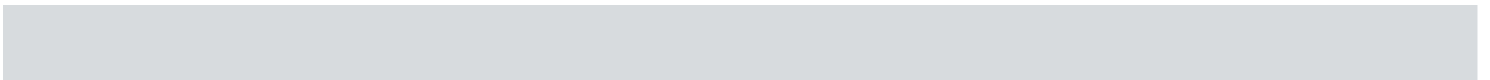
COMMERZBANK

Finance & Covered Bond S.A.

COMMERZBANK

Group

Interim Report as at June 30, 2018



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Interim Management Report by the Board of Directors as at June 30, 2018

Overall conditions

Economic developments

The global economy performed well again in the first half of 2018. Emerging markets continued to deliver strong momentum, although China is seeing the first signs of a renewed slowdown in growth. In the USA the usual dip in growth at the start of the year was smaller than last year and the second quarter already looks set to post higher growth once more. The unemployment rate is now lower than it was before the deep recession of 2007 to 2009. Against this backdrop, the Federal Reserve has raised the target corridor for key interest rates by a further 50 basis points to 1.75%-2.00% since the start of the year. In the eurozone, however, the upturn has noticeably slowed. This has been driven by the appreciation of the euro, which has risen by nearly 9% in the past twelve months, leaving heavy traces on industries heavily dependent on exports. But economic growth is still strong enough to continue to cut unemployment further. In the first three months of 2018 the German economy expanded at a clearly slower rate than in the final quarter of 2017 and growth looks set to be no stronger in the second quarter. Volatility has picked up perceptibly on the financial markets. Monetary policy of the major central banks is still very expansive, providing support.

Outlook and opportunities report

Future macroeconomic situation

The performance of the global economy in the second half of 2018 will be marked by geopolitical risks as well as the economic performance of emerging markets. The spotlight here remains on China, where growth will probably slow somewhat. Firstly, the important construction sector in China is likely to expand less rapidly as real estate prices are hardly rising anymore; secondly, heavily indebted companies (mainly state-owned ones) will boost their investments at a lower rate.

In the USA there is every chance that the expansion will continue, assisted by tax cuts. Private consumption will again rise sharply, driven by rising employment and accelerating wage growth. The same applies to corporate investment, which is being buoyed by promising sales prospects. In addition, the stronger crude oil price will again provide impetus to capital expenditure in oil and gas production. The US economy is set to grow by 2.7% in 2018, again faster than production potential. The biggest risk is the protectionist policy being pursued by the US government. The US economy would suffer from a trade war.

In the eurozone the trade dispute, the end of the real estate boom in China, the previous appreciation of the euro and the higher oil price are casting a shadow on economic prospects. The economy is only likely to expand modestly in the second half of the year. Given the ECB's very expansionary monetary policy, however, no end to the upturn is expected. While the ECB will stop buying bonds at the end of the year, this does not mean an end to expansionary monetary policy. The ECB deposit rate is likely to remain at –0.4% for a considerable time. There are increasing signs that wage pressure is slowly picking up. It will take some time for this to be reflected in the inflation rate, though.

In Germany the weak economic growth at the start of the year is likely to mark the start of a dip. The average rate for 2018 will only be growth of 1.8%, but this is still a good figure in historical terms. Private consumption in particular remains a driver of the economy.

The US interest rate reversal and the continuation of the ECB's highly expansionary monetary policy will once again shape the future for the financial markets. The end to ECB bond purchases at the end of the year will not have any major upward impact on the yield of 10-year German government bonds. The bull run on equity markets is not yet over, although volatility has risen substantially. The yield on 10-year German government bonds is likely to continue to drift sideways – partly because the ECB will continue to reinvest the proceeds of maturing bonds long after the purchasing programme has ended.

Future situation in the banking sector

Our views regarding the expected development of the banking sector structurally and over the medium term have not changed significantly since the statements

published in the 2017 Annual Report. However, the short-term prospects for the banking environment have become less certain in the past months.

The mood among German corporates has dimmed after the previous record highs, and key financial markets are starting to focus on concerns about the potential negative impact of rising protectionism, persistent geopolitical tension and greater political uncertainty in some countries in the eurozone and the European Union. Banks themselves, their stocks and bonds are also affected by the unclear consequences of global trade conflicts. The fear on the capital markets is that banks will have to set more money aside for loan loss provisions if their clients suffer from weaker business due to new tariffs and other trade restrictions.

Following the perceptible weakening of growth in the winter half-year 2017/2018, growth forecasts for overall economic activity in Germany and the eurozone have recently been brought back across the board, with an emphasis on the downside risk. Global trade and the whole global economy have no longer been expanding so dynamically in the past months as in the second half of 2017. Foreign business is key to the financial sector's corporate clients, but they are suffering from the fact that foreign demand will only make a modest contribution to the economic upturn, growth in the markets that German exporters sell to is gradually weakening, and the previous appreciation of the euro is causing German companies to lose market share abroad. The fear is that corporate willingness to invest (which is crucial for the corporate lending business) will also suffer as a result, especially as increased trade conflicts are making these clients nervous about the global value chains they have set up over the last 20 years. Uncertainty on the financial markets and the divergence of monetary policy between the US Federal Reserve and the ECB could make securities clients reluctant to act, which would hurt financial institutions’ commission business. On the other hand, increased volatility in major segments of the stock exchange would boost the need for hedging and might help net commission income.

Since the Governing Council of the European Central Bank decided to discontinue its bond buying programme it has been apparent that benchmark interest rates will remain at their current low levels until at least summer 2019. Hence banks in the eurozone are likely to see their interest rate margins remain under pressure. However, the anticipated slight steepening of the yield curve could have a positive impact on the net interest margins of European banks. Overall, in the short term the interest rate environment will not be able to materially improve the underlying profitability of the banking sector. In fact, the business model, operating efficiency and an ability to attract and retain clients will probably be more important. But, large repayments by customers and the increased use of internal and alternative external sources of funding, along with tough competition, will limit income growth.

Significant events in the first half of 2018

Public Finance

Political developments in Italy again resulted in higher credit spreads on bonds for both the country itself and other countries on the euro periphery. The debate on migration is dividing Europe and has in many countries led to governments that are substantially more critical of the EU than their predecessors, reducing the overall willingness to cede further financial and economic policy powers to Brussels. The ECB will throttle back its bond purchasing programme, which is likely to further increase pressure on credit spreads.

Lending business

The Bank’s lending volume was reduced nominally by some €0.388bn from around €9.247bn as at December 31, 2017 to around €8.909bn as at June 30, 2018. This amount includes around €0.04bn of scheduled maturities and partial repayments and some €0.26bn of active portfolio reduction and currency effects owing to currency fluctuations (EUR vs USD and GBP) over the entire portfolio.

There remain risks, albeit now reduced, arising from the over-indebtedness of public budgets.

As at June 30, 2018 the Bank had an exposure of a nominal €1.10bn (12.4% of total exposure) in Italy (December 31, 2017: €1.14bn), a nominal €0.45bn (5.0%) in Spain (December 31, 2017: €0.463bn), and a nominal €0.386bn (4.3%) in Portugal (December 31, 2017: €0.439bn).

The internal rating of Italy (cb2.8) remained unchanged between June 30, 2017 and June 30, 2018. The internal rating of Portugal was raised in June 2018 to cb2.8 (previously cb3.0) and that of Spain to cb2.2 (previously cb2.4).

These developments result in high hidden liabilities of €0.6bn on the difference between the carrying amount and market values of holdings measured at amortised cost.

Average risk-weighted assets (RWA) stood at €2.7bn at June 30, 2018 (December 31, 2017: €3.1bn). The interest balance before loan loss provisions was €10.8m, having been €3.4m as at the end of the first half of the previous year.

No defaults or delays in payment occurred in the first half of the year.

The Bank applies the Commerzbank Group's internal certified rating procedure, which is subject to constant review, recalibration and validation. The internal rating system indicates that the proportion of assets with a rating of AA- or better rose from 36.0% of the nominal total loan portfolio as at December 31, 2017 to 37.0% as at June 30, 2018.

The internal rating system indicated that 93.8% of these were of investment grade as at June 30, 2018 (December 31, 2017: 89.6%). Maturities, active portfolio reduction and rating changes meant that the Bank's rating breakdown and debtor structure changed in the first half of 2018.

Refinancing

As at June 30, 2018 Commerzbank Finance & Covered Bond S.A. had an issuer rating of Baa1 (outlook stable) from Moody's.

The Bank did not redeem any of its own LdG (Lettres de Gage) issues on the market in the first half of 2018. As at the end of June 2018, the volume of LdGs in circulation had fallen to €2.2bn. This reduced the cover pool to €2.4bn.

Repos and unsecured refinancing transactions were executed within the Group, and assets were sold to compensate for the need for liquidity resulting from maturities.

Earnings performance

At the end of the reporting period, net interest and commission income was €14.9m, after €6.3m the previous year. Net interest income was €+10.8m (June 30, 2017: €+3.4m). Net loan loss provisions under IFRS 9 as at June 30, 2018 were €–1.0m (compared to €+0.4m at June 30, 2017 under IAS 39). Net commission income was €+4.0m, compared with €+3.0m the previous year. Net income from hedge accounting, which includes the net remeasurement gain or loss from using hedge accounting under IAS 39, was €–1.4m (June 30, 2017: €–3.6m).

The Bank's net trading income in the first half of 2018 was €43.6m (June 30, 2017: an expense of €–59.6m). The investment result showed income of €1.0m following an expense of €5.3m in the preceding year. The Bank incurred increased operating expenses as a consequence of higher service charges within the Group; they increased by 3.9% to €14.3m (June 30, 2017: €13.8m).

The result before taxes was €+42.8m (June 30, 2017: €–74.7m).

As at June 30, 2018, there was a profit after taxes of €+42.8m (June 30, 2017: loss of €–56.2m).

Financial position and assets

No major investments were planned up to June 2018. Liquidity was maintained throughout the first half of 2018. The cash flow statement and the comments on it are to be found in the Notes. During the first half of the financial 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.

Total assets

The Bank's total assets fell by €2.3bn (15.6%) from €14.7bn on December 31, 2017 to €12.4bn.

Equity capital

As at June 30, 2018, the Bank's equity capital as required by Luxembourg regulations amounted to €1,110m, made up of €1,098m in Tier 1 capital and €12m in Tier 2 capital, with a core capital ratio of 40.7%.

Internal controls and risk management during compilation of financial data

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.

Events are recorded in the IT system on a daily basis and 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 and dormant 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.

Monthly internal reports are generated to keep the Managing Directors 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.

Internal audit

Group Management Audit (Group Audit) supports the Managing Directors by evaluating the appropriateness and effectiveness of the internal control system, risk management, and business processes, providing support on key projects in an internal auditing capacity and issuing recommendations. In doing so, it contributes to the security of business processes and assets. Group Audit also operates in the subsidiaries within the framework of Group risk management.

Group Audit is directly accountable to the Board of Managing Directors of Commerzbank and reports to it; within the Board of Managing Directors, it is the CEO who is responsible for it. It performs its functions autonomously and independently. Particularly with regard to reporting and the assessment of audit results, Group Audit is not subject to any directives. The audit of the suitability and effectiveness of risk management covers the risk management and controlling systems, reporting, IT systems and financial reporting. In performing its duties, Group Audit has an unrestricted right to information.

Group Audit promptly prepares a written report on each audit, recipients of which include the responsible members of the Board of Managing Directors. On the basis of these audit reports, Group Audit oversees and documents the steps taken to remedy the deficiencies identified within the specified time. If such deficiencies are ignored, an escalation process comes into effect. In addition, Group Audit prepares an annual report on the audits that it has carried out during the course of the financial year, the material deficiencies identified and the measures taken. The report is submitted to both the Managing Directors and the Board of Directors of Commerzbank Finance & Covered Bond S.A.

Organisation

Both the Finance Director (CFO) of Commerzbank AG 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. Group Management Finance, a Commerzbank AG Group unit, is responsible for ensuring that the financial statements are drawn up in compliance with the relevant laws and internal and external guidelines.

The allocation of responsibilities is set out clearly in Commerzbank Finance & Covered Bond S.A.'s business allocation plan. The work to be done by the outsourced divisions, and the services to be provided by them are clearly set out in service level agreements.

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 on 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 under service level agreements. The work done by internal service providers within the Group is regularly reviewed and evaluated as part of outsourcing controlling. This process also considers any further outsourcings that might have occurred. Where necessary, all organisational changes are agreed with the ECB (via the local regulator, the CSSF).

Service level agreements have been under continual development and continue to be so. The Bank has no subsidiaries or branches. 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. The parent company is the Luxembourg branch of Commerzbank AG.

Personnel report

As at June 30, 2018, the Bank had 12 employees, 5 of whom were 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).

Report on events after the reporting period

On July 26, 2018 Mr Thorsten Kanzler stepped down as Chairman of the Board of Directors at his own request. We wish to thank him for his dedicated work for the Bank.

On August 3, 2018 Moody's raised the ratings of Commerzbank Finance & Covered Bond S.A. as a "highly integrated and harmonised entity" of Commerzbank AG. The counterparty risk rating/assessment is now A1/A1 (cr) (previously: A2/A2 (cr)), the issuer rating A1 stable (previously: Baa1 stable), the stand-alone rating baa2 (previously: baa3) and the short-term rating P-1.

Outlook and thanks

The Board of Directors and the Managing Directors wish to thank the employees for their hard work over the past six months and the firm's business partners for the working relationship, which has been agreeable and at all times characterised by cooperation and trust.

Luxembourg, August 20, 2018
The Board of Directors

Interim Risk Report

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 Company-wide framework of guidelines, structured limits and a holistic risk management system. 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.

Risk-oriented overall bank management

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 committed capital – and those that are not quantifiable, such as reputational and compliance risks.

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

Specific committees have been set up throughout the Group for the purpose of conducting risk management operations; these act on the basis of delegated competences and assist the Board of Directors in reaching decisions on risk-related issues.

Risk-bearing capacity

The Bank has an Internal Capital Adequacy Assessment Process (ICAAP) through which it uses its own methodologies and processes to assess its own capacity to bear its material risks. In assessing its capital resources it uses the Commerzbank Group's own risk-bearing capacity concept. This measures risk-bearing capacity by comparing economic risk-bearing capacity (RBC) and economically required capital (ErC) using the gone-concern approach.

This procedure shows that Commerzbank Finance & Covered Bond S.A. had, as at June 30, 2018, and in an unstressed scenario, an economic risk-bearing capacity of €479m, as against economically required capital amounting to €1.387bn. This results in an RBC ratio of +35% (December 31, 2017: 40%). The minimum risk-bearing capacity is deemed to be met as long as the RBC ratio is higher than 100%.

The slight deterioration in the RBC ratio since December 31, 2017 is mainly due to methodological changes in the calculation of the economic capital requirements and various effects from the switch to IFRS 9, especially relating to risk cover potential.

Given the continuing shortfall in capacity, the Bank is relying on its regulatory risk-bearing capacity. The shortfall in economic capacity is itself underwritten by the letter of comfort given by Commerzbank AG, Frankfurt in respect of Commerzbank Finance & Covered Bond S.A.'s liabilities.

Commerzbank Finance & Covered Bond S.A. is endeavouring to bring about a further long-term improvement in its economic risk-bearing capacity on a stand-alone basis by making use of opportunities to reduce the size of its portfolio.

The Bank also determines risk-bearing capacity in terms of liquidity as part of the Internal Liquidity Adequacy Assessment Process (ILAAP). It does this using the liquidity gap profile (LGP), which measures compliance with the survival period. During the period under review, risk-bearing capacity in terms of liquidity was assured.

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.

Counterparty 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) and risk-weighted assets (RWA). The "All-in" approach is used for cluster risks. 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.

The rating breakdown constantly reflects the improvement in the international macroeconomic environment by means of occasional upgrades, which have positive effects. The winding down of the portfolio over recent years has also had the effect of changing the debtor structure.

Market risk

Market risks indicate the risk of potential losses of economic value brought about by changes in market prices (interest rates, exchange rates, basis risks, volatilities, credit spreads and, albeit less significantly, prepayment risk) or in other parameters with an influence on pricing.

These risks are managed and monitored at Group level. The Bank uses Group-wide tools: value at risk (VaR), stress tests, sensitivity analysis and other scenario analyses.

The VaR limit for Commerzbank Finance & Covered Bond S.A. was €27m as at June 30, 2018. During the first half of 2018, the utilisation of the VaR limit fluctuated between 40% and 68%. The stress test limit for Commerzbank Finance & Covered Bond S.A. was €850m as at June 30, 2018. This was raised from the previous limit of €750m in mid-January 2018 when switching the market risk models as part of the implementation of IFRS 9. The higher limit mainly covers credit spread risks on positions measured at fair value for the first time under IFRS 9 and which have since then been shown accordingly in internal market risk management.

In the course of the first half of 2018, the utilisation of the stress test limit fluctuated between 56% and 102%. Utilisation exceeds 100% because of a two-day limit overshoot during the change in market risk models mentioned above.

The main driver of market risk in the first half of 2018 was credit risk spreads, followed by general market risk (interest rate risks).

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, it sees it as 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.

Liquidity management closely follows the approach used by the Commerzbank Group. This is based on the liquidity gap profile (LGP). The LGP provides an overview of the liquidity position of Commerzbank Finance & Covered Bond S.A. on the basis of contractual and economic cash flows and assets that can be liquidated. A limit is set on the overall LGP for a horizon of 10 years. These overall LGP limits were observed at all times in the first half of 2018.

Operational risk

Operational risk (OpRisk) is defined throughout the Group as the risk of a loss resulting from inadequacies or errors in processes, controls or projects caused by staff, organisation, technology or external factors. This definition includes legal and IT risks but not strategic or reputational risks.

Basel III states that banks must provide capital for operational risks. The amount of required capital for operational risks is also calculated centrally by the parent company using the advanced measurement approach (AMA). This requires permission from the competent supervisory authorities, namely the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the Commis-

sion de Surveillance du Secteur Financier (CSSF), which these have given.

In the interests of Group-wide transparency concerning operational risks, a Global Operational Risk Policy has been drawn up and is updated once a year. This Group-wide concept, by describing such essential elements of risk management as objectives, definitions, components, methodologies and processes, and clearly allocating roles and responsibilities, establishes the basis for the structured control and consistent management of operational risks throughout the Group. It is a declared corporate objective to make employees aware of potential operational risks and thereby build a culture of risk appropriate to the Bank.

The Bank has sustained no monetary losses as a result of trading activities in the first half of 2018. As at June 30, 2018 capital of €0.76m (December 31, 2017: €0.57m) was allocated by the Bank for operational risk.

Public Finance

The winding down, in such a way as to preserve value, of Commerzbank Finance & Covered Bond S.A.'s public finance portfolio continued in the first half of 2018.

The reduction of the portfolio by the equivalent of around €338m as at June 30, 2018 to a nominal of roughly €8,909bn included final maturities, partial repayments, active reduction and changes due to exchange rate fluctuations.

Commerzbank Finance & Covered Bond S.A.'s public finance portfolio is made up of receivables and securities, most of which are assigned to category AC under IFRS 9 (financial assets – amortised cost). Public finance borrowers (nominally around €6.015bn) are states, regions, cities and local authorities as well as supranational institutions. The remainder of the portfolio is made up of financial institutions (nominal around €0.403bn) and securitisations (nominal around €2.491bn), predominantly securities and loans covered by guarantees, guarantee obligations and other declarations of liability by public bodies.

Cover portfolio

The cover pool for the Lettres de Gage (LdG) issued by Commerzbank Finance & Covered Bond S.A. in Luxembourg is based on lending to the public sector.

The Bank fully complies with the requirements of the Pfandbriefbank Act of November 21, 1997 as currently amended. The management of the cover pool is monitored and audited by the Trustee (KPMG). The cover pool report is sent to the CSSF on a monthly basis.

Commerzbank Finance & Covered Bond S.A.'s cover pool complies with local requirements. The Bank's LdG business is integrated into the Commerzbank Group's risk management system and is subject to regular and comprehensive internal and external audits. Full information on the Bank and its cover pool may be found on the Internet at www.commerzbank-fcb.com.

Other risks

In terms of all other risks, whether quantifiable or not, there were no significant changes in the first half of 2018 compared with the position reported in the 2017 Annual Report.

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 in this report 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 Luxembourg and European 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 only show examples of the risks to which a portfolio may be exposed in extreme market situations. However, stress testing all imaginable scenarios is not feasible. Stress tests cannot offer a final estimate of the maximum loss should an extreme event occur.

Interim financial statement as at June 30, 2018

Unlike the annual report, the interim report is not attested by the auditor.

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

Statement of comprehensive income

in €000	01.01.-30.06.2018	01.01.-30.06.2017	Change in €000	Change in %
Interest income	105,007	97,842	7,164	7.3
Interest expenses	94,158	94,474	-316	-0.3
Net interest income	**10,848**	**3,369**	**7,480**	**> 100**
Loan loss provisions	-1,002	407	-1,409	> -100
Net interest income after loan loss provisions	**9,846**	**3,775**	**6,071**	**> 100**
Commission income	4,289	3,393	896	26.4
Commission expenses	250	420	-171	-40.6
Net commission income	**4,039**	**2,972**	**1,066**	**35.9**
Net income from hedge accounting	-1,350	-3,586	2,236	62.4
Net trading income	43,604	-59,562	103,166	> 100
Net investment income	1,016	-5,270	6,286	> 100
Operating expenses	14,342	13,810	532	3.9
Other net operating income	28	762	-734	-96.4
Operating profit/loss	**42,841**	**-74,718**	**117,559**	**> 100**
Taxes on income	0	18,485	-18,485	-100.0
Surplus/shortfall for the year	**42,841**	**-56,233**	**99,074**	**> 100**
Change in revaluation reserve				
before taxes	0	27,189	-27,189	-100.0
Taxes	0	-7,072	7,072	100.0
Total other comprehensive income	**0**	**20,117**	**-20,117**	**-100.0**
Total comprehensive income	**42,841**	**-36,116**	**78,957**	**> 100**

Balance sheet

Assets in €000	30.06.2018	01.01.2018[1]	Change in €000	Change in %
Cash reserve	5,315	105,326	-100,011	-95.0
Financial assets – mandatorily fair value P&L	2,659,524	3,176,822	-517,298	-16.3
Financial assets – amortised cost	8,900,937	9,515,285	-614,348	-6.5
Positive fair values of derivative hedging instruments	487,163	574,124	-86,961	-15.1
Trading assets	331,418	380,881	-49,463	-13.0
Intangible assets	8,353	10,024	-1,671	-16.7
Fixed assets	32	32	0	0.0
Other assets	26,131	25,877	254	1.0
Total	**12,418,873**	**13,788,370**	**-1,369,497**	**-9.9**

Liabilities in €000	30.06.2018	01.01.2018[1]	Change in €000	Change in %
Financial liabilities – amortised cost	8,669,598	9,067,196	-397,598	-4.4
Negative fair values of derivative hedging instruments	1,089,429	1,255,240	-165,811	-13.2
Trading liabilities	1,447,372	2,295,419	-848,047	-36.9
Provisions	7,703	7,678	26	0.3
Current tax liabilities	27,948	27,948	0	0.0
Other liabilities	3,649	4,459	-810	-18.2
Equity	1,173,174	1,130,432	42,742	3.8
Subscribed capital	235,000	235,000	0	0.0
Capital reserve	1,859,000	1,859,000	0	0.0
Retained earnings	-963,668	-963,568	-100	0.0
Surplus/shortfall for the year	42,841	0	42,841	>100
Total	**12,418,873**	**13,788,370**	**-1,369,497**	**-9.9**

[1] Opening balance sheet under IFRS 9

Opening balance sheet as at January 1, 2018

Reconciliation of IAS 39 to IFRS 9: please see the 2017 Annual Report on initial application of IFRS 9.

Assets in €000	01.01.2018	31.12.2017	Change in €000	Change in %
Cash on hand and cash on demand	105,326	105,326	0	0.0
Financial assets – amortised cost	9,515,285		9,515,285	+100
Financial assets – loans and receivables		12,701,655	-12,701,655	-100
Financial assets – available for sale		864,155	-864,155	-100
Financial assets – mandatorily fair value P&L	3,176,822		3,176,822	+100
Financial assets – held for trading	380,881	403,744	-22,863	-5.7
Positive fair values of derivative hedging instruments	574,124	574,124	0	0.0
Intangible assets	10,024	10,024	0	0.0
Fixed assets	32	32	0	0.0
Current tax assets	0	0	0	0.0
Deferred tax assets	0	20,422	-20,422	-100
Other assets	25,877	25,877	0	0.0
Total	**13,788,370**	**14,705,358**	**-916,988**	**-6.2**

Liabilities in €000	01.01.2018	31.12.2017	Change in €000	Change in %
Financial liabilities – amortised cost	9,067,195	9,067,195	0	0.0
Financial liabilities – held for trading	2,295,419	213,291	2,082,127	>100
Negative fair values of derivative hedging instruments	1,255,240	3,337,367	-2,082,127	-62.4
Provisions	7,678	7,678	0	0.0
Current tax liabilities	27,948	27,948	0	0.0
Deferred tax liabilities	0	0	0	0.0
Other liabilities	4,459	4,459	0	0.0
Equity	1,130,432	2,047,419	-916,988	-44.8
Subscribed capital	235,000	235,000	0	0.0
Capital reserve	1,859,000	1,859,000	0	0.0
Retained earnings	-963,568	206,503	-1,170,071	<-100
Revaluation reserve	0	-169,439	169,439	-100
Surplus/shortfall for the year	0	-83,644	83,644	-100
Total	**13,788,370**	**14,705,358**	**-916,988**	**-6.2**

Statement of changes in equity

in €000	Subscribed capital	Capital reserve	Retained earnings	Revaluation reserve	IAS 19 reserve	Surplus/ shortfall for the year	Total
Balance as at 01.01.2017	**235,000**	**859,000**	**149,872**	**-210,877**	**-2,255**	**58,810**	**1,089,549**
Total comprehensive income				**20,117**		**-56,233**	**-36,116**
Net income for the year						-56,233	-56,233
Change in revaluation reserve				20,117			20,117
Change in IAS 19 reserve					227		227
Transfer to retained earnings			**58,810**			**-58,810**	**0**
Portfolio as at 30.06.2017	**235,000**	**859,000**	**208,682**	**-190,760**	**-2,029**	**-56,233**	**1,053,660**
Balance as at 01.01.2018	**235,000**	**1,859,000**	**-877,746**	**0**	**-2,179**	**-83,644**	**1,130,432**
Total comprehensive income				**0**		**42,841**	**42,841**
Net income for the year						42,841	42,841
Change in revaluation reserve				0			0
Change in IAS 19 reserve					-100		-100
Transfer to retained earnings			**-83,644**			**83,644**	**0**
Portfolio as at 30.06.2018	**235,000**	**1,859,000**	**-961,390**	**0**	**-2,278**	**42,841**	**1,173,174**

Cash flow statement

in €000	30.06.2018	31.12.2017
Surplus/shortfall for the year	**42,841**	**-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 receivables, fixed and other assets, changes in provisions and net changes due to hedge accounting	2,704	-439,395
Change in other non-cash positions	-885,491	-150,746
Net gain or loss on the sale of fixed and other assets	-1,016	6,103
Other adjustments	-10,849	-8,836
Sub-total	**-851,811**	**-676,518**
Changes to assets and liabilities from operating activities after adjustment for non-cash positions		
Claims on banks	517,298	254,198
Claims on customers	613,315	345,616
Trading securities	0	73,195
Other assets from operating activities	7,802	253,448
Liabilities to banks	-397,598	-1,899,661
Liabilities to customers	0	-307,415
Securitised liabilities	0	-1,079,389
Other liabilities from operating activities	-883	-1,520
Interest received	105,007	486,273
Interest paid	-94,158	-477,437
Cash flow from operating activities	**-101,028**	**-3,029,210**
Proceeds from disposals of		
Financial assets	1,017	2,127,805
Fixed assets	0	0
Cash flow from investing activities	**1,017**	**2,127,805**
Proceeds from capital increases	0	1,000,000
Payments from repayment of subordinated capital	0	0
Cash flow from financing activities	**0**	**1,000,000**
Cash and cash equivalents as at Jan 1	**105,326**	**6,731**
Cash flow from operating activities	-101,028	-3,029,210
Cash flow from investing activities	1,017	2,127,805
Cash flow from financing activities	0	1,000,000
Cash and cash equivalents as at Jun 30	**5,315**	**105,326**

The cash flow statement shows the changes in cash and cash equivalents for Commerzbank Finance & Covered Bond S.A.

Cash and cash equivalents are narrowly defined as only the cash reserve, which is made up of cash on hand and credit balances with central banks. 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. The cash flow statement is no substitute for either liquidity planning or financial planning, and is not employed as a management tool.

Notes

Legal basis

The company is entered in the Commercial Register of the Luxembourg District Court under B 30.469. The Bank was granted a special banking licence (no. 356/99) by the Luxembourg Ministry of Finance on September 23, 1999.

Commerzbank AG holds 100% of the shares in the Bank, which was established on September 1, 2014 – with retroactive effect in accounting terms to January 1, 2014 – by the merger of Erste Europäische Pfandbrief- und Kommunalkreditbank Aktiengesellschaft in Luxemburg S.A. with Hypothekenbank Frankfurt International S.A. As part of the reorientation of Commerzbank's operations in Luxembourg, Erste Europäische Pfandbrief- und Kommunalkreditbank Aktiengesellschaft in Luxemburg was renamed as Commerzbank Finance & Covered Bond S.A. with legal effect from February 15, 2016.

The Board of Directors of Commerzbank Finance & Covered Bond S.A. determines its business policy and measurement principles except where these are prescribed by Luxembourg directives and regulations, and ensures the Bank's compliance with all these.

Object of the Bank

The object of the Company is to conduct all such business as is permitted to a Pfandbriefbank by the Law on the Financial Sector of April 5, 1993 as most recently amended. The Bank (then operating under the name of "Europäische Hypothekenbank S.A.") has, since September 23, 1999, been the holder of a special banking licence (no. 356/99) under the Luxembourg Law on Lettres de Gage dated November 21, 1997, which was incorporated into the Law of April 5, 1993 as amended to date as Articles 12-1 to 12-9 thereof. The Bank is thus authorised to issue Lettres de Gage (Pfandbriefe under Luxembourg law) and conduct related secondary and ancillary business.

Summary of accounting and measurement methods

Basis on which the interim report has been prepared

The IFRS interim financial statements as at June 30, 2018 include the additional national requirement specified by the Law of June 17, 1992 (as currently amended) on the financial statements of banks subject to Luxembourg law. This report takes particular account of the requirements of IAS 34 relating to interim financial reporting. The interim financial statements comprise the statement of comprehensive income, the balance sheet, the IFRS 9 opening balance sheet as at January 1, 2018, the cash flow statement, the statement of changes in equity and selected Notes. They are to be read in conjunction with the Bank's audited annual financial statements as at December 31, 2017.

The internal evaluations carried out by the Board of Directors and the Managing Directors do not consider individual segments, Commerzbank Finance & Covered Bond S.A. is an independent bank within the Commerzbank Group which is assigned to Group Management Treasury (GM-T).

Financial assets and liabilities are generally measured at amortised cost, unless a different form of measurement is required by IFRS. This applies in particular to those financial instruments that, under IFRS 13, are measured at fair value. The account treatment and measurement assume that the Bank is a going concern. Income and expenses are accounted for on an accrual basis; they are recorded and recognised 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, or, where it originates from trading transactions, in trading income.

The Bank recognises commission income and expenses in net commission income based on the accounting treatment of the associated financial instruments and the nature of the activity. Commission income for services which are performed over a certain period is recognised over the period in which the service is performed. Fees which are associated with the completion of a particular service are recognised at the time the service is completed in full. Performance-related fees are recognised when the performance criteria are met.

The Bank recognises commission from trading transactions under net trading income.

Assets and liabilities are generally reported on a gross basis in the balance sheet, i.e. without netting. In accordance with IAS 32.42, financial assets and liabilities relating to the same counterparty are offset and shown in the balance sheet on a net basis if there is a legally enforceable right to offset the amounts and the transactions are settled on a net basis or the asset is realised simultaneously with the settlement of the liability. The Bank avails itself of this option when netting positive and negative market values from derivatives and the margin payments relating to them.

The estimates and judgements required in IFRS accounting are reached in accordance with the relevant standard, are regularly reviewed and are based on experience and on other factors, including expectations of future events that appear reasonable under the given circumstances. Where estimates had to be wider in scope, the material assumptions underlying them are set out. The estimates and judgements themselves and the underlying estimation methods and judgement factors are reviewed and compared with actual events.

Commerzbank Finance & Covered Bond S.A. regards the parameters used as reasonable and appropriate. Areas in which estimates may be uncertain include the calculation of pension obligations, which are measured on the basis of the projected-unit-credit method for defined benefit pension plans. In measuring these obligations, a number of assumptions have to be made, notably as regards long-term salary and pension trends and average life expectancy. Changes in the underlying assumptions from year to year and divergences from the actual effects each year are reported under actuarial gains and losses. Uncertainties remain in the estimation of deferred tax assets, loan loss provisions, the determination of fair value using measurement models, and in the measurement of financial instruments. Further information on risk provisions may be found in the Bank's risk report. The assumptions and parameters underlying the estimates we have made are based on the exercise of appropriate judgement by management. 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, management uses its judgement to determine the choice of the model to be used. Changes to estimates are taken into consideration only where they relate to only one period, and then only in that period and, where the change relates to both the present period and those following it, correspondingly in this and subsequent periods. The reporting currency in the financial statements is the euro. Unless otherwise indicated, all amounts are shown in thousands of euro.

Application of IFRS 9

The Bank has been applying IFRS 9 since January 1, 2018 in the version adopted by the European Union. The Group has not restated the prior-year figures because this is not required when applying the new standard for the first time.

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)

Financial assets are allocated to one of the following business models based on the respective strategic aim of profit realisation:

- "hold" business model: receipt of contractual cash flows with only seldom or immaterial sales activities.
- "hold and sell" business model:
- residual business model – all portfolios that are not allocated to the "hold" or "hold-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" or "hold-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" 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-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, i.e. if the asset cannot be clearly allocated to one of the two other measurement categories, it must be measured according to this category. 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 designating financial assets on acquisition into 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 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 FVPL.

- **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, the contractual cash flows of the financial instrument (SPPI criterion) and 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" 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-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, the possibility exists of applying the fair value option. 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. A provision must be recognised for the full lifetime of expected credit losses, if the credit risk increases significantly, but the borrower is not yet in default. If an instrument is in default, a provision must be recognised for the lifetime expected loss on the basis of the estimated cash flows that can still be expected. In this case, interest income is calculated based on the net carrying amount.

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. We have utilised the option provided in the standard and have continued to apply the previous IAS 39 regulations.

The significant effects from the application of IFRS 9 Financial Instruments as at January 1, 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 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 has allocated the financial assets to a business model based on how the financial assets are managed to generate cash flows:

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 April 5, 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 Pfandbrief bank.

In view of this, the Bank allocated a significant portion of the assets (€8.5bn nominal) to the "hold" business model as at January 1, 2018 and thus measured them at amortised cost. A smaller portion of the portfolio (€2.1bn nominal) was allocated to the residual business model and is therefore measured at mFVPL. This relates to loans to British 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.

In addition, the classification of the public finance business, which was allocated to the hold business model, had a positive effect on equity capital of almost €0.2bn.

The change in the provision methodology had a negative effect of almost €50m.

Fair value of financial instruments as at June 30, 2018

	Fair value	Carrying amount
Assets in €000	30.06.2018	
Cash reserve	5,315	5,315
Financial assets – mandatorily fair value P&L	2,659,524	2,659,524
Financial assets – amortised cost	8,900,937	8,272,647
Positive fair values of derivative hedging instruments	487,163	487,163
Trading assets	331,418	331,418

	Fair value	Carrying amount
Liabilities in €000	30.06.2018	
Financial liabilities – amortised cost	8,669,598	8,498,391
Negative fair values of derivative hedging instruments	1,089,429	1,089,429
Trading liabilities	1,447,372	1,447,372

Fair value of financial instruments as at December 31, 2017

	Fair Value	Carrying amount
Assets in €000	31.12.2017	
Cash reserve	**105,326**	**105,326**
Claims on banks	**1,486,609**	**1,486,609**
due on demand	970,481	970,481
Sundry receivables	516,128	516,128
Claims on customers	**3,242,838**	**4,352,258**
Public-sector loans	3,175,503	4,283,340
Sundry receivables	67,337	68,920
Positive fair values of derivative hedging instruments	**574,124**	**574,124**
Trading assets	**403,744**	**403,744**
Financial investments	**7,261,523**	**7,726,942**

	Fair Value	Carrying amount
Liabilities in €000	31.12.2017	
Liabilities to banks	**5,648,280**	**5,649,119**
due on demand	174,596	174,596
Other liabilities	5,473,685	5,474,524
Liabilities to customers	**1,290,898**	**1,365,949**
Registered bonds	1,289,825	1,364,876
Other liabilities	1,073	1,073
Securitised liabilities	**1,972,049**	**2,034,398**
Negative fair values of derivative hedging instruments	**3,337,367**	**3,337,367**
Trading liabilities	**213,291**	**213,291**
Subordinated capital	**18,271**	**17,729**

When netted, the difference between carrying amount and fair value across all items as at June 30, 2018 is €–0.5bn (December 31, 2017: €–1.4bn).

Fair value hierarchy

Under IFRS 13, all financial instruments are initially recognised at fair value; financial instruments that are not classified as at fair value through profit or loss are recognised at fair value including certain transaction costs. Those financial instruments that are classified as at fair value through profit or loss and financial assets available-for-sale at any time are subsequently measured at fair value on an ongoing basis. For this purpose, financial instruments classified at fair value through profit or loss include derivatives, instruments held for trading and instruments designated for measurement at fair value.

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 a realisable 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 fair value of a liability also reflects own credit risk. If third parties provide security (e.g. guarantees) for the liabilities of the Bank, such security is not taken into account in the measurement of the liability, as the Bank's repayment obligation remains the same. The most suitable measure of fair value is the quoted market price for an identical instrument in an active market (Level I in the fair value hierarchy).

Where no quoted prices are available, valuation is based on quoted prices for similar instruments in active markets. To reflect the price at which an asset could be exchanged or a liability settled, asset positions are valued at the bid price and liability positions are valued at the ask price. Where quoted prices are not available for identical or similar financial instruments, fair value is derived using an appropriate valuation model where the data inputs are, as far as possible, obtained from verifiable market sources (Level II in the fair value hierarchy).

In accordance with IFRS 13, valuation methods are chosen that are commensurate with the situation and for which the required information is available. For the selected methods, observable input parameters are used to the maximum extent possible and unobservable input parameters to the minimum extent possible.

While most methods of measurement rely on data from observable market sources, certain financial instruments are measured using models incorporating other input values for which there insufficient recent observable market data are available. IFRS 13 recognises the market approach, income approach and cost approach as potential methods of measurement. 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. The cost approach (which may only be applied to non-financial instruments) defines fair value as the current replacement cost of the asset, taking into account the asset's current condition. These valuations are inherently subject to management judgement to a greater extent. These unobservable inputs may include data that is extrapolated or interpolated, or may be derived by approximation to correlated or historical data. However, such inputs maximise market or third-party inputs and rely as little as possible on company-specific inputs (fair value hierarchy Level III).

Valuation models must be consistent with accepted business methodologies for pricing financial instruments and must incorporate all factors that market participants would consider appropriate in setting a price. All fair values are subject to the Commerzbank 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. The models, input data and resulting fair values are reviewed regularly by management and the risk function.

Under IFRS 13, financial instruments reported at fair value are assigned to the three levels of the fair value hierarchy as follows: Level I: Financial instruments where fair value is based on quoted prices for identical financial instruments in an active market; Level II: Financial instruments where no quoted prices are available for identical instruments in an active market and fair value is established using valuation techniques which rely on observable market parameters; Level III: Financial instruments valued using methods with input values where insufficient observable market data are available and where these inputs have a more than insignificant impact on the fair value. The allocation of particular financial instruments to the relevant level requires systematic judgement by management, particularly if the valuation is based both on observable and unobservable market data. An instrument's classification may also change over time due to

changes in market liquidity and consequently in price transparency.

There were no financial instruments valued according to Level III in the portfolio as at either June 30, 2018 or December 31, 2017.

In the tables below, the financial instruments reported in the balance sheet at fair value are grouped by category and valuation method. They are broken down according to whether fair value is based on quoted market prices (Level I), observable market data (Level II) or unobservable market data (Level III).
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Fair value hierarchy in €000	Level I	Level II	Total 30.06.2018	Total 01.01.2018
Assets				
Positive fair values of derivative hedging instruments	0	487,163	487,163	574,124
Trading assets	0	331,418	331,418	380,881
of which: positive fair values from derivatives	0	331,418	331,418	380,881
Financial assets – mandatorily fair value P&L	0	2,659,524	2,659,524	3,176,822
Total	**0**	**3,478,105**	**3,478,105**	**4,131,827**
Liabilities				
Negative fair values of derivative hedging instruments	0	1,089,429	1,089,429	1,255,240
Trading liabilities	0	1,447,372	1,447,372	2,295,419
of which: negative fair values from derivatives	0	1,447,372	1,447,372	2,295,419
Total	**0**	**2,536,801**	**2,536,801**	**3,550,658**

Commerzbank Finance & Covered Bond S.A. has not reclassified any financial instrument from Level I to Level II or vice versa during the current financial year, nor did it do so in the previous financial year.

Responsibility statement by the company's legal representatives

To the best of our knowledge, the balance sheet, the IFRS 9 opening balance sheet as at January 1, 2018 and the statement of comprehensive income, having been compiled in accordance with the reporting principles applicable in the Grand Duchy of Luxembourg, give a true and fair view of the financial position and financial performance of the Bank as at June 30, 2018, and the interim management report includes a fair review of the main events occurring in the first half of 2018 and of the material risks and the expected development of the business in the second half of 2018.

Luxembourg, August 20, 2018

Commerzbank Finance & Covered Bond S.A.
Executive Board

Gerard-Jan Bais   Markus Blaes

Other details

Headquarters

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

Bank Committees

Board of Directors

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

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 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

Executive Board

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

Commerzbank Finance & Covered Bond S.A.
25, rue Edward Steichen
L-2540 Luxembourg

P.O. Box 321
L-2013 Luxembourg

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

Commercial register:
R.C.S. Luxembourg B 30 469
VAT ID No. LU14147251

Satz: MEFA Medienfabrik, www.mefa-medienfabrik.com