Annual Report 2017

Deutsche Pfandbriefbank Group

pbb
DEUTSCHE PFANDBRIEFBANK

Business model
pbb Group

BORROWER

REF

REAL ESTATE FINANCE

We structure medium- to large-sized financings for professional real estate investors, with a focus on office, retail, residential, and logistics properties. Our clients benefit from the mix of local and international expertise we offer.

PIF

PUBLIC INVESTMENT FINANCE

We finance public-sector infrastructure investments, such as public housing, utilities and waste disposal, health care and nursing care properties, as well as childcare and educational facilities. We also provide export finance facilities under public guarantees.

LENDING

Interest & redemption

Interest & redemption

DEUTSCHE PFANDBRIEFBANK AG

pbb Deutsche Pfandbriefbank is a leading specialist bank for commercial real estate finance and public investment finance in Europe and the US. Within Europe, the Bank's focus is on Germany as well as on the United Kingdom, France, Scandinavia as well as countries in Central and Eastern Europe.

FUNDING

PFANDBRIEF ISSUANCE

The Bank's main funding instrument is the Pfandbrief: pbb is one of the largest issuers in this market. It issues Mortgage Pfandbriefe, collateralised by mortgages as well as Public Sector Pfandbriefe, collateralised by guarantees from the public sector. Moreover, pbb issues unsecured instruments, and operates a retail deposit business for private investors.

Interest & redemption

Interest & redemption

INVESTORS

Facts and figures

€ 28.8 billion

Pfandbrief volume
Pfandbriefe are covered bonds under German law, and therefore represent a cost-efficient source of funding. With an outstanding total volume of €28.8 billion (nominal), pbb ranks among the largest issuers.

€ – 6 million

Loan loss provisions
In 2017, as in previous years, pbb only had to make low loss provisions for its credit portfolio in 2017, thanks to the bank's risk-conservative approach.

17.6%

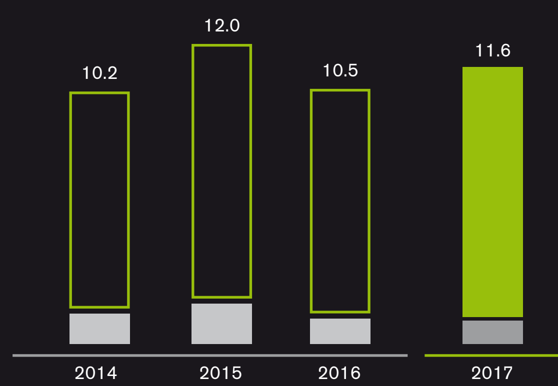
CET1 ratio (Basel III, fully phased-in)
pbb has a good capital base; the Bank is thus able to fulfil regulatory requirements whilst maintaining a buffer for potential cyclical market fluctuations and planned strategic growth.

Transactions in 2017 (REF & PIF)

251

New business

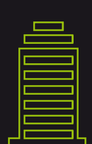
€11.6 bn



New business
in € billion (commitments, including extensions > 1 year)

Real Estate Finance Public Investment Finance

New business volumes within the Real Estate Financing segment 2017 (€)



4.8 bn
Office

1.9 bn
Retail

1.3 bn
Logistics/storage

1.9 bn
Residential

0.5 bn
Hotels and leisure

0.3 bn
Mixed use/
other properties

Overview

Deutsche Pfandbriefbank Group (pbb Group)		2017	2016	2016[1]
Operating performance according to IFRS				
Profit or loss before tax	in € million	204	301	169
Net income/loss	in € million	182	197	88
Key ratios				
Cost-income ratio	in %	50.9	39.0	51.4
Return on equity before tax	in %	7.3	11.1	6.3
Return on equity after tax	in %	6.5	7.3	3.3
Earnings per share	in €	1.35	1.46	0.65
Dividend per share	in €	1.07[2]	1.05	
New business volume[3]	in € billion	11.6	10.5	
Balance sheet figures according to IFRS		**31.12.2017**	**31.12.2016**	**31.12.2016[1]**
Total assets	in € billion	58.0	62.7	62.5
Equity	in € billion	2.9	2.8	2.7
Financing volumes Real Estate Finance and Public Investment Finance	in € billion	31.9	31.5	
Key regulatory capital ratios		**31.12.2017[4]**	**31.12.2016[5]**	**31.12.2016[1][5]**
CET1 ratio	in %	17.7	19.5	19.5
CET1 ratio fully phased-in	in %	17.6	19.0	19.0
Own funds ratio	in %	22.3	23.7	23.7
Own funds ratio fully phased-in	in %	22.2	20.7	20.7
Leverage ratio	in %	4.6	4.6	4.6
Leverage ratio fully phased-in	in %	4.5	4.2	4.2
Staff		**31.12.2017**	**31.12.2016**	
Employees (on full-time equivalent basis)		744	756	
Long-term issuer rating/outlook[6][7]		**31.12.2017**	**31.12.2016**	
Standard & Poor's		A–/Negative	BBB/ CreditWatch Positive	
DBRS		BBB/Stable	BBB/Stable	
Moody's Pfandbrief rating[7]		**31.12.2017**	**31.12.2016**	
Public Sector Pfandbriefe		Aa1	Aa1	
Mortgage Pfandbriefe		Aa1	Aa1	

[1] Without consideration of the one-off effect from Heta Asset Resolution AG (Heta).
[2] Proposal to the Annual General Meeting on 21 June 2018.
[3] Including prolongations with maturities of more than one year.
[4] After confirmation of the 2017 financial statements, less the proposed dividend (subject to approval by the Annual General Meeting).
[5] After confirmation of the 2016 financial statements and appropriation of profits.
[6] The ratings of unsecured liabilities may diverge from the issuer ratings.
[7] Please refer to the "Report on Economic Position" for a detailed description of the ratings.

Cover
Office complex "Karl", Munich.
For more information, please turn to page IV.

Information due to rounding
Due to rounding, numbers presented throughout this document may not add up precisely to the totals provided and percentages may not precisely reflect the absolute figures.

Explanation of alternative performance measures
For further information regarding the definition, usefulness and calculation of alternative permormance measures see "investors/financial-reports" at www.pfandbriefbank.com.

Growth with a sense of proportion

Our business activities in Real Estate Finance and Public Investment Finance help buildings and infrastructure projects to grow. Hence, we select our exposures with a sound sense of proportion, as pbb's growth is based on two solid pillars: **strong risk awareness** and sustained profitability. We have a close eye on both when **expanding into new markets and client groups** or when developing new products and thus adapting the existing business model **flexibly to current requirements.**

Letter from the Management Board

DEAR SHAREHOLDERS, DEAR BUSINESS PARTNERS, LADIES AND GENTLEMEN,

The key developments in recent years – a high degree of competitive and margin pressure in a fundamentally intact market environment as well as ongoing regulatory activities – also characterised the real estate finance sector in 2017. These issues also substantially affected Deutsche Pfandbriefbank AG as one of the leading real estate finance providers in Europe. Despite this challenging environment, pbb grew its new business and, once again generated sound operating results clearly exceeding the previous record year's figure – which benefited from a non-recurring effect. We owe this success to the trust of our clients and the performance of all our colleagues at pbb.

New business amounted to €11.6 billion and was thus higher than in the previous year (€10.5 billion). Growth was driven predominantly by the expansion of business activities into new markets and client groups, as well as by the broadening of pbb's product range – with unchanged conservative risk standards. Hence, the real estate finance business in the US, which pbb recommenced during the second half of 2016, contributed a share of 8% to new business in Commercial Real Estate Finance in 2017. High net worth individuals, usually being reached by pbb through the cooperation with asset managers, have gained in significance as an independent client group. Finally, more new business was generated by loan structures with relatively low loan-to-value ratios – so-called low-leverage lending. Whilst gross margins on new business remained under pressure during the 2017 financial year, declining new issues spreads, which pbb realised on rising funding volumes, led to lower funding costs. Hence, net margins on new business remained broadly stable in 2017.

Looking at the consolidated income statement (in accordance with IFRS) for Deutsche Pfandbriefbank, interest expenses declined noticeably due to the lower funding costs, resulting in an increase in net interest income. At the same time, risk costs for the loan portfolio remained at a very low level. However, higher personnel expenses – as well as rising regulatory costs and expenses incurred for strategic projects – resulted in higher general and administrative expenses. On the whole, we achieved sound profit before taxes of € 204 million (or profit after taxes of €182 million).

Against the background of this good result and the sound capitalisation, the Management and Supervisory Boards have resolved to implement a new dividend policy. The current distribution ratio of between 40% and 50% of consolidated profit after taxes in accordance with IFRS is set to be raised to a regular dividend of 50% plus a special dividend of 25%, until 2019 inclusive. For the 2017 financial year, the Management and the Supervisory Boards want to distribute income (after taxes) over and above pbb's original results guidance, in full, equating to a dividend of €1.07 per share and a distribution ratio of 79%.

In the course of its regulatory activities, the ECB is currently harmonising bank risk quantification models on a European and bank-specific level. As a result of this process, pbb's risk-weighted assets increased by approximately € 2 billion already in 2017, leading to a decrease in the CET1 ratio. pbb remained well-capitalised in this context and reported a CET1 ratio of 17.6% (fully phased-in) as at the end of 2017. According to the ECB, this revision will take until 2019, which makes a final assessment of future risk-weighted assets difficult. New regulations imposed by the

Basel Committee on Banking Supervision at the Bank for International Settlements – also known as Basel IV – will also require further adjustments. However, these requirements will not be effective immediately, but will be gradually phased in from 2022 onwards.

In 2017, our activities did not just focus on the lending business, but also on the launch of further initiatives for pbb's digital transformation. Our newly established subsidiary CAPVERIANT is developing a portal for public-sector financings. Its main function will be to intermediate loan supply and demand. The platform will start in Germany, and is intended to cover further countries and offer additional functionaities and services we want to develop in cooperation with our clients. Additional digitalisation initiatives are planned in pbb's core business. These will address the interface to our clients and also our internal processes.

We expect the 2018 business year to be just as challenging as the previous year. We will continue to work hard for pbb to continue its successful development in the next few years.

Yours sincerely,

Thomas Köntgen
Deputy Chairman of the
Management Board
Treasury and Real Estate Finance

Andreas Arndt
Chairman of the
Management Board and
Chief Financial Officer

Andreas Schenk
Chief Risk Officer

Office complex “Karl”, Munich

PROFILE

Project
New building of an office complex

Location
Karlstrasse in Munich – a central location in the vicinity of Munich’s central railway station in the so-called “Brewery Quarter”

Facts about the building
- → Designed by the renowned London-based architect David Chipperfield
- → The highest standards in terms of sustainability and energy efficiency, LEED Gold certification
- → Around 30,000m² of rentable space, 1,400m² courtyard garden, 300 underground car parking spaces
- → Construction start in 2018, completion scheduled for 2021

Key points of financing
- → The initial loan amounts to €112 million, and will be reduced to €110 million on a long-term level after completion
- → The loan matures at the end of 2040
- → The tailor-made financing includes both the variable-rate interim construction financing as well as a long-term investment loan
- → The Brecht-Bergen family of entrepreneurs are the developers and borrowers. With this joint project, pbb is expanding its network amongst high net worth private clients

A place for encounters
The ground floor of the office complex offers spaces for various restaurant concepts which – along with the courtyard garden – will create an attractive meeting place in this quarter of the city.

Our growth targets follow the same rules as the buildings we finance: we always provide a safe and solid foundation.

Growing profitably on a strong foundation

Growth and profitability targets go hand in hand with high risk standards – this is the typical handwriting of Deutsche Pfandbriefbank.

Where we stand

pbb is one of the leading European specialist banks for commercial real estate finance and public investment finance. These two segments build our strategic business. Our core funding instrument is the Pfandbrief.

In the Real Estate Finance (REF) segment, we structure medium to large financing transactions for professional investors. We finance exclusively commercial real estate, with a focus on office buildings, retail properties, residential buildings and logistics properties.

The Public Investment Finance (PIF) segment covers investment finance for public-sector clients. The financed infrastructure projects comprise, among other things, public housing as well as healthcare and educational facilities. We also provide publicly guaranteed export finance.

"We will accept lower new business volumes rather than compromise our standards concerning risk and return."

Where we want to go

We want to grow sustainably, and our 2017 results show that we have once again been achieving this goal. The following factors were key drivers for this solid development:

→ We opened up to **new markets** and new target groups – in our pursuit to build long-term client relationships

→ We extended our **product portfolio** appropriately, and with a sense of proportion

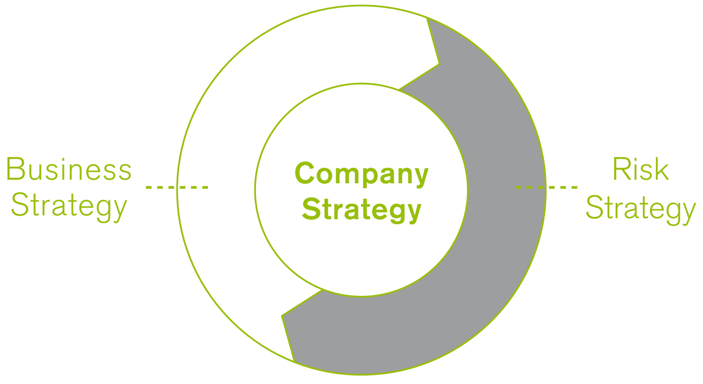
→ We have driven pbb's **digital transformation** forward

Always in focus: a strong risk policy

A solid operating performance, and a sound portfolio quality and capital base – this is what pbb stands for. Above all, the consistent adherence to high risk standards is one of our special characteristics, from which we do not stray – not even in times of fierce competition. We will not enter into any transactions which do not comply with the requirements of our profitability and risk policies.

Pfandbrief – our most important funding instrument

In accordance with our conservative business practice, we rely on the Pfandbrief in our funding business. pbb issues Mortgage Pfandbriefe and Public Sector Pfandbriefe. With new issues of € 3.8 billion (nominal) and an outstanding volume of around € 28.8 billion (nominal) in 2017, pbb is among the largest issuers in this area. Pfandbriefe are subject to strict legal requirements and offer a high degree of security and transparency. As such, they represent a cost-efficient source of funding for issuers.



pbb's strategy comprises the business strategy and risk strategy – with equal levels of importance. These standards are applied with a high level of consistency, resulting in economically stable and sustainable projects, which are characteristic for pbb.

How we control our risks

→ **Dynamically:** pbb Group's risk strategy is reviewed and updated at least once a year – and whenever we see a reason to do so.

→ **Proactively:** all risks are constantly being monitored. In order to identify potential threats in good time, we apply early warning systems and stress tests.

→ **Consistently:** we ensure an active risk culture at all levels throughout the Group. The Management Board as well as all employees act in line with a defined Code of Conduct which is specified in the corporate guidelines.

Key factors for continued success

Our aim is to be a reliable financing partner to our clients, supporting them in demanding projects in the established manner.

We see customer orientation as the key to sustainably securing new business on our growth course and managing our existing portfolio in a risk-minimising way. This can only succeed in a corporate culture that is recognised at all levels – and with that, consistently aims for efficiency and quality.

Specialist for large-volume transactions

Our positioning as an internationally recognised financing partner demonstrates that we are already implementing this successfully. Clients particularly appreciate our ability to structure complex, large-volume transactions, in many cases with several partners involved. In other words, when things get really demanding, we are the first port of call for many.

"We see client orientation as the key to securing new business on a sustained basis and managing our existing portfolio in a risk-minimising way."

Business Strategy

Client focus

→ Focus on clients and solutions
→ Further expand customer contacts through specialised advice
→ Continuously guarantee transparency and reliable execution

Efficiency

→ Critically examine existing processes and adapt them if necessary
→ Take a comprehensive view of processes, from the client's point of view – and implement them accordingly
→ Encourage cross-departmental interaction

Culture

→ Constantly deliver high quality and accuracy
→ Take responsibility for own actions
→ Remain open to new ways of thinking and approaches

pbb's core markets are Germany and selected European markets. We have been active in the US real estate market since the third quarter of 2016.

Be specialised
Be proficient
Be solution-orientated
Be dynamic
Be risk-aware

Focused entry into the world's largest real estate market

We intend to further establish our strong position as a specialised, competent mortgage bank beyond our core market of Europe. This is why we are expanding our business activities in the US.

We have attached great importance to regional expertise and proximity to our clients. To ensure this, we are pooling our sales organisation in our main markets into regional offices. This will enable us to make effective use of capacities and local knowledge.

While the pbb Group has previously concentrated on financing in Europe, the US real estate market is now on the map of our business activities. There are good reasons for this:

The US – a new target market for pbb

→ We are opening up a new market which, due to its size, transparency and liquidity, is perfectly suited to pbb's orientation

→ We are tapping into new growth potential – therefore generating additional revenue

→ We support our international clients in their business in the US

Prudent market entry

As is our nature, we have organised our market entry in a prudent and cautious manner. Initially we concentrated on co-financing activities with strategic partners.

Focus on the East Coast

The successful performance of our business activities in the US market has strengthened our resolve to increase the exposure. Local presence is essential for this and for that reason we are opening a representative office in New York (see box). We will manage our US business activities from there.

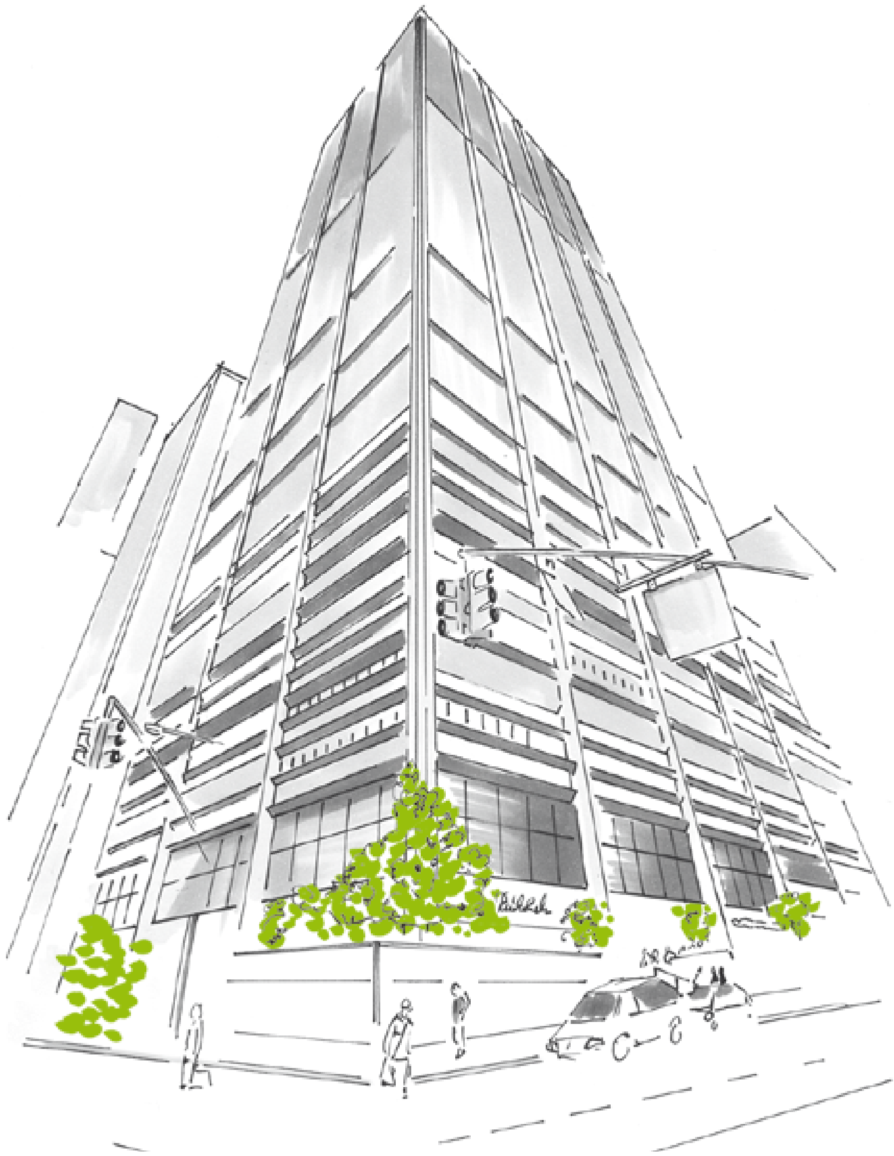
Transactions executed in the US are eligible for inclusion in the cover assets pool and can thus be refinanced through Pfandbriefe. As pbb also issues Pfandbriefe in US dollars, the currency risk is mitigated.

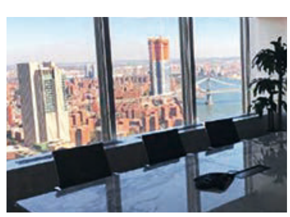
US$ 1.0 bn

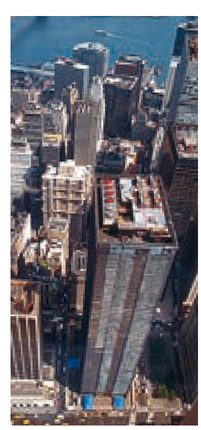
Demonstrating a strong start, at the end of 2017 – just over a year after entering the market – pbb's US portfolio has already reached almost USD1 billion.

pbb NYC office

The New York office will act as a representative office and will ensure that our clients have local access to qualified personnel and market expertise. To this end, a small, powerful team of real estate experts will be working there. Credit decisions will continue to be made in Germany.







In the heart of the Big Apple
Situated in Manhattan's prime location, One Liberty Plaza soars 220 metres into the New York sky.

"By issuing Pfandbriefe in US dollars, we mitigate the currency risk."

Office "One Liberty Plaza", New York City

PROFILE

Project
Participation in the funding of the New York Office Tower "One Liberty Plaza"

Location
New York City's financial district

Facts about the Building
→ Skyscraper with a height of 226m
→ With 210,000 m², divided over 54 floors, it is amongst the highest office buildings in New York City
→ High letting rate of over 90% on average over the last 10 years

Cornerstones of the Financing
→ pbb participates in a syndication with USD 75 mn
→ Transaction's total volume is USD 850 mn
→ Large volume transaction with a number of syndication partners

Adding value to the portfolio – attracting new clients

pbb is expanding its range of real estate financing products and services against a backdrop of shifts in the market and competitive environments. Gerhard Meitinger, Head of Real Estate Finance Germany at pbb, explains what this means in practice and why good judgement is also key here.

Adapting the product range to client needs

Gerhard, what is the objective of pbb expanding its customer base?

GM: We are facing very intense competition. Moreover, the total number of transactions is falling, and the needs of our clients are also changing. Logically, we do not want to stand still if everything around us is moving. We do this by broadening our range of products and services, and thereby the spectrum of potential clients and transactions.

Does that mean you're moving away from your conservative approach?

GM: Our view has not changed at all. We continue to consciously position ourselves at the conservative end of the market spectrum. And this is precisely where we are now addressing specific clients. Basically, it is a matter of recognising their needs and developing our services accordingly. Always with an open mind and a critical view of possible risks.

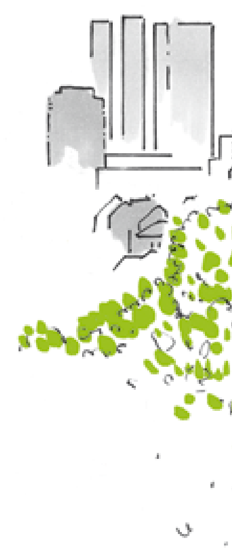
"Using leeway without compromising our risk strategy."

Could you give a concrete example?

GM: Look at loan-to-value ratios: we see increased market demand for more flexibility in the debt portion – and this also means new business potential. There is therefore room for manoeuvre within the framework of our risk strategy. This means that, under certain conditions, we can allow both higher and lower loan-to-value ratios. Lower loan-to-value ratios mean lower gross margins, but we also reduce our refinancing costs and streamline processes. In the case of higher loan-to-value ratios, we ensure to structure exposures in a manner that reflects the higher risk, such as higher redemptions.

... and will this make them interesting for new client groups?

GM: In fact, we can expand our network towards fund managers or commercial housing, for example. We are also intensifying our acquisition of high net worth individuals. Business with these investors is mainly aimed at transactions with A1 properties in prime locations. We intend to use our expertise in Commercial Real Estate Finance to support asset managers in cooperation with their clients – and in return, to benefit from access to this high-class clientèle.



Exclusive residential tower
pbb is financing the tallest residential building in Frankfurt/Main's Westend district. From 2020 onwards, anyone living andor staying overnight in 160 PARK VIEW will enjoy premium luxury and a panoramic view of the Frankfurt skyline.

Hotel and residential complex, "160 PARK VIEW", Frankfurt/Main

PROFILE

Project
"160 PARK VIEW": a premium hotel and residential complex in Frankfurt/Main

Location
Frankfurt's Westend district, next to the Grüneburgpark

Facts about the building
- → Renovation and conversion of two former office buildings into a hotel and residential complex in the high-end market sector
- → Interior and exterior renovation, redesign of façades
- → 26-floor residential tower with 130 apartments and a public childcare facility
- → 5-star hotel with 135 rooms over 20 floors
- → Start of construction 2017, planned completion 2020

Financing key points
- → pbb is providing €163 million in financing to a joint venture between RFR Holding, Revcap and Hines

Business models: thinking digital

When municipal turns digital: pbb is establishing a platform for public-sector financing with its subsidiary, CAPVERIANT. A transparent market place for market participants and moreover, an important step in pbb's digitalisation strategy.

The ongoing process of digitalisation is driving the banking sector forward. In many areas, we need to find a new way of thinking about processes and interfaces. We are taking this into account.

Not only do we want to implement digital technologies, but we also want to digitally transform pbb. A recent example shows how traditional businesses can be raised to a digital level in the course of this transformation, and can even yield entirely new business models. Our new subsidiary CAPVERIANT, a type of FinTech with an established bank in the background, is developing an online public finance platform. This brings with it a new role for pbb; it does not act as a lender, but instead provides an online market place. We want to build on our experience with the platform to enhance digital processes in our core businesses and to explore other innovative business models.

High security standards

The platform is user-friendly and offers high security standards that meet the requirements of public-sector clients. After the market launch in Germany, the service is set to be extended to France.

"Acting with foresight means minimising risks. We are setting ourselves up for the future with digitally supported business models."

CAPVERIANT brings borrowers and lenders together

The CAPVERIANT financial platform effectively brings together public-sector borrowers and institutional investors. At CAPVERIANT, public-sector entities can submit financing requests for which they are seeking financing partners. This platform broadens the circle of potential lenders. In turn, the lenders receive a pooled overview of public-sector financing projects.

Core functionality of the CAPVERIANT platform

→ Intermediation and market search – providing access to public-sector entities and institutional investors from Germany and other countries

→ Loan agreements stored on the platform: standardised agreements or customised contracts for greater efficiency

Institute for Political Studies “SciencesPo”, Paris

PROFILE

Project
Construction of a campus complex for the Institute of Political Science in Paris (“SciencesPo”)

Location
Saint-Germain-des- Prés, a central quarter in the city of Paris (7th Arrondissement)

Facts about the Building
→ The historic Hotel d’Artillerie building from the 17th century and the location 13 Rue de l’Université will be made into one complex – an exciting combination of historical architecture and the requirements of a university in the 21st century
→ Creation of an innovative urban campus in the heart of the business, cultural and social centre of Paris with an approximate area of 22,000 m²
and many varied uses
→ Planned construction timeframe until 2021

Cornerstones of the Financing
→ As arranger, pbb – together with La Banque Postale – provides a credit totalling €160 million with each partner providing €80 million
→ The transaction is divided into two parts: The first loan was provided at the end of 2016
→ It is an acquisitions financing, secured with a guarantee from the city of Paris (75%) and first ranking mortgages (25%)

From the 17th century to the digital age
Space for modern learning, interaction and innovation. The open-plan concept, which combines old and new, is creating new benchmarks in campus architecture.

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To our Shareholders

Report of the Supervisory Board

In this section, the Supervisory Board of Deutsche Pfandbriefbank AG ("pbb") reports on the focal points of its supervisory and advisory activities during the 2017 financial year.

As in the previous year, the 2017 financial year was shaped by intense competition and the low interest rate environment – accompanied by constantly evolving challenges on the regulatory front as well as in accounting and financial reporting such as the Targeted Review of Internal Models (TRIM), the discussions on "Basel IV" and new risk weights (affecting risk-weighted assets or "RWAs") as well as the preparations for IFRS 9, which is applicable as of 2018. Even in this environment, the Deutsche Pfandbriefbank Group ("pbb Group") was able to maintain its stable business development and, in particular, to further strengthen its leading market position in commercial real estate finance. Also in the financial year 2017, pbb was able to build on its solid core business, and increase its new business in an intense competitive environment – whilst continuing to apply high risk standards. This was shown, inter alia, by pbb's re-entry into US real estate financing. Further new strategic initiatives in the digitalisation area were launched as well.

As always, monitoring ongoing business development and its risks were a key focus in the supervisory and advisory activities of the Supervisory Board. In addition, the Supervisory Board concerned itself with identifying a successor to Dr Hedda von Wedel, since her term of office will end upon the close of 2018's Annual General Meeting. In 2017, the Supervisory Board devoted particular attention to issues concerning legal supervisory requirements and IT.

CORPORATE GOVERNANCE

The Supervisory Board continuously monitored the Management Board during the financial year 2017, as in the past, and provided it with regular advice on the management of the Company.

It assured itself in all cases that the management measures taken by the Management Board were lawful, appropriate, due and proper. The Management Board fulfilled its duties to provide information, and informed the Supervisory Board in a regular, timely and comprehensive manner, both in writing and orally, about matters and measures relevant to the Company. This also included information on any deviations between target and actual figures or developments. The members of the Supervisory Board had sufficient opportunity, at all times, to critically assess the reports and proposed resolutions submitted by the Management Board, and to make their own suggestions during Supervisory Board committee meetings and in the plenary sessions. The CEO also reported to the Chairman of the Supervisory Board, as well as to the respective Committee Chairmen, on all material developments between meetings.

In particular, the Supervisory Board held in-depth discussions on, and reviewed the plausibility of, all business transactions material to the Company, on the basis of written and oral reports provided by the Management Board. Furthermore, it concerned itself intensively – with assistance of legal advisors and experts – with the synthetic securitisation transaction "Estate UK-3" and the expert procedure initiated in summer.

The Supervisory Board examined the requisite independence of the external auditors of the financial statements, KPMG AG Wirtschaftsprüfungsgesellschaft («KPMG»), instructed KPMG with the audit, and agreed the auditors' fee.

On 1 March 2018, the Supervisory Board concerned itself with the Declaration of Compliance with the German Corporate Governance Code for the financial year 2017, which is published on pbb's website (http://www.pfandbriefbank.com/en/investors/mandatory-publications.html). Please also refer to the Group's remuneration report, which is printed in this annual report. With respect to the requirements of the German Corporate Governance Code, in conjunction with section 111 (5) of the AktG, concerning the target and actual quotas of female members of the Supervisory Board, please refer to the table outlining the composition of the Supervisory Board and its committees, and to the comments in the Corporate Governance Report as well as in the non-financial report and in the Corporate Governance Statement.

MEETINGS OF THE SUPERVISORY BOARD

The Supervisory Board of pbb held seven meetings in 2017, including two extraordinary meetings. Its members were:

Dr Günther Bräunig (Chairman), Dagmar Kollmann (Deputy Chairman), Dr Thomas Duhnkrack, Dr Christian Gebauer-Rochholz, Georg Kordick, Joachim Plesser, Oliver Puhl , Heike Theißing, Dr Hedda von Wedel.

All ordinary meetings addressed the current business situation of pbb Group, which was discussed in detail with the Management Board in each case. The Management Board informed the Supervisory Board, regularly and in a timely manner, about pbb's financial situation and performance. During the ordinary meetings, the Supervisory Board also received reports on the risk position, risk management, new business, the liquidity situation and strategy, funding developments, current regulatory issues, as well as on significant events that were of material importance to the assessment of the Company's position, development and management.

Alongside the regular topics already mentioned, the ordinary meeting on 16 February 2017 primarily adopted pbb's updated business and risk strategy, and discussed the Recovery Plan. Furthermore, the meeting determined the target achievement at an institutional level as well as the variable remuneration for the Management Board members for the financial year 2016 (including malus review). The Supervisory Board also intensively discussed the appropriateness of the Management Board remuneration and, resulting from this, adopted an adjustment within the scope of an increase in the target bonus of Andreas Arndt, Chairman of the Management Board. Moreover, the Supervisory Board adopted the adjustments of the assignment of responsibilities and of the Rules of Procedure of the Management Board, required due to the departure of Dr Scholz, and approved the changed submission requirements for the Risk Management and Liquidity Strategy Committee regarding credit exposures. A further key focus of the meeting was the report on the examination of efficiency, by which the evaluation of the Supervisory Board and the Board of Managing Directors for the year 2016 was concluded.

In the accounts review meeting held on 24 March 2017, the Consolidated Financial Statements for 2016 were approved and the Annual Financial Statements for 2016 adopted. Moreover, the Annual General Meeting for 2017 was prepared and respective resolutions regarding the agenda – including the submitted proposed resolutions – were adopted. Following the discussion during the meeting in February, the variable remuneration for 2016 was confirmed and adopted. In addition, the preparation of a profile of skills and expertise for the entire Board was assigned pursuant to section 5.4.1 of the German Corporate Governance Code and the annual Declaration of Compliance was adopted. Another key focus was on the analysis of the new European bail-in regime and its potential impact on the funding markets as well as the methodologies of rating agencies.

The meeting on 12 May 2017 was dominated by pbb Group's first-quarter report for 2017. Further, the Supervisory Board discussed the progress of various strategic initiatives, the Bank's roadmap on IT and digitalisation, the Variable Remuneration Plan 2017 for the Management Board, the remuneration reports 2016 as well as current legal cases, and adopted the adjustment of the Bank's risk strategy.

Subsequent to the Annual General Meeting, the minutes on the meeting in March were adopted during the meeting on 30 May 2017.

During its meeting on 11 August 2017, the Supervisory Board discussed pbb Group's interim report as at 30 June 2017 and the review of the six-month financial statements by the external auditors. In addition, the profile of skills and expertise pursuant to section 5.4.1 of the German Corporate Governance Code assigned during the meeting in March was adopted. The Board also concerned itself with the final report on the review of the Compliance organisation, the progress of the preparations for IFRS 9, the results of the IT audit by the ECB, the current SREP status as well as with the replacement of Dr Hedda von Wedel on the Supervisory Board.

On the basis of the debates in the course of its annual strategy meeting on 27 October 2017, the Supervisory Board initially discussed pbb Group's results for the third quarter of 2017 and then adopted the corporate planning and the business strategy, each for the financial years 2018-2020, as well as the IT and risk strategy for 2018 on 10 November 2017. The Supervisory Board also prepared the examination of efficiency for the Management Board pursuant to section 25d (11) of the KWG and determined the parameters for the risk-adjusted performance measurement at the institutional level, as well as targets for the Management Board for the financial year 2018. Furthermore, the identification of risk takers, the assessment of the appropriateness of the remuneration system, the appointment of remuneration officers, the adjustment of the Executive and Nomination Committee's Rules of Procedure and the (renewed) determination of a targeted female proportion in the Supervisory Board and Board of Directors were approved. Also a report on the progress of the representative office in the US, which is currently being established, was presented.

During an extraordinary conference call on 29 November 2017, the Supervisory Board discussed strategic options regarding the present M&A environment.

SUPERVISORY BOARD COMMITTEES

During the period from 1 January to 31 December 2017, pbb's Supervisory Board maintained an Executive and Nomination Committee, an Audit Committee, a Risk Management and Liquidity Strategy Committee, as well as a Remuneration Committee. During this period, the committees comprised the following members:

The **Executive and Nomination Committee** held ten meetings (including five extraordinary meetings); it consisted of Dr Günther Bräunig (Chairman), Dagmar Kollmann and Joachim Plesser.

The committee concerned itself with strategic and current regulatory issues, as well as with matters concerning the Management Board, for which it prepared corresponding proposals for the plenary meeting. These primarily involved the achievement of the Management Board members' targets, as well as the determination of their variable remuneration for the financial year 2016 (including malus review). Furthermore, the Executive and Nomination Committee discussed adjustments of the assignment of responsibilities and of the Rules of Procedure of the Management Board, as well as the replacement of Dr Hedda von Wedel on the Supervisory Board, required for 2018. The committee also prepared the 2017 examination of efficiency for the Management Board as well as the Supervisory Board (including its committees); it informed the Supervisory Board concerning corporate governance issues in accordance with the Rules of Procedure and concerned itself with the Corporate Governance Statement in accordance with section 289f of the HGB (including the Corporate Governance Report and Declaration of Compliance with the German Corporate Governance Code). The Committee also discussed the profile of skills and expertise for the Supervisory Board (pursuant to section 5.4.1 of the German Corporate Governance Code). In the course of several meetings in 2017, the Committee also concerned itself with different strategic opportunities in particular.

The **Audit Committee** held five meetings; it consisted of Dagmar Kollmann (Chairman), Dr Günther Bräunig, Dr Thomas Duhnkrack and Dr Hedda von Wedel.

During its meetings, the committee reviewed and discussed the Annual Financial Statements and Consolidated Financial Statements for 2016, the interim reports (or statements) of 2017, and the reports by Internal Audit and external auditors KPMG on internal and external audit findings. In addition, the Audit Committee discussed the effects of current regulatory issues with the Management Board, and was informed of the development of ongoing audits. The Audit Committee also concerned itself with the mandate for the external auditors and their audit plan for the 2017 financial year. Furthermore, the Audit Committee satisfied itself concerning the independence of the external auditors, and recommended to the Supervisory Board to propose to the Annual General Meeting to elect KPMG as external auditors for the 2017 financial year. In addition, the Audit Committee discussed the review of the Compliance organisation, the "Estate-UK 3" securitisation transaction, as well as the shareholder and dividend strategy. With regard to current regulatory issues and supervisory audits, the Audit Committee was informed by the Management Board concerning, inter alia, IFRS 9, Basel IV, IRBA models, the IT audit carried out by the ECB and the SREP stress test. Furthermore, regular reports were received on the Internal Control System and the monitoring of key controls implemented, current litigation, Compliance issues, data protection and IT security, notable accounting issues, the results of external audits, as well as the audit plan established by Internal Audit and its implementation.

The **Risk Management and Liquidity Strategy Committee** convened for four ordinary meetings. It also discussed credit exposures requiring Supervisory Board approval, usually during monthly conference calls. The committee consisted of Joachim Plesser (Chairman), Dr Günther Bräunig, Oliver Puhl and Dr Hedda von Wedel.

The committee supported the Supervisory Board's supervision of risk management and liquidity management; it reviewed the Management Board's risk reporting, and was involved in the credit approval process to the extent laid down in the Rules of Procedure. The committee also regularly discussed new business developments as well as the liquidity and funding status and syndication business. During 2017, the committee also concerned itself with reports on sub-portfolios (including development financings); it dealt with foreclosures, specific allowances, the reporting of own funds in accordance with the German Solvency Regulation, country limits, and asset/liability management. The committee also concerned itself with expected medium-term developments on real estate markets, the submission requirements for the Risk Management and Liquidity Strategy Committee regarding credit approvals, and with updates to the risk strategy.

In addition, the committee addressed individual credit exposures on numerous occasions, usually in the form of monthly conference calls. These related to new business, regular re-submissions and approvals for change applications, required to be submitted under the committee's Rules of Procedure.

The **Remuneration Committee** held five meetings; it consisted of Dr Günther Bräunig (Chairman), Dagmar Kollmann, Joachim Plesser and Heike Theißing.

The Committee concerned itself with the remuneration reports, the variable remuneration for the financial year 2016, the target agreements and achievements for the Management Board members as well as the Variable Remuneration Plan 2017 for the Board of Managing Directors. Furthermore, the committee prepared the approval of the determination of risk-taker functions, and the determination of parameters for the risk-adjusted performance measurement at the institution level, for the Supervisory Board. Other key focuses of the meetings were on the Bank's remuneration system, including the assessment of its appropriateness, as well as on regulatory changes (i.e. the German Regulation on Remuneration in Financial Institutions (InstVergV) comprehensively revised in 2017).

Supervisory Board of pbb

Name and place of residence	Principal activity	**Supervisory Board function and meeting attendence**	Committee function and meeting attendence: Executive and Nomination Committee	Audit Committee	Risk Management and Liquidity Strategy Committee	Remunaration Committee
Dr Günther Bräunig Frankfurt/Main, Germany	Deputy CEO of KfW (CEO since 1.1.2018)	Chairman 7 of 7	Chairman 10 of 10	Member 5 of 5	Member 4 of 4	Chairman 5 of 5
Dagmar Kollmann Vienna, Austria	Entrepreneur	Deputy Chairman 7 of 7	Member 10 of 10	Chairman 5 of 5		Member 5 of 5
Dr Thomas Duhnkrack Kronberg/Taunus, Germany	Entrepreneur	Member 6 of 7		Member 4 of 5		
Dr Christian Gebauer-Rochholz Hochheim, Germany	Bank employee	Employee representative 7 of 7				
Georg Kordick Poing, Germany	Bank employee	Employee representative 7 of 7				
Joachim Plesser Ratingen, Germany	Consultant	Member 7 of 7	Member 10 of 10		Chairman 4 of 4	Member 5 of 5
Oliver Puhl Frankfurt/Main, Germany	Entrepreneur	Member 6 of 7			Member 4 of 4	
Heike Theißing Munich, Germany	Bank employee	Employee representative 7 of 7				Member 4 of 5
Dr Hedda von Wedel Andernach, Germany	President of the Bundes-rechnungshof (retired)	Member 7 of 7		Member 5 of 5	Member 4 of 4	

TRAINING AND CONTINUOUS PROFESSIONAL DEVELOPMENT

The members of the Supervisory Board took responsibility for undertaking any training or professional development measures necessary to fulfil their duties.

ANNUAL FINANCIAL STATEMENTS

KPMG, the auditors of the Annual and Consolidated Financial Statements elected by the Annual General Meeting, audited the Annual and Consolidated Financial Statements of pbb as at 31 December 2017, including the Combined Management Report, and issued them with unqualified audit opinions. The non-financial statement, which now has to be submitted as part of the management report for the first time pursuant to sections 315b and 289b of the HGB, is published in a separate non-financial report comprised in the present Annual Report. In the context of its audit obligation as per section 171 (1) of the German Stock Corporation Act (AktG), the Supervisory Board made use of the possibility of a content-related external audit of the non-financial statement according to section 111 (2) of the AktG, carried out by KPMG in the course of a separate commissioning.

KPMG has submitted a declaration of its independence to the Supervisory Board. The financial statements documents and audit reports were submitted to all Supervisory Board members in good time. The Audit Committee addressed the financial statements documents in its meeting on 23 March 2018. The Annual Financial Statements and Consolidated Financial Statements, the Combined Management Report as well as audit reports were discussed in detail with the Management Board and representatives of the external auditors. Following its own review, the Supervisory Board did not raise any objections to the audit results submitted by the external auditors. In the accounts review meeting held on 23 March 2018, the Supervisory Board approved the Consolidated Financial Statements prepared by the Management Board, and the Annual Financial Statements were adopted. During the same meeting, the Supervisory Board also discussed the Management Board's proposal for the appropriation of profits with the Management Board. Following its examination, the Supervisory Board has endorsed the proposal for the appropriation of profit submitted by the Management Board.

The Supervisory Board would like to thank the Management Board and all employees for their strong personal commitment and contribution, as well as for their successful work.

For the Supervisory Board

Dr Günther Bräunig
Chairman

The pbb Share

Deutsche Pfandbriefbank AG shares (pbb) are listed in the Prime Standard of the Frankfurt Stock Exchange (FWB) and included in the MDAX® index. Thus, pbb shares belong to the 50 largest companies of the traditional sectors – below the constituents of the DAX® – within the Prime Standard of the FWB.

Basic information

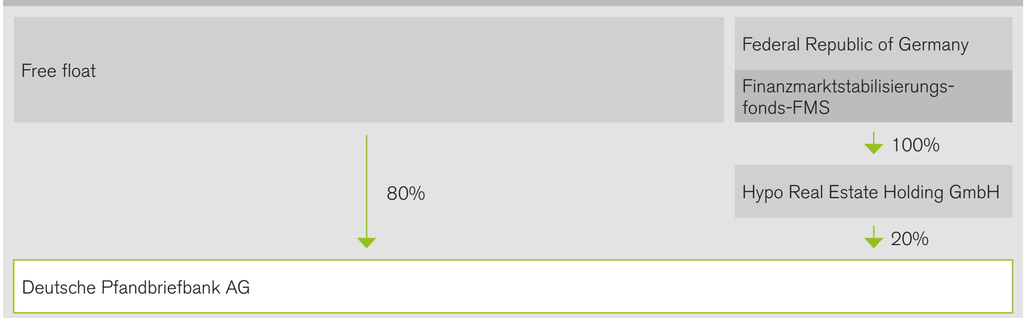
As of 31 December 2017

WKN (German Securities Code)	801900
ISIN	DE0008019001
Class of shares	Ordinary bearer shares with no par value
Number of ordinary shares	134.475.308
Exchange mnemonic	PBB
Stock exchange	Xetra, Frankfurt
Stock segment	Regulated market, Prime Standard
Index	MDAX® (since 21 September 2015)
Initial listing	16 July 2015

In total, 134,475,308 ordinary shares have been issued. The free float is 80%; the remaining 20% is held by the Federal Republic of Germany (indirectly, via the Financial Markets Stabilisation Fund (Finanzmarktstabilisierungsfonds – “FMS”) and Hypo Real Estate Holding GmbH (HRE Holding)). The two-year lock-up agreement, concluded in 2015 by HRE Holding in the context of pbb’s IPO, under which HRE Holding had undertaken to hold a 20% share in pbb’s share capital (subject to certain exemptions), expired on 16 July 2017. FMS is administered by the German Financial Markets Stabilisation Agency (FMSA), an institution of the Federal Republic of Germany.

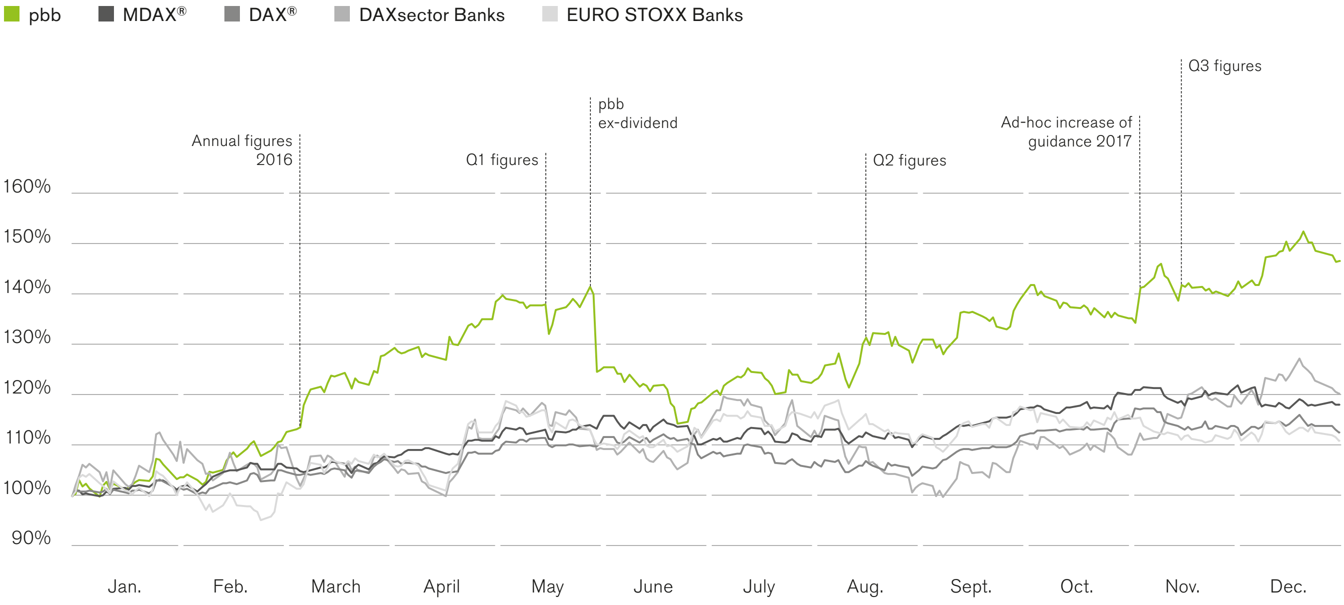
Ownership structure Deutsche Pfandbriefbank AG

As of 31 December 2017



SHARE PRICE PERFORMANCE 2017

Shares of Deutsche Pfandbriefbank AG
Benchmark comparison 2017
indexed as of 31 December 2016



Source: Reuters

Equity markets continued their uptrend during 2017, with major indices reaching new record highs – despite political and economic uncertainty. In Germany and Europe, strong economic figures and the European Central Bank's loose monetary policy provided positive impulses.

The pbb share price additionally benefited from the Company's good performance.

Following a subdued performance of the share price at the beginning of the year, with the annual low of €9.11 on 9 January 2017, the announcement of a special dividend for the 2016 financial year triggered a strong price rise in early March 2017. The pbb share price rose to €12.76 until the payout of the dividend of €1.05 per share on 31 May 2017, following pbb's Annual General Meeting. The share price recovered the ex-dividend markdown during the course of the year. An increase in the guidance for 2017 profit before taxes gave a further boost to the pbb share price.

The share reached its high for the year of €13.88 on 19 December 2017, closing 2017 at €13.36 (plus 46.5% for the year) and thus significantly outperforming the German banking sector index DAXsector Banks (+20.2%). The pbb share price also outperformed the European sector index EURO STOXX Banks (+10.9%) and the German overall indices MDAX® (+18.1%) and DAX® (+12.5%).

Key figures		2017	2016
Share prices[1]			
Year-end closing	in €	13.36	9.12
High	in €	13.88	10.99
Low	in €	9.11	7.43
Market capitalisation[2]	in € million	1,797	1,226
Free-float market capitalisation[2]	in € million	1,437	981
Book value per share	in €	21.24	20.93[3]
Earnings per share	in €	1.35	1.46
Dividend per share	in €	1.07[4]	1.05
Price/earnings ratio[2]	in %	9.90	6.25
Dividend yield[2]	in %	8.0[4]	11.5

[1] Xetra closing prices.
[2] Xetra year-end closing price.
[3] Revised due to IAS 8.42.
[4] Proposal for 2017 to be submitted to the Annual General Meeting 2018.

CAPITAL MARKETS COMMUNICATION

The main priority of Investor Relations (IR) activities during 2017 remained on stabilising and broadening pbb's analyst and investor base. pbb maintained an intense, open and transparent capital markets communication by holding a regular series of talks with numerous analysts and investors. The IR team organised numerous roadshows, and investment conferences were visited. The focus was on the international financial centres Frankfurt, London and New York, but also on smaller European financial markets.

In the context of the annual results 2016, pbb held an analyst conference in March 2017. Conference calls for analysts were also held to present the interim results for the first, second and third quarter of 2017. During each of these calls, the Management Board explained the results in detail, informed about current developments and (with the annual results) provided a strategic outlook.

ANALYSTS

Research and comments from brokerages and analyst firms are important information sources for investors, which is why pbb pays financial analysts a lot of attention. In 2017, two further brokerages and analyst firms initiated coverage of pbb's shares, bringing the number of brokerages and analyst firms publishing their research on pbb to twelve at the end of the financial year. As of 31 December 2017, these included seven “buy” recommendations, four “neutral” recommendations and one “sell” recommendation. pbb publishes analysts' current recommendations on its website.

ANNUAL GENERAL MEETING

pbb's Annual General Meeting was held on 30 May 2017, in Munich. The Management Board and Supervisory Board gave an extensive overview of the business development in 2016, of the results of the first quarter of 2017, and provided an outlook for the financial year 2017. 64.2% of the share capital was represented.

Shareholders approved the proposal from the Management Board and the Supervisory Board, to use the unappropriated retained earnings 2016 according to the German Commercial Code (HGB) (amounting to €141,199,073.40) for the distribution of a dividend of €1.05 per ordinary bearer share with no par value entitled to a dividend, with a large majority. All the other items on the agenda were also agreed upon with a large majority.

pbb publishes the detailed voting results and further documentation concerning the Annual General Meeting on its website.

DIVIDEND POLICY

The Management Board and Supervisory Board have adopted a new dividend policy. The current pay-out ratio of between 40%–50% of consolidated profit after taxes in accordance with International Financial Reporting Standards (IFRS) is to be raised to a regular dividend of 50% plus a special dividend of 25%, until, and including, 2019. In addition, for 2017 pbb wants to distribute net income (after taxes) over and above its original results guidance in full. This equates to a total dividend of €1.07 per share and a pay-out ratio of 79% relating to a result per share of €1.35. As a result, the dividend return amounts to 8.0% on the basis of the Xetra-year end closing price for 2017 of €13.36. The dividend policy is subject to regular review against legal and regulatory requirements, as well as in terms of economic viability.

In formulating a new dividend policy, pbb has taken into account its strong capital base, whilst bearing in mind ongoing considerable regulatory requirements, potential cyclical market fluctuations, as well as its planned strategic growth.

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Information due to rounding
Due to rounding, numbers presented throughout the Combined Management Report may not add up precisely to the totals provided and percentages may not precisely reflect the absolute figures.

Fundamental Information about the Group

The management report of Deutsche Pfandbriefbank AG (pbb) and the group management report are combined, in accordance with the German Accounting Standard (GAS) 20. Thus, the parent company Deutsche Pfandbriefbank AG is included as well, in addition to the Deutsche Pfandbriefbank Group (pbb Group), with explanations on the basis of the German Commercial Code (HGB). The annual report of pbb in accordance with the HGB and the consolidated management report are published simultaneously in the German Federal Gazette (Bundesanzeiger).

GROUP STRUCTURE

pbb Group consists primarily of the parent company pbb. Information provided in this consolidated management report relates – if not explicitly stated otherwise – to both ppb Group and pbb.

Next to the bank's headquarters in Unterschleissheim near Munich, pbb has offices in four additional locations within Germany. In its foreign core markets, pbb offers branch offices in the European capital cities of London, Madrid, Paris and Stockholm, from where the bank operates the majority of its international financing activities.

Sales locations
as of 31 December 2017

BUSINESS MODEL AND STRATEGY

The strategic business segments of pbb Group are Real Estate Finance (REF) and Public Investment Finance (PIF); the focus is on business eligible for inclusion in Pfandbrief cover. The geographic focus is on Europe. Its significant core markets are Germany, France, the United Kingdom, the Nordic countries and selected Central and Eastern European countries, as well as Spain. Since second half of 2016 pbb is also active in the US real estate market, where the Bank is focusing on the East coast metropolises of New York City, Boston and Washington. The opening of a representative office in New York City is planned for the first half of 2018. While pbb regularly reviews business opportunities outside the markets it serves, it remains committed to its core markets.

pbb's core business is medium- to long-term lending: pbb Group plays an important role in this area, supplying credit to the real estate sector and also supporting the public sector with project financings for the provision and improvement of public infrastructure. pbb Group's focus is on primary client business. Besides traditional financing solutions tailored to clients' needs, the Group offers its clients derivatives for hedging risks associated with lending. pbb does not maintain a trading book for securities or derivatives portfolios held to realise short-term gains.

In the lending business, pbb Group either acts as a sole lender or, particularly for large-volume transactions, cooperates with financing partners. In this regard, the Group has a wide network of banking and other partners, including insurance companies and private equity firms. In this so-called syndicate business, when acting as arranger, the Group takes over the complete coordination between the syndicate and the borrower or, in the role of an Agent, deals with tasks in connection with the management of syndicated loans.

In addition, pbb Group acts as an underwriter, initially being the sole provider of financing and then selling parts of this loan to interested partners in the context of syndication.

In the course of pbb's digitalisation strategy, the launch of the digital platform CAPVERIANT on the German market is planned for the first half of 2018. CAPVERIANT aims at bringing together borrowers and investors in the Public Investment Finance sector. The platform's focus is primarily on the intermediation of budget financing solutions of public authorities which – due to relatively small margins – are generally not in line with pbb Group's return requirements. Therefore, pbb Group does not act as a lender but only as an intermediary. As pbb Group intends to further advance its digital transformation, it is reviewing measures in order to digitalise internal processes and the interfaces with clients as well as new digital business models.

Over the course of the past few years, pbb Group has reviewed its IT-landscape and has, as a result, simplified it considerably. On the basis of this modernisation, pbb Group will, in the future, invest in certain sector-specific topics such as protection requirement analysis, outsourcing and user authorisation.

COMPETITIVE POSITION

In Commercial Real Estate Finance, pbb Group is one of the leading finance providers in its target markets and segments. In its core markets, pbb Group possesses a strong local presence and expertise across the entire process chain, providing or having access to real estate experts, property law specialists and financing experts, up to the management of loan exposures. pbb Group also actively deploys this local expertise to support clients with international transactions.

Strategic portfolios

In real estate financing, pbb's range of services is targeted primarily at professional real estate investors (both national and international) with mid- to long-term investment horizons such as real estate companies, institutional investors, real estate funds as well as – particularly in Germany – SMEs and clients with a regional focus on Germany. pbb Group targets complex medium-sized to larger financing volumes. Financed properties mainly involve office buildings, properties for residential use, retail and logistics properties as well as hotels as portfolio additions. The regional focus is on the core markets eligible for inclusion in Pfandbrief cover in Europe and the US. In this area, pbb Group offers both local and cross-border financing expertise. A large majority of the loans granted are investment financings, i.e. loans for the acquisition or follow-up financing of existing properties with existing cash flows. The financing of development projects (development financing) has substantially lower significance; it is primarily of a non-speculative nature and also encompasses the property developer business in Germany.

In Public Investment Finance, pbb Group finances medium- to long-term projects for the provision and improvement of public infrastructure. The focus here lies on public institutions, municipal and social housing, buildings for the utilities and waste disposal market, transport infrastructure, as well as healthcare and nursing facilities. Moreover, the Group is active in long-term publicly guaranteed export financings hedged by public export-credit insurers, so-called Export Credit Agencies. Depending on the structure of the respective export credit guarantee, a retention remains with the Group, which normally does not exceed 10% of the credit risk. It provides financing to public sector borrowers, companies operating under public or private law, and special-purpose vehicles under public guarantee. The Group also intends to reinforce its collaboration with institutional investors – directly or via loan funds. Currently, the Group's regional focus is on France, but it is also active in other selected European regions.

Run-down portfolio

In addition to the portfolios of its two strategic business segments, pbb Group has a non-strategic portfolio, the Value Portfolio (VP). The Value Portfolio consists almost entirely of existing financings to the public sector which are not linked to specific projects (budget financing). The Group does not originate any new business in this area. It only enters into individual transactions in order to manage the cover pools or secure liquidity. The portfolio is primarily refinanced at matched maturities. It generates interest income, and matures in accordance with the underlying fixed terms. A few structured, fully state-guaranteed products, with a nominal value of €0.5 billion, remain in the Value Portfolio. If and when economically feasible, pbb Group also uses portfolio sales to bring about a more rapid reduction.

Funding

Loans are largely funded using matching maturities, and primarily via the Pfandbrief market, supplemented with unsecured funding. Issues are regularly placed on the international capital market in the benchmark format, and via private placements. pbb Group structures private placements as bearer or registered securities in accordance with investors' requirements, meaning that term and interest structure can, for instance, be negotiated on an individual basis. In accordance with the lending business, issues are denominated in various currencies, albeit with a focus on the euro.

pbb Group issues Mortgage Pfandbriefe and Public Sector Pfandbriefe, and is one of the largest issuers of Pfandbriefe (measured by outstanding volume). The Pfandbrief market is highly liquid, with a broad investor base. It is the second-largest market for fixed-income securities in Germany, after the market for public sector bonds. The main vehicles used for unsecured funding are promissory notes and bearer bonds.

Banks, funds, insurance companies, central banks and government funds, are investors in debt instruments.

In March 2013, pbb Group entered into the retail deposit-taking business with private investors in Germany. Via the pbbdirekt.com platform, pbb Group offers overnight and fixed term deposits denominated in Euro and US dollars with various maturities. Since August 2017, pbb Group has offered selected fixed term deposits on an external platform of a third-party provider as well. This enables clients of selected banks to easily and quickly invest in fixed-term deposits at pbbdirekt without having to open an account.

STRATEGY

pbb Group's strategy focuses on sustainable business success. Crucial success factors are the assessment and appropriate pricing of credit risk in the lending business on the one hand, and the access to funding markets at adequate terms on the other. Managing the existing portfolio – so as to identify changing risks at an early stage and mitigate them by taking appropriate measures – is another important factor.

The Management Board has committed itself to further increasing profitability in 2018 In addition to the expansion of sales activities in the US real estate financing market by opening a representative office in New York City, pbb Group is pursuing several initiatives with the objective of extending its value-creation chain as well as client groups. An extension of the business area with regard to sectors and new export-credit insurers has taken place in the context of reviewing the strategy for the ECA financing segment. Moreover, pbb Group intends to further advance its initiatives in 2018. Regarding its digitalisation strategy in particular, the Group plans to first launch its digital platform CAPVERIANT in Germany, followed by expansion throughout France. It also intends to extend the range of services offered on the platform. Furthermore, pbb Group will examine further opportunities to digitalise its business – especially in the real estate financing segment. It will also constantly review the options available to increase its process and cost efficiencies.

INTERNAL MANAGEMENT SYSTEM

pbb Group's internal management system is pursuing a sustainable enhancement in value of the Group considering aspects of risks and regulatory requirements. The key objective is to achieve a balanced risk/return ratio. Risks should be compatible with external and internal risk-bearing capacity guidelines generating an adequate return on capital.

Monitoring and stearing at pbb Group are based on a consistent and integrated key performance indicator system (KPI system), which assists executives in the management of the Group. The KPI system comprises the dimensions of profitability, growth in the strategic real estate finance and public investment finance portfolios, risk limitation and capital. Regular plan-actual comparisons and related analyses disclose the reasons for any deviations in the key performance indicators. Current market developments, such as the change on interest rate levels, are also displayed. In addition to strategic planning for the Bank as a whole, regular medium-term projections of profitability indicator and (stress) scenario forecasts ensure the management has a comprehensive overview of the Group's future business development.

No changes were made to the internal management system year-on-year. Non-financial key performance indicators are not explicitly managed. The following financial key performance indicators have been defined:

> One key profitability indicator is the return on equity after tax. It is calculated by dividing IFRS net income/loss by the average IFRS equity available in the financial year excluding the revaluation reserve. Profit or loss before tax is a further financial key performance indicator. The aim is to increase it both by generating higher revenues and through strict cost discipline. Cost discipline and efficiency are monitored using the cost-income ratio, i.e. the ratio of general and administrative expenses to operating income.

> The notional amount of the funding in the strategic Real Estate Finance (REF) and Public Investment Finance (PIF) segments is a significant factor influencing the future earning power and has therefore been redefined as an additional financial key performance indicator. The financing volume can be controlled, above all, by the volume of new business including prolongations with maturities of more than one year, which also represent a financial key performance indicator. A present value approach is used for managing and calculating new business.

> Risk management is based on two risk-bearing capacity approaches, the going-concern approach and gone-concern approach. Management using the going-concern approach ensures that pbb Group can still meet the regulatory minimum capital ratios even after an adverse economic scenario, which occurs at a maximum of once every 20 years. The gone-concern approach, on the other hand, is based on the assumption that pbb Group, in the hypothetical event of the institute being liquidated, is able to fully service its unsubordinated debt instruments even in an extreme loss event. A precondition for demonstrating the risk-bearing capacity in both cases is that the risk covering potential exceeds the required economic risk capital. The methods and results of the risk-bearing capacity assessment and the methods used are described in detail in the Risk and Opportunity Report.

> The CET1 ratio, a key management parameter, is determined on a regular basis; it is calculated by dividing Common Equity Tier 1 (CET1) by risk-weighted assets (RWAs). The Advanced Internal Rating Based Approach (Advanced IRBA) is used to determine regulatory capital requirements for all material portfolios.

NON-FINANCIAL STATEMENT

Companies must assume responsibility for their actions in the environment in which they operate. The key principle of pbb Group's corporate responsibility philosophy is that of sustainability. This means long-term, responsible actions that take the consequences for all the company's stakeholders and for the environment into account.

pbb Group is convinced that sustainable and responsible business practices are an essential requirement for securing the future of the Company and increasing its value.

pbb Group goes into those topics and aspects of sustainability which it has identified as being important for the Company in more detail in the Combined Separate Non-Financial Report (see chapter "Non-Financial Report") according to § 315b and § 289b HGB which is not part of the Combined Management Report. This has been put together in accordance with the requirements of the CSR Directive Implementation Act and, in addition, will be published via the German Federal Gazette (Bundesanzeiger). The Non-Financial Report has not been audited by the auditors. However, it has been subject to an audit of limited assurance by the external auditing company KPMG AG according to ISAE 3000.

Report on Economic Position

MACROECONOMIC ENVIRONMENT

The global economic growth rate clearly gained momentum throughout 2017, after 2016 had produced the weakest growth rate since the global financial crisis (3.2%). The International Monetary Fund (IMF) assumed in its October 2017 Update that the growth rate of the global gross domestic product (GDP) stood at 3.6% compared to 2016. Besides the broad scope of the economic upswing, it is remarkable that reputable institutions, such as the IMF and the European Commission, had to improve their projections from the beginning of the year – a first for many years. The upswing was based on increasing investments and the improvement in global trade, supported by a favourable market environment, expansive monetary policies, and stronger business and consumer confidence.

According to the IMF, the 2017 growth rate of the industrialised economies ("Advanced Economies") stood at 2.2%, which was 0.5 percentage points above the previous year. Businesses developed very dynamically against the background of increasing capacity utilisation, low financing costs and stronger business confidence. This was reflected on the labour market as well: the unemployment rate reached the lowest level in the last ten years. This provided further support to private consumption – along with moderate wage improvements. Despite this economic momentum, price increases remained at a subdued level in most industrial countries.

Within the group of industrialised nations, it was growth momentum in the euro area that particularly stood out. According to the Autumn 2017 Economic Forecast of the European Commission, the real GDP growth forecast stood at 2.2% for 2017, which is the fastest growth pace in a decade. The European Commission expects a growth rate for the German economy of 2.2% as well. This dynamic pace was reflected in the ifo Business Climate Index, which in the fourth quarter of 2017 reached a new record level since German reunification, while the unemployment rate was at the lowest level since 1991. With a growth rate of 1.6%, the French economy grew solidly. This is a clear improvement over the 1.2% recorded in the previous year. The Italian GDP – which was second to last within the euro area in the previous year – improved by 0.6 percentage points, to 1.5%. With a growth rate of 3.1% in 2017, the Spanish economy improved by more than 3% for the third year in a row.

According to the latest projections, pbb Group's key markets of Northern and Eastern Europe as well as North America have developed solidly as well. The projected growth rate for Sweden is 3.2%, which is almost on par with the strong figure of 3.3% generated in the previous year. The US economy grew by 2.2%, bolstered by a strong labour market and long-term record levels in terms of consumer and business confidence. This is a clear improvement compared to the previous year which produced modest growth of only 1.5%.

In the United Kingdom, the economic performance in 2017 was better than expected immediately following the Brexit referendum adopted in June 2016. In March 2017, the UK government entered into the official two-year exit phase with the European Union. However, British foreign trade profited from the marked downgrade of the pound sterling, which lost almost 14% against the euro since June 2016. Overall, the British growth rate declined by only 0.3 percentage points compared with 2016, to 1.5%.

The European Central Bank (ECB) and the US Federal Reserve (Fed) have taken the robust economic development as a reason to somewhat reduce the extent of their expansive monetary measures. In December 2016, the ECB decided to extend its monthly government bond purchasing programme by 12 months, but to reduce its monthly pace by € 20 billion, to € 60 billion, as from April 2017. In October 2017, the ECB announced that the programme will be extended by another nine months, and that the monthly pace will be reduced to € 30 billion as from January 2018. The Fed increased its key interest rate – in three stages – by 125 basis points to 1.5%, and began to gradually reduce its balance sheet as from October 2017. The Bank of England increased its key interest rate in November for the first time in a decade. The key interest rate increased by 0.25 percentage points to 0.5%, and was intended to curb inflation, which reached a recent high of 3.1% in the fourth quarter of 2017.

Despite the somewhat less expansive monetary policies, interest rates in the US and the euro area remained relatively subdued in 2017, and close to their historical lows. This was reflected by the moderate development of inflation, and the expectation of structurally low real interest rates. Against the background of the low interest rate environment and low volatility on financial markets, investors were searching for yield. As a result, even European governments with less favourable credit ratings were able to profit from clearly lower interest rates. However, this environment also entailed high, and increasing, private and public debt levels in many countries.

On the currency markets, the euro improved by an astonishing 14% vs. the US dollar. This was due in particular to the declining political uncertainty in the euro area, which remains high historically, but the electoral success of the moderate forces vis-à-vis their populist challengers in France and the Netherlands resulted in a more positive perception of the political landscape in Europe. The pound sterling lost 4.1% on the euro throughout the course of 2017. This should be viewed in light of the fact that the Brexit negotiations were more or less at a stalemate between March and December, and that sufficient progress was made only as part of the EU Summit held on 15 December 2017, which cleared the way to opening negotiations for a transitional agreement.
Sources: Bloomberg, European Commission, ECB, IMF, World Bank

SECTOR-SPECIFIC ENVIRONMENT

Overall Situation in the Banking Sector

The European banking sector further improved its overall capital position in 2017. Simultaneously, the share of non-performing loans declined to 4.2% of the total loan volume during the third quarter of 2017, which is the lowest level since the fourth quarter of 2014. However, many banks are still concerned about the operating environment. Profitability is restricted by fierce competition, particularly in countries with a high banking density. Furthermore, interest income remains subdued given the low interest rate environment, while regulatory costs are continuously rising.

On the financial markets, the stance on the banking sector improved slightly during 2017, which was proven by declining credit default risks, positive rating trends as well as the relative outperformance of European banking shares compared to the overall market.
Sources: Bloomberg, ECB

Real Estate Finance

The combination of the consistently low interest rate environment and investors searching for yield kept activity on the commercial real estate markets at a very high level. As in the previous years, the high liquidity levels provided by professional real estate investors, financial intermediaries, insurers and other institutional investors in 2017 translated into transaction volumes clearly above long-term average values.

In Germany alone, a volume of €57 billion (2016: €53 billion) was generated with commercial real estate in 2017 despite the shortage of supply in individual market segments. This represented one of the peak years since the financial crisis – for example, the average transaction volume in the period between 2007 and 2016 stood at only €33 billion. Yields generally continued to decline throughout 2017, particularly in the “top 7” German cities. For instance, the peak yield in the office property segment declined from 3.56% as at 31 December 2016 to 3.27% at the reporting date in the “top 7” German cities.

The 2017 global investment volume slightly exceeded the previous year, and was therefore clearly above the long-term average value. While investment volumes in Europe generated double-digit growth rates, investments – particularly in the US – declined considerably compared to the previous year (31 December 2017; source: JLL Global Market Perspektive).

However, the European development was very heterogeneous; while Germany (see above), the Czech Republic and Finland developed very strongly, the French and Swedish investment volumes clearly declined in 2017.

Overall, many investors simply adhered to their investment strategy, which led to rising prices for established locations and property types. At the same time, the search for attractive alternatives offering higher yields has also fuelled markedly higher demand for properties outside the established locations and usage types. In this context, investor demand for project developments increased noticeably throughout Europe.

The high demand for real estate had a positive impact on the development of new business amongst financing banks as well as non-banks. However, competitive pressure on margins and credit terms remained high, even though margins stabilised to some extent. The persistently high level of (early) repayments on existing loans, affecting virtually all competitors, was striking; at the same time, high levels of new real estate lending commitments were observed.

Sources: researches by Jones Lang Lasalle, BNP Paribas Real Estate, CBRE, Association of German Pfandbrief Banks

Public Investment Finance

Public investment finance is a large market. Even though considerable investment amounts are not covered by public statistics, these are made in market sectors subject to public supervision. However, the declining trend observable in previous years prevailed in the majority of European countries. In addition, different political developments translated into a growing reticence amongst foreign investors. The events in Catalonia during the second half of 2017, and their potential repercussions for Spain, were among these developments. Declining margins and rising government bond prices led to lower spreads and thus a growing reticence amongst institutional investors.

Value Portfolio

The non-strategic Value Portfolio (VP) segment almost exclusively comprises public budget financing exposures. In 2017, almost all European countries recorded a stabilisation or positive credit spread development. Especially the development of the periphery like Spain, Italy and Portugal should be emphasised.

Funding Markets

As in the previous years, capital markets were mainly driven by central bank monetary policies in 2017. The markets responded very calmly to political uncertainty and regulatory ambiguity. Against the background of a thriving US economy, the Fed announced a gradual reduction in its balance sheet – which had been considerably inflated in the years following the financial crisis. Despite the persistently low inflation, the Fed also decided to gradually increase its key interest rate. The latest adjustment was made in December 2017, when it was lifted from 1.25% to 1.50%. Inflation in the UK sharply grew since the Brexit referendum. As a result, the Bank of England (BoE) increased its interest key rate by 25 basis points, to 0.5%, in November 2017. As expected by the majority of market participants, the European Central Bank (ECB) announced the gradual withdrawal from its bond-buying programme in October 2017. As from January 2018, the programme was extended by another nine months, and the monthly acquisition pace reduced to €30 billion. So far, the announcement of the ECB to further reduce its bond acquisition programme did not result in a widening of financing spreads; spreads however declined in several asset classes. As in the previous years, the inflation rate in the euro area in 2017 remained under the level of 2% targeted by the ECB. In line with expectations, the key interest rates remained unchanged. The ECB's deposit facility rate was set to –0.40% in March 2016.

On 25 October 2017, the EU institutions resolved the harmonisation of the European Insolvency Directive. According to the resolution, a new category for unsecured debt instruments will be introduced for the ranking of such instruments in insolvency hierarchies (separated disclosure of "preferred" and "non-preferred" classes). Transposition into national law of individual EU member states will be concluded by the end of 2018.

COURSE OF BUSINESS

pbb Group had a successful financial year 2017: it posted profit before tax of €204 million, which was clearly above the Group's projections from the beginning of the year (€150 million to €170 million), and slightly above the lifted Group projection from 2 November 2017 (€195 million to €200 million). The solid results were due in particular to the positive development of net interest income – a key figure for pbb – and to the unexpectedly low level of loan loss provisions. pbb Group was able to exceed its lifted projections given the unexpected positive profit contribution resulting from arbitration proceedings recognised in December 2017.

Return on equity after tax, and the cost-income ratio, had profited in 2016 from non-recurring income from the reversal of write-downs related to Heta Asset Resolution AG (Heta). Against this background, a marked decline in return on equity after tax (2016: 7.3%) and a significant increase in the cost-income ratio (2016: 39.0%) were expected for 2017. In 2017, return on equity after tax stood at 6.5%, thus clearly below the previous year, as expected, while the cost-income ratio of 50.9% considerably exceeded the 2016 ratio. Excluding the non-recurring income effects from the reversal of write-downs related to Heta, pbb Group's return on equity after tax would have improved considerably and its cost-income ratio would have improved slightly from the previous year.

At €11.6 billion, the volume of new business (including prolongations with maturities of more than one year) was within the projected range of between €10.5 billion and €12.5 billion. At the beginning of 2017, pbb Group projected a considerable increase in the strategic financing volume until the end of the year (31 December 2016: €31.5 billion). However, pbb Group adjusted this projection at the mid-year point. Against the background of repayments running above projections and loan disbursements below planned levels, during the first half of 2017, pbb Group adjusted its forecast to a moderate portfolio growth. At €31.9 billion, strategic financing volumes at the reporting date were slightly above the previous year, matching the forecast which was adjusted in the interim report as at 30 June 2017.

Forecasts concerning pbb's risk-bearing capacity at the beginning of 2017 materialised during the course of the year: based on the going-concern approach, available financial resources – above minimum regulatory ratios – exceeded economic capital requirements. In the gone-concern approach, capital available to cover risk exposure exceeded required economic capital.

As at 31 December 2017, the CET1 ratio[1] amounted to 17.7% and, as expected, was significantly above the SREP ratio of 9.0% that banks have to comply with since the beginning of 2017 in addition to the country-specific (and thus portfolio-specific) varying counter-cyclical capital buffer which, as at 31 December 2017, amounted to 0.11%.

[1] After confirmation of the 2017 financial statements, less the proposed dividend (subject to approval by the Annual General Meeting).

DEVELOPMENT IN EARNINGS

Deutsche Pfandbriefbank Group ("pbb Group")

pbb Group achieved profit before tax of €204 million in the financial year 2017. This figure was below the prior-year figure of €301 million, which, however, was positively influenced by the non-recurring effect in the amount of €132 million from the reversal of valuation allowances in connection with Heta Asset Resolution AG (Heta) (of which an amount of €123 million was recorded in net income from financial investments and €9 million as loan loss provisions). Excluding non-recurring effects, pre-tax profit in 2017 therefore increased considerably compared to 2016's adjusted pre-tax profit of €169 million. Positive effects mainly came from the good development of net interest income. Profit or loss is presented as follows:

pbb Group		2017	2016	Change
Operating performance				
Operating income	in € million	424	508	−84
Net interest and commission income	in € million	443	412	31
Net interest income	in € million	435	404	31
Net fee and commission income	in € million	8	8	–
Net trading income	in € million	−5	−6	1
Net income from financial investments	in € million	−4	125	−129
Net income from hedging relationships	in € million	−1	6	−7
Net other operating income/expenses	in € million	−9	−29	20
Loan loss provisions	in € million	−6	−1	−5
General and administrative expenses	in € million	−216	−198	−18
Net miscellaneous income/expenses	in € million	2	−8	10
Profit or loss before tax	in € million	204	301	−97
Income taxes	in € million	−22	−104	82
Net income/loss	in € million	182	197	−15
Key ratios				
Earnings per share (basic and diluted)	in €	1.35	1.46	
Cost-income ratio	in %	50.9	39.0	
Return on equity before tax	in %	7.3	11.1	
Return on equity after tax	in %	6.5	7.3	

Operating Income

Net interest income increased to €435 million (2016: €404 million). The current net interest income rose due to lower interest expenses from maturities of higher-yielding liabilities and from the slight increase in the average margin of the overall portfolio. The average financing volume of the two strategic segments Real Estate Finance and Public Investment Finance increased to €31.8 billion (2016: €31.3 billion), while the average financing volume of the non-strategic Value Portfolio continued to decline in line with our strategy from €17.3 billion in 2016 to €14.8 billion in 2017. Positive non-recurring effects from prepayment penalties and from the redemption of liabilities amounted to €31 million, and were below the previous year's level (2016: €52 million).

Net fee and commission income from non-accruable fees were on the previous year's level of €8 million.

Net trading income amounted to €−5 million (2016: €−6 million). Income was generated in the amount of €6 million (2016: expense of €3 million) from the measurement of pbb's default risk and its derivative counterparties, whilst interest rate and exchange rate fluctuations led to measurement effects of derivatives amounting to €1 million (2016: €13 million). This was offset by expenses from the pull-to-par effect (according to which the present value of derivatives approaches zero towards maturity) in the amount of €12 million (2016: €13 million). In the previous year, expenses in the amount of €2 million resulted from the inclusion of the funding value adjustment into derivative measurement, and expenses of €1 million from adjustments of estimates used to determine the bilateral Credit Valuation Adjustments for certain derivative counterparties.

The negative net income from financial investments of €−4 million (2016: positive net income of €125 million) largely resulted from net additions to portfolio-based allowances due to the changed risk assessment for Southern European regions. Additional expenses of €1 million from the deconsolidation of a subsidiary in Spain were fully offset by income generated from disposals of securities in the amount of €1 million. In the previous year, pbb Group recognised income of €123 million from non-recurring effects associated with Heta.

Of the net income from hedging relationships, an amount of €−1 million (2016: €6 million) was due to ineffective portions from fair value micro-hedge relationships within the range permitted under IAS 39 (80% to 125%).

Net other operating income/expenses (€−9 million; 2016: €−29 million) was burdened, inter alia, by the bank levy. Taking into account pledged collateral amounting to 15%, pbb recognised expenses of €19 million (2016: €21 million). Various other factors translated into effects in the amount of €10 million: income from the disposal of assets held in pbb's non-strategic Value Portfolio, an arbitration procedure and VAT reimbursements, together more than offset the expenses incurred from net additions to provisions (for legal risks and litigation costs).

Loan Loss Provisions
Loan loss provisions amounted to €−6 million (2016: €−1 million). Even though significantly above the previous year's figure, loan loss provisions continued to be below expectations as regards the overall portfolio and the standard risk costs. Specific provisions for a small number of exposures in the Real Estate Finance segment were increased by a net amount of €3 million. Additions to portfolio-based allowances amounted to €4 million (net amount) were primarily recorded due to a changed risk assessment for two Southern European regions. This was offset by €1 million in recovery payments received on loans and advances previously written off. In the previous year, there were €6 million in net reversals to specific provisions, €12 million in net additions to portfolio-based allowances, income of €4 million from recovery payments on previously written-off loans and advances as well as €1 million in income from the reversal of provisions that had been created for contingent liabilities and other commitments.

General and Administrative Expenses
General and administrative expenses increased to €216 million (2016: €198 million). In the previous year, personnel expenses benefited from the utilisation of provisions recognised in previous periods. Personnel expenses have reached a normalised level in the current financial year, whilst the average staffing level declined. Non-personnel expenses for the period under review were in line with the previous year's level; they included expenses for a Bank-wide project to further optimise the finance and risk IT target architecture. Specifically, this project comprises, inter alia, the implementation of the requirements resulting from IFRS 9 and other regulatory changes, as well as the adjustment of the IT systems and processes used to prepare financial statements. In addition, non-personnel expenses include start-up costs for setting up a portal for public sector financing at CAPVERIANT GmbH and for the planned opening of a representative office in New York in 2018.

Net Miscellaneous Income/Expenses

Net miscellaneous income/expenses in the amount of €2 million (2016: €–8 million) was due to the reversal of restructuring provisions.

Income Taxes

Expenses for current taxes of €39 million (2016: €59 million) and income from deferred taxes of €17 million (2016: expenses of €45 million) resulted in total tax expenses of €22 million (2016: €104 million). The current tax expenses payable in Germany in the amount of €32 million (2016: €36 million) were fully (2016: €27 million) attributable to the current year, whilst €9 million was attributable to previous years in 2016. Out of the current tax expenses payable abroad of €7 million (2016: €23 million), tax expenses of €16 million (2016: €16 million) was attributable to the 2017 financial year, whilst tax income of €9 million (2016: tax expense of €7 million) was attributable to previous years. The deferred tax income of €17 million (2016: expenses of €45 million) were due to a deferred tax income item of €15 million (2016: expenses of €20 million) resulting from changes in temporary differences. Furthermore, the Bank incurred deferred tax income in the amount of €2 million (2016: expenses of €25 million) due to the income of deferred tax assets on loss carry-forwards.

Operating Segments

Segment reporting is based on management reporting results. Given that pbb Group has integrated different business activities within the segments, the allocation of income and expenses to individual segments is subject to certain assumptions and estimates.

Net interest income is determined by deducting matched-maturity funding rates prevailing at the time of concluding a transaction from the interest rate charged to the client. The input parameters required for this purpose are set at the time of originating a new business transaction, within the scope of accounting for individual transactions. In addition, income from investing pbb's own funds and imputed costs for holding liquidity after liquidity drawdown are included at segment level.

Further income or expenses that cannot be allocated directly to a specific lending transaction are allocated to the business segments (in particular, the results from disposal of assets held for liquidity management, early termination fees, from market-induced effects on net trading income, hedging relationships, and the bank levy), usually on a pro-rata basis, in line with financing volumes.

The allocation of general and administrative expenses to the operating segments differentiates between expenses which can be directly attributed and those which are not directly attributable. Expenses (of the sales units, for example) which are directly attributable can be clearly assigned to the segments via the cost centre. Expenses (of the central units, for example) which are not directly attributable are assigned to the segments' cost centres via well-defined allocation models.

Segment risk-weighted assets (RWA) are determined in accordance with the allocation of individual transactions (credit risk, for example) and with the allocated risk types (operational risks, for example). Risk types which are not directly attributable are assigned to the segments in accordance with well-defined allocation models. The RWA increase in 2017, resulting from the harmonisation of the risk models, was fully attributable to the REF segment.

The allocation of equity (excluding revaluation reserves) was made in line with for the distribution of diversified economic capital within risk management (gone-concern approach).

Real Estate Finance (REF)

The REF operating segment comprises all commercial real estate financing arrangements of pbb Group. With €10.7 billion, new business volume (including prolongations with maturities of more than one year) was significantly above the level of the previous year (€9.5 billion), while the net margin declined slightly. Pre-tax profit amounted to €160 million (2016: €146 million). As projected at the beginning of 2017, total comprehensive income was largely attributable to the REF segment.

Real Estate Finance		2017	2016	Change
Operating performance				
Operating income	in € million	337	306	31
Net interest and commission income	in € million	359	330	29
Net interest income	in € million	350	321	29
Net fee and commission income	in € million	9	9	–
Net trading income	in € million	–	–2	2
Net income from financial investments	in € million	–1	3	–4
Net income from hedging relationships	in € million	–1	3	–4
Net other operating income/expenses	in € million	–20	–28	8
Loan loss provisions	in € million	–7	2	–9
General and administrative expenses	in € million	–172	–156	–16
Net miscellaneous income/expenses	in € million	2	–6	8
Profit or loss before tax	in € million	160	146	14
Key ratio				
Cost-income ratio	in %	51.0	51.0	
Balance-sheet-related measures		**31.12.2017**	**31.12.2016**	
Financing volumes	in € billion	24.9	24.1	
Risk-weighted assets[1]	in € billion	8.3	6.4	
Equity (excluding revaluation reserve)	in € billion	0.7	0.6	

[1] Including weighted credit risk positions and capital charges for market risk positions and operational risk, using a scaling factor of 12.5.

Operating Income Net interest income was €350 million, up from the previous year's figure of €321 million. This positive development was due to lower interest expenses, which reflected maturities of higher-yielding liabilities. Furthermore, the average financing volume increased to €24.4 billion (2016: €24.0 billion). In contrast, allocated income from early termination fees decreased to €15 million (2016: €20 million). Net fee and commission income in the amount of €9 million (2016: €9 million) resulted from non-accruable fees. The Group disclosed a balanced net trading income (2016: €–2 million). Net income from financial investments of €–1 million (2016: €3 million) resulted from the deconsolidation of a subsidiary in Spain. Net other operating income/expenses in the amount of €–20 million (2016: €–28 million) was burdened, inter alia, with expenses in connection with the bank levy.

Loan Loss Provisions Net additions to loan loss provisions totalled €7 million (2016: net reversals of €2 million). Specific provisions in a net amount of €3 million were recognised (2016: €3 million), whilst net additions to portfolio-based allowances amounted of €5 million (2016: €0 million). Income from recovery payments on previously written-off loans and advances amounted to €1 million (2016: €4 million). Additional income of €1 million was recognised in the previous year from the reversal of provisions for contingent liabilities and other commitments.

General and Administrative Expenses General and administrative expenses increased to €172 million (2016: €156 million). Personnel expenses increased to a normalised level, since the personnel expenses recorded in the previous year benefited from the utilisation of provisions. The higher non-personnel expenses were attributable to increased regulatory expenses.

Public Investment Finance (PIF)

The PIF business segment comprises financing eligible for covered bonds aimed at the provision of public infrastructure. The volume of new business amounted to €0.9 billion during the period under review (2016: €1.0 billion). The loss before tax amounted to €5 million (2016: profit before tax of €3 million), while slightly positive earnings before tax were originally projected. This was due to the changed risk assessments for Southern European regions, which had a negative effect on net income from financial investments.

Public Investment Finance		2017	2016	Change
Operating performance				
Operating income	in € million	24	30	−6
Net interest and commission income	in € million	36	35	1
Net interest income	in € million	36	35	1
Net fee and commission income	in € million	–	–	–
Net trading income	in € million	−2	−1	−1
Net income from financial investments	in € million	−6	1	−7
Net income from hedging relationships	in € million	–	1	−1
Net other operating income/expenses	in € million	−4	−6	2
Loan loss provisions	in € million	–	–	–
General and administrative expenses	in € million	−29	−26	−3
Net miscellaneous income/expenses	in € million	–	−1	1
Profit or loss before tax	in € million	−5	3	−8
Key ratio				
Cost-income ratio	in %	>100.0	86.7	
Balance-sheet-related measures		**31.12.2017**	**31.12.2016**	
Financing volumes	in € billion	7.0	7.4	
Risk-weighted assets[1)]	in € billion	1.6	1.4	
Equity (excluding revaluation reserve)	in € billion	0.3	0.3	

[1)] Including weighted credit risk positions and capital charges for market risk positions and operational risk, using a scaling factor of 12.5.

Operating Income Given the average financing volume of €7.4 billion (2016: €7.3 billion) and a stable portfolio margin, net interest income amounted to €36 million, roughly on par with the previous year's level of €35 million. The allocated early termination fees amounted to €5 million (2016: €6 million). Net trading income of €−2 million (2016: €−1 million) resulted from the pull-to-par effect and market rate fluctuations of interest derivatives not covered by hedging relationships. Net additions to portfolio-based allowances resulting from changed risk assessments for Southern European regions led to a net income from financial investments of €−6 million (2016: €1 million). Net other operating income/expenses in the amount of €−4 million (2016: €−6 million) was burdened, inter alia, by the bank levy.

Loan Loss Provisions No net additions or reversals were necessary in the financial years 2017 and 2016.

General and Administrative Expenses Due to rising personnel and non-personnel expenses general and administrative expenses increased to €29 million (2016: €26 million).

Value Portfolio (VP)

The Value Portfolio (VP) operating segment includes all of pbb Group's non-strategic portfolios and activities. The Bank generally does not enter into new business in this segment. It only enters into individual transactions in order to manage the cover pools or secure liquidity. Profit before tax stood at € 42 million (2016: €145 million) and was thus ahead of projections, guiding for overall balanced results. The reasons for this development were, inter alia, income from the disposal of assets and higher-than-expected early termination fees.

Value Portfolio		2017	2016	Change
Operating performance				
Operating income	in € million	56	165	−109
Net interest and commission income	in € million	41	40	1
Net interest income	in € million	42	41	1
Net fee and commission income	in € million	−1	−1	–
Net trading income	in € million	−3	−3	–
Net income from financial investments	in € million	3	121	−118
Net income from hedging relationships	in € million	–	2	−2
Net other operating income/expenses	in € million	15	5	10
Loan loss provisions	in € million	1	−3	4
General and administrative expenses	in € million	−15	−16	1
Net miscellaneous income/expenses	in € million	–	−1	1
Profit or loss before tax	in € million	42	145	−103
Key ratio				
Cost-income ratio	in %	26.8	9.7	
Balance-sheet-related measures		**31.12.2017**	**31.12.2016**	
Financing volumes	in € billion	13.8	15.8	
Risk-weighted assets[1]	in € billion	3.5	4.1	
Equity (excluding revaluation reserve)	in € billion	1.5	1.5	

[1] Including weighted credit risk positions and capital charges for market risk positions and operational risk, using a scaling factor of 12.5.

Operating Income Due to maturities of higher-yielding liabilities, net interest income was stable at € 42 million (2016: € 41 million), although the financing volume declined as planned. Net trading income of € −3 million (2016: € −3 million) resulted from the pull-to-par effect and market rate fluctuations of derivatives. The net income from financial investments in the amount of € 3 million (2016: €121 million) was mainly the result of the reversal of portfolio-based allowances, whilst in the previous year a positive effect in the amount of €123 million came from non-recurring effects associated with Heta. Net other operating income/expenses amounted to €15 million (2016: € 5 million) and resulted from income generated with asset disposals, which more than offset expenses incurred in connection with the bank levy.

Loan Loss Provisions Loan loss provisions in the amount of €1 million (2016: net additions of € 3 million) resulted from net reversals of portfolio-based allowances. In the previous year, reversals of specific allowances on the Heta exposure of € 9 million were offset by net additions to portfolio-based allowances of €12 million.

General and Administrative Expenses General and administrative expenses amounted to €15 million (2016: €16 million). Given that the Value Portfolio's share in the total financing volume has declined, there has been a commensurate decline in the allocated overhead costs.

Consolidation & Adjustments (C&A)

C&A reconciles the segment results with the consolidated result. Besides consolidation adjustments, this includes certain income and expense items outside the operating segments' areas of responsibility.

Consolidation & Adjustments		2017	2016	Change
Operating performance				
Operating income	in € million	7	7	–
Net interest and commission income	in € million	7	7	–
Net interest income	in € million	7	7	–
Net fee and commission income	in € million	–	–	–
Net trading income	in € million	–	–	–
Net income from financial investments	in € million	–	–	–
Net income from hedging relationships	in € million	–	–	–
Net other operating income/expenses	in € million	–	–	–
Loan loss provisions	in € million	–	–	–
General and administrative expenses	in € million	–	–	–
Net miscellaneous income/expenses	in € million	–	–	–
Profit or loss before tax	in € million	7	7	–
Balance-sheet-related measures		**31.12.2017**	**31.12.2016**	
Risk-weighted assets[1)]	in € billion	1.1	1.2	
Equity (excluding revaluation reserve)	in € billion	0.4	0.4	

[1)] Including weighted credit risk positions and capital charges for market risk positions and operational risk, using a scaling factor of 12.5.

Net interest income was the only income item, and arose from the investment of equity allocated to C&A.

DEVELOPMENT IN ASSETS

Assets

in € million	31.12.2017	31.12.2016[1]	Change
Cash reserve	999	1,136	–137
Trading assets (HfT)	870	1,089	–219
Loans and advances to other banks (LaR)	2,415	2,841	–426
Loans and advances to customers (LaR)	40,274	41,146	–872
Allowances for losses on loans and advances	–71	–130	59
Valuation adjustment from portfolio hedge accounting	–1	2	–3
Financial investments (LaR)	8,240	9,534	–1,294
Financial investments (AfS)	2,385	3,311	–926
Property and equipment	6	8	–2
Intangible assets	36	24	12
Other assets	2,712	3,572	–860
Income tax assets	129	118	11
Total assets	**57,994**	**62,651**	**–4,657**

[1] Corrected due to IAS 8.42. Details are disclosed in note "Consistency".

General Development in Assets

Total assets as at 31 December 2017 declined compared to the end of the previous year, largely due to decreasing loans and advances to customers, financial assets and other assets. Loans and advances to customers were below the previous year's level since the decline in public sector loans was stronger than the increase in real estate financing arrangements. In addition, fair value adjustments of loans and advances that are part of hedging relationships in the amount of €0.5 billion resulted in decreasing loans and advances to customers. LaR and AfS financial investments declined due to maturing securities. The uptick of the yield curves and the associated higher discount rates led to decreasing derivative market values recognised under "other assets" and "trading assets".

As at the reporting date, the nominal volume of the strategic portfolios amounted to €31.9 billion, slightly ahead of the value recorded as at 31 December 2016 (€31.5 billion). The non-strategic portfolio declined from €15.8 billion on 31 December 2016 to €13.8 billion, as anticipated.

Investments

Given the business model, investments in property and equipment and intangible assets are of minor significance for pbb Group. Additions to intangible assets amounted to €20 million during the year under review (2016: €12 million) and were due, inter alia, to a project aimed at the further optimisation of the finance and risk IT target structure – as well as due to setting up a portal for public sector financings. Services rendered by third parties were used for internally developed software. These investments covered all segments of pbb Group.

DEVELOPMENT IN FINANCIAL POSITION

Equity and liabilities

in € million	31.12.2017	31.12.2016[1]	Change
Liabilities to other banks (at amortised cost)	3,280	3,179	101
Liabilities to customers (at amortised cost)	8,275	9,949	−1,674
Securitised liabilities (at amortised cost)	38,362	40,381	−2,019
Valuation adjustment from portfolio hedge accounting	–	1	−1
Trading liabilities (HfT)	956	1,355	−399
Provisions	245	242	3
Other liabilities	2,959	3,785	−826
Income tax liabilities	57	59	−2
Subordinated capital (at amortised cost)	1,002	886	116
Liabilities	**55,136**	**59,837**	**−4,701**
Equity	2,858	2,814	44
Total equity and liabilities	**57,994**	**62,651**	**−4,657**

[1] Corrected due to IAS 8.42. Details are disclosed in note "Consistency".

Liabilities

In line with the development observed on the assets side in relation to market-induced derivative effects affecting "other liabilities" and "trading liabilities", liabilities decreased also due to maturities of promissory notes recognised under liabilities to customers. The decrease in securitised liabilities resulted from maturities (which exceeded new issues) and from fair value adjustments of items covered by hedging relationships.

Regarding subordinated capital, the termination and repayment of hybrid capital instruments of € 0.4 billion was more than compensated for by new issues of € 0.5 billion.

Equity

The equity attributable to shareholders changed as follows:

Equity

in € million	31.12.2017	31.12.2016[1]	Change
Equity attributable to shareholders	**2,858**	**2,814**	**44**
Subscribed capital	380	380	–
Additional paid-in capital	1,637	1,637	–
Retained earnings[2]	731	674	57
Gains/losses on pension commitments	−75	−82	7
Revaluation reserve	3	8	−5
AfS reserve	−19	−36	17
Cash flow hedge reserve	22	44	−22
Consolidated profit	182	197	−15
Total Equity	**2,858**	**2,814**	**44**

[1] Corrected due to IAS 8.42. Details are disclosed in note "Consistency".
[2] Due to immateriality, the foreign currency reserve is reported under retained earnings.

As in the previous year, pbb's subscribed capital amounted to € 380,376,059.67 as at 31 December 2017, and is composed of 134,475,308 registered ordinary bearer shares with no par value and a notional interest in the subscribed capital of appoximately € 2.83 per share.

Changes recognised under the item gains/losses on pension commitments translated into an increase in equity by € 7 million. The reason for this increase was the discount rate used to measure defined benefit pension obligations: it rose from 1.75% as at 31 December 2016 to 1.93% on 31 December 2017, reflecting market interest rates.

pbb Group has ceased active cash flow hedge accounting, meaning that changes in the cash flow hedge reserve only reflect utilisations. The remaining cash flow hedge reserve will be reversed in line with the hedged cash flows from underlying transactions.

At the beginning of June 2017, pbb distributed dividends of €141 million (or €1.05 per share). The remaining consolidated profit for 2016 of € 56 million was appropriated to retained earnings.

The Management Board and Supervisory Board will propose to the Annual General Meeting (scheduled for 21 June 2018) to distribute a dividend of € 1.07 per share entitled to dividends.

Key Regulatory Capital Ratios[1]

The CET1 ratio amounted to 17.7% as at 31 December 2017 (31 December 2016: 19.5%), the own funds ratio amounted to 22.3% (31 December 2016: 23.7%). Fully phased-in, therefore after expiry of all Basel III transitional regulations, CET1 ratio amounted to 17.6% (31 December 2016: 19.0%) and own funds ratio to 22.2% (31 December 2016: 20.7%). Please refer to the Risk and Opportunity Report for further information regarding the key regulatory capital ratios.

The decrease of the capital ratios corresponds with the increase in the risk weighted assets. The increase in the risk weighted assets resulted mainly from the credit risk. This was mainly driven by the hamonisation of risk models by ECB. The effect was compensated by the emission of subordinated capital recognised for regulatory purposes with regard to the fully phased-in own funds ratio.

For further display of the key regulatory capital ratios see Risk and Opportunity Report chapter "Internal Capital Adequacy Assessment Process (ICAAP)".

Liquidity

Principles and Objectives of the Liquidity and Financial Management

The primary objective of pbb Group's financial management is to secure and manage the liquidity of pbb and its subsidiaries in such a way that their financing and funding capabilities are assured at all times. Central liquidity management is done by raising and investing liquidity on the money and capital markets and on the interbank money market, as well as with central banks.

Liquidity management within pbb Group is performed centrally by pbb's Treasury division. The sales units are refinanced internally on a one-to-one basis when they enter into new business. This means that risks are bundled and centrally managed.

[1] After confirmation of the 2017 financial statements, less the proposed dividend (subject to approval by the Annual General Meeting).

Maturities

Asset/liability management for pbb Group is performed by the Asset and Liability Committee (ALCO). The following table compares the remaining terms of the assets and liabilities:

Statement of financial position maturity structure

in € million	31.12.2017 Assets	31.12.2017 Equity and liabilities	31.12.2016[1)] Assets	31.12.2016[1)] Equity and liabilities
Total	**57,994**	**57,994**	**62,651**	**62,651**
up to 3 months	5,569	5,531	6,171	8,761
More than 3 months to 1 year	3,106	3,443	4,595	5,200
more than 1 year to 5 years	20,073	22,506	20,773	19,231
More than 5 years	25,565	19,439	26,429	21,203
Other assets[2)]/equity and liabilities[3)]	3,681	7,075	4,683	8,256

[1)] Corrected due to IAS 8.42. Details are disclosed in note "Consistency".
[2)] Trading assets, allowances for losses on loans and advances, valuation adjustment from portfolio hedge accounting, property and equipment, intangible assets, other assets, income tax assets.
[3)] Valuation adjustment from portfolio hedge accounting, trading liabilities, provisions, other liabilities, income tax liabilities, equity.

Liquidity Ratios

The liquidity ratio is calculated at the level of the individual institution at pbb in accordance with the Liquiditätsverordnung (LiqV – German Liquidity Regulation), and amounted to 2.0 at the balance sheet date (31 December 2016: 1.6). This was significantly higher than the statutory minimum of 1.0. The Monitoring of complying with liquidity ratios within foreign regulations of permanent establishments is also ensured, if this is demanded by local regulatory authorities.

Since 1 January 2017, a minimum Liquidity Coverage Ratio (LCR) of 80% has been mandatory in regulatory liquidity reporting. This minimum value will rise to 100% by 1 January 2018. In the reporting period the figures determined for pbb Group were significantly higher than 100%.

Funding

In the financial year 2017, a new long-term funding volume of € 6.6 billion (2016: € 5.6 billion) was realised. Repurchases and terminations totalled €1.0 billion (2016: €1.4 billion). The funding volume comprised unsecured issues as well as Pfandbrief issues, both in the form of benchmark issues and private placements. € 2.3 billion (2016: € 2.7 billion) was attributable to unsecured issues, € 0.6 billion (2016: €1.2 billion) of which was in the form of benchmark issues and €1.7 billion (2016: €1.5 billion) in the form of private placements. € 3.8 billion (2016: € 2.9 billion) was attributable to Pfandbrief issues, € 2.7 billion (2016: € 2.3 billion) of which was in the form of benchmark issues and €1.1 billion (2016: € 0.6 billion) in the form of private placements. Subordinated issues amounted to € 0.5 billion (2016: € 0.1 billion). Most issues were denominated in euro, and were placed as fixed-rate bonds. Unhedged interest rate exposures are usually hedged by swapping fixed against floating interest rates. To minimise foreign currency risk between assets and liabilities, Pfandbriefe were also issued in GBP (equivalent of € 0.9 billion) and in USD (equivalent of € 0.7 billion).

Overnight and term deposits from retail investors taken via "pbb direct" amounted to € 3.3 billion as at 31 December 2017 (31 December 2016: € 3.5 billion).

Ratings

The following table shows the senior unsecured ratings and ratings for pbb's Pfandbriefe, mandated by pbb, as of the reporting date:

Senior unsecured ratings and ratings for Pfandbriefe of Deutsche Pfandbriefbank AG (pbb)[1)]

	31.12.2017			31.12.2016		
	Standard & Poor's	DBRS	Moody's	Standard & Poor's	DBRS	Moody's
Long-term issuer rating/outlook	A–/negative	BBB/stable	–	BBB/Credit Watch Positive	BBB/Stable	–
Short-term issuer rating	A–2	R–2 (high)	–	A–2	R–2 (high)	–
Long-term "preferred" senior unsecured debt rating [2)]	A–	BBB[4)]	–	BBB/ CreditWatch Developing	BBB	–
Long-term "non-preferred" senior unsecured debt rating [3)]	BBB–	BBB[4)]	–	n/a [4)]	n/a[4)]	–
Public Sector Pfandbriefe	–	–	Aa1	–	–	Aa1
Mortgage Pfandbriefe	–	–	Aa1	–	–	Aa1

[1)] This overview does not include all ratings/outlooks.
[2)] S&P: "Senior Unsecured Debt"; DBRS: "Senior Unsecured Debt".
[3)] S&P: "Senior Subordinated Debt"; DBRS: "Senior Unsecured Debt".
[4)] As of 31.12.2016, the intended split of S&P's rating class for "senior unsecured debt" was not implemented; at present, DBRS does formally not differentiate in this respect.

Rating agencies may alter or withdraw their ratings at any time. Ratings of individual securities issued by pbb may deviate from the ratings indicated above, or an individual security may not be rated at all. For the evaluation and usage of ratings, please refer to the rating agencies' pertinent criteria and explanations and the relevant terms of use, which are to be considered. Ratings should not serve as a substitute for individual analysis. They do not constitute a recommendation to purchase, sell or hold securities issued by pbb.

The unsecured ratings of pbb were mainly influenced by changes to legislative parameters and, in this context, resulting changes to rating methodologies. Particularly in view of increasingly detailed specifications concerning implementation of the European Bank Recovery and Resolution Directive (BRRD), rating actions took place, some of which had already been announced at year-end 2016.

Ongoing changes to the regulatory and economic environment, as well as any other distortions, particularly those related to the United Kingdom's exit from the European Union, may result in general rating pressure going forward.

Standard & Poor's (S&P)

In the context of the regulatory changes related to the BRRD, S&P has split the rating class for "senior unsecured debt". Depending on the future ranking in a "bail-in" or insolvency scenario, such debt was allocated either to a new "senior subordinated" rating class or remained in the hitherto existing "senior unsecured" rating class.

Against this background, S&P had launched a review of the ratings assigned to unsecured refinancing instruments of 13 German banks, as well as of unsecured long-term issuer ratings of the four systematically important banks within this group of 13, including pbb, and placed the ratings on "CreditWatch" on 15 December 2016.

The ratings review was completed on 28 March 2017, and resulted in the following material changes for pbb:

> The long-term issuer credit rating improved by two notches, from "BBB" to "A–", due to the consideration of senior subordinated debt within the Additional Loss-Absorbing Capacity framework (ALAC). The short-term issuer rating was confirmed at "A-2".
> At the same time, the long-term ratings for "senior unsecured" (preferred) liabilities improved from "BBB" to "A–", whereas the long-term ratings for "senior subordinated" (non-preferred) liabilities were downgraded by one notch, from "BBB" to "BBB–".
> The rating for subordinated refinancing instruments remained unchanged, at "BB+".
> The rating outlook remained negative. Now it essentially reflects the risk that pbb is unable to maintain the current RAC (Risk-adjusted capital) ratio that forms the basis for the current capital assessment.

DBRS
On 13 January 2017, DBRS placed subordinated debt securities of 27 European banks, including pbb, on "Under Review with Negative Implications". At that time, the rating agency expected a rating downgrade by one notch, on the grounds that the probability of losses under the BRRD for all subordinated debt had increased. The rating review was completed on 9 June 2017, following the introduction of the updated Bank Capital Methodology: as suggested at the beginning of the review, the subordinated debt rating was downgraded from "BBB (low)" to "BB (high)". On 23 June 2017, DBRS affirmed the unsecured ratings assigned to the bank with a stable outlook.

Moody's
On 17 August 2017, Moody's reduced the overcollateralization requirements for Mortgage Pfandbriefe issued by pbb keeping the "Aa1" rating unchanged. As a result of the changed overcollateralization requirement, pbb no longer needed to commit itself to maintain overcollateralization beyond the legal requirements in order to maintain the "Aa1" rating. Against this background, pbb terminated a contract, entered into in December 2015, according to which it had undertaken to maintain excess coverage above minimum legal requirements for its Mortgage Pfandbriefe.

Off-balance-sheet obligations

Irrevocable loan commitments of €4,667 million (31 December 2016: €3,802 million) constitute the material part of off-balance-sheet obligations. Contingent liabilities under guarantees and warranties amounted to €120 million (31 December 2016: €171 million) and commitments from bank levies due to collateral pledged to €15 million (31 December 2016: €11 million).

MATERIAL RELATED PARTY TRANSACTIONS

No material transactions with related parties were entered into during 2017 and 2016. See Note "Relationship with Related Parties" for detail information.

SUMMARY

Due to the good net interest income and lower-than-expected loan loss provisions, pbb Group achieved profit before tax of € 204 million. This is considerably above the range of €150 million to €170 million projected at the beginning of 2017 and even slightly above the raised forecast of €195 million to € 200 million.

Average financing volumes in the Group's strategic business – comprising the two segments of Real Estate Finance and Public Investment Finance – increased slightly year-on-year, despite the fact that pbb Group adhered to its risk-sensitive new business policy and repayments remained on a high level, due to low market interest rates.

Regulatory requirements regarding equity and liquidity were complied with at all times. Comfortable levels of capitalisation and liquidity provide pbb Group with the ability to exploit future growth potential; moreover, pbb Group is well-positioned for potential future regulatory changes.

Report on Post-balance Sheet Date Events

For significant events occured after balance sheet date please refer to note "Report on Post-balance Sheet Date Events".

Risk and Opportunity Report

The Risk and Opportunity Report shows the identified risks and the opportunities for the individual risk types within the framework of the implemented risk management and risk controlling system. For more general or bank-wide risks and opportunities, please refer to the Report on Expected Developments.

ORGANISATION AND PRINCIPLES OF RISK AND CAPITAL MANAGEMENT

pbb Group had implemented a Group-wide risk management and risk control system, which provides for uniform risk identification, measurement and limitation in accordance with section 91 (2) of the German Stock Corporation Act (AktG) and section 25 a of the German Banking Act (Kreditwesengesetz – "KWG"). With the approval of the European Central Bank (ECB) granted in August 2017, Deutsche Pfandbriefbank AG, at a single-entity level, applies an exemption according to section 2a (2) of the KWG. The exemption refers to the requirements concerning the risk control function pursuant to section 25a (1) sentence 3 nos. 1, 2, 3b and 3c of the KWG.

Organisation and Committees

The Management Board of pbb is responsible for the risk management system, and decides on the strategies and material issues of risk management and risk organisation at pbb Group.

The principles, methods and processes of pbb Group's risk management system are specified centrally by pbb's Risk Management and Controlling, and are applied throughout pbb Group, subject to any special requirements at single-entity level. The risk management system comprises the plausible and systematic identification, analysis, valuation, management, documentation, monitoring and communication of all major risks.

The following are major components of the risk management system in the responsibility of the Management Board:
- Defining, updating and communicating business and risk strategies as the basis of business activities and risk acceptance within pbb Group
- Defining and improving organisation structures within pbb Group and in particular for risk management, which ensures that all major risks of pbb Group are managed and monitored
- Adopting credit competences as a decision-making framework along the credit processes within pbb Group
- Taking decisions regarding (portfolio) management measures outside the delegated competences

The Management Board notifies the Supervisory Board with regard to significant changes in the business and risk strategies as well as the risk profile of pbb Group. The Risk Management and Liquidity Strategy Committee (RLA) of the Supervisory Board is mainly responsible for controlling the overall risk situation and for monitoring, establishing and improving an efficient risk management system, and is also responsible for the liquidity management and assurance of pbb Group and resolves upon necessary credit approvals for credit decisions. The Management Board notifies this committee of all increases to specific allowances and the creation of new specific allowances in excess of €5 million and also notifies this committee at regular intervals of major exposures with higher levels of risk.

The committees detailed in the following have been set up at pbb Group level with the involvement of the respective decision-makers.

The **Risk Committee (RC),** consists of the CRO (Chairman), the CFO (Deputy Chairperson), the Chief Credit Officers REF/PIF (CCO), the Head of "Projekte Risk Management" as well as the Head of Risk Management & Control (RMC). In general, the committee meets on a monthly basis and discusses the risk development, adopts guidelines/policies, methods for risk measurement, the related parameters as well as methods of monitoring for all risk types. The RC is responsible for the development of standard guidelines of risk management and risk controlling across the Group and also monitors the development of the risk-bearing capacity, economic capital, available financial resources as well as the credit portfolio and the compliance with limits. The Risk Committee discusses the portfolio developments of pbb Group. Additional sub-committees have been established below the Risk Committee, as outlined below.

The **Credit Committee** is chaired by the CRO or a CCO. As a general rule, the committee meets at least once a week and takes credit decisions on new business, prolongations and material changes that fall within the scope of its authority. It also votes on all credit decisions which are in the responsibility of the Management Board or which have to be approved by the Risk Management and Liquidity Strategy Committee. The responsible decision-makers ensure that the credit decisions are consistent with the prevailing business and risk strategy.

The **Watchlist Committee** is chaired by the CCOs (with delegation opportunities to a Senior Credit Executive) and meets every month. All exposures identified by the early warning system are discussed and, if appropriate, individual measures are decided there; these measures have to be subsequently implemented by the relevant departments. Where necessary, the committee takes decisions regarding the need to transfer exposures to CRM REF Workout, which then takes the necessary steps for restructuring or workout on the basis of an individual exposure strategy. All necessary credit decisions are taken by the key personnel in line with the allocation of credit powers or in the Credit Committee.

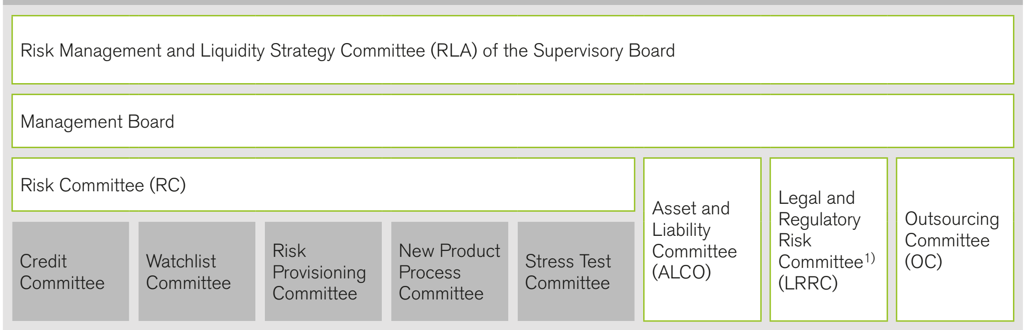
If there are any objective indications of an impairment in accordance with IAS 39.59 of an exposure, the extent of the impairment is first determined and the result is presented in the **Risk Provisioning Committee (RPC).** It is chaired by the CRO. The RPC decides upon recognition, charge-off and reversals of loan loss provisions, within the scope of a pre-defined assignment of approval powers and in accordance with IFRS and the German Commercial Code (HGB); where the RPC cannot take a final decision, it issues a recommendation. Finally, the RPC decides upon any foreclosures which may be necessary. The recommendations made by the committee form the basis of decisions to be made in line with the relevant set of rules governing powers.

The **New Product Process Committee ("NPPC")** comprises representatives from the most important units reponsible for infrastructure and controls. The representatives are determined by the RC. The NPPC convenes on an event-driven basis; it ensures that, before business commences with new products or in new markets, the resulting risks as well as the related impact on processes, controls and infrastructure are systematically analysed and duly addressed. Only after approval of new product process committee business with new products or in new markets can be started.

The **Stress Test Committee** is responsible for the methodology, performance and monitoring of the internal stress tests. It is chaired by the CRO. The Committee also contributes to the preparation of scenarios for the Recovery Plan which every bank is required by law to prepare.

Besides the Risk Committee, there are the **Asset and Liability Committee (ALCO)** as well as the **Legal and Regulatory Risk Committee (LRRC).** The tasks of the ALCO are: managing liquidity as well as pbb Group's balance sheet structure, defining long-term financing strategies, managing capital, regulatory capital ratios, as well as market risk exposure. The LRRC advises on legal and regulatory requirements, and may assign responsibility for implementation to business divisions, following consultation. The **Outsourcing Committee** deals with the preparation of, and compliance with, guidelines as well as with the overall management and monitoring of outsourced activities.

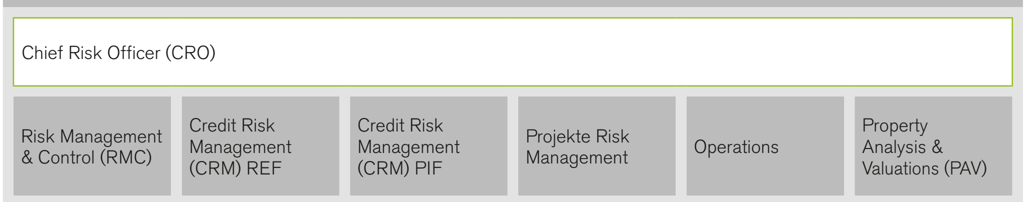
Organisation of Risk Management
31 December 2017



[1] Reporting via Compliance.

Chief Risk Officer (CRO) In addition to the above-mentioned committees, the following organisation units of the CRO, form an integral part of the risk management system of pbb Group:

Organisation of Chief Risk Officer (CRO)
31 December 2017



The organisation of the CRO function comprises the following monitoring and back-office units at pbb Group level:

> The unit Risk **Management & Control,** which is amongst others responsible for monitoring market, credit, operational and liquidity risks as well as the risk-bearing capacity of pbb Group and which is also responsible for Group-wide uniform risk measuring methods and risk reports.

> The units of the **Chief Credit Officers REF/PIF** and **"Projekte Risk Management"** of pbb Group, which are each responsible for the analysis of new business and portfolio management. In addition, CRM REF also comprises the Workout (Real Estate) unit, which is responsible for the recovery and workout of all critical exposures in the Real Estate Finance segment, and the central unit Credit Processes, which is responsible in particular for the organisation of the Credit Committee and implementation of regulatory requirements in the credit processes.

> The unit **Operations,** which is responsible for the global servicing and administration of the loan portfolio (including technical implementation of loan agreements), settlement of capital markets transactions, administration and processing of the Group's securities and derivatives portfolios, as well for handling domestic and international payments.

> The unit **Property Analysis & Valuation,** which is responsible for the analysis and uniform valuation of properties serving as collateral, using market valuation and loan-to-value methods as well as for the monitoring of financed developments.

In addition to the CRO function, the Corporate Office/Compliance entity and the Group Internal Audit entity (independent) complement the risk management system of pbb Group. Compliance has established checking and reporting processes with regard to money laundering, sanctions, embargos and other criminal acts, as well as for other Compliance topics. Moreover, Compliance is responsible for the central coordination of key controls within the framework of the Internal Control System. Corporate Office/Compliance is also represented in various committees. The area of responsibility of Group Internal Audit comprises risk-oriented regular as well as event-driven audits of processes, controls and systems. This also includes the revision of the risk management system. Regarding legal issues Risk Management is also supported by the Legal department. The Head of the unit Group Internal Audit has changed in the reporting period.

Risk Strategy and -Policies

Together with pbb's business strategy, the risk strategy forms the foundation for pbb Group's planning. The risk strategy has been defined on the basis of the Group-wide risk tolerance; it reflects pbb Group's strategic direction as a specialist for real estate finance and public investment finance with a focus on Pfandbrief funding. Subject to any special requirements at single-entity level, the risk strategy is applicable for pbb Group's operating segments and legal entities. It is reviewed at least annually, and updated if applicable.

In 2017 the risk strategy was revised during the course of the annual strategy development process as well as during the period. Each update was adopted by the management board and approved by the supervisory board respectively.

The operationalisation of the risk strategy is carried out via risk policies for the individual operating segments as well as for all major risk types (credit risk, market risk, liquidity risk, business risk, prop- erty risk, pension risk and operational risk); these risk policies describe risk measurement, risk monitoring, risk management, the limitation process as well as the escalation process if a limit is exceeded. The policies are reviewed regularly and updated if necessary.

Risk Reporting

Risk reporting reflects the structure of the operating segments. The Management Board of pbb receives regular risk reports which include an extensive overview as well as detailed information concerning the risk situation for each risk type as well as other management-relevant information. The supervisory bodies are also notified of risk-relevant issues at regular intervals. In addition, special reports are prepared on an ad hoc basis or at the request of the Management Board or Supervisory Board; such special reports consider specific and acute risk issues, for instance in relation to critical markets, products or counterparties.

Risk Quantification and Risk Management

For the purposes of systematically identifying and analysing potential risks arising from the business model or pbb Group's external environment, the Group carries out a comprehensive risk inventory at least once a year. The objective of this risk inventory is to establish a full risk profile which identifies any and all risks, provides an assessment as to whether these risks are material for pbb Group, and scans them for the existence of potential risk concentrations. Where possible, risks are quantified using applicable risk models or other methods.

Risks which cannot be quantified (or only in part) are monitored and managed using dedicated capital buffers or separate management tools, as well as by way of regular, detailed reports and clearly-defined requirements such as the Compliance and Corporate Governance guidelines.

As part of its risk strategy, pbb Group has implemented four approaches to risk and capital management, which pursue different objectives: besides two approaches under the Internal Capital Adequacy Assessment Process (ICAAP), the risk strategy also provides two approaches according to which the Group manages regulatory capital and focuses on its liquidity position.

pbb Group's risk management is therefore based on the following approaches or objectives:
1. to ensure compliance with minimum regulatory capital ratios, via the going-concern approach of the ICAAP
2. to protect senior creditors in the event of liquidation, via the gone-concern approach of the ICAAP
3. to ensure the regulatory capital base, in order to monitor the own funds ratio as well as the CET1 ratio
4. to monitor the liquidity status, in order to ascertain pbb's ability to meet its payment obligations at all times

Besides the measurement, limitation and monitoring of risks, all risk management approaches also comprise regular reporting as well as escalation processes; they are supplemented by scenario analyses and stress testing. Within the framework of these strategic management approaches and objectives, pbb Group defines its risk appetite – which sets out the scope within which pbb Group is prepared to assume risks.

Limit and early warning systems have been implemented, in line with the risk appetite, for each type of risk as well as across risk types, at the level of capital management circuits. The strategy underlying the respective type of risk, together with the associated risk definition, risk calculation methods, and risk reporting systems are described in detail in the following chapters.

RISK TYPES

pbb Group distinguishes the following major risk types for its business activities:
- Credit risk (counterparty risk)
- Market risk
- Liquidity risk
- Operational risk (including legal risk)
- Business risk
- Property risk
- Pension risk

The following are major risk types of pbb Group which are not quantified but capitalised by suitable buffers, are limited by reports, guidelines and policies:
- Strategic risks
- Regulatory risks
- Tenant cluster risk (as part of credit risk)

Credit Risk (Counterparty Risk)

Definitions

The credit risk in general is defined as the risk due to a threatened unexpected default or decline in the market value of a receivable (loan or bond) or a derivative (alternatively of an entire portfolio of claims/derivatives). The reason for this can be either a deterioration in a country's or counterparty's creditworthiness or by a deterioration in collateralization.

The credit risk comprises the default risk, migration risk, realization risk of defaulted positions, transfer and conversion risk, tenant risk, settlement risk, extension risk as well as concentration risk which are defined as follow in pbb Group's risk strategy.

- Default risk comprises risk due to defaults of other parties. This includes defaults of loans and other traditional credit products (loan risk) or bonds and other securities (issuer risk) and counterparty risk due to default of a counterparty of derivatives (replacement risk) and money market transactions (repayment risk). The impact of rating migrations of state or regional governments is also included (sovereign risk).
- Migration risk is the risk of a decline in value through rating migration. This includes rating migrations of loans and other traditional credit products (loan risk) or bonds and other securities (issuer risk) and counterparty risk caused through rating migrations of a counterparty of derivatives (replacement risk) and money market transactions (repayment risk). The impact of rating-migrations of state or regional governments is also included (sovereign default risk).
- Realization risk of defaulted positions is the risk that the existing general and specific loan loss provisions change during the timeframe of the evaluation or that deviations occur in the case of realization.
- Transfer risk is the risk that a government or central bank restricts the use of the currency to their own country. This includes the conversion risk, which is the risk that a government or central bank declares its own currency as non-convertible. Together with the sovereign risk, the transfer and the conversion risk form the country risk.
- Tenant risk describes the risk that losses in rental income for properties will negatively influence the respective borrowers' debt service capacity. In addition, it includes the secondary concentration risk (tenant cluster risk), which arises when one and the same tenant is involved in multipleproperties funded by the bank.
- Extension risk is the risk of an unexpected extension of the holding period of a credit risk related asset.
- Fulfilment risk is defined as the risk that the Bank makes a payment or delivers an asset which has been sold to a counterparty but does not receive a payment or the purchased asset.
- Concentration risk is defined as the risk of cluster formation in relation to a risk factor or counterparty, or a strongly correlated group of risk factors or counterparties.

Credit Risk Strategy and Principles

pbb Group has broken down the overall credit portfolio into the segments Real Estate Finance (REF), Public Investment Finance (PIF), Value Portfolio (VP) and "Consolidation & Adjustments" (C&A). The strategic business is attributable to commercial Real Estate Finance (REF) and Public Investment Finance (PIF). The risk strategy of pbb Group also reflects this structure.

Please refer to the information in the section "Fundamental Information about the Group" for a description of the business focus with regard to strategic portfolios, and for statements outlining the strategy adopted for the run-down portfolio.

Credit Risk Reports

The credit risk reports of pbb Group provide information about the following main components:

> The pbb Group Risk Report contains the development in volumes as well as relevant credit risk management indicators such as the development of the expected loss as well as the unexpected loss via value at risk (VaR). The report shows the credit risk at the level of pbb Group in the context of the overall bank risk and the risk-bearing capacity, it reports limit utilisations and violations of existing limits, and also identifies risk concentrations. Key indicators, such as the development of the exposure at default (EaD), the expected loss (EL), the credit value at risk (Credit VaR) as well as problem loans are integrated in this report and are discussed by the Management Board; the report is also submitted to the RLA of the Supervisory Board to be noted.
> For decisions to be made regarding new business, or regarding material changes to the credit quality of existing financings (such as a maturity extension), key financial indicators, content and analysis are presented to, and discussed by the Credit Committee.
> In the active business, further regular reports support operational management with regard to the management and timely recognition of risks at the sub-portfolio level.
> Unusual developments which might result in a major deterioration in the risk position of an individual exposure are ad-hoc reported to a wider group up to the CRO by way of so-called "Credit Issue Notes".

Credit Risk Quantification via Economic Capital and Risk-weighted Assets according to Capital Requirements Regulation (CRR)

Credit Portfolio Model For calculating the economic capital for credit risk pbb Group uses a credit portfolio model. For details concerning this model and economic credit risk quantification, please refer to the sections "Internal Capital Adequacy Assessment Process (ICAAP)".

Stress Tests The stress tests for economic capital in credit risk are described in greater detail in the section "Internal Capital Adequacy Assessment Process (ICAAP)".

In addition to the stress tests for economic capital, there are also RWA reverse stress tests. They investigate the extent to which a certain risk parameter (e.g. rating, loss given default (LGD), currency) can change before a minimum common equity tier 1ratio (CET1) is no longer met. The minimum level for the common equity tier 1 (CET1) ratio is derived from the bank's individual SREP CET1 ratio. Tolerance change levels have been defined for all tested risk parameters; these levels must not be violated if the test of pbb Group is to be successfully completed.

Credit Risk Quantification according to CRR The Basel III Framework Agreement of the Basel Committee was implemented in the European context by means of the Capital Requirements Regulation ("CRR"). pbb Group applies the so-called Advanced Internal Rating-Based Approach (Advanced IRBA) for determining the regulatory capital backing.

Credit Risk Management and Monitoring

Credit Risk Management At the portfolio level, the intended portfolio structure is defined in the risk strategy by means of structure components. The limits are also based on the available financial resources, and include for pbb Group for example:

- Limiting of country risks
- Definition of strategic risk parameters (e.g. regions, financing duration)

The following reports and measures are key elements for monitoring compliance with the defined limits and the intended risk and return parameters at the portfolio level and also at the level of individual transactions:

- Analysis of portfolio developments in the Risk Committee
- Determining the credit-VaR at the portfolio level by way of a credit portfolio model and partly limiting at the segment level; analysis of concentration risks and various stress tests
- Central Group-wide monitoring of risk concentrations by way of special, regular and ad hoc evaluations, such as regional or product-specific evaluations
- Continuous analysis of the portfolio and the relevant markets by the local Credit Risk Management units
- Regular evaluation of the collateral
- Special reports for exposures which are potentially at risk (e.g. "credit issue notes")
- Calculation of a risk-adjusted margin using the economic return after tax

Depending upon the counterparty group, Expected Loss class or exposure size at GCC (Group of Connected Clients) level, the lending authority regulations determine the approval powers for new as well as existing exposures. Approval powers are assigned to individual employees in line with their individual experience and qualification.

Credit Risk Management and Monitoring At the level of individual transactions, the credit process guidelines define the necessary steps of assessing risk for new business as well as for substantial changes as prolongations or increase of credit limit and the procedures for transferring exposures to the watchlist or workout.

Core processes of credit risk management and monitoring as well as the relevant areas of the CRO function which are involved are described in the following:

The CRM entities carry out the initial risk analysis for new business and annual risk analysis for existing business. Probability of default (PD) and loss given default (LGD) rating tools, which are developed by Credit Risk as part of RMC and annually validated and calibrated, are used for valuation purposes and for preparing the credit decision in new and prolongation business. Property Analysis & Valuation (PAV) provides support for analysing and valuing collateralised properties.

The Legal department, where appropriate together with external lawyers/lawyers' offices, is responsible for the contract and collateral organisation.

Defined early warning indicators are constantly monitored by CRM. If essential problems are identified, an exceptional test is performed on the credit default risk (including a review of the value of collateral) and appropriate alternative actions are identified. Such cases are also included in a monthly, at least quarterly monitoring cycle and presented in the Watchlist Committee.

If there are any objective indications of an impairment, the extent of such an impairment is determined. In the Risk Provisioning Committee, the results are discussed and, where necessary, decisions are taken with regard to creating or reversing impairments.

Where an individual decision is taken as to whether a critical or impaired exposure is to be restructured or liquidated, scenario analyses outlining the potential development of the borrower, of collateral and/or the relevant market, are taken into account. These analyses are presented to the Credit Committee, which approves them or issues a recommendation for approval to holders of higher lending authority.

Critical exposures (watchlist) as well as restructuring and workout cases (non-performing loans) are reported on an aggregate basis monthly in the Group Risk Report and in the Risk Committee and also, upon request, in special analyses to the Management Board and Supervisory Board.

Hedging and Minimising Risk by Collateral

In the REF segment, financing arrangements are normally backed by property charges. On the occasion of the regular credit reports for existing financing arrangements or as part of the decision-making process in the case of new financing, the LTVs (loan-to-value) as well as the property (amongst others micro and macro location, rental situation, condition of property) and market circumstances are discussed and are also taken into consideration as part of the assessment process for individual loans.

In addition to the property charge, the financing security in the REF segment also generally comprises amongst others rent assignation as well as the assignation of insurance claims, accompanied by extensive notification and consultation obligations of the borrowers. Apart from the property charges, only a few more selected securities are considered to be of value in the credit assessment process or in the calculation of LGD, and in particular this is applicable for cash security, furthermore under certain circumstances bank guarantees, other credit protections as well as guarantees of public-sector institutions. Corresponding haircuts are recognised in relation to foreign currency collateral, that means in a currency differing from the loan currency, in order to take account of potential exchange rate risks.

Properties in the REF business are valued using strict quality criteria. Property collateral values are determined when the loan is initially granted, and reviewed on an annual basis. pbb maintains a separate department of real estate analysts and surveyors (reporting directly to the CRO); the majority of staff members in this department have either passed the HypZert examination or qualifications (such as RICS certification). This department is always involved in the initial valuation (when a new loan is granted) or regular revaluations, as well as in the valuation reviews which are carried out at least once a year. Depending on the type and location of the property involved, market developments and other risk indicators, valuation reviews may also be carried out, in some cases, by credit department staff, based on defined parameters and processes.

For development financings, regular project monitoring comprises the monitoring of planning progress, budget, procurements, construction schedule, sales/letting progress and construction stage, amongst other factors. As a rule, for complex developments, such monitoring is carried out by renowned external project monitors on the bank's behalf, coordinated by PAV – usually on a monthly, but at least on a quarterly basis. For less complex residential real estate developments, construction progress is generally monitored, every three months, by experienced internal property analysts. CRM always monitors costs, thus facilitating a current overview of actual costs, as well as a cost projection for development projects, which is reconciled against the results of internal monitoring (as well as external monitoring, if applicable). This allows for recognition of any divergence from project planning (and hence, project risks during construction) as early as possible.

In the PIF segment, guarantees are often accepted as collateral (including contractual guarantees from public-sector authorities, export credit guarantees). Moreover, Public Investment Finance exposures often involve a specific legal framework, such as the maintenance obligation (Anstaltslast) of public-sector entities, or other (direct and indirect) cover mechanisms which allow for recourse to a public-sector institution in the case of borrowers organised under public law. For some exposures in PIF, guarantees and indemnities or the legal framework are supplemented by additional loan collateral, as well as borrowers' disclosure or consultation duties. However, such additional loan collateral is generally not considered as valuable in assessing the exposure, or for the purposes of calculating LGD.

In Treasury, mainly cash contributions and securities are made available or accepted as collateral when trading with other banks. The collateralisation is based on standard agreements, which can be amended in individual cases if required or which can be subjected to individual review by the legal department.

Credit Portfolio
The entire credit portfolio of pbb Group is calculated by using the exposure at default (EaD).

For most products, EaD is equal to the IFRS carrying amount (including accrued interest). Committed, undrawn credit lines are additionally included in EaD with a product-specific credit conversion factor (CCF). The CCF indicates the portion of an undrawn credit line that is expected to be drawn upon (based on experience) within one year before a potential default. Derivatives and repo trans- actions are an exception since their EaD is not identical to their carrying amount but must be determined, in accordance with the Capital Requirements Regulation ("CRR") using a different methodology. For instance, the regulatory mark-to-market method is applied to derivatives, using the market value plus any regulatory add-ons for potential future market value increases and taking any netting or collateralisation effects into account.

The Group's credit portfolio had an aggregated EaD of €57.5 billion (31. December 2016: €60.6 billion[1]).

Overview of the Total Exposure of pbb Group: € 57.5 billion EaD The credit portfolio is broken down into the following segments
- Real Estate Finance (REF),
- Public Investment Finance (PIF) as well as the
- non-strategic segment Value Portfolio (VP) which is earmarked for being wound down.

In addition "Consolidation & Adjustments" shows besides the internal reconciliation and consolidation positions, the EaD for transactions which are not directly attributable to the operating segments. These are basically asset positions for asset and liability management.

As of 31 December 2017, 58% (31 December 2016: 57%) of the EaD in C&A was attributed to the rating classes AAA to AA– and 21% (31 December 2016: 27%) of the EaD was attributed to the rating classes A+ to A–. 18% (31 December 2016: 15%) of the EaD was in the rating classes BBB+ to BBB–. The figure for the EaD in BB+ and positions rated lower was at 3% (31 December 2016: 1%). Internal rating classes were mapped to external rating classes for the purpose of determining the breakdown of EaD by rating class.

[1] Excluding €0.2 billion in exposure guaranteed by FMS Wertmanagement.

Total portfolio: EaD according to operating segments

in € billion	31.12.2017[1]	31.12.2016[2]	Change in € billion	Change in %
Real Estate Finance	28.3	27.1	1.2	4.4
Public Investment Finance	7.9	8.5	−0.6	−7.1
Value Portfolio	17.0	19.5	−2.5	−12.8
Consolidation & Adjustments	4.3	5.5	−1.2	−21.8
Total	**57.5**	**60.6**	**−3.1**	**−5.1**

[1] Including exposure guaranteed by FMS Wertmanagement.
[2] Excluding €0.2 billion in exposure guaranteed by FMS Wertmanagement.

As of 31 December 2017 the total exposure at default (EaD) of pbb Group decreased compared to year-end 2016 by € 3.1 billion to € 57.5 billion. On the whole, the percentage share of EaDs in the strategic segments REF (49%; 31 December 2016: 45%) and remained stable in PIF (14%: 31 December 2016: 14%) whereas it decreased in the non-strategic VP (29%; 31 December 2016: 32%). The percentage share of the EaD in C&A decreased at 7% compared to year-end 2016 (9%). Explanations concerning changes in individual segments are provided with the detailed presentation of the respective segment.

Risk Parameters The expected loss (EL) for a time period of one year is calculated for the entire exposure, with the exception of non-performing loans for which a specific allowance has already been recognised. This is calculated from the annual probability of default (PD), the loss given default (LGD) and the exposure at default (EaD) using the parameters defined under Basel III.

Expected Loss for pbb Group totalled € 106 million as at 31 December 2017 (31 December 2016: € 83 million). The increase in Expected Loss was mainly attributable to the downgrading of a foreign regional government (within the PIF Segment) as well as to the harmonisation of risk models by the European Central Bank (within the REF Segment).

The figure was split to the segments as follows:

Total exposure: expected loss according to operating segments

in € million	31.12.2017	31.12.2016	Change in € million	Change in %
Real Estate Finance	65	46	19	41.3
Public Investment Finance	9	2	7	>100.0
Value Portfolio	32	35	−3	−8.6
Consolidation & Adjustments	–	1	−1	−100.0
Total	**106**	**83**	**23**	**27.7**

It has to be stated that future changes, for instance in the economy or in developments of individual risks, may result in changes in the EL figures stated above. Realised losses can differ from the expected losses.

Economic Credit Risk Capital pbb Group calculates economic capital for credit risk using a credit portfolio model. For details concerning credit risk quantification, please refer to the section “Internal Capital Adequacy Assesment Process (ICAAP)”.

Regional Breakdown of the Portfolio At the reporting date, the main focus of the exposure of pbb Group was unchanged on Western Europe. Germany continued to account for most of the overall exposure, with 40% (€23.1 billion). The marked year-on-year EaD reduction in Germany (down €1.9 billion) was attributable to lower money market exposure in C&A , as well as to repayments in PIF and the VP, which exceeded new business originated in the REF portfolio. The lower exposure to Spain was mainly due to repayments in the VP, as well as to sales of bonds as part of liquidity management. The EaD decline concerning Austria was due to repayments as well as changes in the general interest rate levels and the associated changes in hedge adjustments in the VP.

The increase of the US exposure was influenced by new business in the strategic REF segment.

The category "Other", which accounted for €1.6 billion (or around 2.8% of the portfolio), largely comprises bonds issued by supranational organisations. The largest items of the category "Other Europe" were the Netherlands with €0.6 billion, Switzerland with €0.4 billion as well as Slovenia and Belgium with €0.3 billion each (31 December 2016: the Netherlands €0.8 billion, Switzerland €0.4 billion, Slovenia €0.3 billion and Belgium €0.3 billion).

Total portfolio: EaD according to regions

			Change	
in € billion	**31.12.2017**[1)]	**31.12.2016**[2)]	in € billion	in %
Germany	23.1	25.0	−1.9	−7.6
France	7.6	7.6	–	–
Austria	6.4	6.8	−0.4	−5.9
United Kingdom	5.3	5.0	0.3	6.0
Spain	3.1	4.3	−1.2	−27.9
Italy	2.1	2.3	−0.2	−8.7
Other Europe[3)]	2.0	2.1	−0.1	−4.8
Poland	1.7	1.6	0.1	6.3
Sweden	1.6	1.4	0.2	14.3
Other[4)]	1.6	1.6	–	–
Portugal	0.9	1.2	−0.3	−25.0
United States[5)]	0.9	0.5	0.4	80.0
Czech Republic	0.4	0.4	–	–
Finland	0.4	0.4	–	–
Hungary	0.3	0.6	−0.3	−50.0
Total	**57.5**	**60.6**	**−3.1**	**−5.1**

1) Including exposure guaranteed by FMS Wertmanagement.
2) Excluding €0.2 billion in exposure guaranteed by FMS Wertmanagement.
3) 2017 the category "Other Europe" comprises the Netherlands, Switzerland, Slowenia, Belgium, Slovakia, Romania, Luxembourg, Ireland, Denmark, Norway and Lettland.
4) 2017 the category "Other" comprises Supranationals, Japan, Canada and Hongkong.
5) In the Annual Report 2016 the United States were included in the category "Other" and are now reported separately.

Depending on the results of the internal rating process, maximum limits are defined for each individual country; these limits restrict pbb Group's business activities. All country limits are monitored daily by RMC.

Real Estate Finance: € 28.3 billion EaD

The REF segment comprises real estate loans and related customer derivatives. EaD of the REF portfolio rose by a total of € 1.2 billion, compared to 31 December 2016, to € 28.3 billion. Customer derivatives in the portfolio accounted for EaD of € 0.2 billion as at 31 December 2017 and therefore reduced by € 0.2 billion compared to year-end 2016.

The exposure increase in the REF segment was mainly due to new business in Germany, in the United States as well as in France.

Real Estate Finance: EaD according to regions

in € billion	31.12.2017[1]	31.12.2016[2]	Change in € billion	Change in %
Germany	13.9	13.1	0.8	6.1
United Kingdom	4.7	4.7	–	–
France	3.4	3.3	0.1	3.0
Sweden	1.6	1.3	0.3	23.1
Poland	1.4	1.4	–	–
Other Europe[3]	1.1	1.2	−0.1	−8.3
United States[4]	0.9	0.3	0.6	>100.0
Austria	0.5	0.5	–	–
Czech Republic	0.4	0.4	–	–
Finland	0.2	0.2	–	–
Spain	0.2	0.3	−0.1	−33.3
Hungary	0.2	0.3	−0.1	−33.3
Italy[5]	–	0.1	−0.1	−100.0
Total	**28.3**	**27.1**	**1.2**	**4.4**

[1] Breakdown including customer derivatives of approximately €0.2 billion.
[2] Breakdown including customer derivatives of approximately €0.4 billion.
[3] 2017 the category "Other Europe" comprises the Netherlands, Switzerland, Slowenia, Slovakia, Romania, Belgium, Luxembourg and Norway.
[4] In the Annual Report 2016 the United States were shown within the category "Other" and is now reported separately.
[5] Italy (2017): €24 million.

The main items in the REF portfolio were still the property types office buildings, with an EaD of €10.4 billion or 37% of the overall REF portfolio (31 December 2016: €8.9 billion, or 33%), and retail properties (EaD of €6.7 billion, or 24% of the REF portfolio – 31 December 2016: €7.1 billion, or 26%). The percentage shares of residential properties and of hotel/leisure properties remained unchanged from their levels as at the 2016 year-end, at 16% and 5%, respectively, whilst the share of other properties declined from 5% to 4%. The share of logistics/storage properties remained unchanged, at 11%. Mixed-use properties accounted for a share of 3% as at 31 December 2017 (31 December 2016: 4%).

Real Estate Finance: EaD according to property type

in € billion	31.12.2017	31.12.2016	Change in € billion	Change in %
Office buildings	10.4	8.9	1.5	16.9
Retail	6.7	7.1	−0.4	−5.6
Housing construction	4.6	4.4	0.2	4.5
Logistics/storage	3.1	3.0	0.1	3.3
Hotel/leisure	1.5	1.3	0.2	15.4
Other	1.2	1.4	−0.2	−14.3
Mixed Use	0.8	1.2	−0.4	−33.3
Total	**28.3**	**27.1**	**1.2**	**4.4**

At 31 December 2017, investment financings continued to dominate the portfolio (81%; 31 December 2016: 85%); development financings accounted for 17% of EaD (31 December 2016: 13%). There was strong demand throughout 2017 for both commercial real estate investments and development financings. In line with its conservative risk strategy, the pbb Group provided development financings exclusively to professional partners, and subject to commensurate covenants regarding equity, pre-sales and pre-letting. Investment financings are defined as real estate loans, the debt servicing ability of which largely depend upon current cash flows from the property. The EaD decline for client derivatives was due, on the one hand, to lower market values (reflecting higher interest rates), and on the other hand, to increased client demand for caps (which have no impact upon EaD).

Real Estate Finance: EaD according to loan type

in € billion	31.12.2017	31.12.2016	Change in € billion	Change in %
Investment financing	23.0	23.0	–	–
Development financing	4.9	3.6	1.3	36.1
Customer derivatives	0.2	0.4	−0.2	−50.0
Other	0.2	0.1	0.1	100.0
Total	**28.3**	**27.1**	**1.2**	**4.4**

Public Investment Finance: € 7.9 billion EaD

The portfolio comprises the following financing:

(I) Financing concluded directly with a public sector debtor, eligible according to the German Pfandbrief Act, on the basis of a specific earmarking according to a defined product catalogue;
(II) Financing of companies, which have a public sector or private legal structure and funding, which are to a great extent collateralised with a public sector guarantee within the meaning of the German Pfandbrief Act (transport and utility companies, municipal utilities, special-purpose associations, management companies, non-profits, associations); and
(III) Financing of special-purpose vehicles, which are almost entirely collateralised with a public sector guarantee within the meaning of the German Pfandbrief Act. This also includes export financings covered by insurance policies or guarantees issued by the Federal Government or by other export credit agencies permitted for inclusion in Pfandbrief cover.

EaD in the Public Investment Finance segment decreased by € 0.6 billion compared to the end of the previous year mainly due to maturing loans and repayments in Germany. New Business originated in France was partly compensated by repayments.

Public Investment Finance: EaD according to regions

			Change	
in € billion	31.12.2017	31.12.2016	in € billion	in %
France	3.5	3.4	0.1	2.9
Germany	1.9	2.6	−0.7	−26.9
Spain	1.5	1.5	–	–
Other Europe[1]	0.3	0.3	–	–
Austria	0.3	0.3	–	–
United Kingdom	0.2	0.1	0.1	100.0
Finland	0.1	0.2	−0.1	−50.0
Other[2]	0.1	< 0.1	0.1	100.0
Sweden[3]	–	< 0.1	–	–
Total	**7.9**	**8.5**	**−0.6**	**−7.1**

[1] 2017 the category "Other Europe" comprises Belgium and the Netherlands.
[2] 2017 the category "Other" comprises amongst others Canada and bonds issued by supranational organisations.
[3] Sweden (2017): € 44 million.

"Public Sector Borrowers" summarises claims against sovereign states (25%), public-sector enterprises (21%), and regional governments and municipalities (54%). The definition also includes exposures guaranteed by these counterparties.

Public Investment Finance: EaD according to counterparty structure

			Change	
in € billion	31.12.2017	31.12.2016	in € billion	in %
Public sector borrowers	7.7	8.3	−0.6	−7.2
Companies/special-purpose entities[1]	0.2	0.3	−0.1	−33.3
Financial institutions[2]	–	< 0.1	–	–
Total	**7.9**	**8.5**	**−0.6**	**−7.1**

[1] Largely collateralised by guarantees and surety bonds.
[2] Financial institutions with a state background or state guarantee.

The EaD share of exposures in the PIF segment in rating classes AAA to AA– declined year-on-year, to 43% (31 December 2016: 48%), whilst the share in rating classes A+ to A– went up slightly to 47% (31 December 2016: 46%). The shares in rating classes BBB+ to BBB– as well as BB+ or lower also increased. Internal rating classes were mapped to external rating classes for the purpose of determining the breakdown of EaD by rating class.

Public Investment Finance: EaD according to internal ratings

in € billion	31.12.2017	31.12.2016	Change in € billion	Change in %
AAA to AA–	3.4	4.1	–0.7	–17.1
A+ to A–	3.7	3.9	–0.2	–5.1
BBB+ to BBB–	0.4	0.2	0.2	100.0
BB+ and worse	0.4	0.3	0.1	33.3
Total	**7.9**	**8.5**	**–0.6**	**–7.1**

Value Portfolio: € 17.0 billion EaD

The Value Portfolio comprises non-strategic portfolios of pbb Group.

The continued reduction of exposures as at 31 December 2017, compared to the previous year (31 December 2016), in line with strategy, was mainly due to repayments in exposures to Germany, Spain, Austria and Portugal; Austria and Germany continue to account for the lion’s share of the portfolio. To some extent, the EaD decline concerning Austria was due to changes in the general interest rate levels and the associated changes in hedge adjustments.

Value Portfolio: EaD according to regions

in € billion	31.12.2017[1]	31.12.2016[2]	Change in € billion	Change in %
Austria	5.6	6.0	–0.4	–6.7
Germany	4.8	5.7	–0.9	–15.8
Italy	2.0	2.2	–0.2	–9.1
Spain	1.2	1.8	–0.6	–33.3
Other[3]	1.1	1.2	–0.1	–8.3
Portugal	0.9	1.2	–0.3	–25.0
France	0.7	0.7	–	–
Other Europe[4]	0.2	0.3	–0.1	–33.3
Poland	0.2	0.2	–	–
Hungary	0.1	0.2	–0.1	–50.0
Czech Republic[5]	–	< 0.1	–	–
Finland[5]	–	< 0.1	–	–
Total	**17.0**	**19.5**	**–2.5**	**–12.8**

[1] Including exposure guaranteed by FMS Wertmanagement.
[2] Excluding € 0.2 billion in exposure guaranteed by FMS Wertmanagement.
[3] 2017 the category “Other” comprises supranational organisations and Japan.
[4] 2017 the category “Other Europe” comprises Slovenia, Switzerland and Denmark.
[5] Czech Republic (2017): €11 million; Finland (2017): € 9 million.

EaD by Counterparty is shown including regulatory permitted guarantees or other forms of credit support.

Value Portfolio: EaD according to counterparty structure

in € billion	31.12.2017[1]	31.12.2016[2]	Change in € billion	Change in %
Public sector borrowers	15.4	17.1	−1.7	−9.9
Financial institutions[3]	1.5	2.3	−0.8	−34.8
Companies	–	< 0.1	–	–
Total	**17.0**	**19.5**	**−2.5**	**−12.8**

[1] Including exposure guaranteed by FMS Wertmanagement.
[2] Excluding € 0.2 billion in exposure guaranteed by FMS Wertmanagement.
[3] Mainly Spanish covered bonds.

Structured Products

pbb Group's residual holdings of Collateralised Debt Obligations guaranteed by one regional government had a notional value of € 0.5 billion as at 31 December 2017 (31 December 2016: € 0.6 billion) and a current fair value of € 0.5 billion (31 December 2016: € 0.6 billion).

The valuation of assets was based on available market prices.

Watchlist and Non-performing Loans

Early Warning System The early warning system of pbb Group has defined criteria respectively threshold values (triggers) for including loans in the watchlist and for being classified as workout loans (e.g. past due payments, failure to meet financial ratios – e.g. loan-to-value [LTV], interest service coverage [ISC]). The system constantly monitors whether a trigger has been set off. In the event of any problems being identified, the credit exposure is analysed and, where appropriate, promptly transferred to restructuring or workout loans. In this context an assessment is made to determine whether there is an objective indication of an impairment.

Watchlist and non-performing loans (restructuring and workout loans) are defined as follows:

> *Watchlist Loans* Payments past due by more than 60 days or another defined early warning signal is triggered (for instance insolvency of a main tenant in the REF segment).

> *Restructuring Loans* A default has occurred (for example, due to payments past due by more than 90 days, or the borrower's insolvency), or another contractual or regulatory trigger is applicable. The focus with restructuring is on active implementation of a restructuring concept – with the objective of either returning the exposure to regular coverage, or realising collateral on the market, without enforcement measures. An SLLP test is always performed, and a single loan loss provision recognised if necessary.

> *Workout Loans* There are no indications that the loan can be restructured. Enforcement measures have been/will be introduced, respectively specific allowances have been created or are planned if necessary.

CRM REF Workout is also responsible for carrying out an impairment test in line with the relevant accounting regulations (HGB and IFRS).

Development of Watchlist and non-performing loans of pbb Group

	31.12.2017				31.12.2016				Change	
EaD in € million	REF	PIF	VP	Total[1]	REF	PIF	VP	Total[1]	in € million	in %
Workout loans	15	–	–	15	3	–	–	3	12	>100.0
Restructuring loans	233	–	–	233	385	–	–	385	–152	–39.5
Non-performing loans	**248**	**–**	**–**	**248**	**388**	**–**	**–**	**388**	**–140**	**–36.1**
Watchlist loans	**24**	**112**	**224**	**360**	**37**	**–**	**237**	**274**	**86**	**31.4**

[1] No exposure in C&A.

Watchlist and non-performing loans declined by a total of €54 million during the period from 31 December 2016 to 31 December 2017.

Watchlist loans increased by €86 million. The increase was largely due to the transfer of two exposures with an aggregate balance of €112 million to intensified handling. Specifically, this concerns loans to French borrowers in the PIF segment, which are ultimately guaranteed by local authority guarantees, or covered by a sovereign maintenance obligation. The volume of exposures requiring intensified handling was reduced by a further €13 million. The slight decline in the VP segment (down €13 million) was attributable to a more favourable measurement of loans, due to improved borrower ratings.

Non-performing loans were reduced by €140 million during 2017. A lower volume of new additions (€3 million) was offset by €143 million in successful workouts or restructurings, whereby loans were repaid, partially utilising loan loss provisions recognised previously.

Impairments and Provisions

Specific Allowances and Portfolio-based Allowances All financial assets which are not evaluated at fair value through profit or loss are subject to a regular impairment test. An assessment is first made to determine whether there is an objective indication of an impairment. The extent of any such impairment is then calculated as the difference between the carrying amount, at AfS assets plus AfS reserve, and the present value of the cash flows expected in future.

Portfolio-based allowances are calculated using risk parameters which are compliant with Basel III, such as probability of default (PD) and loss given default (LGD). The resultant expected loss in relation to a time horizon of one year is scaled using an IFRS-compliant conversion factor to the period which on average is required for identifying the impairment event in the pbb.

If differences are identified between long-term average values for the parameters PD and LGD on the one hand and the current figures on the other as a result of the market environment in some portfolios of the operating segments, these are taken into consideration accordingly.

The specific allowances are approved in the Risk Provisioning Committee.

Risk Provisioning of pbb Group An overview of the development in provisions for losses on loans and advances and provisions is set out in the Notes.

Opportunities

The parameters for the risk dimensions for the credit risk are defined using statistical methods on the basis of numerous historical observations. The risk measures also depend on assumptions relating to future developments of macro-economic factors as well as developments on the credit markets. These economic conditions may turn out to be more positive than anticipated; in which case, potential losses from counterparty credit risk may theoretically be lower than quantified by the risk measures. Such potentially positive developments then represent opportunities for pbb Group which can be utilised for reducing risk.

In specific terms, there are opportunities if fewer loans in future are affected by a default in performance than is assumed as part of the risk quantification process.

There are also opportunities if there are in future fewer migrations to less positive rating categories than assumed.

There are also opportunities if the loss ratios of non-performing loans in future are lower than was assumed as part of the risk quantification process. Lower loss ratios may be triggered by various positive developments. Firstly, it is possible that the process of disposing of collateral might generate higher proceeds than was originally assumed in the risk quantification process. Secondly, it is possible that a higher percentage of non-performing loans subsequently become performing loans again without any losses than had been the case in the past.

Besides positive developments in default rates or loss ratios, opportunities may arise in connection with counterparty credit risk – theoretically, and regardless of other corporate objectives – in the event of declining portfolio exposure. For instance, this may occur if borrowers redeem or repay their loans faster than anticipated, given contractual agreements or historical data. Exposure values in the derivatives portfolio may decline where the market values of positions associated with replacement risk decrease, due to changes in certain market parameters such as interest rates or exchange rates.

Market Risk

Definition

Market risk is defined as the risk of a loss of value resulting from the fluctuation of the market values of financial instruments. Transactions entered into by pbb Group are mainly exposed to the following types of market risk:

- Credit spread risk (risk from changes in credit spreads)
- General interest rate risk (risk from changes in market interest rates)
- Volatility risk (risk from changes in implied volatility)
- Foreign currency risk (risk from changes in foreign exchange rates)
- Basis risk (risk from changes in OIS spreads, tenor spreads, and cross-currency basis spreads)
- Concentration risk (risk of additional losses due to a non-diversified portfolio mix)

Market Risk Strategy

pbb Group adheres to the following fundamental principles in relation to market risks:

- Transactions may be conducted exclusively in financial instruments which have successfully passed the new product process, and for which market values are either observable or determinable via a model.
- All positions entered into are subject to daily monitoring, in terms of value-at-risk (VaR) and performance, by RMC.
- The measurement and monitoring of interest rate risk, with regard to period net interest income, was added in 2017.

Market Risk Management Organisation
Positions are monitored by the RMC unit, which is separated from trading in the structural organisation, right through to senior management.

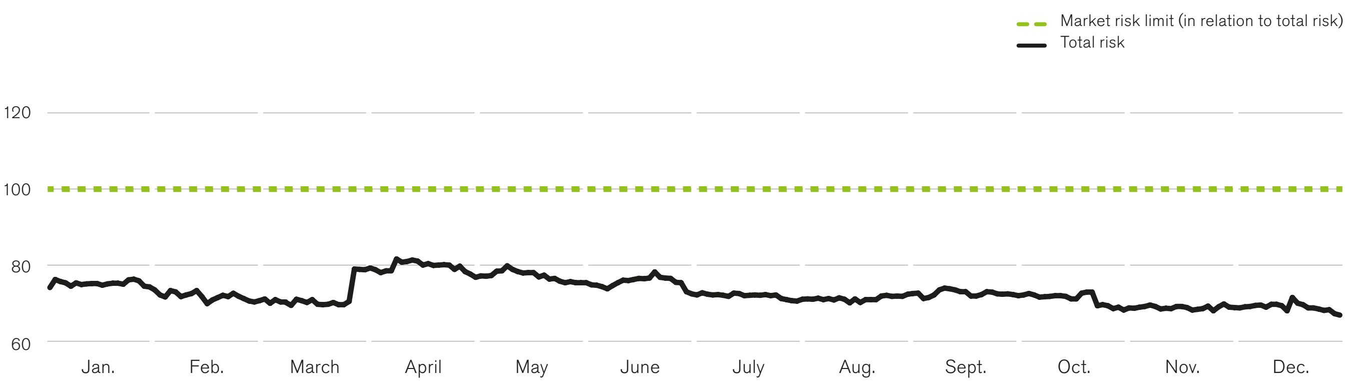
Market Risk Reports
RMC prepares detailed market risk reports for various recipients, on a daily basis:
> The daily Market Risk Report is addressed to the Management Board of pbb Group in particular. It outlines value-at-risk (VaR) attributable to market risk, limit utilisations and economic performance figures across all relevant levels of the portfolio structure.
> Daily sensitivity reports comprise analyses for the main risk factors, at various levels of detail. They are also made available to the Management Board.

Market Risk Measurement and Limits
Market risk Value-at-Risk RMC determines VaR attributable to market risk, at an overall as well as partial portfolio level, on a daily basis, using a simulated model based on historical data. All positions are taken into account for determining VaR, whereby the credit spread VaR from items classified under IFRS category Loans & Receivables is not taken into consideration within market risk, but in credit risk.
> The simulation model is based on historical market data of the past seven years, which is incorporated in the simulation with an equal weighting.
> Individual types of market risk are aggregated to form a total VaR, which forms the basis of limit monitoring.
> For the purposes of daily operational risk management, VaR is determined using a holding period of ten days and a one-sided 99 % confidence interval.

Market risk VaR as at end of 2017 amounted to €66 million, taking diversification effects between the individual market risk types into consideration (end of 2016: €74 million). There were no breaches of market risk VaR limits at pbb Group level during the period under review. As part of regular adjustments the market risk limit was left unchanged at €100 million.

The following chart shows the development of market-risk-induced VaR and its components, compared to the market risk VaR limit during the course of the year:

Market risk VaR (10 days, 99%) of individual risk types and market risk limit January to December 2017
in € million



The VaR assessment is complemented by additional tools, such as sensitivity analysis, stress tests and back-testing.

Sensitivity Analyses Overnight yield curves are used for the purposes of measurement relevant to sensitivity analyses. Sensitivity analyses quantify the impact of changes in individual market parameters upon the value of positions. For instance, the credit spread sensitivity provides an indication of the change in economic present value which results from a one basis point increase in the credit spreads which are relevant for measurement purposes.

Stress Testing Whilst VaR measures market risk in «normal» market conditions and does not provide a measure for potential maximum losses, stress scenarios are used to show market risk in extreme conditions. pbb Group employs hypothetical stress scenarios for key risk drivers, on a monthly basis, to determine the impact of extreme changes in yield curves, foreign exchange rates, credit spreads and volatility on the economic present value of pbb Group's overall portfolio. Historical stress scenarios are simulated additionally. A 200 basis point parallel upwards or downwards shift in the yield curve would have resulted in a maximum market value loss of €239 million across all of pbb Group's positions (31 Dec 2016: maximum market value loss of €60 million). The change was largely attributable to an extension of the average maturity applied to the notional investment of reported equity in high-quality fixed-income assets, whereby the size of such equity investment was adapted to the amount of reported equity. An extreme widening in the relevant credit spreads – given the scenarios applied by pbb internally – would have resulted in market value losses of €231 million as at end of 2017. The Management Board and the executive bodies are informed about the results of stress test scenarios on a regular basis.

Back Testing The quality of the risk measurement methods in use is checked on an ongoing basis by comparing one-day VaR figures to the actual changes occurring in the portfolio's present value on a daily basis. pbb Group has adopted the Basel Capital Accord's "traffic light" system for the qualitative analysis of its risk model. For this purpose, the number of outliers detected in backtesting within a period of 250 trading days are counted. As at end of 2017, based on a data history of 250 trading days, no outliers were observed. The risk model employed by pbb Group therefore has "green" status, as defined in the "traffic light" system of the Basel Capital Accord.

Economic Capital for Market Risk The chapter "Internal Capital Adequacy Assessment Process (ICAAP)" provides details concerning the calculation as well as the quantification of economic capital for market risk.

Mapping and Recognition of Economic Hedges as On-balance-sheet Hedges
The concept of hedge accounting refers to specific accounting rules applicable to hedge relationships in accordance with IAS 39, entered into for the purpose of neutralising the change in value of the hedged underlying transaction against the change in value of the hedging instrument to a large extent. The criteria set out in IAS 39 must be satisfied for a hedge to be recognised accordingly. To a certain extent, these criteria – such as the requirements relating to hedge effectiveness – are inconsistent with the methods applied to bank management. As a result, there may be differences between economic hedges and hedge relationships recognised on the balance sheet.

Market Risk Management, Monitoring and Reduction
pbb Group uses a three-pillar approach for managing and monitoring market risk:
> management of positions maintained by the Treasury
> risk measurement and monitoring compliance with limits by RMC and
> escalation processes across all decision-making bodies, right through to the Management Board

For all positions, market risk is monitored through a combination of value-at-risk (VaR) limits and monitoring of sensitivities by RMC, which is independent from trading units.

General Interest Rate Risk General interest rate risk was at € 38 million as at end of 2017 compared to € 33 million as at end of 2016.

Volatility Risk VaR used for the measurement of volatility risk amounted to € 4 million as at year-end 2017 (end of 2016: € 9 million). The decline was largely due to rising interest rates, and with the associated reduction in the risk of changes in the value of legal or contractual interest rate floors in connection with financial instruments bearing variable rates of interest.

Credit Spread Risk Credit spread risk reflects potential changes in the present value of exposures as a result of changes in the corresponding credit spread. The majority of credit spread risk is attributable to assets eligible as cover for Pfandbriefe. The Bank has risk measurement systems in place for calculating credit spread risk for all relevant exposures. Only credit spread risks of holdings classified as available for sale (AfS) are subject to market risk VaR limitation. Positions classified as Loans and Receivables (LaR), however, are not subject thus.

The credit spread VaR amounted to € 88 million at the end of December 2017 (as at end of 2016: €100 million).

Other Market Risks The present value of foreign currency risk was €11 million as at end of 2017 (end of 2016: €12 million).

Basis risks include OIS, cross-currency spread and tenor spread basis risks (including Libor/Euribor basis risks); these are quantified and recognised within the framework of the VaR model. All basis risks are included in aggregate VaR and are therefore subject to market risk limitation. The bank reported overnight index risks of € 5 million, tenor spread risks of € 0.4 million, and cross-currency spread risks of € 2 million on the reporting date. The bank is not exposed to share price or commodity risks. Financial derivatives are mainly used for hedging purposes.

Outlook
Communications by BaFin, the EBA and the Basel Committee on Banking Supervision – whether already published or still planned – regarding regulatory requirements concerning interest rate risk in the banking book, as well as planned revisions of the CRD IV and the CRR, will lead to changed requirements for risk management. To the extent that action is required in order to fulfil such new requirements, suitable measures were taken to ensure implementation in good time.

Opportunities
As detailed above, the sensitivities result in value at risk: a possible future (economic) loss in the event of an unfavourable market development. The very same sensitivities may also result in eco- nomic gains, in the event of a positive market development. For instance, as described above, high negative credit spread sensitivities represent a risk. In the event of a narrowing of the relevant credit spreads, however, these credit spread sensitivities will yield economic profits, constituting an opportunity.

Liquidity Risk

Definition
Liquidity risk is defined as the risk of not being able to meet the amount and/or due dates of existing or future payment obligations, in full or on time.

Internal Liquidity Adequacy Assessment Process
In accordance with the Supervisory Review and Evaluation Process (SREP), Deutsche Pfandbriefbank AG has conducted an Internal Liquidity Adequacy Assessment Process (ILAAP), which was examined and approved by the Management Board. The ILAAP ascertains that all material liquidity and funding risks can be identified, measured and monitored, and that measures to prevent a liquidity shortage are taken in good time if required.

Liquidity Risk Strategy
The Management Board determines both the risk strategy as well as the risk appetite of pbb Group. The liquidity risk strategy is a key component of pbb Group's risk strategy. It is broken down into various modules (comprising various liquidity scenarios, given certain market conditions and stress parameters). This ensures that the Group's short- and medium-term funding is monitored and managed by means of a limit system. The limits are defined as part of the annual business planning process, approved by the Management Board.

Organisation of Liquidity Risk Management
RMC identifies, measures, reports and monitors liquidity risk. The Treasury department, which is independent from RMC, is responsible for managing liquidity risk. The processes and methods employed are reviewed on a regular basis by the Risk Committee and the Asset Liability Committee. Liquidity Risk cannot be calculated and reported at a business segment level.

Liquidity Risk Report
Liquidity management reports are prepared daily and submitted to the entire Management Board, as well as to the Joint Supervisory Teams (JSTs) of ECB and national competent authorities. The reports contain up-to-date information on the day's liquidity situation as well as forecasts made using contractual cash flows and in recognition of future events that could potentially influence liquidity developments.

Liquidity Risk Measurement and Limits
To manage liquidity risks, pbb has established a system for measuring and limiting short-term and medium-term variances within cash flows. This incorporates both contractual as well as optional cash flows. The data is subject to regular back-testing.

The liquidity position resulting from the liquidity reserve as well as contractual and optional cash flows is measured in different scenarios, with three liquidity positions being projected on a daily basis. The projections assume:
- unchanged market and funding conditions (base scenario),
- a risk scenario (modified [historical] stress scenario) and
- liquidity stress ([historical] stress scenario).

For instance, the risk and the (historical) stress scenario simulate possible client behaviour in "stress situations". Historical time series are used to calculate 95% and 99% quantiles.

Liquidity risk triggers (early warning indicators) have been defined for a 24-month horizon in the base scenario. Limits in the risk and the (historical) stress scenario are applicabel for a six- respectively three-month horizon.

The limit system consists of:
> limits relating to the liquidity stress profile (risk scenario and (historical) stress scenario); and
> triggers for the base scenario as well as the six-month bucket of [historical] stress-szenario.

In addition to reporting, pbb Group uses stress tests, conducted at regular intervals, for investigating the impact of additional stress events on the liquidity position.

Scenario analyses are performed to simulate the potential impact of crises attributable to macroeconomic, monetary policy or political crises on the liquidity situation.

The scenarios are reported to the Management Board, as well as to external bodies such as the Joint Supervisory Teams (JSTs) of ECB and national competent authorities.

Liquidity Risk Monitoring and Management

Monitoring of liquidity risks is ascertained through daily reporting of the liquidity situation and a defined escalation process. A liquidity emergency plan has also been adopted in this context; this plan forms the functional and organisational framework for the handling of any liquidity shortages. The liquidity emergency plan is part of the pbb Recovery Plan and updated at least annually.

Liquidity risk management is based on various interconnected components (daily and monthly liquidity reports), which are based on a “liquidity risk tolerance” defined by the Management Board. This ensures that pbb Group has adequate liquidity reserves at its disposal.

Hedging and Reduction of Liquidity Risk

A risk tolerance system is in place, to limit liquidity risk. Risk tolerance is integrated in the liquidity management process by means of triggers (limit system), in order to safeguard a “survival period” for pbb Group in stressed conditions.

The limits applicable for risk tolerance are determined in line with stress scenarios, and adjusted at regular intervals.

Development of pbb Group’s Risk Position

The cumulative liquidity position (liquid assets plus projected net cash flows) determined as part of the liquidity risk measurement process as at 31 December 2017 amounted to €7.0 billion for a 12-month horizon in the base scenario – a €0.2 billion increase compared to the previous year (based on the same projection horizon). As at 31 December 2017, the cumulative liquidity position for a six-month horizon amounted to €2.5 billion in the risk scenario (31 December 2016: €3.5 billion).

pbb’s liquidity indicator pursuant to the German Liquidity Regulation (Liquiditätsverordnung – “LiqV”), on a stand-alone level, was 2.0 as at 31 December 2017, thus exceeding the legally required minimum of 1.0.

Regulatory Liquidity Coverage Requirements (Liquidity Coverage Ratio, LCR)

A minimum Liquidity Coverage Ratio (LCR) of 80% has applied to regulatory liquidity reports since 1 January 2017; this minimum value will rise to 100% by 1 January 2018.

pbb monitors the regulatory liquidity coverage requirement in addition to its internal liquidity risk metrics. With an (internal) ratio that exceeds minimum regulatory requirements, this forms part of pbb's risk tolerance system.

The figures determined for pbb Group were clearly above 100% throughout 2017. The Liquidity Coverage Ratio as of 31 December 2017 was at 187%.

Funding Markets
Please refer to the Report on the Economic position for details concerning developments on funding markets, and changes in pbb's funding volumes during the year under review.

Forecast Liquidity Requirement
In addition to the forecast liquidity requirement for new business activities, the extent of future liquidity requirements also depends on numerous external factors:

- further developments in the context of the European financial crisis and negotiations on Brexit and possible effects on the real economy;
- future developments of haircuts applied to securities for repo funding on the market, and with central banks;
- possible additional collateral requirements as a result of changing market parameters (such as interest rates and foreign exchange rates);
- developments in requirements for hedges;
- changed requirements from rating agencies regarding the necessary over-collateralisation in the cover pools;
- refinancing requirements of real estate investors

Funding Risk
Please refer to the description of business risk in the "Internal Capital Adequacy Assessment Process (ICAAP)" for details concerning funding risk.

Market Liquidity Risk
For financial instruments, quantitative details for a better assessment of market liquidity risk can be obtained from the presentation of the three levels of the fair value hierarchy in the notes. Generally, there is no intention to sell LaR holdings for liquidity management purposes, as liquidity for these holdings can mainly be generated by way of including them in the cover pool, using the funding opportunities provided by the central bank, or using them in repo transactions. Market liquidity risk is included in the internal risk management process as part of market risk.

Opportunities
pbb Group's cumulative liquidity position of € 7.0 billion in the base scenario over a 12-month horizon, which is detailed in the section "Development of pbb Group's Risk Position", as at 31 December 2017 provides the Group with scope for a flexible response, particularly with regard to possible new business.

If the external factors specified in the section "Forecast Liquidity Requirement" were to develop favourably for pbb Group, this would result in a lower future liquidity requirement.

Operational Risk (including Legal Risk)

Definition

According to Regulation 575/2013/EU (CRR) pbb defines the operational risk as follows: "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk". Furthermore, pbb recognises the following risks within the operational risk category: behavioural risk, reputational risk, outsourcing risk, model risk, risks associated with information and communication technologies (ICT Systems risk), as well as data quality risk.

Strategy for Operational Risk

The top priority of pbb Group's operational risk management is to prevent operational risk events and to meet the defined risk appetite. Key cornerstones of this strategy are the early recognition, systematic recording and assessment of operational risk, taking measures for risk mitigation as well as implementing early management reporting. The operational risk management strategy is adopted by the Management Board on an annual basis as part of the overall risk strategy, after the Risk Committee voting. The risk strategy describes the risk management framework as well as pbb Group's measures regarding operational risk.

Organisation of Operational Risk Management including Legal Risk

pbb Group actively manages operational risk by way of a consistent Group-wide framework based on the principle of three lines of defence. In this context, the risk owners – meaning heads of divisions – are responsible for managing operational risk, and for implementing risk-mitigating measures within the various business units (first line of defence). Specifically, Legal is responsible for managing legal risks, whilst the IT and Corporate Office/Compliance divisions are responsible for managing ICT systems risk and outsourcing risk.

Compliance and RMC form the second line of defence. Within RMC, the Operational Risk unit is responsible for uniform procedures, instruments and methods for identifying, assessing, monitoring, quantifying and reporting on operational risk throughout the Group. Internal Audit constitutes the third line of defence.

Risk Reports, Monitoring and Management of Operational Risk including Legal Risk

Risk management is applied to all business processes in an overall approach. In particular, operational risk is analysed and assessed explicitly as part of major decision-making processes (such as new product processes and outsourcing agreements).

Operational risk is managed using a variety of procedures, instruments and methods deployed throughout the Group: this includes recording and analysing internal and external loss data, operational risk self-assessments (ORSA) and scenario-based analyses.

A structured and central reporting system is used to inform the Management Board and the division heads, the Risk Committee and other supervisory bodies concerning risk events on a regular, timely and comprehensive basis. Reports are prepared both ad-hoc (where material risk events are escalated) as well as on a monthly basis (Group Risk Report), on a quarterly (Key Risk Indicator Report) or annual (Annual Risk Report) basis, and are part of risk reporting to the entire Management Board, and the division heads. Operational risk reporting encompasses material loss events and near-losses, analyses of causes, top risk issues, development of risk indicators and of capital requirements, as well as the results from ORSA and scenario analyses.

Management of legal risk, as performed by the Legal department, is aimed at a prevention of losses which could be incurred if business activities of pbb Group are not documented with legal certainty. In order to achieve this goal, the Legal department provides business units with a forward-looking, comprehensive and business-driven consultancy service.

The Legal department assists business divisions by monitoring developments in the relevant legislation and case law, and reviews the effects of such developments on new and existing business. The results are discussed with the responsible divisions and/or in the Legal and Regulatory Risk Committee. The Legal Policy describes the roles and responsibilities of the Legal department within pbb Group and serves as a guideline for employees in the Legal department.

Furthermore, the Legal department gives an assessment towards the respective business divisions whether provisions for pending legal cases have to be recognised. Provisions for legal risks are recognised in accordance with IAS 37 and section 249 HGB if (a) an obligation of pbb Group is probable, and (b) a reliable estimate can be made of the amount of the obligation. According to IAS 37.15, it is not clear whether there is a present obligation in rare cases. In such cases, pbb takes into account all available evidence, including the opinion of experts, to assess whether provisions have to be recognised at the reporting date.

Moreover, the OpRisk loss database captures losses from – and provisions for – legal risks which need to be seen in conjunction with operational risk events. Overall, legal risks are taken into consideration in the existing operational risk management framework, and are an integral part of, inter alia, the Key Risk Indicator Report, the Operational Risk Self-Assessment (ORSA), the analysis and reporting of risk events, as well as for determining economic capital.

Risk Measurement
Please refer to the chapter "Internal Capital Adequacy Assessment Process (ICAAP)" for further details on the quantification of operational risk including legal risks as well as the calculation results of the economic capital for operational risk.

In line with the Standardised Approach according to article 317 et seq. of Regulation 575/2013/EU (CRR), the own funds requirement for operational risk, which is calculated at the end of each year, was €72 million as at 31 December 2017 (31 December 2016: €69 million).

Operational Risks Profile of pbb Group
pbb Group suffered financial losses of €4.1 million from operational risks (excluding legal risk) during 2017 (2016: €0.3 million). Furthermore, pbb disclosed financial losses of €15.9 million from legal risks resulting mainly from net additions to provisions (31 December 2016: €3.0 million). Furthermore, income of €7.8 million was recognised upon release of provisions for legal risks. Overall, pbb assesses its operational risk profile (including legal risk) as stable.

Opportunities
pbb Group aims to reduce potential operational risk to the extent possible, through continuous development of its operational risk framework and the ongoing optimisation of processes.

Business Risk

pbb Group generally defines business risk as the risk of reductions in profit, due to changes in the external business environment which affect the Bank's economic conditions. Business risk comprises risks to income, as well as funding risk. Please refer to the chapter "Internal Capital Adequacy Assessment Process (ICAAP)" for further details on the quantification as well as the calculation results of the economic capital of business risk.

Property Risk

Property risk is defined as potential negative changes in the value of the Company's own property portfolio, due to a deterioration of the general real estate situation or a negative change of the specific characteristics of the individual property – caused by the property being vacant, changed usage options, building damages, investment requirements, changes to the legal framework or economic environment as well as other factors.

pbb Group's own property portfolio contains exclusively the result of salvage acquisitions carried out by subsidiaries of pbb Group. Since pbb sold all properties held during the year under review, it no longer carried any own property as at 31 December 2017. Salvage acquisitions are not regarded as a part of the Company's objectives (within the meaning of its business strategy) but are subject to a case-by-case assessment. In this context, the fundamental objective is to develop such properties with reference to comprehensive real estate criteria, such as costs vs. income, increasing occupancy ratios, optimising usage options as well as further development of the location, and to work out solutions in individual cases – or to subsequently sell the property with the most favourable impact on value.

By calculating economic capital at portfolio level, property risk as a whole is quantified, monitored and reported via the Capital Adequacy Assessment Process.

The administration and active risk management of salvage acquisitions is carried out by the Bank's Rescue Deal Management unit, which is specialised on this business area.

Pension risk

Pension risk is defined as the risk of incurring additional expenses due to insufficient capitalisation of pension obligations from defined benefit plans. Please refer to the chapter "Internal Capital Adequacy Assessment Process (ICAAP)" for further details on the quantification as well as the calculation results of the economic capital of pension risk.

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP)

Pursuant to section 91 (2) of the German Stock Corporation Act (AktG) and section 25a (1) of the German Banking Act (Kreditwesengesetz – "KWG"), credit institutions are obliged to set up adequate and effective internal procedures to determine and sustainably maintain their risk-bearing capacity. The Internal Capital Adequacy Assessment Process (ICAAP) is the subject of regulatory reviews (within the Supervisory Review and Evaluation Process – SREP); it complements the regulatory procedures under Pillar 1 of the Basel III framework, as laid down in the Capital Requirements Regulation ("CRR") and the Capital Requirements Directive IV ("CRD IV").

The risk inventory carried out in 2017 identified market risk, credit risk, business risk, operational risk and property risk as higher-level risks having an impact on capital and income; accordingly, these five types of risk were included in the ICAAP, and are being quantified using models or other methods. Within these types of risk, there are additional sub-risks on a granular level which were taken into account in the ICAAP during the period under review. Certain material types of risk, such as extension risk, settlement risk, realisation risk for defaulted loans, or pension risk, are integrated into the ICAAP in the form of buffers which are validated on a regular basis. Liquidity risk in the narrower sense is not being taken into consideration as part of calculating the risk-bearing capacity, since the Group's solvency is ascertained through a separate management approach.

pbb Group has implemented a risk-bearing capacity analysis based on the ICAAP. This analysis uses the concept of economic capital to quantify risk. Economic capital is defined as the quantity of capital required by a bank in order to cover the potential losses with a defined probability (the confidence level) over a time horizon of one year. It is calculated for all relevant types of risk, and aggregated to form total economic capital (after diversification effects). Evidence of the bank's risk-bearing capacity is provided by comparing aggregate diversified economic capital to the corresponding available financial resources: If the latter exceed the former, the risk-bearing capacity is evidenced.

To evidence its risk-bearing capacity, pbb Group applies a going-concern approach as one of two management approaches: this is explicitly based on the assumption that business will continue, and the bank's specific minimum regulatory capital ratios, as defined by the SREP, will be complied with. For this purpose, minimum ratios derived from SREP requirements are protected, thus ensuring that pbb Group will remain sufficiently capitalised, even upon occurrence of an adverse economic scenario and the associated losses.

In addition, pbb Group has also implemented a gone-concern approach as an additional management approach. The objective of the gone-concern approach is to protect senior creditors in a hypothetical liquidation scenario, after the bank has incurred extreme losses. Besides a higher confidence level, the gone-concern approach encompasses a different level of available financial resources and different risk exposures in the liquidation scenario, compared to the going-concern approach. Moreover, given the assumed liquidation, the gone-concern approach also takes hidden losses as well as credit spread risks of securities in the banking book into consideration.

The methods of calculating economic capital for the individual risk types, as well as current risk indicators, are described in greater detail in the following subsections, and in the section "Result of Risk-bearing Capacity Analysis".

Over and above the risk-bearing capacity analysis, the ICAAP comprises additional management tools, including a system of limits and early-warning thresholds, as well as a comprehensive monthly monitoring and reporting process. Moreover, stress tests are employed to analyse the impact of hypothetical developments on the risk-bearing capacity.

The results of the ICAAP and of the stress tests are regularly presented to the Management Board and the Risk Committee. The results are discussed there and if necessary management measures are defined.

Method Used for the individual Risk Types

Economic capital for quantifiable risks is determined using models or scenario analyses, and aggregated into overall bank risk using a mathematical-statistical approach, taking specific correlations between market and credit risks into account. Risks are calculated for a one-year period, using a confidence level of 99.91% for the gone-concern and 95% for the going-concern approach.

The methods of calculating economic capital for the individual material risk types for 2017 are explained below:

Credit Risk in the ICAAP

For calculating the credit risk at the portfolio level, pbb Group uses a credit portfolio model which is based on the approach of a so-called asset value model. The fundamental concept used involves the repeated simulation of correlated rating migrations for borrowers, whereby the associated portfolio revaluation is used to derive a statistical distribution of losses – which is in turn used to derive economic capital in terms of unexpected losses. Economic capital quantifies the maximum unexpected loss, given a pre-defined confidence level, which may be incurred due to rating migrations (including defaults) in the lending business within a single year. Besides the loss distribution of the credit portfolio, as a significant result of this process, credit risk capital can be assigned to individual borrower units in line with the risks involved, using the so-called expected shortfall principle. This ensures a fair, risk-adequate allocation to borrowers, and thus constitutes a major cornerstone in the risk-oriented management of the credit portfolio. During the observation period, correlations between borrowers, borrower groups and regions were reviewed during the course of the regular validation process; updated correlations were applied during the fourth quarter of 2017.

Credit risk reported comprises default and migration risk, transfer and conversion risk, as well as concentration risk. Certain elements of credit risk, such as the realisation risk for defaulted clients, settlement risk, and extension risk are not reported directly as part of credit risk, but are instead taken into account as deductions in the available financial resources. The credit portfolio model is used to examine the appropriateness of these deductions on a regular basis. Furthermore, tenant risk is backed by capital using a buffer for risks which can only be partially quantified, or which cannot be quantified at all.

Market Risk in the ICAAP (including Pension Risk)

The purpose of calculating economic capital for market risk is to identify potential financial losses resulting from price changes affecting all positions. In this process, the potential non-systematic losses are derived from an analysis of historical time series of specific influencing factors (risk factors), including interest rates, exchange rates and credit spreads, over the preceding seven years. The seven-year horizon ensures that economic phases which were not favourable for the bank are also taken into account in the model. Ultimately, using a simulation procedure and applying sensitivities of financial instruments to risk factors, the annual loss distribution of portfolio market value is determined, which allows to determine economic capital at the set confidence level.

Besides the risk types described in the "Market Risk" chapter, the ICAAP also encompasses pension risk, which is not disclosed directly under market risk; instead, it is deducted from available financial resources in the form of a buffer, which is validated on a regular basis.

Operational Risk in the ICAAP

Within the framework of the ICAAP, operational risk is quantified using the so-called loss distribution approach (LDA), whereby distributions for damage amounts and frequency are determined individually, using internal loss data from the loss database. External and scenario-based data is also included in the modelling approach. The full loss distribution is generated using Monte Carlo simulation techniques; diversification effects between the various sub-types of risk and modelling categories are not being considered. Furthermore, care is taken to ensure that the economic capital figure calculated for operational risk does not fall short of a floor defined at 90% of adjusted regulatory capital determined in accordance with the standardised approach pursuant to the EU Capital Requirements Regulation (575/2013 (EU) – "CRR"). Sub-types of operational risk which can only be partially quantified, or which cannot be quantified at all, such as for instance model risk, are covered by way of a capital buffer.

Business Risk in the ICAAP

Business Risk comprises risks to income, as well as funding risks. Adopting a conservative approach, planned income from new business is fully excluded from available financial resources thereby. The funding risk comprises funding requirement risk (defined as the risk of an unexpected increase in funding costs, due to higher funding requirements) and funding spread risk (defined as an increase in funding costs due to widened funding spreads). Funding risks are quantified via scenario-based approaches, and reported explicitly in business risk. Unquantifiable risks such as regulatory or strategic risk are backed by capital using a buffer for risks which can only be partially quantified, or which cannot be quantified at all, deducted from available financial resources.

Property Risk in the ICAAP

pbb Group's property risk is calculated using a mathematical-statistical model that enables the Bank to make statements on the probability of potential declines in the value of properties in its portfolio. Model parameters are essentially based on time series of representative real estate indices for the individual properties of the portfolio, and on valuations of individual properties.

Liquidity Risk in the ICAAP

Capital backing of liquidity risk in the narrower sense is not possible. Liquidity risk in the broader sense – i.e. the risk of higher funding costs for unexpected potential funding requirements, is mapped in economic capital for business risk.

Result of Risk-bearing Capacity Analysis

Going-Concern

The going-concern approach explicitly focuses on protecting regulatory minimum capitalisation, and hence, on the continuation of pbb Group's business activities during periods of difficult economic downturns. In order to prove the risk-bearing capacity the first step is to calculate the economic capital, using a confidence level of 95%. This includes the risk types which pbb Group defines as being material, namely credit risk, market risk, operational risk, funding risk (as part of the business risk), and property risk.

Going-concern: Economic capital

in € million	31.12.2017	31.12.2016	Change
Credit risk	238	188	50
Market risk	175	177	–2
Operational risk	25	21	4
Business risk	–	–	–
Property risk	–	1	–1
Total before diversification effects	**438**	**387**	**51**
Total after diversification effects	**403**	**357**	**46**
Available financial resources (free capital)	987	955	32
Excess capital	584	598	–14

An increase in diversified risk was observed as at the reporting date, mainly in terms of credit risk. This increase was mainly driven by a harmonisation of risk models by the European Central Bank, as well as regular adjustments of credit portfolio model parameters to prevailing developments and validation results. Economic capital for market risk only changed slightly as at the reporting date; during the course of the year, however, it was subject to fluctuations which were mainly due to changes in medium- and long-term interest rates, and in the credit spreads for some European countries. The increase in operational risk was due to regular model updates, whilst property risk was neutralised altogether during the period under review, given the sale of remaining own property and foreclosed assets.

Total risk (after diversification effects) is opposed by available financial resources in the form of so-called free capital, largely comprising available CET1 capital, plus accrued profits, less the CET1 capital necessary for covering the regulatory bank-specific minimum ratios according to the SREP and additional adjustment items. In accordance with the principle of prudence, an additional charge in relation to risk-weighted assets is taken into account in order to determine the CET1 capital necessary for covering the regulatory minimum ratios.

Calculation of free capital was modified in 2017. At the year-end 2016, free capital was calculated both as at the reporting date as well as 12 months forward, with the lower of the two used as free capital. (At the reporting date of 31 December 2016, this was the 12-month projection.)

This minimum-value analysis was replaced at the beginning of 2017; since then, free capital has been calculated as at the reporting date, backed up by an extensive early warning system, which closely monitors planned changes or trends in regulatory capitalisation and risk-weighted assets, over a 12-month forward period. The results of this forward-looking monitoring are incorporated into the overall risk-bearing capacity status, thus enabling the early identification of potentially adverse developments, and the timely adoption of measures if required. The changeover from projections to actual figures as at the reporting date was the main reason for the € 32 million increase in available financial resources.

To enhance the comparability of year-end figures, a pro-forma calculation as at 31 December 2016 was carried out, based on the figures prevailing at that date: this yielded available financial resources of €1,220 million, translating into a € 233 million reduction for the period under review. This decline was predominantly attributable to an increase in CET1 capital tied up for regulatory purposes, which in turn reflected higher risk-weighted assets (due to the harmonisation of risk models) as well as the update of the Bank's specific SREP ratios for 2017. Accordingly, the Bank had less CET1 capital available for covering economic risk at the reporting date.

The increase in economic capital (after diversification effects) and the simultaneous increase in available financial resources (compared to the 2016 Annual Report) together led to lower excess coverage. Overall, the Bank's risk-bearing capacity at the reporting date was evidenced under this approach. Likewise, the forward-looking monitoring of free capital also did not indicate any critical developments.

Going-concern: Economic capital according to segments

in € million	31.12.2017	31.12.2016	Change
Real Estate Finance	155	96	59
Public Investment Finance	20	14	5
Value Portfolio	141	177	−36
Consolidation & Adjustments	87	79	8
Total[1]	**403**	**357**	**46**

[1] The capital allocation procedure, as outlined above, was adjusted as at 31.12.2017: aggregate economic capital for pbb Group is now equivalent to the sum of economic capital figures for the segments. Whilst this was not yet the case as at 31.12.2016, application of this method would have reduced all figures across the segments by 2.7% – an adjustment that would have been negligible compared to other segment developments.

The largest change on a segment level during 2017 took place in the REF segment, where the harmonisation of risk models by the European Central Bank led to an increase in credit risk. The increase in economic capital in C&A was mainly due to an increase in market risk, whereas economic capital in the run-off Value Portfolio decreased due to lower credit risk exposure. Credit risk for the PIF segment increased, with rating downgrades of some public-sector debtors having a detrimental effect amongst other factors.

Gone-Concern

Supplementing the going-concern approach, pbb Group uses a gone-concern approach (liquidation perspective) as an additional, parallel management approach. The objective of the gone-concern approach is to guarantee protection of senior lenders in a hypothetical liquidation scenario, with a very high probability. pbb Group has selected a confidence level of 99.91% that is harmonised with the generally conservative parametrisation of the models. However, this liquidation scenario does not assume an opportunistic winding up of portfolios as postulated by the German Pfandbrief Act, and instead assumes an immediate sale of assets recognised at fair value and of securities in the investment book. In line with this assumption, over and above the material risks from the going-concern approach (as mentioned above), credit spread risks arising from securities in the banking book are additionally taken into account when calculating economic capital for market risk, whilst net hidden losses attributable to these securities is deducted when determining available financial resources. Furthermore, rating migration risks are included (as part of credit risk) for all positions of the credit portfolio.

Gone-concern: Economic capital

in € million	31.12.2017	31.12.2016	Change
Credit risk	1,213	1,140	73
Market risk	883	916	–33
Operational risk	78	85	–7
Business risk	21	15	6
Property risk	–	2	–2
Total before diversification effects	**2,195**	**2,158**	**38**
Total after diversification effects	**1,990**	**1,951**	**39**
Available financial resources before net hidden losses	3,179	3,267	–88
Net hidden losses	–	–	–
Available financial resources	**3,179**	**3,267**	**–88**
Excess capital	1,189	1,316	–127

Diversified economic capital increased during the period under review, mainly due to higher credit risk and business risk. As in the going-concern approach, a harmonisation of risk models by the European Central Bank was the main factor driving economic capital for credit risk. The increase was also due to regular adjustments of credit portfolio model parameters to prevailing developments, and to higher exposure given new business originated.

Business risk rose year-on-year, reflecting higher funding risk, particularly driven by new business transacted during the second half of 2017. The reduction in market risk was largely due to changes in interest rate risk and credit spread risk, reflecting changes in medium- and long-term interest rates, and in the credit spreads for some European countries. Following the disposal of a property in Spain in December 2017, pbb no longer holds any own property; as a result, property risk has been neutralised altogether, as in the going-concern approach. The change in the risk contribution from operational risk was the result of regular model adjustments carried out. Given the changes outlined above, overall economic capital after diversification effects increased.

In contrast, available financial resources declined by €88 million during 2017, mainly reflecting the repurchase of hybrid capital and maturities of subordinated capital instruments. However, this effect was partially offset by the issue of various Tier 2 bonds, an increase in equity in accordance with IFRS (mainly due to accrued profits), as well as the positive development of AfS reserves due to changes in credit spreads. Hence, excess coverage declined in 2017, compared to the 2016 year-end; evidence of the risk-bearing capacity in the gone-concern approach was thus provided as at the reporting date as well.

Should the European sovereign debt crisis escalate again, with credit spreads widening and credit ratings of numerous European debtors worsening as a consequence, both a corresponding increase in counterparty credit risk as well as a reduction in available financial resources (given an increase in net hidden encumbrances and lower equity) is to be expected, notwithstanding any countermeasures taken.

Gone-concern: Economic capital according to segments

in € million	31.12.2017	31.12.2016	Change
Real Estate Finance	656	437	219
Public Investment Finance	173	198	−25
Value Portfolio	865	1,087	−222
Consolidation & Adjustments	296	264	32
Total[1)]	**1,990**	**1,951**	**39**

[1)] The capital allocation procedure, as outlined above, was adjusted as at 31.12.2017: aggregate economic capital for pbb Group is now equivalent to the sum of economic capital figures for the segments. Whilst this was not yet the case as at 31.12.2016, application of this method would have reduced all figures across the segments by 2.7% – an adjustment that would have been negligible compared to other segment developments.

In the REF segment, a harmonisation of risk models by the European Central Bank was the main factor driving higher economic capital, especially for credit risk. The increase was also due to regular adjustments of credit portfolio model parameters to prevailing developments, and to higher exposure given new business originated.

The reduction in VP positions, caused by maturity effects, led to a corresponding decline in economic capital during the period under review, predominantly for credit risk. Economic capital for the PIF segment was lower for market risk and credit risk: whilst in terms of market risk, it was especially credit spread risk which declined due to lower bond exposure, credit risk saw an additional decline, reflecting the regular update of credit portfolio model parameters. The increase in economic capital for C&A was caused by a higher business risk – which is concentrated in this segment – as well as by higher market risk.

Opportunities

pbb Group observed a decline of credit spreads on the bond markets of some Southern European countries during the course of 2017. If confidence in European sovereign budgets were to be fully restored, narrowing credit spreads and systematic rating improvements for public-sector issuers might reduce risks, thus further strengthening available financial resources and hence, excess coverage in the ICAAP.

Stress Testing

Stress tests play an important role, both from a supervisory perspective and for the Bank's internal management. All activities, developments and decisions relating to stress tests are brought together within the Stress Test Committee, which reports directly to the Risk Committee.

As part of an integrated approach, the impact of macroeconomic stress scenarios on all material risks and on available financial resources under stressed market parameters was calculated for a horizon of several years during the period under review. These scenarios focus on an escalation of the sovereign debt crisis and on unfavourable developments on the real estate markets.

Furthermore, stress tests relating to economic capital and available financial resources are used to obtain a deeper understanding of the sensitivity of risk-bearing capacity to adverse changes in economic factors. In addition, inverse stress tests are conducted regularly. The results of these tests describe specific constellations of parameters under which the risk-bearing capacity would be at risk.

SREP

The objective of the Supervisory Review and Evaluation Process ("SREP") is a comprehensive ana- lysis of institutions supervised by the ECB – comprising an assessment of the business model, risk and corporate governance, risk situation, as well as capitalisation and liquidity status.

Based on the results of the analysis as well as using benchmark comparison, the ECB may impose minimum capitalisation or liquidity requirements, over and above existing regulatory requirements. As a key result of SREP, pbb Group has been required to maintain a minimum CET1 ratio of 9.0% for 2017 (excluding the countercyclical capital buffer, which varies according to country, and hence, for specific portfolios – as at 31 December 2017, it stood at 0.11%). This capital requirement is based on the Basel III transitional rules and comprises a Pillar 1 minimum capital requirement (4.5%), a Pillar 2 capital requirement (P2R: 3.25%) and the capital conservation buffer (CCB:1.25% phased-in for 2017). Furthermore, pbb Group had to fulfil a total capital requirement of 12.50% which was newly introduced 2017 compared to 2016 (excluding the countercyclical capital buffer, which varies according to country, and hence, for specific portfolios). It is based on the Basel III transitional rules and comprises a Pillar 1 minimum own funds requirement (8%), a Pillar 2 capital requirement (3.25%) and the capital conservation buffer (1.25% phased-in for 2017). Both requirements, the Group complied with at all times during the year under review.

Toward the end of the year, the ECB notified pbb Group of the regular annual re-determination of minimum capital requirements for 2018: with effect from 1 January 2018, pbb Group has been required to maintain a minimum CET1 ratio of 9.125% (excluding the countercyclical capital buffer, which varies according to country, and hence, for specific portfolios – as at 31 December 2017, it stood at 0.11%). This capital requirement is based on the Basel III transitional rules and comprises a Pillar 1 minimum capital requirement (4.50%), a Pillar 2 capital requirement (2.75%) and the capital conservation buffer (CCB: 1.875% phased-in for 2018). The CET1 minimum capital requirement that applies for 2018 also represents the threshold for mandatory calculation of a so-called maximum distributable amount (MDA). This generally limits distributions to the CET1 capital, new performance-based remuneration, and interest payments on additional Tier 1capital.

With effect from 1 January 2018 pbb Group has been required to maintain a total capital requirement of 12.625% (excluding the countercyclical capital buffer, which varies according to country, and hence, for specific portfolios – as at 31 December 2017, it stood at 0.11%). It is based on the Basel III transitional rules and comprises a Pillar 1 minimum own funds requirement (8.00%), a Pillar 2 capital requirement (2.75%) and the capital conservation buffer (1.875% phased-in for 2018). The minimum, fully phased-in total capital requirement (valid from 2019 onwards, following expiration of transitional provisions) will be 13.25%, assuming a constant Pillar 2 capital requirement and excluding the countercyclical capital buffer.

Key Regulatory Capital Ratios

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (the Capital Requirements Regulation or "CRR") has been in force since 1 January 2014. Together with Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC (the Fourth Capital Requirements Directive or "CRD IV"), the CRR forms the basis for determining regulatory capital requirements. Besides the minimum capital ratios, these regulations also govern requirements for the eligibility of capital instruments as well as the mandatory determination of regulatory capital, in line with the accounting standards used. For this reason, pbb has determined its regulatory capital ratios based on IFRS since 1 January 2014.

With the approval of the European Central Bank (ECB) granted in December 2016, pbb Group uses the waiver rule pursuant to Article 7 (3) of the CRR; the Group is therefore exempt from determining own funds requirements at a single-entity level.

The Advanced Internal Rating Based Approach (Advanced IRBA) is used to determine regulatory capital requirements for all material portfolios.

Own Funds

in € million	31.12.2017[1)]	31.12.2017 Basel III fully phased-in[1)2)]	31.12.2016 Basel III[3)]	31.12.2016 Basel III fully phased-in[2)3)]
CET1	2,569	2,552	2,553	2,492
Additional Tier 1	–	–	186	–
Tier 1	2,569	2,552	2,739	2,492
Tier 2	670	675	366	216
Own Funds	**3,239**	**3,227**	**3,105**	**2,708**

1) After confirmation of the 2017 financial statements, less the proposed dividend (subject to approval by the Annual General Meeting).
2) After expiry of all Basel III transitional regulations.
3) After confirmation of the 2016 financial statements and appropriation of profits.

Risk-weighted assets (RWA)

in € million	31.12.2017	31.12.2017 Basel III fully phased-in[1)]	31.12.2016 Basel III	31.12.2016 Basel III fully phased-in[1)]
Market risks	370	370	346	346
thereof interest rate risks	–	–	–	–
thereof foreign exchange risks	370	370	346	346
Operational risks	899	899	866	866
Credit risks	13,099	13,099	11,760	11,760
thereof CVA charge	294	294	312	312
Other RWA	147	147	141	141
RWA total	**14,515**	**14,515**	**13,113**	**13,113**

1) After expiry of all Basel III transitional regulations.

Capital ratios

in %	31.12.2017[1)]	31.12.2017 Basel III fully phased-in[1)2)]	31.12.2016 Basel III[3)]	31.12.2016 Basel III fully phased-in[2)3)]
CET1 Ratio	17.7	17.6	19.5	19.0
Tier 1 Ratio	17.7	17.6	20.9	19.0
Own Funds Ratio	22.3	22.2	23.7	20.7

1) After confirmation of the 2017 financial statements, less the proposed dividend (subject to approval by the Annual General Meeting).
2) After expiry of all Basel III transitional regulations.
3) After confirmation of the 2016 financial statements and appropriation of profits.

Recovery and Resolution Planning

Recovery and Resolution Planning

A uniform bank resolution regime is a key component of European Banking Union. With the European Bank Recovery and Resolution Directive ("BRRD"), which has harmonised recovery and resolution tools, and with the Regulation setting up the Single Resolution Mechanism ("SRM"), the legal basis therefore was established. In Germany, the BRRD was implemented through the German Act on Restructuring and Resolution (Sanierungs- und Abwicklungsgesetz – "SAG").

Recovery Planning

Pursuant to section 12 (1) of the SAG, every institution [subject to the Act] must prepare a recovery plan and submit it to the supervisory authorities. pbb Group's Recovery Plan is based on the Bank's accounting and financial reporting in accordance with IFRS; it takes numerous directives and regulations into account, including the EU Bank Recovery and Resolution Directive ("BRRD"), together with related directives and technical standards published by the European Banking Authority (EBA), the SRM, as well as the SAG. The objective of the Recovery Plan is to set out the measures that the institution may use in order to secure or restore its financial stability in the event of its assets, financial position and earnings materially deteriorating, in a theoretical crisis event, where such deterioration may threaten the institution's continued existence. A possible impact upon the financial sector as a whole is also considered in this context.

The monitoring of recovery indicators, as well as recovery governance, are enshrined within pbb Group's organisational as well as operating structures; they form part of the Bank's overall management.

The Recovery Plan is updated at least once a year, or on an event-driven basis, taking applicable regulatory requirements into account.

Resolution Planning

For institutions directly supervised by the ECB, the Single Resolution Board (SRB), based in Brussels, is responsible for resolution planning and has resolution powers. In this regard, the SRB cooperates with the national resolution authority (until 31 December 2017 German Financial Markets Stabilisation Agency (FMSA), since 1 January 2018 Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)). pbb Group supports resolution authorities in their duty of preparing a resolution plan in accordance with the BRRD and the SAG.

INTERNAL CONTROL SYSTEM AND RISK MANAGEMENT SYSTEM RELEVANT FOR THE CONSOLIDATED FINANCIAL REPORTING PROCESS

Concept

The internal control system and risk management system relevant for the consolidated financial reporting process ("IKS") comprise the principles, processes and measures used to ensure the effectiveness and efficiency of financial reporting, as well as to ensure compliance with statutory provisions. The objective of the IKS system is to ensure that the Consolidated Financial Statements comply with the relevant rules in respect of the Consolidated Financial Statement. Risks that may prevent this overall objective from being achieved are identified and assessed in the process; any risks identified are limited and their effect on the financial statements and their appropriate presentation are reviewed. The IKS is an integral part of the risk management system. It aims to implement controls so as to provide sufficient assurance that, despite the risks identified, the financial statements are prepared in accordance with the relevant rules. However, an IKS cannot provide an absolute guarantee that these goals will be met.

pbb Group's IKS is reflected in its organisational structure and workflows. With respect to the organisational structure, it primarily comprises the Management Board, the Supervisory Board as the supervisory body, the Audit Committee established by the Supervisory Board, the Finance division reporting to CEO/CFO and the Group Finance Committee (GFC).

pbb's Management Board prepares Consolidated Financial Statements and a Combined Management Report. In connection with the requirement to establish a Group-wide IKS, the whole Management Board of pbb is also responsible for the form – i.e. the concept, implementation, maintenance and monitoring – of an appropriate and effective IKS. All strategies are decided on by the whole Management Board on the basis of recommendations made by the CEO/CFO or the GFC.

The Supervisory Board is tasked with advising and monitoring the Management Board. It also has audit and reporting-related obligations. pbb's Supervisory Board established an Audit Committee to support its activities in this area. In accordance with section 100 (5) of the Aktiengesetz (AktG – German Stock Corporation Act), at least one member of the Supervisory Board must have expertise in accounting or auditing. Pursuant to the so-called EU Audit Reform, pbb's Audit Committee will have to comply with stricter requirements, with effect from 17 June 2016: for example, the committee as a whole needs to have extensive knowledge of the banking sector (the concept of "sector competence"). Given the relevant professional experience of every Audit Committee member, the Committee already has the sector competence which will be required in the future.

Group Internal Audit supports the Management Board and the Supervisory Board in its control function by performing independent audits.

At 31 December 2017, the CEO/CFO was responsible for Communications, Corporate Office/Compliance, Finance, Group Internal Audit, Human Resources, Legal and Information Technology. The Finance division comprises the Accounting, Financial Reporting, Procurement Services & Corporate Controlling, Regulatory Reporting, Tax department as well as the cross-functional Data Governance. The Finance division prepares the Consolidated Financial Statements in accordance with IFRS as applicable in the EU and provides the capital market information relevant to accounting. pbb Group companies and branches prepare their financial statements in accordance with the relevant local legal requirements. These financial statements are standardised around uniform Group accounting policies in accordance with IFRS for the purposes of Group financial reporting. Each entity included in the Consolidated Financial Statements reports its statement of financial position, income statement, and notes to a central department in Group Accounting via the consolidation software. Group Accounting translates the foreign currency positions into euros using the consolidation software. The data are validated, analysed and consolidated.

The GFC issues recommendations to the Management Board. These include, among other things, establishing and monitoring the accounting and reporting policies as well as workflows for all units and segments. The GFC is composed of the members of the Management Board, the chief representatives and the managers of the Finance, Risk Management & Control and Treasury divisions.

With respect to workflows, the IKS is based on the objective of largely standardised the processes and software. Core activities and processes are governed by policies, according to which the four eye principle must be applied in all material transactions. Data and IT systems are protected against unauthorised access. In addition, certain relevant information is only made available to those employees who need it for their work. Where necessary, results are agreed at Group level.

Implementation

pbb Group implemented the concept for the IKS to identify, assess and limit risks.

pbb Group has introduced a control attestation process to strengthen the IKS. After adjusting for risk, all the significant controls of divisions of pbb Group are recorded and controlled in this process. These key controls are reviewed and confirmed by the divisions in a regular reporting process. Corporate Office/Compliance and Group Internal Audit review these in a downstream process.

There is a clear separation of functions within the Finance division. The GFC and other committees, as well as divisional meetings serve as overarching links between the different tasks. In addition, executing, accounting and administrative activities such as payment transfers and payment entries are clearly separated or subject to the four eye principle. Furthermore, the units included in the Consolidated Financial Statements report their data to a central Group department, ensuring the subsequent processing in a uniform manner.

Systems-based and non-systems-based risk management measures and internal controls are used within the workflows. At the systems level, standard software is used as far as possible to post, reconcile, check and report data so as to avoid errors. The same applies to consolidation, which is performed using standard market software. The consolidation software supports the reconciliation of intragroup transactions at a technical level in a clearly defined process, ensuring that these transactions are eliminated correctly and in full. Data from the entities included in the Consolidated Financial Statements are reported using a uniform, standardised chart of accounts. Automated plausibility checks are performed on the data reported by subsidiaries for consolidation purposes, for example. The largest part of assets and liabilities is held by the parent company pbb. The balances carried forward are checked by the system. New controls and votes were introduced to validate the balances carried forward. To prevent data loss, the data in the consolidation software are backed up on a daily basis and the backup is stored on tape. As a general rule, pbb Group's software is protected against unauthorised access by a clearly defined administration concept and authorisation rules.

Alongside the systems-based measures, pbb Group has implemented manual and non-systems-based processes. For example, the correctness and completeness of the data reported are checked using a standardised process involving variance analyses over time, among other things. In addition, the consolidated statement of financial position and the consolidated income statement are determined on a monthly basis. Projections and forecasts are also drawn up. Mandatory Group-wide accounting guidelines are defined and communicated in a manual, among other ways. These guidelines cover the analysis and interpretation of new and existing IFRS standards and interpretations so as to ensure the application of uniform accounting policies across the Group. Generally applicable valuation methods are used. The procedures used and the underlying parameters are reviewed at regular intervals and modified as necessary.

In order to improve the quality of controls, various divisions are integrated in certain processes and are required to reconcile. For example, the interdepartmental new product process and the review of existing products (with a right of veto by the divisions Finance and Risk Management & Control) are designed to ensure that products are recognised in the financial reporting in a uniform and systematic manner. In addition, the processes of the market valuations undertaken by Risk Management & Control are coordinated in the GFC. Annual and interim report preparation is another example of interdepartmental coordination. All of the areas involved must sign off on these reports before they are officially prepared by the Management Board (subcertification process), creating an additional level of control for the products to be disclosed. All of the divisions affected agree in advance on the content of material sections of the annual and interim reports in editorial meetings.

As part of the IKS, pbb Group takes measures to combat fraud and intentional violations that negatively impact the Group. Fraud against pbb Group includes theft, embezzlement, or breach of fiduciary duty, as well as intentional accounting errors in connection with the consolidated financial reporting process. pbb Group identifies and evaluates risks and takes measures to prevent such fraudulent activities and intentional violations. In addition, a systems-based concept is used to train employees in compliance regulations.

Maintenance

pbb Group reviews and improves its IKS on an ongoing basis, amongs others, as part of Management Board and GFC meetings, to ensure that risks are identified, assessed and limited as accurately and as comprehensively as possible. Consequently, the IKS is adapted to new circumstances such as changes to pbb Group's structure and business model or new statutory requirements.

The risk of fraud and intentional violations is regularly analysed in order to take defensive measures. Factors taken into account include suspicious events and changes in pbb Group's situation and that of individual employees.

Any changes to processes and IT systems required as a result of legislative amendments are implemented as separate interdepartmental projects with a clear allocation of functions. At the same time, the IKS is also adapted to the changes in the provisions.

pbb Group's IT landscape is continually enhanced. In the reporting year a project to further optimise the finance and risk IT target architecture has been successfully completed. Specifically, this project comprises, inter alia, the implementation of the requirements resulting from IFRS 9 and other regulatory changes, as well as the adjustment of the IT systems and processes used to prepare financial statements. For example, a new subledger was introduced which is used to optimise processes. In particular the automation affects fair value accounting and hedge accounting. As a result, Excel-based solutions used so far have been replaced. In addition control activities like the reconciliation of the general ledger and subledgers habe been further automated.

Monitoring

The Group Internal Audit division is in particular responsible for checking that processes and procedures are carried out in a due and proper manner and identifying inefficiencies, irregularities or manipulation. The Group Internal Audit division also reviews the effectiveness and appropriateness of the IKS in an independent and risk-oriented manner in line with the rules set out in the Minimum Requirements for Risk Management (MaRisk), and identifies any weaknesses in risk identification, assessment and mitigation. This also includes reviewing the IT systems and the processes and controls of the Finance functions. Concrete action plans with specific deadlines are drawn up and their implementation monitored to remedy the identified shortcomings. Group Internal Audit as an independent division is not integrated into the workflow, nor is it responsible for the results of the audited process. In order to be able to carry out its duties, Group Internal Audit has a full and unrestricted right to information on activities, processes and the IT systems.

As the body responsible for supervising and advising the Management Board, the Supervisory Board may inspect and examine the Company's books and assets in accordance with section 111 (2) of the AktG. In addition, the Management Board reports regularly to the Supervisory Board. Group Internal Audit reports to the whole Management Board and the Audit Committee of the Supervisory Board at appropriate intervals, however, at least quarterly. In accordance of section 25 d (8) of the German Banking Act (Kreditwesengesetz) the Chairman of the Audit Committee can directly obtain information from the heads of Group Internal Audit and Risk Management & Control. The Supervisory Board discusses the IKS. The Supervisory Board appoints the auditors of the Consolidated Financial Statements and the Combined Management Report. The Supervisory Board approves the Consolidated Financial Statements and the Combined Management Report prepared by the Management Board and audited by the independent auditors.

The auditors of the financial statements attend the Supervisory Board meetings relating to the financial statements and all of the meetings of pbb Group's Audit Committee to report on the material findings of their audit including material weaknesses in the IKS. Where relevant, the auditors immediately eport findings and issues that emerge during the audit and that are material for Supervisory Board to carry out their duties. The Supervisory Board discusses the focus of the audit with the auditors in advance.

Remuneration Report

The Remuneration Report follows the recommendations of the German Corporate Governance Code (the Code) and includes the information required pursuant to the German Commercial Code (Handelsgesetzbuch – HGB) and in accordance with the International Financial Reporting Standards (IFRS).

In the first section, the Remuneration Report provides detailed information on the structure and components of remuneration for the Management Board and Supervisory Board. Furthermore, the first section of the report contains information on the individual remuneration granted by the Supervisory Board to pbb's Management Board members, and on the amount of remuneration for the Supervisory Board members. The second section of the Remuneration Report provides information on the remuneration system and the remuneration structure for employees of pbb Group. The 2017 quantitative remuneration information on employees, to be disclosed in compliance with Article 450 of the Capital Requirements Regulation ("CRR") in conjunction with section 16 of the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – "InstVergV"), is scheduled to be disclosed after completion of the remuneration review during the second quarter of 2018, as part of pbb's Remuneration Report (according to the InstVergV). This information will be available online under www.pfandbriefbank.com as soon as the remuneration review is completed. The third section of the Remuneration Report comprises information on the governance structure regarding remuneration.

REMUNERATION SYSTEM AND REMUNERATION STRATEGY OF pbb GROUP

The remuneration system and the remuneration strategy of pbb Group are integral components of the Group's business and risk strategy. The remuneration strategy sets out the framework for the performance and remuneration of Management Board members and employees of pbb Group. The remuneration strategy was developed as part of the business and risk strategy, involving the relevant business divisions and the Remuneration Officer. The remuneration strategy was updated in 2017, and the Management Board and Supervisory Board approved the latest amendments. All employees of pbb Group have access to the remuneration strategy via the intranet. The remuneration strategy is subject to regular revision, and may be subject to extraordinary revision in case of amendments to the business and risk strategy.

The remuneration strategy aims to guarantee a performance-oriented remuneration in line with the market – one that is geared to achieving the targets enshrined in the business and risk strategy. pbb's business management is targeted towards a sustainable enhancement of pbb Group's profitability, whilst maintaining the Group's strict risk policy. Performance measurement at institutional level is one of the key elements in achieving these objectives. Referring to performance measurement at institutional level, particular attention is given to (key) performance indicators – as defined within the business and risk strategy as well as business planning – which particularly reflect the defined business and risk strategy, fulfil all regulatory requirements regarding risk, capital and liquidity, and are transparent as well as comprehensible. The performance at institutional level, derived from the performance indicators in line with the business and risk strategy, forms the basis for the total variable remuneration available for disbursement at pbb Group. Hence, variable remuneration of Management Board members and all other employees is directly linked to – and driven by – pbb Group's business and risk strategy. Moreover, this guarantees compatibility of the remuneration system with the Group's capital and liquidity planning, as stipulated in the applicable regulatory requirements. Performance measurement in connection with variable remuneration comprises two other performance levels: division performance and individual performance. Targets for these subsequent performance levels will be derived from pbb Group's business and risk strategy.

Besides the required compatibility with the Group's business and risk strategy, the remuneration strategy is also an integral part of the HR strategy. pbb Group's business model requires highly qualified employees, possessing expert knowledge. The key objective of pbb Group's strategy therefore is to attract, retain and develop – for the long run – highly qualified employees with expert knowledge, a high quality awareness, customer focus, leading competence at both divisional and project level, the willingness to be deployed flexibly, and a high degree of entrepreneurial thinking. Capable and dedicated employees are key to achieving the objective set in the business and risk strategy: that is, to increase income by generating profitable new business in line with the strict risk policy. Besides the Group's differentiated personnel planning, restructuring strategy and the diversified internal and external qualification programme, implementation of the Group's strategy is based on variable remuneration, featuring incentives for individual performance, and promoting cooperation between business divisions, departments and teams. With the variable remuneration components offered by pbb Group, employees have the chance to participate directly in pbb's success.

Implementation of regulatory requirements regarding remuneration systems of banks is another key element in pbb Group's remuneration strategy. The aim of pbb's remuneration system is to reflect the basic regulatory principle of appropriateness regarding the amount and structure of individual remuneration components. Another goal is to avoid incentives for taking disproportionately high risks. Going forward, the total remuneration as well as the individual remuneration components of employees and Management Board members, will be subject to regular review in order to establish an appropriate relationship of remuneration to function and performance, as well as to pbb Group's overall performance. At present, pbb prepares adjustments to its remuneration system in order to implement the revised InstVergV dated 4 August 2017 (one of the adjustments has to be made to reflect the new clawback requirements for risk takers). pbb Group is regularly supported by independent external remuneration experts (hkp Germany), and an external legal advisor (Gleiss Lutz). pbb Group intends to implement any future regulatory amendments without undue delay.

The current remuneration system was implemented in 2016; during 2017 it was used without amendments. Within this context, pbb Group's objective is to implement its remuneration system for all domestic and international staff in as uniform a manner as possible with regard to content, insofar as this is meaningful content-wise, and is legally and regulatory permissible (or required).

MANAGEMENT BOARD

Principles

In principle, remuneration for members of pbb's Management Board is designed to ensure a performance-oriented payment, taking the Company's size and international business activities into account. Besides a peer review, based on remuneration for Management Boards and senior management roles in similar companies in Germany and abroad, and a comparison to remuneration for higher functions within pbb Group, the Company's financial situation and performance is also taken into account. The Remuneration Committee and the plenary meeting of the Supervisory Board discussed the amount, structure and appropriateness of Management Board remuneration in 2017, also involving external advisors.

Remuneration Components

The service contracts entered into with Management Board members generally provide for the following remuneration components:

> non-performance related (monetary) remuneration plus non-cash remuneration
> performance-related variable remuneration
> pension commitment

Non-performance-related Remuneration

Fixed remuneration levels are reviewed, and adjusted if appropriate, at regular intervals, using an external market survey. No automatic adjustment will take place. In 2017, fixed remuneration amounted to € 500,000 gross per annum for each Management Board member.

In addition, pbb granted non-cash benefits to Management Board members which are within customary scope. These non-cash benefits include the provision of a company car (including driver), whereby the Company covers all costs incurred in this respect. Where a member of the Management Board was required to maintain a second household, the Company paid the cost for a second apartment at the place of work, in general for a maximum of two years. Moreover, the Company has taken out a group accident insurance policy for the members of the Management Board. The Management Board members pay taxes due on these benefits in kind.

Performance-related variable remuneration

The 2017 variable remuneration system, which was unadjusted from the previous year, was designed as an appropriate and transparent system which sustainably takes pbb Group's development into account. pbb's remuneration system is in line with the regulatory requirements for remuneration systems as set out in the CRD IV, the German Banking Act (Kreditwesengesetz – "KWG") and the InstVergV, and in relation to the members of the Management Board, the requirements of the German Stock Corporation Act (Aktiengesetz – "AktG"), and the German Corporate Governance Code (the "Code"). Moreover, provisions under contractual arrangements as well as the remuneration principles of the FMS (as amended in February 2012) were observed.

Variable remuneration is paid in cash. pbb Group introduced a share-based remuneration system with cash settlement, where the amount of the variable remuneration is influenced by the performance of the pbb share as part of the sustainability components. pbb Group did not grant any share options in 2017.

The variable remuneration component is determined on the basis of an individual calculatory reference value. This is a reference value which reflects the amount of variable remuneration attributed to a performance level of 100% on all relevant performance levels. The calculatory reference value for 2017 has been set at a uniform level of € 200,000 for all Management Board members.

The variable remuneration granted to each Management Board member for a given year is capped at 150% of his/her individual calculatory reference value, as set out above.

pbb has not sought any resolution by the Annual General Meeting pursuant to section 25a (5) sentence 5 of the KWG; the variable remuneration for members of the Management Board must therefore not exceed 100% of their fixed remuneration.

In line with section 4.2.3 of the Code, the service contracts entered into with Management Board members comprise for 2017 uniform caps regarding the maximum amount of remuneration. According to these contractual stipulations, the total remuneration for each Management Board member for a given calendar year is capped at €850,000, including the basic annual remuneration (€500,000), variable remuneration (maximum of €300,000), and non-cash benefits.

Examination of Requirements according to section 7 of the InstVergV
Granting of variable remuneration is subject to the prior determination of a total amount of variable remuneration (taking into account the requirements of section 7 of the InstVergV). The total amount of variable remuneration is determined by the Supervisory Board at the end of each financial year, within the framework of a formal and transparent process. The Supervisory Board approved the total amount of variable remuneration for 2017 as part of its review in 2018. For the examination of requirements according to section 7 of the InstVergV, pbb uses relevant recovery threshold values as indicators in line with the reporting on recovery and resolution plans. Provided all requirements were fulfilled and the Group disclosed (positive) consolidated profit in its IFRS financial statements, a total amount available for disbursement as variable remuneration at pbb is then determined. As a rule, if a consolidated net loss was disclosed – in particular if such net loss translated into a depreciation of the enterprise value – no total amount available for disbursement as variable remuneration at pbb is determined.

Performance Measurement
The amount of variable remuneration is determined on three levels: (i) the institution's performance, (ii) the performance of the organisational unit (the Management Board member's respective area of responsibility) and (iii) the Management Board member's individual performance.

As the first step of performance measurement, the calculatory reference values (as adjusted through the determination of the total amount of the variable remuneration) are distributed among the three performance measurement levels. 80% is allocated to an institution pool (exclusively linked to the institution's performance) and 10% each to a division pool (exclusively linked to the performance of the respective Management Board member's area of responsibility) and a personal pool (exclusively linked to the individual performance of the respective Management Board member). Based on these calculatory pools, the performance is measured on the three levels of institution, area of responsibility, and individual. On the basis of this performance measurement, a specific share of the calculatory reference value is calculated and allocated to the respective member of the Management Board (envisaged personal reward value – "EPR value").

The Supervisory Board reviewed and approved the 2017 target agreements with Management Board members in November 2016 including institutional targets, divisional targets and individual targets. As part of the corresponding performance determination, the Supervisory Board reviewed and established the level of target achievement in February/March 2018. As in the previous year, the institution's performance for 2017 was calculated as follows: the level of target achievement for the (adjusted) IFRS consolidated profit before tax, plus the level of target achievement for the risk-reward profile, determined as the ratio between net margin x average portfolio volume and risk-weighted assets. Furthermore, additional modifiers may have an impact on overall target achievement at institutional level, including – in particular – general and administrative expenses, efficiency projects, and the total capital ratio. The target achievement at institutional level relevant to the variable remuneration in 2017 depends on the institution's performance for several years. Therefore, pbb fulfils the regulatory requirement of having a multiple-year assessment basis for the variable remuneration.

The divisional and individual targets were derived from the corporate targets and the business plans made for the respective financial year. In 2017, the target agreements with the Management Board members comprised targets on new business volume, risk management levels and funding, and particularly targets regarding strategic projects of pbb Group, the promotion of talents and women as well as the expansion and diversification of the investor base.

Disbursement Structure
As a significant institution as defined by section 17 of the InstVergV, pbb must in particular observe the requirements of section 20 of the InstVergV regarding variable remuneration of risk takers. Members of the Management Board are risk takers, as defined by the Delegated Regulation (EU) 604/2014. The disbursement structure of the variable remuneration for Management Board members is therefore generally subject to the following conditions:

The EPR value is broken down into a disbursement portion and a deferral portion, whereby the purpose of the latter includes establishing a multi-year assessment basis within the meaning of the company law and thus gear the variable remuneration of the Management Board members upon the Company's long-term performance.

The disbursement portion for Management Board members amounts to 40% of their personal EPR value, with the deferral portion equivalent to 60%. 50% of the disbursement portion is paid out in cash when the conditions for disbursement have been met. The remaining 50% is disbursed after a retention period of one year, whereby the amount is adjusted in line with the sustainability component to be applied. The variable remuneration depending on the sustainability component is calculated based on the performance of pbb's share price (virtual options; no share option program). For this purpose, the applicable amount of variable remuneration is multiplied with a factor representing the ratio between the average performance of pbb's share price observed during the month of February of the year subsequent to the financial year for which the variable remuneration is to be granted, and the average performance of pbb's share price observed during the month of February after another twelve-month period has elapsed. The EPR value portions linked to the sustainability component are granted on the basis of the performance of the pbb share.

The deferral period for the deferral portion due to Management Board members is five years. The deferral portion is vested in line with current regulatory requirements (pro-rata vesting under a synchronised approach). The malus test, which may lead to a reduction in the deferral portion, considers ex-post negative performance contributions affecting the performance of the institution, the organisational unit and the individual Management Board member (back-testing), as well as the personal misconduct (knock-outs) and the relevant financial conditions for disbursement (pursuant to section 7 of the InstVergV). Following this malus test, 50% of the relevant deferral portion is subject to an additional one-year retention; it is linked during this period to pbb's sustainable development, in line with the applicable sustainability component.

Therefore, half of the variable remuneration of Management Board members is linked to the performance of the pbb share price as part of the sustainability component.

Conclusion and Termination of Service Contracts

No new service contracts were concluded in 2017. pbb entered into a service contract with Andreas Arndt in 2016 due to his early re-appointment as a member of the Management Board, which became effective as from 15 April 2017. In the financial year 2017, the Supervisory Board carried out a review of the appropriateness of variable remuneration for Management Board members. The Supervisory Board resolved, as part of this review, to increase the calculatory reference value for Andreas Arndt's variable remuneration by €40,000, to €240,000, taking effect 1 January 2018. With this measure, pbb takes appropriately into account the customary difference in remuneration between the Chairman of the Management Board and the other Management Board members, and follows the overall development customary in the market regarding the remuneration of Management Board chairmen.

The service contract of Dr Bernhard Scholz was terminated on 30 April 2017 after his retirement from the Management Board.

Disclosure of Management Board remuneration in Accordance with the German Corporate Governance Code

Pursuant to section 4.2.5 of the Code, which has been detailed further by way of sample tables attached to the Code, benefits granted for the year under review (including target or expected values), as well as the allocation (i.e. the actual amounts disbursed for the year under review) for each member of the Board of Managing Directors, as disclosed. Both benefits and allocations must be broken down by fixed remuneration, non-cash benefits, variable remuneration and pension expenses (that is, service cost as defined under IAS 19). For reasons of clarity, these details have been compiled into only one table for each member of the Management Board who was in office during 2017.

Andreas Arndt
CEO/CFO

	Benefits granted				Allocation	
in € thousand	**2017**	Minimum	Maximum	**2016**	**2017**	**2016**
Fixed remuneration	500	500	500	500	500	500
Fringe benefits[1]	18	18	18	21	18	21
Total	**518**	**518**	**518**	**521**	**518**	**521**
One-year variable remuneration for 2017	50	–	60	–	–	–
Multi-year variable remuneration for 2017						
Disbursement portion subject to holding period 2017 (second quarter 2019)	50	–	60	–	–	–
Deferral 2017 (second quarter 2019)[2]	30	–	36	–	–	–
Deferral 2017 (second quarter 2020)[2]	30	–	36	–	–	–
Deferral 2017 (second quarter 2021)[2]	30	–	36	–	–	–
Deferral 2017 (second quarter 2022)[2]	30	–	36	–	–	–
Deferral 2017 (second quarter 2023)[2]	30	–	36	–	–	–
One-year variable remuneration for 2016	–	–	–	49	49	–
Multi-year variable remuneration for 2016						
Disbursement portion subject to holding period 2016 (second quarter 2018)	–	–	–	49	–	–
Deferral 2016 (second quarter 2018)	–	–	–	30	–	–
Deferral 2016 (second quarter 2019)	–	–	–	30	–	–
Deferral 2016 (second quarter 2020)	–	–	–	30	–	–
Deferral 2016 (second quarter 2021)	–	–	–	30	–	–
Deferral 2016 (second quarter 2022)	–	–	–	30	–	–
Total	**768**	**518**	**818**	**769**	**567**	**521**
Service[3)4)]	696	696	696	597	696	597
Total remuneration	1,464	1,214	1,514	1,366	1,263	1,118

[1] Including taxable non-cash benefits within the customary scope.
[2] The disclosed maximum amounts may be exceeded at allocation, given pbb's share price performance.
[3] Service expenses according to the German Commercial Code (HGB) amounted to € 446,000 (rounded) in 2017 (2016: € 425,000 (rounded)).
[4] The increased service expenses necessary to provide unchanged pension commitments are based on the persistently low interest rate of 1.5%.

Thomas Köntgen
Deputy CEO,
Treasury and Real Estate Finance

in € thousand	Benefits granted 2017	Benefits granted Minimum	Benefits granted Maximum	Benefits granted 2016	Allocation 2017	Allocation 2016
Fixed remuneration	500	500	500	500	500	500
Fringe benefits[1]	25	25	25	31	25	31
Total	**525**	**525**	**525**	**531**	**525**	**531**
One-year variable remuneration for 2017	50	–	60	–	–	–
Multi-year variable remuneration for 2017						
Disbursement portion subject to holding period 2017 (second quarter 2019)	50	–	60	–	–	–
Deferral 2017 (second quarter 2019)[2]	30	–	36	–	–	–
Deferral 2017 (second quarter 2020)[2]	30	–	36	–	–	–
Deferral 2017 (second quarter 2021)[2]	30	–	36	–	–	–
Deferral 2017 (second quarter 2022)[2]	30	–	36	–	–	–
Deferral 2017 (second quarter 2023)[2]	30	–	36	–	–	–
One-year variable remuneration for 2016	–	–	–	49	49	–
Multi-year variable remuneration for 2016						
Disbursement portion subject to holding period 2016 (second quarter 2018)	–	–	–	49	–	–
Deferral 2016 (second quarter 2018)	–	–	–	30	–	–
Deferral 2016 (second quarter 2019)	–	–	–	30	–	–
Deferral 2016 (second quarter 2020)	–	–	–	30	–	–
Deferral 2016 (second quarter 2021)	–	–	–	30	–	–
Deferral 2016 (second quarter 2022)	–	–	–	30	–	–
Total	**775**	**525**	**825**	**779**	**574**	**531**
Service[3][4]	663	663	663	688	663	688
Total remuneration	1,438	1,188	1,488	1,467	1,237	1,219

[1] Including taxable non-cash benefits within the customary scope.
[2] The disclosed maximum amounts may be exceeded at allocation, given pbb's share price performance.
[3] Service expenses according to the German Commercial Code (HGB) amounted to € 343,000 (rounded) in 2017 (2016: € 417,000 (rounded)).
[4] The increase of service expenses is low besides the persisting low interest rate of 1.5%. The reason for this is that for 2016 the adjustment of the annual tranches for the pension commitment of Thomas Köntgen was taken into account owing to his early reappointment.

Andreas Schenk
CRO

in € thousand	Benefits granted 2017	Minimum	Maximum	2016	Allocation 2017	2016
Fixed remuneration	500	500	500	500	500	500
Fringe benefits[1]	9	9	9	12	9	12
Total	**509**	**509**	**509**	**512**	**509**	**512**
One-year variable remuneration for 2017	50	–	60	–	–	–
Multi-year variable remuneration for 2017						
Disbursement portion subject to holding period 2017 (second quarter 2019)	50	–	60	–	–	–
Deferral 2017 (second quarter 2019)[2]	30	–	36	–	–	–
Deferral 2017 (second quarter 2020)[2]	30	–	36	–	–	–
Deferral 2017 (second quarter 2021)[2]	30	–	36	–	–	–
Deferral 2017 (second quarter 2022)[2]	30	–	36	–	–	–
Deferral 2017 (second quarter 2023)[2]	30	–	36	–	–	–
One-year variable remuneration for 2016	–	–	–	49	49	–
Multi-year variable remuneration for 2016						
Disbursement portion subject to holding period 2016 (second quarter 2018)	–	–	–	49	–	–
Deferral 2016 (second quarter 2018)	–	–	–	30	–	–
Deferral 2016 (second quarter 2019)	–	–	–	30	–	–
Deferral 2016 (second quarter 2020)	–	–	–	30	–	–
Deferral 2016 (second quarter 2021)	–	–	–	30	–	–
Deferral 2016 (second quarter 2022)	–	–	–	30	–	–
Total	**759**	**509**	**809**	**760**	**558**	**512**
Service[3][4]	611	611	611	474	611	474
Total remuneration	1,370	1,120	1,420	1,234	1,169	986

[1] Including taxable non-cash benefits within the customary scope.
[2] The disclosed maximum amounts may be exceeded at allocation, given pbb's share price performance.
[3] Service expenses according to the German Commercial Code (HGB) amounted to € 277,000 (rounded) in 2017 (2016: € 268,000 (rounded)).
[4] The increased service expenses necessary to provide unchanged pension commitments are based on the persistently low interest rate of 1.5%.

Dr Bernhard Scholz
Credit Markets/Public Finance (until 30 April 2017)

in € thousand	Benefits granted 2017	Minimum	Maximum	2016	Allocation 2017	2016
Fixed remuneration	167	167	167	500	167	500
Fringe benefits[1]	4	4	4	12	4	12
Total	**171**	**171**	**171**	**512**	**171**	**512**
One-year variable remuneration for 2017	17	–	20	–	–	–
Multi-year variable remuneration for 2017						
Disbursement portion subject to holding period 2017 (second quarter 2019)	17	–	20	–	–	–
Deferral 2017 (second quarter 2019)[2]	10	–	12	–	–	–
Deferral 2017 (second quarter 2020)[2]	10	–	12	–	–	–
Deferral 2017 (second quarter 2021)[2]	10	–	12	–	–	–
Deferral 2017 (second quarter 2022)[2]	10	–	12	–	–	–
Deferral 2017 (second quarter 2023)[2]	10	–	12	–	–	–
One-year variable remuneration for 2016	–	–	–	49	49	–
Multi-year variable remuneration for 2016						
Disbursement portion subject to holding period 2016 (second quarter 2018)	–	–	–	49	–	–
Deferral 2016 (second quarter 2018)	–	–	–	30	–	–
Deferral 2016 (second quarter 2019)	–	–	–	30	–	–
Deferral 2016 (second quarter 2020)	–	–	–	30	–	–
Deferral 2016 (second quarter 2021)	–	–	–	30	–	–
Deferral 2016 (second quarter 2022)	–	–	–	30	–	–
Total	**255**	**171**	**271**	**760**	**220**	**512**
Service[3)4)]	42	42	42	117	42	117
Total remuneration	297	213	313	877	262	629

[1] Including taxable non-cash benefits within the customary scope.
[2] The disclosed maximum amounts may be exceeded at allocation, given pbb's share price performance.
[3] Due to vested pension claims from his years of service for HRE Holding, Dr Bernhard Scholz receives an annual pension of 1% for each full year of service as a member of pbb's Management Board, subject to a cap of 15%; the rate of increase for the period from 1 September 2016 to 30 April 2017 (the date on which Dr Scholz's service contract has expired) will be determined pro rata temporis, and will thus amount to 0.67% for this period.
[4] The Service expenses according to the German Commercial Code (HGB) amounted to € 60,000 (rounded) in 2017 (2016: € 85,000 (rounded)).

Pension Commitments

No commitment to pension benefits for old age, for occupational and general disability, were made to members of the Management Board who were in office in 2017.

As a member of pbb's Management Board, Andreas Arndt receives a pension in the amount of 5.2% of his basic annual remuneration for each completed year of service, subject to a cap of 60%. The pension entitlements are considered to be immediately vested. They may be drawn upon once the age of 62 has been reached.

As member of pbb's Management Board, Thomas Köntgen receives a pension in the amount of 5.2% of his basic annual remuneration for each completed year of service, subject to a cap of 55%. The pension entitlements are considered to be immediately vested. They may be drawn upon once the age of 62 has been reached.

As member of pbb's Management Board, Andreas Schenk receives a pension in the amount of 5.2% of his basic annual remuneration for each completed year of service, subject to a cap of 50%. The pension entitlements are considered to be immediately vested. They may be drawn upon once the age of 63 has been reached.

Dr Bernhard Scholz receives an annual pension of 1% of his basic annual remuneration for each full year of service as a member of pbb's Management Board, subject to a cap of 15% of his basic annual remuneration. The rate of increase for the period from 1 September 2016 to 30 April 2017 (the date on which his contract expired) was determined pro rata temporis, and thus amounted to 0.67% for this period. The pension entitlements may be drawn upon once the age of 62 has been reached.

Section 16 of the German Company Pensions Act (Betriebsrentengesetz) applies to the examination of whether pension benefits need to be adjusted after retirement.

In case of the death of a Management Board member, his or her spouse receives 60% of the pension entitlement. In addition, pensions to half-orphans or orphans are paid until the respective children reach the age of 18. Where a child is still in education beyond the age of 18, orphans' benefits will continue to be paid until conclusion of vocational training – however, not after the child has reached the age of 25. The total amounts received by half-orphans must not exceed 30% of the pension entitlement of the deceased parent as long as the surviving spouse receives survivor benefits. Full orphans will jointly receive up to 60% of the pension of the deceased parent. Surviving spouses and children from a marriage that the member of the Management Board enters into after retirement are not entitled.

Pension commitments to Management Board members of pbb[1)] in office during the financial year 2017 according to IFRS[2)]

	2017				2016			
in € thousand	Present value of pension claims vested during the business year	Interest expenses	Past service costs	Pension obligation as at 31.12.2017	Present value of pension claims vested during the business year	Interest expenses	Past service costs	Pension obligation as at 31.12.2016
Andreas Arndt	696	21	–	1,904	597	13	–	1,290
Thomas Köntgen	663	22	–	1,867	535	12	153	1,333
Andreas Schenk	611	18	–	1,546	474	10	–	1,073
Dr Bernhard Scholz	42	2	–	332	117	3	–	252
Total	**2,012**	**63**	**–**	**5,649**	**1,723**	**38**	**153**	**3,948**

[1)] For details concerning pension commitments to former members of the Management Board and their surviving dependants, please refer to the Notes.
[2)] Statements without salary conversion.

Pension commitments to Management Board members of pbb[1)] in office during the financial year 2017 according to HGB[2)]

	2017		2016	
in € thousand	Provisions for pensions as at 31.12.	Additions to provisions for pensions	Provisions for pensions as at 31.12.	Additions to provisions for pensions
Andreas Arndt	1,417	553	864	424
Thomas Köntgen	1,215	464	751	408
Andreas Schenk	920	381	539	260
Dr Bernhard Scholz	251	79	172	84
Total	**3,803**	**1,477**	**2,326**	**1,176**

[1)] For details concerning pension commitments to former members of the Management Board and their surviving dependants, please refer to the Notes.
[2)] Statements without salary conversion.

Other Provisions

In the event that pbb does not renew the employment relationship for reasons outside the respective Management Board member's responsibility, the service contract with Andreas Arndt effective until 14 April 2017 contained a clause whereby he is entitled – in accordance with the remuneration principles of the German Financial Markets Stabilisation Fund (FMS) – to a transitional allowance in the amount of half a basic annual remuneration for each five full years of service as a member of pbb's Management Board. Within the scope of the new service contract that is in place since 15 April 2017, Andreas Arndt has waived to renew the agreement for a transitional allowance. In the aforementioned case, in line with the original service contract for Dr Bernhard Scholz, his current contract provides for a transitional allowance of €50,000 (gross) per month during the period from May 2017 until the end of the month in which he turns 60 (February 2018). Dr Bernhard Scholz was not granted any transitional allowance since he retired from pbb at his own request. Within the scope of the new service contracts concluded in 2016 and 2015, Thomas Köntgen and Andreas Schenk had waived an agreement for a transitional allowance.

Where the appointment as a member of the Management Board is terminated prematurely without good cause, severance pay to Management Board members is capped at two years' remuneration, calculated as follows: two years' remuneration is calculated as twice the amount of (i) basic annual remuneration for the preceding calendar year and (ii) the share of variable remuneration exclusively attributable to the Bank's performance. In this context, pbb is entitled to determine a higher or lower amount for the share of the calculatory variable remuneration attributable to a given calendar year, if there is sufficient evidence that the Company's performance during the current calendar year is higher or lower than its performance in the preceding calender year. Furthermore, the severance pay is limited to the extent that it must not exceed the remuneration due for the remaining term of the employment relationship. The service contracts entered into with the members of the Board of Managing Directors do not include any clauses giving rise to severance payments.

No member of the Board of Managing Directors received payments from or benefits committed upon by third parties, by reference to the office held as member of the Board of Managing Directors during the year under review. The service contracts entered into with the members of the Management Board do not contain any clauses for severance pay upon a change of control.

No compensation agreements, as defined in section 315 (4) No. 9 HGB, which provide for compensation in the event of a takeover bid, have been entered into with Management Board members or employees.

SUPERVISORY BOARD

In accordance with section 11 (1) of the Memorandum and Articles of Association, applicable since 18 June 2015, the members of the Supervisory Board receive a basic annual remuneration of €30,000. The Chairman receives twice this amount and the Deputy Chairman one-and-half times this amount. The fixed remuneration is increased by €10,000 p.a. for any Supervisory Board committee member, and by twice this amount for chairmanship of a Supervisory Board committee. Remuneration entitlements accrue on a pro rata basis for the period of the appointment in each case.

In addition, members of the Supervisory Board receive a €500 attendance fee for each meeting of the Supervisory Board (or Supervisory Board committee) they attend, except where meetings are held in the form of a conference call or video conference. The members of the Supervisory Board receive their remuneration and attendance fees plus statutory value-added tax. Furthermore, members of the Supervisory Board are reimbursed for their reasonable expenses.

pbb may take out a Directors & Officers (D&O) liability insurance policy in favour of members of the Supervisory Board, with a maximum annual aggregate cover of € 200 million, which covers statutory third-party liability claims that may arise from Supervisory Board work (including work on Supervisory Board committees), as well as any statutory third-party liability claims arising from Supervisory Board members' work on corporate bodies and committees of the Company's subordinated associates.

pbb took out a corresponding D&O insurance policy with aggregate cover of €150 million. The Company is convinced that, given its risk profile, the aggregate cover is adequate. pbb shall bear the costs of this insurance.

Remuneration for members of pbb's Supervisory Board in 2017[1)]

in €	Basic remuneration and remuneration for committee work	Attendance fees	Subtotal	Value-added tax (19%)	Total 2017	Total 2016
Dr Günther Bräunig	135,000.00	13,500.00	148,500.00	28,215.00	176,715.00	176,715.00
Dr Thomas Duhnkrack	40,000.00	4,500.00	44,500.00	8,455.00	52,955.00	49,225.68
Dr Christian Gebauer-Rochholz[2)]	30,000.00	3,000.00	33,000.00	6,270.00	39,270.00	40,460.00
Dagmar Kollmann[3)]	85,000.00	11,500.00	96,500.00	18,335.00	114,835.00	101,161.20
Georg Kordick[2)]	30,000.00	3,000.00	33,000.00	6,270.00	39,270.00	40,460.00
Joachim Plesser	70,000.00	11,000.00	81,000.00	15,390.00	96,390.00	102,531.83
Oliver Puhl (since 13 May 2016)	40,000.00	4,500.00	44,500.00	8,455.00	52,955.00	32,682.73
Heike Theißing[2)]	40,000.00	5,000.00	45,000.00	8,550.00	53,550.00	54,740.00
Dr Hedda von Wedel	50,000.00	7,500.00	57,500.00	10,925.00	68,425.00	69,615.00
Total	**520,000.00**	**63,500.00**	**583,500.00**	**110,865.00**	**694,365.00**	**667,591.44**

[1)] The table does not specify the cost of the D&O liability insurance policy taken out in favour of Supervisory Board members. pbb has entered into a group insurance policy which, in addition to the Supervisory Board members, also covers the members of the Management Board as well as staff members of pbb and its associates. The total cost of this D&O liability insurance policy amounts to approximately €1.26 million p.a., plus insurance tax. The table does not specify the remuneration of the employee representatives provided under their individual employment contracts.
[2)] Employee representative.
[3)] No value-added tax applies, due to the member's domicile abroad. pbb pays tax on behalf of the Supervisory Board member.

EMPLOYEE REMUNERATION

The employee remuneration system was developed within the scope of the remuneration strategy as a future-oriented system appropriate to pbb Group's current situation. The performance-oriented remuneration system is in line with prevailing market conditions, and with the regulatory and statutory requirements – in particular the CRD IV, the German Banking Act (Kreditwesengesetz – "KWG") as well as the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – "InstVergV"). Furthermore, this remuneration system is in line with the remuneration principles of the FMS, as amended in February 2012. The current remuneration system was implemented until year-end 2015 in cooperation with all relevant parties, in particular the Supervisory Board, the German Financial Markets Stabilisation Agency (Bundesanstalt für Finanzmarktstabilisierung – "FMSA"), the supervisory authorities and employee representatives. pbb Group was supported by independent external remuneration experts (hkp Germany), and an external legal advisor (Gleiss Lutz).

The remuneration system was not amended in 2017. At present, pbb prepares adjustments to its remuneration system in order to implement the amendment to the InstVergV dated 4 August 2017.

Remuneration Components

In the financial year 2017, total remuneration of senior staff and employees comprised the following elements:
> non-performance related (monetary) remuneration, including social insurance and fringe benefits
> performance-related variable remuneration

Non-performance-related Remuneration

All employees of pbb Group receive an annual fixed salary, which is reviewed – and may be adjusted – as part of an annual standard process. pbb Group uses functional and country-specific market comparisons for the determination of fixed salaries. The appropriateness and competitiveness of fixed salaries, and compliance with regulatory requirements, is subject to review by independent external remuneration and legal advisors.

Taking various tax and social security aspects into account, pbb Group offers its employees social insurance and fringe benefits. pbb Group established different company pension schemes in order to provide retirement benefits to employees.

Performance-related variable remuneration

The key elements of the variable remuneration system were harmonised for Management Board members and employees:
> the examination of requirements for determining the total amount of the variable remuneration, and
> the risk-adjusted performance measurement parameter at the level of the institution;
> the maximum level of target achievement (150%);
> the disbursement structure for risk takers; and
> determination of the variable remuneration component on the basis of an individual calculatory reference value.

Performance Measurement
Employee performance is also measured on three levels: institutional, organisational unit (division) and individual performance. Allocation of variable remuneration is based on the achievement of qualitative and quantitative targets at both divisional and individual level – to the extent possible, reference shall be made to pbb Group's business and risk strategy; target achievement shall be determined for every division and every employee at pbb Group.

The qualitative and quantitative divisional targets are established on an annual basis and derived from the corporate targets and the business plans made for the respective financial year. The establishment of targets commences with the setting of overall corporate strategic priorities by the Management Board, in order to facilitate the setting and management of divisional targets. In particular, qualitative divisional targets are established on this basis. In a second step, quantifiable targets are defined, which have to be related to key performance indicators, such as new business volume, new business margins, cost budgets, etc. Furthermore, the targets have to be closely connected with the corporate planning for the current – or future – financial year(s). Qualitative targets are to be based on quantifiable indicators as well, and the target level of 100% has to be defined. The link to the corporate business and risk strategy shall be reviewed and documented for every divisional target. This will ensure that the divisional targets were derived from – and synchronised with – the strategic targets according to pbb Group's business and risk planning. The Management Board of pbb adopts the divisional targets, which have to be provided to all employees of the respective division at the beginning of the year.

At the individual level, every employee is provided with an annual target agreement comprising quantitative and qualitative targets for the current financial year. Targets at the individual level shall also be derived from the indicators established at institutional and divisional level. In particular, the quantitative and qualitative work targets of employees have to be in line with the business and risk strategy, and shall be designed to support the targets derived from this strategy. The measurement of every target is based on indicators, allowing transparent performance assessments at the end of every financial year. This forms the basis for the allocation of variable remuneration components to individual employees.

Employee performance measurement is based on a pool system which links the three levels of performance measurement. For this purpose, pbb compiles the calculatory reference values of all employees into a bonus pool, the total amount of which is based on the institutional performance. The bonus pool is subsequently allocated to the different divisions: 50% is allocated based on the divisional performance, and 50% based on the institutional performance. The divisional bonus pools are distributed to the employees of the respective division on the basis of their individual performance. The share in the relevant divisional pool is allocated to each respective employee in the form of a calculatory Envisaged Personal Reward ("EPR") value. In principle, the calculatory EPR value allocated may range between a minimum of 0% and a maximum of 150% of the relevant personal calculatory reference value.

Disbursement Structure

As a significant institution according to section 17 of the InstVergV, pbb must in particular observe the requirements of section 20 of the InstVergV; regarding the disbursement structure, pbb distinguishes between employees who have a material influence on pbb's overall risk profile (so-called risk takers), and other employees (so-called non-risk takers). If an employee becomes a risk taker in the course of a year, the relevant risk taker regulations apply to his/her variable remuneration earned during the entire financial year.

For non-risk takers, the EPR value corresponds to the variable remuneration, which is usually granted in cash at the end of the first half of the year subsequent to the year for which the variable remuneration is granted.

The requirements to the disbursement of variable remuneration, pursuant to section 20 of the InstVergV, were implemented on a uniform basis for Management Board members and employees. This applies in particular to:

- the deferral portion (60% for Management Board members and second-level managers; 40% for all other risk takers),
- the deferral period (five years for Management Board members and second-level managers; three years for all other risk takers) and the rule governing the (pro rata) vesting of deferrals,
- back-testing and malus review; as well as
- the sustainability component.

This disbursement structure, in line with regulatory requirements, will not apply where the EPR value determined for a given financial year is lower than a threshold defined by law (or by the German Federal Financial Supervisory Authority (BaFin) or by another competent supervisory authority), below which such disbursement structure for risk takers is waived for reasons of proportionality (currently up to, and including, €50,000 p.a. per person).

pbb identifies risk takers according to section 18 of the InstVergV, in line with the criteria laid out in Delegated Regulation (EU) 604/2014. These criteria refer in particular to:
- function of senior manager or other form of executive position
- Loan-granting competences
- voting rights in important committees, and
- remuneration of the employee.

In total, besides the four members of the Management Board (since 1 April 2017: three Management Board members), a further 91 employees (2016: four Management Board members and 74 employees) were identified as risk takers in 2017. The Management Board informed the Supervisory Board concerning the identified risk takers, while the details of the internal risk analysis were documented.

Additional Provisions of the Adjusted Remuneration System

Remuneration of Employees in Monitoring Units (section 9 of the InstVergV)
Regarding the remuneration of employees working in monitoring units, emphasis is placed upon fixed remuneration. In order to avoid conflicts of interest, the amount of variable remuneration components for employees working in monitoring units is never based on the same remuneration parameters applicable in the organisational unit to be monitored.

Hedging Ban (section 8 of the InstVergV)
The risk-adjustment of variable remuneration must not be limited or overridden by hedging or other countermeasures, such as third-party contracts obliging the third party to make direct or indirect compensation payments to the employee in the event of a reduction of variable remuneration (insurance); this applies mutatis mutandis to derivatives designed to hedge price losses of pbb financial instruments, or financial instruments based on pbb financial instruments, such as put options, warrants, certificates, or any other financial instrument with comparable characteristics.

pbb has taken appropriate measures to prevent hedging or other countermeasures intended to limit or override risk-orientation. Moreover, the hedging ban is contractually regulated in collective wage agreements (applies to employees in Germany) and in individual employment agreements (applies to employees as well as second-level managers, and employees abroad). Compliance with these agreements is subject to reviews (spot checks). Given that pbb is considered a significant institution according to section 17 of the InstVergV, such reviews are made by the Remuneration Officer.

Review of, and Adjustments to, the Remuneration Systems (section 12 of the InstVergV)
In the case of any change to the business and risk strategy, the remuneration strategy and the structure of the remuneration systems will be reviewed and adjusted if necessary. In addition, pbb carries out reviews (and adjustments, if necessary) of its remuneration system and the respective parameters to ensure appropriateness at least once a year, with a particular view to their compatibility with Group strategies.

GOVERNANCE OF REMUNERATION SYSTEMS

pbb established a two-tier organisational and management structure in line with the AktG: it comprises the Supervisory Board as an independent supervisory body, and the Management Board, responsible for the management of the Bank. The Supervisory Board monitors, determines, and is responsible for the remuneration of the Management Board members, while the Management Board monitors, determines, and is responsible for the remuneration systems pertaining to senior staff and other employees of pbb Group; in addition, the Management Board ratifies the amount and allocation of the remuneration granted. In accordance with section 111 (4) of the AktG, the Supervisory Board has introduced a requirement that the remuneration system for employees requires Supervisory Board approval.

In line with the regulatory requirements as set by the KWG and the InstVergV, pbb's remuneration governance comprises the Remuneration Committee established by the Supervisory Board, and the Remuneration Officer appointed by the Management Board.

The Remuneration Committee supports the Supervisory Board in ensuring that the remuneration systems for the members of the Management Board have an appropriate structure, and prepares Supervisory Board resolutions on the remuneration of Management Board members. This includes in particular the preparation of Supervisory Board resolutions regarding the determination of the total amount available for variable remuneration within the meaning of section 45 (2) sentence 1 no. 5a of the KWG in conjunction with section 7 of the InstVergV, as well as regarding the determination of appropriate remuneration parameters, performance contributions, performance and retention periods, the conditions for partial or full reduction of variable remuneration, and the regular – at least annual – review considering the appropriateness of the regulations established by the Supervisory Board.

Furthermore, the Remuneration Committee monitors the appropriate structure of the remuneration systems for employees, and in particular for the Risk Controlling Function and Compliance Function, and for risk takers. In this context, the Remuneration Committee assesses the effects of the remuneration systems on the Group's risk, capital, and liquidity management.

In addition, the Remuneration Committee supports the Supervisory Board in monitoring the proper inclusion of internal control instances and any other relevant areas in the structuring of remuneration systems. As part of its duties, the Remuneration Committee assesses the impact of remuneration systems on the Bank's risk, capital and liquidity situation; it also ensures that remuneration systems are in line with (i) the Bank's business strategy (which is geared towards the Bank's sustainable development) and the risk strategies derived from such strategy, as well as (ii) the remuneration strategies at institutional and Group level.

The Remuneration Committee consists of the Supervisory Board's Chairman and Deputy Chairperson, as well as one shareholder and one employee representative. The Remuneration Committee convened five times during 2017.

pbb appointed a Remuneration Officer and a deputy in order to ensure appropriate, sustained and effective monitoring of employee remuneration. The Remuneration Officer is responsible for the constant monitoring of the appropriateness of pbb's remuneration systems for employees. Therefore, the Remuneration Officer is involved with the ongoing processes regarding remuneration systems, both in terms of the conceptual and further redevelopment of such systems, as well as with regard to their current implementation. An institutional reporting channel was established for the remuneration officer to report directly – i.e. excluding involvement of the Management Board – to the chair of the Remuneration Committee. At least once per year, the Remuneration Officer produces a remuneration report containing an assessment of the appropriateness of the remuneration systems for employees (section 24 of the InstVergV).

Report on Expected Developments

MACROECONOMIC FORECAST

The macroeconomic environment is forecast to remain positive in 2018. The International Monetary Fund (IMF) projects further acceleration of global economic growth; at 3.7%, this would imply the strongest increase since 2011. This momentum is primarily due to emerging markets, where growth is attributed to the recovery of commodity prices. Developed economies on the other hand have probably already surpassed their peak levels: the IMF expects a moderate slowdown, from 2.2% in 2017 to 2.0% in 2018. Despite these positive prospects, both IMF and World Bank urge that existing risks should not be ignored; inter alia, financial markets and governments failing to implement reforms in order to make their economies more crisis-resistant – despite the economic recovery.

In industrialised economies, investments and trading remain the driving forces behind the upswing. Headwinds, however, result from the ongoing gradual monetary policy normalisation and – at least outside the United States – from ongoing fiscal policy consolidation. In addition, according to a small, albeit growing number of companies, it is becoming increasingly harder to fill vacant positions with qualified staff. This should be reflected in somewhat stronger wage improvements compared to 2017. Inflation is expected to remain on the previous year's level of 1.7%, thus providing positive impulses for private consumption.

In its Autumn 2017 Economic Forecast, the European Commission has forecast a GDP growth of 2.1% for the euro area in 2018, i.e. a minor decline compared to the previous year's rate of 2.2%. Consumption is expected to grow slightly less than in 2017, whilst investment activity is set to gain further momentum. The situation on the labour market should continue to improve – with a decline in the unemployment rate to 8.5%, from 9.1% in 2017. This would be the lowest level since 2008. Thanks to lower interest expenses and the anticipated robust growth, public-sector finances should also improve slightly. Therefore, the debt level – measured in per cent of GDP – will probably sink to 87.2%. The stronger euro, which recently reached a three-year-peak versus the US dollar, poses a risk: further appreciation could burden exports.

Within the euro area, at 1.8% and 2.1%, growth rates in France and Germany are expected to remain roughly in line with the previous year's figures. Declining economic momentum is projected for Italy (with growth rates set to decline from 1.5% to 1.3% year-on-year) and Spain (from 3.1% to 2.5% year-on-year). Political risks in both countries should be kept in mind.

The economic situation in the United Kingdom and the associated progress of the Brexit negotiations pose another risk. A so-called 'clean' Brexit, i.e. a departure in March 2019 without an agreement on the future relationship with the European Union (EU) in place, would also have negative implications for the remaining 27 member states. The European Commission expects merely a slight reduction of the British GDP growth rate, to 1.3% in 2018 from 1.5% in 2017. In 2018, private consumption should continue to increase at a subdued pace, since inflation – for which an increase of 2.6% is projected – is anticipated to continue exceeding wage growth. Businesses are still facing uncertainties regarding the Brexit negotiations. Generally, this is likely to impact the propensity to invest. However, early indicators show that the business climate improved markedly during the course of 2017. Accordingly, the European Commission expects corporate investment in machinery and equipment to recover from its decrease of 0.4% in the previous year, moderately rising at 1.3% this year.

Growth momentum in Sweden should ease a little, from 3.2% in 2017 to 2.7% in 2018. In contrast, growth rates in Eastern Europe are expected to remain relatively strong: at 3.6% in Hungary, 3.0% in the Czech Republic, 4.0% in Slovenia, and 3.8% in Poland.

For the US, growth of just over 2% is anticipated for 2018. Impulses from the tax reform adopted in December 2017 yield potential, whilst trade decisions such as the withdrawal from the North American Free Trade Agreement (NAFTA) present potential burdening factors.

Similar to the group of industrialised nations, inflation in the euro area is likely to remain roughly in line with last year's level, at 1.4%. Whilst this below the ECB's 2% inflation target, the Central Bank will – as announced in October 2017 – reduce its government bond purchases to a monthly volume of €30 billion between January and September. The question remains whether the programme will be extended once more in the fourth quarter of 2018 – potentially with a further reduced volume – or whether it will finally expire. Regardless of this, the first interest rate movement should not be expected before the second half of 2019. At the end of 2017, the Bank of England also announced the continuation of its gradual monetary policy normalisation. If negative surprises, e.g. associated with the Brexit negotiations, fail to materialise, at least one additional interest rate movement can be expected within the course of 2018. The US Federal Reserve ("Fed") anticipates three further interest rate hikes this year, even if inflation is projected to be only slightly higher than in the previous year (2.1% compared to 2%).

The trend of a tightening monetary policy visible in all developed economies except Japan should also impact the interest rate environment and be accompanied by rising long-term interest rates.
Sources: Bloomberg, ECB, IMF

SECTOR-SPECIFIC FORECASTS

Overall Situation in the Banking Sector

Despite the successes with regard to raising capital and reducing non-performing loans, the European banking sector will continue to operate in a difficult environment during 2018.

In the euro area, banks in the countries most affected by the sovereign debt crisis (Italy, Spain and Portugal) continue to groan under the weight of non-performing loans. Albeit declining, the share of these non-performing loans remains high when compared with historical levels. Coupled with continuously rising regulatory requirements and the low interest rate environment, all these factors mean that profitability in the sector continues to be significantly limited.

Global geopolitical risks remain high. Any future intensification or expansion of these conflicts could have an adverse effect on the financial markets and thus on the environment the banking sector operates in.
Sources: Bloomberg, ECB

Real Estate Finance

Prospects for the commercial real estate market are likely to remain favourable in 2018, as no immediate significant changes to decision-relevant parameters – such as the economic outlook of investors – are to be expected. On a global level, however, transaction volumes are not likely to increase. Realised volumes should remain above long-term averages. Regarding the country allocation, no major surprises are expected; preferred regions such as Germany will probably continue to benefit from strong demand. The results from Brexit negotiations should dominate the development in the United Kingdom, whilst the tax reform adopted in the US could provide new impulses for transaction volumes.

With regard to yields, it is fair to assume that they will remain stable due to the late phase in the cycle, or will only decline selectively in sub-segments.

As the supply of prime properties, and in prime locations, falls short of market demand, opportunistic real estate investments – markets and segments as well as the demand for project developments – should continue to develop favourably.

As a rule, the financing capacities of credit institutions and alternative lenders should suffice, even though many providers are planning to reduce their new business origination, or at best keep it at a stable level. pbb Group thus anticipates ongoing pressure, potentially leading to further margin reductions.

Sources: researches by Jones Lang Lasalle, BNP Paribas Real Estate

Public Investment Finance

S&P projects annual gross borrowing of European local and regional authorities to gradually recover to approximately € 300 billion in 2017 and 2018, after a significant decline in 2016. The slower debt reduction of German local and regional authorities, coupled with rising financing and funding requirements in Russia, Sweden, Norway, and Finland should advance this increase.

In export financing, plenty of opportunities should arise for originating new business. Due to quite a few scheduled large-scale projects, the Middle East is likely to be the most important growth region in 2018. Asia is also expected to be a growth region.

Credit institutions, insurance companies, and other alternative lenders continue to show interest in granting loans to the public sector, as such loans offer higher margins than government bonds; in addition, there is no evidence that relevant local or international lenders will change their strategy. Thus, pbb Group expects ongoing margin pressure in the different markets.

Value Portfolio

The future pace of the Value Portfolio wind-down depends heavily on how risk premiums develop for European sovereign debt. Depending on the development of these premiums, this could create further opportunities to increase that pace by sales.

Funding Markets

As in previous years, central banks are expected to significantly influence capital markets in 2018. The monetary policy of the central banks described in the macroeconomic forecast, and the development of the ECB's purchasing programmes, are particularly relevant in this context. In the United Kingdom, uncertainty reigning due to the ongoing Brexit negotiations will continue, influencing the Bank of England's monetary policy.

On 25 October 2017, the EU institutions resolved the harmonisation of the European Insolvency Directive. According to the resolution, a new category for unsecured debt instruments will be introduced for the ranking of such instruments in insolvency hierarchies (separated disclosure of "preferred" and "non-preferred" classes). Transposition into national law of individual EU member states will be concluded by the end of 2018.

Despite the reduction of the third covered bond purchase programme (CBPP3), the ECB will remain a significant buyer in the covered bond market. In conjunction with a lower new issue volume in 2018, pbb Group anticipates a manageable spread widening for Pfandbriefe.

COMPANY FORECASTS

The forecasts for pbb Group's future development represent estimates that were made on the basis of the information currently available. If the assumptions on which the forecasts are based on do not materialise or if risks and opportunities do not occur to the extent calculated, the actual results may differ significantly from the results currently expected.

Future Developments in Assets, Financial Position and Earnings

In the financial year 2017, the key performance indicators – as defined in the chapter "Internal Management System" – are expected to develop as follows:

Key performance indicator	Initial position (financial year 2017)	Forecast (financial year 2018)
New business volume (including prolongations with maturities of more than one year)	€11.6 billion	A new business volume of between €10.0 billion and €11.0 billion is aimed.
Strategic financing volumes (REF and PIF)	€31.9 billion	A slight increase in the strategic financing volume is aimed.
Profit or loss before tax	€204 million	A profit or loss in a range between €150 million and €170 million is aimed.
Cost-income ratio	50.9%	A slight increase is expected.
Return on equity after tax	6.5%	A range between 4% and 5% is aimed.
CET1 ratio	17.7%	pbb Group aims to achieve a CET1 ratio significantly above the SREP ratio of 9.125% that banks have to comply with in addition to the country-specific (and thus portfolio-specific) varying counter-cyclical capital buffer.

For pbb Group to meet its earnings and profitability targets, its risk bearing capacity must be ensured. From a going-concern perspective, the regulatory minimum capital ratios will be complied with, even under adverse economic scenarios. From a gone-concern perspective, pbb Group aims for the available capital to exceed the required economic capital. This goal remains within reach as long as spreads in the European countries in focus do not widen significantly, increasing the hidden losses.

The financing volume attributable to the non-strategic Value Portfolio should continue to decline in line with the strategy.

In 2018, the REF segment is expected to once again contribute the lion's share to profit before taxes. In the PIF and in the VP segment, pbb Group expects a slightly negative profit before taxes.

Opportunities and Risks

Politics

Depending on their outcome, current economic and geopolitical tensions could distort the markets relevant to pbb Group, burdening assets, the Bank's financial position, and earnings. At the same time, better than expected future developments could positively impact assets, the Bank's financial position, and earnings. Rating changes of economic regions, for example, may impact pbb Group's provisioning requirements.

Economy

The economic development of the euro area and especially in Germany is expected to have a favourable impact on the development in earnings, as, for example, pbb Group has to recognise only moderate provisions when taking over credit risks. A slowing economy or recession could increase the necessary level of provisions, and lead to lower new business volume, thus also burdening the development in earnings.

Interest Rates

Should market interest rates in the euro area rise again, investing the liquidity reserves and own funds could improve the development in earnings; at the same time, funding costs would increase. An opposite effect could occur if the low interest rate policy was to persist for the longer term. Moreover, in a low interest rate environment, early loan repayments are to be expected. Whilst this could positively impact the short-term development in earnings – for instance due to early termination fees – in the long term it could burden the development as a result of the lower financing volume.

Competition

The intense competition, especially in commercial real estate financing – and the resulting margin pressure – will probably continue or even increase throughout 2018, which in turn may weigh on pbb's development in earnings. Conversely, a slowdown in the intensity of competition – for example due to consolidations in the banking industry – would benefit the Bank's development in earnings.

Digitalisation

In view of increasing cost competition in the banking sector – enhanced by so-called FinTech and PropTech companies – and in order to explore new sources of income, pbb Group is increasingly focusing on digital business processes and models. In future, digitalisation may incur risks as well as opportunities for the assets, financial position and earnings, depending especially on the success of digital business models and further IT developments.

Regulatory Environment

pbb Group has to apply IFRS 9 from 2018 onwards. The initial application of IFRS 9 is expected to have an extensive impact on the development in assets, financial position and earnings. The impact of the first-time application of IFRS 9 is included in the notes under "Principles" and "Consistency". Regarding subsequent reporting periods, the application of IFRS 9 regulations will result in more volatile results of operations compared to the current regulations under IAS 39, due to the higher number of financial instruments to be measured at fair value through profit or loss, and the new regulations regarding credit loss allowances pursuant to IFRS 9. This volatility may result in multi-million euro fluctuations, and may thus be considered substantial regarding pbb Group's recent net income levels.

Within the scope of the SREP, a CET1 minimum ratio and an own funds minimum ratio were set for pbb Group. It cannot be ruled out that the ECB defines even higher capital requirements, or even higher capital ratios in future. This could impact pbb Group's assets, financial position and earnings.

The further development of national and international supervisory requirements may impact capital requirements, funding and pbb Group's business activities. These requirements include the revision of the Basel III regime and further supervisory initiatives with regard to risk identification (e.g. the amendment of the credit risk standard approach [CRSA], and the TRIM process) as well as the Minimum Requirement for Own Funds and Eligible Liabilities (MREL).

IT Security

pbb Group attaches great importance to the security of its information systems. The aim is a constant operation of the IT systems, whilst avoiding unauthorised access to the system and data sets. Despite implemented measures regarding IT security, negative risks on the development in earnings cannot be ruled out.

Human Resources

As a listed company, pbb was able to increase its attractiveness as an employer. The Bank is in a good position to recruit and retain highly capable and very well-qualified employees and executives who can significantly participate in achieving the ambitious targets of pbb Group. An attractive range of trainings and personnel development possibilities, as well as systematic health management, round off the offer. Nevertheless, risks from employee losses and the associated loss of knowledge cannot be fully excluded. In addition, winning new employees will likely become increasingly difficult, especially against the background of high demand for banking sector specialists in the midst of continuing demographic change. To confront this situation, pbb Group is developing innovative instruments for employee recruitment, which could burden earnings in the short term – but which in the long term should secure pbb Group's success.

Legal Issues

pbb Group has recognised an appropriate level of provisions for legal risks. It is however possible that legal proceedings yield different results than expected by pbb Group. Thus, an outflow of resources can deviate positively or negatively from the recognised provisions. Depending on the deviation, this may result in opportunities or risks for the development in earnings, inter alia, for the following matters:

- External tax audits by fiscal authorities may result in additional taxable income, and thus in higher tax expenses for previous periods. Despite the fact that pbb Group recognised an appropriate level of provisions for such risks, it cannot be ruled out that said provisions may not suffice, and that the future development in earnings is negatively affected. On the other hand, better than expected audit results would lead to a reversal of provisions, and thus be beneficial for the development in earnings.
- pbb, the legal successor of Hypo Real Estate Bank International AG, Stuttgart, is the issuer of credit linked notes of the "Estate UK-3" synthetic securitisation transaction ("Credit Linked Notes"). These Credit Linked Notes hedge the default risk from certain credit exposures of pbb, provided that the conditions for the allocation of realised losses have been fulfilled in accordance with the terms of the Credit Linked Notes. A default affecting one of the hedged exposures ("Reference Claim No. 3") has caused a loss of approximately GBP 113 million; pbb intends to allocate this loss to the Credit Linked Notes. This loss allocation would trigger a total loss for Credit Linked Notes Classes A2, B, C, D and E, and would reduce the nominal amount of Class A1+ (of GBP 400,000) by approximately 0.1%. On 13 December 2016, Deloitte GmbH Wirtschaftsprüfungsgesellschaft, in its capacity as trustee of the ESTATE UK-3 transaction, notified pbb that in their view doubts exist as to whether the loss allocation intended by pbb is justified, and that the Trustee will appoint an Expert, in accordance with the terms of the ESTATE UK-3 transaction, who will decide on whether the loss allocation is in fact justified. In the event of the loss allocation being fully or partially unjustified, pbb would have to bear the losses to that extent. This would result in adverse effects on future development in assets, financial position and earnings. In June 2017, the Expert was appointed by the Trustee; the corresponding review process is currently ongoing. In pbb's opinion, the conditions for the planned allocation of losses have been met.

Brexit

Since the United Kingdom's Brexit vote, pbb Group has been intensely focusing on this topic. The Bank is continuously analysing the consequences and risks arising as a result of Brexit for pbb Group and its business model and strategy. pbb is assessing the macro-economic development of the United Kingdom and the corresponding impact on real estate markets. Another core element of the analysis examines the question as to whether, and if so, which new regulatory requirements pbb's branch office in London will have to adhere to with the British supervisory authorities PRA and FCA, in order to be able to continue operating in the United Kingdom after Brexit takes place in 2019. On this basis, pbb submitted the first application draft to the UK supervisory authorities for gaining the status of a third-country branch office, on 16 January 2018.

In addition to the above-mentioned internal analyses, the ECB as well as British banking supervisors have implemented a rule concerning reporting procedure for banks in preparation for Brexit. pbb has complied with the respective reporting obligations.

Given its current organisational and operational structure, pbb Group recognises no immediate need for action in the business model and in the adjustment of the business structure. Thanks to its specialist approach, pbb Group can, however, engineer a relatively speedy reaction to potential necessary amendments, and implement a business model adapted to new framework conditions in the United Kingdom.

From an economic perspective, the Brexit referendum has led to a period of ongoing uncertainty in the United Kingdom, combined with an increased likelihood of slowing economic demand. In the event that Brexit negotiations with the EU fail, the slowdown could become a recession, property values could fall, and the number of transactions in the commercial real estate market could drop significantly. In this case, these factors would increase the probabilities of default and impair market values in the existing portfolio. Therefore, pbb Group has reinforced monitoring of its portfolio in the United Kingdom, and reviewed and analysed local business operations – particularly regarding the risk factors influenced by Brexit.

However, to date pbb Group continues to believe that the British real estate market will remain attractive. The Bank thus continued, in principle, to generate new business in the United Kingdom in 2017, but tightened the selection process. That strategy will probably continue along these lines during 2018.

SUMMARY

pbb Group is well-positioned for continued profitability, in an environment that features not only declining margins due to intensified competition, but also growing regulatory requirements. However, this assessment is based on the assumption that additional risks – arising from factors beyond pbb's control, for example – do not materialise. Giving due consideration to the opportunities and risks, pbb Group expects to generate a pre-tax profit of between €150 million and €170 million in 2018.

Commentary on pbb's Unconsolidated Annual Financial Statements under HGB

COURSE OF BUSINESS

At €277 million, pbb achieved a very solid profit before taxes in the 2017 financial year compared to total equity (€2.6 billion). Compared to the previous year (2016: €312 million), profit before taxes declined considerably, although non-recurring effects were clearly more prominent in the previous financial year than in the period under review. This refers in particular to income in the amount of €104 million (€95 million recognised in net income from financial investments, and €9 million recognised within risk provisions) generated in connection with an amicable agreement entered into with the Republic of Austria regarding the restructuring of Heta liabilities. Excluding this non-recurring item, profit before taxes would have clearly improved from the previous year.

The new business volume, as well as the financing volume of the overall portfolio and the strategic and non-strategic portfolios, were in line with the information provided in pbb Group's report on economic position.

DEVELOPMENT IN EARNINGS

Development in earnings

in € million	2017	2016	Change
Net interest income	484	373	111
Net fee and commission income	8	8	–
Net other operating income	18	5	13
Net operating income	**510**	**386**	**124**
General and administrative expenses	–240	–207	–33
Personell expenses	–122	–108	–14
Non-personell expenses	–118	–99	–19
Operating results (before loan loss provisions)	**270**	**179**	**91**
Risk provisioning	9	53	–44
Net income from financial investments	–5	86	–91
Additions to the fund for general banking risks	–	–	–
Operating results	**274**	**318**	**–44**
Extraordinary result	3	–6	9
Profit or loss before tax	**277**	**312**	**–35**
Taxes	–40	–60	20
Net income/loss	**237**	**252**	**–15**

Net Operating Income

Net interest income rose from €373 million to €484 million, due to lower interest expenses (reflecting maturities of higher-yielding liabilities) and from the slight increase in the average margin of the overall portfolio. The average financing volume in Commercial Real Estate Finance and Public Investment Finance increased to €31.8 billion (2016: €31.3 billion), while the average financing volume of the non-strategic Value Portfolio continued to decline in line with our strategy from €17.3 billion in 2016 to €14.8 billion in 2017. During the year under review, pbb generated income in the amount of €38 million (2016: expenses of €25 million) due to the closing-out of derivatives transactions. Furthermore, income of € 22 million (2016: € 0 million) was generated in connection with a distribution made by a formerly affiliated entity.

Net fee and commission income from non-accruable fees were on the previous year's level of € 8 million.

Net other operating income (€18 million; 2016: € 5 million) was burdened, inter alia, by the bank levy. Taking into account pledged collateral amounting to 15%, pbb recognised expenses of €19 million (2016: € 21 million). Various other factors translated into positive non-recurring effects in the amount of € 34 million, resulting in particular from the disposal of assets held in pbb's non-strategic Value Portfolio, and VAT reimbursements. Furthermore, currency translations generated income of € 3 million (2016: € 7 million).

General and Administrative Expenses
At € 240 million, general and administrative expenses increased year-on-year (2016: € 207 million). During the same period of the previous year, personnel expenses benefited from the utilisation of provisions recognised in previous periods. Personnel expenses have reached a normalised level in the current financial year, whilst the average staffing level declined. Non-personnel expenses increased compared to the previous year, and included expenses for a Bank-wide project to further optimise the finance and risk IT target architecture, expenses for setting up a portal for public sector financings, as well as additions to provisions.

Risk Provisioning
Risk provisioning resulted in net income of € 9 million during the year under review, compared to € 53 million in 2016. Net income in the securities and promissory notes business declined from € 61 million in the previous year to €14 million: value increases amounted to €12 million (2016: € 51 million), and price gains to € 2 million (2016: € 3 million). In the previous year, income from the disposal of securities amounted to € 7 million. Net additions to general loan loss provisions amounted to € 3 million (2016: €12 million), while net expenses for specific loan loss provisions, additions to provisions and direct loan write-offs amounted to € 2 million (2016: net income of € 4 million).

Net income from Financial Investments
Net income from financial investments stood at € – 5 million (2016: € 86 million), which was particularly due to loss absorptions amounting to € 3 million (2016: € 7 million) and the impairment of incidental acquisition costs incurred at a formerly affiliated entity in Japan, in the amount of € 2 million (2016: € 0 million). The result for the previous year was largely driven by the net income generated from the disposal of investment securities (€ 95 million) in connection with the Heta exposure.

Additions to the Fund for General Banking Risks
As in the previous year, no amounts were transferred to or withdrawn from the fund for general banking risks pursuant to section 340g of the HGB.

Extraordinary result
The extraordinary result in the amount of € 3 million (2016: € – 6 million) was due in particular to the net reversal of restructuring provisions.

Profit or Loss Befores Tax
In 2017, pbb's profit or loss before tax amounted to € 277 million (2016: € 312 million).

Taxes
pbb's net tax expenses of € 40 million (2016: € 60 million) comprised income tax expenses of € 45 million (2016: € 35 million) attributable to the current year, and tax income of € 5 million (2016: expenses of € 24 million) attributable to previous years. In 2017, pbb did not incur any other tax expense items (2016: €1 million).

Net income/loss
For 2017, pbb discloses net income of € 237 million (2016: € 252 million).

DEVELOPMENT IN ASSETS

Development in assets

in € million	31.12.2017	31.12.2016	Changes
Cash reserve	999	1,136	–137
Loans and advances to other banks	3,008	3,425	–417
Loans and advances to customers	38,310	38,675	–365
Bonds and other fixed-income securities	10,454	12,930	–2,476
Equity shares and other variable-yield securities	2	2	–
Participating interests	–	–	–
Investments in affiliated companies	15	52	–37
Assets held in trust	–	–	–
Intangible assets	8	4	4
Tangible assets	6	8	–2
Sundry assets	145	137	8
Prepaid expenses	388	419	–31
Overfunded plan assets	6	–	6
Total assets	**53,341**	**56,788**	**–3,447**

General Development in Assets

As at the balance sheet date, pbb's total assets stood at €53.3 billion, which is a decline of €3.5 billion compared to the previous year (31 December 2016: €56.8 billion). The decrease in pbb's total assets was due in particular to maturing bonds and other fixed-income securities, which declined by €2.5 billion to €10.5 billion as at the balance sheet date (31 December 2016: €12.9 billion).

DEVELOPMENT IN FINANCIAL POSITION

Development in financial position

in € million	31.12.2017	31.12.2016	Changes
Liabilities to other banks	4,276	4,347	–71
Liabilities to customers	23,581	25,756	–2,175
Securitised liabilities	20,836	22,078	–1,242
Liabilities held in trust	–	–	–
Sundry liabilities	34	179	–145
Deferred income	619	690	–71
Provisions	310	280	30
Subordinated liabilities	1,002	875	127
Fund for general banking risks	47	47	–
Total liabilities	**50,705**	**54,252**	**–3,547**
Equity	2,636	2,536	100
Total liabilities and equity	**53,341**	**56,788**	**–3,447**

Liabilities

Liabilities as at 31 December 2017 amounted to € 50.7 billion (31 December 2016: € 54.3 billion). Liabilities to customers were down from € 25.8 billion to € 23.6 billion, which was due to maturing promissory note loans, among other things. The decline in securitised liabilities from € 22.1 billion to € 20.8 billion resulted from maturities which exceeded new issues.

Equity

Equity

in € million	**31.12.2017**	**31.12.2016**	Changes
Share capital	380	380	–
Additional paid-in capital	1,639	1,639	–
Retained earnings	473	376	97
Unappropriated retained earnings	144	141	3
Equity	**2,636**	**2,536**	**100**

As in the previous year, pbb's share capital amounted to € 380,376,059.67 as at 31 December 2017, and is composed of 134,475,308 registered ordinary bearer shares in the form of no-par value shares with a notional interest in the subscribed capital of € 2.83 per share. The additional paid-in capital remained unchanged. Net additions of € 97 million (2016: € 97 million) were made to retained earnings during the year under review. Unappropriated retained earnings in the amount of €144 million (31 December 2016: €141 million) comprised net income of € 237 million (2016: € 252 million), net additions to retained earnings in the amount of € –97 million (2016: € –97 million) and the adjustment of profit-participation certificates in the amount of € 4 million (2016: € –14 million).

Key Regulatory Capital Ratios

According to Art. 7 (3) of the Capital Requirements Regulation ("CRR"), pbb was exempted from the requirements laid out in parts 2 to 5 and 8 of the CRR; for instance, this includes own funds and capital requirements, stipulations on large exposures and exposures to transferred credit risk, as well as disclosure requirements.

Supplemental Information

DISCLOSURES PURSUANT TO SECTION 315A (1) OF THE GERMAN COMMERCIAL CODE (HGB)[1]

Composition of Subscibed Capital (Section 315a (1) No. 1 HGB)

The composition of pbb's subscribed capital is disclosed in the Note "Equity". Each bearer share with no par value entitles the shareholder to one vote at the Annual General Meeting. pbb currently does not hold any nonvoting treasury shares. No shareholder and no shareholder group is entitled to special rights, that confer power to control vis-á-vis pbb.

Restrictions Affecting the Voting Rights or the Transfer of Shares (Section 315a (1) No. 2 HGB)

With respect to the exercise and transfer of voting rights of shares only the statutory provisions apply. The voting rights are not limited by size. All shareholders who register for participation in the Annual General Meeting in time and who have demonstrated their right to participate in the Annual General Meeting and to exercise their vorting rights may exercise the voting rights attached to all the shares held and registered by them. Where pbb holds treasury shares, section 71b of the German Stock Corporation Act (Aktiengesetz, AktG) prohibits the exercise of rights vested in such shares.

HRE Holding has committed itself to avoid exercise of control over pbb by entering into a control avoidance agreement with pbb. HRE Holding undertakes to exercise voting rights vested to it at the point in time at which the control avoidance agreement enters into effect, and/or at any subsequent point in time at which HRE Holding holds pbb shares, to a maximum of 49% of the present voting capital at the adoption of resolutions regarding the appointment or removal of Supervisory Board members as well as resolutions taken as part of management decisions according to sections 83, 111 (4) sentences 3 to 5, 119 (2) or 179a of the AktG, not to make any proposals for resolution to pbb's Annual General Meeting, in particular for the appointment of Supervisory Board members, and not to vote for candidates for pbb's Supervisory Board which are not independent from HRE Holding, Finanzmarktstabilisierungsfonds-FMS (FMS), FMSA and the Federal Republic of Germany, with the exception of two Supervisory Board members proposed by FMSA to pbb in line with the new framework agreement.

pbb is not aware of any other restrictions affecting voting rights or the transfer of shares.

Shareholdings Exceeding 10% of Voting Rights (Section 315a (1) No. 3 HGB)

As at 31 December 2017, the Federal Republic of Germany, through the intermediary of the FMS, Frankfurt/Main, and HRE Holding, Munich, were the only shareholders with shareholdings of more than 10% of the shares, to the knowledge of pbb. The respective shareholding totaled 20% plus one share as at 31 December 2017.

The notifications of voting rights pursuant to sections 26 et seq. of the German Securities Trading Act (Wertpapierhandelsgesetz, WpHG), published by pbb, are available online, inter alia, under "https://www.pfandbriefbank.com/en/investors/mandatory-publications/notifications-according-to-26-et-seq-wphg.html".

[1] pbb Group's Supplemental Information according to section 315a (1) HGB is equal to pbb's Supplemental Information according to section 289a (1) HGB.

Shares with Special Rights Conferring Powers of Control (Section 315a (1) No. 4 HGB)

No shares carrying special rights, which would permit the holder to exercise control, were issued.

Type of Control of Voting Rights Regarding Shares Held by Employees with their Rights of Control not Being Directly Exercised (Section 315a (1) No. 5 HGB)

Employees holding pbb shares exercise their rights, like all other shareholders, according to statutory provisions and the Articles of Association.

Statutory Provisions, and Provisions in the Articles of Association Regarding the Appointment and Removal of Members of the Management Board, and Regarding Amendments to the Articles of Association (Section 315a (1) No. 6 HGB)

In accordance with section 84 of the AktG and section 6 of the Articles of Association, the members of the Management Board are appointed by the Supervisory Board. The number of members of the Management Board is determined by the Supervisory Board. Pursuant to the Articles of Association, the Management Board consists of at least two members. Members of the Management Board are appointed for no more than five years per term. The term of office may be renewed or extended for a maximum of five years in each case. In case of urgency, the Local Court of Munich (Amtsgericht) shall appoint a missing member of the Management Board upon application of a party involved (section 85 of the AktG). The Supervisory Board may revoke an appointment to the Management Board, and also an appointment to the position of Chairman of the Management Board, should there be good cause for doing so.

Evidence that the Management Board members are trustworthy, have the required professional qualifications, and are sufficiently available, must be provided to BaFin, ECB and the German Bundesbank. According to section 45c of the German Banking Act (Kreditwesengesetz, KWG), BaFin may appoint a special representative, and entrust him or her with the performance of activities of individual Management Board members. BaFin may prohibit members of the Management Board from carrying out their activities, or limit the performance of these activities.

Any amendment of the Articles of Association requires a resolution of the Annual General Meeting (section 179 (1) sentence 1 of the AktG), for which generally a simple majority of the votes cast is required according to section 17 of the Articles of Association, provided, however, that no higher majority is required by law or other sections of the Articles of Association. In cases where a majority of the share capital represented during the passing of the relevant resolution is required – under no formal restrictions – due to regulatory requirements, the simple majority of the share capital represented during the passing of the relevant resolution shall be sufficient. According to section 9 (3) of the Articles of Association, the Supervisory Board shall be authorised to amend the Articles of Association, provided that such amendments are restricted to the wording.

Authorisation of the Management Board to Issue or Repurchase Shares (Section 315a (1) No. 7 HGB)

Authorised Capital

The Management Board is authorised to increase, on one or more occasions, pbb's share capital by up to a maximum total amount of €190,188,029.83 by issuance of new ordinary bearer shares with no par value for contribution in cash or in kind, subject to the approval of the Supervisory Board (Authorised Capital 2015). The shareholders' subscription rights may be excluded under certain conditions. The authorised capital has not been used yet.

Conditional Capital

Pursuant to the resolution of the Annual General Meeting dated 10 June 2015, the share capital of pbb shall be conditionally increased by up to €190,188,029.83 through the issuance of up to 67,237,653 new ordinary bearer shares with no par value (Conditional Capital 2015). The conditional capital increase can only be carried out to the extent to which the conversion or option rights of the holders or creditors of convertible bonds, convertible profit participation rights, convertible hybrid bonds or warrants attached to warrant bonds or profit-sharing certificates with warrants, which are issued or guaranteed by pbb or group entities (section 18 (1) of the AktG) subordinated to pbb in accordance with the authorisation resolution of the Annual General Meeting dated 10 June 2015 (Authorisation 2015) before 9 June 2020, are exercised, or holders or creditors with an obligation to convert fulfil their obligations to convert, or pbb uses its right to substitute, and other forms of performance in satisfaction thereof are not chosen. The new shares are to be issued at the option and/or conversion prices calculated in each case in accordance with the Authorisation 2015. The new shares shall be entitled to a dividend from the beginning of the financial year in which they are created, by exercise of conversion and/or option rights or by fulfilment of respective obligations to convert or by use of pbb's right to substitute; to the extent legally permissible, the Management Board shall be authorised, with the consent of the Supervisory Board, to assign the profit participation of the new shares in derogation from section 60 (2) of the AktG, also for a financial year which has already expired.

Furthermore, the Management Board shall be authorised, with the consent of the Supervisory Board, to determine further details concerning the rights attached to shares as well as the conditions of share issuances in the context of the capital measures specified in section 4 of the Articles of Association (authorised and conditional capital).

Convertible Bonds, Warrant Bonds, Profit Participation Rights and Hybrid Bonds

The Management Board is authorised to issue convertible bonds, warrant bonds, profit participation rights or hybrid bonds, on one or more occasions, on or before 9 June 2020 with or without limitation of maturities against contributions in cash or in kind. The total nominal amount of all Financial Instruments to be issued under the authorisation shall not exceed a total value of € 3,000,000,000.00. As further set out in the conditions of the relevant Financial Instruments, conversion and/or option rights and/or the respective obligations have to be granted to or imposed on the holders respectively the creditors of the Financial Instruments, which may entitle or oblige to subscribe no-par-value shares up to 67,237,653 shares and with a proportionate amount of share capital of up to a nominal sum of €190,188,029.83 as described in more detail in the resolution of the Annual General Meeting of 10 June 2015. Such conversion and/or option rights and/or the respective obligations may also be granted to or imposed on the holders of profit participation rights and/or hybrid bonds issued.

Treasury Shares

pbb is authorised to buy, for purposes other than securities trading, its own shares in a total volume of up to 10% of the share capital as of 10 June 2015 or – if such amount is lower – of the share capital at the time this authorisation is exercised. Together with other own shares which are in the Company's possession or attributable to the Company pursuant to sections 71d and 71e of the AktG, the own shares purchased on the basis of this authorisation may not at any time exceed 10% of the Company's share capital. This authorisation to acquire own shares may be exercised directly by pbb, Group entities (section 18 (1) of the AktG) subordinated to pbb, or third parties acting on behalf of pbb or on behalf of Group entities subordinated to pbb. This authorisation may be exercised fully or partially, and – in case of a partial exercise – more than once. This authorisation applies until 9 June 2020. The own shares may, at the discretion of the Management Board, be bought through a stock exchange or by means of a public purchase offer or by means of a public invitation to all shareholders to submit tenders described in more detail in the resolution of the Annual General Meeting of 10 June 2015.

The Management Board is authorised, with the consent of the Supervisory Board, to use any shares purchased on the basis of the authorisation described above for a disposal on the stock exchange or for an offer to all shareholders or to dispose against cash payment provided that the price may not be substantially lower than the stock price of the shares of the Company of the same kind by applying section 186 (3) sentence 4 of the AktG analogously, or to dispose against contribution in kind or to redeem the shares. The shareholders' subscription rights may be excluded as described in more detail in the resolution of the Annual General Meeting of 10 June 2015.

As at 31 December 2017, pbb neither held treasury shares nor equity derivatives.

Material Company Agreements which are Subject to Change of Control Clauses Triggered in the Event of a Takeover Offer (Section 315a (1) No. 8 HGB)

pbb did not enter into material agreements which are subject to change of control clauses triggered in the event of a takeover offer.

Compensation Agreements Entered into with Members of the Management Board or Employees in the Event of a Takeover Offer (Section 315a (1) No. 9 HGB)

Please refer to the remuneration report for further information on compensation agreements entered into with members of the Management Board or employees in the event of a takeover offer.

CORPORATE GOVERNANCE STATEMENT AND CORPORATE GOVERNANCE REPORT[1]

Declaration of Compliance with the German Corporate Governance Code, pursuant to section 161 of the AktG

Since 16 July 2015, pbb shares have been listed on the Frankfurt Stock Exchange. Since that date, pbb has been subject to disclosure requirements pursuant to section 161 of the AktG. Its first-time Declaration of Compliance with the German Corporate Governance Code (the "Code") dated 14 August 2015, as well as all subsequent Declarations of Compliance, are available on the company's website: https://www.pfandbriefbank.com/en/investors/mandatory-publications.html. The most recent Declaration of Compliance issued by the Management Board and the Supervisory Board was dated 24 March 2017.

Pursuant to section 161 (1) sentence 1 of the AktG, the Management Board and the Supervisory Board of pbb shall declare, on an annual basis, that the company has complied with, and continues to comply with, the recommendations of the Government commission "German Corporate Governance Code", or which recommendations have not been (or are not being) complied with, stating reasons for any non-compliance (the concept of "comply or explain").

Accordingly, the Management Board and the Supervisory Board of pbb declare that pbb complied with the recommendations of the Government Commission "German Corporate Governance Code" (as amended on 7 February 2017) during the 2017 financial year, and continues to do so.

Munich, 23 March 2018

The Management Board The Supervisory Board

[1] The chapter "Corporate Governance Statement and Corporate Governance Report" has not been part of the audit carried out by the external auditors.

Corporate Governance Report

pbb is a leading European specialist bank for Commercial Real Estate Finance and Public Investment Finance; it ranks amongst the largest issuers of Pfandbriefe. pbb has been listed in the Prime Standard segment of the Regulated Market at the Frankfurt Stock Exchange since 16 July 2015; its shares have been included in the MDAX® index since 21 September 2015. pbb holds a General Meeting of shareholders at least once a year.

Recommendations of the German Corporate Governance Code

The Company's current as well as previous Declarations of Compliance with the German Corporate Governance Code (the "Code"), pursuant to section 161 of the AktG, are permanently available on the Company's website: https://www.pfandbriefbank.com/en/investors/mandatory-publications.html.

Description of Management Board and Supervisory Board work processes

The Management Board informs the Supervisory Board, as well as the Supervisory Board committees, regularly and in a timely manner, about pbb Group's financial situation and performance. During meetings, the Supervisory Board receives reports on the risk position, risk management, new business, the liquidity strategy, as well as on significant events which are of material importance to the assessment of the Company's position, development and management.

The CEO maintains continuous contact with the Chairman of the Supervisory Board (or the Chairmen of the respective committees) with regard to important developments. Regular topics of discussion during Supervisory Board meetings additionally include developments in the lending business and the overall credit policy, all lending exposures which must be reported to the Supervisory Board, risk developments, risk management, business policy as well as market trends and developments regarding the lending business and refinancing.

Management Board

The Management Board manages pbb's business in its own responsibility, and in accordance with the law, the Articles of Association, and the Internal Rules of Procedure for the Management Board (Geschäftsordnung). Moreover, the members of the Management Board observe the internal Code of Conduct, which applies for all members of staff and is publicly available on pbb's website.

During the year under review, the members of pbb's Management Board were responsible for the following portfolios:

- Andreas Arndt: CEO and CFO
- Thomas Köntgen: Deputy CEO, Treasury & Real Estate Finance
  (since 1 May 2017, including Credit Markets and Public Investment Finance)
- Andreas Schenk: CRO
- Dr Bernhard Scholz: Credit Markets and Public Investment Finance (until 30 April 2017)

Members of the Management Board are bound to act in the interests of pbb; they must not pursue personal interests in their decision-making. During their term of office for pbb, they are bound to observe an extensive no-competition clause and are prohibited from exploiting opportunities available to the Company for their own benefit. Members of the Management Board must draw their fellow Board members' attention to potential conflicts of interest; they are obliged to disclose any actual conflicts of interest to the Supervisory Board (or the Executive and Nomination Committee), without delay. No such conflicts of interest occurred during the year under review.

pbb does not grant any loans to Management Board members.

As far as pbb is aware, the members of the Management Board and their closely related parties did not hold any shares in the Company (or any financial instruments based thereon) during the year under review, to an extent that would have been reportable.

Supervisory Board

The Supervisory Board continuously monitors the Management Board and provides it with regular advice on the management of the Company. In accordance with the Memorandum and Articles of Association, the Supervisory Board consists of nine members, six of which are elected by shareholders and three by employees, in accordance with the German One-Third Employee Participation Act (Drittelbeteiligungsgesetz).

The current terms of office of shareholders' representatives on the Supervisory Board will end upon the close of the Annual General Meeting in 2021, which resolves on the formal approval for the 2020 financial year – with one exception: Dr Hedda von Wedel's term of office will end upon the close of the Annual General Meeting in 2018, which resolves on the formal approval for the 2017 financial year. The next regular elections of employee representatives to the Supervisory Board are scheduled to take place in 2021.

The Supervisory Board elected Dr Günther Bräunig as its Chairman, and Dagmar Kollmann as his deputy.

During the financial year 2017, the company's Supervisory Board comprised:

Supervisory Board of pbb in financial year 2017

Name and place of residence Function in Supervisory Board	**Principal occupation** Functions in the Committees of the Supervisory Board	**Supervisory Board memberships and other directorships in 2017**
Dr Günther Bräunig Frankfurt/Main, Germany Chairman	**Deputy CEO of KfW** **(CEO since 1 January 2018)** Chairman of the Executive and Nomination Committee and of the Remunaration Committee, Member of the Audit Committee and of the Risk Management and Liquidity Strategy Committee	**True Sale International GmbH, Frankfurt/Main, Germany** – Chairman of the Shareholder's Advisory Board
Dagmar Kollmann Vienna, Austria Deputy Chairman	**Entrepreneur** Chairman of the Audit Committee and Member of the Executive and Nomination Committee and of the Remunaration Committee	**Deutsche Telekom AG, Bonn, Germany** – Member of the Supervisory Board **KfW IPEX-Bank GmbH, Frankfurt/Main, Germany** – Member of the Supervisory Board **Bank Gutmann AG, Vienna, Austria** – Member of the Supervisory Board **Unibail-Rodamco SE, Paris, France** – Member of the Supervisory Board
Dr Thomas Duhnkrack Kronberg/Taunus, Germany Member	**Entrepreneur** Member of the Audit Committee	**Hauck & Aufhäuser Privatbankiers AG, Frankfurt/Main, Germany** – Member of the Supervisory Board **Lloyd Fonds AG, Hamburg, Germany** – Deputy Chairman of the Supervisory Board (until 10.12.2017)
Dr Christian Gebauer-Rochholz Hochheim, Germany Employee Representative	**Bank employee**	–
Georg Kordick Poing, Germany Employee Representative	**Bank employee**	–
Joachim Plesser Ratingen, Germany Member	**Consultant** Chairman of the Risk Management and Liquidity Strategy Committee, Member of the Executive and Nomination Committee and of the Remunaration Committee	**Commerz Real Investmentgesellschaft mbH, Wiesbaden, Germany** – Member of the Supervisory Board **DIC Beteiligungs AG, Frankfurt/Main, Germany** – Member of the Supervisory Board **GEG German Estate Group AG, Frankfurt/Main, Germany** – Member of the Supervisory Board **Pandion AG, Cologne, Germany** – Chairman of the Supervisory Board
Oliver Puhl Frankfurt/Main, Germany Member	**Entrepreneur** Member of the Risk Management and Liquidity Strategy Committee	–
Heike Theißing Munich, Germany Employee Representative	**Bank employee** Member of the Remunaration Committee	–
Dr Hedda von Wedel Andernach, Germany Member	**President of the Bundesrechnungshof (retired)** Member of the Audit Committee and of the Risk Management and Liquidity Strategy Committee	–

In accordance with section 5.4.1 of the Code, as part of its Rules of Procedure, the Supervisory Board has defined specific goals for its composition; at the Supervisory Board meeting held on 11 August 2017, it also resolved a profile of skills and expertise for the entire Board. These are supplemented by a catalogue of criteria for new Supervisory Board members to be appointed, which takes into account Company-specific requirements and the requiste professional skills and expertise. Changes in the composition of the Supervisory Board are not expected to occur prior to the end of Dr Hedda von Wedel's term of office, and the related elections at the Annual General Meeting in 2018.

Moreover, the Supervisory Board should consist of independent members, in a number that the Supervisory Board considers sufficient. The Supervisory Board should also not include more than two former members of the Management Board. Former Management Board members should not chair the Supervisory Board, or one of its committees. With the exception of Oliver Puhl, all shareholder representatives on the Supervisory Board were appointed at a point in time when pbb was wholly owned by Hypo Real Estate Holding GmbH, and thus indirectly by the German Financial Markets Stabilisation Agency (FMSA) and the Federal Republic of Germany. However, all Supervisory Board members, with the exception of Dr Günther Bräunig, consider themselves independent. No former member of the Management Board currently sits on the Supervisory Board.

The Supervisory Board has established four committees in order to perform its supervisory duties in an efficient manner: the Executive and Nomination Committee, the Audit Committee, the Risk Management and Liquidity Strategy Committee, and the Remuneration Committee.

The committees consist of the following members:

The members of the **Executive and Nomination Committee** are:
Dr Günther Bräunig (Chairman), Dagmar Kollmann and Joachim Plesser

The members of the **Audit Committee** are:
Dagmar Kollmann (Chairman), Dr Günther Bräunig, Dr Thomas Duhnkrack and Dr Hedda von Wedel

The members of the **Risk Management and Liquidity Strategy Committee** are:
Joachim Plesser (Chairman), Dr Günther Bräunig, Oliver Puhl and Dr Hedda von Wedel

The members of the **Remuneration Committee** are:
Dr Günther Bräunig (Chairman), Dagmar Kollmann, Joachim Plesser and Heike Theißing.

The Executive and Nomination Committee concerns itself with strategic and current issues affecting the Group, as well as with matters concerning the Management Board, for which it prepares corresponding proposals for the plenary meeting. It also advises the Supervisory Board regarding issues of Management Board personnel and succession planning, the individual specifications of Management Board contracts, and submits corresponding recommendations to the Supervisory Board. In addition, the committee prepares the examination of efficiency for the Management Board as well as the Supervisory Board and its committees. Moreover, it deals with the implementation of the female quota for pbb's Supervisory Board and Management Board, and makes proposals for the succession of Supervisory Board members to be elected by shareholders.

The Audit Committee is concerned with all accounting issues, as well as with the audit of pbb and pbb Group. It is responsible for the preparation, and monitors the audit of the Annual and Consolidated Financial Statements, the interim reports, as well as the reports submitted by Internal Audit and the external auditors regarding internal and external audit findings. Moreover, the Audit Committee discusses the impact of current regulatory issues with the Management Board; it concerns itself with the mandate for the external auditors and their audit plan, submits proposals for the appointment of the external auditors to the Supervisory Board, and prepares the Supervisory Board's proposals for the election of external auditors to the Annual General Meeting. The Audit Committee is also responsible for monitoring the effectiveness of the Internal Control System and of key controls implemented; it receives regular reports on current litigation, Compliance issues, data protection and IT security, notable accounting issues, as well as the audit plan established by Internal Audit and its implementation.

The Risk Management and Liquidity Strategy Committee supports the Supervisory Board's supervision of risk management and liquidity management; it reviews the Management Board's risk reporting, and is involved in the credit approval process to the extent laid down in the Rules of Procedure. The committee also regularly discusses new business developments as well as the liquidity and funding status; it looks at all types of risks associated with the banking business, such as credit, market, liquidity and operational risks, taking the Group's risk-bearing capacity into account. The committee also concerns itself with the syndication business, foreclosures and development financings; it deals with specific allowances, the reporting of own funds in accordance with the German Solvency Regulation, country limits, and asset/liability management. In addition, it deals with individual loans requiring approval under the Internal Rules of Procedure for the Management Board, with new business, regular re-submissions and approvals for change applications.

The Remuneration Committee monitors whether remuneration systems for the Management Board and for the bank's employees are appropriate; it deals with the remuneration report, the agreement of targets for Management Board members, and for examining and determining staff having risk-taking functions.

The Supervisory Board assured itself in all cases that the management measures taken by the Management Board were lawful, appropriate, due and proper. The Management Board fulfilled its duties to provide information, and informed the Supervisory Board (and/or its committees) in a regular, timely and comprehensive manner, both in writing and orally, about matters and measures relevant to the Company. This also included information on any deviations between target and actual figures or developments. The members of the Supervisory Board had sufficient opportunity, at all times, to critically assess the reports and proposed resolutions submitted by the Management Board, and to make their own suggestions during Supervisory Board committee meetings and in the plenary sessions.

In particular, the Supervisory Board held in-depth discussions on, and reviewed the plausibility of, all business transactions material to the Company on the basis of written and oral reports provided by the Management Board.

Members of the Supervisory Board shall take responsibility for any training or professional development measures that are necessary to fulfil their duties. The Company adequately supports them in this regard.

Due to offices they hold with other credit institutions and real estate investors, some of the Supervisory Board members may conceivably have conflicts of interest which require disclosure to the Supervisory Board, particularly regarding conflicts of interest which may arise due to a consultant or directorship function with clients, suppliers, lenders or other parties. In case of existing conflicts of interests of Supervisory Board members or their related parties, in particular stemming from relationships with clients and/or relationships with other credit institutions, the Supervisory Board's Rules of Procedure provide regulations to avoid or mitigate such conflicts of interest, for instance the disclosure of imminent conflicts of interest or the waiver of voting rights.

pbb does not grant any loans to Supervisory Board members.

As far as pbb is aware, the members of the Supervisory Board and their closely related parties did not hold any shares in the Company (or any financial instruments based thereon) during the year under review, to an extent that would have been reportable.

During the financial year under review, the Supervisory Board examined the efficiency of its work in line with the requirements of section 25d (11) of the KWG, drawing on external support for this purpose. At the Supervisory Board meeting held on 16 February 2017, the results of the Supervisory Board and Management Board evaluations for 2016 were discussed, and measurement recommendations were derived.

In line with the recommendations of the Code, the Chairman of the Supervisory Board does not chair the Audit Committee: this position is held by Ms Kollmann. Ms Kollmann fulfils the requirements as set in the Supervisory Board's Rules of Procedure according to which the chair of the Audit Committee must fulfil the requirements established in section 25d (9) sentence 3 of the KWG and section 5.3.2 of the Code, and shall in particular have expertise in accounting and auditing as well as specific knowledge and experience in applying accounting principles and internal control procedures.

When making proposals to the Annual General Meeting for the election of new Supervisory Board members, the Supervisory Board ensures that the proposed candidates fulfil the requirements applicable to the respective position, and coincide with the goals for the composition of the Supervisory Board derived from the profile of skills and expertise for the entire Board, taking into account the knowledge of the respective candidate. Furthermore, the Supervisory Board makes sure that the respective candidates are able to provide the time required for the position.

For further details on the work of the Supervisory Board, please refer to the Report of the Supervisory Board, which forms part of this Annual Report.

Other Disclosures Regarding Corporate Governance Standards

Transparency

Information provided by pbb on its website includes all key details regarding the financial statements and Consolidated Financial Statements, the half-yearly report, quarterly reports or statements, and the financial calendar. Within the framework of Investor Relations activities (such as analyst conferences and roadshows) as well as via Corporate Communications, the Group provides additional, regular information on corporate developments. This includes mandatory disclosures such as voting rights and ad-hoc disclosures. The Corporate Governance Report (including the Declaration of Compliance with the German Corporate Governance Code) is permanently available on pbb's website.

Risk Management

Risk management and risk control are key tasks within the scope of pbb's overall bank management. Through the business and risk strategy, the Management Board sets the framework for pbb's risk appetite and risk-bearing capacity in its business activities. Monthly risk reports to the Management Board provide an extensive analysis of pbb's overall risk situation and adjustments are made where necessary. The Supervisory Board is informed about the risk situation on a regular basis, at least once a quarter.

Compliance

Transparent, fair, responsible and honest conduct – with the required degree of skills, professionalism and integrity in dealings with one another and in relation to clients and business partners, competitors and the public – provide the foundation for pbb's business success. This trust is not least based upon implementation of, and compliance with, relevant statutory, regulatory and internal rules. Besides adherence to legal and regulatory requirements, the Code of Conduct sets the internal ethical and legal framework; it serves the purpose of voluntary self-regulation and provides guidance for employees. The Code of Conduct contains the indispensable requirements which apply to all of pbb's staff. In addition, as part of the Compliance organisation, precautions have been taken to ensure compliance with data protection rules, as well as to prevent money laundering, the financing of terrorism, insider trading, and any other prohibited and/or criminal acts. Moreover, pbb's employees receive regular training courses on the prevention of money laundering and other criminal offences, and on Compliance issues.

Remuneration Report

As part of pbb's Annual Report, the Remuneration Report outlines the structure of remuneration systems for the Supervisory Board, the Management Board, and employees. This includes a description of Supervisory Board remuneration, in accordance with the Memorandum and Articles of Association; remuneration for the Management Board is broken down into monetary remuneration, ancillary benefits, and pension benefits, and is shown individually for each Management Board member. For details on share option programmes or other share-based incentive systems of the Company, please refer to pbb's Remuneration Report. The 2017 quantitative remuneration information on employees, to be disclosed in compliance with Article 450 of the Capital Requirements Regulation ("CRR") in conjunction with section 16 of the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – "IVV"), is scheduled to be disclosed after completion of the remuneration review during the second quarter of 2018, in line with the IVV, as part of pbb's remuneration report, which is permanently available on the Company's website (http://www.pfandbriefbank.com).

Related Party Transactions

Please refer to the notes to the Consolidated Financial Statements for further information regarding related party transactions.

Accounting policies

pbb prepares its Annual Financial Statements in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – "HGB"); its Consolidated Financial Statements are prepared in accordance with International Financial Reporting Standards (IFRS), as adopted in the European Union. The Management Board prepares the Annual and Consolidated Financial Statements. The external auditors submit their report on the audit of the Annual Financial Statements and Consolidated Financial Statements to the Supervisory Board. The Annual General Meeting appointed KPMG AG Wirtschaftsprüfungsgesellschaft (KPMG), as the external auditors for the 2017 financial year. Having ascertained the independence of the external auditors, the Supervisory Board appointed the external auditors and defined the focal points of the audit. Details regarding the fees paid to the external auditors are provided in the notes to the Consolidated Financial Statements.

KPMG, the auditors of the Annual and Consolidated Financial Statements elected by the Annual General Meeting, audited the Annual and Consolidated Financial Statements including the Combined Management Report of pbb as at 31 December 2017 and issued them with an unqualified audit opinion. The financial statements documents and audit reports were submitted to all Supervisory Board members in good time. The Audit Committee of the Supervisory Board addressed the financial statements documents in its meeting on 23 March 2018. The Annual Financial Statements and Consolidated Financial Statements, as well as the Combined Management Report and the audit reports, were discussed in detail with the Management Board and representatives of the external auditors. Following its own review, the Supervisory Board did not raise any objections to the audit results submitted by the external auditors. The Supervisory Board meeting on 23 March 2018 approved the Consolidated Financial Statements and adopted the Annual Financial Statements. Details regarding the examinations carried out by the Supervisory Board, and the results of such examinations, are provided in the Report of the Supervisory Board.

Diversity, and disclosures pursuant to section 289f (2) nos. 4 to 6 of the HGB

In its Code of Conduct (which is also published on pbb's website), pbb Group has committed itself to respect all people, independent of age, sex, race, social background, skills, sexual orientation or religion. The Group welcomes and fosters diversity amongst its staff – this includes safeguarding the principle of equal opportunity, whilst rejecting discrimination of any kind.

On this basis, when appointing the Company's executives, the Management Board and Supervisory Board consider the principle of diversity within the scope of their long-term succession planning; in particular, they endeavour to ensure that women are appropriately represented. In its internal rules of procedure, and based on catalogues of criteria concerning personal aptitude and professional skills for new members of the Management Board and Supervisory Board, the Supervisory Board has adopted standards for its composition and the qualification of its members. These standards are supplemented by the skills profile for the Supervisory Board adopted in 2017.

In principle, every candidate must be reliable and sufficiently qualified; he or she must be able to ensure sufficient availability to exercise his or her office. Besides holding the necessary professional skills with regard to management and sector experience, candidates shall be trustworthy and of high integrity. Likewise, the selection of candidates shall take their requisite independence into account. Where several candidates are being considered, the goal of achieving maximum diversity shall also be considered. Moreover, the composition of executive bodies is supposed to reflect pbb Group's international activities as well as the structure of the workforce.

Specific requirements exist with regard to the age and gender of Supervisory Board and Management Board members. For instance, the members of the Management Board should generally not be older than 60 years. Whilst all current Management Board members satisfy this requirement, Andreas Arndt will exceed the age limit of 60 years during the term of his current appointment. The Supervisory Board consciously accepted this in order to safeguard stability in the composition of the Management Board after privatisation was completed, as well as to secure Mr Arndt's long-standing experience for pbb. As a rule, the members of the Supervisory Board should not be older than

70 years, and the term of office of a Supervisory Board member should generally end upon the close of the ordinary Annual General Meeting following their reaching the age of 70. As a rule, members of the Supervisory Board should not serve for more than three full terms of office (as defined by section 102 (1) of the AktG). In principle, pbb currently complies with these rules, except for one case where the age limit has been exceeded (Dr Hedda von Weddel, who will retire from the Supervisory Board upon the close of the ordinary Annual General Meeting 2018, after expiry of her term of office). In another case, the term of office will end later than upon the close of the ordinary Annual General Meeting following the member's reaching the age of 70 (Joachim Plesser, whose term of office will end upon the close of the Annual General Meeting 2021, which will resolve on formal approval for the 2020 financial year).

A key aspect of the diversity concept pursued by pbb is on the issue of gender balance: in principle, when appointing executive staff, pbb Group endeavours to ensure that the under-represented gender is appropriately represented. The Supervisory Board accordingly set the following target levels, most recently in November 2017, which are applicable until 30 June 2022:

- Target female quota for Supervisory Board members: 30%.
- Target female quota for Management Board members: 20%.

On 31 December 2017, 33.3% of Supervisory Board members were women; the female quota of the Management Board, whose composition was unchanged during the reference period (except for the retirement of Dr Bernhard Scholz), remained at 0%. The Supervisory Board maintains its endeavours to ensure the under-represented gender is appropriately represented when filling vacancies on the Management Board, in a targeted manner – given candidates who have the requisite skills and qualifications. However, in view of the terms of Management Board members' service contracts (which run at least until 2020), and considering the introduction phase for Marcus Schulte (currently Senior General Manager), prior to his planned appointment to the Management Board to assume responsibility for the Treasury division, a change of the present situation is currently not expected.

The Management Board has set target female quotas for the first and second management levels below the Management Board, most recently in October 2017; the Management Board aims to achieve these targets by 30 June 2022:

- Target female quota for the first management level below the Management Board: 15%.
- Target female quota for the second management level below the Management Board: 15%.

Against the background of stabilising the workforce following privatisation, and the resulting low fluctuation in pbb's staff, the Bank was not able to achieve these targets during the period under review – despite a higher share of female managers on the second management level below the Management Board. On 31 December 2017, 10% of first-level managers and 11.8% of second-level managers were women. pbb has decided to affirm its target levels for the share of female managers on the first and second level below the Management Board. This reflects the high level of importance pbb assigns to the objective of further increasing the number of women in executive positions. Therefore, pbb maintains its intention to raise the number of women in executive positions, and to ensure women are appropriately represented when filling vacancies, in a targeted manner – given candidates who have the requisite skills and qualifications. A higher awareness for this topic, across all levels of hierarchy, together with a corresponding management and corporate culture, also contribute to this objective. Moreover, pbb offers employees attractive working conditions – especially flexible working hours and teleworking opportunities, which help balancing family and working life.

Disclosures pursuant to section 289a (2) no. 5 of the HGB

Given that the Company is subject to the One-Third Employee Participation Act (DrittelBG), no disclosure pursuant to section 289a (2) no. 5 of the HGB is required.

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Consolidated Income Statement

Consolidated income statement

in € million	Note	2017	2016
Operating income		**424**	**508**
Net interest income	31	435	404
Interest income		1.672	1.843
Interest expenses		–1.237	–1.439
Net fee and commisssion income	32	8	8
Fee and commisssion income		11	10
Fee and commisssion expenses		–3	–2
Net trading result	33	–5	–6
Net income from financial investments	34	–4	125
Net income from hedging relationships	35	–1	6
Net other operating income/expenses	36	–9	–29
Loan loss provisions	37	–6	–1
General and administrative expenses	38	–216	–198
Net miscellaneous income/expenses	39	2	–8
Profit or loss before tax		**204**	**301**
Income taxes	40	–22	–104
Net income/loss		**182**	**197**
attributable to:			
Equity holders		182	197

Earnings per share

in €	Note	2017	2016
Basic earnings per share	42	1.35	1.46
Dilluted earnings per share	42	1.35	1.46

Consolidated Statement of Comprehensive Income

Consolidated statement of comprehensive income

in € million	2017	2016
Net income/loss	**182**	**197**
Other comprehensive income for the period, net of tax	3	–87
Items that will not be reclassified subsequently to profit or loss	7	–11
Gains/losses on pension commitments, before taxes	10	–15
Income taxes relating to items that will be reclassified to profit or loss	–3	4
Items that may be reclassified subsequently to profit or loss	–4	–76
Gains/losses on translating foreign currency, before taxes	1	–1
Unrealised gains/losses	–	–1
Gains/losses reclassified to profit or loss	1	–
Gains/losses on AfS assets, before taxes	23	–44
Unrealised gains/losses	19	–50
Gains/losses reclassified to profit or loss	4	6
Gains/losses on cash flow hedge accounting, before taxes	–30	–59
Gains/losses reclassified to profit or loss	–30	–59
Income taxes relating to items that may be reclassified subsequently to profit or loss	2	28
Total comprehensive income for the period	**185**	**110**
attributable to:		
Equity holders	185	110

Consolidated Statement of Financial Position

Assets

in € million	Note	31.12.2017	31.12.2016[1]	1.1.2016[1]
Cash reserve	9, 43	999	1,136	1,265
Trading assets (HfT)	10, 44	870	1,089	1,600
Loans and advances to other banks (LaR)	11, 45	2,415	2,841	2,742
Loans and advances to customers (LaR)	11, 46	40,274	41,146	41,226
Allowances for losses on loans and advances	12, 47	–71	–130	–149
Valuation adjustment from portfolio hedge accounting	7, 48	–1	2	1
Financial investments (LaR)	7, 49	8,240	9,534	11,406
Financial investments (AfS)	7, 50	2,385	3,311	3,521
Property and equipment	14, 51	6	8	10
Intangible assets	15, 52	36	24	21
Other assets	3, 16, 53	2,712	3,572	5,035
Thereof: Positive fair values from hedging derivatives		2,678	3,492	4,960
Income tax assets	24	129	118	105
Current tax assets		42	47	21
Deferred tax assets		87	71	84
Total assets		**57,994**	**62,651**	**66,783**

[1] Corrected due to 8.42. Details are disclosed in note "consistency".

Equity and liabilities

in € million	Notes	31.12.2017	31.12.2016[1]	1.1.2016[1]
Liabilities to other banks (at amortised cost)	17, 57	3,280	3,179	2,514
Liabilities to customers (at amortised cost)	17, 58	8,275	9,949	10,824
Securitised liabilities (at amortised cost)	17, 59	38,362	40,381	42,648
Valuation adjustment from portfolio hedge accounting	7, 60	–	1	1
Trading liabilities (HfT)	18, 61	956	1,355	1,643
Provisions	19, 62	245	242	229
Other liabilities	3, 20, 63	2,959	3,785	4,925
Thereof: Negative fair values from hedging derivatives		2,889	3,719	4,818
Income tax liabilities	24	57	59	113
Current tax liabilities		57	59	113
Subordinated capital (at amortised cost)	21, 64	1,002	886	1,125
Liabilities		**55,136**	**59,837**	**64,022**
Equity attributable to equity holders		**2,858**	**2,814**	**2,761**
Subscribed capital	65	380	380	380
Additional paid-in capital	65	1,637	1,637	1,637
Retained earnings[2]	3, 65	731	674	502
Gains/losses on pension commitments	19	–75	–82	–71
Revaluation reserve	7	3	8	83
AfS reserve		–19	–36	–4
Cash flow hedge reserve		22	44	87
Consolidated profit		182	197	230
Equity		**2,858**	**2,814**	**2,761**
Total equity and liabilities		**57,994**	**62,651**	**66,783**

[1] Adjusted due to IAS 8.14ff. and corrected due to 8.42. Details are disclosed in note "consistency".
[2] Due to immateriality, the foreign currency reserve is reported under retained earnings.

Consolidated Statement of Changes in Equity

Consolidated statement of changes in equity

in € million	Equity attributable to equity holders							
					Revaluation reserve			
	Subscribed capital	Additional paid-in capital	Retained earnings[1]	Gains/losses on pension commit-ments	AfS reserve	Cash flow hedge reserve	Consolidated profit	**Equity**
Equity at 31.12.2015	**380**	**1,637**	**487**	**-71**	**-4**	**87**	**230**	**2,746**
Corrected due to IAS 42[2]	–	–	15	–	–	–	–	15
Equity at 1.1.2016	**380**	**1,637**	**502**	**-71**	**-4**	**87**	**230**	**2,761**
Disbursement	–	–	–	–	–	–	-57[3]	-57
Total comprehensive income for the period	–	–	-1	-11	-32	-43	197	110
Net income/loss	–	–	–	–	–	–	197	197
Other comprehensive income for the period, net of tax	–	–	-1	-11	-32	-43	–	-87
Transfer to retained earnings	–	–	173	–	–	–	-173	–
Equity at 31.12.2016	**380**	**1,637**	**674**	**-82**	**-36**	**44**	**197**	**2,814**
Equity at 1.1.2017	**380**	**1,637**	**674**	**-82**	**-36**	**44**	**197**	**2,814**
Disbursement	–	–	–	–	–	–	-141	-141
Total comprehensive income for the period	–	–	1	7	17	-22	182	185
Net income/loss	–	–	–	–	–	–	182	182
Other comprehensive income for the period, net of tax	–	–	1	7	17	-22	–	3
Transfer to retained earnings	–	–	56	–	–	–	-56	–
Equity at 31.12.2017	**380**	**1,637**	**731**	**-75**	**-19**	**22**	**182**	**2,858**

[1] Due to immateriality, the foreign currency reserve is reported under retained earnings.
[2] Details are disclosed in note "consistency".
[3] Rounded down; disbursement of dividends amounted to € 57,824,382.44 in 2016.

Consolidated Statement of Cash Flows

Consolidated statement of cash flows[1]

in € million	2017	2016
Net income/loss	**182**	**197**
Write-downs, provisions for losses on, and write-ups of, loans and advances and additions to provisions in lending business	7	5
Write-downs and depreciation less write-ups on non-current assets	14	–112
Change in other non-cash positions	136	146
Result from the sale of non-current assets	–	–2
Other adjustments	–408	–295
Subtotal	**–69**	**–61**
Change in assets and liabilities from operating activities after correction for non-cash components		
Increase in assets/decrease in liabilities (–)		
Decrease in assets/increase in liabilities (+)		
Trading portfolio	14	86
Loans and advances to other banks	414	–102
Loans and advances to customers	136	–435
Other assets from operating activities	–126	–5
Liabilities to other banks	271	1,461
Liabilities to customers	–1,599	–821
Securitised liabilities	–1,160	–2,201
Other liabilities from operating activities	–106	–156
Interest income received	1,726	1,613
Interest expense paid	–1,335	–1,259
Taxes on income paid/refund	–35	–134
Cash flow from operating activities	**–1,869**	**–2,014**
Proceeds from the sale of non-current assets	2,582	3,301
Payments for the acquisition of non-current assets	–835	–1,132
Proceeds from the sale of subsidiaries	–	–
Cash flow from investing activities	**1,747**	**2,169**
Disbursement of dividends	–141	–58
Payments in/of subordinated capital	126	–225
Cash flow from financing activities	**–15**	**–283**
Cash and cash equivalents at the end of the previous period	1,136	1,265
+/– Cash flow from operating activities	–1,869	–2,014
+/– Cash flow from investing activities	1,747	2,169
+/– Cash flow from financing activities	–15	–283
+/– Effects of exchange rate changes	–	–1
Cash and cash equivalents at the end of the period	**999**	**1,136**

[1] Explanations in Note "Notes to the Items in the Consolidated Statement of Cash Flows".

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1 General Information

Deutsche Pfandbriefbank AG (pbb), with its registered offices in Munich, is a leading provider of commercial real estate finance and public investment finance. The Company is registered in the commercial register of the Amtsgericht (local court) Munich (HRB 41054) and represents the ultimate parent company of the Deutsche Pfandbriefbank Group (pbb Group).

These Consolidated Financial Statements were prepared in millions of euros. Due to rounding, numbers presented may not add up precisely to the totals provided.

ACCOUNTING POLICIES

2 Principles

pbb has prepared the present Consolidated Financial Statements for the period ended 31 December 2017 in line with EC ordinance No. 1606/2002 of the European Parliament and Council of 19 July 2002 in accordance with International Financial Reporting Standards (IFRS). The IFRS are standards and interpretations adopted by the International Accounting Standards Board (IASB). These are the International Financial Reporting Standards (IFRS), the International Accounting Standards (IAS) and the interpretations of the IFRS Interpretations Committee (formerly IFRIC) respectively the former Standing Interpretations Committee (SIC); they are also based on the regulations of commercial law which are applicable in accordance with Section 315e (1) HGB (German Commercial Code).

The Consolidated Financial Statements are based on IFRS as adopted in European law by the European Commission as part of its endorsement process. With the exception of certain regulations on fair value hedge accounting for a portfolio hedge of interest rate risks in IAS 39 Financial Instruments: Recognition and Measurement, all the IFRS published by the IASB and required to be applied were fully endorsed by the European Union (EU). Within the framework of fair value hedge accounting for a portfolio hedge of interest rate risks, pbb Group applies a part of the exemptions permitted under European law. Therefore, the present Consolidated Financial Statements comply with IFRS applicable in the EU, but not with IFRS as a whole as promulgated by the IASB.

In addition, the German Accounting Standards (Deutsche Rechnungslegungs Standards – DRS) published by the Accounting Standards Committee of Germany (Deutsche Rechnungslegungs Standards Committee – DRSC) have been taken into account provided they are not inconsistent with the IFRS.

The Management Board of pbb prepared these Consolidated Financial Statements on 6 March 2018.

Initially Adopted IFRS in 2017
The following IFRS standards were applied for the first time in financial year 2017:
> Amendments to IAS 7: Disclosure Initiative
> Amendments to IAS 12: Recognition of Deferred Tax Assets for Unrealised Losses
> Annual Improvements to IFRS Standards 2014–2016 Cycle (only these parts that were applied for the first time from 1 January 2017)

Amendments to IAS 7 The objective of the amendments to IAS 7 is to show the changes in financial liabilities as a result of financing activities in a more transparent manner. The requirements were fulfilled by means of relevant explanations in the “Notes to the Consolidated Statement of Cash Flows”.

Amendments to IAS 12 The amendment to IAS 12 mainly provides clarification concerning the recognition of deferred tax assets on temporary differences arising from unrealised losses. The first-time application had no effects on the Consolidated Financial Statements, as there were no relevant facts which would have to be taken into account.

Annnual Improvements to IFRS Thus, certain disclosures of IFRS 12 also need to be made for shares in subsidiaries, joint ventures or associates which are held for sale within the meaning of IFRS 5. The first-time application had no effects on the Consolidated Financial Statements, given that pbb Group did not hold any such assets in the financial year 2017.

IFRS Endorsed by the EU but Not Yet Effective
An earlier adoption of IFRS, which will be applicable in future financial years, is not planned. The following IFRS were endorsed by the EU as of the balance sheet date, but their application is not yet required:

Name	Publication	First-time application	Expected effects
Amendments to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts	12.9.2016	1.1.2018	No effects as pbb Group does not operate as insurance provider
IFRS 16 Leases	13.1.2016	1.1.2019	See description
IFRS 9 Financial Instruments	24.7.2014	1.1.2018	See description
IFRS 15 Revenue from Contracts with Customers incl. Amendments to IFRS 15 Effective date und Clarifications to IFRS 15	12.4.2016 (Clarifications); 11.9.2015 (Amendments); 28.5.2014 (Standard)	1.1.2018	See description
Annual Improvements to IFRS Standards 2014 – 2016 Cycle	25.4.2014	1.1.2018	No material effects expected

IFRS 16 The new standard on lease accounting will replace IAS 17 as well as the related interpretations IFRIC 4 SIC 15 and SIC 27. According to the new regulations, lessees have to recognise the majority of leases going forward. However, the new standard provides options according to which exemptions apply to leasing contracts with lease terms of 12 months or less as well as underlying assets with low values. IFRS 16's approach to lessor accounting is substantially unchanged from IAS 17 rules. Moreover, the new standard comprises detailed regulations on sale-and-leaseback transactions as well as on the disclosure of lease modifications and reassessments without contractual modifications. In addition, disclosure requirements for lessees and lessors were considerably extended compared to IAS 17. IFRIC 16 is required to be applied for financial years beginning on or after 1 January 2019. IFRS 16 may be applied with full retrospective effect according to IAS 8, or with a modified retrospective effect based on the transitional regulations as defined in the standard.

With regard to its activities as lessor, pbb Group only expects an expansion of disclosures in the Notes. pbb Group has not planned any sale-and-leaseback transactions. The most significant impacts will affect pbb Group in its role as lessee. The right-of-use assets as well as the corresponding lease liabilities will have to be recognised in the amount of the present values of lease payments, eventually increasing total assets. Land and buildings used by pbb Group under lease contracts are particularly relevant in this context, while the Group's operating equipment should be affected to a lesser extent. The increase in total assets as at 31 December 2017 and 31 December 2016 are expected to roughly correspond to the amounts of future minimum lease payments disclosed under the respective Notes "Leases" in these Consolidated Financial Statements. Compared to the income after taxes of pbb Group, only minor total effects on consolidated income are expected.

In 2016, pbb Group started a project for the implementation of the new requirements of IFRS 16. In 2017, the existing contracts in particular have been examined with regard to their relevance in view of IFRS 16. The software for technical implementation of the requirements has been selected, and the functional and technical specifications have largely been completed. The new software – a standard system – is planned to be technically implemented, tested and put into operation in 2018. Overall, pbb Group believes it is making good progress with regard to the first-time application of IFRS 16 as of 1 January 2019, on schedule.

IFRS 9 With IFRS 9 IASB issued a new standard for the accounting of financial instruments which supersedes the current regulations of IAS 39. Financial instruments mainly comprise loans, securities, financial liabilities and derivatives, which collectively represent more than 95% of pbb Group's total assets. The standard contains fundamental revisions regarding classification and measurement, impairment methodology and hedge accounting – however, without any specific regulations on so-called macro hedge accounting.

The classification and measurement of financial instruments was changed substantially compared to IAS 39. The former measurement categories valid pursuant to IAS 39 at fair value through profit or loss, held to maturity, loans and receivables and available for sale were replaced by the following measurement categories:
> at fair value through profit or loss
> at fair value through other comprehensive income
> at amortised cost.

The categorisation of financial assets depends on the entity's business model for managing financial assets (business model criterion) and the contractual cash flow characteristics of the financial asset (contractual cash flow criterion) at initial recognition.

A financial asset shall be measured at amortised cost if both of the following conditions are met:
> the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows; and
> the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.

A financial asset shall be measured at fair value through other comprehensive income if both of the following conditions are met:
> the financial asset is held within a business model whose objective is achieved by both collecting cash flows and selling financial assets; and
> the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.

A financial asset shall be measured at fair value through profit or loss unless it is measured at amortised cost or at fair value through other comprehensive income. However, an entity can make an irrevocable election at initial recognition for particular investments in equity instruments that would otherwise be measured at fair value through profit or loss to present subsequent changes in fair value in other comprehensive income.

The business model criterion is the first step of the categorisation. An entity's business model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. For this, the entity must consider all relevant evidence that is available at the date of assessment. Such relevant evidence includes, but is not limited to:

> how the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
> the risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way in which those risks are managed; and
> how managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or the contractual cash flows collected); and
> the expected frequency, value and timing of sales in prior periods, the reasons for those sales and expectations about future sales activities.

As the second step of the categorisation an entity has to classify a financial asset on the basis of the contractual cash flow characteristics. For this, an entity shall assess whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding. The principal is the fair value of the financial asset at initial recognition. Interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks (for example, liquidity risk) and costs, as well as a profit margin.

An entity may, at initial recognition, irrevocably designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (so called fair value option).

Non derivative financial liabilities have to be measured at amortised cost, unless they are hold for trading purposes or are designated at fair value through profit or loss. The amount of change in the fair value of financial liabilities that is attributable to changes in the credit risk of that liability shall be presented in other comprehensive income and the remaining amount of change in profit or loss. Derivatives have to be measured at fair value through profit or loss as before unless they are accounted for in cash flow hedge accounting.

When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset in accordance with IFRS 9, an entity shall recalculate the gross carrying amount of the financial asset and shall recognise a modification gain or loss in profit or loss. In some circumstances, the renegotiation or modification of the contractual cash flows of a financial asset can lead to the derecognition of the existing financial asset. When the modification of a financial asset results in the derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified financial asset is considered a new financial asset.

The regulations regarding impairments in accordance with IFRS 9 fundamentally differ from IAS 39 regulations and are relevant for assets measured either at amortised cost or at fair value through other comprehensive income as well as for off-balance sheet obligations, such as loan commitments and financial guarantees. While the IAS 39 impairment model provides for the recognition of loss allowances in the case where a triggering event occurs, IFRS 9 introduces a model according to which provisions for credit losses upon initial recognition of the financial asset (or at the date when the Group becomes a contracting party of the loan commitment or financial guarantee) are recognised on the basis of potential credit losses expected at that time. According to IFRS 9 this is an unbiased and probability-weighted amount that is determinated by evaluation of a range of possible outcomes and scenarios. IFRS 9 clarifies that this is a probability weighted average and not the most probable amount.

Upon initial recognition, the impairments in lending business are based on expected credit losses for the first twelve months (so-called stage 1). The 12-month expected credit loss is that part of the lifetime expected credit losses, which is equal to the expected credit losses from defaults that may occur for the financial instrument within twelve months after balance sheet date. In case of a significant increase in the financial asset's credit risk within the context of subsequent measurement (stage 2) or in case of a credit impairment (stage 3), the impairment has to reflect the lifetime expected credit losses.

The same definition of default is used for IFRS 9 as for regulatory purposes. For this a default is defined if
- it is unlikely that the borrower can fully fulfill its payment obligations, or
- the borrower has material past dues of more than 90 days.

For purchased or originated credit-impaired financial assets (POCI) only the cumulative changes in lifetime expected credit losses since initial recognition have to be recognised as a loss allowance.

With the new regulations in hedge accounting, accounting for hedging relationships will be more closely tied to the economic risk management of a company. As long as regulations on accounting for macro hedges have not yet been adopted, the IASB provides the option to apply the former rules pursuant to IAS 39.

IFRS 7 (Financial Instruments: Disclosures) has been amended as part of the introduction of IFRS 9. In particular, this comprises amendments to disclosure requirements regarding information about the significance of financial instruments for an entity's financial position and performance as well as the nature and extent of risks arising from financial instruments.

The intitial application of IFRS 9 has to be accounted retrospectively as of 1. January 2018. Hence, the initial application effects are shown directly in equity not affecting profit or loss. pbb Group will not restate comparative information for 2017 in the annual report 2018.

pbb Group has implemented the requirements of IFRS 9 in a perennial project. The project was embedded in a program to further develop the IT target architecture for the Finance and Risk divisions to use synergies between the different regulatory requirements in the best possible manner. The IFRS 9 project was divided into sub-projects for classification and measurement, the determination of impairments of stage 1 and 2 and the determination of impairments of stage 3.

In the scope of the implementation of IFRS 9 new IT systems were implemented or existing systems were amended. New processes were established or existing processes were changed and specifications were determined:

- The financial assets of pbb Group were classified to the measurement categories according to the IFRS 9 requirements. Therefore, the financial assets were classified according to the business model criterion and the contractual cash flow criterion. In addition, both criteria were integrated in the new business process and the new product process.
- The fair value option is not used for debt instruments on the asset side and financial liabilities on the liability side.
- pbb Group holds equity instruments of an insignificant amount. These are measured at fair value through profit or loss.
- The impairment regulations were implemented. For these pbb Group developed models for the calculation of the 12-months expected credit loss and the lifetime expected credit loss and defined criteria for the significant increase in credit risk. The amount of impairments is determined on an individual basis.
- The process for modification of financial assets was amended and a simulation tool was developed as the basis for decisions about contractual modificiations.
- For hedge accounting pbb Group will exercise the accounting option and will retain the current regulation of IAS 39.
- In the scope of the technical implementation the posting-keeping sub-ledgers to account for loans and securities and the general ledger were amended to the new requirements. A new sub-ledger was implemented for fair value accounting. A system was developed for the determing the allowances in stage 1 and 2. The existing IT system was enhanced to take into account scenarios for stage 3.
- The new or changed notes disclosures were implemented to a large extent in the multi disciplinary data warehouse.
- In the second half of 2017 the new processes were tested in parallel with the existing processes and the initial and subsequent application effects were simulated.

The initial application of IFRS 9 has significant effects on the Group balance sheet as it consists of financial instruments in the vast majority. The changes mainly result from the regulations for the classification and measurement and from the accounting of impairments.

According to IFRS 9 the non-derivative financial instruments of pbb Group are classified and measured as follows:

- Segment Real Estate Finance: Non-derivative financial instruments are principally measured at amortised cost (business model: financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows). The exceptions are:
  - Financial assets or parts of financial assets, for which there is an intention to syndicate (business model: financial asset is neither held within a business model whose objective is to hold financial assets in order to collect contractual cash flows nor within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets). These have to be accounted at fair value through profit or loss.
  - Financial assets which do not fulfill the contractual cash flow criterion and therefore have to be measured at fair value through profit or loss.
- Segment Public Investment Finance: Non-derivative financial instruments are principally measured at amortised cost (business model: financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows). Exceptions are: Financial assets or parts of financial assets, for which there is an intention to syndicate (business model: financial asset is neither held within a business model whose objective is to hold financial assets in order to collect contractual cash flows nor within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets). These have to be accounted at fair value through profit or loss.

- Segment Value Portfolio: Non-derivative financial instruments are principally measured at amortised cost (business model: financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows). Exceptions are:
  - Financial assets held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. These are measured at fair value through other comprehensive income.
  - Financial assets which do not fulfill the contractual cash flow criterion and therefore have to be measured at fair value through profit or loss.
- Portfolios in Consolidation and Adjustments: Non-derivative financial instruments are principally measured at amortised cost (business model: financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows). Exceptions are:
  - Financial assets held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. These financial assets of the liquidity portfolio are measured at fair value through other comprehensive income.
  - Financial assets which do not fulfill the contractual cash flow criterion and therefore have to be measured at fair value through profit or loss.

As a consequence of the changed classification and measurement of financial assets some loans and securities have to be accounted differently as per the former regulations of IAS 39:
- 22 deals which were categorised as loans and receivables according to IAS 39 and therefore were measured at amortised cost do not fulfill the contractual cash flow criterion of IFRS 9. Therefore they have to be measured at fair value through profit or loss.
- There is a syndication intention for parts of five deals on 1. January 2018. These parts have to be measured at fair value through profit or loss due to the business model criterion.
- Six deals which were categorised as available for sale pursuant to IAS 39 and therefore were measured at fair value through other comprehensive income have to be measured at amortised cost according to IFRS 9.
- 55 deals wich were categorised loans and receivables pursuant to IAS 39 and therefore were measured at amortised cost have to be accounted at fair value through other comprehensive income according to IFRS 9 due to business model of the underlying portfolios.
- 27 deals were recategorised from the measurement category available for sale to the measurement category loans and receivables in the year 2008. The AfS reserve of these deals which have to be accounted at amortised cost pursuant to IFRS 9 has to be released according to IFRS 9.
- The contractual cash flows of three deals were modified in the past. Therefore the carrying amount under IFRS 9 had to be adjusted.

There are no changes in the measurement for all other financial assets compared to accounting pursuant to IAS 39.

In total there is a positive effect from the initial application of IFRS 9 in equity of €158 million before deferred taxes. There are no changes for financial liabilities and derivatives compared to former IAS 39 in pbb Group.

pbb Group developed check criteria for the allocation to the three impairment stages of IFRS 9. Each financial asset which does not have to be measured at fair value through profit or loss has to be allocated to stage 1 at initial recognition if it is not credit-impaired. A financial asset moves to stage 2 if the credit risk has increased significantly. This is the case if

> as rebuttable presumption there is a past due of more than 30 days; or
> the financial is non-investment grade and the multi-year probability of default at balance sheet date exceeds the multi-year probability of default at initial recognition of the financial asset by a defined factor.

The criteria for a move from stage 2 to stage 3 do not differ significantly from the objective evidence according to IAS 39 leading to specific loan loss provisions.

Regulatory risk parameters (probability of default / PD, loss given default / LGD) and contract information like for example the contractually agreed cash flows are used as a basis for determining the amount of credit losses of the financial instruments. The regulatory risk parameters are transformed adequately so that the requirements of IFRS 9 are fulfilled. Particularly this transformation ensures that the risk parameters are unbiased. Historic data about rating migration together with forecasts of macro-economic developments are used for the determination of multi-year probabilities of default. For this information according to the type are customer are used. The forecast of relevant indicators for example market value developments or the economic growth is based on internal analyses and externally available data.

The IFRS 9 initial application effect in equity before deferred taxes from the accounting of impairments sums up to €–32 million.

In total there is an increase in IFRS equity by €126 million before deferred taxes and €109 million after deferred taxes from the classification and measurement and the accounting of impairments.

pbb Group will change the disclosure of the income statement and the statement of financial position in the scope of the initial application of IFRS 9. The new disclosure structure is shown in the note "Consistency".

Regarding subsequent reporting periods, the application of IFRS 9 regulations will result in more volatile results of operations compared to the current regulations under IAS 39, due to the higher number of financial instruments to be measured at fair value through profit or loss and the new regulations regarding impairments pursuant to IFRS 9. This volatility may result in multi-million euro fluctuations, and may thus be considered material regarding pbb Group's recent net income levels. In addition, it should be considered that common interpretations have not been developed in the common accounting pratcice for some regulations of the principle based IFRS 9. This may lead to effects in the future.

IFRS 15 IFRS 15 determines when revenue has to be recognised, and in what amounts. In accordance with IFRS 15, revenue has to be recognised when the customer obtains control over the contractual goods and services – and can obtain benefits from these goods and services. Referring to the existing products and contractual arrangements of pbb Group, no material changes to the timing of revenue recognition are expected. Thus, no material effects on the Consolidated Financial Statements are anticipated.

IFRS Issued but Not Yet Endorsed by the EU

In addition, the following standards were issued, but had not yet been endorsed by the European Union:

Name	Publication	First-time application	Expected effects
Annual Improvements to IFRS Standards 2015–2017 Cycle	12.12.2017	1.1.2019	No material effects expected
Amendments to IFRS 9: Prepayment Features with Negative Compensation	12.10.2017	1.1.2019	No effects as there are no such contracts
Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures	12.10.2017	1.1.2019	No effects as there are no material interests in such associates and joint ventures
IFRIC 23 Uncertainty over Income Tax Treatments	7.6.2017	1.1.2019	See description
IFRS 17 Insurance Contracts	18.5.2017	1.1.2021	No effects as pbb Group does not operate as insurance provider
IFRIC 22 Foreign Currency Transactions and Advance Consideration	8.12.2016	1.1.2018	See description
Amendments to IAS 40: Transfers of Investment Property	8.12.2016	1.1.2018	No effects as there are no investment properties
Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions	20.6.2016	1.1.2018	See description

IFRIC 23 This interpretation is set to ensure the application of clear and uniform accounting policies in unclear tax situations with regard to the recognition and measurement of tax liabilities. The application may affect the Consolidated Financial Statements if uncertainties in terms of income tax treatment arise in the course of future transactions.

IFRIC 22 Where prepayments are made in foreign currency transactions, the interpretation provides guidance for the determination of the exchange rate. At present, pbb Group expects no material effects.

Amendments to IFRS 2 The amendments to IFRS 2 have been published in order to clarify classification and measurement of share-based payment transactions. At present, pbb Group expects no material effects arising from the amendments to IFRS 2, while future effects will depend on the amount and structure of share-based payments.

Statement of Compliance for the German Corporate Governance Code

Company's Management Board and the Supervisory Board published a statement of compliance for the German Corporate Governance Code in this annual report as well as on pbb's website (http://www.pfandbriefbank.com/en/investors/mandatory-publications.html).

Combined Management Report

The Combined Management Report meets the requirements of section 315 (1) and (2) HGB and DRS 20. It comprises fundamental information about the Group, a report on the economic position, a report on post-balance sheet date events, a Risk and Opportunity Report, a report on expected developments, commentary on pbb's Unconsolidated Annual Financial Statements under HGB and supplemental information. The Risk and Opportunity Report contains information which, under IFRS 7, is required to be disclosed.

3 Consistency

pbb Group applies its accounting policies on a consistent basis in accordance with the Conceptual Framework for Financial Reporting as well as IAS 1 and IAS 8.

In the Consolidated Financial Statements as at 31 December 2017, the previous line item "Financial investments" was split into the two new line items "financial investments (LaR)" and "financial investments (AfS)". In addition, the measurement categories defined in IAS 39 (HfT, LaR, amortised cost) were added to the name of the line items "trading assets", "loans and advances to other banks", "loans and advances to customers", "liabilities to other banks", "liabilities to customers", "securitised liabilities" and "trading liabilities". By introducing these changes, pbb Group increases the transparency of its financial reporting, since the application of different measurement bases for different classes of assets in accordance with IAS 1.59 suggests that their nature or function differs. The presentation of the previous year's figures was adjusted accordingly.

It was identified in the fourth quarter of 2017 that consolidation matters had been recognised in the past which should have been derecognised before 2016. These consolidation matters result from the incorrect use of balances carried forward from the ultimate parent company's Consolidated Financial Statements in the preparation of the first-time Consolidated Financial Statements of pbb in 2009. These matters relate to negative "goodwill", assumptions of profit or loss, and income tax allocations. These accounting entries that were wrongly carried forward to the current periods were corrected in accordance with IAS 8.42.
The following retrospective restatements were made in the statement of financial position as at 1 January 2016:

> Other assets increased from € 5,013 million by € 22 million to € 5,035 million.
> Other liabilities increased from € 4,918 million by € 7 million to € 4,925 million.
> Retained earnings[1] increased from € 487 million by €15 million to € 502 million.

The following retrospective restatements were made in the statement of financial position as at 31 December 2016:

> Other assets increased from € 3,550 million by € 22 million to € 3,572 million.
> Other liabilities increased from € 3,778 million by € 7 million to € 3,785 million.
> Retained earnings[1] increased from € 659 million by €15 million to € 674 million.

In addition, the Consolidated Financial Statements as at 31 December 2017 were prepared under the same accounting policies used for the Consolidated Financial Statements as at 31 December 2016.

pbb Group plans to change the structure and the presentation of the items reported in the income statement and the statement of financial position as well as the related notes, starting from the financial year 2018. This will result in a change in the characteristics of the transactions reported in the line items. The new presentation will no longer be guided by the product-specific logic, which in general was previously applied in Germany, but will be based on the internationally common presentation focusing on measurement categories. To a large degree, the new structure is in line with banking supervisory requirements in relation to financial reporting (FinRep). This is a procedure for a report published by the Committee of European Banking Supervisors and the European Banking Authority (EBA) in relation to standardised financial reporting for financial and credit institutions. By introducing the proposed changes, pbb Group will increase the transparency of its financial reporting, since the application of different measurement bases for different classes of assets in accordance with IAS 1.59 suggests that their nature or function differs.

The respective line items of the income statement and the statement of financial position are explained in the following. In addition, the income statement for the financial year 2017 in accordance with IAS 39 in the new structure, as well as the statement of financial position as at 31 December 2017 in the new structure in accordance with IAS 39 and IFRS 9 is presented, thus including the effects on equity from the first-time application of IFRS 9.

[1] Due to immateriality, the foreign currency reserve is reported under retained earnings.

Income statement in new structure

in € million	2017
Net interest income	407
Net fee and commission income	8
Net income from financial assets at fair value trough profit or loss	–5
Net income from derecognition of financial instruments not measured at fair value through profit or loss	45
Net income from hedge accounting	–1
Net other operating income	23
Net gains/losses from allowances on financial assets	–10
Net gains/losses from modifications of financial instruments	–
General and administrative expenses	–199
Expenses from bank levies and similar dues	–28
Net gains/losses from depreciation or amortisation/impairments and reversals on non-financial assets	–14
Net gains/losses from provisions	–22
Profit or loss before tax	**204**
Income tax	–22
Net income/loss	**182**
attributable to:	
Equity holders	182

The individual items of the income statement comprise the following:

- Net interest income primarily includes current interest income and expenses, but no gains or losses from the disposal of financial assets or the early redemption of liabilities, as well as no prepayment fees. The item also does not comprise additions and reversals of provisions that are similar to interest.
- Net fee and commission income, which is unchanged from the previous presentation method, shows the non-accruable fees.
- Net income from financial assets at fair value through profit or loss includes the changes in the fair value of stand-alone derivatives and of non-derivative financial assets that are required to be accounted for at fair value due to the cash flow criterion and the business model criterion set out in IFRS 9.
- Net income from derecognition of financial instruments not measured at fair value through profit or loss includes gains or losses from the disposal of financial assets, e.g. within the framework of sales of financial assets, redemptions of liabilities, prepayment fees or modifications, including derecognition of the previous financial instrument and recognition of the modified financial instrument.
- Net income from hedge accounting, which is unchanged from the previous presentation method, includes hedge inefficiencies within the permitted range.
- Net other operating income consists of components of the previous net other operating income, such as rental income, effects from the disposal of non-financial instruments, or from currency translation. The item no longer includes expenses for the bank levy as well as additions and reversals of provisions.
- Net gains/losses from allowances on financial assets comprises additions and reversals of allowances of all three stages in relation to all financial loans and advances and securities not measured at fair value through profit or loss. Additions and reversals of allowances for loans and advances were previously reported in the item "loan loss provisions", while those for securities were shown under net income from financial investments.
- Net gains/losses from modifications of financial instruments include effects from modifications that do not lead to a derecognition of the previous financial instrument and a recognition of the modified financial instrument.

- General and administrative expenses remain largely unchanged compared to the previous presentation method. However, depreciation, amortisation, impairment losses and reversals of impairment losses in relation to non-financial assets are no longer included in this item.
- The item "expenses from bank levies and similar dues" mainly consists of expenses for bank levies and deposit protection.
- Net gains/losses from depreciation or amortisation/impairments and reversals on non-financial assets comprise depreciation, amortisation, impairment losses and reversals of impairment losses in relation to non-financial assets.
- Net gains/losses from provisions include additions and reversals of provisions.

Balance sheet in new structure
Assets

in € million	31.12.2017 (IAS 39)	1.1.2018 (IFRS 9)
Cash reserve	999	999
Financial assets at fair value through profit or loss	870	1,735
Financial assets at fair value through other comprehensive income	2,385	2,182
Financial assets at amortised cost	50,942	50,427
Credit loss allowances on financial assets	−84	−104
Positive fair values of hedge accounting derivatives	2,678	2,678
Valuation adjustment from porfolio hedge accounting (assets)	−1	−1
Tangible assets	6	6
Intangible assets	36	36
Other assets	34	34
Current income tax assets	42	42
Deferred income tax assets	87	71
Total assets	**57,994**	**58,105**

The individual items of the assets side of the statement of financial position comprise the following:

- The cash reserve, which is unchanged from the previous presentation method, contains balances with central banks.
- The item "financial assets at fair value through profit or loss" includes the positive market values of stand-alone derivatives and financial assets that are to be allocated to the measurement category "at fair value through profit or loss" due to the cash flow criterion or the business model criterion set out in IFRS 9. The instruments were previously reported in the items "trading assets", "loans and advances" and "financial investments".
- The item "financial assets at fair value through other comprehensive income" consists of financial assets of the measurement category "at fair value through other comprehensive income". Financial assets of this measurement category are held within the context of a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets, and whose contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. The instruments were previously reported in the item "financial investments".
- Financial assets allocated to the measurement category "at amortised cost" are reported in the item "financial assets at amortised cost". These financial assets are held within the context of a business model whose objective is to hold financial assets in order to collect contractual cash flows, and whose contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. The holdings were previously reported in the items "loans and advances" and "financial investments".

> The deduction item "credit loss allowances on financial assets" includes the allowances of all three levels in relation to all financial assets that are not measured at fair value through profit or loss. The allowances can refer both to loans and advances and to securities. Allowances in relation to loans and advances were previously reported in the item "allowances for losses on loans and advances". Allowances in relation to securities were previously directly offset against the carrying amount of the security and reported under financial investments.
> The item "positive fair values of hedge accounting derivatives", which is unchanged from the previous presentation method, consists of derivatives having a positive fair value that are used as hedging instruments within the context of micro fair value hedges or portfolio hedges of interest rate risks.
> The item "valuation adjustment from portfolio hedge accounting (assets)", which is unchanged from the previous presentation method, comprises positive fair values as regards the hedged risks in the hedged cash flows from the portfolios of hedged items.
> The item "other assets" includes other non-financial assets. Compared with the previous presentation method, this item no longer comprises hedge accounting derivatives.
> The items "tangible assets", "intangible assets", "current income tax assets" and "deferred income tax assets" have not changed compared with the previous presentation method as regards their composition and nature.

Liabilities and equity

in € million	31.12.2017 (IAS 39)	1.1.2018 (IFRS 9)	
Financial liabilities at fair value through profit or loss	956	1,040	
Financial liabilities measured at amortised cost	50,919	50,919	
Negative fair values of hedge accounting derivatives	2,889	2,805	
Valuation adjustment from porfolio hedge accounting (liabilities)	–	–	
Provisions	245	247	
Other liabilities	70	70	
Current income tax liabilities	57	57	
Liabilities	**55,136**	**55,138**	
	31.12.2017 (IAS 39)	**1.1.2018 (IFRS 9)**	**initial application effect**
Equity attributable to the shareholders of pbb	**2,858**	**2,967**	**109**
Subscribed capital	380	380	–
Additional paid-in capital	1,637	1,637	–
Retained earnings	731	722	−9
Consolidated profit	182	182	–
Accumulated other comprehensive income	−72	46	118
Equity	**2,858**	**2,967**	**109**
Total liabilities and equity	**57,994**	**58,105**	

The individual items of the equity and liabilities side of the statement of financial position comprise the following:

> The item "financial liabilities at fair value through profit or loss" includes stand-alone derivatives with a negative fair value. The item has not changed compared to the previous item "Trading liabilities".

- Financial liabilities allocated to the measurement category “at amortised cost” are reported in the item “financial liabilities at amortised cost”. The holdings were previously reported in the items “Lliabilities to other banks”, “liabilities to customers”, “securitised liabilities” and “subordinated capital”.
- The item “negative fair values of hedge accounting derivatives” consists of derivatives having a negative fair value that are used as hedging instruments within the context of micro fair value hedges or portfolio hedges of interest rate risks.
- The item “valuation adjustment from portfolio hedge accounting (liabilities)”, which is unchanged from the previous presentation method, comprises negative fair values as regards the hedged risks in the hedged cash flows from the portfolios of hedged items.
- The item “provisions” has remained virtually unchanged compared with the previous presentation method as regards its composition and nature.
- The item “other liabilities” includes other non-financial liabilities. Compared with the previous presentation method, this item no longer comprises hedge accounting derivatives.
- The item “current income tax liabilities” has not changed compared with the previous presentation method as regards its composition and nature.
- The composition of equity has remained largely unchanged compared with the presentation in accordance with IAS 39. Accumulated other comprehensive income consists of gains and losses from pension commitments, from currency translation, from cash flow hedge accounting and from financial assets measured at fair value through other comprehensive income, with such gains and losses being recognised in other comprehensive income.

4 Consolidation

	Fully consolidated subsidiaries		Not fully consolidated subsidiaries[2]		Associated entities and other investments		
Number of subsidiaries/entities[1]	Total	Thereof special-purpose entities	Total	Thereof special-purpose entities	Associated entities	Other investments	**Total**
1.1.2016	**10**	**4**	**2**	**–**	**3**	**3**	**18**
Disposals	–1	–1	–1	–	–	–	**–2**
31.12.2016	**9**	**3**	**1**	**–**	**3**	**3**	**16**
1.1.2017	**9**	**3**	**1**	**–**	**3**	**3**	**16**
Additions	1	–	–	–	–	–	**1**
Disposals	–5	–3	–	–	–	–1	**–6**
Mergers/accruals	–1	–	–	–	–	–	**–1**
31.12.2017	**4**	**–**	**1**	**–**	**3**	**2**	**10**

[1] pbb, subsidiaries, associated companies and other investments.
[2] Due to immateriality not fully consolidated.

A subsidiary is an entity that is controlled by another entity. Control is deemed to exist if pbb has decision-making powers to manage relevant activities, has a right to significant returns from the subsidiary, and can use its decision-making powers to influence the amount of significant variable returns.

Structured entities are entities in which voting rights or similar rights are not the dominant factors in determining control, such as if the voting rights relate merely to administrative duties and the relevant activities are governed by contractual agreements. As for subsidiaries, structured entities must be consolidated if the structured entity is controlled.

During the year under review, the following entities were deconsolidated, following their liquidation:
> Hypo Real Estate Capital India Corp. i.L., Mumbai
> Hypo Real Estate Capital Japan Corp. i.L., Tokio
> Hypo Real Estate International LLC I, Wilmington
> Hypo Real Estate International Trust I, Wilmington

Overall, pbb Group's consolidated income statement and consolidated statement of financial position were only mildly affected.

Furthermore Ragnarök Vermögensverwaltung AG & Co. KG, Munich, was merged into pbb.

RPPSE Espacio Oviedo S.L.U., Madrid, was deconsolidated, following its liquidation. The resulting pre-tax loss in the amount of €1 million was recognised in net income from financial investments. RPPSE's net result, generated between 1 January 2017 and the disposal date, 15 December 2017, was included in pbb's Consolidated Financial Statements. According to the reporting standards applicable to pbb's Consolidated Financial Statements, RPPSE's total assets stood at €6 million. RPPSE's statement of financial position comprised loans and advances to banks (€4 million), other assets (€2 million) as well as other liabilities (€5 million) and equity items (€1 million).

CAPVERIANT GmbH, Munich, a wholly-owned subsidiary of pbb established in December 2017, was included in pbb Group's scope of consolidation for the first time. Overall, pbb Group's consolidated income statement and consolidated statement of financial position were not materially affected.

Uniform Consolidated Accounting
The Unconsolidated Financial Statements of the consolidated domestic and foreign companies are incorporated in the Consolidated Financial Statements of pbb using uniform accounting and measurement principles.

Consolidation Principles
At the acquisition date the costs of a business combination are allocated by recognising the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria according to IFRS 3.10 at their fair values at that date. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities so recognised are accounted as goodwill or as an excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities in accordance with IFRS 3.32–36. If the interest in net fair value of the identifiable assets, liabilities and contingent liabilities exceeds the costs of business combination the acquirer shall reassess the identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination, and recognise immediately in profit or loss any excess remaining after reassessment.

Business relations within the group of consolidated companies are netted with respect to each other. Intercompany results attributable to internal transactions are eliminated.

There are no material interests in associated companies or joint ventures. The holdings are accounted as AfS financial instruments.

5 Disclosures of Interests in Subsidiaries

These Consolidated Financial Statements set out a list of shareholdings in the Note "Holdings of pbb". In this list, the subsidiaries are classified on the basis of whether or not they are consolidated. Other shareholdings are also listed. The financial year for all fully-consolidated companies is the calendar year.

The effects of the contractual relations between the Group companies and the subsidiaries which are not consolidated are set out in the Consolidated Financial Statements. pbb Group was unable to reliably determine a fair value for one interest in subsidiaries (31 December 2016: one) that is not included as it is of minor importance to the Group. Interests in these companies in the legal form of a limited company (GmbH) are not traded in an active market and are therefore measured at cost and accounted for in the AfS financial investments.

The total amount of the book values of the company's interests in subsidiaries individually regarded as minor amounted to €0 million (31 December 2016: €0 million). The summarised balance sheet totals of the subsidiaries not included in the scope of consolidation comprised less than 0.1% of the consolidated balance sheet total, as in the previous year. The total of the Group's interests in the profit or loss of the interests in subsidiaries regarded as minor amounted to €0 million (31 December 2016: €0 million). In the financial year 2017, no financial investment whose fair value could not be reliably determined were derecognised (2016: one financial investment (carrying amount €0 million)).

Significant Restrictions with Respect to the Usability of Assets within the Group
Statutory, contractual or regulatory restrictions and protective rights of non-controlling interests may limit the Group in its ability to obtain access to the assets and to easily transfer same to another company or other companies and pay the Group's liabilities. As of the balance sheet date the Group had no significant interests over which it could exert control. 100% of the voting right is retained in all the companies controlled by pbb. Consequently, there are no significant restrictions due to third-party protective rights.

6 Disclosures of Interests in Associates

pbb Group held interests in three associated companies (31 December 2016: three). pbb Group currently has no investments in associated companies to be included according to the at-equity method due to minor importance. Interests in these companies in the legal form of a partnership are measured at amortised cost and accounted for under the AfS financial investments.

The total amount of the book values of the company's interests in associated companies individually regarded as minor amounted to €0 million (31 December 2016: €0 million). The totals of the Group's interests in the profit or loss of the interests in associated companies individually regarded as minor amounted to €1 million (2016: €1 million).

7 Financial Instruments

According to IAS 32, a financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Recognition and Derecognition
pbb Group recognises a financial asset or a financial liability in its statement of financial position if a Group company becomes party to the contractual provisions of the financial instrument.

The purchases or sales of financial instruments are recognised on the trading date. Premiums and discounts are recognised in accordance with the accrual concept in the position net interest and similar income. In accordance with the primary derecognition concept of IAS 39, a financial asset has to be derecognised when all risks and rewards have substantially been transferred. If the main risks and rewards of ownership of the transferred financial asset are neither transferred nor retained, and if control over the transferred asset is retained, the Company has to recognise the asset to the extent of its continuing involvement. There are no transactions within pbb Group which result in partial derecognition due to a continuing involvement.

In case of repos and synthetic securitisations the assets transferred do not qualify for derecognition because derecognition criteria of IAS 39 are not met.

Collateral with the same counterparty and same conditions (e.g. ISDA master agreement) must be netted according to IAS 32. Accordingly, only the net amount is disclosed.

Categories According to IAS 39
When a financial asset or financial liability is recognised initially, it is measured at fair value.

For subsequent measurement purposes IAS 39 requires that all financial instruments have to be classified according to this standard, to be disclosed in the statement of financial position and to be measured according to its categorisation:

Held-for-Trading (HfT) A financial asset or a financial liability is held for trading if it is:
- acquired or incurred principally for the purpose of selling or repurchasing it in the near term,
- part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking, or
- a derivative (except for a derivative that is a designated and effective hedging instrument).

HfT financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. HfT financial instruments are disclosed as trading assets (HfT) and trading liabilities (HfT); these are exclusively derivatives. Interest and dividend income as well as the refinancing costs for the HfT instruments are recognised in net interest income.

If there is a difference between transaction price and market value at the trading date and the difference results from unobservable data that have a significant impact on the measurement of a financial instrument, the difference (so-called day one profit) is not recognised immediately in profit or loss but is recognised over the life of the transaction. The remaining difference is recognised only then in profit or loss when the inputs become observable, when the transaction matures or is closed out. In the financial years 2017 and 2016 there were no material day one profits.

Designated at Fair Value Through Profit or Loss (dFVTPL) If certain conditions are satisfied, financial assets or liabilities can be classified as a financial asset respectively a financial liability at fair value through profit or loss when they are initially recognised. A designation can be made if the use of the measurement category means that a recognition and measurement inconsistency is either avoided or considerably reduced, and management and performance measurement of a portfolio of financial instruments are based on the fair values or if the instrument contains a separable embedded derivative. dFVTPL financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. As of 31 December 2017 and as of 31 December 2016, pbb Group had no financial assets and no financial liabilities in the category dFVTPL.

Held-to-Maturity (HtM) Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity. HtM financial investments are measured at amortised cost. In financial years 2017 and 2016, no financial assets were classified as HtM at pbb Group.

Loans and Receivables (LaR) Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables include promissory notes.

Loans and receivables are recognised in the positions loans and advances to other banks (LaR), loans and advances to customers (LaR) and financial investments (LaR), and are measured at amortised cost. Interest income from loans and receivables is recognised in net interest income. Market price related net gains and net losses attributable to prepayment penalties and disposal of loans and advances to customers and of loans and advances to other banks are disclosed in net interest income. Such net gains and net losses from financial investments (LaR) are recognised in net income from financial investments. Impairments due to credit standing factors and which affecting profit or loss are recognised in loan loss provisions respectively, in the case of financial investments, in net income from financial investments.

Available-for-Sale (AfS) Available-for-sale assets are those non-derivative financial assets that are classified as available for sale and which are not classified as loans and receivables, held-tomaturity investments or financial assets at fair value through profit or loss. pbb Group only classifies securities as AfS but not loans and advances.

AfS financial assets are measured at fair value. Changes in fair value are recognised in a separate item of equity (AfS reserve) not affecting profit or loss until the asset is sold, withdrawn or otherwise disposed of or if an impairment is established for the financial asset in accordance with IAS 39.58 et seq., so that the cumulative loss previously recognised in equity is now recognised in profit or loss. If the objective evidence for the impairment of an AfS debt instrument drops out, the impairment has to be reversed through profit or loss. On the other hand, impairments of an AfS equity instrument which have been recognised in profit or loss are not permitted to be reversed through profit or loss.

AfS financial assets are disclosed as financial investments (AfS). Interest income from AfS assets is recognised in net interest income. Net gains and net losses generated by the disposal of AfS financial instruments as well as by changes in value as a result of impairment or reversals to be recognised in profit or loss are recognised in net income from financial investments.

Financial Liabilities at Amortised Cost Financial liabilities at amortised cost are those non-derivative financial liabilities that are not classified at fair value through profit or loss.

Financial liabilities at amortised cost are measured at amortised cost. Financial liabilities at amortised cost that are not securitised are recognised in liabilities to other banks and liabilities to customers. If these financial liabilities are securitised and not subordinated, they are recognised in securitised liabilities. Subordinated liabilities are recognised in subordinated capital. Interest expenses from financial liabilities at amortised cost are recognised in net interest income. In addition, the position net interest income includes net gains and net losses attributable to repurchases or withdrawals before maturity as well as impairments and impairment reversals of financial liabilities at amortised cost.

Derivatives Derivatives are measured at fair value. Changes in fair value are recognised in profit or loss if the derivatives are not part of cash flow hedge accounting. The measurement gains and losses from stand-alone derivatives are recognised in net trading income and from fair value hedging derivatives in net income from hedging relationships. In the statement of financial position, stand-alone derivatives are disclosed as trading assets and trading liabilities. Hedging derivatives are disclosed as other assets and other liabilities.

Outside the HfT and dFVTPL category, embedded derivative financial instruments within a structured product and which are required to be separated are separated from the host contract and recognised as stand-alone derivative financial instruments. Thereafter, the host contract is measured in accordance with its classification. The change in value arising from the separated derivatives that are measured at fair value is recognised in profit or loss.

Classes
IFRS 7 and IFRS 13 required disclosures according to classes of financial instruments. pbb Group mainly defined the IAS 39 measurement categories, irrevocable loan commitments, financial guarantees, hedging derivatives and cash reserve as classes as well as claims from finance lease agreements.

Measurement Methods Financial instruments at fair value are measured on the basis of stock market prices or other market prices, if existent (Level 1). If a price is not available from an active market, observable market prices from comparable financial instruments are used (Level 2). If prices from comparable financial instruments are not available, valuation models are used that base on observable market parameters. If these parameters are not observable at the markets, the measurement of the financial assets is based on models with non-market-observable parameters (Level 3). The used measurement models are market standard models. A description of these models and the products is given in the Note “Fair Values of Financial Instruments”.

Impairment

According to IAS 39.58 a financial asset must be tested for impairment. At least at each balance sheet date pbb Group assesses on a case-by-case basis whether there is objective evidence for impairment. The criteria used to determine if there is such objective evidence included:
> significant financial difficulties of the borrower
> overdue contractual payments of either principal or interest or other breaches of contract
> increased probability that the borrower will enter bankruptcy or other financial reorganisation
> renegotiations due to economic problems
> a decline in the fair value of a financial asset below its (amortised) cost

Loans at risk of default are restructured by pbb Group if the borrower's financial position has deteriorated but a positive going-concern forecast for the loan exposure can still be carried out. This is carried out by changing the underlying terms and conditions or side agreements by means of a unilateral or mutual declaration of intent. Restructuring agreements should maximise opportunities for pbb Group to realise its outstanding loans or at least minimise the risk of default of the loan exposure. These generally include inter alia standstill agreements, changed interest payment/repayment terms, interest/repayment reductions or the suspension of contractual agreements (e.g. financial covenants) so that the borrower is again able to meet their payment obligations. The credit risk associated with restructured loans is managed by the Group's Credit Risk Management units. The methods used to measure and manage risk are presented in the section of the Risk and Opportunity Report entitled "Credit Risk". Further information is provided in the Note "Restructured Loans and Advances".

Two types of allowances are in place: specific allowances and portfolio-based allowances. Allowances for loans and advances are recognised in a separate account (allowances for losses on loans and advances) instead of directly reducing the carrying amount of the assets. The expense is recognised in loan loss provisions through profit or loss. Changes in an impairment already recognised are recorded as a change in the allowance and also disclosed in profit or loss as a component of loan loss provisions. Specific allowances on AfS financial investments as well as specific allowances and portfolio-based allowances on LaR financial investments are deducted directly from the carrying amount of the asset. The expense is recognised in net income from financial investments through profit or loss. Where subsequent measurement of financial assets is based on fair value through profit or loss, impairment is implied in the fair value.

pbb Group impairs loans and advances as well as financial investments whose terms have been renegotiated if there is objective evidence for impairment.

To measure the impairment loss, the following factors are especially considered:
> pbb Group's aggregate exposure to the customer
> the amount and timing of expected interest and redemption payments
> the realisable value of collateral and likelihood and time of successful repossession
> the likely deduction of any costs involved in recovering amounts outstanding
> the market price of the asset if available

If there is no reasonable prospect for a repayment of the loan or advance and the collateral were realised or transferred to pbb Group, the respective loan or advance and the associated allowance is written off.

For the purpose of calculating portfolio-based allowances, financial assets measured at amortised cost for which no impairment has been identified on an individual basis are grouped in portfolios according to their credit risk. The portfolio-based allowances cover impairments which have been incurred but not yet been identified. The parameters used to determine portfolio-based allowances are checked regularly and adjusted if necessary. The allowances are determined after taking into account the following factors:

> historical loss experience in portfolios of similar credit risk characteristics
> a judgement whether current economic conditions and credit conditions improved or deteriorated compared to the past
> the estimated period between impairment occurring and the impairment being identified
> state of the current economic cycle

Netting of Derivates

The European Market Infrastructure Regulation (EMIR) imposes a clearing obligation for standardised OTC derivatives. pbb uses Eurex Clearing as central clearing agent for derivatives. For Eurex cleared transactions, pbb applies on-balance sheet netting. On-balance sheet netting is applied for each currency, and comprises the carrying amounts of the derivatives as well as the margins calculated (and collected or credited) by Eurex Clearing. The carrying amounts derived from the netting are disclosed under "other assets" or "other liabilities".

Hedge Accounting

Hedging relationships between financial instruments are classified as a fair value hedge, a cash flow hedge or hedge of a net investment in a foreign operation in accordance with IAS 39. Hedging instruments used to hedge interest rate risks are mainly interest rate derivatives, for example interest rate swaps and options.

Fair Value Hedge Under IAS 39, with a fair value hedge, a recognised asset, a recognised liability, offbalance-sheet fixed obligation or a precisely designated part of such an asset, liability or obligation, is hedged against the risk of a change in fair value which is attributable to a specific risk and possibly has an effect on profit or loss for the period.

If the hedge of the fair value in the course of the reporting period meets the criteria of IAS 39.88, the hedge is accounted as follows:

> The profit or loss arising when the hedging instrument is remeasured at fair value (for a derivative hedging instrument) or the currency component of its carrying amount measured in accordance with IAS 21 (for non-derivative hedging instruments) is recognised in profit or loss for the period and
> The carrying amount of a hedged item is adjusted by the profit or loss arising from the hedged item and attributable to the hedged risks, and is recognised in profit or loss for the period. This is applicable if the hedged item is otherwise measured at cost. The profit or loss attributable to the hedged risk is recognised in profit or loss for the period if the hedged item is an available-forsale (AfS) financial asset. The amortisation of the hedge adjustment is started on the date of the revoking of the hedge relationship.

pbb Group uses fair value hedge accounting for presenting micro-hedge and macro-hedge relationships.

Interest rate risks are hedged under micro fair value hedge accounting. Any ineffectiveness within the permissible range pursuant to IAS 39 is reported under net income from hedging relationships. Positive and negative market values of hedging instruments are reported at fair value in other assets or other liabilities, respectively. The adjustment of the hedged item's carrying amount by the profit or loss attributable to the hedged risk directly affects the hedged item. The retrospective effectiveness test is conducted using the regression analysis. The dollar-offset method is used to quantify prospective ineffectiveness. If the hedge relationship is terminated for reasons other than the derecognition of the hedged item, the difference between the carrying amount of the hedged item at that point and the value at which it would have been carried, had the hedge never existed (the unamortised fair value adjustment), is amortised through profit or loss over the remaining term of the original hedge and recognised in net interest income. If the hedged item is derecognised, e.g. due to disposal or repayment, the unamortised fair value adjustment is recognised immediately in profit or loss.

In the context of portfolio hedge accounting within the meaning of IAS 39, interest rate risks from loans and advances as well as from liabilities are hedged on a portfolio basis. The fair values as regards the hedged risks in the hedged cash flows of the portfolios of hedged items are reported either on the assets or on the liabilities side as valuation adjustments from portfolio hedge accounting. The changes in the fair value of hedged risks from the portfolios of hedged items are recognised in net income from hedging relationships. Positive and negative market values of hedging instruments are recognised in statement of financial position at fair value in other assets or other liabilities, respectively. The changes in value are shown in net income from hedging relationships, thus largely compensating the effect on profit or loss from the valuation of the cash flows from the portfolios of hedged items. The cash flows from the portfolios of hedged items are determined monthly within the framework of a dynamic hedge designation and discontinuation process. The resulting valuation adjustments are amortised over the remaining term of the time band and recognised in net interest income. In case of a derecognition of cash flows of hedged items from the portfolio of hedged items, the associated valuation adjustment is reversed on a pro-rata basis and recognised in net interest income.

Cash Flow Hedge Hedge According to IAS 39, a cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with the recognised asset or liability (for instance some or all future interest payments on variable-interest debt) or a highly probable forecast transaction that could affect profit or loss.

Under cash flow hedge accounting, hedging instruments are measured at fair value. The measurement result has to be broken down into an effective and an ineffective portion of the hedge relationship.

As at 31 December 2017, and 31 December 2016, pbb Group did not designate any derivatives to cash flow hedges. The cash flow hedge reserve remaining from designations will be reversed in line with the hedged cash flows from underlying transactions. pbb applies a prospective effectiveness test every quarter. In case ineffectiveness is discovered, the cash flow hedge reserve is reversed through profit or loss.

Hedge of a Net Investment in a Foreign Operation A net investment hedge is a hedge of the foreign currency exposure on a net investment in a foreign operation. Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. pbb Group did not hedge a net investment in a foreign operation in the financial years 2017 and 2016.

8 Leases

In accordance with IAS 17, a lease is an agreement whereby the lessor conveys to the lessee in return for a payment the right to use an asset for an agreed period. Lease agreements have to be classified as either finance leases or operating leases. A lease is classified as an operating lease if substantially all the risks and rewards incidental to ownership of the leased asset remains with the lessor. In contrast, a lease is classified as a finance lease if substantially all risks and rewards incidental to ownership are transferred to the lessee.

pbb Group as a Lessor
Operating Lease In the case of operating leases, the assets leased to the lessee are attributed to the lessor who has to continue to account for the leased assets. pbb Group does not hold any assets under operating leases as lessor.

Finance Lease In the case of finance leases, the lessor has to recognise a receivable from the lessee as an asset. This receivable is measured at the amount of the net investment in the lease at inception of the lease. The received lease payments are divided into an interest portion, which is recognised in profit or loss, and a principal portion. Interest income is recognised over the lease term, generally based on a pattern reflecting a constant periodic rate of return on the net investment in the lease; the principal portion (being a redemption of principal) reduces the outstanding receivable.

pbb Group as a Lessee
Operating Lease The lease instalments paid by the lessee in the context of operating leases are recognised as an expense over the lease term and reported as other operating expenses, or administrative expenses if the payments refer to rental expenses. The rental term commences as soon as the lessee starts to control the actual use of the leased asset. The corresponding leased assets are not recognised as an asset by the lessee.

Finance Lease In the case of finance leases, the lessee recognises the leased assets in its statement of financial position. pbb Group does not hold any assets under finance leases as lessee.

9 Cash Reserve

Cash reserve contains balances with central banks which are measured at cost.

10 Trading Assets

Trading assets comprise positive market values of stand-alone derivatives of the bank book. pbb Group has no non-derivative trading instruments in its portfolio. Trading assets are measured at fair value. Gains and losses arising from the valuation and realisation of trading assets are recognised in net trading income in profit or loss.

11 Loans and Advances

Loans and advances to other banks and loans and advances to customers are measured in accordance with IAS 39 at amortised cost if they are not categorised dFVTPL or AfS or a hedged item of a fair value hedge. As of 31 December 2017, and as of 31 December 2016, pbb Group did not have loans and advances which are classified as AfS or dFVTPL.

Additions to allowances for losses on loans and advances are disclosed as a separate item loan loss provisions in profit or loss. Value changes from hedge relationships are recognised under net income from hedging relationships. All other income and expenses from loans and advances, including net gains and net losses, are recognised in net interest income.

12 Allowances for Losses on Loans and Advances and Provisions for Contingent Liabilities and Other Commitments (Risk Provisioning)

Allowances for losses on loans and advances are recognised if there is objective evidence that it will not be possible for the entire amount which is due in accordance with the original contractual conditions to be recovered. Allowances for loans and advances are measured mainly on the basis of expectations with regard to loan defaults, the structure and quality of the loan portfolio as well as macroeconomic parameters on an specific and portfolio basis.

Specific Allowances
For all recognisable default risks, the extent of the allowance for losses on loans and advances is calculated as the difference between the carrying amount of the asset and the present value of the expected future cash flows. The latter is calculated on the basis of the initial effective interest rate. Market interest rate changes do not have any effect in this respect. The increase in the present value of an adjusted receivable (so-called unwinding) which occurs over a period of time is recognised as an interest income.

Portfolio-based Allowances
Under IAS 39.64, loans which were not specifically impaired are pooled in risk-inherent portfolios. Portfolio-based allowances are recognised for these portfolios; these allowances are measured in respect of current events and information with regard to significant changes with detrimental consequences which have occurred in the technology, market, economic or legal environment, as well as historical default rates.

Risk provisioning is broken down into allowances relating for losses on loans and advances and provisions for contingent liabilities and other commitments like irrevocable loan commitments. An allowance for losses on loans and advances is disclosed as a negative item on the assets side of the statement of financial position, whereas a provision for contingent liabilities and other commitments is disclosed on the liabilities side of the statement of financial position. In profit or loss, all effects are disclosed as loan loss provisions apart from unwinding effects which are disclosed in net interest income.

13 Financial Investments

Financial investments (LaR) are measured at amortised cost. Specific allowances and portfolio-based allowances on LaR financial investments are directly deducted from the carrying amount of the assets. AfS financial assets are measured at fair value. Changes in fair value of financial assets (AfS) are disclosed as a separate item of equity (AfS reserve) not affecting profit or loss until the asset is sold, withdrawn, disposed of, or if impairment is established for the financial asset in accordance with IAS 39.58 et seq. Therefore, the cumulative profit or loss previously recognised in equity is now affecting profit or loss. Specific allowances on AfS financial assets are directly deducted from the carrying amount of the assets. Portfolio-based allowances on AfS financial assets shall not be created for AfS financial assets. AfS financial assets which are hedged effectively against market price risks are part of the hedge accounting. In the financial years 2017 and 2016, pbb Group did not have any HtM and dFVTPL financial assets.

14 Property and Equipment

Property and equipment are generally measured at cost of purchase or cost of production. The carrying amounts (except land) are depreciated on a straight-line basis in accordance with the expected useful lives of the assets. In addition, property and equipment are tested at least annually for impairment. If the value of property and equipment has impaired, an impairment loss is recognised in profit or loss. If the reasons for the impairment no longer exist, an amount not exceeding amortised cost or cost of production is reversed through profit or loss. In the case of fittings in rented buildings, the contract duration taking account of extension options is used as the basis of this contract duration if it is shorter than the useful life.

Useful lives

Fixture in rental buildings	5–15 years
IT equipment (broad sense)	3–5 years
Other operating equipment	3–25 years

Subsequent cost of purchase or costs of conversion are capitalised if an additional economic benefit flows to the Company. Maintenance expenses of property and equipment are recognised in profit or loss of the financial year in which they arose.

15 Intangible Assets

Purchased and internally generated software are the main items recognised as intangible assets. Goodwill, brand names and customer relations are not capitalised.

Software is an intangible asset with a finite useful life. Purchased software is measured at the amortised purchase cost. pbb Group capitalises internally generated software if it is probable that future economic benefits will flow to the Group and the expenses can be measured reliably. Expenses eligible for the capitalisation of internally generated software include external, directly attributable costs of materials and services as well as personnel expenses for employees directly associated with the creation of software used by the Company. Software is amortised on a straight-line basis over expected useful lives of three to five years. In addition, intangible assets with a finite useful life are tested for impairment annually or whenever there is an indication that the intangible asset may be impaired.

16 Other Assets

Other assets mainly comprise positive fair values from derivative financial instruments (hedging derivatives) and salvage acquisitions. Salvage acquisitions are measured as inventories at the lower of cost of purchase and net realisable value in accordance with IAS 2.

17 Liabilities

Liabilities other than hedged items of an effective fair value hedge and which are not classified as dFVTPL are measured at amortised cost. Premiums and discounts are recognised on a pro rata basis. Interest-free liabilities are recognised with their present value. pbb Group has not designated any liabilities into the category dFVTPL. Changes in value resulting from hedge relationships are disclosed under net income from hedging relationships. All income and expenses from liabilities including net gains and net losses resulting from redemption of liabilities are recognised in net interest income.

18 Trading Liabilities

Trading liabilities include negative market values of trading derivatives and of stand-alone derivatives of the bank book. Trading liabilities are measured at fair value. Unrealised and realised profits and losses attributable to trading liabilities are recognised in net trading income in profit or loss.

19 Provisions

A provision is a liability of uncertain timing or amount. A provision shall be recognised when an entity has a present obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. According to IAS 37.15 in rare cases it is not clear whether there is a present obligation. In these cases a present event is deemed to give rise to a present obligation if, taking into account of all available evidence, it is more likely than not that a present obligation exists at the end of the reporting period. In rare cases, for example in a law suit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, pbb determines whether a present obligation exists at the end of the reporting period by taking account of all available evidence, including, for example, the opinion of experts.

Under IAS 37.36 et seq., the best estimate is used for measuring provisions for contingent liabilities and contingent losses attributable to pending transactions. Long-term provisions are generally discounted with an interest rate that reflects the current assessments of the time value of money and the risks specific to the liability.

Provisions for defined benefit plan are calculated on the basis of actuarial reports in accordance with IAS 19. They are measured using the projected unit credit method. The amount of the provision equals the so-called net defined benefit liability which is the difference between the present value of the defined benefit obligation and the fair value of plan assets. pbb closed plan assets in the form of a qualifying insurance policy to hedge parts of the risk from the defined benefit obligations. The reinsurance is pledged to the plan beneficiaries.

The determination of the net defined benefit liability is based on demographic and financial actuarial assumptions. A demographic assumption is for example the mortality for which pbb uses guidance tables. In financial actuarial assumptions the discount rate has the greatest effect on the amount of defined benefit liability. The rate used for the measurement is determined by reference to market yields at the end of the reporting period on high-quality, fixed-interest corporate bonds.

Net interest on the defined benefit liability is determined by multiplying the defined benefit liability by the discount rate. The determination is done at the beginning of the financial year taking account of any changes in the net defined benefit liability during the period as a result of contribution and benefit payments. Net interest on defined benefit liability are shown together with all other effects on income statement from the defined benefit obligations and the plan assets in the position pension expenses and related employee benefit costs in general and administrative expenses.

Remeasurements of the net defined benefit liability result from actuarial gains and losses and the return on plan assets excluding amounts included in net interest on the net defined benefit liability. Remeasurements of the net defined benefit liability are shown in equity in the position profit/losses from pension obligations. Changes of remeasurements of the net defined benefit liability within a period are shown as a component of the consolidated statement of comprehensive income. Actuarial gains and losses result from increases or decreases in the present value of the defined benefit obligation due to changes of actuarial assumptions and experience adjustments. Changes of the discount rate usually have the biggest effect on the actuarial gains and losses.

Along with other German financial institutions, pbb Group is a member of the pension fund BVV Versorgungskasse des Bankgewerbes e.V. ("BVV"). Both pbb Group as an employer and the eligible employees make regular contributions to the BVV pension schemes. BVV insurance tariffs are calculated and designed to provide fixed pension payments, plus profit participations. Every BVV member entity has a subsidiary responsibility for the pension claims of its eligible employees. pbb Group classifies the BVV pension scheme as a defined benefit plan, but discloses it as a defined contribution plan for accounting purposes because the information available is not sufficient to recognise it as a defined benefit plan. pbb Group considers the risk of becoming liable to pension obligations due to its subsidiary responsibility as very remote, and does not recognise any provisions in this respect.

20 Other Liabilities

Besides negative fair values from derivatives recognised in hedge accounting, accrued liabilities are one of the items recognised in other liabilities. Accruals arise from liabilities for products or services which have been received or supplied and have not yet been paid for, invoiced by the supplier or formally agreed. This also includes short-term liabilities to employees, for instance flexitime credits and vacation entitlements. The accrued liabilities are recognised at the amount likely to be utilised. If the obligations listed at this note cannot be quantified more precisely on the balance sheet date and if the criteria specified in IAS 37 for recognising provisions are satisfied, these items have to be disclosed as provisions.

21 Subordinated Capital

In the event of insolvency or liquidation subordinated capital may only be repaid after all non-subordinated creditors have been satisfied. Subordinated capital of pbb Group encompasses subordinated liabilities. Hybrid capital instruments were repaid in 2017. For some instruments of subordinated capital the holders participate in any net loss or consolidated loss. In addition, the interest entitlement can be ceased or reduced under specific conditions. For other instruments the interest ceases only in case of a net loss which can be caught up depending on the structuring.

Pursuant to IAS 32 the subordinated capital instruments issued by companies of pbb Group were classified as financial liabilities or equity instruments in accordance with the substance of the contractual arrangement and the definitions of a financial liability and an equity instrument. Financial liabilities are measured at amortised cost. The amortised costs are the amount at which the financial liability is measured at initial recognition minus principal payments, plus or minus the cumulative amortisation using the effective interest rate method of any difference between that initial amount and the maturity amount and minus any expected reduction of interest and/or principal payments.

22 Share-based Payment

pbb Group awarded share-based remuneration with cash settlement to individual eligible persons. Eligible persons will receive a fraction of their variable remuneration (60%) in subsequent years, based on the average share price of the pbb share in February of the respective year. Thus, the disbursement portion amounts to 40%. Portions linked to the sustainability component are granted on the basis of the performance of the pbb share. Therefore, eligible persons participate financially in the price development of the pbb share via their sustainability-based variable remuneration. As at 31 December 2017, the total amount of share-based remuneration was less than €1 million (31 December 2016: less than €1 million).

23 Currency Translation

Currency translation is carried out in accordance with the regulations of IAS 21. On the balance sheet date, monetary items in a foreign currency are translated into the functional currency. The reporting currency is the euro. Non-monetary items which were stated in a foreign currency using historical cost of purchase are measured using the exchange rate applicable at date of purchase.

Income and expenses attributable to currency translation of the affiliated companies' single financial statements into the functional currency are generally recognised in profit or loss in balance of other operating income/expenses.

In these Consolidated Financial Statements, balance sheet items of the subsidiaries, if they do not prepare financial statements in euros, are translated using the closing rates at the balance sheet date. For translating the expenses and income of these subsidiaries, the average rates are used. Differences resulting from the translation of the financial statements of the subsidiaries do not affect profit or loss and are disclosed in the consolidated statement of changes in equity in the foreign currency reserve[1]. The group of consolidated companies does not include any companies from hyperinflationary countries.

[1] Due to immateriality, the foreign currency reserve is reported under retained earnings.

24 Income Taxes

Income taxes are accounted for and measured in accordance with IAS 12. Apart from the exceptions defined in the standard, deferred taxes are calculated for all temporary differences between the IFRS values and the tax values as well as for the differences resulting from uniform Group measurement principles and differences from the consolidation (balance sheet method). Deferred tax assets arising from non-utilised losses carried forward, interest assets carried forward and tax credits are recognised if required in accordance with IAS 12.34 et seq. and not opposed by a change in tax status in accordance with SIC-25.

Deferred taxes are calculated using the national tax rates which are expected at the time the differences are balanced, as the concept of deferred taxes is based on the presentation of future tax assets or tax liabilities (liability method). Changes in tax rates have been taken into account. The payout period of the corporate income tax claim, which was capitalised on 31 December 2006, expired on 30 September 2017, after the final payment was made.

25 Non-current Assets Held for Sale

In accordance with IFRS 5, a non-current asset or disposal group must be classified as held for sale if the related carrying amount is primarily realised by a disposal transaction and not by continued use. To reclassify an asset as held for sale, certain conditions must be met on a cumulative basis. Above all, there must be a specific intention to sell, the asset must be immediately available and the disposal must be highly probable. As at 31 December 2017 and at 31 December 2016 pbb Group did not own any assets held for sale.

26 Accounting Estimates and Assumptions

When the financial statements are being prepared, pbb Group makes future-related assumptions as well as estimations, resulting in a considerable risk of a major change to the disclosed assets and liabilities becoming necessary during the next financial year. The assumptions and parameters underlying the estimates to be made are based on the exercise of appropriate judgement.

Going-Concern
The Consolidated Financial Statements of pbb are based on the assumption of going-concern. The conditions of going-concern are described in the report on expected developments.

Allowances
The portfolio of pbb Group is reviewed for impairments at least annually. It is necessary to assess whether the estimated future cash flows of a loan portfolio are lower than the actually agreed cash flows. For this purpose, it is necessary to make judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers, or national or economic factors that correlate with defaults on assets in the portfolio. The methods and assumptions concerning the estimates of the extent and timing of the payment streams are reviewed regularly to keep any differences between estimated and actual defaults as low as possible. In addition, the determination of portfolio-based allowances is based on a loss identification period as well as the expected loss based on statistical data.

Fair Values of Original and Derivative Financial Instruments

The fair value of financial instruments that are not listed on active markets is measured using valuation models. In such cases, a check is performed regularly to assess whether the valuation models provide a comparable benchmark for current market prices. The valuation models can only take account of quantifiable factors (e.g. cash flows and discount rates) that also require estimates. Changes in assumptions relating to these factors might have an impact on the fair values of the financial instruments.

According to IAS 8.34, an estimate may need revision if changes occur in the circumstances upon which the estimate was based, or as a result of new information received, or further knowledge acquired. Effective 31 December 2017, pbb Group revised its accounting-related estimates of credit spreads not observable on the market, which are factored into the fair value assessments of loans. The valuation parameters used to determine credit spreads, probability of default (PD) and loss given default (LGD), were based on the parameters used for portfolio-based allowances. The adjustment of the accounting-related estimates resulted in an increase in the fair values of loans and advances to customers (€+38 million). Furthermore, pbb Group adjusted its estimates regarding the execution of termination rights used to determine the fair values of loans in the Real Estate Finance segment; this resulted in a decline in the fair values of loans and advances to customers (€–34 million). The adjustment of the accounting-related estimates described above did not affect pbb Group's consolidated income statement and consolidated statement of financial position. However, the amended estimates affected the disclosure of fair values in the notes.

Embedded Derivatives

In accordance with IAS 39.11, an embedded derivative must be separated from the host contract and measured separately if, in addition to other criteria, the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract. In order to evaluate the existence of an obligation to separate, the economic risks of the host contracts and embedded derivatives are assessed.

Hedge Accounting

Relations between hedged items and hedging instruments can be presented in hedge accounting. A relation only qualifies for hedge accounting when certain conditions specified under IAS 39.88 are satisfied. One of these conditions is that the hedge has to be very efficient with regard to achieving compensation for the risks resulting from changes in the fair value or the cash flow in relation to the hedged risk.

The determination of the effectiveness of the risk hedge depends on risk measuring methods, the parameters which are used and assumptions relating to the probability of occurrence. These methods and parameters are continuously developed in line with the risk management objectives and strategies.

Intangible Assets and Property and Equipment

pbb Group's accounting for intangible assets and property and equipment is subject to estimating uncertainty, particularly in the determination of the useful life of assets and the associated amount of depreciation/amortisation recognised per period.

Provisions

Estimates are used in the measurement of provisions at pbb Group. Estimating uncertainty arises in particular during assessment of the amount of the future cash outflows, the time horizon and the discount rate.

Income Taxes

pbb Group is subject to a wide range of national tax regulations with regard to the calculation of income taxes. In order to measure the tax expenses, it is necessary to make estimates that are calculated with the knowledge existing as of the balance sheet date and closely related to the tax return prepared in the following financial year. In some countries, the current tax charges attributable to the current financial year can only be definitely finalised after the corresponding tax audit has been completed. The variances with regard to the estimated tax burden may have a positive or negative influence on the tax burden in future financial years.

With regard to the capitalisation of losses carried forward and other tax credits, the extent as well as the actual availability of such tax benefits are subject to estimation. Major losses carried forward are subject to national German tax law, and their availability also depends inter alia on the restrictions set out in Sections 10 d EStG, 8 c KStG as well as Section 10 a GewStG. Restrictions based on a change in the tax status (SIC-25) as a result of the privatisation implemented in 2015 did not occur as of the balance sheet date. Deferred tax assets arising from losses carried forward are therefore recognised to the extent as it is likely that future taxable income will be available to offset the non-utilised tax losses carried forward.

Consolidation

Companies and structured entities must be consolidated if pbb has direct or indirect control over them. Control is deemed to exist if pbb has decision-making powers to manage relevant activities, has a right to significant returns from the subsidiary and can use its decision-making powers to influence the amount of the significant variable returns. The level of control is assessed on the basis of contractual and economic relationships to the company or the structured entity. In assessing whether pbb exerts control or substantial influence over the company, estimates or discretionary leeways are required.

SEGMENT REPORTING

27 Notes to Segment Reporting by Operating Segment

Segment reporting for the 2017 financial year was prepared in accordance with IFRS 8 Operating Segments. In line with the Management Approach under IFRS 8, segment reporting discloses segment-specific, management-relevant financial information that is also regularly used by Management Board (Chief Operating Decision Maker) when deciding on the allocation of resources, and for assessing the earnings power of segments. Based on the organisational structure of pbb Group, which is aligned to the various products and services offered, three business segments have been determined in line with internal management reporting.

Within segment reporting, income is determined by deducting matched-maturity funding rates prevailing at the time of concluding a transaction from the interest rate charged to the client. The input parameters required for this purpose are set at the time of originating a new business transaction, within the scope of accounting for individual transactions. In addition, income from investing the Bank's own funds and imputed costs for holding liquidity after drawdown are included at segment level.

Further income or expenses that cannot be allocated directly to a specific lending transaction (in particular, the results from disposal of assets held for liquidity management, early termination fees, from market-induced effects on net trading income, hedging relationships, and the bank levy) are allocated to the business segments, usually on a pro-rata basis, in line with financing volumes.

The allocation of general and administrative expenses to the operating segments differentiates between expenses which can be directly attributed and those which are not directly attributable. Expenses (of the sales units, for example) which are directly attributable can be clearly assigned to the segments via the cost centre. Expenses (of the central units, for example) which are not directly attributable are assigned to the segments' cost centres via well-defined allocation models.

Segment risk-weighted assets (RWA) are determined in accordance with the allocation of individual transactions (credit risk, for example) and with the allocated risk types (operational risks, for example). Risk types which are not directly attributable are assigned to the segments in accordance with well-defined allocation models. The RWA increase in 2017, resulting from the harmonisation of the risk models, was fully attributable to the REF segment.

Equity, excluding revaluation reserves, is fully allocated to the operating segments and the Consolidation & Adjustments (C&A) reconciliation column without disclosure of excess capital. The allocation of equity (excluding revaluation reserves) to the operating segments and C&A follows a proportionate approach and is therefore consistent with the distribution of diversified economic capital within risk management (gone-concern approach).

Real Estate Finance (REF)
The REF operating segment comprises financing for professional real estate investors with a medium to long-term orientation. These include professional national and international real estate companies, institutional investors, property funds as well as, in Germany, customers with a regional focus. Adequate batch sizes and loan-to-values commensurate for the level of risk involved are essential. Strategic partnerships are agreed with other institutions with the aim of permitting higher loan-to-values and larger volumes for customers by means of syndications and syndicated financing arrangements.

Public Investment Finance (PIF)
The PIF operating segment comprises financing eligible for covered bonds for the provision of public infrastructure. The focus here is on public institutions, municipal and social housing construction, buildings for the utilities and waste disposal market, transport infrastructure as well as healthcare and nursing institutions. In addition, pbb Group is active in publicly guaranteed export financing. Financing is given to public sector debtors, companies with a public or private legal structure as well as special-purpose vehicles with a public service guarantee.

Value Portfolio (VP)
The VP operating segment includes all of pbb Group's non-strategic portfolios and activities. In particular, the Budget Finance segment comprises non-strategic public investment finance exposures, as well as selected structured products.

Consolidation & Adjustments (C&A) reconciles the aggregated segment results with the consolidated result. The column also includes income from the investment of allocated equity.

28 Income Statement by Operating Segment

Income/expenses

in € million		REF	PIF	VP	C&A	**pbb Group**
Operating income	2017	337	24	56	7	**424**
	2016	306	30	165	7	**508**
Net interest income	2017	350	36	42	7	**435**
	2016	321	35	41	7	**404**
Net fee and commission income	2017	9	–	–1	–	**8**
	2016	9	–	–1	–	**8**
Net trading income	2017	–	–2	–3	–	**–5**
	2016	–2	–1	–3	–	**–6**
Net income from financial investments	2017	–1	–6	3	–	**–4**
	2016	3	1	121	–	**125**
Net income from hedging relationships	2017	–1	–	–	–	**–1**
	2016	3	1	2	–	**6**
Net other operating income/expenses	2017	–20	–4	15	–	**–9**
	2016	–28	–6	5	–	**–29**
Loan loss provisions	2017	–7	–	1	–	**–6**
	2016	2	–	–3	–	**–1**
General and administrative expenses	2017	–172	–29	–15	–	**–216**
	2016	–156	–26	–16	–	**–198**
Net miscellaneous income/expenses	2017	2	–	–	–	**2**
	2016	–6	–1	–1	–	**–8**
Profit or loss before tax	**2017**	**160**	**–5**	**42**	**7**	**204**
	2016	**146**	**3**	**145**	**7**	**301**

Cost-income ratio[1)]

in %		REF	PIF	VP	**pbb Group**
Cost-income ratio	2017	51.0	>100.0	26.8	**50.9**
	2016	51.0	86.7	9.7	**39.0**

[1)] The cost-income ratio is the ratio of general and administrative expenses and operating income.

29 Balance-sheet-related Measures by Operating Segment

The Management Board controls balance-sheet-related measures by operating segments based on financing volumes, on risk-weighted assets and on equity.

Balance-sheet-related measures by operating segment

in € billion		REF	PIF	VP	C&A	pbb Group
Financing volumes[1]	31.12.2017	24.9	7.0	13.8	–	**45.7**
	31.12.2016	24.1	7.4	15.8	–	**47.3**
Risik-weighted assets[2]	31.12.2017	8.3	1.6	3.5	1.1	**14.5**
	31.12.2016	6.4	1.4	4.1	1.2	**13.1**
Equity[3]	31.12.2017	0.7	0.3	1.5	0.4	**2.9**
	31.12.2016	0.6	0.3	1.5	0.4	**2.8**

[1] Notional amounts of the drawn parts of granted loans and parts of the securities portfolio.
[2] Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5.
[3] Excluding revaluation reserve.

30 Breakdown of Operating Income

Operating income by products

in € million		Real estate financing	Public investment financing	Other products	pbb Group
Operating income	2017	337	24	63	**424**
	2016	306	30	172	**508**

Operating Revenues by Regions

pbb Group differentiates between the regions Germany, Rest of Europe and America/Asia. Allocation of values to regions is based on the location of the registered offices of the Group companies or their branches.

Operating revenues by regions

in € million		Germany	Rest of Europe	America/Asia	pbb Group
Operating income	2017	357	68	–1	**424**
	2016	453	55	–	**508**

Operating Revenues by Customers

There were no significant customers within the meaning of IFRS 8.34 in the financial years 2017 and 2016.

NOTES TO THE CONSOLIDATED INCOME STATEMENT

31 Net Interest Income

Net interest income by categories of income/expenses

in € million	2017	2016
Interest income	**1,672**	**1,843**
Lending and money-market business	1,105	1,180
Fixed-income securities and government-inscribed debt	368	414
Current gains/losses from swap transactions (net interest income and expense)	195	245
Other	4	4
Interest expenses	**–1,237**	**–1,439**
Liabilities to other banks and customers	–220	–298
Securitised liabilities	–965	–1,083
Subordinated capital	–52	–58
Total	**435**	**404**

Interest income for financial assets measured at amortised cost amounted to €1,382 million (2016: €1,498 million). Interest income for AfS assets amounted to €91 million (2016: €96 million). Total net interest income for assets not measured at fair value through profit or loss amounted to €1,473million (2016: €1,594 million).

Interest expenses incurred in the 2017 and 2016 financial years were entirely attributable to liabilities not measured at fair value through profit or loss.

Negative interest income amounted to €16 million (2016: €15 million) and positive interest expenses to €16 million (2016: €14 million); the predominant part was respectively disclosed in current gains losses from swap transactions (net interest income and expense).

32 Net Fee and Commission Income

Net fee and commission income

in € million	2017	2016
Securities and custodial services	–2	–1
Lending operations and other service	10	9
Total	**8**	**8**

Net commission income is attributable exclusively to financial assets and financial liabilities which are not designated at fair value through profit or loss.

33 Net Trading Income

Net trading income

in € million	2017	2016
From interest rate instruments and related derivatives	–	–9
From foreign currency instruments and related derivatives	–5	3
Total	**–5**	**–6**

34 Net Income from Financial Investments

Net income from financial investments consists of income from the sale of securities of the measurement categories AfS and LaR together with changes in the value of such instruments that are to be recognised in profit or loss. Based on measurement categories, net income from financial investments is broken down as follows:

Net income from financial investments of financial instruments by IAS 39 categories

in € million	2017	2016
Financial investments (AfS)	–	3
Financial investments (LaR)	–4	122
Total	**–4**	**125**

35 Net Income from Hedging Relationships

Net income from hedging relationships

in € million	2017	2016
Result from micro fair value hedge accounting	–1	6
Result from hedged items	106	189
Result from hedging instruments	–107	–183
Result from portfolio hedge accounting	–	–
Result from hedged items	–1	2
Result from hedging instruments	1	–2
Total	**–1**	**6**

36 Net Other Operating Income/Expenses

Net other operating income/expenses

in € million	2017	2016
Other operating income	60	48
Other operating expenses	–69	–77
Net other operating income/expenses	**–9**	**–29**

37 Loan Loss Provisions

Loan loss provisions

in € million	2017	2016
Allowances for losses on loans and advances	–7	–6
Allowances for contingent liabilities and other commitments	–	1
Additions	–	–
Reversals	–	1
Recoveries from written-off loans and advances	1	4
Total	**–6**	**–1**

The development of specific allowances on loans and advances as well as portfolio-based allowances is disclosed in the note "Allowances for Losses on Loans and Advances".

38 General and Administrative Expenses

General and administrative expenses

in € million	2017	2016
Personnel expenses	–119	–103
Wages and salaries	–93	–78
Social security costs	–16	–16
Pension expenses and related employee benefit costs	–10	–9
Non-personnel expenses	–97	–95
Other general and administrative expenses	–87	–84
Consulting expenses	–20	–16
IT expenses	–31	–33
Office and operating expenses	–9	–9
Other non-personnel expenses	–27	–26
Depreciation, amortisation and impairment	–10	–11
of software and other intangible assets	–8	–8
of property and equipment	–2	–3
Total	**–216**	**–198**

39 Net Miscellaneous Income/Expenses

Net miscellaneous income/expenses

in € million	2017	2016
Miscellaneous income	2	1
Thereof: Reversals of restructuring provisions	2	1
Miscellaneous expenses	–	–9
Thereof: Additions to restructuring provisions	–	–8
Other taxes	–	–1
Net miscellaneous income/expenses	**2**	**–8**

40 Income Taxes

Breakdown

in € million	2017	2016
Current taxes	–39	–59
Deferred taxes	17	–45
Thereof: Deferred taxes on losses carried forward	2	–25
Total	**–22**	**–104**

Current taxes include a tax income for prior years of €8 million (2016: expenses of €16 million) which was largely due to the effects from a tax audit.

The following overview shows the development of the deferred taxes recognised in the financial statements:

Development of deferred taxes

in € million	2017	2016
Deferred taxes recognised in the statement of financial position	87	71
Difference to prior year	16	–13
Thereof: Recognised in profit or loss	17	–45
Recognised in profits/losses on pension commitments	–3	4
Recognised in AfS reserve	–6	12
Recognised in cash flow hedge reserve	8	16

The change in deferred taxes regarding profits/losses from pension commitments recognised outside profit or loss in the amount of €–3 million (2016: €4 million) is included in deferred taxes from provisions.

The change in deferred taxes regarding the AfS reserve recognised outside profit or loss in the amount of €–6 million (2016: €12 million) is included in deferred taxes from financial investments.

The change in deferred taxes regarding the cash flow hedge reserve recognised outside profit or loss in the amount of €8 million (2016: €16 million) is included in deferred taxes from other assets/liabilities.

Reconciliation

in € million (unless otherwise indicated)	2017	2016
Profit or loss before tax	204	301
Applicable (legal) tax rate in %	27.67	27.67
Expected (computed) tax expense	−56	−83
Tax effects		
arising from tax rate differences	−1	–
arising from tax-free income	−1	−3
arising from deductible and non-deductible items	−15	−19
arising from valuation adjustments and non-application of deferred taxes	43	17
arising from prior years	8	−16
Reported income taxes	**−22**	**−104**
Group tax ratio in %	**10.78**	**34.55**

Following the precise determination on euro basis, the corporate tax rate is at 11.13% (2016: 34.59%).

The tax rate applicable for the reporting year, including solidarity surcharge, is 27.67% (2016: 27.67%) and is comprised of the 15.0% German corporate tax rate currently valid, the payable solidarity surcharge of 5.5% as well as the average trade tax rate of 11.843% (2016: 11.843%).

Foreign tax rates ranged between 19.0% and 35.6%.

Tax effects arising from tax-free income comprise, inter alia, effects from tax-free investment income as well as distributions from German and international companies. Locally applicable tax regulations were taken into account for the determination of profits.

The effects attributable to deductible and non-deductible items relate primarily to non-deductible expenses, which do not have to be taken into account as deferred taxes as a result of permanent differences, but which have reduced or increased the basis of taxation.

The effects arising from valuation adjustments and non-application of deferred taxes, on the one hand, comprise effects from the write down of deferred tax assets on losses carried forward and, on the other hand, opposing effects from the use of tax losses carried forward previously not accounted for.

The effects from previous years include current taxes for previous years which have been incurred as a result of tax audits or a reassessment of the tax liability.

The Group tax ratio is the quotient of the stated income taxes (current and deferred taxes) and profit or loss before tax.

The deferred tax liabilities or deferred tax assets relate to the following items:

Deferred tax liabilities/assets

in € million	2017	2016
Loans and advances to other banks/customers (including loan loss allowances)	–	11
Financial investments	5	154
Trading assets	49	28
Other assets/liabilities	107	137
Deferred tax liabilities before offsetting	**161**	**330**
Offsetting	–161	–330
Deferred tax liabilities after offsetting	**–**	**–**
Financial investments	7	161
Provisions	38	38
Other assets/liabilities	83	114
Trading assets	37	8
Losses carried forward	83	80
Deferred tax assets before offsetting	**248**	**401**
Offsetting	–161	–330
Deferred tax assets after offsetting	**87**	**71**

For domestic companies, the deferred taxes are calculated using the future uniform rate of corporation tax of 15.0% plus the corresponding 5.5% solidarity surcharge and the trade tax depending on the locally applicable assessment rate (the current basic rate is 3.5%). For pbb, the tax rate for the calculation of deferred taxes is 27.67% (2016: 27.67%).

On the reporting date, there are unused tax losses carried forward totalling €3,550 million (2016: €3,712 million) at corporate tax level and €3,591 million (2016: €3,804 million) at trade tax level. Deferred tax assets have been recognised on a portion of €341 million (2016: €334 million) at corporate tax level and €241 million (2016: €234 million) at trade tax level, because the criteria for recognition in accordance with IAS 12.34 et seq. were satisfied. The impairment assessment as regards deferred tax assets on tax loss carryforwards is based on a 5-year tax planning (2016: 3-year tax planning) which was derived from general corporate planning. Loss carryforwards may be applied for an unlimited period, unless in the event of a change of shareholders which is detrimental for tax purposes. An allowance of €0 million was recognised on deferred taxes from temporary differences in the financial year 2017 (2016: €–2 million). Deferred tax income from the origination and reversal of temporary differences arose in the amount of €15 million (2016: deferred tax expenses of €20 million).

Tax rate changes did not result in major deferred tax expenses or income in the current year nor in the previous year.

The use of tax losses previously not recognised resulted in no reduction in the current income tax expense (2016: no reduction in the current income tax expense). From the origination and write-down of loss carryforwards previously recognised, deferred tax income arose in the amount of € 2 million (2016: deferred tax expense arose of € 25 million).

2017 there were no differences associated with investments in subsidiaries (2016: € 58 million). In the prior year on differences associated with investments in subsidiaries, deferred tax liabilities have not been recognised because pbb Group has the ability and the intention to invest profits permanently in these subsidiaries.

41 Net Gains/Net Losses

The income statement contains the following net gains/net losses recognised in profit or loss according to IFRS 7.20 (a):

Net gains/net losses

in € million	2017	2016
Loans and receivables	22	167
Available for sale	–	3
Held for trading	–5	–6
Financial liabilities at amortised cost	–	8

42 Earnings Per Share

Earnings per share[1]		2017	2016
Net income/loss	in € million	182	197
Average number of ordinary shares issued	pieces	134,475,308	134,475,308
Adjusted average number of ordinary shares issued pieces	pieces	134,475,308	134,475,308
Basic earnings per share	in €	**1.35**	**1.46**
Diluted earnings per share	in €	**1.35**	**1.46**

[1] Earnings per share are calculated in accordance with IAS 33 by dividing net income/loss attributable to the ordinary equity holders by the weighted average number of ordinary shares.

Under the assumption that authorised and contingent capital was fully utilised, the number of ordinary shares issued would double, which in turn would result in a decrease of earnings per share by 50%.

NOTES TO THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION (ASSETS)

43 Cash Reserve

Cash reserve

in € million	31.12.2017	31.12.2016
Balance with central banks	999	1,136
Total	**999**	**1,136**

Cash in hand as of 31 December 2017 amounts to €0 million as was the case in the previous year.

44 Trading Assets

Trading assets

in € million	31.12.2017	31.12.2016
Positive fair values of derivative financial instruments	870	1,089
Total	**870**	**1,089**

45 Loans and Advances to Other Banks

Loans and advances to other banks by type of business

in € million	31.12.2017	31.12.2016
Loans and advances	2,415	2,841
Public sector loans	706	780
Other loans and advances	1,709	2,061
Total	**2,415**	**2,841**

Loans and advances to other banks by maturities

in € million	31.12.2017	31.12.2016
Repayable on demand	1,709	2,059
With agreed maturities	706	782
up to 3 months	45	18
more than 3 months to 1 year	104	45
more than 1 year to 5 years	15	164
more than 5 years	542	555
Total	**2,415**	**2,841**

46 Loans and Advances to Customers

Loans and advances to customers by type of business

in € million	31.12.2017	31.12.2016
Loans and advances	40,052	40,913
Public sector loans	15,112	16,813
Real estate loans	24,934	24,081
Other loans and advances	6	19
Claims from finance lease agreements	222	233
Total	**40,274**	**41,146**

Loans and advances to customers by maturities

in € million	31.12.2017	31.12.2016
Repayable on demand	1,178	1,023
With agreed maturities	39,096	40,123
up to 3 months	1,447	1,167
more than 3 months to 1 year	2,462	2,860
more than 1 year to 5 years	17,371	18,067
more than 5 years	17,816	18,029
Total	**40,274**	**41,146**

47 Allowances for Losses on Loans and Advances

Development

in € million	Specific allowances	Portfolio-based allowances	Total
Balance at 1.1.2016	**–117**	**–32**	**–149**
Changes through profit or loss	8	–12	–4
Changes not affecting profit or loss	23	–	23
Use of existing allowances	16	–	16
Effects of foreign currency translations and other changes	7	–	7
Balance at 31.12.2016	**–86**	**–44**	**–130**
Balance at 1.1.2017	**–86**	**–44**	**–130**
Changes through profit or loss	–2	–4	–6
Changes not affecting profit or loss	64	1	65
Use of existing allowances	64	1	65
Effects of foreign currency translations and other changes	–	–	–
Balance at 31.12.2017	**–24**	**–47**	**–71**

Regarding the changes in specific allowances regognised through profit or loss, an amount of €1 million (2016: €2 million) was due tot he increase in the present value of an adjusted receivable (co-called unwinding), which occurs over a period of time.

The allowances for losses on loans and advances were exclusively created for the measurement ategory loans and receivables. The gross carrying amount of impaired loans and advances amounted to € 204 million (31 December 2016: € 336 million) as at the balance sheet date.

48 Valuation Adjustment from Portfolio Hedge Accounting

The line item valuation adjustments from portfolio hedge accounting includes the positive fair values in relation to the hedged risks in the portfolios of hedged items. They amounted to € –1 million as at 31 December 2017 (31 December 2016: € 2 million).

49 Financial Investments (LaR)

Financial investments (LaR) solely consist of debt securities and other fixed-income securities.

The carrying amounts of the LaR financial investments were reduced by portfolio-based allowances amounting to €14 million (31 December 2016: €10 million).

Financial investments (LaR) by maturities

in € million	31.12.2017	31.12.2016
With agreed maturities	8,240	9,534
up to 3 months	144	318
more than 3 months to 1 year	489	1,265
more than 1 year to 5 years	2,264	2,044
more than 5 years	5,343	5,907
Total	**8,240**	**9,534**

pbb Group has made use of the IASB amendments to IAS 39 and IFRS 7, published on 13 October 2008, and reclassified retrospectively as of 1 July 2008 financial investments out of the measurement category AfS of € 30.2 billion. At the date of reclassification the effective interest rate for the AfS securities was between 0.25% and 34.4%.

The following tables summarise the carrying amounts and fair values as of 31 December 2017 and 31 December 2016 as well as fair value gains and losses that would have been recognised in 2017 and 2016 if the financial assets had not been reclassified.

Reclassifications in 2008
Effects as of 31 December 2017

	Into: Financial investments (LaR)			
	31.12.2017		Effect in reporting period if no assets had been reclassified (1.1.–31.12.2017)	
	Carrying amount in € billion	Fair value in € billion	Profit or loss in € million	AfS reserve (after tax) in € million
Out of: Financial investments (AfS)	4.0	4.2	–	–62

Reclassifications in 2008 Effects as of 31 December 2016

	Into: Financial investments (LaR)		Effect in reporting period if no assets had been reclassified (1.1.–31.12.2016)	
	31.12.2016			
	Carrying amount in € billion	Fair value in € billion	Profit or loss in € million	AfS reserve (after tax) in € million
Out of: Financial investments (AfS)	5.0	5.2	–	–14

50 Financial Investments (AfS)

Breakdown

in € million	31.12.2017	31.12.2016
Debt securities and other fixed-income securities	2,382	3,308
Equity securities and other variable-yield securities	3	3
Total	**2,385**	**3,311**

Financial investments (AfS) by maturities

in € million	31.12.2017	31.12.2016
Unspecified terms	3	3
With agreed maturities	2,382	3,308
up to 3 months	44	447
more than 3 months to 1 year	51	425
more than 1 year to 5 years	423	498
more than 5 years	1,864	1,938
Total	**2,385**	**3,311**

51 Property and Equipment

Development of property and equipment

in € million	2017	2016
Operating equipment		
Acquisition/production costs		
Balance at 1.1.	**21**	**23**
Additions	–	1
Reclassifications	–	2
Disposals	–	–5
Balance at 31.12.	**21**	**21**
Depreciation and write-ups		
Balance at 1.1.	**–13**	**–13**
Depreciation	–2	–3
Reclassifications	–	–2
Disposals	–	5
Balance at 31.12.	**–15**	**–13**
Carrying amounts		
Balance at 31.12.	**6**	**8**

52 Intangible Assets

Development of intangible assets

in € million	Software acquired	Internally developed software	Other intangible assets	2017 Total	2016 Total
Acquisition/production costs					
Balance at 1.1.	**42**	**42**	**10**	**94**	**83**
Additions	5	10	5	20	12
Reclassifications	–	6	–6	–	–
Disposals	–	–	–	–	–1
Balance at 31.12.	**47**	**58**	**9**	**114**	**94**
Amortisation and write-ups					
Balance at 1.1.	**–41**	**–29**	**–**	**–70**	**–62**
Amortisation	–1	–7	–	–8	–8
Balance at 31.12.	**–42**	**–36**	**–**	**–78**	**–70**
Carrying amounts					
Balance at 31.12.	**5**	**22**	**9**	**36**	**24**

Research and development expenditure recognised as an expense amounted to € 4 million (2016: € 7 million).

53 Other Assets

Other assets

in € million	31.12.2017	31.12.2016[1]
Positive fair values from hedging derivatives	2,678	3,492
Micro fair value hedge	2,678	3,492
Salvage acquisitions	–	9
Other assets	32	69
Reimbursements under insurance policies	2	2
Total	**2,712**	**3,572**

[1] Corrected due to IAS 8.42. Details are disclosed in note “Consistency”.

The fair values of Eurex Clearing derivatives (see also note "Netting of financial instruments") are disclosed net under other assets (positive fair values) or other liabilities (negative fair values) in the line micro fair value hedge.

Salvage acquisitions were written down by €3 million during the financial year 2017 (2016: €6 million). In addition, salvage acquisitions with a carrying amount of €6 million (2016: €8 million) were sold, realising an effect on income of less than €1 million (2016: less than €1 million).

54 Subordinated Assets

The statement of financial position as of 31 December 2017 and as of 31 December 2016 do not contain subordinated assets.

55 Repurchase Agreements

As a pledgor of genuine repurchase agreements, pbb Group has pledged assets with a book value of €2.0 billion (31 December 2016: €1.9 billion). The securities are still recognised as assets. The considerations which have been received amount to €1.9 billion (31 December 2016: €1.8 billion) and are recognised solely as liabilities to other banks. Assets in repurchase agreements are the only transferable assets the acquirer can sell or repledge in the absence of default according to IAS 39.37 (a).

56 Securitisation

As of 31 December 2017 pbb Group had the synthetic securitisation Estate UK-3 with a transaction period of 15 years (maturity 2022) and a total volume of lending of €178 million (31 December 2016: €187 million) in the portfolio. The collateral-taker of the transaction with commercial mortgage loans is pbb. The credit linked notes were completely sold to the investors. Overall a reduction of expected loss according to Basel III of €154 million (31 December 2016: €161 million) was achieved. The trustee of one particular securitisation transaction doubts the admissibility of the loss allocation intended by pbb, in the amount of approximately GBP113 million. According to the contractual stipulations of the securitisation transaction, the trustee has appointed an Expert to decide on the loss allocation. In pbb's opinion, the conditions for the planned allocation of losses have been met. In the event of the loss allocation being fully or partially inadmissible, pbb would have to bear the losses to the corresponding extent.

NOTES TO THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION (EQUITY AND LIABILITIES)

57 Liabilities to Other Banks

Liabilities to other banks by maturities

in € million	31.12.2017	31.12.2016
Repayable on demand	991	924
With agreed maturities	2,289	2,255
up to 3 months	19	1,583
more than 3 months to 1 year	5	56
more than 1 year to 5 years	1,949	73
more than 5 years	316	543
Total	**3,280**	**3,179**

58 Liabilities to Customers

Liabilities to customers by maturities

in € million	31.12.2017	31.12.2016
Repayable on demand	1,395	1,560
With agreed maturities	6,880	8,389
up to 3 months	702	1,381
more than 3 months to 1 year	1,356	1,654
more than 1 year to 5 years	3,751	4,083
more than 5 years	1,071	1,271
Total	**8,275**	**9,949**

59 Securitised Liabilities

Securitised liabilities by type of business

in € million	31.12.2017	31.12.2016
Debt securities issued	19,876	20,752
Mortgage Pfandbriefe	9,963	9,551
Public Pfandbriefe	5,740	6,962
Other debt securities	4,173	4,209
Money market securities	–	30
Registered notes issued	18,486	19,629
Mortgage Pfandbriefe	5,080	5,346
Public Pfandbriefe	11,050	12,208
Other debt securities	2,356	2,075
Total	**38,362**	**40,381**

Securitised liabilities by maturities

in € million	31.12.2017	31.12.2016
With agreed maturities		
up to 3 months	2,298	3,259
more than 3 months to 1 year	1,900	3,129
more than 1 year to 5 years	16,735	14,829
more than 5 years	17,429	19,164
Total	**38,362**	**40,381**

60 Valuation Adjustment from Portfolio Hedge Accounting

The line item valuation adjustments from portfolio hedge accounting includes the negative fair values in relation to the hedged risks in the portfolios of hedged items. They amounted to €0 million as at 31 December 2017 (31 December 2016: €1 million).

61 Trading Liabilities

Trading liabilities

in € million	31.12.2017	31.12.2016
Negative fair values of derivative financial instruments	956	1,355
Total	**956**	**1,355**

62 Provisions

Breakdown

in € million	31.12.2017	31.12.2016
Provisions for pensions and similar obligations	86	95
Restructuring provisions	3	14
Other provisions	156	133
Thereof: Provisions for legal risks	66	75
Long-term liabilities to employees	1	1
Total	**245**	**242**

There are defined contribution and defined benefit plans for the employees of pbb Group. In the defined contribution plans pbb makes payments for commitments by industry-wide organisations, for instance the BVV in Germany. In almost all non-German entities, a defined percentage of fixed salary is paid into externally managed pension funds for employees as part of defined contribution pension schemes. Expenses in respect of defined contribution plans amounted to €2 million (2016: €2 million). The expense is expected to remain stable in 2018. Expenses in respect of defined contribution plans for persons with a key function in the Group amounted to less than €1 million (2016: less than €1 million). The employer's contribution to the statutory pension insurance amounted to €6 million in 2017 (2016: €6 million).

There are defined benefit pension commitments for many employees in Germany. There are no defined benefit pension commitments in the non-German entities. For the defined benefit plans the employees receive a direct commitment from their respective company. The pension plan especially contains retirement pensions, disability pensions and surviving dependant's pensions. The receipt of retirement pensions or disability pensions starts after a vesting period is fulfilled, at the earliest after reaching a minimum age in the case of part or full incapacity for work, at the latest when going into retirement, usually after completion of the 65th year of life. In the case of active employees, there are predominantly modern modular pension plans. For the other eligible persons there are also final salarybased defined benefit plans. The annual pension module depends, among other things, on the gross annual salary paid and the member's length of service. The surviving dependant's pension usually amounts to 60% of the pension of the spouse respectively the entitlement on that. The pension plan is administered by pbb itself with the aid of an external service provider for the administration.

Pension provisions are recognised for obligations arising from direct commitments. The defined benefit plans have been principally closed for new entrants since 1 April 2004. There have been no plan amendments, curtailments and settlements in the years 2017 and 2016.

The risk of insolvency is covered within the framework of legal requirements by Pensionssicherungsverein a. G. in relation to the total amount of pension obligations.

The following actuarial assumptions were used to measure the defined benefit pension obligations:

Actuarial assumptions

in %	31.12.2017/ 1.1.2018	31.12.2016/ 1.1.2017
Discount rate	1.93	1.75
Rate of increase in pension obligations	1.50	1.50
Rate of increase in future compensation and vested rights[1]	2.50	2.50

[1] Against the background of the adjustments of annual base salaries made in 2015 to a uniform amount of € 500,000 and the introduction of a variable remuneration component, we expect a rate of increase in future compensation and vested rights of 0%, also in view of the appropriateness of Management Board compensation for the active Management Board members in the financial years 2017 and 2016.

The rate of increase in career for members of the Management Board amounts 0.0% (31 December 2016: 0.0%), for directors and non-pay-scale staff 1.5% (31 December 2016: 1.5%) and for payscale staff 0.5% (31 December 2016: 0.5%). The guidance tables 2005G from Klaus Heubeck were used as the biometric basis.

The defined benefit pension commitments of pbb do not contain any unusual or entity-specific risks. pbb is faced by the common demographic risks, for example from longevity or invalidity of the entitled employees, and common financial risks like for example a change of the discount rate. pbb took out reinsurance to protect itself against parts of these risks. The reinsurance is a qualifying insurance policy in accordance with IAS 19 and thus is a plan asset. The fair value of plan assets is a component of the net liability from defined benefit plans which is deducted from the present value of the defined benefit obligation. The reinsurance does not consist of any unusual or plan-specific risks.

Principally, the pension payments of the reinsured pension obligations are funded by the income from the plan assets. If the income does not cover the pension payments pbb has to pay the pensions out of its own funds. For the non-reinsured pension obligations the payments are also made out of own funds.

Statement of financial position items (net defined benefit liability)

in € million	2017	2016
Present value of defined benefit obligation	279	291
Fair value of plan assets	–193	–196
Total	**86**	**95**

Development of net defined benefit liability

in € million	2017	2016
Balance at 1.1.	**95**	**102**
Transfer of staff	–	–
Pension expenses	5	5
Remeasurements	–10	15
Reclassifications in reimbursements	–	–6
Payments into plan assets	–	–16
Direct payments to beneficiaries	–4	–5
Balance at 31.12.	**86**	**95**

Development of defined benefit obligation

in € million	2017	2016
Balance at 1.1.	**291**	**281**
Transfer of staff	–	–
Current service costs	3	3
Interest expenses	5	6
Remeasurements	–7	15
Actuarial gains/losses from demographic assumptions	–	–
Actuarial gains/losses from financial assumptions	–7	14
Actuarial gains/losses from experience assumptions	–	1
Settlements	–	–
Payments to beneficiaries	–13	–14
Balance at 31.12.	**279**	**291**

Plan assets consist exclusively of reinsurance pledged to plan beneficiaries. The plan assets accordingly do not contain any own financial instruments or any own used property and equipment. No further material contributions to the plan assets are aimed in 2018. pbb does not use special asset-liability matching strategies to manage the pledged reinsurance.

Development of fair value of plan assets

in € million	2017	2016
Balance at 1.1.	**196**	**179**
Transfer to staff	–	–
Interest income	3	4
Remeasurements	3	–
Payments into plan assets	–	16
Payments to beneficiaries	–9	–9
Reclassifications in/from reimbursements	–	6
Balance at 31.12.	**193**	**196**

Development of pension expenses

in € million	2017	2016
Service costs	3	3
Current service costs	3	3
Past service costs	–	–
Curtailments	–	–
Settlements	–	–
Net interest expenses	2	2
Interest expenses on defined benefit obligation	5	6
Interest income on plan assets	–3	–4
Total	**5**	**5**

Compared to 2017 a largely constant pension expense is expected for 2018. Pension expenses are part of general and administrative expenses.

Remeasurements of the net defined benefit liability result from actuarial gains and losses and the return on plan assets excluding amounts included in net interest on the net defined benefit liability.

Remeasurement recognised in other comprehensive income (equity)

in € million	2017	2016
Actuarial gains/losses from demographic assumptions	–	–
Actuarial gains/losses from financial assumptions	7	–14
Actuarial gains/losses from experience assumptions	–	–1
Remeasurements from plan assets	3	–
Total	**10**	**–15**

Delevopment of reimbursement

in € million	2017	2016
Balance at 1.1.	**2**	**8**
Disposals	–	–6
Balance at 31.12.	**2**	**2**

The quantitative sensitivity analysis – which uses the same measurement methods as the obligation recognised in the statement of financial position – for the material actuarial assumptions is as follows:

Actuarial assumptions

in € million	Change of sensitivity level (+ increase/– decrease)		Gross obligation 31.12.2017	Gross obligation 31.12.2016
Basic value of the calculation of sensitivity			279	291
Discount rate	in percentage points	+0.5	260	270
	in percentage points	–0.5	300	314
Rate of increase in pension obligations	in percentage points	+0.5	295	308
	in percentage points	–0.5	264	276
Rate of increase in future compensation and vested rights	in percentage points	+0.5	279	292
	in percentage points	–0.5	279	291

The assumption of mortality only has an immaterial effect because the risk of longevity is mainly covered by the plan assets.

The weighted average duration of the defined benefit obligations amounted to 15 years at 31 December 2017 (31 December 2016: 15 years).

Development of provisions (without provisions for pension and similar obligations)

in € million	Restructuring provisions	Provisions for contingent liabilities and other commitments	Other provisions
Balance at 1.1.2016	**15**	**1**	**111**
Additions	8	–	57
Reversals	–1	–1	–9
Amounts used	–7	–	–27
Reclassifications	–1	–	1
Balance at 31.12.2016	**14**	**–**	**133**
Balance at 1.1.2017	**14**	**–**	**133**
Additions	–	–	76
Reversals	–3	–	–24
Amounts used	–8	–	–32
Reclassifications	–	–	3
Balance at 31.12.2017	**3**	**–**	**156**

Restructuring provisions mainly comprised personnel measures and will have been used by 2020 according to current projections.

The provisions for contingent liabilities and other commitments mainly comprise provisions for guarantee risks, letters of credit, irrevocable loan commitments and litigation risks in the lending business.

Legal Risks (Litigation Risks)
pbb Group is obliged, in all jurisdictions in which it conducts its business, to comply with a large number of statutory and supervisory requirements and regulations such as certain rules of conduct to compliance with competition rules, to avoid conflicts of interest, to combat money laundering, to prevent terrorist financing, to prevent criminal offences, to regulate foreign trade and to safeguard bank, business and data secrecy. Given the nature of business and international expansion of activities and the large number of relevant requirements and regulations, pbb Group is involved in litigation, arbitration and administrative proceedings in some countries. These also include criminal proceedings as well as the assertion of claims in an amount not specified by the party asserting the claim. pbb Group recognises provisions for the uncertain obligations arising from these proceedings if the potential outflow of resources is sufficiently likely and the amount of the obligation can be estimated. The probability of the outflow of resources, which often cannot be estimated with certainty, is highly dependent on the outcome of the proceedings. The assessment of this probability and the quantification of the obligation are largely based on estimates. The actual liability can vary considerably from this estimate. Accounting for the individual legal procedure, pbb Group analyses developments of the individual cases and comparable cases, drawing on its own expertise or opinions by external consultants, and in particular by legal advisors, depending on the significance and complexity of the respective case. The provisions recognised for the proceedings are not reported separately as pbb Group believes that the outcome of the proceedings would be seriously compromised by their disclosure.

The profit participation certificates issued by the predecessor institutions participated in significant losses due to the net losses for the period incurred in the yeras 2008 et. seq. respectively pbb's unappropriated retained losses since this time. The redemption amounts have reduced and interest payment has been suspended. Individual investors therefore initiated legal proceedings, contesting in particular various individual clauses relating to loss participation and replenishment following loss participation. The key questions in this connection are which balance sheet items must be taken into account to calculate loss participation and whether replenishment is required if pbb records a net income, unappropriated retained earnings or another income. Courts have decided against the legal view of pbb in view of the individual decisions regarding profit participation certificates. Some of the court decisions are legally binding; some have been subject to appeals lodged by pbb. At present, legal proceedings with a total amount in dispute of approximately €22 million are pending. These proceedings may result in a partial or comprehensive increase in redemption claims, or in the subsequent distribution of cancelled coupon payments or interest payment claims. Further claims could possibly follow. Whilst pbb endeavours to solve legal disputes by way of out-of-court settlements, it exploits the legal remedies at its disposal when needed.

pbb Group recognised sufficient provisions for trial costs of first and second instance proceedings at the German fiscal court (Finanzgericht) regarding fiscal authority audit findings affecting one of pbb's predecessor institutions during the period from 2003 to 2008, and the corresponding tax assessment notes, which were issued in 2016.

Hypo Real Estate Bank International AG – a predecessor institution of pbb – issued Credit Linked Notes ("CLNs") in February 2007, within the scope of the Estate UK-3 ("UK-3") synthetic securitisation transaction. The CLNs were issued in order to hedge a portfolio of loans in the UK. The portfolio comprised 13 loans, financing 110 commercial property assets. The CLNs have an aggregate volume of GBP113.68 million, structured in six classes with sequential loss allocation. The biggest individual loan in the portfolio (amounting to approximately GBP176 million) subsequently defaulted, and the underlying collateral was realised in January 2016. The proceeds from realisation were clearly lower than the original collateral value, leading to a default loss of approximately GBP113 million. On 30 November 2016, pbb requested the auditor Deloitte (the Trustee of the UK-3 transaction) to allocate the losses to UK-3 investors. On 13 December 2016, Deloitte has notified pbb that doubts remain as to whether the loss allocation intended by pbb is admissible, and that they will appoint an Expert to decide on that matter. In the second quarter of 2017, the expert was appointed. In pbb's opinion, the prerequisites for the intended allocation of losses have been met. In the event of the loss allocation being fully or partially inadmissible, pbb would have to bear the losses to the corresponding extent.

On 4 July 2017, the German Federal Court of Justice (Bundesgerichtshof, "BGH") determined the inadmissibility of processing fees for corporate loans agreed upon by way of a standard form. pbb still believes that the financing pa-rameters used for complex financing structures in the lending business are generally subject to individual negotiations. pbb Group recognised sufficient provisions for all doubtful cases.

Moreover, no proceedings exist for which the Management Board believes the probability of an outflow of resources to be likely (or which are of material significance to pbb Group for other reasons) with an amount in dispute in excess of €5 million. However, pbb is subject to prudential proceedings, which bear the risk of a material outflow of resources.

63 Other Liabilities

Other liabilities

in € million	31.12.2017	31.12.2016[1)]
Negative fair values from hedging derivatives	2,889	3,719
Micro fair value hedge	2,889	3,715
Portfolio hedge	–	4
Other liabilities	70	66
Total	**2,959**	**3,785**

[1)] Corrected due to IAS 8.42. Details are disclosed in note "Consistency".

The fair values of Eurex Clearing derivatives (see also note "Netting of financial instruments") are disclosed net under other assets (positive fair values) or other liabilities (negative fair values) in the line micro fair value hedge.

Other liabilities include, amongst others, accruals pursuant to IAS 37 including accounts payable in respect of invoices still outstanding, short-term liabilities to employees and other accruals.

64 Subordinated Capital

Breakdown

in € million	31.12.2017	31.12.2016
Subordinated liabilities	1,002	525
Hybrid capital instruments	–	361
Total	**1,002**	**886**

Early repayment obligation on the part of the issuer cannot occur for any subordinated liabilities. In the event of bankruptcy or liquidation, such liabilities may only be repaid after all non-subordinated creditors have been satisfied.

Subordinated capital by maturities

in € million	31.12.2017	31.12.2016
With agreed maturities		
up to 3 months	126	54
more than 3 months to 1 year	182	361
more than 1 year to 5 years	71	246
more than 5 years	623	225
Total	**1,002**	**886**

65 Equity

Subscribed capital equals the maximum liability of the shareholder for the liabilities of the corporation to its creditors. The subscribed capital as of 31 December 2017 and during the entire financial year 2017 amounted to € 380,376,059.67 which is divided into 134,475,308 ordinary bearer shares with no par value representing a theoretical interest in the share capital of approximately € 2.83 per share. As at 31 December 2017 and during the entire financial year 2017, pbb did not hold any treasury shares.

Please refer to the disclosures pursuant to section 315a (1) HGB included in the "Supplemental Information" section of the Combined Management Report for information on authorised and contingent capital.

Additional paid-in capital includes contributions from a previous financial year as well as premiums from the issue of shares; except for an amount of € 25,383,131.91 (31 December 2016: € 25,383,131.91) the additional paid-in capital is freely available pursuant to section 272 (2) no. 4 HGB. Retained earnings were generally created only from net income of the current financial year or previous periods. This includes legal reserves to be created from net income and other retained earnings.

At the Annual General Meeting on 21 June 2018, the Management Board and the Supervisory Boards will propose to distribute a dividend of €1.07 per dividend bearing share.

66 Trust Business

As at 31 December 2017 and 31 December 2016, there were no trust assets or liabilities reported in the statement of financial position.

NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS

67 Disclosures to the Items in the Consolidated Statement of Cash Flows

The consolidated statement of cash flows shows the cash flows of the financial year broken down by operating activities, investing activities and financing activities. Cash and cash equivalents correspond to the balance sheet item cash reserve, and include cash in hand and credit balances at central banks.

Operating activities are defined broadly, and correspond to operating result. Cash flow from operating activities includes payments (inflows and outflows) attributable to loans and advances to other banks and customers as well as securities attributable to trading assets and other assets. Inflows and outflows attributable to liabilities to other banks and customers, securitised liabilities and other liabilities are also included under operating activities. The interest and dividend payments resulting from operating activities are shown under cash flow from operating activities. This also relates to cash flows from subordinated liabilities.

Cash flow from investing activities comprises payments for investment and security holdings as well as for property and equipment. In the financial year 2017 RPPSE Espacio Oviedo S.L.U., Madrid, was sold (2016: no subsidiary). The selling price of €1 was regognised in the cash flow from investing activities.

Cash flow from financing activities comprises inflows from capital increases, payments into reserves and silent participations as well as inflows and outflows for subordinated capital.

Liabilities Development from Financing Activities

in € million	2017
Subordinated liabilities	
Balance at 1.1.	**886**
changes from financing cash flows	126
changes arising from obtaining or losing control of subsidiaries or other businesses	–
the effect of changes in foreign exchange rates	–
changes in fair values	–
Other changes	–10
Balance at 31.12.	**1,002**

NOTES TO THE FINANCIAL INSTRUMENTS

68 Derivative Transactions

In order to minimise (reduce) both the economic and the regulatory credit risk, bilateral netting agreements have been concluded. By means of such netting agreements, the positive and negative fair values of the derivatives contracts included under the master agreement can be offset against one another, and the future regulatory risk add-ons for these products can be reduced. Through this netting process, the credit risk is limited to a single net claim on the party to the contract.

For both regulatory reports and the internal measurement and monitoring of the credit commitments, such risk-reducing techniques are utilised only if they are considered to be enforceable under the respective legal system in the event that the business associate becomes insolvent. Legal advice is taken in order to check enforceability.

Similar to the master agreements, pbb Group concludes collateral agreements with its business associates to collateralise the net claim or liability remaining after netting (obtained or pledged collateral). Usually, this collateral management reduces credit risk by means of prompt measurement and adjustment of the exposure to customers.

Volume of derivatives as of 31 December 2017

in € million	Notional amount: Remaining maturities: up to 1 year	Notional amount: Remaining maturities: more than 1 year to 5 years	Notional amount: Remaining maturities: more than 5 years	Notional amount: **Total**	Fair value: positive	Fair value: negative
Interest-based transactions						
OTC products	28,893	24,414	22,317	75,624	3,510	3,799
Interest rate swaps	27,144	17,063	20,655	64,862	3,502	3,767
Interest rate options	1,749	7,351	1,662	10,762	8	32
Call options	135	1,480	76	1,691	2	–
Put options	1,614	5,871	1,586	9,071	6	32
Sum	**28,893**	**24,414**	**22,317**	**75,624**	**3,510**	**3,799**
Foreign-currency-based transactions						
OTC products	4,540	507	405	5,452	38	46
Spot and forward currency transactions	3,794	–	–	3,794	29	17
Interest rate/currency swaps	746	507	405	1,658	9	29
Sum	**4,540**	**507**	**405**	**5,452**	**38**	**46**
Total	**33,433**	**24,921**	**22,722**	**81,076**	**3,548**	**3,845**

Use made of derivative transactions at of 31 December 2017

in € million	Notional amount	Fair value: positive	Fair value: negative
Interest-based transactions			
Hedge accounting	53,035	2,675	2,870
Stand-alone derivatives	22,589	835	929
Sum	**75,624**	**3,510**	**3,799**
Foreign-currency-based transactions			
Hedge accounting	267	3	19
Stand-alone derivatives	5,185	35	27
Sum	**5,452**	**38**	**46**
Total	**81,076**	**3,548**	**3,845**

Volume of derivatives as of 31 December 2016

	Notional amount				Fair value	
	Remaining maturities					
in € million	up to 1 year	more than 1 year to 5 years	more than 5 years	**Total**	positive	negative
Interest-based transactions						
OTC products	25,805	28,051	25,246	79,102	4,567	4,850
Interest rate swaps	24,655	21,429	23,485	69,569	4,561	4,803
Interest rate options	1,150	6,622	1,761	9,533	6	47
Call options	575	3,250	117	3,942	4	–
Put options	575	3,372	1,644	5,591	2	47
Sum	**25,805**	**28,051**	**25,246**	**79,102**	**4,567**	**4,850**
Foreign-currency-based transactions						
OTC products	4,592	897	448	5,937	14	224
Spot and forward currency transactions	4,383	–	–	4,383	8	116
Interest rate/currency swaps	209	897	448	1,554	6	108
Sum	**4,592**	**897**	**448**	**5,937**	**14**	**224**
Total	**30,397**	**28,948**	**25,694**	**85,039**	**4,581**	**5,074**

Use made of derivative transactions at of 31 December 2016

		Fair value	
in € million	Notional amount	positive	negative
Interest-based transactions			
Hedge accounting	52,598	3,490	3,659
Stand-alone derivatives	26,504	1,077	1,191
Sum	**79,102**	**4,567**	**4,850**
Foreign-currency-based transactions			
Hedge accounting	289	2	60
Stand-alone derivatives	5,648	12	164
Sum	**5,937**	**14**	**224**
Total	**85,039**	**4,581**	**5,074**

Counterparties

	31.12.2017		**31.12.2016**	
	Fair value		Fair value	
in € million	positive	negative	positive	negative
OECD banks	3,142	3,803	3,990	5,034
OECD financial institutions	–	–	4	–
Other companies and private individuals	406	42	587	40
Total	**3,548**	**3,845**	**4,581**	**5,074**

69 Undiscounted Cash Flows of Financial Liabilities

Contractually agreed undiscounted cash flows of the financial liabilities according to IFRS 7.39

in € billion	31.12.2017	31.12.2016
Up to 3 months	4	7
From derivative financial instruments	–	–
From non-derivative financial instruments	4	7
More than 3 months to 1 year	5	6
From derivative financial instruments	1	–
From non-derivative financial instruments	4	6
More than 1 year to 5 years	26	24
From derivative financial instruments	1	2
From non-derivative financial instruments	25	22
More than 5 years	24	27
From derivative financial instruments	2	2
From non-derivative financial instruments	22	25
Total	**59**	**64**

The undiscounted cash flows are presented in accordance with the contractually maturity, meaning that options or terminations rights are not taken into account. This presentation does not reflect the economic management which is based on expected cash flows. The liquidity risk strategy and management of pbb Group is described in the Risk and Opportunity Report.

70 Assets Assigned or Pledged as Collateral

Assets (without cash collaterals) have been pledged as collateral for the following liabilities and received collaterals:

Liabilities

in € million	31.12.2017	31.12.2016
Liabilities to other banks	2,185	2,036
Total	**2,185**	**2,036**

The following assets were pledged as collateral for the aforementioned liabilities:

Assets pledged

in € million	31.12.2017	31.12.2016
Loans and advances to customers	285	277
Financial investments	1,970	1,935
Total	**2,255**	**2,212**

The assets pledged mainly resulted from repurchase agreements. The transactions were carried out at the normal standard terms for repurchase transactions and concluded on an arm's-length basis.

In addition, pbb was required to provide cash collateral in the amount of €15 million (31 December 2016: €11 million) in connection with the bank levy.

71 Collaterals Permitted to Resell or Repledge

As of 31 December 2017 and as of 31 December 2016 there were no collaterals that may be esold or repledged in the absence of default.

72 Transfer of Financial Assets

When pbb Group transfers financial assets that do not qualify for derecognition (see also Note "Financial Instruments"), they continue to be reported in the statement of financial position.

Transfer of financial assets as of 31 December 2017

	Transferred assets that are not derecognised in their entirety			
	Transferred assets		Corresponding liabilities	
in € million	**Carrying amounts**	Thereof: Repo transactions	**Carrying amounts**	Thereof: Repo transactions
LaR assets	2,255	1,970	1,153	876
Bonds	1,970	1,970	876	876
Loans and advances	285	–	277	–
Total	**2,255**	**1,970**	**1,153**	**876**

Transfer of financial assets as of 31 December 2016

in € million	Transferred assets that are not derecognised in their entirety			
	Transferred assets		Corresponding liabilities	
	Carrying amounts	Thereof: Repo transactions	**Carrying amounts**	Thereof: Repo transactions
AfS assets	1,022	1,022	883	883
Bonds	1,022	1,022	883	883
LaR assets	1,190	913	1,153	876
Bonds	913	913	876	876
Loans and advances	277	–	277	–
Total	**2,212**	**1,935**	**2,036**	**1,759**

At balance sheet date the fair value of LaR bonds amounted to € 1,974 million (31 December 2016: € 922 million) and of LaR loans and advances to € 287 million (31 December 2016: € 289 million).

In addition, securities with a carrying amount of € 67 million (31 December 2016: € 66 million) were transferred to Eurex as collateral for clearing fund contribution and initial margin for derivative transactions.

pbb Group generally has no continuing involvement in transferred and derecognised financial assets.

73 Fair Values of Financial Instruments

The fair value of financial instruments, in the opinion of pbb Group, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price). The fair values were determined as of the balance sheet date based on the market information available and on valuation methods described here.

All financial assets and liabilities that are measured at fair value are grouped into the three fair value hierarchies by pbb Group. Reclassifications within the fair value hierarchy are made at the end of the reporting period. The three-level hierarchy is based on the degree to which the input for the fair value measurement is observable:
> Level 1 – quoted priced (unadjusted) in active markets for identical financial assets or financial liabilities (market prices)
> Level 2 – inputs that are observable either directly or indirectly, other than quoted prices included within Level 1
> Level 3 – valuation techniques that include inputs that are not based on observable market data (unobservable inputs)

Fair values and fair value hierarchy of financial instruments

in € million	Carrying amount	Fair value	Level 1	Level 2	Level 3
					31.12.2017
					Fair value
Financial assets	**57,567**	**59,621**	**9,011**	**21,130**	**29,480**
at fair value through profit or loss	3,548	3,548	–	3,548	–
at fair value not affecting profit or loss	2,385	2,385	2,385	–	–
not measured at fair value in the statement of financial position	51,634	53,688	6,626	17,582	29,480
Cash reserve	999	999	999	–	–
Trading assets (HfT)	870	870	–	870	–
Loans and advances to other banks (LaR)	2,415	2,437	1,709	728	–
Loans and advances to customers (LaR)[1]	39,981	41,829	–	13,952	27,877
Real Estate Finance	24,882	26,167	–	–	26,167
Public Investment Finance	5,978	6,257	–	4,967	1,290
Value Portfolio	8,019	8,255	–	7,835	420
Consolidation & Adjustments	1,102	1,150	–	1,150	–
Valuation adjustment from portfolio hedge accounting	–1	–	–	–	–
Financial investments (LaR)	8,240	8,423	3,918	2,902	1,603
Financial investments (AfS)	2,385	2,385	2,385	–	–
Other assets	2,678	2,678	–	2,678	–
Hedging derivatives	2,678	2,678	–	2,678	–
Financial liabilities	**54,794**	**56,199**	**17,883**	**4,039**	**34,277**
at fair value through profit or loss	3,845	3,845	–	3,828	17
not measured at fair value in the statement of financial position	50,949	52,354	17,883	211	34,260
Liabilities to other banks (at amortised cost)	3,280	3,266	990	–	2,276
Liabilities to customers (at amortised cost)	8,275	8,504	240	–	8,264
Securitised liabilities (at amortised cost)	38,362	39,503	16,280	–	23,223
covered	31,833	32,749	13,342	–	19,407
uncovered	6,529	6,754	2,938	–	3,816
Valuation adjustment from portfolio hedge accounting	–	–	–	–	–
Trading liabilities (HfT)	956	956	–	956	–
Other liabilities	2,919	2,919	–	2,872	47
Hedging derivatives	2,889	2,889	–	2,872	17
Other financial liabilities	30	30	–	–	30
Subordinated capital (at amortised cost)	1,002	1,051	373	211	467

[1] Reduced by allowances for losses on loans and advances and claims from finance lease agreements. Since 30 June 2017, portfolio-based allowances are not disclosed separately anymore, but they were allocated to the individual segments.

Fair values and fair value hierarchy of financial instruments

					31.12.2016
			Fair value		
in € million	Carrying amount	Fair value	Level 1	Level 2	Level 3
Financial assets	**62,188**	**64,429**	**10,137**	**24,678**	**29,614**
at fair value through profit or loss	4,581	4,581	–	4,541	40
at fair value not affecting profit or loss	3,311	3,311	3,311	–	–
not measured at fair value in statement of financial position	54,296	56,537	6,826	20,137	29,574
Cash reserve	1,136	1,136	1,136	–	–
Trading assets (HfT)	1,089	1,089	–	1,089	–
Loans and advances to other banks (LaR)	2,841	2,872	2,018	812	42
Loans and advances to customers (LaR)[1)]	40,783	42,906	–	15,837	27,069
Real Estate Finance	23,969	25,377	–	–	25,377
Public Investment Finance	6,226	6,542	–	5,155	1,387
Value Portfolio	9,046	9,365	–	9,016	349
Consolidation & Adjustments	1,586	1,666	–	1,666	–
Portfolio-based allowances	–44	–44	–	–	–44
Valuation adjustment from portfolio hedge accounting	2	–	–	–	–
Financial investments (LaR)	9,534	9,623	3,672	3,488	2,463
Financial investments (AfS)	3,311	3,311	3,311	–	–
Other assets	3,492	3,492	–	3,452	40
Hedging derivatives	3,492	3,492	–	3,452	40
Financial liabilities	**59,491**	**61,018**	**21,437**	**5,463**	**34,118**
at fair value through profit or loss	5,074	5,074	–	5,053	21
not measured at fair value in the statement of financial position	54,417	55,944	21,437	410	34,097
Liabilities to other banks	3,179	3,300	2,430	–	870
Liabilities to customers	9,949	10,235	1,371	–	8,864
Securitised liabilities	40,381	41,480	17,636	410	23,434
covered	34,097	35,014	14,375	277	20,362
uncovered	6,284	6,466	3,261	133	3,072
Valuation adjustment from portfolio hedge accounting	1	–	–	–	–
Trading liabilities (HfT)	1,355	1,355	–	1,355	–
Other liabilities	3,740	3,740	–	3,698	42
Hedging derivatives	3,719	3,719	–	3,698	21
Other financial liabilities	21	21	–	–	21
Subordinated capital	886	908	–	–	908

1) Reduced by allowances for losses on loans and advances and claims from finance lease agreements.

In the financial years 2017 and 2016, no financial instruments measured at fair value were reclassified from Level 1 to Level 2 and vice versa. Furthermore, no financial instruments measured at fair value were were reclassified from Level 2 to Level 3 and vice versa in the years 2017 and 2016. In 2017 financial assets in the amount of €40 million (2016: €0 million) and financial liabilities in the amount of €5 million (2016: €0 million) were reclassified from Level 3 to Level 2 since inputs were observable on the market again.

Disclosures to the Measurement Methods and Input Parameters

Measurement Process Both the Finance and the Risk Management & Control divisions play a role in the measurement process. The Finance division supplies accounting data. This includes:

- identification data, such as business identification numbers or International Securities Identification Numbers (ISINs)
- static data such as notional amounts, name and country of the counterparty and (remaining) terms
- accounting data such as carrying amounts, accruals and the effects of hedge accounting

Risk Management & Control calculates additional data used to measure fair value such as interest rates, credit spreads and market prices, as well as internal ratings and LGDs for certain financial instruments.

Risk Management & Control uses the determined input parameters to calculate (and provide to Finance) the fair value or measurement price of financial instruments based on accepted and validated measurement methods. Finance consolidates the data received from Risk Management & Control with the data held for accounting and reporting purposes, and verifies completeness.

Level 2 instruments measured at fair value as of 31.12.2017

Measurement methods	Observable parameter
DCF methods	Euro zone inflations rates
	Reference interest rates
	Saisonalities of Euro zone inflations rates
	Spot market exchange rates
	Yield curves
Option pricing models	Cap volatilities
	CMS Spread Options (strike price)
	CMS Spread Options (option price)
	Euro zone inflations rates
	Reference interest rates
	Saisonalities of Euro zone inflations rates
	Swaption volatilities
	Spot market exchange rates
	Exchange rates volatilities
	Yield curves

Level 3 instruments measured at fair value as of 31.12.2017

Measurement methods	Non-observable parameters	Range (weighted average)
Option pricing models	Historical index/index correlations	+82.67%
	Historical index/exchange rate correlations	−27.32 to +17.02% (−5.15%)

Financial instruments not measured at fair value as of 31.12.2017

Measurement methods	Observable parameter (level 2)	Non-observable parameter (level 3)
DCF models (discounted cash flows)	(Own) credit spreads and Liqui-AddOns, if necessary	Internal rating classes
	Reference interest rates	Recovery rates
	Risk-free interest rate	Estimated remaining maturities
	Observable future cash flows	Estimated future cash flows
	Benchmark interest rates	(Own) credit spreads (secondary market grid)
Bachelier cap-floor model (for floored plain vanilla floater)	Additional cap volatilities including smile	Additional cap volatilities including smile
Bachelier cap-floor model (for fixed coupons options)	Additional swaption volatilities including smile	Additional swaption volatilities including smile
Prices on non-active markets	Prices of proxy trades	–

Sensitivities

The calculation of the sensitivity is based on shock scenarios for correlations and volatilities pursuant to the level 3 measurement methods table. These amounts were calculated independently from each other. There are interactions between the input parameters used, except for spread volatilities. As at 31 December 2017, level 3 financial liabilities measured at fair value were subject to positive and negative changes of less than €1 million each. If the scenario effects are taken into account on an aggregate basis, the maximum change for level 3 financial liabilities is €1 million. As at 31 December 2017 there was only one level 3 derivative which was used in micro fair value hedge accounting. There were no methodological changes compared to the previous year. As at 31 December 2016, the sensitivity analysis resulted in positive and negative changes in financial assets and liabilities of less than €1 million each. If the scenario effects are taken into account on an aggregate basis, the maximum change for assets was less than €1 million and for liabilities of €1 million as of 31 December 2016.

Changes in Level 3 Financial Instruments measured at Fair Value

Changes in level 3 instruments measured at fair value through profit or loss

	Financial assets	Financial liabilities
in € million	Hedging derivatives	Hedging derivatives
Balance at 1.1.2016	**44**	**16**
Profit or loss	–4	5
Balance at 31.12.2016	**40**	**21**
Balance at 1.1.2017	**40**	**21**
Profit or loss	–	1
Reclassification out of level 3	–40	–5
Balance at 31.12.2017	**–**	**17**

The earnings contributions made by trading liabilities are presented under net trading income, whereas the effects of hedging derivatives recognised in profit or loss are reported under net income from hedging relationships.

Assets and Liabilities According to Measurement Categories and Classes

The carrying amounts reflect the maximum on balance sheet exposure to credit default risk of the assets.

Asset and liabilities according to measurement categories and classes in accordance with IAS 39

in € million	31.12.2017	31.12.2016
Assets		
Loans and receivables (LaR)	50,635	53,160
Available for sale (AfS)	2,385	3,311
Held for trading (HfT)	870	1,089
Cash reserve	999	1,136
Claims from finance lease agreements	222	233
Positive fair values from hedging derivatives	2,678	3,492
Liabilities		
Held for trading (HfT)	956	1,355
Financial liabilities at amortised cost	50,949	54,417
Negative fair values from hedging derivatives	2,889	3,719

74 Past Due but Not Impaired Assets

The following table shows the total portfolio of the partly or completely past due but not impaired loans and advances as of 31 December 2017 and as of 31 December 2016. However, no specific allowances were made for these assets respectively the underlying collaterals as pbb Group does not consider that there is any issue regarding their recoverability. Such timing issues in receipts of payments due occur regularly (up to three months) in the normal course of business and are not considered to be an evidence for impairment.

LaR Assets

Carrying amounts of past due but not impaired LaR assets

in € million	31.12.2017	31.12.2016
up to 3 months	1	1
more than 3 months to 6 months	1	–
more than 6 months to 1 year	–	1
more than 1 year	1	5
Total	**3**	**7**

Carrying amounts LaR assets before allowances

in € billion	31.12.2017	31.12.2016
Carrying amount of LaR assets that are neither impaired nor past due	52.8	52.7
Carrying amount of LaR assets that are past due but not impaired (total investment)	–	–
Carrying amount of individually assessed impaired LaR assets (net)	0.2	0.3
Balance of specific allowances	–	0.1
Balance of portfolio-based allowances	0.1	0.1
Total	**53.1**	**53.2**
Thereof: Loans and advances to other banks (including investments)	2.4	2.8
Loans and advances to customers (including investments)	40.1	40.9
Financial investments (gross)	10.6	9.5

The carrying amount of assets that would otherwise be past due or impaired and whose terms have been renegotiated amounted to €31 million (31 December 2016: €28 million).

The fair value of collaterals for the impaired financial assets amounted to approximately €0.2 billion (31 December 2016: €0.3 billion). The collaterals mainly consist of land charges.

AfS Assets

As of 31 December 2017 and as of 31 December 2016 pbb Group had neither past due and not impaired nor impaired AfS financial investments in the portfolio.

75 Restructured Loans and Advances

As of 31 December 2017 and as of 31 December 2016, restructuring agreements mainly related to standstill agreements and to the discontinuation of contractual arrangements.

Restructured loans and advances

in € million	31.12.2017	31.12.2016
Carrying amount of loans and advances that are neither impaired nor past due	31	27
Carrying amount of loans that are past due but not impaired (gross)	–	4
Carrying amount of individually assessed impaired loans and advances (gross)	187	310
Total	**218**	**341**

Proportion of restructured loans and advances in the total portfolio

in %	31.12.2017	31.12.2016
Proportion of restructured loans and advances in the total portfolio	0.5	0.8

Allowances for losses on restructured loans and advances

in € million	31.12.2017	31.12.2016
Specific allowances	12	74
Portfolio-based allowances	1	2
Total	**13**	**76**

Proportion of allowances for losses in the restructured loans and advances portfolio

in %	31.12.2017	31.12.2016
Ratio of allowances for losses and the restructured loans and advances portfolio	6.0	22.3

The decrease of specific allowances on restructured loans and advances is due to processing financing transactions in 2017 which are almost completely covered. For this reason the ratio of allowances for losses and the restructured loans and advances portfolio decreased as well.

76 Netting of Financial Instruments

The following tables show the gross carrying amounts of recognised financial assets respectively liabilities, the gross carrying amounts of the items offset in the statement of financial position and the net amounts of the financial assets and liabilities recognised in the statement of financial position. They also show the rights of set-off that did not lead to an offsetting in the statement of financial position, the collateral received for financial assets, the collateral pledged for financial liabilities and the net amounts of financial assets and liabilities remaining following the application of the netting agreements and deduction of the collateral.

Gross Carrying Amounts of the Items offset in the Statement of Financial Position
On-balance sheet netting of derivatives which are settled through Eurex Clearing led to a reduction in total assets of €1.6 billion as at 31 December 2017 (31 December 2016: €1.8 billion).

Netting Agreements
pbb Group routinely enters into standardised bilateral netting agreements in the derivatives business to minimise the legal risk as well as the economic and regulatory counterparty default risk. The national respectively international agreements used are the German Master Agreement for Financial Futures and the ISDA Master Agreement issued by the International Swaps and Derivatives Association. The derivatives cannot be offset in the statement of financial position since their conditions are not identical (e.g. different terms or currency underlyings).

Collateral
In addition, pbb Group also enters into collateral agreements to hedge the net receivables and net liabilities arising following offsetting according to the netting agreements (collateral received or pledged). The collateral used is primarily cash collateral; however, securities are sometimes also used by way of title transfer. The collateral agreements likewise cannot be offset against the derivatives.

Netting of financial instruments as of 31 December 2017

in € billion	Gross carrying amounts of recognised financial assets/liabilities	Gross carrying amounts of the items offset in the statement of financial position	Net amounts presented in the statement of financial position	Rights of set-off that did not lead to an offsetting in the statement of financial position	Received respectively pledged collateral	Remaining net
Financial assets	**5.2**	**1.6**	**3.6**	**2.1**	**1.2**	**0.3**
Positive fair values of derivatives	5.2	1.6	3.6	2.1	1.2	0.3
Financial liabilities	**5.4**	**1.6**	**3.8**	**2.1**	**1.7**	**–**
Negative fair values of derivatives	5.4	1.6	3.8	2.1	1.7	–

Netting of financial instruments as of 31 December 2016

in € billion	Gross carrying amounts of recognised financial assets/liabilities	Gross carrying amounts of the items offset in the statement of financial position	Net amounts presented in the statement of financial position	Rights of set-off that did not lead to an offsetting in the statement of financial position	Received respectively pledged collateral	Remaining net
Financial assets	**6.4**	**1.8**	**4.6**	**3.0**	**1.1**	**0.5**
Positive fair values of derivatives	6.4	1.8	4.6	3.0	1.1	0.5
Financial liabilities	**6.9**	**1.8**	**5.1**	**3.0**	**2.0**	**0.1**
Negative fair values of derivatives	6.9	1.8	5.1	3.0	2.0	0.1

OTHER NOTES

77 Contingent Liabilities and Other Commitments

Contingent liabilities and other commitments

in € million	31.12.2017	31.12.2016
Contingent liabilities	**120**	**171**
Guarantees and warranties	120	171
Other commitments	**4,667**	**3,802**
Irrevocable loan commitments	4,667	3,802
Commitments from bank levies	**15**	**11**
Collateral pledged	15	11
Total	**4,802**	**3,984**

For pbb Group irrevocable loan commitments form the largest part of other commitments. Irrevocable oan commitments comprise all commitments of a creditor which can grant a loan and advance at a later date and which can cause a credit risk. These are mainly credit commitments which are not fully drawn.

As at balance sheet date the fair value of contingent liabilities amounted to €120 million (31 December 2016: €171 million) and the fair value of irrevocable loan commitments to € 4,680 million (31 December 2016: € 3,834 million).

Contingent liabilities and other commitments represent the maximum default risk within the meaning of IFRS 7.

78 Leases

Operate Lease as a Lessee

pbb Group is a lessee in the context of operate lease agreements. Non-terminable operate lease agreements for land and buildings as well as for operating and business equipment existed as of 31 December 2017 and as of 31 December 2016.

Future minimum lease payments by maturities

in € million	31.12.2017	31.12.2016
up to 1 year	7	7
more than 1 year to 5 years	24	14
more than 5 years	13	2
Total	**44**	**23**

Operating lease agreements concluded by pbb Group were made on an arm's-length basis and are mainly related to the rental of land and buildings. The agreements include partial renewal options that the lease can be extended for several periods, and price escalation clauses in the form of tepped rents or indexation clauses as well as release clauses. Rental expenses including incidental rental costs amounted to € 6 million (2016: € 6 million).

Finance Lease as a Lessor

Reconciliation

in € million	31.12.2017	31.12.2016
Gross investment	**256**	**271**
Unearned finance income	–34	–38
Net investment/present value of minimum lease payments	**222**	**233**

Allocation by maturities

in € million	31.12.2017	31.12.2016
Gross investment	**256**	**271**
up to 1 year	15	11
1 year to 5 years	62	61
5 years and over	179	199
Present value of minimum lease payments	**222**	**233**
up to 1 year	11	7
1 year to 5 years	48	46
5 years and over	163	180

Finance lease agreements resulted from setting up the financing for an office building as a finance lease.

79 Key Regulatory Capital Ratios

The Management Board manages the Group's capitalisation, based on regulatory capital ratios in accordance with the CRR and additional regulations announced by the ECB (Supervisory Review and Evaluation Process – "SREP").

Based on the results of the analysis as well as using benchmark comparison, the ECB may impose minimum capitalisation or liquidity requirements, over and above existing regulatory requirements. As a key result of SREP, pbb Group has been required to maintain a minimum CET1 ratio of 9.0% for 2017 (excluding the countercyclical capital buffer, which varies according to country, and hence, for specific portfolios– as at 31 December 2017, it stood at 0.11%). This capital requirement is based on the Basel III transitional rules and comprises a Pillar 1 minimum capital requirement (4.5%), a Pillar 2 capital requirement (P2R: 3.25%) and the capital conservation buffer (CCB:1.25% phased-in for 2017). Furthermore, pbb Group had to fulfil a total capital requirement of 12.50% which was newly introduced 2017 compared to 2016 (excluding the countercyclical capital buffer, which varies according to country, and hence, for specific portfolios). It is based on the Basel III transitional rules and comprises a Pillar 1 minimum own funds requirement (8%), a Pillar 2 capital requirement (3.25%) and the capital conservation buffer (1.25% phased-in for 2017). Both requirements, the Group complied with at all times during the year under review.

Toward the end of the year, the ECB notified pbb Group of the regular annual re-determination of minimum capital requirements for 2018: with effect from 1 January 2018, pbb Group has been required to maintain a minimum CET1 ratio of 9.125% (excluding the countercyclical capital buffer, which varies according to country, and hence, for specific portfolios – as at 31 December 2017, it stood at 0.11%). This capital requirement is based on the Basel III transitional rules and comprises a Pillar 1 minimum capital requirement (4.50%), a Pillar 2 capital requirement (2.75%) and the capital conservation buffer (CCB: 1.875% phased-in for 2018). The CET1 minimum capital requirement that applies for 2018 also represents the threshold for mandatory calculation of a so-called maximum distributable amount (MDA). This generally limits distributions to the CET1 capital, new performance-based remuneration, and interest payments on additional Tier 1capital.

With effect from 1 January 2018 pbb Group has been required to maintain a total capital requirement of 12.625% (excluding the countercyclical capital buffer, which varies according to country, and hence, for specific portfolios – as at 31 December 2017, it stood at 0.11%). It is based on the Basel III transitional rules and comprises a Pillar 1 minimum own funds requirement (8.00%), a Pillar 2 capital requirement (2.75%) and the capital conservation buffer (1.875% phased-in for 2018). The minimum, fully phased-in total capital requirement (valid from 2019 onwards, following expiration of transitional provisions) will be 13.25%, assuming a constant Pillar 2 capital requirement and excluding the countercyclical capital buffer.

Please refer to Risk and Opportunity Report for key regulatory capital ratios.

80 Group Auditors' Fee

Group auditors' fee

in € thousand	2017	2016
Audit	1,945	1,889
Other assurance services	271	191
Tax advisory services	–	–
Other non-audit services	1,392	217
Total	**3,608**	**2,297**

The auditors' fee for KPMG AG WPG Wirtschaftsprüfungsgesellschaft comprised – for the most part – the audit of the Consolidated Financial Statements and the single-entity financial statements of pbb as well as the audit of financial statements prepared by different subsidiaries, including the extension of the audit assignment in line with the applicable legal requirements and the focal points of the audit as agreed upon with the Supervisory Board. In addition, audit reviews of interim financial statements and project-related audits pursuant to IDW PS 850 were performed.

Other assurance services comprised the preparation of comfort letters in connection with bond issues, a limited assurance engagement for the summarised separate non-financial report of pbb, as well as statutory audits such as the audit according to section 36 (1) of the WpHG, and other assurance services required by supervisory authorities.

Other non-audit services mainly comprised quality assurance services in connection with recently introduced legal and regulatory requirements, together with compliance and IT projects unrelated to the introduction or implementation of internal control and risk management procedures. Moreover, services within the framework of a transaction-based due diligence, and a permissible determination of the market value without material impact on the financial statements are included.

KPMG AG Wirtschaftsprüfungsgesellschaft has been appointed as external auditor for the Annual and Consolidated Financial Statements of Deutsche Pfandbriefbank AG since the merger of Hypo Real Estate Bank AG and DEPFA Deutsche Pfandbriefbank AG to form Deutsche Pfandbriefbank AG in 2009. KPMG had already worked in the same function for predecessor institutions of Hypo Real Estate Bank AG. The financial statements were signed by German Public Auditors (Wirtschaftsprüfer) Mr Wiechens and, since the financial year 2012, Ms Schmidt. In the financial year 2015, the financial statements were signed by the German Public Auditors (Wirtschaftsprüfer) Messrs. Mock and Haider. In the financial year 2016, the financial statements were signed by the German Public Auditors (Wirtschaftsprüfer) Mr. Winner and Mr. Dielehner. The latter had already signed pbb's financial statements in 2009. For the financial year 2017, Messrs. Dielehner and Winner are intended to be the responsible German Public Auditors (Wirtschaftsprüfer).

81 Related Parties Disclosures

According to IAS 24 (Related-Party Disclosures), a party is related to an entity if, directly or indirectly through one or more intermediaries, the party controls or is controlled by the reporting entity, has an interest in the entity that gives it significant influence over the entity or has joint control over the entity as well as associates and joint ventures. In addition, retirement benefit schemes for postemployment benefits for employees are also included under related parties.

Related Entities
Hypo Real Estate Holding GmbH's (HRE Holding's) share in pbb stood at 20.0% plus one share as at 31 December 2017 (31 December 2016: 20.0% plus one share). pbb Group considers HRE Holding, as well as all other entities that were subject to the control, joint control or significant influence of the Federal Republic of Germany, as related parties within the meaning of IAS 24.

Income of €6 million was generated with FMS Wertmanagement which was disclosed under net other operating income/expenses.

Income and expenses as well as receivables and liabilities generated/incurred in connection with HRE Holding were of minor significance in the financial years 2017 and 2016.

In line with the requirements of corporate law, expenses incurred in the context of pbb's privatisation have to be borne by the seller, HRE Holding.

As at 31 December 2017, pbb Group recognised liabilities (after netting of receivables) towards DEPFA in the amount of €88 million (31 December 2016: €99 million). Net interest income generated with DEPFA amounted to €–10 million (2016: €–13 million), while the net income from hedging relationships stood at €14 million (2016: €–18 million).

As at 31 December 2017 and 31 December 2016, there were no loans and advances or liabilities to non-consolidated subsidiaries. As at the reporting date, pbb Group had loans and advances to associates not accounted for using the equity method in the amount of €27 million (31 December 2016: €31 million) and unchanged no liabilities to such associates.

On 31 December 2017 liabilities to defined contribution plans amounted to €2 million (31 December 2016: €1 million).

Related Persons

pbb Group defines related persons as the members of the Management Board and the Supervisory Board, plus pbb's second-level managers and members of senior management of pbb's subsidiaries, as well as close members of their families and affiliated enterprises.

Total remuneration of former members of the Board of Managing Directors and their surviving dependants amounted to € 4,926 thousand for 2017 (2016: € 5,010 thousand). Remuneration for the Supervisory Board totalled € 694 thousand (2016: € 668 thousand) during the year under review. This comprised exclusively fixed remuneration.

Vested remuneration claims of persons holding key positions within the Group (senior management)[1]

in € thousand	2017						2016
	Short-term benefits	Post-employment benefits	Other long-term benefits	Termination benefits	Share-based payments	Total	Total
Total	**9,588**	**2,723**	**649**	**512**	**1,151**	**14,623**	**12,537**

[1] Reporting follows the "vesting principle", disclosing those remuneration components which were vested during the relevant 2017 reporting period.

Pension obligations to persons holding key positions within pbb Group (senior management)

in € thousand	31.12.2017	31.12.2016
Total[1]	**80,172**	**82,484**

[1] Including € 61,204 thousand (2016: € 64,731 thousand) for pensioners and their surviving dependants.

Disclosure by pbb Pursuant to Section 314 No. 6 of the HGB, by Groups of Individuals

Remuneration paid to Management Board members of pbb

in € thousand	2017[1]	
	Remuneration	Total
Management Board members who were in office during the financial year 2017	2,557	2,557
Management Board members who retired prior to the financial year 2017	–	–
Total	**2,557**	**2,557**

[1] In 2016 a remuneration of € 3,068 thousand was paid to Management Board members who were in offce during the 2016 financial year. Management Board members who retired prior to the year 2016 did not receive any remuneration in the 2016 financial year.

As of the balance sheet date, there were no receivables to related persons from loans or advances or other commitments.

Provisions for pensions

in € thousand	2017[1] Additions	2017[1] Total
Management Board members who were in office during the financial year 2017	1,701	5,649
Management Board members who retired prior to the financial year 2017	−3,527	61,204
Total	**−1,826**	**66,853**

[1] Provisions for pensions recognised for Management Board members who were in office during the financial year 2016 amounted to €3,948 thousand. Provisions for pensions recognised for Management Board members who retired prior to the 2016 financial year amounted to €64,731 thousand as at 31.12.2016.

Remuneration paid to Supervisory Board members

in € thousand	2017[1] Total fixed remuneration
Supervisory Board members who were in office during the financial year 2017	694
Supervisory Board members who retired prior to the financial year 2017	–
Total	**694**

[1] Remuneration paid to Supervisory Board members who were in office during the 2016 financial year totalled €668 thousand. Supervisory Board members who retired prior to the year 2016 did not receive any remuneration in the 2016 financial year.

The remuneration of the Management Board and the Supervisory Board members for their respective Board activities (including the corresponding tables) is disclosed in the remuneration report on an individual basis. Except for employee representatives to the Supervisory Board, who are remunerated by pbb under their individual employment contracts, the members of pbb's Supervisory Board did not receive any remuneration for personal services, as defined in section 5.4.6 of the German Corporate Governance Code, during 2017.

Statement According to Article 19 MMV
According to pbb's knowledge, the members of the Management Board and the Supervisory Board as well as persons closely related to these members did not hold any shares of the Company in a reportable extent as at 31 December 2017 and as at 31 December 2016. In the years 2017 and 2016, according to pbb's knowledge, no pbb shares or derivatives relating to such shares in a reportable extend were acquired or sold by members of the Management Board and the Supervisory Board or by persons closely related to such members.

82 Employees

Average number of employees

	2017	2016
Employees (excluding apprentices)	777	801
Thereof: senior staff in Germany	18	17
Total	**777**	**801**

83 Members of the Supervisory Board and of the Management Board

Supervisory Board of pbb in financial year 2017

Name and place of residence Function in Supervisory Board	**Principal occupation** Functions in the Committees of the Supervisory Board	**Supervisory Board memberships and other directorships in 2017**
Dr Günther Bräunig Frankfurt/Main, Germany Chairman	**Deputy CEO of KfW** **(CEO since 1.1.2018)** Chairman of the Executive and Nomination Committee and of the Remunaration Committee, Member of the Audit Committee and of the Risk Management and Liquidity Strategy Committee	**True Sale International GmbH, Frankfurt/Main, Germany** – Chairman of the Shareholder's Advisory Board
Dagmar Kollmann Vienna, Austria Deputy Chairman	**Entrepreneur** Chairman of the Audit Committee and Member of the Executive and Nomination Committee and of the Remunaration Committee	**Deutsche Telekom AG, Bonn, Germany** – Member of the Supervisory Board **KfW IPEX-Bank GmbH, Frankfurt/Main, Germany** – Member of the Supervisory Board **Bank Gutmann AG, Vienna, Austria** – Member of the Supervisory Board **Unibail-Rodamco SE, Paris, France** – Member of the Supervisory Board
Dr Thomas Duhnkrack Kronberg/Taunus, Germany Member	**Entrepreneur** Member of the Audit Committee	**Hauck & Aufhäuser Privatbankiers AG, Frankfurt/Main, Germany** – Member of the Supervisory Board **Lloyd Fonds AG, Hamburg, Germany** – Deputy Chairman of the Supervisory Board (until 10.12.2017)
Dr Christian Gebauer-Rochholz Hochheim, Germany Employee Representative	**Bank employee**	–
Georg Kordick Poing, Germany Employee Representative	**Bank employee**	–
Joachim Plesser Ratingen, Germany Member	**Consultant** Chairman of the Risk Management and Liquidity Strategy Committee, Member of the Executive and Nomination Committee and of the Remunaration Committee	**Commerz Real Investmentgesellschaft mbH, Wiesbaden, Germany** – Member of the Supervisory Board **DIC Beteiligungs AG, Frankfurt/Main, Germany** – Member of the Supervisory Board **GEG German Estate Group AG, Frankfurt/Main, Germany** – Member of the Supervisory Board **Pandion AG, Cologne , Germany** – Chairman of the Supervisory Board
Oliver Puhl Frankfurt/Main, Germany Member	**Entrepreneur** Member of the Risk Management and Liquidity Strategy Committee	–
Heike Theißing Munich, Germany Employee Representative	**Bank employee** Member of the Remunaration Committee	–
Dr Hedda von Wedel Andernach, Germany Member	**President of the Bundesrechnungshof (retired)** Member of the Audit Committee and of the Risk Management and Liquidity Strategy Committee	–

Management Board of pbb in financial year 2017

Name and place of residence	**Function in the Management Board**	**Supervisory Board memberships**
Andreas Arndt Munich, Germany	CEO/CFO	–
Thomas Köntgen Frankfurt/Main, Germany	Deputy CEO Treasury and Real Estate Finance (including Credit Markets/Public Fincance since 1.5.2017)	–
Andreas Schenk Dreieich, Germany	CRO	–
Dr Bernhard Scholz Regensburg, Germany	Credit Markets/Public Fincance (until 30.4.2017)	–

84 Holdings of pbb

Holdings of pbb as of 31 December 2017

Additional statement according to HGB Name Place of business and country	Purpose of business	Interest in % Total (Sec 16 (4) Aktien-gesetz)	Of which held indirectly	Differing voting rights in %	Currency	Equity in thousands	Net income/loss in thousands
Consolidated companies							
CAPVERIANT GmbH München, Deutschland	Marketplace of municipal finance	100.00	–	–	EUR	4,772	–728
IMMO Immobilien Management GmbH & Co. KG Munich, Germany	Real estate company	100.00	–	–	EUR	569	34
IMMO Invest Real Estate GmbH[1] Munich, Germany	Salvage acquisition	100.00	–	–	EUR	8,448	–
Non-consolidated companies due to minor significance							
Immo Immobilien Management Beteiligungsgesellschaft mbH Munich, Germany	Real estate company	100.00	–	–	EUR	25	–
Associated companies not measured at equity due to minor significance							
SANO Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Dresden KG[2] Dusseldorf, Germany	Model of bank holding	33.33	–	25.00%	EUR	–1,413	695
SOMA Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Darmstadt KG[2] Dusseldorf, Germany	Model of bank holding	33.33	–	25.00%	EUR	–8,864	2,660
WISUS Beteiligungs GmbH & Co. Zweite Vermietungs-KG Munich, Germany	Model of bank holding	33.00	–	24.44%	EUR	–271	488

[1] Profit transfer by shareholders on the basis of profit and loss transfer agreement.
[2] Financial figures from the financial year 2016.

85 Country-by-Country Reporting

The requirements of Article 89 of EU Directive 2013/36/EU (Capital Requirements Directive CRD IV) concerning to so-called Country-by-Country Reporting were endorsed in German law by Section 26a KWG (German Banking Act). In financial years 2017 and 2016 no entity respectively no branch of pbb received public subsidies. On 31 December 2017, the ratio of net profit and total balance sheet of pbb Group was 0.3% (31 December 2016: 0.3%). The further figures required by Section 26a KWG are disclosed in the following table:

Country-by-Country Reporting (Additional statement according to Section 26a KWG) 31 December 2017

Type of business Name and place of business	Country	Number of employees[1]	Turnover[2)3)] (in € million)	Income/loss before tax[3)] (in € million)	Income taxes[3)] (in € million)
Deposit taking credit institution					
Deutsche Pfandbriefbank AG, Munich	Germany	612	376	189	–15
Branch of a deposit taking credit institution					
Deutsche Pfandbriefbank AG, London branch	United Kingdom	63	32	18	–3
Deutsche Pfandbriefbank AG, Madrid branch	Spain	15	3	–	–
Deutsche Pfandbriefbank AG, Paris branch	France	45	27	15	–3
Deutsche Pfandbriefbank AG, Stockholm branch	Sweden	9	9	6	–1
Provider of ancillary services					
CAPVERIANT GmbH, Munich	Germany	–	–	–1	–
IMMO Immobilien Management GmbH & Co. KG, Munich	Germany	–	–	–	–
IMMO Invest Real Estate GmbH, Munich	Germany	–	–	–6	–

1) Full-time equivalents not including apprentices, interns/working students and short-term employees with fixed terms < 1 year.
2) Operating income as turnover equivalent.
3) Figures before consolidation.

86 Report on Post-balance Sheet Date Events

The Management Board and Supervisory Board of pbb resolved on a new dividend policy on 1 March 2018: The current pay-out ratio of between 40% and 50% of consolidated profit after taxes in accordance with IFRS is set to be raised to a regular dividend of 50% plus a special dividend of 25%, until 2019 inclusive. The dividend policy is subject to regular review against legal and regulatory requirements, as well as in terms of commercial viability.

No further significant events occured after 31 December 2017.

Munich, 6 March 2018

Deutsche Pfandbriefbank AG
The Management Board

Andreas Arndt **Thomas Köntgen** **Andreas Schenk**

Responsibility Statement

To the best of our knowledge, and in accordance with the applicable reporting principles, the Consolidated Financial Statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Combined Management Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the material opportunities and risks associated with the expected development of the Group.

Munich, 6 March 2018

Deutsche Pfandbriefbank AG
The Management Board

Andreas Arndt	**Thomas Köntgen**	**Andreas Schenk**

Independent Auditor's Report

[Note: This is a translation of the German original. Solely the original text in German language is authoritative.]

To Deutsche Pfandbriefbank AG, Munich

REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS AND OF THE COMBINED MANAGEMENT REPORT

Opinions

We have audited the consolidated financial statements of Deutsche Pfandbriefbank AG, and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2017, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the financial year from 1 January 2017 to 31 December 2017, and notes to the consolidated financial statements, including a summary of significant accounting policies. In addition, we have audited the management report of Deutsche Pfandbriefbank AG and the Group (combined management report) for the financial year from 1 January 2017 to 31 December 2017. In accordance with the German legal requirements we have not audited the content of the corporate governance statement/corporate governance report which is included in the 'Other disclosures' section of the combined management report.

In our opinion, on the basis of the knowledge obtained in the audit,

> the accompanying consolidated financial statements comply, in all material respects, with the IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to Section 315e (1) HGB [Handelsgesetzbuch: German Commercial Code] and, in compliance with these requirements, give a true and fair view of the assets, liabilities, and financial position of the Group as of December 31, 2017, and of its financial performance for the financial year from January 1 to December 31, 2017, and

> the accompanying combined management report as a whole provides an appropriate view of the Group's position. In all material respects, this combined management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our opinion on the combined management report does not cover the content of the corporate governance statement/corporate governance report mentioned above.

Pursuant to Section 322 (3) sentence 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the consolidated financial statements and of the combined management report.

Basis for the Opinions

We conducted our audit of the consolidated financial statements and of the combined management report in accordance with Section 317 HGB and EU Audit Regulation No. 537/2014 (referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the combined Management Report" section of our auditor's report. We are independent of the group entities in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinions on the consolidated financial statements and on the combined management report.

Key Audit Matters in the Audit of the Consolidated Financial Statements

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements for the financial year from 1 January to 31 December 2017. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Determination of specific loan loss provisions for the Real Estate Finance segment
For the accounting policies and assumptions applied, please refer to the disclosures in the notes, section 12 'Loan loss provisions and provisions for contingencies and other commitments (risk provisions)'.

The Financial Statement Risk

As at 31 December 2017, Deutsche Pfandbriefbank Group's loan loss provisions amounted to EUR 71 million (PY: EUR 130 million). Of this amount, EUR 24 million (PY: EUR 86 million) is attributable to specific loan loss provisions for the Real Estate Finance segment. The net contribution to loan loss provisions as at 31 December 2017 was EUR 7 million, of which EUR 3 million (net) is attributable to specific loan loss provisions.

Determining specific loan loss provisions requires judgements and estimates of future cash flows from principal and interest payments by borrowers and/or the use of loan collateral provided depending on the restructuring or settlement strategy specified for the loan commitment. Expectations as to rental and sales success also have an effect on the valuation of collateral for the purpose of real estate financing. This has implications in particular with regard to expected future market developments and the associated changes in cash flows from ongoing management of the mortgaged property.

Therefore, it was of particular significance with respect to our audit that specific loan loss provisions were recognised in sufficient or the necessary amount and that appropriate assumptions were made when determining specific loan loss provisions with regard to the borrowers' capacity to repay principal and interest and regarding estimates of future cash flows from the use of loan collateral provided.

Our Audit Approach

Based on our risk assessment and evaluation of the risks of material misstatement, we used both control-based and substantive audit procedures for our audit opinion. Accordingly, we have performed the following audit procedures, among others:

In a first step, we gained a better understanding of the performance of the credit portfolio, the associated credit risks and the internal control system with regard to identifying, controlling, monitoring and evaluating credit risks for the credit portfolio.

To identify particular risk attributes, we conducted IT-based analyses of the entire credit portfolio. We analysed the credit portfolio on the basis of various product types and with respect to the presence of early warning indicators pointing to increased credit risk.

To assess the appropriateness of the internal control system with regard to identifying, controlling, monitoring and evaluating credit risks for the credit portfolio we conducted interviews and inspected the procedural and process documentation. In addition, we verified that proper controls were implemented and that they are effective to ensure adherence to the procedure for determining specific loan loss provisions. For the IT systems used, we verified the effectiveness of rules and procedures relating to numerous IT applications and supporting the effectiveness of application controls, with the involvement of our IT experts.

By taking into account the early warning indicators, we confirmed the recoverability of receivables using a risk-based selection of individual items and in doing so particularly assessed the estimates of future cash flows based on borrowers' credit ratings and/or the use of loan collateral provided, depending on the restructuring or settlement strategy specified for the loan commitment. For the purposes of impairment-testing of the underlying collateral, we used appraisals from independent experts for our opinion as well as publicly available data to assess whether the assumptions used for the independent expert opinions were properly derived. We also confirmed the competence, professional skills and impartiality of the experts based on interviews and publicly available information on the experts engaged.

Our Observations

Judgements were properly exercised as at 31 December 2017 with respect to assumptions about the amount of expected future cash flows based on borrowers' credit ratings and/or the use of loan collateral provided to determine specific loan loss provisions for the Real Estate Finance segment and were made in accordance with the applicable accounting standards.

Valuation of the receivable underlying Reference Claim No 3 relating to the securitised transaction 'Estate UK-3'

Please refer to section 62 'Provisions' of the notes and the 'Forecast' section of the combined management report for the risks relating to the securitised transaction Estate UK-3.

The Financial Statement Risk

Deutsche Pfandbriefbank AG, the legal successor of Hypo Real Estate Bank International AG, Stuttgart, issues credit linked notes in connection with the securitised transaction Estate UK-3. These credit linked notes secure the credit risk of a UK credit portfolio of Deutsche Pfandbriefbank AG, provided the requirements for loss allocation in accordance with the terms of the credit linked notes are fulfilled. A default affecting one of the hedged exposures (Reference Claim No 3) has caused a loss of approximately GBP 113 million, and a request has been made by Deutsche Pfandbriefbank AG to allocate this loss to the credit linked notes. The trustee of the transaction has raised doubts as to the permissibility of loss allocation and has appointed an expert who will decide on whether the loss allocation is justified.

As it is considered highly likely that the loss will be allocated in full to the credit linked notes, Deutsche Pfandbriefbank Group does not recognise any risk provisions for the receivable underlying Reference Claim No 3. In the event of the loss allocation being fully or partially impermissible, Deutsche Pfandbriefbank Group would have to bear the losses to that extent.

Material judgements are exercised in relation to Estate UK-3, particularly with regard to the legal assessment of the prospects of success of the loss allocation request during the expert proceedings. Based on opinions provided by legal firms, Deutsche Pfandbriefbank Group as at 31 December 2017 assumed that the contract terms and conditions were fulfilled and consequently that the expert will confirm the permissibility of loss allocation.

There is the risk for the consolidated financial statements that receivables are overvalued in the event that loss allocation is not feasible.

Our Audit Approach

Our risk assessment and evaluation of the risks of material misstatement are based in particular on an assessment of the adequacy of internal control with regard to credit risk and our understanding of the transaction and its legal basis. As a result, our opinion was based on substantive audit procedures. We therefore performed the following audit procedures, among others:

We obtained and used confirmations from lawyers who were commissioned by the Bank to provide a legal assessment of the prospects of success of the requested loss allocation. We also confirmed the competence, professional skills and impartiality of these lawyers based on interviews conducted with Deutsche Pfandbriefbank AG's management as well as publicly available information on the lawyers engaged. We also tasked experts of KPMG Rechtsanwalts GmbH with assessing the prospects of success and included their opinion in our evaluation of Deutsche Pfandbriefbank AG's assessment of the prospects of success.

Our Observations

The judgements exercised as at 31 December 2017 were reasonable with respect to determining the risk provisions for the receivable underlying Reference Claim No 3. The assumptions and estimates used for determining specific loan loss provisions, especially with regard to the legal enforceability of the requested loss application, were plausibly derived from the available information.

Other Information

Management is responsible for the other information. The other information comprises:
> the corporate governance statement/corporate governance report, and
> the remaining parts of the annual report, with the exception of the audited consolidated financial statements and combined management report and our auditor's report.

Our opinions on the consolidated financial statements and on the combined management report do not cover the other information, and consequently we do not express an opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in doing so, to consider whether the other information
> is materially inconsistent with the consolidated financial statements, with the combined management report or our knowledge obtained in the audit, or
> otherwise appears to be materially misstated.

Responsibilities of Management and the Supervisory Board for the Consolidated Financial Statements and the combined Management Report

Management is responsible for the preparation of the consolidated financial statements that comply, in all material respects, with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Section 315e (1) HGB and that the consolidated financial statements, in compliance with these requirements, give a true and fair view of the assets, liabilities, financial position, and financial performance of the Group. In addition, management is responsible for such internal control as they have determined necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the Group or to cease operations, or there is no realistic alternative but to do so.

Furthermore, management is responsible for the preparation of the combined management report that, as a whole, provides an appropriate view of the Group's position and is, in all material respects, consistent with the consolidated financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, management is responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a combined management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the combined management report.

The supervisory board is responsible for overseeing the Group's financial reporting process for the preparation of the consolidated financial statements and of the combined management report.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the combined Management Report

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the combined management report as a whole provides an appropriate view of the Group's position and, in all material respects, is consistent with the consolidated financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our opinions on the consolidated financial statements and on the combined management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Section 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements and this combined management report.

We exercise professional judgement and maintain professional scepticism throughout the audit. We also:
- Identify and assess the risks of material misstatement of the consolidated financial statements and of the combined management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinions. The risk of not detecting a material misstatement 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 controls.
- Obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures (systems) relevant to the audit of the combined management report 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 these systems.
- Evaluate the appropriateness of accounting policies used by management and the reasonableness of estimates made by management and related disclosures.
- Conclude on the appropriateness of management's 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 Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements and in the combined management report or, if such disclosures are inadequate, to modify our respective opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to be able to continue as a going concern.

> Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Section 315e (1) HGB.
> Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express opinions on the consolidated financial statements and on the combined management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our opinions.
> Evaluate the consistency of the combined management report with the consolidated financial statements, its conformity with [German] law, and the view of the Group's position it provides.
> Perform audit procedures on the prospective information presented by management in the combined management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by management as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

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

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

OTHER LEGAL AND REGULATORY REQUIREMENTS

Further Information pursuant to Article 10 of the EU Audit Regulation

We were elected as group auditor by the annual general meeting on 30 May 2017. We were engaged by the chairperson of the audit committee of the supervisory board on 25 July 2017. We have been the group auditor of Deutsche Pfandbriefbank AG and its legal predecessors without interruption for more than 20 years.

We declare that the opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

GERMAN PUBLIC AUDITOR RESPONSIBLE FOR THE ENGAGEMENT

The German Public Auditor responsible for the engagement is Markus Winner.

Munich, 7 March 2018

KPMG AG
Wirtschaftsprüfungsgesellschaft
[Original German version signed by:]

Dielehner	**Winner**
Wirtschaftsprüfer	Wirtschaftsprüfer
[German Public Auditor]	[German Public Auditor]

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Summary of Quarterly and Annual Financial Data

pbb Group

in € million	2016 4th quarter	2017 1st quarter	2017 2nd quarter	2017 3rd quarter	2017 4th quarter
Operating performance					
Operating income	113	98	105	106	115
Net interest income	112	103	103	109	120
Net fee and commission income	3	3	2	1	2
Net trading income	4	−2	2	−4	−1
Net income from financial investments	−3	1	–	−1	−4
Net income from hedging relationships	5	1	–	−1	−1
Net other operating income/expenses	−8	−8	−2	2	−1
Loan loss provisions	−4	−2	2	−2	−4
General and administrative expenses	−51	−50	−52	−53	−61
Net miscellaneous income/expenses	−3	1	1	–	–
Profit or loss before tax	55	47	56	51	50

Real Estate Finance

in € million	2016 4th quarter	2017 1st quarter	2017 2nd quarter	2017 3rd quarter	2017 4th quarter
Operating performance					
Operating income	81	73	86	86	92
Net interest income	87	83	84	88	95
Net fee and commission income	4	3	2	2	2
Net trading income	4	–	2	−2	–
Net income from financial investments	–	–	–	−1	–
Net income from hedging relationships	2	–	1	−1	−1
Net other operating income/expenses	−16	−13	−3	–	−4
Loan loss provisions	8	−3	2	−2	−4
General and administrative expenses	−42	−40	−41	−42	−49
Net miscellaneous income/expenses	−2	1	1	–	–
Profit or loss before tax	45	31	48	42	39

Public Investment Finance

in € million	2016 4th quarter	2017 1st quarter	2017 2nd quarter	2017 3rd quarter	2017 4th quarter
Operating performance					
Operating income	7	5	9	8	2
Net interest income	10	9	9	8	10
Net fee and commission income	–	–	–	–	–
Net trading income	–	−1	–	–	−1
Net income from financial investments	–	1	–	−1	−6
Net income from hedging relationships	1	–	–	–	–
Net other operating income/expenses	−4	−4	–	1	−1
Loan loss provisions	–	–	–	–	–
General and administrative expenses	−6	−6	−8	−7	−8
Net miscellaneous income/expenses	–	–	–	–	–
Profit or loss before tax	1	−1	1	1	−6

Value Portfolio

in € million	2016 4th quarter	2017 1st quarter	2017 2nd quarter	2017 3rd quarter	2017 4th quarter
Operating performance					
Operating income	21	19	9	9	19
Net interest income	12	10	9	10	13
Net fee and commission income	-1	–	–	-1	–
Net trading income	–	-1	–	-2	–
Net income from financial investments	-3	–	–	1	2
Net income from hedging relationships	2	1	-1	–	–
Net other operating income/expenses	11	9	1	1	4
Loan loss provisions	-12	1	–	–	–
General and administrative expenses	-3	-4	-3	-4	-4
Net miscellaneous income/expenses	-1	–	–	–	–
Profit or loss before tax	5	16	6	5	15

Consolidation & Adjustments

in € million	2016 4th quarter	2017 1st quarter	2017 2nd quarter	2017 3rd quarter	2017 4th quarter
Operating performance					
Operating income	4	1	1	3	2
Net interest income	3	1	1	3	2
Net fee and commission income	–	–	–	–	–
Net trading income	–	–	–	–	–
Net income from financial investments	–	–	–	–	–
Net income from hedging relationships	–	–	–	–	–
Net other operating income/expenses	1	–	–	–	–
Loan loss provisions	–	–	–	–	–
General and administrative expenses	–	–	–	–	–
Net miscellaneous income/expenses	–	–	–	–	–
Profit or loss before tax	4	1	1	3	2

Summary of annual financial data

in € million	2015	2016	2017
Operating performance			
Operating income	400	508	424
Net interest and commission income	440	412	443
Net interest income	426	404	435
Net fee and commission income	14	8	8
Net trading income	15	-6	-5
Net income from financial investments	-32	125	-4
Net income from hedging relationships	11	6	-1
Net other operating income/expenses	-34	-29	-9
Loan loss provisions	1	-1	-6
General and administrative expenses	-207	-198	-216
Net miscellaneous income/expenses	1	-8	2
Profit or loss before tax	195	301	204

Non-financial Report

Pursuant to sections 315b and 289b of the German Commercial Code (HGB), Deutsche Pfandbriefbank AG (pbb) has published this separate, Combined Non-Financial Statement, which was prepared based on the German Sustainability Code (DNK) and in accordance with the requirements of the German CSR Directive Implementation Act (CSR-Richtlinie-Umsetzungsgesetz).

SUSTAINABILITY STRATEGY

pbb is a leading specialist bank for commercial real estate finance and public investment finance in Europe and the US. As financing partner for the real estate industry and the public sector, the Bank holds an important real economic and macroeconomic function. At the same time, pbb ranks amongst the largest issuers of Pfandbriefe (German covered bonds), and is thus also a key issuer of covered bonds in Europe. This way, pbb bundles funds for granting loans, and transforms illiquid loans with concentrated risks into investment opportunities with a diversified risk structure and a high degree of fungibility. For details on the Group structure, business model and business strategy, please refer to the section on Fundamental Information about the Group in pbb Group's Management Report 2017.

When carrying out its business activities, pbb Group is responsible for its environment, i.e.:

> Employees
> Clients and banking partners
> Equity and debt investors
> Service providers and suppliers
> Society and environment.

Sustainability is our guiding principle. With its sustainability strategy, pbb Group pursues the goal of combining economic success and sustainability aspects in the best way possible. pbb Group aims for ongoing economic success – through law-abiding and honest conduct, responsible corporate governance, whilst adhering to high ethical principles. In this context, pbb Group wants to fulfil the demands of its stakeholder groups and create long-term value for all stakeholders, establish benefits to society, and protect natural resources.

Stakeholders' markets and demands undergo constant change. Thus, pbb Group deems a regular and open dialogue to be essential for identifying the needs of all stakeholder groups at an early stage, and being able to include these needs in decision-making processes.

pbb Group aims at consolidating and extending sustainability awareness by implementing appropriate measures, as well as integrating and embedding sustainability aspects within the company. In its sustainability strategy, pbb Group takes up aspects which, on the one hand, have a material impact on the Bank's business activities and business success, and which pbb Group, on the other hand, can itself significantly influence. These aspects were identified by way of a materiality analysis.

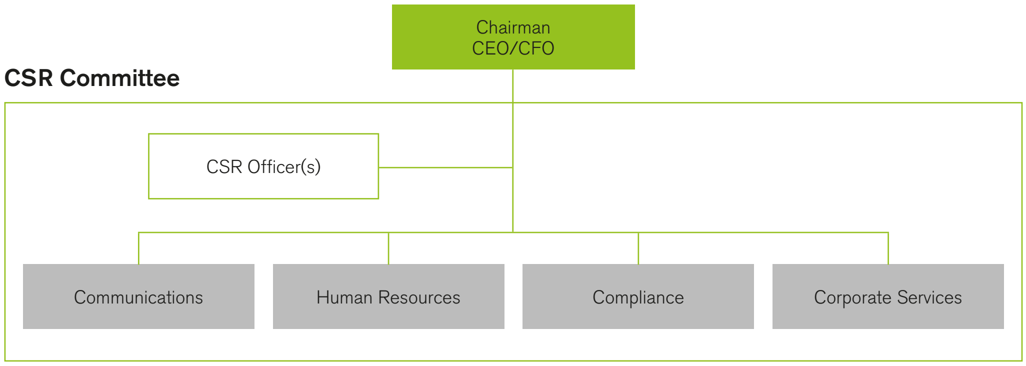
CSR Committee and Corporate Governance Officer

Established in 2017, the CSR Committee is a vital instrument for embedding sustainability topics in pbb Group. Internal rules of procedure determine the purpose and scope of action of the Committee.

The Management Board appoints the CSR Committee members. The Committee is comprised of the division heads of Communications, Corporate Office/Compliance, Human Resources (HR), Information Technology and the CSR Officer(s) appointed by the CSR Committee. Membership is linked to the respective function, ensuring that the different divisions are always effectively represented within the Committee. The division head of Communications is the chairman of the CSR Committee.

The chief responsibility of the CSR Committee is to develop a sustainability strategy, and to monitor its implementation. In addition, it determines sustainability targets and the measures necessary to achieve them. Within the scope of an ordinary meeting, held at least once a year, the CSR Officer(s) provide(s) information about current legal developments and market requirements, as well as about the status of implementation and the level of completion of measures and targets determined. Based on this, the CSR Committee may approve new measures and targets where appropriate. Furthermore, on an ad hoc basis, resolutions may be passed in an extraordinary process. The CSR Committee generally follows the principle of materiality when assessing and prioritising measures and targets.

Minutes shall be prepared for any and all meetings. The Management Board shall be informed about the date and time of the meetings in a timely manner, and may attend them if desired. Furthermore, the Management Board may obtain further reports and recommendations by the CSR Committee at any time.



Andreas Arndt (CEO/CFO) – responsible for any and all issues regarding the implementation of corporate governance provisions and standards, and the monitoring of their compliance within the Management Board – is Corporate Governance Officer on Management Board level.

Incentive system

The remuneration system is another vital instrument for deeply embedding sustainability topics in pbb Group. As per its structure, the remuneration system explicitly considers the sustainable development of pbb Group. The focus lies on the economic success of the company. (For further details, please refer to the Remuneration Report in pbb Group's Management Report 2017.)

MATERIALITY ANALYSIS

pbb Group carried out a materiality analysis in several steps, in order to determine the material sustainability aspects for pbb Group and its stakeholders.

As a first step, the CSR Committee identified the essential stakeholders for pbb Group.

Stakeholder

As a second step, potential sustainability topics and aspects were identified and categorised on the basis of a so-called “long list”. In addition to the general topics environment, employee matters, social concerns, and corporate governance, particular emphasis was placed on the identification of industry-specific and pbb Group-specific aspects.

The third step comprised the assessment of the aspects identified as relevant for pbb Group with regard to their materiality. pbb Group employees determined the relevance for individual stakeholder groups by simulating stakeholder roles. The employees involved represented different areas and various functions with close contact to the relevant stakeholders. They were thus able to see things from the respective stakeholders’ view in the best way possible. In addition, pbb Group’s CSR Officers assessed the business relevance and impact of business activities according to the German CSR Directive Implementation Act.

The results of the materiality analysis were presented to and discussed within the CSR Committee. The following topics and aspects were identified as material for pbb Group’s non-financial report:

Topics	Aspects
Industry-specific aspects	Client orientation Sustainable financing solutions Risk management
Corporate Governance	Compliance Human Rights
Employee matters	Remuneration and employee benefits Working environment Training and continuing professional development
Environment	Mobility

Social concerns were identified as non-material within the scope of our materiality analysis.

Regarding the influence on pbb Group's business activities, the possibility of pbb Group to influence the aspects, as well as regarding the stakeholder relevance, the materiality analysis yielded the following results:

Industry-specific aspects, corporate governance aspects and employee matters have the largest impact on pbb Group's business activities, whilst the impact of environmental aspects is comparatively small due to the business model. The most important industry-specific aspects are client orientation and sustainable financing solutions, as well as sustainable risk management. These aspects significantly impact the business activities of pbb Group. At the same time, it is precisely these topics or aspects that can be influenced most effectively by pbb Group itself. The same applies to corporate governance aspects, compliance, and human rights. Amongst employee matters, the following aspects bear the highest relevance: the working environment, training and continuing professional development, and employee benefits. Even though the named aspects also have a significant impact on the Bank's business activities, pbb Group only recognises limited possibilities of influence. With regard to environmental issues, the topic of mobility was the only aspect to be considered relevant. However, the impact on business activities is rather low, as are the possibilities of pbb Group to exert influence on this topic. Stakeholders considered the aspects Compliance and risk management to be especially relevant, whilst the relevance of all other topics was only classified as medium.

In addition, within the framework of the materiality analysis, the essential aspects along the value chain were categorised, and the potential influence of pbb Group along this chain was assessed. pbb Group provides a large part of the entire value chain within commercial real estate finance and public investment finance itself, primarily procuring the funds for the lending business by issuing Pfandbriefe and unsecured bonds, as well as with its retail deposit-taking business with private clients. In the lending business, pbb Group initiates business transactions, provides loan coverage along the entire loan lifecycle up until loan repayment, or, if applicable, the realisation of collateral. Therefore, pbb Group sees the largest potential influence here.

Potential influence on up- and downstream activities of the value chain, on the other hand, are limited to only a few aspects. Upstream activities are especially services rendered by suppliers and service providers. Due to pbb Group's business model, these activities are, however, of only minor significance. The human rights aspect is material for pbb Group; nevertheless, the Bank sees little possibilities for influence. The key downstream activities include especially the use and further utilisation of real estate objects and infrastructure projects financed by pbb Group. In this case, pbb Group recognises a high level of potential influence by implementing sustainable financing solutions.

RISKS AND OPPORTUNITIES

Should pbb Group fail to appropriately take the sustainability aspects categorised as material into consideration, or even ignore them, especially financial and social risks would arise. Ecological risks play merely a minor role.

Financial risks result mainly from the following topics: employee matters, corporate governance, and industry-specific aspects. At the same time, this is the area with the greatest opportunities for pbb Group. The qualifications and satisfaction of our employees are the main foundation for the quality of their work, and thus for the Company's potential. In the case of corporate governance, pbb Group focuses mainly on potential financial damage resulting from Compliance effects, whereas in the case of industry-specific aspects, financial damage may occur due to all material aspects. Client orientation is a fundamental success factor for pbb Group in order to secure the financing portfolio; sustainable financing solutions reduce the credit default probability and increase the value of the collateral; risk management is a central monitoring and management system. It is however particularly the industry-specific aspects which allow pbb Group to positively stand out from its competitors in a direct comparison.

Potential financial risks along the value chain arise especially in connection with the own business activities; however, they also occur downstream with regard to sustainable financing solutions – by the construction and use of financed real estate objects and infrastructure projects.

pbb Group recognises social risks, mainly in relation to corporate governance and industry-specific aspects. Focus is especially laid on reputational risks, as reputational damage can have significant adverse effects on pbb Group's sustainable business success. Along the value chain, potential social risks are mainly related to own business activities; on the other hand, pbb Group classifies risks from upstream activities provided by suppliers and service providers as low.

pbb recognises ecological risks, particularly in relation to industry-specific aspects, and especially within the scope of sustainable financing solutions. Risks arising from non-sustainable construction and use of financed real estate objects and infrastructure projects are in focus, i.e. the potential ecological risks are primarily downstream of the own business activities along the value chain.

pbb Group' sustainability strategy is designed to minimise sustainability risks to the greatest extent possible, whilst making use of the opportunities arising.

In the following, we will illustrate the material sustainability topics and aspects.

INDUSTRY-SPECIFIC ASPECTS

Client orientation

pbb Group's clients are fundamental to its business. Therefore, clients' needs are at the core of pbb business activities, and we continuously strive to reach the best possible balance between client demands and our own interests.

Client orientation is a key success factor for pbb Group in order to generate a business portfolio – through new commitments and prolongations – that matches the Group's risk and return profile. For pbb, client orientation goes beyond processes and structures – it is the top priority in the everyday business of every employee, and a way of life. In this context, the following aspects are crucial: Client dialogue, client proximity, and a relationship based upon trust between pbb and its clients.

pbb Group maintains a regular and intensive exchange of views with its clients in order to identify their needs, be it in one-on-one talks in the context of long-standing business relationships, or at events. For instance, pbb regularly attends the real estate trade fairs MIPIM in Cannes and Expo Real in Munich. Moreover, pbb organises regular events for clients in commercial real estate finance and public investment finance. In 2017, pbb Group held client events in Germany, France, Poland, Sweden and the United Kingdom, with a total of 1,500 attendees – including professional real estate clients and experts as well as public investment finance clients. pbb plans to organise similar client events in 2018.

Every market has its own local idiosyncrasies. Detailed knowledge about individual market conditions and developments allows pbb to better understand client needs, and to hold an in-depth dialogue with its clients. In order to stay up-to-date, pbb maintains a comprehensive network of sales offices in Germany and other important locations throughout Europe. Overall, pbb Group maintains nine local sales offices. In further pursuit of local presence, following its re-entry into the US market and expansion of its business activities there, pbb Group recognises the importance of establishing another local sales office – in New York City. Our newest representative office will open there in the first half of 2018.

Besides its strong local presence, pbb also features expert teams for selected real estate financing aspects such as property development, logistics, retail and residential topics, hotels – as well as real estate for social purposes. The purpose of these teams is to integrate existing know-how within the Bank, to build up more in-depth knowledge in a targeted manner, and to provide expert opinions when needed. The teams consist of experts from different areas of specialisation, and are staffed internationally. Among their regular members are employees from Real Estate Finance, Credit Risk Management, Property Analysis & Valuation, and from the Legal department. The competent decision-making bodies may resolve that the respective expert teams become involved in certain new business processes as consultants, or to provide expert opinions on certain aspects. The Developments and Hotels expert teams gets involved at an early stage, immediately after the New Deal Committee (NDC) approved the respective deal.

Based on its profound market and product knowledge, pbb Group enters into a highly specialised dialogue with its clients, aiming at individual and tailor-made financial solutions. Given the early involvement – and structural embedding – of Risk Management (for further details, please refer to the Risk and Opportunity Report in pbb Group's 2017 Management Report) and the Property Analysis & Valuation department for real estate valuation purposes, pbb intends to identify, and mitigate, potential risks at an early stage.

Client confidence plays another crucial role in pbb's business activities. As a fundamental prerequisite, pbb Group implements the necessary security standards in order to ascertain confidentiality of information about clients, and of all transaction data (cf. the chapter "Data protection"). Since its establishment, pbb Group has used a Code of Conduct, which comprises the non-negotiable requirements that pbb expects from all its employees when dealing with clients, or other stakeholders. The Code of Conduct provides more than just guidance – it is an explicit and integral part of the employment contracts of all employees, and forms the basis for all other framework regulations within the pbb Group.

The Code of Conduct is implicitly applied to all clients, prospective clients or other business partners (e.g. suppliers). Should an employee become aware of any indications that a client, prospective client or other business partner (e.g. a supplier) may be involved in illegal activities, or activities that could damage our reputation, he must inform the competent member of the Management Board as well as the Compliance function. The competent member of the Management Board will initiate a review of every single case – in cooperation with Compliance, and other divisions, if required (such as Internal Audit, Legal, or the Credit department).

In 2014, pbb Group introduced a new purchase guideline designed to streamline purchase processes and established the so-called Compliance Caution Framework (CCF Scout). CCF Scout is used as an IT-based search engine to check business partners, counterparties, purchasers or suppliers for entries or any sort of conspicuous features immediately, and at an early stage, before new business is generated or an existing business relationship is extended. CCF Scout entries have been collected by a respected external service provider, which draws upon worldwide sanctions lists collated from publicly available sources, such as the EU, OFAC, or the German Bundesbank. Furthermore, CCF Scout comprises relevant information from press releases and media content.

Regarding client confidence, fair treatment is another crucial factor. pbb Group is committed to openness, professionalism and excellence when providing services to clients.

This also includes a high performance standard as well as appropriate and effective complaints management that ensures the efficient, targeted and rapid processing of complaints. Complaints received not only offer the chance to amend mistakes, and to restore client satisfaction – they also provide important clues to organisational weaknesses. Therefore, pbb Group takes every complaint seriously, handles them carefully, and documents them irrespective of background or appropriateness. For this purpose, pbb Group established a dedicated process in order to ensure that complaints are dealt with efficiently – this process has been laid out in an internal guideline, which is binding for all employees. The responsible department within pbb Group office collects all complaints, reviews them on a regular basis, and provides reports to the Management Board and the Supervisory Board, amongst others. If necessary, the Management Board resolves appropriate improvements. Against this background, the number of complaints received at pbb Group declined by 30% in 2016, and by another 27% in 2017. In 2017, the number of complaints was in the low double-digit range.

Sustainable financing solutions

As a specialist bank, pbb Group finances commercial real estate projects as well as infrastructure projects of the public sector. pbb Group sets high standards when granting loans – also in terms of sustainability. As a general rule, pbb Group's actions are always within the boundaries set by legal, and in particular the applicable prudential, requirements. In addition, pbb Group laid out additional ethical and moral standards in its Code of Conduct, which emphasises sustainable behaviour. pbb Group does not support business practices that could harm our reputation or give rise to the suspicion that the client is acting unlawfully, or is violating our ethical and moral standards. Illegal activities or activities that could otherwise damage the Group's reputation include:

- Money laundering
- Financing terrorism
- Drug trafficking
- Illegal weapons trade
- Violation of human rights
- Human trafficking
- Smuggling of goods
- Bribery of government officials or other officials
- Granting and/or accepting undue benefits
- Tax offences
- Illegal or unauthorised use of property, including land ownership
- Market abuse, such as market manipulation or insider trading

- All forms of organised crime
- Environmental pollution including excessive emissions, illegal waste disposal as well as any type of falsification of documents associated therewith
- Illegal use of labour, including forced labour and child labour

The above list is not exhaustive, yet representative of pbb Group's commitment to distance itself from any illegal practices or any other activities that may damage its reputation. Our ethical principles and guidelines are more important than pbb Group's interests of generating profit with individual transactions.

Besides economic aspects, ecological considerations, in particular the sustainability of income streams and the building structure itself, play an important role for the financing of commercial building projects and the overall real estate portfolio. If pbb were to ignore its sustainability principles, the Group would considerably increase potential risk regarding interest and principal payments, and the repayment of granted loans. In addition, this would represent considerable financial risk for clients and real estate investors, given that their equity investments would be drawn upon before the loans granted by pbb in any form of insolvency proceedings. Moreover, waiving our sustainability principles may have repercussions on the environment and the society. Therefore, the interests of pbb Group are in line with general sustainability interests. pbb integrates its clearly defined and carefully designed due diligence process into the credit approval procedures, involving the Management Board.

The assessment of income sustainability is generally based on the valuation of relevant aspects, such as economic, demographic and sociographic factors as well as real estate (e.g. property location, sales ratios, occupancy and vacancy rates, tenant structure, rental income, general administrative and maintenance costs) and financing considerations (e.g. financing volume and structure, loan-to-value ratios, financing conditions). The assessment of the building structure sustainability is generally based on the structural quality, taking ecological aspects into account, such as the composition and quality of the used materials and the quality of the construction work. Furthermore, eco certifications are taken into account, such as Green Building Programme certificates, or energy labels. If pbb were to ignore contaminations of properties, or if it tolerated ecologically irresponsible construction work, the sustainability of the respective property (or the corresponding mortgage securities) would be jeopardised.

In order to ensure financing sustainability, close cooperation between Sales, Risk Management as well as Property Analysis & Valuation is required at an early stage of the credit process within the pbb Group – which has been laid out in the corresponding process structure and internal guidelines. pbb Group maintains a dedicated department comprising 45 real estate surveyors, and cooperates with external real estate experts. In the case of suspected contaminated sites, pbb carries out additional research and usually obtains specialised expert opinions. In order to ensure the sustainability of properties yet to be financed, our surveyors provide an assessment of the real estate regarding its economic and structural risks. The assessment result – including any conspicuous or unusual features – are summarised in a property report, which is used, among other factors, to take the credit decision. Furthermore, in the corresponding valuation opinion, the sustainability of the property value as a financing object is explicitly considered through the lending value concept. More specifically, sustainability aspects such as the energy efficiency of a building, or any contaminations, are considered very carefully in the valuation of properties. In addition, the basis and time intervals for credit decision reviews have been clearly laid down. The same applies to the inspection of properties – our guidelines provide unambiguous instructions, when and by whom these inspections shall be conducted. pbb applies particularly rigorous monitoring and supervisory processes for new buildings as part of so-called development financings, and for construction measures within existing properties (e.g. modernisation or renovation activities) as part of so-called investment financings. Our monitoring processes also comprise working conditions as well as human rights. Given the close cooperation of all pbb divisions, in particular the involvement of Property Analysis & Valuation at an early stage, pbb Group efficiently selects its new business exposure, which is essential for the long-term success of the Group and its clients. Furthermore, this approach allows us to avoid negative repercussions for the environment and society as a whole.

In Public Investment Finance, pbb Group contributes to society by financing investments for the provision and improvement of public infrastructure. Many of the public investment financing projects have a direct and sustainable positive social as well as environmental impact. For instance, pbb Group finances investments in social housing, public administration buildings, or renewable energy. Whilst the relevant credit process is largely in line with Commercial Real Estate Finance, pbb Group's lending business in Public Investment Finance is not only based on tangible assets and income generated from such assets, but additionally on the credit quality of public-sector entities such as cities or regions. Transactions are also geared towards sustainability: a detailed due diligence process is employed to ensure the long-term value of loan receivables – and hence, debt servicing ability as well as the ability to repay the loan. Social and environmental aspects are explicitly incorporated into the assessment. Sustainability is a key concept, especially as far as export finance facilities under public guarantees (export credit agency or "ECA" financings) are concerned: external consultants are retained to evaluate sustainability issues, such as environmental aspects but also working conditions and human rights. Given the major importance of sustainability aspects in the ECA business, over and above the general guidelines set out in the Code of Conduct, pbb Group's Management Board adopted an additional internal business-specific guideline in 2017 governing the determination and assessment of risks relating to human rights, corruption as well as environmental protection, in relation to ECA-covered export, project or infrastructure financings.

pbb Group has committed itself to making an active contribution to further develop and promote sustainability standards. For this reason, the Group is active in numerous working groups: in the real estate (financing) business, pbb Group takes part in working groups of the Association of German Banks (BdB) and the Association of German Pfandbrief Banks (vdp), as well as in the initiative launched by the European Mortgage Federation (EMF) and the European Covered Bond Council (ECBC) to determine energy efficiency of buildings in Europe. Through its participation in working groups as well as in various association bodies, the Group succeeded in further advancing sustainability standards: for example, including sustainability aspects and incorporating environmental certificates into pbb Group's databases. Thanks to the active involvement of pbb Group, the vdp valuation committee determined energy-efficiency criteria (as part of a property and market rating) which will be included as additional criteria into vdp's transaction database. In the public finance sphere, pbb Group is active in the BdB export and commodity finance working group, vdp 's export finance working group, in the ICC Export Finance Working Group, as well as in the Euler Hermes expert committee.

Risk management

Besides client focus, risk management constitutes another core success factor for pbb to secure its sustainable business performance. Within the framework of risk management, pbb Group identifies, analyses and monitors all potential risks. Given its key importance for pbb Group, the risk management function is anchored as an integral component of the Group, both in terms of organisation and concerning processes. Please refer to the Risk and Opportunity Report in pbb Group's Management Report 2017 for more detailed information on risks and opportunities identified for the various types of risk, within the scope of the risk management and risk control system implemented.

CORPORATE GOVERNANCE

Code of Conduct and ethical principles

Transparent, fair, responsible and honest conduct – with the required degree of expertise, professionalism and integrity in dealings with one other, clients and business partners, competitors and the public – are deeply rooted in pbb Group, and require that the relevant legal, supervisory and internal obligations as well as other relevant laws and regulations are implemented and adhered to.

pbb Group's Code of Conduct sets out the ethical and legal framework as well as the non-negotiable standards the Group expects its employees to live by. The Code of Conduct provides more than just guidance – it is an explicit and integral part of the employment contracts of all employees, forming the basis for all other framework regulations within the pbb Group.

The Code of Conduct offers amongst others clear guidance on questions regarding relationships with clients, suppliers, shareholders, investors and competitors – as well as how to respond to conflicts of interest, bribery, the granting of advantages, preventing money laundering and market abuse.

pbb Group strives not to support business practices that could visibly harm our reputation or give rise to the suspicion that the Group assists clients or suppliers in violating its ethical standards or in breaking the law.

The applicable law, as well as all the regulatory provisions in force in the various jurisdictions where pbb Group does business, form the basis for the entire corporate decision-making process and our day-to-day operations. They are complemented by internal regulations and detailed process descriptions. As a listed company, pbb adheres to the German Corporate Governance Code under application of the "comply or explain" principle. This Code describes the legal requirements posed for managing and supervising German listed companies, and reflects the current national and international developments and standards of good and responsible corporate management.

Compliance

Compliance means ensuring adherence to legal and other requirements by building an organisation that proactively meets these needs and implementing other measures. This holds especially true for legal requirements concerning the performance of investment services. Compliance with these requirements serves the goal of client/investor protection and, as a consequence, the protection of pbb's reputation. At the core of the norms pbb must adhere to lies the EU Market Abuse Regulation, the German Securities Trading Act, and the regulations and guidelines based on these documents. Compliance risks include sanctions, financial losses and reputational risks that may arise from violations of these rules. The Group takes any fraudulent act very seriously, both for commercial reasons and because of its legal obligation to prevent such acts.

pbb and its Group entities have devoted themselves to very high standards of honesty, openness and responsibility, applied both within the organisation and during all external business activities. We need to be able to rely on each other, and our clients must be able to trust us. As our employees play a central role in this context, we have established tools that allow our internal staff – as well as external third parties – to blow the whistle on statutory violations and undesirable conduct. Compliance regularly reports on these tools to the Management Board and Supervisory Board.

Beyond the Code of Conduct mentioned above, pbb employees are required to adhere to numerous internal guidelines and instructions, for example on combating criminal acts, on information security, on preventing money laundering and the financing of terrorism, as well as on competition law.

In pursuit of the goals of raising awareness amongst and educating staff, all of pbb's employees are obliged to take part in compliance trainings on a regular basis. These trainings cover a variety of topics, including the prevention of money laundering and other criminal acts such as corruption (granting or accepting an advantage, engaging in active or passive bribery), breach of confidentiality and tax offences, as well as general compliance issues. Successful participation in these trainings is only certified after a test. Group Internal Audit regularly reviews how these trainings are conducted.

Banks are bound by a multitude of legal and regulatory provisions that have been installed to provide clients and business partners with a high degree of security. pbb Group, in turn, has installed various processes to ensure compliance with these provisions, such as a centralised monitoring process for key controls and risks. This so-called control attestation process has all business divisions report to Compliance on a quarterly basis. For this process, pbb identified the key risks on a risk map and assigned them so-called key controls, which are subject to a continuous monitoring and confirmation process. The state of the Internal Control System is regularly reported to the Management Board and the Supervisory Board, based on the key controls in all business divisions.

Pursuant to article 18 of the Market Abuse Regulation, issuers or any person acting by order of or for the account of such issuer, must maintain lists of persons who are active on their behalf, and who are authorised to access inside information. pbb Group shall inform these persons on the legal duties associated with access to inside information, and on the legal consequences of violations of rules.

The harmonised purchasing policy stipulates that all relevant purchasing needs must be fulfilled through the IT-based purchasing and contracts management system, which also serves as the contracts database (incl. deadline management). Our purchasing policy also defines the multi-layer approval process, which includes the sourcing unit and is based on a pre-defined assignment of approval powers. Suppliers are regularly rated, allowing us to rank and compare them, to monitor their performance, and talk openly about weak spots.

The relevant Compliance processes are continuously reviewed in pursuit of further digitalisation, expansion of the monitoring systems, and reconciliation with the Group's risk information.

The Management Board and the Supervisory Board's Audit Committee receive detailed reports on all Compliance-relevant topics on a quarterly basis.

Combatting money laundering and terrorist financing

pbb Group has committed to very high standards in the prevention of money laundering and the financing of terrorism, to make sure that constant reforms are always accounted for. The Group has installed comprehensive policies, rules and regulations and requires all employees to adhere to its stipulations. Examples of the Group's commitment include thorough Know Your Customer (KYC) processes, a continuous review of international lists regarding, inter alia, sanctions, suspicion of money laundering or terrorist financing , as well as risk analysis and ongoing reporting. The actions of pbb Group in this regard are essentially based on the German Money Laundering Act, compliance with which is reviewed and controlled through controls of the Origination, Compliance and Internal Audit units of the different divisions along the three lines of defence. The task of preventing money laundering and financing of terrorism is constantly revised, and is reviewed by Internal Audit on an annual basis. It is also covered during the audit of the financial statements.

Anti-corruption and bribery

As a shield against corruption, pbb Group has established clear principles and guidelines for proper and professional conduct – for example in case of conflicts of interest, fighting corruption, active and passive bribery. Special attention is given to accepting and granting benefits and gifts.

In their interactions with government representatives and public agencies, staff must refrain from any actions that could unlawfully influence the decisions of officials. In particular, cash payments, gifts and other benefits or perquisites to officials that could, in any way, be interpreted as undue influence, bribery or corruption, are prohibited.

Data protection

Handling confidential data with great care and protecting our clients is a top priority. We adhere to the EU General Data Protection Regulation, German Data Protection Act, to national legal and regulatory provisions, to contractually agreed confidentiality clauses (including concerning the so-called "banking secrecy") as well as to internal regulations on data protection.

To ensure that these data protection requirements are met, pbb has implemented controls and sanctions. An in-house data protection officer, in his or her management function, also exercises control tasks. Further, the issue of data protection is covered in every employment contract, and our staff receive ongoing training regarding data protection issues. Any breach of the data protection rules and regulations may have disciplinary consequences.

Competition and antitrust legislation

In its Code of Conduct and internal instructions, pbb Group has set high standards of compliance with competition and antitrust stipulations as well as rules for discussions with competitors.

The expert units that are of relevance in terms of competition law have been identified and receive regular, in-depth training on the subject. The heads of these units are required to regularly report on the Bank's alignment with competition and antitrust legislation to Compliance, as laid out in the pbb Group control concept.

Human rights

Respecting human rights is a matter of great importance to pbb Group. Above and beyond legal requirements, for example such as set by the German General Act on Equal Treatment and the German Act to Promote Transparency of Pay Structures (AGG), pbb Group installed further non-negotiable stipulations in its Code of Conduct. The Code of Conduct is partly based on the European Convention on Human Rights.

pbb Group has bound itself to respecting and complying with human rights. It therefore distances itself from any cases of human rights breaches, be it that human rights were offended through a member of staff or another stakeholder group. Transparency, honesty and fairness, but also dignity and respect are among the most central maxims.

pbb Group respects all people, independent of age, sex, race, social background, skills, sexual orientation or religion, and is committed to fostering diversity amongst its staff as far as possible. No form of unfair treatment or discrimination will be tolerated.

pbb Group sets great store by the diversity of its workforce, which is why the Group is devoted to preventing or removing discrimination against all employees . In terms of prevention, it is important that all employees be bound by the Code of Conduct, the document that makes it clear to all members of staff what pbb Group deems non-negotiable.

pbb has established an internal Complaints Office that employees may turn to when they feel that discrimination pursuant to the German General Act on Equal Treatment has occurred. Complaints made thereto will be reported to the Head of Human Resources, and followed up by an internal clearance and review as to whether the General Act on Equal Treatment has indeed been violated. Depending on the severity, the implications and the legal or economic risks associated with the violation, other entities such as Data Protection, Compliance, Legal, the Management Board or the Works Council may be involved where necessary. Based on the result of the review, further action or measures will be discussed and decided upon. The Complaints Office informs the complainant about the handling of his or her complaint, and will include a reasoning if the complaint is rejected. The complaint is documented separately from the personnel file.

Employees who discriminate against others do so knowing that there will be labour law-related sanctions and disciplinary measures for their behaviour, ranging from a written warning to a possible redeployment or even dismissal. On the intranet, pbb informs its workforce concerning protective measures against discrimination with a dedicated pamphlet.

pbb Group employees are also duty-bound when it comes to human rights violations by other stakeholders. Should a staff member become aware of any indications that a prospective client or other business partner (e.g. supplier) may be involved in illegal activities or activities that could damage our reputation, they must inform the member of the Management Board who is responsible for the relevant area, as well as the Compliance Officer in accordance with our Code of Conduct. The relevant Management Board member, by involving the Compliance function, will then arrange for an investigation of the specific circumstances. In addition, other organisational units within the Group may also be involved in any further investigations (e.g. Internal Audit, Legal, Credit, etc.).

The issue is also covered on a preventive basis during the Know Your Customer processes on clients and business partners, as well as during country analysis aimed at identifying target markets. The review also covers suppliers. In 2017, pbb Group prepared a statement of compliance with the UK Modern Slavery Act, in which suppliers and service providers were identified and the processes that have been set up to ensure conformity with this Act, whose applicability is limited to the United Kingdom, were laid out.

Human rights also have a place in the credit process: salience during the assessment and ongoing credit management must be put on record in the credit application, or be reported.

The Management Board and the Audit Committee are informed about Compliance-relevant topics on a quarterly basis. This also applies to human rights abuses that have been reported or have occurred, but in the case of serious breaches, the Management Board and the Audit Committee will be informed at short notice.

pbb Group regularly holds – and will continue to regularly hold – compliance trainings, which also cover the basics on human rights. The goal of these trainings is to avoid as many cases of breach as possible through the preventive measures and to reduce the number of cases in which human rights were abused.

Further information on human rights can be found in some of the chapters on sustainability issues.

There were no human rights abuses at pbb Group during the 2017 financial year.

EMPLOYEE MATTERS

pbb Group as employer

An increased need for specialisation and demographic change, all within an environment marked by regulatory requirements, brings new challenges to pbb Group in its HR work.

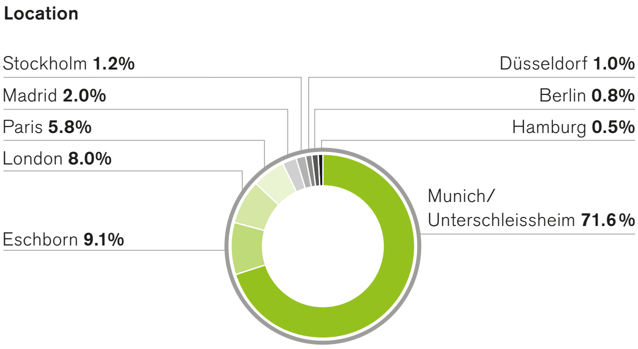
pbb Group's HR work is based on a far-sighted HR strategy, which translates the Group's business and risk strategy (as well as its business model) into the HR world. pbb's business model requires highly qualified employees with expert knowledge. The key objective of pbb Group's HR strategy therefore is to attract, retain and develop – for the long run – highly qualified employees with vast knowledge, a high degree of quality awareness, customer focus, leading competence at both divisional and project level, the willingness to be deployed flexibly, and a high degree of entrepreneurial thinking.

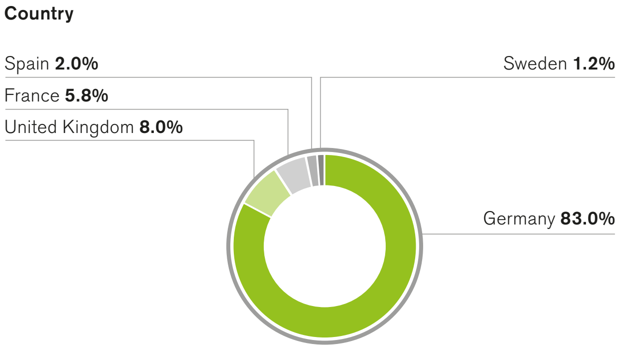
Implementation of the HR strategy is based on differentiated, strategic personnel planning, where medium- and long-term changes in the workforce and staffing needs are meticulously and systematically assessed and managed from a far-sighted point of view, as part of pbb Group's multi-year planning. pbb Group takes great care in structuring the organisation and workflows efficiently, and with a focus on the clients. Lean processes are continuously optimised, also for the purpose of cost-effectiveness.

One result of the HR strategy is the restructuring strategy, another is the successful, diversified internal and external qualification programme, and yet another is the variable remuneration, which features incentives for individual performance, and promotes cooperation between business divisions, departments and teams. This shows that the HR strategy directly helps to ensure that pbb Group will remain competitive in the future, since it naturally contests with other banks, and continuously vies for the best talent in the market.

pbb Group creates a dynamic working environment, offers ways to earn qualifications, and presents career perspectives. The goal is to empower employees to find individual solutions with their clients, to think and act like an entrepreneur, with their focus on the client.

Regional distribution of employees (pbb Group)
As of 31 December 2017





As in the previous year, pbb Group's workforce remained stable during 2017, by and large. At the end of the year under review, pbb Group employed a total of 782 people[1] (2016: 791 people). The adjusted[2] fluctuation for pbb Group was 9.11% (2016: 8.82%). The ratio of voluntary redundancies was 4.23% (2016: 4.10%).

Remuneration and employee benefits

The remuneration system and the remuneration strategy of pbb Group are integral components of the business and risk strategy of pbb Group. The system aims to guarantee a performance-oriented remuneration in line with the market – one that is geared to achieving the targets enshrined in the business and risk strategy. The objective of pbb Group's business and risk strategy is to increase Group profitability on a sustainable basis, by acquiring profitable new business and applying a stringent risk policy. Business management is targeting these objectives, with performance measurement at institutional level being one of its key elements. This performance is measured through performance indicators derived from the business and risk strategy, and also forms the basis for the total variable remuneration available for disbursement at the pbb Group. Hence, variable remuneration of Management Board members and all other employees is directly linked to – and driven by – pbb Group's business and risk strategy.

The remuneration strategy is not only closely linked to the business and risk strategy of pbb Group, it is also an integral element of the Group's HR strategy. The variable remuneration system includes appropriate incentives for individual performance and promotes and improves cooperation between business divisions, departments and teams. With the variable remuneration components, employees have the chance to participate directly in the success of pbb Group.

Another key element in the remuneration strategy of pbb Group and its remuneration system is the fulfilment of regulatory requirements that deal with the remuneration systems of banks. On the one hand, this means that the implementation of the statutory principle of appropriateness of individual remuneration components regarding total amounts and structures is accounted for, with the ultimate objective being the avoidance of disproportionately high risks. Total remuneration amounts, and individual remuneration components of Management Board members and employees, are subject to regular review in order to establish an appropriate relation regarding function and performance as well as pbb Group's overall performance. The appropriateness of the Group's remuneration system

[1] Headcount pursuant to the HGB (excluding Members of the Management Board, interns and student employees).
[2] Adjusted fluctuation comprises any fluctuation initiated by the employer or employee, as well as discharges due to fixed-term employment contracts running out.

is reviewed by an independent external remuneration consultant, who uses external benchmarks to produce market comparisons of remuneration amounts and structures.

On the other hand, the remuneration system of pbb Group implements all other regulatory requirements regarding remuneration, in particular those regarding the variable remuneration component. Of particular importance for pbb Group are the regulatory requirements regarding remuneration systems pursuant to the German Banking Act (KWG) and pursuant to the German Ordinance on Remuneration in Financial Institutions (InstitutsVergV; especially requirements on the variable remuneration of risk takers and senior managers), as well as – for the Management Board – those resulting from the German Stock Corporation Act (AktG) and the German Corporate Governance Code (DCGK). Moreover, provisions under contractual arrangements – as well as the remuneration principles of the SoFFin (as amended in 2012) – are observed. Compatibility of the remuneration system with the central regulatory requirements are regularly reviewed and approved by an independent external remuneration consultant, external lawyers and the auditor. pbb established dedicated processes to ensure that any future regulatory changes will be implemented in a timely manner. The above-mentioned InstitutsVergV was amended on 4 August 2017. pbb Group is currently evaluating what changes this will require to its remuneration system, and is taking appropriate steps.

The remuneration system of pbb Group is explained in detail in the Remuneration Report of pbb Group's Annual Report.

Fair remuneration
The remuneration of members of staff whose conditions of employment are governed by collective wage agreements, so-called tariff employees, is ruled by the collective agreement for private and public-sector banks. pbb is a member of the employers' association for the private banking sector (AGV Banken). Tariff employees are assigned to a grade along the scale agreed in collective agreement, based on the work they do. With this approach, an industry-standard minimum remuneration independent from questions of race, ethnicity, sex, religion or personal beliefs, handicaps, age or sexual orientation is warranted, and it is ensured that a person's remuneration reflects their qualifications, duties, function as well as their professional experience.

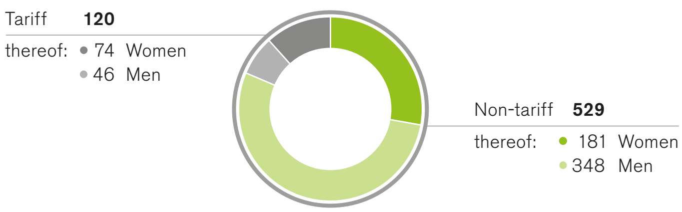
To provide for adequacy and fairness in the remuneration of non-tariff employees, remuneration is regularly reviewed as to whether it is in line with prevailing market terms, using external benchmarks and a functional classification system. The benchmarking is based on a standard classification scheme for job or function levelling (the Towers Watson Career Map), with three so-called career paths ("M" = Management; "P" = Professional, and "T/U" = Services/Administration), and to different career levels within these career paths. This functional classification lays the groundwork for the verification of remuneration in terms of market levels (the so-called "market matching"). Further development of the salaries of non-tariff members of staff is determined by the individual employee's qualifications, duties, function, performance as well as professional experience, disregarding questions of race, ethnicity, sex, religion or personal beliefs, handicaps, age and sexual orientation. With this approach, it is warranted that non-tariff employees also receive an adequate and fair remuneration.

Variable remuneration, which applies throughout pbb and all other Group entities in as uniform and viable a manner as possible, is determined using a formalised and transparent process, harmonised across the Group. Allocation of variable remuneration is based on the achievement of qualitative and quantitative targets at both divisional and individual level – to the extent possible, reference shall be made to pbb Group's business and risk strategy; target achievement shall be determined for every division and every employee at pbb Group. The qualitative and quantitative divisional targets are established on an annual basis and derived from the corporate targets and the business plans made for the respective financial year. A reference value representing 100% target achievement is defined, in advance, for each target, to facilitate measuring the level of target achievement and hence, determining variable remuneration. The Management Board of pbb adopts the divisional targets, which are communicated to all employees of the respective divisions at the beginning of the year. At the individual level, every employee is provided with an annual target agreement comprising quantitative and qualitative targets for the current financial year. The measurement of every target is based on indicators, allowing transparent performance assessments at the end of every financial year. pbb Group conducts annual employee reviews within the scope of an annual process; holding these reviews is part of managers' responsibility. The structured employee review takes place between each employee and his or her manager, for the purpose of assessing the employee's performance during the year under review, and for agreeing upon targets for the following financial year. Accordingly, the employee review is a key instrument for establishing a common understanding of performance standards, as well as on concrete targets and expected results. For this purpose, the discussion focuses on priority issues for the respective financial year, which need to be aligned with and are derived from the business and risk strategy. Employee review and performance appraisal are key management tools which ascertain that staff activities and priorities are aligned with target achievement and the Company's performance, and ensure fair remuneration. Human Resources supports and monitors the regular conduct of employee reviews. A guideline for managers and employees containing important information on target agreements and employee review discussions is available on pbb's intranet.

Company pensions are an important pillar of the additional benefits pbb Group has to offer. For its employees in Germany, pbb Group has established defined-contribution and defined-benefit plans. In the defined-contribution plans, pbb makes payments for commitments by industry-wide organisations such as the German pension provider for the financial industry BVV; BVV has been an important company pension option for employees joining since 1 April 2004. To ensure adequate retirement provisions in this prolonged period of low interest rates, the members of BVV decided on 24 June 2016 to reduce the benefits that can be obtained starting with 2017 by 24.02%. This applies to all employees who joined BVV prior to 31 December 2004 and whose contracts are subject to a certain scale. pbb will compensate the drawbacks associated with the reduction in future pension entitlements in full for a limited period of time, by paying a corresponding amount until a possible new decision by BVV as per 31 December 2020. With this move, pbb Group demonstrates the high importance it assigns as an employer to a stable pension scheme for its employees. In almost all of the Group's non-German entities, a company pension scheme – in a locally common form – is in place.

Proportion of tariff employees/non-tariff employees
As of 31 December 2017

Germany only



Employee benefits

pbb Group provides members of its staff with a comprehensive employee benefits package, including – depending on the employee's location – capital-building payment schemes, sickness benefit and grants to the statutory sick pay, anniversary pay, lunch allowance, special leave in case of special events and a group accident insurance policy. Depending upon the title of an employee within the Bank, or of the necessity of a car for company travel, pbb Group grants company cars that may be used for private journeys at all German locations. In Unterschleissheim and Eschborn, voluntary preventive healthcare measures such as free flu shots, health checks and computer glasses are available. In August and September of the year under review, pbb Group held "Prevention Days" in the Eschborn offices, during which employees were informed and advised on health-related measures. Since 2015, pbb Group has considerably expanded its health promotion initiatives. On a voluntary basis pbb also has a workplace integration management system in place, which all employees affected may make use of.

In 2017, pbb introduced a new benefit for its employees: For the first time, they could lease high-quality communication devices of the newest generation such as PCs, notebooks, tablets or smartphones, through pbb Group at attractive terms and for their private use. The monthly lease instalments are directly offset against gross salary, allowing pbb employees to benefit from tax benefits for private use of communication technology available in Germany, in line with their own marginal tax rate.

Working environment

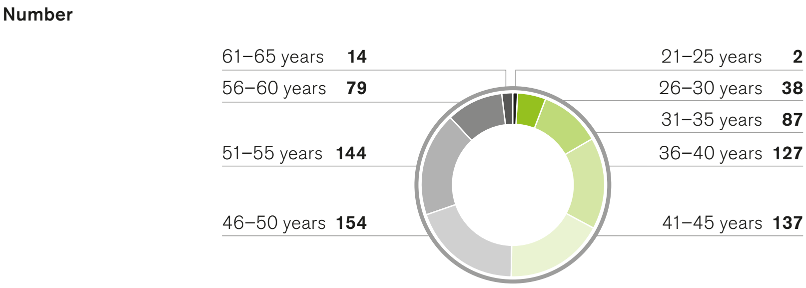
At all of its locations, pbb Group provides its workforce with a modern, secure and healthy environment to work in.

pbb Group employs women and men from many different nationalities with different skills and different backgrounds. These form the basis for sustainable corporate success. Promoting diversity and the personal growth of the employees, with fair working conditions, is at the heart of the Group's HR work. pbb Group respects human dignity, human rights and an employee's right to privacy. All staff members are treated with fairness, dignity and respect. pbb Group has zero tolerance with regard to unfair or discriminatory behaviour towards its staff. It is committed to the principles of equal treatment in the selection and further development of staff, without discriminating against any employee (or potential employee) due to race, ethnicity, sex, religion or personal beliefs, handicaps, age or sexual orientation. Employees are assessed on their performance alone. pbb Group honours the legal and contractual rights of its employees. These values are essential to the Compliance instruction, which employees must adhere to as per works council agreements and/or their employment contract, as well as to pbb's Code of Conduct. They form the foundation for our executives' and employees' work. The work and conduct of executives and employees alike – and therefore that of the Bank – is based on mutual respect, openness, honesty and a joint understanding of trusting collaboration.

pbb Group focuses in particular on the issue of gender balance. This focus is supported by increased awareness for the topic across all levels and the establishment of a corresponding management and corporate culture, as well as the internal obligation to specifically address the under-represented gender for the given situation when filling vacant positions, while taking in account ability and qualifications. Further information on this topic can be found in the Corporate Governance Report, published as part of the 2017 Annual Report.

pbb has established an internal office that employees may turn to when they feel that discrimination pursuant to the German General Act on Equal Treatment has occurred. On the intranet, pbb informs its workforce concerning protective measures against discrimination with a dedicated pamphlet.

Age structure of employees (pbb Group)
As of 31 December 2017



Nationalities of pbb Group's employees

As of 31 December 2017

Austrian	5	Latvian	1
Belgian	2	Lithuanian	1
British	48	Macedonian	1
Bulgarian	2	Polish	4
Chinese	5	Romanian	2
Croatian	2	Russian	3
Czech	1	Schwedish	10
Dutch	4	Slowenian	1
French	48	Spanish	18
German	606	Swiss	1
Indian	2	Turkish	2
Irish	4	US American	2
Italian	6	Vietnamese	1
Total			**782**

Fair working conditions

Since 2010, pbb has been a signatory to the Diversity Charter, thus demonstrating its fundamental commitment to the economic benefits of diversity, tolerance and fairness among a company's employees as well as among its customers and business partners. The Diversity Charter binds its signatories to creating a working environment that is free of prejudice and exclusion, and to establishing an open corporate culture based upon mutual respect. This vision is something pbb Group actively lives. pbb Group takes heed of an even-keeled structure of its workforce in the demographic sense, and employs people from a vast variety of education and sector backgrounds. Every employee must be able to address workplace problems without fearing repercussions. The Group fosters an open corporate culture that provides for the inclusion of employees in the decision-making process, while at the same time maintaining discretion. It further ensures that procedures exist within the Group in order to resolve any workplace problems confidentially and as quickly as possible. Neither in 2016 nor in 2017 were there any complaints about working conditions or inhumane activities.

Efficient and committed employees are central to the success of every company, which is why pbb Group invests in the health of its employees. The Health and Safety Committee (ASA) that was implemented in Germany, together with a company doctor and the occupational safety specialist, as well as representatives of the Works Council and the safety officers, meets on a regular basis to consult on the status of occupational safety and health protection at pbb Group's German offices, and to decide upon measures to improve occupational safety and the prevention of accidents. Company doctors hold consultation hours for employees at the Unterschleissheim and Eschborn locations. Furthermore, pbb Group voluntarily offers its employees various health measures, for which it assumes the costs. In 2017, pbb Group conducted 28 preventive checkups on working with display screen equipment, 19 workplace health promotions, 8 very extensive consultations on individual topics and 60 vaccination advice sessions/vaccinations. The offer to visit a company doctor was taken up by a total of 115 employees.

All executives receive regular training on occupational safety issues from the occupational safety specialist, in compliance with the German Act on the Implementation of Measures of Occupational Safety and Health. In 2017, 75% of executives took part in such a training. The Bank also offers first aid courses and further training for first-aiders every year, which also deal with the handling of automated external defibrillators. Similarly, fire prevention training is given annually, with refresher courses held every two years.

pbb Group has also expanded its health-promotion measures since 2015 and supports customised, personal offers as well as staff initiatives in the areas of exercise, nutrition and stress prevention. It supports joint sporting activities such as running, bike racing, participation in company runs, and a beach volleyball competition in support of child organ transplantation aid, as well as preventative measures held by external physiotherapists at pbb Group's offices in Unterschleissheim and Eschborn. Yet pbb Group's sponsorship of health-promoting measures is not limited to its German offices. Also at its international locations, the Group supports membership in sports clubs or gyms, eyesight tests, training for first-aiders and fire prevention officers, health checkups and workplace evaluations.

Work-life balance

By providing the corresponding work organisational conditions, such as flexible working models or the possibility of a home office, pbb Group offers attractive arrangements that make it easier to balance work and family. Parental leave is granted in line with statutory provisions; when employees return from parental leave, their working hours are organised with a high degree of flexibility. Furthermore, pbb is subject to the collective wage agreement for the German private banking sector and public-sector banks; in certain conditions, this provides for extended parental leave. In France, pbb offers kindergarten fee subsidies and for its new Garching location, which the Bank plans to occupy in the summer of 2019, it is looking into a cooperation with a kindergarten. In addition, in case of childcare problems pbb offers flexible home office opportunities, or permits bringing children to the office. Employees who care for a family member can not only rely on the legal provisions, but may also take unpaid leave or temporarily reduce their working hours.

The flexible working opportunities and the support given to family and working life balance is also demonstrated by the 15.86% share of staff in part-time employment (part-time rate of women: 35.28% and of men: 3.17%).

Involvement and co-determination

In Germany, pbb has two local Works Councils (in Unterschleissheim and Eschborn) as well as a representation body for severely handicapped employees. In addition to these bodies, there is a Joint Works Council, which has formed an economic committee. No Group works council exists. An employee representation body is active in the French offices, no other such bodies exist at the remaining international offices. The working relationship between pbb Group and employee representation bodies is based on trust and regular exchanges, and pbb Group respects their rights. Employees are kept in the loop through regular information provided by both their representatives and pbb Group via the intranet or e-mail, as well as in personal meetings. All members of staff have the opportunity and the right to organise in trade unions, as well as the right to assembly. In Germany, regular works meetings ensure that employees are comprehensively informed, and the time employees spend at these meetings is working time.

Training and continuing professional development

The business model pbb Group pursues, and the ever more challenging and complex environment that it is active in, calls for highly qualified employees with expert knowledge. This makes training and continuing professional development (CPD) an important ingredient of the Group's HR strategy, and a core element of achieving the Bank's goals. In terms of personnel development, pbb Group follows a holistic approach that looks at each individual member of staff, provides them with guidance and, where necessary, support in their professional and personal qualifications and development. This requires that the qualification measures of the individual employee be identified and planned, to meet the needs the employee has in terms of knowledge and competence. Together with the principle of "leading, challenging, encouraging" and the employee review, individual qualification is a cornerstone of pbb Group's personnel development.

The annual employee review forms the basis for establishing qualification needs. If qualification measures are earmarked during the review, manager and employee mainly – but not exclusively – select and plan the contents of these measures in the context of the target agreement. The measure may be on-the-job, near-the-job, as well as off-the-job, and may be offered in-house or externally. Where qualification needs arise in the course of the year, further seminars or trainings above and beyond what was agreed during the review may be requested.

pbb Group offers a variety of in-house training and qualification measures, in particular in the realm of professional qualification, management and social skills to make line managers and project heads better leaders and to foster understanding for working in teams. In the course of the re-privatisation of pbb, pbb Group took a fresh look at training and CPD, set it up anew and intensified it. The measures will be detailed in the following. The continued systematic development of the organisational structure on the one hand, and a personnel development that is aligned with the individual requirements of divisions and employees on the other, will continue to challenge pbb Group, while also serving as an important standard for successful HR work. Against this background, pbb Group strives to continuously evolve its qualification programme. With new initiatives adding to the broad range of existing measures, pbb Group will forge ahead to give important impulses in 2018 and beyond, to support our staff in their professional and personal growth in a modern and goal-driven way.

Continuing professional development

Training and personnel development of pbb Group employees, in respect of professional as well of their management and social competence, was continued and expanded, to ensure that the promotion and further development of its employees is actively supported in the future too.

Joint projects implemented on a cross-departmental level and across various locations within the scope of the Getting Involved Initiative introduced in 2016, and the Bank-wide mentoring programme for employees by second-level mentors, all support the promotion and long-term loyalty of employees. In addition to the permanent series of seminars offered, pbb Group offers a constantly expanding range of in-house seminars on professional qualifications in the own field of work, as well as beyond this own area of expertise (i.e. dealing with topics relevant for pbb Group), and on qualifications in the areas of social and methodological competencies in a modern working environment as well as language training. Via the Leadership Academy, managers can acquire basic qualifications. Since 2016, the extended offer of in-house qualifications also includes the Leadership Excellence Initiative, designed to support more experienced managers to reflect on and further improve their management and social competence in an increasingly challenging and complex working environment. pbb Group also enables executives with significant management responsibility to participate in individual coaching sessions.

In addition to the internal on-the-job and near-the-job measures – organised centrally as well as decentralised – pbb employees can resort to a wide range of external training measures. As a rule, the employee and his or her manager decide on the – in this case mostly professional – training measures within the scope of the employee review. The selected measures depend on the employee's needs. Thus, pbb Group paves the way for suitable employees to complete, inter alia, the international Real Estate Manager training (EBS).

Expenses for internal and external staff qualification measures totalled €0.8 million (2016: €0.7 million) during 2017. This was equivalent to 2.5 training days on average for each employee, or 4.95 days on average for the 390 staff members who took part in the qualification measures.

Knowledge management

In order to make the transition into their job at pbb Group easier for new employees, the Bank has strengthened its onboarding efforts. Introduction plans and sponsorships – in which an employee with relevant experience is at the disposal of new employees for any questions they might have – are systematically included and requested by HR as a standard procedure with each new recruitment. Since 2017, pbb Group has organised a half-day "Welcome Day" three times a year for all new staff members, providing information on the targets, the business model and pbb's primary process, as well as on interesting facts from the Human Resources department, in a casual atmosphere. The event aims to improve the integration of new employees and to help them familiarise themselves with the business and key (as well as cross-divisional) processes at pbb. In addition, 2017 saw the introduction of a welcome brochure with "nice-to-know" information on pbb's locations. New employees receive this brochure on their first day of work at pbb; it is also available on the intranet. Within the scope of its in 2017 once again significantly extended recruitment strategy, pbb Group increasingly focuses on modern, digitalised recruitment processes and on the recruitment via social media – with the goal of attracting more young people. Thus, pbb recruits new personnel actively and passively, as well as carrying out various other measures. In October 2017, for example, pbb Group organised a very successful two-day business challenge on digitalisation together with Senacor Technologies AG as partner. More than 200 students had applied for the event.

pbb Group has a trainee programme called "Programme for Young Professionals" in place. In this 12-18-month programme, young people gain work experience, especially in the Credit department, thus obtaining comprehensive training in the interfaces of Sales and Credit, as well as in the further participating departments such as Property Analysis. The programme was expanded in 2017 and now takes in ten participants instead of five. It will be continued, depending on demand. Furthermore, pbb Group provides student employees with the opportunity for extra-curricular activities in many areas, and should said students possess the relevant skills, also in combination with a bachelor's or master's thesis with practical orientation.

Securing new talent and employer attractiveness

pbb Group is facing increasing competition for experts with other employers. To meet the Bank's need for experts in the different departments, pbb Group has implemented various initiatives to attract young talent and strengthen their capabilities. In this context, pbb Group is increasingly paying attention to a better cooperation with key universities. In the event that pbb Group needs to cover short-term needs, the Bank uses external resources as well as various recruitment strategies for hiring new employees. Active searches via networks, especially social media, are a main focus. Passive searches are mainly performed via job portals, but also via social media. In addition, pbb Group engages agencies if required. Our attractive working conditions are one of our key success factors in attracting experts.

Furthermore, pbb Group has taken action with initiatives aimed at making the brand "pbb" more visible as an attractive employer to experts and young professionals (e.g. new online presence, social media/network presence, participation in selected recruiting fairs).

The fact that 99% of the positions in the Group are permanent, and a very high share of positions are filled internally, underlines pbb Group's position as an attractive employer and boosts staff loyalty. The unchanged low to average overall fluctuation rate of 10% in 2016 and 2017 also shows this.

ENVIRONMENT

The Group has committed itself to handling natural resources responsibly, to make an active contribution to climate protection by minimising its requirements for energy and raw materials, and to avoid environmental impacts. This is also defined in the Code of Conduct, in which pbb Group has obligated itself to conducting its business in a sustainable and environmentally friendly way, and to identifying environmental risks that may arise in its business activities. Reference points for this are especially the buildings used by pbb Group, the organisation of workflows, and the mobility of the Group's employees.

Our rented headquarters buildings in Unterschleissheim near Munich have received the LEED certification for an energy-efficient and environmentally friendly building quality – and have been classified in the quality level Gold. They have a high level of energy efficiency, due to energy-efficient cooling ceilings instead of conventional air conditioning systems, for example. Furthermore, 100% of power demand has been met using renewable energy sources since 2011. Electricity is saved by using energy-efficient office equipment, such as printers with the Energy Star logo, and by strictly reducing the number of electronic devices.

Working processes are generally designed to be as paper saving as possible. Hence, multiple electronic devices are used in order to replace paper-based processes; for example regarding electronic employee services (recording of working time, payrolls, income tax and social insurance receipts, travel expense accounting, etc.), an electronic invoice and contract management, electronic credit cards and document spaces. The paper we use is certified as eco-friendly. Our Annual Reports have been printed climate-neutrally since 2015. Furthermore, pbb Group has been dispensing with the provision of printed interim reports since 2014. We further support recycling by re-using the cartons in our shipping activities.

pbb Group has specified in its Travel Policy that train services should generally be used to travel between the business locations in Munich (Unterschleissheim) and Frankfurt (Eschborn). Train travel should also be used for other journeys within Germany whenever possible. The employees, as well as their direct superiors, are responsible for the fulfilment of this Travel Policy, which they will confirm through their electronic signature when recording and approving travel expense reports in an online tool. Deviations from the Travel Policy are generally to be avoided. Exemptions from this regulation can only be made with the explicit consent of the superior, for the sake of time and cost efficiency. Since the implementation of the Travel Policy in September 2013, employees' air traffic on the above-mentioned route has decreased significantly – by 88%. pbb Group further contributes to the reduction of business travel by the utilisation of video conference systems.

Company cars have to meet well-defined carbon dioxide emission standards in accordance with the Company Car Policy so as to limit their impact on the environment. Vehicles with emissions of more than 155 g/km are given a financial penalty, whilst vehicles with emissions of more than 180 g/km may not be purchased at all. These regulations are designed to the current development standards, and may be adjusted according to technological advances. Every company car purchase has to be approved in advance by the respective executive and the HR department. The purchase order is processed via the fleet management department/Corporate Services.

The company car fleet currently includes one electric car for which a charging station has been established. Further such purchases are planned between now and the end of 2019.

In 2019, pbb Group will relocate its headquarters from Unterschleissheim to Garching. The new office building is also oriented to a responsible handling of limited resources: heat is obtained from geothermal energy, and electricity is generated from photovoltaic systems. Moreover, the location is well-connected to the local public transportation network – a high-frequency metro connection makes the use of public transport reliable and attractive for our employees. In addition, the new location will provide car-sharing offers. pbb Group also considers to purchase service bikes for the new location, and will provide its employees with charging stations for e-bikes.

Report on equal treatment and equal pay, pursuant to section 21 of the German Remuneration Transparency Act (Entgelttransparenzgesetz – "EntgTranspG")

This report contains the disclosures by Deutsche Pfandbriefbank AG ("pbb") as required pursuant to section 21 of the EntgTranspG. In accordance with section 25 (3) of the EntgTranspG, unless expressly stated otherwise, all details quoted relate to the year 2016 and to pbb's German operations.

The first section of the report explains measures taken by pbb to promote the equal treatment of women and men, and the impact of such measures. Statistical disclosures required under section 21 (2) of the EntgTranspG are also provided in this context. The second section of the report outlines measures designed to ensure equal pay for women and men.

1. MEASURES TO PROMOTE THE EQUAL TREATMENT OF WOMEN AND MEN, AND THE IMPACT OF SUCH MEASURES

pbb employs women and men from many different nationalities with different skills and different backgrounds. Promoting diversity of our workforce and the individual development of employees, whilst ensuring fair working conditions, is a key element of pbb's human resources work – and the foundation for the Company's sustainable success. pbb respects all people, regardless of race, ethnic origin, gender, religion or belief, disability, age, or sexual orientation; the Bank promotes diversity amongst its staff. Since 2010, pbb has been a signatory to the "Diversity Charter", thus demonstrating its fundamental commitment to the economic benefits of diversity, tolerance and fairness among a company's employees, as well as among its clients and business partners. It is committed to creating a working environment that is free of prejudice and exclusion, and which aims to establish an open corporate culture based on mutual respect and the involvement of stakeholders. This approach is implemented actively. All staff members are treated with fairness, dignity and respect. pbb has zero tolerance with regard to unfair or discriminatory behaviour towards its staff. It is committed to the principles of equal treatment in the selection and further development of staff, without discriminating against anyone due to race, ethnic origin, gender, religion or belief, disability, age, or sexual orientation. Employees are appraised solely on the basis of their performance.

In this context, pbb places particular emphasis on the topics of gender balance and the promotion of women. This focus is supported by increased awareness for the topic across all levels and the establishment of a corresponding management and corporate culture, as well as the internal obligation to specifically address the under-represented gender when filling vacant positions, whilst taking ability and qualification into account. pbb provides all employees with a very attractive framework in terms of work organisation, which helps to balance family and working life – with the specific purpose of promoting the under-represented gender within pbb.

> pbb has implemented family-friendly flex-time models specific to the Bank: going beyond fixed full-time or half-day arrangements, these flexible working-time models harmonise employees' personal lives with pbb's operational requirements. Specifically, pbb's work-time organisation

takes employees' family responsibilities into consideration: this includes the open handling of everyday family situations. Subject to coordination within their team, employees are thus able to respond to unexpected situations at short notice – for example, picking up their children from childcare in case of urgent need, or to bring them to the office for a limited time.

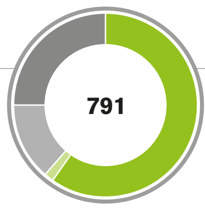
> Moreover, pbb offers the possibility of working from home, allowing staff members to adapt their working arrangements to their personal situation – for instance, to reduce commuting times or to allow them to care for relatives. In addition, in case of childcare problems – e.g. where a childcare facility is closed on a normal working day – pbb offers flexible home office opportunities, or permits bringing children to the office.
> A decision was taken in 2016 to incorporate the promotion of female pbb staff into the target-agreement process for divisional targets for 2017 and 2018, thus including this aspect in determining variable remuneration for employees. This decision was implemented for target agreements covering both years, and was followed up accordingly.
> Participation of female employees in personnel development measures is being especially promoted.
> pbb is looking into a cooperation with a childcare facility for its new Garching location, which the Bank plans to occupy in the summer of 2019. At present, the Bank pays a childcare subsidy to staff at its Paris office.
> Parental leave is granted in line with statutory provisions; when employees return from parental leave, their working hours are organised with a high degree of flexibility. Furthermore, pbb is subject to the collective wage agreement for the German private banking sector and public-sector banks; in certain conditions, this provides for extended parental leave.

Through its working organisation framework, pbb wants to create good development opportunities and career perspectives, which ensure the required flexibility and reliability – for both employer and employees. The fact that pbb offers an attractive concept for balancing family and working life is evidenced in particular by the high number of female staff, and the high proportion of part-time employees.

Employees (pbb Group)
31 December 2016

Gender allocation

Women **305**
of which: • 197 full-time employees
• 108 part-time employees



Men **486**
of which • 473 full-time employees
• 13 part-time employees

(Disclosures pursuant to section 21 (2) of the EntgTranspG)

2. MEASURES TO ENSURE EQUAL PAY FOR WOMEN AND MEN

The system and structure of remuneration at pbb ensures a high degree of equal pay for women and men.

a) Tariff employees

Remuneration for tariff employees is governed by the collective wage agreement for the German private banking sector and public-sector banks. pbb is a member of the German Employers' Association of Private-Sector Banks. Staff are allocated to tariff groups in line with their tasks, and by reference to their job activities. This ensures that remuneration is in line with sector standards, and solely based on the respective employee's qualification, tasks, function and professional experience – and is provided without regard to race, ethnic origin, gender, religion or belief, disability, age, or sexual orientation. Tariff employees participate with their remuneration in line with developments of collective wage negotiation rounds.

b) Non-tariff employees

To ensure that remuneration for non-tariff employees is both appropriate and fair, each function performed by pbb staff has been assigned to an overarching group of functions, using an established industry framework for classification and allocation of functions (the Towers Watson Career Map Model). Within this framework, functions are in turn allocated to one of three so-called career paths ("M" = Management; "P" = Professional, and "T/U" = Services/Administration), and to different career levels within these career paths. With this functional classification system, which was negotiated and agreed upon with pbb's General Works Council, pbb has established a framework which allows for different activities within the Bank to be allocated transparently – based on qualifications, duties and functions, performance, and professional experience.

The functional classification system deployed by pbb forms the basis for setting and developing the remuneration of non-tariff employees. For this purpose, pbb applies remuneration bands defined by itself, with reference to functional groups and career levels; these remuneration bands are regularly reviewed and adjusted (if necessary), based on the functional classification system, as to whether they are in line with prevailing market conditions. The salary for each employee is determined, within the applicable remuneration band, when he or she joins pbb. Going forward, remuneration within the applicable band will develop in line with the degree of his or her target achievement regarding the respective function performed. The degree of target achievement is determined on the basis of the knowledge, experience, soft skills and personal aptitude recognisably contributed by the employee. An analogous process is applied for executive staff (leitende Angestellte).

Their individual functional classification, as well as their position within the remuneration band, are transparently disclosed to employees: pbb informs each employee about the fixed salary band applicable for his or her function when joining the Bank, and in the event of any change. Moreover, pbb provides employees with annual information outlining the reasons for their position within the respective remuneration band, by reference to their personal target achievement regarding their function performed.

Hence, both the setting and the further development of salaries paid by pbb are based on a fair, transparent, performance-based and recognised system which is in line with prevailing market conditions – without regard to race, ethnic origin, gender, religion or belief, disability, age, or sexual orientation.

c) Requirements applicable to all employees

Variable remuneration, which applies throughout pbb and all other Group entities in as uniform and viable a manner as possible, is determined using a formalised and transparent process, harmonised across the Group. Allocation of variable remuneration is based on the achievement of qualitative and quantitative targets at both divisional and individual level – to the extent possible, reference shall be made to pbb Group's business and risk strategy; target achievement shall be determined for every division and every employee at pbb Group.

The qualitative and quantitative divisional targets are established on an annual basis and derived from the corporate targets and the business plans made for the respective financial year. A reference value representing 100% target achievement is defined, in advance, for each target, to facilitate measuring the level of target achievement and hence, determining variable remuneration. The entire Management Board of pbb adopts the divisional targets, which are communicated to all employees of the respective division at the beginning of the year.

At the individual level, every employee is provided with an annual target agreement comprising quantitative and qualitative targets for the current financial year. In this context, extra care is taken to ensure that targets are non-discriminatory and without gender reference. The measurement of every target is based on indicators, allowing transparent performance assessments at the end of every financial year. pbb conducts annual employee reviews within the scope of an annual process; holding these discussions is part of managers' responsibility. The structured employee review takes place between each employee and his/her manager, for the purpose of assessing the employee's performance during the year under review, and for agreeing upon targets for the following financial year. Accordingly, the employee review is a key instrument for establishing a common understanding of performance standards, as well as on concrete targets and expected results. For this purpose, the discussion focuses on priority issues for the respective financial year, which need to be aligned with (or are derived from) the business and risk strategy. Employee review and performance appraisal are key management tools which ascertain that staff activities and priorities are aligned with target achievement and the Company's performance, and ensure fair and non-discriminatory remuneration. Human Resources supports and monitors the regular conduct of employee reviews. A guideline for managers and employees containing important information on target agreements and employee review discussions is available on pbb's intranet.

Financial Calendar

Financial calendar 2018

14 May 2018	Result of the first quarter 2018
21 June 2018	Annual General Meeting
13 August 2018	Result of the second quarter 2018/Interim Report as of 30 June 2018
12 November 2018	Result of the third quarter 2018

Future-oriented Statements

This report contains future-oriented statements in the form of intentions, assumptions, expectations or forecasts. These statements are based on the plans, estimates and predictions currently available to the management board of pbb. Future-oriented statements therefore only apply on the day on which they are made. We do not undertake any obligation to update such statements in light of new information or future events. By their nature, future-oriented statements contain risks and factors of uncertainty. A number of important factors can contribute to actual results deviating considerably from future-oriented statements. Such factors include the condition of the financial markets in Germany, Europe and the USA, the possible default of borrowers or counterparties of trading companies, the reliability of our principles, procedures and methods for risk management as well as other risks associated with our business activity.

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