedging instruments	462,993	-
Financial Assets – Held for Trading	1,107,580	-
Other liabilities	6	-
Liabilities to related parties and persons	**7,190,002**	**-**

Furthermore, Commerzbank AG has issued a letter of comfort for the Bank ensuring, except in the case of political risks, that the Bank is able to meet its contractual liabilities (see also Note 6.3.3).

Transactions with related parties in the financial year under review resulted in interest income of €4,395 thousand (31 December 2017: €11,275 thousand) and interest expense of €80,816 thousand (31 December 2017: €71,100 thousand).

Further information on expenses relating to the remuneration of board members may be found in Note 7.10.1.

Moreover, expenses amounting to €15,504 thousand were incurred in the context of service charges within the Group.

All claims and liabilities as at 31 December 2018 and 31 December 2017 relate solely to the parent company.

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9.23 Cash flow statement

The cash flow statement is compiled in accordance with IAS 7. It shows the structure of and changes in cash and cash equivalents during the financial year. It is broken down into operating activities, investing activities and financing activities.
Net cash from operating activities includes payments (inflows and outflows) relating to financial assets and also other assets. Increases and decreases in financial liabilities and other liabilities also come under operating activities. The interest and dividend payments resulting from operating activities are similarly reflected in net cash from operating activities.

Net cash from investing activities is made up of cash flows relating to financial investments and fixed assets. Net cash from financing activities consists of the proceeds of capital increases as well as payments made or received on subordinated debt.

Cash and cash equivalents consists of items that can be rapidly converted into liquid funds and are subject to a negligible risk of changes in value. This includes the "cash reserve" item, which is made up of cash on hand and credit balances with central banks (Note 8.1). Claims on banks which are due on demand are not included.

The cash flow statement is not very informative with regard to Commerzbank Finance & Covered Bond S.A. For the Bank, the cash flow statement replaces neither liquidity planning nor financial planning, nor is it employed as a management tool.

Changes in liabilities from financing activities were as follows:

in €000	Notes	31.12.2017	Cash items	Exchange rate change	Other non-Cash items	31.12.2018
Financial liabilities – Amortised Cost	5.4, 9.1					
Total		**17,729**	**-750**	**0**	**390**	**17,369**

In the cash flow statement, interest payments on subordinated loans, €750m for the year 2018, are allocated to cash flow from operating activities.

9.24 Events after the reporting date

In January 2019, the Bank decided to sell a portfolio of loans to British local authorities, which was reported under the balance-sheet item "Financial assets – mandatorily fair value P&L" with a carrying amount of €2,592.3m as at 31 December 2018, to Commerzbank AG.

No further events of particular significance in relation to the Bank's equity capital, financial position or results occurred during the period from 31 December 2018 to 11 April 2019.

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10.1 Cover holdings and public mortgage bonds

The cover holdings required by Articles 12–1 to 12–12 of the amended, consist solely of securities subject to monitoring Law of 5 April 1993 on the financial sector, as currently by a trustee.

The cover holdings are broken down by balance-sheet item as follows:

Public Lettres de gage/ordinary cover	in €000	in % of cover assets
Claim on banks	-	**0.00**
Claim on customers		
Public-sector loans	1,234,838	51.17
Bonds and notes		
issued by public-sector borrowers	1,168,621	48.43
other (secured bypublic bodies)	9,612	0.40
Total cover assets	**2,413,071**	**100.00**
Substitute cover	-	-
	2,413,071	**100.00**
Public Lettres de gage for which cover is required	**2,239,715**	**92.82**
Cover surplus	**173,356**	**7.74**

Using internal ratings on a prescribed scale between 1.0 and 6.5, cover holdings broke down at the end of the financial year as follows:

Ratings	in €000	in % of cover assets
1.0 - 1.2.	121,062	5.02
1.4 - 1.6.	346,682	14.37
1.8 - 2.0	1,208,597	50.09
2.2 - 2.8	520,751	21.58
3.0 - 3.6	163,112	6.76
3.8 - 5.0	42,852	1.78
5.2 - 5.8	10,013	0.41
6.1 - 6.2	0	0.00
Total portfolio	**2,413,071**	**100.00**

Cover holdings broke down by size as follows:

By size	Number	in €000	in % of cover assets
up to 5m	57	133,127	5.52
up to 10m	72	454,605	18.84
up to 25m	57	830,249	34.41
over 25m	21	995,090	41.24
Total	**207**	**2,413,071**	**100.00**

Cover holdings broken down by country as follows:

Countries 31.12.2018	in €000	in % of cover assets
Canada	54,526	2.26
United Kingdom	1,176,400	48.75
Italy	302,102	12.52
Japan	93,100	3.86
Portugal	37,800	1.57
Spain	50,682	2.10
United States	698,461	28.94
Total	**2,413,071**	**100.00**

10.2 Group Financial Statements

The Bank's annual financial statements are included in the Group financial statements of Commerzbank AG, Frankfurt am Main.

These may be obtained from the following address:

Commerzbank AG
Investor Relations
Kaiserplatz
60261 Frankfurt am Main
Germany

Or as download from:

https://www.commerzbank.de/media/aktionaere/service/archive/konzern/2019_1/Geschaeftsbericht_2018_Konzern_EN.pdf

10.3 Deposit guarantee scheme

The Luxembourg law on the resolution, recovery and dissolution measures of banks and securities firms and on deposit guarantee and investor compensation schemes ("the Law") was adopted on 18 December 2015; this transposes into Luxembourg law EU directives 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms and 2014/49/EU on deposit guarantee and investor compensation schemes. The deposit guarantee and investor compensation scheme that had been in place until then and which was introduced by the AGDL, was replaced by a new deposit guarantee and investor compensation scheme based on contributions.

The new system guarantees all recoverable deposits from the same depositor up to €100,000 ("Fonds de garantie des dépôts Luxembourg" (FGDL / Luxembourg deposit guarantee fund)) and investment transactions up to €20,000 per investor ("Système d'indemnisation des investisseurs Luxembourg" (SIIL / Luxembourg investor compensation scheme)).

Provisions recognised in the past in banks' annual financial statements for the purposes of the AGDL will be progressively used up in line with the contributions to be paid by banks to the Luxembourg deposit guarantee fund ("Fonds de garantie des dépôts Luxembourg" (FGDL)) and/or the Luxembourg resolution fund ("Fonds de résolution" (FDR)).

Since the Bank neither accepts deposits from private individuals nor conducts securities transactions for its customers, it is under no obligation in the event of the failure of another bank. No provision for this purpose has therefore been recognised.

10.4 Registered Office

Commerzbank Finance & Covered Bond S.A.
P.O. Box 321, L-2013 Luxembourg
25 rue Edward Steichen
L-2540 Luxembourg

Tel.: + 352 477 911 - 1
Fax: + 352 477 911 - 5348
Email: info@commerzbank-fcb.com
Website: www.commerzbank-fcb.com

Commercial Registry:
R.C.S. Luxembourg B 30.469
VAT ID No. LU14147251

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Responsibility statement by the Board of Managing Directors

To the best of our knowledge, and in accordance with the applicable reporting principles, the financial statements give a true and fair view of the net assets, financial position and results of operations of Commerzbank Finance & Covered Bond S.A., and the management report includes a fair review of the development and performance of the business and the position of the Bank, together with a description of the principal opportunities and risks associated with the expected development of the Bank.

Luxembourg, 11 April 2019

Commerzbank Finance & Covered Bond S.A.
The Managing Directors

Gerard-Jan Bais Markus Blaes

Bank Committees

Board of Directors

Hermann RAVE
Bad Soden am Taunus, Germany
Deputy Chairman
Head of Group Accounting, Commerzbank AG, Frankfurt am Main

Gerard-Jan BAIS
Steinsel, Luxembourg
Member of the Board of Directors and Managing Director, Commerzbank Finance & Covered Bond S.A., Luxembourg

Markus BLAES
Freudenburg, Germany
Member of the Board of Directors and Managing Director, Commerzbank Finance & Covered Bond S.A., Luxembourg and Head of Treasury, Commerzbank AG, Luxembourg branch

Manfred BIER
Goergeshausen, Germany
Head of Group Treasury Investment Office (IO), Commerzbank AG, Frankfurt am Main

Arno KRATKY
Hofheim, Germany
Principal Project Manager, Group Market Risk Management, Commerzbank AG, Frankfurt am Main

Thorsten KANZLER
Wiesbaden, Germany
Chairman
Head of Group Treasury, Divisional Board Member, Commerzbank AG, Frankfurt am Main (until 26 July 2018)

General Management

Gerard-Jan BAIS
Steinsel, Luxembourg
Member of the Board of Directors and Managing Director

Markus BLAES
Freudenburg, Germany
Member of the Board of Directors and Managing Director

Heads of Department

Markus BLAES
Asset Liability Management

Robert THÖMMES
Analytics & Regulatory Issues

Auditors

Ernst & Young S.A., Luxembourg

Trustees (Cover Pool Auditors)

KPMG Luxembourg, Société coopérative, Luxembourg

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