Annual Report 2016

Deutsche Pfandbriefbank Group

PUBLIC SECTOR FINANCE
REAL ESTATE FINANCE

pbb

DEUTSCHE PFANDBRIEFBANK

Overview

Deutsche Pfandbriefbank Group (pbb Group)

		2016	2015
Operating performance according to IFRS			
Profit or loss before tax	in € million	301	195
Net income/loss	in € million	197	230
Key ratios			
Earnings per share	in €	1.46	1.71
Dividend per share	in €	1.05[1]	0.43
Cost-income ratio	in %	39.0	51.8
Return on equity before tax	in %	11.1	6.2
Return on equity after tax	in %	7.3	7.4
New business volume[2]	in € billion	10.5	12.0
Balance sheet figures according to IFRS		**31.12.2016**	**31.12.2015**
Total assets	in € billion	62.6	66.8
Financing volumes Real Estate Finance and Public Investment Finance	in € billion	31.5	31.3
Equity	in € billion	2.8	2.7
Key regulatory capital ratios		**31.12.2016[3]**	**31.12.2015[4]**
CET1 ratio	in %	19.5	18.9
CET1 ratio fully phased-in	in %	19.0	18.2
Own funds ratio	in %	23.7	23.4
Own funds ratio fully phased-in	in %	20.7	19.9
Leverage ratio[5]	in %	4.6	4.4
Leverage ratio fully phased-in[5]	in %	4.2	3.9
Staff		**31.12.2016**	**31.12.2015**
Employees (on full-time equivalent basis)		756	785

[1] Proposal to the Annual General Meeting on 30 May 2017.
[2] Including prolongations with maturities of more than one year.
[3] After confirmation of the 2016 financial statements, less the proposed dividend (subject to approval by the Annual General Meeting).
[4] After confirmation of the 2015 financial statements and appropriation of profits.
[5] Leverage ratio is defined as the ratio of Tier 1 capital and the relevant exposure in accordance with CRR.

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

	31.12.2016			31.12.2015		
	Standard & Poor's	DBRS	Moody's	Standard & Poor's	DBRS	Moody's
Long-term issuer rating/outlook	BBB/Credit Watch Positive	BBB/Stable	–	BBB/Stable	BBB/Stable	–
Short-term issuer rating/outlook	A–2/–	R–2 (high)/ Stable	–	A–2/–	R–2 (high)/ Stable	–
Long-term senior unsecured debt rating/ outlook	BBB/ CreditWatch Developing	BBB/Stable	–	BBB/Stable	BBB/Stable	–
Public sector Pfandbriefe	–	–	Aa1	–	–	Aa1
Mortgage Pfandbriefe	–	–	Aa1	–	–	Aa1

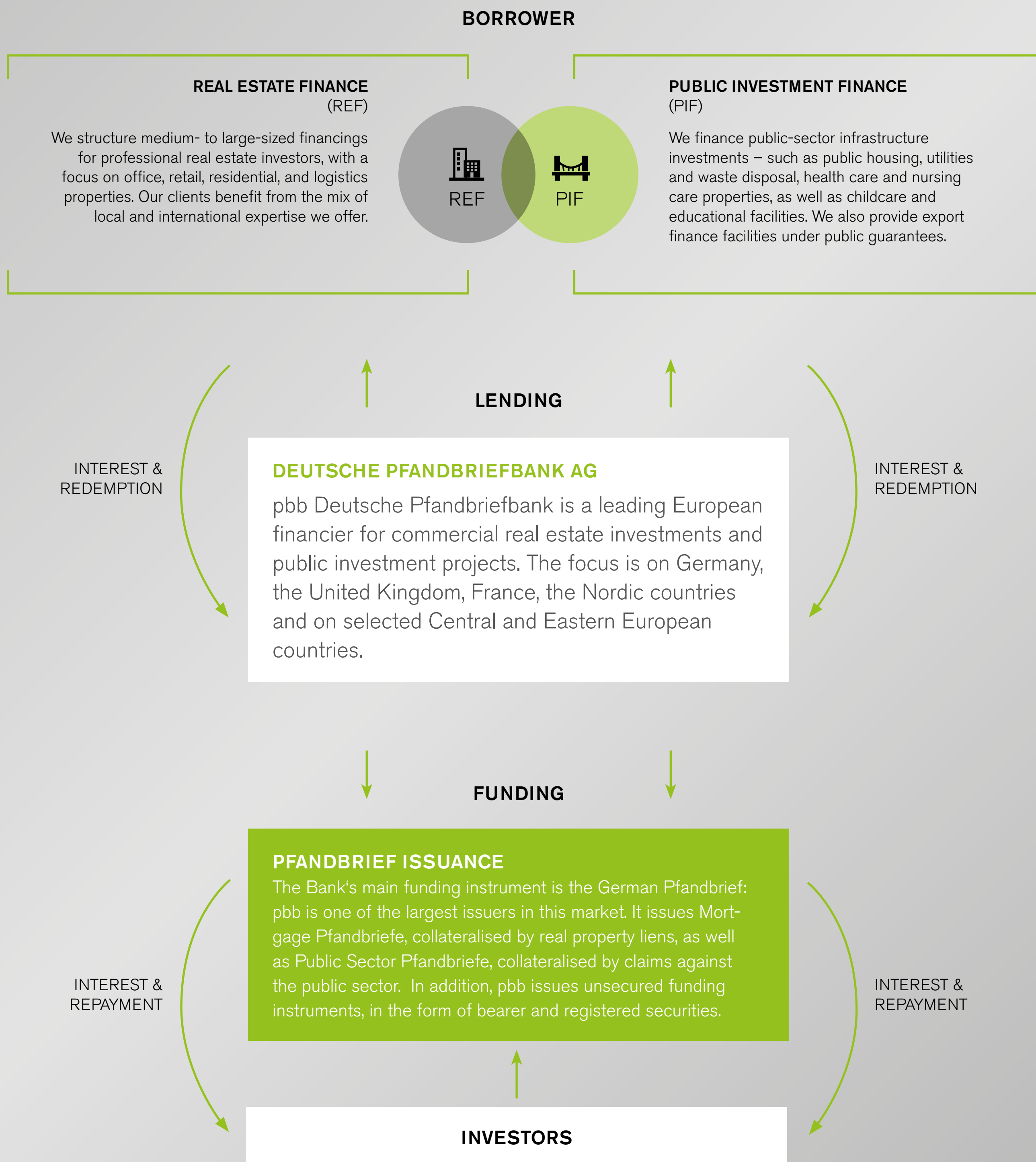
[1] Ratings from mandated rating agencies; the overview does not include all ratings.

Cover
„Quartier am Strandkai" Hamburg, for more information, please turn to page XIV-XV.

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

Explanation of alternative performance measures
For further information regarding the definition, usefulness and calculation of alternative permormance measures see „Investor Relations/ Financial Reports" at www.pfandbriefbank.com.

Business model
pbb Group



Facts and figures 2016

€ 30.4 bn

Securities outstanding

Outstanding Pfandbrief volume amounted to €30.4 bn (nominal) – comprising €16.2 bn in Public Sector Pfandbriefe and €14.2 bn in Mortgage Pfandbriefe.

48%

Share of German exposures in the REF portfolio

International profile, strongly anchored in the home market.

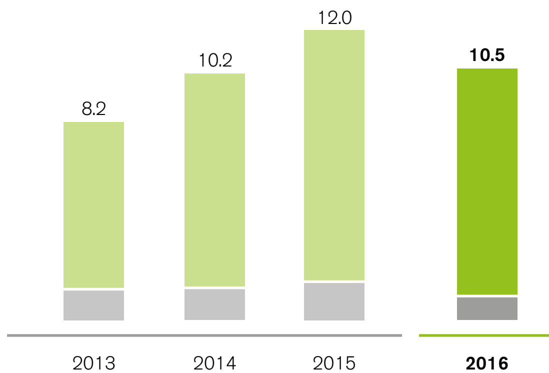
19%

CET1 ratio

Thanks to a CET1 ratio of 19% (fully phased-in), pbb Group has a cushion for the potential impact of regulatory changes.

New business

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



217

transactions in 2016 (REF & PIF)

€10.5 bn

New business 2016

Sales offices and markets

- 9 offices in Europe
- Experts with local knowledge
- Long-standing business relationships with national and international professional real estate clients
- Focus on the markets of Germany, France, the United Kingdom the Nordic countries, as well as on selected countries in Central and Eastern Europe
- Since 2016, pbb has also been active in the US real estate market (focus on the East Coast metropolitan areas)

Precision work.

Each project made to measure – that's the principle we at pbb Deutsche Pfandbriefbank follow. Whenever we work with a client, we look very carefully and take exact measure – for an all-round coherent result. Clients value our exceptional mix of specialist knowledge and an eye for the big picture.

It is our mission to be experts for the design and implementation of tailor-made financing solutions. Our projects have one thing in common: they are all based on a solid foundation, and structured in accordance with high quality standards. We are proud of our consistent reliability: it is an essential part of our success.

Letter from the Management Board

DEAR SHAREHOLDERS, DEAR BUSINESS PARTNERS, LADIES AND GENTLEMEN,

Leveraging its solid core business and supported by non-recurring income through the reversal of write-downs, in 2016, Deutsche Pfandbriefbank Group achieved the best result in its corporate history since the restart in 2009. This success is also based on the very good work, strong commitment and high level of expertise of all our colleagues within pbb Group. We would like to express our very sincere thanks to them.

Once again, the year 2016 was defined by intense competition in our strategic business segments. The Commercial Real Estate Finance business is currently shaped by excess supply from lenders – a trend further exacerbated by new market entrants. This supply is met by relatively stable financing demand from real estate investors, although the supply of attractive real estate investments properties is becoming scarce in many markets. In Public Investment Finance, the unchanged low level of investment being carried out by the public sector – combined with a prevailing high level of credit supply – limited business opportunities meeting our risk and return requirements.

Nonetheless, our strong market penetration and renowned expertise helped us originate a high volume of new business: €10.5 billion. The fourth quarter was particularly strong in this respect; we originated €3.7 billion in new business, a record quarterly result since our restart in 2009. Our business activities in the US market, which we commenced during the second half of 2016 contributed to the strong new deal flow in Commercial Real Estate Finance. Having concluded initial transactions in the largest and most important real estate market in the world, we plan to further expand our activities through a local presence in the US.

Looking at margin developments, the slight increase in average gross new business margins in Commercial Real Estate Finance – in some cases, bucking the market trend – gives us cause for optimism: we consider this not least as confirmation of our expertise in structuring complex transactions, thus providing added value for our clients. We also increased average gross new business margins in Public Investment Finance, albeit primarily due to the composition of new business. In both business segments, we were able to increase margins whilst maintaining our risk standards.

Consolidated profit in accordance with IFRS totalled €301 million. Profit after taxes amounted to €197 million, or €1.46 per share. On this basis, the Management Board and the Supervisory Board will propose to pay shareholders a significantly higher dividend of €1.05 per share. This proposal includes a special dividend in addition to the regular distribution as part of our communicated dividend strategy: this means that we will distribute the entire non-recurring income from the reversal of write-downs related to Heta Asset Resolution AG. This equates to a dividend yield of 11.5%, based on the pbb share price at year-end 2016.

The environment in the banking industry has been defined by regulatory changes and highly competitive markets, and this will not change for the foreseeable future. At present, changing relates especially to the measurement of risks on bank's balance sheets, and the required equity changing regulation relates backing for these risks. Whilst an increase in risk-weighted assets seems to be certain, the extent and timing is uncertain. We do believe however that pbb is well-capitalised, with a sound capital buffer over and above current requirements. We expect the bank's capitalisation to turn out as a distinct competitive advantage. As soon as we have gained clarity about future regulatory requirements, we will review the capital and dividend strategy and adjust it to new requirements if necessary.

We will tackle the tougher competitive environment by implementing a bundle of measures aimed at increasing the diversification of pbb's range of products and services, and at further enhancing its profitability. In our view, this is without alternative in the prevailing low interest rate environment – an environment that has led to significantly lower income generated from investing own funds and the liquidity the bank is required to hold. What remains unchanged is that we will enter into business which we consider to be appropriate – and we will refrain from those transactions that fail to meet our requirements. We also want to invest into the digitalisation of our business.

Of course, competition also means that you, as our clients and business partners, may choose with whom you want to do business. We sincerely appreciate the trust you have placed in pbb in the past. For us, you doing business with us is not a foregone conclusion. We always strive to be your partner of choice.

Yours sincerely

Dr Bernhard Scholz
Member of the Management Board
Public Investment Finance

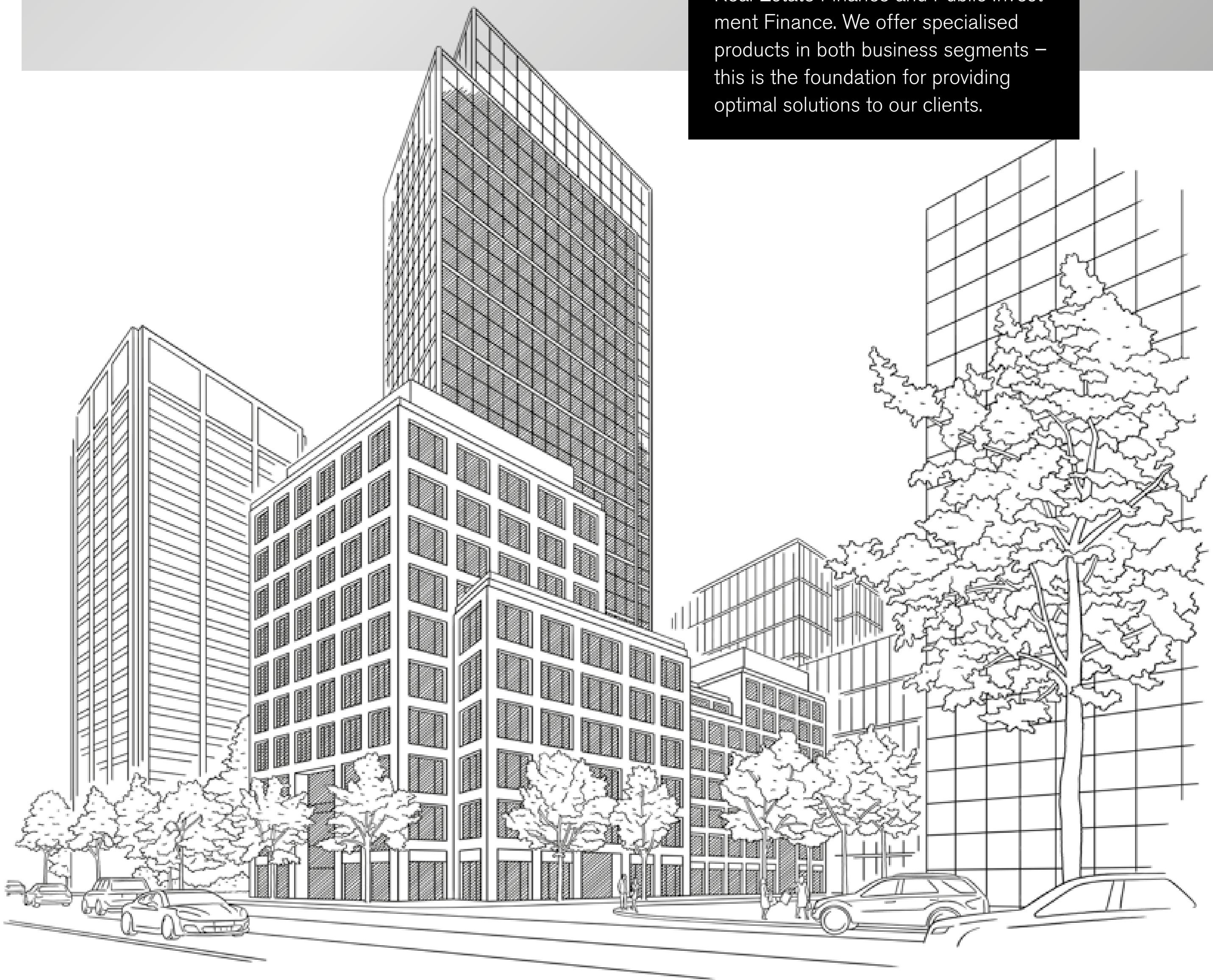
Andreas Arndt
Chairman of the
Management Board
and Chief Financial Officer

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

Andreas Schenk
Chief Risk Officer

ONLY SOLUTIONS THAT SUIT OUR CLIENTS

Our core businesses are Commercial Real Estate Finance and Public Investment Finance. We offer specialised products in both business segments – this is the foundation for providing optimal solutions to our clients.



Working in the heart of the central business district:
together with Deutsche Hypo, pbb is jointly financing the "Marieninsel" development project in Frankfurt/Main. With a project volume of approx. €267 million, the construction of two exclusive multi-storey buildings for mixed use is under way, and will be finished in 2019.

OUR CLIENTS APPROACH US WITH DEMANDING PROJECTS, WHICH WE ALWAYS ADDRESS IN-DEPTH AND ON AN INDIVIDUAL BASIS.

OUR PRODUCTS AND SERVICES – ALWAYS TAILOR-MADE

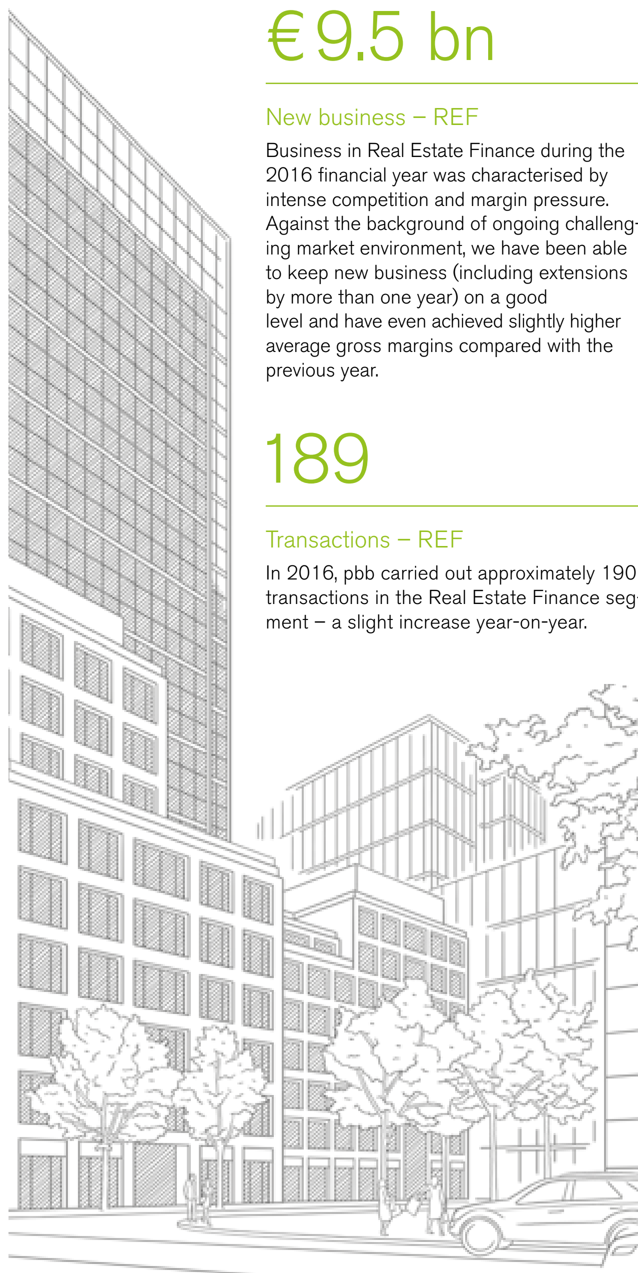
> We are a leading European specialist bank for Commercial Real Estate Finance and Public Investment Finance
> pbb stands for a strong client-focused approach
> Combining experience and passion, we find suitable solutions for our clients' specific requirements

Two pillars of stability
In our core business area Real Estate Finance (REF), we structure medium to large financing transactions for professional real estate investors. The focus is on property types such as offices, retail, residential and logistics. Our clients benefit from our local and cross-border financing expertise.

In Public Investment Finance (PIF), our second core business segment, we finance public sector investment in infrastructure projects – including public housing, utilities and waste disposal, health care and nursing care properties, as well as childcare and educational facilities. We also provide export finance facilities under public guarantees.

Knowing what concerns our clients
We have a thorough understanding of the complex issues our clients face. pbb's in-depth industry knowledge – and its ability to meet especially difficult challenges – is one of the bank's top traits. Another characteristic of our business: every deal is structured individually, and addressed in-depth.

Convincing with quality
We analyse current market developments as well as our customers' changing needs, so that our solutions always fit in the best way possible. We want to convince our customers with qualities such as flexibility, a strong market presence, and specialised and transparent advisory activities. In our opinion, these essential success factors support both, originating new business and managing the portfolio in a risk-minimising way.



€ 9.5 bn

New business – REF

Business in Real Estate Finance during the 2016 financial year was characterised by intense competition and margin pressure. Against the background of ongoing challenging market environment, we have been able to keep new business (including extensions by more than one year) on a good level and have even achieved slightly higher average gross margins compared with the previous year.

189

Transactions – REF

In 2016, pbb carried out approximately 190 transactions in the Real Estate Finance segment – a slight increase year-on-year.

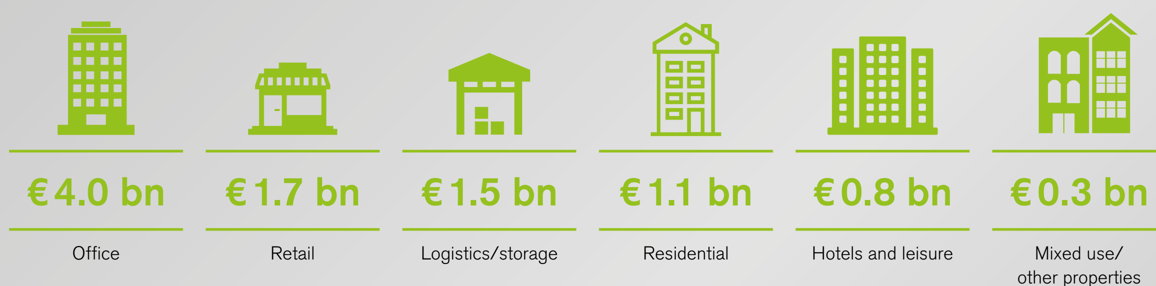
Typical for pbb

pbb has established itself as an internationally renowned financing partner – with the ability to structure cross-border and cross-jurisdiction portfolio transactions. Our business is less of a sprint and more of a marathon. This is confirmed by long-term relationships with our highly professional clients. They rely upon our in-depth market knowledge, and our assessments and recommendations.

New business development 2016 within our core asset classes

NEW BUSINESS BY PROPERTY TYPE

Loan commitments, including extensions > 1 year



REAL ESTATE FINANCE

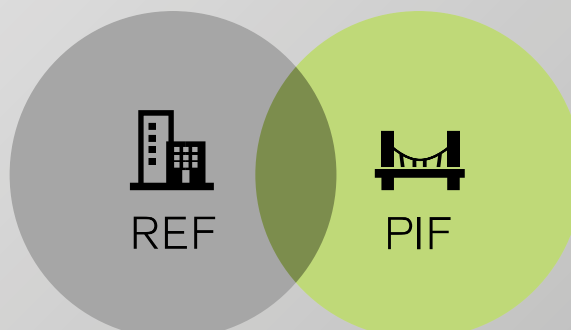
In this segment, the following products are available for our clients:

- Investment loans
- Development loans
- Cross-border portfolio financing
- Bridge financing for investments
- Acquisition/credit lines
- Derivatives (used as investment hedges)

PUBLIC INVESTMENT FINANCE

In this business area, the following products are available for our clients:

- Public Investment Finance with a project property background
- Export Finance (if backed by Export Credit Agencies)
- Finance leasing
- Derivatives (used as investment hedges)



On-site meeting

"MARIENINSEL" PROJECT IN FRANKFURT/MAIN

> Frankfurt's skyline will soon have another eye-catcher: pbb Deutsche Pfandbriefbank is an important financing partner for the "Marieninsel" development project, an ambitious construction project with two multi-storey buildings.

Financial centre Frankfurt – pbb is helping to shape its development

First-class view, high-quality design

Frankfurt/Main, in the centre of the financial district. The so-called "Marieninsel" is located at the junction of Taunusanlage and Mainzer Landstrasse. Still a large construction site today, but as soon as in 2019 passers-by will have to put their heads back to see the top of this multi-storey building complex. Comprising two buildings, "Marienturm" tower and "Marienforum", they will be 155 and 40 metres high, respectively.

The construction is based on an innovative concept for the design of trend-setting working environments. The highest efficiency class, plugs for electric cars, its own bicycle garage – "Marieninsel" is going to set new standards, regarding energy efficiency as well as design. "This is currently one of the most interesting development projects in Frankfurt", says Charles Balch, Head of Real Estate Financing, International Clients at pbb.

The bank as Lead Manager, provided half of the financing of €267 million, and additionally took over various important roles in the lending approval and advisory process.

"In the current market environment, hardly any providers are granting a loan of this size on their own. A syndicated financing is a more likely scenario", Balch explains. pbb gained an experienced bank partner in Deutsche Hypothekenbank – with whom pbb has already successfully provided large-sized transactions in the past. As Facility Agent and Security Agent, pbb also manages the loan on behalf of the syndicate and acts as Security Trustee.

Large-sized financing in close cooperation with partners

However, as Charles Balch emphasises, the project volume wasn't the only challenge to be confronted: "Structuring development loans is a lot more complicated than structuring investment loans. That's why an in-depth market analysis is indispensable before starting projects such as "Marieninsel"." In development finance, lenders also have to deal with more complex risk management issues: the risk of completion and cost risk, the rental and marketing risk, and last but not least compliance with the timeline and the construction progress – all these factors need to be simultaneously monitored on an ongoing basis. "Changes can also occur during the construction phase, at all times; in such cases, fast and flexible solutions are indispensable", Balch adds. "It is crucial that all partners involved work hand in hand, in order to ensure the entire project's success."

Profile

PROJECT: Financing for the construction of a top-quality building complex, comprised of two high-rise buildings, to be mainly used as office premises

LOCATION: "Marieninsel", in the heart of Frankfurt's financial district

TASKS: Structuring and monitoring the financing as Lead Manager, Facility Agent and Security Agent

CHALLENGES:
> Development loan with a project volume of €267 million
> Elaborate pre-market analysis by in-house surveyors, so as to be able to asses marketing and rental risks in the best way possible
> Plausibility check of the estimated construction costs as well as of the timeline
> Search for an appropriate bank partner

SOLUTION:
> Organising a syndicate with Deutsche Hypothekenbank
> Providing a loan to two project companies of Perella Weinberg II LP carrying out the construction activity
> Selection of highly professional experts and teams for each task within the project and risk management, as well as for the construction monitoring, for optimal processes during the implementation of the project

OUR SOLID PERFORMANCE CONSTITUTES THE FOUNDATION

As a bank which offers custom work, it is our top priority to know our job. Market- and industry-specific knowledge, diligence and strict risk management: it is not only our clients' projects that benefit from the way we work; our far-sightedness also pays off for our own performance.

Living and working directly on the river Elbe:
pbb is financing a very special building ensemble in a top location within the very popular Hamburg HafenCity. Designed by Richard Meier, the "Quartier am Strandkai" is currently under construction and scheduled to be completed by the end of 2017.

QUALITY HAS PRIORITY OVER QUANTITY. INSTEAD OF ONLY PURSUING VOLUME TARGETS, WE PREFER OUR TRANSACTIONS TO BE ECONOMICALLY SOUND.

FORWARD-THINKING AND RESPONSIBLE FINANCING

- We have many years of experience in the real estate and public investment finance business
- Our core funding instrument is the German Pfandbrief
- Risk awareness and cost discipline are essential parts of all pbb's business activities

Successful financing – but not at any price

Every financing request pbb receives from its customers undergoes an extensive first review. A positive decision is only made if the transaction makes sense economically, and is compatible with the bank's risk policy. We will remain true to this strict lending approach.

Sounds conservative?

For us, "conservative" has a positive connotation. pbb's most distinguished traits are a solid operating performance, high portfolio quality and sound capitalisation – based on our risk strategy on the one hand, and a stable, diversified funding base on the other. Our core financing instrument is the German Pfandbrief. We have become a major market player in this field (see diagram on the right).

One of our key principles is to fund loans using largely matching maturities. This way, we want to ensure that outstanding loans are matched with funding of at least the same maturity.

Quality as a stance

Our corporate culture is based on shared values. In our work, we focus on efficiency and cost discipline; the same applies to our processes and structures, making quality our top priority and embedding responsible thinking and acting in our daily work routine. The result is beneficial to our customers and the bank itself.

97%

Investment grade

pbb's excellent portfolio quality is underscored by the high share of loans with strong ratings (based on its internal ratings). In 2016, our already low proportion of problem loans decreased to €388 million, which equals 0.6% of the total portfolio.

€ –1 million

Loan loss provisions

a low figure which speaks for pbb's high risk standards. We benefit from our risk-conservative approach and from a positive real estate market environment.

Typical for pbb

Large-sized and complex transactions are no problem for us, not least due to top-notch networks with different kinds of financing partners. Our consistency is what makes us different as we say "no" when the transaction's risk profile and cash flow structures don't comply with our strict requirements. Security, more precisely a stable Pfandbrief, is also a top priority within our funding business. Today, we are the largest active issuer within the Pfandbrief market.

The German Pfandbrief – our most important funding instrument

As a specialist bank for real estate finance and public investment finance, pbb is an issuer of both Mortgage Pfandbriefe and Public Sector Pfandbriefe. With an outstanding total volume of €32 billion, we are the largest issuer.

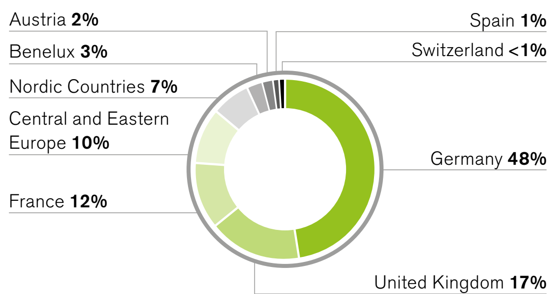
Next to the market for public-sector bonds, the Pfandbrief market is the second-largest market for fixed income bonds in Germany. The Pfandbrief's good reputation results from the particularly high level of security it offers and its untarnished credit history.

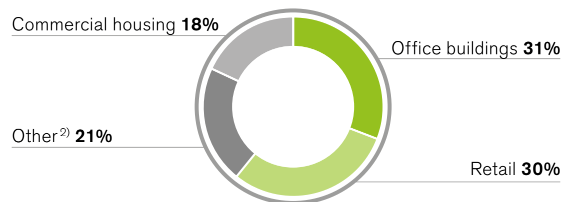
MORTGAGE PFANDBRIEF

pbb Deutsche Pfandbriefbank uses Mortgage Pfandbriefe for the funding of cover pool eligible real estate business. Currently, the outstanding volume amounts to €14.2 billion (31 December 2016).

Our Mortgage Pfandbrief cover pool can be broken down as follows:

By country and property type (as at 31 December 2016) [1]





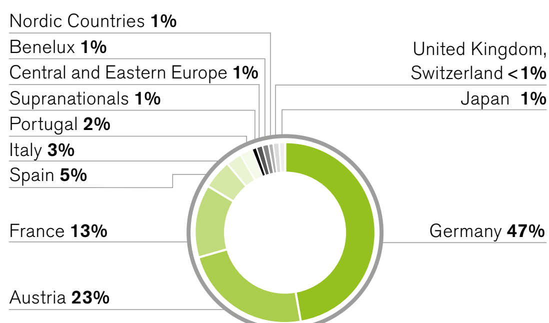
[1] Excluding substitute cover and derivatives. [2] Including industrial and other commercial properties.

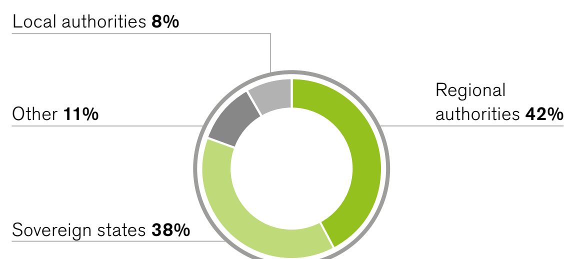
PUBLIC SECTOR PFANDBRIEF

Public Sector Pfandbriefe are used for the funding of Public Investment Finance business. Currently, the outstanding volume amounts to €16.2 billion (31 December 2016).

Our Public Sector Pfandbrief cover pool can be broken down as follows:

By country and counterparty type (as at 31 December 2016)



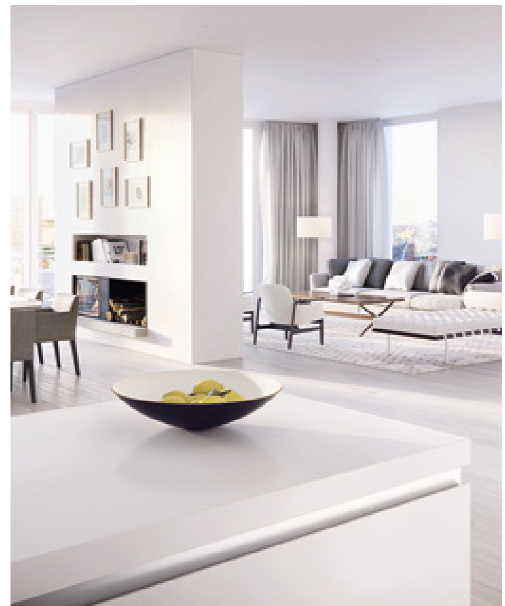


On-site meeting

“QUARTIER AM STRANDKAI” IN HAMBURG’S HAFENCITY

> An exclusive location, renowned sponsors, an intelligent usage concept, designed by New York-based star architects – the attractiveness of the financing project “Quartier am Strandkai” is based on a number of factors.

Representative entrance hall in the new building complex “Strandkai”



Stylish ambiance with the river Elbe at your doorstep

Hamburg HafenCity is probably the town’s most dynamic neighbourhood at the moment. Thus, a month is a long time, with new buildings and even entire streets being constructed with breathtaking pace. Standing on the viewing platform of Hamburg’s recently inaugurated Elbe Philharmonic Hall, Gerhard Meitinger, Head of Real Estate Finance Germany at pbb, is taking in the construction progress of the “Quartier am Strandkai”, which has been growing floor by floor at an astounding pace, especially in the past few weeks.

The construction of this high-end building complex – consisting of three buildings with different uses – started at the beginning of 2015: many of the apartments in the 15-storey residential tower will offer a view onto Hamburg’s dazzling concert hall and a dock, which is currently being developed into a marina with private moorings. The so-called “Engel & Völkers-Haus” will mainly be used as the real estate agents’ new headquarters, and the third building is to be used primarily for price-controlled rental apartments.

As financier, pbb is providing €102 million for the construction of the building complex. The total volume comprises three separate financing tranches, for three borrower entities. The opportunity/risk analysis for this project is extraordinarily positive, Gerhard Meitinger stresses: "The pro-side of this list is very long. For one thing, the site – directly on the banks of the river Elbe – is one of Hamburg's most-coveted locations. In addition, an exciting living and working concept – backed by a strong joint venture of renowned sponsors – rounds it off."

A property in demand, in Hamburg's intense real estate market

Designed by the world-renowned New York architects Richard Meier & Partners, the building complex is also promising to be an optical highlight. Meitinger points out another special feature. "Beneath the "Quartier am Strandkai" lies Hamburg HafenCity's first four-storey underground garage. Considering the direct proximity to the Elbe, this is quite a challenge, construction-wise."

Since its planning phase, this appealing "comprehensive package" has attracted numerous buyers and investors. According to Meitinger, "it is possible that all available space will in fact be sold before the building is completed in 2017".

Profile

PROJECT: Financing of the construction project "Quartier am Strandkai", a mixed-use residential and business building complex

LOCATION: HafenCity Hamburg – near the town centre, with a view of the port and the Elbe Philharmonic Hall

TASKS: Structuring and monitoring the project financing with a total volume of €102 million

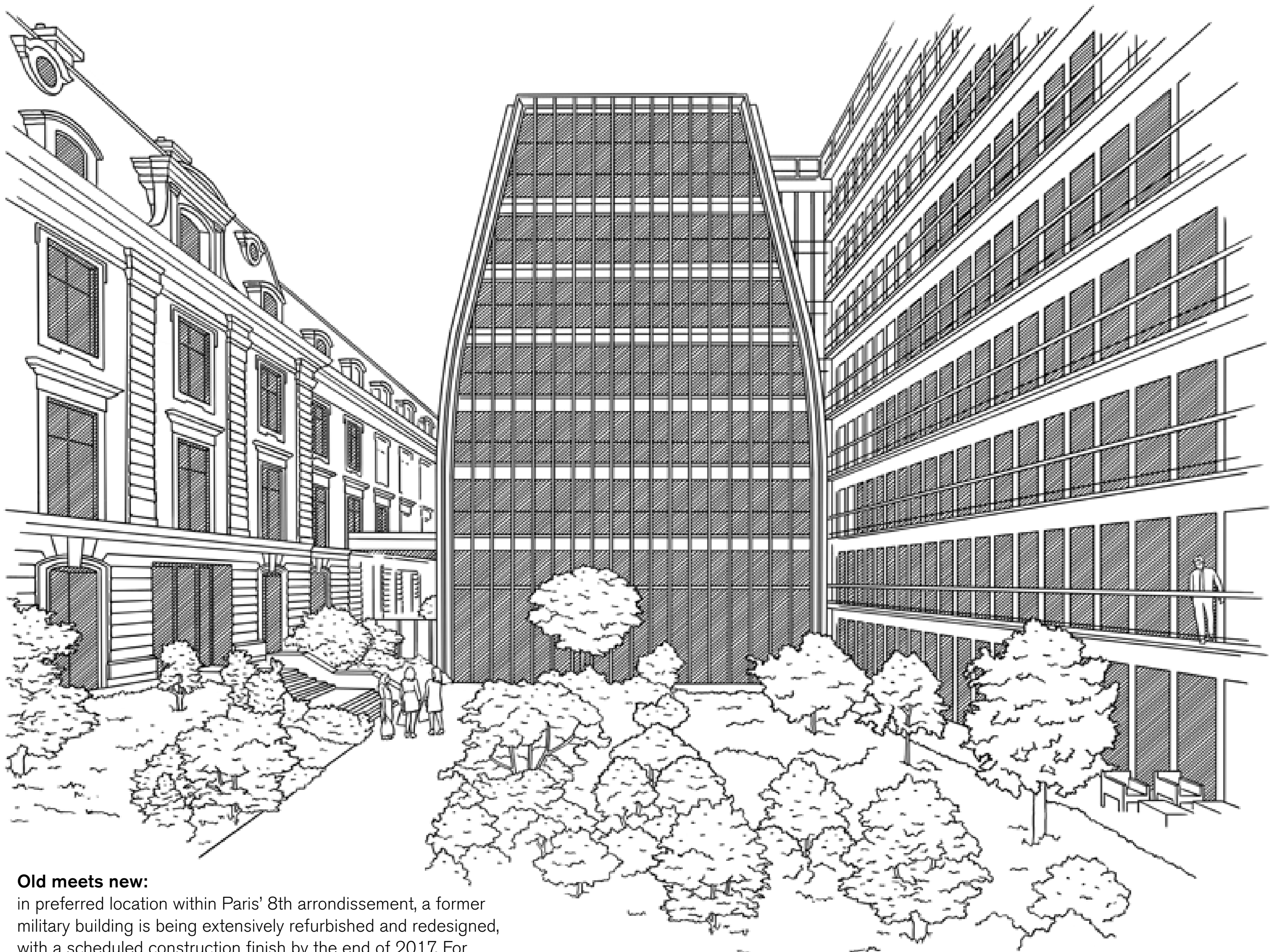
CHALLENGES:

> Property with three different uses – office and owner-occupied housing, as well as price-controlled rental – and three borrowing entities (with joint liability towards the bank)

> Complex financing, with the involvement of a joint venture of two project developers/investors, a pension fund and pbb Deutsche Pfandbriefbank as project financier

ACHIEVING MORE WITH IN-DEPTH MARKET KNOWLEDGE

Every market has its own local characteristics. Being familiar with them, using them to one's own advantage and in the best way possible for business activities, is a key factor for success. We at pbb achieve this with an effective network of excellently staffed offices in Germany and in strategically important locations all over Europe, as well as with flexible teams of experts.



Old meets new:
in preferred location within Paris' 8th arrondissement, a former military building is being extensively refurbished and redesigned, with a scheduled construction finish by the end of 2017. For this project – an exciting mix of historical and modern architecture – pbb is providing more than half of the total financing volume.

AS A EUROPEAN SPECIALIST BANK WITH STRONG ROOTS, WE HAVE EXPANDED OUR CROSS-BORDER BUSINESS STEP BY STEP.

EUROPEAN PRESENCE – REGIONAL EXPERTISE

- We are an acknowledged business partner with extensive industry expertise in the national and international real estate sector
- We link our expertise cross-market and cross-border
- Our "expert teams" bundle the bank's expertise on various specialist topics of real estate finance

Local presence in German and Europe's metropolises
For pbb, customer proximity has two levels: we can support our clients with the topics they are concerned with on a professional level, while – due to our strong regional presence – we are also physically at their side on a personal level. Next to branch offices in the German central economic centres of Berlin, Düsseldorf, Frankfurt am Main/Eschborn, Hamburg and Munich/Unterschleissheim, pbb can also offer offices in further European capital cities – London, Paris, Madrid and Stockholm. Outside Europe, we plan to expand our business activities, namely in the US, where we began our coverage in the second half of 2016.

International real estate management – pbb's speciality
We have created an excellent cross-border network in order to fulfil our mission at all times, which is: advising and supporting our clients with their projects the best way possible, by means of our extensive industry-specific knowledge. Our clients can count on the expertise of over 200 real estate professionals, e.g. customer advisers and loan specialists, as well as lawyers and surveyors.

Expert knowledge bundled in teams
Several years ago, six teams of experts were established with the aim of further concentrating pbb's internal knowledge and expanding it in a more targeted way. These teams deal with specific topics within real estate financing, such as logistics, retail or hotels. The individual members of the cross-divisional and international teams constantly exchange information and develop new, innovative approaches in their respective fields.

138

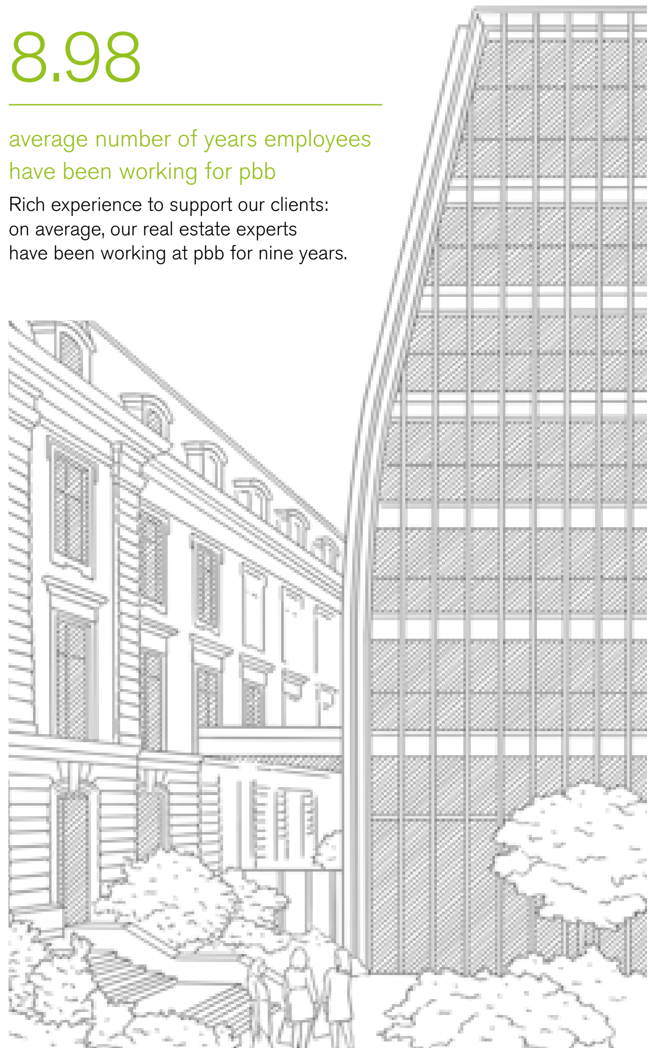
Real estate specialists

Across various locations and countries, 138 employees are active in real estate origination. Whenever required, we complement our excellent internal know-how with external partners.

8.98

average number of years employees have been working for pbb

Rich experience to support our clients: on average, our real estate experts have been working at pbb for nine years.



Typical for pbb

A good sense for our core markets, and openness to new areas of business activity – that's what makes pbb special. Our branch office network in Germany and Europe also reflects this. Highly qualified and experienced teams at all the bank's locations are the foremost guarantee for the excellent and valued expertise which converts clients into long-standing business partners.

“Clear allocation of competences.”

INTERVIEW WITH JÖRG QUENTIN, HEAD OF PROPERTY ANALYSIS & VALUATION, WHO ALSO RUNS THE ENTIRE TEAMS OF EXPERTS PROJECT AT pbb

Jörg, what are the roles of pbb’s various expert teams?
“We are pursuing several goals: first of all, we want to bundle specialist knowledge across divisional borders and business areas. By merging such information within pbb for financing purposes, we can derive recommended actions for the financing of different property types, e.g. hotel, logistic, retail etc. In addition, this way we create a panel, which is capable of offering an expert opinion after only a short time.”

How do internal processes benefit from this?
“The information processed in such way is available to all employees dealing with real estate finance for their individual area of activity. Bundled by topics, there is always a direct contact person at hand, ensuring a more efficient workflow due to the explicit allocation of competences. At the end of the day, this additional flow of internal information and communication benefits our clients as well.”

What exactly are the topics the expert teams are dealing with?
“That always depends heavily on the type of property. For instance, logistics experts mostly deal with the different types of logistics, which form the base for the use of the property. Retail experts are especially interested in the different types of properties and their potential for the future. Trade flows are subject to permanent and rapid changes. Real estate has to adapt to these.”

What about overlaps and interdisciplinary work – do they exist?
“One major overlap is the internet. Retail and its effects on retail properties are just as much an issue as logistics – the backbone of internet trading. New hybrid forms are coming into existence in the real estate sector, e.g. Click & Collect – consisting of only a small retail space, but requiring large storage space in the cities – or pure showrooms, where products are displayed, but not take them away. Cross-divisional cooperation between the teams of experts is of utmost importance here.”

€148.5 million

Loan for construction project in Paris’ central business district

In Rue de Laborde, a top-notch location in the French capital, a former military barrack is being redeveloped into a charming office building. With a total project volume of €238 million – of which pbb is providing €148.5 million via a loan to sponsor Eurosic – the building is being completely refurbished both architecturally and with regard to energy usage and efficiency; new building elements are also being added. The property is supposed to be fully let before construction is completed. This demonstrates the importance of our French office. pbb offers strong local presence, a sound network and lots of experience in this core market.

CONTENTS

Page 02
To our Shareholders

02 REPORT OF THE SUPERVISORY BOARD

09 THE pbb SHARE

Page 13
Group Management Report

14 FUNDAMENTAL INFORMATION ABOUT THE GROUP

24 REPORT ON ECONOMIC POSITION

42 REPORT ON POST-BALANCE SHEET DATE EVENTS

43 RISK AND OPPORTUNITY REPORT

86 pbb GROUP AS AN EMPLOYER

88 REMUNERATION REPORT

98 REPORT ON EXPECTED DEVELOPMENTS

108 SUPPLEMENTAL INFORMATION

Page 119
Consolidated Financial Statements

120 CONSOLIDATED INCOME STATEMENT

121 CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

122 CONSOLIDATED STATEMENT OF FINANCIAL POSITION

123 CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

124 CONSOLIDATED STATEMENT OF CASH FLOWS

125 NOTES

203 RESPONSIBILITY STATEMENT

204 AUDITORS' REPORT

Page 205
Additional Information

206 SUMMARY OF QUARTERLY AND ANNUAL FINANCIAL DATA

208 CORPORATE GOVERNANCE REPORT AND CORPORATE GOVERNANCE STATEMENT

217 FINANCIAL CALENDAR

217 FUTURE-ORIENTED STATEMENTS

217 IMPRINT

TO OUR SHARE-HOLDERS

Report of the Supervisory Board

In this section, the Supervisory Board of Deutsche Pfandbriefbank AG ("pbb") reports on the focal points of its supervisory and advisory activities during the 2016 financial year.

As in the previous year, the 2016 financial year was shaped by intense competition and the low interest rate environment – accompanied by constantly evolving challenges on the regulatory front, as well as in accounting and financial reporting. By way of example, this involved issues such as Basel IV and new risk weights (affecting risk-weighted assets or RWAs), the SREP stress test, and IFRS 9. Even in this environment, the Deutsche Pfandbriefbank Group ("pbb Group") was able to maintain its stable business development and, in particular, to further strengthen its leading market position in real estate finance. In this context, the Group also explored new markets and business areas, as shown by its re-entry into US real estate financing, for example. As always, monitoring ongoing business development was a key focus in the supervisory and advisory activities of the Supervisory Board. In addition, the Supervisory Board paid particular attention to regulatory issues affecting the bank.

The Supervisory Board also concerned itself with the future composition and distribution of responsibilities of the Management Board; in May, the Supervisory Board re-appointed Andreas Arndt and Thomas Köntgen as Management Board members, for a five-year term of office. Dr Bernhard Scholz, however, will retire from the Management Board, on his own request, upon expiry of his contractual term of office at the end of April 2017, and will seek new tasks outside pbb Group. The Supervisory Board would like to thank Dr Scholz for his strong commitment, and for his great achievements on behalf of pbb. In connection with these changes, the assignment of responsibilities within the Management Board was adjusted; the Supervisory Board appointed Andreas Arndt as sole Chairman of the Management Board, and Thomas Köntgen as Deputy Chairman. Furthermore, during 2016 the Supervisory Board initiated the appointment of a new Management Board member responsible for Treasury: Marcus Schulte joined pbb on 1 January 2017, initially as a Senior General Manager. Following the customary introduction phase in line with regulatory requirements, he is set to assume responsibility for the Treasury division at Management Board level.

An additional key issue was the conduct of the first public Annual General Meeting (AGM) following successful privatisation, on 13 May 2016. At the AGM shareholders re-appointed all shareholder representatives, and elected Oliver Puhl – who had been proposed by management – as a member of the Supervisory Board for the first time. Prior to the AGM, staff had already re-elected employee representatives to the Supervisory Board in April.

CORPORATE GOVERNANCE

The Supervisory Board continuously monitored the Management Board during the financial year 2016, as in the past, and provided it with regular advice on the management of the Company.

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

In particular, the Supervisory Board held in-depth discussions on, and reviewed the plausibility of, all business transactions material to the Company on the basis of written and oral reports provided by the Management Board. On 24 March 2017, the Supervisory Board concerned itself with the Declaration of Compliance with the German Corporate Governance Code for the financial year 2017, which is published in this annual report as well as on pbb's website (http://www.pfandbriefbank.com/en/investor-relations/mandatory-publications.html). Please also refer to the Group's remuneration report, which is printed in this annual report. With respect to the requirements of the German Corporate Governance Code, in conjunction with section 111 (5) of the AktG, concerning the target and actual quotas of female members of the Supervisory Board, please refer to the table outlining the composition of the Supervisory Board and its committees, and to the comments in the Corporate Governance Report and in the Corporate Governance Statement.

SUPERVISORY BOARD MEETINGS

The Supervisory Board of pbb held eight meetings in 2016, including one constituting and two extraordinary meetings. Its members were:

Dr Günther Bräunig (Chairman), Dagmar Kollmann (Deputy Chairperson), Dr Thomas Duhnkrack, Dr Christian Gebauer-Rochholz, Georg Kordick, Joachim Plesser, Oliver Puhl (since 13 May 2016), Heike Theißing, Dr Hedda von Wedel.

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

Alongside the regular topics already mentioned, the ordinary meeting on 26 February 2016 primarily discussed pbb's updated business strategy, and adopted the risk strategy as well as the Recovery Plan. The meeting also adopted the Declaration of Compliance with the German Corporate Governance Code for the 2016 financial year, and discussed the remuneration reports. The Supervisory Board was informed about implementation of the new remuneration system, and on progress made with material (IT) projects to improve the links between risk and finance functions, as well as about implementation of regulatory requirements. Moreover, the Supervisory Board resolved on the proposal regarding the appointment of the auditor for the annual accounts, to be submitted to the Annual General Meeting, and concerned itself with the report on the examination of efficiency, thus concluding the evaluation process for the Supervisory Board and the Management Board for 2015.

In the accounts review meeting held on 17 March 2016, the consolidated financial statements for 2015 were approved and the annual financial statements adopted. Moreover, the meeting prepared the Annual General Meeting 2016, adopted the business strategy and personnel planning, and decided upon pbb's resumption of real estate finance business in the US. Discussions on the future composition of the Management Board, and the assignment of responsibilities amongst its members, formed another focal point of this meeting.

The extraordinary meeting on 11 May 2016 focused on the renewal of Management Board contracts for Andreas Arndt and Thomas Köntgen. In addition, the Supervisory Board initiated the search for a new Management Board member responsible for the Treasury division.

The meeting on the following day (12 May 2016) was dominated by pbb Group's first-quarter report for 2016. The Supervisory Board also discussed pension scheme arrangements based on a defined-contribution scheme for future first-time appointees to the Management Board, as well as developments concerning regulatory requirements (including the German Financial Markets Amendment Act, the EU Market Abuse Directive/Market Abuse Regulation, as well as future risk weightings).

Following the (re-)election of shareholder representatives to the Supervisory Board by the Annual General Meeting on 13 May 2016, during its constituting meeting on the same day, the Supervisory Board re-elected Dr Günther Bräunig as its Chairman, and Dagmar Kollmann as his deputy. Moreover, the Supervisory Board resolved the composition of its committees.

During its meeting on 12 August 2016, the Supervisory Board discussed pbb Group's interim report as at 30 June 2016 and the review of the six-month financial statements by the external auditors. Furthermore, the Supervisory Board resolved to amend the Rules of Procedure of the Audit Committee, against the background of EU reforms to statutory external auditing. It also dealt with current regulatory developments as well as the potential impact of the UK's Brexit referendum. The Supervisory Board also adopted the determination of interim targets for the members of the Management Board (which had become necessary due to the change in the assignment of responsibilities), the selection of providers for a defined-contribution pension scheme arrangement for new Management Board members and the update of the risk strategy 2016. Moreover, during a strategy meeting on the day before the ordinary meeting, the Supervisory Board discussed developments in the market environment as well as strategic initiatives, e.g. concerning digitalisation.

During an extraordinary meeting on 22 September 2016, the Supervisory Board resolved to appoint Marcus Schulte as a future Management Board member responsible for the Treasury division, and approved his appointment as a Senior General Manager until his appointment to the Management Board.

On 11 November 2016, the Supervisory Board discussed pbb Group's third-quarter 2016 results and resolved on the Group's multi-year planning and the business strategy for the period from 2017 to 2019. The Supervisory Board also determined the approach for the examination of efficiency of the Management Board and Supervisory Board pursuant to section 25d (11) of the KWG. Furthermore, the Supervisory Board determined parameters for risk-adjusted performance measurement at the institution level, as well as Management Board targets for 2017. The Supervisory Board also approved the identification of risk takers, a report on the development of the newly-launched US business, the annual discussion of corporate governance issues, the examination of appropriateness of remuneration systems for 2017, as well as a report on staff development measures and gender balance.

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

The co-CEOs (from 12 May 2016, the CEO) maintained continuous contact with the Chairman of the Supervisory Board (or the Chairmen of the respective committees) with regard to important developments.

SUPERVISORY BOARD COMMITTEES

During the period from 1 January to 31 December 2016, pbb's Supervisory Board maintained an Executive and Nomination Committee, an Audit Committee, a Risk Management and Liquidity Strategy Committee, as well as a Remuneration Committee. During this period, the committees comprised the following members:

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

The committee concerned itself with strategic and current issues, as well as with matters concerning the Management Board, for which it prepared corresponding proposals for the plenary meeting. Specifically, this concerned the renewal of Management Board contracts, as mentioned above, the potential appointment of Marcus Schulte as Management Board member with responsibility for the Treasury division, as well as the amendment of the allocation of responsibilities amongst the members of the Management Board. Moreover, the committee discussed the candidates to be proposed to the Annual General Meeting for election as shareholder representatives, including one candidate for the vacant Supervisory Board seat at the time. The committee also prepared the examination of efficiency for the Management Board as well as the Supervisory Board (including its committees); it informed the Supervisory Board concerning corporate governance issues and concerned itself with the Corporate Governance Statement in accordance with section 289a of the HGB (including the Corporate Governance Report).

The **Audit Committee** held five meetings; it consisted of Dagmar Kollmann (Chairman), Dr Günther Bräunig, Dr Thomas Duhnkrack (since 13 May 2016), Joachim Plesser (until 13 May 2016) and Dr Hedda von Wedel.

During its meetings, the committee reviewed and discussed the annual financial statements and consolidated financial statements for 2015, the interim reports, and the reports by Internal Audit and external auditors KPMG on internal and external audit findings. In addition, the Audit Committee discussed the effects of current regulatory issues with the Management Board, and was informed of the development of ongoing audits. The Audit Committee also concerned itself with the mandate for the external auditors and their audit plan for the 2016 financial year. Furthermore, the Audit Committee satisfied itself of the independence of the external auditors, and recommended to the Supervisory Board to propose to the Annual General Meeting to elect KPMG as external auditors for the 2016 financial year. The Management Board of pbb, as well as the KPMG representatives, informed the committee about various individual topics, such as legislative requirements regarding the appointment of external auditors, IFRS 9, Basel IV, and the SREP stress test. Furthermore, regular reports were received on the Internal Control System and the monitoring of key controls implemented, current litigation, Compliance issues, data protection and IT security, notable accounting issues, the results of external audits, as well as the audit plan established by Internal Audit and its implementation.

The **Risk Management and Liquidity Strategy Committee** convened for four ordinary meetings. It also discussed credit exposures requiring Supervisory Board approval, usually during monthly conference calls. The committee consisted of Joachim Plesser (Chairman), Dr Günther Bräunig, Dagmar Kollmann (until 13 May 2016), Oliver Puhl (since 13 May 2016) and Dr Hedda von Wedel.

The committee supported the Supervisory Board's supervision of risk management and liquidity management; it reviewed the Management Board's risk reporting, and was involved in the credit approval process to the extent laid down in the Rules of Procedure. The committee also regularly discussed new business developments as well as the liquidity and funding status and syndication business. During 2016, the committee also concerned itself with reports on sub-portfolios (including development financings); it dealt with foreclosures, specific allowances, the reporting of own funds in accordance with the German Solvency Regulation, country limits, and asset/liability management. The committee also concerned itself with expected medium-term developments on real estate markets, and with updates to the risk strategy.

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

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

It dealt with the implementation of the new remuneration system and the impact of new regulatory requirements, the remuneration reports for 2015, the appointment of the Remuneration Officer, target agreements with the members of the Management Board, the determination of interim targets (which had become necessary due to the change in the assignment of responsibilities), pension commitments (based on a defined contribution system) for new Management Board members, and the examination of appropriateness of the 2017 remuneration system. Furthermore, the committee prepared the approval of the determination of risk-taker functions, and the determination of parameters for the risk-adjusted performance measurement at the institution level, for the Supervisory Board.

Supervisory Board of pbb

as of 31 December 2016			Committee function and meeting attendence			
Name and place of residence	Principal activity	**Supervisory Board function and meeting attendence**	Executive and Nomination Committee	Audit Committee	Risk Management and Liquidity Strategy Committee	Remunaration Committee
Dr Günther Bräunig Frankfurt/Main, Germany	Member of the Management Board of KfW	Chairman 8 of 8	Chairman 6 of 6	Member 5 of 5	Member 4 of 4	Chairman 4 of 4
Dagmar Kollmann Vienna, Austria	Entrepreneur	Deputy Chairperson 8 of 8	Member 6 of 6	Chairperson 5 of 5	Member until 13.5.2016 2 of 2	Member 4 of 4
Dr Thomas Duhnkrack Kronberg/Taunus, Germany	Entrepreneur	Member 8 of 8		Member from 13.5.2016 2 of 2		
Dr Christian Gebauer-Rochholz Hochheim, Germany	Bank employee	Employee representative 8 of 8				
Georg Kordick Poing, Germany	Bank employee	Employee representative 8 von 8				
Joachim Plesser Ratingen, Germany	Consultant	Member 8 of 8	Member 6 of 6	Member until 13.5.2016 3 of 3	Chairman 4 of 4	Member 4 of 4
Oliver Puhl Frankfurt/Main, Germany	Entrepreneur	Member from 13.5.2016 3 of 4			Member from 13.5.2016 1 of 2	
Heike Theißing Munich, Germany	Bank employee	Employee representative 8 of 8				Member 4 of 4
Dr Hedda von Wedel Andernach, Germany	Deputy Chairperson of Transparency International Deutschland e.V. (until 11.6.2016)	Member 8 of 8		Member 5 of 5	Member 4 of 4	

TRAINING AND CONTINOUS PROFESSIONAL DEVELOPMENT

Members of the Supervisory Board took responsibility for any training or professional development measure that are necessary to fulfil their duties.

ANNUAL FINANCIAL STATEMENTS

KPMG, the auditors of the annual and consolidated financial statements elected by the Annual General Meeting, audited the annual and consolidated financial statements of pbb as at 31 December 2016, including the management reports, and issued them with an unqualified audit opinion. KPMG has submitted a declaration of its independence to the Supervisory Board. The financial statements documents and audit reports were submitted to all Supervisory Board members in good time. The Audit Committee addressed the financial statements documents in its meeting on 23 March 2017. The annual financial statements and consolidated financial statements, as well as the management reports and audit reports, were discussed in detail with the Management Board and representatives of the external auditors. Following its own review, the Supervisory Board did not raise any objections to the audit results submitted by the external auditors. In the accounts review meeting held on 24 March 2017, the Supervisory Board approved the consolidated financial statements prepared by the Management Board, and the annual financial statements were adopted. During the same meeting, the Supervisory Board also discussed the Management Board's proposal for the appropriation of profits with the Management Board. Following its examination, the Supervisory Board has endorsed the proposal for the appropriation of profit submitted by the Management Board.

The Supervisory Board would like to thank the Management Board and all employees for their strong personal commitment and contribution, and for their work during the financial year under review.

For the Supervisory Board

Dr Günther Bräunig
Chairman

The pbb Share

Deutsche Pfandbriefbank AG shares (pbb) have been listed in the Prime Standard of the Frankfurt Stock Exchange (FWB) since 16 July 2015; on 21 September 2015, they were admitted to the MDAX® index. Thus, pbb shares belong to the 50 largest companies of the traditional sectors – below the constituents of the DAX® – within the Prime Standard of the FWB.

Basic information

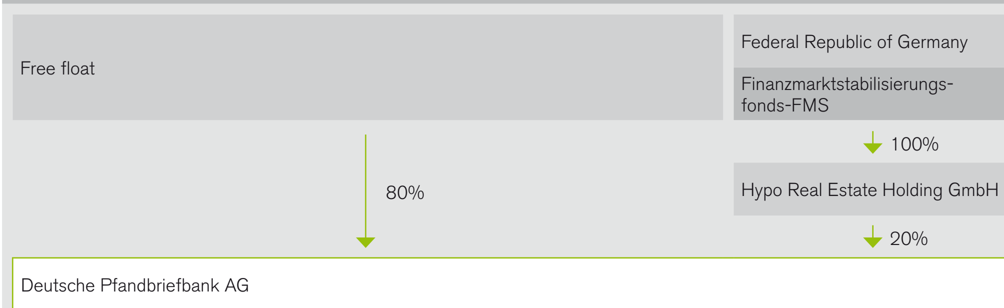
As at 31 December 2016

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

In total, 134,475,308 ordinary shares have been issued. The free float is 80%; 20% is held by the Federal Republic of Germany (indirectly via the Financial Markets Stabilisation Fund [Finanzmarktstabilisierungsfonds – "FMS"] which is holding 100% of Hypo Real Estate Holding GmbH [HRE Holding]). Under a lock-up agreement, and depending on specific exemption rules, HRE Holding is obliged to hold a share of 20% of pbb's share capital until 16 July 2017. FMS is administered by the German Financial Market Stabilisation Agency (FMSA), an institution of the Federal Republic of Germany.

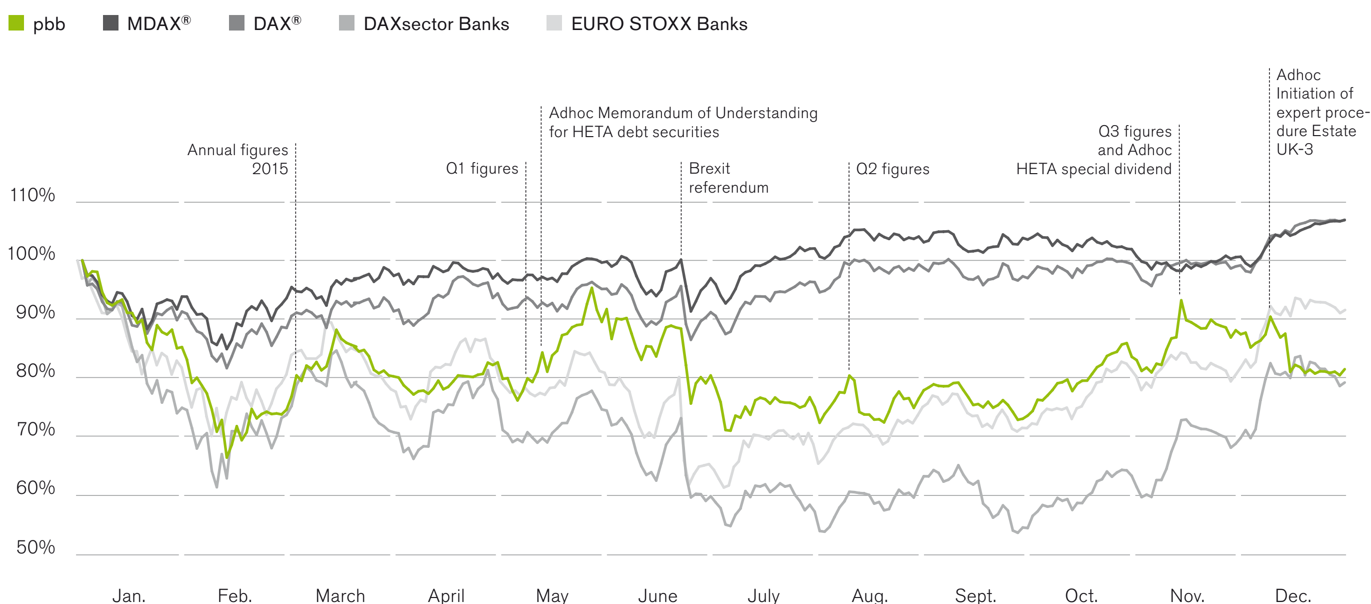
Ownership structure Deutsche Pfandbriefbank AG

As at 31 December 2016



SHARE PRICE PERFORMANCE 2016

Shares of Deutsche Pfandbriefbank AG
Benchmark comparison 2016
indexed as of 31 December 2015



Source: Reuters

European equity markets were strongly affected by political and economic uncertainty throughout 2016. Events in geopolitical crisis regions, terrorist attacks, the Brexit referendum, the US presidential elections and the negative outcome of the referendum in Italy all took their toll on economic development, thus leading to high volatility on the equity markets.

The beginning of 2016 was additionally burdened by weak Chinese economic data, a significant drop in oil prices and negative news concerning Italian banks. Thus, until mid-February 2016, share prices on international stock exchanges plummeted. The subsequent recovery was supported by a bundle of measures implemented by the European Central Bank (ECB) at the beginning of March 2016 to stimulate demand.

pbb shares were not immune to the general development. Thus, after having reached their yearly high of €10.99 at the beginning of the year, they fell to their annual low of €7.43 in mid-February. After that the shares rallied, driven by solid financial results for the year 2015 released in March, and by the potential positive non-recurring income communicated in May, which was related to the debt securities of the Austrian workout institution Heta Asset Resolution AG ("Heta") pbb was holding at that time.

From mid-June 2016 onwards, uncertainties attributable to the Brexit referendum were a crucial factor for an overall negative development on European equity markets. The ongoing low interest rate environment, strong competition and high volatility on the equity markets especially impacted share prices in the banking sector. In the fourth quarter 2016, however, banking shares were able to reduce their underperformance compared to the leading indices.

After initially following this upwards trend, pbb shares fell again in mid-December 2016 – influenced by the initiation of an Expert Procedure for the securitisation transaction "Estate UK3".

pbb shares closed the year 2016 at €9.12 (a minus of 18.6% for the year). However, pbb shares still performed slightly better than the German banking sector index DAXsector Banks (–20.7%), whilst underperforming the European sector index EURO STOXX Banks (–8.5%) and the German overall indices MDAX® (+6.8%) and DAX® (+6.9%).

Key figures		2016	2015
Share prices[1]			
Year-end closing	in €	9.12	11.20
High	in €	10.99	12.03
Low	in €	7.43	10.28
Market capitalisation[2]	in € million	1,226	1,506
Free-float market capitalisation[2]	in € million	981	1,205
Book value per share	in €	20.81	20.42
Earnings per share	in €	1.46	1.71
Dividend per share	in €	1.05[3]	0.43
Price/earnings ratio[2]	in %	6.25	6.55
Dividend yield[2]	in %	11.5[3]	7.7[4]

[1] Xetra closing prices.
[2] Xetra year-end closing price.
[3] Proposal for 2016 to be submitted to the Annual General Meeting 2017.
[4] Dividend payment for the period following the IPO, extrapolated for the financial year.

CAPITAL MARKETS COMMUNICATION

The main priority of Investor Relations (IR) activities during 2016 was on stabilising and extending pbb's analyst and investor base. pbb maintained an intense, open and transparent capital markets communication by holding a regular series of talks with numerous analysts and investors. The IR team organised numerous roadshows, and investment conferences were visited. The focus was on the international financial centres Frankfurt, London and New York, but also on smaller European financial markets.

In the context of the annual results 2015, pbb held an analyst conference in March 2016. Conference calls for investors and analysts were also held to present the interim results for the first, second and third quarter of 2016. During each of these calls, the Management Board explained the results in detail, informed about current developments and (with the annual results) provided a strategic outlook.

ANALYSTS

Research and comments from brokerages and analyst firms are important information sources for investors, which is why pbb pays financial analysts a lot of attention. In 2016, three further brokerages and analyst firms initiated coverage of pbb's shares, while one analyst firm terminated coverage for the time being (in the context of a change of analysts) at the beginning of 2016. Thus, a total of ten brokerages and analyst firms are publishing their research on pbb by the end of the financial year. As at 31 December 2016, these included six "buy" recommendations, three «neutral» recommendations and one "sell" recommendation. pbb publishes analysts' current recommendations on its website.

ANNUAL GENERAL MEETING

pbb's Annual General Meeting was held on 13 May 2016, in Munich. The Management Board and Supervisory Board gave an extensive overview of the business development in 2015, of the first quarter of 2016, and provided an outlook for the financial year 2016. 59.2% of the share capital was represented.

Within this meeting, shareholders voted for the six shareholder representatives of the Supervisory Board (nine members in total), as scheduled. The three employee representatives on the Supervisory Board had been previously confirmed by the employees. The shareholders also approved the proposal from the Management Board and the Supervisory Board to use the net retained earnings 2015 (amounting to €57,824,382.44) for the distribution of a dividend of €0.43 per ordinary bearer share. All the other items on the agenda were also agreed upon with a large majority.

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

DIVIDEND POLICY

pbb's dividend policy is based on a distribution ratio of 40% to 50% of consolidated profit after taxes and non-controlling interest income, in accordance with International Financial Reporting Standards (IFRS). For 2016, the Management Board and Supervisory Board will propose a dividend distribution of €1.05 per share on the Annual General Meeting on 30 May 2017. In addition to the distribution within the communicated dividend strategy, this dividend includes a special distribution regarding the non-recurring income from Heta, after taxes. Thus, the distribution ratio (based on the IFRS-consolidated net income after taxes per share of €1.46) amounts to 72%, equating to a dividend yield of 11.5%, based on the Xetra year-end closing share price of €9.12.

GROUP MANAGEMENT REPORT

14 FUNDAMENTAL INFORMATION ABOUT THE GROUP

14 Group Structure
14 Business Model and Strategy
15 Competitive Position
17 Strategy
17 Internal Management System
18 Sustainability

24 REPORT ON ECONOMIC POSITION

24 Macroeconomic Environment
25 Sector-specific Environment
27 Course of Business
29 Development in Earnings
36 Development in Assets
37 Development in Financial Position
42 Material Related Party Transactions
42 Summary

42 REPORT ON POST-BALANCE SHEET DATE EVENTS

43 RISK AND OPPORTUNITY REPORT

43 Organisation and Principles of Risk and Capital Management
47 Risk Types
71 Internal Capital Adequacy Assessment Process (ICAAP)
74 Result of Risk-bearing Capacity Analysis
82 Internal Control System and Risk Management System Relevant for the Consolidated Financial Reporting Process

86 pbb GROUP AS AN EMPLOYER

86 Personnel Development
86 Occupational Safety, Health Protection and Health Promotion
87 Promoting Social Commitment
87 Sustainability

88 REMUNERATION REPORT

88 Management Board
95 Supervisory Board
96 Employee Remuneration
97 Remuneration Committee and Remuneration Officer
97 Risk Takers

98 REPORT ON EXPECTED DEVELOPMENTS

98 Macroeconomic Forecast
99 Sector-specific Forecasts
101 Company Forecasts
107 Summary

108 SUPPLEMENTAL INFORMATION

108 Disclosures Pursuant to Section 315 (4) of the German Commercial Code (HGB)

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

Fundamental Information about the Group

GROUP STRUCTURE

Deutsche Pfandbriefbank AG (pbb) is the parent company of Deutsche Pfandbriefbank Group (pbb Group).

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

Sales locations
as of December 2016

BUSINESS MODEL AND STRATEGY

The strategic business segments of pbb Group are Real Estate Finance (REF) and Public Investment Finance (PIF); the focus is on Pfandbrief eligible business. The geographic focus is on Germany, France, the United Kingdom, the Nordic countries and on selected Central and Eastern European countries. In addition to the European markets, pbb extended its business in the second half of 2016 by entering the US real estate market, where the bank is focusing on East coast metropolises, primarily in the form of co-financing with strategic partners. While pbb regularly reviews business opportunities outside the markets it currently serves, it remains committed to its core markets.

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

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

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

COMPETITIVE POSITION

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

Strategic portfolios

In Real Estate Finance, the bank offers funding solutions for professional real estate investors with a medium- to long-term horizon. This includes national and international real estate investors and companies, institutional investors and real estate funds. pbb Group targets medium-sized to larger financing volumes. The focus is on office buildings, retail properties, residential real estate and logistics properties. The regional focus is on core European markets eligible for inclusion in Pfandbrief cover – Germany, the United Kingdom, France, and the Nordic countries , as well as selected countries in Central and Eastern Europe. In the second half of 2016, we also entered the US market where we focus on East coast metropolitan areas. In this area, pbb Group offers both local and cross-border financing expertise. A large majority of the loans granted are investment financings, i.e. loans for the acquisition or follow-up financing of existing properties with existing cash flows. The financing of development projects (development financing) has substantially lower significance; it is primarily of a non-speculative nature and also encompasses the property developer business in Germany.

In Public Investment Finance, pbb Group finances medium- to long-term projects for the provision and improvement of public infrastructure. The focus here lies on public institutions, municipal and social housing, buildings for the utilities and waste disposal market, transport infrastructure, as well as healthcare and nursing facilities. In addition, pbb Group is active in the publicly-guaranteed export credit business. It provides financing to public sector borrowers, companies operating under public or private law, and special-purpose vehicles under public guarantee. Currently, the Group's regional focus is on France, but it is also active in other selected European regions.

Run-down portfolio

In addition to the portfolios of its two strategic business segments, pbb Group has a non-strategic portfolio, the Value Portfolio (VP). The Value Portfolio consists almost entirely of existing financings to the public sector which are not linked to specific projects (budget financing). The Group does not originate any new business in this area. It only enters into individual transactions in order to manage the cover pools or secure liquidity. The portfolio is basically refinanced at matched maturities. It generates interest income, and matures in accordance with the underlying fixed terms. A few structured, fully state-guaranteed products, with a nominal value of €0.6 billion, remain in the Value Portfolio. If and when economically feasible, the bank also uses portfolio sales to bring about a more rapid reduction.

Funding

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

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

Banks, funds and insurance companies, but also central banks and government funds are the biggest investors in debt instruments.

In March 2013, pbb Group entered into the retail deposit-taking business with private investors in Germany. Via the pbbdirekt.com online platform, pbb Group offers overnight and fixed term deposits with various maturities. Mid-2016, pbb Group expanded its online offer with fixed term deposits denominated in US dollars, with maturities of 1, 2, 3, 5 and 10 years.

STRATEGY

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

The Management Board has committed itself to further increasing profitability in 2017 by increasing strategic portfolios whilst running down existing non-strategic portfolios. Moreover, pbb intends to use the year 2017 to implement certain strategic decisions, including initiatives aimed at further diversifying its existing business in line with the bank's risk standards – as already seen during the second half of 2016, with pbb's entry into the US market. In addition, pbb Group intends to expand its value-creation chain, reviewing platforms and processes with a view to digitalising its business. The bank also wants to devise measures enabling it to react swiftly to regulatory changes. Finally, pbb will take specific action to counter future increases in its cost base.

INTERNAL MANAGEMENT SYSTEM

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

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

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

- One key profitability indicator is the return on equity after tax. It is calculated by dividing IFRS net income/loss by the average IFRS equity available in the financial year excluding the revaluation reserve. Profit or loss before tax is a further financial key performance indicator. The aim is to increase it both by generating higher revenues and through strict cost discipline. Cost discipline and efficiency are monitored using the cost-income ratio, i.e. the ratio of general and administrative expenses to operating income.
- The notional amount of the funding in the strategic Real Estate Finance (REF) and Public Investment Finance (PIF) segments is a significant factor influencing the future earning power and has therefore been redefined as an additional financial key performance indicator. The financing volume can be controlled, above all, by the volume of new business including prolongations with maturities of more than one year, which also represent a financial key performance indicator. A present value approach is used for managing and calculating new business. In line with the management of the Bank as a whole, each new business transaction should make a positive value contribution to the Bank's overall income after the deduction of all costs (full cost approach).

- Risk management is based on two risk-bearing capacity approaches, the going-concern approach and gone-concern approach. Management using the going-concern approach ensures that pbb Group can still meet the regulatory minimum capital ratios even after an adverse economic scenario, which occurs at a maximum of once every 20 years. The gone-concern approach, on the other hand, is based on the assumption that pbb Group, in the hypothetical event of the institute being liquidated, is able to fully service its unsubordinated debt instruments even in an extreme loss event. A precondition for demonstrating the risk-bearing capacity in both cases is that the risk covering potential exceeds the required economic risk capital. The methods and results of the risk-bearing capacity assessment and the methods used are described in detail in the risk and opportunity report.
- The CET1 ratio, a key management parameter, is determined on a regular basis; it is calculated by dividing Common Equity Tier 1 (CET1) by risk-weighted assets (RWAs). The Advanced Internal Rating Based Approach (Advanced IRBA) is used to determine regulatory capital requirements for all material portfolios.

SUSTAINABILITY

Companies must assume responsibility for their actions in the environment in which they operate: towards their employees, their clients, their investors, and also towards society and the environment. pbb Group integrates this into its corporate responsibility programme.

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

pbb Group is convinced that sustainable and responsible business practices are essential when it comes to securing the Company's future and increasing its value.

Compliance

Code of conduct and ethical principles

Transparent, fair, responsible and honest conduct – with the required degree of expertise, professionalism and integrity in dealings with one other and in relation to clients and business partners, competitors and the public – are deeply rooted in pbb, and demand that the relevant legal, supervisory and internal requirements as well as other relevant laws and regulations, are implemented and adhered to.

Within pbb, the Group's code of conduct set outs the ethical and legal framework. Details of the non-negotiable requirements that pbb Group expects of all its employees are available to the public on pbb's website.

The code of conduct offers very clear guidance on questions regarding relationships with clients, suppliers, shareholders, investors and competitors – as well as how to respond to conflicts of interest, bribery, the granting of undue benefits, preventing money laundering and market abuse.

pbb Group does not support business practices that could harm its reputation or give rise to the suspicion that the Group assists clients in violating its ethical standards or in breaking the law.

The applicable law, as well as all the regulatory provisions in force in the various jurisdictions where pbb Group does business, form the basis for the entire corporate decision-making process and day-to-day operations. They are complemented by internal regulations and detailed process descriptions.

As a listed company, pbb adheres to the German Corporate Governance Code and is subject to the principle of "comply or explain". This Code describes the legal requirements laid down for managing and supervising German listed companies, and reflects the current national and international developments and standards of good and responsible corporate management.

Compliance

Compliance means ensuring adherence to legal and other requirements by building an organisation that proactively meets these needs and implementing additional measures. This is particularly true for legal requirements regarding the trading and/or managing of securities/assets. Compliance with these requirements serves the goal of client/investor protection and, as a consequence, the protection of pbb's reputation. At the core of the norms pbb must adhere to, lie the EU Market Abuse Regulation, the German Securities Trading Act, and the regulations and guidelines based on these documents. Compliance risks include sanctions, financial losses and reputational losses that may arise from violations of these regulations.

pbb employees are bound by numerous internal guidelines and instructions, for example on combating criminal acts, on information security, on preventing money laundering and the financing of terrorism.

In pursuit of the goals of raising awareness amongst and educating staff, pbb employees are obliged to take part in compliance trainings on a regular basis. These trainings cover a variety of topics, including the prevention of money laundering and other criminal acts such as corruption (granting or accepting benefits, engaging in active or passive bribery), breach of confidentiality and tax offences, as well as general compliance issues. Successful participation in these trainings is only certified after completion of a test. Group Internal Audit regularly reviews how such training is conducted.

As a shield against corruption, pbb Group has established clear principles and guidelines for proper and professional conduct – for example in case of conflicts of interest, fighting corruption and active and passive bribery. Special attention is given to accepting and granting benefits and gifts.

In their interaction with government representatives and public agencies, staff must refrain from any actions that could unlawfully influence the decisions of officials. In particular, cash payments, gifts and other benefits or perquisites to officials that could, in any way, be interpreted as undue influence, bribery or corruption, are prohibited. As a rule, political donations of any kind are not permitted within the Group where they are effected in a professional context.

Data protection

Handling confidential data with great care and protecting our clients is a top priority. pbb Group adheres to the German Data Protection Act, to national legal and regulatory provisions, to contractually agreed confidentiality clauses (including the so-called "banking secrecy") as well as to internal regulations on data protection.

To ensure that these data protection requirements are met, pbb has implemented controls and sanctions.

Every contract of employment or service contains provisions on data protection. Our staff receive ongoing training on data protection issues. Any breach of the data protection rules and regulations may have disciplinary consequences.

Pursuant to article 18 of the market abuse regulation, issuers or any person acting by order of, or for the account of, such issuer must maintain lists of persons who are active on their behalf, and who are authorised to access inside information. pbb Group shall inform those persons identified in such lists as to the legal duties associated with access to inside information, and with regard to the legal consequences of violating these regulations.

Employees

Diversity and Equal Opportunity

pbb Group respects human dignity, human rights and privacy. It respects all people, independent of age, sex, race, social background, skills, sexual orientation or religion and fosters diversity amongst its staff. All staff members are treated with fairness, dignity and respect. pbb Group has zero tolerance with regard to unfair or discriminatory behaviour towards its staff. It is committed to the principles of equal treatment in the selection and further development of staff, without discriminating against any employee (or potential employee) due to age, handicap, race, colour, sex, pregnancy, religion, marital status or any other characteristics. pbb employees are evaluated according to their performance.

pbb Group has been a signatory to the "Diversity Charter" since 2010, and is fundamentally committed to the economic benefit that comes with diversity, tolerance and fairness. By signing the Diversity Charter, pbb Group also made an obligation to provide a working environment free from prejudices and exclusion and to establish a culture of trust based on mutual respect and inclusion of participants. pbb Group takes these commitments seriously, and actively lives by them. Every employee must be able to address workplace problems without fearing repercussions.

The Group fosters an open corporate culture that provides for the inclusion of employees in the decision-making process, as appropriate, while at the same time maintaining discretion. It further ensures that appropriate procedures exist within the Group in order to resolve any workplace problems confidentially and as quickly as possible.

Staff development

It is pbb Group's intention to provide its employees with the right basis for their development, be it in the technical, professional or even personal sphere, and offers a variety of in-house training and qualification measures. To support and promote the long-term development of its staff, the bank has implemented additional, individual programmes that allow for a holistic and systematic qualification, in particular in the realm of technical qualification and management skills to make line managers and project managers better, more active leaders. In addition to the permanent series of seminars offered, the bank offers a constantly expanding range of in-house seminars for professional qualifications and qualifications in the areas of social and methodological competencies as well as language training. Any further requirements for training are met by external providers.

An important management instrument to align employees' skills to the objectives and success of the company is the annual employee appraisal, in which not only performance is reviewed, but personnel development and qualification measures are also agreed.

In 2016, pbb Group re-introduced regulations for variable remuneration – allowing employees to participate in their company's success.

pbb Group is fully aware that in every company, it is capable and committed employees who drive success, and therefore invests in employee health (see "pbb Group as an Employer").

Clients and Products

Clients

pbb Group's business hinges on its clients. At all times, pbb Group's staff must act with integrity and in a transparent and open manner in relation to clients and all other parties with whom pbb Group interacts. pbb Group is committed to openness, professionalism and excellence when providing services to clients. This also includes a high performance standard as well as appropriate and effective complaint management that ensures the efficient, targeted and rapid processing of complaints.

pbb Group creates transparency through clear and regular client communication, be it in one-on-one talks in the context of business relationships or at pbb Group events.

Products

As a specialist bank, pbb Group finances commercial real estate projects as well as infrastructure projects within the public sector. In both of these fields, pbb sets high standards when granting loans – also in terms of sustainability, giving priority to financings that meet the requirements for sustainability.

Commercial Real Estate Finance mainly involves real estate such as office buildings, retail properties, properties for residential use and logistics properties. In order to promote sustainability aspects in the real estate industry and the real estate financing business, pbb Group is, for example, involved in the working groups of the Association of German Banks (Bundesverband deutscher Banken: BdB) and the Association of German Pfandbrief Banks (Verband deutscher Pfandbriefbanken – "vdp").

In Public Sector Finance, pbb contributes to society by financing projects for the provision and improvement of public infrastructure.

Investors

pbb Group is committed to generating a sustainable and adequate return for its shareholders.

When making an investment decision, more and more institutional investors consider an issuer's take on corporate responsibility, rated by an independent agency. pbb Group meets these demands with two actively supported corporate responsibility ratings, provided by the agencies oekom and imug/EIRIS.

Corporate Responsibility Ratings

The rating agency oekom currently rates pbb Group as "Prime". oekom awards the "Prime" status to companies that are among the leaders in their industry in the context of oekom's corporate ratings, and which meet the industry-specific minimum requirements. Around 6,200 companies are regularly rated by oekom, and of those around 550 companies have currently achieved "Prime" status.

The rating agency imug rates pbb's debt instruments. pbb's Pfandbriefe are currently classed as above-average, with a "positive" rating. The mortgage Pfandbriefe and unsecured bonds are classed as average with "neutral". imug/EIRIS currently analyses and rates approximately 70 German and European bank bond issuers and covered bonds.

Social Responsibility

pbb Deutsche Pfandbriefbank primarily fulfils its responsibility to society through two charitable foundations: pbb Stiftung Deutsche Pfandbriefbank and pbb Stiftung für Kunst und Wissenschaft. The foundations are independently funded, with their capital ring-fenced from the bank and used solely to fulfil the foundations' purposes.

- pbb Stiftung Deutsche Pfandbriefbank supports projects aimed at promoting art and culture, with a particular focus on the targeted support of young talent.
- pbb Stiftung für Kunst und Wissenschaft focuses its activities in the federal state of Baden-Württemberg, promoting intellectual and artistic work mainly in the realms of literature, painting, sculpture, music, theatre, architecture/design, regional and cultural studies.

pbb Group has also donated its collection of historical paper money from Württemberg as a permanent loan to the HVB Stiftung's banknote collection. It comprises around 8,000 notes from every period of Württemberg's monetary history, and is the largest and most significant special collection of Württemberg paper money in existence. The complete pbb Group collection remains intact as part of the HVB Stiftung's banknote collection and is accessible to interested members of the public.

pbb Group combines this support of primarily cultural and academic work with social action. It supports the Kinderhospiz St. Nikolaus children's hospice based in the Allgäu region, which acts as a retreat for families with children who are terminally ill or who suffer from a life-limiting illness. The Kinderhospiz focuses on helping both these children and their families by providing relief, holistic medical care, professional nursing and other forms of support.

In addition, the Group funds projects near the Company's office locations. Since 2013, this includes the "JugendKulturHaus Gleis 1" youth centre near the Unterschleißheim branch, where pbb Group has supported mobile youth work, the acquisition of the IT equipment for a "job application terminal", and a roller hockey team. In 2016, pbb Group further provided funds for assisting refugee children in learning the German language and further education at a local primary school.

pbb Group also supports the personal, voluntary commitment of its employees in other social projects. For pbb to provide financial aid, one or more employees need to be involved with the charity in question in their free time. These charities may cater to helping the sick, the elderly, teenagers or socially disadvantaged, or may cover topics such as environmental protection or integration.

Furthermore, pbb Group launched a corporate volunteering programme in 2016, together with Dominik-Brunner-Haus, a facility house centre that supports children and teenagers from socially disadvantaged backgrounds, run by the voluntary humanitarian organisation "Die Johanniter". pbb colleagues offer English classes and English conversational groups for teenagers at Dominik-Brunner-Haus.

Environment

With the Code of Conduct, pbb Group has obligated itself to conducting its business in a sustainable and environmentally friendly way, and to identifying environmental risks that may arise in its business activities. The Group handles natural resources responsibly, and has committed itself to making an active contribution to climate protection by minimising its requirements for energy and raw materials.

Our rented headquarters buildings in Unterschleissheim near Munich are extremely energy efficient, with energy-efficient cooling ceilings instead of a conventional air conditioning system. Furthermore, 100% of the buildings' power demand has been met using renewable energy sources since 2011.

Company cars have to meet carbon dioxide emission standards so as to limit their impact on the environment. Vehicles with emissions of more than 155 g/km are given a financial penalty, whilst vehicles with emissions of more than 180 g/km may not be purchased at all. These regulations are designed to the current development standards, and may be adjusted according to technological advances. pbb Group plans to include electric vehicles in its car park.

Report on Economic Position

MACROECONOMIC ENVIRONMENT

Although moderate global economic growth continued throughout 2016, industrialised nations which are key to pbb Group lost some of their momentum. The International Monetary Fund (IMF) assumes in its January 2017 Update that growth rates for industrialised economies ("Advanced Economies") for 2016 stood at 1.6% (after 2.1% in 2015).

In the relevant countries, private and public investments recovered slightly in 2016, albeit with subdued growth rates. Conversely, falling unemployment rates led to a more positive development in private consumption. In the euro area, real gross domestic product (GDP) rose by 1.7% in 2016, which is a deterioration compared to the previous year's growth rate of 2%. The German GDP growth rate of 1.9% was mainly driven by private consumption. With a real economic growth rate of 1.2% in 2016, France was not able to overcome the economic weakness of the previous year, while the Italian growth rate improved to slightly to 0.9%, compared with 0.7% in the previous year. In Spain, positive economic development continued, leading to a strong 2016 GDP growth rate of 3.2%, as in the previous year. The US economy grew by 1.6% in 2016, thus one percentage point below the level of the previous year. The United Kingdom showed solid economic performance throughout the second half of 2016, despite the Brexit referendum, and reached a real growth rate of 2%, only 0.2 percentage points behind the previous year. Economic momentum in Sweden remained strong in 2016. At 3.3%, the growth rate was only slightly behind the very elevated level of the previous year (4.1%). Economic performances in Poland (expected real growth rate of 2.8%, after 3.9% in the previous year), and Romania (GDP growth rate of 4.9% expected, after 3.9% in the previous year), were additional positive aspects.

In 2016, interest rates in the markets relevant to pbb Group again tended to reach new historical lows. In the euro area, the European Central Back bank (ECB) lowered its key interest rate to a record low of 0%, and the deposit rate for banks from –0.3% in 2015 to –0.4%. Inflation was very low during the first half of 2016, but increased in line with accelerating energy prices during the second half of the year, especially in December.

The currency markets reflected the central bank decisions for looser monetary policy in the euro area, and the expectations of a future tightening of monetary policy – together with a more expansive fiscal policy – in the United States. During the last quarter of 2016 the euro lost notable ground against the US dollar, particularly as the yield pick-up of US dollar investments increased again due to the anticipated extension of the ECB's bond purchase programme and the key interest rate hike in the US. In the United Kingdom, a tightening of monetary policy is now expected after the key interest rate was cut by half, to only 0.25% in August. This should help to limit inflation, which was being fuelled by the devaluation of the British currency. Pound sterling depreciated against the euro by 15.8% in 2016 following the Brexit referendum. The euro exchange rate against a basket of major global currencies is an important indicator for the economic development in the euro area. During 2016, this key parameter declined by 1.0%.

Sources: Bloomberg, ECB, IMF

SECTOR-SPECIFIC ENVIRONMENT

Overall Situation in the Banking Sector

The international banking sector continued to operate in a difficult environment during 2016, notwithstanding the glut of liquidity. In the euro area, banks in the countries most affected by the sovereign debt crisis suffered from the weight of non-performing loans. The negative rating pressure weighing on the banking sector as a whole decreased slightly, although not limited to countries affected by the crisis. Rather, it challenges the European banking sector as a whole. Profitability is restricted by fierce competition and zero interest rates as well as by rising regulatory requirements. The implementation of plans to more strongly involve subordinated debt investors in bank resolutions (the so-called 'bail-in') continues to weigh on banks' capital costs.

Sources: Bloomberg, ECB

Real Estate Finance

In line with the previous year, investors provided strong inflows of capital on the commercial real estate markets, in view of the continued low interest rate environment. The high liquidity levels provided by professional real estate investors, financial intermediaries, insurers and other institutional investors translated into transaction volumes clearly above long-term average values. Furthermore, investor uncertainty – fuelled by the political risks in 2016, such as the Brexit referendum – may have contributed to the high demand for properties on Continental European markets.

In Germany alone, a turnover of €52.9 billion was generated with commercial properties in 2016 (2015: €55.1 billion), driven in particular by the exceptionally strong final quarter. This figure was clearly above the average level of €37.9 billion generated in the 2011 to 2016 period. As in the previous year, the focal point was on the office and retail property segments. However, peak yields continued to decline across the majority of segments. For instance, the peak yield in the office property segment declined from 4.2% as at 31 December 2015 to 3.6% at the reporting date.

It is worth noting that during the second half of 2016, investment volumes on German commercial property markets were slightly above UK markets for the first time. The declining investment volumes in the United Kingdom were related to the limited investor interest after the Brexit referendum. However, market volumes accelerated towards the end of 2016, driven in particular by the strong demand from Asian investors. Overall, price declines were moderate (only two to four per cent), while rents remained largely stable. Accordingly, London remained the top performer in terms of office rents in Europe.

At €31 billion, investment volumes on the commercial real estate markets in France were down by 2% compared to 2015, yet remained at a high level. Yields were falling; in some top locations in Paris, they declined to only 3.2%, compared to 4% the year before.

Amsterdam experienced significant increases in terms of real estate volumes as well as office rents. Likewise, the markets in Madrid and Barcelona posted a marked recovery from the lows seen in recent years, with increases in both office rental volumes as well as rent levels.

Overall, many investors simply adhered to their investment strategy, which led to rising prices for established locations and property types. At the same time, the search for attractive and lucrative alternatives offering higher yields has also fuelled markedly higher demand for properties outside the established locations and usage types. In particular, logistics properties and hotels, owner-operated real estate and alternative housing concepts – such as micro-apartments – were particularly sought after. In this context, investor demand for project developments increased noticeably throughout Europe.

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

Sources: Cushman & Wakefield research, BNP Paribas Real Estate, CBRE, Association of German Pfandbrief Banks, Jones Lang Lasalle, WSJ, RCA

Public Investment Finance

The public sector continues to face major challenges, in spite of record low interest rates. Economic developments during 2016 were burdened by uncertainty surrounding China's economic performance, and by Brexit. In addition, growth in developed countries was impeded by continued weakness of external demand in emerging markets, and by the overall weakness of world trade. Given the low nominal growth rates in numerous industrialised nations, the state has a decisive role in the revival of the economy – against the background of continued high debt levels.

The markets for public investment finance were unusually quiet during the 2016 financial year, largely due to two reasons: firstly, the Brexit referendum in the UK on 23 June 2016, and the announcement by the French government that it will provide "operational support" to its local authorities. Whilst in Germany, there was sufficient demand for public investment finance, clients requested facilities with very long-term maturities – provided by public-sector banks as well as development and promotional banks in particular, at very low margin levels. Competition on the French market intensified again, leading to low margins.

Value Portfolio

The non-strategic Value Portfolio (VP) segment almost exclusively comprises public budget financing exposures. Market values declined somewhat during 2016 – only a few countries (such as Spain) were able to maintain the positive trend seen in 2015, with further declines in yield during 2016.

Funding Markets

As in previous years, central banks represented both the major influencing as well as the major supporting force on the market. The US Federal Reserve bolstered the economic cycle by waiving any reductions of its balance sheet and postponing further interest rate increases until after the US presidential elections. After the Brexit referendum, the Bank of England found itself constrained to reduce its key interest rate to a record low of 0.25%. In March 2016, the European Central Bank (ECB) announced further key interest rates cuts as well as an expansion of its monthly securities purchasing programme from €60 billion to €80 billion. The ECB's deposit facility rate was reduced to –0.40% in March 2016. Besides the expansion of the securities purchase programme, ECB also decided to cover corporate bonds going forward. The ECB measures produced further deterioration in the market environment for investors, which was characterised by a steady decline in investment offerings as well as further interest rate and risk premium cuts until well into the third quarter of 2016. Interest rates for medium- and long-term maturities increased considerably towards the end of the reporting period, translating into a slight widening of refinancing spreads for unsecured bank bonds and Pfandbriefe.

On 23 November 2016, the European Commission published proposals suggesting amendments to the Capital Requirements Directive (CRD IV), the Capital Requirements Regulation (CRR), and the Bank Recovery and Resolution Directive (BRRD). Even though German legislators have already established clarity regarding the ranking of outstanding issues, through amendments to the German Banking Act and the Insolvency Regulation, the most recent proposals of the European Commission provide for the establishment of a specific additional level in the liability cascade for future issues. The timing of transposition into national law – as well as possible amendments brought about in the EU Parliament or the Council of Ministers – is as yet unclear.

COURSE OF BUSINESS

At the outset of 2016, the pbb Group envisaged full-year profit or loss before tax to be slightly below the good results of €195 million for 2015, with return on equity before tax projected to remain stable, according to the forecast communicated at the beginning of the year. In 2015, return on equity after tax benefited by significant income from deferred taxes; the assumption for 2016 did not encompass a repeat of favourable effects to the same extent. Hence, return on equity after taxes was projected to be significantly lower than for 2015, assuming a normalised tax rate. pbb Group aimed to remain the cost-income ratio on the level seen in 2015 (51.8%).

As it turned out, the financial indicators of profit or loss before tax, return on equity after tax, and cost-income ratio developed far better during 2016 than anticipated at the beginning of the year. This was driven by income generated as a result of an agreement with the Republic of Austria regard the liabilities of Heta Asset Resolution AG ("Heta"): this caused a positive effect in the amount of €132 million, with €123 million being recognised in net income from financial investments and €9 million in reversals of loan loss provisions. The forecast communicated at the beginning of the year had only incorporated a moderate €10 million release of write-downs on Heta debt instruments. Profit or loss before tax was €301 million in 2016, with a cost-income ratio of 39.0%. Return on equity after tax was 7.3%; the underlying average equity (excluding the revaluation reserve) declined from €3.1 billion in the financial year 2015 to €2.7 billion in the year under review. The decline was due to the redemption of the silent partnership contribution in July 2015.

Excluding the non-recurring income from Heta, which exceeded the original forecast by €122 million (€132 million less €10 million in Heta-related write-ups already included in the forecast made at the beginning of 2016), profit or loss before tax would have been €179 million – slightly below the strong result of €195 million for 2015, as projected at the outset of 2016. The correspondingly adjusted return on equity after tax would have been markedly lower year-on-year, whilst the cost-income ratio would have been approximately in line with the previous year's level.

Reflecting the signing of a memorandum of understanding between the Republic of Austria and Heta's creditors already in May 2016, the pbb Group projected non-recurring income exceeding the original forecast by €122 million in its interim report as at 30 June 2016, with favourable effects upon return on equity and the cost-income ratio. These effects materialised upon the final agreement being reached in October 2016.

At €10.5 billion, the volume of new business (including prolongations with maturities of more than one year) was clearly lower year-on-year (2015: €12.0 billion), in line with the forecast – which was reduced at the mid-year point. The main reason for this development was the still-conservative approach to risk regarding new business, against the background of still-rising competitive pressure, very demanding credit markets, and financing requests which increasingly failed to meet pbb Group's risk-rewar expectations. Whilst new business (including prolongations with maturities of more than one year) in the REF segment of €9.5 billion was almost in line with original projections, new business in the PIF segment, at €1.0 billion, fell short of the original forecast. Original new business in REF was roughly in line with the previous year's figure, whereas prolongations with maturities of more than one year no longer matched 2015's levels, due to the changed risk-rewar ratios. As a consequence, the Group adjusted its forecast for the financing volumes in its strategic REF and PIF segments at the mid-year point. At €31.5 billion, strategic financing volumes at the reporting date were in line with the previous year (31 December 2015: €31.3 billion), matching the forecast which was adjusted in the interim report as at 30 June 2016, due to lower new business volumes and the level of repayments running above planned levels.

Forecasts concerning pbb's risk-bearing capacity at the beginning of 2016 materialised during the course of the year: based on the going-concern approach, available financial resources – above minimum regulatory ratios – exceeded economic capital requirements. In the gone-concern approach, capital available to cover risk exposure exceeded required economic capital.

The CET1 ratio[1] stood at 19.5% as at 31 December 2016 – as forecast, it significantly exceeded the minimum requirement of 5.125% pursuant to the CRR, and was also markedly higher than pbb Group's minimum target level of 12.5%.

At €62.6 billion, total assets were slightly lower than the previous year's figure (31 December 2015: €66.8 billion), and in line with the developments predicted at the beginning of the year.

[1] After confirmation of the 2016 financial statements, less the proposed dividend (subject to approval by the Annual General Meeting).

DEVELOPMENT IN EARNINGS

Deutsche Pfandbriefbank Group (“pbb Group”)

Profit or loss in comparison to the previous year is presented as follows:

pbb Group		2016	2015	Change
Operating performance				
Operating income	in € million	508	400	108
Net interest and commission income	in € million	412	440	−28
Net interest income	in € million	404	426	−22
Net fee and commission income	in € million	8	14	−6
Net trading income	in € million	−6	15	−21
Net income from financial investments	in € million	125	−32	157
Net income from hedging relationships	in € million	6	11	−5
Net other operating income/expenses	in € million	−29	−34	5
Loan loss provisions	in € million	−1	1	−2
General and administrative expenses	in € million	−198	−207	9
Net miscellaneous income/expenses	in € million	−8	1	−9
Profit or loss before tax	in € million	301	195	106
Income taxes	in € million	−104	35	−139
Net income/loss	in € million	197	230	−33
Key ratios				
Earnings per share (basic and diluted)	in €	1.46	1.71	
Cost-income ratio	in %	39.0	51.8	
Return on equity before tax	in %	11.1	6.2	
Return on equity after tax	in %	7.3	7.4	

Operating Income

Although the interest rate environment was challenging for banks, pbb Group was able to generate net interest income of € 404 million, slightly below the previous year (€ 426 million), but stable since the second half of 2015. In pbb’s strategic business, net interest income increased slightly, while it declined in the non-strategic Value Portfolio segment as anticipated. Net interest income generated in the strategic segments Real Estate Finance and Public Investment Finance benefited from the increased average disbursed volume of financings in 2016 (average of € 31.3 billion compared to € 30.2 billion in 2015). Financing volume is the notional amount of the drawn parts of granted loans and parts of the securities portfolio (customer business). In addition, the allocation of income from compensation for early terminations had a positive effect on net interest income in both segments, offsetting slightly declining average margins on existing exposures. Margins on existing exposures continued to decline, given the high repayment rates of higher-margin business were partially retained in 2016, as well as pbb Group’s strategy not to enter into disproportionately high risks in favour of new business with significantly higher margins. The non-strategic Value Portfolio segment almost exclusively comprises budget financing. The financing volume of this run-down portfolio was reduced according to strategy, thus also decreasing this segment’s contribution to net interest income. In contrast to the previous year, in 2016 the Value Portfolio’s net interest income did not benefit from income generated by financing sales.

Net fee and commission income from non-accruable fees declined to € 8 million (2015: € 14 million). The figure for the previous year included € 5 million in commission income generated in connection with a financing arrangement, which was repaid in full.

Negative net trading income (€ –6 million; 2015: €15 million) was burdened with €13 million (2015: €19 million) by the so-called pull-to-par effect, according to which the present value of derivatives approaches zero towards maturity. Additionally, net trading income was affected by the measurement of pbb's credit risk and its derivative counterparties (so-called bilateral Credit Valuation Adjustment), which resulted in expenses of € 3 million (2015: income of €14 million). Expenses incurred in connection with the bilateral Credit Valuation Adjustment resulted from increased credit spreads amongst pbb's derivatives counterparties. Furthermore, adjustments of estimates used to determine the bilateral Credit Valuation Adjustments for certain derivative counterparties incurred additional expenses of €1 million. Costs incurred by the respective refinancing of the collateralisation and the transfer of the funding to the counterparty are taken into account as additional assessment components for the first time. The inclusion of the funding valuation adjustment into derivative measurement as an additional adjustment of estimates translated into expenses of € 2 million. On a positive note, interest rate and exchange rate fluctuations led to positive measurement effects of derivatives in the amount of €13 million (2015: € 20 million).

In particular, the non-recurring effect of €123 million from Heta contributed to the positive net income from financial investments of €125 million (2015: € –32 million). In addition, income was generated from disposals of securities held in the liquidity cushion. The previous year's figure was burdened significantly by additional write-downs of € 73 million on Heta, which was only partially offset by net income (€ 40 million) from the sale of securities.

The net income from hedging relationships of € 6 million (2015: €11 million) was due exclusively to ineffective portions from fair value hedge relationships within the range permitted under IAS 39 (80% to 125%) (2015: €10 million). Furthermore, income from inefficiencies of cash flow hedge accounting recognised through profit or loss were disclosed in the previous year (€1 million).

Net other operating income/expenses in the amount of € –29 million (2015: € –34 million) was burdened, inter alia, by the bank levy. Overall, the bank levy amounted to € 24 million (2015: € 25 million). Given the ability to pledge collateral amounting to 15% (2015: 30%) of the bank levy, it was only expenses of € 21 million (2015: €18 million) that needed to be recognised. Additional expenses for the write-down of salvage acquisitions and for recognising provisions were partly offset by subsequent effects in connection with income from the disposal of securities. Recurring effects were recognised for rental income of € 4 million (2015: €10 million) generated from foreclosed properties, while currency translation effects contributed € 3 million (2015: € 5 million). The net figure for the previous year benefited from the divestment of a property in Japan, generating € 39 million.

Loan Loss Provisions

Loan loss provisions amounted to € –1 million (2015: €1 million). Specific provisions of € 6 million (net amount) were reversed (2015: net additions of €16 million). Heta-specific provisions of € 9 million were reversed, whilst various individual items contributed to total additions of € 3 million. Net additions to portfolio-based allowances amounted to €12 million (2015: net reversals of €13 million) and were related to an internal risk assessment for a region in Southern Europe. Income of € 4 million resulted from recovery payments from previously written-off loans and advances (2015: € 3 million), and income of €1 million resulted from the reversal of provisions that had been created for contingent liabilities and other commitments (2015: €1 million).

General and Administrative Expenses

pbb Group reduced general and administrative expenses to €198 million (2015: € 207 million). Non-personnel expenses remained stable at € 95 million (2015: € 95 million), while personnel expenses declined from €112 million in the previous year to €103 million in 2016. Non-personnel expenses includes expenses for a bank-wide project for the implementation of new regulatory requirements, and to enhance efficiency (also encompassing the process to prepare the financial statements). The decline in personnel expenses was driven by a lower average number (801) of employees (2015: 832), and payments for which provisions had been created in prior periods and which were completed by year-end 2016.

Net Miscellaneous Income/Expenses

Net miscellaneous income/expenses (€ –8 million; 2015: €1 million) was related to net additions of restructuring provisions, resulting from the adjustment of parameters included in the calculation. Personnel-related restructuring provisions are required to further support the optimisation process at pbb Group aimed at an efficient and lean workforce.

Income Taxes

Expenses for current taxes of € 59 million (2015: € 48 million) and expenses for deferred taxes of € 45 million (2015: income of € 83 million) resulted in total tax expenses of €104 million (2015: total tax income of € 35 million). Out of the current tax expenses payable in Germany of € 36 million (2015: € 28 million), an amount of € 27 million (2015: € 6 million) was attributable to the current financial year, whilst € 9 million (2015: € 22 million) was attributable to previous years. Out of the current tax expenses payable abroad of € 23 million (2015: € 20 million), an amount of €16 million (2015: €14 million) was attributable to the current financial year, whilst € 7 million (2015: € 6 million) was attributable to previous years. The deferred tax expenses of € 45 million (2015: income of € 83 million) were due to a deferred tax expense item of € 20 million (2015: income of €154 million) resulting from the reduction of temporary differences, which were attributable mainly to the creation of hidden reserves in the German single-entity financial statements prepared in accordance with the German Commercial Code (HGB). Furthermore, the bank incurred deferred tax expenses in the amount of € 25 million (2015: € 71 million) due to the reduction of deferred tax assets on loss carryforwards.

Operating Segments

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

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

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

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

Real Estate Finance (REF)

The REF operating segment comprises all commercial real estate financing arrangements of pbb Group. With € 9.5 billion, new business volume (including prolongations with maturities of more than one year) was below the level of the previous year (€10.4 billion). The originated new business volume was about on a par with the previous year, while the prolongations with maturities of more than one year were below the level of the previous year. The main reason for this development was the still-conservative approach to risk regarding new business against the background of a declining risk-reward relation. Profit or loss before tax stood at €146 million (2015: € 206 million). According to the projections from the beginning of 2016, the REF segment was expected to make the by far the largest contribution to profit before tax. However, since the non-recurring Heta effects were attributable exclusively to the Value Portfolio, REF segment's contribution to total profit or loss was smaller than expected.

Real Estate Finance		2016	2015	Change
Operating performance				
Operating income	in € million	306	358	–52
Net interest and commission income	in € million	330	322	8
Net interest income	in € million	321	308	13
Net fee and commission income	in € million	9	14	–5
Net trading income	in € million	–2	14	–16
Net income from financial investments	in € million	3	18	–15
Net income from hedging relationships	in € million	3	5	–2
Net other operating income/expenses	in € million	–28	–1	–27
Loan loss provisions	in € million	2	7	–5
General and administrative expenses	in € million	–156	–160	4
Net miscellaneous income/expenses	in € million	–6	1	–7
Profit or loss before tax	in € million	146	206	–60
Key ratio				
Cost-income ratio	in %	51.0	44.7	
Balance-sheet-related measures		**31.12.2016**	**31.12.2015**	
Financing volumes	in € billion	24.1	24.0	
Exposure at Default[1]	in € billion	27.1	25.8	
Risk-weighted assets[2]	in € billion	6.4	6.5	
Equity (excluding revaluation reserve)	in € billion	0.6	0.6	

[1] For details see Risk and Opportunity Report.
[2] Including weighted credit risk positions and capital charges for market risk positions and operational risk, using a scaling factor of 12.5.

Operating Income Net interest income rose to € 321 million (2015: € 308 million). One positive aspect was the average total financing volume, which increased from € 23.2 billion in 2015 to € 24.0 billion in the year under review. Furthermore, net interest income benefited from early termination fees of € 20 million (2015: € 9 million). This was partly offset by lower average margins on existing exposures due to repayments of high-margin financings. Net fee and commission income in the amount of € 9 million (2015: €14 million) resulted from non-accruable fees. The figure for the previous year included € 5 million in commission income generated in connection with a financing arrangement, which was repaid in full. Net trading income of € –2 million (2015: €14 million) was burdened mainly by so-called pull-to-par effects and by bilateral Credit Valuation Adjustments, partly offset by positive interest rate and currency-related measurement effects of derivatives. Due to lower income generated from disposals of securities, net income from financial investments declined to € 3 million (2015: €18 million). Net other operating income/expenses in the amount of € –28 million (2015: € –1 million) was burdened, inter alia, with expenses in connection with the bank levy. In the previous year, these expenses were partly offset by income from the disposal of a property in Japan.

Loan Loss Provisions Net reversals of € 2 million were recognised in loan loss provisions (2015: net reversals of € 7 million). Due to a low number of individual exposures, net additions to specific allowances amounted to € 3 million, compared to €10 million in the previous year. Portfolio-based allowances were balanced (2015: reversal of €13 million). In addition, pbb recognised recovery payments on previously written-off loans and advances of € 4 million (2015: € 3 million) and income from the reversal of provisions for contingent liabilities and other commitments of €1 million (2015: €1 million).

General and Administrative Expenses General administrative expenses declined to €156 million during the year under review (2015: €160 million) against the background of reduced personnel expenses.

Public Investment Finance (PIF)

The PIF business segment comprises financing eligible for covered bonds aimed at the provision of public infrastructure. The volume of new business amounted to €1.0 billion during the year under review (2015: €1.6 billion). Profit or loss before tax stood at €3 million (2015: €13 million) and was thus in line with projections, guiding for slightly positive pre-tax profit.

Public Investment Finance		2016	2015	Change
Operating performance				
Operating income	in € million	30	41	–11
Net interest and commission income	in € million	35	44	–9
Net interest income	in € million	35	44	–9
Net fee and commission income	in € million	–	–	–
Net trading income	in € million	–1	–	–1
Net income from financial investments	in € million	1	5	–4
Net income from hedging relationships	in € million	1	2	–1
Net other operating income/expenses	in € million	–6	–10	4
Loan loss provisions	in € million	–	–	–
General and administrative expenses	in € million	–26	–28	2
Net miscellaneous income/expenses	in € million	–1	–	–1
Profit or loss before tax	in € million	3	13	–10
Key ratio				
Cost-income ratio	in %	86.7	68.3	
Balance-sheet-related measures		**31.12.2016**	**31.12.2015**	
Financing volumes	in € billion	7.4	7.3	
Exposure at Default[1]	in € billion	8.5	8.3	
Risk-weighted assets[2]	in € billion	1.4	1.4	
Equity (excluding revaluation reserve)	in € billion	0.3	0.2	

[1] For details see Risk and Opportunity Report.
[2] Including weighted credit risk positions and capital charges for market risk positions and operational risk, using a scaling factor of 12.5.

Operating Income Net interest income of €35 million slightly declined compared to the previous year (€44 million), given that the previous year's figure benefited from the sale of promissory note loans generating income of €9 million. Furthermore, increasing allocated funding expenses led to a decline in net interest income. However, allocated fees from early terminations increased to €6 million (2015: €3 million). The average total financing volume grew to €7.3 billion (2015: €7.0 billion) at a stable portfolio margin. Net trading income of €–1 million (2015: €0 million) resulted from market rate fluctuations of interest derivatives not covered by hedging relationships. Income from security disposals led to a net income from financial investments of €1 million (2015: €5 million). Net other operating income/expenses amounted to €–6 million (2015: €–10 million), inter alia, with the allocated bank levy.

Loan Loss Provisions No net additions or reversals were necessary in the financial years 2016 and 2015.

General and Administrative Expenses General and administrative expenses declined from €28 million in 2015 to €26 million in 2016, which was due to lower personnel expenses.

Value Portfolio (VP)

The VP operating segment includes all non-strategic portfolios and activities of pbb Group. The bank does not enter into new business in this segment. Profit or loss before tax stood at €145 million (2015: €–30 million) and was thus ahead of projections, guiding for overall balanced results. The Heta effects were the key driver of this development.

Value Portfolio		2016	2015	Change
Operating performance				
Operating income	in € million	165	–5	170
Net interest and commission income	in € million	40	68	–28
Net interest income	in € million	41	68	–27
Net fee and commission income	in € million	–1	–	–1
Net trading income	in € million	–3	1	–4
Net income from financial investments	in € million	121	–55	176
Net income from hedging relationships	in € million	2	4	–2
Net other operating income/expenses	in € million	5	–23	28
Loan loss provisions	in € million	–3	–6	3
General and administrative expenses	in € million	–16	–19	3
Net miscellaneous income/expenses	in € million	–1	–	–1
Profit or loss before tax	in € million	145	–30	175
Key ratio				
Cost-income ratio	in %	9.7	>100.0	
Balance-sheet-related measures		**31.12.2016**	**31.12.2015**	
Financing volumes	in € billion	15.8	18.7	
Exposure at Default[1]	in € billion	19.5	21.7	
Risk-weighted assets[2]	in € billion	4.1	4.4	
Equity (excluding revaluation reserve)	in € billion	1.5	1.5	

[1] For details see Risk and Opportunity Report.
[2] Including weighted credit risk positions and capital charges for market risk positions and operational risk, using a scaling factor of 12.5.

Operating Income Net interest income declined to €41 million (2015: €68 million) based on the scheduled reduction of the financing volume, and due to the fact that no income was generated from the sale of promissory note loans during the year under review (2015: €25 million). On a positive note, early termination fees increased to €17 million (2015: €6 million). Net income from financial investments of €121 million (2015: €–55 million) comprised positive non-recurring Heta effects in the amount of €123 million. Additional write-downs of €73 million on Heta, partly offset by net income from security disposals, led to a net loss from financial investments in the previous year. Net other operating income/expenses in the amount of €5 million (2015: €–23 million) was burdened by the allocated bank levy, partly offset by subsequent income in connection with the disposal of securities.

Loan Loss Provisions Net additions to loan loss provisions amounted to €3 million (2015: €6 million). Reversals of specific allowances on the Heta exposure of €9 million were offset by additions to portfolio-based allowances of €12 million, which were related to an internal risk assessment for a region in Southern Europe.

General and Administrative Expenses General and administrative expenses declined to €16 million during the year under review (2015: €19 million) against the background of reduced personnel expenses.

Consolidation & Adjustments (C&A)

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

Consolidation & Adjustments		2016	2015	Change
Operating performance				
Operating income	in € million	7	6	1
Net interest and commission income	in € million	7	6	1
Net interest income	in € million	7	6	1
Net fee and commission income	in € million	–	–	–
Net trading income	in € million	–	–	–
Net income from financial investments	in € million	–	–	–
Net income from hedging relationships	in € million	–	–	–
Net other operating income/expenses	in € million	–	–	–
Loan loss provisions	in € million	–	–	–
General and administrative expenses	in € million	–	–	–
Net miscellaneous income/expenses	in € million	–	–	–
Profit or loss before tax	in € million	7	6	1
Balance-sheet-related measures		**31.12.2016**	**31.12.2015**	
Exposure at Default[1)]	in € billion	5.5	5.6	
Risk-weighted assets[2)]	in € billion	1.2	1.1	
Equity (excluding revaluation reserve)	in € billion	0.4	0.4	

[1)] For details see Risk and Opportunity Report.
[2)] Including weighted credit risk positions and capital charges for market risk positions and operational risk, using a scaling factor of 12.5.

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

DEVELOPMENT IN ASSETS

Assets

in € million	31.12.2016	31.12.2015[1]	Change
Cash reserve	1,136	1,265	–129
Trading assets	1,089	1,600	–511
Loans and advances to other banks	2,841	2,742	99
Loans and advances to customers	41,146	41,226	–80
Allowances for losses on loans and advances	–130	–149	19
Valuation adjustment from portfolio hedge accounting	2	1	1
Financial investments	12,845	14,927	–2,082
Property and equipment	8	10	–2
Intangible assets	24	21	3
Other assets	3,550	5,013	–1,463
Income tax assets	118	105	13
Current tax assets	47	21	26
Deferred tax assets	71	84	–13
Total assets	**62,629**	**66,761**	**–4,132**

[1] Adjusted according to IAS 8.14 et seq. Details are disclosed in Note "Consistency".

General Development in Assets

Total assets of the pbb Group as at 31 December 2016 amounted to €62.6 billion, down 6.2% from the previous year's level (31 December 2015: €66.8 billion). The decline was attributable in particular to maturities of financial investments in the amount of €2.3 billion. Furthermore, on-balance sheet netting of derivatives entered into with Eurex Clearing led to a reduction of total assets of €1.8 billion. Out of the total netting amount, €1.4 billion was attributable to hedging derivatives disclosed as other assets or other liabilities, while €0.4 billion was attributable to derivatives disclosed as trading assets or trading liabilities.

As at the reporting date, the notional volume of the strategic portfolios remained stable at €31.5 billion (31 December 2015: €31.3 billion). The non-strategic portfolio declined from €18.7 billion on 31 December 2015 to €15.8 billion, as anticipated.

Investments

Given the business model, investments in property and equipment and intangible assets are of minor significance. Additions to intangible assets amounted to €12 million during the year under review (2015: €6 million) and were due, inter alia, to a project aiming at the further optimisation of the finance and risk IT target structure. Service rendered by third parties were used for internally developed software. These investments covered all segments of pbb Group.

DEVELOPMENT IN FINANCIAL POSITION

Equity and liabilities

in € million	31.12.2016	31.12.2015	Change
Liabilities to other banks	3,179	2,514	665
Liabilities to customers	9,949	10,824	–875
Securitised liabilities	40,381	42,648	–2,267
Valuation adjustment from portfolio hedge accounting	1	1	–
Trading liabilities	1,355	1,643	–288
Provisions	242	229	13
Other liabilities	3,778	4,918	–1,140
Income tax liabilities	59	113	–54
Current tax liabilities	59	113	–54
Subordinated capital	886	1,125	–239
Liabilities	**59,830**	**64,015**	**–4,185**
Equity	2,799	2,746	53
Total equity and liabilities	**62,629**	**66,761**	**–4,132**

Liabilities

Liabilities amounted to € 59.8 billion (31 December 2015: € 64.0 billion). Securitised liabilities were down to € 40.4 billion (31 December 2015: € 42.6 billion), which was attributable particularly to maturing Pfandbriefe. In line with total assets, on-balance sheet netting of derivatives entered into with Eurex Clearing led to a reduction of trading liabilities and other liabilities.

Equity

The equity attributable to shareholders changed as follows:

Equity

in € million	31.12.2016	31.12.2015	Change
Equity attributable to shareholders	**2,799**	**2,746**	**53**
Subscribed capital	380	380	–
Additional paid-in capital	1,637	1,637	–
Retained earnings	656	483	173
Gains/losses on pension commitments	–82	–71	–11
Foreign currency reserve	3	4	–1
Revaluation reserve	8	83	–75
AfS reserve	–36	–4	–32
Cash flow hedge reserve	44	87	–43
Consolidated profit	197	230	–33
Total Equity	**2,799**	**2,746**	**53**

As in the previous year, pbb's subscribed capital amounted to € 380,376,059.67 as at 31 December 2016, and is composed of 134,475,308 registered ordinary bearer shares with no par value and a notional interest in the subscribed capital of appoximately € 2.83 per share.

Amendments to actuarial assumptions led to two opposite effects in the item profit/losses on pension commitments: the discount rate used to measure defined benefit pension obligations fell from 2.25% as at 31 December 2015 to 1.75% as at 31 December 2016, reflecting market interest rates, which eventually led to a decline in pbb Group's equity. The decline in equity was partly offset by reducing the rate of increase in pension obligations to 1.50% (31 December 2015: 1.75%). Overall, equity declined by €11 million.

The decline in the AfS reserve largely reflected deteriorated spreads for sovereign bonds issued by Southern European countries. pbb Group has ceased active cash flow hedge accounting, meaning that changes in the cash flow hedge reserve only reflect utilisations. The remaining cash flow hedge reserve will be reversed in line with the hedged cash flows from underlying transactions.

In May 2016, a dividend of € 57,824,382.44 (or € 0.43 per share) was distributed. The remaining profit 2015 was appropriated to retained earnings, and thus increased equity by €173 million.

The Management Board and Supervisory Board will propose to the Annual General Meeting (scheduled for 30 May 2017) to distribute a dividend of €1.05 per share entitled to dividends.

Key Regulatory Capital Ratios[1]

The CET1 ratio amounted to 19.5% as at 31 December 2016 (31 December 2015: 18.9%), the own funds ratio amounted to 23.7% (31 December 2015: 23.4%). Fully phased-in, therefore after expiry of all Basel III transitional regulations, CET1 ratio amounted to 19.0% (31 December 2015: 18.2%) and own funds ratio to 20.7% (31 December 2015: 19.9%). Please refer to the Risk and Opportunity Report for further information regarding the key regulatory capital ratios.

Liquidity

Principles and Objectives of the Liquidity and Financial Management

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

[1] After confirmation of the 2016 financial statements, less the proposed dividend (subject to approval by the Annual General Meeting).

Maturities

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

Statement of financial position maturity structure

in € million	31.12.2016 Assets	31.12.2016 Equity and liabilities	31.12.2015 Assets[1]	31.12.2015 Equity and liabilities
Total	**62,629**	**62,629**	**66,761**	**66,761**
up to 3 months	6,171	8,761	6,490	6,247
More than 3 months to 1 year	4,595	5,200	4,344	6,995
more than 1 year to 5 years	20,773	19,231	22,246	24,024
More than 5 years	26,429	21,203	27,080	19,845
Other assets[2]/equity and liabilities[3]	4,661	8,234	6,601	9,650

[1] Adjusted according to IAS 8.14 et seq. Details are disclosed in Note „Consistency“.
[2] Trading assets, allowances for losses on loans and advances, valuation adjustment from portfolio hedge accounting, property and equipment, intangible assets, other assets, income tax assets.
[3] Valuation adjustment from portfolio hedge accounting, trading liabilities, provisions, other liabilities, income tax liabilities, equity.

Liquidity Management

Liquidity management within pbb Group is performed centrally by pbb's Treasury division. The sales units are refinanced internally on a one-to-one basis when they enter into new business. This means that risks are bundled and centrally managed. The liquidity ratio is calculated at the level of the individual institution at pbb in accordance with the Liquiditätsverordnung (LiqV – German Liquidity Regulation), and amounted to 1.6 at the balance sheet date (31 December 2015: 2.9). This was significantly higher than the statutory minimum of 1.0. The Monitoring of complying with liquidity ratios within foreign regulations of permanent establishments is also ensured, if this is demanded by local regulatory authorities.

Funding

In the financial year 2016, a new long-term funding volume of € 5.6 billion (2015: € 4.5 billion) was realised. The total amount comprised unsecured issues as well as Pfandbrief issues, both in the form of benchmark issues and private placements. € 2.7 billion (2015: € 2.6 billion) was attributable to unsecured issues, €1.2 billion (2015: €1.2 billion) of which was in the form of benchmark issues and €1.5 billion (2015: €1.4 billion) in the form of private placements. € 2.9 billion (2015: €1.9 billion) was attributable to Pfandbrief issues, € 2.3 billion (2015: €1.0 billion) of which was in the form of benchmark issues, and € 0.6 billion (2015: € 0.9 billion) in the form of private placements. Most issues were placed as fixed-rate bonds. Unhedged interest rate exposures are usually hedged by swapping fixed against floating interest rates.

Overnight and term deposits from retail investors taken via "pbb direct" amounted to € 3.5 billion as at 31 December 2016 (31 December 2015: € 2.6 billion).

Benchmark issues

ISIN	Announcement	Settlement	Maturity	Coupon in %	Volume in million	Issue price in %	Currency
Unsecured Issues							
DE000A13SWD8	28.1.2016	4.2.2016	4.2.2019	1.250	500	99.816	EUR
DE000A12UAR2 (tap)[1]	4.3.2016	11.3.2016	17.9.2019	1.500	100	101.382	EUR
DE000A13SWH9	19.4.2016	26.4.2016	27.4.2020	1.125	500	99.751	EUR
CH0341440300	20.10.2016	2.11.2016	2.11.2021	0.300	100	100.074	CHF
Pfandbriefe							
DE000A13SWC0 (mortgage Pfandbrief)	12.1.2016	19.1.2016	19.1.2023	0.500	750	99.221	EUR
DE000A13SWE6 (mortgage Pfandbrief)	22.2.2016	29.2.2016	1.3.2022	0.200	500	99.863	EUR
DE000A13SWG 1 (public sector Pfandbrief)	13.4.2016	20.4.2016	20.4.2035	1.250	500	99.647	EUR
DE000A1PG3M8 (3rd tap)[2]	11.7.2016	18.7.2016	20.12.2019	1.875	100	102.817	GBP
DE000A2AAVU8 (public sector Pfandbrief)	23.8.2016	31.8.2016	30.8.2019	1.625	500	99.954	USD
DE000A1PG3M8 (4th tap)[2]	19.10.2016	26.10.2016	20.12.2019	1.875	25	102.351	GBP

[1] Tap of an unsecured benchmark issue in the original amount of € 300 million on 10 September 2014.
[2] Tap of a mortgage Pfandbrief in the original amount of GBP 250 million on 6 November 2012.

Ratings

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

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

	31.12.2016			31.12.2015		
	Standard & Poor's	DBRS	Moody's	Standard & Poor's	DBRS	Moody's
Long-term issuer rating/ outlook	BBB/Credit Watch Positive	BBB/Stable	–	BBB/Stable	BBB/Stable	–
Short-term issuer rating/ outlook	A-2/–	R-2 (high)/ Stable	–	A-2/–	R-2 (high)/ Stable	–
Long-term senior unsecured debt rating/outlook	BBB/ CreditWatch Developing	BBB/Stable	–	BBB/Stable	BBB/Stable	–
Public Sector Pfandbriefe	–	–	Aa1	–	–	Aa1
Mortgage Pfandbriefe	–	–	Aa1	–	–	Aa1

[1] This overview does not include all ratings.

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

During the financial year 2016, pbb's unsecured ratings were substantially influenced by legislative changes and, in this context, changes to rating methodologies. Particularly in view of the growing specifications with regard to implementing the European Bank Recovery and Resolution Directive (BRRD), rating actions took place or rating agencies have announced the possibility of further rating adjustments.

Standard & Poor's (S&P)
Due to the regulatory changes related to the BRRD, S&P intends to split the rating class for "senior unsecured" debt. Depending on the future ranking in a "bail-in" or insolvency scenario, such debt will be allocated either to a new "senior subordinated" rating class or remain in the current "senior unsecured" rating class.

Thus, S&P launched a review of the ratings assigned to unsecured refinancing instruments of 13 German banks, as well as of unsecured long-term issuer ratings of the four systematically important banks within this group of 13, including pbb, on 15 December 2016. S&P named the statutory subordination of specific unsecured securities valid in Germany as of 1 January 2017 as the main reason for the proposed rating adjustments.

The following changes occurred for pbb:
- The long-term issuer credit rating was confirmed at "BBB" and, due to the expected consideration of "senior subordinated" debt within the Additional Loss-Absorbing Capacity framework ("ALAC"), was changed to "CreditWatch Positive". The resulting potential for a rating upgrade amounts to up to two notches – depending on the size of the subordinated buffer (ALAC), which has yet to be determined by S&P. The short-term issuer rating was confirmed at "A-2".
- Simultaneously, the long-term ratings for "senior unsecured" debt were changed to "CreditWatch Developing": depending on the securities' classification within the new rating categories, the ratings of individual unsecured refinancing instruments can be lowered by likely one notch if they are allocated to the "senior subordinated" category, and in case of an allocation to the category "senior unsecured" and depending on a potential improvement of the long-term issuer rating, be raised by up to two notches or be confirmed at their current level.
- In addition, pbb's "Standalone Credit Profile" (SACP) showed a positive development. S&P raised this rating by one notch on the back of a higher capital assessment – from "bbb–" to "bbb". In return, the previously existing additional so-called "transitional" rating uplift for anticipated subordinated buffers (ALAC) was eliminated from the issuer credit rating. The SACP improvement had a positive effect on the ratings of subordinated refinancing instruments, elevating them by one notch and thus leading to ratings of "BB+" and "BB–", respectively.

DBRS
On 20 June 2016, DBRS affirmed the unsecured ratings assigned to the bank with an unchanged stable outlook. For rating actions after the reporting date with regards to subordinated debt instruments, we refer to the report on post-balance sheet date events.

Moody's
The Pfandbrief ratings assigned by Moody's remained unchanged throughout the financial year 2016.

Reasons for potential rating changes, as well as their impact on the development of pbb's assets, financial position and earnings, are discussed in more detail within the report on expected developments.

Off-balance-sheet obligations

Irrevocable loan commitments account for the majority of off-balance-sheet obligations and mounted to € 3.8 billion as at balance sheet date (31 December 2015: € 2.9 billion). Contingent liabilities resulted from guarantees and warranty agreements and amounted to € 0.2 billion as of 31 December 2016 (31 December 2015: € 0.2 billion).

MATERIAL RELATED PARTY TRANSACTIONS

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

SUMMARY

Thanks to significantly higher operating income and lower general and administrative expenses, pbb Group's profit or loss before tax of € 301 million for the 2016 financial year significantly exceeded the previous year's figure of €195 million. Operating income benefited from write-ups on Heta debt securities.

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

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

Report on Post-balance Sheet Date Events

On 13 January 2017, DBRS placed subordinated debt of 27 European banks, including those of pbb, under "Review with Negative Implications". The rating agency expects a rating downgrade by one notch, on the grounds that the probability of losses under BRRD has increased for all subordinated debt. The review is due to be concluded within 90 days.

No further significant events occured after 31 December 2016.

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. With regard to risks and opportunities relating to all areas of the Company and also general Company-specific risks and opportunities, please refer to the details in the report on expected developments.

ORGANISATION AND PRINCIPLES OF RISK AND CAPITAL MANAGEMENT

pbb Group had implemented a Group-wide risk management and risk control system, which provides for uniform risk identification, measurement and limitation in accordance with section 91 (2) of the German Stock Corporation Act (AktG) and section 25 a of the German Banking Act (Kreditwesengesetz – "KWG").

Organisation and Committees

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

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

The following are major components of the risk management system in the responsibility of the Management Board:

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

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

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

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

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

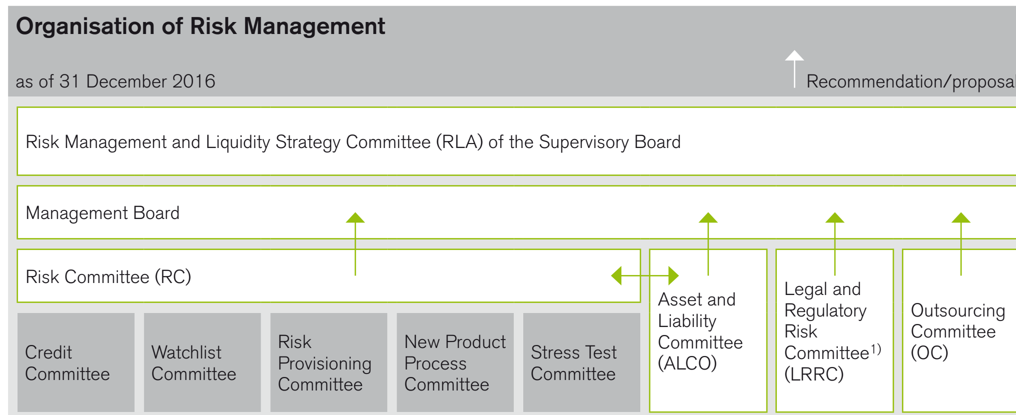
The **Watchlist Committee** is chaired by the CCOs (with delegation opportunities to a Senior Credit Executive) and meets every month. All exposures identified by the early warning system are discussed and, if appropriate, individual measures are decided there; these measures have to be subsequently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

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

The **New Product Process Committee** ensures that, before business commences with new products or in new markets, the resultant risks as well as the related impact on processes, controls and the infrastructure are systematically analysed and addressed. Only after approval of new product process committee business with new products or in new markets can be started.

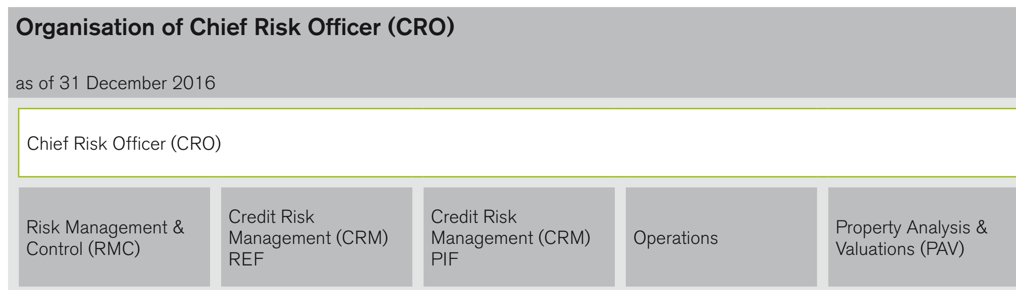
The **Stress Test Committee,** which is a sub-committee of the Risk Committee, is responsible for the methodology, performance and monitoring of the internal stress tests. It is chaired by the CRO. The Committee also contributes to the preparation of scenarios for the Recovery Plan which every bank is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

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



[1] Reporting via Compliance.

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



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

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

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

- The unit **Operations,** which is responsible for the global servicing and administration of the loan portfolio (including technical implementation of loan agreements), settlement of capital markets transactions, administration and processing of the Group's securities and derivatives portfolios, as well for handling domestic and international payments.
- The unit **Property Analysis & Valuation,** which is responsible for the analysis and uniform valuation of properties serving as collateral, using market valuation and loan-to-value methods.

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

Risk Strategy and -Policies

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

The risk strategy was last revised during the course of the annual strategy development process in February 2016, and adopted by the Management Board on 23 February 2016. The risk strategy was presented to the Risk Management and Liquidity Strategy Committee of pbb's Supervisory Board for acknowledgement, and approved by the plenary meeting of the Supervisory Board on 26 February 2016. The risk strategy was updated during the course of the third quarter of the year under review. It was adopted by the Management Board on 26 July 2016 and approved by the Supervisory Board on 12 August 2016. There were no further updates during the course of 2016. The next update of the risk strategy is scheduled to take place during the annual strategy development process for 2017.

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

Risk Reporting

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

Risk Quantification and Risk Management

For the purposes of systematically identifying and analysing potential risks arising from the business model or pbb Group's external environment, the Group carries out a comprehensive risk inventory once a year. The objective of this risk inventory is to establish a complete and meaningful risk profile which assesses all identified risks as to whether they are material for pbb Group and, where possible, quantifies them using applicable risk models or other methods. Risks which cannot be quantified (or only in part) are monitored and managed using dedicated capital buffers or separate management tools, as well as by way of regular, detailed reports and clearly-defined requirements such as the Compliance and Corporate Governance guidelines.

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

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

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

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

RISK TYPES

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

The following are major risk types of pbb Group which are not quantified but which are limited by means of suitable reports, guidelines and policies:
- Strategic risks
- Regulatory risks

Credit Risk (Counterparty Risk)

Definitions

The credit risk in general is defined as the risk of an unexpected default or decline in the fair value of a receivable (loan or bond) or a derivative, resulting from a deterioration in the hedging situation or deterioration in the creditworthiness of a country or a counterparty.

The credit risk comprises the loan risk, counterparty default risk, issuer risk, country risk, concentration risk, fulfilment risk, tenant risk, realisation risk (related to defaulted clients) and extension risk, which are defined as follows in pbb Group's risk strategy:

- > Loan risk is defined as the risk which considers loans and traditional credit products. A major factor determining the loan risk is the ability of the borrower to fulfil his financial obligations as well as the value of collateral in the case of a borrowers' default. Declines in the fair value as a result of rating changes are taken into consideration for risk measurement within the framework of Pillar II.
- > Counterparty default risk is defined as the risk of a potential unexpected default or decline in the fair value of a claim or a derivative. This is due to a deterioration in the creditworthiness of a counterparty or a deterioration of the hedging situation. The counterparty default risk includes the replacement risk and the repayment risk.
- > Issuer risk is defined as the risk in relation to bonds and other securities. In particular, it refers to the ability of the issuer to meet his financial obligations and also relates to the value of collateral in the event of the default of an issuer. Declines in the fair value as a result of rating changes are taken into consideration for calculating the issuer risk.
- > Country risk arises from changes in the values of international exposures due to country-specific political and economic conditions. It essentially comprises the risk that arises in connection with business activities in certain countries. The country risk includes the conversion risk, transfer risk and sovereign default risk.
- > Concentration risk is defined as the risk of cluster formation in relation to a risk factor or counterparty, or a strongly correlated group of risk factors or counterparties.
- > Fulfilment risk is defined as the risk that the Bank makes a payment or delivers an asset which has been sold to a counterparty but does not receive a payment or the purchased asset.
- > Tenant risk describes the risk that losses in rental income for properties will negatively influence the respective borrowers' debt service capacity. In addition, it includes the secondary concentration risk (tenant cluster risk), which arises when one and the same tenant is involved in multiple properties funded by the bank.
- > Realisation risk occurs with defaulted clients; it is defined as the risk that actual proceeds – in the event of realisation – differ from projections, or that specific provisions or portfolio-based allowances recognised will need to be adjusted in the event of a change in expected realisation proceeds.
- > Extension risk is defined as the risk that migration and default risks increase as a result of an unexpected extension of the holding period.

Credit Risk Strategy and Principles

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

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

Credit Risk Reports

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

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

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

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

Stress Tests The stress tests for economic capital in credit risk are described in greater detail in the section "Result of Risk-bearing Capacity Analysis".

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

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

Credit Risk Management and Monitoring

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

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

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

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

Depending upon the counterparty group, Expected Loss class or exposure size at GCC (Group of connected clients) level, the lending authority regulations determine the approval powers of individual Credit Officers for new or existing exposures. Moreover, lending authorities for new business are defined by reference to individual credit risks.

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

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

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

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

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

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

A restructuring plan or workout plan is drawn up for critical or impaired exposures, as part of an individual strategy. The decision regarding restructuring or workout takes account of scenario analyses

for the potential development of the borrower, the collateral or the relevant market. These analyses are presented to the Credit Committee, which approves them or issues a recommendation for approval to holders of higher lending authority.

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

Hedging and Minimising Risk by Collateral

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

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

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

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

In the PIF segment, guarantees are often accepted as collateral (including contractual guarantees from public-sector authorities, export credit guarantees). Moreover, Public Investment Finance exposures often involve a specific legal framework, such as the support obligation (Anstaltslast) of public-sector entities, or other (direct and indirect) cover mechanisms which allow for recourse to a public-sector institution in the case of borrowers organised under public law.

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

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

For most products, EaD is equal to the IFRS carrying amount (including accrued interest). Committed, undrawn credit lines are additionally included in EaD with a product-specific credit conversion factor (CCF). The CCF indicates the portion of an undrawn credit line that is expected to be drawn upon (based on experience) within one year before a potential default. Derivatives and repo 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.

As of 31 December 2016 the Group-wide credit portfolio EaD amounted to €60.7 billion (31 December 2015: €61.6 billion). This figure includes assets not regarded upon as core exposure of pbb Group, with an EaD of €0.2 billion (EaD as at 31 December 2015: €0.2 billion), which were selected for transfer to FMS Wertmanagement but where the legal transfer has not yet been possible as a result of various considerations. In 2010, the credit risk of these assets was transferred by means of guarantees provided by FMS Wertmanagement, so that pbb Group ultimately retains a counterparty risk with regard to FMS Wertmanagement and thus indirectly with regard to BRD in connection with these positions.

To adequately reflect pbb Group's actual economic risk exposure, the following overviews of portfolio development and structure do not include these positions. Without these positions the EaD for pbb Group's aggregate exposure totalled €60.6 billion as at 31 December 2016 (31 December 2015: €61.4 billion).

Overview of the Total Exposure of pbb Group: €60.6 billion EaD The credit portfolio is broken down into the following segments
> Real Estate Finance (REF),
> Public Investment Finance (PIF) as well as the
> non-strategic segment Value Portfolio (VP) which is earmarked for being wound down.

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

As of 31 December 2016, 57% (31 December 2015: 71%) of the EaD in C&A was attributed to the rating classes AAA to AA– and 27% (31 December 2015: 13%) of the EaD was attributed to the rating classes A+ to A–. 15% (31 December 2015: 16%) of the EaD was in the rating classes BBB+ to BBB–. The figure for the EaD in BB+ and positions rated lower was at 1% (31 December 2015: <1%). Internal rating classes were mapped to external rating classes for the purpose of determining the breakdown of EaD by rating class.

Total portfolio: EaD according to business segments

in € billion	31.12.2016	31.12.2015	Change in € billion	Change in %
Real Estate Finance	27.1	25.8	1.3	5.0
Public Investment Finance	8.5	8.3	0.2	2.4
Value Portfolio	19.5	21.7	−2.2	−10.1
Consolidation & Adjustments	5.5	5.6	−0.1	−1.8
Total	**60.6**	**61.4**	**−0.8**	**−1.3**

As of 31 December 2016 the total exposure at default (EaD) of pbb Group decreased compared to year-end 2015 by €0.8 billion to €60.6 billion. On the whole, the percentage share of EaDs in the strategic segments REF (45%; 31 December 2015: 42%) and PIF (14%: 31 December 2015: 14%) increased whereas it decreased in the non-strategic VP (32%; 31 December 2015: 35%). The percentage share of the EaD in C&A remained stable at 9% compared to year-end 2015. Explanations concerning changes in individual segments are provided with the detailed presentation of the respective segment.

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

Expected Loss for pbb Group totalled €83 million as at 31 December 2016 (31 December 2015: €73 million). The increase in Expected Loss was mainly attributable to the downgrading of a foreign regional government; this was partially offset by repayments, and an update to the parameters of the LGD model (as part of the annual validation) for domestic real estate lending.

The figure was split to the segments as follows:

Total exposure: expected loss according to business segments

in € million	31.12.2016	31.12.2015	Change in € million	Change in %
Real Estate Finance	46	51	-5	-9.8
Public Investment Finance	2	2	–	–
Value Portfolio	35	20	15	75,0
Consolidation & Adjustments	1	–	1	100,0
Total	**83**	**73**	**10**	**13,7**

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

Economic Credit Risk Capital pbb Group calculates economic capital for credit risk using a credit portfolio model. For details concerning credit risk quantification, please refer to the section "Result of Risk-bearing Capacity Analysis".

Regional Breakdown of the Portfolio At the reporting date, the main focus of the exposure of pbb Group was unchanged on Western Europe. Germany continued to account for most of the overall exposure, with 41% (€ 25.0 billion). The € 0.4 billion year-on-year decline in EaD for Germany was mainly attributable to repayments of matured promissory notes in VP. Exposure expansion in France reflected new business originated in the strategic REF and PIF segments. The reduction in the exposure to Austria was mainly due to the sale of Heta bonds, whereby this was offset to some extent by exposure increases due to fair value adjustments. The minor EaD reduction for exposure to the United Kingdom was driven by exchange rate effects, whilst purchases of bonds for the liquidity reserve caused a slight increase in EaD for Spain.

The category "Other Europe" new business in the REF segment led to an exposure increase in the Netherlands.

The category "Other", which accounted for € 2.1 billion (or around 3% of the portfolio), largely comprises bonds issued by supranational organisations. The largest items of the category "Other Europe" were the Netherlands with € 0.8 billion, Switzerland with € 0.4 billion as well as Slovenia and Belgium with € 0.4 billion each (31 December 2015: the Netherlands € 0.3 billion, Switzerland € 0.4 billion, Slovenia € 0.3 billion and Belgium € 0.4 billion).

A € 0.3 billion EaD decline for exposure to the Czech Republic was due to repayments.

Total portfolio: EaD according to regions

			Change	
in € billion	**31.12.2016**	**31.12.2015**	in € billion	in %
Germany	25.0	25.4	−0.4	−1.6
France	7.6	7.1	0.5	7.0
Austria	6.8	6.9	−0.1	−1.4
United Kingdom	5.0	5.1	−0.1	−2.0
Spain	4.3	4.2	0.1	2.4
Italiy	2.3	2.3	–	–
Other Europe[1]	2.1	1.8	0.3	16.7
Other[2]	2.1	2.4	−0.3	−12.5
Poland	1.6	1.6	–	–
Sweden	1.4	1.5	−0.1	−6.7
Portugal	1.2	1.4	−0.2	−14.3
Hungary	0.6	0.6	–	–
Czech Republic	0.4	0.7	−0.3	−42.9
Finland	0.4	0.5	−0.1	−20.0
Total	**60.6**	**61.4**	**−0.8**	**−1.3**

[1] Category "Other Europe" comprises amongst others the Netherlands, Switzerland, Slovenia, Belgium, Denmark, Luxembourg und Romania.
[2] Category "Other" comprises amongst others supranational organisations, the United States of America and Japan.

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

Real Estate Finance: € 27.1 billion EaD

The REF segment comprises real estate loans and related customer derivatives. EaD of the REF portfolio rose by a total of € 1.3 billion, compared to 31 December 2015, to € 27.1 billion. Customer derivatives in the portfolio accounted for EaD of € 0.4 billion as at 31 December 2016 and remained stable compared to year-end 2015.

The exposure increase in the REF segment was mainly due to new business in Germany, France and the Netherlands. Moreover, as a result of a regulatory review, the Credit Conversion Factor (CCF) for mortgage loans was increased during the fourth quarter of 2016, which increased EaD for undrawn loan commitments, especially for new business. A € 0.2 billion EaD decline for exposure to the Czech Republic was due to repayments.

Real Estate Finance: EaD according to regions

			Change	
in € billion	**31.12.2016[1]**	**31.12.2015[2]**	in € billion	in %
Germany	13.1	12.2	0.9	7.4
United Kingdom	4.7	5.0	-0.3	-6.0
France	3.3	3.2	0.1	3.1
Poland	1.4	1.3	0.1	7.7
Sweden	1.3	1.4	-0.1	-7.1
Other Europe[3]	1.2	0.8	0.4	50.0
Austria	0.5	0.3	0.2	66.7
Czech Republic	0.4	0.6	-0.2	-33.3
Hungary	0.3	0.4	-0.1	-25.0
Other[4]	0.3	–	0.3	100.0
Spain	0.3	0.3	–	–
Finland	0.2	0.3	-0.1	-33.3
Italy	0.1	<0.1	0.1	100.0
Portugal	–	<0.1	–	-100.0
Total	**27.1**	**25.8**	**1.3**	**5.0**

[1] Breakdown including custumer derivatives of approx. € 0.4 billion.
[2] Breakdown including custumer derivatives of approx. € 0.4 billion.
[3] Category "Other Europe" comprises amongst others the Netherlands, Switzerland, Slovenia, Luxembourg, Romania and Denmark.
[4] Category "Other" comprises the United States of America.

The breakdown of the portfolio by property type as at 31 December 2016 changed only slightly as against year-end 2015. The main items were still the property types "office buildings", with an EaD of € 8.9 billion or 33% of the overall REF portfolio (31 December 2015: € 8.5 billion, or 33%), and "retail" (€ 7.1 billion, or 26% of the REF portfolio – 31 December 2015: € 7.5 billion, or 29%). At 16%, the percentage share of financings for residential properties remained stable compared to the 2015 year-end, as well as the share of "logistics/storage" properties (11%). The "mixed-use" property category accounted for a share of 4% of the overall REF portfolio as at 31 December 2016 (unchanged from 31 December 2015), and "hotel/leisure" properties accounted for 5% (31 December 2015: 4%).

Real Estate Finance: EaD according to property type

in € billion	31.12.2016	31.12.2015	Change in € billion	Change in %
Office buildings	8.9	8.5	0.4	4.7
Retail	7.1	7.5	−0.4	−5.3
Housing construction	4.4	4.1	0.3	7.3
Logistics/storage	3.0	2.7	0.3	11.1
Mixed use	1.2	1.1	0.1	9.1
Hotel/leisure	1.3	1.0	0.3	30.0
Other	1.4	0.9	0.5	55.6
Total	**27.1**	**25.8**	**1.3**	**5.0**

At 31 December 2016, investment financings continued to dominate the portfolio (85%; 31 December 2015: 90%); development financings accounted for 13% of EaD (31 December 2015: 7%). 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	31.12.2016	31.12.2015	Change in € billion	Change in %
Investment financing	23.0	23.3	−0.3	−1.3
Development financing	3.6	1.9	1.7	89.5
Customer derivatives	0.4	0.4	–	–
Other	0.1	0.2	−0.1	−50.0
Total	**27.1**	**25.8**	**1.3**	**5.0**

Public Investment Finance: €8.5 billion EaD

The portfolio comprises the following financing:

(I) Financing concluded directly with a public sector debtor, eligible according to the German Pfandbrief Act, on the basis of a specific earmarking according to a defined product catalogue;

(II) Financing of companies, which have a public sector or private legal structure and funding, which are to a great extent collateralised with a public sector guarantee within the meaning of the German Pfandbrief Act (transport and utility companies, municipal utilities, special-purpose associations, management companies, non-profits, associations); and

(III) Financing of special-purpose vehicles, which are almost entirely collateralised with a public sector guarantee within the meaning of the German Pfandbrief Act. This also includes export financings covered by insurance policies or guarantees issued by the Federal Government or by other export credit agencies permitted for inclusion in Pfandbrief cover.

EaD in the Public Investment Finance segment increased compared to the end of the previous year, in particular as a result of new business originated in France. Besides an EaD decrease in Germany, this was offset, in particular, by a decline in EaD for Spain, due to maturing securities and loans. Overall, this translated into a net overall increase of €0.2 billion for the PIF segment.

Public Investment Finance: EaD according to regions

in € billion	31.12.2016	31.12.2015	Change in € billion	Change in %
France	3.4	2.9	0.5	17.2
Germany	2.6	2.8	−0.2	−7.1
Spain	1.5	1.7	−0.2	−11.8
Other Europe[1]	0.3	0.3	–	–
Austria	0.3	0.3	–	–
Finland	0.2	0.2	–	–
United Kingdom	0.1	0.1	–	–
Sweden	<0.1	<0.1	–	–
Other[2]	<0.1	0.1	−0.1	−100.0
Total	**8.5**	**8.3**	**0.2**	**2.4**

[1] Category "Other Europe" comprises Belgium and the Netherlands.
[2] Category "Other" exclusively comprises bonds issued by supranational organisations.

"Public Sector Borrowers" summarises claims against sovereign states (25%), public-sector enterprises (20%), and regional governments and municipalities (55%). The definition also includes exposures guaranteed by these counterparties.

Public Investment Finance: EaD according to counterparty structure

in € billion	31.12.2016	31.12.2015	Change in € billion	Change in %
Public sector borrowers	8.3	7.9	0.4	5.1
Companies/special-purpose entities[1]	0.3	0.4	−0.1	−25.0
Financial institutions[2]	<0.1	<0.1	–	–
Total	**8.5**	**8.3**	**0.2**	**2.4**

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

The EaD share of exposures in the PIF segment in rating classes AAA to AA– declined year-on-year, to 48% (31 December 2015: 52%), whilst the share in rating classes A+ to A– increased to 46% (31 December 2015: 37%). The share in rating classes BBB+ or lower declined overall. Internal rating classes were mapped to external rating classes for the purpose of determining the breakdown of EaD by rating class.

Public Investment Finance: according to internal ratings

in € billion	31.12.2016	31.12.2015	Change in € billion	Change in %
AAA to AA–	4.1	4.3	−0.2	−4.7
A+ to A–	3.9	3.1	0.8	25.8
BBB+ to BBB–	0.2	0.5	−0.3	−60.0
BB+ and worse	0.3	0.4	−0.1	−25.0
Total	**8.5**	**8.3**	**0.2**	**2.4**

Value Portfolio: € 19.5 billion EaD

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

The continued reduction of exposures as at 31 December 2016, compared to the previous year (31 December 2015), in line with strategy, was mainly due to reductions in exposures to Germany, Austria, Portugal and Poland; Austria and Germany continue to account for the lion's share of the portfolio. The reduction in exposures to Austria was largely due to the sale of Heta bonds.

Value Portfolio: EaD according to regions

			Change	
in € billion	31.12.2016	31.12.2015	in € billion	in %
Austria	6.0	6.3	–0.3	–4.8
Germany	5.7	6.6	–0.9	–13.6
Italy	2.2	2.3	–0.1	–4.3
Spain	1.8	1.8	–	–
Portugal	1.2	1.4	–0.2	–14.3
Other[1]	1.2	1.4	–0.2	–14.3
France	0.7	0.7	–	–
Other Europe[2]	0.3	0.5	–0.2	–40.0
Hungary	0.2	0.3	–0.1	–33.3
Poland	0.2	0.3	–0.1	–33.3
Czech Republic	<0.1	0.1	–0.1	–100.0
Finland	<0.1	<0.1	–	–
Total	**19.5**	**21.7**	**–2.2**	**–10.1**

[1] Category "Other" comprises supranational organisations and Japan.
[2] Category "Other Europe" comprises Slovenia, Switzerland, and Denmark.

EaD by Counterparty is shown including guarantees permitted under Basel II or other forms of credit support.

Value Portfolio: EaD according to counterparty structure

			Change	
in € billion	31.12.2016	31.12.2015	in € billion	in %
Public sector borrowers	17.1	19.3	–2.2	–11.4
Financial institutions	2.3	2.4	–0.1	–4.2
Companies	<0.1	<0.1	–	–
Total	**19.5**	**21.7**	**–2.2**	**–10.1**

Structured Products

pbb Group's residual holdings of Collateralised Debt Obligations guaranteed by one regional government had a notional value of € 0.6 billion as at 31 December 2016 (31 December 2015: € 0.6 billion) and a current fair value of € 0.6 billion (31 December 2015: € 0.6 billion).

The valuation of assets was based on available market prices.

Watchlist and Non-performing Loans

Early Warning System

The early warning system of pbb Group has defined criteria respectively threshold values (triggers) for including loans in the watchlist and for being classified as workout loans (e.g. past due payments, failure to meet financial ratios – e.g. loan-to-value [LTV], interest service coverage [ISC]). The system constantly monitors whether a trigger has been set off. In the event of any problems being identified, the counterparty is analysed and, where appropriate, promptly transferred to restructuring or workout loans. Watchlist and non-performing loans (restructuring and workout loans) are defined as follows:

- *Watchlist Loans* Payments past due by more than 60 days or another defined early warning signal is triggered (for instance insolvency of a main tenant in the REF segment).
- *Restructuring Loans* Payments past due by more than 90 days or another defined early warning signal is triggered (for instance insolvency of a borrower). The focus with restructuring is on active implementation of a restructuring concept – with the objective of either returning the exposure to regular coverage, or realising collateral on the market, without enforcement measures.
- *Workout Loans* There are no indications that the loan can be restructured. Enforcement measures have been/will be introduced, respectively specific allowances have been created or are planned.

Non-performing loan processing is also responsible for carrying out an impairment test in line with the relevant accounting regulations.

Development of Watchlist and non-performing loans of pbb Group

				31.12.2016				31.12.2015		Change
EaD in € million	REF	PIF	VP	Total[1]	REF	PIF	VP	Total[1]	in € million	in %
Workout Loans	3	–	–	3	3	–	–	3	–	–
Restructuring Loans	385	–	–	385	533	–	241	774	–389	–50.3
Non-performing loans[1]	**388**	**–**	**–**	**388**	**536**	**–**	**241**	**777**	**–389**	**–50.1**
Watchlist Loans	**37**	**–**	**237**	**274**	**91**	**–**	**244**	**335**	**–61**	**–18.2**

[1] No exposure in C&A.

Watchlist and non-performing loans declined by a total of €450 million during the period from 31 December 2015 to 31 December 2016.

Non-performing loans declined by €444 million (gross, without taking offsetting effects into account) or €389 million (net). This development was mainly driven by two effects: firstly, by the sale of guaranteed Heta bonds in a total amount of €241 million, and secondly, by successful restructuring and redemptions in an aggregate amount of €203 million. The reductions were offset by exposures totalling €55 million, which were newly classified as problem loans.

Watchlist exposures were reduced by a net €61 million. In the REF segment, three exposures totalling €48 million were returned to normal handling; two exposures totalling €6 million were repaid, and three exposures totalling €35 million were newly classified as problem loans. Furthermore, Watchlist exposures in the VP segment declined by €7 million, due to repayments. Conversely, a €13 million exposure in the REF segment was included on the Watchlist; one exposure with a volume of €22 million was restructured, and reclassified from 'problem loans' to the Watchlist.

Impairments and Provisions

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

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

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

The specific allowances are approved in the Risk Provisioning Committee.

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

Opportunities

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

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

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

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

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

Market Risk

Definition
Market risk is defined as the risk of a loss of value resulting from the fluctuation of the market values of financial instruments. Transactions entered into by pbb Group are mainly exposed to the following types of market risk:
> Credit spread risk (risk from changes in credit spreads)
> General interest rate risk (risk from changes in market interest rates)
> Volatility risk (risk from changes in implied volatility)
> Foreign currency risk (risk from changes in foreign exchange rates)
> Basis risk (risk from changes in OIS spreads, tenor spreads, and cross-currency basis spreads)
> Concentration risk (risk of additional losses due to a non-diversified portfolio mix)

Market Risk Strategy
pbb Group adheres to the following fundamental principles in relation to market risks:
> Transactions may be conducted exclusively in financial instruments which have successfully passed the new product process, and for which market values are either observable or determinable via a model.
> All positions entered into are subject to daily monitoring, in terms of risk and performance, by RMC.

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

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

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

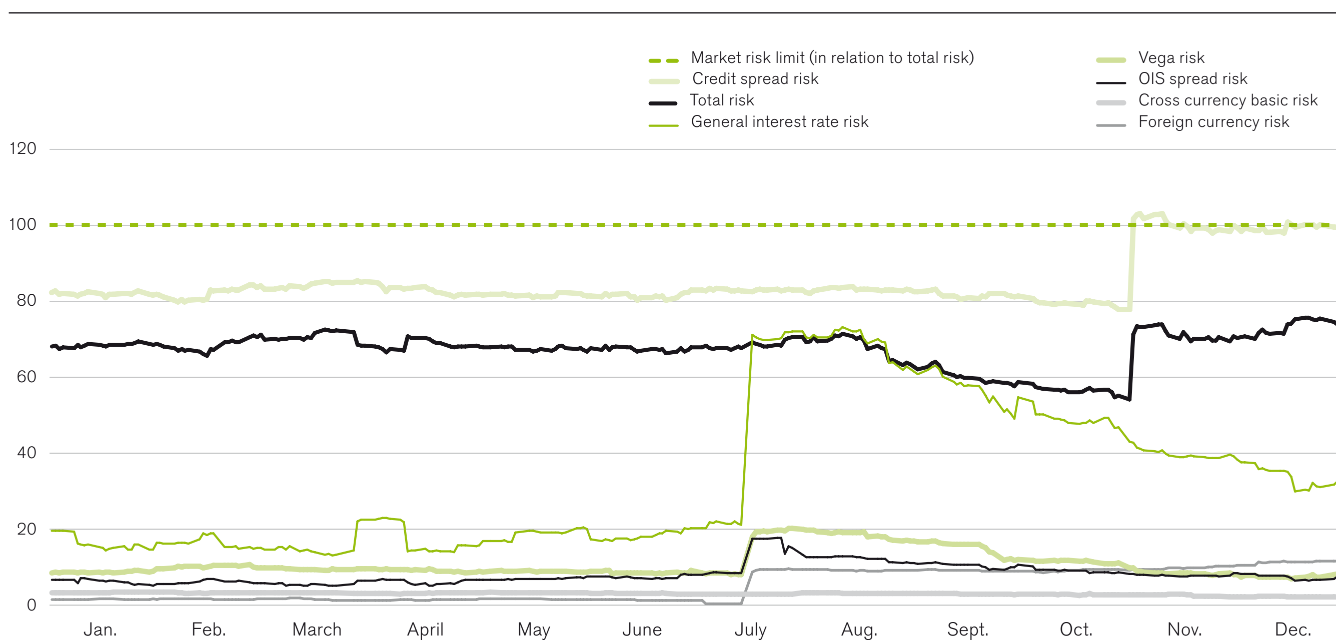
The increase in interest rate risks in the third quarter of 2016 was due to measurement and recognition effects of embedded interest rate floors in connection with asset and liability items bearing variable rates of interest. Such interest rate floors, resulting from legal restrictions as well as contractual stipulations, prevent the disbursement of interest payments to borrowers, or issuers of bearer bonds, due to negative interest rates. Using appropriate hedging transactions, pbb was able to reduce these risks during the second half of 2016, while total VaR was hardly affected at any time. During the fourth quarter of 2016, the model used for the calculation of economic capital for market risk was adjusted. Further it was integrated into the VaR model for consistency reasons, which eventually led to higher credit spreads and an increased total VaR.

Market risk VaR as at end of 2016 amounted to € 74 million, taking diversification effects between the individual market risk types into consideration (end of 2015: € 67 million). There were no breaches of market risk VaR limits at pbb Group level during the period under review. The market risk limit of pbb Group was increased from € 90 million to € 100 million as part of regular adjustments carried out at the beginning of 2016.

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

Market risk VaR (10 days, 99 %) of individual risk types and market risk limit January to December 2016

in € million



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

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

Stress Testing Whilst VaR measures market risk in «normal» market conditions and does not provide a measure for potential maximum losses, stress scenarios are used to show market risk in extreme conditions. pbb Group employs hypothetical stress scenarios for the main types of market risk, on a

monthly basis, to determine the impact of extreme changes in yield curves, foreign exchange rates, credit spreads and volatility on the economic present value of pbb Group's overall portfolio. Historical stress scenarios are simulated additionally. The 200 basis point parallel upwards shift in the yield curve – as required by regulatory authorities – would have resulted in market value profits of € 84 million as at end of 2016 (end of 2015: market value losses of € 116) on the aggregate exposure of pbb Group. Conversely, a 200 basis point parallel downwards shift in the yield curve would have resulted in market value losses of € 60 million (end of 2015: market value profits € 19 million). In order to reflect current prudential practices, customer margins have been applied in the simulations for the first time, which primarily accounts for the changes compared to the previous year. Discount rate curves which reflect the respective credit risk of transactions are now used for discounting; in the past, only swap curves were used for this purpose. The asymmetry between potential profits and losses is due, in particular, to the fact that the 200 basis point downward shift is capped at an interest rate of zero per cent. An extreme increase in the relevant credit spreads would have resulted in market value losses of € 267 million as at end of 2016. The Management Board and the executive bodies are informed about the results of stress test scenarios on a regular basis.

Back Testing The quality of the risk measurement methods in use is checked on an ongoing basis by comparing one-day VaR figures to the actual changes occurring in the portfolio's present value on a daily basis. pbb Group has adopted the Basel Capital Accord's "traffic light" system for the qualitative analysis of its risk model. For this purpose, the number of outliers detected in backtesting within a period of 250 trading days are counted. Overall, two outliers were observed as at end of 2016, based on a data history of 250 trading days which both were mainly attributable to extraordinarily strong fluctuations of credit spreads. The risk model employed by pbb Group therefore has "green" status, as defined in the "traffic light" system of the Basel Capital Accord.

Economic Capital for Market Risk The chapter "Result of Risk-bearing Capacity Analysis" provides details concerning the calculation as well as the quantification of economic capital for market risk.

Mapping and Recognition of Economic Hedges as On-balance-sheet Hedges

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

Market Risk Management, Monitoring and Reduction

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

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

Credit Spread Risk Credit spread risk reflects potential changes in the present value of exposures as a result of changes in the corresponding credit spread. The majority of credit spread risk is attributable to assets eligible as cover for Pfandbriefe. The Bank has risk measurement systems in place for calculating credit spread risk for all relevant exposures. Only credit spread risks of holdings classified under IFRS category "available for sale" (AfS) are subject to VaR limitation.

The credit spread VaR for the AfS portfolio amounted to € 100 million at the end of December 2016; the year-on-year increase (end of 2015: € 82 million) was primarily due to the model adjustment during the fourth quarter of 2016 as outlined above.

General Interest Rate Risk General interest rate risk increased significantly to € 33million as at end of 2016, compared to € 21 million as at end of 2015. As described earlier, the increase in General Interest Rate Risk was due to measurement and recognition effects of embedded interest rate floors in connection with asset and liability items bearing variable rates of interest.

Volatility Risk VaR used for the measurement of volatility risk amounted to € 9 million as at year-end 2016 (end of 2015: € 9 million). As described earlier, the increase in volatility risk in the second half of 2016 was due in particular to measurement and recognition effects of legal or contractual interest rate floors in connection with financial instruments bearing variable rates of interest. Subsequently pbb was able to reduce volatility risk by using appropriate hedging transactions.

Other Market Risks The present value of foreign currency risk was € 12 million as at end of 2016 (end of 2015: € 2 million). As described earlier, the increase in the second half of 2016 was due in particular to measurement and recognition effects of legal or contractual interest rate floors in connection with financial instruments bearing variable rates of interest.

Basis risks include OIS, cross-currency spread and tenor spread basis risks (including Libor/Euribor basis risks); these are quantified and recognised within the framework of the VaR model. All basis risks are included in aggregate VaR and are therefore subject to market risk limitation. The bank reported overnight index risks of € 8 million, tenor spread risks of € 0.4 million, and cross-currency spread risks of € 2 million on the reporting date. The bank is not exposed to share price or commodity risks. Financial derivatives are mainly used for hedging purposes.

Opportunities

As detailed above, the sensitivities result in value at risk: a possible future (economic) loss in the event of an unfavourable market development. The very same sensitivities may also result in economic gains, in the event of a positive market development. For instance, as described above, high negative credit spread sensitivities represent a risk. In the event of a narrowing of the relevant credit spreads, however, these credit spread sensitivities will yield economic profits, constituting an opportunity. Within the framework of the stress scenarios required by supervisory authorities, for example, a 200 basis point parallel upwards shift of the interest rate curve provides the opportunity for a market value gain of € 84 million.

Liquidity Risk

Definition

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

Liquidity Risk Strategy

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

Organisation of Liquidity Risk Management

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

Liquidity Risk Report

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

Liquidity Risk Measurement and Limits

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

The liquidity position resulting from the liquidity reserve as well as contractual and optional cash flows is measured in different scenarios, with three liquidity positions being projected on a daily basis. The projections assume:

- unchanged market and funding conditions (base scenario),
- a risk scenario (modified [historical] stress scenario) and
- liquidity stress ([historical] stress scenario).

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

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

The limit system consists of:

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

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

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

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

Liquidity Risk Monitoring and Management
Monitoring of liquidity risks is ascertained through daily reporting of the liquidity situation and a defined escalation process. A liquidity emergency plan has also been adopted in this context; this plan forms the functional and organisational framework for the handling of any liquidity shortages.

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

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

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

Development of pbb Group's Risk Position
The cumulative liquidity position (liquid assets plus projected net cash flows) determined as part of the liquidity risk measurement process as at 31 December 2016 amounted to €6.8 billion for a 12-month horizon in the base scenario – a €0.8 billion increase compared to the previous year (based on the same projection horizon). As at 31 December 2016, the cumulative liquidity position for a six-month horizon amounted to €3.5 billion in the risk scenario (31 December 2015: €4.0 billion).

pbb's liquidity ratio in accordance with the German Liquidity Ordinance was 1.6 as at 31 December 2016, thus exceeding the statutory minimum of 1.0.

Regulatory Liquidity Coverage Requirements (Liquidity Coverage Ratio, LCR)
A minimum Liquidity Coverage Ratio (LCR) of 70% has applied to regulatory liquidity reports since 1 January 2016; this minimum value will rise to 100% by 1 January 2018.

The figures determined (internally) for pbb Group were clearly above 100% throughout the reporting period.

Funding Markets
As in previous years, central banks represented both the major influencing as well as the major supporting forces on the market. The US Federal Reserve (the Fed) bolstered the economic cycle by waiving any reductions of its balance sheet and postponing further interest rate increases until after the US presidential elections. After the Brexit referendum, the Bank of England (BoE) found itself constrained to reduce its key interest rate to a record low of 0.25%. In March 2016, the European Central Bank (ECB) announced further key interest rates cuts as well as an expansion of its monthly securities purchase programme from €60 million to €80 million. ECB's deposit facility rate was reduced to -0.40% in March 2016. Besides the increase of the securities purchase programme, ECB also decided to expand the programme by accepting corporate bonds going forward. The ECB measures produced further deterioration in the market environment for investors, which was characterised by a steady decline in investment offerings as well as further interest rate and risk premium

cuts until well into the third quarter of 2016. Interest rates for medium- and long-term maturities increased considerably towards the end of the reporting period, translating into a slight widening of refinancing spreads for unsecured bank bonds and Pfandbriefe.

pbb was able to exploit this market environment. During the 2016 financial year, new long-term funding was raised in the amount of € 5.6 billion (2015: € 4.5 billion). The total amount comprised unsecured issues as well as Pfandbrief issues, both issued either in the form of benchmark issues or private placements. € 2.7 billion (2015: € 2.6 billion) was attributable to unsecured issues, € 1.2 billion (2015: € 1.2 billion) of which was in the form of benchmark issues and € 1.5 billion (2015: € 1.4 billion) in the form of private placements. € 2.9 billion (2015: € 1.9 billion) was attributable to Pfandbriefe issues, € 2.3 billion (2015: € 1.0 billion) of which was in the form of benchmark issues and € 0.6 billion (2015: € 0.9 billion) in the form of private placements. Most issues were placed as fixed-rate bonds. Unhedged interest rate exposures are usually hedged by swapping fixed against floating interest rates.

In addition to capital markets funding, pbb Group has extended its unsecured funding base through overnight and term deposits from retail investors. As at 31 December 2016, the volume of deposits taken via “pbb direkt” totalled € 3.5 billion (31 December 2015: € 2.6 billion).

On 23 November 2016, the European Commission published proposals suggesting amendments to the Capital Requirements Directive (CRD IV), the Capital Requirements Regulation (CRR), and the Bank Recovery and Resolution Directive (BRRD). pbb is currently unable to predict the timing of transposition into national law – let alone possible amendments brought about in the EU Parliament or the Council of Ministers. According to the European Commission’s proposals, German banks could be obliged to split unsecured refinancing into two separate risk classes going forward.

Forecast Liquidity Requirement

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

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

Funding Risk

Please refer to the description of business risk in the “Result of Risk-bearing Capacity Analysis” for details concerning funding risk.

Market Liquidity Risk

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

Opportunities

pbb Group's cumulative liquidity position of €6.8 billion in the base scenario over a 12-month horizon, which is detailed in the section "Development of pbb Group's Risk Position", as at 31 December 2016 provides the Group with scope for a flexible response, particularly with regard to possible new business.

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

Operational Risk (including Legal Risk)

Definition

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

Strategy for Operational Risk

The top priority of pbb Group's operational risk management is to prevent operational risk events and to meet the defined risk appetite. Key cornerstones of this strategy are the early recognition, systematic recording and assessment of operational risk, taking measures for risk mitigation as well as implementing early management reporting.

Organisation of Operational Risk Management including Legal Risk

Within RMC, the Operational Risk unit is responsible for coordinating consistent, Group-wide processes, tools and practices for the recording, assessment, monitoring, quantification and reporting of operational risks. Risk owners are responsible for the management of operational risk within pbb's business divisions. For instance, the Legal department is responsible, among other things, for the management of legal risks and hence forms an integral part of risk management in this context. IT and Corporate Office/Compliance are responsible for managing ICT risks.

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

pbb Group actively manages operational risk based on a framework applied consistently throughout the Group with the aim of systematically identifying an overall risk profile, and to define, prioritise, and implement measures to mitigate risks. Risk management is applied to all business processes in an overall approach. In addition, operational risk is analysed and assessed explicitly as part of major decision-making processes (such as new product processes and outsourcing agreements). The operational risk management strategy is adopted by the Management Board on an annual basis as part of the overall risk strategy, after the Risk Committee voting. The risk strategy describes the risk management framework as well as pbb Group's measures regarding operational risk.

In this context, pbb uses the following methods and procedures: recording – including the corresponding history - of loss events, Operational Risk Self-Assessment (ORSA) applied throughout the Group, as well as the analysis of theoretically possible scenarios. Furthermore, operational risk management comprises the quantification of risk by calculating the economic and regulatory capital requirements as well as training courses for employees designed to increase their risk awareness and enhance their competence to cope with situations associated with operational risk.

A structured and central reporting system is used to inform executive bodies at business divisional and Group level, the Risk Committee and other supervisory bodies concerning operational risk on a regular, timely and comprehensive basis. Reports are prepared on a monthly and quarterly basis (Group Risk Report), on a quarterly (KRI Report) or annual (Annual Risk Report) basis and are part of risk reporting to the entire Management Board, or the division heads. Risk reports comprise information on the current risk assessment at divisional level, on major loss events, hot topics regarding risk, performance of risk indicators, status of initiated measures as well as capital requirement developments.

Management of legal risks, as performed by the Legal department, is aimed at (a) the prevention of losses which could be incurred by business activities of pbb Group legally infeasible or insecure, and (b) the protection of pbb Group's integrity and reputation. In order to achieve this goal, the Legal department provides the entire pbb Group with a forward-looking, business-driven and comprehensive consultancy service.

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

In addition to the management activities described earlier, the Legal and Finance departments assess whether provisions for pending legal cases have to be recognised, and disclosed. Provisions for legal risks are recognised in accordance with IAS 37 for liabilities if (a) an obligation of pbb Group is probable, and (b) a reliable estimate can be made of the amount of the obligation. According to IAS 37.15, it is not clear whether there is a present obligation in rare cases. In such cases, pbb takes into account all available evidence, including the opinion of experts, to assess whether provisions have to be recognised at the reporting date.

Legal risks are taken into consideration in the operational risk management framework, and are an integral part of, inter alia, the Key Risk Indicator Report, the Operational Risk Self-Assessment, and an analysis of risk events.

Risk Measurement

Please refer to the chapter "Result of Risk-bearing Capacity Analysis" 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 €69 million as at 31 December 2016 (31 December 2015: €64 million).

Operational Risks Profile of pbb Group

pbb Group suffered financial losses of €0.3 million from operational risks (excluding legal risks) during 2016 (2015: €2.8 million). Furthermore, pbb disclosed financial losses of €3.0 million from legal risks resulting mainly from net additions to provisions (31 December 2015: €8.2 million).

pbb suffered losses from operational risks which incurred mainly in the event categories "Execution, Delivery & Process Management" and "Clients, Products and Business Practices". The internal Operational Risk Self-Assessment (ORSA) delivered similar results.

Opportunities
Following the privatisation of pbb Group and the introduction of the new remuneration system, reliance on employees in key positions, as reported in previous years, declined. Furthermore, the harmonisation of IT systems led to reduced complexity within the IT landscape. Overall, pbb assesses its operational risk profile as stable.

Property Risk

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

pbb Group's own property portfolio (exclusively the result of salvage acquisitions carried out by subsidiaries) of pbb Group is limited to a few isolated cases. Salvage acquisitions are not regarded as a part of the Company's objectives (within the meaning of its business strategy) but are subject to a case-by-case assessment. In this context, the fundamental objective is to develop such properties with reference to comprehensive real estate criteria, such as costs vs. income, increasing occupancy ratios, optimising usage options as well as further development of the location, and to work out solutions in individual cases – or to subsequently sell the property with the most favourable impact on value.

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

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

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP)

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

The risk inventory carried out in 2016 identified market risk, credit risk, business risk, operational risk and property risk as higher-level risks having an impact on capital and income; accordingly, these five types of risk were included in the ICAAP, and are being quantified using models or other methods. Within these types of risk, there are additional sub-risks on a granular level which were taken into account in the ICAAP during the period under review. Certain material types of risk, such as extension risk, settlement risk, realisation risk for defaulted loans, or pension risk, are integrated into the ICAAP in the form of buffers which are validated on a regular basis. Liquidity risk in the narrower sense is not being taken into consideration as part of calculating the risk-bearing capacity, since the Group's solvency is ascertained through a separate management approach.

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

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

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

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

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

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

Method Used for the individual Risk Types

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

The methods of calculating economic capital for the individual material risk types for 2016 are explained below:

Credit Risk in the ICAAP

For calculating the credit risk at the portfolio level, pbb Group uses a credit portfolio model which is based on the approach of a so-called asset value model. The fundamental concept used involves the repeated simulation of correlated rating migrations for borrowers, whereby the associated portfolio revaluation is used to derive a statistical distribution of losses – which is in turn used to derive economic capital in terms of unexpected losses. Economic capital quantifies the maximum unexpected loss, given a pre-defined confidence level, which may be incurred due to rating migrations (including defaults) in the lending business within a single year. Besides the loss distribution of the credit portfolio, as a significant result of this process, credit risk capital can be assigned to individual borrower units in line with the risks involved, using the so-called expected shortfall principle. This ensures a fair, risk-adequate allocation to borrowers, and thus constitutes a major cornerstone in the risk-oriented management of the credit portfolio. During the observation period, correlations between borrowers, borrower groups and regions were reviewed during the course of the regular validation process; updated correlations were applied during the fourth quarter of 2016.

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

Market Risk in the ICAAP (including Pension Risk)

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

The market risk methodology was developed further during the period under review: one of the changes implemented involved the inclusion of legal provisions with regard to negative interest rates in the measurement of financial instruments. Moreover, in the market risk model, the measurement of spread risk for liquid bonds was aligned with that of illiquid bonds; as a result (and in line with established market standards), all spreads are now defined relative to an overnight index swap (OIS) curve. Furthermore, risks from credit valuation adjustments (CVA), debt valuation adjustments (DVA) and funding valuation adjustments (FVA) for derivatives positions were integrated into market risk modelling for the first time during the period under review.

With pension risk, an additional facet of market risk was incorporated into the risk-bearing capacity analysis in 2016. Pension risk is defined as the risk of incurring additional expenses due to insufficient capitalisation of pension obligations from defined benefit plans. This type of risk is influenced most strongly by changes in the discount rate; it is quantified by way of simulating historical interest rate developments in the market risk model. However, pension risk is not disclosed directly under market risk; instead, it is deducted from available financial resources in the form of a buffer which is validated on a regular basis.

Operational Risk in the ICAAP

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

Business Risk in the ICAAP

pbb Group generally defines business risk as the risk of reductions in profit, due to changes in the external business environment which affect the Bank's economic conditions. Business risk comprises risks to income, which also include concentration risks, as well as funding risk. Adopting a conservative approach, planned income from new business is fully excluded from available financial resources. Funding risk comprises funding requirement risk (defined as the risk of an unexpected increase in funding costs, due to higher funding requirements) and funding spread risk (defined as an increase in funding costs due to widened funding spreads); this is mapped to business risk via scenario-based approaches, and reported accordingly. Unquantifiable risks such as regulatory or strategic risk are backed by capital using a buffer for risks which can only be partially quantified, or which cannot be quantified at all, deducted from available financial resources.

Property Risk in the ICAAP

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

Liquidity Risk in the ICAAP

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

RESULT OF RISK-BEARING CAPACITY ANALYSIS

Going-Concern

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

Going-Concern: economic capital

in € million	31.12.2016	31.12.2015	Change
Credit risk	188	221	–32
Market risk	177	155	22
Operational risk	21	41	–20
Business risk	–	–	–
Property risk	1	4	–2
Total before diversification effects	**387**	**420**	**–33**
Total after diversification effects	**357**	**390**	**–33**
Available financial ressources (free capital)	955	1,610	–655
Excess capital (+)/capital shortfall (–)	598	1,220	–623

A decline in diversified risk was observed at the reporting date. The increase in economic capital for market risk, mainly attributable to the first-time inclusion of economic capital for CVA, DVA and FVA risks from derivatives positions, as well as to adjustments in the measurement of liquid bonds, was more than offset by the decline in economic capital for credit risk and operational risk.

Credit risk declined mainly on account of updated correlation data in the credit portfolio model during the fourth quarter of 2016, whilst the decrease in operational risk was due to model updates.

Lower property risk was largely due to the sale of a property in Hungary, as well as to partial write-offs of foreclosed assets in Spain and Germany.

This is opposed by available financial resources in the form of so-called free capital, largely comprising available CET1 capital, plus accrued profits, less the CET1 capital necessary for covering the regulatory bank-specific minimum ratios according to SREP and additional adjustment items. In accordance with the principle of prudence, an additional charge in relation to risk-weighted assets is taken into account in order to determine the CET1 capital necessary for covering the regulatory minimum ratios. The free capital is calculated both on the basis of current figures, as well as on planned values over a time horizon of one year. The lower free capital arising from these calculations is used as available financial resources in the going-concern approach. The significant decline in free capital was mainly attributable to higher minimum regulatory requirements for Pillar 2. Year-end figures for 2015 had been based on capital ratios in accordance with the CRR ; since the beginning of 2016, the bank has applied a higher CET1 ratio to be protected, derived from the bank's individual CET1 ratio, as defined in the SREP. The higher CET1 ratio to be protected, as well as planning for higher RWA levels (as adopted during the second half of the year), both increased the level of capital tied up for regulatory purposes – free capital was reduced accordingly.

The reduction in economic capital (after diversification effects) and the simultaneous decline in available financial resources together led to lower excess coverage. Proof of pbb's riskbearing capacity as at the reporting date was thus evident in this approach.

The distribution of the economic capital according to segments was as follows:

Going-Concern: economic capital according to segments

in € million	31.12.2016	31.12.2015	Change
Real Estate Finance	96	124	−28
Public Investment Finance	14	16	−2
Value Portfolio	177	213	−36
Consolidation & Adjustments	79	43	36
Total[1)]	**357**	**390**	**−33**

[1)] Due to diversification effects the total of economic capital of pbb Group does not equal the sum of economic capital of the individual segments.

In the Value Portfolio, the pbb Group experienced declines in credit risk and market risk, mainly due to lower exposures, particularly during the second half of 2016. Conversely, economic capital in Consolidation & Adjustments increased: here, the inclusion of CVA, DVA and FVA risks and changes in the valuation of liquid financial instruments caused an increase in market risk. Economic capital for the Real Estate Portfolio declined despite exposure growth, due on the one hand to lower credit risk (as a result of updated correlation data in the credit portfolio model) and to lower allocated operational risk on the other hand.

Gone-Concern

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

Gone-Concern: economic capital

in € million	31.12.2016	31.12.2015	Change
Credit risk	1,140	1,249	−109
Market risk	916	1,072	−157
Operational risk	85	86	−1
Business risk	15	35	−20
Property risk	2	6	−4
Total before diversification effects	**2,158**	**2,448**	**−291**
Total after diversification effects	**1,951**	**2,221**	**−271**
Available financial resources before net hidden losses	3,267	3,243	24
Net hidden losses	–	–	–
Available financial resources	**3,267**	**3,243**	**24**
Excess capital (+)/capital shortfall (−)	1,316	1,021	295

Diversified economic capital declined significantly during the period under review, mainly due to lower market risk, credit risk, and business risk.

Market risk was largely reduced due to the first-time inclusion of legally-valid floors for negative interest payments into measurement, but also due to the adjustments to measurement of liquid assets using spreads over OIS curves. This decline was only partially offset by the first-time inclusion of CVA, DVA and FVA risks.

The decline in credit risk was largely driven be the inclusion of guarantees extended by an Austrian Federal state, and by a general reduction of exposures in the Value Portfolio. In particular, lower concentration of Portuguese public-sector debtors led to a reduction in economic capital – an effect that was only partly offset by updated (increased) correlations between public-sector borrowers in the credit portfolio model.

Business risk was lower year-on-year, reflecting lower funding risk, mainly due to issuance of unsecured benchmark bonds, a reduction of excess coverage requirements for Pfandbrief issues, and the sale of securities which are not eligible for central bank refinancing (Heta bonds).

As in the going-concern approach, lower property risk was largely due to the sale of a property in Hungary, as well as to partial write-offs of foreclosed assets in Spain and Germany.

The change in the risk contribution from operational risk was the result of model adjustments carried out.

Given the changes outlined above, overall economic capital after diversification effects declined, whilst available financial resources increased slightly, due to profits, despite a lower level of eligible subordinated capital. Overall, an increase in excess coverage was observed in 2016, thus providing evidence of the risk-bearing capacity in the gone-concern approach as at the reporting date as well.

Should the European sovereign debt crisis escalate again, with credit spreads and credit ratings of numerous European debtors worsening as a consequence, a corresponding increase in credit risk as well as of net hidden losses is to be expected, notwithstanding any countermeasures taken.

The distribution of the economic capital according to segments is as follows:

Gone-Concern: economic capital according to segments

in € million	31.12.2016	31.12.2015	Change
Real Estate Finance	437	482	–45
Public Investment Finance	198	209	–11
Value Portfolio	1,087	1,266	–179
Consolidation & Adjustments	264	302	–38
Total[1]	**1,951**	**2,221**	**–271**

[1] Due to diversification effects the total of economic capital of pbb Group does not equal the sum of economic capital of the individual segments.

Lower exposure in the Value Portfolio segment during the second half of the year – caused by repayments, maturing exposures and lower measurement of items carried at fair value – led to a corresponding decline in economic capital during the period under review. In addition, a decrease in economic capital for credit risk was caused by changes in the inclusion of guarantee relationships. The update of correlation data in the credit risk model, which led to an increase in credit risk due to higher correlations of public-sector borrowers, had an opposite – yet weaker – effect. Market risk in the Value Portfolio declined; besides lower exposures, this also reflected the changed measurement of liquid bonds.

In the Real Estate Finance segment, the regular update of correlation data in the credit portfolio model triggered a decline in economic capital for credit risk, which was only partially offset by higher exposure from new business.

Developments in the Public Investment Finance segment were markedly influenced by two opposing effects: market risk in the segment declined on account of the changed measurement method for liquid bonds, whereas credit risk rose due to higher correlations for public-sector borrowers in the credit portfolio model. Overall, this led to a slight decrease in economic capital.

The decrease in economic capital for Consolidation & Adjustments was caused by a reduction in business risk – which is concentrated in this segment – as well as by lower market risk.

Opportunities

The pbb Group observed a widening of credit spreads on the bond markets of some Southern European countries during the course of 2016. If confidence in European sovereign budgets were to be fully restored, narrowing credit spreads and systematic rating improvements for public-sector issuers might reduce risks, thus further strengthening available financial resources and hence, excess coverage in the ICAAP.

Stress Testing

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

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

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

SREP

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

Based on the results of the analysis as well as using benchmark comparison, the ECB may impose minimum capitalisation or liquidity requirements, over and above existing regulatory requirements. As a key result of SREP, a minimum common equity tier 1 (CET1) ratio of 10.75% was set for pbb Group in 2016, which the Group complied with at all times during the year under review. A limit system was used to ensure ongoing compliance with the prevailing SREP ratio. A 'traffic light' system and regular reporting within the Group Risk Report ensure that any potential shortfall can be detected at an early stage, and that senior management can be informed accordingly.

Toward the end of the year, the ECB notified pbb Group of the regular annual re-determination of minimum capital requirements for 2017: with effect from 1 January 2017, pbb Group has been required to maintain a minimum CET1 ratio of 9.00% (excluding the countercyclical capital buffer, which varies according to country, and hence, for specific portfolios – as at 31 December 2016, it stood at 0.08%). This capital requirement is based on the Basel III transitional rules and comprises a Pillar 1 minimum capital requirement (4.50%), a Pillar 2 capital requirement (3.25%) and the capital conservation buffer (1.25% phased-in for 2017). The minimum, fully phased-in CET1 ratio (valid from 2019 onwards, following expiration of transitional provisions) will be 10.25%, assuming a constant Pillar 2 capital requirement and excluding the countercyclical capital buffer. The CET1 minimum capital requirement that applies for 2017 also represents the threshold for mandatory calculation of a so-called maximum distributable amount (MDA). This generally limits distributions to the CET1 capital, new performance-based remuneration, and interest payments on additional Tier 1 capital.

Under the newly-introduced own funds requirement, introduced with effect from 1 January 2017, pbb Group has been required to maintain an own funds ratio of 12.50% (excluding the countercyclical capital buffer, which varies according to country, and hence, for specific portfolios – as at 31 December 2016, it stood at 0.08%). It is based on the Basel III transitional rules and comprises a Pillar 1 minimum own funds requirement (8.00%), a Pillar 2 capital requirement (3.25%) and the capital conservation buffer (1.25% phased-in for 2017). The minimum, fully phased-in own funds ratio (valid from 2019 onwards, following expiration of transitional provisions) will be 13.75%, assuming a constant Pillar 2 capital requirement and excluding the countercyclical capital buffer.

Key Regulatory Capital Ratios

The Capital Requirements Regulation ("CRR") came into effect on 1 January 2014. Together with the EU Capital Requirements Directive ("CRD IV"), the "CRR" forms the basis for determining regulatory capital. Besides the minimum capital ratios, these regulations also govern requirements for the eligibility of capital instruments as well as the mandatory determination of regulatory capital, in line with the accounting standards used. For this reason, pbb has determined its regulatory capital ratios based on IFRS since 1 January 2014.

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

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

Own Funds

in € million	31.12.2016[1]	31.12.2016 Basel III fully phased-in[1)2)]	31.12.2015 Basel III[3]	31.12.2015 Basel III fully phased-in[2)3)]
CET1	2,553	2,492	2,533	2,439
Additional Tier 1	186	–	209	–
Tier 1	2,739	2,492	2,742	2,439
Tier 2	366	216	398	231
Own Funds	**3,105**	**2,708**	**3,140**	**2,670**

[1] After confirmation of the 2016 financial statements, less the proposed dividend (subject to approval by the Annual General Meeting).
[2] After expiry of all Basel III transitional regulations.
[3] After confirmation of the 2015 financial statements and appropriation of profits.

Risk-weighted assets (RWA)[1]

in € million	31.12.2016	31.12.2016 Basel III fully phased-in[2]	31.12.2015 Basel III	31.12.2015 Basel III fully phased-in[2]
Market risks	346	346	70	70
thereof interest rate risks	–	–	–	–
thereof foreign exchange risks	346	346	70	70
Operational risks	866	866	795	795
Credit risks	11,760	11,760	12,371	12,371
thereof CVA charge	312	312	374	374
Other RWA	141	141	166	166
RWA total	**13,113**	**13,113**	**13,402**	**13,402**

[1] Including weighted credit risk positions and capital charges for market risk positions and operational risk, using a scaling factor of 12.5.
[2] After expiry of all Basel III transitional regulations.

Capital ratios

in %	31.12.2016[1]	31.12.2016 Basel III fully phased-in[1)2)]	31.12.2015 Basel III[3]	31.12.2015 Basel III fully phased-in[2)3)]
CET1 Ratio	19.5	19.0	18.9	18.2
Tier 1 Ratio	20.9	19.0	20.5	18.2
Own Funds Ratio	23.7	20.7	23.4	19.9

[1] After confirmation of the 2016 financial statements, less the proposed dividend (subject to approval by the Annual General Meeting).
[2] After expiry of all Basel III transitional regulations.
[3] After confirmation of the 2015 financial statements and appropriation of profits.

Recovery and Resolution planning

Recovery and Resolution Planning

A uniform bank resolution regime is a key component of European Banking Union. The requisite legislation has been largely completed with the European Bank Recovery and Resolution Directive (2014/59/EEU – "BRRD"), which has harmonised recovery and resolution tools, and with the Regulation establishing the Single Resolution Mechanism ("SRM"). In Germany, the BRRD was implemented through the German Act on Restructuring and Resolution (Sanierungs- und Abwicklungsgesetz – "SAG").

Recovery Planning

Pursuant to section 12 (1) of the SAG, every institution [subject to the Act] must prepare a recovery plan and submit it to the supervisory authorities. The Recovery Plan pbb Group has drawn up in line with its accounting and financial reporting system based on IFRS takes numerous rules and regulations into account, including the BRRD, the SRM and the SAG. The objective of the Recovery Plan is to set out the measures that the institution may use in order to secure or restore its financial stability in the event of its financial position and earnings materially deteriorating, in a theoretical crisis event, where such deterioration may threaten the institution's continued existence. A possible impact upon the financial sector as a whole is also considered in this context.

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

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

Resolution Planning

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

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

Concept

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

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

pbb's Management Board is required to prepare consolidated financial statements and a Group management report. In connection with the requirement to establish a Group-wide IKS, the whole Management Board of pbb is also responsible for the form – i.e. the concept, implementation, maintenance and monitoring – of an appropriate and effective IKS. All strategies are decided on by the whole Management Board on the basis of recommendations made by the CEO/CFO or the GFC.

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

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

At 31 December 2016, the CEO/CFO was responsible for Communications, Corporate Office/Compliance, Finance, Group Internal Audit, Human Resources and Legal. The Finance division comprises the Accounting, Financial Reporting, Procurement Services & Corporate Controlling, Regulatory Reporting and Tax departments. The Finance division prepares the consolidated financial statements in accordance with IFRS as applicable in the EU and provides the capital market information relevant to accounting. pbb Group companies and branches prepare their financial statements in

accordance with the relevant local legal requirements. These financial statements are standardised around uniform Group accounting policies in accordance with IFRS for the purposes of Group financial reporting. Each entity included in the consolidated financial statements reports its statement of financial position, income statement, and notes to a central department in Group Accounting via the consolidation software. Group Accounting translates the foreign currency positions into euros using the consolidation software. The data are validated, analysed and consolidated.

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

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

Implementation

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

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

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

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

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

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

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

Maintenance

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

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

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

pbb Group's IT landscape is continually enhanced. In 2016 measures were taken on a project to further optimise the finance and risk IT target architecture. The scope of this project bundles the implementation of new accounting requirements (such as IFRS 9) and regulatory equirements, plus adjustments to IT systems and processes for preparing the financial statements.

Monitoring

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

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

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

pbb Group as an Employer

pbb Group employed a total of 791 people at the end of 2016 (2015: 824 people). In 2016, the adjusted fluctuation rate for pbb Group was 8.82% (2015: 8.42%). The ratio of voluntary redundancies was 4.10% (2015: 5.89%).

Following the privatisation of pbb Group, further organisational measures were implemented in 2016 that have further improved the efficient and streamlined specifications of processes.

PERSONNEL DEVELOPMENT

Training and personnel development of pbb Group employees, in respect of their professional as well as their management and social skills, was continued and expanded in 2016. This ensures active support for the promotion and further development of employees in the future.

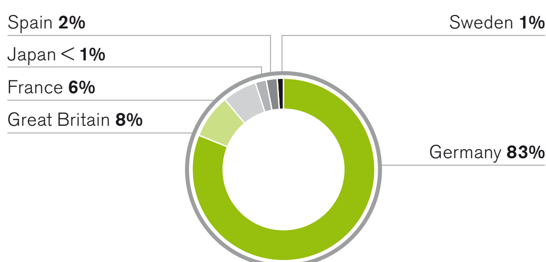
New measures were designed and implemented as part of central initiatives to expand personnel development. The focus was on strengthening the networked, interdisciplinary (across divisions and locations) collaboration, measures for enhancing management and social competence in a modern working environment and on dealing with topics in pbb Group that extend beyond the employees' own areas of expertise.

Expenses for internal and external staff qualification measures totalled €0.7 million (2015: €0.7 million) during 2016. This was equivalent to 2.1 training days on average for each employee, or 5.7 days on average for the 284 staff members who took part in the qualification measures.

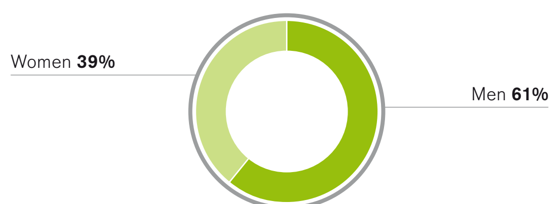
The fact that 99% of the positions in the Group are permanent, and that a very high share of positions are filled internally, underlines pbb Group's position as an attractive employer and boosts staff loyalty.

Employees pbb Group

Regional breakdown



Gender distribution



OCCUPATIONAL SAFETY, HEALTH PROTECTION AND HEALTH PROMOTION

Efficient and committed employees are central to the success of every company, which is why pbb Group invests in the health of its employees. The Health and Safety Committee (Arbeitsschutzausschuss – ASA) that was implemented in Germany, together with a company doctor and the occupational safety specialist, as well as representatives of the Works Council and the safety officers, met

on a regular basis to consult on the status of occupational safety and health protection, and to decide on measures designed to improve occupational safety and prevent accidents. Company doctors hold regular consultation hours for employees at the Unterschleissheim and Eschborn locations. Furthermore, pbb Group voluntarily offers flu vaccinations to employees, for which it assumes the costs.

All executives receive regular training on occupational safety issues from the occupational safety specialist. The bank also offers first aid courses and further training for first aiders every year, which also deal with the handling of automated external defibrillators. Similarly, fire protection training is given annually, with refresher courses held every two years.

pbb Group has also expanded its health-promotion measures since 2015 and supports customised, private offers as well as staff initiatives in the areas of exercise, nutrition and stress prevention. It supports joint sporting activities such as running, bike racing, participation in company runs and a beach volleyball competition in aid of child organ transplantation aid, as well as preventative measures held by external physiotherapists at pbb Group's offices in Unterschleißheim and Eschborn.

PROMOTING SOCIAL COMMITMENT

pbb Group highly values the social commitment of its employees, actively promoting the corresponding staff initiatives. As a prerequisite for financial support by pbb for social projects, such private initiatives by the employees must be dedicated to non-profit projects, such as working with sick, elderly, young or socially-disadvantaged people, or within the scope of projects on topics such as environmental protection or the integration of foreigners into society.

SUSTAINABILITY

pbb Group employs women and men from many different nationalities with different skills and different backgrounds. These form the basis for sustainable corporate success. Since 2010, pbb has been a signatory to the "Diversity Charter", thus demonstrating its fundamental commitment to the economic benefits of diversity, tolerance and fairness among a company's employees as well as among its customers and business partners. It is committed to creating a working environment that is free of prejudice and exclusion, and aims to establish an open corporate culture that is based on mutual respect and the involvement of stakeholders. This approach is actively implemented.

pbb Group focuses in particular on the issue of gender balance. This focus is supported by increased awareness for the topic across all levels and the establishment of a corresponding management and corporate culture, as well as the obligation to specifically address the under-represented gender when filing vacant positions, while taking ability and qualifications into account. By providing the corresponding work organisational conditions, such as flexible working models or the possibility of teleworking, pbb Group also offers attractive conditions for women with families. The flexible working opportunities and the support given to family and working life balance is also demonstrated by the 15.30% share of staff in part-time employment (part-time rate of women: 35.41% and of men: 2.67%).

Remuneration Report

The Remuneration Report follows the recommendations of the German Corporate Governance Code (the Code) and includes the information required pursuant to the German Commercial Code (Handelsgesetzbuch – HGB) and in accordance with the International Financial Reporting Standards (IFRS). The report provides an overview of the individual components of remuneration for the members of the Management Board and the Supervisory Board, and on the principles of staff remuneration.

The remuneration system and the remuneration strategy of pbb Group are integral components of the business and risk strategy of pbb Group. The remuneration strategy sets out the framework for the performance and remuneration of members of the Board of Managing Directors and employees within the pbb governance. It aims to guarantee a performance-oriented remuneration in line with the market – one that is geared to achieving the targets enshrined in the business and risk strategy. Legal and regulatory requirements are observed, especially those that apply to variable remuneration.

Since the privatisation of pbb Group and related lapse of the provisions of section 10 (2a), (2b) of the German Financial Markets Stabilisation Act (FMStFG) in 2015, the remuneration system of pbb Group has been in line with market conditions with the introduction of variable remuneration. It is in compliance with applicable legal requirements and was appropriately reorganised for pbb Group in its current situation. This adjusted remuneration system was implemented with effect from 2016. Within this context, pbb Group's objective was to implement the adjusted remuneration system for all domestic and international staff in as uniform a manner as possible with regard to content, insofar as this is meaningful content-wise and is legally and regulatory permissible.

MANAGEMENT BOARD

Principles

In principle, remuneration for members of pbb's Management Board is designed to ensure a performance-oriented payment, taking the Company's size and international business activities into account. Besides a peer review, based on remuneration for Management Boards and senior management roles in similar companies in Germany and abroad, and a comparison to remuneration for other functions within pbb Group, the Company's financial situation and performance is also taken into account. The Remuneration Committee and the plenary meeting of the Supervisory Board discussed the amount, structure and appropriateness of Management Board remuneration in 2016, also involving external advisors.

Remuneration Components

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

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

Non-performance-related Remuneration

Fixed remuneration levels are reviewed, and adjusted if appropriate, at regular intervals, using an external market survey. No automatic adjustment will take place. As part of the review carried out during 2015 as to whether existing remuneration for Management Board members was appropriate, the fixed remuneration for Messrs Andreas Arndt, Thomas Köntgen und Andreas Schenk was brought in line with the fixed remuneration for Dr Bernhard Scholz. With effect from 1 November 2015, fixed remuneration thus amounts to € 500,000 gross per annum for each Management Board member. In addition, the Company granted non-cash benefits to the members of the Board of Managing Directors which are within customary scope. These non-cash benefits include the provision of a company car (including driver), whereby the Company covers all costs incurred in this respect. Where a member of the Management Board was required to maintain a second household, the Company paid the cost for a second apartment at the place of work, in general for a maximum of two years. Moreover, the Company has taken out a group accident insurance policy for the members of the Management Board. The Management Board members pay taxes due on these benefits in kind.

Variable remuneration

Following privatisation and the associated lapse of the limitations of section 10 (2a) and (2b) of the FMStFG, an adjusted variable remuneration system was developed during in 2015 for the members of the Management Board and variable remuneration was introduced with effect from 1 January 2016.

The adjusted variable remuneration system was designed as an appropriate and transparent system which sustainably takes pbb Group's development into account. Specifically, the adjustment to the remuneration system considered the regulatory requirements of remuneration systems as set out in the new or amended rules pursuant to CRD IV, the German Banking Act (KWG) and the German Ordinance on Remuneration in Financial Institutions, and in relation to the members of the Management Board, the requirements of the German Stock Corporation Act (AktG) and the German Corporate Governance Code. Moreover, provisions under framework or contractual arrangements as well as the remuneration principles of the FMS (as amended most recently in February 2012) were observed.

Variable remuneration is paid in cash. A share-based remuneration system is in place with a cash settlement, where the amount of the variable remuneration is influenced by the performance of the pbb share as part of the sustainability component.

The variable remuneration component is determined on the basis of an individual calculatory reference value, which reflects the amount of variable remuneration attributed to a performance level of 100% on all relevant performance levels. The calculatory reference value has been set at uniform level of € 200,000 for all members of the Board of Managing Directors. The variable remuneration earned by each Management Board member for a given year is capped at 150% of his/her individual calculatory reference value, as set out above.

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

Granting of variable remuneration is subject to the prior determination of a total amount of the variable remuneration (taking into account the requirements of section 7 of the InstVergV). The total amount of variable remuneration is determined by the Supervisory Board at the end of each financial year, within the framework of a formal and transparent process.

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

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

As a significant institution as defined by section 17 of the InstVergV, pbb must in particular observe the requirements of section 20 of the German Regulation on Remuneration in Financial Institutions (Instituts-Vergütungsverordnung – "InstVergV") regarding variable remuneration of risk takers. Management Board members are risk takers, as defined by the Delegated Regulation (EU) 604/2014. The disbursement structure of the variable remuneration for Management Board members is therefore generally subject to the following conditions: the EPR value is broken down into a disbursement portion and a deferral portion, whereby the purpose of the latter includes establishing a multi-year assessment basis within the meaning of the company law and thus gears the variable remuneration of the Management Board members on the Company's long-term performance. The disbursement portion for Management Board members amounts to 40% of their respective EPR value, with the deferral portion equivalent to 60%. 50% of the disbursement portion is paid out in cash when the conditions for disbursement have been met. The remaining 50% is disbursed after one year, whereby the amount is adjusted in line with sustainability component to be applied. Portions linked to the sustainability component are granted on the basis of the performance of the pbb share, so that the members of the Management Board participate financially in the price development of the pbb share. The deferral period for the deferral portion due to Management Board members is five years. The deferral portion is vested in line with current regulatory requirements (pro-rata vesting under a synchronised approach). The malus test, which may lead to a reduction in the deferral portion, considers ex-post negative performance contributions affecting the performance of the institution, the organisational unit and the individual Management Board member (back-testing), as well as the personal misconduct (knock-outs) and the relevant financial conditions for disbursement (pursuant to section 7 of the InstVergV). Following this malus test, 50% of the relevant deferral portion is subject to an additional one-year retention; it is linked during this period to pbb's sustainable development, in line with the applicable sustainability component.

Conclusion of New Service Contracts

The Supervisory Board has extended the appointment of Thomas Köntgen to the Management Board, with effect from 12 May 2016, for a further term of five years expiring on 11 May 2021. The reason for this extension was the expiry of Dr Bernhard Scholz's service agreement, in the interest of the stability of pbb Group, as well as securing continuity and personnel stability. In this context, a new service agreement was concluded with Thomas Köntgen.

Andreas Arndt was re-appointed as member of the Management Board, one year prior to the expiry of the term, for a further five years, with effect from 15 April 2017 until 14 April 2022. A corresponding service agreement was concluded.

In November 2016, the service contracts of Andreas Arndt, Andreas Schenk and Dr Bernhard Scholz were amended to include a rule on carrying over holidays not taken for business or operational reasons to the following year. These comply with the corresponding rules of the Federal Leave Act (BUrlG). The new service agreement of Thomas Köntgen already includes such a rule.

The service agreements of all members of the Management Board observe the current remuneration principles of the FMS.

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

Pursuant to section 4.2.5 of the German Corporate Governance Code (the "Code"), which has been detailed further by way of sample tables attached to the Code, benefits granted for the year under review (including target or expected values), as well as the allocation (i.e. the actual amounts disbursed for the year under review) for each member of the Management Board, were disclosed. Both benefits and allocations must be broken down by fixed remuneration, non-cash benefits, variable remuneration and pension expenses (that is, service cost as defined under IAS 19). For reasons of clarity, these details have been compiled into only one table for each member of the Management Board who was in office during 2016.

Andreas Arndt
CEO/CFO

	Benefits granted				Allocation	
in € thousand	**2016**	Minimum	Maximum	**2015**	**2016**	**2015**
Fixed remuneration	500	500	500	483	500	483
Fringe benefits[1]	21	21	21	27	21	27
Total	**521**	**521**	**521**	**510**	**521**	**510**
One-year variable remuneration	49	–	60	–	–	–
Multi-year variable remuneration						
Disbursement portion subject to holding period (second quarter 2018)	49	–	60	–	–	–
Deferral 2016 (second quarter 2018)	30	–	36	–	–	–
Deferral 2016 (second quarter 2019)	30	–	36	–	–	–
Deferral 2016 (second quarter 2020)	30	–	36	–	–	–
Deferral 2016 (second quarter 2021)	30	–	36	–	–	–
Deferral 2016 (second quarter 2022)	30	–	36	–	–	–
Total	**769**	**521**	**821**	**510**	**521**	**510**
Service	597	597	597	616	597	616
Total remuneration	1,366	1,118	1,418	1,126	1,118	1,126

[1] Including taxable non-cash benefits within the customary scope.

Thomas Köntgen

Deputy CEO, Real Estate Finance/Treasury

in € thousand	Benefits granted				Allocation	
	2016	Minimum	Maximum	**2015**	**2016**	**2015**
Fixed remuneration	500	500	500	483	500	483
Fringe benefits[1)]	31	31	31	34	31	34
Total	**531**	**531**	**531**	**517**	**531**	**517**
One-year variable remuneration	49	–	60	–	–	–
Multi-year variable remuneration						
Disbursement portion subject to holding period (second quarter 2018)	49	–	60	–	–	–
Deferral 2016 (second quarter 2018)	30	–	36	–	–	–
Deferral 2016 (second quarter 2019)	30	–	36	–	–	–
Deferral 2016 (second quarter 2020)	30	–	36	–	–	–
Deferral 2016 (second quarter 2021)	30	–	36	–	–	–
Deferral 2016 (second quarter 2022)	30	–	36	–	–	–
Total	**779**	**531**	**831**	**517**	**531**	**517**
Service[2)]	688	688	688	562	688	562
Total remuneration	1,467	1,219	1,519	1,079	1,219	1,079

[1)] Including taxable non-cash benefits within the customary scope.
[2)] Based on an equal benefit commitment, the adjusted term of office – given the early re-appointment of Mr Köntgen – led to non-recurring post-service costs due to the partial entitlements that have vested already.

Andreas Schenk

CRO

in € thousand	Benefits granted				Allocation	
	2016	Minimum	Maximum	**2015**	**2016**	**2015**
Fixed remuneration	500	500	500	483	500	483
Fringe benefits[1)]	12	12	12	20	12	20
Total	**512**	**512**	**512**	**503**	**512**	**503**
One-year variable remuneration	49	–	60	–	–	–
Multi-year variable remuneration						
Disbursement portion subject to holding period (second quarter 2018)	49	–	60	–	–	–
Deferral 2016 (second quarter 2018)	30	–	36	–	–	–
Deferral 2016 (second quarter 2019)	30	–	36	–	–	–
Deferral 2016 (second quarter 2020)	30	–	36	–	–	–
Deferral 2016 (second quarter 2021)	30	–	36	–	–	,
Deferral 2016 (second quarter 2022)	30	–	36	–	–	–
Total	**760**	**512**	**812**	**503**	**512**	**503**
Service	474	474	474	466	474	466
Total remuneration	1,234	986	1,286	969	986	969

[1)] Including taxable non-cash benefits within the customary scope.

Dr Bernhard Scholz
Credit Markets/Public Investment Finance

in € thousand	Benefits granted 2016	Minimalwert	Maximalwert	2015	Allocation 2016	2015
Fixed remuneration	500	500	500	500	500	500
Fringe benefits[1]	12	12	12	13	12	13
Total	**512**	**512**	**512**	**513**	**512**	**513**
One-year variable remuneration	49	–	60	–	–	–
Multi-year variable remuneration						
Disbursement portion subject to holding period (second quarter 2018)	49	–	60	–	–	–
Deferral 2016 (second quarter 2018)	30	–	36	–	–	–
Deferral 2016 (second quarter 2019)	30	–	36	–	–	–
Deferral 2016 (second quarter 2020)	30	–	36	–	–	–
Deferral 2016 (second quarter 2021)	30	–	36	–	–	–
Deferral 2016 (second quarter 2022)	30	–	36	–	–	–
Total	**760**	**512**	**812**	**513**	**512**	**513**
Service[2]	117	117	117	120	117	120
Total remuneration	877	629	929	633	629	633

[1] Including taxable non-cash benefits within the customary scope.
[2] Due to vested pension claims from his years of service for HRE Holding, Dr Bernhard Scholz receives an annual pension of 1% for each full year of service as a member of pbb's Management Board, subject to a cap of 15%; the rate of increase for the period from 1 September 2016 to 30 April 2017 (the date on which Dr Scholz's service contract will expire) will be determined pro rata temporis, and will thus amount to 0.67% for this period.

Pension Commitments

Contractual commitments to pension benefits for old age, for occupational and general disability, were made to members of the Management Board who were in office in 2016.

As a member of the Management Board, Andreas Arndt receives a pension in the amount of 5.2% of his basic annual remuneration for each completed year of service, subject to a cap of 60%. In conjunction with the reappointment contract extension of Andreas Arndt, the claims on pension rights benefits were considered to be immediately vested, with a view to further retaining his loyalty to pbb Group. They may be drawn upon once the age of 62 has been reached.

Thomas Köntgen receives a pension in the amount of 5.2% of his basic annual remuneration for each completed year of service, whereby the maximum level of pension benefits in the new service agreement was mutually determined at 55% of the basis annual remuneration. In this context, the annual tranches for the pension commitment for the term of office that was changed owing to the early reappointment was adapted at the same value. The pension entitlements may be drawn upon once the age of 62 has been reached and were to be immediately vested, with a view to further retaining further commitment to pbb Group.

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

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

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

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

Full orphans will jointly receive up to 60% of the pension of the deceased parent. Surviving spouses and children from a marriage that the member of the Management Board enters into after retirement are not entitled.

Pension commitments to current Management Board members of pbb[1)]

				2016				2015
in € thousand	Present value of pension claims vested during the business year	Interest cost	Outstanding past service cost	Pension obligation as at 31 December 2016	Present value of pension claims vested during the business year	Interest cost	Outstanding past service cost	Pension obligation as at 31 December 2015
Andreas Arndt	597	13	–	1,290	616	–	–	597
Thomas Köntgen	535	12	153	1,333	562	–	–	528
Andreas Schenk	474	10	–	1,073	–	–	466	466
Dr Bernhard Scholz	117	3	–	252	120	–	–	117
Total	**1,723**	**38**	**153**	**3,948**	**1,298**	**–**	**466**	**1,708**

[1)] For details concerning pension commitments to former members of the Management Board and their surviving dependants, please refer to the Notes.

Other Provisions

In the event that the Company does not renew the employment relationship for reasons outside the respective Management Board member's responsibility, the service contract entered into with Andreas Arndt contains a clause whereby he is entitled – in accordance with the remuneration principles of the FMS – to a transitional allowance in the amount of half a basic annual remuneration for each five full years of service. Within the scope of the new service contract that will be in place from 15 April 2017, Andreas Arndt has waived to renew the agreement for a transitional allowance. In the aforementioned case, in line with the original service contract for Dr Bernhard Scholz, his current contract provides for a transitional allowance of € 50,000 (gross) per month during the period from May 2017 until the end of the month in which he turns 60 (February 2018). Within the scope of the new service contracts concluded in 2015 and 2016, Thomas Köntgen und Andreas Schenk had waived an agreement for a transitional allowance.

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

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

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

SUPERVISORY BOARD

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

In addition, members of the Supervisory Board receive a € 500 attendance fee for each meeting of the Supervisory Board (or Supervisory Board committee) they attend, except where meetings are held in the form of a conference call or video conference.

The members of the Supervisory Board receive their remuneration and attendance fees plus statutory value-added tax. Furthermore, members of the Supervisory Board are reimbursed for their reasonable expenses.

The Company may take out a Directors & Officers (D&O) liability insurance policy in favour of members of the Supervisory Board, with a maximum annual aggregate cover of € 200 million, which covers statutory third-party liability claims which may arise from Supervisory Board work (including work on Supervisory Board committees), as well as any statutory third-party liability claims arising from Supervisory Board members' work on corporate bodies and committees of the Company's subordinated associates. The Company took out a corresponding D&O insurance policy with aggregate cover of €150 million. The Company is convinced that, given its risk profile, the aggregate cover is adequate. The Company bears the costs of this insurance policy.

Remuneration for members of pbb's Supervisory Board in 2016[1)]

in €	Basic remuneration and remuneration for committee work (2016)	Attendance fees (2016)	Subtotal (2016)	Value-added tax (19%) (2016)	Total (2016)	Total (2015)
Dr Günther Bräunig	135,000.00	13,500.00	148,500.00	28,215.00	176,715.00	101,109.24
Dr Thomas Duhnkrack (since 21 July 2015)	36,366.12	5,000.00	41,366.12	7,859.56	49,225.68	17,825.55
Dr Christian Gebauer-Rochholz[2)]	30,000.00	4,000.00	34,000.00	6,460.00	40,460.00	22,794.52[3)]
Dagmar Kollmann[5)]	88,661.20	12,500.00	101,161.20	–	101,161.20	63,376.71
Georg Kordick[2)]	30,000.00	4,000.00	34,000.00	6,460.00	40,460.00	26,530.48
Joachim Plesser	73,661.20	12,500.00	86,161.20	16,370.63	102,531.83	65,784.18
Oliver Puhl (since 13 May 2016)	25,464.48	2,000.00	27,464.48	5,218.25	32,682.73	–
Dr Ludger Schuknecht (until 20 July 2015)[4)]	–	–	–	–	–	7,815.07
Heike Theißing[2)]	40,000.00	6,000.00	46,000.00	8,740.00	54,740.00	28,691.78[3)]
Dr Hedda von Wedel	50,000.00	8,500.00	58,500.00	11,115.00	69,615.00	42,350.96
Dr Jeromin Zettelmeyer (until 20 July 2015)[4)]	–	–	–	–	–	7,815.07
Total	**509,153.00**	**68,000.00**	**577,153.00**	**90,438.44**	**667,591.44**	**384,093.56**

[1)] The table does not specify the cost of the D&O liability insurance policy taken out in favour of Supervisory Board members. The Company has entered into a group insurance policy which, in addition to the Supervisory Board members, also covers the members of the Management Board as well as staff members of the Company and its associates. The total cost of this D&O liability insurance policy amounts to approximately €1.26 million p.a., plus insurance tax.
[2)] Employee representative.
[3)] Income from this activity is exempted from value-added tax, under the so-called 'small business rule' (Kleinunternehmerregelung).
[4)] Since representatives of ministries exercise their Supervisory Board work on instruction of their employer, income from this activity is exempted from value-added tax.
[5)] No value-added tax applies, due to the member's domicile abroad. The Company pays tax on behalf of the Supervisory Board member.

Until the privatisation of pbb, the Supervisory Board remuneration was provided mainly by HRE Holding as the parent company of pbb, where the Supervisory Boards of pbb and HRE Holding were largely made up of the same people, apart from the employee representatives. A small additional basic remuneration only was granted for the Supervisory Board work at pbb. In the course of the privatisation, the Annual General Meeting of 10 June 2015 adopted an amendment to the Memorandum and Articles of Association, so that a remuneration appropriate for the Supervisory Board work is granted to the shareholder representatives and the employee representatives within pbb itself.

EMPLOYEE REMUNERATION

Employees are remunerated in accordance with the regulatory and statutory requirements – in particular Articles 92 et seq. of CRD IV, the FMStFG a well as the InstVergV.

Following privatisation of pbb and the associated lapse of limitations of section 10 (2a) and (2b) of the FMStFG variable remuneration – in line with the requirements of the InstVergV as amended on 16 December 2013 – was reintroduced also for employees with effect from 1 July 2016. Contractual preparations for implementation already took place in 2015. The functional allowance payment that was introduced in 2011 in order to maintain the Company's operational capacity to act was granted only up to 30 June 2016.

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

The key elements of the variable remuneration system were harmonised for Management Board members and employees:

- the examination of requirements for determining the total amount of the variable remuneration, as well as the risk-adjusted performance measurement parameter at the level of the institution;
- the maximum level of target achievement (150 %);
- the disbursement structure for risk takers; and
- determination of the variable remuneration component on the basis of an individual calculatory reference value.

Performance Measurement

Employee performance is also measured on three levels: institutional, organisational unit (division) and personal performance. For employees, these three levels are connected by aggregating calculatory reference values for employees into a variable remuneration pool, the amount of which is linked to the institution's performance. This variable remuneration pool is then distributed among the divisions, with 50% linked to the performance of the respective organisational unit (division) and 50% linked to the institution's performance. Divisional pools created in this manner are then distributed amongst employees in the division concerned, based on the personal performance contribution of each staff member. The share in the relevant divisional pool is allocated to each respective employee in the form of an calculatory EPR value. In principle, the calculatory EPR value allocated may range between a minimum of 0% and a maximum of 150% of the relevant personal calculatory reference value.

REMUNERATION COMMITTEE AND REMUNERATION OFFICER

The Supervisory Board has established a Remuneration Committee.

Two of the Company's employees were appointed as Remuneration Officers, who act as deputies for each other.

RISK TAKERS

The functions which significantly influence the bank's risk profile (risk takers), as defined by section 18 InstVergV, were identified by means of the criteria set out in the Delegated Regulation (EU) 604/2014. In total, besides the four members of the Management Board, a further 74 employees (2015: five Management Board members and 94 employees) were identified as risk takers. The requirements to variable remuneration, pursuant to section 20 InstVergV, were implemented on a uniform basis for Management Board members and employees. This applies in particular to:

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

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

Report on Expected Developments

MACROECONOMIC FORECAST

Macroeconomic developments in 2017 are forecast to remain positive. Despite current geopolitical turbulence, the global economy should continue to gain some momentum – assuming no significant financial, economic or political shocks materialise. The IMF projects real economic growth in developed economies to rise from the 1.6% registered in 2016, to 1.9% in 2017. The euro area's sluggish economy will continue along a slow path of recovery, with marked differences in progress between countries.

Fiscal policy consolidation should continue to limit the short-term potential for economic expansion in the member states. In turn, the consolidation of national budgets is likely to contribute positively to the sustainability of public finances. The euro area's gross domestic product (GDP) growth is expected to accelerate slightly in 2017, especially as investment demand and net exports stabilise – not least due to the current weak state of the euro.

The European Commission and the IMF expect a slight expansion of economic growth in the region, to 1.6% in 2017. Growth momentum is anticipated to remain moderate, mainly driven by robust labour market data and a steady rise in consumer spending. The ongoing weak global economy and low export activities to the United Kingdom – driven by the devaluation of the British pound – are limiting export growth.

Growth rates in Spain should once more exceed those registered in France and Italy, although both countries have overcome their economic standstill. The moderate development of the US economy and uncertainty regarding the future trade policies in the US will probably be further factors reducing euro area net exports. Following a surprisingly positive performance in the previous year, economic growth in the UK is expected to slow down, albeit remaining on a comparatively high level. Growth rates in Eastern Europe should also stay on an encouragingly high level, whereas in Sweden, growth momentum is expected to decline slightly.

Inflation in developed countries, but especially in the euro area, is expected to pick up during 2017. However, it is expected to remain beneath the ECB's inflation target, a development which is supported, above all, by a stabilisation of energy prices. Against the background of ongoing deflationary tendencies, the ECB is likely to remain committed to its asset purchase programmes, in particular the purchase of bonds issued by euro area countries. It will also continue to treat providing liquidity to the banking sector as its top priority.

Economically, a positive development is expected. However, in political terms, significant risks exist, emanating from the awakening – and strengthening – of nationalist and protectionist tendencies. The new US government's political agenda concentrates on an isolating economic and foreign policy which could burden global economic growth, global investments and international affairs. Polls indicate that right-wing parties in the Netherlands and France are experiencing rising approval among the public, potentially leading to corresponding results in the general elections in March (Netherlands) and in the parliamentary and presidential elections taking place in France between April and June 2017. As these parties promote the exit from the European Monetary and Economic Union, the current situation is putting the euro area at risk. In Germany, the populist party AfD will likely at least complicate the formation of a new government, and endanger political stability.

The ECB's ongoing expansive take on monetary policy should widen the schism between short-term and long-term interest rates in the euro and the dollar areas. While short-term interest rates in the euro area should remain relatively close to their historic lows, short-term and long-term interest rates in the US are likely to continue rising.
Sources: Bloomberg, ECB, IMF

SECTOR-SPECIFIC FORECASTS

Overall Situation in the Banking Sector

Despite the glut of liquidity, the international banking sector will continue to operate in a difficult environment during 2017.

In the euro area, banks in the countries most affected by the sovereign debt crisis (Italy, Spain and Portugal) continue to groan under the weight of non-performing loans. Albeit declining, the share of these non-performing loans remains high when compared with historical levels, and continues to significantly limit profitability in the sector.

The negative rating pressure on the banking sector – not limited to the countries hit hardest by the sovereign debt crisis, but affecting the European banking sector as a whole – seems to have eased. Most ratings should already reflect plans to strongly involve subordinated debt investors in bank resolutions. However, they continue to burden banks' capital costs. Profitability in the sector is further limited by continuously rising regulatory requirements and ongoing low economic momentum.

The financial markets factored in an increased credit default risk for the largest European banks in 2016, leading to lower share prices and increased credit default swap prices in the entire industry. Whilst the operating environment for banks remains challenging, the ongoing major expansion of the balance sheet of the ECB – combined with even higher levels of excess liquidity in the banking sector – is likely to limit the sector's credit risk (as implied by the markets).

Geopolitical conflicts further intensified during 2016. Any future intensification or expansion of these conflicts could have an adverse effect on the financial markets and thus on the environment the banking sector operates in.
Sources: Bloomberg, ECB

Real Estate Finance

In 2017, transaction volumes on most European commercial real estate markets will probably fall below the very high volumes reached in 2016. However, they are still expected to be significantly above their long-term averages. On the back of the prevailing low interest rate environment, and in combination with an ongoing "hunt for yield", this asset class should hold up well. Surveys[1] suggest that potential investors are looking to increase the share of real estate in their portfolios. In this context, the German real estate market will remain especially attractive for investors. However, smaller markets like the Netherlands and Spain should also generate a sufficient amount of investor interest. According to professional market observers, the real estate market in the UK is likely to attract only limited investor interest, although some analysts do not rule out positive surprises. Pricing is generally high already, and the low supply level of reasonably priced real estate ready for occupancy, as well as uncertainty regarding Brexit efforts, combine to produce an inhibiting effect on the UK market.

[1] Including a semi-annual real estate survey conducted by Union Investment on the European real estate market, and a survey by E&Y on the German real estate market.

The "yield search" should continue to have a favourable impact on demand for more opportunistic real estate objects and types, e.g. hotels, student housing or project developments in general.

In a long-term comparison, financing conditions continue to be recognised as favourable – despite an ongoing competitive environment. Also, there is an increasing number of projects being financed that are speculative in nature, or projects with weaker credit conditions.

Sources: Cushman & Wakefield research, BNP Paribas Real Estate

Public Investment Finance

In 2017, a higher level of public debt will need to be refinanced in developed countries, thus leading to slightly increased funding requirements in the public sector. According to a survey conducted by Moody's, Germany, the United Kingdom, France, Spain and Italy will require an annual refinancing amount of €171 billion between 2016 and 2018. Spending for the accommodation and integration of immigrants will doubtless rise in developed countries that have taken in many refugees, such as Germany, Sweden, Austria or Finland. Expenses in individual countries which have been granted a larger fiscal flexibility by the European Commission within the framework of the European Stability and Growth Pact can make a larger contribution to economic growth.

In export financing, plenty of opportunities should arise for originating new business. Due to quite a few scheduled large-scale projects, the Middle East should be the most important growth region in 2017. Asia is also expected to be a growth region.

Value Portfolio

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

Funding Markets

Persistently low yields throughout 2016 saw a further push for investment opportunities, fed by ongoing high levels of liquidity. Taking into account a continuation of the ECB's current monetary and interest rate policy, no significant change can be expected in 2017, especially as the allocation of the last of the four series of targeted longer term refinancing operations (TLTROs) with a maturity of (up to) four years is scheduled for March 2017. In general, high demand from commercial banks is expected, as – in a best case scenario – the interest rate payable corresponds to the current negative interest rate of the deposit facility. In such an environment, funding costs for banks are expected to remain on a low level. However, a further decline in secondary market liquidity, especially on the Pfandbrief market, will probably occur.

The amendment proposals made by the European Commission regarding the Capital Requirements Directive (CRD IV), the Capital Requirements Regulation (CRR) and the Bank Recovery and Resolution Directive (BRRD) should – after their transposition into national law – allow a final definition of bail-in in insolvency proceedings. However, uncertainty continues to persist – regarding the final content as well as the timing of the implementation and the reactions of rating agencies to the new regulatory environment. In the years to come, European banks are likely to adapt their individual funding strategies to the new regulatory requirements.

COMPANY FORECASTS

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

Future Developments in Assets, Financial Position and Earnings

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

Key performance indicator	Initial position (financial year 2016)	Forecast (financial year 2017)
New business volume (including prolongations with maturities of more than one year)	€10.5 billion	A new business volume of between €10.5 billion and €12.5 billion is aimed.
Strategic financing volumes (REF and PIF)	€31.5 billion	A significant increase in the strategic financing volume is targeted.
Profit or loss before tax	€301 million	A profit before tax of between €150 million and €170 million is aimed. Results in 2016 benefited from the non-recurring Heta effect.
Cost-income ratio	39.0% (pro forma without Heta effect: 54.1%)	The cost-income ratio should be significantly higher than in 2016, as this year was favoured by the non-recurring income related to Heta.
Return on equity after tax	7.3%	With nearly unchanged average equity (excluding revaluation reserve), return on equity after tax should be materially below the figure recorded in 2016, which had benefited from the non-recurring Heta effect.
CET1 ratio	19.5%	For 2017, pbb aims to achieve a CET1 ratio significantly above the SREP ratio of 9.00% that banks have to comply with since the beginning of 2017 in addition to the country-specific (and thus portfolio-specific) varying counter-cyclical capital buffer which, as at 31 December 2016, amounted to 0.08%.

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

The financing volume attributable to the non-strategic Value Portfolio should continue to decline.

In 2017, the REF segment is expected to once again contribute the lion's share to profit before taxes. In the PIF segment, pbb expects a moderately positive profit before taxes; in the VP segment, an almost break-even result before taxes.

Opportunities

The following opportunities may affect the future development in assets, financial position and earnings:

> Leveraging its many years of experience, pbb Group has developed an strong market position, building the basis to achieve growth in its core business areas of Commercial Real Estate Finance and Public Investment Finance, and to increase profitability.

- Conditions imposed by the European Commission on pbb Group in connection with the approval of state aid have been lifted following privatisation in 2015, opening the door to cautious adjustments in business – in line with changes in market values, but without changing the portfolio's conservative risk profile. For instance, the US business – recently taken up in the current reporting period – is set to be expanded. With these initiatives, pbb intends to further diversify its existing business along the risk standards.
- In addition, pbb will expand its value-creation chain, reviewing platforms and processes, also with a view to digitalising its business.
- There is strong demand for financing on the markets which are relevant for pbb Group. In this context, pbb Group considers that the market climate in commercial real estate finance will be attractive in the long term (regardless of cyclical fluctuations); this would have a positive impact on the volume of new business and could thus have a positive impact on the development in assets and earnings.
- Likewise, pbb Group sees an attractive market environment in the second strategic segment public investment finance. A high demand for financing of the public infrastructure continues to be expected, which could have a positive effect on the volume of new business and consequently on the development in assets and earnings.
- The non-strategic Value Portfolio has decreased significantly in recent years, and is expected to decline further in the future. The associated release of risk-weighted assets will create potential for growth in the strategic segments, which might have a positive effect on the development in earnings.
- Any future recovery in the value of impaired assets, for example by means of successful restructurings, may contribute positively to pbb Group's development in assets, financial position and earnings.
- Currently the market interest rate is at low levels. If market interest rates increase in the long run, this could have positive effects on income of some of pbb Group's portfolios, such as the investment of the liquidity reserve and of own funds. This may boost the development in earnings.
- Pfandbriefe are perceived as a sound investment with a tried-and-tested market infrastructure; this is also reflected by the strong demand from investors. pbb Group has extensive experience in the Pfandbrief market and is able to build on its existing customer relationships. As a result, it was able to successfully place several Pfandbrief issues on the market in recent years. pbb Group therefore utilises a capital market instrument that is still in demand – something that has a positive effect on its development in financial position.
- pbb Group issues overnight deposits and term deposits in euro and US dollar with terms of up to ten years via "pbb direkt". The latter's deposit volumes have increased continuously in recent years, allowing pbb Group to access a new source of funding and react flexibly to market opportunities. This has a positive impact on pbb Group's liquidity and the development in financial position.
- pbb Group's strict focus on costs represents a further opportunity. The status of processes will be continuously monitored in order to identify appropriate improvement measures. pbb is also consistently developing its IT landscape (e.g. by way of a project for further optimising its finance and risk IT target architecture), thus enabling the optimisation of future processes.
- The succesful privatisation boosted the attractiveness of pbb Group as an employer. Capable and highly qualified employees and executives can be recruited and retained who support pbb Group in achieving its ambitious targets. These initiatives are accompanied by attractive and appropriate continuous professional and personnel development measures.
- Investors are increasingly basing their investment decisions on a company's sustainability. Currently, pbb Group meets this demand through two actively supported Corporate Responsibility ratings, from oekom and imug/EIRIS. pbb is continually expanding its sustainability activities to attract the attention of this additional investor base.

Risks

However, the possibility of future negative effects on pbb Group's development in assets, financial position and earnings cannot be ruled out. The level of exposure is influenced through the occurrence or non-occurrence as well as the seriousness of the following:

> Several European countries were only able to obtain funding with the support of international aid programmes in recent years. If the debt crisis in certain countries worsened further and it became necessary for creditors to take a haircut on other countries' liabilities (including sub-sovereigns) or if public sector debtors became insolvent pbb Group could also suffer substantial allowances for losses on loans and advances and securities. These allowances might increase if, due to market integration or turbulences, the crisis of individual countries spreads to debtors currently considered to be solvent. The legal framework for government guarantees and warranties may change.

> Risk provisioning was only required for a small number of individual exposures in recent years thanks, among other things, to pbb Group's successful portfolio management. Nevertheless, it is still possible that significant risk provisioning will have to be recognised in the future. The need for risk provisioning in commercial real estate finance primarily depends on the economic situation of the financed objects and their owners respectively their anchor tenants, although it could also be the result of a general crisis in individual markets, such as the real estate markets of various countries. Changes to monetary policy can also negatively impact the performance of real estate assets.

> Geopolitical conflicts have further intensified on a global level. Any future intensification or expansion of these conflicts could have an adverse effect on the markets, and thus on pbb Group's profitability. Furthermore, last November's US election and upcoming national elections in Europe have led (and will lead) to uncertainty on the markets. Political changes can result in trading or customs restrictions which burden development in earnings.

> On 23 June 2016, the people of the UK decided in a referendum that the UK should leave the EU. The referendum might also have a negative impact on the rating drivers – and hence, the ratings – of pbb or its funding vehicles. Furthermore, the UK's decision might have medium- to long-term implications for real estate markets, both in the United Kingdom and Continental Europe. At the very least, the impending phase of uncertainty may lead to significant delays of investment and financing decisions. Should further countries leave the European Union or even just the euro area, uncertainty and negative implications might increase. Overall, this could have an adverse effect on pbb Group's development in assets, financial position and earnings.

> In December 2016, the ECB announced the reduction of monthly securities purchases from April 2017 onwards – from €80 billion to €60 billion – whilst confirming the continuation of purchases until at least year-end 2017. Hence, the ECB will remain the dominant market player on the markets for both government bonds and Pfandbriefe. In combination with negative interest rates, this massive and ongoing intervention by the ECB on funding markets may – over the medium term – impair the placement of covered issues as traditional investors are driven out of the market.

> The Executive Board of the Association of German Banks (Bundesverband deutscher Banken – "BdB") is working on a reform of the voluntary deposit guarantee scheme for private banks, and recommends reducing the scope of protection of the Joint Fund for Securing Customer Deposits. Should the committee approve the proposals with the necessary majority of votes, the reform could come into force as early as 1 October 2017. The amendments to the scope of protection of the Joint Fund for Securing Customer Deposits could negatively impact pbb's funding capacities. According to the proposal, from 1 October 2017 onwards, deposits made by the federal government, regional and local governments as well as bank-like clients will no longer be covered by the voluntary deposit guarantee scheme. Grandfathering arrangements will protect deposits made by these client groups before 1 October 2017. Bank-like clients are considered to be investment firms in accordance with Article 4 (1) no. 1 of MiFID, and financial institutions in accordance with Article 4 (1) no. 26 of the CRR. Protection for deposits by companies, institutional investors and semi-governmental agencies, e.g. pension insurance carrier, will be adjusted in two steps. As of 1 October 2017, promissory notes and registered bonds will no longer be covered by the voluntary deposit guarantee scheme. As of 1 January 2020, deposits

with a term of over 18 months will be excluded from the scope of protection. However, in both cases, deposits made before this date will be covered by grandfathering arrangements.

> On 23 November 2016, the European Commission proposed amendments to the current rules of the Capital Requirements Directive (CRD IV), the Capital Requirements Regulation (CRR) and the Bank Recovery and Resolution Directive (BRRD). At present, no one knows whether, when and to what extent these amendments will be transposed into European and national law. If a timely implementation does not occur, unsecured funding activities could be negatively impacted as the new category of lower-risk issues is not available yet. Nonetheless, the draft (in its current version) includes partially intensified regulatory requirements which could have further adverse effects on banks.

> The expected official start of negotiations between the EU and the United Kingdom, and the election results in the Netherlands, France and Germany (and possibly Italy) could lead to lasting changes within the economic area of the European Union as well as within the euro area. A resurgence of the European debt crisis and an increase of "centrifugal forces" within the EU could burden funding markets and result in a targeted reduction of new business volume.

> Rating agencies continuously adapt their methodologies and models in order to assess, amongst other factors, the changing macro-economic environment and the potential impact of the European sovereign debt crisis; this may lead to rating changes. Examples are the referendum in the UK to leave the EU, the new European legislative initiatives to centralise supervision of large banks and to support bank restructuring and resolution, the bail-in of senior unsecured creditors and the ranking in a bail-in or insolvency scenario, as well as the suggested amendments of S&P's Bank Capital Methodology. As of 31 December 2016, the methodological respectively rating changes that have been anounced in this context were not fully finalised. For pbb, S&P expect to resolve the rating reviews launched in December 2016 before the end of the first quarter of 2017. S&P expect to publish their amended Bank Capital Methodology from the end of the first quarter of 2017 onwards, and to be implemented in the further course. Furthermore, changes to specific rating drivers with regards to the bank and the Pfandbriefe, its other debt and hybrid instruments, may result in rating changes. This also includes the termination of the Federal Republic of Germany's indirect minority shareholding in pbb, which is laid out for a duration of a minimum of two years from the flotation, and – against this background – especially the continued positive development of the bank and its rating drivers, in line with the rating agencies' expectation. Downgrades of the bank and/or Pfandbrief ratings and/or other debt and hybrid instrument ratings could have a negative impact, particularly on the bank's funding conditions, on triggers and termination rights within derivatives and other contracts, and on access to suitable hedge counterparties and, hence, may compromise pbb's liquidity, as well as the development of its assets, financial position and earnings.

> pbb Group's planned profitability is based on the assumption of adequate growth and reasonably high portfolio profitability. Should the targeted development of portfolio size and margins not be achieved – for example, due to a further increased competition on the market or early repayments above the plan – pbb Group will not be able to reach the required ratio between expenses and income.

> Currently the market interest rate is at low levels. If market interest rates remained at this low in the long run or dropped even further, it could have negative effects on some of pbb Group's portfolios, such as the investment of the liquidity reserve and the investment of own funds. This may compromise the development in earnings. Negative effects may also impact other market participants, which may have a positive or negative effect on the competition. In extreme cases, turbulences may arise on the market due to the interconnected nature of the markets. Furthermore low market interest rates may result in premature adjusting conditions of credit exposures, possibly pressuring future margins. The low interest rate environment may also trigger market exuberance in other asset classes. As such, the volatilities of real estate valuations may rise, irrespective of the quality of the underlying property. Long-term negative interest rates could also lead to longer maturities, ongoing political uncertainty and a potential economic recession could disrupt funding markets and thus also pbb Group – also resulting in a targeted reduction of new business volume.

> Adjustments of the ECB's interest rate policy in the light of the European financial crisis and the resulting decline in overall interest rates entail the risk that investors underweight the bond market when allocating funds. This could lead to a general increase in funding spreads. The ongoing debates regarding the continuation of the euro zone in its current composition could also influence the development of the funding spread.
> The ongoing development of national and international regulatory requirements may have an impact on pbb Group's business activities – in particular, on the structure of assets and liabilities, as well as on the fact that expenses incurred for compliance with regulatory requirements could affect the development in earnings. For instance the further development of the obligations presented by the Basel Committee on Banking Supervision ("Basel III" regulation), introduced in the EU via the CRR, regarding more stringent liquidity and capital requirements might have a negative impact on profitability. Further changes to the three-pillar regime of Basel III are on the horizon, particularly a review of risk assessment. For instance, the amendment proposals published by the Basel Committee in the consultative documents BCBS 306, 347 and 362 (review of the credit risk standard approach [CRSA], introduction of a CRSA floor, partial abolishment of Internal Rating Based Approach [IRBA] models), as well as the TRIM process (target review of internal models) implemented by the EBA (systematic, industry-wide review of all IRBA models) may affect pbb's capital requirements and business model. In addition it is possible that additional requirements for the capital structure (Minimum Requirement for Own Funds and Eligible Liabilities – MREL) and the level of indebtedness (Leverage Ratio) currently under discussion may have a negative effect on the funding and business activity of pbb Group. Existing regulatory and economic parameters could be impacted, too resulting for example in a change in the capitalisation. A stricter regulatory environment may also burden general and administrative expenses and thus the development in earnings of pbb Group.
> ECB and EBA have introduced various initiatives (among others, TRIM) in order to harmonise the use of IRBA models throughout Europe. This may lead to different, stricter new requirements being imposed upon pbb, that may result in higher RWAs and, as a consequence, a call for higher capital requirements. As part of a sector-wide review, the ECB has started to also review some of the models used by pbb Group. Should one or more models need be adapted, pbb Group expects the ECB to grant them an appropriate period of time for implementation. It is impossible to completely rule out the following risks: the ECB could refrain from authorising model adaptations; also, specific IRBA models may no longer be recognised.
> In December 2014, the EBA published its "Guidelines for common procedures and methodologies for the supervisory review and evaluation process" (SREP Guidelines), to be applied in the supervision and evaluation of all institutions. This guideline (EBA/GL/2014/13) is directed at national competent authorities of the EU member states; it is set for implementation by institutions from 2016 onwards. As the competent supervisory authority, ECB applies its SREP Guidelines in the supervision and assessment of pbb Group. It focuses on the evaluation of the financial position of an institution with selected key indicators, a review of the business model, of corporate governance and risk governance, and of the institution's capital and liquidity base. Review and evaluation are based, amongst other things, on a bank's credit risk, interest rate risk in the banking book, operational risk and liquidity risk. As a material result from the SREP, a CET1 minimum ratio and an own funds minimum ratio were set for pbb Group. It cannot be ruled out that the ECB defines even higher capital requirements, or even higher capital ratios. This could impact the development in assets, financial position and earnings of pbb Group.

- External tax audits may result in additional taxable income, and thus in higher tax expenses for previous periods. In particular, tax audits in Germany and France question the appropriateness of the distribution of profits between pbb in Germany and its permanent establishment in France. Where no "Advanced Pricing Agreement" (APA) has been (or will be) signed, external tax audits in other countries in which pbb has a permanent establishment may also raise this subject. For its international business posted abroad (loans granted until 30 June 2016), pbb has calculated cross-border profit distribution between pbb in Germany and permanent establishments by means of matched funding, i.e. the congruent funding of permanent establishments by the head office, and internal Credit Default Swaps corresponding to the head office's credit default risk associated with loans granted by the respective permanent establishment. For new business originated (loans granted as of 01 July 2016), the cross-border profit distribution between pbb in Germany and such permanent foreign establishments was re-calculated after legislative adjustments to transfer pricing guidelines in Germany, effective 1 July 2016. For new business generated in permanent establishments (which is henceforth recognised exclusively with pbb in Germany), these permanent establishments receive remuneration for carrying out specific functions within the new business process, as well as an administrative fee for the credit portfolio management. Regarding taxation of its permanent establishments in Paris and London, pbb has applied for the initiation of an APA with the competent financial authorities in Germany, France and the United Kingdom, allowing for the binding recognition of the new profit distribution. If a tax audit does not deem the profit attribution to be appropriate, and the APAs applied for do not enter into force, this usually results in double taxation. To eradicate these double taxations, so-called mutual understandings are arranged between the competent financial authorities. While pbb Group has recognised sufficient provisions to allow for the risk of double taxation, these provisions may not suffice.
- pbb Group will have to apply IFRS 9 Financial Instruments from 2018 onwards. The initial application of IFRS 9 is expected to have an extensive impact on the development in assets, financial position and earnings. The impact of the changes in recognition and measurement of financial assets will depend, amongst other things, on the market values of the assets carried at fair value as at 1 January 2018. Risk provisioning in accordance with IFRS 9 are expected to exceed the level of specific and portfolio-based allowances recognised, based on loss events that have materialised in accordance with IAS 39. Furthermore, the bank's earnings are expected to exhibit a higher level of volatility than they currently do under the rule of IAS 39, due to the higher number of financial assets to be measured at fair value through profit or loss, and also due to the new regulations on risk provisioning under IFRS 9. Expenses incurred with the implementation of IFRS 9 will burden pbb's development in earnings until 2018.
- The methods used to value financial instruments are constantly evolving on the market. For example, the market conventions for valuing derivatives have changed, the effect of which can, inter alia, be seen in the increasing use of funding valuation adjustments for taking into account funding costs of unsecured transactions when measuring derivatives. Such or similar changes could have a negative impact on pbb Group's development in earnings in the future.
- The risk bearing capacity concept is enhanced on a continuous basis. These enhancements respectively new regulatory requirements could have an impact on the risk bearing capacity assessment using both the going-concern approach and the gone-concern approach. The development of the market values of securities in the investment book is an influencing factor affecting the risk bearing capacity in the gone-concern approach. If hidden liabilities increased due to changes in fair value, the cover capital could fall below the economic capital requirement.

- Due to the nature of its business and the international expansion as well as the high number of relevant laws and regulations, pbb Group is involved in litigation, arbitration and regulatory proceedings in some countries. Legal disputes which are currently pending (especially relating to participation certificates issued, described under the Note "Provisions"), or could become pending in the future, could have a material negative impact on pbb Group's profit or loss and equity base.
- pbb, the legal successor of Hypo Real Estate Bank International AG, Stuttgart, is the issuer of credit linked notes of the "Estate UK-3" synthetic securitisation transaction ("Credit Linked Notes"). These Credit Linked Notes hedge the default risk from certain credit exposures of pbb, provided that the conditions for the allocation of realised losses have been fulfilled in accordance with the terms of the Credit Linked Notes. A default affecting one of the hedged exposures ("Reference Claim No. 3") has caused a loss of approximately GBP 113 million; pbb intends to allocate this loss to the Credit Linked Notes. This loss allocation would trigger a total loss for Credit Linked Notes Classes A2, B, C, D and E, and would reduce the nominal amount of Class A1+ (of GBP 400,000) by approximately 0.1%. On 13 December 2016, Deloitte GmbH Wirtschaftsprüfungsgesellschaft, in its capacity as trustee of the ESTATE UK-3 transaction, notified pbb that in their view doubts exist as to whether the loss allocation intended by pbb is justified, and that the Trustee will appoint an Expert, in accordance with the terms of the ESTATE UK-3 transaction, who will decide on whether the loss allocation is in fact justified. In the event of the loss allocation being fully or partially unjustified, pbb would have to bear the losses to that extent. This would result in adverse effects on future development in assets, financial position and earnings. In pbb's opinion, the conditions for the planned allocation of losses have been met.
- New developments in legislation and case law could have a negative effect on the business and thus the development in assets, financial position and earnings of pbb Group.
- pbb Group is exposed to operational risks, resulting, for example, from technology risks. Although pbb Group has partially already successfully completed a number of projects to optimise processes and IT infrastructure, it is exposed to operational risks that could result in significant losses.
- A further operational risk results from reliance on employees who hold risk-taking positions. Resignations of employees in key positions, as well as the inability to replace such employees with appropriate successors, cannot be ruled out. This could impact the development in assets, financial position and earnings.
- Additional bank levies are planned or under discussion in most EU countries. Examples include the introduction of a European restructuring fund or a financial market transaction tax. Such taxes could have a negative impact on pbb Group's total comprehensive income for the period and render certain transactions unprofitable.

SUMMARY

pbb Group is well-positioned for continued profitability, even in an increasingly difficult market environment that features not only growing regulatory requirements but also declining margins due to intensified competition. However, this assessment is based on the assumption that additional risks – arising from factors beyond pbb's control, for example – do not materialise. Giving due consideration to the opportunities and risks, pbb Group expects to generate a profit before tax of between €150 million and €170 million in 2017.

Supplemental Information

DISCLOSURES PURSUANT TO SECTION 315 (4) OF THE GERMAN COMMERCIAL CODE (HGB)

Composition of Subscibed Capital (section 315 (4) No. 1 HGB)

The composition of pbb's subscribed capital is shown in the notes to the consolidated financial statements under "Equity". Each bearer share with no par value entitles the shareholder to one vote at the Annual General Meeting of the Company. The Company currently does not hold any treasury shares.

Restrictions Affecting the Voting Rights or the Transfer of Shares (section 315 (4) No. 2 HGB)

The exercise of voting rights from the shares concerned is precluded by law in the cases where section 136 of the German Stock Corporation Act (AktG) applies. Where the Company holds treasury shares, section 71b of the AktG prohibits the exercise of rights vested in such shares.

HRE Holding has agreed to enter into a lock-up agreement, according to which – subject to certain contractually-agreed exceptions – it will continue to hold a minimum stake of 20% until 16 July 2017. HRE Holding has committed itself to avoid exercise of control over pbb by entering into a control termination agreement with pbb. The control termination agreement applies for the first time to pbb's 2016 Annual General Meeting and remains in place until the end of the fifth subsequent Annual General Meeting; however, it applies to a minimum period of five years, beginning on 16 July 2015. Until the end of such period, the agreement cannot be terminated ordinarily. After the end of such period, the agreement will be extended automatically until the end of the subsequent Annual General Meeting if it is not cancelled by one of the contracting parties by no later than two months prior to its expiry. According to the control termination agreement, HRE Holding undertakes

a) to exercise voting rights vested to it at the point in time at which the control termination agreement enters into effect, and/or at any subsequent point in time at which HRE Holding holds pbb shares, to a maximum of 49% of the present voting capital (according to the list of participants made available to all participants before the first vote, or any additional vote, if applicable) at the adoption of resolutions regarding the appointment or removal of Supervisory Board members as well as resolutions taken as part of management decisions according to sections 83, 111 (4) sentences 3 to 5, 119 (2) or 179a of the (AktG),
b) not to make any proposals for resolution to pbb's Annual General Meeting, in particular for the appointment of Supervisory Board members (the right to make proposals according to lit. c) in line with the new framework agreement entered into between pbb, the German Federal Agency for Financial Market Stabilisation (FMSA) and the German Financial Markets Stabilisation Fund (FMS) remains unaffected), and
c) not to vote for candidates for pbb's Supervisory Board which are not independent from HRE Holding, FMS, FMSA and the Federal Republic of Germany, with the exception of two Supervisory Board members proposed by FMSA to pbb in line with the new framework agreement; nevertheless, the regulations as set in lit. a) remain unaffected.

pbb shares attributable to HRE Holding according to section 16 (4) of the AktG shall also be considered as "held by HRE Holding". In such cases, HRE Holding undertakes to ensure that the restrictions to exercise voting rights described above are adhered to by any and all of its dependent companies.

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

Shareholdings Exceeding 10% of Voting Rights (Section 315 (4) No. 3 HGB)

As at 31 December 2016, the Federal Republic of Germany, through the intermediary of the FMS, Frankfurt/Main, and HRE Holding, Munich, were the only shareholders with shareholdings of more than 10% of the shares, to the knowledge of the Company. The respective shareholding of these two shareholders totaled 20.000001% as at 31 December 2016.

The notifications of voting rights pursuant to sections 21 et seq. of the WpHG, published by the Company, are available online inter alia under "https://www.pfandbriefbank. com/en/investor-relations/mandatory-publications/notifications-on-voting-rights.html".

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

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

Type of Control of Voting Rights Regarding Shares Held by Employees with their Rights of Control not Being Directly Exercised (Section 315 (4) No. 5 HGB)

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

Statutory Provisions, and Provisions in the Memorandum and Articles of Association Regarding the Appointment and Removal of Members of the Management Board, and Regarding Amendments to the Memorandum and Articles of Association (Section 315 (4) No. 6 HGB)

In accordance with section 84 of the AktG and section 6 of the Memorandum and Articles of Association, the members of the Management Board are appointed by the Supervisory Board. The number of members of the Management Board is determined by the Supervisory Board. Pursuant to the Memorandum and Articles of Association, the Management Board consists of at least two members. Members of the Management Board are appointed for no more than five years per term. This term of office may be renewed or extended for a maximum of five years in each case. In case of urgency, the Munich Amtsgericht (District Court) shall appoint a missing member of the Management Board upon application of a party involved (section 85 of the AktG). The Supervisory Board may revoke an appointment to the Management Board, and also an appointment to the position of Chairman of the Management Board, should there be good cause for doing so. In particular, such cause shall be a gross breach of duty, inability to properly manage the business, or the withdrawal of confidence by the Annual General Meeting – unless confidence is withdrawn for evidently subjective reasons.

Evidence that the Management Board members are trustworthy, have the required professional qualifications, and are sufficiently available, must be provided to BaFin, ECB and the German Bundesbank. A prerequisite for the professional qualifications of Management Board members is that they have adequate theoretical and practical knowledge of the business concerned, as well as managerial experience (sections 24 (1) no. 1 and 25 c (1) of the German Banking Act [KWG]). BaFin may appoint a special representative, and entrust him or her with the performance of activities of individual Management Board members and assign him or her the requisite power, if such Management Board members are not trustworthy or do not have the required professional qualifications – or if the minimum threshold of Management Board members at the credit institution is not met. If the members of the Management Board are not trustworthy or do not have the required professional qualifications, or if they are unaware of serious violations of the principles of proper management, or if they did not do

everything needed to counter detected infringements, BaFin may entrust the special representative with the performance of all Management Board activities and assign him or her the requisite powers. In all such cases, the tasks and powers of the Management Board, or the Management Board members affected, shall be suspended (section 45 c (1) to (3) of the KWG).

If there is any danger to the discharge of an institution's obligations to its creditors, or if there are grounds for suspecting that effective supervision of the institution is not possible, BaFin may take temporary measures to avert this danger. Within this context, BaFin may prohibit members of the Management Board from carrying out their activities, or limit the performance of these activities (section 46 (1) of the KWG).

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

Authorisation of the Management Board to Issue or Repurchase Shares (Section 315 (4) No. 7 HGB)

Authorised Capital

The Management Board is authorised to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of €190,188,029.83 by issuance of bearer share with no par value for contribution in cash or in kind, subject to the approval of the Supervisory Board (Authorised Capital 2015). This authority will expire on 9 June 2020. Shareholders shall generally be granted a subscription right; the statutory subscription rights may be granted in such a way that the new shares are subscribed by one or more credit institutions, or by entities which are to be treated as credit institutions according to section 186 (5) sentence 1 of the AktG, subject to the obligation of offering these to the shareholders for subscription.

However, subject to the approval of the Supervisory Board, the Management Board may exclude subscription rights in the following cases:

- in order to exclude fractional amounts from subscription rights;
- in order to grant subscription rights, to the extent necessary, to holders of conversion or option rights issued already or subject to issue from the Bank or group entities (section 18 (1) of the AktG) subordinated to the Bank, in a volume to which they would be entitled after the conversion or option right had been exercised, or after the conversion or option obligation had been satisfied, or after the Bank's substitution rights had been exercised;
- in order to issue employee shares with a total nominal amount of up to €2,852,820.45 to employees of the Bank or employees of affiliated entities (within the meaning of section 15 of the AktG), in which the Company directly or indirectly holds interests, or can exercise a controlling influence;
- in order to increase the Company's share capital against contribution in kind;
- in order to carry out scrip dividends pursuant to which the shareholders of the Company are granted the option to trade (all or parts of) their dividend rights for new shares out of the Authorised Capital 2015 by way of contribution in kind;
- In the event of a capital increase against cash contributions, provided that the issue price of the new shares is not significantly lower than the quoted price of the Company's listed shares of the same kind at the time of the final determination of the issue price. The shares issued under this

authorisation and excluding subscription rights pursuant to sections 203 (1), 186 (3) sentence 4 of the AktG are limited to a notional interest of no more than 10% of the Company's share capital at the time the authorisation becomes effective or – if the relevant amount is lower – at the time this authorisation is utilised. Furthermore, said threshold of 10% of the share capital is reduced by the proportionate interest in the share capital attributable to those treasury shares of the Company that were sold and transferred by the Company during the term of the Authorised Capital 2015, while excluding shareholders' subscription rights pursuant to sections 71 (1) no. 8 sentence 5, 186 (3) sentence 4 of the AktG. In addition, said threshold is reduced by the proportionate interest in the share capital attributable to those shares which have to be granted to service convertible bonds, convertible profit participation rights, convertible hybrid bonds or warrants attached to warrant bonds or profit-sharing certificates with warrants, in each case, issued with conversion or option right or with obligation to convert or the Company's right to substitute, to the extent that such bonds or profit participation rights are issued during the term of the Authorised Capital 2015, while excluding the subscription rights subject to appropriate application of Section 186 (3) sentence 4 of the AktG.

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

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

Convertible Bonds, Warrant Bonds, Profit Participation Rights and Hybrid Bonds
1. Term of Authorisation; Nominal Amount; Number of Shares; Maturities; Interest Rates The Management Board is authorised to issue convertible bonds, warrant bonds, profit participation rights or hybrid bonds, on one or more occasions, on or before 9 June 2020 (in the context of the Authorisation, the term "hybrid bonds" refers to hybrid bonds which fulfil the requirements of banking regulatory law to be attributable to the Company's Additional Tier 1 capital but are possibly not classified by law as profit participation rights), with or without conversion or option rights or obligation to convert or the Company's right to substitute as well as with or without limitation of maturities against contributions in cash or in kind (all financial instruments listed above collectively referred to as "Financial Instruments"). The total nominal amount of all Financial Instruments to be issued under the Authorisation shall not exceed a total value of € 3,000,000,000.00. The Financial Instruments may be issued in registered or bearer form. As further set out in the conditions of the relevant Financial Instruments, the conversion and/or option rights and/or the respective obligations to convert granted to or imposed on the holders of the Financial Instruments (hereinafter referred to as "Holders")

(including, for the avoidance of doubt, profit participation rights and/or other hybrid bonds issued with such conversion and/or option rights and/or the respective obligations to convert) may be issued in respect of shares of the Company in the total number of up to 67,237,653 shares and with a proportionate amount of share capital of up to a nominal sum of €190,188,029.83. The Company may abstain from granting conversion and/or option rights to the Holders of the Financial Instruments if this is permitted pursuant to the AktG at the time the Authorisation is exercised. The respective maturity of the conversion and/or option rights and/or the obligations to convert must not exceed the maturity of the relevant Financial Instruments. Interest payable on the Financial Instruments may be variable; it may also be fully or partially dependent on key profit figures of the Company or the Group (including net retained earnings or the dividend payable on Company shares as set by the resolution on the appropriation of profits). Moreover, the conditions of the Financial Instruments may provide for a subsequent payment for benefits not provided in previous years.

2. Currency; Issuances of Group Entities; Qualification as Additional Tier 1 Capital or Regulatory Capital

a) The Financial Instruments may, other than in euro – and subject to a limit on the equivalent amount in euro – also be issued in the currency of another OECD country.
b) Furthermore, the Financial Instruments may also be issued by group entities (section 18 (1) of the AktG) subordinated to the Company. In this case, the Management Board shall be authorized to provide the guarantee for such Financial Instruments on behalf of the Company, to grant a right to substitute to the Company (see No. 4 (a)) and to grant or guarantee to the Holders of such Financial Instruments conversion and/or option rights or obligations to convert in respect of shares of the Company.
c) The Financial Instruments may be structured to qualify as Additional Tier 1 capital instruments or otherwise as regulatory capital at the time of issue.

3. Conversion and Option Rights

a) If convertible bonds are issued, Holders of the respective individual bonds (a "Bond", or the "Bonds") have the right to convert their Bond(s) into shares of the Company, subject to the conditions of the respective convertible bond. The ratio of conversion is calculated by dividing the nominal amount or – if the price is lower – the issue price of the Bond by the fixed conversion price of the share of the Company. Fractions of shares resulting from the ratio of conversion will be settled in cash; moreover, an additional cash adjustment may be determined as well as the combination or a compensation for fractional amounts which cannot be converted. The conditions of the Financial Instruments linked to a conversion right may provide for a variable ratio of conversion and a determination of the conversion price (subject to the minimum price specified under No. 5) within a predetermined range, depending on the performance of the share of the Company during the term of the respective convertible bond. The proportion of share capital attributed to each individual share to be issued upon conversion must not exceed the nominal amount or – if the price is lower – the issue price of the Bond.
b) When issuing warrant bonds linked to an option right, one or more warrants are attached to each Bond which entitle the Holder of such Bond(s), subject to the conditions of the respective Financial Instrument, to buy shares of the Company against contributions in cash or in kind. The conditions of the Financial Instrument linked to an option right may also provide that the option price can fully or partially be settled by the transfer of Bonds. In this case, the ratio of subscription is calculated by dividing the nominal amount or – if the price is lower – the issue price of the Bond by the fixed option price of the share of the Company. Fractions of shares resulting from the ratio of subscription will be settled in cash; moreover, such fractions may be added together for the acquisition of whole shares, where appropriate, against payment of an additional amount – where applicable – and in accordance with the conditions of the respective Financial Instrument. The conditions of the Financial Instruments linked to an option right may also provide for a variable determination of the option price (subject to the minimum price specified under No. 5) within a predetermined range, depending on the performance of the share of the Company during the

term of the respective Financial Instrument. The proportion of share capital attributed to each individual share to be issued upon exercise of the option right may not exceed the nominal amount or – if the price is lower – the issue price of the Bond.

c) When issuing profit participation rights or hybrid bonds with conversion rights, No. 3 a) shall apply; when issuing profit participation rights or hybrid bonds with option rights, No. 3 b) shall apply.

4. Conversion or Option Obligations and Substitution Rights; Granting of New or Existing Shares; Cash Payments

a) The conditions of the Financial Instruments may create the unconditional or conditional obligation to exercise the conversion and/or option rights at the end of the term or at another time (hereinafter collectively referred to as "Final Maturity") of the respective Financial Instrument (including the Final Maturity depending on an uncertain future event at the time the financial instrument is issued and/or the exercise of a right of termination) or provide the obligation of the Company to grant shares of the Company instead of payment of a cash amount upon Final Maturity of the respective Financial Instrument. Moreover, the conditions of the Financial Instruments may give the right to the Company, upon Final Maturity of the respective Financial Instrument, to grant the Holders of the Financial Instruments shares in the Company in full or in part instead of payment of the due cash amount (substitution rights). The proportion of share capital attributed to each individual share to be issued upon Final Maturity may once again not exceed the nominal amount or the issue price (if lower) of the Financial Instruments. For the determination of the number of shares to be issued upon Final Maturity of the Financial Instruments (i) linked to a conversion obligation, the rules on the ratio of conversion, on the compensation for fractional portions or amounts which cannot be converted, on payments of additional amounts, on the variable ratio of conversion and on the determination of the conversion price within a predetermined range (No. 3 (a)) shall apply, and (ii) linked to an option obligation, the rules on the transfer of Bonds to settle the option price, on the subscription ratio, on the compensation for fractional portions without subscription rights, on the adding together of such fractions for the acquisition of whole shares as well as on the determination of the option price within a predetermined range (No. 3 (b)) shall apply mutatis mutandis subject to the conditions of the respective Financial Instruments.

b) In the case of conversions (including conversion obligations), or the exercise of options (including option obligations), or the use of the Company's right to substitute, where the Company is obliged to grant shares of the Company, the Company is entitled at its free discretion to either grant new shares or already existing shares of the Company. In addition, the conditions of the Financial Instruments with conversion or option rights or obligations to convert may give the right to the Company, upon exercise of the conversion and/or option rights or fulfilment of the obligations to convert, to pay the equivalent value in cash instead of granting shares of the Company. In this regard, the value of the shares of the Company corresponds to the arithmetic mean of the volume-weighted average prices of the Company's shares in Xetra trading on the Frankfurt Stock Exchange (or in a successor system replacing Xetra) on the last ten trading days prior to the decision of the Company to pay the equivalent value of the shares in cash.

5. Conversion and Option Prices; Value-preserving Adjustments to the Conversion and Option Prices

a) The conversion or option price to be determined must
   - aa) correspond to at least 50% of the arithmetic mean of volume-weighted average prices of the Company's shares in Xetra trading on the Frankfurt Stock Exchange (or in a successor system replacing Xetra) on the last ten trading days prior to the resolution of the Management Board on the issuance of Financial Instruments with conversion or option right, or
   - bb) in case a subscription right is granted, correspond to at least 50% of the arithmetic mean of volume-weighted average prices of the Company's shares in Xetra trading on the Frankfurt Stock Exchange (or in a successor system replacing Xetra) over the period commencing at the beginning of the subscription period up to and including the day prior to the announcement of the final terms and conditions established pursuant to section 186 (2) AktG, or

cc) in case of convertible bonds or warrant bonds issued under exclusion of subscription rights against contribution of variable remuneration claims, gratifications or similar claims of Management Board members or senior managers or employees of the Company and such affiliated entities (within the meaning of section 15 of the AktG) in which the Company, directly or indirectly, holds interests or over which the Company can exercise a controlling influence, the conversion or option price must correspond to the arithmetic mean of volume-weighted average prices of the Company's shares in Xetra trading on the Frankfurt Stock Exchange (or in a successor system replacing Xetra) on all trading days in Frankfurt am Main during the reference period from December of the financial year which has expired up to and including February of the following financial year in which the Management Board resolves, with the consent of the Supervisory Board, to issue the convertible bonds or warrant bonds.

b) In derogation from (a) (aa) and (bb) above, the conversion or option price of Financial Instruments linked to a conversion or option obligation and/or to the Company's right to substitute (No. 4 (a)) may correspond to the arithmetic mean of volume-weighted average prices of the Company's shares in Xetra trading on the Frankfurt Stock Exchange (or in a successor system replacing Xetra) on the ten trading days prior to or following the Final Maturity of the Financial Instruments even if such average stock price falls below the aforementioned minimum conversion or option price (50%).
c) Section 9 (1) and section 199 (2) of the AktG shall remain unaffected.
d) If during the term of Financial Instruments linked to a conversion or option right or a conversion or option obligation, the economic value of the existing conversion or option rights or existing conversion or option obligations is diluted, the conversion or option prices may, notwithstanding section 9 (1) of the AktG, be adjusted to preserve value where such adjustment is not already required by mandatory legal provisions. Subject to the more specific conditions of the Financial Instruments pursuant to section 216 (3) of the AktG, the conversion or option price may, in particular, be adjusted to preserve value if, during the conversion or option period, (i) the Company increases the nominal share capital from retained earnings by issuing new shares, or (ii) the Company increases the nominal share capital or sells treasury shares by granting an exclusive subscription right to the shareholders (irrespective of any exclusion of subscription rights for fractional amounts), or (iii) while granting an exclusive subscription right to its shareholders, the Company issues, grants or guarantees further Financial Instruments with conversion or option rights or a conversion or option obligation or the Company's right to substitute (irrespective of any exclusion of subscription rights for fractional amounts), and in the cases (i) to (iii) listed above, the Holders of already existing conversion or option rights or existing conversion or option obligations or Financial Instruments with the Company's right to substitute are not granted the subscription right they would have been entitled to by operation of law following the exercise of the conversion or option right or fulfilment of the conversion or option obligation or use of the Company's right to substitute.
e) Instead of the aforementioned adjustment of the conversion or option price to preserve value the conditions of the Financial Instruments may provide for an adjustment of the conversion or option rights or conversion or option obligations or the Company's right to substitute with regard to all aforementioned cases and additionally, in the event that the share capital of the Company is decreased or other extraordinary courses of action or events occur, which lead to a dilution of the economic value of the existing conversion or option rights or existing conversion or option obligations (e.g. reorganizations, share splits, dividend payments or a change of control). Such adjustment may, subject to the conditions of the Financial Instruments, include a corresponding cash payment by the Company upon exercise of the conversion or option rights, or fulfilment of the conversion or option obligations, or the granting of subscription rights to the Holders of the Financial Instruments as a compensation. To the extent necessary for the protection against dilution, the conditions of the Financial Instruments may also provide in all abovementioned cases that the number of conversion or option rights or conversion or option obligations per Bond gets adjusted. Section 9 (1) and section 199 (2) of the AktG shall remain unaffected.

6. Subscription Rights; Exclusion of Subscription Rights

a) Subscription rights with regard to Financial Instruments have to be granted to the Company's shareholders to the extent a statutory subscription right applies. The statutory subscription rights may be granted in such a way that the Financial Instruments are subscribed by one or more credit institutions, or by entities which are to be treated as credit institutions according to section 186 (5) sentence 1 of the AktG, subject to the obligation of offering these to the shareholders for subscription (indirect subscription right). In case the Financial Instruments are issued by a subordinated Group entity, the Company has to ensure the statutory subscription rights of the shareholders of the Company.
b) However, subject to the approval of the Supervisory Board, the Management Board may exclude shareholders' subscription rights with regard to Financial Instruments,
   aa) ffor fractional amounts arising from the subscription ratio;
   bb) insofar as is necessary to grant to the Holders of Financial Instruments previously issued (with conversion and/or option rights or obligations to convert or the Company's right to substitute) subscription rights to the extent that they as shareholders would be entitled to such subscription rights after exercising their conversion and/or option rights, or fulfilment of the obligations to convert, or the use of the Company's right to substitute;
   cc) insofar as, in case of Financial Instruments issued against cash payments, the issue price is not substantially lower than the theoretical market value of the Financial Instruments established using recognised actuarial methods. However, the total number of shares to be issued on the basis of Financial Instruments with conversion and/or option rights or conversion and/or options obligations, or the Company's right to substitute while excluding the shareholders' subscription right, is limited to shares of the Company with a proportionate amount of no more than 10% of the Company's share capital at the time the Authorisation becomes effective or – if the value is lower – at the time the Authorisation is utilised. This maximum threshold of 10% of the share capital is reduced by the proportionate amount of the share capital attributable to those shares that are sold and transferred or issued by the Company during the term of the Authorisation, on the basis of other authorisations for the sale and transfer or the issuance of shares of the Company or Financial Instruments with the right or the obligation to buy such shares of the Company, while excluding the shareholders' subscription rights pursuant to section 186 (3) sentence 4 of the AktG;
   dd) if the Financial Instruments are issued against contributions in kind;
   ee) in case of profit participation rights or hybrid bonds without conversion or option rights or obligations to convert (or without the Company's right to substitute), provided these are structured like straight bonds, i.e. (i) do not confer any rights of membership in the Company or (ii) rights to liquidation proceeds from the Company and (iii) the interest paid on them is not linked to the size of the net profit for the year, the net retained earnings or the dividend of the Company. Furthermore, the interest payable and the issue price of the profit participation rights or hybrid bonds must reflect current market conditions for similar fund-raising transactions at the time of issue.

7. Authorisation to Determine Further Details of Financial Instruments

The Management Board shall be authorised to determine within the framework defined above further details concerning the issuance and features of the Financial Instruments, in particular, volume, time of issue, rate of interest, method of interest calculation, issue price, variable ratio of conversion or variable option price, term and denomination, provisions on protection against dilution as well as the option or conversion period. In case of Financial Instruments issued by Group entities (section 18 (1) of the AktG) subordinated to the Company, such determination also requires the consent of the Boards of the respective Group entity.

Treasury Shares

The Company is authorised to buy, for purposes other than securities trading, its own shares in a total volume of up to 10% of the share capital as of 10 June 2015 or – if the value is lower – of the share capital at the time this authorisation is exercised. Together with other own shares which are in the Company's possession or attributable to the Company pursuant to sections 71 d and 71 e of the AktG, the own shares purchased on the basis of this authorisation may not at any time exceed 10% of the Company's share capital. This authorisation to acquire own shares may be exercised directly by the Company, Group entities (section 18 (1) of the AktG) subordinated to the Company, or third parties acting on behalf of the Company or on behalf of Group entities subordinated to the Company. This authorisation may be exercised fully or partially, and – in case of a partial exercise – more than once. This authorisation applies until 9 June 2020.

a) The own shares may, at the discretion of the Management Board, be bought aa) through the stock exchange or bb) by means of a public purchase offer or cc) by means of a public invitation to all shareholders to submit tenders.
   aa) The price for the purchase of shares (excluding ancillary purchase costs) through the stock exchange may not be more than 10% higher or lower than the arithmetic mean of volume-weighted average prices of the Company's shares in Xetra trading on the Frankfurt Stock Exchange (or in a successor system replacing Xetra) on the last three trading days prior to the acquisition of the shares.
   bb) In the case of a public purchase offer to all shareholders, the offered and paid purchase price per share (excluding ancillary purchase costs) may not be more than 10% higher or lower than the arithmetic mean of volume-weighted average prices of the Company's shares in Xetra trading on the Frankfurt Stock Exchange (or in a successor system replacing Xetra) on the last three trading days prior to the cutoff date (as specified below). Cutoff date shall be the day on which the Management Board takes the final decision on the formal purchase offer. In case of any adjustment to the purchase offer, which is permissible if, after the publication of the offer, the market price of the shares has deviated significantly from the relevant price, the relevant cutoff date is the date on which the Management Board finally and formally decides on the adjustment of the offer. The buyback volume of a public purchase offer may be limited. If the volume of shares offered in a public purchase offer exceeds the planned buyback volume, acceptance may be in proportion to the shares offered in each case (tender ratio); in this regard, the right of the shareholders to offer their shares in proportion to their interest in the Company's share capital is excluded. Moreover, commercial rounding to avoid fractions of shares and the preferred acceptance of small quantities of up to 50 of the Company's shares offered for purchase per shareholder may be provided for. In these cases, any further shareholders' rights to offer their shares are excluded.
   cc) In the case of a public invitation to all shareholders to submit tenders, the Management Board shall be authorised to determine a purchase price range per share within which offers may be submitted. The purchase price range may be adjusted if during the tender floating period the market price of the shares deviates significantly from the relevant price at the time of the publication of the public invitation to submit tenders. The purchase price per share paid by the Company on the basis of the submitted tenders (excluding ancillary purchase costs) may not be more than 10% higher or lower than the arithmetic mean of volumeweighted average prices of the Company's shares in Xetra trading on the Frankfurt Stock Exchange (or in a successor system replacing Xetra) on the last three trading days prior to the cutoff date (as specified below). Cutoff date shall be the day on which the Management Board takes the final decision to accept the tenders. The buyback volume of a public invitation to submit tenders may be limited. If not all of several similar tenders can be accepted due to the volume restriction, acceptance may be in proportion to the shares offered in each case (tender ratio); in this regard, the right of the shareholders to offer their shares in proportion to their interest in the Company's share capital is excluded. Moreover, commercial rounding to avoid fractions of shares and the preferred acceptance of small quantities of up to 50 of the Company's shares offered for purchase per shareholder may be provided for. In these cases, any further shareholders' rights to offer their shares are excluded.

b) The Management Board is authorised, with the consent of the Supervisory Board, to use any shares purchased on the basis of the authorisation described under (a) – besides the disposal on the stock exchange or for an offer to all shareholders – for certain other purposes:
  aa) any other form of disposal of the shares against cash payment provided that the price may not be substantially lower than the stock price of the shares of the Company of the same kind [at the time of sale] in accordance with section 186 (3) sentence 4 of the AktG. In this case, the total number of shares to be disposed of, together with those new shares which during the term of this authorisation have been issued by increasing the share capital of the Company while excluding the shareholders' subscription right pursuant to section 186 (3) sentence 4 of the AktG, may not exceed 10% of the share capital as of 10 June 2015 or – if the value is lower – of the share capital at the time this authorisation is exercised. This maximum threshold of 10% of the share capital is also reduced by the proportionate amount of the share capital attributable to those shares that are issued to service convertible bonds, convertible profit participation rights, convertible hybrid bonds or warrants attached to warrant bonds or profit-sharing certificates with warrants, in each case, issued with conversion or option right or conversion or option obligation to the extent that such bonds or profit participation rights are issued during the term of this authorisation, while excluding the subscription rights subject to appropriate application of section 186 (3) sentence 4 of the AktG.
  bb) to dispose the purchased shares against contribution in kind, in particular for the purpose of acquiring companies, parts thereof or shareholdings in companies, including increasing existing shareholdings and the merger of companies.
  cc) to redeem all or some of the shares, without the execution of this redemption process requiring a further resolution by the Annual General Meeting. The redemption leads to a decrease of the share capital of the Company in the proportionate amount of the share capital attributable to such redeemed shares. The Supervisory Board shall be authorised to make amendments to the Memorandum and Articles of Association reflecting the decrease of the share capital of the Company. Alternatively, the Management Board shall be authorised, with the consent of the Supervisory Board, to decide that the share capital remains unaffected by the redemption process and that instead the proportion to the interest of the remaining shares in the Company's share capital increases due to the redemption pursuant to section 8 (3) of the AktG. In this case, the Management Board may amend the number of shares of the Company in the Memorandum and Articles of Association. The redemption may be limited to a fraction of the purchased shares. This authorisation to redeem shares may be exercised more than once.

c) The authorisations as described under (b) may be exercised separately or collectively, in whole or in part, on one or more occasions. Such authorisation also comprises the use of treasury shares of the Company which are acquired pursuant to section 71 d sentence 5 of the AktG, or by Group entities (within the meaning of section 18 (1) of the AktG) subordinated to the Company or third parties acting on behalf of the Company or on behalf of Group entities subordinated to the Company.

d) The shareholders' subscription rights are excluded to the extent that the Company's treasury shares are used according to the authorisations described under (b), (aa) and (bb). In addition, the Management Board may, with the consent of the Supervisory Board, except fractional amounts from shareholders' subscription rights in case of a public purchase offer to all shareholders.

The purchase of shares, subject to the authorisation to acquire own shares as set out above, may be executed, apart from in the ways described in the paragraphs above, with the use of put and call options or forward purchase contracts (hereinafter collectively referred to as "Equity Derivatives").

The Company may enter into Equity Derivatives based on physical delivery if the derivative conditions provide that these Equity Derivatives may be fulfilled only through the delivery of shares which themselves were acquired subject to compliance with the principle of equal treatment. All share purchases based on Equity Derivatives are limited to shares in a maximum volume of 5% of the share capital as of 10 June 2015 or – if the value is lower – of the share capital at the time this authorisation is exercised. The term of the Equity Derivatives must be selected in such a way that the share purchase based on the Equity Derivatives or upon their exercise is carried out, at the latest, on 9 June 2020.

The purchase price to be paid per share upon exercise of the put options or upon the maturity of the forward purchase may not be more than 10% higher or more than 10% lower than the arithmetic mean of volume-weighted average prices of the Company's shares in Xetra trading on the Frankfurt Stock Exchange (or in a successor system replacing Xetra) on the last three trading days prior to the conclusion of the respective transaction, in each case excluding ancillary purchase costs but taking into account the option premium received. The call options may only be exercised if the purchase price to be paid is not more than 10% higher or more than 10% lower than the arithmetic mean of volume-weighted average prices of the Company's shares in Xetra trading on the Frankfurt Stock Exchange (or in a successor system replacing Xetra) on the last three trading days prior to the acquisition of the shares, in each case excluding ancillary purchase costs but taking into account the option premium paid. The option premium paid by the Company with regard to call options, and received by the Company with regard to put options, may not deviate from the theoretical market value of the respective options by more than 5%, established using recognised actuarial methods.

If treasury shares are acquired with the use of Equity Derivatives in line with the provisions set out above, the right of the shareholders to conclude such Equity Derivatives with the Company is excluded pursuant to appropriate application of section 186 (3) sentence 4 of the AktG. Shareholders only have a right to offer their shares to the Company to the extent that the Company is obliged to purchase the relevant shares under the Equity Derivatives. Any further shareholders' rights to offer their shares are excluded. With regard to the disposal and the redemption of own shares acquired with the use of Equity Derivatives, the corresponding provisions set forth under (a) to (d) apply mutatis mutandis.

As at 31 December 2016, the Company neither held treasury shares nor Equity Derivatives.

Material Company Agreements which are Subject to Change of Control Clauses Triggered in the Event of a Takeover Offer (Section 315 (4) No. 8 HGB)

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

Compensation Agreements Entered into with Members of the Management Board or Employees in the Event of a Takeover Offer (Section 315 (4) No. 9 HGB)

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

CONSOLIDATED FINANCIAL STATEMENTS

120 CONSOLIDATED INCOME STATEMENT

121 CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

122 CONSOLIDATED STATEMENT OF FINANCIAL POSITION

123 CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

124 CONSOLIDATED STATEMENT OF CASH FLOWS

125 NOTES

126 Accounting Policies
152 Segment Reporting
155 Notes to the Consolidated Income Statement
162 Notes to the Consolidated Statement of Financial Position (Assets)
168 Notes to the Consolidated Statement of Financial Position (Equity and Liabilities)
178 Notes to the Consolidated Statement of Cash Flows
178 Notes to the Financial Instruments
192 Other Notes

203 RESPONSIBILITY STATEMENT

204 AUDITOR'S REPORT

Consolidated Income Statement

Consolidated income statement

in € million	Note	2016	2015
Operating income		**508**	**400**
Net interest income	32	404	426
Interest income		1,843	2,071
Interest expenses		–1,439	–1,645
Net fee and commisssion income	33	8	14
Fee and commisssion income		10	17
Fee and commisssion expenses		–2	–3
Net trading result	34	–6	15
Net income from financial investments	35	125	–32
Net income from hedging relationships	36	6	11
Net other operating income/expenses	37	–29	–34
Loan loss provisions	38	–1	1
General and administrative expenses	39	–198	–207
Net miscellaneous income/expenses	40	–8	1
Profit or loss before tax		**301**	**195**
Income taxes	41	–104	35
Net income/loss		**197**	**230**
attributable to:			
Equity holders		197	230

Earnings per share

in €	Note	2016	2015
Basic earnings per share	43	1.46	1.71
Dilluted earnings per share	43	1.46	1.71

Consolidated Statement of Comprehensive Income

Consolidated statement of comprehensive income

in € million	2016	2015
Net income/loss	**197**	**230**
Other comprehensive income for the period, net of tax	–87	4
Items that will not be reclassified subsequently to profit or loss	–11	8
Gains/losses on pension commitments, before taxes	–15	12
Income taxes relating to items that will be reclassified to profit or loss	4	–4
Items that may be reclassified subsequently to profit or loss	–76	–4
Gains/losses on translating foreign currency, before taxes	–1	2
Unrealised gains/losses	–1	2
Gains/losses reclassified to profit or loss	–	–
Gains/losses on AfS assets, before taxes	–44	132
Unrealised gains/losses	–50	132
Gains/losses reclassified to profit or loss	6	–
Gains/losses on cash flow hedge accounting, before taxes	–59	–142
Unrealised gains/losses	–	–37
Gains/losses reclassified to profit or loss	–59	–105
Income taxes relating to items that may be reclassified subsequently to profit or loss	28	4
Total comprehensive income for the period	**110**	**234**
attributable to:		
Equity holders	**110**	**234**

Consolidated Statement of Financial Position

Assets

in € million	Note	31.12.2016	31.12.2015[1]	1.1.2015[1]
Cash reserve	10, 44	1,136	1,265	57
Trading assets	11, 45	1,089	1,600	2,016
Loans and advances to other banks	12, 46	2,841	2,742	6,800
Loans and advances to customers	12, 47	41,146	41,226	38,986
Allowances for losses on loans and advances	13, 48	–130	–149	–160
Valuation adjustment from portfolio hedge accounting	8, 49	2	1	–
Financial investments	8, 50	12,845	14,927	20,475
Property and equipment	15, 51	8	10	8
Intangible assets	16, 52	24	21	23
Other assets	17, 53	3,550	5,013	6,659
Income tax assets	25, 54	118	105	30
Current tax assets		47	21	29
Deferred tax assets		71	84	1
Total assets		**62,629**	**66,761**	**74,894**

Equity and liabilities

in € million	Notes	31.12.2016	31.12.2015	1.1.2015
Liabilities to other banks	18, 58	3,179	2,514	3,187
Liabilities to customers	18, 59	9,949	10,824	10,593
Securitised liabilities	18, 60	40,381	42,648	47,827
Valuation adjustment from portfolio hedge accounting	8, 61	1	1	–
Trading liabilities	19, 62	1,355	1,643	1,960
Provisions	20, 63	242	229	272
Other liabilities	21, 64	3,778	4,918	6,182
Income tax liabilities	25, 65	59	113	82
Current tax liabilities		59	113	82
Subordinated capital	22, 66	886	1,125	1,279
Liabilities		**59,830**	**64,015**	**71,382**
Equity attributable to equity holders		**2,799**	**2,746**	**3,512**
Subscribed capital	67	380	380	380
Silent partnership contribution		–	–	999
Additional paid-in capital	67	1,637	1,637	3,265
Retained earnings	67	656	483	–1,148
Gains/losses on pension commitments	20	–82	–71	–79
Foreign currency reserve	24	3	4	2
Revaluation reserve	8	8	83	89
AfS reserve		–36	–4	–100
Cash flow hedge reserve		44	87	189
Consolidated profit		197	230	4
Equity		**2,799**	**2,746**	**3,512**
Total equity and liabilities		**62,629**	**66,761**	**74,894**

[1] Adjusted according to IAS 8.14 et seq. (change in accounting policy). Details are disclosed in Note "Consistency".

Consolidated Statement of Changes in Equity

Consolidated statement of changes in equity

in € million	Equity attributable to equity holders									
							Revaluation reserve			
	Subscribed capital	Silent partnership contribution	Additional paid-in capital	Retained earnings	Gains/losses on pension commit-ments	Foreign currency reserve	AfS reserve	Cash flow hedge reserve	Consolidated profit	**Equity**
Equity at 1.1.2015	**380**	**999**	**3,265**	**-1,148**	**-79**	**2**	**-100**	**189**	**4**	**3,512**
Equity transfer	–	–	-1,628	1,628	–	–	–	–	–	–
Redemption of silent partnership contribution	–	-999	–	-1	–	–	–	–	–	-1,000
Total comprehensive income for the period	–	–	–	–	8	2	96	-102	230	234
Net income/loss	–	–	–	–	–	–	–	–	230	230
Other comprehensive income for the period, net of tax	–	–	–	–	8	2	96	-102	–	4
Transfer to retained earnings	–	–	–	4	–	–	–	–	-4	–
Equity at 31.12.2015	**380**	**–**	**1,637**	**483**	**-71**	**4**	**-4**	**87**	**230**	**2,746**
Equity at 1.1.2016	**380**	**–**	**1,637**	**483**	**-71**	**4**	**-4**	**87**	**230**	**2,746**
Disbursement	–	–	–	–	–	–	–	–	-57[1)]	-57
Total comprehensive income for the period	–	–	–	–	-11	-1	-32	-43	197	110
Net income/loss	–	–	–	–	–	–	–	–	197	197
Other comprehensive income for the period, net of tax	–	–	–	–	-11	-1	-32	-43	–	-87
Transfer to retained earnings	–	–	–	173	–	–	–	–	-173	–
Equity at 31.12.2016	**380**	**–**	**1,637**	**656**	**-82**	**3**	**-36**	**44**	**197**	**2,799**

[1)] Rounded down; disbursement of dividends amounted to € 57,824,382.44.

Consolidated Statement of Cash Flows

Consolidated statement of cash flows[1]

in € million	2016	2015
Net income/loss	**197**	**230**
Write-downs, provisions for losses on, and write-ups of, loans and advances and additions to provisions in lending business	5	–6
Write-downs and depreciation less write-ups on non-current assets	–112	84
Change in other non-cash positions	146	–224
Result from the sale of non-current assets	–2	–40
Other adjustments	–295	–459
Subtotal	**–61**	**–415**
Change in assets and liabilities from operating activities after correction for non-cash components		
Increase in assets/decrease in liabilities (–)		
Decrease in assets/increase in liabilities (+)		
Trading portfolio	86	137
Loans and advances to other banks	–102	3,991
Loans and advances to customers	–435	–2,440
Other assets from operating activities	–5	53
Liabilities to other banks	1,461	–666
Liabilities to customers	–821	293
Securitised liabilities	–2,201	–4,394
Other liabilities from operating activities	–156	–172
Interest income received	1,613	1,960
Interest expense paid	–1,259	–1,447
Taxes on income paid/refund	–134	–9
Cash flow from operating activities	**–2,014**	**–3,109**
Proceeds from the sale of non-current assets	3,301	5,795
Payments for the acquisition of non-current assets	–1,132	–321
Proceeds from the sale of subsidiaries	–	–
Cash flow from investing activities	**2,169**	**5,474**
Disbursement of dividends	–58	–
Redemption of silent partnership contribution	–	–1,000
Payments of subordinated capital	–225	–157
Cash flow from financing activities	**–283**	**–1,157**
Cash and cash equivalents at the end of the previous period	1,265	57
+/– Cash flow from operating activities	–2,014	–3,109
+/– Cash flow from investing activities	2,169	5,474
+/– Cash flow from financing activities	–283	–1,157
+/– Effects of exchange rate changes	–1	–
Cash and cash equivalents at the end of the period	**1,136**	**1,265**

[1] Explanations in Note "Notes to the Items in the Consolidated Statement of Cash Flows".

Notes

126 1 General Information

126 Accounting Policies
126 2 Principles
135 3 Consistency
135 4 Uniform Consolidated Accounting
136 5 Consolidation
137 6 Disclosures of Interests in Subsidiaries
138 7 Disclosures of Interests in Associates
138 8 Financial Instruments
144 9 Leases
144 10 Cash Reserve
144 11 Trading Assets
144 12 Loans and Advances
145 13 Allowances for Losses on Loans and Advances and Provisions for Contingent Liabilities and Other Commitments
145 14 Financial Investments
146 15 Property and Equipment
146 16 Intangible Assets
146 17 Other Assets
147 18 Liabilities
147 19 Trading Liabilities
147 20 Provisions
148 21 Other Liabilities
148 22 Subordinated Capital
149 23 Share-based Payment
149 24 Currency Translation
149 25 Income Taxes
149 26 Non-current Assets Held for Sale
150 27 Accounting Estimates and Assumptions

152 Segment Reporting
152 28 Notes to Segment Reporting by Operating Segment
153 29 Income Statement by Operating Segment
154 30 Balance-sheet-related Measures by Operating Segment
154 31 Breakdown of Operating Income

155 Notes to the Consolidated Income Statement
155 32 Net Interest Income
155 33 Net Fee and Commission Income
156 34 Net Trading Income
156 35 Net Income From Financial Investments
156 36 Net Income from Hedging Relationships
157 37 Net Other Operating Income/Expenses
157 38 Loan Loss Provisions
157 39 General and Administrative Expenses
158 40 Net Miscellaneous Income/Expenses
158 41 Income Taxes
161 42 Net Gains/Net Losses
161 43 Earnings Per Share

162 Notes to the Consolidated Statement of Financial Position (Assets)
162 44 Cash Reserve
162 45 Trading Assets
162 46 Loans and Advances to Other Banks
163 47 Loans and Advances to Customers
163 48 Allowances for Losses on Loans and Advances
164 49 Valuation Adjustment from Portfolio Hedge Accounting
164 50 Financial Investments
165 51 Property and Equipment
166 52 Intangible Assets
166 53 Other Assets
167 54 Income Tax Assets
167 55 Subordinated Assets
167 56 Repurchase Agreements
167 57 Securitisation

168 Notes to the Consolidated Statement of Financial Position (Equity and Liabilities)
168 58 Liabilities to Other Banks
168 59 Liabilities to Customers
168 60 Securitised Liabilities
169 61 Valuation Adjustment from Portfolio Hedge Accounting
169 62 Trading Liabilities
169 63 Provisions
175 64 Other Liabilities
176 65 Income Tax Liabilities
176 66 Subordinated Capital
177 67 Equity
177 68 Trust Business

178 Notes to the Consolidated Statement of Cash Flows
178 69 Notes to the Items in the Consolidated Statement of Cash Flows

178 Notes to the Financial Instruments
178 70 Derivative Transactions
181 71 Undiscounted Cash Flows of Financial Liabilities
181 72 Assets Assigned or Pledged as Collateral
182 73 Collaterals Permitted to Resell or Repledge
182 74 Transfer of Financial Assets
183 75 Fair Values of Financial Instruments
188 76 Past Due but Not Impaired Assets
189 77 Restructured Loans and Advances
190 78 Netting of Financial Instruments

192 Other Notes
192 79 Contingent Liabilities and Other Commitments
192 80 Leases
193 81 Key Regulatory Capital Ratios
195 82 Group Auditors' Fee
196 83 Relationship with Related Parties
198 84 Employees
199 85 Members of the Supervisory Board and of the Management Board
200 86 Holdings of pbb
201 87 Country-by-Country Reporting
202 88 Report on Post-balance Sheet Date Events

1 General Information

Deutsche Pfandbriefbank AG (pbb), with its registered offices in Munich, is a leading provider of commercial real estate finance and public investment finance. The Company is registered in the commercial register of the Amtsgericht (local court) Munich (HRB 41054) and represents the ultimate parent company of the Deutsche Pfandbriefbank Group (pbb Group).

These consolidated financial statements were prepared in millions of euros. Due to rounding, numbers presented may not add up precisely to the totals provided.

ACCOUNTING POLICIES

2 Principles

pbb has prepared its these consolidated financial statements for the period ended 31 December 2016 in line with EC ordinance No. 1606/2002 of the European Parliament and Council of 19 July 2002 in accordance with International Financial Reporting Standards (IFRS). The IFRS are standards and interpretations adopted by the International Accounting Standards Board (IASB). These are the International Financial Reporting Standards (IFRS), the International Accounting Standards (IAS) and the interpretations of the IFRS Interpretations Committee (formerly IFRIC) respectively the former Standing Interpretations Committee (SIC); they are also based on the regulations of commercial law which are applicable in accordance with Section 315 a (1) HGB (German Commercial Code).

The consolidated financial statements are based on IFRS as adopted in European law by the European Commission as part of its endorsement process. With the exception of certain regulations on fair value hedge accounting for a portfolio hedge of interest rate risks in IAS 39 Financial Instruments: Recognition and Measurement, all the IFRS published by the IASB and required to be applied were fully recognised by the European Union (EU). Within the framework of fair value hedge accounting for a portfolio hedge of interest rate risks, pbb Group applies a part of the exemptions permitted under European law. Therefore, the present consolidated financial statements comply with IFRS applicable in the EU, but not with IFRS as a whole as promulgated by the IASB.

In addition, the German Accounting Standards (Deutsche Rechnungslegungs Standards – DRS) published by the Accounting Standards Committee of Germany (Deutsche Rechnungslegungs Standards Committee – DRSC) have been taken into account provided they are not inconsistent with the IFRS.

The Management Board of pbb prepared these consolidated financial statements on 7 March 2017.

Initially Adopted Standards, Interpretations and Amendments Applied for the First Time
The following standards, interpretations and amendments were applied for the first time in financial year 2016:
- Amendments to IAS 1: Disclosure Initiative
- Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation
- Amendments to IAS 16 and IAS 41: Agriculture: Bearer Plants
- Amendments to IAS 19 (revised 2011) Employee Benefits: Defined Benefit Plans: Employee Contributions
- Amendments to IAS 27: Equity Method in Separate Financial Statements
- Amendments to IFRS 10, IFRS 12 and IAS 28: Investment Entities – Applying the Consolidation Exception
- Amendments to IFRS 11: Accounting for Acquisitions of Interests in Joint Operations
- Annual Improvements Projects

> Annual Improvements to IFRSs 2010–2012 Cycle
> Annual Improvements to IFRSs 2012–2014 Cycle

Amendments to IAS 1 The amendments to IAS 1 further highlight the concept of materiality, aiming at removing immaterial information from IFRS financial statements and enhancing the presentation of relevant information. For this purpose, the amendments clarify that the concept of materiality must be applied to all components of the IFRS financial statements, which is intended to avoid a move of irrelevant information from other parts of the financial statements to the Notes. In this context, it is also clarified that immaterial information does not have to be presented separately, even if its presentation is explicitly required in another IFRS. This even applies to situations where certain minimum line items are required. The amendments to IAS 1 also include the following guidance, clarifications and suggestions:
> Presentation of subtotals
> The structure of the Notes, for instance, depending on the relevance of individual information for understanding development in assets, financial position and earnings
> Disclosures regarding accounting policies
> Presentation of results of companies measured at equity in the statement of comprehensive income as an separate item

No material changes to the consolidated financial statements resulted from the first-time application of IAS 1 amendments.

Amendments to IAS 16 and IAS 38 The amendments to IAS 16 and IAS 38 clarify that depreciation of property and equipment and amortisation of intangible assets with a limited useful life on the basis of revenues of goods produced by such items is, in principle, not appropriate. Given that pbb Group recognises depreciation of property and equipment, and amortisation of intangible assets on a straight-line basis using the assumed useful lives, first-time application of the amendments did not result in any changes to the consolidated financial statements.

Amendments to IAS 16 and IAS 41 The amendments govern the accounting requirements for biological assets that meet the definition of so-called "bearer plants". The amendments have no effect on the consolidated financial statements, since pbb Group has no assets in the scope of IAS 41 in its portfolio.

Amendments to IAS 19 (revised 2011) The amendments to IAS 19 clarify the attribution of contributions from employees, or third parties, which are linked to service. In addition, they permit a practical expedient regarding the attribution of contributions from employees (or third parties) which are linked to service, to periods of service. Moreover, they permit a practical expedient if the amount of the contributions is independent of the number of years of service. First-time application did not have any material effects.

Amendments to IAS 27 According to these amendments, interests in subsidiaries, joint ventures and associated companies may be measured at equity in IFRS separate financial statements. Given that the regulations exclusively affect IFRS separate financial statements, they have no effects on pbb's IFRS consolidated financial statements.

Amendments to IFRS 10, IFRS 12 and IAS 28 The amendments exclusively refer to items in connection with the application of exceptions from consolidation for investment entities. Due to the business model of pbb Group, the amendments had no effects on the consolidated financial statements.

Amendments to IFRS 11 Amendments to IFRS 11 relate to acquisitions of shares in joint arrangements that represent a business within the meaning of IFRS 3, and therefore have to be disclosed in accordance with IFRS 3. Since the pbb Group does not hold any shares in joint arrangements within the meaning of IFRS 11, the first-time application of the amendments had no effects.

Annual Improvements Projects The standards affected by the Annual Improvements to IFRSs 2010–2012 Cycle are IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24 as well as IAS 38. Annual Improvements to IFRSs 2012–2014 Cycle introduced amendments to IFRS 5, IFRS 7, IAS 19 and IAS 34. First-time application did not have any material effects.

Standards, Interpretations and Amendments Endorsed by the EU but Not Yet Effective
pbb Group does not plan earlier adoption of standards, interpretations and amendments, which will be applicable in future financial years. The following standards and amendments were endorsed by the EU as of the balance sheet date, but their application is not yet required:
> IFRS 9 Financial Instruments
> IFRS 15 Revenue from Contracts with Customers

IFRS 9 In July 2014, the IASB published IFRS 9, the new IFRS for financial instruments accounting. This standards will supersede the current regulations of IAS 39. Financial instruments mainly comprise loans and advances, securities, financial liabilities and derivatives, which collectively represent more than 95% of pbb Group's total assets. In its final version, the standard contains fundamental revisions regarding classification and measurement, impairment methodology and hedge accounting – however, without any specific regulations on so-called macro hedges.

Compared to IAS 39, IFRS 9 introduces fundamental changes to the classification and measurement of financial instruments. IFRS 9 provides for the following measurement categories:
> at fair value through profit or loss
> at fair value through other comprehensive income
> at amortised cost

The classification of financial debt instruments on the assets side depends on the entity's business model for managing financial assets and the characteristics of the contractual cash flows of the financial asset. Upon initial recognition, the relevant financial asset is either classified as "at fair value through profit or loss", as "at amortised cost", or as "at fair value through other comprehensive income". However, equity instruments are generally measured at fair value, with an option for equity investments not held for trading to recognise fair value changes either through profit or loss or through other comprehensive income. Non-derivative liabilities are generally measured at amortised cost, except where they are held for trading or voluntarily measured at their fair value. Changes in the fair value of liabilities measured at fair value through profit or loss that are attributable to changes in the entity's own credit risk have to be recognised through other comprehensive income, while the remaining fair value changes are recognised through profit or loss.

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. Upon initial recognition, the lending business loss allowance is based on expected credit losses for the first twelve months (so-called stage 1). In case of a significant increase in the financial asset's credit risk within the context of subsequent measurement, the loss allowance has to reflect the lifetime expected credit losses (so-called stage 2 and stage 3).

With the new regulations in hedge accounting, accounting for hedging relationships will be more closely tied to the economic risk management of a company. In general, some of the restrictions imposed under IAS 39 were lifted, leading to a broader variety of hedging instruments and hedged items recognised under IFRS 9 for hedge accounting purposes. In addition, mandatory tests to prove the quantitative effectiveness of hedging relationships are no longer required. Instead, qualitative tests may be provided. As long as regulations on accounting for macro hedges have not yet been adopted, the IASB provides the option to apply the former rules pursuant to IAS 39.

IFRS 7 (Financial Instruments: Disclosures) has been amended as part of the introduction of IFRS 9. In particular, this comprises amendments to disclosure requirements regarding information about the significance of financial instruments for an entity's assets, financial position and earnings as well as the nature and extent of risks arising from financial instruments.

In 2011, pbb Group started a project for the implementation of IFRS 9. This project was suspended in 2012 since the finalisation of the IFRS 9 regulations was delayed, leading to legal uncertainty. After the finalisation of the standard, pbb Group's implementation project was resumed in 2014. The IFRS 9 project is divided into sub-projects concerning classification and measurement, determination of allowances of stage 1 and 2 as well as determination of allowances of stage 3. The IFRS 9 project is closely tied to the implementation of other requirements, such as new regulatory reporting requirements.

In order to implement the new classification and measurement rules, the portfolio of loans and advances and securities was classified based on contractual cash flow criterion. Moreover, contractual cash flow criterion tests have been integrated into the new business and new product processes. In addition, the analysis of the portfolios was made on the basis of the current business model. pbb Group's portfolios were allocated to the measurement categories as part of the analysis. The technical implementation for the sub-ledgers comprising the majority of loans and advances was completed and put into operation. The required adjustments to the sub-ledgers comprising securities and derivatives are scheduled for the second quarter of 2017, and will be put into operation thereafter. The fair value accounting will be provided in a new sub-ledger, the introduction of which is planned for the second quarter of 2017 as well. As regards the implementation of the new allowance rules, pbb Group is in the process of developing a system for determining the amount of impairment for stages 1 and 2. Adjustments to the general ledger have been largely completed. In addition, pbb plans to reflect the information provided in the notes in the data repository during the second half of 2017. Overall, pbb Group believes it is making good progress with regard to its intention to apply IFRS 9 for the first time as of 1 January 2018.

Since pbb Group's statement of financial position largely consists of financial instruments, first-time application of IFRS 9 will have significant effects on the consolidated financial statements. Given the new classification and measurement regulations for the disclosure of financial assets, some of the assets currently measured at amortised cost will presumably be measured at their fair value, going forward. For instance, financial assets which do not pass the contractual cash flow criterions test due to contractual stipulations have to be disclosed at fair value through profit or loss. Another example is the liquidity portfolio, at least a part of which has to be measured at fair value through other comprehensive income. In turn, some securities recognised as part of the available-for-sale portfolio in accordance with IAS 39 will be measured at amortised cost, pursuant to IFRS 9. Moreover, pbb will have to make considerable adjustments to the accounting of impairment losses according to the new regulations, eventually resulting in elevated loss allowances. The reason for this is the requirement to recognise loss allowances in the amount of the credit losses expected within twelve months following the reporting date, including instruments for which credit risk has not increased since initial recognition - and also in the amount of the lifetime expected credit losses for financial assets for which credit risk has significantly increased. Regarding hedge accounting, pbb Group will presumably use the option provided under IFRS 9 according to which the former rules pursuant to IAS 39 still apply.

pbb plans the first-time application of IFRS 9 as from 1 January 2018 with retrospective effect. First-time application effects are recognised directly in equity. Both the new regulations on the classification and measurement of financial instruments as well as the amendments regarding the determination and accounting of impairment losses will incur first-time application effects at pbb Group. The amount of such first-time application effects depends on several factors, which are beyond, or partly beyond, pbb Group's sphere of influence. For instance, the changeover effects largely depend on the fair values to be disclosed as at 1 January 2018 for the financial assets measured at fair value. The fair value of financial assets vary with current interest rates and the borrowers' credit rating, for example. Regarding impairment losses, borrowers' default probabilities as at the date of first-time application as well as future expectations are among the crucial factors in the determination of first-time application effects. The first-time application effects from the classification and measurement of financial assets will depend, among other things, on the portfolios' business models as at the date of IFRS 9 first-time application. Furthermore, IFRS 9 is a principle-based standard, which provides for interpretations where appropriate, depending on the specific circumstances. While pbb Group has drafted working hypotheses for key definitions and interpretations, they are subject to further amendments and/or developments based on the latest views provided by banking and auditor experts before the date of first-time application.

Against this background, and at the time these consolidated financial statements were prepared, pbb is not able to provide a reliable quantification of the expected first-time application effects to be incurred as at 1 January 2018. Nevertheless, pbb Group simulated the first-time application effects for 2016 based on the following factors: parameters then applicable to the measurement of financial instruments, impairment losses, portfolio composition pursuant to the contractual cash flow characteristics test and the entity's business model as well as the existing working hypotheses for the interpretation of IFRS 9. The classification and measurement of financial assets carried out as part of the simulation resulted in positive effects in the upper double-digit euro million range. However, the positive effects were almost entirely offset by impairment losses to be recognised pursuant to IFRS 9, the amount of which is expected to exceed the total amount of specific and portfolio-based allowances disclosed in accordance with IAS 39 on the basis of loss events occurred. The result of the simulation would have been a slight increase in equity. Against this background, first-time application of IFRS 9 is expected to have relatively minor effects considering pbb Group's total equity.

Regarding subsequent reporting periods, the application of IFRS 9 regulations will result in more volatile results of operations compared to the current regulations under IAS 39, due to the higher number of financial instruments to be measured at fair value through profit or loss and the new regulations regarding loss allowances pursuant to IFRS 9. This volatility may result in multi-million euro fluctuations, and may thus be considered substantial regarding pbb Group's recent net income levels.

IFRS 15 The new standard replaces IAS 18 and IAS 11 as well as a series of interpretations on revenue recognition. IFRS 15 determines when revenue has to be recognised, and in what amounts. In accordance with IFRS 15, revenue has to be recognised when the customer obtains control over the contractual goods and services – and can obtain benefits from these goods and services. IFRS 15 is required to be applied for financial years beginning on or after 1 January 2018. Referring to the existing products and contractual arrangements of pbb Group, no material changes to the timing of revenue recognition are expected. Thus, no material effects on the consolidated financial statements are anticipated.

Standards, Interpretations and Amendments Issued but Not Yet Endorsed by the EU
In addition, standards, interpretations and amendments were issued, but had not yet been endorsed by the European Union:

> IFRS 14 Regulatory Deferral Accounts
> IFRS 16 Leases
> IFRIC 22 Foreign Currency Transactions and Advance Consideration
> Amendments to IAS 7: Disclosure Initiative
> Amendments to IAS 12: Recognition of Deferred Tax Assets for Unrealised Losses
> Amendments to IAS 40: Transfers of Investment Property
> Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions
> Amendments to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts
> Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture
> Clarifications to IFRS 15: Revenue from Contracts with Customers
> Annual Improvements to IFRSs 2014–2016 Cycle

IFRS 14 With the new interim standard, first-time adopters of IFRS will be able to retain certain regulatory deferral accounts in the IFRS financial statements. The currently available standard is intended by the IASB as an interim solution until the accounting rules for rate-regulated activities are published in their final version. The current version of IFRS 14 is required to be applied for financial years beginning on or after 1 January 2016. The European Commission will exclusively adopt the final version of IFRS 14, but not the current interim solution. As pbb Group is not a first-time adopter of IFRS, there will be no effects on its consolidated financial statements.

IFRS 16 The new standard on lease accounting will replace IAS 17 as well as the related interpretations IFRIC 4, SIC 15 and SIC 27. According to the new regulations, lessees have to recognise the majority of leases going forward. However, the new standard provides options according to which exemptions apply to leasing contracts with lease terms of 12 months or less as well as underlying assets with low values. The approach to lessor accounting is substantially unchanged from IAS 17 rules.

According to IFRS 16, a contract is a lease if it conveys the right to control the use of an asset for a period of time in exchange for consideration. Compared to IAS 17, more emphasis is given to the principle of conveying the right to control the use of an underlying asset in IFRS 16.

Under IFRS 16, lessees are generally obliged to recognise all leases by disclosing a right-of-use asset as well as a corresponding lease liability in the amount of the present value of the lease payments. In subsequent periods, the right-of-use asset shall be subject to depreciation over the remaining lease term; unaccrued interest shall be added to the lease liability according to the effective interest rate method over the remaining lease term. The accounting of leases in the lessee's consolidated financial statements is thus similar to the accounting of credit financing.

Disclosure requirements for lessors have only marginally changed compared to IAS 17: leasing contracts have to be classified either as finance leases or operating leases. Classification depends on the question as to whether the risks and rewards incidental to the leasing contract are transferred. Regarding the recognition of finance lease contracts which pbb Group has entered into as a lessor, the following rule still applies: upon lease commencement, a lessor shall recognise assets held under a finance lease as a receivable at an amount equal to the net investment in the lease. Furthermore, the lessor recognises finance income over the lease term of a finance lease, based on a pattern reflecting a constant periodic rate of return on the net investment in the finance lease.

Sale and leaseback transaction means: an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor. The transfer of the underlying asset within the meaning of IFRS 15 is decisive for the disclosure of sale and leaseback transactions. If the requirements of IFRS 15 are not fulfilled, the transaction is disclosed following the rules for recognising collateralised lending business. If the requirements of IFRS 15 are met, the leasing contract shall be accounted according to IFRS 16.

Moreover, the new standard comprises detailed regulations regarding the disclosure of lease modifications and reassessments without contractual modifications. In addition, disclosure requirements for lessees and lessors were considerably extended compared to IAS 17.

IFRS 16 is required to be applied for financial years beginning on or after 1 January 2019. Earlier application is permitted, provided that IFRS 15 is also applied earlier. However, earlier application is not intended by pbb Group. IFRS 16 may be applied with full retrospective effect according to IAS 8, or with a modified retrospective effect based on the transitional regulations as defined in the standard.

Referring to its activities as a lessor, pbb Group anticipates extended disclosure requirements, whilst no material effects on the consolidated income statement or the consolidated statement of financial position are expected. During the preceding financial years, pbb Group did not enter into any sale and leaseback transactions, and it currently has no intentions to enter into such transactions going forward. Effects from IFRS 16 are expected mainly for pbb's leased assets. pbb Group will be obliged to recognise the right-of-use assets as well as the corresponding lease liabilities in the amount of the present values of lease payments, eventually translating into an extension of the total assets. Land and buildings used by pbb Group under lease contracts are particularly relevant in this context, while the Group's operating equipment should be affected to a lesser extent. The extension of the total assets to be disclosed as at 31 December 2016 and 31 December 2015 should roughly correspond to the amount of future minimum lease payments disclosed under the respective leases notes of these consolidated financial statements. The effects from the first-time application of IFRS 16 depend on the remaining term of the leasing contracts to be disclosed. Additional expenses will be incurred and income will be generated given the depreciation of the right-of-use assets and the unaccrued interest to be added to the lease liabilities. pbb Group expects leases to result in net expenses during the early periods of the lease term, and in net income during later periods. Compared to the annual consolidated net profit of pbb Group, only minor total effects on the consolidated income statement are expected from IFRS 16.

IFRIC 22 IFRIC 22 clarifies the accounting for transactions that include the receipt or payment of advance consideration in a foreign currency. The date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the prepayment asset or deferred income liability. IFRIC 22 is required to be applied for financial years beginning on or after 1 January 2018. The effects of this interpretation on pbb Group's consolidated financial statements depend on whether and to what extent the Group enters into appropriate transactions in future. At present, pbb Group expects no material consequences for the consolidated financial statements.

Amendments to IAS 7 The objective of the amendments is to require the presentation of information enabling users of financial information to assess the development of financial liabilities. To achieve this objective, the IASB requires that the following changes in liabilities arising from financing activities are disclosed (to the extent necessary):

> changes from financing cash flows
> changes arising from obtaining or losing control of subsidiaries or other businesses
> effect of changes in foreign exchange rates
> changes in fair values
> other changes

The amendments to IAS 7 are required to be applied for financial years beginning on or after 1 January 2017. pbb Group assessed the relevance of the amendments to IAS 7 and will provide extended notes, in particular a reconciliation between the opening and closing balances in the consolidated statement of financial position for liabilities arising from financing activities.

Amendments to IAS 12 With these amendments, the IASB clarifies how to account for the following issue: the value of a debt instrument measured at fair value in the IFRS consolidated statement of financial position has to be decreased to a lower fair value due to changes in the market interest rate, while the carrying amount of the debt instrument as disclosed under tax law remains unchanged in line with the concept of amortised cost. The IASB confirms the occurrence of temporary differences in such circumstances, given that the resulting loss is not realised, and may turn into gains in future, provided that the debt instrument, which is settled at its nominal value, is held until maturity. The rules apply independently from the fact whether the debt instrument's holder expects to hold the instrument until maturity (or not) in order to recover the full nominal value.

The IASB also clarifies that an entity has to assess - for all of its deductible temporary differences – whether taxable profits are expected to be available in future, in order to utilise and recognise these. Only if - and to the extent that - tax laws make a distinction between different types of taxable profits, do these different types have to be assessed separately. Moreover, IAS 12 introduces rules and examples which clarify how future taxable income has to be determined for the recognition of deferred tax assets. The amendments to IAS 12 are required to be applied for financial years beginning on or after 1 January 2017. These amendments will presumably have no effects on the consolidated financial statements, given that pbb Group does not hold any applicable items.

Amendments to IAS 40 The amendment clarify the timing, when the classification of real estate as investment property begins or ends, while the property is still under construction or development. The classification of property under construction or development was not clearly established with the list of examples provided in IAS 40, which was so far considered exhaustive. This list of examples has now been designated as non-exhaustive, allowing reporting entities to apply the existing regulations to property under construction. The amendments to IAS 40 are required to be applied for financial years beginning on or after 1 January 2018. The effects on pbb Group's consolidated financial statements depend on whether the Group will hold investment property in future, which was not the case in the financial year 2016.

Amendments to IFRS 2 These amendments clarify the disclosure of cash-settled share-based payment transactions that include a performance condition, the classification of share-based payment transactions with net settlement features for withholding taxes, as well as the accounting for modifications of share-based payment transactions from cash-settled to equity-settled. The amendments to IFRS 2 are required to be applied for financial years beginning on or after 1 January 2018. The effects on the consolidated financial statements depend on whether the pbb Group will make share-based payments going forward. As at 31 December 2016, the amount of share-based payments was less than €1 million.

Amendments to IFRS 4 With these latest amendments to IFRS 4, the IASB provided reporting entities with options regarding the disclosure of insurance contracts applicable until the effective date of the forthcoming new insurance contracts standard (IFRS 17). These options may be used to avoid certain effects in the statement of financial position resulting from the different effective dates of IFRS 9 and the forthcoming new IFRS 17. The amendments to IFRS 4 are required to be applied for financial years beginning on or after 1 January 2018. The effects on the consolidated financial statements depend on whether pbb Group will enter into applicable contracts in future. pbb Group did not hold any such contracts during the financial year 2016, and currently has no intention to do so.

Amendments to IFRS 10 and IAS 28 These amendments remove an inconsistency between IFRS 10 and IAS 28, and clarify the recognition of unrealised gains from a disposal or transfer of assets between an investor and an associate or joint venture. The amendments were originally required to be applied for financial years beginning on or after 1 January 2016. However, the IASB postponed the date of mandatory first-time application for the time being, since a conflict was identified between the new and the existing regulations of IAS 28. The effects on the consolidated financial statements depend on whether pbb Group will enter into applicable transactions in future, which was not the case in the financial year 2016.

Clarifications to IFRS 15 The IASB published clarifications to IFRS 15 addressing the following issues:
- Identification of performance obligations
- Classification as principal or agent
- Licensing

In addition, the IASB provided two practical expedients applicable to modified and previously entered-into contracts. The amendments are required to be applied for financial years beginning on or after 1 January 2018. Given pbb Group's business model, its existing products and contractual stipulations, no material effects on the consolidated financial statements are expected from these amendments.

Annual Improvements Annual Improvements to IFRS 2014-2016 Cycle introduced minor amendments to IFRS 12, IFRS 1, and IAS 28. The amendments are required to be applied for financial years beginning on or after 1 January 2017 (amendments to IFRS 12), and on or after 1 January 2018, respectively. At present, pbb Group expects no material consequences for the consolidated financial statements.

Statement of Compliance for the German Corporate Governance Code

Company's Management Board and the Supervisory Board published a statement of compliance for the German Corporate Governance Code in this annual report as well as on pbb's website (http://www.pfandbriefbank.com/en/investor-relations/mandatory-publications.html).

Group Management Report

The Group management report meets the requirements of section 315 (1) and (2) HGB and DRS 20. It comprises fundamental information about the Group, a report on the economic position, a report on post-balance sheet date events, a risk and opportunity report, a report on expected developments and supplemental information. The risk and opportunity report contains information which, under IFRS 7, is required to be disclosed. Events after the balance sheet date are described in the report on post-balance sheet date events.

3 Consistency

pbb Group applies accounting policies consistently in accordance with the IFRS framework concept as well as IAS 1 and IAS 8.

In order to improve transparency, pbb Group amended one accounting method during the financial year 2016 – in line with IAS 8.14 et seq. – affecting the disclosure of loans and advances to customers as well as allowances for losses on loans and advances. Provided there is objective evidence for impairment regarding significant individual loan/advance items, the amount of the specific allowances to be recognised is calculated (according to IAS 39) as the difference between the carrying amount of the asset and the present value of the expected future cash flows. Contractually agreed interest payments and costs shall be charged to customers irrespective of expected future cash flows.

In the past, contractually agreed (but uncollected) interest payments and costs led to an adjustment of the carrying amount of a loan/advance item before allowances for losses (gross carrying amount). The gross carrying amount was reduced by the contractually agreed (but uncollected) interest payments and costs. Overall, interest payments and costs movements had no effect on the disclosed gross carrying amounts.

Since the amendment of the accounting method, the contractually agreed (but uncollected) interest payments and costs are disclosed as part of the allowances for losses. The gross carrying amount is increased by interest payments and costs movements according to the contractual stipulations. Following the new approach, the increase in gross carrying amount of the loan/advance item corrsponds now exactly to the increase in allowances for losses on loans and advances.

The previous year's figures were adjusted accordingly. As at 31 December 2015, contractually agreed (but uncollected) interest payments and costs amounted to €22 million (1 January 2015: €22 million). After the adjustments, specific allowances recognised as at 31 December 2015 increased from €95 million to €117 million, while loans and advances to customers increased from €41,204 million to €41,226 million. Accordingly, allowances for losses on loans and advances recognised as at 31 December 2015 were increased, from €127 million to €149 million. As at 1 January 2015, specific allowances increased from €93 million to €115 million, while loans and advances to customers increased from €38,964 million to €38,986 million, after the adjustments. Accordingly, allowances for losses on loans and advances recognised as at 1 January 2015 were increased, from €138 million to €160 million. However, earnings per share were not affected from the adjustments.

Excluding the effects from the adjusted accounting method, loans and advances to customers would have amounted to €41,135 million as at 31 December 2016, while allowances for losses on loans and advances would have stood at €119 million; specific allowances would have been €75 million, excluding the adjustments.

Regarding the adjustments of future minimum lease payments as at 31 December 2015 in accordance with IAS 8.42, please refer to our note on leases.

Apart from the adjustments described earlier, pbb Group applied the same accounting and measurement principles to the consolidated financial statements as at 31 December 2016 compared to the reporting date of 31 December 2015.

4 Uniform Consolidated Accounting

The separate financial statements of the consolidated domestic and foreign companies are incorporated in the consolidated financial statements of pbb using uniform accounting and measurement principles.

5 Consolidation

Number of subsidiaries/entities[1]	Fully consolidated subsidiaries		Not fully consolidated subsidiaries[2]		Associated entities and other investments		
	Total	Thereof special-purpose entities	Total	Thereof special-purpose entities	Associated entities	Other investments	**Total**
1.1.2015	**10**	**4**	**2**	**–**	**3**	**3**	**18**
Additions	–	–	–	–	–	–	–
Disposals	–	–	–	–	–	–	–
Mergers	–	–	–	–	–	–	–
31.12.2015	**10**	**4**	**2**	**–**	**3**	**3**	**18**
1.1.2016	**10**	**4**	**2**	**–**	**3**	**3**	**18**
Additions	–	–	–	–	–	–	–
Disposals	–1	–	–1	–	–	–	–2
Mergers	–	–	–	–	–	–	–
31.12.2016	**9**	**4**	**1**	**–**	**3**	**3**	**16**

[1] pbb, subsidiaries, associated companies and other investments.
[2] Not fully consolidated due to immateriality.

A subsidiary is an entity that is controlled by another entity. Control is deemed to exist if pbb has decision-making powers to manage relevant activities, has a right to significant returns from the subsidiary, and can use its decision-making powers to influence the amount of significant variable returns.

Structured entities are entities in which voting rights or similar rights are not the dominant factors in determining control, such as if the voting rights relate merely to administrative duties and the relevant activities are governed by contractual agreements. As for subsidiaries, structured entities must be consolidated if the structured entity is controlled.

Hayabusa Godo Kaisha i.L., Tokyo, was deconsolidated in the financial year 2016. The remaining assets and liabilities were allocated to Hypo Real Estate Capital Japan Corp., Tokyo, as part of the liquidation proceedings at the end of June 2016. Liquidation proceedings for this entity were initiated on 31 August 2016, and are expected to be concluded during the 2017 financial year. Consolidated income statement and consolidated statement of financial position were not affected.

Liquidation of the not fully consolidated subsidiary GfI-Gesellschaft für Immobilienentwicklung und -verwaltung mbG i.L., Stuttgart, Germany, was concluded in December 2016.

Consolidation Principles

At the acquisition date the costs of a business combination are allocated by recognising the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria according to IFRS 3.10 at their fair values at that date. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities

and contingent liabilities so recognised are accounted as goodwill or as an excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities in accordance with IFRS 3.32–36. If the interest in net fair value of the identifiable assets, liabilities and contingent liabilities exceeds the costs of business combination the acquirer shall reassess the identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination, and recognise immediately in profit or loss any excess remaining after reassessment.

Business relations within the group of consolidated companies are netted with respect to each other. Intercompany results attributable to internal transactions are eliminated.

There are no material interests in associated companies or joint ventures. The holdings are accounted as AfS financial instruments.

6 Disclosures of Interests in Subsidiaries

These consolidated financial statements set out a list of shareholdings in the Note "Holdings of pbb". In this list, the subsidiaries are classified on the basis of whether or not they are consolidated. Other shareholdings are also listed. The financial year for all fully-consolidated companies is the calendar year.

The effects of the contractual relations between the Group companies and the subsidiaries which are not consolidated are set out in the consolidated financial statements. pbb Group was unable to reliably determine a fair value for one interest in subsidiaries (31 December 2015: two) that are not included as they are of minor importance to the Group. Interests in these companies in the legal form of a limited company (GmbH) are not traded in an active market and are therefore measured at cost and accounted for in the AfS financial investments.

The total amount of the book values of the company's interests in subsidiaries individually regarded as minor amounted to €0 million (31 December 2015: €0 million). The summarised balance sheet totals of the subsidiaries not included in the scope of consolidation comprised less than 0.1% of the consolidated balance sheet total, as in the previous year. The total of the Group's interests in the profit or loss of the interests in subsidiaries regarded as minor amounted to €0 million (31 December 2015: €0 million). In the financial year 2016, one financial investment (carrying amount €0 million) whose fair value could not be reliably determined were derecognised (2015: €0 million).

Two consolidated subsidiaries were in liquidation. The balance sheet totals of these companies amounted to €54 million in total (31 December 2015: €72 million). These liquidations are expected to be concluded in 2017.

Significant Restrictions with Respect to the Usability of Assets within the Group

Statutory, contractual or regulatory restrictions and protective rights of non-controlling interests may limit the Group in its ability to obtain access to the assets and to easily transfer same to another company or other companies and pay the Group's liabilities. As of the balance sheet date the Group had no significant interests over which it could exert control. 100% of the voting right is retained in all the companies controlled by pbb. Consequently, there are no significant restrictions due to third-party protective rights.

7 Disclosures of Interests in Associates

pbb Group held interests in three associated companies (31 December 2015: three). pbb Group currently has no investments in associated companies to be included according to the at-equity method due to minor importance. Interests in these companies in the legal form of a partnership are measured at amortised cost and accounted for under the AfS financial investments.

The total amount of the book values of the company's interests in associated companies individually regarded as minor amounted to €0 million (31 December 2015: €0 million). The totals of the Group's interests in the profit or loss of the interests in associated companies individually regarded as minor amounted to €1 million (2015: €1 million).

8 Financial Instruments

According to IAS 32, a financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Recognition and Derecognition
pbb Group recognises a financial asset or a financial liability in its statement of financial position if a Group company becomes party to the contractual provisions of the financial instrument.

The purchases or sales of financial instruments are recognised on the trading date. Premiums and discounts are recognised in accordance with the accrual concept in the position net interest and similar income. In accordance with the primary derecognition concept of IAS 39, a financial asset has to be derecognised when all risks and rewards have substantially been transferred. If the main risks and rewards of ownership of the transferred financial asset are neither transferred nor retained, and if control over the transferred asset is retained, the Company has to recognise the asset to the extent of its continuing involvement. There are no transactions within pbb Group which result in partial derecognition due to a continuing involvement.

In case of repos and synthetic securitisations the assets transferred do not qualify for derecognition because derecognition criteria of IAS 39 are not met.

Collateral with the same counterparty and same conditions (e.g. ISDA master agreement) must be netted according to IAS 32. Accordingly, only the net amount is disclosed.

Categories According to IAS 39
When a financial asset or financial liability is recognised initially, it is measured at fair value.

For subsequent measurement purposes IAS 39 requires that all financial instruments have to be classified according to this standard, to be disclosed in the statement of financial position and to be measured according to its categorisation:

Held-for-Trading (HfT) A financial asset or a financial liability is held for trading if it is:
- acquired or incurred principally for the purpose of selling or repurchasing it in the near term,
- part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking, or
- a derivative (except for a derivative that is a designated and effective hedging instrument).

HfT financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss. HfT financial instruments are disclosed as trading assets and trading liabilities; these are exclusively derivatives. Interest and dividend income as well as the refinancing costs for the HfT instruments are recognised in net interest income.

If there is a difference between transaction price and market value at the trading date and the difference results from unobservable data that have a significant impact on the measurement of a financial instrument, the difference (so-called day one profit) is not recognised immediately in profit or loss but is recognised over the life of the transaction. The remaining difference is recognised only then in profit or loss when the inputs become observable, when the transaction matures or is closed out. In the financial years 2016 and 2015 there were no material day one profits.

Designated at Fair Value Through Profit or Loss (dFVTPL) If certain conditions are satisfied, financial assets or liabilities can be classified as a financial asset respectively a financial liability at fair value through profit or loss when they are initially recognised. A designation can be made if the use of the measurement category means that a recognition and measurement inconsistency is either avoided or considerably reduced, and management and performance measurement of a portfolio of financial instruments are based on the fair values or if the instrument contains a separable embedded derivative. dFVTPL financial instruments are measured at fair value. Changes in fair value are recognised in profit or loss.

As of 31 December 2016 and as of 31 December 2015, pbb Group had no financial assets and no financial liabilities in the category dFVTPL.

Held-to-Maturity (HtM) Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity. HtM financial investments are measured at amortised cost.

In financial years 2016 and 2015, no financial assets were classified as HtM at pbb Group.

Loans and Receivables (LaR) Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables include promissory notes.

Loans and receivables are recognised in the positions loans and advances to other banks, loans and advances to customers and financial investments, and are measured at amortised cost. Interest income from loans and receivables is recognised in net interest income. Market price related net gains and net losses attributable to prepayment penalties and disposal of loans and advances to customers and of loans and advances to other banks are disclosed in net interest income. Such net gains and net losses from financial investments are recognised in net income from financial investments. Impairments due to credit standing factors and which affecting profit or loss are recognised in loan loss provisions respectively, in the case of financial investments, in net income from financial investments.

Available-for-Sale (AfS) Available-for-sale assets are those non-derivative financial assets that are classified as available for sale and which are not classified as loans and receivables, held-tomaturity investments or financial assets at fair value through profit or loss. pbb Group only classifies securities as AfS but not loans and advances.

AfS financial assets are measured at fair value. Changes in fair value are recognised in a separate item of equity (AfS reserve) not affecting profit or loss until the asset is sold, withdrawn or otherwise disposed of or if an impairment is established for the financial asset in accordance with IAS 39.58 et seq., so that the cumulative loss previously recognised in equity is now recognised in profit or loss. If the objective evidence for the impairment of an AfS debt instrument drops out, the impairment has to be reversed through profit or loss. On the other hand, impairments of an AfS equity instrument which have been recognised in profit or loss are not permitted to be reversed through profit or loss.

AfS financial assets are disclosed as financial investments. Interest income from AfS assets is recognised in net interest income. Net gains and net losses generated by the disposal of AfS financial instruments as well as by changes in value as a result of impairment or reversals to be recognised in profit or loss are recognised in net income from financial investments.

Financial Liabilities at Amortised Cost Financial liabilities at amortised cost are those non-derivative financial liabilities that are not classified at fair value through profit or loss.

Financial liabilities at amortised cost are measured at amortised cost. Financial liabilities at amortised cost that are not securitised are recognised in liabilities to other banks and liabilities to customers. If these financial liabilities are securitised and not subordinated, they are recognised in securitised liabilities. Subordinated liabilities are recognised in subordinated capital. Interest expenses from financial liabilities at amortised cost are recognised in net interest income. In addition, the position net interest income includes net gains and net losses attributable to repurchases or withdrawals before maturity as well as impairments and impairment reversals of financial liabilities at amortised cost.

Derivatives Derivatives are measured at fair value. Changes in fair value are recognised in profit or loss if the derivatives are not part of cash flow hedge accounting. The measurement gains and losses from stand-alone derivatives are recognised in net trading income and from hedging derivatives in net income from hedging relationships. In the statement of financial position, stand-alone derivatives are disclosed as trading assets and trading liabilities. Hedging derivatives are disclosed as other assets and other liabilities.

Outside the HfT and dFVTPL category, embedded derivative financial instruments within a structured product and which are required to be separated are separated from the host contract and recognised as stand-alone derivative financial instruments. Thereafter, the host contract is measured in accordance with its classification. The change in value arising from the separated derivatives that are measured at fair value is recognised in profit or loss.

Classes

IFRS 7 and IFRS 13 required disclosures according to classes of financial instruments. pbb Group mainly defined the IAS 39 measurement categories, irrevocable loan commitments, financial guarantees, hedging derivatives and cash reserve as classes as well as claims from finance lease agreements.

Measurement Methods Financial instruments at fair value are measured on the basis of stock market prices or other market prices, if existent (Level 1). If a price is not available from an active market, observable market prices from comparable financial instruments are used (Level 2). If prices from comparable financial instruments are not available, valuation models are used that base on observable

market parameters. If these parameters are not observable at the markets, the measurement of the financial assets is based on models with non-market-observable parameters (Level 3). The used measurement models are market standard models. A description of these models and the products is given in the Note "Fair Values of Financial Instruments".

Impairment

According to IAS 39.58 a financial asset must be tested for impairment. At least at each balance sheet date pbb Group assesses on a case-by-case basis whether there is objective evidence for impairment. The criteria used to determine if there is such objective evidence included:

> significant financial difficulties of the borrower
> overdue contractual payments of either principal or interest or other breaches of contract
> increased probability that the borrower will enter bankruptcy or other financial reorganisation
> renegotiations due to economic problems
> a decline in the fair value of a financial asset below its (amortised) cost

Loans at risk of default are restructured by pbb Group if the borrower's financial position has deteriorated but a positive going-concern forecast for the loan exposure can still be carried out. This is carried out by changing the underlying terms and conditions or side agreements by means of a unilateral or mutual declaration of intent. Restructuring agreements should maximise opportunities for pbb Group to realise its outstanding loans or at least minimise the risk of default of the loan exposure. These generally include inter alia standstill agreements, changed interest payment/ repayment terms, interest/repayment reductions or the suspension of contractual agreements (e.g. financial covenants) so that the borrower is again able to meet their payment obligations. The credit risk associated with restructured loans is managed by the Group's Credit Risk Management units. The methods used to measure and manage risk are presented in the section of the risk and opportunity report entitled "Credit Risk". Further information is provided in the Note "Restructured Loans and Advances".

Two types of allowances are in place: specific allowances and portfolio-based allowances. Allowances for loans and advances are recognised in a separate account (allowances for losses on loans and advances) instead of directly reducing the carrying amount of the assets. The expense is recognised in loan loss provisions through profit or loss. Changes in an impairment already recognised are recorded as a change in the allowance and also disclosed in profit or loss as a component of loan loss provisions. Specific allowances on AfS financial investments as well as specific allowances and portfolio-based allowances on LaR financial investments are deducted directly from the carrying amount of the asset. The expense is recognised in net income from financial investments through profit or loss. Where subsequent measurement of financial assets is based on fair value through profit or loss, impairment is implied in the fair value.

pbb Group impairs loans and advances as well as financial investments whose terms have been renegotiated if there is objective evidence for impairment.

To measure the impairment loss, the following factors are especially considered:

> pbb Group's aggregate exposure to the customer
> the amount and timing of expected interest and redemption payments
> the realisable value of collateral and likelihood and time of successful repossession
> the likely deduction of any costs involved in recovering amounts outstanding
> the market price of the asset if available

If there is no reasonable prospect for a repayment of the loan or advance and the collateral were realised or transferred to pbb Group, the respective loan or advance and the associated allowance is written off.

For the purpose of calculating portfolio-based allowances, financial assets measured at amortised cost for which no impairment has been identified on an individual basis are grouped in portfolios according to their credit risk. The portfolio-based allowances cover impairments which have been incurred but not yet been identified. The parameters used to determine portfolio-based allowances are checked regularly and adjusted if necessary. The allowances are determined after taking into account the following factors:

- historical loss experience in portfolios of similar credit risk characteristics
- a judgement whether current economic conditions and credit conditions improved or deteriorated compared to the past
- the estimated period between impairment occurring and the impairment being identified
- state of the current economic cycle

Netting of Derivates

The European Market Infrastructure Regulation (EMIR) imposes a clearing obligation for standardised OTC derivatives. pbb uses Eurex Clearing as central clearing agent for derivatives. Given the increased relevance regarding the number of transactions and the growing transaction volumes, pbb applies on-balance sheet netting. On-balance sheet netting is applied for each currency, and comprises the carrying amounts of the derivatives as well as the margins calculated (and collected or credited) by Eurex Clearing. The carrying amounts derived from the netting are disclosed under "other assets" or "other liabilities".

Hedge Accounting

Hedging relationships between financial instruments are classified as a fair value hedge, a cash flow hedge or hedge of a net investment in a foreign operation in accordance with IAS 39. Hedging instruments used to hedge interest rate risks are mainly interest rate derivatives, for example interest rate swaps and options.

Fair Value Hedge Under IAS 39, with a fair value hedge, a recognised asset, a recognised liability, offbalance-sheet fixed obligation or a precisely designated part of such an asset, liability or obligation, is hedged against the risk of a change in fair value which is attributable to a specific risk and possibly has an effect on profit or loss for the period.

If the hedge of the fair value in the course of the reporting period meets the criteria of IAS 39.88, the hedge is accounted as follows:

- The profit or loss arising when the hedging instrument is remeasured at fair value (for a derivative hedging instrument) or the currency component of its carrying amount measured in accordance with IAS 21 (for non-derivative hedging instruments) is recognised in profit or loss for the period and
- The carrying amount of a hedged item is adjusted by the profit or loss arising from the hedged item and attributable to the hedged risks, and is recognised in profit or loss for the period. This is applicable if the hedged item is otherwise measured at cost. The profit or loss attributable to the hedged risk is recognised in profit or loss for the period if the hedged item is an available-forsale (AfS) financial asset. The amortisation of the hedge adjustment is started on the date of the revoking of the hedge relationship.

pbb Group uses fair value hedge accounting for presenting micro-hedge and macro-hedge relationships.

Interest rate risks are hedged under micro fair value hedge accounting. Any ineffectiveness within the permissible range pursuant to IAS 39 is reported under net income from hedging relationships. Positive and negative market values of hedging instruments are reported at fair value in other assets or other liabilities, respectively. The adjustment of the hedged item's carrying amount by the profit or loss attributable to the hedged risk directly affects the hedged item. The retrospective effectiveness test is conducted using the regression analysis. The dollar-offset method is used to quantify prospective ineffectiveness. If the hedge relationship is terminated for reasons other than the derecognition of the hedged item, the difference between the carrying amount of the hedged item at that point and the value at which it would have been carried, had the hedge never existed (the unamortised fair value adjustment), is amortised through profit or loss over the remaining term of the original hedge and recognised in net interest income. If the hedged item is derecognised, e.g. due to disposal or repayment, the unamortised fair value adjustment is recognised immediately in profit or loss.

In the context of portfolio hedge accounting within the meaning of IAS 39, interest rate risks from loans and advances as well as from liabilities are hedged on a portfolio basis. The fair values as regards the hedged risks in the hedged cash flows of the portfolios of hedged items are reported either on the assets or on the liabilities side as valuation adjustments from portfolio hedge accounting. The changes in the fair value of hedged risks from the portfolios of hedged items are recognised in net income from hedging relationships. Positive and negative market values of hedging instruments are recognised in statement of financial position at fair value in other assets or other liabilities, respectively. The changes in value are shown in net income from hedging relationships, thus largely compensating the effect on profit or loss from the valuation of the cash flows from the portfolios of hedged items. The cash flows from the portfolios of hedged items are determined monthly within the framework of a dynamic hedge designation and discontinuation process. The resulting valuation adjustments are amortised over the remaining term of the time band and recognised in net interest income. In case of a derecognition of cash flows of hedged items from the portfolio of hedged items, the associated valuation adjustment is reversed on a pro-rata basis and recognised in net interest income.

Cash Flow Hedge Hedge According to IAS 39, a cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with the recognised asset or liability (for instance some or all future interest payments on variable-interest debt) or a highly probable forecast transaction that could affect profit or loss.

Under cash flow hedge accounting, hedging instruments are measured at fair value. The measurement result has to be broken down into an effective and an ineffective portion of the hedge relationship.

As at 31 December 2016, and 31 December 2015, pbb Group did not designate any derivatives to cash flow hedges. The cash flow hedge reserve remaining from designations will be reversed in line with the hedged cash flows from underlying transactions. pbb applies a prospective effectiveness test every quarter. In case ineffectiveness is discovered, the cash flow hedge reserve is reversed through profit or loss.

Hedge of a Net Investment in a Foreign Operation A net investment hedge is a hedge of the foreign currency exposure on a net investment in a foreign operation. Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. pbb Group did not hedge a net investment in a foreign operation in the financial years 2016 and 2015.

9 Leases

In accordance with IAS 17, a lease is an agreement whereby the lessor conveys to the lessee in return for a payment the right to use an asset for an agreed period. Lease agreements have to be classified as either finance leases or operating leases. A lease is classified as an operating lease if substantially all the risks and rewards incidental to ownership of the leased asset remains with the lessor. In contrast, a lease is classified as a finance lease if substantially all risks and rewards incidental to ownership are transferred to the lessee.

pbb Group as a Lessor
Operating Lease In the case of operating leases, the assets leased to the lessee are attributed to the lessor who has to continue to account for the leased assets. pbb Group does not hold any assets under operating leases as lessor.

Finance Lease In the case of finance leases, the lessor has to recognise a receivable from the lessee as an asset. This receivable is measured at the amount of the net investment in the lease at inception of the lease. The received lease payments are divided into an interest portion, which is recognised in profit or loss, and a principal portion. Interest income is recognised over the lease term, generally based on a pattern reflecting a constant periodic rate of return on the net investment in the lease; the principal portion (being a redemption of principal) reduces the outstanding receivable.

pbb Group as a Lessee
Operating Lease The lease instalments paid by the lessee in the context of operating leases are recognised as an expense over the lease term and reported as other operating expenses, or administrative expenses if the payments refer to rental expenses. The rental term commences as soon as the lessee starts to control the actual use of the leased asset. The corresponding leased assets are not recognised as an asset by the lessee.

Finance Lease In the case of finance leases, the lessee recognises the leased assets in its statement of financial position. pbb Group does not hold any assets under finance leases as lessee.

10 Cash Reserve

Cash reserve contains balances with central banks which are measured at cost.

11 Trading Assets

Trading assets comprise positive market values of stand-alone derivatives of the bank book. pbb Group has no non-derivative trading instruments in its portfolio. Trading assets are measured at fair value. Gains and losses arising from the valuation and realisation of trading assets are recognised in net trading income in profit or loss.

12 Loans and Advances

Loans and advances to other banks and loans and advances to customers are measured in accordance with IAS 39 at amortised cost if they are not categorised dFVTPL or AfS or a hedged item of a fair value hedge. As of 31 December 2016, and as of 31 December 2015, pbb Group did not have loans and advances which are classified as AfS or dFVTPL.

Additions to allowances for losses on loans and advances are disclosed as a separate item loan loss provisions in profit or loss. Value changes from hedge relationships are recognised under net income from hedging relationships. All other income and expenses from loans and advances, including net gains and net losses, are recognised in net interest income.

13 Allowances for Losses on Loans and Advances and Provisions for Contingent Liabilities and Other Commitments (Risk Provisioning)

Allowances for losses on loans and advances are recognised if there is objective evidence that it will not be possible for the entire amount which is due in accordance with the original contractual conditions to be recovered. Allowances for loans and advances are measured mainly on the basis of expectations with regard to loan defaults, the structure and quality of the loan portfolio as well as macroeconomic parameters on an specific and portfolio basis.

Specific Allowances
For all recognisable default risks, the extent of the allowance for losses on loans and advances is calculated as the difference between the carrying amount of the asset and the present value of the expected future cash flows. The latter is calculated on the basis of the initial effective interest rate. Market interest rate changes do not have any effect in this respect. The increase in the present value of an adjusted receivable (so-called unwinding) which occurs over a period of time is recognised as an interest income. Since the 2016 financial year, the contractually agreed (but uncollected) interest payments and costs are disclosed as part of the specific allowances (see note on "consistency").

Portfolio-based Allowances
Under IAS 39.64, loans which were not specifically impaired are pooled in risk-inherent portfolios. Portfolio-based allowances are recognised for these portfolios; these allowances are measured in respect of current events and information with regard to significant changes with detrimental consequences which have occurred in the technology, market, economic or legal environment, as well as historical default rates.

Risk provisioning is broken down into allowances relating for losses on loans and advances and provisions for contingent liabilities and other commitments like irrevocable loan commitments. An allowance for losses on loans and advances is disclosed as a negative item on the assets side of the statement of financial position, whereas a provision for contingent liabilities and other commitments is disclosed on the liabilities side of the statement of financial position. In profit or loss, all effects are disclosed as loan loss provisions apart from unwinding effects which are disclosed in net interest income.

14 Financial Investments

LaR and AfS securities are recognised and disclosed as financial investments. AfS financial assets are measured at fair value. Changes in fair value of AfS financial assets are disclosed as a separate item of equity (AfS reserve) not affecting profit or loss until the asset is sold, withdrawn, disposed of, or if impairment is established for the financial asset in accordance with IAS 39.58 et seq. Therefore, the cumulative profit or loss previously recognised in equity is now affecting profit or loss. Specific allowances on AfS financial assets are directly deducted from the carrying amount of the assets. Portfolio-based allowances on AfS financial assets shall not be created for AfS financial assets. AfS financial assets which are hedged effectively against market price risks are part of the

hedge accounting. LaR financial investments are measured at amortised cost. Specific allowances and portfolio-based allowances on LaR financial investments are directly deducted from the carrying amount of the assets. In the financial years 2016 and 2015, pbb Group did not have any HtM and dFVTPL financial assets.

15 Property and Equipment

Property and equipment are generally measured at cost of purchase or cost of production. The carrying amounts (except land) are depreciated on a straight-line basis in accordance with the expected useful lives of the assets. In addition, property and equipment are tested at least annually for impairment. If the value of property and equipment has impaired, an impairment loss is recognised in profit or loss. If the reasons for the impairment no longer exist, an amount not exceeding amortised cost or cost of production is reversed through profit or loss. In the case of fittings in rented buildings, the contract duration taking account of extension options is used as the basis of this contract duration if it is shorter than the useful life.

Useful lives

Fixture in rental buildings	5–15 years
IT equipment (broad sense)	3–5 years
Other operating equipment	3–25 years

Subsequent cost of purchase or costs of conversion are capitalised if an additional economic benefit flows to the Company. Maintenance expenses of property and equipment are recognised in profit or loss of the financial year in which they arose.

16 Intangible Assets

Purchased and internally generated software are the main items recognised as intangible assets. Goodwill, brand names and customer relations are not capitalised.

Software is an intangible asset with a finite useful life. Purchased software is measured at the amortised purchase cost. pbb Group capitalises internally generated software if it is probable that future economic benefits will flow to the Group and the expenses can be measured reliably. Expenses eligible for the capitalisation of internally generated software include external, directly attributable costs of materials and services as well as personnel expenses for employees directly associated with the creation of software used by the Company. Software is amortised on a straight-line basis over expected useful lives of three to five years. In addition, intangible assets with a finite useful life are tested for impairment annually or whenever there is an indication that the intangible asset may be impaired.

17 Other Assets

Other assets mainly comprise positive fair values from derivative financial instruments (hedging derivatives) and salvage acquisitions. Salvage acquisitions are measured as inventories at the lower of cost of purchase and net realisable value in accordance with IAS 2.

18 Liabilities

Liabilities other than hedged items of an effective fair value hedge and which are not classified as dFVTPL are measured at amortised cost. Premiums and discounts are recognised on a pro rata basis. Interest-free liabilities are recognised with their present value. pbb Group has not designated any liabilities into the category dFVTPL. Changes in value resulting from hedge relationships are disclosed under net income from hedging relationships. All income and expenses from liabilities including net gains and net losses resulting from redemption of liabilities are recognised in net interest income.

19 Trading Liabilities

Trading liabilities include negative market values of trading derivatives and of stand-alone derivatives of the bank book. Trading liabilities are measured at fair value. Unrealised and realised profits and losses attributable to trading liabilities are recognised in net trading income in profit or loss.

20 Provisions

A provision is a liability of uncertain timing or amount. A provision shall be recognised when an entity has a present obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. According to IAS 37.15 in rare cases it is not clear whether there is a present obligation. In these cases a present event is deemed to give rise to a present obligation if, taking into account of all available evidence, it is more likely than not that a present obligation exists at the end of the reporting period. In rare cases, for example in a law suit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, pbb determines whether a present obligation exists at the end of the reporting period by taking account of all available evidence, including, for example, the opinion of experts.

Under IAS 37.36 et seq., the best estimate is used for measuring provisions for contingent liabilities and contingent losses attributable to pending transactions. Long-term provisions are generally discounted with an interest rate that reflects the current assessments of the time value of money and the risks specific to the liability.

Provisions for defined benefit plan are calculated on the basis of actuarial reports in accordance with IAS 19. They are measured using the projected unit credit method. The amount of the provision equals the so-called net defined benefit liability which is the difference between the present value of the defined benefit obligation and the fair value of plan assets. pbb closed plan assets in the form of a qualifying insurance policy to hedge parts of the risk from the defined benefit obligations. The reinsurance is pledged to the plan beneficiaries.

The determination of the net defined benefit liability is based on demographic and financial actuarial assumptions. A demographic assumption is for example the mortality for which pbb uses guidance tables. In financial actuarial assumptions the discount rate has the greatest effect on the amount of defined benefit liability. The rate used for the measurement is determined by reference to market yields at the end of the reporting period on high-quality, fixed-interest corporate bonds.

Net interest on the defined benefit liability is determined by multiplying the defined benefit liability by the discount rate. The determination is done at the beginning of the financial year taking account of any changes in the net defined benefit liability during the period as a result of contribution and benefit payments. Net interest on defined benefit liability are shown together with all other effects on income statement from the defined benefit obligations and the plan assets in the position pension expenses and related employee benefit costs in general and administrative expenses.

Remeasurements of the net defined benefit liability result from actuarial gains and losses and the return on plan assets excluding amounts included in net interest on the net defined benefit liability. Remeasurements of the net defined benefit liability are shown in equity in the position profit/losses from pension obligations. Changes of remeasurements of the net defined benefit liability within a period are shown as a component of the consolidated statement of comprehensive income. Actuarial gains and losses result from increases or decreases in the present value of the defined benefit obligation due to changes of actuarial assumptions and experience adjustments. Changes of the discount rate usually have the biggest effect on the actuarial gains and losses.

21 Other Liabilities

Besides negative fair values from derivatives recognised in hedge accounting, accrued liabilities are one of the items recognised in other liabilities. Accruals arise from liabilities for products or services which have been received or supplied and have not yet been paid for, invoiced by the supplier or formally agreed. This also includes short-term liabilities to employees, for instance flexitime credits and vacation entitlements. The accrued liabilities are recognised at the amount likely to be utilised. If the obligations listed at this note cannot be quantified more precisely on the balance sheet date and if the criteria specified in IAS 37 for recognising provisions are satisfied, these items have to be disclosed as provisions.

22 Subordinated Capital

In the event of insolvency or liquidation subordinated capital may only be repaid after all non-subordinated creditors have been satisfied. Subordinated capital of pbb Group encompasses subordinated liabilities, participating certificates outstanding and hybrid capital instruments. For some instruments of subordinated capital the holders participate in any net loss or consolidated loss. In addition, the interest entitlement can be ceased or reduced under specific conditions. For other instruments the interest ceases only in case of a net loss which can be caught up depending on the structuring.

Pursuant to IAS 32 the subordinated capital instruments issued by companies of pbb Group were classified as financial liabilities or equity instruments in accordance with the substance of the contractual arrangement and the definitions of a financial liability and an equity instrument. Financial liabilities are measured at amortised cost. The amortised costs are the amount at which the financial liability is measured at initial recognition minus principal payments, plus or minus the cumulative amortisation using the effective interest rate method of any difference between that initial amount and the maturity amount and minus any expected reduction of interest and/or principal payments.

23 Share-based Payment

pbb Group awarded share-based remuneration with cash settlement to individual eligible persons for 2016. The eligible persons will receive a fraction of their variable remuneration in subsequent years, based on the average share price of the pbb share in February of the respective year. As at 31 December 2016, the total amount of share-based payments was less than €1 million.

24 Currency Translation

Currency translation is carried out in accordance with the regulations of IAS 21. On the balance sheet date, monetary items in a foreign currency are translated into the functional currency. The reporting currency is the euro. Non-monetary items which were stated in a foreign currency using historical cost of purchase are measured using the exchange rate applicable at date of purchase.

Income and expenses attributable to currency translation of the affiliated companies' single financial statements into the functional currency are generally recognised in profit or loss in balance of other operating income/expenses.

In these consolidated financial statements, balance sheet items of the subsidiaries, if they do not prepare financial statements in euros, are translated using the closing rates at the balance sheet date. For translating the expenses and income of these subsidiaries, the average rates are used. Differences resulting from the translation of the financial statements of the subsidiaries do not affect profit or loss and are disclosed in the consolidated statement of changes in equity. The group of consolidated companies does not include any companies from hyperinflationary countries.

25 Income Taxes

Income taxes are accounted for and measured in accordance with IAS 12. Apart from the exceptions defined in the standard, deferred taxes are calculated for all temporary differences between the IFRS values and the tax values as well as for the differences resulting from uniform Group measurement principles and differences from the consolidation (balance sheet method). Deferred tax assets arising from non-utilised losses carried forward, interest assets carried forward and tax credits are recognised if required in accordance with IAS 12.34 et seq. and not opposed by a change in tax status in accordance with SIC-25.

Deferred taxes are calculated using the national tax rates which are expected at the time the differences are balanced, as the concept of deferred taxes is based on the presentation of future tax assets or tax liabilities (liability method). Changes in tax rates have been taken into account. The corporate income tax claim which was capitalised on 31 December 2006 has been paid out since 1 January 2008 over a period of ten years independently of a dividend payment. The interest-free claim is measured at the present value. An unchanged rate of 3.7% p.a. was used for discounting purposes.

26 Non-current Assets Held for Sale

In accordance with IFRS 5, a non-current asset or disposal group must be classified as held for sale if the related carrying amount is primarily realised by a disposal transaction and not by continued use. To reclassify an asset as held for sale, certain conditions must be met on a cumulative basis.

Above all, there must be a specific intention to sell, the asset must be immediately available and the disposal must be highly probable. As at 31 December 2016 and at 31 December 2015 pbb Group did not own any assets held for sale.

27 Accounting Estimates and Assumptions

When the financial statements are being prepared, pbb Group makes future-related assumptions as well as estimations, resulting in a considerable risk of a major change to the disclosed assets and liabilities becoming necessary during the next financial year. The assumptions and parameters underlying the estimates to be made are based on the exercise of appropriate judgement.

Going-Concern

The consolidated financial statements of pbb are based on the assumption of going-concern. The conditions of going-concern are described in the report on expected developments.

Allowances

The portfolio of pbb Group is reviewed for impairments at least annually. It is necessary to assess whether the estimated future cash flows of a loan portfolio are lower than the actually agreed cash flows. For this purpose, it is necessary to make judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers, or national or economic factors that correlate with defaults on assets in the portfolio. The methods and assumptions concerning the estimates of the extent and timing of the payment streams are reviewed regularly to keep any differences between estimated and actual defaults as low as possible. In addition, the determination of portfolio-based allowances is based on a loss identification period as well as the expected loss based on statistical data.

Fair Values of Original and Derivative Financial Instruments

The fair value of financial instruments that are not listed on active markets is measured using valuation models. In such cases, a check is performed regularly to assess whether the valuation models provide a comparable benchmark for current market prices. The valuation models can only take account of quantifiable factors (e.g. cash flows and discount rates) that also require estimates. Changes in assumptions relating to these factors might have an impact on the fair values of the financial instruments.

According to IAS 8.34, an estimate may need revision if changes occur in the circumstances on which the estimate was based, or as a result of new information received, or further knowledge acquired. In the third quarter of 2016, pbb Group revised its accounting-related estimates factored into the valuation of derivatives, which are also used to determine the Credit Valuation Adjustments for certain derivatives counterparties. The revision of the accounting-related estimates resulted in expenses of €1 million, recognised within the net trading income. In the fourth quarter of 2016, pbb Group expanded the valuation of derivatives by the so-called Funding Valuation Adjustment, meaning that the costs incurred by the respective refinancing of the collateralisation and the transfer of the refinancing to the counterparty are taken into account as additional valuation components. These amendments resulted in expenses of €2 million, to be recognised in net trading income through profit or loss.

Embedded Derivatives
In accordance with IAS 39.11, an embedded derivative must be separated from the host contract and measured separately if, in addition to other criteria, the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract. In order to evaluate the existence of an obligation to separate, the economic risks of the host contracts and embedded derivatives are assessed.

Hedge Accounting
Relations between hedged items and hedging instruments can be presented in hedge accounting. A relation only qualifies for hedge accounting when certain conditions specified under IAS 39.88 are satisfied. One of these conditions is that the hedge has to be very efficient with regard to achieving compensation for the risks resulting from changes in the fair value or the cash flow in relation to the hedged risk.

The determination of the effectiveness of the risk hedge depends on risk measuring methods, the parameters which are used and assumptions relating to the probability of occurrence. These methods and parameters are continuously developed in line with the risk management objectives and strategies.

Intangible Assets and Property and Equipment
pbb Group's accounting for intangible assets and property and equipment is subject to estimating uncertainty, particularly in the determination of the useful life of assets and the associated amount of depreciation/amortisation recognised per period.

Provisions
Estimates are used in the measurement of provisions at pbb Group. Estimating uncertainty arises in particular during assessment of the amount of the future cash outflows, the time horizon and the discount rate.

Income Taxes
pbb Group is subject to a wide range of national tax regulations with regard to the calculation of income taxes. In order to measure the tax expenses, it is necessary to make estimates that are calculated with the knowledge existing as of the balance sheet date and closely related to the tax return prepared in the following financial year. In some countries, the current tax charges attributable to the current financial year can only be definitely finalised after the corresponding tax audit has been completed. The variances with regard to the estimated tax burden may have a positive or negative influence on the tax burden in future financial years.

With regard to the capitalisation of losses carried forward and other tax credits, the extent as well as the actual availability of such tax benefits are subject to estimation. Major losses carried forward are subject to national German tax law, and their availability also depends inter alia on the restrictions set out in Sections 10 d EStG, 8 c KStG as well as Section 10 a GewStG. Restrictions based on a change in the tax status (SIC-25) as a result of the privatisation implemented in 2015 did not occur as of the balance sheet date. Deferred tax assets arising from losses carried forward are therefore recognised to the extent as it is likely that future taxable income will be available to offset the non-utilised tax losses carried forward.

Consolidation
Companies and structured entities must be consolidated if pbb has direct or indirect control over them. Control is deemed to exist if pbb has decision-making powers to manage relevant activities, has a right to significant returns from the subsidiary and can use its decision-making powers to influence the amount of the significant variable returns. The level of control is assessed on the basis of contractual and economic relationships to the company or the structured entity. In assessing whether pbb exerts control or substantial influence over the company, estimates or discretionary leeways are required.

SEGMENT REPORTING

28 Notes to Segment Reporting by Operating Segment

Segment reporting for the 2015 financial year was prepared in accordance with IFRS 8 Operating Segments. In line with the Management Approach under IFRS 8, segment reporting discloses segment-specific, management-relevant financial information that is also regularly used by senior management when deciding on the allocation of resources, and for assessing the earnings power of segments. Based on the organisational structure of pbb Group, which is aligned to the various products and services offered, three business segments have been determined in line with internal management reporting.

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

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

Equity, excluding revaluation reserves, is fully allocated to the operating segments and the Consolidation & Adjustments (C&A) reconciliation column without disclosure of excess capital. The allocation of equity (excluding revaluation reserves) to the operating segments and C&A follows a proportionate approach and is therefore consistent with the distribution of diversified economic capital within risk management (gone-concern approach).

Real Estate Finance (REF)
The REF operating segment comprises financing for professional real estate investors with a mediumto long-term orientation. These include professional national and international real estate companies, institutional investors, property funds as well as, in Germany, customers with a regional focus. Adequate batch sizes and loan-to-values commensurate for the level of risk involved are essential. Strategic partnerships are agreed with other institutions with the aim of permitting higher loan-to-values and larger volumes for customers by means of syndications and syndicated financing arrangements.

Public Investment Finance (PIF)
The PIF operating segment comprises financing eligible for covered bonds for the provision of public infrastructure. The focus here is on public institutions, municipal and social housing construction, buildings for the utilities and waste disposal market, transport infrastructure as well as healthcare and nursing institutions. In addition, pbb Group is active in publicly guaranteed export financing. Financing is given to public sector debtors, companies with a public or private legal structure as well as special-purpose vehicles with a public service guarantee.

Value Portfolio (VP)
The VP operating segment includes all of pbb Group's non-strategic portfolios and activities. In particular, the Budget Finance segment comprises non-strategic public investment finance exposures, as well as selected structured products.

Consolidation & Adjustments (C&A) reconciles the aggregated segment results with the consolidated result. The column also includes income from the investment of allocated equity.

29 Income Statement by Operating Segment

Income/expenses

in € million		REF	PIF	VP	C&A	**pbb Group**
Operating income	2016	306	30	165	7	508
	2015	358	41	−5	6	400
Net interest income	2016	321	35	41	7	404
	2015	308	44	68	6	426
Net fee and commission income	2016	9	–	−1	–	8
	2015	14	–	–	–	14
Net trading income	2016	−2	−1	−3	–	−6
	2015	14	–	1	–	15
Net income from financial investments	2016	3	1	121	–	125
	2015	18	5	−55	–	−32
Net income from hedging relationships	2016	3	1	2	–	6
	2015	5	2	4	–	11
Net other operating income/expenses	2016	−28	−6	5	–	−29
	2015	−1	−10	−23	–	−34
Loan loss provisions	2016	2	–	−3	–	−1
	2015	7	–	−6	–	1
General and administrative expenses	2016	−156	−26	−16	–	−198
	2015	−160	−28	−19	–	−207
Net miscellaneous income/expenses	2016	−6	−1	−1	–	−8
	2015	1	–	–	–	1
Profit or loss before tax	**2016**	**146**	**3**	**145**	**7**	**301**
	2015	**206**	**13**	**−30**	**6**	**195**

Cost-income ratio[1]

in %		REF	PIF	VP	**pbb Group**
Cost-income ratio	2016	51.0	86.7	9.7	39.0
	2015	44.7	68.3	>100.0	51.8

[1] The cost-income ratio is the ratio of general and administrative expenses and operating income.

30 Balance-sheet-related Measures by Operating Segment

The Management Board controls balance-sheet-related measures by operating segments based on financing volumes, on risk-weighted assets and on equity.

Balance-sheet-related measures by operating segment

in € billion		REF	PIF	VP	C&A	pbb Group
Financing volumes[1]	31.12.2016	24.1	7.4	15.8	–	**47.3**
	31.12.2015	24.0	7.3	18.7	–	**50.0**
Risik-weighted assets[2]	31.12.2016	6.4	1.4	4.1	1.2	**13.1**
	31.12.2015	6.5	1.4	4.4	1.1	**13.4**
Equity[3]	31.12.2016	0.6	0.3	1.5	0.4	**2.8**
	31.12.2015	0.6	0.2	1.5	0.4	**2.7**

[1] Notional amounts of the drawn parts of granted loans and parts of the securities portfolio.
[2] Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5.
[3] Excluding revaluation reserve.

31 Breakdown of Operating Income

Operating income by products

in € million		Real estate financing	Public investment financing	Other products	pbb Group
Operating income	2016	306	30	172	**508**
	2015	358	41	1	**400**

Operating Revenues by Regions

pbb Group differentiates between the regions Germany, Rest of Europe and America/Asia. Allocation of values to regions is based on the location of the registered offices of the Group companies or their branches.

Operating revenues by regions

in € million		Germany	Rest of Europe	America/Asia	pbb Group
Operating income	2016	453	55	–	**508**
	2015	330	53	17	**400**

Operating Revenues by Customers

There were no significant customers within the meaning of IFRS 8.34 in the financial years 2016 and 2015.

NOTES TO THE CONSOLIDATED INCOME STATEMENT

32 Net Interest Income

Net interest income by categories of income/expenses

in € million	2016	2015
Interest income	**1,843**	**2,071**
Lending and money-market business	1,180	1,254
Fixed-income securities and government-inscribed debt	414	511
Current gains/losses from swap transactions (net interest income and expense)	245	304
Other	4	2
Interest expenses	**−1,439**	**−1,645**
Liabilities to other banks and customers	−298	−329
Securitised liabilities	−1,083	−1,232
Subordinated capital	−58	−84
Total	**404**	**426**

Interest income for financial assets measured at amortised cost amounted to €1,498 million (2015: €1,630 million). Interest income for AfS assets amounted to €96 million (2015: €135 million). Total net interest income for assets not measured at fair value through profit or loss amounted to €1,594 million (2015: €1,765 million).

Interest expenses incurred in the 2016 and 2015 financial years were entirely attributable to liabilities not measured at fair value through profit or loss.

Negative interest income amounted to €15 million (2015: €8 million) and positive interest expenses to €14 million (2015: €10 million); the predominant part was respectively disclosed in current gains losses from swap transactions (net interest income and expense).

33 Net Fee and Commission Income

Net fee and commission income

in € million	2016	2015
Securities and custodial services	−1	−1
Lending operations and other service	9	15
Total	**8**	**14**

Net commission income is attributable exclusively to financial assets and financial liabilities which are not designated at fair value through profit or loss.

34 Net Trading Income

Net trading income

in € million	2016	2015
From interest rate instruments and related derivatives	−9	14
From credit risk instruments and related derivatives	3	1
Total	**−6**	**15**

35 Net Income From Financial Investments

Net income from financial investments consists of income from the sale of securities of the measurement categories AfS and LaR together with changes in the value of such instruments that are to be recognised in profit or loss. HtM and dFVTPL investments were not held in 2016 and 2015. Based on measurement categories, net income from financial investments is broken down as follows:

Net income from financial investments of financial instruments by IAS 39 categories

in € million	2016	2015
AfS financial investments	3	−3
LaR financial investments	122	−29
Total	**125**	**−32**

The agreement achieved with the Republic of Austria on the liabilities of Heta Asset Resolution AG (“Heta”) resulted in positive effects of €123 million in the period under review, recognised within LaR financial investments.

36 Net Income from Hedging Relationships

Net income from hedging relationships

in € million	2016	2015
Result from micro fair value hedge accounting	6	10
Result from hedged items	189	−16
Result from hedging instruments	−183	26
Result from portfolio hedge accounting	–	–
Result from hedged items	2	−1
Result from hedging instruments	−2	1
Ineffectiveness from cash flow hedge accounting through profit or loss	–	1
Total	**6**	**11**

37 Net Other Operating Income/Expenses

Net other operating income/expenses

in € million	2016	2015
Other operating income	48	72
Other operating expenses	−77	−106
Net other operating income/expenses	**−29**	**−34**

38 Loan Loss Provisions

Loan loss provisions

in € million	2016	2015
Allowances for losses on loans and advances	−6	−3
Additions	−28	−26
Reversals	22	23
Allowances for contingent liabilities and other commitments	1	1
Additions	–	–
Reversals	1	1
Recoveries from written-off loans and advances	4	3
Total	**−1**	**1**

The development of specific allowances on loans and advances as well as portfolio-based allowances is disclosed in the note “Allowances for Losses on Loans and Advances”.

39 General and Administrative Expenses

General and administrative expenses

in € million	2016	2015
Personnel expenses	−103	−112
Wages and salaries	−78	−85
Social security costs	−16	−16
Pension expenses and related employee benefit costs	−9	−11
Non-personnel expenses	−95	−95
Other general and administrative expenses	−84	−85
Consulting expenses	−16	−13
IT expenses	−33	−34
Office and operating expenses	−9	−11
Other non-personnel expenses	−26	−27
Depreciation, amortisation and impairment	−11	−10
of software and other intangible assets	−8	−8
of property and equipment	−3	−2
Total	**−198**	**−207**

40 Net Miscellaneous Income/Expenses

Net miscellaneous income/expenses

in € million	2016	2015
Miscellaneous income	1	8
Thereof: Reversals of restructuring provisions	1	4
Other taxes	–	4
Miscellaneous expenses	–9	–7
Thereof: Additions to restructuring provisions	–8	–7
Other taxes	–1	–
Net miscellaneous income/expenses	**–8**	**1**

41 Income Taxes

Breakdown

in € million	2016	2015
Current taxes	–59	–48
Deferred taxes	–45	83
Thereof: Deferred taxes on losses carried forward	–25	–71
Total	**–104**	**35**

Current taxes include a tax expense for prior years of €16 million (2015: €27 million) which was largely due to the effects from a tax audit.

The following overview shows the development of the deferred taxes recognised in the financial statements:

Development of deferred taxes

in € million	2016	2015
Deferred taxes recognised in the statement of financial position	71	84
Difference to prior year	–13	83
Thereof: Recognised in profit or loss	–45	83
Recognised in profits/losses from pension commitments	4	–4
Recognised in AfS reserve	12	–36
Recognised in cash flow hedge reserve	16	40

The change in deferred taxes regarding profits/losses from pension commitments recognised outside profit or loss in the amount of €4 million (2015: €–4 million) is included in deferred taxes from provisions.

The change in deferred taxes regarding the AfS reserve recognised outside profit or loss in the amount of €12 million (2015: €–36 million) is included in deferred taxes from financial investments.

The change in deferred taxes regarding the cash flow hedge reserve recognised outside profit or loss in the amount of €16 million (2015: €40 million) is included in deferred taxes from other assets/liabilities.

Reconciliation

in € million (unless otherwise indicated)	2016	2015
Profit or loss before tax	301	195
Applicable (legal) tax rate in %	27.67	27.67
Expected (computed) tax expense	−83	−54
Tax effects		
arising from tax rate differences	–	−30
arising from tax-free income	−3	10
arising from deductible and non-deductible items	−19	237
arising from valuation adjustments and non-application of deferred taxes	17	−101
arising from prior years	−16	−27
Reported income taxes	**−104**	**35**
Group tax ratio in %	**34.55**	**−17.95**

The tax rate applicable for the financial year, including solidarity surcharge, is 27.67% (2015: 27.67%) and is comprised of the 15.0% German corporate tax rate currently valid, the payable solidarity surcharge of 5.5% as well as the average trade tax rate of 11.843% (2015: 11.843%).

Foreign tax rates ranged between 20.0% and 35.6%.

Tax effects arising from tax-free income comprise, inter alia, effects from tax-free investment income as well as distributions from German and international companies. Locally applicable tax regulations were taken into account for the determination of profits.

The effects attributable to deductible and non-deductible items relate primarily to non-deductible expenses, which do not have to be taken into account as deferred taxes as a result of permanent differences, but which have reduced or increased the basis of taxation.

The effects arising from valuation adjustments and non-application of deferred taxes, on the one hand, comprise effects from the write down of deferred tax assets on losses carried forward and, on the other hand, opposing effects from the use of tax losses carried forward previously not accounted for.

The effects from previous years include current taxes for previous years which have been incurred as a result of tax audits or a reassessment of the tax liability.

The Group tax ratio is the quotient of the stated income taxes (current and deferred taxes) and profit or loss before tax.

The deferred tax liabilities or deferred tax assets relate to the following items:

Deferred tax liabilities/assets

in € million	2016	2015
Loans and advances to other banks/customers (including loan loss allowances)	11	24
Financial investments	154	152
Trading assets	28	117
Other assets/liabilities	137	139
Deferred tax liabilities before offsetting	**330**	**432**
Offsetting	−330	−432
Deferred tax liabilities after offsetting	**–**	**–**
Loans and advances to other banks/customers (including loan loss allowances)	–	14
Financial investments	161	138
Provisions	38	35
Other assets/liabilities	114	106
Trading assets	8	118
Losses carried forward	80	105
Deferred tax assets before offsetting	**401**	**516**
Offsetting	−330	−432
Deferred tax assets after offsetting	**71**	**84**

For domestic companies, the deferred taxes are calculated using the future uniform rate of corporation tax of 15.0% plus the corresponding 5.5% solidarity surcharge and the trade tax depending on the locally applicable assessment rate (the current basic rate is 3.5%). For pbb, the tax rate for the calculation of deferred taxes is 27.67% (2015: 27.67%).

On the reporting date, there are unused tax losses carried forward totalling €3,712 million (2015: €3,831 million) at corporate tax level and €3,804 million (2015: €3,757 million) at trade tax level. Deferred tax assets have been recognised on a portion of €334 million (2015: €424 million) at corporate tax level and €234 million (2015: €324 million) at trade tax level, because the criteria for recognition in accordance with IAS 12.34 et seq. were satisfied. The impairment assessment as regards deferred tax assets on tax loss carryforwards is based on a 3-year tax planning which was derived from general corporate planning. Loss carryforwards may be applied for an unlimited period, unless in the event of a change of shareholders which is detrimental for tax purposes. An allowance of €–2 million was recognised on deferred taxes from temporary differences in the financial year 2016 (2015: €–1 million). Deferred tax expenses from the origination and reversal of temporary differences arose in the amount of €20 million (2015: €154 million).

Tax rate changes did not result in major deferred tax expenses or income in the current year nor in the previous year.

The use of tax losses previously not recognised resulted in no reduction in the current income tax expense (2015: €3 million). From the origination and write-down of loss carryforwards previously recognised, deferred tax expense arose in the amount of €25 million (2015: €71 million).

On differences associated with investments in subsidiaries, deferred tax liabilities in the amount of €58 million (2015: €50 million) have not been recognised because the Group has the ability and the intention to invest profits permanently in these subsidiaries.

42 Net Gains/Net Losses

The income statement contains the following net gains/net losses recognised in profit or loss according to IFRS 7.20 (a):

Net gains/net losses

in € million	2016	2015
Loans and receivables	167	23
Available for sale	3	−3
Held for trading	−6	15
Financial liabilities at amortised cost	8	−9

43 Earnings Per Share

Earnings per share[1)]

		2016	2015
Net income/loss	in € million	197	230
Average number of ordinary shares issued	pieces	134,475,308	134,475,308
Adjusted average number of ordinary shares issued pieces	pieces	134,475,308	134,475,308
Basic earnings per share	in €	**1.46**	**1.71**
Diluted earnings per share	in €	**1.46**	**1.71**

[1)] Earnings per share are calculated in accordance with IAS 33 by dividing net income/loss attributable to the ordinary equity holders by the weighted average number of ordinary shares.

Under the assumption that authorised and contingent capital was fully utilised, the number of ordinary shares issued would double, which in turn would result in a decrease of earnings per share by 50%.

NOTES TO THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION (ASSETS)

44 Cash Reserve

Cash reserve

in € million	31.12.2016	31.12.2015
Balance with central banks	1,136	1,265
Total	**1,136**	**1,265**

Cash in hand as of 31 December 2016 amounts to €0 million as was the case in the previous year.

45 Trading Assets

Trading assets

in € million	31.12.2016	31.12.2015
Positive fair values of derivative financial instruments	1,089	1,600
Total	**1,089**	**1,600**

46 Loans and Advances to Other Banks

Loans and advances to other banks by type of business

in € million	31.12.2016	31.12.2015
Loans and advances	2,841	2,733
Public sector loans	780	972
Other loans and advances	2,061	1,761
Investments	–	9
Total	**2,841**	**2,742**

Loans and advances to other banks by maturities

in € million	31.12.2016	31.12.2015
Repayable on demand	2,059	1,758
With agreed maturities	782	984
up to 3 months	18	3
more than 3 months to 1 year	45	190
more than 1 year to 5 years	164	234
more than 5 years	555	557
Total	**2,841**	**2,742**

47 Loans and Advances to Customers

Loans and advances to customers by type of business

in € million	31.12.2016	31.12.2015[1]
Loans and advances	40,913	40,870
Public sector loans	16,813	16,847
Real estate loans	24,081	24,006
Other loans and advances	19	17
Investments	–	125
Claims from finance lease agreements	233	231
Total	**41,146**	**41,226**

Loans and advances to customers by maturities

in € million	31.12.2016	31.12.2015[1]
Repayable on demand	1,023	1,085
With agreed maturities	40,123	40,141
up to 3 months	1,167	1,447
more than 3 months to 1 year	2,860	2,696
more than 1 year to 5 years	18,067	18,052
more than 5 years	18,029	17,946
Total	**41,146**	**41,226**

[1] Adjusted according to IAS 8.14 et seq. Details are disclosed in Note "Consistency".

48 Allowances for Losses on Loans and Advances

Development

in € million	Specific allowances[1]	Portfolio-based allowances	Total
Balance at 1.1.2015	**–115**	**–45**	**–160**
Changes through profit or loss	–11	13	2
Additions	–25	–1	–26
Reversals	9	14	23
Unwinding	5	–	5
Changes not affecting profit or loss	9	–	9
Use of existing allowances	19	–	19
Effects of foreign currency translations and other changes	–10	–	–10
Balance at 31.12.2015	**–117**	**–32**	**–149**
Balance at 1.1.2016	**–117**	**–32**	**–149**
Changes through profit or loss	8	–12	–4
Additions	–13	–15	–28
Reversals	19	3	22
Unwinding	2	–	2
Changes not affecting profit or loss	23	–	23
Use of existing allowances	16	–	16
Effects of foreign currency translations and other changes	7	–	7
Balance at 31.12.2016	**–86**	**–44**	**–130**

[1] Adjusted according to IAS 8.14 et seq. Details are disclosed in Note "Consistency".

The allowances for losses on loans and advances were exclusively created for the measurement ategory loans and receivables. The gross carrying amount of impaired loans and advances amounted to € 336 million (31 December 2015: € 534 million) as at the balance sheet date.

49 Valuation Adjustment from Portfolio Hedge Accounting

The line item valuation adjustments from portfolio hedge accounting includes the positive fair values in relation to the hedged risks in the portfolios of hedged items. They amounted to € 2 million as at 31 December 2016 (31 December 2015: €1 million).

50 Financial Investments

Breakdown

in € million	31.12.2016	31.12.2015
AfS financial investments	3,311	3,521
Debt securities and other fixed-income securities	3,308	3,518
Equity securities and other variable-yield securities	3	3
LaR financial investments	9,534	11,406
Debt securities and other fixed-income securities	9,534	11,406
Total	**12,845**	**14,927**

The carrying amounts of the LaR financial investments were reduced by portfolio-based allowances amounting to €10 million (31 December 2015: € 8 million).

Financial investments by maturities

in € million	31.12.2016	31.12.2015
Unspecified terms	3	3
With agreed maturities	12,842	14,924
up to 3 months	765	929
more than 3 months to 1 year	1,690	1,458
more than 1 year to 5 years	2,542	3,960
more than 5 years	7,845	8,577
Total	**12,845**	**14,927**

pbb Group has made use of the IASB amendments to IAS 39 and IFRS 7, published on 13 October 2008, and reclassified retrospectively as of 1 July 2008 financial investments out of the measurement category AfS of € 30.2 billion. At the date of reclassification the effective interest rate for the AfS securities was between 0.25% and 34.4%.

The following tables summarise the carrying amounts and fair values as of 31 December 2016 and 31 December 2015 as well as fair value gains and losses that would have been recognised in 2016 and 2015 if the financial assets had not been reclassified.

Reclassifications in 2008 Effects as of 31 December 2016

	Into: Financial investments (LaR)			
	31.12.2016		Effect in reporting period if no assets had been reclassified (1.1.–31.12.2016)	
	Carrying amount in € billion	Fair value in € billion	Profit or loss in € million	AfS reserve (after tax) in € million
Out of: Financial investments (AfS)	5.0	5.2	–	–14

Reclassifications in 2008 Effects as of 31 December 2015

	Into: Financial investments (LaR)			
	31.12.2015		Effect in reporting period if no assets had been reclassified (1.1.–31.12.2015)	
	Carrying amount in € billion	Fair value in € billion	Profit or loss in € million	AfS reserve (after tax) in € million
Out of: Financial investments (AfS)	6.0	6.3	–2	–21

51 Property and Equipment

Development of property and equipment

in € million	2016	2015
Operating equipment		
Acquisition/production costs		
Balance at 1.1.	**23**	**21**
Additions	1	5
Reclassifications	2	–
Disposals	–5	–3
Balance at 31.12.	**21**	**23**
Depreciation and write-ups		
Balance at 1.1.	**–13**	**–13**
Depreciation	–3	–2
Reclassifications	–2	–
Disposals	5	2
Balance at 31.12.	**–13**	**–13**
Carrying amounts		
Balance at 31.12.	**8**	**10**

52 Intangible Assets

Development of intangible assets

in € million	Software acquired	Internally developed software	Other intangible assets	2016 Total	2015 Total
Acquisition/production costs					
Balance at 1.1.	**41**	**41**	**1**	**83**	**122**
Additions	1	1	10	12	6
Reclassifications	–	1	−1	–	3
Disposals	–	−1	–	−1	−48
Balance at 31.12.	**42**	**42**	**10**	**94**	**83**
Amortisation and write-ups					
Balance at 1.1.	**−40**	**−22**	**–**	**−62**	**−99**
Amortisation	−1	−7	–	−8	−8
Disposals	–	–	–	–	45
Balance at 31.12.	**−41**	**−29**	**–**	**−70**	**−62**
Carrying amounts					
Balance at 31.12.2016	**1**	**13**	**10**	**24**	
Balance at 31.12.2015	**1**	**19**	**1**	**21**	**21**

Research and development expenditure recognised as an expense amounted to €7 million (2015: €7 million).

53 Other Assets

Other assets

in € million	31.12.2016	31.12.2015
Positive fair values from derivative financial instruments	3,492	4,960
Hedging derivatives	3,492	4,960
Micro fair value hedge	3,492	4,959
Portfolio hedge	–	1
Salvage acquisitions	9	23
Other assets	47	23
Reimbursements under insurance policies	2	7
Total	**3,550**	**5,013**

Foreclosed assets were written down by €6 million during the financial year 2016. In addition, foreclosed assets with a carrying amount of €8 million were sold, realising an effect on income of less than €1 million. Salvage acquisitions were entirely measured at net realisable value.

54 Income Tax Assets

Income tax assets

in € million	31.12.2016	31.12.2015
Current tax assets	47	21
Deferred tax assets	71	84
Total	**118**	**105**

55 Subordinated Assets

The statement of financial position do not contain subordinated assets.

56 Repurchase Agreements

As a pledgor of genuine repurchase agreements, pbb Group has pledged assets with a book value of €1.9 billion (31 December 2015: €0.9 billion). The securities are still recognised as assets. The considerations which have been received amount to €1.8 billion (31 December 2015: €0.6 billion) and are recognised solely as liabilities to other banks. Assets in repurchase agreements are the only transferable assets the acquirer can sell or repledge in the absence of default according to IAS 39.37 (a).

57 Securitisation

As of 31 December 2015 pbb Group had the synthetic securitisation Estate UK-3 with a transaction period of 15 years (maturity 2022) and a total volume of lending of €187 million (31 December 2015: €306 million) in the portfolio. The collateral-taker of the transaction with commercial mortgage loans is pbb. The credit linked notes were completely sold to the investors. Overall a reduction of expected loss according to Basel III of €161 million (31 December 2015: €168 million) was achieved. The trustee of one particular securitisation transaction doubts the admissibility of the loss allocation intended by pbb, in the amount of GBP113 million. According to the contractual stipulations of the securitisation transaction, the trustee has appointed an independent expert to review the loss allocation. In the event of the loss allocation being fully or partially inadmissible, pbb would have to bear the losses to the corresponding extent.

NOTES TO THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION (EQUITY AND LIABILITIES)

58 Liabilities to Other Banks

Liabilities to other banks by maturities

in € million	31.12.2016	31.12.2015
Repayable on demand	924	1,255
With agreed maturities	2,255	1,259
up to 3 months	1,583	157
more than 3 months to 1 year	56	430
more than 1 year to 5 years	73	150
more than 5 years	543	522
Total	**3,179**	**2,514**

59 Liabilities to Customers

Liabilities to customers by maturities

in € million	31.12.2016	31.12.2015
Repayable on demand	1,560	1,271
With agreed maturities	8,389	9,553
up to 3 months	1,381	1,291
more than 3 months to 1 year	1,654	2,139
more than 1 year to 5 years	4,083	4,829
more than 5 years	1,271	1,294
Total	**9,949**	**10,824**

60 Securitised Liabilities

Securitised liabilities by type of business

in € million	31.12.2016	31.12.2015
Debt securities issued	20,752	21,520
Mortgage Pfandbriefe	9,551	10,382
Public Pfandbriefe	6,962	6,833
Other debt securities	4,209	4,193
Money market securities	30	112
Registered notes issued	19,629	21,128
Mortgage Pfandbriefe	5,346	5,896
Public Pfandbriefe	12,208	13,341
Other debt securities	2,075	1,891
Total	**40,381**	**42,648**

Securitised liabilities by maturities

in € million	31.12.2016	31.12.2015
With agreed maturities		
up to 3 months	3,259	2,050
more than 3 months to 1 year	3,129	4,411
more than 1 year to 5 years	14,829	18,335
more than 5 years	19,164	17,852
Total	**40,381**	**42,648**

61 Valuation Adjustment from Portfolio Hedge Accounting

The line item valuation adjustments from portfolio hedge accounting includes the negative fair values in relation to the hedged risks in the portfolios of hedged items. They amounted to €1 million as at 31 December 2016 (31 December 2015: €1 million).

62 Trading Liabilities

Trading liabilities

in € million	31.12.2016	31.12.2015
Negative fair values of derivative financial instruments	1,355	1,643
Total	**1,355**	**1,643**

63 Provisions

Breakdown

in € million	31.12.2016	31.12.2015
Provisions for pensions and similar obligations	95	102
Restructuring provisions	14	15
Provisions for contingent liabilities and other commitments	–	1
Other provisions	133	111
Thereof: Provisions for legal risks	75	87
Long-term liabilities to employees	1	1
Total	**242**	**229**

There are defined contribution and defined benefit plans for the employees of pbb Group. In the defined contribution plans pbb makes payments for commitments by industry-wide organisations, for instance the BVV in Germany. In almost all non-German entities, a defined percentage of fixed salary is paid into externally managed pension funds for employees as part of defined contribution pension schemes. Expenses in respect of defined contribution plans amounted to €3 million (2015: €4 million). The expense is expected to slightly increase in 2017. Expenses in respect of defined contribution plans for persons with a key function in the Group amounted to less than €1 million (2015: less than €1 million). The employer's contribution to the statutory pension insurance amounted to €6 million in 2016 (2015: €5 million).

There are defined benefit pension commitments for many employees in Germany. There are no defined benefit pension commitments in the non-German entities. For the defined benefit plans the employees receive a direct commitment from their respective company. The pension plan especially contains retirement pensions, disability pensions and surviving dependant's pensions. The receipt of retirement pensions or disability pensions starts after a vesting period is fulfilled, at the earliest after reaching a minimum age in the case of part or full incapacity for work, at the latest when going into retirement, usually after completion of the 65th year of life. In the case of active employees, there are predominantly modern modular pension plans. For the other eligible persons there are also final salarybased defined benefit plans. The annual pension module depends, among other things, on the gross annual salary paid and the member's length of service. The surviving dependant's pension usually amounts to 60% of the pension of the spouse respectively the entitlement on that. The pension plan is administered by pbb itself with the aid of an external service provider for the administration.

Pension provisions are recognised for obligations arising from direct commitments. The defined benefit plans have been principally closed for new entrants since 1 April 2004. There have been no plan amendments, curtailments and settlements in the years 2016 and 2015.

The risk of insolvency is covered within the framework of legal requirements by Pensionssicherungsverein a. G. in relation to the total amount of pension obligations.

The following actuarial assumptions were used to measure the defined benefit pension obligations:

Actuarial assumptions

in %	31.12.2016/ 1.1.2017	31.12.2015/ 1.1.2016
Discount rate	1.75	2.25
Rate of increase in pension obligations	1.50	1.75
Rate of increase in future compensation and vested rights[1]	2.50	2.50

[1] Against the background of the adjustments of annual base salaries made in 2015 to a uniform amount of € 500,000 and the introduction of a variable remuneration component, we expect a rate of increase in future compensation and vested rights of 0%, also in view of the appropriateness of Management Board compensation for the active Management Board members in the financial years 2016 and 2015.

The rate of increase in career for members of the Management Board amounts 0.0% (31 December 2015: 0.0%), for directors and non-pay-scale staff 1.5% (31 December 2015: 1.5%) and for payscale staff 0.5% (31 December 2015: 0.5%). The guidance tables 2005G from Klaus Heubeck were used as the biometric basis.

The defined benefit pension commitments of pbb do not contain any unusual or entity-specific risks. pbb is faced by the common demographic risks, for example from longevity or invalidity of the entitled employees, and common financial risks like for example a change of the discount rate. pbb took out reinsurance to protect itself against parts of these risks. The reinsurance is a qualifying insurance policy in accordance with IAS 19 and thus is a plan asset. The fair value of plan assets is a component of the net liability from defined benefit plans which is deducted from the present value of the defined benefit obligation. The reinsurance does not consist of any unusual or plan-specific risks.

Principally, the pension payments of the reinsured pension obligations are funded by the income from the plan assets. If the income does not cover the pension payments pbb has to pay the pensions out of its own funds. For the non-reinsured pension obligations the payments are also made out of own funds.

Statement of financial position items (net defined benefit liability)

in € million	2016	2015
Present value of defined benefit obligation	291	281
Fair value of plan assets	–196	–179
Total	**95**	**102**

Development of net defined benefit liability

in € million	2016	2015
Balance at 1.1.	**102**	**115**
Transfer of staff	–	–
Pension expenses	5	6
Remeasurements	15	–12
Reclassifications in reimbursements	–6	–1
Payments into plan assets	–16	–1
Direct payments to beneficiaries	–5	–5
Balance at 31.12.	**95**	**102**

Development of defined benefit obligation

in € million	2016	2015
Balance at 1.1.	**281**	**297**
Transfer of staff	–	–1
Current service costs	3	4
Interest expenses	6	6
Remeasurements	15	–11
Actuarial gains/losses from demographic assumptions	–	–
Actuarial gains/losses from financial assumptions	14	–12
Actuarial gains/losses from experience assumptions	1	1
Settlements	–	–
Payments to beneficiaries	–14	–14
Balance at 31.12.	**291**	**281**

Plan assets consist exclusively of reinsurance pledged to plan beneficiaries. The plan assets accordingly do not contain any own financial instruments or any own used property and equipment. No further material contributions to the plan assets are aimed in 2017. pbb does not use special asset-liability matching strategies to manage the pledged reinsurance.

Development of fair value of plan assets

in € million	2016	2015
Balance at 1.1.	**179**	**182**
Transfer to staff	–	−1
Interest income	4	4
Remeasurements	–	1
Payments into plan assets	16	1
Payments to beneficiaries	−9	−9
Reclassifications in/from reimbursements	6	1
Balance at 31.12.	**196**	**179**

Development of pension expenses

in € million	2016	2015
Service costs	3	4
Current service costs	3	3
Past service costs	–	1
Curtailments	–	–
Settlements	–	–
Net interest expenses	2	2
Interest expenses on defined benefit obligation	6	6
Interest income on plan assets	−4	−4
Total	**5**	**6**

Compared to 2016 a largely constant pension expense is expected for 2017. Pension expenses are part of general and administrative expenses.

Remeasurements of the net defined benefit liability result from actuarial gains and losses and the return on plan assets excluding amounts included in net interest on the net defined benefit liability.

Remeasurement recognised in other comprehensive income (equity)

in € million	2016	2015
Actuarial gains/losses from demographic assumptions	–	–
Actuarial gains/losses from financial assumptions	−14	12
Actuarial gains/losses from experience assumptions	−1	−1
Remeasurements from plan assets	–	1
Total	**−15**	**12**

Delevopment of reimbursement

in € million	2016	2015
Balance at 1.1.	**8**	**9**
Disposals	−6	−1
Balance at 31.12.	**2**	**8**

As at 31 December 2016, the quantitative sensitivity analysis – which uses the same measurement methods as the obligation recognised in the statement of financial position – for the material actuarial assumptions is as follows:

Actuarial assumptions

in € million	Change of sensitivity level (+ increase/– decrease)		Gross obligation 31.12.2016	Gross obligation 31.12.2015
Basic value of the calculation of sensitivity			291	281
Discount rate	in percentage points	+0.5	270	262
	in percentage points	–0.5	314	303
Rate of increase in pension obligations	in percentage points	+0.5	308	297
	in percentage points	–0.5	276	266
Rate of increase in future compensation and vested rights	in percentage points	+0.5	292	281
	in percentage points	–0.5	291	280

The assumption of mortality only has an immaterial effect because the risk of longevity is mainly covered by the plan assets.

The weighted average duration of the defined benefit obligations amounted to 15 years at 31 December 2016 (31 December 2015: 15 years).

Development of provisions (without provisions for pension and similar obligations)

in € million	Restructuring provisions	Provisions for contingent liabilities and other commitments	Other provisions
Balance at 1.1.2015	**42**	**11**	**104**
Additions	7	–	87
Reversals	–4	–9	–13
Unwinding	–	–	–
Amounts used	–30	–1	–67
Reclassifications	–	–	–
Balance at 31.12.2015	**15**	**1**	**111**
Balance at 1.1.2016	**15**	**1**	**111**
Additions	8	–	57
Reversals	–1	–1	–9
Unwinding	–	–	–
Amounts used	–7	–	–27
Reclassifications	–1	–	1
Balance at 31.12.2016	**14**	**–**	**133**

Restructuring provisions comprised personnel measures in the amount of €14 million (31 December 2015: €14 million). According to current projections, all of the current restructuring provisions will have been used by 2020.

The provisions for contingent liabilities and other commitments mainly comprise provisions for guarantee risks, letters of credit, irrevocable loan commitments and litigation risks in the lending business.

Legal Risks (Litigation Risks)
pbb Group is obliged, in all jurisdictions in which it conducts its business, to comply with a large number of statutory and supervisory requirements and regulations such as certain rules of conduct to compliance with competition rules, to avoid conflicts of interest, to combat money laundering, to prevent terrorist financing, to prevent criminal offences, to regulate foreign trade and to safeguard bank, business and data secrecy. Given the nature of business and international expansion of activities and the large number of relevant requirements and regulations, pbb Group is involved in litigation, arbitration and administrative proceedings in some countries. These also include criminal proceedings as well as the assertion of claims in an amount not specified by the party asserting the claim. pbb Group recognises provisions for the uncertain obligations arising from these proceedings if the potential outflow of resources is sufficiently likely and the amount of the obligation can be estimated. The probability of the outflow of resources, which often cannot be estimated with certainty, is highly dependent on the outcome of the proceedings. The assessment of this probability and the quantification of the obligation are largely based on estimates. The actual liability can vary considerably from this estimate. Accounting for the individual legal procedure, pbb Group analyses developments of the individual cases and comparable cases, drawing on its own expertise or opinions by external consultants, and in particular by legal advisors, depending on the significance and complexity of the respective case. The provisions recognised for the proceedings are not reported separately as pbb Group believes that the outcome of the proceedings would be seriously compromised by their disclosure.

In appraisal proceedings relating to the merger of three predecessor mortgage banks to form pbb in 2001, the new appraisal ordered by the Munich Regional Court I has resulted in an additional payment averaging €1.00 per share. The potential subsequent payment claims amount up to €9.4 million plus interest since 2001. However, the Munich Regional Court I has rejected requests of claimants to increase compensation payments. Individual applicants have lodged complaints against the court's decision. As the Munich Regional Court I did not rectify these complaints, complaint proceedings have been initiated at the Munich Higher Regional Court since mid-2015.

The profit participation certificates issued by the predecessor institutions participated in significant losses due to the net losses for the period incurred in the yeras 2008 et. seq. respectively pbb's unappropriated retained losses since this time. The redemption amounts have reduced and interest payment has been suspended. Individual investors therefore initiated legal proceedings, contesting in particular various individual clauses relating to loss participation and replenishment following loss participation. The key questions in this connection are which balance sheet items must be taken into account to calculate loss participation and whether replenishment is required if pbb records a net income, unappropriated retained earnings or another income. Courts have decided against the legal view of pbb in view of the individual decisions regarding profit participation certificates. Some of the court decisions are legally binding; some have been subject to appeals lodged by pbb. At present, legal proceedings with a total amount in dispute of €65.4 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 the Bank endeavours to solve legal disputes by way of out-of-court settlements, it exploits the legal remedies at its disposal when needed.

Provisions in the amount of €5.0 million were recognised for legal 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 recently issued.

Hypo Real Estate Bank International AG 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 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.

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.

64 Other Liabilities

Other liabilities

in € million	31.12.2016	31.12.2015
Negative fair values from derivative financial instruments	3,719	4,818
Hedging derivatives	3,719	4,818
Micro fair value hedge	3,715	4,818
Portfolio hedge	4	–
Other liabilities	59	100
Total	**3,778**	**4,918**

Other liabilities include, amongst others, accruals pursuant to IAS 37 including accounts payable in respect of invoices still outstanding, short-term liabilities to employees and other accruals in respect of commission, interest, non-personnel expenses and similar expenses.

65 Income Tax Liabilities

Income tax liabilities

in € million	31.12.2016	31.12.2015
Current tax liabilities	59	113
Deferred tax liabilities	–	–
Total	**59**	**113**

66 Subordinated Capital

Breakdown

in € million	31.12.2016	31.12.2015
Subordinated liabilities	525	764
Hybrid capital instruments	361	361
Total	**886**	**1,125**

Early repayment obligation on the part of the issuer cannot occur for any subordinated liabilities. In the event of bankruptcy or liquidation, such liabilities may only be repaid after all non-subordinated creditors have been satisfied.

Subordinated capital by maturities

in € million	31.12.2016	31.12.2015
With agreed maturities		
up to 3 months	54	223
more than 3 months to 1 year	361	15
more than 1 year to 5 years	246	710
more than 5 years	225	177
Total	**886**	**1.125**

Hybrid Capital Instruments

Hybrid capital instruments in particular include issues in the form of preferred securities placed by pecifically established special-purpose entities. These instruments differ from conventional supplementary capital as they are subject to more stringent conditions in terms of maturity. In addition, hybrid capital instruments are not repaid until after supplementary capital (subordinated liabilities and participating certificates outstanding) in the event of bankruptcy. In contrast to traditional components of core capital, the claim to a share of profit, which depends on the existence of profit, takes the form of a fixed or variable interest payment in the case of hybrid capital instruments. Moreover, hybrid capital can be issued both with unlimited maturity and repayable in the long term.

67 Equity

Subscribed capital equals the maximum liability of the shareholder for the liabilities of the corporation to its creditors. The subscribed capital as of 31 December 2016 and during the entire financial year 2016 amounted to €380,376,059.67 which is divided into 134,475,308 ordinary bearer shares with no par value representing a theoretical interest in the share capital of approximately €2.83 per share. As at 31 December 2016 and during the entire financial year 2016, pbb did not hold any treasury shares.

Please refer to the disclosures pursuant to section 315 (4) HGB included in the "Supplemental Information" section of the Group Management Report for information on authorised and contingent capital.

Additional paid-in capital includes contributions from a previous financial year as well as premiums from the issue of shares. Retained earnings were generally created only from net income of the current financial year or previous periods. This includes legal reserves to be created from net income and other retained earnings.

At the Annual General Meeting on 30 May 2017, the Management Board and the Supervisory Boards will propose to distribute a dividend of €1.05 per dividend bearing share.

68 Trust Business

As at 31 December 2016 and 31 December 2015, there were no trust assets or liabilities reported in the statement of financial position.

NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS

69 Disclosures to the Items in the Consolidated Statement of Cash Flows

The consolidated statement of cash flows shows the cash flows of the financial year broken down by operating activities, investing activities and financing activities. Cash and cash equivalents correspond to the balance sheet item cash reserve, and include cash in hand and credit balances at central banks.

Operating activities are defined broadly, and correspond to operating result. Cash flow from operating activities includes payments (inflows and outflows) attributable to loans and advances to other banks and customers as well as securities attributable to trading assets and other assets. Inflows and outflows attributable to liabilities to other banks and customers, securitised liabilities and other liabilities are also included under operating activities. The interest and dividend payments resulting from operating activities are shown under cash flow from operating activities.

Cash flow from investing activities comprises payments for investment and security holdings as well as for property and equipment.

Cash flow from financing activities comprises inflows from capital increases, payments into reserves and silent participations as well as inflows and outflows for subordinated capital.

In the financial years 2016 and 2015, no subsidiaries were disposed.

NOTES TO THE FINANCIAL INSTRUMENTS

70 Derivative Transactions

In order to minimise (reduce) both the economic and the regulatory credit risk, bilateral netting agreements have been concluded. By means of such netting agreements, the positive and negative fair values of the derivatives contracts included under the master agreement can be offset against one another, and the future regulatory risk add-ons for these products can be reduced. Through this netting process, the credit risk is limited to a single net claim on the party to the contract.

For both regulatory reports and the internal measurement and monitoring of the credit commitments, such risk-reducing techniques are utilised only if they are considered to be enforceable under the respective legal system in the event that the business associate becomes insolvent. Legal advice is taken in order to check enforceability.

Similar to the master agreements, pbb Group concludes collateral agreements with its business associates to collateralise the net claim or liability remaining after netting (obtained or pledged collateral). Usually, this collateral management reduces credit risk by means of prompt measurement and adjustment of the exposure to customers.

Volume of derivatives as of 31 December 2016

in € million	Notional amount				Fair value	
	Remaining maturities					
	up to 1 year	more than 1 year to 5 years	more than 5 years	**Total**	positive	negative
Interest-based transactions						
OTC products	25,805	28,051	25,246	79,102	4,567	4,850
Interest rate swaps	24,655	21,429	23,485	69,569	4,561	4,803
Interest rate options	1,150	6,622	1,761	9,533	6	47
Call options	575	3,250	117	3,942	4	–
Put options	575	3,372	1,644	5,591	2	47
Sum	**25,805**	**28,051**	**25,246**	**79,102**	**4,567**	**4,850**
Foreign-currency-based transactions						
OTC products	4,592	897	448	5,937	14	224
Spot and forward currency transactions	4,383	–	–	4,383	8	116
Interest rate/currency swaps	209	897	448	1,554	6	108
Sum	**4,592**	**897**	**448**	**5,937**	**14**	**224**
Total	**30,397**	**28,948**	**25,694**	**85,039**	**4,581**	**5,074**

Use made of derivative transactions at of 31 December 2016

in € million	Notional amount	Fair value positive	Fair value negative
Interest-based transactions			
Hedge accounting	52,598	3,490	3,659
Stand-alone derivatives	26,504	1,077	1,191
Sum	**79,102**	**4,567**	**4,850**
Foreign-currency-based transactions			
Hedge accounting	289	2	60
Stand-alone derivatives	5,648	12	164
Sum	**5,937**	**14**	**224**
Total	**85,039**	**4,581**	**5,074**

Volume of derivatives as of 31 December 2015

in € million	Notional amount – Remaining maturities: up to 1 year	more than 1 year to 5 years	more than 5 years	Total	Fair value: positive	negative
Interest-based transactions						
OTC products	10,192	39,645	34,301	84,138	6,472	6,363
Forward rate agreements	341	–	–	341	–	–
Interest rate swaps	9,255	33,524	34,067	76,846	6,463	6,354
Interest rate options	596	6,121	234	6,951	9	9
Call options	306	3,065	117	3,488	9	–
Put options	290	3,056	117	3,463	–	9
Sum	**10,192**	**39,645**	**34,301**	**84,138**	**6,472**	**6,363**
Foreign-currency-based transactions						
OTC products	4,590	1,239	447	6,276	88	98
Spot and forward currency transactions	4,477	–	–	4,477	51	35
Interest rate/currency swaps	113	1,239	447	1,799	37	63
Sum	**4,590**	**1,239**	**447**	**6,276**	**88**	**98**
Total	**14,782**	**40,884**	**34,748**	**90,414**	**6,560**	**6,461**

Use made of derivative transactions at of 31 December 2015

in € million	Notional amount	Fair value: positive	negative
Interest-based transactions			
Hedge accounting	48,770	4,946	4,769
Stand-alone derivatives	35,368	1,526	1,594
Sum	**84,138**	**6,472**	**6,363**
Foreign-currency-based transactions			
Hedge accounting	398	13	49
Stand-alone derivatives	5,878	75	49
Sum	**6,276**	**88**	**98**
Total	**90,414**	**6,560**	**6,461**

Counterparties

in € million	31.12.2016 Fair value: positive	31.12.2016 Fair value: negative	31.12.2015 Fair value: positive	31.12.2015 Fair value: negative
OECD banks	3,990	5,034	5,917	6,396
OECD financial institutions	4	–	4	–
Other companies and private individuals	587	40	639	65
Total	**4,581**	**5,074**	**6,560**	**6,461**

71 Undiscounted Cash Flows of Financial Liabilities

Contractually agreed undiscounted cash flows of the financial liabilities according to IFRS 7.39

in € billion	31.12.2016	31.12.2015
Up to 3 months	7	3
From derivative financial instruments	–	–
From non-derivative financial instruments	7	3
More than 3 months to 1 year	6	8
From derivative financial instruments	–	1
From non-derivative financial instruments	6	7
More than 1 year to 5 years	24	28
From derivative financial instruments	2	2
From non-derivative financial instruments	22	26
More than 5 years	27	26
From derivative financial instruments	2	3
From non-derivative financial instruments	25	23
Total	**64**	**65**

In conformity with the requirements, the contractually agreed undiscounted cash flow maturities are presented in accordance with the worst-case scenario, meaning that if there are options or terminations rights involved the most unfavourable case from a liquidity perspective will be assumed. This presentation does not reflect the economic management which is based on expected cash flows. The liquidity risk strategy and management of pbb Group is described in the risk and opportunity report.

72 Assets Assigned or Pledged as Collateral

Assets (without cash collaterals) have been pledged as collateral for the following liabilities and received collaterals:

Liabilities

in € million	31.12.2016	31.12.2015
Liabilities to other banks	2,036	881
Liabilities to customers	–	1
Total	**2,036**	**882**

The following assets were pledged as collateral for the aforementioned liabilities:

Assets pledged

in € million	31.12.2016	31.12.2015
Loans and advances to customers	277	251
Financial investments	1,935	861
Total	**2,212**	**1,112**

The assets pledged mainly resulted from repurchase agreements. The transactions were carried out at the normal standard terms for repurchase transactions and concluded on an arm's-length basis.

In addition, pbb was required to provide cash collateral in the amount of €11 million (31 December 2015: €8 million) in connection with the bank levy.

73 Collaterals Permitted to Resell or Repledge

As of 31 December 2016 and as of 31 December 2015 there were no collaterals that may be esold or repledged in the absence of default.

74 Transfer of Financial Assets

Transfer of financial assets as of 31 December 2016

	Transferred assets that are not derecognised in their entirety			
	Transferred assets		Corresponding liabilities	
in € million	**Carrying amounts**	Thereof: Repo transactions	**Carrying amounts**	Thereof: Repo transactions
AfS assets	1,022	1,022	883	883
Bonds	1,022	1,022	883	883
LaR assets	1,190	913	1,153	876
Bonds	913	913	876	876
Loans and advances	277	–	277	–
Total	**2,212**	**1,935**	**2,036**	**1,759**

Transfer of financial assets as of 31 December 2015

in € million	Transferred assets that are not derecognised in their entirety			
	Transferred assets		Corresponding liabilities	
	Carrying amounts	Thereof: Repo transactions	**Carrying amounts**	Thereof: Repo transactions
AfS assets	376	376	252	252
Bonds	376	376	252	252
LaR assets	736	485	630	379
Bonds	485	485	379	379
Loans and advances	251	–	251	–
Total	**1,112**	**861**	**882**	**631**

At balance sheet date the fair value of LaR bonds amounted to € 922 million (31 December 2015: € 480 million) and of LaR loans and advances to € 289 million (31 December 2015: € 255 million).

When pbb Group transfers financial assets that do not qualify for derecognition (see also Note "Financial Instruments"), they continue to be reported in the statement of financial position. These transactions particularly are securities repurchase transactions (31 December 2016: €1.935 million; 31 December 2015: € 861 million) as well as loans granted against the assignment of claims (31 December 2016: € 277 million; 31 December 2015: € 251 million). In addition, securities with a carrying amount of € 66 million (31 December 2015: € 38 million) were transferred to Eurex as collateral for clearing fund contribution and initial margin for derivative transactions.

pbb Group generally has no continuing involvement in transferred and derecognised financial assets.

75 Fair Values of Financial Instruments

The fair value of financial instruments, in the opinion of pbb Group, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price). The fair values were determined as of the balance sheet date based on the market information available and on valuation methods described here.

All financial assets and liabilities that are measured at fair value are grouped into the three fair value hierarchies by pbb Group. Reclassifications within the fair value hierarchy are made at the end of the reporting period. The three-level hierarchy is based on the degree to which the input for the fair value measurement is observable:

- Level 1 – quoted priced (unadjusted) in active markets for identical financial assets or financial liabilities (market prices)
- Level 2 – inputs that are observable either directly or indirectly, other than quoted prices included within Level 1
- Level 3 – valuation techniques that include inputs that are not based on observable market data (unobservable inputs)

Fair values and fair value hierarchy of financial instruments

in € million					31.12.2016
					Fair value
	Carrying amount	Fair value	Level 1	Level 2	Level 3
Financial assets	**62,188**	**64,429**	**10,137**	**24,678**	**29,614**
at fair value through profit or loss	4,581	4,581	–	4,541	40
at fair value not affecting profit or loss	3,311	3,311	3,311	–	–
not measured at fair value in the statement of financial position	54,296	56,537	6,826	20,137	29,574
Cash reserve	1,136	1,136	1,136	–	–
Trading assets (HfT)	1,089	1,089	–	1,089	–
Loans and advances to other banks	2,841	2,872	2,018	812	42
Category LaR	2,841	2,872	2,018	812	42
Loans and advances to customers[1]	40,783	42,906	–	15,837	27,069
Category LaR	40,783	42,906	–	15,837	27,069
Real Estate Finance	23,969	25,377	–	–	25,377
Public Investment Finance	6,226	6,542	–	5,155	1,387
Value Portfolio	9,046	9,365	–	9,016	349
Consolidation & Adjustments	1,586	1,666	–	1,666	–
Portfolio-based allowances	–44	–44	–	–	–44
Valuation adjustment from portfolio hedge accounting	2	–	–	–	–
Financial investments	12,845	12,934	6,983	3,488	2,463
Category AfS	3,311	3,311	3,311	–	–
Category LaR	9,534	9,623	3,672	3,488	2,463
Other assets	3,492	3,492	–	3,452	40
Hedging derivatives	3,492	3,492	–	3,452	40
Financial liabilities	**59,491**	**61,018**	**21,437**	**5,463**	**34,118**
at fair value through profit or loss	5,074	5,074	–	5,053	21
at fair value not affecting profit or loss	–	–	–	–	–
not measured at fair value in the statement of financial position	54,417	55,944	21,437	410	34,097
Liabilities to other banks	3,179	3,300	2,430	–	870
Liabilities to customers	9,949	10,235	1,371	–	8,864
Securitised liabilities	40,381	41,480	17,636	410	23,434
covered	34,097	35,014	14,375	277	20,362
uncovered	6,284	6,466	3,261	133	3,072
Valuation adjustment from portfolio hedge accounting	1	–	–	–	–
Trading liabilities (HfT)	1,355	1,355	–	1,355	–
Other liabilities	3,740	3,740	–	3,698	42
Hedging derivatives	3,719	3,719	–	3,698	21
Other financial liabilities	21	21	–	–	21
Subordinated capital	886	908	–	–	908
Other items	**3,973**	**4,005**	**–**	**–**	**4,005**
Contingent liabilities	171	171	–	–	171
Irrevocable loan commitments	3,802	3,834	–	–	3,834

[1] Reduced by allowances for losses on loans and advances and claims from finance lease agreements.

Fair values and fair value hierarchy of financial instruments

in € million	Carrying amount	Fair value	Level 1	Level 2	Level 3
	31.12.2015		Fair value		
Financial assets	**66,341**	**68,560**	**11,706**	**24,710**	**32,144**
at fair value through profit or loss	6,560	6,560	–	6,516	44
at fair value not affecting profit or loss	3,521	3,521	3,521	–	–
not measured at fair value in statement of financial position	56,260	58,479	8,185	18,194	32,100
Cash reserve	1,265	1,265	1,265	–	–
Trading assets (HfT)	1,600	1,600	–	1,600	–
Loans and advances to other banks	2,742	2,769	1,696	767	306
Category LaR	2,742	2,769	1,696	767	306
Loans and advances to customers[1]	40,846	42,941	–	13,862	29,079
Category LaR	40,846	42,941	–	13,862	29,079
Real Estate Finance	23,866	25,223	–	–	25,223
Public Investment Finance	5,974	6,290	–	4,658	1,632
Value Portfolio	9,209	9,524	–	7,648	1,876
Consolidation & Adjustments	1,829	1,936	–	1,556	380
Portfolio-based allowances	−32	−32	–	–	−32
Valuation adjustment from portfolio hedge accounting	1	–	–	–	–
Financial investments	14,927	15,025	8,745	3,565	2,715
Category AfS	3,521	3,521	3,521	–	–
Category LaR	11,406	11,504	5,224	3,565	2,715
Other assets	4,960	4,960	–	4,916	44
Hedging derivatives	4,960	4,960	–	4,916	44
Financial liabilities	**63,601**	**64,932**	**19,842**	**7,769**	**37,321**
at fair value through profit or loss	6,461	6,461	–	6,445	16
at fair value not affecting profit or loss	–	–	–	–	–
not measured at fair value in the statement of financial position	57,140	58,471	19,842	1,324	37,305
Liabilities to other banks	2,514	2,624	1,254	379	991
Liabilities to customers	10,824	11,101	1,075	–	10,026
Securitised liabilities	42,648	43,602	17,513	934	25,155
covered	36,563	37,513	14,245	813	22,455
uncovered	6,085	6,089	3,268	121	2,700
Valuation adjustment from portfolio hedge accounting	1	–	–	–	–
Trading liabilities (HfT)	1,643	1,643	–	1,643	–
Other liabilities	4,846	4,846	–	4,802	44
Hedging derivatives	4,818	4,818	–	4,802	16
Other financial liabilities	28	28	–	–	28
Subordinated capital	1,125	1,116	–	11	1,105
Other items	**3,130**	**3,156**	**–**	**–**	**3,156**
Contingent liabilities	184	184	–	–	184
Irrevocable loan commitments	2,946	2,972	–	–	2,972

[1] Reduced by allowances for losses on loans and advances and claims from finance lease agreements.

In the financial years 2016 and 2015, no financial instruments measured at fair value were reclassified from Level 1 to Level 2 and vice versa. Furthermore, no financial instruments measured at fair value were were reclassified from Level 2 to Level 3 and vice versa in the reporting year. In 2015, financial liabilities in the amount of €6 million were reclassified from Level 2 to Level 3 since inputs were no longer fully observable on the market; financial assets measured at fair value in the amount of €27 million and financial liabilities in the amount of €1 million were reclassified from Level 3 to Level 2 since inputs were observable on the market again.

Disclosures to the Measurement Methods and Input Parameters

Measurement Process Both the Finance and the Risk Management & Control divisions play a role in the measurement process. The Finance division supplies accounting data. This includes:

- identification data, such as business identification numbers or International Securities Identification Numbers (ISINs)
- static data such as notional amounts, name and country of the counterparty and (remaining) terms
- accounting data such as carrying amounts, accruals and the effects of hedge accounting

Risk Management & Control calculates additional data used to measure fair value such as interest rates, credit spreads and market prices, as well as internal ratings and LGDs for certain financial instruments.

Risk Management & Control uses the determined input parameters to calculate (and provide to Finance) the fair value or measurement price of financial instruments based on accepted and validated measurement methods. Finance consolidates the data received from Risk Management & Control with the data held for accounting and reporting purposes, and verifies completeness.

Level 2 instruments measured at fair value as of 31.12.2016

Measurement methods	Observable parameter
DCF methods	Euro zone inflations rates
	Reference interest rates
	Saisonalities of Euro zone inflations rates
	Spot market exchange rates
	Yield curves
Option pricing models	Cap volatilities
	CMS Spread Options (strike price)
	CMS Spread Options (option price)
	Euro zone inflations rates
	Reference interest rates
	Saisonalities of Euro zone inflations rates
	Swaption volatilities
	Volatilities of Euro zone inflation caps
	Spot market exchange rates
	Exchange rates volatilities
	Yield curves

Level 3 instruments measured at fair value as of 31.12.2016

Measurement methods	Non-observable parameters	Range (weighted average)
Option pricing models	Historical index/index correlations	+72.68% (+72.68%)
	Historical index/exchange rate correlations	–73.38% to –24.99% (–49.19%)
	Asset swap spread volatilities	+0.54% (+0.54%)

Financial instruments not measured at fair value as of 31.12.2016

Measurement methods	Observable parameter (level 2)	Non-observable parameter (level 3)
DCF models (discounted cash flows)	(Own) credit spreads and Liqui-AddOns, if necessary	Internal rating classes
	Reference interest rates	Recovery rates
	Risk-free interest rate	Estimated remaining maturities
	Observable future cash flows	Estimated future cash flows
	Benchmark interest rates	(Own) credit spreads (secondary market grid)
Bachelier cap-floor model (for floored plain vanilla floater)	Additional cap volatilities including smile	Additional cap volatilities including smile
Bachelier cap-floor model (for fixed coupons options)	Additional swap volatilities including smile	Additional swap volatilities including smile
Prices on non-active markets	Prices of proxy trades	–

Sensitivities

As at 31 December 2016, financial assets measured at fair value were subject to positive and negative changes of less than €1 million each, and financial liabilities measured at fair value were subject to positive and negative changes of €1 million each. The calculation of the sensitivity for the three relevant derivatives, which are used in hedge accounting, is based on shock scenarios for cor-relations and volatilities pursuant to the level 3 measurement methods table. There are interactions between the input parameters used, except for spread volatilities. If the scenario effects are taken into account on an aggregate basis, the maximum change for assets is less than €1 million and for liabilities of €1 million. As at 31 December 2015, the sensitivity analysis resulted in positive and negative changes in financial assets of €1 million each and in financial liabilities of less than €1 million each. These amounts were calculated independently from each other. Offsetting effects due to compensating derivatives and hedge relationships reduce both positive and negative changes. There were no methodological changes compared to the previous year.

Changes in Level 3 Financial Instruments measured at Fair Value

Changes in level 3 instruments measured at fair value through profit or loss

	Financial assets	Financial liabilities	
in € million	Hedging derivatives	Trading liabilities	Hedging derivatives
Balance at 1.1.2015	**75**	**2**	**6**
Profit or loss	−4	−1	4
Transfers into level 3	–	–	6
Transfers out of level 3	−27	−1	–
Balance at 31.12.2015	**44**	**–**	**16**
Balance at 1.1.2016	**44**	**–**	**16**
Profit or loss	−4	–	5
Balance at 31.12.2016	**40**	**–**	**21**

The earnings contributions made by trading liabilities are presented under net trading income, whereas the effects of hedging derivatives recognised in profit or loss are reported under net income from hedging relationships.

Assets and Liabilities According to Measurement Categories and Classes

The carrying amounts reflect the maximum on balance sheet exposure to credit default risk of the assets.

Asset and liabilities according to measurement categories and classes in accordance with IAS 39

in € million	31.12.2016	31.12.2015
Assets		
Loans and receivables (LaR)	53,160	54,995
Available for sale (AfS)	3,311	3,521
Held for trading (HfT)	1,089	1,600
Cash reserve	1,136	1,265
Claims from finance lease agreements	233	231
Positive fair values from hedging derivatives	3,492	4,960
Liabilities		
Held for trading (HfT)	1,355	1,643
Financial liabilities at amortised cost	54,417	57,140
Negative fair values from hedging derivatives	3,719	4,818

76 Past Due but Not Impaired Assets

The following table shows the total portfolio of the partly or completely past due but not impaired loans and advances as of 31 December 2015 and as of 31 December 2014. However, no specific allowances were made for these assets respectively the underlying collaterals as pbb Group does not consider that there is any issue regarding their recoverability. Such timing issues in receipts of payments due occur regularly (up to three months) in the normal course of business and are not considered to be an evidence for impairment.

LaR Assets

Carrying amounts of past due but not impaired LaR assets

in € million	31.12.2016	31.12.2015
up to 3 months	1	10
more than 3 months to 6 months	–	2
more than 6 months to 1 year	1	–
more than 1 year	5	12
Total	**7**	**24**

Carrying amounts LaR assets before allowances

in € billion	31.12.2016	31.12.2015
Carrying amount of LaR assets that are neither impaired nor past due	52.7	54.5
Carrying amount of LaR assets that are past due but not impaired (total investment)	–	–
Carrying amount of individually assessed impaired LaR assets (net)	0.3	0.5
Balance of specific allowances	0.1	0.1
Balance of portfolio-based allowances	0.1	–
Total	**53.2**	**55.1**
Thereof: Loans and advances to other banks (including investments)	2.8	2.7
Loans and advances to customers (including investments)	40.9	41.0
Financial investments (gross)	9.5	11.4

The carrying amount of assets that would otherwise be past due or impaired and whose terms have been renegotiated amounted to €28 million (2015: €11 million).

The fair value of collaterals for the impaired financial assets amounted to approximately €0.3 billion (2015: €0.4 billion). The collaterals mainly consist of land charges.

AfS Assets

As of 31 December 2016 and as of 31 December 2015 pbb Group had neither past due and not impaired nor impaired AfS financial investments in the portfolio.

77 Restructured Loans and Advances

In the financial years 2016 and 2015, restructuring agreements mainly related to standstill agreements and to the discontinuation of contractual arrangements.

Restructured loans and advances

in € million	31.12.2016	31.12.2015[1)]
Carrying amount of loans and advances that are neither impaired nor past due	27	223
Carrying amount of loans that are past due but not impaired (gross)	4	5
Carrying amount of individually assessed impaired loans and advances (gross)	310	482
Total	**341**	**710**

[1)] Adjusted according to IAS 8.14 et seq. Details are disclosed in Note "Consistency".

Proportion of restructured loans and advances in the total portfolio

in %	31.12.2016	31.12.2015
Proportion of restructured loans and advances in the total portfolio	0.8	1.6

Allowances for losses on restructured loans and advances

in € million	31.12.2016	31.12.2015[1)]
Specific allowances	74	94
Portfolio-based allowances	2	3
Total	**76**	**97**

[1)] Adjusted according to IAS 8.14 et seq. Details are disclosed in Note "Consistency".

Proportion of allowances for losses in the restructured loans and advances portfolio

in %	31.12.2016	31.12.2015[1)]
Proportion of allowances for losses in the restructured loans and advances portfolio	22.3	13.7

[1)] Adjusted according to IAS 8.14 et seq. Details are disclosed in Note "Consistency".

78 Netting of Financial Instruments

The following tables show the gross carrying amounts of recognised financial assets respectively liabilities, the gross carrying amounts of the items offset in the statement of financial position and the net amounts of the financial assets and liabilities recognised in the statement of financial position. They also show the rights of set-off that did not lead to an offsetting in the statement of financial position, the collateral received for financial assets, the collateral pledged for financial liabilities and the net amounts of financial assets and liabilities remaining following the application of the netting agreements and deduction of the collateral.

Gross Carrying Amounts of the Items offset in the Statement of Financial Position

During the year under review, new positions in derivative contracts were settled through Eurex Clearing. In addition, derivatives held in pbb's portfolio have been transferred to Eurex Clearing. On-balance sheet netting – to the extent permissive for such derivatives – led to a reduction in total assets of €1.8 billion as at 31 December 2016.

Netting Agreements

pbb Group routinely enters into standardised bilateral netting agreements in the derivatives business to minimise the legal risk as well as the economic and regulatory counterparty default risk. The national respectively international agreements used are the German Master Agreement for Financial Futures and the ISDA Master Agreement issued by the International Swaps and Derivatives Association. The derivatives cannot be offset in the statement of financial position since their conditions are not identical (e.g. different terms or currency underlyings).

Collateral

In addition, pbb Group also enters into collateral agreements to hedge the net receivables and net liabilities arising following offsetting according to the netting agreements (collateral received or pledged). The collateral used is primarily cash collateral; however, securities are sometimes also used by way of title transfer. The collateral agreements likewise cannot be offset against the derivatives.

Netting of financial instruments as of 31 December 2016

in € billion	Gross carrying amounts of recognised financial assets/liabilities	Gross carrying amounts of the items offset in the statement of financial position	Net amounts presented in the statement of financial position	Rights of set-off that did not lead to an offsetting in the statement of financial position	Received respectively pledged collateral	Remaining net
Financial assets	**6.4**	**1.8**	**4.6**	**3.0**	**1.1**	**0.5**
Positive fair values of derivatives	6.4	1.8	4.6	3.0	1.1	0.5
Financial liabilities	**6.9**	**1.8**	**5.1**	**3.0**	**2.0**	**0.1**
Negative fair values of derivatives	6.9	1.8	5.1	3.0	2.0	0.1

Netting of financial instruments as of 31 December 2015

in € billion	Gross carrying amounts of recognised financial assets/liabilities	Gross carrying amounts of the items offset in the statement of financial position	Net amounts presented in the statement of financial position	Rights of set-off that did not lead to an offsetting in the statement of financial position	Received respectively pledged collateral	Remaining net
Financial assets	**6.6**	**–**	**6.6**	**4.8**	**1.4**	**0.4**
Positive fair values of derivatives	6.6	–	6.6	4.8	1.4	0.4
Financial liabilities	**6.5**	**–**	**6.5**	**4.8**	**1.6**	**0.1**
Negative fair values of derivatives	6.5	–	6.5	4.8	1.6	0.1

OTHER NOTES

79 Contingent Liabilities and Other Commitments

Contingent liabilities and other commitments

in € million	31.12.2016	31.12.2015
Contingent liabilities	**171**	**184**
Guarantees and warranties	171	184
Performance guarantees and warranties	171	184
Other commitments	**3,802**	**2,946**
Irrevocable loan commitments	3,802	2,946
Guarantees	23	23
Mortgage and public sector loans	3,779	2,923
Commitments from bank levies	**11**	**8**
Collateral pledged	11	8
Total	**3,984**	**3,138**

For pbb Group irrevocable loan commitments form the largest part of other commitments. Irrevocable oan commitments comprise all commitments of a creditor which can grant a loan and advance at a later date and which can cause a credit risk. These are mainly credit commitments which are not fully drawn.

Contingent liabilities and other commitments represent the maximum default risk within the meaning of IFRS 7.

80 Leases

Operate Lease as a Lessee

pbb Group is a lessee in the context of operate lease agreements. Non-terminable operate lease agreements for land and buildings as well as for operating and business equipment existed as of 31 December 2016 and as of 31 December 2015.

Future minimum lease payments by maturities

in € million	31.12.2016	31.12.2015[1)]
up to 1 year	7	6
more than 1 year to 5 years	14	20
more than 5 years	2	4
Total	**23**	**30**

[1)] Corrections were made to the future minimum lease payments as at 31 December 2015 according to IAS 8.42, due to erroneous determinations. Prior to the correction, the value of payments within the maturity band of up to 1 year was € 11 million, the value of payments within the maturity band of more than 1 year to 5 years was € 39 million, and the value of payments within the maturity band of more than 5 years was € 21 million. Hence, the total value of the future minimum lease payments as at 31 December 2015 – as disclosed in these notes – declined by € 41 million.

Operating lease agreements concluded by pbb Group were made on an arm's-length basis and are mainly related to the rental of land and buildings. The agreements include partial renewal options that the lease can be extended for several periods, and price escalation clauses in the form of tepped rents or indexation clauses as well as release clauses. Rental expenses including incidental rental costs amounted to €6 million (2015: €7 million).

Finance Lease as a Lessor

Reconciliation

in € million	31.12.2016	31.12.2015
Gross investment	**271**	**273**
Unearned finance income	–38	–42
Net investment/present value of minimum lease payments	**233**	**231**

Allocation by maturities

in € million	31.12.2016	31.12.2015
Gross investment	**271**	**273**
up to 1 year	11	11
1 year to 5 years	61	56
5 years and over	199	206
Present value of minimum lease payments	**233**	**231**
up to 1 year	7	7
1 year to 5 years	46	41
5 years and over	180	183

Finance lease agreements resulted from setting up the financing for an office building as a finance lease.

81 Key Regulatory Capital Ratios

The Management Board manages the Group's capitalisation, based on regulatory capital ratios in accordance with the CRR and additional regulations announced by the ECB (Supervisory Review and Evaluation Process – "SREP").

Based on the results of the analysis as well as using benchmark comparison, the ECB may impose minimum capitalisation or liquidity requirements, over and above existing regulatory requirements. As a key result of SREP, a minimum common equity tier 1 (CET1) ratio of 10.75% was set for pbb Group in 2016, which the Group complied with at all times during the year under review. A limit system was used to ensure ongoing compliance with the prevailing SREP ratio. A "traffic light" system and regular reporting within the Group Risk Report ensure that any potential shortfall can be detected at an early stage, and that senior management can be informed accordingly.

Toward the end of the year, the ECB notified pbb Group of the regular annual re-determination of minimum capital requirements for 2017: with effect from 1 January 2017, pbb Group has been required to maintain a minimum CET1 ratio of 9.00% (excluding the countercyclical capital buffer, which varies according to country, and hence, for specific portfolios – as at 31 December 2016, it stood at 0.08%). This capital requirement is based on the Basel III transitional rules and comprises a Pillar 1 minimum capital requirement (4.50%), a Pillar 2 capital requirement (3.25%) and the capital conservation buffer (1.25% phased-in for 2017). The minimum, fully phased-in CET1 ratio (valid from 2019 onwards, following expiration of transitional provisions) will be 10.25%, assuming a constant

Pillar 2 capital requirement and excluding the countercyclical capital buffer. The CET1 minimum capital requirement that applies for 2017 also represents the threshold for mandatory calculation of a so-called maximum distributable amount (MDA). This generally limits distributions to the CET1 capital, new performance-based remuneration, and interest payments on additional Tier 1 capital.

Under the newly-introduced own funds requirement, introduced with effect from 1 January 2017, pbb Group has been required to maintain an own funds ratio of 12.50% (excluding the countercyclical capital buffer, which varies according to country, and hence, for specific portfolios – as at 31 December 2016, it stood at 0.08%). It is based on the Basel III transitional rules and comprises a Pillar 1 minimum own funds requirement (8.00%), a Pillar 2 capital requirement (3.25%) and the capital conservation buffer (1.25% phased-in for 2017). The minimum, fully phased-in own funds ratio (valid from 2019 onwards, following expiration of transitional provisions) will be 13.75%, assuming a constant Pillar 2 capital requirement and excluding the countercyclical capital buffer.

Own funds

in € million	31.12.2016[1]	31.12.2016 Basel III fully phased-in[1)2)]	31.12.2015 Basel III[3]	31.12.2015 Basel III fully phased-in[2)3)]
CET1	2,553	2,492	2,533	2,439
Additional Tier 1	186	–	209	–
Tier 1	2,739	2,492	2,742	2,439
Tier 2	366	216	398	231
Own funds	**3,105**	**2,708**	**3,140**	**2,670**

1) After confirmation of the 2016 financial statements, less the proposed dividend (subject to approval by the Annual General Meeting).
2) After expiry of all Basel III transitional regulations.
3) After confirmation of the 2015 financial statements and appropriation of profits.

Risk-weighted assets (RWA)[1]

in € million	31.12.2016	31.12.2016 Basel III fully phased-in[2]	31.12.2015 Basel III	31.12.2015 Basel III fully phased-in[2]
Market risks	346	346	70	70
Thereof interest rate risks	–	–	–	–
Thereof foreign exchange risks	346	346	70	70
Operational risks	866	866	795	795
Credit risks	11,760	11,760	12,371	12,371
Thereof CVA charge	312	312	374	374
Other RWA	141	141	166	166
RWA total	**13,113**	**13,113**	**13,402**	**13,402**

1) Including weighted credit risk positions and capital charges for market risk positions and operational risk, using a scaling factor of 12.5.
2) After expiry of all Basel III transitional regulations.

Capital ratios

in %	31.12.2016[1]	31.12.2016 Basel III fully phased-in[1][2]	31.12.2015 Basel III[3]	31.12.2015 Basel III fully phased-in[2][3]
CET1 Ratio	19.5	19.0	18.9	18.2
Tier 1 Ratio	20.9	19.0	20.5	18.2
Own Funds Ratio	23.7	20.7	23.4	19.9

[1] After confirmation of the 2016 financial statements and appropriation of profits, less the proposed dividend (subject to approval by the Annual General Meeting).
[2] After expiry of all Basel III transitional regulations.
[3] After confirmation of the 2015 financial statements and appropriation of profits.

82 Group Auditors' Fee

Group auditors' fee

in € thousand	2016	2015[1]
Audit	1,889	2,564
Other assurance services	191	178
Tax advisory services	–	–
Other non-audit services	217	232
Total	**2,297**	**2,974**

[1] According to IDW RS HFA 36 (amended) dated 8 September 2016, auditors' fees for the review of interim financial statements were recognised within the "audit" item instead of the "other assurance services" item.

The table shows fees to the Group auditor KPMG AG Wirtschaftsprüfungsgesellschaft.

83 Related Parties Disclosures

According to IAS 24 (Related-Party Disclosures), a party is related to an entity if, directly or indirectly through one or more intermediaries, the party controls or is controlled by the reporting entity, has an interest in the entity that gives it significant influence over the entity or has joint control over the entity as well as associates and joint ventures. In addition, retirement benefit schemes for postemployment benefits for employees are also included under related parties.

Related Entities
Hypo Real Estate Holding GmbH's (HRE Holding's) share in pbb stood at 20.0% as at 31 December 2016 (31 December 2015: 20.0%). pbb Group considers HRE Holding, as well as all other entities that were subject to the control, joint control or significant influence of the Federal Republic of Germany, as related parties within the meaning of IAS 24.

pbb is party to an underwriting agreement entered into between pbb, HRE Holding and the syndicate banks supporting the flotation. HRE Holding has undertaken, as part of pbb's privatisation process, to hold at least 20% of pbb's share capital for a period of at least two years after the flotation.

Income and expenses as well as receivables and liabilities generated/incurred in connection with HRE Holding were of minor significance in the financial years 2016 and 2015.

Under the current law, expenses incurred in the context of pbb's privatisation have to be borne by the seller, HRE Holding.

As at 31 December 2016, pbb Group recognised liabilities (after netting of receivables) towards DEPFA in the amount of €99 million (31 December 2015: €161 million). Net interest income generated with DEPFA amounted to €–13 million (2015: €–13 million), while the net income from hedging relationships stood at €–18 million (2015: €16 million).

As at 31 December 2016 and 31 December 2015, there were no loans and advances or liabilities to non-consolidated subsidiaries. As at the reporting date, pbb Group had loans and advances to associates not accounted for using the equity method in the amount of €31 million (31 December 2015: €39 million) and unchanged no liabilities to such associates.

On 31 December 2016 liabilities to defined contribution plans amounted to €1 million (31 December 2015: €2 million).

Related Persons
pbb Group defines related persons as the members of the Management Board and the Supervisory Board, plus pbb's second-level managers and members of senior management of pbb's subsidiaries, as well as close members of their families and affiliated enterprises.

Total remuneration of former members of the Board of Managing Directors and their surviving dependants amounted to €5,010 thousand for 2016 (2015: €5,067 thousand). Remuneration for the Supervisory Board totalled €668 thousand (2015: €384 thousand) during the year under review. This comprised exclusively fixed remuneration.

There were no claims against related parties from loans or advances on the balance sheet date.

Vested remuneration claims of persons holding key positions within the Group (senior management)[1)]

in € thousand	2016						2015
	Short-term benefits	Post-employment benefits	Other long-term benefits	Termination benefits	Share-based payments	**Total**	**Total**
Total	**9,410**	**2,209**	**344**	**–**	**574**	**12,537**	**10,722**

[1)] Reporting follows the "vesting principle", disclosing those remuneration components which were vested during the relevant 2016 reporting period.

Pension obligations to persons holding key positions within pbb Group (senior management)

in € thousand	**31.12.2016**	**31.12.2015**
Total[1)]	**82,484**	**79,226**

[1)] Including €64,731 thousand (2015: €65,034 thousand) for pensioners and their surviving dependants.

Disclosure by pbb Pursuant to Section 314 Nos. 6 a and 6 b of the HGB, by Groups of Individuals

Remuneration paid to Management Board members of pbb

in € thousand	2016[1)]	
	Remuneration	**Total**
Management Board members who were in office during the financial year 2016	3,068	3,068
Management Board members who retired prior to the financial year 2016	–	–
Total	**3,068**	**3,068**

[1)] A remuneration of €2,172 thousand was paid to Management Board members who were in offce during the 2015 financial year. As in 2015, retired Management Board members did not receive any remuneration in the 2016 financial year.

Provisions for pensions

in € thousand	2016[1)]	
	Additions	**Total**
Management Board members who were in office during the financial year 2016	2,240	3,948
Management Board members who retired prior to the financial year 2016	–303	64,731
Total	**1,937**	**68,679**

[1)] Provisions for pensions recognised for Management Board members who were in office during the financial year 2015 amounted to €1,708 thousand. Provisions for pensions recognised for Management Board members who retired prior to the 2015 financial year amounted to €65,034 thousand as at 31 December 2015.

Remuneration paid to Supervisory Board members

in € thousand	2016[1)] Total fixed remuneration
Supervisory Board members who were in office during the financial year 2016	668
Supervisory Board members who retired prior to the financial year 2016	–
Total	**668**

[1)] Remuneration paid to Supervisory Board members who were in office during the 2015 financial year totalled €384 thousand. As in 2015, Supervisory Board members who retired prior to the 2016 financial year did not receive any remuneration in the 2016 financial year.

The remuneration of the members of the Management Board and the Supervisory Board (including the corresponding tables) is disclosed in the remuneration report on an individual basis. Members of pbb's Supervisory Board did not receive any remuneration for services rendered in person during 2016. As at 31 December 2016, there were no claims against Supervisory Board members who were in office on the balance sheet date.

Statement According to Article 19 MMVO in Connection with Section 15a WpHG
According to the pbb's knowledge, the members of the Management Board and the Supervisory Board as well as persons closely related to these members did not hold any shares of the Company in a reportable extent as at 31 December 2016 or 31 December 2015. In the years 2016 and 2015, according to the Company's knowledge, no pbb shares or derivatives relating to such shares in a reportable extend were acquired or sold by members of the Management Board and the Supervisory Board or by persons closely related to such members.

84 Employees

Average number of employees

	2016	2015
Employees (excluding apprentices)	801	832
Thereof: senior staff in Germany	17	17
Total	**801**	**832**

85 Members of the Supervisory Board and of the Management Board

Supervisory Board of pbb in financial year 2016

Name and place of residence Function in Supervisory Board	**Principal occupation** Functions in the Committees of the Supervisory Board	**Supervisory Board memberships and other directorships**
Dr Günther Bräunig Frankfurt/Main, Germany Chairman	**Member of the Management Board of KfW** Chairman of the Executive and Nomination Committee and of the Remunaration Committee, Member of the Audit Committee and of the Risk Management and Liquidity Strategy Committee	**True Sale International GmbH, Frankfurt/Main, Germany** – Chairman of the Shareholder's Advisory Board
Dagmar Kollmann Vienna, Austria Deputy Chairperson	**Entrepreneur** Chairperson of the Audit Committee and Member of the Executive and Nomination Committee, of the Risk Management and Liquidity Strategy Committee and of the Remunaration Committee	**Deutsche Telekom AG, Bonn, Germany** – Member of the Supervisory Board **KfW IPEX-Bank GmbH, Frankfurt/Main, Germany** – Member of the Supervisory Board **Bank Gutmann AG, Vienna, Austria** – Member of the Supervisory Board **Unibail-Rodamco SE, Paris, France** – Member of the Supervisory Board
Dr Thomas Duhnkrack Kronberg/Taunus, Germany Member	**Entrepreneur** Member of the Audit Committee (since 13.5.2016)	**Hauck & Aufhäuser Privatbankiers KGaA, Frankfurt/Main, Germany** – Member of the Supervisory Board **Lloyd Fonds AG, Hamburg, Germany** – Deputy Chairman of the Supervisory Board
Dr Christian Gebauer-Rochholz Hochheim, Germany Employee Representative	**Bank employee**	–
Georg Kordick Poing, Germany Employee Representative	**Bank employee**	–
Joachim Plesser Ratingen, Germany Member	**Consultant** Chairman of the Risk Management and Liquidity Strategy Committee, Member of the Executive and Nomination Committee, of the Audit Committee (until 13.5.2016) and of the Remunaration Committee	**Commerz Real Investmentgesellschaft mbH, Wiesbaden, Germany** – Member of the Supervisory Board **DIC Beteiligungs AG, Frankfurt/Main, Germany** – Member of the Supervisory Board **GEG German Estate Group AG, Frankfurt/Main, Germany** – Member of the Supervisory Board **Pandion AG, Cologne, Germany** – Chairman of the Supervisory Board
Oliver Puhl Frankfurt/Main, Germany Member (since 13.5.2016)	**Entrepreneur** Member of the Risk Management and Liquidity Strategy Committee (since 13.5.2016)	–
Heike Theißing Munich, Germany Employee Representative	**Bank employee** Member of the Remunaration Committee	–
Dr Hedda von Wedel Andernach, Germany Member	**Deputy Chairperson of Transparency International Deutschland e.V. (until 11.6.2016)** Member of the Audit Committee and of the Risk Management and Liquidity Strategy Committee	–

Management Board of pbb in financial year 2016

Name and place of residence	Function in the Management Board	Supervisory Board memberships and other directorships
Andreas Arndt Munich, Germany	CEO/CFO (since 12.5.2016) Co-CEO/CFO (until 12.5.2016)	–
Thomas Köntgen Frankfurt/Main, Germany	Deputy CEO, Real Estate Finance/Treasury (since 12.5.2016) Co-CEO/Treasury (until 12.5.2016)	–
Andreas Schenk Dreieich, Germany	CRO	–
Dr Bernhard Scholz Regensburg, Germany	Credit Markets/Public Investment Finance (since 12.5.2016) Real Estate Finance/Public Investment Finance (until 12.5.2016)	–

86 Holdings of pbb

Holdings of pbb as of 31 December 2016

Additional statement according to HGB Name Place of business and country	Purpose of business	Interest in % Total (Sec 16 (4) Aktiengesetz)	Interest in % Of which held indirectly	Differing voting rights in %	Currency	Equity in thousands	Net income/loss in thousands
Consolidated companies							
Hypo Real Estate Capital India Corp. Private Ltd. i. L.[1] Mumbai, India	in liquidation	100.00	–	–	INR	–	–36
Hypo Real Estate Capital Japan Corp. i. L. [1] Tokyo, Japan	in liquidation	100.00	–	–	JPY	7,049,554	1,563,297
Hypo Real Estate International LLC I[1] Wilmington, USA	Funding	100.00	–	–	EUR	9,348	9,322
Hypo Real Estate International Trust I[1] Wilmington, USA	Funding	100.00	–	–	EUR	–7,473	51,977
IMMO Immobilien Management GmbH & Co. KG Munich, Germany	Real estate company	100.00	–	–	EUR	535	226
IMMO Invest Real Estate GmbH[2] Munich, Germany	Salvage acquisition	100.00	–	–	EUR	8,448	–
Ragnarök Vermögensverwaltung AG & Co. KG[3] Munich, Germany	Real estate company	100.00	6.00	–	EUR	975	–310
RPPSE Espacio Oviedo S.L.U.[1] Madrid, Spain	Salvage acquisition	100.00	100.00	–	EUR	–7,348	–11,163
Non-consolidated companies due to minor significance							
Immo Immobilien Management Beteiligungsgesellschaft mbH Munich, Germany	Real estate company	100.00	–	–	EUR	25	1
Associated companies not measured at equity due to minor significance							
SANO Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Dresden KG[1] Dusseldorf, Germany	Model of bank holding	33.33	–	25.00	EUR	–2,108	634
SOMA Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Darmstadt KG[1] Dusseldorf, Germany	Model of bank holding	33.33	–	25.00	EUR	–11,524	177
WISUS Beteiligungs GmbH & Co. Zweite Vermietungs-KG[1][4] Munich, Germany	Model of bank holding	33.00	–	24.44	EUR	–1,210	392

[1] Financial figures from the financial year 2015.
[2] Profit transfer by shareholders on the basis of profit and loss transfer agreement.
[3] General partner liability (Komplementärhaftung) of pbb.
[4] In accordance with section 264 b HGB the annual financial statement was not published.

Exchange rates

1 € corresponds to		31.12.2016
India	INR	71.5935
Japan	JPY	123.4000

87 Country-by-Country Reporting

The requirements of Article 89 of EU Directive 2013/36/EU (Capital Requirements Directive CRD IV) concerning to so-called Country-by-Country Reporting were endorsed in German law by Section 26a KWG (German Banking Act). In financial years 2016 and 2015 no entity respectively no branch of pbb received public subsidies. On 31 December 2016, the ratio of net profit and total balance sheet of pbb Group was 0.3%. The further figures required by Section 26a KWG are disclosed in the following table:

Country-by-Country Reporting (Additional statement according to Section26a KWG) 31 December 2016

Type of business Name and place of business	Country	Number of employees[1]	Turnover[2)3)] (in € million)	Income/loss before tax[3)] (in € million)	Income taxes[3)] (in € million)
Deposit taking credit institution					
Deutsche Pfandbriefbank AG, Munich	Germany	622	446	263	–81
Branch of a deposit taking credit institution					
Deutsche Pfandbriefbank AG, London branch	United Kingdom	64	27	14	–2
Deutsche Pfandbriefbank AG, Madrid branch	Spain	13	1	–1	–
Deutsche Pfandbriefbank AG, Paris branch	France	46	28	15	–20
Deutsche Pfandbriefbank AG, Stockholm branch	Sweden	10	7	5	–1
Financial corporation					
Hypo Real Estate Capital Japan Corp., Tokyo	Japan	2	–	–1	–
Hypo Real Estate International LLC I, Wilmington	USA	–	–	–	–
Hypo Real Estate International Trust I, Wilmington	USA	–	–	–	–
Provider of ancillary services					
IMMO Invest Real Estate GmbH, Munich	Germany	–	6	6	–
IMMO Immobilien Management GmbH & Co. KG, Munich	Germany	–	–	–	–
Ragnarök Vermögensverwaltung AG & Co. KG, Munich	Germany	–	–	–	–
Other corporations					
Hypo Real Estate Capital India Corp. Private Ltd. i.L., Mumbai	India	–	–	–	–
RPPSE Espacio Oviedo S.L.U., Madrid	Spain	–	4	4	–

[1)] Full-time equivalents not including apprentices, interns/working students and short-term employees with fixed terms < 1 year.
[2)] Operating income as turnover equivalent.
[3)] Figures before consolidation.

88 Report on Post-balance Sheet Date Events

On 13 January 2017, DBRS revised the status of subordinated debenture bonds of 27 European banks, including those of pbb, setting them to "Under Review with Negative Implications". The rating agency expects a rating downgrade by one notch, on the grounds that the probability of losses under BRRD has increased for all subordinated debt. The review is due to be concluded within the next 90 days.

No further significant events occured after 31 December 2016.

Munich, 7 March 2017

Deutsche Pfandbriefbank AG
The Management Board

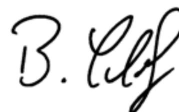
Andreas Arndt **Thomas Köntgen** **Andreas Schenk** **Dr Bernhard Scholz**

Responsibility Statement

To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Group management report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the material opportunities and risks associated with the expected development of the Group.

Munich, 7 March 2017

Deutsche Pfandbriefbank AG
The Management Board



Andreas Arndt **Thomas Köntgen** **Andreas Schenk** **Dr Bernhard Scholz**

Auditor's Report

We have audited the consolidated financial statements prepared by the Deutsche Pfandbriefbank AG, Munich, comprising Consolidated Statement of Financial Position, Consolidated Income Statement, Consolidated Statement of Comprehensive Income, Consolidated Statement of Changes in Equity, Consolidated Statement of Cash Flows and Notes, together with the group management report for the business year from 1 January 2016 to 31 December 2016. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB [Handelsgesetzbuch "German Commercial Code"] are the responsibility of the parent company`s management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 HGB [Handelsgesetzbuch "German Commercial Code"] and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs, as adopted by the EU, the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements, complies with the German statutory requirements, and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Munich, 7 March 2017

KPMG AG
Wirtschaftsprüfungsgesellschaft
[original German version signed by:]

Dielehner
Wirtschaftsprüfer
[German Public Auditor]

Winner
Wirtschaftsprüfer
[German Public Auditor]

ADDITIONAL INFORMATION

206 SUMMARY OF QUARTERLY AND ANNUAL FINANCIAL DATA

208 CORPORATE GOVERNANCE REPORT AND CORPORATE GOVERNANCE STATEMENT

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

217 FINANCIAL CALENDAR

217 FUTURE-ORIENTED STATEMENTS

217 IMPRINT

Summary of Quarterly and Annual Financial Data

pbb Group

in € million	2015 4th quarter	2016 1st quarter	2016 2nd quarter	2016 3rd quarter	2016 4th quarter
Operating performance					
Operating income	100	90	91	214	113
Net interest income	102	102	93	97	112
Net fee and commission income	2	2	1	2	3
Net trading income	8	-5	-2	-3	4
Net income from financial investments	–	4	1	123	-3
Net income from hedging relationships	2	1	-1	1	5
Net other operating income/expenses	-14	-14	-1	-6	-8
Loan loss provisions	-7	–	–	3	-4
General and administrative expenses	-57	-45	-49	-53	-51
Net miscellaneous income/expenses	-6	–	–	-5	-3
Profit or loss before tax	30	45	42	159	55

Real Estate Finance

in € million	2015 4th quarter	2016 1st quarter	2016 2nd quarter	2016 3rd quarter	2016 4th quarter
Operating performance					
Operating income	83	68	74	83	81
Net interest income	82	77	75	82	87
Net fee and commission income	2	2	1	2	4
Net trading income	7	-5	-2	1	4
Net income from financial investments	–	3	–	–	–
Net income from hedging relationships	1	–	–	1	2
Net other operating income/expenses	-9	-9	–	-3	-16
Loan loss provisions	-7	–	–	-6	8
General and administrative expenses	-44	-36	-37	-41	-42
Net miscellaneous income/expenses	-5	–	–	-4	-2
Profit or loss before tax	27	32	37	32	45

Public Investment Finance

in € million	2015 4th quarter	2016 1st quarter	2016 2nd quarter	2016 3rd quarter	2016 4th quarter
Operating performance					
Operating income	14	9	9	5	7
Net interest income	16	9	9	7	10
Net fee and commission income	–	–	–	–	–
Net trading income	–	–	–	-1	–
Net income from financial investments	-1	–	1	–	–
Net income from hedging relationships	1	1	-1	–	1
Net other operating income/expenses	-2	-1	–	-1	-4
Loan loss provisions	–	–	–	–	–
General and administrative expenses	-8	-6	-7	-7	-6
Net miscellaneous income/expenses	-1	–	–	-1	–
Profit or loss before tax	5	3	2	-3	1

Value Portfolio

in € million	2015 4th quarter	2016 1st quarter	2016 2nd quarter	2016 3rd quarter	2016 4th quarter
Operating performance					
Operating income	1	11	8	125	21
Net interest income	2	14	8	7	12
Net fee and commission income	–	–	–	–	–1
Net trading income	1	–	–	–3	–
Net income from financial investments	1	1	–	123	–3
Net income from hedging relationships	–	–	–	–	2
Net other operating income/expenses	–3	–4	–	–2	11
Loan loss provisions	–	–	–	9	–12
General and administrative expenses	–5	–3	–5	–5	–3
Net miscellaneous income/expenses	–	–	–	–	–1
Profit or loss before tax	–4	8	3	129	5

Consolidation & Adjustments

in € million	2015 4th quarter	2016 1st quarter	2016 2nd quarter	2016 3rd quarter	2016 4th quarter
Operating performance					
Operating income	2	2	–	1	4
Net interest income	2	2	1	1	3
Net fee and commission income	–	–	–	–	–
Net trading income	–	–	–	–	–
Net income from financial investments	–	–	–	–	–
Net income from hedging relationships	–	–	–	–	–
Net other operating income/expenses	–	–	–1	–	1
Loan loss provisions	–	–	–	–	–
General and administrative expenses	–	–	–	–	–
Net miscellaneous income/expenses	–	–	–	–	–
Profit or loss before tax	2	2	–	1	4

Summary of annual financial data

in € million	2014	2015	2016
Operating performance			
Operating income	326	400	508
Net interest and commission income	422	440	412
Net interest income	421	426	404
Net fee and commission income	1	14	8
Net trading income	–30	15	–6
Net income from financial investments	–77	–32	125
Net income from hedging relationships	–3	11	6
Net other operating income/expenses	14	–34	–29
Loan loss provisions	–21	1	–1
General and administrative expenses	–251	–207	–198
Net miscellaneous income/expenses	–	1	–8
Profit or loss before tax	54	195	301

Corporate Governance Report and Corporate Governance Statement

DECLARATION OF COMPLIANCE WITH THE GERMAN CORPORATE GOVERNANCE CODE, PURSUANT TO SECTION 161 OF THE AKTG

Deutsche Pfandbriefbank AG ("pbb") has been a listed company since 16 July 2015, and has been subject to disclosure duties under section 161 of the AktG since then. Its first-time Declaration of Compliance with the German Corporate Governance Code (the "Code") dated 14 August 2015, as well as all subsequent Declarations of Compliance, are available on the company's website: https://www.pfandbriefbank.com/en/investor-relations/mandatory-publications.html. The most recent Declaration of Compliance issued by the Management Board and the Supervisory Board was dated 26 February 2016.

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

Accordingly, the Management Board and the Supervisory Board of pbb declare that pbb complied with the recommendations of the Government Commission "German Corporate Governance Code" (as amended on 5 May 2015 as well as based on the future wording, as amended on 7 February 2017, which has not yet been published in the German Federal Gazette) during the 2016 financial year, and continues to do so.

Munich, 24 March 2017

The Management Board The Supervisory Board

CORPORATE GOVERNANCE REPORT

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

Recommendations of the German Corporate Governance Code

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

Description of Management Board and Supervisory Board work processes

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

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

Management Board

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

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

> Andreas Arndt: Co-CEO and CFO (until 11 May 2016) – CEO and CFO (since 12 May 2016)
> Thomas Köntgen: Co-CEO and Treasurer (until 11 May 2016) – Deputy CEO, Real Estate Finance/Treasurer (since 12 May 2016)
> Andreas Schenk: CRO
> Dr Bernhard Scholz: Real Estate Finance and Public Investment Finance (until 11 May 2016) – Credit Markets and Public Investment Finance (since 12 May 2016)

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

pbb does not grant any loans to Management Board members.

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

Supervisory Board

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

The Annual General Meeting on 13 May 2016 re-elected existing shareholder representatives, and elected Oliver Puhl as a member of the Supervisory Board for the first time. Prior to the Annual General Meeting, staff had already re-elected employee representatives to the Supervisory Board in April. The current terms of office of shareholders' representatives on the Supervisory Board will end upon the close of the Annual General Meeting in 2021, which resolves on the formal approval for the 2020 financial year – with one exception: Dr Hedda von Wedel's term of office will end upon the close of the Annual General Meeting in 2018, which resolves on the formal approval for the 2017 financial year. The next regular elections of employee representatives to the Supervisory Board are scheduled to take place in 2021.

At its constituting meeting on 13 May 2016, the Supervisory Board re-elected Dr Günther Bräunig as its Chairman, and Dagmar Kollmann as his deputy.

During the financial year 2016, the company's Supervisory Board comprised:

Supervisory Board of pbb in financial year 2016

Name and place of residence Function in Supervisory Board	**Principal occupation** Functions in the Committees of the Supervisory Board	**Supervisory Board memberships and other directorships**
Dr Günther Bräunig Frankfurt/Main, Germany Chairman	**Member of the Management Board of KfW** Chairman of the Executive and Nomination Committee and of the Remunaration Committee, Member of the Audit Committee and of the Risk Management and Liquidity Strategy Committee	**True Sale International GmbH, Frankfurt/Main, Germany** – Chairman of the Shareholder's Advisory Board
Dagmar Kollmann Vienna, Austria Deputy Chairperson	**Entrepreneur** Chairperson of the Audit Committee and Member of the Executive and Nomination Committee, of the Risk Management and Liquidity Strategy Committee and of the Remunaration Committee	**Deutsche Telekom AG, Bonn, Germany** – Member of the Supervisory Board **KfW IPEX-Bank GmbH, Frankfurt/Main, Germany** – Member of the Supervisory Board **Bank Gutmann AG, Vienna, Austria** – Member of the Supervisory Board **Unibail-Rodamco SE, Paris, France** – Member of the Supervisory Board
Dr Thomas Duhnkrack Kronberg/Taunus, Germany Member	**Entrepreneur** Member of the Audit Committee (since 13.5.2016)	**Hauck & Aufhäuser Privatbankiers KGaA, Frankfurt/Main, Germany** – Member of the Supervisory Board **Lloyd Fonds AG, Hamburg, Germany** – Deputy Chairman of the Supervisory Board
Dr Christian Gebauer-Rochholz Hochheim, Germany Employee Representative	**Bank employee**	–
Georg Kordick Poing, Germany Employee Representative	**Bank employee**	–
Joachim Plesser Ratingen, Germany Member	**Consultant** Chairman of the Risk Management and Liquidity Strategy Committee, Member of the Executive and Nomination Committee, of the Audit Committee (until 13.5.2016) and of the Remunaration Committee	**Commerz Real Investmentgesellschaft mbH, Wiesbaden, Germany** – Member of the Supervisory Board **DIC Beteiligungs AG, Frankfurt/Main, Germany** – Member of the Supervisory Board **GEG German Estate Group AG, Frankfurt/Main, Germany** – Member of the Supervisory Board **Pandion AG, Cologne, Germany** – Chairman of the Supervisory Board
Oliver Puhl Frankfurt/Main, Germany Member (since 13.5.2016)	**Entrepreneur** Member of the Risk Management and Liquidity Strategy Committee (since 13.5.2016)	–
Heike Theißing Munich, Germany Employee Representative	**Bank employee** Member of the Remunaration Committee	–
Dr Hedda von Wedel Andernach, Germany Member	**Deputy Chairperson of Transparency International Deutschland e.V. (until 11.6.2016)** Member of the Audit Committee and of the Risk Management and Liquidity Strategy Committee	–

In accordance with section 5.4.1 of the Code, as part of its Rules of Procedure, the Supervisory Board has defined specific goals for its composition; during the current financial year, it also plans to prepare a profile of skills and expertise for the entire Board. These goals are supplemented by a catalogue of criteria for new Supervisory Board members to be appointed, based on the Company's specific requirements and the requisite professional skills and expertise. Changes in the composition of the Supervisory Board are not expected to occur prior to the end of Dr Hedda von Wedel's term of office, and the related elections at the Annual General Meeting in 2018.

As a rule, the members of the Supervisory Board should not be older than 70 years, and the term of office of a Supervisory Board member should generally end upon the close of the ordinary Annual General Meeting following their reaching the age of 70. As a rule, members of the Supervisory Board should not serve for more than three full terms of office (as defined by section 102 (1) of the AktG). At present, Supervisory Board members comply with all of these requirements, with one exception concerning the age limit (Dr Hedda von Wedel).

Moreover, the Supervisory Board should consist of independent members, in a number that the Supervisory Board considers sufficient. The Supervisory Board should also not include more than two former members of the Management Board. Former Management Board members should not chair the Supervisory Board, or one of its committees. Notwithstanding the fact that all shareholder representatives to the Supervisory Board, with the exception of Oliver Puhl, were appointed at a time when pbb was still wholly owned by HRE Holding GmbH (and thus indirectly by the Federal Republic of Germany), all members of the Supervisory Board except Dr Günther Bräunig consider themselves as independent. No former member of the Management Board currently sits on the Supervisory Board.

The Supervisory Board has determined a target ratio of 30% for the under-represented gender amongst its members. The female quota of Supervisory Board members is currently 33.3%.

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

The committees consist of the following members:

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

The members of the **Audit Committee** are:
Dagmar Kollmann (Chairperson), Dr Günther Bräunig, Dr Thomas Duhnkrack (since 13 May 2016), Joachim Plesser (until 13 May 2016) and Dr Hedda von Wedel.

The members of the **Risk Management and Liquidity Strategy Committee** are:
Joachim Plesser (Chairman), Dr Günther Bräunig, Dagmar Kollmann (until 13 May 2016), Oliver Puhl (since 13 May 2016) and Dr Hedda von Wedel.

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

The Executive and Nomination Committee concerns itself with strategic and current issues affecting the Group, as well as with matters concerning the Management Board, for which it prepares corresponding proposals for the plenary meeting. It also advises the Supervisory Board regarding issues of Management Board personnel and succession planning, the individual specifications of Management Board contracts, and submits corresponding recommendations to the Supervisory Board. In addition, the committee prepares the examination of efficiency for the Supervisory Board and its committees. Moreover, it deals with the implementation of the female quota for pbb's Supervisory Board and Management Board, and with succession of Supervisory Board offices.

The Audit Committee is concerned with all accounting issues, as well as with the audit of pbb and pbb Group. It is responsible for the preparation, and monitors the audit of the financial statements and consolidated financial statements, the interim reports, as well as the reports submitted by Internal Audit and the external auditors regarding internal and external audit findings. Moreover, the Audit Committee discusses the impact of current regulatory issues with the Management Board; it concerns itself with the mandate for the external auditors and their audit plan, submits proposals for the appointment of the external auditors to the Supervisory Board, and prepares the Supervisory Board's proposals for the election of external auditors to the Annual General Meeting. The Audit Committee is also responsible for monitoring the effectiveness of the Internal Control System and of key controls implemented; it receives regular reports on current litigation, Compliance issues, data protection and IT security, notable accounting issues, as well as the audit plan established by Internal Audit and its implementation.

The Risk Management and Liquidity Strategy Committee supports the Supervisory Board's supervision of risk management and liquidity management; it reviews the Management Board's risk reporting, and is involved in the credit approval process to the extent laid down in the Rules of Procedure. The committee also regularly discusses new business developments as well as the liquidity and funding status; it looks at all types of risks associated with the banking business, such as credit, market, liquidity and operational risks, taking the Group's risk-bearing capacity into account. The committee also concerns itself with the syndication business, foreclosures and development financings; it deals with specific allowances, the reporting of own funds in accordance with the German Solvency Regulation, country limits, and asset/liability management. In addition, it deals with individual loans requiring approval under the Internal Rules of Procedure for the Management Board, with new business, regular re-submissions and approvals for change applications.

The Remuneration Committee monitors whether remuneration systems for the Management Board and for the bank's employees are appropriate; it deals with the remuneration report, the agreement of targets for Management Board members, and for examining and determining staff having risk-taking functions.

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

In particular, the Supervisory Board held in-depth discussions on, and reviewed the plausibility of, all business transactions material to the Company on the basis of written and oral reports provided by the Management Board.

Members of the Supervisory Board shall take responsibility for any training or professional development measures that are necessary to fulfil their duties. The Company adequately supports them in this regard.

No conflicts of interest arose with respect to the members of the Supervisory Board during the year under review; in particular, no conflicts of interest arose from a consultant or directorship function with clients, suppliers, lenders or other business partners that would have required disclosure to the Supervisory Board.. To the extent that members of the Supervisory Board maintain relationships to clients and/or other banks, the Rules of Procedure for the Supervisory Board contain provisions governing the handling of any conflicts of interest.

pbb does not grant any loans to Supervisory Board members.

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

During the financial year under review, the Supervisory Board examined the efficiency of its work in line with the requirements of section 25d (11) of the KWG, drawing on external support for this purpose. The Supervisory Board discussed the results of the examination for 2015 and the proposed measures to enhance efficiency during the meeting on 26 February 2016; results and measures for 2016 were covered during the Supervisory Board meeting on 16 February 2017. Recommendations for action were deducted from the results of the evaluation for the Management Board and the Supervisory Board, and resolved accordingly.

In line with the recommendations of the Code, the Chairman of the Supervisory Board does not chair the Audit Committee: this position is held by Ms Kollmann.

When making proposals to the Annual General Meeting 2016 concerning the election of new members of the Supervisory Board, the Supervisory Board satisfied itself that the respective candidates can devote the expected amount of time required.

For further details on the work of the Supervisory Board, please refer to the Report of the Supervisory Board, which forms part of this Annual Report.

Other Disclosures Regarding Corporate Governance Standards

Transparency

Information provided by pbb on its website include all key details regarding the financial statements and consolidated financial statements, the half-yearly report, quarterly reports or statements, and the financial calendar. Within the framework of Investor Relations activities (such as analyst conferences and road shows) as well as via Corporate Communications, the Group provides additional, regular information on corporate developments. This includes mandatory disclosures such as voting rights and ad-hoc disclosures. The Corporate Governance Report (including the Declaration of Compliance with the German Corporate Governance Code) is permanently available on pbb's website.

Risk Management

Risk management and risk control are key tasks within the scope of pbb's overall bank management. Through the business and risk strategy, the Management Board sets the framework for pbb's risk appetite and risk-bearing capacity in its business activities. Monthly risk reports to the Management Board provide an extensive analysis of the bank's overall risk situation: adjustments are made where necessary. The Supervisory Board is informed about the risk situation on a regular basis, at least once a quarter.

Compliance

Transparent, fair, responsible and honest conduct – with the required degree of skills, professionalism and integrity in dealings with one other and in relation to clients and business partners, competitors and the public – provide the foundation for pbb's business success: this trust is not least based upon implementation of, and compliance with, relevant statutory, regulatory and internal rules. Besides adherence to legal and regulatory requirements, the Code of Conduct sets the internal ethical and legal framework; it serves the purpose of voluntary self-regulation and provides guidance for employees. The Code of Conduct contains the indispensable requirements which apply to all of pbb's staff. In addition, as part of the Compliance organisation, precautions have been taken to ensure compliance with data protection rules, as well as to prevent money laundering, the financing of terrorism, insider trading, and any other prohibited and/or criminal acts. Moreover, pbb's employees receive regular training courses on the prevention of money laundering and other criminal offences, and on Compliance issues.

Remuneration Report
As part of pbb's Annual Report, the Remuneration Report outlines the structure of remuneration systems for the Supervisory Board, the Management Board, and employees. This includes a description of Supervisory Board remuneration, in accordance with the Memorandum and Articles of Association; remuneration for the Management Board is broken down into monetary remuneration, ancillary benefits, and pension benefits, and shown individually for each Management Board member. For specific details regarding share option programmes and other securities-based incentive schemes the Company offers, please refer to pbb's Remuneration Report in accordance with the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – "InstVergV"), which is permanently available on the Company's website (www.pfandbriefbank.com).

Related Party Transactions
Details on transactions with related parties are provided in the management report and the notes to the financial statements, as well as in the group management report and the notes to the consolidated financial statements, respectively.

Accounting policies
pbb prepares its annual financial statements in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – "HGB"); its consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), as adopted in the European Union. The Management Board prepares the annual and consolidated financial statements. The external auditors submit their report on the audit of the annual financial statements and consolidated financial statements to the Supervisory Board. The Annual General Meeting appointed KPMG AG Wirtschaftsprüfungsgesellschaft (KPMG), as the external auditors for the 2016 financial year. Having ascertained the independence of the external auditors, the Supervisory Board appointed the external auditors and defined the focal points of the audit. Details regarding the fees paid to the external auditors are provided in the notes to the consolidated financial statements.

KPMG, the auditors of the annual and consolidated financial statements elected by the Annual General Meeting, audited the annual and consolidated financial statements of pbb as at 31 December 2016, including the management reports, and issued them with an unqualified audit opinion. The financial statements documents and audit reports were submitted to all Supervisory Board members in good time. The Audit Committee of the Supervisory Board addressed the financial statements documents in its meeting on 23 March 2017. The annual financial statements and consolidated financial statements, as well as the management reports and audit reports, were discussed in detail with the Management Board and representatives of the external auditors. Following its own review, the Supervisory Board did not raise any objections to the audit results submitted by the external auditors. The Supervisory Board meeting on 24 March 2017 approved the consolidated financial statements and adopted the annual financial statements. Details regarding the examinations carried out by the Supervisory Board, and the results of such examinations, are provided in the Report of the Supervisory Board.

Determinations pursuant to sections 76 (4) and 111 (5) of the AktG
The pbb Group assigns particular importance to gender balance issues. In particular, the Group strives to ascertain that the under-represented gender is appropriately represented when filling vacant management positions.

The Supervisory Board set the following target levels in August 2015, which are applicable until 30 June 2017, and have been met:
- Target female quota for Supervisory Board members: 30%.
- Target female quota for Management Board members: 0%.

The current target female quota for the Management Board, resolved in 2015, was set against the background of the terms of current members' service contracts.

On 31 December 2016, 33.3% of Supervisory Board members were women; the female quota of the Management Board, whose composition was unchanged during the reference period, was 0%. The service contracts for Andreas Arndt and Thomas Köntgen were renewed during 2016. In connection with filling the vacancy for a Management Board member responsible for the Treasury division, the Supervisory Board paid particular attention to female candidates throughout the selection process. However, the number of potential female candidates in this specialist field is limited overall. Key aspects for the decision for a particular candidate were the professional skills in this specialist field, and the candidate's network of market relationships. With Marcus Schulte, pbb attracted a renowned expert with extensive knowledge and many years of experience, as well as a very strong international network with banks and investors. Mr Schulte joined pbb on 1 January 2017, initially as a Senior General Manager. Following the customary introduction phase in line with regulatory requirements, he is set to assume responsibility for the Treasury division at Management Board level. The Supervisory Board maintains its endeavours to ensure the under-represented gender is appropriately represented when filling vacancies on the Management Board, in a targeted manner – given candidates have the requisite skills and qualifications. At present, the Supervisory Board is targeting a female quota for the Management Board of 20% beyond 30 June 2017. However, in view of the terms of renewed service contracts, and considering the introduction phase for Marcus Schulte, prior to his planned appointment to the Management Board, to assume responsibility for the Treasury division, a change of the present situation is currently not expected.

The Management Board already set target female quotas for the first and second management levels below the Management Board in June 2015; the Management Board aims to achieve these targets by 30 June 2017:

- Target female quota for the first management level below the Management Board: 15%.
- Target female quota for the second management level below the Management Board: 15%.

On 31 December 2016, 11% of first-level managers and 9% of second-level managers were women. pbb has decided to set an ambitious target level for the share of female managers on the first and second level below the Management Board. This reflects the high level of importance the bank assigns to the objective of further increasing the number of women in executive positions. However, against the background of the stabilised workforce following privatisation and the resulting low fluctuation in pbb's staff, the bank was not able to achieve the targets during the reference period. pbb maintains its intention to raise the number of women in executive positions, and to ensure women are appropriately represented when filling vacancies, in a targeted manner – given candidates have the requisite skills and qualifications. A higher awareness for this topic, across all levels of hierarchy, together with a corresponding management and corporate culture, also contribute to this objective. Moreover, pbb offers employees attractive working conditions – especially flexible working hours and teleworking opportunities, which help balancing family and working life.

Disclosures pursuant to section 289a (2) no. 5 of the HGB

Given that the Company is subject to the One-Third Employee Participation Act (DrittelBG), no disclosure pursuant to section 289a (2) no. 5 of the HGB is required.

Financial Calendar

Financial calendar 2017

15 May 2017	Result of the first quarter 2017
30 May 2017	Annual General Meeting
14 August 2017	Result of the second quarter 2017/Interim Report as of 30 June 2017
13 November 2017	Result of the third quarter 2017

Future-oriented Statements

This report contains future-oriented statements in the form of intentions, assumptions, expectations or forecasts. These statements are based on the plans, estimates and predictions currently available to the management board of pbb. Future-oriented statements therefore only apply on the day on which they are made. We do not undertake any obligation to update such statements in light of new information or future events. By their nature, future-oriented statements contain risks and factors of uncertainty. A number of important factors can contribute to actual results deviating considerably from future-oriented statements. Such factors include the condition of the financial markets in Germany, Europe and the USA, the possible default of borrowers or counterparties of trading companies, the reliability of our principles, procedures and methods for risk management as well as other risks associated with our business activity.

Imprint

PUBLISHER

Deutsche Pfandbriefbank AG, Munich, Germany
(Copyright 2017)

CONCEPT, DESIGN AND REALISATION

HGB Hamburger Geschäftsberichte GmbH & Co. KG, www.hgb.de

PICTURE CREDIT

Page VII-IX: Pecan Development GmbH
Page XIV-XV: bloomimages
Page XIX: Philippe Chiambaretta Architecte
Illustration: Eva-Maria Birkhoff

PRINT

Hartung Druck + Medien GmbH, Hamburg

Deutsche Pfandbriefbank AG
Freisinger Strasse 5
85716 Unterschleissheim
Germany

T +49 (0)89 2880-0
F +49 (0)89 2880-10319
info@pfandbriefbank.com
www.pfandbriefbank.com