

Interim Report as of 30 June 2018

Deutsche Pfandbriefbank Group



**DEUTSCHE
PFANDBRIEFBANK**

Overview

Deutsche Pfandbriefbank Group (pbb Group)		1.1. – 30.6.2018	1.1. – 30.6.2017
Operating performance according to IFRS			
Profit or loss before tax	in € million	122	103
Net income/loss	in € million	99	85
Key ratios			
Earnings per share	in €	0.72	0.63
Cost-income ratio ¹⁾	in %	40.9	43.9
Return on equity before tax ²⁾	in %	8.2	7.4
Return on equity after tax ²⁾	in %	6.7	6.1
New business volume ³⁾	in € billion	3.8	5.0
Balance sheet figures according to IFRS			
Total assets	in € billion	57.8	58.0
Equity	in € billion	3.2	2.9
Financing volumes Real Estate Finance and Public Investment Finance	in € billion	32.4	31.9
Key regulatory capital ratios (fully phased-in)			
CET1 ratio	in %	19.4	17.6
Own funds ratio	in %	26.3	22.2
Leverage ratio	in %	5.3	4.5
Staff			
Employees (on full-time equivalent basis)		747	744
Long-term issuer rating/outlook^{6/7)}			
Standard & Poor's		A-/Negative	A-/Negative
DBRS		BBB/Positive	BBB/Stable
Moody's Pfandbrief rating⁷⁾			
Public Sector Pfandbriefe		Aa1	Aa1
Mortgage Pfandbriefe		Aa1	Aa1

¹⁾ Cost-income ratio is the ratio of general and administrative expenses and net income from write-downs and write-ups on non-financial assets to operating income.

²⁾ Return on equity before tax respectively after tax is the ratio of profit or loss before tax (net income/loss) (annualised during the course of the year) less AT1-coupon (after tax) and average equity excluding accumulated other comprehensive income (OCI) from cash flow hedge accounting, financial assets at fair value through OCI and additional equity instruments (AT1).

³⁾ Including prolongations with maturities of more than one year.

⁴⁾ In consideration of the first quarters 2018 net profit less the maximum permissible dividend according to the ECB methodology.

⁵⁾ After confirmation of the 2017 financial statements and appropriation of profits.

⁶⁾ The ratings of unsecured liabilities may diverge from the issuer ratings. Further information on ratings can be found in the Report on Economic Position.

⁷⁾ The 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 personal analysis. They do not constitute a recommendation to purchase, sell or hold securities issued by Deutsche Pfandbriefbank AG (pbb).

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 performance measures see "investors/financial-reports" at www.pfandbriefbank.com.

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Group Interim Management Report

Report on Economic Position

DEVELOPMENT IN EARNINGS

Deutsche Pfandbriefbank Group (“pbb Group”)

pbb Group generated a profit before tax of €122 million in the first half of 2018 (6m2018), significantly exceeding the €103 million result for the first half of 2017 (6m2017). The positive development was driven mainly by net interest income, which increased despite the highly competitive environment. In addition, results benefited from measurement income from the so-called conditional additional purchase price adjustment (Besserungsanspruch) – in connection with accepting a buy-back offer made for Heta Asset Resolution AG (“Heta”) debt securities from the year 2016. This conditional additional purchase price adjustment was disposed of in July 2018. A detailed breakdown of the results is provided below:

pbb Group

in € million	1.1.–30.6.2018 (IFRS 9)	1.1.–30.6.2017 (IAS 39)	Change
Operating income	232	228	4
Net interest income	220	196	24
Net fee and commission income	3	5	-2
Net income from financial instruments at fair value through profit or loss (Net income from fair value measurement) ¹⁾	4	-	4
Net income from derecognition of financial instruments not measured at fair value through profit or loss (Net income from realisations) ¹⁾	15	22	-7
Thereof: from financial assets at amortised cost	13	22	-9
Net income from hedge accounting	-2	1	-3
Net other operating income	-8	4	-12
Net income from allowances on financial assets (Net income from risk provisioning) ¹⁾	7	-	7
General and administrative expenses	-88	-92	4
Expenses from bank levies and similar dues	-22	-25	3
Net income from write-downs and write-ups on non-financial assets	-7	-8	1
Profit or loss before tax	122	103	19
Income taxes	-23	-18	-5
Net income/loss	99	85	14
attributable to: Equity holders	99	85	14

¹⁾ Solely the condensed and parenthesised line item descriptions are used subsequently.

The composition of the individual line items of the income statement is described in the note “Consistency”.

Net interest income increased to €220 million (6m2017: €196 million). This positive development was due to lower interest expenses, which reflected maturities of higher-yielding liabilities. At €32.3 billion, the average interest-bearing financing volumes in commercial Real Estate Finance and Public Investment Finance in the first half of 2018 exceeded the level of the previous year (6m2017: €31.8 billion), whereas the average volume of the non-strategic Value Portfolio continued to decline, in line with pbb's strategy (€13.6 billion; 6m2017: €15.3 billion). The average margin of the total portfolio was stable relative to the first half of 2017.

Net fee and commission income from non-accrueable fees amounted to €3 million (6m2017: €5 million).

Net income from fair value measurement totalled €4 million (6m2017: €0 million). The positive result was due to changes in the fair value of derivatives and from non-derivative financial instruments which must be measured at fair value. Income from non-derivative financial instruments comprises the measurement income from the Heta conditional additional purchase price adjustment and expenses from the changes in the credit ratings of southern European borrowers.

Net income from realisations (€15 million; 6m2017: €22 million) comprised prepayment fees of €8 million (6m2017: €16 million), fee realisations of €5 million (6m 2017: €4million), and fees from redemption of liabilities of €2 million (6m2017: €1 million).

Net income from hedge accounting of €–2 million (6m2017: €1 million) was due to ineffective portions of micro fair value hedges. pbb Group exercised the option available under IFRS 9 and continued to apply the hedge accounting rules of IAS 39.

Net other operating income of €–8 million (6m2017: €4 million) comprised expenses from net new provisions recognised for legal expenses and risks of €6 million (6m2017: €15 million) and currency translation expenses in the amount of €2 million (6m2017: €1 million). The result for the same period of the previous financial year benefited from income generated in connection with the derecognition of assets held in pbb's non-strategic Value Portfolio.

Net income from risk provisioning (€7 million; 6m2017: €0 million) mainly resulted from net reversals of stage 1 and 2 allowances in the amount of €9 million, which were due to holdings in the portfolio set to expire in the short term. These effects were partly offset by net additions to stage 3 impairments of €2 million.

General and administrative expenses were reduced slightly, to €88 million (6m2017: €92 million). While non-personnel expenses were lower thanks to the successful conclusion of projects, personnel expenses remained constant.

Expenses from bank levies and similar dues (€22 million; 6m2017: €25 million) mainly comprised expenses for the bank levy, taking into account pledged collateral amounting to 15% (€20 million; 6m2017: €19 million). Furthermore, this line item comprised expenses of €2 million (6m2017: €5 million) for the private and the statutory deposit protection scheme. Expenses were lower than in the prior-year period, due to the change in the basis for calculation and the fact that pledged collateral of 30% was included for the first time.

Net income from write-downs and write-ups on non-financial assets (€–7 million; 6m2017: €–8 million) resulted primarily from depreciation of tangible assets, and amortisation of intangible assets.

Income taxes (€–23 million (6m2017: €–18 million) resulted from an actual tax expense of €22 million (6m2017: €22million) and a deferred tax expense in the amount of €1 million (6m2017: tax income of €4 million).

Operating Segments

Real Estate Finance (REF)

The REF segment comprises all strategic real estate financing arrangements. New business volume (including extensions with maturities of more than one year) totalled €3.6 billion (6m2017: €4.5 billion).

Real Estate Finance		1.1.–30.6.2018 (IFRS 9)	1.1.–30.6.2017 (IAS 39) ¹⁾	Change
Operating performance				
Operating income	in € million	189	184	5
Net interest income	in € million	183	163	20
Net fee and commission income	in € million	3	5	-2
Net income from fair value measurement	in € million	-4	2	-6
Net income from realisations	in € million	14	22	-8
Net income from hedge accounting	in € million	-1	1	-2
Net other operating income	in € million	-6	-9	3
Net income from risk provisioning	in € million	-1	-2	1
General and administrative expenses	in € million	-70	-74	4
Expenses from bank levies and similar dues	in € million	-12	-13	1
Net income from write-downs and write-ups on non-financial assets	in € million	-6	-7	1
Profit or loss before tax	in € million	100	88	12
Key ratio				
Cost-income ratio	in %	40.2	44.0	
Balance-sheet-related measures				
Financing volumes	in € billion	25.7	24.9	
Risk-weighted assets ²⁾	in € billion	8.1	8.3	
Equity ³⁾	in € billion	1.4	1.2	

¹⁾ Adjusted due to IFRS 8.29. Details are disclosed in note "Consistency".

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 accumulated other comprehensive income (OCI) from cash flow hedge accounting, financial assets at fair value through OCI and additional equity instruments (AT1 capital). The amount as of 31.12.2017 was adjusted due to IFRS 8.29. Details are disclosed in note "Consistency".

Net interest income (€183 million; 6m2017: €163 million) benefited from an increase in the average interest-bearing financing volumes, to €25.4 billion (6m2017: €24.2 billion). The decline in funding costs, which reflected maturities of higher-yielding liabilities, also had a positive effect. Net income from realisations (€14 million; 6m2017: €22 million) comprised prepayment fees of €8 million (6m2017: €16 million), fee realisations of €5 million (6m2017: €4million) and positive effects from the redemption of liabilities. Net other operating income (€-6 million; 6m2017: €-9 million) comprised additions to provisions for legal matters and currency translation expenses.

Net income from risk provisioning (€-1 million; 6m2017: €-2 million) resulted from net reversals of stage 1 allowances in the amount of €1 million, which were offset by net additions to stage 3 impairments of €2 million.

At €70 million, general and administrative expenses were below the previous year's figure (6m2017: €74 million), in line with the positive development at Group level.

Expenses from bank levies and similar dues (€12 million; 6m2017: €13 million) comprised in particular the allocated expenses for the bank levy, taking into account pledged collateral amounting to 15%.

Net income from write-downs and write-ups on non-financial assets (€-6 million; 6m2017: €-7 million) resulted primarily from depreciation of tangible assets, and amortisation of intangible assets.

Public Investment Finance (PIF)

The PIF segment comprises all strategic financings of public infrastructure projects. The volume of new business amounted to €0.2 billion (6m2017: €0.5 billion).

Public Investment Finance		1.1.–30.6.2018 (IFRS 9)	1.1.–30.6.2017 (IAS 39) ¹⁾	Change
Operating performance				
Operating income	in € million	14	12	2
Net interest income	in € million	16	14	2
Net fee and commission income	in € million	–	–	–
Net income from fair value measurement	in € million	–1	–1	–
Net income from realisations	in € million	–	–	–
Net income from hedge accounting	in € million	–	–	–
Net other operating income	in € million	–1	–1	–
Net income from risk provisioning	in € million	4	1	3
General and administrative expenses	in € million	–12	–12	–
Expenses from bank levies and similar dues	in € million	–3	–4	1
Net income from write-downs and write-ups on non-financial assets	in € million	–1	–1	–
Profit or loss before tax	in € million	2	–4	6
Key ratio				
Cost-income ratio	in %	92.9	>100.0	
Balance-sheet-related measures				
Financing volumes	in € billion	6.7	7.0	
Risk-weighted assets ²⁾	in € billion	1.3	1.6	
Equity ³⁾	in € billion	0.1	0.2	

¹⁾ Adjusted due to IFRS 8.29. Details are disclosed in note "Consistency".

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 accumulated other comprehensive income (OCI) from cash flow hedge accounting, financial assets at fair value through OCI and AT 1 capital. The amount as of 31.12.2017 was adjusted due to IFRS 8.29. Details are disclosed in note "Consistency".

The increase in net interest income, to €16 million (6m2017: €14 million) was due in particular to lower funding costs. The decline in the average financing volume, to €6.9 billion (6m2017: €7.6 billion) was partially offset by an increase in the average portfolio margin.

Net income from risk provisioning (€4 million; 6m2017: €1 million) mainly resulted from net reversals of stage 2 allowances due holdings in the portfolio set to expire in the short term.

At €12 million, general and administrative expenses were in line with the previous year (6m2017: €12 million).

Value Portfolio (VP)

The VP operating segment includes all of pbb Group's non-strategic portfolios and activities, and is continuously divested in line with pbb's strategy.

Value Portfolio		1.1. – 30.6.2018 (IFRS 9)	1.1. – 30.6.2017 (IAS 39) ¹⁾	Change
Operating performance				
Operating income	in € million	26	29	-3
Net interest income	in € million	18	16	2
Net fee and commission income	in € million	-	-	-
Net income from fair value measurement	in € million	9	-1	10
Net income from realisations	in € million	1	-	1
Net income from hedge accounting	in € million	-1	-	-1
Net other operating income	in € million	-1	14	-15
Net income from risk provisioning	in € million	4	1	3
General and administrative expenses	in € million	-6	-6	-
Expenses from bank levies and similar dues	in € million	-7	-8	1
Net income from write-downs and write-ups on non-financial assets	in € million	-	-	-
Profit or loss before tax	in € million	17	16	1
Key ratio				
Cost-income ratio	in %	23.1	20.7	
Balance-sheet-related measures				
Financing volumes	in € billion	13.5	13.8	
Risk-weighted assets ²⁾	in € billion	3.4	3.5	
Equity ³⁾	in € billion	1.0	1.1	

¹⁾ Adjusted due to IFRS 8.29. Details are disclosed in note "Consistency".

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 accumulated other comprehensive income (OCI) from cash flow hedge accounting, financial assets at fair value through OCI and AT1 capital. The amount as of 31.12.2017 was adjusted due to IFRS 8.29. Details are disclosed in note "Consistency".

Due to maturities of higher-yielding liabilities, net interest income rose to €18 million (6m2017: €16 million), although the financing volume declined as scheduled. Net income from fair value measurement benefited from the Heta conditional additional purchase price adjustments.

Net income from risk provisioning (€4 million; 6m2017: €1 million) mainly resulted from net reversals of stage 2 allowances due to holdings in the portfolio set to expire in the short term.

At €6 million, general and administrative expenses were on par with the previous year (6m2017: €6 million).

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' responsibility.

Consolidation & Adjustments		1.1. – 30.6.2018 (IFRS 9)	1.1. – 30.6.2017 (IAS 39)¹⁾	Change
Operating performance				
Operating income	in € million	3	3	–
Net interest income	in € million	3	3	–
Net fee and commission income	in € million	–	–	–
Net income from fair value measurement	in € million	–	–	–
Net income from realisations	in € million	–	–	–
Net income from hedge accounting	in € million	–	–	–
Net other operating income	in € million	–	–	–
Net income from risk provisioning	in € million	–	–	–
General and administrative expenses	in € million	–	–	–
Expenses from bank levies and similar dues	in € million	–	–	–
Net income from write-downs and write-ups on non-financial assets	in € million	–	–	–
Profit or loss before tax	in € million	3	3	–
Balance-sheet-related measures				
Financing volumes	in € billion	0.9	1.1	
Equity ³⁾	in € billion	0.3	0.4	

¹⁾ Adjusted due to IFRS 8.29. Details are disclosed in note "Consistency".

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 accumulated other comprehensive income (OCI) from cash flow hedge accounting, financial assets at fair value through OCI and AT1 capital.

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	30.6.2018 (IFRS 9)	1.1.2018 (IFRS 9)	31.12.2017 (IAS 39)
Cash reserve	1,551	999	999
Financial assets at fair value through profit or loss	1,621	1,735	870
Positive fair values of stand-alone derivatives	846	870	870
Debt securities	327	333	–
Loans and advances to customers	445	529	–
Shares in investment funds qualified as debt instruments	3	3	–
Financial assets at fair value through other comprehensive income	2,052	2,182	2,385
Debt securities	1,616	1,735	2,382
Loans and advances to other banks	16	17	–
Loans and advances to customers	420	430	–
Shares in investment funds qualified as debt instruments	–	–	3
Financial assets at amortised cost after credit loss allowances	50,060	50,323	50,858
Financial assets at amortised cost before credit loss allowances	50,157	50,427	50,942
Debt securities	8,263	8,667	8,253
Loans and advances to other banks	2,405	2,400	2,415
Loans and advances to customers	39,489	39,360	40,274
Credit loss allowances on financial assets at amortised cost	–97	–104	–84
Positive fair values of hedge accounting derivatives	2,326	2,678	2,678
Valuation adjustment from portfolio hedge accounting (assets)	1	–1	–1
Tangible assets	5	6	6
Intangible assets	35	36	36
Other assets	33	34	34
Current income tax assets	43	42	42
Deferred income tax assets	79	71	87
Total assets	57,806	58,105	57,994

The composition of the individual asset line items is described in the note “Consistency”.

Total assets declined slightly compared to 1 January 2018 (IFRS 9). The cash reserve increased during the first half of 2018, on the back of repaid public-sector loans and securities. In contrast, market-induced fair value adjustments in particular led to a decline in hedging derivatives. In addition, financial assets measured at fair value through profit or loss declined due to maturities and placements.

At €32.4 billion, the aggregate nominal value of strategic financings, comprising Real Estate Finance and Public Investment Finance, exceeded the previous year-end figure (31 December 2017: €31.9 billion). The non-strategic Value Portfolio declined to €13.5 billion (31 December 2017: €13.8 billion), in line with the strategy.

DEVELOPMENT IN FINANCIAL POSITION

Liabilities and equity

in € million	30.6.2018 (IFRS 9)	1.1.2018 (IFRS 9)	31.12.2017 (IAS 39)
Financial liabilities at fair value through profit or loss	983	1,040	956
Negative fair values of stand-alone derivatives	983	1,040	956
Financial liabilities measured at amortised cost	50,681	50,919	50,919
Liabilities to other banks	4,471	3,797	3,797
Liabilities to customers	25,008	26,244	26,244
Bearer bonds	20,503	19,876	19,876
Subordinated liabilities	699	1,002	1,002
Negative fair values of hedge accounting derivatives	2,584	2,805	2,889
Valuation adjustment from portfolio hedge accounting (liabilities)	12	–	–
Provisions	252	247	245
Other liabilities	41	70	70
Current income tax liabilities	58	57	57
Liabilities	54,611	55,138	55,136
Equity attributable to the shareholders of pbb	2,897	2,967	2,858
Subscribed capital	380	380	380
Additional paid-in capital	1,637	1,637	1,637
Retained earnings	760	722	731
Consolidated profit	99	182	182
Accumulated other comprehensive income (OCI)	21	46	–72
from pension commitments	–73	–75	–75
from cash flow hedge accounting	8	22	22
from financial assets at fair value through OCI (IAS 39: AfS reserve)	86	99	–19
Additional equity instruments (AT1 capital)	298	–	–
Equity	3,195	2,967	2,858
Total liabilities and equity	57,806	58,105	57,994

The composition of the individual liabilities and equity line items is described in the note “Consistency”.

Liabilities

Liabilities decreased, especially due to lower liabilities to customers and the negative fair values of the hedging derivatives. Liabilities to customers declined, reflecting a lower level of promissory note loans and registered bonds. In line with assets, the negative fair values of the hedging derivatives were lower due to market-induced effects.

Equity

The equity development is disclosed in note “Equity”. Return on equity before tax amounted to 8.2% (6m2017: 7.4%) and return on equity after tax to 6.7% (6.1%).

Funding

During the first half of 2018, pbb Group raised new long-term funding in the amount of €3.2 billion (6m2017: €4.5 billion). The total amount comprised unsecured issues as well as Pfandbrief issues, both in the form of benchmark issues and private placements. At €1.9 billion (6m2017: €2.3 billion), Pfandbriefe accounted for just over half of the total volume, with unsecured funding accounting for €1.0 billion (6m2017: €1.7 billion). Furthermore, additional equity instruments (AT1 capital) in the amount of €0.3 billion was raised for the first time. €0.5 billion in subordinated tier 2 liabilities had been issued in the previous year's period. The transactions were placed mainly on a fixed-rate basis. Unhedged interest rate exposures are usually hedged by swapping fixed against floating interest rates.

Overnight and term deposits from retail investors taken via "pbb direkt" amounted to €3.2 billion as at 30 June 2018 (31 December 2017: €3.3 billion).

Key Regulatory Capital Ratios (fully phased-in)

The CET1 ratio amounted to 19.4% as at 30 June 2018 (31 December 2017: 17.6%) and the own funds ratio to 26.3% (31 December 2017: 22.2%). The leverage ratio amounted to 5.3% as at 30 June 2018 (31 December 2017: 4.5%).

Liquidity

Since 1 January 2018, a minimum Liquidity Coverage Ratio (LCR) of currently 100% has been mandatory in regulatory liquidity reporting. The LCR figures for pbb Group during the first half of 2018 as well as during the previous year's period significantly exceeded 100%.

The maturity structure is disclosed in note "Maturities of specific financial assets and liabilities".

Ratings

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

Senior unsecured ratings and ratings for Pfandbriefe¹⁾

	30.06.2018			31.12.2017		
	Standard & Poor's	DBRS	Moody's	Standard & Poor's	DBRS	Moody's
Long-term issuer rating/outlook	A-/negative	BBB/positive	–	A-/negative	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⁾	–	A-	BBB ⁴⁾	–
Long-term "non-preferred" senior unsecured debt rating ³⁾	BBB-	BBB ⁴⁾	–	BBB-	BBB 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 at the reporting dates, DBRS did not differentiate between "senior preferred" and "senior non-preferred" liabilities issued by pbb (please refer to note "Report on post-balance sheet date events").

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 personal analysis. They do not constitute a recommendation to purchase, sell or hold securities issued by pbb.

Most recently, pbb's unsecured ratings were mainly influenced by legislative changes and, in this context, changes to rating methodologies. Rating actions took place in particular due to the more detailed specifications with regard to the implementation of the Bank Recovery and Resolution Directive (BRRD). The reduction of the federal government's indirect partial ownership of pbb (from 20% to 3.5%) in May 2018 had no impact on the ratings.

Ongoing changes to the regulatory and economic environment may lead to general rating pressure going forward.

During the first half of 2018, one significant rating action by DBRS took place regarding pbb's ratings: on 25 June 2018, DBRS confirmed the Bank's ratings and raised the rating outlook from "stable" to "positive" against the background of the Bank's risk profile and capitalisation.

MATERIAL RELATED PARTY TRANSACTIONS

No material transactions with related parties were entered into during the first half of 2018.

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 risks and opportunities, please refer to the Report on Expected Developments.

This report only includes a general description of the Company's risk management organisation, or a description of definitions, methods, management and measurement of particular types of risk, to the extent that there were changes during the period under review in comparison to the Risk and Opportunity Report provided in the 2017 Annual Report. For more details, please refer to the disclosures in the Risk and Opportunity Report in the 2017 Annual Report.

ORGANISATION AND PRINCIPLES OF RISK AND CAPITAL MANAGEMENT

pbb Group has 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 Public Limited Companies Act (Aktiengesetz – "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.

Risk Strategy and Policies

At the beginning of 2018 the risk strategy was revised during the course of the annual strategy development process. The update was adopted by the management board and approved by the supervisory board. Essentially, this change involved adjustments to the ICAAP management approach, related to the normative and economic perspectives.

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. To the extent 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.

pbb Group's approach to managing risk, capital and liquidity is based on the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP), each of which is seen in a normative and an economic perspective. The normative perspective is geared towards ongoing fulfilment of all of the Bank's capital- and liquidity-related legal requirements and supervisory demands, as well as to the achievement of internal objectives. The economic perspective covers all material risks which might threaten pbb Group's economic viability, with a focus on the present-value analysis of risks.

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, pbb Group defines its risk appetite, which sets out the scope within which pbb Group is prepared to assume risks. pbb Group uses this information to derive input for operative management, through limit systems, committee decisions, and other management decisions.

RISK TYPES

pbb Group distinguishes the following major risk types for its business activities:

- > Credit risk (counterparty risk)
- > Market risk
- > Liquidity and Funding risk
- > Operational risk (including legal risk)
- > Business and Strategic risk
- > Property risk
- > Pension risk

Credit Risk (Counterparty Risk)

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. 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 transactions 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 €57.7 billion as at 30 June 2018 (31 December 2017: €57.5 billion).

Overview of the Total Exposure of pbb Group: €57.7 billion EaD The credit portfolio is broken down into three segments:

- > Real Estate Finance (REF),
- > Public Investment Finance (PIF) and
- > the non-strategic segment Value Portfolio (VP) which is earmarked for being wound down.

In addition "Consolidation & Adjustments (C&A)" 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.

EaD in the C&A segment was almost fully attributable (>99%; 31 December 2017: >99%) to EL classes 1 to 8; according to the internal classification, these are considered investment grade.

Total portfolio: EaD according to operating segments

in € billion	30.6.2018	31.12.2017	Change	
			in € billion	in %
Real Estate Finance	28.8	28.3	0.5	1.8
Public Investment Finance	7.6	7.9	-0.3	-3.8
Value Portfolio	16.6	17.0	-0.4	-2.4
Consolidation & Adjustments	4.7	4.3	0.4	9.3
Total	57.7	57.5	0.2	0.3

Risk Parameters Expected Loss (EL) for pbb Group totalled €94 million as at 30 June 2018 (31 December 2017: €106 million). The EL decline was predominantly due to the scheduled repayment of a security issued by a foreign regional government, new write-downs in the REF segment as well as LGD changes in the REF segment.

Total exposure: expected loss according to operating segments

in € million	30.6.2018	31.12.2017	Change	
			in € million	in %
Real Estate Finance	61	65	-4	-6.2
Public Investment Finance	2	9	-7	-77.8
Value Portfolio	30	32	-2	-6.3
Consolidation & Adjustments	1	-	1	100.0
Total	94	106	-12	-11.3

Future developments, such as changes in the economic environment or developments concerning individual risks, may result in changes to the EL figures set out above. Furthermore, actual losses incurred may differ materially from expected losses.

Regional Breakdown of the Portfolio The main focus of pbb Group's exposure at the reporting date remained unchanged, on Western Europe. At 41% (€23.6 billion; 31 December 2017: 40% or €23.1 billion), Germany accounted for the largest part of the aggregate portfolio. Exposure increases in Germany and in the US were mainly attributable to new business; reductions in the United Kingdom and in Spain were mainly due to repayments.

The largest items in the category "Other Europe" were the exposures to the Netherlands (€0.6 billion; 31 December 2017: €0.6 billion), to Switzerland (€0.3 billion; 31 December 2017: €0.4 billion), Belgium and Slovenia (€0.3 billion each; 31 December 2017: €0.3 billion each). The category "Other", which accounted for approximately 3% of the portfolio (€1.6 billion), largely included bonds issued by supranational organisations.

Total portfolio: EaD according to regions

in € billion	30.6.2018	31.12.2017	Change	
			in € billion	in %
Germany	23.6	23.1	0.5	2.2
France	7.7	7.6	0.1	1.3
Austria	6.3	6.4	-0.1	-1.6
United Kingdom	5.0	5.3	-0.3	-5.7
Spain	2.9	3.1	-0.2	-6.5
Italy	2.1	2.1	-	-
Other Europe ¹⁾	2.1	2.0	0.1	5.0
Poland	1.6	1.7	-0.1	-5.9
Other ²⁾	1.6	1.6	-	-
Sweden	1.5	1.6	-0.1	-6.3
United States	1.4	0.9	0.5	55.6
Portugal	0.9	0.9	-	-
Czech Republic	0.4	0.4	-	-
Finland	0.4	0.4	-	-
Hungary	0.3	0.3	-	-
Total	57.7	57.5	0.2	0.3

¹⁾ As of 30 June 2018 the category "Other Europe" comprises the Netherlands, Switzerland, Belgium, Slovenia, Slovakia, Luxembourg, Ireland, Romania, Denmark, Norway and Latvia.

²⁾ As of 30 June 2018 the category "Other" comprises amongst others Supranationals, Japan and Canada.

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

Real Estate Finance: €28.8 billion EaD

The REF segment comprises real estate loans and corresponding client derivatives. EaD of the REF portfolio increased by a total of €0.5 billion, compared to 31 December 2017, to €28.8 billion. The strongest exposure increases occurred in Germany and in the US, reflecting new business. Client derivatives in the REF segment accounted for an EaD of €0.2 billion as at 30 June 2018 (31 December 2017: €0.2 billion).

Real Estate Finance: EaD according to regions

in € billion	30.6.2018	31.12.2017	Change	
			in € billion	in %
Germany	14.3	13.9	0.4	2.9
United Kingdom	4.3	4.7	-0.4	-8.5
France	3.3	3.4	-0.1	-2.9
Sweden	1.4	1.6	-0.2	-12.5
Poland	1.3	1.4	-0.1	-7.1
United States	1.3	0.9	0.4	44.4
Other Europe ¹⁾	1.2	1.1	0.1	9.1
Austria	0.5	0.5	-	-
Czech Republic	0.4	0.4	-	-
Finland	0.3	0.2	0.1	50.0
Spain	0.3	0.2	0.1	50.0
Hungary	0.2	0.2	-	-
Italy ²⁾	-	-	-	-
Total	28.8	28.3	0.5	1.8

¹⁾ As of 30 June 2018 the category "Other Europe" comprises the Netherlands, Switzerland, Slovenia, Luxembourg, Slovakia, Belgium, Romania and Norway.

²⁾ Italy (30 June 2018): €34 million.

The portfolio breakdown by property type as at 30 June 2018 changed slightly compared to the 2017 year-end. The further increase in the Office buildings category was largely due to new business originated in Germany, France and the US. The reduction in the Retail category was mainly caused by loans repaid.

Real Estate Finance: EaD according to property type

in € billion	30.6.2018	31.12.2017	Change	
			in € billion	in %
Office buildings	11.5	10.4	1.1	10.6
Retail	6.1	6.7	-0.6	-9.0
Housing construction	4.7	4.6	0.1	2.2
Logistics/storage	3.0	3.1	-0.1	-3.2
Hotel/leisure	1.5	1.5	-	-
Other	1.2	1.2	-	-
Mixed Use	0.9	0.8	0.1	12.5
Total	28.8	28.3	0.5	1.8

At 30 June 2018, investment financings continued to dominate the portfolio (82%; 31 December 2017: 81%); development financings accounted for 17% of EaD (31 December 2017: 17%). Investment financings are defined as real estate loans, the debt servicing ability of which largely depend upon current cash flows from the property.

Real Estate Finance: EaD according to loan type

in € billion	30.6.2018	31.12.2017	Change	
			in € billion	in %
Investment financing	23.5	23.0	0.5	2.2
Development financing	5.0	4.9	0.1	2.0
Customer derivatives	0.2	0.2	–	–
Other	0.2	0.2	–	–
Total	28.8	28.3	0.5	1.8

Public Investment Finance: €7.6 billion EaD

The portfolio comprises the following financing:

- (I) Financing concluded directly with a public sector debtor, eligible according to the 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 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 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.

In addition, the portfolio comprises only very few financings for public-sector institutions without public guarantee.

EaD in the Public Investment Finance segment decreased by €0.3 billion compared to the end of the previous year especially due to repayments in Spain. New Business mainly originated in France and Germany was compensated by repayments.

Public Investment Finance: EaD according to regions

in € billion	30.6.2018	31.12.2017	Change	
			in € billion	in %
France	3.5	3.5	–	–
Germany	1.8	1.9	–0.1	–5.3
Spain	1.2	1.5	–0.3	–20.0
Other Europe ¹⁾	0.3	0.3	–	–
Austria	0.3	0.3	–	–
United Kingdom	0.2	0.2	–	–
Finland	0.1	0.1	–	–
Other ²⁾	0.1	0.1	–	–
Sweden ³⁾	–	–	–	–
Total	7.6	7.9	–0.3	–3.8

¹⁾ As of 30 June 2018 the category "Other Europe" comprises Belgium, the Netherlands and Switzerland.

²⁾ As of 30 June 2018 the category "Other" comprises amongst others Canada and bonds issued by supranational organisations.

³⁾ Sweden (30 June 2018): €43 million.

"Public Sector Borrowers" summarises claims against sovereign states (25%), public-sector enterprises (22%), and regional governments and municipalities (53%). The definition also includes exposures guaranteed by these counterparties.

Public Investment Finance: EaD according to counterparty structure

in € billion	30.6.2018	31.12.2017	Change	
			in € billion	in %
Public sector borrowers	7.4	7.7	–0.3	–3.9
Companies/special-purpose entities ¹⁾	0.1	0.2	–0.1	–50.0
Financial institutions ²⁾	–	–	–	–
Total	7.6	7.9	–0.3	–3.8

¹⁾ Largely collateralised by guarantees and surety bonds.

²⁾ Financial institutions with a state background or state guarantee.

99% of EaD (31 December 2017: 97%) was assigned to EL classes 1–8; according to the internal classification, these are considered investment-grade. 1% (31 December 2017: 3%) was in the non-investment grade category (EL classes 9 to 18). The shift reflected the repayment of a maturing non-investment grade bond.

Public Investment Finance: EaD according to Expected-Loss-Class

in € billion	30.6.2018	31.12.2017	Change	
			in € billion	in %
EL-Class 1–5	7.4	7.5	–0.1	–1.3
EL-Class 6–8	0.1	0.2	–0.1	–50.0
EL-Class 9–11	–	–	–	–
EL-Class 12–14	–	0.2	–0.2	–100.0
EL-Class 15–18	–	–	–	–
Total	7.6	7.9	–0.3	–3.8

Value Portfolio: €16.6 billion EaD

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

In line with the strategy, the further decrease in the exposure as of 30 June 2018 compared with 31 December 2017 was due to reductions in Germany and Austria; Germany and Austria continued to account for the lion's share of the portfolio. The slight EaD increase for Italy 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	30.6.2018	31.12.2017	Change	
			in € billion	in %
Austria	5.5	5.6	-0.1	-1.8
Germany	4.6	4.8	-0.2	-4.2
Italy	2.1	2.0	0.1	5.0
Spain	1.2	1.2	-	-
Other ¹⁾	1.1	1.1	-	-
Portugal	0.9	0.9	-	-
France	0.7	0.7	-	-
Other Europe ²⁾	0.2	0.2	-	-
Poland	0.2	0.2	-	-
Hungary	0.1	0.1	-	-
Czech Republic ³⁾	-	-	-	-
Finland ³⁾	-	-	-	-
Total	16.6	17.0	-0.4	-2.4

¹⁾ As of 30 June 2018 the category "Other" comprises supranational organisations and Japan.

²⁾ As of 30 June 2018 the category "Other Europe" comprises Slovenia and Denmark.

³⁾ Czech Republic (30 June 2018): €11 million; Finland (30 June 2018): €8 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	30.6.2018	31.12.2017	Change	
			in € billion	in %
Public sector borrowers	15.1	15.4	-0.3	-1.9
Financial institutions ¹⁾	1.5	1.5	-	-
Companies	-	-	-	-
Total	16.6	17.0	-0.4	-2.4

¹⁾ Mainly Spanish covered bonds.

Structured Products

pbb Group's residual holding of a Mortgage-backed Security guaranteed by one regional government had a notional value of €0.5 billion as at 30 June 2018 (31 December 2017: €0.5 billion) and a current fair value of €0.5 billion (31 December 2017: €0.5 billion).

The valuation of these assets was based on available market prices.

Breakdown of on-balance sheet and off-balance sheet business by rating class

The following tables provide a breakdown of gross carrying amounts of non-derivative financial assets (excluding cash funds), and of default risks in irrevocable loan commitments and contingent liabilities, by internal rating class and impairment level. The breakdown is in line with pbb Group's internal rating classes. The default definition follows Article 178 of the CRR.

Breakdown of non-derivative financial assets (excluding cash funds) by internal rating class and impairment level (as at 30 June 2018)

in € billion	Stage 1	Stage 2	Stage 3	FVPL	Total
Class 1	1.0	–	–	0.2	1.2
Class 2	14.2	–	–	0.3	14.5
Class 3-6	–	–	–	–	–
Class 7	1.7	–	–	0.1	1.8
Class 8	4.2	–	–	0.1	4.3
Class 9	4.5	–	–	–	4.5
Class 10	3.4	–	–	–	3.4
Class 11	5.5	0.6	–	–	6.1
Class 12	6.9	0.3	–	–	7.2
Class 13	2.5	0.5	–	–	3.0
Class 14	1.3	–	–	–	1.3
Class 15	0.9	0.4	–	–	1.3
Class 16	1.5	0.1	–	–	1.6
Class 17	0.4	0.1	–	–	0.5
Class 18	0.7	0.1	–	–	0.8
Class 19	0.4	0.3	–	–	0.7
Class 20	–	0.1	–	–	0.1
Class 21	0.1	0.1	–	–	0.2
Class 22	–	–	–	–	–
Class 23	0.1	–	–	–	0.1
Class 24	–	–	–	–	–
Class 25	–	0.1	–	–	0.1
Class 26	–	–	–	–	–
Class 27	–	0.1	–	–	0.1
Defaulted	–	–	0.2	–	0.2
Total	49.0	3.1	0.2	0.8	53.0

Breakdown of irrevocable loan commitments and contingent liabilities by internal rating class and impairment level (as at 30 June 2018)

in € billion	Stage 1	Stage 2	Stage 3	Total
Class 1	–	–	–	–
Class 2	0.3	–	–	0.3
Class 3–7	–	–	–	–
Class 8	0.1	–	–	0.1
Class 9	0.1	–	–	0.1
Class 10	0.1	–	–	0.1
Class 11	0.2	–	–	0.2
Class 12	0.4	–	–	0.4
Class 13	0.4	–	–	0.4
Class 14	0.3	–	–	0.3
Class 15	0.5	–	–	0.5
Class 16	0.7	–	–	0.7
Class 17	0.2	–	–	0.2
Class 18	0.4	0.1	–	0.5
Class 19	0.4	–	–	0.4
Class 20	–	0.1	–	0.1
Class 21–27	–	–	–	–
Defaulted	–	–	–	–
Total	4.1	0.2	–	4.3

Watchlist and Non-performing Loans

Development of Watchlist and non-performing loans of pbb Group

EaD in € million	30.6.2018				31.12.2017				Change	
	REF	PIF	VP	Total ¹⁾	REF	PIF	VP	Total ¹⁾	in € million	in %
Workout loans	16	–	–	16	15	–	–	15	1	6.7
Restructuring loans	210	–	–	210	233	–	–	233	–23	–9.9
Non-performing loans	226	–	–	226	248	–	–	248	–22	–8.9
Watchlist loans	60	117	217	394	24	112	224	360	34	9.4

¹⁾ No exposure in C&A.

Watchlist and non-performing loans increased by a net €12 million between 31 December 2017 and 30 June 2018.

Watchlist loans increased by a total of €34 million. The increase in the REF segment was largely due to the transfer of a €58 million exposure to intensified handling. At the same time, it was possible to return a €22 million exposure to normal handling. The minor increase in the PIF segment was largely due to the transfer of an exposure to a French borrower to intensified handling. The slight decline in the VP segment was attributable to a more favourable measurement of claims, due to improved borrower ratings.

The volume of problem loans decreased by €22 million during the first half of 2018, with the major part being attributable to the first-time application of IFRS 9.

Market Risk

Market Risk Measurement and Limits

Market Risk Value at Risk Market risk VaR as at 30 June 2018 amounted to €33 million, taking diversification effects between the individual market risk types into consideration (31 December 2017: €66 million). The reduction in market risk VaR compared to the year-end 2017 was primarily due to reduced credit spread risk. Credit spread risk is considered for all assets measured at fair value through profit or loss (FVPL) or at fair value through other comprehensive income (FVOCI).

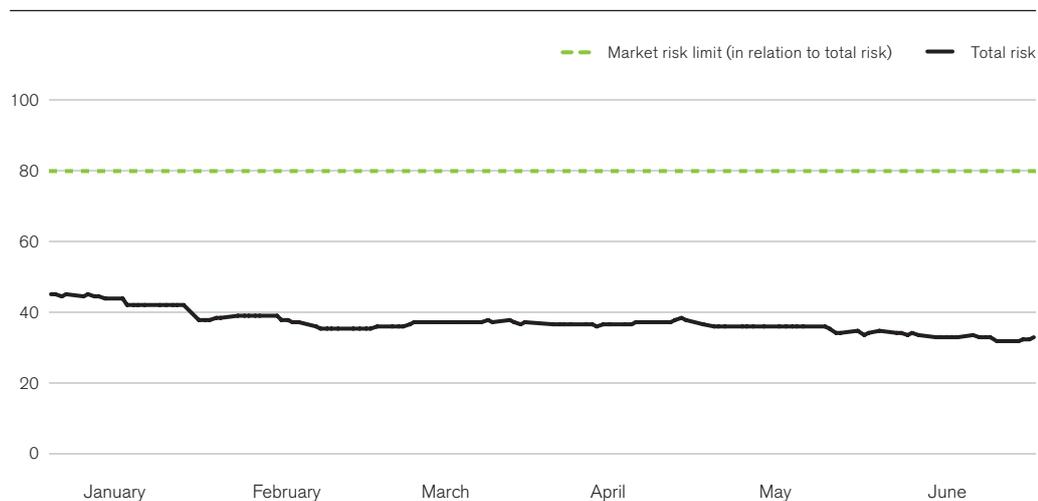
In accordance with IFRS 9, some financial assets previously allocated to the available for sale measurement category now need to be measured at amortised cost (AC). Since credit spread risks are only included in market risk VaR for transactions of measurement categories FVOCI or FVPL, total market risk VaR was reduced upon the changeover to IFRS 9, at the beginning of 2018. Other effects on market risk VaR (besides the initial application of IFRS 9) were of minor importance. Accordingly, the market risk VaR limit was reduced from €100 million to €80 million at the beginning of 2018.

There were no breaches of market risk VaR limits at pbb Group level during the period under review.

The following chart shows the development of market risk VaR 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 June 2018

in € million



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

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 map 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 in addition.

A 200 basis point parallel upwards or – to the extent applicable – downwards shift in the yield curve would have resulted in a maximum market value loss of €195 million across all of pbb Group’s interest rate-sensitive positions (excluding equity) at the end of June 2018 (31 Dec 2017: €239 million). The decrease during the first half of 2018 was due, in particular, to the issue of bonds which were not fully hedged via interest rate derivatives.

An extreme widening of relevant credit spreads – given the scenarios applied by pbb internally – would have resulted in a market value loss of €186 million as at 30 June 2018.

The Management Board of pbb 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 is counted, given a 99% confidence interval. No outliers were detected for the past 250 trading days as at 30 June 2018. The risk model employed by pbb Group therefore has “green” status, as defined in the “traffic light” system of the Basel Capital Accord.

General Interest Rate Risk General interest rate risk amounted to €30 million as at 30 June 2018, and was thus below the figure at the 2017 year-end (€38 million).

Volatility Risks Volatility risk amounted to €4 million as at 30 June 2018 (31 Dec 2017: €4 million).

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 for inclusion in Pfandbrief cover. The Bank has risk measurement systems in place to determine credit spread risks for all relevant exposures. Only credit spread risks of holdings classified as FVOCI or FVPL are subject to VaR limits; AC exposures are not subject to these limits. As outlined above, IFRS 9 requires that some financial assets of the previous available-for-sale measurement category now need to be measured at amortised cost; at the beginning of 2018, this led to a decline in credit spread risk. Specifically, credit spread VaR of exposures at FVOCI and FVPL totalled €31 million as at 30 June 2018, and was thus lower than at the 2017 year-end (€88 million). Other effects on credit spread risk (besides the initial application of IFRS 9) were of minor importance.

Other Market Risks The present value of foreign currency risk amounted to €1 million as at 30 June 2018. Basis risk includes overnight index swap spread, cross-currency spread and tenor-spread basis risk (including LIBOR/Euribor basis risk); these risks are quantified and recognised within the framework of the VaR model. All types of basis risk are included in aggregate VaR, and are therefore subject to market risk limitation. At the reporting date, overnight index swap spread risk (€4 million), tenor spread risk (€1 million) and cross-currency spread risk (€3 million) were reported. The Bank was not exposed to share price or commodity risk. Financial derivatives are mainly used for hedging purposes.

Liquidity and Funding Risk

Development of pbb Group's Risk Position

The cumulative (internal) liquidity position (liquid assets plus projected net cash flows) determined as part of the liquidity risk measurement process as at 30 June 2018 amounted to €6.8 billion for a twelve-month horizon in the base scenario – an €0.2 billion decrease from the end of the previous year. As at 30 June 2018, the cumulative liquidity position for a six-month horizon amounted to €3.4 billion in the risk scenario (31 December 2017: €2.5 billion).

Regulatory Liquidity Coverage Requirements (LCR)

The Liquidity Coverage Ratio (LCR) is calculated using the ratio of the liquidity buffer (liquid assets) to net liquidity outflows during a stress period of 30 days. A minimum LCR of 100% is mandatory in regulatory liquidity reporting.

The levels determined for pbb Group during the first half of 2018 were clearly in excess of 100%. The Liquidity Coverage Ratio as at 30 June 2018 was 321%.

Funding Markets

Please refer to the Report on the Economic position, section Development in Financial Position for details concerning developments on funding markets and changes in pbb's funding volumes during the period under review.

Operational Risk (including Legal Risk)

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 risks, which is calculated at the end of each year, was €72 million as at 31 December 2017 (31 December 2016: €69 million).

Operational Risk Profile of pbb Group

pbb Group suffered financial losses of €0.4 million from operational risks (including legal risks) during the first half of 2018 (6m 2017: €11 million). pbb assesses its operational risk profile (including legal risk) as stable.

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP)

Pursuant to section 91 (2) of the German Public Limited Companies Act (Aktiengesetz – “AktG”) and section 25a (1) of the German Banking Act (Kreditwesengesetz – “KWG”), pbb Group is obliged to establish appropriate and effective internal procedures in order to ensure the Bank’s risk-bearing capacity at all times. The Internal Capital Adequacy Assessment Process (ICAAP) is subject to regulatory review (within the framework of 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 Fourth Capital Requirements Directive (CRD IV).

Pursuant to the “Multi-year plan on SSM Guides on ICAAP and ILAAP”, published by the European Central Bank in February 2017, regulatory authorities expect banks to apply two supplementary ICAAP perspectives: a normative and an economic perspective. This view was affirmed in the draft “ECB Guide to the internal capital adequacy assessment process (ICAAP)”, published in March 2018. Whilst the normative perspective is aimed at the fulfilment of all capital-related legal requirements, supervisory demands and internal objectives, on an ongoing basis, the economic perspective covers all material risks which might threaten the institution’s economic viability.

Both perspectives are designed to safeguard the financial institution’s ability to survive: they are based on internal assessments of the capital required to safeguard the institution’s continued existence – considering all of its specific effects, risks and losses. Both perspectives were implemented by pbb Group when the new 2018 risk strategy came into effect.

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

The results of the ICAAP and of the stress tests are regularly presented to the Management Board and the Risk Committee, who discuss the results and adopt further management measures if required.

Method Used for the individual Risk Types

The methodologies applied to individual types of risk are described in the 2017 Annual Report. Changes to the methodologies outlined there until the half-year point 2018 concerned market risk: the historical observation period for risk factors underlying market risk calculations was extended, to ensure that economic phases which are adverse for the Bank continue to be adequately taken into account, and captured by the model.

Result of Risk-bearing Capacity Analysis

Normative Perspective

The normative perspective is geared towards ongoing fulfilment of all of the Bank's capital-related supervisory demands, as well as to the achievement of internal objectives. For a detailed description of the regulatory indicators measured as at the reporting date (CET1 ratio, tier 1 ratio, own funds ratio, MREL and Leverage Ratio), please refer to the chapter "Key regulatory capital ratios (fully phased-in)". The readings for these indicators were non-critical at the reporting date. The "going-concern" management approach, which was geared towards protecting minimum regulatory capital ratios and was still a separate approach in 2017, has now been transformed into the normative perspective, alongside the monitoring and management of regulatory capital ratios.

Going-concern

in € million	30.6.2018	31.12.2017	Change
Credit risk	201	238	-37
Market risk	133	175	-41
Operational risk	25	25	-
Business risk	-	-	-
Property risk	-	-	-
Total before diversification effects	360	438	-78
Total after diversification effects	333	403	-70
Available financial resources (free capital)	1,539	987	552
Excess capital	1,206	584	622

Aggregate risk (after diversification effects) decreased during the period under review, which was attributable to declines in both market risk and credit risk. The main contributor to the reduction in market risk were the effects from the first-time application of IFRS 9, due to which certain financial assets of the previous available-for-sale measurement category have been required to be measured at amortised cost since January 2018. Accordingly, no credit spread risk needed to be considered for these exposures within the going-concern approach, which led to a decrease in market risk. Credit risk also decreased due to the change in classification of certain securities, as outlined above, given the fact that only default risk (but no rating migration risk) needed to be taken into account for these exposures. Shorter maturities (compared to the 2017 financial statements) and the repayment of maturing securities additionally contributed to a reduction in credit risk during the period under review. In addition, the enhanced inclusion of lower default correlations of small and medium-sized enterprises in the credit portfolio model had a positive effect during the first quarter of 2018. Operational risk, which is regularly determined once a year, remained unchanged. Since the Bank did not hold any properties on the reporting date, no details regarding property risk need to be disclosed.

Available financial resources (so-called "free capital") is compared to aggregate risk (after diversification effects). Available financial resources increased to €1,539 million during the first half of 2018. CET1 capital – which is tied up by regulatory requirements – declined due to lower risk-weighted assets, combined with relief for SREP capital ratios and the effect of a subordinated (AT 1) bond during the period under review. Free capital increased accordingly; this effect was boosted by profits accrued during the first half of 2018, which need to be taken into account. Higher carrying amounts of financial assets (reflecting the effects of the first-time application of IFRS 9), which increased CET1 capital, also contributed to the increase in free capital.

The reduction in economic capital (after diversification effects) and the simultaneous increase in available financial resources together led to higher excess coverage. Overall, the Bank's risk-bearing capacity at the reporting date was evidenced under this approach.

Going-concern: Risk according to segments

in € million	30.6.2018	31.12.2017	Change
Real Estate Finance	146	155	-9
Public Investment Finance	11	20	-9
Value Portfolio	96	141	-45
Consolidation & Adjustments	80	87	-7
Total	333	403	-70

The risk reduction in the VP was driven by lower market risk in particular: effects from the first-time application of IFRS 9 led to a decrease in credit spread risks in this segment in particular. Lower risk in the REF and PIF segments was mainly driven by lower credit risk: in PIF, this was due to shorter maturities and the repayment of maturing securities, whilst the reduction in REF was mainly due to lower correlations of small and medium-sized enterprises in the credit risk model.

Economic Perspective

At the beginning of 2018, the "gone-concern" management approach (which was implemented until 2017) was transposed to the new economic perspective, following an adjustment of the confidence interval (from 99.91% to 99.9%). The following table compares the 2017 year-end figures under the gone-concern approach with the figures of the economic perspective as at the record date:

Economic Perspective

in € million	30.6.2018	31.12.2017	Change
Credit risk	1,114	1,213	-99
Market risk	725	883	-158
Operational risk	77	78	-1
Business risk	-	21	-21
Property risk	-	-	-
Total before diversification effects	1,916	2,195	-279
Total after diversification effects	1,730	1,990	-260
Available financial resources before net hidden losses	3,548	3,179	369
Net hidden losses	-	-	-
Available financial resources	3,548	3,179	369
Excess capital	1,818	1,189	629

Aggregate risk (after diversification effects) also decreased in the economic perspective during the first half of 2018 – predominantly due to lower market risk, credit risk, and business risk. The reduction in market risk was mainly due to lower credit spread risk, reflecting reduced sensitivities due to lower fair values, as well as shorter maturities compared to the end of 2017. This development was significantly reinforced by the extension of the historical observation period for calculating market risk – which continues to incorporate unfavourable economic phases, albeit using a lower weighting.

The adjustment of the confidence interval only had a minor effect upon the decrease in market risk (€-9 million). The reduction in credit risk was predominantly driven by maturities and shorter remaining terms (compared to the end of 2017) of financial assets. The lower confidence interval accounted for just under €33 million of the decrease in credit risk. Business risk, which reflects unexpected funding costs in a stress scenario, also declined – predominantly reflecting the harmonisation of the stress scenario with operative liquidity management. Operational risk is regularly determined once a year. The slight decrease during the first half of 2018 was due to the adjustment of the confidence interval. Since the Bank did not hold any properties on the reporting date, no details regarding property risk need to be disclosed.

In contrast, available financial resources increased during the first half of 2018, mainly driven by the higher level of capital (in accordance with IFRS), reflecting the issue of a subordinated bond in April 2018, and due to the effects of the first-time application of IFRS 9. Hence, excess coverage increased compared to the 2017 year-end; evidence of the risk-bearing capacity in the economic perspective 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 credit risk as well as a reduction in available financial resources (given an increase in net hidden losses and lower equity) is to be expected, notwithstanding any countermeasures taken.

Economic Perspective: Risk according to segments

in € million	30.6.2018	31.12.2017	Change
Real Estate Finance	637	656	-20
Public Investment Finance	116	173	-57
Value Portfolio	730	865	-135
Consolidation & Adjustments	248	296	-48
Total	1,730	1,990	-260

Risk exposure in the VP segment declined, particularly regarding market risk, due to lower credit spread risk. In the C&A segment, besides lower market risk, the reduction of business risk concentrated in this segment (as outlined above) was instrumental for the risk reduction. The main drivers for the risk reduction in the PIF segment were repayments of maturing securities and very short-term maturities of some lending exposures, which reduced credit risk. The development in the REF segment was largely attributable to lower credit risk, which in turn reflected the enhanced inclusion of lower default correlations of small and medium-sized enterprises in the credit portfolio model.

Key Regulatory Capital Ratios (fully phased-in)

The requirements for regulatory capital ratios were satisfied throughout the first half of 2018.

Own Funds

in € million	30.6.2018 Basel III ¹⁾²⁾	31.12.2017 Basel III ³⁾
CET1	2,661	2,552
Additional Tier 1	298	–
Tier 1	2,959	2,552
Tier 2	653	675
Own Funds	3,612	3,227

¹⁾ Including the interim results for the first quarter of 2018, less the maximum dividend in accordance with the methodology prescribed by the ECB.

²⁾ With the introduction of IFRS 9, the new rules governing the classification and measurement of financial assets and regarding the recognition of impairments have impacted regulatory capital. pbb has not applied the optional transitional provisions under IFRS 9.

³⁾ After confirmation of the 2017 financial statements and the appropriation of profits.

Risk-weighted assets (RWA)

in € million	30.6.2018 Basel III	31.12.2017 Basel III
Market risks	261	370
thereof interest rate risks	–	–
thereof foreign exchange risks	261	370
Operational risks	899	899
Credit risks	12,446	13,099
thereof CVA charge	299	294
Other RWA	138	147
RWA total	13,744	14,515

Capital ratios

in %	30.6.2018 Basel III ¹⁾²⁾	31.12.2017 Basel III ³⁾
CET1 Ratio	19.4	17.6
Tier 1 Ratio	21.5	17.6
Own Funds Ratio	26.3	22.2

¹⁾ Including the interim results for the first quarter of 2018, less the maximum dividend in accordance with the methodology prescribed by the ECB.

²⁾ With the introduction of IFRS 9, the new rules governing the classification and measurement of financial assets and regarding the recognition of impairments have impacted regulatory capital. pbb has not applied the optional transitional provisions under IFRS 9.

³⁾ After confirmation of the 2017 financial statements and the appropriation of profits.

Leverage Ratio

in %	30.6.2018 Basel III ¹⁾	31.12.2017 Basel III ²⁾
Leverage Ratio	5.3	4.5

¹⁾ Including the interim results for the first quarter of 2018, less the maximum dividend in accordance with the methodology prescribed by the ECB.

²⁾ After confirmation of the 2017 financial statements and the appropriation of profits.

MREL

Within the scope of the new resolution and recovery regime (in accordance with the EU BRRD) and in addition to regulatory own funds, institutions are obliged to hold liabilities which can be converted to equity, in the amount of the so-called MREL (Minimum Requirements on Own Funds and Eligible Liabilities) ratio. However, there are clear limitations regarding the scope of converting liabilities (the concept of "bail-in-ability"): in particular, no provider of capital may be put at a disadvantage compared to its position under national insolvency law. For example, this means that deposits covered by a national deposit guarantee scheme are not bail-inable and thus excluded from conversion. Regulators determine the exact level of this ratio individually for each institution; at present, no details are disclosed. pbb's specific MREL requirement is below the currently-discussed level of 8% in terms of Total Eligible Liabilities and Own Funds (TLOF); pbb even markedly exceeds this latter requirement.

Report on Expected Developments

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 from the results currently expected.

Regarding the potential development of individual performance indicators during the 2018 financial year, in its Annual Report 2017 pbb Group aimed the following:

- > New business volume (including prolongations with maturities of more than one year) between €10.0 billion and €11.0 billion.
- > Slight increase in the strategic financing volume (31 December 2017: €31.9 billion).
- > Profit before tax after taxes in a range between €150 million and €170 million.
- > Cost-income ratio slightly above the 2017 figure (50.9%).
- > Return on equity between 4% and 5%.
- > CET1 ratio significantly above the SREP ratio of 9.125% pbb Group has 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 (since January 2018 economic 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.

After a sound performance for the first half of 2018, pbb's Management Board raised its guidance for 2018 full-year profit before tax to between €175 million and €195 million. The new guidance is based on the assumptions of net interest income coming under pressure during for the second half of 2018 – in line with projections, together with an increase in general and administrative expenses; furthermore, it factors in estimated risk costs for the full year. The good results for the first half of 2018 were driven by strong net interest income, positive net income from risk provisioning, slightly lower general and administrative expenses, plus measurement income from the so-called conditional additional purchase price adjustment (Besserungsanspruch) in connection with accepting a buy-back offer for Heta Asset Resolution AG debt securities from the year 2016. The new for profit before tax guidance has also positively impacted upon the cost-income ratio and the return on equity after taxes.

pbb Group affirmed its other forecasts.

These assessments are based on the assumption that additional risks – arising from factors beyond pbb's control, for example – do not materialise. Individual opportunities and risks which may have a positive or negative effect upon the Group's future development in assets, financial position and earnings are set out in detail on pages 101 to 103 of the 2017 Annual Report.

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Income Statement

Income statement¹⁾

in € million	Note	1.1. – 30.6.2018	1.1. – 30.6.2017
Net interest income	5	220 ²⁾	196
Net fee and commission income	6	3	5
Net income from financial instruments at fair value through profit or loss (net income from fair value measurement) ³⁾	7	4	–
Net income from derecognition of financial instruments not measured at fair value through profit or loss (net income from realisations) ³⁾	8	15	22
Thereof: from financial assets at amortised cost		13	21
Net income from hedge accounting	9	–2	1
Net other operating income	10	–8	4
Net income from allowances for credit losses on financial assets (net income from risk provisioning) ³⁾	11	7	–
General and administrative expenses	12	–88	–92
Expenses from bank levies and similar dues	13	–22	–25
Net income from write-downs and write-ups of non-financial assets	14	–7	–8
Profit or loss before tax		122	103
Income tax	15	–23	–18
Net income/loss		99	85
attributable to:			
Shareholders		99	85

¹⁾ Disclosure structure of the income statement adjusted due to IAS 8.14. Details are disclosed in note "Consistency".

²⁾ Interest income of €923 million in total includes interest income of €656 million from financial instruments not measured at fair value through profit or loss (IAS 1.82a).

³⁾ Solely the condensed and parenthesised line item descriptions are used subsequently.

Earnings per share

in €	Note	1.1. – 30.6.2018	1.1. – 30.6.2017
Basic earnings per share	16	0.72	0.63
Diluted earnings per share	16	0.72	0.63

Statement of Comprehensive Income

Statement of comprehensive income

in € million	1.1. – 30.6.2018	1.1. – 30.6.2017
Net income/loss	99	85
Accumulated other comprehensive income	-25	-3
Items that will not be reclassified to profit or loss, net of tax	2	8
Gains/losses on pension commitments, before tax	3	11
Income tax relating to items that will not be reclassified to profit or loss	-1	-3
Items that may be reclassified to profit or loss, net of tax	-27	-11
Gains/losses on translating foreign currency, before tax	-	-
unrealised gains/losses	-	-
gains/losses reclassified to profit or loss	-	-
Gains/losses on cash flow hedge accounting, before tax	-19	-17
unrealised gains/losses	-	1
gains/losses reclassified to profit or loss	-19	-18
Gains/losses on financial assets at fair value through other comprehensive income, before tax	-17	2
unrealised gains/losses	-17	-1
gains/losses reclassified to profit or loss	-	3
Income tax relating to items that may be reclassified to profit or loss	9	4
Comprehensive income for the period	74	82
attributable to:		
Shareholders	74	82

Statement of Financial Position

Assets¹⁾

in € million	Note	30.6.2018 (IFRS 9)	1.1.2018 (IFRS 9)	31.12.2017 (IAS 39)	1.1.2017 (IAS 39)
Cash reserve		1,551	999	999	1,136
Financial assets at fair value through profit or loss	17	1,621	1,735	870	1,089
Positive fair values of stand-alone derivatives		846	870	870	1,089
Debt securities		327	333	-	-
Loans and advances to customers		445	529	-	-
Shares in investment funds qualified as debt instruments		3	3	-	-
Financial assets at fair value through other comprehensive income	18	2,052	2,182	2,385	3,311
Debt securities		1,616	1,735	2,382	3,308
Loans and advances to other banks		16	17	-	-
Loans and advances to customers		420	430	-	-
Shares in investment funds qualified as debt instruments		-	-	3	3
Financial assets at amortised cost after credit loss allowances	19	50,060	50,323	50,858	53,391
Financial assets at amortised cost before credit loss allowances		50,157	50,427	50,942	53,531
Debt securities		8,263	8,667	8,253	9,544
Loans and advances to other banks		2,405	2,400	2,415	2,841
Loans and advances to customers		39,489	39,360	40,274	41,146
Credit loss allowances on financial assets at amortised cost		-97	-104	-84	-140
Positive fair values of hedge accounting derivatives	20	2,326	2,678	2,678	3,492
Valuation adjustment from portfolio hedge accounting (assets)		1	-1	-1	2
Tangible assets		5	6	6	8
Intangible assets		35	36	36	24
Other assets		33	34	34	80
Current income tax assets		43	42	42	47
Deferred income tax assets		79	71	87	71
Total assets		57,806	58,105	57,994	62,651

¹⁾ Adjusted structure type of assets due to IAS 8.14. Details are disclosed in note "Consistency".

Liabilities and Equity¹⁾

in € million	Note	30.6.2018 (IFRS 9)	1.1.2018 (IFRS 9)	31.12.2017 (IAS 39)	1.1.2017 (IAS 39)
Financial liabilities at fair value through profit or loss	21	983	1,040	956	1,355
Negative fair values of stand-alone derivatives		983	1,040	956	1,355
Financial liabilities measured at amortised cost	22	50,681	50,919	50,919	54,395
Liabilities to other banks		4,471	3,797	3,797	3,779
Liabilities to customers		25,008	26,244	26,244	28,978
Bearer bonds		20,503	19,876	19,876	20,752
Subordinated liabilities		699	1,002	1,002	886
Negative fair values of hedge accounting derivatives	23	2,584	2,805	2,889	3,719
Valuation adjustment from portfolio hedge accounting (liabilities)		12	–	–	1
Provisions	24	252	247	245	242
Other liabilities		41	70	70	66
Current income tax liabilities		58	57	57	59
Liabilities		54,611	55,138	55,136	59,837
Equity attributable to the shareholders of pbb	26	2,897	2,967	2,858	2,814
Subscribed capital		380	380	380	380
Additional paid-in capital		1,637	1,637	1,637	1,637
Retained earnings		760	722	731	674
Consolidated profit		99	182	182	197
Accumulated other comprehensive income		21	46	–72	–74
Thereof: allowances for credit losses on financial assets at fair value through other comprehensive income		1	1	–	–
Additional equity instruments (AT1 capital)		298	–	–	–
Equity		3,195	2,967	2,858	2,814
Total liabilities and equity		57,806	58,105	57,994	62,651

¹⁾ Adjusted structure type of equity and liabilities due to IAS 8.14. Details are disclosed in note "Consistency".

Statement of Changes in Equity

Statement of changes in equity

in € million	Equity attributable to the shareholders								Equity
	Subscribed capital	Additional paid-in capital	Retained earnings	Consolidated profit	Pension commitments	Cash flow hedge accounting	Accumulated other comprehensive income (OCI) from:		
							financial assets at fair value through OCI (IAS 39: AfS reserve)	Additional equity instruments (AT1 capital)	
Balance at 1.1.2017	380	1,637	674	197	-82	44	-36	-	2,814
Distribution	-	-	-	-141	-	-	-	-	-141
Comprehensive income for the period	-	-	-	85	8	-12	1	-	82
Net income/loss	-	-	-	85	-	-	-	-	85
OCI for the period, after taxes	-	-	-	-	8	-12	1	-	-3
Transfer to retained earnings	-	-	56	-56	-	-	-	-	-
Balance at 30.6.2017	380	1,637	730	85	-74	32	-35	-	2,755
Balance at 31.12.2017	380	1,637	731	182	-75	22	-19	-	2,858
Effects from initial adoption of IFRS 9	-	-	-9	-	-	-	118	-	109
Balance at 1.1.2018	380	1,637	722	182	-75	22	99	-	2,967
Capital increase	-	-	-	-	-	-	-	300	300
Transaction costs	-	-	-	-	-	-	-	-2	-2
Distribution	-	-	-	-144	-	-	-	-	-144
Comprehensive income for the period	-	-	-	99	2	-14	-13	-	74
Net income/loss	-	-	-	99	-	-	-	-	99
OCI for the period, after taxes	-	-	-	-	2	-14	-13	-	-25
Transfer to retained earnings	-	-	38	-38	-	-	-	-	-
Balance at 30.6.2018	380	1,637	760	99	-73	8	86	298	3,195

Statement of Cash Flows (condensed)

Statement of cash flows (condensed)

in € million

	2018	2017
Cash and cash equivalents at 1.1.	999	1,136
+/- Cash flows from operating activities	230	-25
+/- Cash flows from investing activities	450	806
+/- Cash flows from financing activities	-128	-15
+/- Currency translation and other non-cash measurement effects	-	-
Cash and cash equivalents at 30.6.	1,551	1,902

Notes (condensed)

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1 Principles

Deutsche Pfandbriefbank AG (pbb) has prepared the condensed consolidated interim financial statements for the period ended 30 June 2018 in line with EC regulation No. 1606/2002 of the European Parliament and of the Council from 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).

The condensed consolidated interim financial statements are based on IFRS as adopted in European law by the European Commission as part of its endorsement process. In particular, requirements of IAS 34 have been considered.

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). According to the option pursuant to IFRS 9.7.2.21 Deutsche Pfandbriefbank Group (pbb Group) still applies the requirements of IAS 39 for hedge accounting instead of the requirements in chapter 6 of IFRS 9. 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 condensed consolidated interim 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 Risk and Opportunity Report contains information which, under IFRS 7, is required to be disclosed.

The Management Board of pbb prepared these condensed consolidated interim financial statements on 31 July 2018 under the going-concern assumption.

2 Consistency

pbb Group applies accounting policies consistently in accordance with the IFRS Conceptual Framework as well as IAS 1 and IAS 8. Principally, the same accounting policies were applied in condensed consolidated interim financial statements as of 30 June 2018 than in the consolidated financial statements as of 31 December 2017.

Initial Application of IFRS 9

As of 1 January 2018, pbb Group has applied IFRS 9 (Financial Instruments) as endorsed by the European Union which superseded the former regulations of IAS 39. 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. IFRS 9 also led to significant amendments on IFRS 7 (Financial Instruments: Disclosures) due to which disclosures of information on financial instruments have been adapted to the new requirements.

The initial application of IFRS 9 was accounted retrospectively as of 1. January 2018. Hence, the initial application effects are shown directly in equity not affecting profit or loss. 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.

As permitted by the transitional requirements of IFRS 9, pbb Group elected not to restate comparative amounts for the previous financial year 2017.

Classification and Measurement of Financial Instruments

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 – consisting of held for trading (HfT) and designated at fair value through profit or loss (dFVTPL) –, held to maturity (HtM), loans and receivables (LaR) and available for sale (AfS) were replaced by the following measurement categories in IFRS 9:

- > at fair value through profit or loss (FVPL)
- > at fair value through other comprehensive income (FVOCI)
- > at amortised cost (AC).

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. pbb Group holds equity instruments of an insignificant amount. These are measured at fair value through profit or loss.

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). pbb Group does not use the fair value option for financial assets.

Non derivative financial liabilities have to be measured at amortised cost, unless they are held for trading purposes or are designated at fair value through profit or loss.

The amount of change in the fair value of financial liabilities designated at fair value through profit or loss (fair value option) 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. pbb Group does not have non-derivative financial liabilities measured at fair value through profit or loss and does not use the fair value option for financial liabilities. 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.

According to IFRS 9 the non-derivative financial instruments of pbb Group are classified and measured as follows:

- > Segment Real Estate Finance (REF): 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 (PIF): 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 (VP): 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 (C&A): 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 in the initial application of IFRS 9 on 1 January 2018:

- > 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 had 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 which were categorised as 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.
- > Participations in investment funds and non-consolidated respectively non-at equity measured entities which were part of the IAS 39 measurement category available for sale were reclassified to the IFRS 9 measurement category fair value through profit or loss.
- > 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 was a positive IFRS 9 initial application effect from the classification and measurement of €158 million before deferred taxes in equity. There are no changes for financial liabilities and derivatives compared to former IAS 39 in pbb Group.

Accounting of Impairments

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 determined 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. pbb Group did not have purchased or originated credit-impaired financial assets as of 1 January 2018 and as of 30 June 2018.

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 asset 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. A financial asset will have to be moved to stage 3 if it is credit-impaired. A deal will be credit-impaired if one or more events that have detrimental impact on the estimated future cash flows of that financial asset occurred. Evidence that a financial asset is credit-impaired include observable data about the following events:

- > significant financial difficulty of the issuer or the borrower;
- > a breach of contract, such as a default or past due event;
- > pbb Group, for economic reasons or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower concessions that pbb Group would not otherwise consider;
- > it is becoming probable that the borrower will enter bankruptcy or other financial reorganization;
- > the disappearance of an active market for that financial asset because of financial difficulties;
- > the purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

pbb Group principally uses a model-based approach for determining the amount of expected credit losses. 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 stage 1 and stage 2 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 of 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 interest income is calculated by applying the effective interest rate to the gross book value (book value before risk provision) of the financial asset.

The expected credit losses of impairment stage 3 are determined on the basis of individual cash flows with several probability-weighted scenarios. The amount of risk provision equals 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. The expected future cash flows take into account the marketability of collaterals like for example charges on the land/mortgages. The interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset.

A financial asset will have to be written-off if there is no recovery. This is generally the case when a residual claim remains after the realization of the collaterals and when no further amounts are expected from the borrower (for example due to insolvency/lack of funds). pbb groups tries to collect the remaining claim completely or at least partly by enforcement activities in justified exceptions.

The IFRS 9 initial application effect in equity before deferred taxes from the accounting of impairments amounted to €–32 million.

Hedge Accounting

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. For hedge accounting pbb Group exercised the accounting option and retains the current regulation of IAS 39.

Disclosure

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.

Impairments on financial assets of the measurement category amortised cost are disclosed in a separate line item "credit loss allowances on financial assets at amortised cost" instead of a deduction of the book value of the asset. Impairments on financial asset of the measurement category at fair value through OCI are shown in the equity component "accumulated other comprehensive income".

Reconciliation from the Statement of Financial Position as of 31 December 2017 to the Statement of Financial Position as of 1 January 2018

The following tables show the reconciliations from the statements of financial positions according to IAS 39 as of 31 December 2017 to the statement of financial positions as of 1 January 2018 pursuant to IFRS 7.42.

Changes in classification of financial assets and liabilities

in € million	IAS 39 carrying amounts 31.12.2017			IFRS 9 carrying amounts by measurement categories			Changes in carrying amounts due to transfer into IFRS 9 measurement categories via Reclassification 1.1.2018			
	Carrying amounts	Credit loss allowances included in carrying amounts	Gross carrying amounts	AC	FVPL	FVOCI	Revaluation due to formerly reclassified deals 1.1.2018	AC	FVPL	FVOCI
Loans and advances to other banks	2,415	-	2,415	2,400	-	17	-	-	-	2
LaR	2,415	-	2,415	2,400	-	17	-	-	-	2
LaR to FVOCI	15	-	15	-	-	17	-	-	-	2
LaR to AC	2,400	-	2,400	2,400	-	-	-	-	-	-
Loans and advances to customers	40,274	-	40,274	39,360	529	430	-	-3	-14	62
LaR	40,274	-	40,274	39,360	529	430	-	-3	-14	62
LaR to FVPL	543	-	543	-	529	-	-	-	-14	-
LaR to FVOCI	368	-	368	-	-	430	-	-	-	62
LaR to AC	39,363	-	39,363	39,360	-	-	-	-3	-	-
Financial investments	10,625	-13	10,638	8,667	336	1,735	4	72	6	22
AfS	2,385	-	2,385	1,706	3	743	-	68	-	-1
AfS to FVPL	3	-	3	-	3	-	-	-	-	-
AfS to FVOCI	744	-	744	-	-	743	-	-	-	-1
AfS to AC	1,638	-	1,638	1,706	-	-	-	68	-	-
LAR	8,240	-13	8,253	6,961	333	992	4	4	6	23
LaR to FVPL	327	-	327	-	333	-	-	-	6	-
LaR to FVOCI	969	-	969	-	-	992	-	-	-	23
LaR to AC	6,944	-13	6,957	6,961	-	-	4	4	-	-
Trading assets	870	-	870	-	870	-	-	-	-	-
HfT	870	-	870	-	870	-	-	-	-	-
Other assets	2,678	-	2,678	-	2,678	-	-	-	-	-
HfT	2,678	-	2,678	-	2,678	-	-	-	-	-
Liabilities to other banks	3,280	-	3,280	3,280	-	-	-	-	-	-
Liabilities to customers	8,275	-	8,275	8,275	-	-	-	-	-	-
Securitized liabilities	38,362	-	38,362	38,362	-	-	-	-	-	-
Subordinated liabilities	1,002	-	1,002	1,002	-	-	-	-	-	-
Trading liabilities	956	-	956	-	1,040	-	-	-	84	-
HfT	956	-	956	-	1,040	-	-	-	84	-
Other liabilities	2,889	-	2,889	-	2,805	-	-	-	-84	-
HfT	2,889	-	2,889	-	2,805	-	-	-	-84	-

Allowances for losses on loans and advances were shown on a gross basis for loans and advances to other banks and to customers in the former disclosure structure. Allowances on securities (financial investments) were deducted directly from the carrying amount. In the new disclosure structure impairments on all loans and advances and securities measured at amortised are disclosed on a gross basis.

Reconciliation of credit loss allowances on financial assets under IAS 39 and provisions under IAS 37 at 31 December 2017 to credit loss allowances on financial assets under IFRS 9 at 1 January 2018

in € million				IFRS 9 credit loss allowances at 1.1.2018			
Changes in measurement category (Presentation: IAS 39 to IFRS 9 category)	Credit loss allowances under IAS 39/IAS 37 provisions at 31.12.2017	Individual allowances	Portfolio-based allowances	Stage 1	Stage 2	Stage 3	Impact on credit loss allowances from changing to IFRS 9 measurement categories at 1.1.2018
Loans and advances to other banks	-	-	-	-	-	-	-
LaR to AC	-	-	-	-	-	-	-
LaR to FVOCI	-	-	-	-	-	-	-
LaR to FVPL	-	-	-	-	-	-	-
Loans and advances to customers	69	24	45	11	43	39	24
LaR to AC	60	15	45	11	43	39	33
LaR to FVOCI	-	-	-	-	-	-	-
LaR to FVPL	9	9	-	-	-	-	-9
Financial investments	13	-	13	1	10	-	-2
AfS to FVOCI	-	-	-	-	-	-	-
AfS to AC	-	-	-	-	-	-	-
LaR to AC	12	-	12	1	9	-	-2
LaR to FVOCI	1	-	1	-	1	-	-
LaR to FVPL	-	-	-	-	-	-	-
Trading assets	-	-	-	-	-	-	-
HfT to FVOCI	-	-	-	-	-	-	-
Contingent liabilities	-	-	-	-	-	-	-
Irrevocable loan commitments	2	-	-	1	-	-	-1

Impacts from reclassifying financial assets and liabilities measured at fair value under IAS 39

in € million		Results (from FV changes) without reclassification 1.1.-30.6.2018	
Assets and liabilities reclassified out of IAS 39 fair value measurement categories	Fair value at 30.6.2018	Income statement	Accumulated other comprehensive income
Reclassified in amortised cost (in the course of IFRS 9 adoption) out of:			
Financial investments			
AfS	1,572	-	-63

Further Changes in Standards

In addition to IFRS 9 pbb Group has been applying further new or amended standards like for example IFRS 15 (revenue from contracts with customers) since 1 January 2018. There have not been material effects on pbb Group's development in earnings, assets and financial position from the initial applications of these further standards, in particular from modified retrospectively initial application of IFRS 15.

Changes in Presentation Structure of Income Statement and Statement of Financial Position

In line with IAS 8.14, pbb Group changed 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. Accordingly the characteristics of the transactions reported in the line items were adjusted. The presentation of the top items does no longer follow the product-specific logic, which in general was previously applied in Germany, but will be based on the internationally more common presentation focusing on measurement categories. The sub-items in the statement of financial position are structured by product types.

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 subsequently by the European Banking Authority (EBA) in relation to standardised financial reporting for financial and credit institutions. By introducing the 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 first half of 2017 as well as the statement of financial position as at 31 December 2017 is reconciled from old to new structure.

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 fair value measurement" 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 realisations" 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, and from currency translation as well as additions and reversals of provisions. The item no longer includes expenses for the bank levy.
- > "Net income from risk provisioning" 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".

- > "General and administrative expenses" remain largely unchanged compared to the previous presentation method. However, net income from write downs and write ups of non-financial assets are no longer included, but presented in a separate item.
- > The item "expenses from bank levies and similar dues" mainly consists of expenses for bank levies and deposit protection.
- > "Net income from write-downs and write-ups of non-financial assets" comprise depreciation, amortisation, impairment losses and reversals of impairment losses on non-financial assets.

Reconciled income statement from old to new structure for the period from 1 January to 30 June 2017

Presentation according to old structure in € million	Write-downs/ups (1)	Restructuring provisions (2)	Bank levies/ deposit protection (3)	Derecognition of financial instruments (4)	Provisions similar to interests (5)	Presentation according to new structure in € million		
Net interest income	206	-	-	-	-21	11	196	Net interest income
Net fee and commission income	5	-	-	-	-	-	5	Net fee and commission income
Net trading result (no corresponding item)	-	-	-	-	-	-	-	Net income from fair value measurement
Net income from financial investments	-	-	-	22	-	-	22	Net income from realisations (deleted)
Net income from hedging relationships	1	-	-	-	-	-	1	Net income from hedge accounting
Net other operating income/expenses	-10	3	2	20	-	-11	4	Net other operating income
Loan loss provisions	-	-	-	-	-	-	-	Net income from risk provisioning
General and administrative expenses (no corresponding item)	-102	5	-	5	-	-	-92	General and administrative expenses
(no corresponding item)	-	-	-	-25	-	-	-25	Expenses from bank levies and similar dues
(no corresponding item)	-	-8	-	-	-	-	-8	Net income from write-downs and write-ups of non-financial assets (deleted)
Net miscellaneous income/expenses	2	-	-2	-	-	-	-	(deleted)
Profit or loss before tax	103	-	-	-	-	-	103	Profit or loss before tax
Income taxes	-18	-	-	-	-	-	-18	Income taxes
Net profit/loss	85	-	-	-	-	-	85	Net profit/loss

- (1) Depreciation/amortisation/impairments and reversals of non-financial assets (in particular tangible and intangible assets) as well as write-downs of salvage acquisitions are no longer presented in "general and administrative expenses" respectively "net other operating income/expenses" but in "net income from write-downs and write-ups of non-financial assets".
- (2) Additions and reversals of restructuring provisions are no longer presented in "net miscellaneous income/expenses" but in "net other operating income".
- (3) Expenses for bank levies are no longer presented in "net other operating income" and expenses for deposit protection fund are no longer presented in "general and administrative expenses" but in a separate position "expenses from bank levies and similar dues".
- (4) Income and expenses from derecognition of loans and advances (prepayment fees, gains or losses from disposals, reversals of accrued fees) and from derecognition of liabilities are no longer presented in "net interest income" but in "net income from realisations".
- (5) Additions and reversals of provisions similar to interests are no longer presented in "net interest income" but in "net other operating income".

The individual items of the assets side 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 positions "positive fair values of stand-alone derivatives", "debt securities", "loans and advances to customers" and "other financial assets at fair value through profit or loss" are presented as sub-items.
- > 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 (AfS)". The positions "debt securities", "loans and advances to other banks", "loans and advances to customers" and "other financial assets at fair value through other comprehensive income" are presented as sub-items.
- > Financial assets allocated to the measurement category at amortised cost are reported in the item "financial assets at amortised cost before credit loss allowances". 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 as loans and advances and financial investments. The positions "debt securities", "loans and advances to other banks" and "loans and advances to customers" are presented as sub-items.
- > The deduction item "credit loss allowances on financial assets at amortised cost" 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 as loan loss allowances. Allowances in relation to securities were previously directly offset against the carrying amount of the securities and reported under financial investments (31 December 2017: €13 million).
- > 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.

The individual items of the equity and liabilities side 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 "liabilities to other banks", "liabilities to customers", "securitised liabilities" and "subordinated capital", which are now presented as sub-items. Within this sub-level registered bonds are presented in "liabilities to other banks" and "liabilities to customers" instead of "securitised liabilities". For this purpose, "bearer bonds" are now presented in a separate item. As of 31 December 2017, registered bonds in the amount of €517 million (1 January 2018: €600 million) were reclassified into "liabilities to other banks" and in the amount of €17,969 million (1 January 2018: €19,029 million) into "liabilities to customers".
- > 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. Since 1 January 2018, this item includes provisions for commitments and guarantees given (1 January 2018: €2 million), which were formerly presented in loan loss allowances until 31 December 2017.
- > The item "other liabilities" includes other non-financial liabilities. Compared with the previous presentation method, this item no longer comprises hedge accounting derivatives.
- > The items "current income tax liabilities" and "deferred income tax liabilities" have 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.

Presentation according old structure in € million	Carrying amount IAS 39 31.12.2017	Presentation according new structure in € million	Carrying amount IAS 39 31.12.2017	Presentation according new structure in € million	Carrying amount IFRS 9 1.1.2018	Revaluation (effect from initial adop- tion of IFRS9)
Cash reserve	999	Cash reserve	999	Cash reserve	999	–
Trading assets (HfT)	870	Financial assets at fair value through profit or loss – Positive fair values of stand-alone derivatives	870	Financial assets at fair value through profit or loss – Positive fair values of stand-alone derivatives	870	–
Loans and advances to other banks (LaR)	2,415	Financial assets at amortised cost – Loans and advances to other banks	2,415	Financial assets at amortised cost – Loans and advances to other banks	2,400	2
				Financial assets at fair value through other comprehensive income – Loans and advances to other banks	17	
Loans and advances to customers (LaR)	40,274	Financial assets at amortised cost – Loans and advances to customers	40,274	Financial assets at amortised cost – Loans and advances to customers	39,360	–3
				Financial assets at fair value through other comprehensive income – Loans and advances to customers	430	62
				Financial assets at fair value through profit or loss – Loans and advances to customers	529	–14
Allowances for losses on loans and advances	–71	Credit loss allowances on financial assets	–84	Credit loss allowances on financial assets	–104	–22
Valuation adjustment from portfolio hedge accounting (assets)	–1	Valuation adjustment from portfo- lio hedge accounting (assets)	–1	Valuation adjustment from portfolio hedge accounting (assets)	–1	–
Financial investments (LaR)	8,240	Financial assets at amortised cost – Debt securities	8,253	Financial assets at amortised cost – Debt securities	6,961	4
				Financial assets at fair value through other comprehensive income – Debt securities	992	23
				Financial assets at fair value through profit or loss – Debt securities	333	6
Financial investments (AFS)	2,385	Financial assets at fair value through other comprehensive income – Debt securities	2,385	Financial assets at amortised cost – Debt securities	1,706	68
				Financial assets at fair value through other comprehensive income – Debt securities	743	–1
				Financial assets at fair value through profit or loss – Other financial assets at fair value through profit or loss	3	–
Property and equipment	6	Tangible assets	6	Tangible assets	6	–
Intangible assets	36	Intangible assets	36	Intangible assets	36	–
Other assets	2,712	Other assets	34	Other assets	34	–
Thereof: Positive market values of hedging derivatives	2,678	Positive fair values of hedge accounting derivatives	2,678	Positive fair values of hedge accounting derivatives	2,678	–
Income tax assets	129	Income tax assets	129	Income tax assets	113	–
Current income tax assets	42	Current income tax assets	42	Current income tax assets	42	–
Deferred income tax assets	87	Deferred income tax assets	87	Deferred income tax assets	71	–16
Total assets	57,994		57,994		58,105	109

Presentation according old structure in € million	Carrying amount IAS 39 31.12.2017	Presentation according new structure in € million	Carrying amount IAS 39 31.12.2017	Presentation according new structure in € million	Carrying amount IFRS 9 1.1.2018	Revaluation (effect from initial adop- tion of IFRS9)
Liabilities to other banks (at amortised cost)	3,280	Financial liabilities at amortised cost – Liabilities to other banks	3,797	Financial liabilities at amortised cost – Liabilities to other banks	3,797	–
Liabilities to customers (at amortised cost)	8,275	Financial liabilities at amortised cost – Liabilities to customers	26,244	Financial liabilities at amortised cost – Liabilities to customers	26,244	–
Securitised liabilities (at amortised cost)	38,362	Financial liabilities at amortised cost – Bearer bonds	19,876	Financial liabilities at amortised cost – Bearer bonds	19,876	–
Valuation adjustment from portfo- lio hedge accounting (liabilities)	–	Valuation adjustment from portfo- lio hedge accounting (liabilities)	–	Valuation adjustment from portfo- lio hedge accounting (liabilities)	–	–
Trading liabilities (HfT)	956	Financial liabilities at fair value through profit or loss – Negative fair values of stand- alone derivatives	956	Financial liabilities at fair value through profit or loss – Negative fair values of stand- alone derivatives	1,040	84
Provisions	245	Provisions	245	Provisions	247	–
Other liabilities	2,959	Other liabilities	70	Other liabilities	70	–
Thereof: Negative market values of hedging derivatives	2,889	Negative fair values of hedge accounting derivatives	2,889	Negative fair values of hedge accounting derivatives	2,805	–84
Income tax liabilities	57	Income tax liabilities	57	Income tax liabilities	57	–
Current income tax liabilities	57	Current income tax liabilities	57	Current income tax liabilities	57	–
Subordinated capital	1,002	Financial liabilities at amortised cost – Subordinated liabilities	1,002	Financial liabilities at amortised cost – Subordinated liabilities	1,002	–
Liabilities	55,136		55,136		55,138	–
Equity attributable to the shareholders	2,858		2,858		2,967	109
Subscribed capital	380	Subscribed capital	380	Subscribed capital	380	–
Additional paid-in capital	1,637	Additional paid-in capital	1,637	Additional paid-in capital	1,637	–
Retained earnings	731	Retained earnings	731	Retained earnings	722	–9
Consolidated profit	182	Consolidated profit	182	Consolidated profit	182	–
Gains/losses on pension commitments and revaluation reserve	–72	Accumulated other comprehensive income	–72	Accumulated other comprehensive income	46	118
Equity	2,858		2,858		2,967	109
Total liabilities and equity	57,994		57,994		58,105	109

Segment Reporting

Segment reporting is conducted by our internal control. Effective 1 January 2018, pbb Group changed the structure of its internal organisation in such a way that the amount of profit before tax as well as the amount of allocated equity of reportable segments changed. These changes relate to the allocation of costs for holding liquidity (reported in net interest income), prepayment penalties (reported in gains or losses from derecognition of financial instruments not measured at fair value through profit or loss) and equity to the business segments and thus also of income from investing own funds (included in net interest income).

- > As in the past, net interest income is calculated as the customer interest rate received less the funding rates with matching maturities valid at the time the transaction is concluded. The required input parameters are determined at the time the new transaction is concluded in single transaction costing. The allocation of costs for providing liquidity to the business segments was adjusted. These costs are now only shown for individual transactions via the transfer price mechanism and are no longer invoiced to the segments at portfolio level on a costing basis as before.
- > The prepayment penalties received are allocated to the segments for individual transactions and not, as in the past, according to the size of the segments.
- > Equity is allocated proportionally to the distribution of diversified economic capital to the business segments on the assumption of continuing operations and also takes into account the effects of changes in risk parameters resulting from the harmonisation of risk models. As a result, a higher amount of equity is allocated to the Real Estate Finance (REF) segment in particular. Previously, equity was allocated in proportion to the distribution of diversified economic capital based on the gone-concern approach to risk management.

pbb Group has adjusted the segmentation of income and expenses for the comparable prior-year period, and of equity as of 31 December 2017, in accordance with IFRS 8.29. As a result of the changes, profit before tax in the REF segment rose, whilst profit before tax in the Public Investment Finance (PIF) and Value Portfolio (VP) segments decreased.

Apart from the adjustments described earlier, pbb Group applied the same accounting and valuation principles to the consolidated financial statements as at 30 June 2018 compared to the reporting date of 31 December 2017.

3 Consolidation

A list of all consolidated and non-consolidated companies of pbb can be found on page 205 of pbb Group's 2017 Annual Report. Immo Immobilien Management Beteiligungsgesellschaft mbH, Munich, Germany which was not previously consolidated due to its minor significance was included in the consolidated financial statements for the first time at the beginning of the first half of 2018. IMMO Immobilien Management GmbH & Co. KG, Munich, was incorporated into Immo Immobilien Management Beteiligungsgesellschaft mbH in May 2018. This had no impact on pbb Group's development in assets, financial position and earnings.

4 Segment Reporting

Income/expenses

in € million		REF	PIF	VP	C&A	pbb Group
Operating income	1.1.–30.6.2018	189	14	26	3	232
	1.1.–30.6.2017 ¹⁾	184	12	29	3	228
Net interest income	1.1.–30.6.2018	183	16	18	3	220
	1.1.–30.6.2017 ¹⁾	163	14	16	3	196
Net fee and commission income	1.1.–30.6.2018	3	–	–	–	3
	1.1.–30.6.2017 ¹⁾	5	–	–	–	5
Net income from fair value measurement	1.1.–30.6.2018	–4	–1	9	–	4
	1.1.–30.6.2017 ¹⁾	2	–1	–1	–	–
Net income from realisations	1.1.–30.6.2018	14	–	1	–	15
	1.1.–30.6.2017 ¹⁾	22	–	–	–	22
Net income from hedge accounting	1.1.–30.6.2018	–1	–	–1	–	–2
	1.1.–30.6.2017 ¹⁾	1	–	–	–	1
Net other operating income	1.1.–30.6.2018	–6	–1	–1	–	–8
	1.1.–30.6.2017 ¹⁾	–9	–1	14	–	4
Net income from risk provisioning	1.1.–30.6.2018	–1	4	4	–	7
	1.1.–30.6.2017 ¹⁾	–2	1	1	–	–
General and administrative expenses	1.1.–30.6.2018	–70	–12	–6	–	–88
	1.1.–30.6.2017 ¹⁾	–74	–12	–6	–	–92
Expenses from bank levies and similar dues	1.1.–30.6.2018	–12	–3	–7	–	–22
	1.1.–30.6.2017 ¹⁾	–13	–4	–8	–	–25
Net income from write-downs and write-ups of non-financial assets	1.1.–30.6.2018	–6	–1	–	–	–7
	1.1.–30.6.2017 ¹⁾	–7	–1	–	–	–8
Profit or loss before tax	1.1.–30.6.2018	100	2	17	3	122
	1.1.–30.6.2017¹⁾	88	–4	16	3	103

¹⁾ Adjusted due to IFRS 8.29. Details are disclosed in note "Consistency".

Cost-income ratio¹⁾

in %		REF	PIF	VP	pbb Group
Cost-income ratio	1.1.–30.6.2018	40.2	92.9	23.1	40.9
	1.1.–30.6.2017	44.0	>100.0	20.7	43.9

¹⁾ Cost-income ratio is the ratio of general and administrative expenses and net income from write-downs and write-ups on non-financial assets to operating income.

Balance-sheet-related measures

in € billion		REF	PIF	VP	C&A	pbb Group
Financing volumes ¹⁾	30.6.2018	25.7	6.7	13.5	–	45.9
	31.12.2017	24.9	7.0	13.8	–	45.7
Risk-weighted assets ²⁾	30.6.2018	8.1	1.3	3.4	0.9	13.7
	31.12.2017	8.3	1.6	3.5	1.1	14.5
Equity ³⁾	30.6.2018	1.4	0.1	1.0	0.3	2.8
	31.12.2017 ⁴⁾	1.2	0.2	1.1	0.4	2.9

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 cash flow hedge reserve, reserves from financial assets at fair value through other comprehensive income and AT1 capital.

⁴⁾ Adjusted due to IFRS 8.29. Details are disclosed in note "Consistency".

NOTES TO THE INCOME STATEMENT

5 Net Interest Income

Net interest income

in € million	1.1. – 30.6.2018 (IFRS 9)	1.1. – 30.6.2017 (IAS 39)
Interest income	923	1,001
from financial assets at fair value through profit or loss	157	156
from financial assets at fair value through other comprehensive income	33	44
from financial assets at amortised cost	623	681
from hedge accounting derivatives (net)	108	116
from other assets	2	4
Interest expenses	-703	-805
from financial liabilities held for trading	-179	-183
from financial liabilities measured at amortised cost	-524	-622
Total	220	196

Negative interest income amounted to €4 million (6m2017: €4 million) and positive interest expenses to €10 million (6m2017: €8 million)

In June 2018, the ECB informed pbb that due to its fulfilment of the benchmark criteria, it would be granted an interest rate reduction for the allocated tranche of targeted long-term refinancing operations (TLTRO) retroactively over the entire term. The interest rate advantage (reimbursement) for the first half of 2018 amounted to €4 million (6m2017: €2 million).

6 Net Fee and Commission Income

Net fee and commission income

in € million	1.1. – 30.6.2018 (IFRS 9)	1.1. – 30.6.2017 (IAS 39)
Fee and commission income	4	6
from financial assets at amortised cost and financial liabilities not at fair value through profit or loss	4	6
Fee and commission expenses	-1	-1
from financial assets at amortised cost and financial liabilities not at fair value through profit or loss	-1	-1
Total	3	5

7 Net Income from Fair Value Measurement

Net income from fair value measurement

in €million	1.1. – 30.6.2018 (IFRS 9)	1.1. – 30.6.2017 (IAS 39)
Net trading income	7	–
from stand-alone derivatives	7	–
Interest derivatives	7	2
Foreign currency derivatives	–	–2
Net income from other financial assets at fair value through profit or loss	–3	–
from debt instruments	–3	–
Debt securities	–7	–
Loans and advances	4	–
Total	4	–

8 Net Income from Realisations

Net income from realisations

in €million	1.1. – 30.6.2018 (IFRS 9)	1.1. – 30.6.2017 (IAS 39)
Income from derecognition of financial instruments	15	23
from assets measured at amortised cost	13	21
from liabilities measured at amortised cost	2	2
Expenses from derecognition of financial instruments	–	–1
from liabilities measured at amortised cost	–	–1
Total	15	22

9 Net Income from Hedge Accounting

Net income from hedge accounting

in €million	1.1. – 30.6.2018 (IFRS 9)	1.1. – 30.6.2017 (IAS 39)
Net income from micro fair value hedge accounting	–2	1
from hedged items	30	42
from hedging instruments	–32	–41
Net income portfolio fair value hedge accounting	–	–
from hedged items	–9	–
from hedging instruments	9	–
Total	–2	1

10 Net Other Operating Income

Net other operating income

in € million	1.1. – 30.6.2018 (IFRS 9)	1.1. – 30.6.2017 (IAS 39)
Net income from foreign currency translation	–2	–1
Net income from provisions	–6	–15
Net income from provisions in lending business	1	–
Net income from provisions in non-lending business	–7	–15
Miscellaneous other operating income	–	20
Total	–8	4

11 Net Income from Risk Provisioning

Net income from risk provisioning

in € million	1.1. – 30.6.2018 (IFRS 9)
Net income from allowances for credit losses by stages	7
Stage 1	1
Stage 2	8
Stage 3	–2
Income from recoveries from written-off financial assets	–
Total	7

Net income from risk provisioning

in € million	1.1. – 30.6.2017 (IAS 39)
Allowances for losses on loans and advances	–
Individual allowances	–4
Portfolio-based allowances	4
Portfolio-based allowances on securities	–
Income from recoveries from written-off financial assets	–
Total	–

12 General and Administrative Expenses

General and administrative expenses

in € million	1.1. – 30.6.2018 (IFRS 9)	1.1. – 30.6.2017 (IAS 39)
Personnel expenses	-56	-56
Wages and salaries	-47	-46
Social security expenses	-6	-7
Pension expenses and related employee benefit expenses	-4	-5
Other personnel expenses/income	1	2
Non-personnel expenses	-32	-36
Office and operating expenses	-5	-5
Consulting expenses	-5	-7
IT expenses	-16	-14
Other non-personnel expenses	-6	-10
Total	-88	-92

13 Expenses from Bank Levies and Similar Dues

Expenses from bank levies and similar dues

in € million	1.1. – 30.6.2018 (IFRS 9)	1.1. – 30.6.2017 (IAS 39)
Bank levies	-20	-19
Deposit protection fund	-2	-5
Compensation scheme of German banks	-	-1
Total	-22	-25

14 Net Income from Write-downs and Write-ups of Non-financial Assets

Net income from write-downs and write-ups of non-financial assets

in € million	1.1. – 30.6.2018 (IFRS 9)	1.1. – 30.6.2017 (IAS 39)
Depreciation or amortisation	-7	-5
Tangible assets	-1	-1
Intangible assets	-6	-4
Impairments	-	-3
Total	-7	-8

15 Income Tax

Income tax

in € million	1.1. – 30.6.2018 (IFRS 9)	1.1. – 30.6.2017 (IAS 39)
Current taxes	-22	-22
Deferred taxes	-1	4
Total	-23	-18

16 Earnings per Share

Earnings per share

		1.1. – 30.6.2018	1.1. – 30.6.2017
Net profit/loss attributable to the shareholders of pbb	in € million	99	85
Thereof attributable to the ordinary shareholders	in € million	97	85
Thereof attributable to the AT1 investors	in € million	2	-
Attributable to the AT1 investors before deferred taxes	in € million	3	-
Deferred taxes	in € million	-1	-
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 €	0.72	0.63
Diluted earnings per share	in €	0.72	0.63

Earnings per share are calculated in accordance with IAS 33 by dividing net income/loss attributable to the ordinary shareholders holders by weighted average number of ordinary shares. Net income/loss is allocated under the assumption of after-tax interests for the AT1 capital, which are accrued pro rata temporis.

NOTES TO THE STATEMENT OF FINANCIAL POSITION

17 Financial Assets at Fair Value Through Profit or Loss

Financial assets at fair value through profit or loss

in € million	30.6.2018 (IFRS 9)	1.1.2018 (IFRS 9)	31.12.2017 (IAS 39)
Positive fair values of stand-alone derivatives	846	870	870
Interests in companies and funds qualified as debt instruments	3	3	–
Debt securities	327	333	–
Bonds and notes	327	333	–
Public-sector issuers	82	83	–
Other issuers	245	250	–
Loans and advances to customers	445	529	–
Public-sector loans and advances	370	401	–
Real estate loans and advances	63	128	–
Other loans and advances	12	–	–
Total	1,621	1,735	870

18 Financial Assets at Fair Value Through Other Comprehensive Income

Financial assets at fair value through other comprehensive income

in € million	30.6.2018 (IFRS 9)	1.1.2018 (IFRS 9)	31.12.2017 (IAS 39)
Debt securities	1,616	1,735	2,382
Bonds and notes	1,616	1,735	2,382
Public-sector issuers	727	782	1,970
Other issuers	889	953	412
Loans and advances to other banks	16	17	–
Public-sector loans and advances	16	17	–
Loans and advances to customers	420	430	–
Public-sector loans and advances	420	430	–
Interests in companies and funds qualified as debt instruments	–	–	3
Total	2,052	2,182	2,385

19 Financial Assets at Amortised Cost After Credit Loss Allowances

Financial assets at amortised cost before credit loss allowances

in € million	30.6.2018 (IFRS 9)	1.1.2018 (IFRS 9)	31.12.2017 (IAS 39)
Debt securities	8,263	8,667	8,253
Bonds and notes	8,263	8,667	8,253
Public-sector issuers	4,506	4,849	3,686
Other issuers	3,757	3,818	4,567
Loans and advances to other banks	2,405	2,400	2,415
Public-sector loans and advances	589	691	706
Investments in money	100	–	–
Other loans and advances to other banks	1,716	1,709	1,709
Loans and advances to customers	39,489	39,360	40,274
Public-sector loans and advances	13,619	14,343	15,112
Real estate loans and advances	25,651	24,793	24,934
Other loans and advances to customers	3	2	6
Claims from finance lease arrangements	216	222	222
Total	50,157	50,427	50,942

Development in risk provisioning

in € million	1.1.2018 (IFRS 9)	Net additions/ reversals	Use	30.6.2018 (IFRS 9)
Credit losses allowances on financial assets	–105	7	–	–98
at fair value through other comprehensive income	–1	–	–	–1
Debt securities	–1	–	–	–1
at amortised cost	–104	7	–	–97
Debt securities	–10	5	–	–5
Loans and advances to customers	–94	2	–	–92
Provisions in the lending business	–2	1	–	–1
Total	–107	8	–	–99

Credit loss allowances on financial assets at amortised cost

in € million	30.6.2018 (IFRS 9)	1.1.2018 (IFRS 9)
Stage 1	-14	-13
Debt securities	-1	-1
Loans and advances	-13	-12
Stage 2	-43	-52
Debt securities	-4	-9
Loans and advances	-39	-43
Stage 3	-40	-39
Loans and advances	-40	-39
Total	-97	-104

Credit loss allowances on financial assets in the measurement categories LaR and AfS

in € million	31.12.2017 (IAS 39)
Credit loss allowances on loans and advances	-71
Portfolio-based allowances	-47
Individual allowances	-24
Credit loss allowances on securities	-13
Portfolio-based allowances	-13
Total	-84

20 Positive Fair Values of Hedge Accounting Derivatives

Positive fair values of hedge accounting derivatives

in € million	30.6.2018 (IFRS 9)	1.1.2018 (IFRS 9)	31.12.2017 (IAS 39)
Positive market values of hedge accounting derivatives	2,326	2,678	2,678
Total	2,326	2,678	2,678

21 Financial Liabilities at Fair Value Through Profit or Loss

Financial liabilities at fair value through profit or loss

in € million	30.6.2018 (IFRS 9)	1.1.2018 (IFRS 9)	31.12.2017 (IAS 39)
Negative fair values of stand-alone derivatives	983	1,040	956
Total	983	1,040	956

22 Financial liabilities at Amortised Cost

Financial liabilities at amortised cost

in € million	30.6.2018 (IFRS 9)	1.1.2018 (IFRS 9)	31.12.2017 (IAS 39)
Liabilities to other banks	4,471	3,797	3,797
Liabilities to central banks	1,890	1,894	1,894
Registered Mortgage Pfandbriefe	284	290	290
Registered Public Pfandbriefe	255	203	203
Other registered securities	23	24	24
Other liabilities to other banks	2,019	1,386	1,386
Liabilities to customers	25,008	26,244	26,244
Registered Mortgage Pfandbriefe	4,525	4,790	4,790
Registered Public Pfandbriefe	10,550	10,847	10,847
Other registered securities	2,303	2,332	2,332
Other liabilities to customers	7,630	8,275	8,275
Bearer bonds	20,503	19,876	19,876
Money market instruments	35	–	–
Mortgage Pfandbriefe	11,552	9,963	9,963
Public Pfandbriefe	4,699	5,740	5,740
Other bearer bonds	4,217	4,173	4,173
Subordinated liabilities	699	1,002	1,002
Securitised subordinated liabilities	639	761	761
Non-securitised subordinated liabilities	60	241	241
Total	50,681	50,919	50,919

23 Negative Fair Values of Hedge Accounting Derivatives

Negative fair values of hedge accounting derivatives

in € million	30.6.2018 (IFRS 9)	1.1.2018 (IFRS 9)	31.12.2017 (IAS 39)
Negative market values of hedge derivatives	2,584	2,805	2,889
Total	2,584	2,805	2,889

24 Provisions

Provisions

in € million	30.6.2018 (IFRS 9)	1.1.2018 (IFRS 9)	31.12.2017 (IAS 39)
Provisions for pensions and similar obligations	83	86	86
Restructuring provisions	2	3	3
Provisions for commitments and guarantees given	1	2	–
Other provisions	166	156	156
Total	252	247	245

The provisions for legal and tax risks amounted to €99 million (31 December 2017: €100 million). The provisions for legal costs amounted to €35 million (31 December 2017: 33 Mio. €).

pbb closed a reinsurance in the form of a qualifying insurance policy according to IAS 19 to hedge parts of the risk from the defined benefit pension obligations. A discount rate of 2.00% (31 December 2017: 1.93%) was used for the measurement of the defined benefit pension obligations. The other actuarial assumption are unchanged compared to the consolidated financial statements 2017.

To date, pension obligations were calculated on the basis of mortality rates based on the guideline tables issued by Prof Dr Klaus Heubeck in 2005 ("Richttafeln 2005 G"). On 20 July 2018, Heubeck AG published new mortality tables, which have a material impact upon the calculation of pension obligations. At present, it is still unclear to what extent the mortality tables published by Heubeck AG on 20 July 2018 need to be generally applied. In connection with the publication of the mortality tables, Heubeck AG also stated the general expectation for pension obligations to increase in a range between 1.5% and 2.5%. pbb's pension obligations as at 30 June 2018 – excluding the impact of adjusted mortality tables – amounted to €274 million.

In the event that the new mortality tables are generally recognised, a determination will be necessary as to whether these accurately reflect mortality rates for the purposes of calculating pbb's pension obligations. In principle, any impact of updated mortality rates on the amount of pension obligations would lead to actuarial gains or losses recognised directly in equity.

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. Due to the nature and international scope of its business activities and the large number of relevant requirements and regulations, pbb Group is involved in litigation, arbitration and official proceedings in some countries. These cases also include criminal proceedings as well as the assertion of claims in an amount not specified by the party asserting the claim. Provisions for contingent liabilities arising from these proceedings are made if the possibility of an outflow of resources is deemed sufficiently probable and a reliable estimate can be made of the obligation amount. The probability of an outflow of resources, which cannot be estimated with certainty at any given time, depends to a large extent on the outcome of the proceedings. The assessment of the probability and the quantification of the contingent liability depends largely on estimates. The actual liability can vary considerably from this estimate. Accounting for the individual legal procedures, pbb analyses developments of the individual cases and comparable cases. Depending on the importance and complexity of each specific case, we rely on our employees' expertise or on the opinions of external consultants, especially legal experts. The provisions set up for the proceedings are not reported separately as pbb Group believes that the outcome of the proceedings would be seriously compromised by such disclosures.

The profit participation certificates issued by predecessor institutions participated in significant losses due to the net losses for the period incurred in the years 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 court 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 parameters 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.

25 Maturities of Specific Financial Assets and Liabilities

Maturities of specific financial assets and liabilities

in € million	30.6.2018 (IFRS 9)					Total
	repayable on demand/not specified	up to 3 months	more than 3 months up to 1 year	more than 1 year up to 5 years	more than 5 years	
Cash reserve	1,551	–	–	–	–	1,551
Financial assets at fair value through profit or loss (excluding derivatives)	15	12	206	70	472	775
Debt securities	–	11	194	–	122	327
Loans and advances to customers	12	1	12	70	350	445
Shares in investment funds qualified as debt instruments	3	–	–	–	–	3
Financial assets at fair value through other comprehensive income	–	35	80	1,167	770	2,052
Debt securities	–	22	50	874	670	1,616
Loans and advances to other banks	–	–	–	16	–	16
Loans and advances to customers	–	13	30	277	100	420
Financial assets at amortised cost before credit loss allowances	1,738	1,642	4,651	20,170	21,956	50,157
Debt securities	–	147	626	2,407	5,083	8,263
Loans and advances to other banks	1,716	133	13	–	543	2,405
Loans and advances to customers	22	1,362	4,012	17,763	16,330	39,489
Total financial assets	3,304	1,689	4,937	21,407	23,198	54,535
Financial liabilities at cost	2,192	2,470	4,759	22,211	19,049	50,681
Liabilities to other banks	916	645	57	2,195	658	4,471
Thereof: Registered bonds	–	30	40	142	350	562
Liabilities to customers	1,261	1,177	1,890	6,355	14,325	25,008
Thereof: Registered bonds	–	638	359	3,026	13,355	17,378
Bearer bonds	15	641	2,807	13,595	3,445	20,503
Subordinated liabilities	–	7	5	66	621	699
Total financial liabilities	2,192	2,470	4,759	22,211	19,049	50,681

Maturities of specific financial assets and liabilities

in € million	31.12.2017 (IAS 39)					Total
	repayable on demand/not specified	up to 3 months	more than 3 months up to 1 year	more than 1 year up to 5 years	more than 5 years	
Cash reserve	999	–	–	–	–	999
Financial assets at fair value through profit or loss (excluding derivatives)	–	–	–	–	–	–
Financial assets at fair value through other comprehensive income	3	44	51	423	1,864	2,385
Debt securities	–	44	51	423	1,864	2,382
Interests in investment funds qualified as debt instruments	3	–	–	–	–	3
Financial assets at amortised cost before credit loss allowances	2,887	1,636	3,055	19,650	23,701	50,929
Debt securities ¹⁾	–	144	489	2,264	5,343	8,240
Loans and advances to other banks	1,709	45	104	15	542	2,415
Loans and advances to customers	1,178	1,447	2,462	17,371	17,816	40,274
Total financial assets	3,889	1,680	3,106	20,073	25,565	54,313
Financial liabilities at cost	2,386	3,145	3,443	22,506	19,439	50,919
Liabilities to other banks	991	42	81	2,056	627	3,797
Thereof: Registered bonds	–	23	76	107	311	517
Liabilities to customers	1,395	1,076	2,312	6,920	14,541	26,244
Thereof: Registered bonds	–	374	956	3,169	13,470	17,969
Bearer bonds	–	1,901	868	13,459	3,648	19,876
Subordinated liabilities	–	126	182	71	623	1,002
Total financial liabilities	2,386	3,145	3,443	22,506	19,439	50,919

¹⁾ Less portfolio-based allowances according to IAS 39.

26 Equity

Equity amounted to €3.2 billion (1 January 2018: €3.0 billion) at 30 June 2018. The discount rate used for measuring defined benefit pension commitments increased from 1.93% at previous year's end to 2.00% at 30 June 2018 in line with the market interest rates; as a consequence, other comprehensive income was less burdened by €2 million. Compared to 1 January 2018, other comprehensive income declined by €27 million due to the cash flow hedge reserve, which furtherly decreased as scheduled, and due to lower reserves from financial assets at fair value through other comprehensive income.

In June 2018, pbb distributed dividends of €144 million (or €1.07 per share) to shareholders. The remaining consolidated profit of €38 million was appropriated to retained earnings.

The additional equity instruments include Additional Tier 1 (AT1) capital in the total nominal amount of €300 million less transaction costs of €2 million. AT1 capital qualifies as equity because there is no obligation to repay, or to make debt servicing payments on an ongoing basis. The bond issued by pbb on 12 April 2018 carries an initial coupon of 5.75% p.a. and has no final maturity. There are certain conditions attached to the coupon payments. This issue enables pbb Group to increase additional regulatory Tier 1 capital and thereby strengthen its leverage ratio. The issue increased both the Tier 1 ratio and the Own Funds Ratio by around two percentage points each; the leverage ratio improved to slightly above 5%. Given the structure of the issue as an AT1 instrument, the Common Equity Tier 1 (CET1) ratio remained unchanged.

NOTES TO THE FINANCIAL INSTRUMENTS

27 Fair Values of Financial Instruments

Fair values and fair value hierarchy of financial instruments

in € million

	30.6.2018 (IFRS 9)				
	Carrying amount	Fair value	Fair value		
Level 1			Level 2	Level 3	
Assets in the scope of IFRS 13	57,611	59,245	9,099	20,069	30,077
Measured at fair value in the statement of financial position	5,999	5,999	1,326	4,294	379
Financial assets at fair value through profit or loss	1,621	1,621	3	1,443	175
Positive fair values of stand-alone derivatives	846	846	–	846	–
Debt securities	327	327	–	327	–
Loans and advances	445	445	–	270	175
Shares in investment funds qualified as debt instruments	3	3	3	–	–
Financial assets at fair value through other comprehensive income	2,052	2,052	1,323	525	204
Debt securities	1,616	1,616	1,323	91	202
Loans and advances	436	436	–	434	2
Positive fair values of hedge accounting derivatives	2,326	2,326	–	2,326	–
Not measured at fair value in the statement of financial position	51,612	53,246	7,773	15,775	29,698
Cash reserve	1,551	1,551	1,551	–	–
Financial assets at amortised cost ¹⁾	50,060	51,695	6,222	15,775	29,698
Debt securities	8,258	8,279	4,567	2,393	1,319
Loans and advances	41,802	43,416	1,655	13,382	28,379
Thereof: Claims from finance lease arrangements	216	228	–	228	–
Valuation adjustment from portfolio hedge accounting (assets)	1	–	–	–	–
Liabilities in the scope of IFRS 13	54,260	55,320	18,499	3,557	33,264
Measured at fair value in the statement of financial position	3,567	3,567	–	3,556	11
Financial liabilities at fair value through profit or loss	983	983	–	972	11
Negative fair values of stand-alone derivatives	983	983	–	972	11
Negative fair values of hedge accounting derivatives	2,584	2,584	–	2,584	–
Not measured at fair value in the statement of financial position	50,693	51,753	18,499	1	33,253
Financial liabilities measured at amortised cost	50,681	51,753	18,499	1	33,253
Liabilities to other banks	4,471	4,466	915	–	3,551
Liabilities to customers	25,008	25,862	219	1	25,642
Bearer bonds	20,503	20,715	16,858	–	3,857
Subordinated liabilities	699	710	507	–	203
Valuation adjustment from portfolio hedge accounting (liabilities)	12	–	–	–	–

¹⁾ Less credit loss allowances.

Fair values and fair value hierarchy of financial instruments

in € million	Carrying amount	Fair value	Fair value		
			Level 1	Level 2	Level 3
31.12.2017 (IAS 39)					
Assets in the scope of IFRS 13	57,789	59,852	9,011	21,361	29,480
Measured at fair value in the statement of financial position	5,933	5,933	2,385	3,548	–
Financial assets at fair value through profit or loss	870	870	–	870	–
Positive fair values of stand-alone derivatives	870	870	–	870	–
Financial assets at fair value through other comprehensive income	2,385	2,385	2,385	–	–
Debt securities ¹⁾	2,385	2,385	2,385	–	–
Positive fair values of hedge accounting derivatives	2,678	2,678	–	2,678	–
Not measured at fair value in the statement of financial position	51,856	53,919	6,626	17,813	29,480
Cash reserve	999	999	999	–	–
Financial assets at amortised cost ²⁾	50,858	52,920	5,627	17,813	29,480
Debt securities	8,240	8,423	3,918	2,902	1,603
Loans and advances	42,618	44,497	1,709	14,911	27,877
Thereof: Claims from finance lease arrangements	222	231	–	231	–
Valuation adjustment from portfolio hedge accounting (assets)	–1	–	–	–	–
Liabilities in the scope of IFRS 13	54,794	56,199	17,883	4,039	34,277
Measured at fair value in the statement of financial position	3,845	3,845	–	3,828	17
Financial liabilities at fair value through profit or loss	956	956	–	956	–
Negative fair values of stand-alone derivatives	956	956	–	956	–
Negative fair values of hedge accounting derivatives	2,889	2,889	–	2,872	17
Not measured at fair value in the statement of financial position	50,949	52,354	17,883	211	34,260
Financial liabilities measured at amortised cost	50,949	52,354	17,883	211	34,260
Liabilities to other banks	3,797	3,796	990	–	2,806
Liabilities to customers	26,244	27,333	240	–	27,093
Bearer bonds	19,876	20,144	16,280	–	3,864
Subordinated liabilities	1,002	1,051	373	211	467
Other financial liabilities	30	30	–	–	30
Valuation adjustment from portfolio hedge accounting (liabilities)	–	–	–	–	–

¹⁾ Including share in investment funds amounting to €3 million.

²⁾ Less credit loss allowances.

As was the case in 2017, in the first half of 2018 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 reclassified from Level 2 to Level 3 and vice versa in the current reporting period and in 2017. In the first half of 2018 financial assets in the amount of €59 million (2017: €40 million) and no financial liabilities (2017: €5 million) were reclassified from Level 3 to Level 2 since inputs were observable on the market again.

Level 2 instruments disclosed at fair value at 30.6.2018

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 modell	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	
Price quotations	Price quotations at inactive markets

Level 3 instruments disclosed at fair value at 30.6.2018

Measurement methods	Unobservable parameter	Range
DCF methods	Historical index/index correlations	+/- 25% for correlations
	Historical index/exchange rate correlations	+/- 25% for correlations
	PD/LGD model spread	+/- 2 rating classes for PD; +/- 0.1 for LGD
Proxy modell	Proxy modell	+/- triple standard deviation

The sensitivity analysis is based on alternative assumptions to unobservable parameters for level 3 financial instruments, which are measured at fair value. These amounts have been calculated independently of each other.

However, for an asset with a EUR/GBP quanto structure, there were correlations between the unobservable input parameters used (EUR-GBP interest or interest/EUR-GBP FX correlations). This is also the case for the associated derivative that hedges the asset from a financial perspective. The fair value of the asset (+/- €33 million) and the associated derivative (+/- €34 million) are offset by each other.

Alongside this, FVOCI securities are valued using a proxy approach. In the alternative scenario, there was a slight change (+/- less than €1 million). Financial assets within the FVOCI category are also valued using a proxy approach. Changes in input parameters resulted in a difference of +/- €2 million.

Non-observable spreads in a PD (probability of default)/LGD (loss given default) model are used for the valuation of drawings intended for syndication. The change in spreads results in a change in fair value of +€2million and -€3million, respectively.

Changes in level 3 instruments measured through profit or loss

in € million	Financial assets at fair value through profit or loss	Financial assets at fair value through other comprehensive income	Financial liabilities at fair value through profit or loss
Balance at 1.1.2017	40	-	21
Income statement	-	-	1
Reclassifications out of Level 3	-40	-	-5
Balance at 31.12.2017	-	-	17
IFRS 9 first-time adoption effect	304	225	-
Balance at 1.1.2018	304	225	17
Income statement	-6	-21	-6
Additions (new business)	33	-	-
Disposals	-97	-	-
Reclassifications out of Level 3	-59	-	-
Balance at 30.6.2018	175	204	11

On-balance sheet netting of derivatives which are settled through Eurex Clearing led to a reduction in total assets of €1.7 billion as at 30 June 2018 (31 December 2017: €1.6 billion).

OTHER NOTES

28 Contingent Liabilities and Other Commitments

Contingent liabilities and other commitments

in € million	30.6.2018	31.12.2017
Contingent liabilities	133	120
Guarantees and warranties	133	120
Other commitments	4,125	4,667
Irrevocable loan commitments	4,125	4,667
Commitments from bank levies	18	15
Collateral pledged	18	15
Total	4,276	4,802

As at balance sheet date the fair value of contingent liabilities amounted to €133 million (31 December 2017: €120 million) and the fair value of irrevocable loan commitments to €4,135 million (31 December 2017: €4,680 million).

29 Relationship with Related Parties

Hypo Real Estate Holding GmbH's (HRE Holding's) share in pbb stood at 3.5% as at 30 June 2018 (31 December 2017: 20.0% plus one share), after selling 16.5% of pbb's share capital in May 2018. As a result, pbb Group no longer considers HRE Holding and all companies under the control, joint management or significant influence of the Federal Republic of Germany to be related parties within the meaning of IAS 24.

No material transactions with related parties were entered into during the first half of 2018.

30 Report on Post-balance Sheet Date Events

On 4 July 2018, DBRS placed the long-term senior unsecured ratings of six German banks, including pbb, under review for downgrade amid the legislative changes in connection with section 46 et seq. of the German Banking Act (Kreditwesengesetz – "KWG"). DBRS terminated the review for downgrade on 27 July 2018 and lowered pbb's long-term "non-preferred" senior unsecured debt rating to "BBB (low)", whilst affirming the rating of "preferred" senior instruments at "BBB", equivalent to the new "senior debt rating" at DBRS. The rating outlook for both ratings is positive.

Apart from the above, there were no significant events after 30 June 2018.

Munich, 31 July 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 for interim financial reporting, the consolidated interim financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group in accordance with German accepted accounting principles, and the Group interim 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 for the remaining months of the fiscal year.

Munich, 31 July 2018

Deutsche Pfandbriefbank AG
The Management Board

Andreas Arndt

Thomas Köntgen

Andreas Schenk

Review Report

To Deutsche Pfandbriefbank AG, Munich

We have reviewed the condensed interim consolidated financial statements of the Deutsche Pfandbriefbank AG, Munich – comprising statement of financial position, income statement, statement of comprehensive income, statement of changes in equity, statement of cash flows (condensed) and notes (condensed) – together with the interim group management report of the Deutsche Pfandbriefbank AG, Munich, for the period from 1 January to 30 June, 2018 that are part of the semi annual according to § 115 WpHG [“Wertpapierhandelsgesetz”: “German Securities Trading Act”]. The preparation of the condensed interim consolidated financial statements in accordance with International Accounting Standard IAS 34 “Interim Financial Reporting” as adopted by the EU, and of the interim group management report in accordance with the requirements of the WpHG applicable to interim group management reports, is the responsibility of the Company’s management. Our responsibility is to issue a report on the condensed interim consolidated financial statements and on the interim group management report based on our review.

We performed our review of the condensed interim consolidated financial statements and the interim group management report in accordance with the German generally accepted standards for the review of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the review so that we can preclude through critical evaluation, with a certain level of assurance, that the condensed interim consolidated financial statements have not been prepared, in material respects, in accordance with IAS 34, “Interim Financial Reporting” as adopted by the EU, and that the interim group management report has not been prepared, in material respects, in accordance with the requirements of the WpHG applicable to interim group management reports. A review is limited primarily to inquiries of company employees and analytical assessments and therefore does not provide the assurance attainable in a financial statement audit. Since, in accordance with our engagement, we have not performed a financial statement audit, we cannot issue an auditor’s report.

Based on our review, no matters have come to our attention that cause us to presume that the condensed interim consolidated financial statements have not been prepared, in material respects, in accordance with IAS 34, “Interim Financial Reporting” as adopted by the EU, or that the interim group management report has not been prepared, in material respects, in accordance with the requirements of the WpHG applicable to interim group management reports.

Munich, 1 August 2018

KPMG AG
Wirtschaftsprüfungsgesellschaft
[original German version signed by:]

Dielehner
[German Public Auditor]

Winner
[German Public Auditor]

Additional Information

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 of pbb. Future-oriented statements therefore only apply on the day on which they are made. pbb Group does 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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CONCEPT, DESIGN AND REALISATION

HGB Hamburger Geschäftsberichte GmbH & Co. KG, Hamburg, Germany

The German version of this Interim Report is the authoritative version and only the German version of the Group Interim Management Report and the Consolidated Interim Financial Statements were reviewed by the auditors.

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