# Basis of the Commerzbank Group

## Structure and organisation

Commerzbank is one of Germany's leading banks for private and corporate customers and an internationally active commercial bank. Domestically, it currently has still one of the densest branch networks of any private-sector bank in Germany, with approximately 1,000 branches, serving a total of around 16.9 million private and small-business customers and over 70,000 corporate clients including multinational groups, financial service providers and institutional clients worldwide.

As part of its strategy, Commerzbank is focusing its business activities on the two segments Private and Small-Business Customers and Corporate Clients, offering a comprehensive portfolio of banking and capital market services. The Asset & Capital Recovery segment was dissolved on 1 July 2019 following the successful winding down of assets over the last few years, with the remaining portfolios transferred to Others and Consolidation and to the Private and Small-Business Customers segment. Each segment is managed by a member of the Board of Managing Directors. All staff and management functions are contained in Group Management: Group Audit, Group Communications, Group Compliance, Group Finance, Group Human Resources, Group Investor Relations, Group Legal, Group Tax, Group Treasury, Group Customer Process & Data Management, Big Data & Advanced Analytics and the central risk functions. The support functions are provided by Group Services. These include Group Digital Transformation & Strategy, Group Banking & Market Operations, Group Technology Foundation, Group Operations Credit, Group Organisation & Security and Group Delivery Centre. The staff, management and support functions are combined in the Others and Consolidation division for reporting purposes.

On the domestic market, Commerzbank Aktiengesellschaft is headquartered in Frankfurt am Main, from where it manages a nationwide branch network through which all customer groups are served. Its major German subsidiaries are comdirect bank AG and Commerz Real AG. Outside of Germany, the Bank has 6 material subsidiaries, 20 operational foreign branches and 30 representative offices in just under 50 countries and is represented in all major financial centres, such as London, New York, Tokyo, Hong Kong and Singapore. However, the focus of the Bank's international activities is on Europe.

Commerzbank prepares Group financial statements which, in addition to Commerzbank Aktiengesellschaft as operating lead company, incorporate all material subsidiaries over which the Bank exercises control. The financial year is the calendar year.

## Objectives and strategy

Commerzbank considers itself to be a fair and competent bank that wants to be a long-term, reliable partner for its customers. We base our actions on the highest ethical values, integrity and fairness and are committed to complying with all applicable laws, guidelines and market standards. For us, this is the basis on which we work in a relationship of trust with our private and business customers, institutional clients, partners and stakeholders. "The bank at your side" – everything we do is measured against this promise: in our advisory services, in our offerings and in the way we conduct ourselves.

In recent years we have focused on the right issues. We have aligned the bank with its customers and completely restructured it. In both market segments we have gained many new customers. We have laid important foundations in the area of digitalisation, and with Campus 2.0 we have built an agile delivery organisation. Commerzbank has achieved a lot since 2016. It is essential, however, that we respond continuously to the changing framework conditions. Our customers' wishes regarding our digital and mobile offerings and personal advisory services are evolving very rapidly. The low interest rates and subdued economic expectations are also exacerbating the situation, not just for us but for the entire sector.

Against this background, our goal is clear: we want to carry on actively and confidently shaping our future. Under the new "Commerzbank 5.0" strategy, the Bank will invest in technological innovation and its core business with the aim of accelerating digitalisation, creating growth and increasing efficiency.

Here are the key elements:

In the Private and Small-Business Customers segment, Commerzbank will focus above all on the rapid expansion of mobile banking, although the branch network will remain a key pillar of its customer offering. The Bank expects to realise additional earnings potential from the enhanced use of data, which will enable the provision of individually tailored products and services. Commerzbank is also planning to introduce a more differentiated pricing strategy. The planned integration of comdirect will allow the Bank to bundle its digital expertise.

In the Corporate Clients segment, the Bank will strengthen its market presence, particularly in the Mittelstand division, where further digitalisation and a more efficient platform should open up greater scope for sales. This is to be reinforced by the addition of sales staff in Germany, enabling the Bank to serve customers even more intensively in the future. The focus will be on better exploiting the potential of existing customer relationships and on improving capital efficiency.

The strategic programme will see the Bank invest a total of around €1.6bn in digitalisation and greater cost efficiency. This will include additional investments of €750m in digitalisation, IT infrastructure and growth. The remaining €850m will consist of restructuring costs related to the planned reduction in full-time positions (4,300 gross, 2,300 net) and the announced changes to the branch network. Commerzbank is aiming to reduce costs by around €600m by 2023 compared with the current year. Investments in the ongoing modernisation of the Group-wide IT infrastructure are geared towards reducing the Bank's IT costs to €1bn. Costs are also to be further reduced in the central divisions and segments.

The Bank aims to use the planned sale of the majority stake in mBank S.A. in Poland to generate the financial resources needed to accelerate implementation of the strategy and the related investments. The mBank sale will only take place if the offer price and transaction structure are right.

## Private and Small-Business Customers: expansion of mobile banking combined with a continued strong branch presence

In the Private and Small-Business Customers segment, the Bank is systematically expanding mobile banking under a mobile first strategy. Of the 1.7 million customer contacts occurring each day, 1.2 million already happen through mobile and online channels. With use of the mobile channel expected to increase, Commerzbank wants to obtain significantly more data points in the future and thus tap further business potential. The use of algorithms will help the Bank design products and services tailored precisely to customers' individual needs. The more intensive use of algorithms and data should also boost the efficiency of new customer acquisition.

Having significantly expanded its customer base over the past few years, Commerzbank is targeting measured growth in the Private and Small-Business Customers segment. In recent years, Commerzbank increased its active customer base by a net 1.3 million customers. The Bank is now aiming to win a net total of more than 1 million new customers in Germany by the end of 2023. Following the sale of ebase with its 1 million customers and the closure of a further 1 million largely inactive customer accounts, the Bank is set to continue its growth on an active customer base of 11.3 million.

Commerzbank is also aiming to systematically tap additional earnings potential with existing customers. The Bank is introducing a new pricing strategy that gives customers more choice in the range of services and prices offered. The basic offering will be supplemented by modular offerings. In future, under a fair use policy, inactivity will also be considered in the pricing models for otherwise free basic products.

Commerzbank will retain a nationwide presence in Germany in future with around 800 branches. The Bank is responding to changing customer needs by gradually closing around 200 branches and implementing the appropriate mix of branch formats. As customers will be making even greater use of digital channels in the future, the Bank is adapting its branch network in line with the expected changes in branch utilisation. The Bank's real estate expertise will in future be bundled in 50 new regional real estate centres.

## Bundling of digital expertise through planned integration of comdirect

The planned integration of comdirect into Commerzbank is also intended to strengthen business with Private and Small-Business Customers. Since it was founded in 1994, comdirect has set benchmarks in online banking with innovative products, services and advice. Commerzbank wants to make this acknowledged expertise available to all customers in future and therefore intends to directly leverage comdirect's high level of digital expertise for the entire Group. comdirect will become part of a strong, innovative multi-channel bank, while also benefiting from economies of scale and growth opportunities within the Group.

Customers of comdirect will keep the service offerings they are used to, while also benefiting from Commerzbank's branch presence. In return, Commerzbank customers will gain access to comdirect's outstanding brokerage offering, which will be continued under the same product brand.

## Corporate Clients: strengthening sales and increasing efficiency

In the Corporate Clients segment, Commerzbank is systematically expanding its market position. Maintaining a balance between additional business, risk appetite and capital efficiency is a clear priority. The Bank is also focusing on increasing its sales and platform efficiency.

In corporate customer business, Commerzbank wants to make better use of the potential offered by existing customer relationships while continuing to acquire new customers. It is therefore strengthening its sales organisation, with additional sales staff in Germany. Sales activities are also to be expanded in selected European markets. Further digitalisation and the efforts to improve platform efficiency will also open up greater scope for sales. In conjunction with the increase in personnel, this will allow even more intensive customer relationship management.

Commerzbank is also expanding its proven sector approach. In future, more than 500 corporate clients in Germany and selected eurozone countries will be managed under this approach, compared with only around 100 clients today. The experience gained since the approach was launched in 2016 shows that infusing comprehensive sector expertise into customer relationship management helps make existing customer relationships more profitable.

The efficiency of the corporate customer platforms is also being improved. The Bank is aiming to consolidate platforms. In future, as many international transactions as possible are to be processed on the German IT platform. Greater platform utilisation is also anticipated as a result of new business. All in all, further growth in corporate banking business will be dependent on capital efficiency and cost discipline that allows the return on capital employed to be increased. The Bank is also supporting this growth trajectory by further strengthening its credit risk expertise.

### Social responsibility to be anchored even more firmly in the business model in future

Commerzbank's economic success is and always will be founded on the social acceptance of its day-to-day business dealings. As a responsible bank, Commerzbank has long held a clear position on controversial issues such as weapons, environmentally harmful energy sources and speculative trading in basic foodstuffs. Responsible action includes careful and conscientious handling of customer data and high data security.

The Bank will adopt an even more ambitious approach to sustainability and environmental issues in future, and will work even more proactively to achieve the Paris climate targets. Commerzbank's operations are already climate-neutral. Commerzbank recently also became one of the world's first signatories to the UN Principles for Responsible Banking. This rigorous approach will also generate business opportunities. Commerzbank will also help its customers achieve enhanced sustainability in future with a greener product range. For instance, private customers are now able to take out green mortgage loans. In corporate customer business, Commerzbank will align its loan portfolio more closely with sustainability criteria.

### Release of equity through planned sale of mBank

As part of its strategy, Commerzbank is planning to sell its majority stake in mBank S.A. ("mBank") in Poland in order to realise its high value. The purpose of the sale is to generate the financial resources needed to accelerate implementation of the strategy and the associated investments. The sale would lead to a significant reduction in risk-weighted assets and the release of equity capital at Commerzbank. The mBank sale will only take place if the offer price and transaction structure are right.

Full details of the "Commerzbank 5.0" strategy can be found on the Commerzbank website at https://www.commerzbank.com.

## Corporate management

Corporate management in the Commerzbank Group is based on a value-oriented steering concept. This concept is focused on ensuring that the risks entered into by the business units are in line with the external and internal guidelines on risk-bearing capacity and on striving to achieve an appropriate return over the long term on the capital employed. In this respect, the Bank regularly monitors the allocation of scarce resources to business units and actively adapts its business strategy to changing market circumstances in order to boost the enterprise value over the long term.

The annual planning process is a key corporate management tool. In this process, the Board of Managing Directors sets targets for the business units based on the business strategy. Existing resources such as capital and risk limits are allocated to the segments in a way that reflects the targets and risk profiles. The segments put the plan into operation based on the business strategy and the results of the planning process. The Board of Managing Directors carries out regular checks to ensure that business planning is being followed. This ensures that any deviations are identified at an early stage through monthly management reporting and corrective measures are taken.

In order to manage the Group and its segments, the Bank uses the standard indicators described below, which cover all the essential dimensions of Group management. Their development is monitored as part of regular management reporting.

The management of the Bank takes account of both pillars of capital adequacy requirements. To ensure internal risk-bearing capacity at all times, planning includes allocating economic capital to the segments broken down by type of risk.

The average capital employed in the segments is calculated based on the average segmented risk-weighted assets. At Group level, Common Equity Tier 1 (CET1) is shown. The reconciliation of average capital employed in the segments to the Group's CET1 capital is carried out in Others and Consolidation. The Common Equity Tier 1 ratio is a key indicator for the Bank in capital management.

The key figures used for measuring success in the corporate management process are operating profit/loss and group profit/loss after tax and non-controlling interests, along with the cost/income and return on equity ratios and the economic value added calculated from these ratios. The cost/income ratio is used to assess cost efficiency and is defined as the ratio of operating expenses (excluding impairments of goodwill and restructuring expenses) to income before the risk result. The cost/income ratio is calculated in two variants: with and without the inclusion of compulsory contributions in the item "expenses". Segment return on equity is calculated as the ratio of operating profit/loss or pre-tax profit/loss to the average amount of regulatory capital employed. It shows the return on the equity invested in a given business segment. As is standard for value-based management concepts, the target minimum return on capital employed is derived from the expected return on the capital market. Here the focus at Group level is on the return on tangible equity.

Economic value added is the indicator used for determining the performance of the Group. It is defined as the difference between the Group's return on equity and the capital cost rate, multiplied by the Group's equity. The Group's return on equity is the ratio of the consolidated profit after tax and non-controlling interests to the average CET1 capital of the Group. The calculation of the capital cost rate is based on the capital market-oriented Capital Asset Pricing Model (CAPM) and is subject to an annual review.

As Group figures, the controlling data listed above form part of a system of other segment-specific data that vary from segment to segment depending on the business strategy.

## Remuneration report

The remuneration report is part of the corporate governance report in the "Corporate responsibility" section. It forms part of the Group Management Report.

## Details pursuant to Art. 315 (4) of the German Commercial Code (HGB)

Details pursuant to Art. 315 (4) of the German Commercial Code (HGB) can be found in the section on corporate responsibility. They form part of the Group Management Report.

## Details pursuant to Art. 315a (1) of the German Commercial Code (HGB) and explanatory report

Details pursuant to Art. 315a (1) of the German Commercial Code (HGB) and explanatory report can be found in the section on corporate responsibility. They form part of the Group Management Report.

## Details pursuant to Art. 315d of the German Commercial Code (HGB)

Details pursuant to Art. 315d in conjunction with Art. 289f of the German Commercial Code (HGB), "Declaration on corporate governance", can be found in the corporate governance report. They form part of the Group Management Report. The corporate governance report can be found at www.commerzbank.com/annualreport2019.

## Details pursuant to Art. 340i (5) in conjunction with Art. 315b (3) of the German Commercial Code (HGB)

Details pursuant to Art. 340i (5) in conjunction with Art. 315b (3) of the German Commercial Code (HGB) can be found in the section on corporate responsibility as a combined separate non-financial report and online at: www.commerzbank.com/NFR2019.

# Important business policy and staffing events

At the end of September, Commerzbank presented the cornerstones of its new "Commerzbank 5.0" strategic programme. Under the new strategy, the Bank will invest in technological innovation and its core business with the aim of accelerating digitalisation, creating growth and increasing efficiency. The stake in comdirect was consequently increased to more than 90%. Further information on this can be found in "Objectives and strategy" on page 67 ff. At the beginning of the reporting year, Commerzbank and Deutsche Bank held talks to clarify whether a merger between the two banks would generate the synergies and size needed to make significant increases in returns likely. The result of the examination was that a merger is not worthwhile. The optimisation of the Bank's capital structure was also on the agenda. We want to make banking transactions simpler, better and faster for customers through the cluster delivery organisation. There were some changes in personnel during the year within the Board of Managing Directors. The Bank also further strengthened its compliance function.

## Commerzbank in merger talks with Deutsche Bank

In mid-March 2019, Commerzbank and Deutsche Bank announced that talks had officially begun on a possible merger between the two banks. On 25 April 2019, Commerzbank and Deutsche Bank decided not to continue talks on a merger of the two institutions. Following a thorough examination it became apparent that a merger would not be in the interests of either set of shareholders or of other stakeholders.

It was a useful exercise to examine this option of consolidation within Germany. For Commerzbank, however, it was clear from the outset that any merger must result in higher and more sustainable returns for Commerzbank shareholders and improved services for customers. After detailed analysis, Commerzbank concluded that a merger with Deutsche Bank would not offer sufficient added value, especially given the implementation risks, restructuring costs and capital requirements that an integration on this scale would entail.

## Changes in the Board of Managing Directors of Commerzbank

At its meeting on 11 July 2019, Commerzbank's Supervisory Board appointed Roland Boekhout to the Board of Managing Directors. He assumed responsibility for Commerzbank's Corporate Clients segment on 1 January 2020. Roland Boekhout, who was previously a member of the Management Board Banking of ING Group succeeds Michael Reuther. As agreed and announced in December 2018, Michael Reuther left the Bank at the end of 2019.

On 5 September 2019, CFO Stephan Engels informed the Board of Managing Directors and the Supervisory Board that he was committed to fulfilling his contract, which runs until April 2020, but would decline any offer to extend it. Stephan Engels has been CFO of Commerzbank since 1 April 2012 and is responsible for Group Finance, Group Tax, Group Treasury, Group Investor Relations and mBank. At its meeting on 26 September, the Supervisory Board decided that Dr. Bettina Orlopp will succeed Mr. Engels as CFO on or before 31 March 2020, at which time she will also take over Group Tax, Group Treasury and Group Investor Relations. Michael Mandel will assume responsibility for mBank. At the same meeting, the Supervisory Board appointed Sabine Schmittroth – previously a Divisional Board member in the Private and Small-Business Customers segment – to the Board of Managing Directors as future Director of Human Resources with effect from 1 January 2020. Sabine Schmittroth, who took charge of Group Human Resources on 1 January 2020, will additionally take on responsibility for Group Compliance by no later than 31 March 2020. Group Legal will then be headed by Martin Zielke.

## Campus 2.0 – a new delivery organisation

Following the successful experience with agile working in the Digital Campus, since mid-2019 digital products and services for our customers have been developed in a new cluster delivery organisation. The aim of this cluster delivery organisation is to make banking transactions simpler, better and faster for our customers. Specialists and IT staff work together in one team, applying agile working methods that will enable us to bring our products to market more efficiently and flexibly.

## Commerzbank acquires comdirect share package and holds more than 90% of comdirect

On 30 October 2019, Commerzbank Aktiengesellschaft published the offer document for the voluntary public purchase offer for all outstanding shares in comdirect bank Aktiengesellschaft. Commerzbank already held around 82% of the shares in comdirect. The remaining 18% were in free float. The acceptance period for Commerzbank Aktiengesellschaft's voluntary public purchase offer for all outstanding shares in comdirect bank Aktiengesellschaft ended on 6 December 2019. By the end of the acceptance period, comdirect shareholders had tendered a total of 457,343 shares. Including the comdirect shares already held by Commerzbank, this corresponded to a stake of approximately 82.63%.

At the beginning of January 2020, Commerzbank Aktiengesellschaft announced that it would acquire a block of shares in comdirect bank Aktiengesellschaft from the institutional investor Petrus Advisers Ltd. through its subsidiary Commerzbank Inlandsbanken Holding GmbH. The transaction was concluded at the end of January and Commerzbank now holds more than 90% of comdirect's shares. Commerzbank has thus reached the required threshold for a squeeze-out under merger law. Under the planned squeeze-out, comdirect shareholders will receive a cash settlement for their shares.

## Commerzbank successfully issues additional Tier 1 bond

Commerzbank Aktiengesellschaft successfully issued its first additional Tier 1 bond at the beginning of July 2019. The bond has a volume of USD 1bn and a fixed coupon of 7.0% per annum. The order book was several times oversubscribed, reflecting the extensive interest among investors. The bond is listed on the Luxembourg Stock Exchange. The issue will enable the Bank to optimise its capital structure, partially in response to the amended regulatory requirements imposed by the European Banking Authority. The subordinated bond meets the criteria set out in the Capital Requirements Regulation (CRR) for additional Tier 1 capital (AT1). The instrument has a perpetual maturity and the first call date is in April 2025. The bond terms provide for a temporary write-down in the event that the Bank's Common Equity Tier 1 ratio (CET1 ratio) drops below 5.125%.

## Further strengthening of the compliance function

The Bank continued its activities in 2019 to further strengthen the compliance function. As before, this pertains not only to structural changes. We also diligently pushed ahead with building up internal staff, staff training and the successful recruitment of additional qualified compliance experts to work at head office and in foreign locations. Following the creation of a dedicated compliance trainee programme in 2017, seven graduates were hired for this international programme in both 2018 and 2019. The eight trainees from the 2018 programme were hired as specialists in 2019.

The compliance function implemented various measures relating to global financial crime, global markets compliance and anti-bribery and corruption in order to improve the management of compliance risks. Steps were also taken to further strengthen compliance governance in Germany and abroad. Amongst other things, the strengthening of the global compliance system landscape in line with the latest market standards was rigorously driven forward. For example, a global upgrade of the systems and models for monitoring transactions with regard to money laundering and terrorist financing was largely completed in 2019, ensuring compliance with global standards on the basis of a uniform set of rules while also taking local circumstances into account in parameterisation. In 2019, Global Markets Compliance continued the Global Surveillance Implementation Programme (GSIP) launched in 2018. The programme is aimed at expanding global surveillance of trade and communications. In addition to defining the future IT target architecture and initial implementations, a target operating model for trade and communications surveillance was also designed. A uniform due diligence business partner was also established in 2019 and the corresponding IT system rolled out. This global rollout will continue at selected locations in 2020.

Commerzbank also continued its activities to expand structures and further improve existing compliance processes in the business units. These included a number of global projects. Examples include the further development of the Group Compliance framework, which meets new regulatory requirements, and a project to incorporate and implement controls applicable across divisions and risk types.

In 2015, Commerzbank reached settlements with various US authorities regarding violations of US sanctions and anti-money laundering provisions. The Bank has already dealt with the majority of the findings relating to the settlements. The Deferred Prosecution Agreement with the District Attorney of New York and the Deferred Prosecution Agreement with the US Department of Justice were subsequently terminated in March 2018 and May 2018 respectively, after consultation with the respective district attorney's offices. The Bank has also received various interim reports and on 15 October 2018 received the final report from the monitor appointed by the New York State Department of Financial Services (DFS), to which it has responded with corresponding implementation programmes. The Bank has made good progress in carrying out the implementation programmes and has executed most of the measures. The US monitor submitted its final report dated 15 October 2018, thus concluding its on-site investigations. In accordance with the terms of the engagement letter between the Bank and the monitor, the monitorship ended on 24 June 2019. Official confirmation from the DFS that Commerzbank is back under regular banking supervision following the monitorship is still pending.

For more information on compliance and on integrity and compliance at Commerzbank, please see page 129 ff. of the Group Risk Report and page 59 ff. of the combined separate non-financial report respectively.

# Economic report

## Economic conditions

### Economic environment

The trade conflict between the USA and China caused a noticeable drag on the world economy in 2019. China recorded its weakest economic growth in almost 30 years. The country suffered not only from higher US tariffs and uncertainty about the further course of the trade dispute, but also from structural problems such as high corporate debt levels that weighed on the economy. The measures taken in the spring by the Chinese government to support the economy were therefore not fully effective.

The trade conflict also left its mark on the US economy. Given the uncertainty surrounding trade policy, companies were noticeably reluctant to invest. The impetus from the tax cuts in 2018 also decreased markedly. Despite this, and against the backdrop of an increasingly scarce labour supply, economic growth was still very respectable at 2.3%. However, the US Federal Reserve still cut its key interest rates by a total of 75 basis points in the second half of the year in order to head off any risks to the economy.

Economic growth in the eurozone continued to slow in the course of 2019, ending up at just 1.2% for the year as a whole. Industry in particular was hit hard by the global weakness in demand. In contrast, the service sector proved to be surprisingly robust. This is probably due mainly to the very expansive monetary policy of the European Central Bank (ECB), because the resulting domestic demand is benefiting not only the construction industry but also the service sector in particular. With the continued slowdown in growth, the decline in unemployment has also come to a halt. At 7.4%, however, the unemployment rate is now almost as low as it was before the outbreak of the financial market crisis in 2008. With labour becoming scarcer, wage growth intensified in 2019, a trend that is also slowly being reflected in slightly higher underlying inflation. The core inflation rate, i.e. the year-on-year rate of the consumer price index excluding the highly volatile prices of energy, food and luxury goods, was 1.3% in December 2019 and thus 0.3 percentage points higher than at the end of 2018.

From the ECB's perspective, however, the upward pressure on prices is still far too weak. It therefore cut the deposit rate by 0.1 percentage points to –0.5% in September and resumed its bond purchasing programme in December at a net pace of €20bn per month.

The heavily export-dependent German economy suffered particularly from weaker demand from abroad. Added to this were the problems in the automotive industry. At 0.6%, economic growth in 2019 was significantly weaker than the 2018 figure of 1.5%. The decline in unemployment came to a halt.

The interest rate cuts by the US Federal Reserve and the ECB brought relief to the financial markets. At the end of 2019, the ten-year German government bond was clearly in negative territory at –0.3%, after reaching a new all-time low of –0.7% at the end of August. Share prices also rose sharply despite the uncertainty surrounding trade policy, with the DAX gaining 25% in 2019. Although the US Federal Reserve relaxed its monetary policy to a much greater extent than the ECB, the US dollar continued to appreciate slightly against the euro.

### Sector environment

2019 was another challenging year for the financial industry. Domestic demand, which continued to benefit from favourable financing conditions and rising income for employees, was once again the mainstay of economic activity in the eurozone along with the services sector. Industry remained very problematic, however. In particular, the unresolved trade dispute between the USA and China and the ongoing conflicts in the Middle East had a sustained negative impact on international trade flows, which in turn affected export financing in the banking sector. The automobile manufacturing industry, which is important for the banking sector, also continued to battle substantial problems – in addition to the trade problems, it was confronted with other challenges relating to climate protection in particular, which also affected other industrial sectors. There was also uncertainty surrounding the high punitive tariffs that the USA is threatening to impose on car imports from the EU, although a final decision by the US administration is still pending.

The trade problems were compounded in Europe by the unforeseeable consequences of Brexit and the latent risk of a general loss of confidence in the stability of Italy's state finances, which significantly dampened macroeconomic stimulus. This applies above all to Germany's export industry, which is hugely important to the country's economic performance and thus also to the banking sector. Against this backdrop, business with corporate and small-business customers in Germany is still noticeably under pressure.

In Germany, banks' retail banking business fared better than business with corporate and small-business customers. It benefited from robust domestic demand, which was supported by further growth in consumption. The labour market also remained stable, despite the threat of job losses in industry. In addition, Germany is experiencing its third real estate boom since the 1970s. Residential property prices have been rising since 2010 at rates that are well above comparable parameters such as consumer prices, rents and disposable income of private households. Lending business in the German banking sector thus expanded again, with housing loans increasing by more than 5% year on year as of September 2019. Consumer instalment loans increased by almost 2.5% over the same period.

The prospects for the banks' securities commission business were also comparatively favourable, with the capital markets performing surprisingly well given the weakness of the German industrial economy. The DAX gained around 25% over the course of 2019. Three key interest rate cuts by the US Federal Reserve boosted the US stock market, with knock-on effects for the EU and Germany. The number of private shareholders in Germany is also likely to have increased again in 2019. However, the future impetus for share prices will be limited. In addition, there are plans to introduce a financial transaction tax in Germany similar to the one already in place in France since 2012. This tax has changed the stock market in France: trading and turnover in the shares concerned have fallen noticeably, and spreads between purchase and selling prices have widened.

In Poland, the business outlook for the banking sector is currently more favourable from an economic perspective than in Germany. Macroeconomic performance is still growing significantly stronger, supported by private consumption. The Polish economy has also lost momentum in recent months, however. We therefore expect economic growth to slow noticeably in 2020. The outcome of the parliamentary elections in autumn 2019 increased the likelihood of a spending offensive and a consequent deterioration in the budgetary position. There is also a degree of uncertainty, chiefly due to the smouldering conflict with the EU over policy issues.

The ECB is not planning to stop its bond purchases until shortly before it starts raising key rates. This will improve banks' liquidity position and financing conditions, but at the same time will put further pressure on net interest margins and thus adversely impact earnings in the financial sector. The financing requirements of the European Commission's planned green deal could also lead to green quantitative easing. This is new, because to date none of the world's central banks have pursued a monetary policy strongly oriented towards climate protection goals.

# Financial performance, assets, liabilities and financial position

The Commerzbank Group has applied IFRS 16 "Leases" since 1 January 2019. The application of IFRS 16 has resulted in changes to the Group's accounting and measurement methods. Explanations regarding changes or amendments to the accounting and measurement methods can be found in Notes 2 and 4 to the Group financial statements.

The Commerzbank Group's operating profit for the year came to €1,258m and was thus stable versus the previous year. Consolidated profit attributable to Commerzbank shareholders for the period under review came to €644m.

Total assets of the Commerzbank Group as at 31 December 2019 were €463.6bn, compared with €462.4bn at the end of 2018.

The increase in risk-weighted assets to €181.8bn was mainly due to the adoption of the international accounting standard IFRS 16 at the turn of the year and a growth-driven rise in risk-weighted assets from credit risks. This growth was partly offset by reductions in risk-weighted assets through the targeted winding-down of portfolios that are not part of the core business and two securitisation transactions in the first and fourth quarters of 2019. In addition, lower risk-weighted assets from market price risks and fewer risk-weighted assets from operational risks had a largely compensatory effect.

Common Equity Tier 1 capital was €24.4bn and the corresponding Common Equity Tier 1 ratio 13.4%.

## Income statement of the Commerzbank Group

The individual items in the income statement were as follows in 2019:

At €5,074m, net interest income in the period under review was 6.9% above the prior-year level. Private and Small-Business Customers managed to increase its net interest income considerably year on year. Net interest income in Germany increased slightly compared with the previous year. Residential mortgage loans performed well, with new business volume rising significantly. At mBank, net interest income showed good growth, driven by an increase both in margins and in the volume of lending and deposit business. In the Corporate Clients segment, the negative impact of the low interest rate environment and intense price competition was more than offset by higher interest income, especially from lending business.

Net commission income fell slightly by 1.1% year on year to €3,056m. In the Private and Small-Business Customers segment, income in the domestic securities business rose steadily over the course of the year, due in part to the positive trend on the capital markets, and was up year on year overall. Income from payment transaction services also increased, but commission income from pension business was significantly lower than in the previous year. Net commission income at mBank was on a par with the previous year. In the Corporate Clients segment, net commission income was stable versus the previous year.

The net income from financial assets and liabilities measured at fair value through profit or loss was €244m in the reporting period, after €366m in the prior-year period. The decline is attributable in particular to remeasurement effects in the Others and Consolidation segment and positive income from restructuring measures in the Corporate Clients segment in the previous year.

| Statement of comprehensive income I €m | 2019 | 2018[1] | Change |
|---|---|---|---|
| Net interest income | 5,074 | 4,748 | 326 |
| Dividend income | 35 | 36 | –1 |
| Risk result | –620 | –446 | –174 |
| Net commission income | 3,056 | 3,089 | –34 |
| Gain or loss from financial assets and liabilities measured at fair value through profit and loss and net income from hedge accounting | 348 | 415 | –66 |
| Other profit or loss from financial instruments, income from at-equity investments and other net income | 130 | 283 | –153 |
| Operating expenses | 6,313 | 6,459 | –146 |
| Compulsory contributions | 453 | 423 | 30 |
| **Operating profit/loss** | **1,258** | **1,242** | **15** |
| Impairments of goodwill and other intangible assets | 28 | – | 28 |
| Restructuring expenses | 101 | – | 101 |
| **Pre-tax profit or loss from continuing operations** | **1,129** | **1,242** | **–113** |
| Taxes on income | 367 | 268 | 99 |
| Consolidated profit or loss from discontinued operations | –18 | –10 | –8 |
| **Consolidated profit/loss** | **744** | **964** | **–221** |
| Consolidated profit or loss attributable to Commerzbank shareholders and investors in additional equity components | 644 | 862 | –219 |

[1] Figures restated due to a change in presentation plus other restatements (see Group financial statements, Note 4).

Other net income was €93m in the reporting period, compared with €245m a year earlier. This includes €103m from the completed sale of ebase GmbH. The result for the previous year includes income from the sale of the group insurance business of the mBank subsidiary mFinanse in the Private and Small-Business Customers segment, and from an investment in the Corporate Clients segment. Income from sales of real estate and interest for tax refund claims also had a positive effect on net income in the previous year.

The risk result was €–620m in the reporting period, compared with €–446m a year earlier. In the Private and Small-Business Customers segment, the risk result was 8.6% above the prior-year level. While risk provisions for lending business in Germany were lower than in the previous year, mBank posted an increase in loan loss provisions associated mainly with corporate loans. The risk result of the Corporate Clients segment increased year on year, mainly due to impairments of individual loan commitments.

Despite ongoing investment in digitalisation and growth, operating expenses were 2.3% lower year on year in the reporting period at €6,313m. While personnel expenses were 3.0% above the prior-year level at €3,543m, in part due to pay scale adjustments, administrative expenses, including depreciation on fixed assets and amortisation of other intangible assets, were reduced by 8.2% to €2,770m. This significant decrease was primarily due to lower costs for external staff on projects and lower consulting costs.

Compulsory contributions, which include the European banking levy, contributions to the Deposit Protection Fund and the Polish bank tax, have been reported separately since the first quarter of 2019 and rose by 7.1% to €453m. The increase of €30m was primarily due to higher regulatory requirements in Poland.

Impairments of intangible assets in the amount of €28m were recognised in the reporting period in the Corporate Clients segment. Earnings performance in the period under review was also impacted by restructuring expenses of €101m relating to a headcount reduction programme brought forward as part of the implementation of the “Commerzbank 5.0” strategy.

Pre-tax profit from continuing operations was €1,129m, compared with €1,242m in the previous year.

Tax expense on continuing operations for the period under review was €367m, compared with €268m in the previous year. The increase resulted in particular from provisions for tax risks and impairments of deferred tax assets in the fourth quarter of 2019.

Profit from continuing operations after tax was €762m, compared with €975m in the prior-year period.

Discontinued operations posted a loss after tax of €–18m. This includes the income and expenses of the Equity Markets & Commodities (EMC) division sold to Société Générale.

Net of non-controlling interests, a consolidated profit of €644m was attributable to Commerzbank shareholders and investors in additional equity components for the 2019 financial year, compared with €862m in the previous year.

As Commerzbank Aktiengesellschaft reports its results for the 2019 financial year in accordance with the German Commercial Code (HGB), the plan is to service all profit-related capital instruments issued by Commerzbank Aktiengesellschaft for the 2019 financial year. We will put a proposal before the Annual General Meeting to distribute a dividend of €0.15.

Total comprehensive income, which includes both consolidated profit/loss and other comprehensive income for the period, showed a net total of €626m in 2019.

Other comprehensive income of €–118m consists of the sum of changes in the revaluation reserve (FVOCImR) (€15m), the cash flow hedge reserve (€13m) and the currency translation reserve (€106m), changes in companies accounted for using the equity method (€–4m), changes from the remeasurement of defined benefit plans not recognised in the income statement (€–180m), changes in the measurement of equity instruments (FVOCIoR) (€8m), and changes in own credit spread of liabilities FVO not recognised in the income statement (€–75m).

Operating profit per share came to €1.00 and earnings per share to €0.51. The comparable figures in the prior-year period were €0.99 and €0.69 respectively.

## Balance sheet of the Commerzbank Group

Total assets of the Commerzbank Group as at 31 December 2019 were €463.6bn and thus at the same level as at year-end 2018.

The cash on hand and cash on demand fell by €12.8bn to €41.2bn. The decrease compared with the end of 2018 was due in particular to a decline in demand deposits held with central banks.

Financial assets at amortised cost increased by €14.5bn to €293.7bn compared with the end of 2018. The increase compared with the end of 2018 was largely attributable to a rise in lending business in the Private and Small-Business Customers and Corporate Clients segments.

Financial assets in the fair value OCI category were €30.9bn, up €4.3bn from the end of 2018. This 16.1% rise was largely driven by an increase in debt securities.

At €30.2bn, financial assets mandatorily measured at fair value through profit or loss were €3.9bn lower than at the end of the previous year. The decline was largely attributable to a 16.6% decrease in loans and advances, especially to central banks.

Financial assets held for trading were €44.8bn at the reporting date, up €2.3bn on the figure at the end of 2018. Positive fair values of interest rate derivatives rose by €2.8bn and loans and advances by €0.7bn, while positive fair values of currency and equity derivatives decreased by €1.1bn overall. Debt securities were €1.5bn or 8.6% lower year on year.

Non-current assets held for sale and disposal groups were €8.0bn, compared with €13.4bn at the end of 2018. The decline resulted from portfolio transfers in connection with the sale of the EMC business to Société Générale and from comdirect bank AG’s sale of ebase GmbH to the FNZ Group.

| **Assets** I €m | **31.12.2019** | **31.12.2018**[1] | **Change in %** |
|---|---|---|---|
| Financial assets – Amortised cost | 293,658 | 279,160 | 5.2 |
| Financial assets – Fair value OCI | 30,942 | 26,659 | 16.1 |
| Financial assets – Mandatorily fair value P&L | 30,196 | 34,073 | –11.4 |
| Financial assets – Held for trading | 44,840 | 42,501 | 5.5 |
| Other assets | 64,000 | 79,993 | –20.0 |
| **Total** | **463,636** | **462,386** | **0.3** |

| **Liabilities and equity** I €m | **31.12.2019** | **31.12.2018**[1] | **Change in %** |
|---|---|---|---|
| Financial liabilities – Amortised cost | 351,909 | 346,668 | 1.5 |
| Financial liabilities – Fair value option | 19,964 | 21,949 | –9.0 |
| Financial liabilities – Held for trading | 39,366 | 43,404 | –9.3 |
| Other liabilities | 21,730 | 20,953 | 3.7 |
| Equity | 30,667 | 29,412 | 4.3 |
| **Total** | **463,636** | **462,386** | **0.3** |

[1] Prior-year figures restated (see Group financial statements, Note 4).

On the liabilities side, financial liabilities at amortised cost were up €5.2bn to €351.9bn compared with the end of 2018. While debt securities issued fell by €3.1bn, sight deposits – from both private and corporate customers – increased significantly compared with the end of 2018.

Financial liabilities under the fair value option decreased by €2.0bn compared with the end of 2018 to €20.0bn. Deposits were down by €1.9bn, mainly due to a decline in collateralised money market transactions in the form of repos.

Financial liabilities held for trading were €39.4bn, down €4.0bn on the end of 2018. This 9.3% decline was due to the negative fair values of derivative financial instruments, which were €2.5bn lower. Delivery commitments arising from short sales of securities also fell by €1.5bn.

Liabilities from disposal groups were €8.5bn, compared with €12.9bn at the end of 2018. The decline resulted from portfolio transfers in connection with the sale of the EMC business to Société Générale and from comdirect bank AG's sale of ebase GmbH to the FNZ Group.

**Equity**

The equity capital attributable to Commerzbank shareholders reported in the balance sheet on 31 December 2019 was €28.5bn, compared with €28.2bn at the end of 2018. Further information on the change in equity can be found on page 143 ff. of the Group financial statements.

Risk-weighted assets were €181.8bn as at 31 December 2019, €1.3bn higher than at year-end 2018. This resulted from effects that largely compensated each other: the increase in credit risk reflected, for instance, the adoption of the IFRS 16 international accounting standard at the turn of the year and the credit growth in the core segments, including mBank. Parameter effects (mainly effects from the review of internal credit risk models by the regulator) also led to higher risk-weighted assets from credit risks. This growth was partly offset by reductions in risk-weighted assets through the targeted winding-down of portfolios that are not part of the core business and two securitisation transactions in the first and fourth quarters of 2019. Lower risk-weighted assets from market price risks and lower risk-weighted assets from operational risks were additional compensating factors, the latter due to model adjustments to improve the quality of forecasts and the updating of internal and external loss data.

As at the reporting date, Common Equity Tier 1 capital was €24.4bn as compared with €23.2bn at 31 December 2018. This €1.2bn increase arose mainly in connection with the regulatory eligible profit and lower regulatory deductions. The Common Equity Tier 1 ratio was thus 13.4%. With the issue of an additional Tier 1 bond for USD 1bn at the beginning of July, Tier 1 capital (with transitional provisions) rose to €26.0bn and the corresponding Tier 1 ratio to 14.3%. The €0.8bn decline in Tier 2 capital was attributable to subordinated liabilities that were no longer fully eligible due to their residual maturities, final maturities of issues and the early repayment of instruments (termination). The total capital ratio was 16.8% as at the reporting date.

The leverage ratio based on the CRD IV/CRR rules applicable on the reporting date, which is equal to Tier 1 capital divided by leverage exposure, was 5.3% (with transitional provisions) or 5.1% (fully loaded).

The Bank complies with all regulatory requirements. This information includes the consolidated profit attributable to Commerzbank shareholders and eligible for regulatory purposes.

## Funding and liquidity of the Commerzbank Group

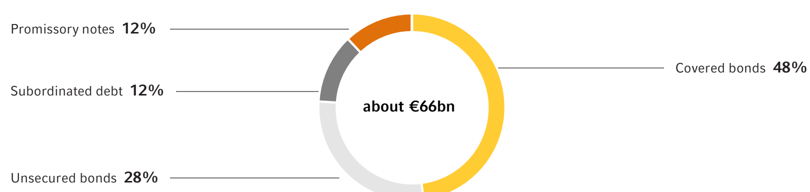
The liquidity management of the Commerzbank Group is the responsibility of Group Treasury, which is represented in all major Group locations in Germany and abroad and has reporting lines in all subsidiaries.

Liquidity management comprises both operational and strategic components. Operational liquidity management encompasses management of daily payment inflows and outflows, planning for payment flows expected in the short term and management of access to central banks. The division is also responsible for access to unsecured and secured sources of funding in the money and capital markets and the management of the liquidity reserve portfolio. Strategic liquidity management involves managing maturity profiles for liquidity-relevant assets and liabilities within specified limits and corridors. Additional information on this subject can be found in the "Liquidity risk" section of the Group Management Report.

Guidelines for the funding profile and funds are derived from the business strategy and reflect risk tolerance. The Group's funding is appropriately diversified in terms of investor groups, regions, products and currencies. Top-level decisions about liquidity management are taken by the central Asset Liability Committee (ALCO), which meets at regular intervals.

The quantification and limitation of liquidity risks is carried out via an internal model in which expected cash inflows are compared against expected cash outflows. The limits set are monitored by the independent risk function. ALCO and the Board of Managing Directors receive regular reports on the liquidity risk situation.

**Capital market funding structure**[1]
As at 31 December 2019




[1] Based on reported figures.

Commerzbank had unrestricted access to the money and capital markets throughout the reporting period, and its liquidity and solvency were also adequate at all times. It was always able to raise the resources required for a balanced funding mix and continued to enjoy a comfortable liquidity position in the period under review. The Commerzbank Group raised a total of €9.0bn in long-term funding on the capital market in 2019. The average maturity of all issues made during the reporting period was around eight years.

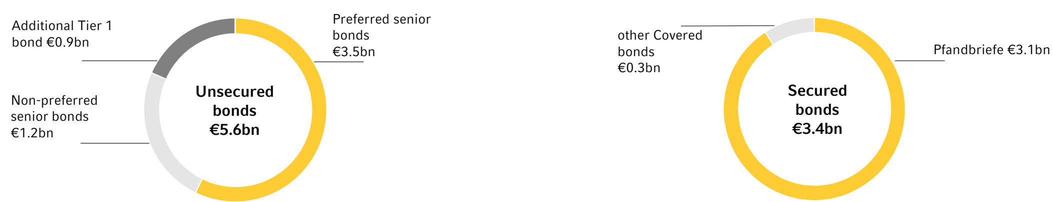
In the unsecured area, Commerzbank Aktiengesellschaft issued preferred senior benchmark bonds with a total volume of €2.75bn and maturities of five years and seven years respectively in the period under review.

Two non-preferred senior bonds with a volume of €500m each and maturities of five years and seven years respectively were also placed. €0.9bn in private placements were also issued. mBank issued a preferred senior bond with a volume of CHF125m. Commerzbank Aktiengesellschaft issued its first additional Tier 1 bond in July. The bond had a volume of USD1bn and a fixed coupon of 7.0% per annum. It has a perpetual maturity, with the first call date in April 2025. The bond terms provide for a temporary write-down in the event that the Bank's Common Equity Tier 1 ratio drops below 5.125%. The issue will further strengthen and optimise the structure of the Bank's regulatory capital. The subordinated bond meets the criteria set out in the Capital Requirements Regulation (CRR) for additional Tier 1 capital. The bond was mainly purchased by foreign investors, who accounted for 96% of the volume.

In the secured area, mortgage Pfandbriefe with a total volume of €3.1bn were issued, including two benchmark issues in January with a volume of €1bn each and maturities of five and fifteen years respectively, and a nine-year bond with a volume of €0.5bn issued in December. Private placements accounted for €0.5bn. In addition, mBank issued €0.3bn in Polish covered bonds.

Commerzbank was able to place its issues with a broad range of domestic and foreign investors.

**Group capital market of 2019**
Volume €9.0bn




At the end of 2019, the Bank had a liquidity reserve of €72.4bn in the form of highly liquid assets. The liquidity reserve portfolio functions as a buffer in stress situations. It is funded in line with the liquidity risk appetite to ensure that it is kept at the required size throughout the entire reserve period stipulated by the Board of Managing Directors. A part of this liquidity reserve is held in a separate stress liquidity reserve portfolio managed by Group Treasury to cover liquidity outflows should a stress event occur and to ensure solvency at all times.

The Bank also holds an intraday liquidity reserve portfolio. At the end of the year, the total value of this portfolio was €6.3bn. At 132.72% (average of the last 12 month-end values), Commerzbank was well above the minimum 100% level required for the liquidity coverage ratio (LCR). Further information on the LCR can be found in Note 65 to the Group financial statements. Commerzbank's liquidity situation therefore remains comfortable given its conservative and forward-looking funding strategy. The Bank is not currently drawing on central bank liquidity facilities.

## Summary of 2019 business position

2019 was another tough year for the banking industry and thus also for Commerzbank, marked by a combination of macroeconomic uncertainties, in particular the further intensification of global trade conflicts, and the pressure on margins triggered by the ECB's September decision to further ease monetary policy. Against this background, we nevertheless succeeded in acquiring new customers in both market segments and expanding our lending and securities volume. The strategic objective of further simplifying the business was also driven ahead as planned last year: The Asset & Capital Recovery segment was dissolved on 1 July 2019 following the successful winding down of assets over the last few years, with the remaining portfolios transferred to Others and Consolidation and to the Private and Small-Business Customers segment. In addition, since the middle of the year digital products and services have been developed in the new cluster delivery organisation. This enables us to deliver functioning products and services for our customers to our sales force faster than in the past. We also further strengthened the Bank's capital structure with the issue of an additional Tier 1 bond, partially in response to the amended regulatory requirements imposed by the European Banking Authority.

Overall, however, despite all the progress made in terms of business policy, it was obvious that we had to respond to the changed and ever tougher framework conditions. The world is turning faster and faster, and innovation cycles are getting shorter and shorter. Our customers' wishes regarding our digital and mobile offerings and personal advisory services are evolving very rapidly.

In an increasingly difficult environment, we almost or entirely met the core objectives we had set for 2019 in terms of both income and costs.

The Private and Small-business Customers segment made good progress in implementing its strategic measures in the 2019 financial year: Progress was made in digitalising services and processes and expanding and bringing together the distribution channels. In November, the new advisory model for private customers was launched in the domestic branch business. Despite the ongoing challenging conditions, the growth strategy was also successfully advanced in 2019. With more than 473,000 net new customers and growth of €35bn in the volume of loans and securities accounts, 2019 ended as a successful year. The portfolio volume in loans and securities in Germany amounted to a total of €261bn at the end of the year. The goal of increasing assets under control in Germany to over €400bn by the end of 2020 was nearly achieved in 2019, despite the sale of the comdirect subsidiary ebase and the associated outflow of assets. The Bank also made progress in 2019 in the core objective of growth, significantly surpassing the previous year's result. For example, the volume of new business in residential mortgage lending grew by around 5% versus 2018 to around €14.0bn. The segment proved to be robust in the face of adverse conditions, particularly with respect to the interest rate environment and slowing economic growth, and was able to increase total operating income in the 2019 financial year. We also succeeded in reducing operating expenses, which led to a significant improvement in the cost/income ratio. Although there was a marked rise in the risk result, it remained at a historically low level. Overall, the segment's operating profit rose in line with the forecast. The operating return on equity improved slightly year on year.

The 2019 reporting year presented several challenges for the Corporate Clients segment, including the tightening of already low interest rates, intense price competition in the German market and a macroeconomic environment fraught with uncertainties that weighed most heavily on international trade relationships. As a result, our expectations of a slight rise in income could not be met in the course of the year. Higher interest income from lending business was offset in particular by lower net income from financial assets and liabilities measured at fair value through profit or loss. As expected, the risk result increased significantly due to the impairment of individual credit exposures and – contrary to our forecast – led to a significant decline in operating profit. The anticipated and achieved slight reduction in the cost base proved insufficient to keep the cost/income ratio stable and it moved up year on year.

At Group level, income before risk result, adjusted for one-off effects such as the sale of ebase in the reporting year and the disposal of the group insurance business in the previous year, was slightly below our expectations at €8.6bn. Despite the difficult framework conditions, however, the previous year's figure was matched thanks to a further improvement in income quality.

Higher charges for regulatory expenses were offset through strict cost management. As expected, total operating expenses were lower than in the previous year at €6,766m. The net return on equity of 2.4% was markedly lower than the prior-year level of 3.4%, while the cost/income ratio including compulsory contributions rose mostly in line with expectations, increasing by 2.0 percentage points to 78.3%.

The Common Equity Tier 1 ratio rose to 13.4% at the end of 2019 from 12.9% at the end of 2018 and was thus well above the target ratio expected for the reporting year. The increase resulted mainly from regulatory eligible profit and reduced regulatory deductions.

# Segment performance

The comments on the segments' results are based on the segment structure described on pages 67 and 247 ff. of the notes to the Group financial statements. The Asset & Capital Recovery segment was dissolved on 1 July 2019 following the successful winding down of assets over the last few years, with the remaining portfolios transferred to Others and Consolidation and to the Private and Small-Business Customers segment. The result achieved by the Asset & Capital Recovery segment up to the point of dissolution is shown in the segment reporting in Note 61 to the Group financial statements.

More information and explanations regarding restatements of prior-year figures can be found in Notes 4 and 61 to the Group financial statements.

## Private and Small-Business Customers

The Private and Small-Business Customers segment encompasses branch business in Germany, comdirect Group, Commerz Real and the mBank Group.

The segment again saw growth in net new customers and assets under management in 2019. With around 11.3 million customers in Germany and roughly 5.6 million in Poland, the Czech Republic and Slovakia, Commerzbank is one of the leading banks for private and small-business customers in these markets.

### Performance

| €m | 2019 | 2018[1] | Change in %/%-points |
|---|---|---|---|
| Income before risk result | 4,913 | 4,806 | 2.2 |
| Risk result | –253 | –233 | 8.6 |
| Operating expenses | 3,529 | 3,586 | –1.6 |
| Compulsory contributions | 285 | 252 | 13.1 |
| **Operating profit/loss** | **846** | **735** | **15.1** |
| | | | |
| Average capital employed | 5,361 | 4,751 | 12.8 |
| Operating return on equity (%) | 15.8 | 15.5 | 0.3 |
| Cost/income ratio in operating business (%) – excl. compulsory contributions | 71.8 | 74.6 | –2.8 |
| Cost/income ratio in operating business (%) – incl. compulsory contributions | 77.6 | 79.9 | –2.2 |

[1] Figures restated due to a change in presentation plus other restatements (see Group financial statements, Notes 4 and 61).

The Private and Small-Business Customers segment proved to be robust in the face of adverse conditions, particularly with respect to the interest rate environment and slowing economic growth, and was able to increase total operating income in the 2019 financial year. It also succeeded in reducing operating expenses. Although the risk result saw an increase in loan impairments, it remained at a historically low level. Overall, the segment's operating profit rose by €111m to €846m.

Total segment income before risk result was €4,913m in the year under review, up €107m on the prior-year figure. Net interest income in Germany increased slightly compared with the previous year. Residential mortgage loans performed well, with new business volume rising significantly. At mBank, net interest income showed good growth, driven by an increase both in margins and in the volume of lending and deposit business. Net interest income for the segment rose sharply by €144m overall to €2,722m. Net commission income was almost unchanged year on year at €1,914m. Income in the domestic securities business rose steadily over the course of the year, due in part to the positive trend on the capital markets, and was up year on year overall. Income from payment transaction services also increased, but commission income from pension business was significantly lower than in the previous year. Net commission income at mBank was on a par with the previous year.

Other earnings components, which include net income from financial assets and liabilities measured at fair value through profit or loss and other net income, totalled €277m, €23m below the prior-year figure. Income of €103m from the sale of the comdirect subsidiary ebase GmbH was posted in the year under review, while a gain of €52m for mBank from the sale of the group insurance business of its subsidiary mFinanse was reported in 2018. mBank's other net income in the period under review was impacted by an allocation of €79m to provisions for legal risks in connection with mortgage loans in foreign currency.

The risk result was €–253m, up 8.6% on the prior-year level. While risk provisions for lending business in Germany were lower than in the previous year, mBank posted an increase in loan loss provisions associated mainly with corporate loans.

The reduction of €57m in operating expenses to €3,529m primarily reflected the measures taken to improve cost efficiency in Germany. At mBank, operating expenses were largely stable year on year. The strong year-on-year increase of €33m to €285m in the segment's expenses for compulsory contributions, which are reported separately, was largely attributable to mBank, where the European banking levy and the Polish bank tax increased by a total of €32m.

Overall, the Private and Small-Business Customers segment posted a pre-tax profit of €846m in the reporting year, compared with €735m in the previous year.

## Corporate Clients

The Corporate Clients segment comprised four reporting areas in 2019. The Mittelstand, International Corporates and Financial Institutions divisions are responsible for business with our core customers: the Mittelstand division covers Mittelstand customers and domestic large corporates with the relevant products they require. The International Corporates division looks after corporate customers headquartered abroad and large German multinational companies. The Financial Institutions division is responsible for managing relationships with banks in Germany and abroad and central banks.

The segment offers customers the complete range of products of an international full-service bank, from traditional credit products, individually tailored financing solutions, cash management and trade finance, investment and hedging products and customised capital market solutions. The Other Result division handles all business that either has a cross-segment risk management function or falls outside the strategic focus of the Corporate Clients segment. These mainly relate to assets transferred from the former Non-Core Assets and Portfolio Restructuring Unit run-off segments and effects from hedging positions.

The performance of the Equity Markets & Commodities (EMC) division is reported separately in view of the sale.



### Performance

| €m | 2019 | 2018[1] | Change in %/%-points |
|---|---|---|---|
| Income before risk result | 3,241 | 3,414 | –5.1 |
| Risk result | –342 | –194 | 76.2 |
| Operating expenses | 2,453 | 2,503 | –2.0 |
| Compulsory contributions | 118 | 119 | –0.9 |
| **Operating profit/loss** | **328** | **597** | **–45.0** |
| | | | |
| Average capital employed | 11,895 | 10,770 | 10.4 |
| Operating return on equity (%) | 2.8 | 5.5 | –2.8 |
| Cost/income ratio in operating business (%) – excl. compulsory contributions | 75.7 | 73.3 | 2.3 |
| Cost/income ratio in operating business (%) – incl. compulsory contributions | 79.3 | 76.8 | 2.5 |

[1] Figures restated due to a change in presentation plus other restatements (see Group financial statements, Notes 4 and 61).

The 2019 reporting year presented several challenges for the Corporate Clients segment, including the tightening of already low interest rates, intense price competition in the German market and a macroeconomic environment fraught with uncertainties that weighed most heavily on international trade relationships. A positive earnings trend in customer business was offset by markedly lower income from the Others division, whose earnings in the previous year were boosted by a range of factors including positive effects from restructuring. Overall, the Corporate Clients segment posted an operating profit of €328m in the year under review, compared with €597m in the previous year. Higher interest income from lending business was offset in particular by lower net income from financial assets and liabilities measured at fair value through profit or loss.

The Mittelstand division benefited from the segment's strong market position, which was chiefly reflected in a higher total lending volume and solid earnings performance. The International Corporates division recorded a positive performance. Earnings growth was achieved in the lending business in particular, but also in other areas such as hedging transactions for our customers. The Financial Institutions division recorded income growth in the year under review, particularly in international trade finance. In the Others division, the positive result from restructuring measures in the previous year raised the benchmark for the earnings comparison, meaning that income in the year under review failed to match the prior-year figure. The prior-year figure also included income from non-strategic portfolios such as Commercial Real Estate, which were further wound down.

In the period under review, income before risk result was €172m lower than in the prior-year period at €3,241m. Net interest income rose by €84m to €1,861m. The increase was mainly due to a higher contribution from lending business. Net commission income was stable year on year at €1,177m. Net income from financial assets and liabilities measured at fair value through profit or loss fell sharply to €187m. This was €237m lower than the figure for the prior-year period, which included positive income from restructuring measures.

The risk result increased year on year, mainly due to impairments of individual loan commitments. The risk result was €–342m in the period under review, compared with €–194m in the previous year.

Operating expenses were €2,453m, down €50m on the prior-year figure. Investments in strategic development were successfully offset. The reduction in operating expenses was achieved ahead of schedule thanks to strict cost discipline and made a significant contribution to earnings.

The reported compulsory contributions of €118m related to regulatory expenses and were largely unchanged from the previous year.

Impairments of intangible assets in the amount of €28m were recognised in the reporting period.

Overall, the segment posted a pre-tax profit of €301m compared with €597m in the prior-year period.

## Others and Consolidation

The Others and Consolidation segment contains the income and expenses which are not attributable to the business segments. Others covers, for example, Group Treasury, equity holdings not allocated to the business segments and overarching specific individual matters such as expenditure on regulatory fees. Consolidation reconciles the figures shown in segment reporting with the Group financial statements in accordance with IFRS. Others and Consolidation also covers staff, management and support functions, which are likewise charged to the segments. For these units, restructuring costs are an exception to transfer charging, as they are reported centrally in the division.

The Others and Consolidation segment reported an operating result of €53m for 2019, compared with €–124m in the prior-year period. The improvement was driven to a large extent by higher income in Group Treasury, which was mainly attributable to better management of interest rate and currency risk due to positive market trends, a net positive effect from the recognition and reversal of provisions, and a positive valuation of equity investments. This was offset by a number of factors including one-off income from sales of real estate in 2018 and the result from the portfolios of the dissolved Asset & Capital Recovery segment, which were transferred to the Others and Consolidation segment in 2019. Others and Consolidation recorded a pre-tax loss of €–48m for 2019. This figure included restructuring expenses of €101m relating to the implementation of the "Commerzbank 5.0" strategy.

# Outlook and opportunities report

## Future economic situation

The world economy is likely to see only modest growth in 2020, with positive economic factors partially neutralised by braking factors. On the plus side, loose monetary policy is driving the economy in many countries. In addition, a cautious rapprochement is emerging on the trade front following the agreement of an initial partial deal between the USA and China. The de-escalation should help reduce the uncertainty surrounding trade policy in 2020, which will be a positive step for the economy compared with 2019.

Companies are likely to remain fundamentally wary, however. The conflict between the USA as an established power and China as a rising power has little chance of being resolved, meaning that the trade conflict could escalate again after the presidential elections in November 2020, regardless of the election outcome, because the Democrats also essentially support the incumbent president's protectionist policy.

China will also remain a burden for the global economy. The country is suffering not only from higher US tariffs and uncertainty about the long-term development of the trade conflict, but also from high levels of debt, particularly among China's state-owned enterprises, which have been under pressure to cut costs for some time. In addition, the impact of coronavirus is likely to put a brake on economic growth in the first quarter, which is why China is again unlikely to be a driver of the global economy in 2020.

The upturn in the USA will continue in 2020, but US growth is also likely to be weaker than in 2019 at 1.7%, partly because the full-employment economy is increasingly reaching the limits of production.

| Real gross domestic product Change from previous year | 2019 | 2020[1] | 2021[1] |
|---|---|---|---|
| USA | 2.3% | 1.7% | 1.8% |
| Eurozone | 1.2% | 0.9% | 1.1% |
| Germany | 0.6% | 0.8% | 0.8% |
| Central and Eastern Europe | 1.8% | 1.9% | 2.0% |
| Poland | 4.3% | 3.1% | 3.7% |

[1] The figures for 2020 and 2021 are all Commerzbank forecasts.

The eurozone economy is likely to outperform the German economy again in 2020 due to its lower dependence on foreign trade, with growth of 0.9%. By ratifying the Brexit agreement, the European Parliament has cleared the way for Britain's withdrawal from the European Union (EU). This brings relief momentarily, but the future relationship between the UK and the EU still has to be negotiated. The timescale for this is very tight, as the transition period expires at the end of 2020. We expect an extensive free trade agreement to be concluded, which would mean no fundamental changes at least for the trade in goods between the UK and the EU.

Weaker growth in important German export markets suggests only a minor upward trend for Germany in 2020. As leading indicators are still pointing downwards, the German economy is likely to remain largely stagnant in the first few months of the new year. Slightly positive growth rates should then return from spring onwards, culminating in growth of 0.8% for 2020.

Domestic demand remains robust, however, suggesting that Germany's economy is unlikely to slip into recession. Higher wage increases will strengthen the purchasing power of working households, and the employment rate will probably continue to rise despite job cuts in industry. Both these factors point to consumer demand remaining buoyant. At the same time, low interest rates will continue to boost investment.

The expansive monetary policy on both sides of the Atlantic will also continue to shape the picture on the financial markets in 2020. The absence of a classic economic upswing and the continued failure to meet the inflation target of just under 2% are arguments for the ECB maintaining its expansive monetary policy in 2020. It will continue to purchase bonds at a net pace of €20bn per month. The US Federal Reserve may even cut key interest rates by a further 25 basis points in spring to secure the upswing.

The low interest rate environment will therefore not change in 2020. The yield on ten-year German government bonds is likely to remain between –0.5% and –0.2% in 2020. The euro is likely to appreciate against the US dollar in 2020. This will not be due to the strength of the euro, however, but to a weakening of the dollar. On the stock markets, subdued economic growth is likely to limit price potential. We thus expect the DAX to be at 13,700 points at the end of 2020, only slightly higher than at the end of 2019.

| Exchange rates | 31.12.2019 | 31.12.2020[1] | 31.12.2021[1] |
|---|---|---|---|
| Euro/US-dollar | 1.12 | 1.10 | 1.14 |
| Euro/Sterling | 0.85 | 0.87 | 0.86 |
| Euro/Zloty | 4.25 | 4.20 | 4.30 |

[1] The figures for 2020 and 2021 are all Commerzbank forecasts.

## Future situation in the banking sector

According to the latest financial stability reports published by the Deutsche Bundesbank and the ECB in November 2019, the German financial system remains vulnerable to weak economic development. Although there are still no alarming signs of declining lending standards or excessive credit growth, future risks could be underestimated and the value of loan collateral such as real estate overestimated. An unexpected economic slump and an abrupt rise in risk premiums would result in substantial losses from bad debts and could have a severe impact on the banking sector. Germany would also be exposed to significant risks in the event of a sudden rise in interest rates. This is attributable to the expansion of maturity transformation undertaken by banks in order to stabilise their income from interest business. Almost half of the new housing loans granted in 2019 have a fixed interest period of more than ten years.

The financial stability reports also indicate that the profitability of the German banking sector is still relatively low. The cost/income ratio of German banks is seen as the key weakness when assessing their earnings situation. According to data from the latest risk assessment conducted by the EBA, this is essentially a revenue problem rather than a cost problem. Further spending cuts would have to be implemented for Germany to survive in international competition, but this would seem difficult to achieve given the highly competitive nature of the banking structure and the urgent need for investment in new technologies.

In contrast to the cost situation, the earnings of German banks relative to their total assets are the lowest in the eurozone. The most important contribution to banks' operating income is generally made by interest-related business. While net interest income, the balance of interest income and interest expense, rose year on year, it is still below its long-term average. Increased revenues could only be achieved by not only raising lending rates and fees but also introducing negative interest rates for customer deposits on a broad basis. Even the ECB's decision to introduce a two-tier system for reserve remuneration that exempts part of banks' excess liquidity holdings from the negative deposit rate will do little to change the negative consequences of the low interest rate environment. The introduction of negative interest rates for a growing number of customers, especially wealthy customers, is therefore being considered.

The stabilisation of net interest income in 2019 was only achieved through volume growth and not by expanding tight margins. This will not change in the coming months. The possibilities for generating revenues from trading activities are still very limited. All in all, increasing earnings represents a major challenge given the cut-throat competition in Germany. The same applies to improving the quality of revenues, not just their volume. As a result, the profits of German banks are unlikely to increase on average in the foreseeable future.

The German banking market is in general facing a major upheaval. The next decade will see a drastic reduction in the number of institutions and even more intense competition. This is because more and more global technology groups, fintech companies, foreign banks and market infrastructure providers such as stock exchanges, clearing houses and information service providers are now offering traditional banking products.

Due to the earnings problems, cost reduction remains the main issue for German banks. The digitalisation of business processes will therefore proceed at a rapid pace, not least so that banks can compete for customers who expect easy-to-use, seamlessly integrated product solutions. Up to now, many banks have generally concentrated more on the pure digitalisation of processes rather than on actively exploiting the data generated and the potential added value that results. In the future, big data will therefore become massively more important in the financial services sector. The same applies to IT security. The protection of data networks and appropriate staff training are an ongoing process for the banking sector. The same applies to ensuring compliance with the legal and regulatory requirements.

With the current EU banking package, further key elements of the Basel 3 framework are now being implemented at European level through amendments to the Capital Requirements Regulation (CRR II) and Capital Requirements Directive (CRD V). The new rules include more risk-sensitive capital requirements, particularly with regard to market risk, and the introduction of a binding leverage ratio and a binding structural liquidity ratio. In addition, banks must in future hold a minimum amount of capital that is available to cover losses in the event of restructuring or resolution. Fulfilment of the additional Pillar 2 capital requirement has been simplified. From 2021 onwards, around 44% of this requirement can be covered by additional Tier 1 (AT1) capital and Tier 2 capital, instead of exclusively with Common Equity Tier 1 (CET1) capital as was previously the case.

However, the entry into force of the EU banking package referred to above does not mean that the reform of European banking regulation has been completed. The European Commission has already started work on CRR III and CRD VI, which will implement new approaches for calculating risk-weighted assets and thus the capital requirements for credit risk, abolish the model-based approach for operational risk, revise the procedure for calculating credit value adjustments in derivatives business and introduce a lower limit for the capital requirement (output floor) for institutions that calculate their risks using internal models. According to the EBA, this output floor will significantly increase capital requirements, especially for global systemically important institutions in the EU.

The capital buffers introduced for the first time under Basel 3 also serve the goal of strengthening banks' ability to absorb losses. Such macroprudential measures are designed to make the financial system as a whole more crisis-resistant, thus better protecting the real economy. One of these tools is the countercyclical capital buffer. It is designed to counteract excessive restrictions on lending in downturns and excessive expansion in upturns.

In response to the existing cyclical systemic risks, BaFin increased this countercyclical capital buffer from 0% to 0.25% of risk-weighted domestic exposures as of 1 July 2019. From 1 July 2020, banks must take this premium into account when calculating their institution-specific buffer rate.

While the German real estate sector is currently booming, and construction along with it, industry in particular is pessimistic about the coming months. As already outlined in the section on the sector environment, the weakness is persisting, particularly in the export-oriented manufacturing sector that is so important to Germany's economic performance. Further declines in exports will hit banks' interest and commission business. Against this backdrop, business with corporate and small-business customers in Germany is likely to come under increasing pressure.

Local retail customer business, meanwhile, continues to benefit from robust private consumption and ongoing high demand for residential mortgages. The latter is being driven by the lack of affordable housing and the related boom in new building, and in particular by the persistently low level of interest rates. The labour market situation is also still favourable at present, although there are increasing signs of a gradual slowdown. A number of large companies have announced that they intend to cut jobs in the future. At the same time, the earnings potential of retail customer business remains limited due to the strong national competition among banks and the narrow interest margins. Furthermore, 2020 will again be a year with no sign of a traditional cycle of interest rate hikes in the eurozone. There is still no prospect of a turning point in monetary policy or a perceptible steepening of the yield curve. Banks thus remain exposed on this front, and market participants' incentives to place their money in risky investments are not weakening.

Although the Brexit agreement has been ratified, the ongoing Brexit process will pose considerable risks for the European banking sector. On the one hand, if the UK government lowers regulatory standards to strengthen London as a financial centre, the competitive position of the banks in the remaining EU countries would be harmed. On the other hand, if London, Europe's financial centre, loses its unrestricted access to the European single market, this will increase fragmentation in investment banking and profitability will suffer as a result. In the worst-case scenario, according to the Deutsche Bundesbank, bottlenecks, frictions and an absence of licenses might mean some activities have to be shut down entirely.

The Polish banking sector has ultimately proved itself to be comparatively robust in assessments of financial stability. There are risks, however, from the growing volumes of unsecured consumer loans and mortgage loans in zloty.

A law was adopted in July 2019 to support private borrowers in default. The new law came into force as of January 2020 and makes it easier for such borrowers to obtain assistance with the repayment of their real estate loans denominated in Polish zloty and foreign currency than was previously the case with the support fund. The monthly support payments were also increased and extended.

There are currently numerous lawsuits pending in Poland relating to Swiss franc real estate loans with indexing clauses. At the beginning of October 2019, the European Court of Justice (ECJ) issued a judgement on the consequences under Polish law of an abusive indexing clause. The ECJ did not issue a legal decision on when an indexing clause may be declared abusive in a given case. Even after the ECJ decision in October 2019, Polish case law on loans with indexing clauses has so far been inconsistent overall. This and the number of judgements handed down since then are not sufficient for a reliable estimate of future case law. The banking sector in Poland – and thus also Commerzbank through its present majority stake in mBank – may therefore be faced with considerable costs, especially for litigation. The provisions for these risks may need to be adjusted significantly in the future.

Climate change is one of the great challenges of our time. From the perspective of macroprudential supervision, it is crucial that the financial system proves sufficiently resilient to the uncertainties and risks of climate change and that no systemic risks build up. For this reason, the EBA is thinking about anchoring climate and environmental risks more firmly in banks' risk management in the coming years.

Overall, the fundamental transformation of the European banking system will continue. The sector is now smaller, more clearly focused on its core functions and less profitable, but probably also more robust and resilient to future crises. Further steps on the road to the European banking union will follow. This includes proposals to ease capital and liquidity restrictions in multinational banking groups. The political efforts to advance the European banking union are also supported by a ruling made by the German Federal Constitutional Court at the end of July 2019, which states that the European banking union and thus the responsibility of the ECB in banking supervision is compatible with German constitutional law.

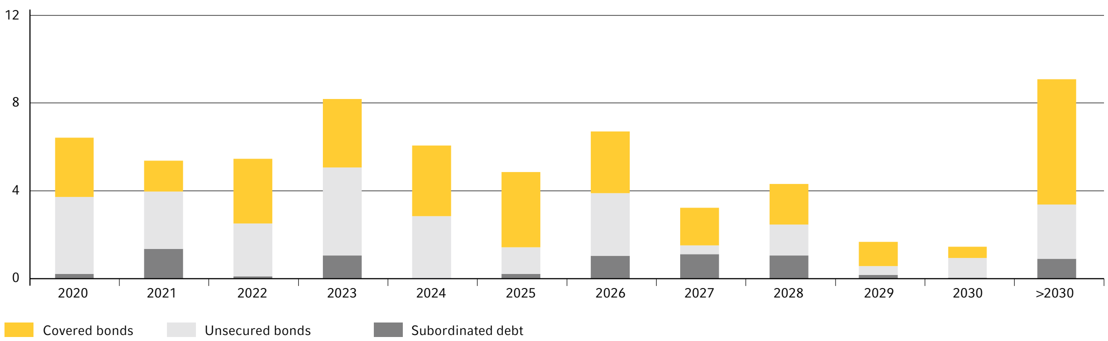
Traditionally, financial services have been provided by integrated universal banks covering the entire value chain of distribution, production and infrastructure. With the advent of digitalisation, a simplified combination of partial services from a diverse range of providers in the value chain is now also being offered in the financial services industry. By modularising offers to perfectly fit specific requirements, customers can enjoy an uninterrupted shopping experience with no annoying transitions between the different providers involved. We expect this trend to also take hold in the financial industry. The interface to the customer is of paramount importance in modularisation. Whoever is positioned at this interface will be customers' primary contact in the future.

## Financial outlook for the Commerzbank Group

### Planned funding measures

Commerzbank anticipates that its capital market funding requirement over the coming years will be on the order of €10bn. Commerzbank offers a broad range of products in the capital market. In addition to unsecured funding instruments (preferred and non-preferred senior bonds and Tier 2 subordinated debt), when refinancing Commerzbank can also issue secured funding instruments, in particular mortgage Pfandbriefe and public-sector Pfandbriefe. As such, Pfandbriefe are a key element of Commerzbank's funding mix. These give Commerzbank stable access to long-term funding with cost advantages compared with unsecured sources of funding. Issuance formats range from large-volume benchmark bonds to private placements. Commerzbank does not anticipate any negative effects on the placing of long-term funding instruments in connection with Brexit.

**Group maturity profile of capital market issues as at 31 December 2019**
€bn




By regularly reviewing and adjusting the assumptions used for liquidity management and the long-term funding requirement, Commerzbank will continue to respond actively to changes in the market environment and business performance in order to secure a comfortable liquidity cushion and an appropriate funding structure.

## Planned investments

Commerzbank plans to invest around €0.7bn in 2020. Two-thirds of the investments will go towards the ongoing digitalisation of the Group's products and processes, enabling Commerzbank to provide its services more efficiently and faster in future. The remaining third will be for regulatory measures.

**Private and Small-Business Customers**

The main investment targets for the branch bank in 2020 are the central initiatives relating to the "Commerzbank 5.0" strategy. In the Private and Small-Business Customers segment, Commerzbank is expanding mobile banking under a mobile first strategy. It also plans to better exploit the potential offered by the expanded customer base, with the targeted use of data and algorithms permitting the creation of customised offerings for cross- and up-selling. The segment intends to continue acquiring new customers in 2020. Commerzbank will also digitalise its products and processes and further simplify the product range. At the same time, the Bank will maintain a personal presence through its nationwide branch network and further develop its existing relationship management model.

In line with the mobile first strategy, the ability to complete transactions in products on the ONE digital platform is being increased with the aim of creating a consistent digital and personal customer experience across all relevant touchpoints. Another large portion of the investments will go towards the further expansion of the instalment credit platform and the digitalisation of the investment business. The banking app is to be enhanced with securities brokerage functions. A key element of the investments is the development of marketing and sales expertise on digital channels, with automated data and control intelligence designed to enable a targeted customer approach and continued new customer growth. A new pricing and premium strategy is intended to give customers more choice and support profitable growth.

One central component of the strategy involves "making the customer more digital". This includes the ability to solve an increasing number of service issues digitally, particularly via the app, and developing the app into a fully fledged channel boasting top usage and interaction statistics.

2020 will also see further investment devoted to making the structure of the branch business more efficient and continuing the development of the relationship management model. The restructuring of the branch network will move ahead, with a focus on opening more city branches. The range of services will continue to be differentiated by location, with a focus on maintaining a local presence. The Customer Centre will also be further expanded.

The implementation of a wide range of regulatory requirements is also on the agenda for the current year. The aim is to further minimise the compliance risk.

To this end, there will be a particular focus on investments relating to the implementation of the EU Price Regulation, further requirements under the Payment Services Directive (PSD2) and the digitalisation of the know-your-customer process. Other investment priorities include the restructuring of securities processes and adjustments in securities investment advisory services to meet the requirements of new suitability and sustainability regulations. In addition, tax compliance in Germany and abroad must be ensured by implementing the regulatory requirements in a timely manner and in accordance with the specifications through automated processes. The integration of comdirect is also due to begin in the fourth quarter of 2020 following the successful squeeze-out. This will be accompanied by corresponding investments.

mBank is planning investments in the 2020 financial year to strengthen its leading competitive position and continue the optimisation and automation of customer-related and internal processes. In line with mBank's business strategy, planned investments include the further development of bank transactions such as express transfers, the Payment Assistant to support the creation of standing orders, and the Personal Finance Manager with its enhanced expenditure analysis. The mobile banking application will also be expanded to include financial investment functions and a new brokerage service, for which development started in 2019. The expansion of mBank's online banking platform will continue in 2020. The navigation will be revised, money transfers both within Poland and to EU countries will be simplified, and the platform will be expanded to include tools for people with visual impairments. A project to accelerate growth in retail banking in the Czech Republic and Slovakia will also be continued in 2020. The focus will remain on projects aimed at continuously increasing process efficiency and optimising costs, such as the digitalisation of sales processes in corporate customer business. mBank will also invest in 2020 in measures to implement regulatory requirements.

**Corporate Clients**

The investments in the Corporate Clients segment in 2020 will again be concentrated on the programmes adopted as part of the "Commerzbank 5.0" strategy. To support growth in the segment's core areas – Mittelstand, International Corporates and Institutionals – investments will mainly be made in the expansion of the sales organisation and back office areas in Germany and other European countries. In particular, the expansion of the European IT platform will be driven forward to maintain and develop competitive products. The programme aims to expand the market position in Germany and other European countries and gain market share by aligning growth measures with the requirements of the sales organisation and customers. Investments will also be made in extending the sector approach, which has already been successfully established, to include the servicing of corporate customers eligible for the capital market.

The digitalisation projects will be continued with the aim of further increasing the degree of digitalisation and creating more customer care time by reducing administrative tasks in sales.

The active management of compliance risks will also be further developed through the expansion of compliance-related processes in customer business.

**IT & Operations**

Commerzbank will continue in 2020 with the ongoing optimisation of the IT structure. There will also be further significant investment in payment transactions and securities processing. In mid-2018, Commerzbank entered into a strategic partnership in payments processing with the payment processing provider equensWorldline. Elements of the planned integration of the direct banking subsidiary comdirect will be implemented as part of the partnership with HSBC Transaction Services GmbH, which is currently being set up. Through these two IT infrastructure projects, Commerzbank is continuing to streamline its operations so that it can concentrate fully on the strategic restructuring. On the IT side, the focus is on modernising the IT architecture and putting the technological base on a more professional footing. Investments to increase automation and boost IT and operational stability are also planned.

Ever stricter regulatory requirements mean Commerzbank needs to make further substantial investments in 2020 in order to comply with national and international standards.

## Anticipated liquidity trends

In the fourth quarter of 2019, events on money and capital markets in the eurozone were again largely dictated by the monetary policy measures implemented by the ECB to support the economic recovery in the eurozone and by the political uncertainty created by trade conflicts and Brexit.

At the end of September 2019, the ECB decided to implement further central bank measures in response to the economic slowdown and declining inflation expectations. These measures include a reduction in the interest rate on the deposit facility by another 10 basis points to –0.50%, an initially unlimited resumption of the securities purchase programme at a monthly pace of €20bn as of 1 November 2019, adjustments to the maturity and interest rate of TLTRO III (targeted longer-term refinancing operations) and the introduction of a two-tier system for minimum reserve remuneration.

Under the two-tier system, the minimum reserve itself and other central bank deposits up to a multiple of six times the minimum reserve are exempt from the negative deposit facility rate. The ECB may change either the remuneration rate and/or the multiplier at any time. The two-tier system will at least mitigate the detrimental effects of the negative interest rate policy on banks' earnings.

Owing to the high excess liquidity in the market, the volume of longer-term securities repo transactions is restricted. The short-term repo market is functioning smoothly, however, and plays an important role in serving the bond and cash markets. Collateral is expected to become even tighter as a result of the introduction of mandatory bilateral margin requirements for over-the-counter (OTC) derivatives. This requirement comes into full effect for all market participants concerned at the end of 2020. The situation in the bond markets is strongly influenced by the high surplus liquidity, ongoing trade conflicts and political uncertainties. This has led to steady demand for good-quality names. With interest rates set to remain in negative territory, additional demand will come from financial investors in search of returns.

Against this backdrop, secondary market liquidity, which has already been significantly reduced, will remain modest. We expect German government bond yields to remain very low, even in the long-term segment (yields are currently negative up to 15 years), and anticipate persistently high demand from investors for high-quality securities. In view of this, we believe credit spreads will remain tight.

Commerzbank's liquidity management is able to respond promptly to new market circumstances. Even given the further uncertainties surrounding Brexit, we still do not expect any significant impact on our liquidity situation. The Bank has a comfortable liquidity position that is above internal limits and the currently applicable requirements prescribed by the German Liquidity Regulation and MaRisk.

## Managing opportunities at Commerzbank

The demands placed on modern, sustainable banking business and the overall framework conditions have changed markedly in the past few years. Whereas personal customer relationship management was formerly a key element of banking, these days customers expect multi-channel advisory services, digital financial offerings and individual, tailor-made products. We have responded to this in recent years through our strategic orientation: in both the Private and Small-Business Customers and Corporate Clients market segments we have gained new customers, pushed ahead with digitalisation projects and built an agile delivery organisation with Campus 2.0.

Against the backdrop of persistently low interest rates and subdued economic expectations, we launched the new "Commerzbank 5.0" strategic programme in September 2019. The measures adopted under the programme give us the opportunity to continue actively shaping our future. The main focus of "Commerzbank 5.0" is on expanding mobile banking in combination with a strong branch presence, bundling digital competencies by integrating comdirect, strengthening sales and increasing efficiency in corporate customer business. It also includes plans to invest heavily in digitalisation, IT infrastructure and growth, significantly reduce the Group's cost base by 2023 and embed social responsibility more strongly in the business model. The further development of the strategy should contribute to further growth in customers, assets and income by 2023, even in a market environment that is set to become even more difficult.

Information on the planned strategic measures in the Private and Small-Business Customers and Corporate Clients segments can be found in "Objectives and strategy" on page 67 ff.

We will further transform the Bank into a digital enterprise across all segments. This restructuring will affect strategy, technology, competence and culture. We will actively drive digitalisation in our banking business, enabling us to offer our customers speed, security and convenience when it comes to technological applications. For some time now we have been involved in start-ups, both directly and through our subsidiaries CommerzVentures and Main Incubator and the digitalisation platform #openspace. We support entrepreneurs and in so doing keep our finger on the pulse of tomorrow's innovations. #openspace is a digitalisation partner for small and medium-sized German businesses. In addition to supporting Commerzbank's customers, #openspace also helps other small and medium-sized businesses overcome the challenges of the digital world and successfully exploit the opportunities it presents. Customers are offered tailor-made solutions for all phases of the digital transformation. Main Incubator GmbH, a wholly-owned subsidiary of Commerzbank, is a research and development unit within the Bank. It addresses future technologies and their impact on financial services. Technical innovations are introduced into the Group through three channels: ventures – strategic (early-stage) investments in technology-driven start-ups; prototyping – development of own prototypes based on future technologies considered relevant; and community building – early identification of tech trends, with work currently under way on topics such as artificial intelligence, biometrics, big data, the cloud, the Internet of Things, machine learning, robotics and quantum computing.

Commerzbank works to encourage its own employees to engage in the kind of entrepreneurial thinking that distinguishes start-ups.

The Digital Campus has become the engine driving the Commerzbank transformation, where we test and develop new, agile working methods and modern forms of cooperation. With the experience gained, the Campus 2.0 project was launched on 1 July 2019. The cluster delivery organisation was introduced at head office for this purpose. Agile working teams (cells) will take the place of traditional hierarchies. The cells are multi-functional, combining both specialist and IT expertise, and work independently in numerous clusters to develop new products and processes in specific areas. This new cluster organisation has fewer interfaces, less complexity and fewer dependencies, meaning that sales staff receive functioning solutions more quickly and are able to focus entirely on customers' needs.

Sustainability and environmental issues and the achievement of the Paris climate targets are also becoming more important for Commerzbank than ever before. We will also help our customers achieve enhanced sustainability in future with a greener product range. For instance, private customers have recently been given the chance to take out green mortgage loans. In corporate customer business, Commerzbank will align its loan portfolio more closely with sustainability criteria and help our customers to enhance the sustainability of their business model as well.

## Anticipated performance of the Commerzbank Group

With the adoption of the new "Commerzbank 5.0" strategic programme in autumn 2019, Commerzbank has set a course that will enable it to permanently secure its competitive position in its core market of Germany and further expand it in the long term. The Bank is laying the foundations for further business growth – in terms of customer numbers, business volumes and hence operating income – through investments in the ongoing digitalisation of the business model and the modernisation of its IT infrastructure. Commerzbank also plans to exploit efficiency potential in all business areas in order to substantially and sustainably reduce the Group's cost base. These measures are ultimately aimed at further increasing the Bank's resilience to an anticipated further deterioration in the market and banking environment, enabling it to emerge all the stronger in the long term.

Commerzbank does not expect to see any significant improvement in the very challenging conditions for the German banking sector even beyond the 2020 forecast period. This is manifested, for example, in the assumption that extremely low or negative interest rates will remain a substantial burden in the current and coming years and, combined with ongoing intense competition, will continue to exert pressure on margins.

In view of the comparatively weak economic momentum that is expected, effective management of all risks will remain very important.

The following forecast for the 2020 financial year is based on the assumption that the planned sale of the stake in the Polish subsidiary mBank will be concluded in the current year and will take effect by the end of 2020. In line with this assumption, mBank's income statement will again be shown in Commerzbank's Group financial statements for the full 12 months of the 2020 financial year. However, a separate detailed forecast of mBank's earnings components is not provided in the following comments on the anticipated performance of individual earnings components and the anticipated performance of the segments. One-off effects relating to the sale of the mBank stake are not included in this forecast either. Overall, we expect mBank to report a positive earnings performance, a disproportionately low increase in operating expenses compared with the increase in earnings and an increase in its risk result in the 2020 financial year. Commerzbank therefore expects mBank's overall contribution to the Group's operating profit to be significantly higher than in the previous year.

Despite the very challenging environment, Commerzbank is aiming to keep total operating income at least stable in the current financial year. Compensating for the adverse effects on earnings resulting from further declines in interest rates in the domestic loan portfolio and the impact of negative interest rates on liquidity deposits held with the ECB remains a key strategic focus. As in previous years, both core business areas are therefore aiming to generate positive earnings effects from new business through further growth. Commerzbank is anticipating an increase in the risk result, which also reflects the expected volume growth in the loan portfolios. With the quality of the broadly diversified loan portfolios still considered to be robust, however, the increase should be limited provided there is no unexpectedly severe deterioration in the global economic outlook. Two opposing trends are expected for total operating expenses (including compulsory contributions). The digitalisation of the service offering and business processes should lead to further efficiency gains. However, the implementation of measures under the "Commerzbank 5.0" strategy programme will result in high investment requirements, meaning that total operating expenses are set to rise above the 2019 level. Overall, Commerzbank is aiming to achieve an operating profit close to the previous year's level in 2020 – even without taking effects relating to the sale of the mBank stake into account.

## Anticipated performance of individual earnings components

As the key source of income, net interest income is of prime importance. Despite the assumption that interest rates will remain negative, Commerzbank is aiming to at least match the previous year's level through the planned further expansion of its lending volume. As in previous years, both the core segments Private and Small-Business Customers and Corporate Clients are targeting loan portfolio growth at least in line with the market – which would mean further slight gains in market share for parts of the overall portfolio. The increase in lending volume is a response to the continuing pressure on margins in Germany. In both private and corporate customer business, maturing loans with higher interest rates will usually only be able to be replaced with new business at lower rates. As well as asset margins falling due to competition, it is also likely to become increasingly difficult to generate higher income in deposit business through measures taken as part of asset/liability management. Interest losses from deposit business will be offset by charging negative interest on very high credit balances held by private and corporate customers.

We expect net commission income to increase slightly this year. Following on from the very good performance in 2019, commission income in securities and asset management business with private and small-business customers should at least match the previous year's level provided there are no phases of excessive volatility on the financial markets. The same applies to capital market business with institutional and corporate customers on the primary and secondary markets. We expect significant earnings gains in payment transactions due to new product offerings that give customers added value at appropriate prices.

In terms of net income from financial assets and liabilities measured at fair value through profit or loss, Commerzbank will stick with its risk-oriented, client-focused approach in order to achieve a contribution to earnings that is as high and as stable as possible. This is difficult to plan, however, given the uncertainties surrounding the performance and volatility of the global capital markets. Similar circumstances may also be reflected in the fair value result in one period, whereas the interest component dominates in another, resulting over time in possible shifts to net interest income, and vice versa.

Experience has shown that the other income items, including realised profit or losses on financial instruments and other net income, are often affected by one-off income and measurement effects, which are hard to forecast.

Such non-recurring income items were non-material in 2019 and are expected to remain at a similar level in 2020.

The risk result is expected to remain at a favourable level by historical standards. The figure under the baseline scenario is expected to be more than €650m, taking into account the weaker economic environment. This assessment is based on the very low level of problem loans, continuing strict standards in new lending business, the dominant share of highly collateralised loans in retail business and risk management in corporate customer business, which has proven successful over a period of many years.

Operating expenses (including compulsory contributions) should again benefit from continued strict cost management in 2020, leading to a slight decrease overall. This should help offset regulatory costs that are expected to be at least as high as in the previous year. At the same time, it is important to start implementing the planned strategic investment measures designed to strengthen future growth and earnings potential and exploit the considerable efficiency potential as early as possible this year. Extensive investments, which will also extend into subsequent years, will target a range of areas including the continued digitalisation of the service offering, distribution channels and underlying processes, and the fundamental modernisation of the IT infrastructure. While some of the planned measures will be recognised directly through profit or loss in the current financial year, some of the expenses can be capitalised and depreciated over the useful life of the assets created. Strategic investments are likely to have an impact of up to €0.2bn on the cost base in 2020. Total operating expenses for the Group as a whole are therefore expected to be slightly higher year on year. Commerzbank also plans to create provisions for restructuring expenses in the current reporting period, mainly for unavoidable adjustments to future staffing levels and the downsizing of the branch network accompanying the shift to mobile banking distribution channels in the coming years. Depending on the progress of negotiations with employee representative bodies over the course of the year, it is possible that the majority of the charges to the income statement resulting from the "Commerzbank 5.0" strategy programme will already be incurred in the 2020 financial year. This will lay the foundation for increasing and sustainably improving profitability in the coming years through a combination of earnings growth and cost reductions.

## Anticipated segment performance

With regard to the Private and Small-Business Customers (PSBC) segment, the following comments on anticipated performance are essentially limited to domestic activities; detailed forecasts are not provided for mBank due to the planned sale of Commerzbank's stake during the course of the year. However, mBank is expected to make another significant contribution to the operating profit of the PSBC segment in 2020, set to be even higher in relative terms than in the previous year. This is based on the expectation of significantly higher income at the Polish subsidiary, which will probably more than offset the increase in both the risk result and operating expenses (including compulsory contributions) of mBank.

Important strategic decisions will have to be made this year to enable development of the business model in the PSBC segment, further consolidate Commerzbank's position in the German banking market, and strengthen both profitability and efficiency through steady earnings growth and reduced operating costs in the medium term. As part of the "Commerzbank 5.0" strategy programme, significant investment funds will be made available in 2020 and beyond to allow the Bank to focus strongly on digital distribution channels in future following the progress made in establishing a multi-channel bank. The mobile first strategy aims to use the already high and accelerating level of interaction with the mobile channel, which is available around the clock, to the mutual advantage of customers and Commerzbank. Analyses of the information available as a result of the large number of contact points will increasingly allow us to offer all customer groups highly individualised solutions featuring products and services that are appropriate to each customer's situation. This should enable us to exploit further earnings potential through a higher level of activity and better penetration of the existing customer base, while keeping Commerzbank attractive for new customers with its combination of simple, transparent products and personal service. Product and service offerings and pricing will be even better aligned in future. This will give customers greater choice, enabling them to supplement basic services, some of which will remain free of charge, with specific services that are appropriately priced in relation to the benefits they provide. Even greater attention will be paid to small-business and wealth management customers, who expect and are granted access to particularly sophisticated, personally tailored premium services.

Commerzbank intends to actively counter the continuing pressure on margins in Germany also in this year by growing customer numbers and business volume faster than its competitors. With more than 200,000 net new domestic customers, the net annual increase in customer numbers is expected to be lower than on average in the period from 2016 to 2019.

New income from the forecast growth in lending and deposit volumes will therefore be generated by existing customers to a higher relative extent than in previous years. In lending business, a significant increase in new business in higher-margin consumer financing, supported by increased use of the online distribution channel, should make a higher contribution to earnings. However, real estate financing, in which growth has outstripped the market considerably in recent years, will remain a cornerstone of the PSBC growth strategy. Higher income is also expected from small-business customers. The new relationship management model is expected to boost business volumes, primarily in respect of customers' corporate business. The new model is also aimed at smaller SMEs with annual sales of up to €15m. In payment transaction services, the share of higher-value product offerings is expected to increase significantly. Coupled with greater customer activity, this should generate higher income. Securities business and asset management in particular for affluent clients and in wealth management should benefit from greater penetration of premium products that combine personal service with the use of advanced technologies. Additional new business can also be expected from customers with very high deposit balances, who are shifting their liquidity to investments to avoid credit balance fees. Depending on the amount of the credit balance, Commerzbank may instead opt to pass on the negative interest rates imposed by the ECB via individual agreements. In the longer term, securities business will also benefit from comdirect's special expertise in this area, which is set to become available to all PSBC customers over time. However, the comdirect integration, which is expected to begin in the second half of the year, is unlikely to lead to any notable short-term contribution to earnings as a result of closer cooperation. Overall, the PSBC segment expects to record a slight increase in operating income in 2020. The strategic measures planned for this year are also designed to offset most of the capital expenditure required to facilitate the expected future earnings growth through further efficiency gains. This includes the further optimisation of the branch network along with the ongoing digitalisation of products and processes, further steps towards completion of the central ONE distribution platform and measures to streamline and simplify the product range. In line with the anticipated rapid increase in the use of digital channels, with the mobile distribution channel in particular set to significantly expand its service offering in the medium term, the relative weights of the various distribution channels will shift over time. The first steps towards sustainably reducing the cost base by streamlining the branch network are expected in 2020. However, customers will still be able to rely on a largely nationwide branch presence in the future.

Positive synergy effects from the integration of comdirect from the second half of the year onwards are also likely to be minimal. The PSBC segment expects operating expenses to increase slightly overall. This includes regulatory costs, which are set to remain high for the foreseeable future. The increase in the risk result predicted for the PSBC segment as a whole is related to the lending volume, which is growing as expected. However, maintaining risk costs at such a low level, historically low in some cases, is not expected. Nevertheless, we believe that the loan portfolios should remain resilient even in a less favourable economic environment. Overall, the PSBC segment is expected to achieve a lower or at best stable operating result in 2020 even taking into account the one-off effects from the sale of ebase in 2019. Both the operating return on equity and the cost/income ratio are therefore likely to be fairly unchanged or slightly weaker.

In implementing the “Commerzbank 5.0” strategy programme, the Corporate Clients (CC) segment will also continue to focus on growth and profitability initiatives aimed at expanding business volume and acquiring new customers. The Bank’s leading position in numerous areas of business with German SMEs is to be further improved by stepping up sales activities and further strengthening the risk functions. Special attention will be paid to smaller SMEs with turnover of between €15m and €100m, which particularly appreciate the local proximity of a bank with a nationwide presence. Building on our core competences, the CC segment is also targeting selective expansion of our business with larger SME customers in the eurozone. The established sector approach will also be extended to other large German and European corporate clients, leading to improved customer penetration and profitability for the business. Realigning the loan portfolio over the long term to focus increasingly on financing investments relating to sustainability, such as projects aimed at reducing $CO_2$ emissions, offers considerable potential. Commerzbank has already begun building up expertise in this area. Commerzbank’s foreign trade financing solutions, payment transaction services in numerous currency areas and risk management hedging products remain the driving force behind the targeted volume growth in lending and capital market business. Achieving growth while conserving equity is becoming an increasingly important condition in this regard. The Bank is also aiming to broaden the net customer base for all customer groups. Business growth will remain necessary in the difficult interest rate environment to counter the ongoing decline in interest margins and still achieve the targeted slight increase in operating income.

Passing on negative interest rates should offset the losses in deposit business. The strategic investments planned to consolidate the growth strategy will lead to an increase in the cost base in the 2020 financial year that is unlikely to be fully offset by further measures to improve efficiency. These measures include the ongoing digital transformation of advisory and distribution processes and the digitalisation of the product range, which will generate increased cost savings over time. There is also significant efficiency potential to be leveraged in IT through the planned consolidation of the European IT platforms and the simplification of the infrastructure. The CC segment is expecting total operating expenses (including compulsory contributions) to be slightly higher overall. The significantly higher risk result predicted for the current financial year reflects the higher degree of uncertainty and risk with regard to economic performance. The basic assumption is a scenario with no significant weakening of economic conditions either domestically or globally. The portfolio quality is still considered to be robust overall due to the broad diversification in the loan portfolios. Even in the event of a deterioration in individual industrial sectors, the increase in risk costs should remain limited and not exceed the extent of the increase in the previous year. With operating expenses and risk costs rising, and income set to increase only slightly, the CC segment is expecting operating profit to remain stable at best year on year in 2020. The cost/income ratio and the operating return on equity are therefore not expected to exceed the previous year’s level.

## General statement on the outlook for the Group

For the 2020 financial year, Commerzbank has set itself the goal of implementing key strategic initiatives, even if these initially have a net negative impact on the earnings position. The external environment, which is still considered to be very challenging, is also likely to have a dampening effect on business and earnings performance this year. Changes with regard to the unfavourable interest rate and competitive environment are considered to be just as unlikely as an end to the pressure on margins, particularly in lending business. Commerzbank nevertheless expects income to be at least stable overall in the current financial year. A slight increase in total operating expenses (including compulsory contributions) is planned due to the significant impact of investment expenses. We also expect a slight increase in the risk result. Depending on earnings performance, this will result in an operating profit close to the previous year’s level, with a corresponding impact on the cost/income ratio.

The items that do not contribute to operating profit primarily relate to provisions for restructuring measures. These could have a substantial impact on income, although the exact amount will depend on the progress of negotiations with the employee representative bodies. If the negotiations can be successfully concluded, full recognition of restructuring expenses, estimated at a total of around €850m over the two-year period from 2019 to 2020, should not be ruled out. A provision of €101m was already set up in the reporting year. Profit from discontinued operations, which again includes profit contributions from the former Equity Markets & Commodities division, is expected to make a small positive contribution.

We expect to post a profit in 2020 even without the effects related to the sale of mBank. However, depending on the amount of restructuring expenses booked, consolidated profit may be significantly lower than in the previous year. Consequently, the return on equity and economic value added would both also be lower than in the previous year.

Commerzbank's Common Equity Tier 1 ratio is largely based on the capital requirements resulting from the Supervisory Review and Evaluation Process (SREP) carried out by the ECB as the responsible supervisory authority, plus a buffer deemed appropriate by Commerzbank's management to cover potential stress situations. Commerzbank expects the capital buffer for other systemically important institutions (D-SIB) defined by the German bank supervisor BaFin, which is currently 1.5% and forms part of the SREP requirement, to be reduced in the foreseeable future. If the sale of the stake in mBank is completed as planned by the end of 2020, Commerzbank believes that the D-SIB capital buffer could be reduced by half a percentage point to 1.0% with effect from the 2021 financial year. Commerzbank is targeting an unchanged Common Equity Tier 1 ratio of at least 12.75% for the end of 2020, which is significantly above the regulatory requirement imposed by the ECB.

We plan to use the 2020 profit mainly to further strengthen the capital base through earnings retention. Given what is considered a sufficiently comfortable capital position at Commerzbank, we expect to be able to propose a dividend for 2020 with a payout ratio comparable to that of the dividend for 2019.

In recent years, Commerzbank has strengthened its resilience through a range of measures such as significantly increasing its capital base. Nonetheless, there are numerous risk factors that could affect the 2020 profit forecast to a considerable, though not reliably quantifiable extent should events take an unfavourable turn. These include the geopolitical situation, which continues to be marked by great uncertainty, and increased global economic risks – especially against the background of the as yet unforeseeable economic impact of the coronavirus. There is still a latent threat of trade conflicts between the economic blocs of Europe, North America and Asia, while the consequences of the UK's withdrawal from the EU will depend on the course of further negotiations. Sharply rising volatilities and strong corrections on the capital markets cannot be ruled out. Valuation levels remain very high by historical standards on both the international equity and bond markets following the large price gains seen in 2019. Central banks remain an important factor influencing financial stability and the outlook for the banking sector. Their future scope, even with unconventional monetary policy measures, for influencing inflation rates and expectations to the desired extent and without harmful side effects, appears to be becoming increasingly exhausted. The economic outlook is now somewhat gloomier. If it were to darken significantly, however, Germany's internationally connected economy could be particularly hard hit, resulting in risk costs in lending business that are much higher than expected. Other risk factors include unfavourable trends in the regulatory or legal environment, which could delay the impact of the intended cost improvements, and a further tightening of the competitive situation in Germany. If margins were to fall further to levels that are unattractive from a risk/return perspective, this could considerably constrain Commerzbank's profitability. For further information on other risks, see the Group Risk Report, page 127 ff.

## Group Risk Report

The Group Risk Report is a separate reporting section in the Annual Report. It forms part of the Group Management Report.

# Group Risk Report

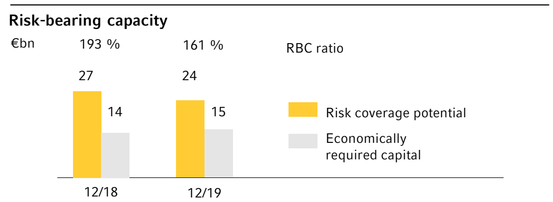
› In the Group Risk Report, we give a comprehensive presentation of the risks we are exposed to. We provide a detailed insight into the organisation and key processes of our risk management. Our primary aim is to ensure that all risks in Commerzbank are fully identified, monitored and managed based on adequate procedures at all times.

# Contents

# Executive summary 2019

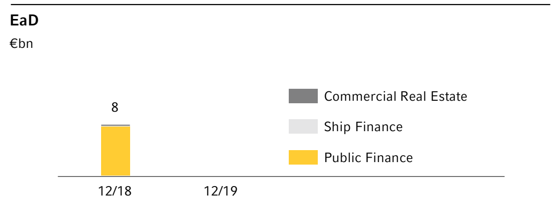
**Risk-bearing capacity ratio stood at 161% as at 31 December 2019**

- The risk-bearing capacity ratio remains well above the minimum requirement.
- The decline in risk coverage potential compared with December 2018 is mainly due to methodological adjustments made on the basis of the ECB's new ICAAP guidelines.



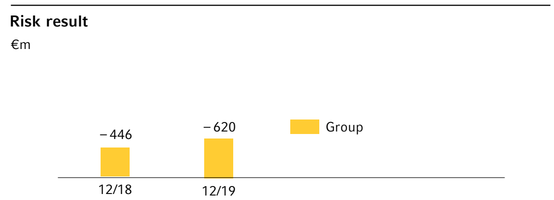

**Dissolution of the Asset & Capital Recovery segment**

- The ACR segment was dissolved on 1 July 2019 following the successful winding down of assets over the last few years.
- The remaining portfolios were transferred to Others and Consolidation and to the Private and Small-Business Customers segment.



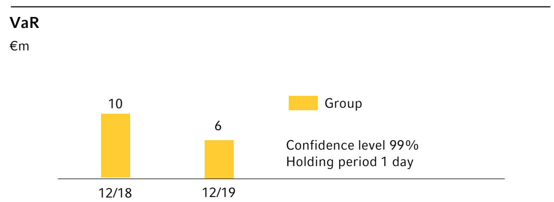

**Risk result for the Group amounted to €–620m**

- The risk result relating to the Group's lending business in 2019 amounted to €–620m.
- From the present perspective, the risk result for the year 2020 as a whole will therefore not be less than €650m.



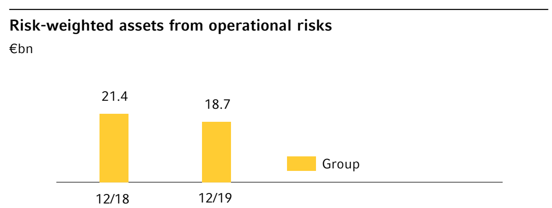

**Market risk in the trading book decreased in 2019**

- The Value-at-Risk decreased from €10m to €6m over the year.
- VaR in the trading book is at a historical low.




**Operational risks decreased year-on-year**

- In 2019 risk-weighted assets from operational risks decreased from €21.4bn to €18.7bn, due also to the model adjustment approved by the supervisory authority in calculating risk-weighted assets for operational risks.
- The total charge for OpRisk events increased from €30m to €127m compared with the previous year.



# Risk-oriented overall bank management

Commerzbank defines risk as the danger of possible losses or profits foregone due to internal or external factors. In risk management, we normally distinguish between quantifiable and non-quantifiable types of risk. Quantifiable risks are those to which a value can normally be attached in financial statements or in regulatory capital requirements, while non-quantifiable risks include compliance and reputational risk.

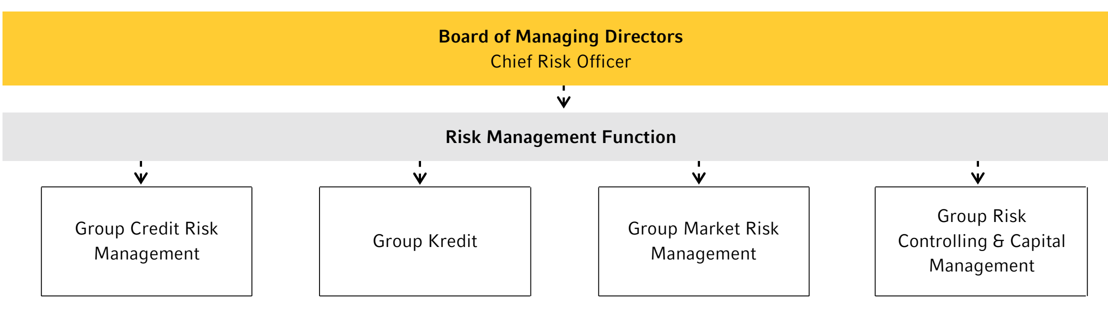
## Risk management organisation

Commerzbank regards risk management as a task for the whole Bank. The Chief Risk Officer (CRO) is responsible for developing and implementing the Group's risk policy guidelines for quantifiable risks, laid down by the Board of Managing Directors, as well as for measuring these risks. The CRO regularly reports to the full Board of Managing Directors and the Supervisory Board's Risk Committee on the overall risk situation within the Group.

The risk management organisation comprises Group Credit Risk Management, Group Credit, Group Market Risk Management and Group Risk Controlling & Capital Management. All divisions have a direct reporting line to the CRO.

On 1 January 2020, Commerzbank established the new Group division "Group Cyber Risk & Information Security", which is also part of the risk management organisation and has a direct reporting line to the CRO.

It is Group Compliance's responsibility to establish appropriate governance, procedures and systems to avoid the Bank being unintentionally endangered as a consequence of compliance risks. This includes the risks associated with money laundering, terrorist financing, sanctions and embargoes, markets compliance, and fraud and corruption. Group Compliance is led by the Chief Compliance Officer, who reports directly to the member of the Board of Managing Directors with responsibility for Group Compliance.




The full Board of Managing Directors has exclusive responsibility for fundamental strategic decisions. The Board of Managing Directors has delegated operative risk management to committees. Under the relevant rules of procedure, these are the Group Credit Committee, the Group Market Risk Committee, the Group OpRisk Committee and the Group Strategic Risk Committee, which decides on risk issues of an overarching nature. The CRO chairs all these committees and has the right of veto. The CRO is also a member of the central Asset Liability Committee. Here the CRO also has a right of veto on certain topics (e.g. liquidity risk issues).

The tasks and competencies of the respective committees are described below:

The **Group Credit Committee** is the decision-making committee for operative credit risk management, comprising two representatives each from the back office and front office. The Group Credit Committee operates on the basis of the credit risk strategy. It takes decisions in line with the competencies delegated to it by the full Board of Managing Directors.

The **Group Market Risk Committee** monitors market risk throughout the Group and manages limit requirements in line with risk-bearing capacity. To do this, all market risks from the trading and banking book are analysed to identify risks early and for active risk management purposes. The focus here is on optimising the risk/return profile.

The **Group OpRisk Committee** (OpRiskCo) is responsible for managing operational risks within the Group and in this regard acts as the highest escalation and decision-making committee below the full Board of Managing Directors. The OpRiskCo also addresses all important regulatory issues that arise in connection with the management of operational risks and the implementation of the advanced measurement approach within the Group. In addition, it deals with standards on governance and assessing the functioning of the Internal Control System (ICS) within the Commerzbank Group. Details about the ICS can be found in the section on operational risks.

The **Group Strategic Risk Committee** acts as the discussion and decision-making committee for all types of risk, and its main objective is to monitor and manage risks at portfolio level. This covers risk measurement, risk transparency and risk management.

The central **Asset Liability Committee** (ALCO) is the Commerzbank Group committee responsible for the Group-wide and integrated management of financial resources, namely capital, liquidity and balance sheet structure as well as net interest income, in accordance with the regulatory framework. The ALCO monitors in particular the Group's risk-bearing capacity and as such plays an important part in the Internal Capital Adequacy Assessment Process (ICAAP). The ALCO resolves the recovery plan. Resolutions of the central ALCO are presented to the full Board of Managing Directors for confirmation. In case of violation of a recovery plan indicator, the ALCO plays a central role regarding the escalation, the estimation of the situation and the introduction of measures.

Moreover, risk issues are dealt with in the Supervisory Board's Risk Committee and in the Risk & Analytics Executive Committee:

The **Supervisory Board**'s Risk Committee is the Bank's highest risk committee. It comprises at least 5 Supervisory Board members. The Risk Committee's tasks include monitoring the risk management system and dealing with all risks, particularly with regard to market, credit and operational risk as well as reputational risk. The Risk Committee determines the type, scope, format and frequency of the information that must be presented to the Board of Managing Directors about strategy and risk.

The **Risk & Analytics Executive Committee** is the discussion and decision-making committee within the risk function and Big Data & Advanced Analytics. It is responsible in particular for the organisation and strategic development of risk management and for creating and maintaining a uniform risk culture. It also ensures that the Group risk strategy and the resolutions of the full Board of Managing Directors are implemented in the risk function.

Compliance topics are dealt with in the **Global Compliance Board** (GCB). The GCB has been established as a forum to share updates on major compliance topics and supervisory actions regarding compliance in the Bank. Furthermore, the GCB serves as information platform for segments and functions about compliance culture, changes in compliance regulations, updates of compliance-related policies and their implications.

## Risk strategy and risk management

The overall risk strategy, in line with the business strategy, governs the strategic risk focus of the Commerzbank Group. It sets the risk appetite as the maximum risk that the Bank is prepared and able to accept while following its business objectives without exposing itself to existential threats over and above the risks inherent in the business. The guiding idea is to ensure that the Group holds sufficient liquidity and capital. Based on these requirements, suitable limits are defined for the risk resources of capital and liquidity available to the Group. The overarching limits of the overall risk strategy are consistent with the indicator thresholds of the recovery plan.

Banks' core functions as transformers of liquidity and risk result in inevitable threats that can in extreme cases endanger the continued existence of the institution. For Commerzbank, in view of its business model, these inherent existential threats include the default of Germany, Poland (until the sale of mBank), one or more of the other major EU countries (France, Italy, Spain or the UK, although Brexit is not deemed to be a default) or the default of the USA. Italy is an idiosyncratic special case due to the major legacy exposures to the Italian government, while in the other countries existential threats would arise from the impact of a government default on banks and companies and the repercussions for the other EU countries. Moreover, inherent threats include a deep recession lasting several years with serious repercussions for the German economy, a bank run and the collapse of global clearing houses or the foreign exchange markets, possibly triggered by a cyber attack. In general, cyber risk includes certain scenarios as the business environment becomes more digitised which under certain circumstance can cause damage and could therefore be significant for Commerzbank.

When pursuing its business targets, the Bank accepts these existential threats. It may be necessary to adjust the business model and hence the business and risk strategies in the medium and long term if the full Board of Managing Directors' assessment of these threats to Commerzbank changes substantially. To the extent that it is able to do so, Commerzbank makes early preparations in anticipation of forthcoming changes in regulatory requirements and accounting standards. Such changes and their (retrospective) interpretation may have lasting implications for – and even threaten the survival of – Commerzbank's business model. Commerzbank accepts these regulatory risks because there are many cases where there is no option to mitigate or manage them.

The overall risk strategy covers all material risks to which Commerzbank is exposed. It is updated annually or on an ad hoc basis as required and set out in further detail in the form of sub-risk strategies for the risk types which are material. These are then specified and made operational through policies, regulations and instructions/guidelines. By means of the upstream risk inventory process, Commerzbank ensures that all risk types of relevance to the Group are identified and their materiality assessed. The assessment of the materiality of a risk is based on whether its occurrence could have a major direct or indirect impact on the Bank's risk-bearing capacity.

As part of the planning process, the Board of Managing Directors decides how much of the risk coverage potential of the Group should be utilised. On that basis, individual types of quantifiable risk contributing to the capital requirements are limited in a second stage. A capital framework is allocated to the management-relevant units through the planning process. Compliance with limits and guidelines is monitored during the year, and management measures are put in place where required. In addition, further qualitative and quantitative early warning indicators are established in the overall risk strategy. Potential negative developments can be identified at an early stage with the help of these indicators.

One of the primary tasks of risk management is the avoidance of risk concentrations. These can arise from the synchronous movement of risk positions both within a single risk type (intra-risk concentrations) and across different risk types (inter-risk concentrations). The latter result from common risk drivers or from interactions between different risk drivers of different risk types.

By establishing adequate risk management and controlling processes, Commerzbank provides for the identification, assessment, management, monitoring and communication of material risks and related risk concentrations. This ensures that all Commerzbank-specific risk concentrations are taken into account in its risk management. Stress tests are regularly used to ensure transparency regarding risk concentrations. The structure of the scenarios and the integrated approach ensure that the impact of adverse scenarios on portfolio priorities and risk concentrations are examined in a targeted manner. Management is regularly informed about the results of the analyses so that the potential risk of losses can be avoided in good time.

The Group Risk & Capital Monitor is the monthly risk report, designed for management purposes, on capital, credit risk, market risk, liquidity risk and OpRisk topics within Commerzbank risk management. It shows all the above risk types, including economic and regulatory risk-bearing capacity, for the Commerzbank Group. The report's aims include providing the full Board of Managing Directors and the Supervisory Board's Risk Committee with transparent and comprehensive information, highlighting important developments from a risk perspective and setting management measures. The report is also used in particular to monitor limits and guidelines within the overall risk strategy. Responsibility for approving the overall risk strategy and the Group Risk & Capital Monitor lies with the full Board of Managing Directors.

Commerzbank has adopted a code of conduct that defines binding minimum standards for Commerzbank's corporate responsibility, its dealings with customers, business partners and colleagues, and its day-to-day business. It goes without saying that the Bank complies with relevant laws, regulatory requirements, industry standards and internal rules, and this therefore forms a particularly important part of its risk culture. It actively requires employees to behave appropriately, courageously, with integrity and in compliance with rules, and any failure to comply with rules is penalised. Expanded procedures ensure that misconduct is evaluated in a uniform and fair manner, strengthening consequence management on a long-term basis.

The main pillar of the Bank's overall risk management and culture is the concept of three lines of defence, which is a core element of the Corporate Charter. Under the three lines of defence principle, protecting against undesirable risks is an activity that is not restricted to the risk function. Each unit (segment or function) forms the first line of defence within its area of operational responsibility and is directly responsible for identifying and managing risks within it while complying with the prescribed risk standards and policies. For example, the front office forms the first line of defence in all business decisions and has to take risk aspects into account in reaching them. The second line of defence for each type of risk lays down standards for appropriate management of risks of that type, monitors this and ensures the application of such standards, and analyses and evaluates the risks. The risk function forms the second line of defence against credit and market risks associated with business decisions. Particularly for credit risk, this includes involvement in the credit decision process by means of a second vote. Units outside the risk function (e.g. Group Compliance and Group Finance) also operate as the second line of defence for certain risk types. The third line of defence is Internal Audit.

## Risk ratios

Commerzbank uses a comprehensive system of ratios and procedures for measuring, managing and limiting various types of risk. The most important of these are listed below:
**Economically required capital** is the amount, corresponding to a high confidence level (currently 99.90% at Commerzbank), that will cover unexpected losses arising from risk positions.

The **risk-bearing capacity ratio (RBC ratio)** indicates the excess coverage of the economically required capital by the risk coverage potential. Risk-bearing capacity is deemed to be assured as long as the RBC ratio is higher than 100%.

**Exposure at default (EaD)** is the expected exposure amount taking into account a potential (partial) drawing of open lines and contingent liabilities that will adversely affect risk-bearing capacity in the event of default. EaD is hereinafter also referred to as "exposure".

**Expected loss (EL)** measures the potential loss on a loan portfolio that can be expected within one year on the basis of historical loss data.

**Risk density** is the ratio of expected loss to exposure at default and thus represents the relative risk content of an exposure or a portfolio.

**Value at risk (VaR)** is a methodology for quantifying risk. It involves setting a holding period (such as one day) and a confidence level (such as 97.5%). The VaR value then denotes the relevant loss threshold that will not be exceeded within the holding period with a probability in line with the confidence level.

**Credit value at risk (CVaR)** is the economic capital requirement for credit risk with a confidence level of 99.90%. The term results from the application of the value at risk concept to credit risk measurement. Credit VaR is an estimate of the amount by which losses from credit risks could potentially exceed the expected loss within a single year, i.e. unexpected loss. The idea behind this approach is that expected loss simply represents the long-term average of lending losses, but this may vary (positively or negatively) from actual credit losses for the current financial year.

In relation to bulk risk, the **"all-in" concept** comprises all customer credit lines approved by the Bank in their full amount – irrespective of the loan utilisation to date. It is independent of statistically modelled parameters to the greatest possible extent and comprises internal as well as external credit lines.

## Risk-bearing capacity and stress testing

Risk-bearing capacity analysis is a key part of overall bank management and Commerzbank's ICAAP. The purpose is to ensure that sufficient capital is held at all times.

At the beginning of 2019 the risk-bearing capacity concept was adapted to the new requirements of the ICAAP and ILAAP guidelines published by the ECB on 9 November 2018. In particular, this involved changing the economic approach from a gone concern approach to a going concern approach.

When determining the economically required capital, allowance is made for potential unexpected fluctuations in value. Where such fluctuations exceed forecasts, they must be covered by the available economic capital to absorb unexpected losses (risk coverage potential). Only the economic value of equity components that absorb losses in the going concern approach is taken into account in determining the economic risk coverage potential.

The capital requirement for the risks taken is quantified using the internal economic capital model. All risk types of the Commerzbank Group classified as significant and quantifiable within the annual risk inventory are taken into account when determining the economically required capital. The economic risk approach therefore also comprises risk types that are not included in the regulatory requirements for banks' capital adequacy. The model also reflects diversification effects incorporating all types of risk. The confidence level for the calculation of economically required capital is 99.90% and is harmonised with the going concern approach. The quantifiable significant risks in the economic capital model are divided into default risk, market risk, operational risk and (not separately disclosed in the table on page 104) business risk and property value change risk. Business risk is the risk of a potential loss resulting from deviations in actual income and expense from the respective budgeted figures. Business risk is used to substantiate a higher-level management buffer that ensures the responsiveness of capital management. Physical asset risk is the risk of an unexpected fall in the value of owned property which is either already recognised as an asset in the Group's balance sheet or which can be recognised during the next 12 months under contractually assured obligations with option character (especially real estate). The risk inventory 2019 reclassified the risk of unlisted investments from a previously independent significant risk type to a significant sub-risk type below market risk and this risk is therefore now included in market risk. Reserve risk fell below the materiality threshold and has now been classified as a non-significant risk sub-type. Allowance is made for this risk by means of a risk buffer when considering risk-bearing capacity. The results of the risk-bearing capacity analysis are shown using the risk-bearing capacity ratio (RBC ratio), indicating the excess of the risk coverage potential in relation to the economically required capital.

Risk-bearing capacity is monitored and managed monthly at Group level. Risk-bearing capacity is deemed to be assured as long as the RBC ratio is higher than 100%. In 2019, the RBC ratio was consistently above 100% and stood at 161% on 31 December 2019. The decline in risk coverage potential compared with December 2018 is mainly due to methodological adjustments made on the basis of the ECB's new ICAAP guidelines (including the exclusion of subordinated capital components). The RBC ratio remains well above the minimum requirement.

| Risk-bearing capacity Group €bn | 31.12.2019[1] New method | 31.12.2018[1] Old method |
|---|---|---|
| **Economic risk coverage potential** | **24** | **27** |
| **Economically required capital[2]** | **15** | **14** |
| thereof for default risk | 10 | 10 |
| thereof for market risk[3] | 4 | 3 |
| thereof for operational risk | 1 | 2 |
| thereof diversification effects | –2 | –2 |
| **RBC ratio (%)[4]** | **161** | **193** |

[1] Confidence level as from 31 March 2019: 99.90%; as at 31 December 2018: 99.91%.
[2] Including physical asset risk, risk of unlisted investments and risk buffer for reserve risk and (from 2019) the quantification of potential fluctuations in value of goodwill and intangibles.
[3] Including deposit model risk.
[4] RBC ratio = economic risk coverage potential/economically required capital (including risk buffer).



Commerzbank uses macroeconomic stress tests to review the risk-bearing capacity in the event of assumed adverse changes in the economic environment. The underlying scenarios take into account the interdependence of the development of the real economy and the financial economy. They are updated quarterly and approved by the ALCO. The scenarios describe an extraordinary but plausible adverse development in the economy, focusing in particular on portfolio priorities (e.g. export-based sectors in Germany) and business strategies of relevance to Commerzbank. Stress tests in the economic perspective cover a time horizon of 12 months. The scenario simulation is run quarterly at Group level using the input parameters of the economic capital requirements calculation for all material and quantifiable risk types. In addition to the capital required, the income statement is also subjected to a stress test based on the macroeconomic scenarios. Based on this, changes in the risk coverage potential are simulated. Whereas the RBC ratio is embedded into Commerzbank's limit system, guidelines for risk-bearing capacity are set as an early warning system in the stressed environment. The ongoing monitoring of the limits and guidelines is a key part of internal reporting. Defined escalations are triggered if the limits are breached.

The risk-bearing capacity and stress testing concept is subject to an annual internal review and is refined on an ongoing basis. The development of the regulatory environment is also taken into account. In addition to the regular stress tests, reverse stress tests are implemented annually at Group level. Unlike regular stress testing, the result of the simulation – a sustained threat to the Bank – is determined in advance. The aim of the analysis process in the reverse stress test is to improve the transparency of Bank-specific risk potential and interactions of risk by identifying and assessing extreme scenarios and events. On this basis, for instance, action fields in risk management including the regular stress tests can be identified and taken into account in the ongoing development efforts.

In 2019, the risk-weighted assets resulting from Commerzbank's business activities increased from €180bn to €182bn.

In the Asset & Capital Recovery (ACR) segment, the Bank had bundled the activities of the Commercial Real Estate and Ship Finance areas and complex financings from the Public Finance area for the purpose of completely winding down the portfolios in these areas over time. The ACR segment was dissolved on 1 July 2019 following the successful winding down of assets over the last few years, with the remaining portfolios transferred to Others and Consolidation and to the Private and Small-Business Customers segment.

The table below gives an overview of the distribution of risk-weighted assets, broken down by segment and risk type:

| | 31.12.2019 | | | | 31.12.2018 | | | |
|---|---|---|---|---|---|---|---|---|
| **Risk-weighted assets €bn** | **Default risk** | **Market risk** | **Operational risk** | **Total** | **Default risk** | **Market risk** | **Operational risk** | **Total** |
| Private and Small-Business Customers | 41 | 1 | 5 | 47 | 36 | 1 | 5 | 41 |
| Corporate Clients | 82 | 5 | 8 | 96 | 79 | 6 | 11 | 97 |
| Asset & Capital Recovery | | | | | 9 | 2 | 1 | 12 |
| Commercial Real Estate | | | | | 1 | 0 | 1 | 2 |
| Ship Finance | | | | | 0 | 0 | 0 | 1 |
| Public Finance | | | | | 8 | 2 | 0 | 9 |
| Others and Consolidation | 29 | 5 | 5 | 39 | 23 | 3 | 4 | 30 |
| **Group** | **152** | **11** | **19** | **182** | **147** | **12** | **21** | **180** |

## Regulatory environment

With Basel 3, the Basel Committee on Banking Supervision published among other things comprehensive rules on the components of equity and equity ratios as well as the management of liquidity risk. The Capital Requirements Directive and Regulation, constituting the European implementation of Basel 3, has been in force since 1 January 2014, with the more stringent capital requirements being phased in up to 2019. Numerous supplementary regulations have since been published by the European Banking Authority (EBA) in particular, and these will now gradually enter into force; this will continue in subsequent years. Commerzbank has mitigated the more stringent capital adequacy requirements by taking a number of steps.

In addition, under Basel 3 the leverage ratio has been introduced as a new and non-risk-sensitive debt ratio. Commerzbank has set its own leverage ratio targets and applies them in its capital management process.

The phasing in of capital buffers is a significant feature of the Basel 3 revision, which has now been completed. The capital conservation buffer, the buffer for other systemically relevant institutions and the countercyclical capital buffer, which the Federal Financial Supervisory Authority (BaFin) has again set at 0% for German exposures for 2019, have applied since 1 January 2016. The buffer for other systemically relevant institutions was again set by BaFin for Commerzbank at 1% for 2019.

Liquidity risk is to be monitored by means of the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR). The LCR entered into force on 1 October 2015 and is binding on all European banks. The final version of the NSFR, which was approved by the Basel Committee in October 2014, was transposed into European law as part of the Capital Requirements Regulation II (CRR II) and will become binding from 2021. Commerzbank is already calculating both ratios as part of its regulatory reporting processes, communicating them in its internal reporting and reporting them to the supervisory authority.

The CRR II was published together with the Capital Requirements Directive (CRD V) as part of the Risk Reduction Package in the Official Journal of the European Union on 7 June 2019. As a European directive, CRD V requires transposition into national law within 18 months. The legislation implements, among other things, the Basel Committee's requirements on leverage ratio, net stable funding ratio, regulations on trading book and large exposures, and the treatment of investment funds. While some regulations are already directly effective, large parts of the regulation will only become binding in 2020 or later. In addition, numerous specifications have yet to be made by the EBA.

The ECB, in its capacity as the supervisory authority for the eurozone banks directly supervised by it, has conducted the annual Supervisory Review and Evaluation Process (SREP) and specified individual minimum capital requirements for each bank.

The aim of the ECB project is to harmonise RWA-relevant models for market, counterparty and credit risk that fall within the scope of the Single Supervisory Mechanism (SSM). In particular, the scope for interpretation permitted by the regulations or arising due to differences in national application is to be significantly reduced in future. The relevant guides include rules that are to be enacted in future and wide-ranging independent interpretations. In addition to a thematic inclusion of the "General Topics", reviews of the counterparty risk, the internal market risk model and the retail, mortgage lending, SME, large corporates and bank portfolios were carried out between 2017 and 2019. With the exception of the bank portfolio, the final reports have been delivered.

For market and counterparty risk, final decisions have been received, for retail, mortgage lending and SME, Commerzbank has received new draft decisions following the completion of the review process at the ECB's Audit Committee and has commented on them in due time, final decisions are outstanding. For large corporates and banks we expect final decisions in 2020.

The EU Bank Recovery and Resolution Directive has been in force since mid-2014. Responsibility for the drafting of resolution plans and the resolution of at-risk banks supervised by the ECB was transferred to the Single Resolution Board (SRB) in Brussels with effect from 1 January 2016. At the same time, eurozone banks started to fund the Single Resolution Fund. The SRB defines the formal minimum requirement for own funds and eligible liabilities (MREL) for the banks under its responsibility on a consolidated and individual basis.

The legal basis for setting MREL and TLAC was revised at European level and published on 7 June 2019 as part of the Risk Reduction Package in the form of the Single Resolution Mechanism Regulation (SRMR II), the Bank Recovery and Resolution Directive II (BRRD II) and the CRR II. The BRRD II as a European directive requires implementation into national law within 18 months. The amendments include, among other things, adjustments to the calculation logic and, for certain banks, a statutory subordination requirement for parts of MREL. Most of the new regulations will come into force in December 2020.

The Group-wide recovery plan was updated in 2019 to reflect the regulatory requirements. The recovery plan describes in detail for instance the courses of action and recovery potential available to the Bank in the event of a crisis and which specific recovery measures, in various stress scenarios, will enable the Bank to complete its recovery.

Commerzbank operates in markets subject to national and supranational regulation. In addition, it is subject to the overarching requirements imposed by accounting standards. Changes in regulatory requirements and accounting standards have significantly grown in frequency and materiality in recent years. They may have lasting implications for the financial industry in general and Commerzbank's business model in particular. Commerzbank participates actively and at an early stage in the consultation processes aimed at preparing for the constant changes in the operating environment. It also monitors and evaluates current developments as regards future regulatory projects. Specific examples of these at global level are the final standards for revising capital requirements for market risk now published by the Basel Committee on Banking Supervision, and the revision of the framework for operational risk and credit risk, including the associated floor rules and disclosure requirements ("Basel 4"). At European level, Commerzbank is monitoring among other things the implementation of Basel 4 as well as European Commission initiatives to introduce a European deposit insurance scheme and establish a capital markets union.

The regulatory environment also remains challenging with regard to compliance risks. The focus here remains unchanged on the subject areas of anti-money laundering (including implementation of the 5th and 6th EU Anti-Money Laundering Directive) and sanctions. In addition, anti-bribery and corruption (including the United Kingdom Bribery Act, the United States Foreign Corrupt Practices Act) and market compliance (primarily US regulations, such as the Dodd-Frank Act, CFTC Regulations) are putting further risk types into the regulatory focus.



# Default risk

Default risk is defined as the risk of losses sustained or profits foregone due to the default of a counterparty. It is a quantifiable material risk and includes the sub-risk types of credit default risk, issuer risk, counterparty risk, country and transfer risk, dilution risk and reserve risk.

## Strategy and organisation

The credit risk strategy is the sub-risk strategy for default risks and is derived from the overall risk strategy. It is embedded in the ICAAP process of the Commerzbank Group and forms a link between the Bank's overall risk management across all risk types and the operationalisation of default risk management. The overriding aim is to ensure the adequate quality of the credit portfolio. To this end, the credit risk strategy defines the credit risk tolerance, specifies risk strategy priorities, provides an overview of the material credit risk management concepts and thereby plays an integral part in maintaining the Group's risk-bearing capacity. The credit risk strategy makes use of quantitative and qualitative management tools that give decision-makers clear guidance on both portfolio management and decisions in specific cases.

Credit risk management is a joint task of the front office and the risk function, based on a standardised Group-wide credit risk culture. Impeccable moral and ethical conduct in compliance with the law and regulations is a key element of a culture of integrity and core to the credit risk culture. Default risks are assessed against uniform standards, regardless of segment limits. In line with the three lines of defence principle, the front office is the first line of defence and must take risk aspects into account when taking business decisions. The risk function (back office and Risk Controlling) is the second line of defence, its fundamental task being to manage, limit and monitor risks. The third line of defence is Internal Audit. It is tasked with independently auditing the Bank's processes and safeguards, and as such also assesses the activities of the first and second lines of defence.

The Group Credit Committee is the highest decision-making committee for operative credit risk management, comprising two representatives each from the back office and front office. It takes decisions in line with the competencies delegated to it by the full Board of Managing Directors and is responsible for managing all credit risks. In so doing, the Group Credit Committee operates on the basis of the valid credit risk strategy. Reporting to the Group Credit Committee are sub-credit committees, which operate on the basis of their respective rules of procedure and within the competencies approved by the full Board of Managing Directors. They comprise at least two representatives from the segments and two representatives from Group Risk Management. The sub-credit committees are responsible for managing all credit risks in the sub-portfolios within their respective remit and are entitled, in turn, to sub-delegate certain credit decisions within their prescribed competencies.

Discrete back-office areas are responsible for operational credit risk management at portfolio level and on a case-by-case basis. The responsibilities are separated between the performing loan area on the one hand and Intensive Care on the other. All credit decisions in the performing loan area are risk/return decisions. The front and back office take joint responsibility for risk and return from an exposure, with the front office having primary responsibility for the return, and the back office for the risk. Accordingly, neither office can be overruled in its primary responsibility in the credit decision process.

Higher-risk customers are handled by specialist Intensive Care areas. The customers are moved to these areas as soon as they meet defined criteria for assignment or mandatory transfer. The principal reasons for assignment to Intensive Care areas are criteria relating to number of days overdrawn, together with event-related criteria such as rating, third-party enforcement measures or credit fraud. The Intensive Care function decides on further action based on the circumstances of individual cases. Customers must be transferred to Intensive Care if they are in default (for example due to insolvency). This graduated approach ensures that higher-risk customers can continue to be managed promptly by specialists in a manner appropriate to the risks involved and in defined standardised processes.

## Risk management

Commerzbank manages default risk using a comprehensive risk management system. The management framework comprises an organisational structure, methods and models, quantitative and qualitative management tools and regulations and processes. The risk management system ensures that the entire portfolio and the sub-portfolios, right down to individual exposure level, are managed consistently and thoroughly on a top-down basis.

The ratios and measures required for the operational process of risk management are based on the overarching Group objectives. The principle of maintaining a low-risk profile in all business decisions is closely combined here with the risk function's aim of providing the front office with appropriate support. The Bank's particular preference is for credit growth in granular lending business with good credit ratings. It also prefers business and products with low complexity and pays attention to the responsiveness of credit lines and exposures.

Quantitative credit risk strategy guidelines limit risks with regard to poorer credit ratings and exposures with high loss-at-default contributions (concentration management) and for selected sub-portfolios with a high risk weight or regulatory importance, and, as applicable, for individual products with a high portfolio share. Detailed arrangements for operationalising the guidelines for selected sub-portfolios are set out in separate portfolio policies. In addition, qualitative management guidelines in the form of credit policies define the target business of the Bank. At the level of individual transactions, they regulate the transaction type for which the available risk resources are to be used. These credit policies are firmly embedded in the credit process: transactions which do not meet the requirements are escalated through a fixed competence regulation.

Group-wide guiding principles are based on risk-oriented analyses of trends (e.g. of the development of weaker credit ratings over time) combined with an assessment of external framework conditions and internal rules. Risk-oriented analyses on key dates (e.g. rating profile of individual asset classes) are used in particular to derive portfolio guiding principles. Trend analyses of product-specific risk drivers are key factors for determining product guiding principles (e.g. loan-to-value of mortgage lending). In contrast, credit and portfolio policies are primarily produced through a multi-level coordination process involving the product and portfolio managers from the front and back offices, combined with an assessment of internal and external information sources.

To monitor compliance with credit risk strategic rules, continuous monitoring and reporting has also been set up at whole Group level and at segment or sub-portfolio level. Asset quality reviews by the risk function make an important contribution here to quality assurance and early risk detection. The key aspects of monitoring vary according to the subject matter and target audience, and ad-hoc reporting processes are in place. In addition, crisis events may pose a risk to the Bank's capital and liquidity adequacy and thereby to its risk-bearing capacity. In a crisis, the Risk Mitigation Task Force will manage decisions flexibly in a coordinated, Group-wide process. As part of the process, emergency action plans ensure that risk-mitigation measures are implemented quickly and efficiently.

The avoidance of risk concentrations is a core strategy of risk management. Risk concentrations are actively managed in order to identify at an early stage and contain the increased potential for loss from the synchronous movement of risk positions. In addition to exposure-related credit risk concentrations (bulk risks), default risk also includes country and sector concentrations. Segment-specific features are taken into account here.

A uniform definition based on "all-in" is used to manage bulk risk. The all-in concept comprises all customer credit lines approved by the Bank in their full amount – irrespective of the loan utilisation to date.

Management and the Supervisory Board's Risk Committee are regularly informed about the results of the analyses.

## Management of economic capital commitment

Economic capital commitment is managed in order to ensure that the Commerzbank Group holds sufficient capital. To this end, all relevant risk types in the overall risk strategy for economic risk capital are given limits on a Group-wide basis, with, in particular, a CVaR limit being specified. Due to the systematically restricted options for reducing default risk on a short-term basis, it is important to take account of expected trends (medium-term and long-term) in order to manage credit risk. For this reason, forecast values of credit risk parameters play a key role in ongoing management. At segment and business area level, changes to forecasts are monitored and adjustments made when necessary. There is no cascaded capital limit concept for credit risk below Group level.

## Overview of management instruments and levels

| | Risk strategies and policies | Limit and guideline systems | Portfolio monitoring and reporting | Structures of organisation and committees |
| --- | --- | --- | --- | --- |
| **Group** | Overall risk strategy plus sub-risk strategies for significant risk types<br><br>Establishment of a general risk understanding and creation of a uniform risk culture | Definition of Group limits (across all risk types) for capital and liquidity management<br><br>Additional definition of guidelines as key points of the aspired target portfolio | Group Risk & Capital Monitor plus risk type specific Group formats (including flash reporting)<br><br>Uniform, consolidated data repository as basis for Group reporting | Ensuring exchange of information and networking in committees that operate across all risk types<br><br>Retaining qualified staff in line with progressive product innovation or regulatory adjustments |
| **Sub-portfolios** | Clear formulation of risk policy in guidelines (portfolios, asset classes, etc.)<br><br>Differenciated credit authorities based on compliance of transactions with the Bank's risk policy | Performance metrics on level of risk categories and sub-portfolios<br><br>Expansion of Group-wide performance metrics using sub-portfolio-specific indicators | Portfolio batches as per established portfolio calendar<br><br>Asset quality review and analysis of High Attention Parts (HAP)<br><br>Trigger monitoring with clear escalation and reporting lines | Interdisciplinary composition of segment committees<br><br>Ensuring uniform economic opinions |
| **Individual exposures** | Rating-dependent and bulk-sensitive credit authority regulations with clear escalation processes | Limitation of bulk risk and uniform management according to model-independent all-in definition | Limit monitoring at individual exposure level<br><br>Monthly report to the Board of Managing Directors on the development of bulk risks<br><br>Review of individual custom-ers/exposures resulting from asset quality review or HAP analyses | Deal team structures<br><br>Institutionalized exchange within the risk function, also taking account of economic developments<br><br>Sector-wise organization of domestic corporate business |

## Rating classification

The Commerzbank rating method comprises 25 rating classes for customers not in default (1.0 to 5.8) and 5 default classes (6.1 to 6.5). The Commerzbank master scale allocates precisely one rating class, stable over time, to each probability of default. The rating methods are validated annually and recalibrated where necessary so that they reflect the latest assessment based on all actual observed defaults. The probability of default ranges assigned to the ratings are the same for all portfolios. This ensures internal comparability consistent with the master scale method. For guidance and indicative purposes, the Commerzbank master scale also shows external ratings as well as credit quality steps in accordance with Article 136 CRR. However, a direct reconciliation is not possible, because external ratings of different portfolios show fluctuating default rates from year to year.

The credit approval authorities of both individual staff and the committees (full Board of Managing Directors, Credit Committee, sub-credit committees) are graduated by a range of factors including size of exposure and rating class.

**Commerzbank master scale**

| Commerzbank AG rating | PD and EL mid-point % | PD and EL range % | S&P scale | | Credit quality steps in accordance with Article 136 CRR[1] | |
|---|---|---|---|---|---|---|
| 1.0 | 0 | 0 | AAA | AAA | I | Investment Grade |
| 1.2 | 0.01 | 0 – 0.02 | | | | |
| 1.4 | 0.02 | 0.02 – 0.03 | AA+ | AA | | |
| 1.6 | 0.04 | 0.03 – 0.05 | AA, AA– | | II | |
| 1.8 | 0.07 | 0.05 – 0.08 | A+, A | A | | |
| 2.0 | 0.11 | 0.08 – 0.13 | A– | | | |
| 2.2 | 0.17 | 0.13 – 0.21 | BBB+ | BBB | III | |
| 2.4 | 0.26 | 0.21 – 0.31 | BBB | | | |
| 2.6 | 0.39 | 0.31 – 0.47 | | | | |
| 2.8 | 0.57 | 0.47 – 0.68 | BBB– | | | |
| 3.0 | 0.81 | 0.68 – 0.96 | BB+ | BB | IV | Sub-investment grade |
| 3.2 | 1.14 | 0.96 – 1.34 | BB | | | |
| 3.4 | 1.56 | 1.34 – 1.81 | | | | |
| 3.6 | 2.10 | 1.81 – 2.40 | BB– | | | |
| 3.8 | 2.74 | 2.40 – 3.10 | | | | |
| 4.0 | 3.50 | 3.10 – 3.90 | B+ | B | V | Non-investment grade |
| 4.2 | 4.35 | 3.90 – 4.86 | B | | | |
| 4.4 | 5.42 | 4.86 – 6.04 | | | | |
| 4.6 | 6.74 | 6.04 – 7.52 | | | | |
| 4.8 | 8.39 | 7.52 – 9.35 | B– | | | |
| 5.0 | 10.43 | 9.35 – 11.64 | | | | |
| 5.2 | 12.98 | 11.64 – 14.48 | CCC+ | CCC | VI | |
| 5.4 | 16.15 | 14.48 – 18.01 | CCC, CCC– | | | |
| 5.6 | 20.09 | 18.01 – 22.41 | CC, C | CC, C | | |
| 5.8 | 47.34 | 22.41 – 99.99 | | | | |
| 6.1 | 100 | > 90 days past due | D | | | Default |
| 6.2 | | Imminent insolvency | | | | |
| 6.3 | | Restructuring with recapitalisation | | | | |
| 6.4 | | Termination without insolvency | | | | |
| 6.5 | | Insolvency | | | | |

[1] CRR = Capital Requirements Regulation (EU) No 575/2013.

## Risk mitigation

The collateral taken into account in risk management changed in the period under review from €104.5bn to €114.1bn for positions in the Group's performing portfolio and from €0.9bn to €1.0bn for positions in the default portfolio.

Commerzbank mitigates credit risk through various measures including collateral and netting procedures.

Types of collateral include in particular land charges, financial collateral, guarantees, indemnities, credit derivatives, life insurance policies, other registered liens and other physical collateral.

The Bank takes account of credit risk mitigation effects from the acceptance of recognisable warranties (guarantees, comparable claims on third parties) by using the guarantor's risk parameters (PD and LGD) and/or the regulatory risk weightings.

As at the reporting date, no loan loss provisions were created for transactions with a total volume of €5.5bn (31 December 2018: €5.3bn), as these are entirely collateralised.

Where eligible from a regulatory point of view, guarantors are subject to a creditworthiness check and rating assignment based on their sector and business as part of the assessment of their declaration of liability. The aim of the creditworthiness check is to establish the guarantor's creditworthiness and maximum solvency.

The quality of the collateralisation is rigorously checked in line with regulatory requirements and monitored on an ongoing basis. This includes in particular checks on legal enforceability and regular measurement of the collateral, carried out at appropriate intervals depending on the type of collateral, at least annually or on an event-driven basis. Positive correlations between the debtor's creditworthiness and the value of the collateral or guarantee are defined in the credit and collateral processing process. Collateral processing for Corporate Clients is performed outside the front office.

The Bank analyses all credit collateral (physical and personal collateral) for evidence of collateral concentrations. The analysis includes checks on various dimensions such as collateral categories, the borrower's rating classes or regional allocations of collateral. The full Board of Managing Directors receives regular information in respect of the above dimensions about changes in the collateral pool and possible issues/concentrations.

The measurement and processing of collateral is governed by generally applicable standards and collateral-specific instructions (guidelines, process descriptions, IT instructions). Legally verified standard agreements and models are used wherever possible. The standards established to hedge or mitigate credit risk include:

- Legal and operational standards for documentation and data collection and measurement standards.
- Standards to ensure the uniformity and timeliness of collateral measurement through the definition of measurement processes, uniform measurement methods, parameters and defined collateral discounts, clear definition of competences and responsibility for the processing and measurement process, and regular remeasurement frequencies.
- Other standards to take account of specific risks such as operational risk, correlation and concentration risk, market price change risk (e.g. due to currency fluctuations), country risk, legal and legal change risk and the risk of inadequate insurance coverage.

# Commerzbank Group

Commerzbank focuses its business on two customer segments, Private and Small-Business Customers (PSBC) and Corporate Clients (CC). In the Asset & Capital Recovery (ACR) segment, the Bank had bundled the activities of the Commercial Real Estate and Ship Finance areas and complex financings from the Public Finance area for the purpose of completely winding down the portfolios in these areas over time. The ACR segment was dissolved on 1 July 2019 following the successful winding down of assets over the last few years, with the remaining portfolios transferred to Others and Consolidation and to the Private and Small-Business Customers segment.

### Credit risk parameters

The credit risk parameters in the Commerzbank Group are distributed in the rating classes 1.0 to 5.8 over the segments as follows:

| Credit risk parameters | 31.12.2019 Exposure at default €bn | 31.12.2019 Expected loss €m | 31.12.2019 Risk density bp | 31.12.2019 CVaR €m | 31.12.2018 Exposure at default €bn | 31.12.2018 Expected loss €m | 31.12.2018 Risk density bp | 31.12.2018 CVaR €m |
|---|---|---|---|---|---|---|---|---|
| Private and Small-Business Customers | 178 | 425 | 24 | 2,207 | 165 | 420 | 25 | 2,476 |
| Corporate Clients | 184 | 473 | 26 | 4,607 | 187 | 467 | 25 | 5,458 |
| Asset & Capital Recovery | | | | | 8 | 46 | 57 | 643 |
| Others and Consolidation[1] | 83 | 120 | 14 | 3,003 | 72 | 35 | 5 | 1,790 |
| **Group** | **445** | **1,017** | **23** | **9,817** | **432** | **968** | **22** | **10,366** |

[1] Mainly liquidity portfolios of Treasury, and since 1 July 2019 the remaining portfolios of the dissolved ACR segment. The positions as at 31 December 2018 have not been retroactively adjusted.

When broken down on the basis of PD ratings, 84% of the Group's portfolio is in the internal rating classes 1 and 2, which comprise investment grade.

| **Rating breakdown** EaD \| % | 31.12.2019 1.0-1.8 | 31.12.2019 2.0-2.8 | 31.12.2019 3.0-3.8 | 31.12.2019 4.0-4.8 | 31.12.2019 5.0-5.8 | 31.12.2018 1.0-1.8 | 31.12.2018 2.0-2.8 | 31.12.2018 3.0-3.8 | 31.12.2018 4.0-4.8 | 31.12.2018 5.0-5.8 |
|---|---|---|---|---|---|---|---|---|---|---|
| Private and Small-Business Customers | 31 | 51 | 14 | 3 | 1 | 32 | 51 | 14 | 3 | 1 |
| Corporate Clients | 20 | 60 | 16 | 3 | 2 | 20 | 59 | 16 | 3 | 1 |
| Asset & Capital Recovery | | | | | | 27 | 56 | 8 | 9 | 1 |
| Others and Consolidation | 51 | 46 | 3 | 1 | 0 | 45 | 53 | 1 | 0 | 0 |
| **Group** | **30** | **54** | **13** | **2** | **1** | **29** | **55** | **13** | **2** | **1** |

The Group's country risk assessment covers both transfer risks and event risks driven by political and economic events which impact on the individual economic entities of a country. Country risks are managed on the basis of transfer risk limits defined at country level. Country exposures which are significant for Commerzbank due to their size are handled by the Credit Committee on a separate basis.

The regional breakdown of the exposure corresponds to the Bank's strategic direction and reflects the main areas of its global business activities.

| Group portfolio by region | 31.12.2019 Exposure at default €bn | 31.12.2019 Expected loss €m | 31.12.2019 Risk density bp | 31.12.2018 Exposure at default €bn | 31.12.2018 Expected loss €m | 31.12.2018 Risk density bp |
|---|---|---|---|---|---|---|
| Germany | 235 | 526 | 22 | 227 | 477 | 21 |
| Western Europe | 90 | 191 | 21 | 84 | 162 | 19 |
| Central and Eastern Europe | 49 | 207 | 42 | 41 | 197 | 48 |
| North America | 34 | 32 | 9 | 32 | 54 | 17 |
| Asia | 27 | 32 | 12 | 37 | 44 | 12 |
| Other | 10 | 29 | 29 | 10 | 34 | 33 |
| **Group** | **445** | **1,017** | **23** | **432** | **968** | **22** |

Around half of the Bank's exposure relates to Germany, another third to other countries in Europe, 8% to North America and 6% to Asia. The rest is broadly diversified and is split among a large number of countries where we serve German exporters in particular or where Commerzbank has a local presence. The expected loss of the Group portfolio is mainly divided between Germany and the other European countries.

In view of current geopolitical developments, national economies such as Russia, Turkey and China are closely monitored. As at the end of the fourth quarter of 2019, exposure to Russia was €2.9bn (31 December 2018: €2.6bn), exposure to Turkey was €1.7bn (31 December 2018: €1.7bn) and exposure to China was €3.9bn (31 December 2018: €6.4bn).

The sovereign exposures of Italy and Spain are also still closely monitored as a result of the sovereign debt crisis. As at the end of the fourth quarter of 2019, Commerzbank's Italian sovereign exposure was €9.3bn (31 December 2018: €8.4bn), while its Spanish sovereign exposure was €2.5bn (31 December 2018: €1.3bn).

**Risk result**

The risk result relating to the Group's lending business in 2019 amounted to €–620m.

The following table shows the breakdown of the risk result by stage according to IFRS 9. In Note (32) of the Group financial statements (credit risks and credit losses) details regarding the stages can be found; in Note (11) (risk result) the definition of the risk result can be found.

Any fluctuations of market values in the shipping portfolio are not recognised in the risk result. They are recognised in the net income from financial assets and liabilities measured at fair value through profit or loss.

From the present perspective, the risk result for the year 2020 as a whole will therefore not be less than €650m.

| | 2019 | | | | 2018[1] | | | |
|---|---|---|---|---|---|---|---|---|
| **Risk result \| €m** | **Stage 1** | **Stage 2[2]** | **Stage 3[2]** | **Total** | **Stage 1** | **Stage 2[2]** | **Stage 3[2]** | **Total** |
| Private and Small-Business Customers | –21 | –9 | –223 | –253 | 9 | –63 | –180 | –233 |
| Corporate Clients | 20 | 38 | –401 | –342 | –26 | –46 | –121 | –194 |
| Asset & Capital Recovery | 0 | 2 | –25 | –24 | 9 | 0 | –18 | –8 |
| Others and Consolidation | –6 | 57 | –52 | 0 | –5 | –6 | 0 | –11 |
| **Group** | **–6** | **88** | **–701** | **–620** | **–13** | **–115** | **–318** | **–446** |

[1] Retroactively adjusted (see Note 4 to the Group financial statements).
[2] Stages 2 and 3 including POCI (POCI – purchased or originated credit-impaired).

**Default portfolio**

The default portfolio declined by €104m year-on-year and amounted to €3,735m as at 31 December 2019.

The following breakdown of the default portfolio shows the claims in the default portfolio in the amortised cost and fair value OCI (other comprehensive income) categories. The loans are assigned almost exclusively to the amortised cost category, of which by far the greatest share of €3.5bn (31 December 2018: €3.6bn) relates to the loans and receivables class and €187m (31 December 2018: €171m) to off-balance sheet transactions. As at 31 December 2019 there were no defaulted securities assigned to the securitised debt instruments class (31 December 2018: €67m fair value OCI category). The collateral shown shall be liable to the full extent for loans in the amortised cost category, with €940m (31 December 2018: €876m) relating to loans and receivables and €37m (31 December 2018: €37m) to off-balance sheet transactions.

The default portfolio of loans in the fair value OCI category amounts to €1m (31 December 2018: – ).

| | 31.12.2019 | | | 31.12.2018 | | |
|---|---|---|---|---|---|---|
| **Default portfolio Group \| €m** | **Loans** | **Securities** | **Total** | **Loans** | **Securities** | **Total** |
| Default portfolio | 3,735 | 0 | 3,735 | 3,769 | 71 | 3,839 |
| LLP[1] | 1,745 | 0 | 1,745 | 1,606 | 3 | 1,609 |
| Coverage ratio excluding collateral (%)[2] | 47 | – | 47 | 43 | 4 | 42 |
| Collateral | 968 | 0 | 968 | 913 | 0 | 913 |
| Coverage ratio including collateral (%)[2] | 73 | – | 73 | 67 | 4 | 66 |
| NPE ratio (%)[3] | | | 0.9 | | | 1.0 |

[1] Loan loss provisions.
[2] Coverage ratio: LLP (and collateral) as a proportion of the default portfolio.
[3] NPE ratio: default portfolio (non-performing exposures – NPE) as a proportion of total exposures (EaD including NPE) according to EBA Risk Dashboard.

Commerzbank uses the definition in Article 178 CRR as the criterion for default. The EBA guidelines on the application of the definition of default referred to in Article 178 of Regulation (EU) No 575/2013 are taken into account. The default portfolio is divided into the following 5 classes based on the nature of the default:

- Rating class 6.1: Over 90 days past due.
- Rating classes 6.2/6.3: Unlikely-to-pay, or the Bank is assisting in financial rescue or distressed restructuring at the customer by making concessions.
- Rating classes 6.4/6.5: The Bank recalls the loan and the customer has become insolvent respectively.

The table below shows the breakdown of the default portfolio based on the 5 rating classes:

| | 31.12.2019 | | | | 31.12.2018 | | | |
|---|---|---|---|---|---|---|---|---|
| **Group rating classification \| €m** | **6.1** | **6.2/6.3** | **6.4/6.5** | **Total** | **6.1** | **6.2/6.3** | **6.4/6.5** | **Total** |
| Default portfolio | 522 | 1,312 | 1,901 | 3,735 | 454 | 1,280 | 2,106 | 3,839 |
| LLP | 252 | 476 | 1,016 | 1,745 | 169 | 395 | 1,045 | 1,609 |
| Collateral | 214 | 353 | 401 | 968 | 173 | 314 | 426 | 913 |
| Coverage ratio including collateral (%) | 89 | 63 | 75 | 73 | 75 | 55 | 70 | 66 |

**Overdrafts in the performing loan book**

In order to avoid an increase in the default portfolio, overdrafts are closely monitored at Commerzbank. In addition to the 90 days-past-due trigger event, IT-based management of overdrafts starts on the first day the account is overdrawn. The table below shows overdrafts outside the default portfolio based on the exposure at default as at the end of December 2019. The changes may also be due to short-term overdrafts:

| | 31.12.2019 | | | | | 31.12.2018 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **EaD €m** | **> 0 ≤ 30 days** | **> 30 ≤ 60 days** | **> 60 ≤ 90 days** | **> 90 days** | **Total** | **> 0 ≤ 30 days** | **> 30 ≤ 60 days** | **> 60 ≤ 90 days** | **> 90 days** | **Total** |
| Private and Small-Business Customers | 1,040 | 169 | 51 | 2 | 1,262 | 787 | 107 | 57 | 1 | 952 |
| Corporate Clients | 3,946 | 182 | 0 | 0 | 4,128 | 1,948 | 50 | 40 | 0 | 2,039 |
| Asset & Capital Recovery | 0 | 0 | 0 | 0 | 0 | 10 | 0 | 0 | 0 | 10 |
| **Group[1]** | **4,986** | **351** | **51** | **2** | **5,390** | **2,746** | **157** | **97** | **1** | **3,000** |

[1] Including Others and Consolidation.



## Private and Small-Business Customers segment

The Private and Small-Business Customers segment (PSBC) comprises the activities of Private Customers, Small-Business Customers, comdirect bank and Commerz Real. mBank is also in the Private and Small-Business Customers segment. Private Customers includes Commerzbank's branch business in Germany for private customers as well as Wealth Management. Small-Business Customers comprises business customers and small corporate customers.

The focus of the portfolio is on traditional owner-occupied home financing and the financing of real estate capital investments (residential mortgage loans and investment properties with a total EaD of €87bn). We provide our business and small-business customers with credit in the form of individual loans with a volume of €23bn. In addition, we meet our customers' day-to-day demand for credit with consumer loans (consumer and instalment loans and credit cards, to a total of €16bn). The portfolio's expansion in the last 12 months was largely due to residential mortgage loans.

Compared with the previous year, the risk density of the portfolio decreased by 1 basis point to 24 basis points.

| | 31.12.2019 | | | 31.12.2018 | | |
|---|---|---|---|---|---|---|
| **Credit risk parameters** | **Exposure at default** €bn | **Expected loss** €m | **Risk density** bp | **Exposure at default** €bn | **Expected loss** €m | **Risk density** bp |
| Private Customers | 104 | 159 | 15 | 99 | 177 | 18 |
| Business Customers | 31 | 73 | 23 | 29 | 67 | 23 |
| comdirect bank | 3 | 7 | 23 | 4 | 6 | 17 |
| Commerz Real | 1 | 2 | 43 | 1 | 2 | 29 |
| mBank | 39 | 183 | 47 | 33 | 167 | 50 |
| **PSBC** | **178** | **425** | **24** | **165** | **420** | **25** |

In 2019, the risk result in the Private and Small-Business Customers segment was €–253m (31 December 2018: €–233m) and therefore remained at a low level.

The default portfolio in the segment stood at €1,795m as at 31 December 2019 (31 December 2018: €1,751m).

| | 31.12.2019 | | | 31.12.2018 | | |
|---|---|---|---|---|---|---|
| **Default portfolio PSBC** \| €m | **Loans** | **Securities** | **Total** | **Loans** | **Securities** | **Total** |
| Default portfolio | 1,795 | 0 | 1,795 | 1,751 | 0 | 1,751 |
| LLP | 895 | 0 | 895 | 850 | 0 | 850 |
| Coverage ratio excluding collateral (%) | 50 | – | 50 | 49 | – | 49 |
| Collateral | 575 | 0 | 575 | 531 | 0 | 531 |
| Coverage ratio including collateral (%) | 82 | – | 82 | 79 | – | 79 |

## Corporate Clients segment

The Corporate Clients segment (CC) comprises the Group's activities with mid-size corporate clients, the public sector, institutional customers and multinational corporates. The segment is also responsible for the Group's relationships with banks and financial institutions in Germany and abroad, as well as with central banks. The regional focus of our activities is on Germany and Western Europe. The Group's customer-oriented capital markets activities are also bundled in this segment.

| | 31.12.2019 | | | 31.12.2018 | | |
|---|---|---|---|---|---|---|
| **Credit risk parameters** | **Exposure at default** €bn | **Expected loss** €m | **Risk density** bp | **Exposure at default** €bn | **Expected loss** €m | **Risk density** bp |
| Mittelstand | 79 | 257 | 33 | 74 | 198 | 27 |
| International Corporates | 68 | 112 | 16 | 68 | 149 | 22 |
| Financial Institutions | 20 | 54 | 27 | 23 | 69 | 30 |
| Other | 17 | 49 | 29 | 22 | 50 | 23 |
| **CC** | **184** | **473** | **26** | **187** | **467** | **25** |

The EaD of the Corporate Clients segment decreased from €187bn to €184bn compared with 31 December of the previous year. Risk density increased from 25 basis points to 26 basis points.

For details of developments in the Financial Institutions portfolio, please see page 116 f.

Influenced by large individual cases in the international corporates credit business, the risk result in the Corporate Clients segment in the 2019 financial year (€– 342m) was, as expected, up on the low figure for the previous year (fiscal year 2018: €– 194m), in which the segment benefited from large reversals.

The default portfolio in the segment stood at €1,707m as at 31 December 2019 (31 December 2018: €1,736m).

| | 31.12.2019 | | | 31.12.2018 | | |
|---|---|---|---|---|---|---|
| **Default portfolio CC \| €m** | **Loans** | **Securities** | **Total** | **Loans** | **Securities** | **Total** |
| Default portfolio | 1,707 | 0 | 1,707 | 1,669 | 67 | 1,736 |
| LLP | 755 | 0 | 755 | 636 | 3 | 639 |
| Coverage ratio excluding collateral (%) | 44 | – | 44 | 38 | 4 | 37 |
| Collateral | 306 | 0 | 306 | 251 | 0 | 251 |
| Coverage ratio including collateral (%) | 62 | – | 62 | 53 | 4 | 51 |

## Further portfolio analyses

The analyses below are independent of the existing segment allocation. The positions shown are already contained in full in the Group and segment presentations above.

**Corporates portfolio by sector**

A breakdown of the corporates exposure by sector is shown below.

| | 31.12.2019 | | | 31.12.2018 | | |
|---|---|---|---|---|---|---|
| **Corporates portfolio by sector** | **Exposure at default** €bn | **Expected loss** €m | **Risk density** bp | **Exposure at default** €bn | **Expected loss** €m | **Risk density** bp |
| Energy supply/Waste management | 21 | 82 | 40 | 18 | 62 | 34 |
| Technology/Electrical industry | 15 | 31 | 21 | 13 | 31 | 24 |
| Consumption | 15 | 49 | 34 | 14 | 54 | 37 |
| Wholesale | 14 | 47 | 35 | 13 | 48 | 37 |
| Transport/Tourism | 12 | 37 | 31 | 11 | 30 | 26 |
| Basic materials/Metals | 11 | 46 | 41 | 11 | 42 | 40 |
| Services/Media | 10 | 28 | 27 | 10 | 30 | 29 |
| Automotive | 10 | 38 | 39 | 10 | 27 | 28 |
| Chemicals/Plastics | 9 | 46 | 49 | 9 | 41 | 43 |
| Mechanical engineering | 9 | 26 | 29 | 9 | 24 | 28 |
| Construction | 6 | 16 | 28 | 6 | 16 | 28 |
| Pharmaceutical/Healthcare | 5 | 9 | 20 | 4 | 10 | 24 |
| Other | 7 | 14 | 21 | 5 | 7 | 13 |
| **Total** | **142** | **470** | **33** | **133** | **421** | **32** |



**Financial Institutions portfolio**

Our network of correspondent banks continued to focus on trade finance activities on behalf of our corporate customers and on capital market activities. In derivatives, we enter into trades with selected counterparties under the European Market Infrastructure Regulation (EMIR) standards.

We continue to keep a close watch on the impact of regulatory requirements on banks. In this context, we continue to pursue our strategy of holding as few exposures as possible which might absorb losses in the event of a bail-in of an affected institution.

We are keeping a close eye on developments in various countries affected by specific issues such as recessions, embargoes and economic uncertainty caused by political events (e.g. trade wars, Brexit) and are responding with flexible portfolio management that is tailored to the individual situation of each country. Overall, our risk appetite is geared to keeping the portfolio as responsive as possible.

| | 31.12.2019 | | | 31.12.2018 | | |
|---|---|---|---|---|---|---|
| **FI portfolio by region** | **Exposure at default** €bn | **Expected loss** €m | **Risk density** bp | **Exposure at default** €bn | **Expected loss** €m | **Risk density** bp |
| Germany | 6 | 4 | 7 | 5 | 6 | 12 |
| Western Europe | 15 | 11 | 8 | 15 | 12 | 8 |
| Central and Eastern Europe | 3 | 15 | 55 | 3 | 17 | 56 |
| North America | 2 | 0 | 2 | 2 | 1 | 4 |
| Asia | 9 | 19 | 22 | 12 | 24 | 21 |
| Other | 5 | 19 | 38 | 6 | 23 | 40 |
| **Total** | **40** | **70** | **18** | **43** | **83** | **19** |

**Non-Bank Financial Institutions portfolio**

The Non-Bank Financial Institutions (NBFI) portfolio mainly comprises insurance companies, asset managers, regulated funds and central counterparties. Business activities are focused on Germany, Western Europe and the United States and Asia.

Commerzbank conducts new business with NBFIs partly in consideration of regulatory requirements (clearing via central counterparties) and partly in the interests of our institutional customers, with a focus on attractive opportunities with customers with good credit ratings and valuable security. We manage our portfolios with the aim of ensuring their high quality and responsiveness. We are keeping a close eye on risks stemming from political events (e.g. Brexit) and are responding with flexible portfolio management that is tailored to the individual situation.

| | 31.12.2019 | | | 31.12.2018 | | |
|---|---|---|---|---|---|---|
| **NBFI portfolio by region** | **Exposure at default** €bn | **Expected loss** €m | **Risk density** bp | **Exposure at default** €bn | **Expected loss** €m | **Risk density** bp |
| Germany | 18 | 38 | 21 | 18 | 25 | 14 |
| Western Europe | 12 | 23 | 20 | 12 | 23 | 19 |
| Central and Eastern Europe | 2 | 19 | 100 | 1 | 8 | 65 |
| North America | 9 | 12 | 13 | 9 | 24 | 28 |
| Asia | 2 | 2 | 13 | 2 | 2 | 13 |
| Other | 1 | 2 | 23 | 1 | 2 | 31 |
| **Total** | **43** | **96** | **22** | **42** | **84** | **20** |

**Originator positions**

Commerzbank has in recent years securitised receivables from loans to the Bank's customers with a current volume of €5.4bn, primarily for capital management purposes (31 December 2018: €5.9bn). In the period under review, the CoCo Finance III-3 transaction was placed with a volume of €1.5bn, mainly on the basis of receivables from European companies and SMEs.

As at the reporting date 31 December 2019, risk exposures with a value of €5.0bn (31 December 2018: €5.5bn) were retained. By far the largest portion of these positions is accounted for by €4.8bn (31 December 2018: €5.3bn) of senior tranches, which are nearly all rated good or very good.

| | | Commerzbank volume[1] | | | |
|---|---|---|---|---|---|
| **Securitisation pool** €bn | **Maturity** | **Senior** | **Mezzanine** | **First loss piece** | **Total volume[1]** |
| Corporates | 2025–2036 | 4.8 | < 0.1 | 0.2 | 5.4 |
| **Total 31.12.2019** | | **4.8** | **< 0.1** | **0.2** | **5.4** |
| Total 31.12.2018 | | 5.3 | < 0.1 | 0.1 | 5.9 |

[1] Tranches/retentions (nominal): banking and trading book.

**Conduit exposure and other asset-backed exposures**

The Bank provides financing to securitise receivables, in particular trade and leasing receivables, from customers in the Corporate Clients segment. In this context, Commerzbank acts mainly as an arranger of asset-backed securities transactions via the Commerzbank-sponsored multi-seller conduit Silver Tower. In view of regulatory changes and the relocation of the Silver Tower conduit to Luxembourg, since the beginning of 2019 financing has been carried out through the direct purchase of funding notes that are taken onto the Bank's balance sheet. The volume and risk values for the securitisation of receivables in the Corporate Clients segment declined from €3.9bn to €3.5bn in 2019.

Liquidity risks from securitisations are modelled conservatively in the internal liquidity risk model. In the modelling, a worst-case assumption is made that Commerzbank will have to take on the funding of a major part of the purchase facilities provided to its special-purpose vehicles within the scope of the Silver Tower conduit. Also, the Bank's holdings of securitisation transactions only qualify as liquid assets if they are eligible for rediscount at the European Central Bank. These positions are only included in the liquidity risk calculation after applying conservative discounts.

The other asset-backed exposures mainly comprise government-guaranteed asset-backed securities (ABS) held by Commerzbank Finance & Covered Bond S.A. and Commerzbank AG in Germany. Over the course of 2019 the volume increased to €4.2bn (December 2018: €4.0bn) and risk values[1] to €4.2bn (December 2018: €3.8bn).

There are also investments in the Structured Credit area. The volume of new investments entered into since 2014 stood at €4.9bn (December 2018: €3.8bn). In general, we have traditionally invested in bonds of senior tranches of securitisation transactions in the consumer (auto) ABS, UK RMBS and CLO asset classes, which have a robust structure and a moderate risk profile. At the end of 2019, this portfolio contained only AAA-rated CLO positions. Remaining structured credit positions with a volume of €0.7bn were already in the portfolio prior to 2014 (December 2018: €1.3bn), while risk values stood at €0.3bn (December 2018: €0.4bn).

**Forbearance portfolio**

The EBA's definition of forbearance comprises two requirements, which have to be met concurrently: The debtor is in financial difficulties and the measures of the bank to help the debtor include concessions to the debtor that the bank would not have agreed to under different circumstances. Examples of concessions include deferrals, increases in limits or loans and waivers in connection with restructuring. The definition of forbearance applies independently of whether the debtor is in the performing or the non-performing portfolio.

The following table shows Commerzbank's total forbearance portfolio on the basis of the EBA definition as well as the loan loss provisions for these positions:

| | 31.12.2019 | | | 31.12.2018 | | |
|---|---|---|---|---|---|---|
| **Forbearance portfolio by segment** | **Forborne exposure** | **LLP** | **LLP coverage ratio** | **Forborne exposure** | **LLP** | **LLP coverage ratio** |
| | €m | €m | % | €m | €m | % |
| Private and Small-Business Customers | 1,007 | 198 | 20 | 1,062 | 178 | 17 |
| Corporate Clients | 1,556 | 178 | 11 | 1,507 | 177 | 12 |
| Others and Consolidation | 176 | 78 | 45 | 902 | 296 | 33 |
| **Group** | **2,739** | **454** | **17** | **3,471** | **651** | **19** |

[1] Risk value is the balance sheet value of cash instruments. For long CDS positions, it comprises the nominal value of the reference instrument less the net present value of the credit derivative.

The forbearance portfolio by region is as follows:

| | 31.12.2019 | | | 31.12.2018 | | |
|---|---|---|---|---|---|---|
| **Forbearance portfolio by region** | **Forborne exposure** €m | **LLP** €m | **LLP coverage ratio** % | **Forborne exposure** €m | **LLP** €m | **LLP coverage ratio** % |
| Germany | 1,587 | 189 | 12 | 1,927 | 381 | 20 |
| Western Europe | 218 | 6 | 3 | 720 | 73 | 10 |
| Central and Eastern Europe | 873 | 257 | 29 | 744 | 183 | 25 |
| North America | 6 | 0 | 2 | 12 | 3 | 23 |
| Asia | 6 | 2 | 26 | 5 | 1 | 22 |
| Other | 48 | 1 | 1 | 62 | 9 | 15 |
| **Group** | **2,739** | **454** | **17** | **3,471** | **651** | **19** |

In addition to the loan loss provisions of €454m (31 December 2018: €651m), the risks of the forbearance portfolio are covered by collateral totalling €816m (31 December 2018: €1,095m).

# Market risk

Market risk is the risk of potential financial losses due to changes in market prices (interest rates, commodities, credit spreads, exchange rates and equity prices) or in parameters that affect prices such as volatilities and correlations. Losses may impact profit or loss directly, e.g. in the case of trading book positions. However, for banking book positions they are generally reflected in the revaluation reserve or in hidden liabilities/reserves.

## Strategy and organisation

Commerzbank's market risk strategy is derived from its overall risk strategy and the business strategies of the individual segments. It sets targets for market risk management in relation to Commerzbank's main business activities. The core market risk management tasks are the identification of all material market risks and drivers of market risk and the independent measurement and evaluation of these. The results and estimates serve as the basis for risk/return-oriented management.

The Board of Managing Directors of Commerzbank is responsible for ensuring the effective management of market risk throughout the Commerzbank Group. Specific levels of authority and responsibility in relation to market risk management have been assigned to the appropriate market risk committees.

Various market risk committees have been established within the Bank. In these, segment representatives, along with representatives from the risk function and finance area, discuss current risk positioning issues and decide on appropriate action. Chaired by the risk function, the Group Market Risk Committee, which meets monthly, deals with the Commerzbank Group's market risk position. Discussions centre on the monthly market risk report, which is also presented to the Board of Managing Directors for their consideration. The report summarises the latest developments on financial markets, the Bank's positioning and related risk ratios. The Segment Market Risk Committee focuses on the Corporate Clients segment and the Group Treasury division.

The risk management process involves the identification, measurement, management and monitoring of risks and reporting on them. It is the responsibility in functional terms of market risk management, which is independent of trading activities. Central market risk management is complemented by decentralised market risk management units at segment level and for regional units and subsidiaries. The close integration of central and local risk management with the business units means that the risk management process starts in the trading areas themselves. The trading units are responsible in particular for the active management of market risk positions, e.g. reduction measures or hedging.

## Risk management

Commerzbank uses a wide range of quantitative and qualitative tools to manage and monitor market risk. Quantitative limits for sensitivities, value at risk, stress tests, scenario analyses and ratios on economic capital limit the market risk. Our comprehensive rulebook, in the form of market risk policies and guidelines as well as restrictions on portfolio structure, new products, maturities and minimum ratings, establishes the qualitative framework for market risk management. The market risk strategy lays down the weighting of figures in each segment by reference to their relevance. Thereby allowance is made for the varying impact of the parameters for the management of the segments in line with the business strategy.

Market risk is managed internally at Group level, segment level and in each segment's reporting units. A comprehensive internal limit system broken down to portfolio level is implemented and forms a core part of internal market risk management.

The quantitative and qualitative factors limiting market risk are determined by the market risk committees by reference to the Group's management of economic capital. The utilisation of these limits, together with the relevant net income figures, is reported daily to the Board of Managing Directors and the responsible heads of the Group divisions. Based on qualitative analyses and quantitative ratios, the market risk function identifies potential future risks, anticipates potential financial losses in collaboration with the finance function, and draws up proposals for further action, which are discussed with the front office units. Voting on the proposed measures or risk positions takes place in the above-mentioned market risk committees and is subsequently submitted to the Board of Managing Directors for approval.

Risk concentrations are restricted directly using specific limits or are indirectly avoided, for example, using stress test limits. In addition, the combination of various conventional risk measures (e.g. VaR, sensitivities) ensures the appropriate management of concentration risks. Furthermore, risk drivers are analysed on a regular basis in order to identify concentrations. The risk management of existing concentrations is also reviewed using situation-driven analyses and, where necessary, supplemented by targeted measures such as limits.

Any limits that are breached are handled in a separate escalation procedure. After a limit breach has been identified, the front office and risk units design adequate countermeasures. If the limit breach cannot be remedied within a reasonable period, it will be escalated by the market risk function to the next hierarchical level.

Regulatory risk measures that are not included in economic risk-bearing capacity are limited and managed separately. These include, for example, stressed VaR and incremental risk charge.

In internal management, all positions relevant to market risk are covered, and trading and banking book positions are jointly managed. In addition, for regulatory purposes the trading book is managed separately (in accordance with regulatory requirements, including currency and commodity risks in the banking book) and interest rate risks in the banking book are managed on a stand-alone basis. In order to provide a consistent presentation in this report, all figures relating to the VaR are based on a confidence level of 99%, a holding period of one day, equally weighted market data and a 254-day history.

For the entire book, VaR in 2019 increased by €54m to €89m. The increase in VaR is due to the sharp rise in volatility on the interest rate markets in conjunction with an extended Treasury interest rate position in the banking book, which has led to extreme scenarios in the VaR calculation.

| VaR contribution \| €m | 31.12.2019 | 31.12.2018 |
|---|---|---|
| **Overall book** | **89** | **34** |
| thereof trading book | 6 | 10 |

## Trading book

Below, we show how the regulatory market risk ratios of the trading book portfolio developed. Most of Commerzbank's trading book positions derive from the Corporate Clients segment and Group Treasury division. The VaR figures comprise all risks in the internal VaR model. Smaller Commerzbank Group entities use standardised approaches for their regulatory capital calculation under partial use rules. These figures are not contained in the VaR figures shown in this report.

The VaR declined from €10m to €6m over the course of 2019. VaR in the trading book is at a historical low. This was mainly due to the sale of the equities business, which was already partially completed in 2019, as well as a risk reduction in investment banking business due to changes in positions in the Corporate Customers segment and Treasury.

| VaR of portfolios in the trading book \| €m | 2019 | 2018 |
|---|---|---|
| Minimum | 4 | 6 |
| Mean | 7 | 9 |
| Maximum | 11 | 12 |
| **VaR at end of reporting period** | **6** | **10** |

The market risk profile is diversified across all asset classes.

| VaR contribution by risk type in the trading book \| €m | 31.12.2019 | 31.12.2018 |
|---|---|---|
| Credit spreads | 1 | 1 |
| Interest rates | 1 | 2 |
| Equities | 1 | 3 |
| FX | 2 | 2 |
| Commodities | 1 | 1 |
| **Total** | **6** | **10** |

Further risk ratios are calculated for regulatory capital adequacy. This includes the calculation of stressed VaR. Stressed VaR is calculated using the internal model on the basis of the VaR method described above. The main difference lies in the market data used to value the assets. Stressed VaR measures the risk in the present position in the trading book by reference to market movements from a specified crisis period in the past. The crisis observation period used for this is checked regularly through model validation and approval processes and adjusted where necessary. The crisis observation period remained the same in the first three months of 2019. Stressed VaR fell from €35m at end-2018 to €26m at end-2019. This was mainly due to the sale of the equities business, which was already partially completed in 2019, as well as a risk reduction in investment banking business due to changes in positions in the Corporate Customers segment and Treasury.

The market risk profile in stressed VaR is also diversified across all asset classes.

| Stressed VaR contribution by risk type in the trading book \| €m | 31.12.2019 | 31.12.2018 |
|---|---|---|
| Credit spreads | 5 | 5 |
| Interest rates | 5 | 12 |
| Equities | 5 | 10 |
| FX | 5 | 4 |
| Commodities | 5 | 4 |
| **Total** | **26** | **35** |

In addition, the incremental risk charge and the equity event VaR figures quantify the risk of deterioration in creditworthiness and event risks in trading book positions. The incremental risk charge in the Commerzbank Group declined by €5m to €14m in 2019. The decline was mainly attributable to changes in positions in the Corporate Clients segment.

The reliability of the internal model (historical simulation) is monitored in various ways, including backtesting, on a daily basis. The VaR calculated is set against actually occurring profits and losses. The VaR used in backtesting is based on the complete historical simulation and therefore represents all internal models used in the market risk VaR calculation of capital adequacy requirements at Group level. The process draws a distinction between “clean P&L” and “dirty P&L” backtesting. In the former, exactly the same positions in the income statement are used as were used for calculating the VaR. This means that the profits and losses result only from changes in market prices (hypothetical changes in the portfolio value). In dirty P&L backtesting, by contrast, profits and losses from newly concluded and expired transactions from the day under consideration are also included (actual profits and losses induced by portfolio value changes). Profits and losses from valuation adjustments and model reserves are factored into dirty and clean P&L according to the regulatory requirements.

If the actual loss exceeds the VaR, it is described as a negative backtesting outlier. Analysing the results of backtesting provides an informative basis for checking parameters and for improving the market risk model. In 2019, we saw no negative clean P&L outliers and no negative dirty P&L outliers.

The results confirm the quality of the VaR model. Backtesting is also used by the supervisory authorities for evaluating internal risk models. Negative outliers are classified by means of a traffic-light system laid down by the supervisory authorities. All negative backtesting outliers at Group level (from both clean P&L and dirty P&L) must be reported to the supervisory authorities, citing their extent and cause.

As the VaR concept gives a prediction of potential losses assuming normal market conditions, it is supplemented by stress tests. These stress tests measure the risk to which Commerzbank is exposed, based on unlikely but still plausible events. These events may be simulated using extreme movements on various financial markets. The key scenarios relate to major changes in credit spreads, interest rates and yield curves, exchange rates, share prices and commodities prices. Events simulated in stress tests include all stock prices falling by 15%, a parallel shift in the yield curve or changes to the curve’s gradient. Extensive Group-wide stress tests and scenario analyses are carried out as part of risk monitoring.

The internal model's individual components are independently validated at regular intervals to assess their appropriateness for risk measurement. The identification and elimination of model weaknesses are of particular importance in this.

## Banking book

The key drivers of market risk in the banking book are the Group Treasury portfolios, with their credit spread, interest rate and basis risks, and the positions held by the subsidiary Commerzbank Finance & Covered Bond S.A.

In market risk management, credit spread sensitivities in the banking and trading books are considered together. Credit spread sensitivities (downshift of 1 basis point) for all securities and derivative positions (excluding loans) were at €49m as at the end of 2019 (31 December 2018: €41m).

Most credit spread sensitivities were related to securities positions measured at amortised cost. Changes in market price have no impact on the revaluation reserve or the income statement for these positions.

The impact of an interest rate shock on the economic value of the Group's banking book is simulated monthly in compliance with regulatory requirements. In accordance with the EU Banking Directive, the German Federal Financial Supervisory Authority (BaFin) and the European Central Bank (ECB) have prescribed two scenarios of uniform, sudden and unexpected changes in interest rates (+/–200 basis points) to be used by all banks, which have to report on the results of this stress test every quarter. In the scenario −200 basis points, the yield curve is floored at 0 (negative sections of the yield curve are left unchanged).

As a result of the scenario + 200 basis points, a potential loss of €2,635m as at 31 December 2019 (31 December 2018: €1,651m potential loss) and in the scenario − 200 basis points a potential profit of €614m (31 December 2018: €230m potential profit) was determined. Commerzbank does not, therefore, need to be classified as a bank with elevated interest rate risk, as the decline in net present value represents less than 20% of its regulatory capital.

As at 31 December 2019, the interest rate sensitivity of the entire banking book (without pension funds) was €9.4m (31 December 2018: €6.3m) per basis point of interest rate reduction.

Pension fund risk is also part of market risk in the banking book. Our pension fund portfolio comprises a well-diversified investment section and a section comprising insurance-related liabilities. The duration of the liabilities is extremely long (cash outflows modelled over almost 90 years), and the main portion of the overall portfolio's present value risk is in maturities of 15 years and over. The main risk drivers are long-term euro interest rates, credit spreads and expected euro inflation due to anticipated pension dynamics. Equity, volatility and foreign exchange risk also need to be taken into consideration. Diversification effects between individual risks reduce the overall risk. The extremely long maturities of these liabilities represent the greatest challenge, particularly for hedging credit spread risk. This is because there is insufficient liquidity in the market for corresponding hedging products.

## Market liquidity risk

Market liquidity risk is the risk of the Bank not being able to liquidate or hedge risky positions in a timely manner, to the desired extent and on acceptable terms as a result of insufficient liquidity in the market. Market liquidity risk is taken into account in Commerzbank's risk-bearing capacity concept by scaling the value at risk to one year, i.e. the implicitly recognised liquidation period. Additional valuation adjustments for market liquidity risk are also reflected in the calculation of the risk coverage capital.

# Liquidity risk

We define liquidity risk in the narrower sense as the risk that Commerzbank will be unable to meet its payment obligations on a day-to-day basis. In a broader sense, liquidity risk describes the risk that future payments cannot be funded for the full amount, in the required currency or at standard market conditions, as and when they are due.

## Strategy and organisation

The Board of Managing Directors adopts the business strategy and the Bank's risk tolerance, which is associated with it. Liquidity risk tolerance is then operationalised by defining the liquidity reserve period and the limit framework. In order to ensure an appropriate liquidity risk management process, the Board of Managing Directors delegates certain competences and responsibilities in connection with the Group-wide liquidity risk strategy to the Risk and Treasury functions.

The central Asset Liability Committee (ALCO) is responsible for limiting, analysing and monitoring liquidity risk and for strategic liquidity positioning. ALCO is supported by various subcommittees in this.

## Risk management

Commerzbank uses a wide range of tools to manage and monitor liquidity risks on the basis of its own liquidity risk model. The stress scenario within the Bank that underlies the model and is relevant for management purposes allows for the impact of both a bank-specific stress event and a broader market crisis. Binding regulatory requirements are an integral component of the management mechanism.

Group Treasury is responsible for the Group's liquidity management operations. Group Treasury is represented in all major locations of the Group in Germany and abroad and has reporting lines into all subsidiaries. Commerzbank manages its global liquidity centrally using cash pooling. This approach ensures that liquidity resources are used efficiently and that this occurs across all time zones, as Group Treasury units are located in Frankfurt, London, New York and Singapore. Additional information on this subject can be found in the "Funding and liquidity of the Commerzbank Group" section of the Group Management Report. Liquidity risk is monitored on the basis of the Bank's own liquidity risk model by the independent risk function.

The Bank has established early warning indicators for the purpose of managing liquidity risk. These ensure that appropriate steps can be taken in good time to secure long-term financial solidity.

Risk concentrations can lead to increased outflows of liquidity, particularly in a stress situation, and thus to increased liquidity risk. They can, for example, occur with regard to maturities, large individual creditors or currencies. By means of ongoing monitoring and reporting, emerging risk concentrations in funding can be recognised in a timely manner and mitigated through suitable measures.

This also applies to payment obligations in foreign currencies. The Bank also mitigates concentration by continuously using its access to broadly diversified sources of funding, in particular diverse customer deposits and capital market instruments. Commerzbank also ensures that it monitors foreign exchange risks and fulfils the currency matching requirements for highly liquid assets and net liquidity outflows.

In the event of a liquidity crisis, the emergency plan provides for various measures for different types of crisis, which can be launched by the central ALCO. The emergency plan forms an integral part of Commerzbank's recovery plan and is updated at least once a year; the individual liquidity emergency measures are checked regularly during the year for plausibility. The emergency plan also defines a clear allocation of responsibilities for the processes to be followed in emergency situations and gives details of any action that may need to be taken.

## Liquidity risk model

A key component of liquidity risk management is the daily calculation of the liquidity gap profile. The liquidity gap profile shows the deterministic or stochastic inflows and outflows expected in the future on a given reporting date and across all portfolios. This forms the basis for calculating liquidity requirements or excess liquidity per maturity band. This also includes modelling the proportion of customer deposits that will be permanently available, known as the core deposit base.

The liquidity gap profile is also used to set the issuance strategy of the Commerzbank Group, which is operationalised by the Group Treasury division. The Group Finance division is responsible for calculating and allocating liquidity costs on the basis of the liquidity gap profile, which are then incorporated in the management of the segments' business activities.

Based on the liquidity gap profile, management mechanisms such as recovery and early warning indicators are limited and monitored accordingly. The liquidity gap profile is limited in all maturity bands. The Group limits are broken down into individual Group units and currencies. The internal liquidity risk model is complemented by the regular analysis of additional adverse, reverse and historical stress scenarios.

## Quantification and stress testing

Commerzbank uses a wide range of tools to manage and monitor liquidity risks on the basis of its own liquidity risk model. In addition to internal economic considerations, liquidity risk modelling also factors in the binding regulatory requirements under the Capital Requirements Regulation (CRR) and the Minimum Requirements for Risk Management (MaRisk). Commerzbank incorporates this within its liquidity risk framework, thereby quantifying the liquidity risk appetite established by the full Board of Managing Directors.

The stress scenarios within the Bank that underlie the model and are relevant for management purposes allow for the impact of both a bank-specific stress event and a broader market crisis. The Commerzbank-specific idiosyncratic scenario simulates a stress situation arising from a rating downgrade of two notches, whereas the market-wide scenario is derived from experience of the subprime crisis and simulates an external market-wide shock. The main liquidity risk drivers of both scenarios are a markedly increased outflow of short-term customer deposits, above-average drawdown of credit lines, prolongations of lending business regarded as commercially necessary, the need to provide additional collateral for secured transactions and the application of higher risk discounts to the liquidation values of assets. As a complement to the individual scenarios, the Bank also simulates the impact on the liquidity gap profile (net liquidity position) of a scenario that combines idiosyncratic and market-specific effects. The liquidity gap profile is shown for the whole of the modelling horizon across the full spectrum of maturities and follows a multi-level concept. This allows for a nuanced presentation – deterministic and modelled cash flows in existing business on the one hand and the inclusion of prolongations on the other.

The table below shows the liquidity gap profile values after application of the respective stress scenarios for periods of one and three months as at the end of the year. Significantly more liquidity flows out in a combined scenario compared with the individual scenarios. As at the end of 2019, in the one-month and three-month periods, the combined stress scenario leaves net liquidity of €11.7bn and €11.2bn respectively (year-end 2018: €11.0bn and €11.7bn respectively).

| **Net liquidity in the stress scenario** \| €bn | | **31.12.2019** | **31.12.2018** |
|---|---|---|---|
| Idiosyncratic scenario | 1 month | 18.4 | 16.6 |
| | 3 months | 20.1 | 19.2 |
| Market-wide scenario | 1 month | 20.7 | 21.6 |
| | 3 months | 20.2 | 22.7 |
| Combined scenario | 1 month | 11.7 | 11.0 |
| | 3 months | 11.2 | 11.7 |

## Liquidity reserves

Significant factors in the liquidity risk appetite include the reserve period, the size of the liquidity reserve portfolio held to compensate for unexpected short-term liquidity outflows, and the limits in the various maturity bands. As the liquidity reserve portfolio consists of highly liquid assets, it functions as a buffer in stress situations. The liquidity reserve portfolio is funded in line with the liquidity risk appetite to ensure that it is kept at the required size throughout the entire reserve period stipulated by the Board of Managing Directors.

As at the reporting date, the Bank had a liquidity reserve of €72.4bn in the form of highly liquid assets (year-end 2018: €77.3bn). A part of this liquidity reserve is held in a separate stress liquidity reserve portfolio managed by Group Treasury to cover liquidity outflows should a stress event occur and to ensure solvency at all times. In addition, the Bank operates an intraday liquidity reserve portfolio in the amount of €6.3bn as at the reporting date (31 December 2018: €10.0bn).

| **Liquidity reserves from highly liquid assets** \| €bn | **31.12.2019** | **31.12.2018** |
|---|---|---|
| Highly liquid assets | 72.4 | 77.3 |
| of which level 1 | 59.6 | 61.9 |
| of which level 2A | 11.5 | 14.1 |
| of which level 2B | 1.3 | 1.3 |

## Liquidity ratios

Throughout 2019, Commerzbank's internal liquidity ratios, including the regulatory liquidity coverage ratio (LCR), were at all times above the limits set by the Board of Managing Directors. The same is true of compliance with the survival period calculation set down by MaRisk.

The regulatory LCR is contained in the internal liquidity risk model as a binding secondary condition. The LCR is calculated as the ratio of liquid assets to net liquidity outflows under stressed conditions. It is used to measure whether a bank has a large enough liquidity buffer to independently withstand any potential imbalance between inflows and outflows of liquidity under stressed conditions over a period of 30 calendar days. Since 1 January 2018, banks have had to maintain a ratio of at least 100%.

In 2019, Commerzbank significantly exceeded the minimum ratio of 100% stipulated for that year on every reporting date. As at the end of 2019, the average month-end value of the LCR over the last 12 months was 132.72% (as at the end of 2018: 135.66%).

The Bank has established corresponding limits and early warning indicators to ensure the LCR minimum requirements are met. Further information on the composition of the LCR is given in Note 65 (Liquidity coverage ratio) of the Group Financial Statements.

# Operational risk

Based on the Capital Requirements Regulation (CRR), Commerzbank defines operational risk (OpRisk) as the risk of loss resulting from the inadequacy or failure of internal processes, people and systems or from external events. This definition includes legal risks; it does not cover strategic or reputational risks. In view of their increased economic significance, compliance risk and cyber risk are managed as separate risk types. However, losses from compliance risks and cyber risks are incorporated into the model for determining the regulatory and economic capital required for operational risks.

## Strategy and organisation

Within Commerzbank, OpRisk and governance issues of the Internal Control System (ICS) are closely connected in terms of both organisational structure and methodology and are continuously being enhanced. This is because many OpRisk cases are closely linked with failures in the control mechanisms. A properly functioning ICS thereby helps to reduce or avoid losses from operational risks and thus to lower the amount of capital required to cover operational risks in the medium to long term. Conversely, the operational risk management systems enable the ICS to adapt itself consistently to them. The further development of the ICS structure is an essential aspect of the proactive reduction or prevention of operational risks. Accordingly, the governance of the ICS was adapted in the course of the Campus 2.0 realignment in order to reflect the new structure. In addition, flexibility was introduced to enable the control loop to be implemented efficiently in the future.

Chaired by the CRO, the Group OpRisk Committee meets four times a year and deals with the management of operational risks within the Commerzbank Group. It also acts as the escalation and decision-making committee for key OpRisk topics that span all areas. The Management Boards and/or the Segment Committees with responsibility for operational risk deal with the management of operational risk in the relevant units. They analyse OpRisk issues that affect them, such as loss events, and define subsequent measures or recommend action.

Commerzbank's OpRisk strategy is approved on an annual basis by the full Board of Managing Directors after it has been discussed and voted upon in the Group OpRisk Committee. The OpRisk strategy describes the risk profile, key elements of the desired risk culture, its management framework and measures to be taken by Commerzbank to manage operational risk.

OpRisk management is based on three consecutive levels (three lines of defence) which, when taken together, are crucial for reaching the given strategic aims.

## Risk management

Commerzbank takes an active approach to managing operational risk, aiming to systematically identify OpRisk profiles and risk concentrations and to define, prioritise and implement risk mitigation measures.

Operational risks are characterised by asymmetric distribution of losses. This means that most of the losses are relatively small, while isolated losses with a very low probability of occurrence have the potential to be large and devastating. This makes it necessary not only to limit high loss potential but also to proactively manage losses that can be expected to occur frequently.

To do this, Commerzbank has set up a multi-stage system that brings together the defined limits on economic capital (risk capacity) and those set for operative risk management during the year (risk appetite/tolerance), complemented by rules on the transparent and conscious acceptance and approval of individual risks (risk acceptance).

OpRisk management includes an annual evaluation of the Bank's ICS and a risk scenario assessment. Furthermore, OpRisk loss events are subjected to ongoing analysis and to ICS backtesting on an event-driven basis. Lessons learned activities are carried out after all material loss events. External OpRisk events at competitors are also systematically evaluated.

Commerzbank uses the advanced measurement approach (AMA) to measure regulatory and economic capital for operational risks. Risk-weighted assets for operational risks on this basis came to €18.7bn at the end of the fourth quarter of 2019 (31 December 2018: €21.4bn, 99.90% quantile). Here, in addition to the updated loss history, Commerzbank benefited from a model adjustment approved by the supervisor in calculating risk assets for operational risks. The decline also reflects progress in strategy implementation toward an even more efficient business model, with a clear focus on the core segments PSBC and CC, as well as risk reduction in investment banking business, and the associated improvement in the operational risk profile. Economically required capital was €1.5bn (since the first quarter of 2019: 99.90% quantile; 31 December 2018: €1.8bn, 99.91% quantile).

The following table gives an overview of risk-weighted assets and the economically required capital (ErC) by segment:

| | 31.12.2019 | | 31.12.2018 | |
|---|---|---|---|---|
| €bn | RWA | ErC | RWA | ErC |
| Private and Small-Business Customers | 5.2 | 0.4 | 5.1 | 0.4 |
| Corporate Clients | 8.3 | 0.7 | 11.4 | 1.0 |
| Asset & Capital Recovery | | | 1.3 | 0.1 |
| Others and Consolidation | 5.3 | 0.4 | 3.6 | 0.3 |
| **Group** | **18.7** | **1.5** | **21.4** | **1.8** |

The total charge for OpRisk events at the end of the fourth quarter of 2019 was approximately €127m (full-year 2018: €30m). The events mainly related to losses in the "Products and business practices" category. This includes the provision of mBank for legal risks related to CHF loan agreements, which is a key driver of the increase compared to the previous year.

| OpRisk events[1] \| €m | 31.12.2019 | 31.12.2018 |
|---|---|---|
| Internal fraud | 6 | 4 |
| External fraud | 12 | 7 |
| Damage and IT failure | 2 | 5 |
| Products and business practices | 103 | –17 |
| Process related | 6 | 30 |
| HR related | –1 | 0 |
| **Group** | **127** | **30** |

[1] Losses incurred and provisions, less OpRisk-based income and repayments.

A structured, centralised and decentralised reporting system ensures that the management of the Bank and its segments, members of the OpRisk Committee and the supervisory bodies are informed regularly, promptly and fully about operational risk. OpRisk reports are produced quarterly. They contain changes in OpRisk losses, the segments' main loss events, current risk analyses, changes in the capital requirement and the status of measures implemented. Operational risks are also part of the regular risk reporting process to the full Board of Managing Directors and to the Supervisory Board's Risk Committee.

The implementation plan of the Basel Committee provides for the introduction of the standardised approach for calculating operational risk (OpRisk) regulatory capital requirements from 1 January 2022. This approach is based on the multiplication of two components. The first component is derived from the business indicator, which is the sum of an interest, service and a financial component and a coefficient determined by the size of the business indicator. The second component in the standardised approach is the risk-sensitive internal loss multiplier, which reflects the Bank's internal operational losses.

# Other risks

To meet the requirements of the Basel framework, MaRisk requires an integrated approach to risk that also includes unquantifiable risk categories. At Commerzbank, these are subjected to a qualitative management and control process. The following risk types except model risk and from 1 January 2020 cyber risk are outside the responsibility of the CRO.

## Legal risk

According to the CRR, legal risk falls within the definition of operational risk. It primarily arises for the Commerzbank Group when the Bank's claims cannot be enforced for legal reasons or when claims can be made against the Bank because the underlying law was not observed or has changed since a transaction was concluded.

The operation of banking and financial services transactions that are subject to regulatory provisions may also result in legal risk. This risk may also take the form of orders or sanctions issued or imposed by one or more authorities whose supervision Commerzbank is subject to anywhere in the world. Legal risk also arises in realised losses or provisions due to or in connection with court cases brought against Commerzbank (passive proceedings). Cases brought by Commerzbank (active proceedings) generally represent a credit risk rather than an operational risk, so the risk of loss is already taken into account through write-downs. However, the costs of legal action (court and lawyers' costs) for active proceedings are classified as legal risk.

**Organisation**

Within Commerzbank, the functional management of legal risk throughout the Group is the responsibility of Group Legal. All legal staff at the various Group Legal locations including the foreign branches as well as the legal staff of the legal departments of the domestic and foreign subsidiaries are as legal risk managers operationally responsible for the identification and management of the Group-wide legal risk within Commerzbank.

**Risk management**

The task of the Group's legal risk managers is to detect legal risks and all losses potentially resulting from them at an early stage, to highlight possible solutions that might avoid or minimise such losses, and to play an active part in reaching decisions concerning legal risks. They must ensure that they are always up to date with all legal changes or new findings within their area of responsibility and inform the business units affected about the impact on legal risk and any action that needs to be taken as a result.

The legal risk managers are responsible for arranging or adjusting legal provisions and look after and monitor new and ongoing court proceedings.

In the case of passive proceedings, provisions are recognised on the basis of the risk assessment carried out by the responsible legal risk manager. The expected risk of loss for proceedings generally corresponds to the size of the provisions to be recognised. To estimate the expected loss, the amount that the Bank would reasonably have to pay to settle the dispute at the current point in time is calculated after each significant stage in the proceedings. In the case of active proceedings, provisions are usually only recognised for the expected court and lawyers' costs.

Group Legal provides information about all major court proceedings and risk trends in the quarterly Litigation Report. This report is sent to the Bank's management and Supervisory Board, the supervisory authority and the OpRisk Committee.

**Current developments**

Commerzbank and its subsidiaries are involved in a variety of court and arbitration cases, claims and official investigations (legal proceedings) in connection with a broad range of issues. They include, for example, allegations of defective advice, disputes in connection with credit finance or payment transactions, entitlements to occupational pensions, allegedly false accounting and incorrect financial statements, enforcement of claims due to tax issues, allegedly incorrect prospectuses in connection with underwriting transactions, alleged violations of competition laws, and cases brought by shareholders and other investors as well as investigations by US authorities. In addition, changes to rulings by supreme courts, which may render them more restrictive, as well as to legal conditions, e.g. in the private customer business, may result in more claims being brought against Commerzbank or its subsidiaries. In these court cases, claimants are mostly asking for the payment of compensation, claims on account of unjust enrichment or the reversal of agreements already entered into. If the courts were to find in favour of one or more of the claimants in these cases, Commerzbank could be liable to pay compensation, which could in some cases be substantial, or could incur the expense of reversing agreements or of other cost-intensive measures. Regulatory authorities and governmental institutions in various countries in which Commerzbank and its subsidiaries are or have been active have for some years been investigating irregularities in connection with the fixing of foreign exchange rates and with foreign exchange business in general. In the course of these investigations, regulatory authorities and governmental institutions have also sought checks on Commerzbank or have approached the company with requests for information. Commerzbank has cooperated fully with these bodies and also looked into the relevant matters on the basis of its own comprehensive investigations. The cases are no longer active with the exception of one case in which the investigating authority transferred the matter to the national competition tribunal. The possibility of financial consequences arising from some of these matters cannot be ruled out.

The public prosecutor's office in Frankfurt is investigating equity transactions conducted by Commerzbank and the former Dresdner Bank around the dividend record date (cum-ex transactions). Commerzbank had already initiated a forensic analysis of cum-ex transactions at the end of 2015, which was concluded at the start of 2018 in respect of Commerzbank's equity transactions and in September 2019 in respect of the equity transactions of the former Dresdner Bank. Appropriate provision has been made for the tax risks.

The public prosecutor's office in Cologne has been conducting investigations at Commerzbank since September 2019 in connection with a separate case concerning cum-ex transactions. The Cologne public prosecutor's office is investigating on suspicion that the Bank (including Dresdner Bank) was involved in cum-ex transactions in various roles, including by supplying shares to third parties who were allegedly acting as short sellers. According to the current understanding, these proceedings do not involve Commerzbank's own tax credit claims with regard to capital gains tax and solidarity surcharge on dividends. Commerzbank has no knowledge of any results of the investigation.

The Bank is cooperating fully with authorities conducting investigations into cum-ex transactions. It is currently not possible to predict whether this will result in a burden, whether it will occur, or the amount of any resulting burden.

In the circular of the German Federal Ministry of Finance (BMF) dated 17 July 2017, the tax authorities addressed the treatment of cum-cum transactions, declaring their intention to critically examine past transactions for indications of abuse of law. According to the view put forward in the BMF circular, abuse of law pursuant to Article 42 of the German Tax Code (Abgabenordnung, AO) is indicated if there are no economically reasonable grounds for the transaction in question and the structure of the transaction appears to be largely tax-induced (tax arbitrage). The circular provides a non-exhaustive list of cases which the BMF will assess for tax purposes. Within the framework of Commerzbank AG's ongoing tax on-site inspection, the tax auditors commented for the first time on the treatment of these transactions in the form of audit notes. Further discussions are taking place on this issue. Furthermore, in the assessments for the years 2014 and 2015, the tax office reduced the credit for capital gains taxes. In response, Commerzbank AG made value adjustments to tax credits shown in the balance sheet and/or formed additional provisions for possible repayment claims in order to reflect the changed risk situation appropriately. The possibility that this conclusion could alter as developments unfold, for example in connection with assessments made by the fiscal courts, cannot be completely ruled out.

With respect to cum-cum securities lending transactions, Commerzbank is exposed to compensation claims from third parties for crediting entitlements that have been denied. Based on the analyses performed, Commerzbank considers it rather unlikely that such claims could be enforced. However, it cannot be ruled out. Based on our estimates, the financial impact could be in the upper double-digit million range, plus interest on arrears, in these cases.

In May 2017, a Polish court admitted a class action lawsuit against a subsidiary of Commerzbank alleging the ineffectiveness of index clauses in loan agreements denominated in Swiss Francs (CHF). In October 2018, the class action suit was dismissed in its entirety by the court of first instance. The claimants are appealing against this judgement. A total of 1,731 plaintiffs have joined the class action. Irrespective thereof, numerous borrowers have additionally filed individual lawsuits against the Commerzbank subsidiary for the same reasons. In addition to the class action, 2,902 other individual proceedings are pending as at 31 December 2019. The subsidiary is defending itself against each of the claims. It has won the majority of the individual lawsuits.

Even after the decision of the European Court of Justice in October 2019, the rulings of the Polish courts on loans with indexation clauses has so far been inconsistent overall. This and the number of judgments handed down since then are not sufficient for a reliable estimate of future rulings.

In deviation from the previous methodology and as a result of the observed increase in the total number of individual lawsuits and the change in the judgments handed down by the courts in such cases, the Group/subsidiary decided as of the fourth quarter of 2019 to take into account possible future lawsuits relating to the existing portfolio and the portfolio already repaid in addition to the lawsuits already filed when calculating the provision. The Group/subsidiary measures the provision for individual claims relating to existing and already repaid loans with CHF indexation clauses using the expected value method permitted under IAS 37.

The provision relates both to the portfolio existing as at 31 December 2019 with a carrying amount of €3.2bn and to the portfolio already repaid. The portfolio that has already been repaid amounted to 6.3bn Polish zloty when it was issued. In the year under review, the provision was increased by a total of €79m, bringing the provision for individual actions as of 31 December 2019 to a high double-digit million euro amount.

The methodology used to calculate the provision is based on parameters that are varied, discretionary and in some cases associated with considerable uncertainty. Key parameters are the estimated total number of plaintiffs, the probability of losing a lawsuit in the last instance, the amount of the loss and the development of the exchange rate. Fluctuations in the parameters and the interdependencies between them may mean that the amount of the provision must be adjusted significantly in the future.

Some of these cases could also have an impact on the reputation of Commerzbank and its subsidiaries. The Group recognises provisions for such proceedings if liabilities are likely to result from them and the amounts to which the Group is likely to be liable can be determined with sufficient accuracy. Since there are considerable uncertainties as to how such proceedings will develop, the possibility cannot be ruled out that some of the provisions recognised for them may prove to be inadequate once the courts' final rulings are known. As a result, substantial additional expense may be incurred. This is also true in the case of legal proceedings for which the Group did not consider it necessary to recognise provisions. The eventual outcome of some legal proceedings might have an impact on Commerzbank's results and cash flow in a specified reporting period; in the worst case it cannot be fully ruled out that the liabilities that might result from them may also have a significant impact on Commerzbank's earnings performance, assets and financial position.

Further information on legal proceedings may be found in Note 58 regarding provisions and Note 60 regarding contingent liabilities and lending commitments in the Group financial statements.

## Compliance risk

Compliance risk falls within the definition of operational risk according to the CRR. Commerzbank acknowledges and understands the existence of inherent compliance risk in its global business, which can be abused overall and in particular by financial crime. Compliance risk includes, in particular, the risks associated with money laundering, terrorist financing, sanctions/embargoes, markets compliance as well as fraud and corruption and preventing the facilitation of tax evasion.

The Board of Managing Directors of Commerzbank actively promotes a compliance culture and has set down and communicated corresponding values in the code of conduct.

**Organisation**

Group Compliance is led by the Divisional Board member for Group Compliance, who reports directly to the Board of Managing Directors. Pursuant to sections 87 (5) of the German Securities Trading Act (WpHG), MaComp (minimum requirements of the compliance function) BT 1.1, the Divisional Board member for Group Compliance is both the Group's Compliance Officer and, under Art. 25h (7) of the German Banking Act (KWG), sections 7 and 9 of the German Anti-Money Laundering Act (GwG), the Anti-Money Laundering officer; this person is supervised as such by the Federal Financial Supervisory Authority (BaFin).

Group Compliance is responsible for:

A. the four types of compliance risk:
(1) anti money laundering/fighting terrorist financing,
(2) sanctions and embargoes,
(3) fraud, anti-bribery and corruption,
(4) markets compliance
as well as

B. further responsibilities:
- coordination of the requirements under MaRisk section 4.4.2 ("MaRisk compliance function"),
- setting down and monitoring the methodical standards of the QI/FATCA/CRS compliance programme (Qualified Intermediary (QI) regime, Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS)),
- compliance with the Bank's Anti-Tax Evasion Facilitation (TEF) obligations in accordance with the "UK Corporate Criminal Offences (UK CCO) of failure to prevent the facilitation of tax evasion" (together with Group Tax) and
- independent implementation of internal special investigations with compliance relevance

**Risk management**

To prevent compliance risks, Commerzbank has implemented security systems and controls for its transactions, customers, products and processes. These procedures for ensuring compliance with material legal provisions and requirements are referred to in their entirety as a compliance management system. Commerzbank's compliance management system is based on international market standards and the regulatory requirements in the various countries which are relevant for Commerzbank's business activities. Commerzbank is constantly developing its compliance management system in order to meet its responsibilities and address the growing complexity and increasing regulatory requirements. Under the three lines of defence principle, protecting against undesirable compliance risks is an activity that is not restricted to the compliance function (Group Compliance). Instead, the organisational control and monitoring elements are aligned in three sequential levels. The units in the first line of defence (1st LoD) assume the main responsibility for identifying and managing risks and for complying with their own business rules; they are also responsible for setting up process-oriented control mechanisms. Group Compliance, the second line of defence (2nd LoD), oversees the appropriateness and effectiveness of the procedures and controls in the first line of defence, and assesses and communicates any deficiencies found. Internal Audit, the third line of defence (3rd LoD), uses regular and independent audits to check that compliance in both the 1st LoD and 2nd LoD is appropriate and effective.

Compliance risks are managed in a control circuit with interacting elements. Commerzbank constantly monitors relevant regulatory requirements as well as the definition and/or adjustment of corresponding internal standards meant to ensure compliance with the requirements. Where necessitated by changes in requirements and standards, internal training measures are defined and/or adapted and the Bank's units are advised how to implement these effectively. Implementation encompasses setting up and carrying out suitable processes and controls in daily work, assuring their quality and testing their effectiveness. Monitoring of the compliance risks is based on key figures and is part of regular internal reporting. Where necessary, matters are escalated according to their urgency and severity. A systematic risk analysis (compliance risk assessment) is a core element of risk management. It assesses the inherent risk arising from doing business with different customer groups and products and compares this with an assessment of the corresponding control environment. It produces a residual risk, the risk content of which is assessed. The Bank defines measures to further enhance risk management (e.g. introducing additional controls) as necessary and tracks implementation closely.

**Current developments**

In 2015, Commerzbank reached settlements with various US authorities regarding violations of US sanctions and anti-money laundering provisions. The Bank has already dealt with the majority of the findings relating to the settlements. The Deferred Prosecution Agreement with the District Attorney of New York and the Deferred Prosecution Agreement with the US Department of Justice were subsequently terminated in March 2018 and May 2018 respectively, after consultation with the respective public prosecutor's offices. The Bank has also received various interim reports and on 15 October 2018 received the final report from the monitor appointed by the New York State Department of Financial Services (DFS), to which it has responded with corresponding implementation programmes. The Bank has made good progress in carrying out the implementation programmes and has executed most of the measures. The US monitor submitted its final report dated 15 October 2018, thus concluding its on-site investigations. In accordance with the terms of the engagement letter between the Bank and the monitor, the monitoring process ended on 24 June 2019. Official confirmation from DFS that Commerzbank is back under regular banking supervision following the monitoring process is still pending.

In line with the requirements of the UK Financial Services and Markets Act 2000 (FSMA), in 2017 Commerzbank London mandated a consulting company as a "skilled person". The consulting company carried out a review of existing structures and processes (especially with regard to money laundering/financing of terrorism as well as sanctions/embargoes) and prepared a report for the UK Financial Conduct Authority (FCA). Commerzbank London subsequently put in place a comprehensive remediation project, the implementation of which is being evaluated by the skilled person, with half-yearly reports to the FCA. Here too, Commerzbank has made good progress in implementation and completed the remediation project carried out at Commerzbank London. The outstanding topics were transferred to small projects and to the line function for further processing.

Since 31 December 2012, Commerzbank has been provisionally registered as a swap dealer with the U.S. Commodity Futures Trading Commission (CFTC). On 8 November 2018, Commerzbank reached agreement with the CFTC in a consent order waiving an investigation into breach of the U.S. swap dealer rules in the U.S. Commodity Exchange Act and the regulations of the CFTC. In accordance with this consent order, Commerzbank has engaged an outside consultant approved by the CFTC (Compliance Consultant) for a period of two years. The CFTC may extend this period by a further year at its discretion, based on its assessment of Commerzbank's remedial efforts. The Compliance Consultant started work in April 2019 and will probably submit their initial report by May 2020.

At the request of the Hong Kong Monetary Authority (HKMA), Commerzbank Hong Kong engaged an outside consultant to review the branch's local control and governance structures. The outside consultant concluded their audit during the summer and provided a report on the audit findings; processing of the issues addressed in the report is under way. The Branch project to implement a regulatory inventory as an overview of existing and relevant local regulatory requirements is still ongoing.

## Reputational risk

Reputational risk is the risk that stakeholders may lose confidence in Commerzbank or that its reputation may be damaged as a result of negative events in its business activities. Commerzbank's stakeholder groups include in particular the public and the media, non-governmental organisations and its customers. In the present-day competitive environment, a company's reputation is becoming more and more important. The main factor determining this is how companies handle sustainability considerations (environmental, ethical or social risks) in the market segments' customer business (intrinsic reputational risks). Companies are judged not only on the basis of people's personal experiences of them, but also on reports reaching the public, especially through the media. Reputational risk therefore goes hand in hand with communication risk.

#### Strategy and organisation

All employees and managers have a fundamental duty to protect and reinforce Commerzbank's good reputation as a significant element of its enterprise value. The segments and significant subsidiaries bear direct responsibility for reputational risk resulting from their particular business activity. The Reputational Risk Management department is part of the central Group Communications division of the Commerzbank Group and focuses on intrinsic reputational risk that may directly lead to reputational damage among stakeholder groups. The department maintains close links with the relevant front office units. Management of intrinsic reputational risk is the responsibility of the Chairman of the Board of Managing Directors. It is a component of Commerzbank's overall risk strategy. Reputational Risk Management's tasks include identifying, evaluating and addressing intrinsic reputational risk in systematic processes at an early stage and suggesting or implementing appropriate measures (early warning function).

#### Risk management

Managing intrinsic reputational risk means identifying and reacting to potential environmental, social and ethical risks at an early stage, thereby reducing any potential communication risk or even preventing it completely. Intrinsic reputational risk is managed by means of a qualitative approach. As part of a structured process, transactions, products and customer relationships in connection with sensitive areas are assessed with reference to environmental, social and ethical risks on a qualitative five-point scale. This assessment can contain conditions and in some cases a negative verdict, which could lead to a rejection.

The sensitive areas regularly and comprehensively analysed in Reputational Risk Management include armaments exports and transactions, products and customer relationships relating to power generation and commodities extraction. Commerzbank's attitude towards these areas is laid down in positions and guidelines that are binding for all employees. Commerzbank's Reputational Risk Management department regularly observes and analyses new environmental, ethical and social issues and informs the relevant parts of the Bank about these. The reputational risks identified and addressed by the department are incorporated into the quarterly report on non-quantifiable risks and the quarterly report on major and high reputational risks (sustainability risks) prepared for the full Board of Managing Directors and the Risk Committee of the Supervisory Board.

## IT risk

IT risk is a form of operational risk. In our internal definition, we define IT risk as risks to the security of information processed in our systems in terms of meeting the four IT security objectives set out below:

**Confidentiality:** Information is confidential if it is not accessible to, or capable of being reconstructed by, unauthorised persons, business processes or IT systems.

**Integrity:** Information possesses integrity if it has not been modified or destroyed by any unauthorised means. An information-processing system (IT system) possesses integrity if it can perform its intended functions without hindrance and free of unauthorised manipulations, whether deliberate or accidental.

**Traceability:** Actions and technologies applied to information are traceable if they themselves and their source can be traced back without any ambiguity.

**Availability:** Information is available if it is always capable of being used to a predefined extent by authorised persons, business processes and IT systems when it is required.

Commerzbank attaches great importance to the protection and security of its own information, of that entrusted to it by customers, and of the business processes and systems used to process it. They form a permanent core element in our IT strategy. The processing of information is based increasingly on information technologies. As such, our IT security requirements are at the heart of information security management. IT security requirements are based on the IT security objectives referred to above and are set down in policies and procedural instructions.

IT risks are identified, evaluated and regularly reviewed as part of IT governance processes. IT risk is covered in the quarterly IT risk report. Information security is also established as a principal objective for our Internal Control System.

Relevant IT risks are also evaluated as part of operational risk management through risk scenarios and considered in the Bank's RWA calculation. This includes the risk of a breakdown of critical IT, the risk of external attack on the systems or data of the Bank (cyber crime and advanced persistent threat (APT)1 scenarios), the theft of corporate data or the default of service providers and vendors. See also the description of cyber risk.

Given the major importance of IT security to Commerzbank, it is further developed and improved on an ongoing basis by means of strategic projects. We have taken into account the significance of the "human" factor in IT security and cyber security by introducing additional training and awareness-raising measures.

## Cyber risk

Cyber risk comprises risks with direct relevance to security and risks that lead to relevance to security (in each case, within cyber space). The part of cyber space of relevance to Commerzbank is all connected IT environments within the Bank and those outside the Bank that lead to customers, business partners and service providers. Cyber risk is therefore concerned with the digital representation of the Bank's assets (data, information) within cyber space.

Unlike information security risk, whose scope is limited to the Bank and third-party companies with a business connection, the scope of cyber risk extends to unknown persons, to take full account of the requirement to protect their legitimate expectations when using cyber space.

The strategic guidelines from the overall risk strategy and the information security strategy apply without limitation to cyber risk.

In order to prevent cyber risk organisationally, Commerzbank has – in addition to the established governance processes of information security, the related risk reports on key risk indicators and management via the Internal Control System (ICS) – set up a cyber security programme focusing on specific aspects of cyber security. The results of the cyber security programme feed both the ICS and the Bank's risk reporting.

Cyber risk is managed by Group Organisation & Security, which reports to the Group Chief Information Security Officer (CISO). On 1 January 2020, Commerzbank established the new Group division "Group Cyber Risk & Information Security" to manage cyber and information security risks.

Cyber risk generally has consequences for operational risk and the Bank's other material risk types. These can be broken down into direct and indirect consequences. All consequences are documented in the cyber sub-risk strategy and updated on an ongoing basis.

## Human resources risk

Human resources risk falls within the definition of operational risk referred to in the Capital Requirements Regulation (CRR). The internal, management-oriented interpretation of this definition at Commerzbank includes the following elements in human resources risk:

**Adjustment risk:** Adjustment risk results when organisational and operational circumstances change (for example, restructuring, changes in management culture, qualification needs), these changes impact employees' scope of responsibilities and therefore require a greater willingness to change on the part of the staff. We offer selected internal and external training, continuing education and change programmes to ensure that the qualification levels of our employees keep pace with the current requirements, guidance is provided for structural changes and our employees can fulfil their duties and responsibilities.

**Motivation risk:** Motivation risk arises when demotivating factors are not eliminated and employees do not adequately perceive motivating factors such as management or remuneration. The effects (such as withheld performance by employees) can have a direct impact on the working environment and the organisation's productivity. Employee surveys enable us to respond as quickly as possible to potential changes in our employees' level of corporate loyalty and to initiate adequate measures.

**Departure risk:** Departure risk takes into account the consequences of undesired employee departures (for example, if an employee resigns voluntarily), particularly when high performers are involved. We take great care to ensure that the absence or departure of employees does not result in long-term disruptions to our operations. We also monitor staff turnover on a regular basis from both a quantitative and a qualitative perspective.

[1] An advanced persistent threat is a special form of cyber attack. The intention of an APT attack is to remain undetected for as long as possible in order to steal sensitive information (internet espionage) or cause other types of damage over a longer period.

**Supply risk:** Supply risk reflects the consequences of insufficient staffing (for example, inadequate development of young staff) and the resulting consequences (operating bottlenecks, increased workload, lower productivity and illness). Appropriate quantitative and qualitative staffing aims to ensure that internal operating requirements, business activities and Commerzbank's strategy can be implemented.

Employees are a key resource for Commerzbank. Human resources risk is systematically managed by Group Human Resources with the aim of identifying, assessing and managing risks, for instance by applying selected personnel tools. The Board of Managing Directors is regularly informed about human resources risk.

In addition, systematic and strategic personnel planning helps to put the management of medium- and long-term human resources risks on a more professional footing. This has been introduced gradually into the Bank's strategically relevant business areas since 2015.

Overall, the Bank will continue to monitor human resources risk. There is a risk that the human resources risk situation may deteriorate due to the impending structural changes under the "Commerzbank 5.0" strategy. Change and organisational measures have already been initiated to counter human resources risk.

## Business strategy risk

Business strategy risk is the medium- to long-term risk of negative influences on the achievement of Commerzbank's strategic goals, for example as a result of changes in the market or competitive environment, capital market requirements, regulatory/political factors or the inadequate implementation of the Group strategy (primary risk drivers).

Group strategy is developed further in a process that takes both external and internal factors into account. On the basis of these factors, the full Board of Managing Directors sets out a sustainable business strategy describing the major business activities and steps required to meet the targets. To ensure proper implementtation of the Group strategy to achieve the business targets, strategic controls are carried out through regular monitoring of quantitative and qualitative targets in the Group and the segments.

Responsibility for strategic corporate management lies with the full Board of Managing Directors. Specific business policy decisions (acquisition and sale of equity holdings >€300m) also require the authorisation of the Supervisory Board's Risk Committee. All major investments are subject to careful review by the full Board of Managing Directors.

## Model risk

Model risk is the risk of incorrect management decisions based upon an inaccurate depiction of reality by the models used. With regard to the causes of model risk we distinguish between model risk from exceeding model boundaries and model risk from model errors (manual errors in model development/implementation). In line with the focus of the Group risk strategy, namely to ensure that the Bank has adequate capital and liquidity, the models for assessing risk-bearing capacity (capital requirements under the Basel framework) and liquidity resources are central for risk management.

The basic principles of model risk management are the identification and avoidance of model risks and appropriate consideration of known model risks (e.g. through conservative calibration or consideration of model reserves). Model risks that are unknown and hence cannot be mitigated are accepted as an inherent risk in the complexity of the Commerzbank business model. In respect of the governance of model risk management, requirements relating to model validation and model changes are established.

There are currently a number of regulatory initiatives that have a strong impact on the management of model risks:

- The aim of the regulatory framework known as "Basel 4" in particular is to limit the benefits of using internal models. The new regulations pertain to all types of risk (credit, market, counterparty and operational risk) and also limit the reliability of certain models in calculating risk-weighted assets.
- Several regulations (guidelines/RTS) of the EBA impact nearly all aspects of the IRB approach and aim to reduce potential unjustified RWA variability from the use of internal models and to increase the quality of the models used. A new default definition has also been prescribed for credit risks.
- The ECB's Targeted Review of Internal Models (TRIM) project also aims to harmonise RWA-relevant models for credit, market and counterparty risk within the scope of the SSM. In particular, the scope for interpretation permitted by the regulations or arising due to differences in national interpretations is to be significantly reduced in future. In doing so, the ECB takes particular account of the new regulatory requirements mentioned above. Under TRIM, the models for credit, market and counterparty risk were subjected to a series of on-site reviews. Deviations from regulatory requirements or their interpretation lead to findings which, depending on their severity and materiality, may also result in capital add-ons. For credit risk, the implementation of TRIM requirements at Commerzbank is covered by the "Future of the IRB" initiative.
- The ECB's ICAAP and ILAAP guidelines also contain requirements for the management of model risk.

**Disclaimer**

Commerzbank's internal risk measurement methods and models which form the basis for the calculation of the figures shown in this report are state-of-the-art and based on banking sector practice. The risk models produce results appropriate to the management of the Bank. The measurement approaches are regularly reviewed by Risk Controlling and Internal Audit as well as by German and European supervisory authorities. Despite being carefully developed and regularly checked, models cannot cover all the influencing factors that have an impact in reality or illustrate their complex behaviour and interactions. These limits to risk modelling apply in particular in extreme situations. Supplementary stress tests and scenario analyses can only show examples of the risks to which a portfolio may be exposed in extreme market situations. However, stress-testing all imaginable scenarios is not feasible. Stress tests cannot offer a final estimate of the maximum loss should an extreme event occur.