II Business report

1 Economic conditions

The German economy's uptrend weakened noticeably in the first six months of 2018. Adjusted for inflation, average overall economic output in the first half of the year was 1.0 percent higher than in the second half of 2017. By contrast, the rate of growth in the half-year period prior to that had been 1.4 percent.

Compared with the respective preceding quarter, German economic output was up by 0.4 percent in the first quarter and by 0.5 percent in the second quarter of 2018. In the fourth quarter of 2017, however, economic output had increased by 0.6 percent compared with the previous quarter.

The boost to the German economy provided by the rise in spending by consumers and the government during the reporting period also diminished slightly, with consumer spending dented by a slight increase in the rate of inflation. However, the robust labor market and the upward income trend, combined with the low level of interest rates, fueled both household spending and demand for private house-building. Against this backdrop, construction investment again accounted for a considerable proportion of the increase in German economic output. Companies' spending on capital equipment also bolstered the growth of the economy as a whole.

Given the generally stable domestic economy and strong increases in tax revenues, German public finances are likely to finish the current year with a small budget surplus once again.

The economy of the eurozone also lost momentum in the first six months of 2018. Following economic expansion of 1.4 percent in the second half of 2017 compared with the first half of 2017, the eurozone's economic output in the period under review rose by 0.9 percent. The rate of growth in the first quarter of 2018 was 0.4 percent. In the second quarter, the economy also grew by 0.4 percent compared with the previous quarter.

By contrast, the economy in the United States was very buoyant in the first half of 2018. The tax reforms introduced at the start of 2018 brought significant tax relief for households and companies alike, thereby providing an extra boost to overall economic demand. In the first half of 2018, a further upturn in consumer spending – the most important driver of growth – was again a key factor in the country's robust economic performance. Capital spending on plant and equipment was also stepped up markedly. Other contributors to the strong economic growth were the further improving situation in the labor market and the sustained recovery of the US real estate market.

Economic difficulties persisted in some emerging economies, particularly in Latin America, during the reporting period. These were often attributable to structural problems and political uncertainty. Meanwhile, China's economic growth held steady.

2 The banking industry amid continued efforts to stabilize the economy of the eurozone

The first half of 2018 was marked by far-reaching changes. In early May 2018, the United States withdrew from the nuclear deal entered into with Iran. Furthermore, the US government imposed customs tariffs on imports from China, the EU, Canada, and Mexico in the first few months of the year. Both of these factors increased uncertainty for the affected companies, as did the retaliatory punitive tariffs imposed by China and the EU on various US products. The price rises caused by the customs tariffs are squeezing consumers' disposable income and, in the medium term at least, will reduce the demand for goods. If the trade disputes were to escalate, both global trade and global economic growth would suffer.

The approach of Brexit, the political turmoil that arose in Italy in the second quarter of 2018, and the challenges faced by the EU as a result of US President Donald Trump's latest protectionist measures have made it abundantly clear that the advantages of globalization can only be assured across the EU if politicians succeed both in containing the negative effects of globalization and in mitigating the developments that reduce prosperity as a result of giving up the benefits of international freedom of movement and division of labor.

Globalization has clearly brought about huge social shifts, and it is evident that not enough has been done at a political level to protect people from their impact. Unemployment remains at a very high level, especially in southern eurozone countries. The European Commission wants to intervene in the event of significant increases in unemployment rates by setting up support programs at national level. Moreover, the German government's coalition agreement envisages contributing to an investment budget for individual eurozone countries that are lagging behind in terms of science, technology, and innovation. This agreement between the coalition partners is designed to support the aim of promoting economic convergence between the EU member states.

Proposals for an overhaul and strengthening of European Monetary Union (EMU) in view of the changed situation have notably been put forward by French President Emmanuel Macron and German Chancellor Angela Merkel. The first steps toward joint EU-wide implementation were decided upon at the EU summit at the end of June 2018.

The core aspects of the resolutions adopted at this summit include using the European Stability Mechanism (ESM) – the eurozone's crisis fund – as a backstop for the bank resolution fund in the future. However, the ultimate amount of this backstop has not yet been decided. It was also agreed that the finance ministers of the eurozone countries would define the core refinements to the ESM by the end of 2018.

Besides the aforementioned macroeconomic measures, however, the implementation of structural reforms aimed at reducing national debt – for which the individual EU countries are responsible themselves – is also crucial to increasing the stability of the eurozone.

On the whole, only limited progress was made in reducing new and total borrowing in the eurozone. These efforts were supported by the ongoing phase of low interest rates and the continued steady path of economic recovery in the first half of 2018, although the increase in the eurozone's economic output of 0.9 percent during the reporting period compared with the second half of 2017 was lower than the rise of 1.4 percent in the first half of 2017 compared with the second half of 2016.

At the end of the first quarter of 2018, the total borrowing of the 19 eurozone countries equated to 86.8 percent of their gross domestic product (GDP), a year-on-year decrease of 2.4 percentage points compared with the figure of 89.2 percent as at March 31, 2017.

Even though France and Italy, countries that are important in generating overall economic growth in Europe, along with Portugal and Spain, which had been reliant on EU aid during the sovereign debt crisis, all made further gains in economic efficiency in the first quarter of 2018 compared with the first quarter of 2017, they continued to suffer from a high level of indebtedness in the same way as some other eurozone countries, notably Greece.

Greece's public debt as a percentage of GDP stood at 180.4 percent in the first quarter of 2018 (first quarter of 2017: 177.7 percent) and its economy's growth was muted at the start of the year. After Greece had implemented a range of further reforms to satisfy certain preconditions, European lenders reached agreement in June 2018 on granting the country further debt relief and giving it the final sum of €15 billion from the €86 billion bailout program approved in 2015, which expires on August 20, 2018. The agreement also provides for a program of enhanced surveillance by the European Commission that includes a quarterly reporting cycle. The only role of the International Monetary Fund (IMF) will be to participate in this future monitoring process.

Italy is suffering from a high volume of non-performing loans and, above all, from having the highest relative government debt ratio in the eurozone after Greece; its public debt as a percentage of GDP stood at 133.4 percent in the first quarter of 2018 (first quarter of 2017: 133.8 percent). This reflects a serious structural crisis, requiring sweeping reforms. However, the government agenda of the coalition formed in early June 2018 by the right-wing nationalist Lega and populist Five Star Movement (M5S) parties specifies not only the reversal of social cutbacks but also measures to reduce the tax burden for citizens and companies. The total cost of this program is at least €100 billion per year. This planned level of spending will probably cause Italy's budget deficit to climb to at least 5 percent of GDP. In this environment, yields on Italian government bonds – and subsequently on those of other eurozone periphery countries – shot up in the weeks after the new government was formed.

Portugal's public debt as a percentage of GDP stood at 126.4 percent in the first quarter of 2018 (first quarter of 2017: 130.1 percent) and the country made further progress on stabilizing its economy during the first half of the year. However, the banking sector continues to have significant legacy issues in the form of non-performing loans. Positive influences on the Portuguese economy included stable consumer demand and, above all, brisker investing activities, albeit still at a far lower level than before the sovereign debt crisis.

Spain's public debt as a percentage of GDP stood at 98.8 percent in the first quarter of 2018 (first quarter of 2017: 99.7 percent) and its economy continued to expand rapidly at the start of this year. The existing conservative government led by Mariano Rajoy was dissolved following a vote of no confidence in June 2018. Rajoy was replaced as prime minister by socialist Pedro Sanchez, who, like his predecessor, is reliant on the support of other parties. As a result, the difficulties in securing the necessary majorities in votes have returned. The political instabilities continue to hamper Spain's progress in reducing its substantial national debt.

France's public debt as a percentage of GDP stood at 97.7 percent in the first quarter of 2018, only a slight reduction compared with the figure a year earlier (first quarter of 2017: 98.9 percent). Nevertheless, President Emmanuel Macron introduced and implemented initial structural reforms in his first year of office, in particular labor market reforms. Changes to unemployment insurance and to professional training and development are on the agenda as well. Restructuring of the state-owned rail company and, from 2019, the gradual standardization of the currently more than 25 pension schemes are also planned.

The developments in the eurozone described above show that the European Central Bank (ECB) with its policy of quantitative easing has 'bought' the necessary time for the EMU countries burdened with significant debt to reduce their fundamental budget deficits. Nonetheless, most of the countries mentioned above have made only limited efforts to reduce their high levels of indebtedness and bring in the necessary structural reforms or, as has recently happened in Italy, have consciously set out to oppose such steps. This is especially worrying because it is questionable whether the EU countries concerned will be in any position at all (because of the size of their debt burden) to cope with substantially higher interest rates arising from further normalization of the ECB's monetary policy.

It is clear that the current low level of interest rates has also had a negative impact on various EMU countries' efforts to implement austerity measures because the availability of low interest rates is noticeably reducing the debt burden anyway.

One of the main reasons why politicians are generally reluctant to introduce the necessary structural improvement measures to reduce public debt is that various EMU countries are still seeing strong political movements that oppose the jointly agreed stabilization efforts of the single currency area. Even if, especially in France, EU skepticism has given way to a pro-European political majority, the parliamentary elections in Austria, Italy, and Hungary have shown that increasingly anti-EU forces are gaining momentum and, in the case of Italy, have even made it into government.

A key reason for the European Commission's reluctance to strictly implement the stability criteria under the Fiscal Compact agreed by the EU member states at the beginning of 2012 is most probably also the widespread return to a more nationalistic focus apparent within the eurozone. In the Fiscal Compact, the signatory countries committed to reducing their debt (as a proportion of GDP) each year by one twentieth of the difference between the debt level and the Maastricht limit of 60 percent of GDP. The aforementioned program put forward by the Italian government adds a whole new dimension to the conflict with this commitment.

At the same time, the ECB's current policy of zero and negative interest rates is making it harder for savers to build up sufficient capital and, in particular, to ensure they have adequate provision for old age. Although the weakness of the euro resulting from low interest rates is boosting companies' exports, it is also diminishing their efforts to lower costs and improve productivity. Furthermore, the ECB's policy of maintaining extremely low interest rates boosts the risk of misallocations and even the formation of bubbles in real estate and equities markets, which could jeopardize the stability of financial markets.

There is also a danger that future interest-rate rises in individual eurozone countries will lead to a wave of bankruptcies among companies with chronic profitability problems. This may subdue economic growth and even trigger a recession if the situation worsens sufficiently. The countries giving rise to concerns about a sharp rise in insolvencies in the event of an interest-rate hike are Portugal, Italy, and Ireland, because they each have a high proportion of non-performing loans to companies. This indicates a prevalence of firms with a sustained lack of profitability.

Another problem facing the ECB is that it will find itself with insufficient leeway in the event of an economic downturn and accompanying fall in inflation, because key interest rates will still be close to zero.

At its meeting on June 14, 2018, the ECB raised the prospect of ending the bond-buying program that it began back in March 2015. It has announced that bond purchases, which amounted to a monthly volume of €30 billion in the first half of 2018, would be halved to a volume of €15 billion per month from October 2018 and would stop completely at the end of December 2018. Explaining this move, ECB President Mario Draghi said that there was increased confidence that inflation in the eurozone was moving permanently in the direction of the central bank's target of below, but close to, 2 percent. The ECB also decided to leave the main refinancing rate unchanged at 0.00 percent and the deposit facility for banks at minus 0.40 percent.

By contrast, the US Federal Reserve (Fed) raised its target range for the federal funds rate by 25 basis points on March 21, 2018 and then again on June 13, 2018, ultimately taking the target range to 1.75 percent to 2.00 percent.

Against a backdrop of challenging market conditions, nearly all the major German banks reported a fall in operating income in the first half of 2018. The net additions to loss allowances made by the major banks in the first six months of last year were not repeated in the reporting period, with most of them reporting an unchanged position overall or a net reversal of loss allowances. Administrative expenses increased slightly across the board.

3 Financial performance

3.1 Financial performance at a glance

The DZ BANK Group successfully consolidated its position in the half-year under review in challenging market conditions influenced primarily by the extremely low level of interest rates and demanding regulatory requirements.

The year-on-year changes in the key figures that make up the net profit generated by the DZ BANK Group compared with the first half of 2017 were as described below.

Operating income in the DZ BANK Group amounted to €3,008 million (first half of 2017: €3,335 million). This figure comprises net interest income, net fee and commission income, gains and losses on trading activities, gains and losses on investments, other gains and losses on valuation of financial instruments, net income from insurance business, and other net operating income.

Net interest income (including income from long-term equity investments) in the DZ BANK Group decreased by 0.4 percent year on year to €1,422 million (first half of 2017: €1,427 million).

Net interest income (excluding income from long-term equity investments) at DZ BANK went up by €33 million. At BSH, net interest income fell by €36 million, at DZ PRIVATBANK by €27 million, and at DVB by €23 million. At TeamBank and VR LEASING, it increased by €10 million and €6 million respectively.

Net income from long-term equity investments in the DZ BANK Group rose by 76.9 percent to €46 million (first half of 2017: €26 million). The figure for the prior-year period had been affected by losses reported by some equity-accounted entities in the DVB subgroup.

Net fee and commission income in the DZ BANK Group decreased by 1.9 percent to €958 million (first half of 2017: €977 million).

At DZ BANK, net fee and commission income rose slightly, by €2 million. Net fee and commission income at UMH declined by €45 million, at DVB by €10 million, at TeamBank by €8 million, and at

VR LEASING by €3 million. It increased by €32 million at DZ PRIVATBANK and by €10 million at BSH.

The DZ BANK Group's **gains and losses on trading activities** came to a net gain of €206 million, compared with a net gain of €304 million in the first half of 2017. This was largely attributable to the gains and losses on trading activities at DZ BANK amounting to a net gain of €195 million (first half of 2017: net gain of €298 million).

Gains and losses on investments advanced by €10 million to a net gain of €98 million (first half of 2017: net gain of €88 million). The main reasons for the year-on-year change were the factors described in the details for the DZ BANK and DVB operating segments.

FIG. 1 – INCOME STATEMENT

€ million	Jan. 1 – Jun. 30, 2018	Jan. 1 – Jun. 30, 2017	Change (%)
Net interest income	1,422	1,427	-0.4
of which: income from long-term equity investments[1]	46	26	76.9
Net fee and commission income	958	977	-1.9
Gains and losses on trading activities	206	304	-32.2
Gains and losses on investments	98	88	11.4
Other gains and losses on valuation of financial instruments	-48	34	>100.0
Net income from insurance business	299	451	-33.7
Loss allowances	44	-396	>100.0
Administrative expenses	-2,018	-2,000	0.9
Staff expenses	-906	-904	0.2
Other administrative expenses[2]	-1,112	-1,096	1.5
Other net operating income	73	54	35.2
Profit before taxes	1,034	939	10.1
Income taxes	-303	-451	-32.8
Net profit	731	488	49.8

1 Total of current income and expense from income from other shareholdings, current income and expense from investments in subsidiaries, current income and expense from investments in associates, income/loss from using the equity method, and income from profit-pooling, profit-transfer, and partial profit-transfer agreements; see note 8 in the notes to the interim consolidated financial statements.

2 General and administrative expenses plus depreciation/amortization expense on property, plant and equipment, and investment property, and on other assets; amount for first half of 2017 restated, see note 2 in the notes to the interim consolidated financial statements.

Other gains and losses on valuation of financial instruments in the DZ BANK Group amounted to a net loss of €48 million in the reporting half-year (first half of 2017: net gain of €34 million). Of the figure reported for the DZ BANK Group, a gain of €30 million (first half of 2017: gain of €161 million) was accounted for by DZ HYP and a loss of €87 million (first half of 2017: loss of €131 million) by DVB.

The DZ BANK Group's **net income from insurance business** comprises premiums earned, gains and losses on investments held by insurance companies and other insurance company gains and losses, insurance benefit payments, and insurance business operating expenses. In the reporting period, this figure decreased by 33.7 percent to €299 million (first half of 2017: €451 million).

The rise in premium income was unable to fully offset the decline in gains and losses on investments held by insurance companies and other insurance company gains and losses, the increase in insurance benefit payments, and the growth of insurance business operating expenses.

Loss allowances, which were calculated in accordance with IFRS 9 for the first time in the reporting period, amounted to a net reversal of €44 million (first half of 2017: net addition of €396 million).

Further detailed disclosures regarding the level of, and changes in, loss allowances can be found in note 47 in the notes to the interim consolidated financial statements.

Administrative expenses in the DZ BANK Group rose slightly, by €18 million or 0.9 percent, to €2,018 million (first half of 2017: €2,000 million), including an increase in staff expenses of €2 million (0.2 percent) to €906 million (first half of 2017: €904 million) and an increase in other administrative expenses of €16 million (1.5 percent) to €1,112 million (first half of 2017: €1,096 million).

The DZ BANK Group's **other net operating income** came to €73 million (first half of 2017: €54 million). The main reasons for this change compared with the first half of 2017 were the factors described in the details for the DZ BANK, DVB, UMH, and VR LEASING operating segments.

Profit before taxes for the first half of 2018 stood at €1,034 million, compared with €939 million in the first half of 2017.

The DZ BANK Group's **cost/income ratio** (i.e. the ratio of administrative expenses to total operating income) for the reporting half-year came to 67.1 percent (first half of 2017: 60.0 percent).

The DZ BANK Group's **income taxes** amounted to €303 million in the period under review (first half of 2017: €451 million). The increase in the tax expense in the first half of last year included the effects of deferred taxes.

Net profit for the first half of 2018 stood at €731 million, compared with €488 million in the first half of 2017.

FIG. 2 – SEGMENT INFORMATION

INFORMATION ON OPERATING SEGMENTS FOR THE PERIOD JANUARY 1 TO JUNE 30, 2018

€ million	DZ BANK	BSH	DVB
Net interest income	591	387	80
Net fee and commission income	185	-12	42
Gains and losses on trading activities	195	-	-4
Gains and losses on investments	74	11	11
Other gains and losses on valuation of financial instruments	19	3	-87
Premiums earned	-	-	-
Gains and losses on investments held by insurance companies and other insurance company gains and losses	-	-	-
Insurance benefit payments	-	-	-
Insurance business operating expenses	-	-	-
Loss allowances	96	-2	-20
Administrative expenses	-756	-237	-97
Other net operating income	33	22	4
Profit/loss before taxes	**437**	**172**	**-71**
Cost/income ratio (%)	68.9	57.7	>100.0
Regulatory RORAC (%)	12.4	31.7	-34.1
Average own funds/solvency requirement	4,699	1,081	378
Total assets/total equity and liabilities as at Jun. 30, 2018	289,868	70,480	21,562

INFORMATION ON OPERATING SEGMENTS FOR THE PERIOD JANUARY 1 TO JUNE 30, 2017

€ million	DZ BANK	BSH	DVB
Net interest income	533	423	103
Net fee and commission income	183	-22	52
Gains and losses on trading activities	298	-	-19
Gains and losses on investments	67	15	-4
Other gains and losses on valuation of financial instruments	15	-1	-131
Premiums earned	-	-	-
Gains and losses on investments held by insurance companies and other insurance company gains and losses	-	-	-
Insurance benefit payments	-	-	-
Insurance business operating expenses	-	-	-
Loss allowances	90	-2	-446
Administrative expenses[1]	-803	-233	-103
Other net operating income	22	23	16
Profit/loss before taxes	**405**	**203**	**-532**
Cost/income ratio (%)	71.8	53.2	>100.0
Regulatory RORAC (%)	11.0	39.5	>100.0
Average own funds/solvency requirement	5,403	1,026	581
Total assets/total equity and liabilities as at Dec. 31, 2017	265,843	68,337	23,414

1 Amount restated.

	DZ HYP	DZ PRIVAT-BANK	R+V	TeamBank	UMH	VR LEASING	Other/ Consolidation	**Total**
	282	33	-	221	6	76	-254	1,422
	1	94	-	-5	705	5	-57	958
	-	5	-	-	-	-	10	206
	4	-	-	-	-7	7	-2	98
	30	-2	-	-	-22	-	11	-48
	-	-	8,115	-	-	-	-	8,115
	-	-	1,269	-	-	-	-54	1,215
	-	-	-7,709	-	-	-	-	-7,709
	-	-	-1,406	-	-	-	84	-1,322
	4	-	-	-32	-	-2	-	44
	-162	-115	-	-112	-425	-70	-44	-2,018
	5	-7	5	4	16	-15	6	73
	164	**8**	**274**	**76**	**273**	**1**	**-300**	**1,034**
	50.3	93.5	-	50.9	60.9	95.9	-	67.1
	22.8	4.6	-	34.2	>100.0	0.6	-	-
	1,444	349	-	444	351	333	-	-
	85,026	18,200	108,179	8,641	2,048	4,770	-70,540	538,234

	DZ HYP	DZ PRIVAT-BANK	R+V	TeamBank	UMH	VR LEASING	Other/ Consolidation	**Total**
	282	60	-	211	4	70	-259	1,427
	-	62	-	3	750	8	-59	977
	7	7	-	-	-	-	11	304
	3	-	-	-	-	6	1	88
	161	5	-	-	2	-	-17	34
	-	-	7,403	-	-	-	-	7,403
	-	-	1,883	-	-	-	-36	1,847
	-	-	-7,543	-	-	-	-	-7,543
	-	-	-1,350	-	-	-	94	-1,256
	7	-	-	-34	-1	-6	-4	-396
	-126	-116	-	-105	-393	-69	-52	-2,000
	2	-6	-4	3	-	4	-6	54
	336	**12**	**389**	**78**	**362**	**13**	**-327**	**939**
	27.7	90.6	-	48.4	52.0	78.4	-	60.0
	45.3	8.4	11.3	36.8	>100.0	8.1	-	11.2
	1,489	295	6,862	425	351	314	-	16,746
	85,855	16,802	103,419	8,009	2,445	4,749	-73,279	505,594

3.2 Financial performance in detail

Figure 2 above shows the details of the financial performance of the DZ BANK Group's operating segments in the first half of 2018 compared with the corresponding period of 2017.

3.2.1 DZ BANK

In the detailed descriptions, the financial performance of the business lines is presented on the basis of the net income values used by financial planning and control for business management purposes.

Net interest income (excluding income from long-term equity investments) at DZ BANK rose by 12.0 percent to €307 million (first half of 2017: €274 million). This result included an increase in the net interest margin contributions from both money market borrowing and money market investments.

At DZ BANK, the Corporate Banking business line comprises the five regional corporate customer divisions that focus on corporate banking in Germany (Northern and Eastern Germany, Western Germany, Central Germany, Baden-Württemberg, and Bavaria), the Investment Promotion division, and the Structured Finance division covering business with German corporate customers and foreign customers with links to Germany.

In accordance with the cooperative principle of decentralization, the tried-and-tested distribution of responsibilities in the Volksbanken Raiffeisenbanken cooperative financial network, and the focus on the needs of companies, customer relationship management for corporate customers is provided by the local cooperative bank in conjunction with DZ BANK, or directly by DZ BANK.

The cooperative financial network has been pivotal in helping to shape the sustained economic upturn experienced by Germany's large and medium-sized companies that began some years ago. This is confirmed by its position in the corporate finance market. Over the past ten years, the cooperative financial network's volume of lending has grown at a much faster rate than that of the market as a whole. In the period March 31, 2017 to March 31, 2018, the cooperative banks (including DZ BANK) grew by 6.3 percent, again exceeding the rate of growth in the overall market.

The macroeconomic conditions in Germany remain positive for the corporate banking business operated jointly by DZ BANK and the cooperative banks; the country's large and medium-sized companies remained in robust financial health. At the same time, however, the competitive environment in corporate banking is becoming increasingly challenging and pressure on credit margins is mounting rapidly. The game changers of our age, digitalization and the accompanying shift in customer behavior, are further intensifying this competition and significantly increasing the need for innovation and optimization in the Corporate Banking business line.

Moreover, the vast majority of large and medium-sized companies continue to be able to meet their capital investment requirements from their own cash flows or reserves thanks to their sound capital and liquidity position. Partly as a result of the stable German economy and companies' robust financial health, large and medium-sized companies are still venturing into international business on a significant scale. DZ BANK has recognized this trend and, in the reporting half-year, entered into a cooperation agreement with Indonesia's third-largest bank, PT Bank Central Asia Tbk. The aim of this agreement is to provide support for each other's corporate customers, i.e. direct and cooperative financial network customers in Germany that are targeting the Indonesian market as well as PT Bank Central Asia's Indonesian customers that are looking to enter the German market.

Although German large and medium-sized companies' propensity to invest is still at a good level, indications of a reluctance to invest started to emerge in the first half of 2018 despite favorable business conditions. One of the key reasons for this is likely to be the shortage of skilled employees, which is an ever-growing concern for these firms. Geopolitical factors, particularly the worldwide trade disputes and the uncertainties linked with the approaching Brexit, are also having an adverse impact.

In the Corporate Banking business line, the net interest margin contribution declined by a total of 9.9 percent to €193.8 million (first half of 2017: €215.1 million), although it should be noted that, unlike in the reporting period, the net interest margin contribution in the first half of 2017 still included an amount of €16.6 million relating to the real estate lending business. This portfolio was segregated from the Corporate Banking portfolio in the second half of 2017 in view of the planned transfer of the real estate lending business to DZ HYP and, in the first six months of 2018, generated a net interest margin contribution of €18.2 million.

The net interest margin contribution in the five regional corporate customer divisions went down by 16.9 percent in total to €98.3 million (first half of 2017: €118.3 million). However, the net interest margin contribution for the first half of 2017 still included an amount of €16.6 million relating to the aforementioned real estate lending portfolio.

Despite a further contraction of margins, the Investment Promotion division was able to increase its net interest margin contribution by 5.7 percent to €31.7 million (first half of 2017: €30.0 million) thanks to the growth in the volume of development lending.

New business in the main areas of development activity within traditional investment finance, which primarily include business start-ups and financing of innovation projects, held steady in this highly competitive field. The significant rise in funding for innovation is also due to the combined efforts of DZ BANK and Kreditanstalt für Wiederaufbau (KfW) [Germany's KfW development bank] in creating attractive program terms and conditions. However, growth was achieved in the development lending portfolio within the private house-building business.

In the product fields of the Structured Finance division, the net interest margin contribution declined by a total of 4.5 percent to €63.8 million (first half of 2017: €66.8 million). The main year-on-year changes in the net interest margin contribution from each of the product fields are described below.

In the acquisition finance/syndicated business product field, the division arranges and structures debt finance to support the acquisition of large and medium-sized companies, primarily in the German-speaking countries. Large numbers of customers made use of the high degree of liquidity in the markets to redeem their loans. The net interest margin contribution fell by 12.8 percent to €10.8 million (first half of 2017: €12.4 million).

There was a slight decrease in the project finance product field's net interest margin contribution in the first half of 2018, which dropped by 2.0 percent to €11.7 million (first half of 2017: €12.0 million).

In the international trade and export finance product field, in which the emphasis is very much on providing support for German large and medium-sized corporate customers involved in international business, the net interest margin contribution fell sharply, by 17.3 percent, to €20.0 million in the first half of 2018 (first half of 2017: €24.2 million).

In the renewable energies/syndicated loans and acquisition finance for the Region West product field, the net interest margin contribution advanced by 10.2 percent to €24.3 million (first half of 2017: €22.0 million). Despite growing competition, there was an increase in renewable energies business during the reporting period, particularly the funding of wind turbines.

Net fee and commission income rose by 1.1 percent to €185 million (first half of 2017: €183 million).

In the Corporate Banking business line, the service contribution declined by a total of 1.1 percent to €72.6 million (first half of 2017: €73.4 million). The figure for the first half of 2017 still included the service contribution from the real estate lending portfolio, which was segregated from the Corporate Banking portfolio in the second half of last year and generated a service contribution of €1.4 million in the first half of this year.

In the five regional corporate customer divisions, the service contribution went down by 9.6 percent in total to €25.8 million (first half of 2017: €28.6 million). However, the service contribution for the first half of 2017 still included an amount of €1.4 million relating to the aforementioned real estate lending portfolio.

The service contribution in the Investment Promotion division, which amounted to minus €3.9 million in the period under review (first half of 2017: minus €3.7 million), was again affected by the margin reimbursement received by the cooperative banks.

In the Structured Finance division, the service contribution rose by a total of 2.0 percent to €49.5 million (first half of 2017: €48.5 million). The main year-on-year changes in the service contribution from each of the product fields in the Structured Finance division are described below.

The acquisition finance/syndicated business product field was characterized by much fiercer competition in the first half of 2018. Nevertheless, the service contribution increased by 44.7 percent in total to €5.9 million due to the encouraging performance of the syndicated business (first half of 2017: €4.1 million).

In the project finance product field, the service contribution was up by 2.8 percent to €4.6 million (first half of 2017: €4.5 million).

The service contribution in the international trade and export finance product field for the reporting period climbed by a substantial 57.6 percent to €5.5 million (first half of 2017: €3.5 million).

By contrast, the service contribution in the international documentary business product field (letters of credit, guarantees, collections) was down slightly year on year at €9.5 million (first half of 2017: €10.0 million).

The asset securitization product field's service contribution grew by 5.5 percent to €22.2 million in the six months under review (first half of 2017: €21.1 million).

In the Capital Markets business line, the comprehensive range of advisory, structuring, and placement services available in relation to capital and mezzanine products again proved popular with customers of the cooperative banks and direct customers of DZ BANK in the reporting half-year.

Based on various ranges of products, DZ BANK managed to prevail against German and international competitors, despite the market remaining fiercely contested. The successfully implemented transactions and the satisfaction of customers are testimony to a high level of product expertise and effectiveness in a constantly changing market environment. For example, DZ BANK was awarded a repeat mandate to implement a share buyback program for Evonik AG in the first half of 2018. The cooperative banks and direct customers value the transaction security offered by DZ BANK in connection with the execution of capital and mezzanine transactions.

The service contribution generated by the Transaction Banking business line was also higher than the equivalent figure reported for the first six months of 2017 as a result of higher income on the back of the growth in the securities custody business.

Gains and losses on trading activities amounted to a gain of €195 million (first half of 2017: gain of €298 million).

The deterioration of gains and losses on trading activities was attributable to market-price-related measurement expenses, specifically spread-induced measurement losses in interest-rate and fixed-income trading and on flow derivative products. Income from trading on behalf of customers matched the high level achieved in the prior-year period.

The other accounting-related influences, including the adjustment of valuation curves for the bank's own issues, interest-rate-related changes in the fair value of cross-currency basis swaps used to hedge investment portfolios, and gains and losses on exchange differences arising from financial instruments in the investment portfolio and from hedge accounting, had countervailing effects on gains and losses on trading activities that, overall, virtually cancelled each other out.

In the period under review, DZ BANK's balance of unrealized and realized gains and losses relating to asset-backed securities (ABSs) amounted to a gain of €1 million (first half of 2017: gain of €13 million).

The key influences on capital markets during the first six months of 2018 were the continuation of the ECB's program of quantitative easing – with a monthly bond-buying volume of €30 billion during the reporting period – and its decision to leave the main refinancing rate unchanged at 0.00 percent and the deposit facility for banks at minus 0.40 percent.

Furthermore, the Fed raised the key interest rate by 25 basis points in March and then again, by the same amount, in June 2018.

The weakening of economic growth that has been discernible in Germany and the eurozone since the start of this year was accompanied by far-reaching changes at geopolitical level. The trade dispute between the United States and China as well as the US withdrawal from the Iran nuclear deal, heightening the already tense situation in the Middle East, adversely affected Germany's heavily export-oriented economy while the customs tariffs already introduced – with the possibility of additional tariffs to follow – acted as a brake on both international trade and global economic growth.

In this environment, the DAX averaged out at 12,658 points in the first half of 2018, which was barely unchanged on the figure of 12,700 points for the second half of 2017. However, share prices were more volatile in the first six months of this year than in the second half of last year.

The regulatory environment also impacted on the markets and market players, which again had to cope with the demanding requirements imposed by banking regulators in the period under review.

The products and services of DZ BANK's customer-oriented capital markets business are geared to the needs of cooperative banks, specialized service providers within the cooperative sector, and their retail and corporate customers. In addition, DZ BANK has business relationships with direct corporate customers and institutional customers in Germany and abroad. The portfolio comprises competitively priced investment and risk management products involving the asset classes of interest rates, equities, loans, and foreign exchange. These products are complemented by a broad range of advisory and research services, structuring expertise, and platforms. In respect of all customer groups, the proportion of business conducted through electronic systems is rising significantly and increasingly replacing traditional telephone trading.

Against the current backdrop of low interest rates, German retail investors' top priorities are safety and understandable investment solutions. Catering to this customer need, DZ BANK works closely with the local cooperative banks and managed to further strengthen its position in the German derivatives market. DZ BANK's performance – as measured by data from the Deutscher Derivate Verband (DDV) [German Derivatives Association] – has been impressive, confirming its market leading position with a market share of 17.6 percent as at the end of March 2018, based on the market volume invested in structured securities.

During the first half of 2018, DZ BANK continued with the targeted stepping up of activities in relation to selling exchange-traded derivative securities products. The comprehensive range of high-quality services also earned DZ BANK the Best Issuer of 2017/2018 award from an independent panel of experts in the annual Investment Certificates Awards, the first time that DZ BANK has received this accolade.

Furthermore, DZ BANK continued to focus on steadily and effectively digitalizing and optimizing securities processes in retail banking. DZ BANK also has an advanced quality management system for customer service and product development based on the new ISO 9001:2015 standard. The system has been audited and certified by DQS GmbH Deutsche Gesellschaft zur Zertifizierung von Management-systemen.

In order to stabilize their financial performance over the long term, the cooperative banks acquired investments with residual maturities of more than 5 years as part of their own-account investing activities. They stepped up their investments in corporate bonds and simply structured credit products in the form of credit-linked notes. Demand for structured bullet maturity bonds and share bonds was also brisk. The cooperative banks also aimed for broad diversification in their securities portfolios, particularly with regard to investments in equities and real estate. To this end, the main focus of demand was on fund products from the Union Investment Group, whose inflows again increased year on year.

Capital markets business with institutional customers proved to be structurally robust during the reporting period. Here too, investment patterns were determined by the ECB's monetary policy of negative interest rates and the accompanying distortion of market prices and thus risk premiums. Income sources were widely spread, ranging across the entire fixed-income product segment but primarily bond trading in the secondary market. In the case of interest-rate structures and credit-linked notes, DZ BANK has been supporting its institutional customers for many years by offering a broad range of products, and it is very highly placed in the relevant rankings.

The growing prevalence of trading business conducted on electronic platforms was again observable in the first two quarters of 2018, resulting in a sharp rise in trading volumes with asset managers and banks both in Germany and abroad. Insurance companies and pension funds are increasingly shifting their activities into alternative asset classes, such as real estate and infrastructure. Multitranches with foreign and supranational issuers were another point of focus. DZ BANK's attractive rating meant that its own issues in the money market were very popular, even those with long terms to maturity.

The capital markets business with large and medium-sized companies as well as major corporations is underpinned by a broad spectrum of products, with a particular focus on currency and interest-rate hedging in order to manage currency and interest-rate risk. This range is complemented by basic products in the core deposit-taking business and securities business for liquidity management.

The ongoing, ECB-driven policy of low interest rates, combined with limited demand for credit given that the majority of large and medium-sized companies have ample liquidity, meant that these companies' interest-rate hedging activities were concentrated on maturities of more than 10 years.

New bond issuance business was significantly influenced by the ECB's aforementioned bond-buying program and policy of zero interest rates in the half-year under review. While the number of issues by public-sector entities was at a low level due to the high tax revenues at national and federal state level, the volume of promissory notes supported for corporates was only just short of the level achieved in the first half of 2017, despite the contraction of the market as a whole. Bucking the market trend, DZ BANK managed to increase its volume of new issues of bank bonds and covered bonds, in some cases significantly. The bank saw growth in its new issuance business, particularly in the segment for sustainable bonds from German and international issuers.

The net gain under **gains and losses on investments** amounting to €74 million (first half of 2017: net gain of €67 million) was essentially attributable to income from the sale of liquidity-pool securities.

Loss allowances, which were calculated in accordance with IFRS 9 in the reporting period, amounted to a net reversal of €96 million (first half of 2017: net reversal of €90 million). This was mainly due to borrowers' rating improvements and to potential for reversals in connection with impaired and written-off loans and advances.

Administrative expenses at DZ BANK amounted to €756 million, a decrease of €47 million or 5.9 percent on the comparable figure in the first half of 2017 (€803 million).

Other administrative expenses went down by €42 million to €432 million (first half of 2017: €474 million), in particular because project expenses were lower than in the prior-year period. Staff expenses fell by €5 million to €324 million (first half of 2017: €329 million), mainly as a result of higher interest income on plan assets to meet defined benefit obligations.

Other net operating income for the first six months of 2018, which totaled €33 million (first half of 2017: €22 million), largely comprised income from the reversal of provisions and accruals – as had also been the case in the prior-year period.

Profit before taxes for the period under review amounted to €437 million. The increase of €32 million compared with the figure of €405 million reported for the first half of 2017 was mainly a consequence of the changes described above.

DZ BANK's **cost/income ratio** came to 68.9 percent in the first half of 2018 (first half of 2017: 71.8 percent).

The **regulatory return on risk-adjusted capital (RORAC)** was 12.4 percent (first half of 2017: 11.0 percent).

3.2.2 BSH

At BSH, **net interest income** declined by 8.5 percent to €387 million (first half of 2017: €423 million).

This change was primarily attributable to the persistently low level of interest rates, which recovered only slightly year on year. Gains and losses on investments in joint ventures and associates accounted for using the equity method were on a par with the first half of 2017, amounting to a net gain of €12 million.

As capital market rates for investments remained low, interest income arising on the investment of available funds in registered securities and bearer bonds declined significantly.

In the case of loans issued under advance or interim financing arrangements, BSH managed to strengthen its income from non-collective business once again in the first half of 2018 on the back of a marked expansion in business over the last few years and despite a fall in average returns. This growth more than made up for the decline in income from home savings loans and other building loans.

Under interest cost, the decrease in net income associated with the growth in the volume of home savings deposits was largely offset by the higher proportion of low-interest-rate tariffs. Home savings deposits rose again, by €1.9 billion, in the reporting period to reach a record volume of €60.2 billion as at June 30, 2018 (December 31, 2017: €58.3 billion).

This impressive volume of home savings deposits reflects customers' appreciation of the financing function of home savings, which enables them to lock in the favorable interest rates for as long a period as possible. It also offers them a reliable basis for calculating their finances in times of volatile financial markets. Almost 60 percent of Germans now take advantage of home ownership as a way of accumulating wealth, compared with just 50 percent in 2013.

The BSH subgroup's **net fee and commission income** improved by €10 million to a net expense of €12 million (first half of 2017: net expense of €22 million).

This improvement was due to the fall in fees and commissions not directly attributable to the conclusion of a home savings contract.

In the home savings business, Bausparkasse Schwäbisch Hall signed approximately 300,000 new home savings contracts, thereby beating the impressive level of new home savings business of €15.1 billion achieved in the first half of 2017 by €0.9 billion. The volume for the period under review was €16.0 billion.

Bausparkasse Schwäbisch Hall achieved a new business volume of €6.7 billion in the home finance business, a further rise of €0.3 billion compared with the corresponding amount for the first half of 2017 of €6.4 billion. This figure does not include home savings loan contracts and bridging loans from Bausparkasse Schwäbisch Hall or other referrals totaling €1.0 billion (first half of 2017: €0.9 billion). If they are included, the total volume of new home finance business came to €7.7 billion, a year-on-year increase of 5.4 percent (first half of 2017: €7.3 billion).

The impressive rate of growth in home savings and home finance can be explained, above all, by the strong inclination of investors to benefit early on from the advantages of using home ownership as a way of saving for old age. Unlike all other forms of investment, the benefit of savings on rent is felt immediately upon purchasing the property without having to wait until retirement.

It is therefore no surprise that, with economic conditions remaining stable, the reporting period saw continued brisk demand for housing. However, there is still a significant level of excess demand despite the further slight increase in the number of homes built in 2017. The construction industry is operating at virtually full capacity. Further reasons why demand for new housing is not being met are the trends of increasing urbanization and the decrease in the average number of people per household.

For the home savings and home finance business, there is also substantial potential for the future as a result of the considerable need to modernize existing real estate, especially as around seven out of ten homes are more than 35 years old. This modernization deficit is not only affecting the quality of living accommodation but also damaging the environment: Residential buildings account for two-thirds of energy consumption in Germany. An increase in the modernization rate alone from the current level of 1 percent to 2 percent would mean an energy-efficient upgrade for 70 percent of the housing stock.

Age-appropriate housing is another key area for future growth, and there is likely to be a substantial increase in the renovation of current housing stock because currently only around 5 percent of the approximately 11 million households made up of older people are in a property with barrier-free access.

By cross-selling supplementary products, Bausparkasse Schwäbisch Hall field sales staff also sold cooperative bank pension products, Union Investment Group investment funds, and R+V insurance policies.

The fees and commissions to be paid to the cooperative banks and to the integrated, bank-supported field sales force across all business lines for the first half of 2018 increased to €284 million. Under IFRS 9 rules, some of these are recognized as interest cost.

The **gains and losses on investments** amounting to a net gain of €11 million (first half of 2017: net gain of €15 million) were primarily attributable to the sale of securities.

Administrative expenses increased by €4 million to €237 million (first half of 2017: €233 million). Within this total, staff expenses fell by €2 million to €111 million (first half of 2017: €113 million). Other administrative expenses advanced by €6 million to €126 million (first half of 2017: €120 million), above all due to higher IT expenses and increased contributions and fees.

Profit before taxes decreased by €31 million to €172 million (first half of 2017: €203 million), primarily as a consequence of the changes described above.

The **cost/income ratio** in the period under review came to 57.7 percent (first half of 2017: 53.2 percent).

Regulatory RORAC was 31.7 percent (first half of 2017: 39.5 percent).

3.2.3 DVB

Net interest income at DVB contracted by 22.3 percent year on year to €80 million (first half of 2017: €103 million).

The reduction in net interest income was largely attributable to the reduced volume of the portfolio as a result of ongoing early repayments of loans. This had a further adverse effect on net interest income because the resulting available funds are invested with the ECB, which pays negative interest rates. The objective of the NCA portfolio, which has been segregated as part of the restructuring of the business lines that was initiated in 2017, is to preserve as much of the value as possible of the assets that are no longer part of core business (non-core assets, NCA).

Net income from long-term equity investments improved by €12 million to €5 million (first half of 2017: net loss of €7 million). The figure for the prior-year period had been affected by losses reported by some equity-accounted entities as a result of loan loss allowances in respect of shipping and container portfolios.

The international transport industry again experienced overcapacity within some segments of the international maritime shipping market during the reporting period, resulting in sharply falling freight rates and considerable pressure on shipping prices.

The DVB subgroup generated new transport finance lending business of €1.9 billion in the first half of 2018 (first half of 2017: €1.8 billion) based on a total of 67 deals (first half of 2018: 65 deals). DVB continues to maintain international branches in Amsterdam, London, Oslo, and Singapore.

At €42 million, **net fee and commission income** was down by €10 million year on year (first half of 2017: €52 million).

The fee and commission income generated by ongoing lending and by new business in transport finance declined by €2 million to €11 million and by €7 million to €14 million respectively. In contrast, fee and commission income from asset management increased by €2 million to €10 million, whereas the equivalent figure from consulting declined by €3 million to €7 million.

Gains and losses on trading activities improved by €15 million to a net loss of €4 million (first half of 2017: net loss of €19 million), largely due to the change in the US dollar/euro exchange rate.

Gains and losses on investments advanced by €15 million to a net gain of €11 million (first half of 2017: net loss of €4 million). The net gain for the reporting period included proceeds of €7 million from the sale of an entity measured at cost and proceeds of €4 million from the disposal of aircraft by an equity-accounted long-term equity investment.

Other gains and losses on valuation of financial instruments improved by €44 million to a net loss of €87 million (first half of 2017: net loss of €131 million) as a result of market conditions.

Loss allowances were calculated in accordance with IFRS 9 in the reporting period and decreased by €426 million to €20 million (first half of 2017: €446 million).

Administrative expenses amounted to €97 million (first half of 2017: €103 million). Within this total, staff expenses fell by €2 million to €54 million as a result of the reduction in headcount (first half of 2017: €56 million), while other administrative expenses decreased by €4 million to €43 million especially because of lower consulting costs (first half of 2017: €47 million).

The €12 million reduction in **other net operating income** to €4 million (first half of 2017: €16 million) was primarily because the figure for the prior-year period had included income of €7 million from the sale of receivables.

The **loss before taxes** for the half-year under review amounted to €71 million. The improvement of €461 million compared with the loss of €532 million reported for the first six months of 2017 was mainly a consequence of the factors described above.

The **cost/income ratio** in the period under review was greater than 100.0 percent (first half of 2017: greater than 100.0 percent).

Regulatory RORAC was minus 34.1 percent (first half of 2017: greater than 100.0 percent).

3.2.4 DZ HYP

The merger of DG HYP and WL BANK to form DZ HYP was completed on July 27, 2018 when the necessary entries were made in the commercial register. DZ HYP is included in the interim consolidated financial statements for the period ended June 30, 2018 as a separate operating segment entity. Instead of the income statement line items of the two operating segment entities DG HYP and WL BANK, which were previously reported separately, the line items of DZ HYP are presented for the first half of 2018.

At €282 million, the **net interest income** of DZ HYP was at the same level as in the first half of 2017 (€282 million).

The main influence on net interest income in the reporting period was a sharp rise in the volume of business. However, the income generated as a result of this growth was offset by a decrease in the contribution from early redemption fees received (first half of 2018: €23 million; first half of 2017: €32 million).

The commercial real estate finance business of the former DG HYP, the real estate lending business of the former WL BANK (retail customers, institutional housing sector, and funds and investors), and the local authority loans business of DZ HYP all performed well. Effects from subsequent measurement in connection with the purchase price allocation (PPA) for the merger of the two former central institutions also had a positive impact on net interest income in the reporting period.

Demand from both German and international investors was again high in the German investment market for commercial real estate in the first half of 2018. However, commercial properties are in increasingly short supply. Against this background, the volume of transactions involving commercial real estate (excluding commercial investment in housing) came to €25.6 billion in the first six months of 2018 (first half of 2017: €25.8 billion). The volume of transactions in the market for commercial investments in housing amounted to €11.3 billion (first half of 2017: €6.2 billion).

These impressive transaction volumes are predominantly attributable to the stable economic environment and the persistently favorable funding conditions resulting from the ECB's expansionary monetary policy with a monthly bond-buying volume of €30 billion and a key interest rate of 0.00 percent. Moreover, only limited alternative investments with adequate returns are available. In respect of residential property, this market situation is compounded both by the high demand for housing created by more and more people moving to urban areas and by the smaller number of people per household resulting from demographic change.

For some years, competition has been increasing in the German real estate market as a result of these macroeconomic conditions. In the first half of 2018, this led to further price rises along with a fall in yields compared with the prior-year period. However, yields in all of Germany's seven prime locations were only slightly lower in the second quarter of 2018 than in the preceding quarter. In these locations, the focus is increasingly on the performance of investment properties, including the potential for rent increases in view of the positive economic conditions.

Investors' preferred diversification strategy of investing in real estate outside the major cities underlines the importance of the long-established close collaboration between DZ HYP's predecessor institutions and around 80 percent of the local cooperative banks in Germany.

The local cooperative banks' extensive market knowledge and proximity to their customers are the ideal complement to the specific real estate expertise of DZ HYP, its nationwide networks, market comparisons between competitors, and individual risk assessments. Supported by its regional centers in six major cities and a further eight regional offices, DZ HYP is also a reliable partner to the cooperative banks in the regions. Its decentralized market presence creates an advantage in terms of the allocation of risk because greater differentiation between credit portfolios based on region, sector, and customer group is possible.

Maintaining the conservative, selective approach to the granting of commercial real estate loans, particularly in view of the persistently challenging market and competitive environment, DZ HYP generated a new business volume of €2.6 billion in the former DG HYP's commercial real estate finance business during the first six months of 2018 (first half of 2017: €2.7 billion). Of this total, €2.5 billion (first half of 2017: €2.6 billion) was accounted for by the German market.

Continued intensification of the collaboration and joint marketing activities with the local cooperative banks in the former DG HYP's commercial real estate finance business enabled DZ HYP to further expand jointly generated new lending business, the volume in the reporting period amounting to €1.6 billion (first half of 2017: €1.5 billion).

The former WL BANK's real estate finance business with retail customers, funds and investors, and housing associations saw demand fall slightly due to rising interest rates, although it remained at a high level. Competition continues to intensify due to the arrival of new market players, in particular insurance companies, that are looking for investment options.

With the same cautious risk policy as before, the volume of real estate lending business of the former WL BANK with retail customers, the institutional housing sector, and funds and investors increased to €2.1 billion in the first half of 2018 (first half of 2017: €1.8 billion).

During the reporting period, the real estate lending business of the former WL BANK was again influenced by investors' desire to lock in interest rates for long periods. While many local cooperative banks offer their own loan products with fixed interest rates of up to 10 years, agency and brokerage business with DZ HYP continues to gain ground owing to the better funding possibilities with long-term fixed interest rates of 15 to 30 years.

Within the DZ BANK Group, DZ HYP also operates as the center of excellence for business involving public-sector customers. This primarily consists of business with local authorities in Germany, and with their legally dependent enterprises. These relationships are managed nationwide with the close involvement of the local cooperative banks. In the period under review, DZ HYP extended new local authority loans with a total volume of €0.4 billion to around 7,000 customers (first half of 2017: €0.4 billion).

Other gains and losses on valuation of financial instruments amounted to a net gain of €30 million in the six months under review (first half of 2017: net gain of €161 million). This was the result of changed credit spreads for bonds from the eurozone's periphery and, in addition, net gains on third-party securities, local authority loans, and own issues that are measured at fair value.

Loss allowances were calculated in accordance with IFRS 9 in the reporting period and amounted to a net reversal totaling €4 million (first half of 2017: net reversal of €7 million), including a net reversal of €2 million of loss allowances for loans and advances to customers, a net reversal of €3 million of loss allowances for investments, and a net addition of €1 million to loss allowances for other loans and advances.

Administrative expenses increased by €36 million to €162 million (first half of 2017: €126 million). This included a €3 million rise in staff expenses to €49 million (first half of 2017: €46 million). Other administrative expenses went up by €33 million to €113 million (first half of 2017: €80 million), one of the main factors being the €25 million increase in expenses for consulting services to €47 million (first half of 2017: €22 million). The consulting expenses included an amount of €33.7 million (first half of 2017: €7.0 million) relating to the following two projects: the 'Commercial real estate finance portfolio integration' project, which involved expenses in connection with the transfer of the commercial real estate portfolio from the former WGZ BANK to the former DG HYP; and the 'Real estate business reorganization' project, which included the necessary consulting and other services in connection with the merger between the former DG HYP and the former WL BANK.

Profit before taxes declined by €172 million to €164 million in the half-year under review (first half of 2017: €336 million). The primary reason behind this decrease was the negative change in other gains and losses on valuation of financial instruments as a consequence of the factors described above.

The **cost/income ratio** came to 50.3 percent in the first half of this year (first half of 2017: 27.7 percent).

Regulatory RORAC was 22.8 percent (first half of 2017: 45.3 percent).

3.2.5 DZ PRIVATBANK

Net interest income at DZ PRIVATBANK contracted by 45.0 percent year on year to €33 million (first half of 2017: €60 million).

The decrease in net interest income was almost entirely due to the fact that the figure for the reporting period contained the sales commission on interest-bearing transactions for the first time (first half of 2018: expense of €26.5 million; first half of 2017: expense of €29.3 million). This commission had been included in net fee and commission income in the prior-year period. Net interest income in the first half of 2018 was also squeezed by the persistently low level of interest rates, the ongoing implementation of a risk-conscious investment strategy, and the expiry of securities exposures bearing higher rates of return.

DZ PRIVATBANK acts as the competence center for foreign-currency lending and investing in the interest-earning business. The average volume of guaranteed LuxCredit loans was €4.4 billion during the reporting period, which was marginally lower than in the first half of 2017 (€4.8 billion).

The decentralized collaboration with the cooperative banks in Germany is coordinated through the ten branches of DZ PRIVATBANK in Berlin, Düsseldorf, Frankfurt, Hamburg, Hannover, Leipzig, Munich, Nuremberg, Oldenburg, and Stuttgart.

Net fee and commission income rose by 51.6 percent to €94 million (first half of 2017: €62 million).

The increase in net fee and commission income is largely due to the fact that, as referred to above, sales commission on interest-bearing transactions was recognized for the first time under net interest income in the reporting period (first half of 2018: expense of €26.5 million; first half of 2017: expense of €29.3 million). Moreover, fee and commission income increased both from the fund services business and from private banking.

As at June 30, 2018, the value of funds under management amounted to €108.5 billion (December 31, 2017: €108.8 billion). The number of fund-related mandates as at June 30, 2018 was 583 (December 31, 2017: 579).

At the end of the first half of 2018, the funds managed on behalf of high-net-worth individuals was slightly higher than at the end of 2017 at €17.5 billion (December 31, 2017: €17.3 billion). The funds under management comprise the volume of securities, derivatives, and deposits of customers in the private banking business.

Other gains and losses on valuation of financial instruments deteriorated by €7 million to a net loss of €2 million (first half of 2017: net gain of €5 million) as a result of market conditions.

The fall in **administrative expenses** of €1 million to €115 million (first half of 2017: €116 million) was a consequence of the small €1 million reduction in staff expenses to €64 million. General and administrative expenses fell slightly to reach €46 million (first half of 2017: €47 million) despite higher regulatory charges and IT costs than in the first half of last year. Depreciation and amortization expense was up by €1 million to €5 million (first half of 2017: €4 million).

Other net operating income amounted to a net expense of €7 million (first half of 2017: net expense of €6 million) and mainly consisted of an amortization expense of €8 million in respect of acquired customer relationships (first half of 2017: €8 million).

In view of the effects from the factors described above, **profit before taxes** declined by €4 million to €8 million (first half of 2017: €12 million).

The **cost/income ratio** for DZ PRIVATBANK in the period under review came to 93.5 percent (first half of 2017: 90.6 percent).

Regulatory RORAC was 4.6 percent (first half of 2017: 8.4 percent).

3.2.6 R+V

Premiums earned rose by 9.6 percent to €8,115 million (first half of 2017: €7,403 million), exceeding the impressive level of premiums earned in the first half of 2017.

Premium income in the life insurance and health insurance business of R+V increased by 12.3 percent to €4,059 million.

In the life insurance business, premium income rose by 12.8 percent to €3,765 million. This growth was predominantly attributable to one-off premiums, particularly in the Performance Rente and bAV product lines, whereas premiums from products in the classic and unit-linked businesses declined.

At R+V Krankenversicherung AG, Wiesbaden, premium income increased by 6.1 percent to €294 million. The year-on-year growth in the full health insurance and occupational health insurance lines was particularly encouraging.

In the non-life insurance business, premium income advanced by 4.5 percent to €2,918 million. This growth was predominantly generated from vehicle insurance and from corporate liability insurance.

Premiums earned from inward reinsurance rose by 14.3 percent to €1,138 million year on year, driven mainly by the vehicle insurance sectors and the loan/deposit sector.

Gains and losses on investments held by insurance companies and other insurance company gains and losses declined by 32.6 percent to a net gain of €1,269 million (first half of 2017: net gain of €1,883 million).

Long-term interest rates went up from the beginning of 2018 although, by the end of the reporting period, they had only returned to the level seen at the end of June 2017. Equities markets relevant to R+V did worse during the first six months of 2018 than they had in the first half of last year. On the whole, the euro performed much more favorably against a variety of currencies in the first half of 2018 than it had in the first six months of 2017.

Overall, these trends in the reporting period essentially resulted in a €414 million deterioration in unrealized gains and losses to a net loss of €196 million (first half of 2017: net gain of €218 million) and a €622 million reduction in the contribution to earnings from disposals of investments to €89 million (first half of 2017: €711 million). Moreover, current income fell by €62 million to €1,192 million (first half of 2017: €1,254 million). These negative effects were offset by a €40 million reduction in impairment losses to €23 million (first half of 2017: €63 million) and a significant improvement in foreign exchange gains and losses, which advanced by €506 million to a net gain of €122 million (first half of 2017: net loss of €384 million).

Owing to the countervailing effects from the recognition of provisions for premium refunds (particularly in the life insurance and health insurance business) and claims by policyholders in the unit-linked life insurance business in the ‘insurance benefit payments’ line item presented below, however, the change in the level of gains on investments held by insurance companies only partially affected the level of net income from insurance business before taxes in the half-year period.

Insurance benefit payments increased by 2.2 percent from €7,543 million in the first half of 2017 to €7,709 million in the first six months of 2018.

In line with the change in premium income and in gains and losses on investments held by insurance companies and other insurance company gains and losses, higher additions were made to insurance liabilities at companies offering personal insurance. Furthermore, an amount of €534 million was added to the supplementary change-in-discount-rate reserve (first half of 2017: €341 million).

The non-life insurance business had to absorb expenses arising from storms Friederike and Burglind of around €100 million and from storms Wilma and Yvonne of around €40 million during the reporting period.

Inward reinsurance business in Europe performed well on the whole, with particularly strong growth in the United Kingdom. Business was also encouraging in Asia, whereas other regions registered a decrease in income.

Insurance business operating expenses went up by 4.1 percent to €1,406 million (first half of 2017: €1,350 million) in the course of ordinary business activities in all divisions, with a particularly sharp rise in the non-life segment.

Given the factors described above, **profit before taxes** for the reporting period declined by €115 million to €274 million (first half of 2017: €389 million).

3.2.7 TeamBank

Net interest income at TeamBank amounted to €221 million, a rise of 4.7 percent compared with the figure of €211 million in the first six months of 2017. This increase was the consequence of a greater portfolio of existing contracts in the easyCredit business.

TeamBank is the consumer finance specialist in the cooperative financial network and, in the period under review, benefited from buoyant consumer demand fueled by the continued stability of the German economy along with low interest rates and rising real wages.

TeamBank continued to focus on the ongoing digital revolution and the associated technological challenges in the first half of 2018. In this environment, consumer finance was a favored area of business for new providers – particularly online portals – to target. Consequently, competition in the market intensified noticeably yet again.

Despite these challenging conditions, TeamBank succeeded in increasing loans and advances to customers by a substantial 3.2 percent to €8,217 million as at June 30, 2018 (December 31, 2017: €7,966 million). The number of customers rose again, by 31,000, to reach 864,000.

This encouraging performance is rooted in the steadfast focus of business activities on TeamBank's unique selling proposition derived from its positioning as an all-round fair lender, reflecting the cooperative values also embodied by the local cooperative banks. The success of the business model, which is based on trust-based partnership, is demonstrated by the fact that TeamBank works in collaboration with 809 of Germany's 912 cooperative banks and with 105 partner banks in Austria.

In the reporting half-year, TeamBank focused on aligning its business activities with market requirements in respect of digitalization and systematically ensuring that all changes are conceived from the customer perspective. The integration of all customer touchpoints – mobile, online, and offline – in a digital ecosystem for liquidity management gives customers easy access to liquidity and services wherever and whenever they want. The digital ecosystem implemented by TeamBank is helping to strengthen the customer relationships already in place, utilize the potential offered by existing customers, and win new customers for the cooperative financial network.

Having introduced the seamless cross-media payment process 'ratenkauf by easyCredit', TeamBank is so far the only provider, both in e-commerce and at the point of sale, to offer a simple and uniformly designed installment purchase function. Moreover, an app called 'fymio', an innovative, proactive personal finance management facility, gives customers a projection of their future liquidity based on intelligent analysis of the transactions across all of their accounts.

Another milestone in creating a fully digitalized customer process was TeamBank's launch in February 2018 of a pilot program that enables loans of up to €3,000 to be sold based on account transaction data. Customers benefit from having to record much less information themselves, which also saves them time.

In the first half of 2018, TeamBank continued to strengthen the market presence of its product variants, which have been successfully established as part of its customer business. In addition to Finanzreserve with a credit card, customers have also been able to benefit from easyCredit-Finanzreserve without a card since October 2016, providing them, free of charge, with a cash reserve incorporating a simple drawdown function. As at June 30, 2018, around 191,000 customers had either signed up for easyCredit-Finanzreserve or were already using this fair and flexible means of borrowing. As a result, some 12 percent of new business was already being generated through easyCredit-Finanzreserve.

The innovative advisory concept known as easyCredit-Liquiditätsberater is helping the cooperative idea to gain more prominence. Approximately 60,000 members benefited from advice in the first half of 2018, of whom around 9,000 were new to the cooperative financial network.

Net fee and commission income declined by €8 million to a net loss of €5 million (first half of 2017: net income of €3 million).

This change was primarily due to the lower level of new business and the related fall in fee and commission income from loan protection insurance agreements.

Loss allowances, which were calculated in accordance with IFRS 9 in the half-year under review, decreased by €2 million to €32 million, compared with €34 million in the corresponding period last year. This was largely because the easyCredit portfolio expanded at a slower rate than in the first half of 2017.

As budgeted, **administrative expenses** rose by €7 million to €112 million (first half of 2017: €105 million), including an increase in staff expenses of €3 million to €45 million (first half of 2017: €42 million) and an increase in other administrative expenses of €4 million to €67 million (first half of 2017: €63 million). The rise in other administrative expenses was predominantly due to higher IT, auditing, and consulting expenses as well as increased expenses for third-party services.

Profit before taxes for the first half of 2018 amounted to €76 million. This small decrease of €2 million compared with the figure of €78 million reported for the first half of 2017 was mainly a consequence of the factors described above.

TeamBank's **cost/income ratio** in the period under review came to 50.9 percent (first half of 2017: 48.4 percent).

Regulatory RORAC was 34.2 percent (first half of 2017: 36.8 percent).

3.2.8 UMH

Net fee and commission income at UMH fell by 6.0 percent to €705 million (first half of 2017: €750 million).

The change in net fee and commission income was predominantly due to the factors described below. Due to the rise in the average assets under management of the Union Investment Group, which climbed by €26.7 billion to €328.9 billion (first half of 2017: €302.2 billion), the volume-related contribution to net fee and commission income rose significantly compared with the prior-year period. It accounted for 89.5 percent of net fee and commission income in the first six months of 2018.

The assets under management of the Union Investment Group comprise the assets and securities portfolios measured at their current market value, also referred to as free assets or asset management, for which Union Investment offers investment recommendations (advisory) or bears responsibility for portfolio management (insourcing). The assets are managed both for third parties and in the name of the group. Changes in the managed assets occur as a result of factors such as net inflows, changes in securities prices, and exchange-rate effects.

In the reporting half-year, income from performance-related management fees was significantly lower than in the corresponding prior-year period. Income from real estate fund transaction fees decreased compared with the first half of 2017.

In the first half of 2018, global capital markets were significantly more volatile than in the second half of 2017. The main influences included escalating international trade disputes, political issues such as the formation of a government in Italy and the US withdrawal from the Iran nuclear deal, and emerging signs of a shift in the direction of the ECB's monetary policy. Given these conditions, the growth prospects for the eurozone and Germany have been diminishing slightly since the start of the year.

Amid this growing uncertainty, Union Investment's investment solutions attracted increased demand as a sought-after instrument for long-term investing. In particular, retail clients took a keener interest in investment funds from Union Investment as a way of gradually supplementing interest-focused investments with material and intangible assets, thereby reflecting the evolution of saving.

This trend was impressively highlighted by the buoyant growth of new business with retail clients in the half-year under review. Building on the high level of €4.1 billion registered in the first six months of last year, Union Investment generated net inflows of €4.7 billion in the reporting period. This success was predominantly the result of long-standing and trust-based partnership with the local cooperative banks, whose expertise and strong dependability again proved to be an anchor of stability for the multitude of customer relationships.

The six variants in the innovative PrivatFonds product range, which are focused on customers' need for security, again attracted a great deal of attention from customers in the first half of 2018. The multi-asset solutions from Union Investment have proven to be a popular investment instrument during the phase of persistently low interest rates, notching up net inflows of €2.2 billion in the period under review. As a result, the portfolio had grown by €1.6 billion to €22.5 billion as at June 30, 2018 (December 31, 2017: €20.9 billion).

The Union Investment Group's open-ended real estate funds, which invest in tangible assets, are also a popular option for investment diversification. The three open-ended real estate mutual funds and the UniImmo:Wohnen ZBI fund, which was issued in July 2017 to add residential real estate to the range of investment funds, generated net new business of €0.5 billion with retail clients.

At a time of low interest rates, Union Investment's fund-linked savings plans represent an extremely rewarding type of investment for long-term accumulation of wealth and give customers the opportunity to achieve adequate returns over the maturity period on the basis of a balanced and broadly diversified investment. The number of traditional fund-linked savings plans had risen to 2.1 million contracts by the end of the period under review, with an increase in the 12-month savings volume to €3.9 billion (June 30, 2017: €3.3 billion).

Furthermore, the fund-based Riester pension products (UniProfiRente and UniProfiRente Select) of the Union Investment Group, which is the market leader in this area, made a significant contribution to total net inflows in the retail business, generating net inflows of €0.6 billion in the six months under review. The total assets in the portfolio of Riester pension solutions swelled by €0.7 billion in the first half of 2018 to reach €17.2 billion (December 31, 2017: €16.5 billion).

In its institutional business, the Union Investment Group generated net inflows amounting to €6.6 billion (first half of 2017: €9.9 billion). A total of 22 new institutional clients were acquired in the first half of 2018.

In an age of persistently low interest rates and increasing complexity in the stock markets, institutional client portfolios are becoming significantly more diversified. On the whole, customers' securities accounts encompass a higher number of asset classes and a broader country allocation. Products with higher risk premiums were particularly popular in the first six months of 2018. Funds with a focus on structured credits saw especially strong demand. Convertible bond funds also attracted healthy interest. Real estate fund products remained high on the wish list of many institutional investors, but limited availability of properties with a suitable risk/return profile put the brakes on investment activity. In addition to these long-term strategies, many institutional clients used money-market and money-market-linked funds to manage their liquid assets.

Institutional clients again showed increased interest in sustainability-related solutions. Unlike in the early years of sustainable investments, investors are now taking a keen interest in economic aspects and not just in ethical, social, and environmental factors. For this reason, Union Investment now systematically incorporates sustainability criteria into the investment process and even integrates its expertise in this area into classic portfolio strategies. At the end of the reporting period, a total of €42.1 billion was invested with Union Investment, one of Germany's leading asset managers, in accordance with sustainability criteria (December 31, 2017: €33.5 billion). This equates to an increase of 25.7 percent.

Moreover, the Union Investment Group's outstanding reputation as a professional risk and portfolio manager was particularly reflected in the popularity of capital preservation strategies, which had attracted a volume of investment of €26.5 billion by the end of the first half of 2018 (December 31, 2017: €25.4 billion).

The €24 million decline in **other gains and losses on valuation of financial instruments** to a net loss of €22 million (first half of 2017: net gain of €2 million) can be explained primarily by the negative contribution from the valuation of own-account investments. At the same time, expenses in relation to the valuation of guarantee commitments increased year on year.

Administrative expenses rose by €32 million to €425 million (first half of 2017: €393 million). This included an increase in staff expenses of €11 million to €198 million, which mainly resulted from average salary increases and appointments to new and vacant posts. The rise in other administrative expenses of €21 million to €227 million was mostly accounted for by higher expenses for research (external research studies) and office expenses.

Other net operating income improved by €16 million to €16 million. The main item in the corresponding figure of €0 million for the first half of 2017 was expenses in connection with the Next Generation Sourcing reconciliation of interests.

Profit before taxes went down by €89 million to €273 million (first half of 2017: €362 million), primarily due to the changes described above.

The **cost/income ratio** came to 60.9 percent in the first half of this year (first half of 2017: 52.0 percent).

Regulatory RORAC was greater than 100.0 percent (first half of 2017: greater than 100.0 percent).

3.2.9 VR LEASING

Net interest income at VR LEASING climbed by 8.6 percent year on year to €76 million (first half of 2017: €70 million).

The growth of net interest income was almost entirely attributable to the increase in the core business, in particular as a result of the sharp rise in the volume of the digital product 'VR Smart flexibel' (until July 2018: VR Leasing flexibel). This offset the slight drop in net interest income from non-core business, which is being scaled back in accordance with the strategy and constitutes real estate leasing, automotive trade and vehicle fleet business, centralized settlement, BFL Leasing, hire purchase and leasing business with a value of more than €750,000, and VR LEASING's factoring and international business.

In the reporting half-year, VR LEASING's market strategy centered on the company's transformation into a digital provider of finance for the self-employed and small businesses. VR LEASING's business activities are geared to providing decentralized support for the cooperative banking sector with an innovative range of products offering simple, rapid, and tailored financing solutions for Germany's small and medium-sized enterprises, which have strong regional ties. The products cater to market requirements in a digital age and are aimed at both small-scale and large-volume business. The product range encompasses leasing, hire purchase, and loans, as well as digital services that help small-business and self-employed customers to manage their day-to-day finances.

The various digitalized solutions are designed to support the banks in the cooperative financial network in making even better use of the income potential offered by their small-business and self-employed customers. For example, the digital platform VR LeasyOnline incorporates integrated, automated decision-making, enabling cooperative banks to make decisions on financing up to an amount of €250,000 within minutes, particularly for small-business customers and the self-employed.

Through VR LeasyOnline, customers can also access the 'VR Smart express' asset finance solution (until July 2018: VR Leasing express) and the 'VR Smart flexibel' business lending product (until July 2018: VR Leasing flexibel), providing particularly flexible and rapid instant financing up to a sum of €60,000. In July 2018, the maximum financing limit for 'VR Smart express' was raised to €250,000.

The growing importance of internet financing solutions was underlined by the year-on-year rise of 9.9 percent (first half of 2017: 43.2 percent) in the volume of online business (leasing and lending) transacted with the cooperative banks in the first half of 2018. The proportion of total new business (leasing and lending) accounted for by contracts concluded online increased from 83.4 percent in the first half of 2017 to 85.2 percent in the reporting period. Digitalization does not prevent a personal customer relationship, however. Rather, the new digital channels strengthen the regional primary banks' customer focus in line with the cooperative principle.

Nevertheless, rapid market changes in the era of digitalization require solutions and processes to be refined and updated on an ongoing basis in order to keep up with the ever-shorter innovation cycles. That is why VR LEASING's innovative online order channel is gaining significance: Small-business customers of the cooperative banks can now use an entirely online process to enter into a borrowing agreement at any time on the website of their local cooperative bank.

In August 2017, VR LEASING launched a new application known as SmartBuchhalter (smart bookkeeper) that is designed to give self-employed people and small businesses a simple overview of their financial situation. This new product is to be combined with DZ BANK's VR-FinanzGuide, which is also a digital application for simple accounting and financial planning, so as to be able to offer an even more effective alternative product to the corporate customers of the cooperative banks.

Net fee and commission income declined by €3 million to €5 million (first half of 2017: €8 million).

The main reason for this change was the level of trailer fees to be paid to the local cooperative banks, which climbed by €5 million to €11 million in line with the volume of business.

Gains and losses on investments amounted to a net gain of €7 million (first half of 2017: net gain of €6 million). The figure for the first half of 2018 included a reversal of the impairment loss, in an amount of €7 million, on VR-LEASING AG's 50 percent long-term equity investment in VB-Leasing International Holding GmbH, Vienna, (VBLI), which is accounted for using the equity method, following its measurement at fair value.

Expenses for **loss allowances**, which amounted to €2 million (first half of 2017: €6 million), included a net addition of €2 million for loans and advances to customers.

Administrative expenses rose slightly, by €1 million, to €70 million (first half of 2017: €69 million). Within this total, staff expenses fell by €6 million to €38 million (first half of 2017: €44 million), mainly due to the reduction in the number of full-time equivalents. Furthermore, other administrative expenses increased by €7 million to €32 million (first half of 2017: €25 million), in particular because of higher consulting expenses in connection with VR LEASING's transformation into a digital provider of finance for the self-employed and small businesses.

Other net operating income amounted to a net expense of €15 million (first half of 2017: net income of €4 million). The main reason for this year-on-year decline of €19 million was that the figure for the first half of 2018 included restructuring expenses of €12 million relating to the company's transformation into a digital provider of finance for the self-employed and small businesses.

VR LEASING's **profit before taxes** amounted to €1 million (first half of 2017: €13 million), largely as a consequence of the factors described above.

The **cost/income ratio** in the six months under review came to 95.9 percent (first half of 2017: 78.4 percent).

Regulatory RORAC was 0.6 percent (first half of 2017: 8.1 percent).

3.2.10 Other/Consolidation

The consolidation-related adjustments shown under Other/Consolidation to reconcile operating segment profit/loss before taxes to consolidated profit/loss before taxes are attributable to the elimination of intragroup transactions and to the fact that investments in joint ventures and associates were accounted for using the equity method.

The adjustments to net interest income were primarily the result of the elimination of intragroup dividend payments and profit distributions in connection with intragroup liabilities to dormant partners and were also attributable to the early redemption of issued bonds and commercial paper that had been acquired by entities in the DZ BANK Group other than the issuer.

The figure under Other/Consolidation for net fee and commission income largely relates to the fee and commission business of TeamBank and the BSH subgroup with the R+V subgroup.

The remaining adjustments are mostly also attributable to the consolidation of income and expenses.

4 Net assets

As at June 30, 2018, the DZ BANK Group's **total assets** had increased by €32.6 billion, or 6.5 percent, to €538.2 billion (December 31, 2017: €505.6 billion). The total assets of DZ BANK and R+V grew by €24.0 billion and €4.8 billion respectively, while those of BSH and DZ PRIVATBANK rose by €2.1 billion and €1.4 billion respectively. By contrast, DVB's total assets fell by €1.9 billion.

The **volume of business** amounted to €934.5 billion (December 31, 2017: €871.1 billion). This figure comprised the total assets, the assets under management at UMH as at June 30, 2018 amounting to €332.7 billion (December 31, 2017: €323.9 billion), the financial guarantee contracts and loan commitments amounting to €62.6 billion (December 31, 2017: €40.5 billion), and the volume of trust activities amounting to €1.0 billion (December 31, 2017: €1.1 billion).

The DZ BANK Group's **loans and advances to banks** rose to €92.8 billion, an increase of €3.4 billion or 3.8 percent. Loans and advances to banks in Germany went up by €2.5 billion to €86.2 billion, and loans and advances to foreign banks increased by €0.9 billion to €6.6 billion. The amounts as at December 31, 2017 have been restated (see note 2 in the notes to the interim consolidated financial statements).

The DZ BANK Group's **loans and advances to customers** increased by €3.2 billion, or 1.8 percent, to €177.6 billion. Loans and advances to customers grew by €2.0 billion at BSH, by €1.1 billion at DZ BANK, by €0.4 billion at DZ HYP, and by €0.3 billion at TeamBank. However, loans and advances to customers at DVB decreased by €1.1 billion.

As at June 30, 2018, **financial assets held for trading** amounted to €40.9 billion, an advance of €2.2 billion or 5.7 percent on the figure as at December 31, 2017. In particular, bonds and other fixed-income securities rose by €2.4 billion, while derivatives (positive fair values) declined by €0.4 billion.

Investments were down by €7.7 billion, or 13.3 percent, to €49.8 billion. The main reason for this change was the €7.4 billion contraction in holdings of bonds and other fixed-income securities.

Investments held by insurance companies rose by €4.7 billion, or 4.9 percent, to €101.1 billion (December 31, 2017: €96.4 billion), above all due to a €3.1 billion increase in fixed-income securities to €48.0 billion and a €1.0 billion increase in registered bonds to €10.1 billion.

The DZ BANK Group's **deposits from banks** as at June 30, 2018 amounted to €144.3 billion, which was €8.2 billion, or 6.0 percent, higher than the figure reported as at December 31, 2017. Deposits from domestic banks were up by €1.7 billion to €126.4 billion, while deposits from foreign banks increased by €6.5 billion to €17.9 billion.

Deposits from customers grew by €11.3 billion, or 8.9 percent, to €137.6 billion. There were increases in deposits from customers at DZ BANK of €8.6 billion, at BSH of €1.7 billion, and at DZ PRIVATBANK of €1.4 billion, whereas deposits from customers went down by €0.5 billion at DZ HYP and by €0.3 billion at DVB.

FIG. 3 – TOTAL ASSETS

At the end of the reporting period, the carrying amount of **debt certificates issued including bonds** in the DZ BANK Group was €69.9 billion (December 31, 2017: €67.3 billion). Within this total, other debt certificates issued grew by €2.8 billion and bonds issued contracted by €0.2 billion.

Financial liabilities held for trading were up by €6.5 billion, or 14.6 percent, to €50.8 billion, predominantly due to the €3.9 billion rise in money market deposits and the €1.7 billion rise in bonds issued.

Insurance liabilities increased by €4.5 billion, or 5.0 percent, to €93.8 billion (December 31, 2017: €89.3 billion). This was largely attributable to rises of €2.3 billion in the benefit reserve, €0.6 billion in the provision for premium refunds, €0.5 billion in the provision for claims outstanding, and €0.8 billion in the provision for unearned premiums.

As at June 30, 2018, the **equity** reported by the DZ BANK Group was €23.8 billion (December 31, 2017: €23.5 billion). The increase of €0.3 billion can essentially be explained by the change in unappropriated earnings (June 30, 2018: €0.6 billion; December 31, 2017: €0.3 billion). Furthermore, the first-time adoption of IFRS 9 had two effects: Retained earnings as at June 30, 2018 were €0.5 billion higher than at the end of 2017 and there was a corresponding decrease of €0.5 billion in the reserve from other comprehensive income.

The **DZ BANK Group's capital and solvency situation** is described in this interim group management report in chapter V (Opportunity and risk report), section 4.2 (Regulatory capital adequacy).

5 Financial position

Liquidity management for the entities in the DZ BANK Group is carried out by the Group Treasury division at DZ BANK and on a decentralized basis by the individual subsidiaries. The individual entities are provided with funding by DZ BANK (group funding) or the entities exchange cash among themselves via DZ BANK (group clearing). Liquidity is managed within DZ BANK centrally by head office treasury in Frankfurt and by the associated treasury units in its international branches, although Frankfurt has primary responsibility.

In the context of liquidity management, the DZ BANK Group distinguishes between operational liquidity (liquidity in the maturity band of up to one year) and structural liquidity (liquidity in the maturity band of more than one year). Dedicated steering committees have been established for both types of liquidity.

The DZ BANK Group has a highly diversified funding base for **operational liquidity**. A considerable portion is accounted for by money market activities resulting from the cash-pooling function with the local cooperative banks. This enables local cooperative banks with available liquidity to invest it with DZ BANK, while local cooperative banks requiring liquidity can obtain it from DZ BANK. Traditionally, this results in a liquidity surplus, which provides the main basis for short-term funding in the unsecured money markets. Corporate customers and institutional clients are another important source of funding for operational liquidity requirements. The DZ BANK Group therefore has a comfortable level of liquidity at its disposal. Funding on the interbank market is not strategically important to the DZ BANK Group.

The DZ BANK Group issues money market products based on debt certificates through its main branches in Frankfurt, New York, Hong Kong, London, and Luxembourg. DZ BANK has initiated a standardized groupwide multi-issuer euro commercial paper program, which DZ BANK and DZ PRIVATBANK S.A. can draw on.

Money market funding also includes collateralized money market activities, which form the basis for broadly diversified funding on money markets. To this end, key repo and securities lending activities, together with the collateral management process, are managed centrally in DZ BANK's Group Treasury division. Group Treasury also has at its disposal a portfolio of investment-grade liquid securities. These securities can be used as collateral in monetary policy funding transactions with central banks, in bilateral repos, or in the tri-party repo market.

Structural liquidity activities are used to manage and satisfy the long-term funding requirements (more than 1 year) of DZ BANK and, in coordination with the group entities, those of the DZ BANK Group.

Both for the DZ BANK Group and each individual group entity, structural liquidity is measured daily on the basis of total cash flows.

DZ BANK secures its long-term funding for structural liquidity by using structured and non-structured capital market products that are mainly utilized for the local cooperative banks' own-account and customer-account securities business and marketed to institutional clients. Long-term funding that is not covered is secured through systematic integration between the entities in the DZ BANK Group. Options for obtaining covered liquidity through Pfandbriefe or DZ BANK BRIEFE are used on a decentralized basis, in other words based on the different cover assets at DZ BANK, DZ HYP, and DVB.

Long-term funding requirements in foreign currencies are covered through the basis swap market, ensuring matching maturities.

The Group Treasury division at DZ BANK carries out groupwide **liquidity planning** annually. This involves determining the funding requirements of the DZ BANK Group for the next financial year on the basis of the coordinated business plans of the individual companies. Liquidity planning is updated throughout the year.

Monthly **structural analyses** of the various resources available on the liabilities side of DZ BANK's balance sheet are also conducted. The purpose of these analyses is to provide senior management with information that can then be used as the basis for actively managing the liability profile.

To complement the description of the funding structure, further information on **liquidity risk** can be found in this interim group management report in chapter V (Opportunity and risk report), section 3.1 (Economic liquidity adequacy). The year-on-year changes in cash flows from operating activities, investing activities, and financing activities are shown in the **statement of cash flows** in these interim consolidated financial statements.