Basis of the Commerzbank Group

Structure and organisation

Commerzbank is one of Germany's leading banks for private and corporate clients, and an internationally active universal bank with locations spanning more than 50 countries. It has one of the densest branch networks of any private-sector bank in Germany. Commerzbank serves a total of over 17.5 million private and small-business customers and more than 60,000 corporate clients worldwide.

As part of its new strategy, Commerzbank is focusing its business activities on the two core segments "Private and Small-Business Customers" and "Corporate Clients", offering them a comprehensive portfolio of banking and capital market services. The run-off segment Asset & Capital Recovery (ACR) comprises – besides the Public Finance business – all non-strategic activities of commercial real estate and ship financing. 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 Development & Strategy, Group Finance, Group Human Resources, Group Investor Relations, Group Legal, Group Treasury and the central risk functions. The support functions are provided by Group Services. These include Group Banking Operations, Group Markets Operations, Group Information Technology, Group Organisation & Security and Group Delivery Center. 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 Germany, the Bank has 6 material subsidiaries, 23 operational foreign branches and 34 representative offices in more than 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 stands for fair and competent advice tailored without exception to the needs of customers and the real economy. "The bank at your side" – everything Commerzbank does is measured against this promise, and the Bank has very clearly demonstrated its commitment in this area over recent years.

The banking business has undergone fundamental changes due to the current low interest rate environment, legal requirements and digitalisation, as have the ways in which customers want to conduct their banking transactions. Commerzbank is meeting these major challenges with its new strategy "Commerzbank 4.0" communicated at the end of September 2016.

As part of this strategy, it will concentrate on its core businesses and digitalise 80% of relevant processes, thereby achieving significant efficiency gains and increasing its profitability on a sustainable basis by the end of 2020. Its business will be focused on two customer segments, "Private and Small-Business Customers" and "Corporate Clients". The former Mittelstandsbank and Corporates & Markets segments were consolidated into a single unit and trading activities in investment banking were scaled back. The downsizing of the trading activities will reduce earnings volatility and regulatory risk, and will free up capital to be invested in the core customer businesses.

Commerzbank is aiming for a net return on tangible equity of more than 6% by the end of 2020. This target is based on the expectation that the interest rate environment will remain challenging. Should interest rates normalise, a net return on tangible equity of more than 8% will be achievable. Commerzbank is expecting revenues for 2020 to total between €9.8bn and €10.3bn. The cost base is to be reduced to €6.5bn, taking the cost/income ratio to below 66%. In a up to 2020 expected normalised interest rate environment, revenues could rise to over €11bn, and the cost/income ratio could fall to around 60%. The Common Equity Tier 1 (CET 1) ratio, after full application of Basel 3, should remain at least 12% until 2018 taking into account currently foreseeable regulatory developments. For 2020 the Bank is expecting a ratio of above 13%.

To cover its restructuring costs of around €1.1bn in 2017/2018, Commerzbank will cease dividend payments for the time being and will fully retain its earnings.

The focus on the core business, with some business activities being discontinued, and the digitalisation and automation of workflows will lead to staff reductions likely to amount to around 9,600 full-time positions. The Bank will begin negotiations about this with the employee representative committees in the next few weeks. At the same time, around 2,300 new jobs will be created in areas of business growth. Hence, the net number of jobs shed will amount to around 7,300 full-time positions.

Concentrating on strengths

With its two segments, "Private and Small-Business Customers" and "Corporate Clients", Commerzbank will in future be even more focused on its core businesses. The Bank is focusing on areas where it delivers particular added value to its customers, thereby setting itself apart from the competition. In addition, it is systematically giving up businesses in which it does not see any future. This relates in particular to the investment bank, where trading activities will be simplified and aligned with the needs of the Bank's core customers. The former Corporates & Markets segment was merged with the former Mittelstandsbank segment (excluding smaller Mittelstand customers) to form the Corporate Clients segment. Services that are important to corporate clients, such as capital market financing on the equity and debt side and risk management products, will remain key to Commerzbank's offering. Commerzbank will first place the business with structured investment and financial products and the associated market-making from the Equity Markets & Commodities area into a subsidiary. This also includes the successful asset management subsidiary ComStage. The details depend on the outcome of negotiations with representative bodies. The new subsidiary will concentrate fully on its core business as one of the leading European and Asian providers and market-makers for financial products and continue to offer attractive products and services and associated technologies. In the medium term, the new subsidiary is then intended to be floated on the stock market. The exotic interest rates and foreign exchange derivatives business will cease, while bond trading in Fixed Income & Currencies will be scaled back. The capital freed up by this withdrawal will be reinvested in the "Private and Small-Business Customers" segment. By 2020 the Bank wants to achieve cost savings of €1.1bn by focusing, eliminating redundancies, simplifying the infrastructure and by digitalisation.

Private and Small-Business Customers: building on our strong position

The new Private and Small-Business Customers segment encompasses Commerzbank's private and small-business customers as well as the subsidiaries comdirect, Commerz Real and mBank. The customer group "Small-Business Customers" comprises commercial clients and smaller SMEs. The Bank wants to gain a net two million new customers in Private and Small-Business Customers in the German market by 2020. Growth will be driven, in particular, by the expansion of digital multi-channel banking and innovative products, such as a new digital instalment loan platform and digital asset management including robo-advice. Commerzbank will also maintain a dense branch network. Besides the large flagship branches in the main population centres, Commerzbank will introduce a new type of small, modern branch: the "city branch". The Bank is planning to substantially increase its market share among small-business customers to 8% over the next four years, thanks to good regional accessibility, tailored product portfolios, digital solutions and its ability to offer private and business services in one place. The aim is for these measures to generate revenue growth of at least €1.1bn in the new Private and Small-Business Customers segment by the end of 2020.

Corporate Clients: national and international growth from a leading position

In corporate banking, the Bank wants to further extend its leading position in trade financing. To achieve this it is looking for focused growth in the most important trade corridors for German and European corporate clients. With its deep penetration of key German industries – automotive and transport, chemicals and pharmaceuticals, engineering, energy and infrastructure, consumer goods and retail – Commerzbank possesses comprehensive sector expertise which sets it apart from the competition. In future it will increasingly offer this expertise to its international clients in Europe as well. Among Mittelstand clients with turnover of between €15m and €100m as well, Commerzbank plans to further expand its market position with the aid of its international expertise and digitalisation. To achieve this it will further develop its offering and introduce new digital products and services. Collaboration between client relationship managers and product experts will be further strengthened by bundling the former Mittelstandsbank and Corporates & Markets segments. The aim is for these measures to generate revenue growth of over €300m in the new segment by the end of 2020.

Evolution into a digital enterprise

Over the next four years Commerzbank will evolve into a digital enterprise. The Bank will invest approximately €700m per year in digitalisation and IT by reallocating existing funds, without increasing its overall investment expenditure. In future, agile project teams working as part of a "Digital Campus" will drive forward digitalisation projects and automate and optimise processes. We want to digitalise 80% of relevant business processes by 2020. The Bank expects significant cost reductions and efficiency gains as a result.

Corporate management

Corporate management in the Commerzbank Group is based on a value-oriented control concept. This concept is based 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 aiming 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 any deviations are identified at an early stage through monthly management reporting and countermeasures 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 regulations. To ensure internal risk-taking capability at all times, planning includes allocating economic capital to the segments broken down by type of risk. Regulatory capital as per the provisions of the Capital Requirements Regulation (CRR) is used as the basis for calculating the capital employed in the segments.

In addition to compliance with the capital requirements currently in place (under phase-in rules), the capital markets are already focusing on the full application of the CRR from 2018. The Common Equity Tier 1 ratio (fully phased-in) is therefore 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 loan loss provisions. 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. With a view to the "Commerzbank 4.0" strategy, the focus at Group level is 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 surplus after tax and non-controlling interests to average Group equity. The capital cost rate represents our shareholders' expectations for the minimum return on their capital employed and is reviewed on an annual basis. The calculation of the capital cost rate is based on the capital market-oriented Capital Asset Pricing Model (CAPM). Commerzbank currently calculates its post-tax capital cost rate to be 7.5%.

As Group figures, the controlling data listed above form part of a system of other segment-specific data that varies 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 (2) no. 5 of the German Commercial Code (HGB)

Details pursuant to Art. 315 (2) no. 5 of the German Commercial Code (HGB) can be found in the Corporate Responsibility section. They form part of the Group Management Report.

Details pursuant to Art. 315 (4) of the German Commercial Code (HGB) and explanatory report

Details pursuant to Art. 315 (4) of the German Commercial Code and explanatory report can be found in the Corporate Responsibility section. They form part of the Group Management Report.

Details pursuant to Art. 315 (5) of the German Commercial Code (HGB)

Details pursuant to Art. 315 (5) in conjunction with Art. 289a of the German Commercial Code, "Declaration on corporate governance", can be found in the Corporate Governance report. They form part of the Group Management Report.

Important staffing and business policy events

Commerzbank further reduced both risks and complexity in 2016. In addition to measures implemented to improve strategic focus, Hypothekenbank Frankfurt was wound up as planned and the international wealth management activities of our Luxembourg subsidiary were sold. The Bank also further strengthened its compliance function. There were some changes in personnel during the year, both within the Board of Managing Directors and as regards the position of Chairman of the Board of Managing Directors. The process of electing a new Chairman of the Supervisory Board in 2018 has already begun.

Change in the Board of Managing Directors of Commerzbank

At its meeting on 6 March 2016, the Supervisory Board of Commerzbank appointed Martin Zielke to succeed Martin Blessing as Chairman of the Board of Managing Directors of Commerzbank with effect from 1 May 2016. Michael Mandel and Dr. Bettina Orlopp were also appointed to the Board of Managing Directors. The decision to appoint Dr. Bettina Orlopp is still subject to regulatory approval. Michael Mandel took over from Martin Zielke as the member of the Board of Managing Directors responsible for Commerzbanks's private customer business. Dr. Orlopp will in future be responsible for the new Board portfolio Compliance, Human Resources and Legal. The new distribution of responsibilities is the Bank's response to the significant demands placed on Frank Annuscheit, Chief Operating Officer and Labour Director, as a result of digitalisation, together with the steady increase in the time required to deal with compliance and legal issues. The appointment also further underlines the importance of a strong compliance culture. Dr. Orlopp will fulfil her new duties in the capacity of Executive Board Member until her appointment to the Board of Managing Directors becomes effective. Until then, the distribution of responsibilities between the members of the Board of Managing Directors will remain unchanged.

At its meeting at the end of September 2016 Commerzbank's Supervisory Board agreed to Markus Beumer's request to release him from his contract, which ran to 31 December 2020, as the member of the Board of Managing Directors of Commerzbank responsible for the Mittelstandsbank segment, with effect from 31 October 2016. Over the last nine years, as a board member, Markus Beumer has played an instrumental role in helping to further enhance Commerzbank's profile as a leading corporate bank in Germany and Europe. Michael Reuther has taken on the management of the Corporate Clients segment.

Dr. Stefan Schmittmann to succeed Klaus-Peter Müller as Chairman of the Supervisory Board from 2018

The Supervisory Board intends to propose to the Annual General Meeting (AGM) in May 2018 that Dr. Stefan Schmittmann be elected to the Supervisory Board as a shareholder representative. The AGM is also to be notified that Dr. Stefan Schmittmann will be put forward as candidate for the position of Chairman of the Supervisory Board. Dr. Schmittmann stepped down from the Bank's Board of Managing Directors at the end of 2015, and would therefore observe the statutory cooling-off period of two years before joining the Supervisory Board.

Commerzbank's Supervisory Board furthermore intends to propose to the AGM in May 2017 that Dr. Tobias Guldimann be elected to the Supervisory Board as a shareholder representative. Dr. Roger Müller would step down from the Bank's Supervisory Board at the end of the 2017 AGM. Should Dr. Tobias Guldimann be elected to the Supervisory Board, the Supervisory Board plans to appoint him as a member of the Audit Committee for the duration of his term as a Supervisory Board member.

Commerzbank completes winding-up of Hypothekenbank Frankfurt AG

In mid-May, Commerzbank completed the winding-up of its wholly-owned subsidiary Hypothekenbank Frankfurt AG (HF), formerly Eurohypo AG. HF's private customer, commercial real estate and public finance portfolios were transferred to Commerzbank Aktiengesellschaft. HF was transformed into the servicing company LSF Loan Solutions Frankfurt GmbH. LSF's task is to process and further reduce the portfolio of commercial real estate loans transferred to Commerzbank. It will do so on behalf of Commerzbank Aktiengesellschaft and as far as possible on its own responsibility. The headcount reduction in Eschborn necessitated by the winding-up of HF was carried out without any compulsory redundancies. With the transformation of HF into the servicer LSF, HF has relinquished its banking licence and Pfandbrief licence.

Following the transaction, all of HF's outstanding Pfandbriefe were transferred to Commerzbank Aktiengesellschaft. Large parts of HF's retail mortgage loans were transferred to the cover pool of Commerzbank Aktiengesellschaft. However, HF's commercial real estate loans earmarked for further reduction were not placed in the Commerzbank Aktiengesellschaft cover pool. With a view to ensuring the necessary excess cover, the legally required amount plus a sufficiently large buffer are held available to manage the cover pool. Mortgage Pfandbriefe and public-sector Pfandbriefe will also form an integral part of the long-term funding of Commerzbank Aktiengesellschaft in future.

Commerzbank restructures US business

Commerzbank decided at the end of June to restructure its business in the USA, one of its most important international locations. Our US business is the competence centre for US corporate and institutional customers and for US subsidiaries of non-US customers. We will continue to offer US dollar loans, bonds, currency and other risk management products and ensure access to the capital market for our customers.

The restructuring will have a twofold impact on our US business, however. Firstly, we have outsourced the settlement and clearing of commercial US dollar payments for our customers that are not executed from the US to third-party banks. This will not result in any change for our customers who conduct US dollar payment transactions with Commerzbank, but it will enable us to reduce the complexity of our international payment transactions services. This decision is also a logical consequence of our efforts to streamline our global network of correspondent banks. Secondly, we have decided to stop offering certain products and services in the USA, as they no longer form part of our local strategic offering for our US customers. This affects the securities lending business and structured financing solutions.

The planned restructuring in New York will lead to a headcount reduction in New York. This will primarily affect the back office support units, where around 100 posts will be made redundant. Job cuts in the front office will be in the low double digits. The reduction process is expected to be completed in 2018, with the majority of the redundancies taking place by the end of this year.

Commerzbank decides to further focus business strategy

Commerzbank has decided to exit the collateralised equity business even though it can produce tax advantages. This underscores the commitment to its position that all businesses must not only contribute to the real economy but also be socially acceptable. The Bank is deliberately walking away from the corresponding contribution to earnings.

In addition, the streamlining of the correspondent banking network that has begun in early 2016 continued in the second quarter. The reduction in the number of correspondent banking relationships is the result of an ongoing review and optimisation of our business model. Apart from earnings, cost and risk issues, compliance standards also play an important role here. Our corporate clients can be confident that we still have a network of correspondent banks which spans the globe. We therefore remain in a position to accompany export- and import-focused SMEs in international trade in the world's key markets.

Commerzbank strengthens compliance function

In 2016 the Bank identified key action areas for further strengthening the compliance function and addressed or initiated them in all divisions. More than €50m was invested in the compliance infrastructure. To develop a global and effective compliance organisation and a future-proof concept, the Global Financial Crime, Regional Compliance Americas and Global Strategy & Steering divisions were restructured and new units such as the Financial Crime Unit, Compliance Training, Compliance Reporting and Client Tax Compliance were implemented. These measures significantly strengthened the compliance function. This was driven not only by structural changes but also by the successful recruitment of additional compliance experts with external experience to work at head office and in foreign locations. This trend will be further consolidated by means of a short- and medium-term HR strategy. The Bank also continued to focus on ensuring the independence and quality of the compliance function. The independence of Group Compliance in respect of the segments is defined in the governance framework and assured through the rights of intervention of the Chief Compliance Officer. The establishment of compliance coordination units in the front office (first line of defence) was resolved and launched as part of the "three lines of defence" model implemented in the Bank. Another area of focus was on boosting a uniform compliance culture that is actively implemented within the entire Bank. In addition to a binding code of conduct, this also involves various compliance training sessions, including "lessons learned" sessions, and improved communication from the Board of Managing Directors and management on compliance risk (tone from the top).

In its efforts to address the findings relating to the settlements with various US authorities the bank has dealt with the majority of the findings. The Bank also received the interim report of the monitor appointed by the New York State Department of Financial Services (DFS) as at 31 October 2016 and responded on 30 November 2016 with an action plan and a management oversight plan.

Commerzbank completes sale of international wealth management activities in Luxembourg

Commerzbank completed the sale of Commerzbank International S.A., Luxembourg, announced in December 2015, to Julius Baer on 4 July 2016. Included in the sale are customer portfolios, the transfer of staff and a corresponding IT platform.

Economic report

Economic conditions

Economic environment

In 2016, the global economy recorded the weakest growth it had seen since the financial market crisis in 2007/2008. Emerging markets continued to suffer from the correction of the macroeconomic and financial excesses caused by more than seven years of cheap funding conditions. This was particularly true for China, where the economy grew even more slowly in 2016 than in 2015. In commodity-producing countries, the recovery of commodity prices offered some relief.

In industrialised countries, economic growth decelerated markedly in 2016. In the USA growth was a full percentage point lower than in 2015 at 1.6%. However, this is still a good result in view of the long-term growth potential of their economy and the fact that the USA has almost achieved full employment. The unemployment rate fell back to the level seen before the deep recession of 2007–09. Increasing competition for labour has caused a stronger pick-up in wage growth. Against this backdrop, the Federal Reserve decided in December 2016 to raise the target corridor for key interest rates by a further 25 basis points to 0.50%–0.75%.

Leaving aside Ireland, which recorded exorbitantly high growth of 26% in 2015, the economy in the eurozone grew slightly more rapidly in 2016 than 2015 at 1.7%. The economy was particularly bolstered by brisk private household and public-sector consumption. On the other hand, export growth declined markedly, due not only to weaker global demand. The price competitiveness of companies in the eurozone also worsened slightly once more. The effective external value of the euro has already regained half of its decline in early 2015. Thanks to solid growth, the situation on the labour market has continued to improve, with the unemployment rate falling from 10.5% at the end of 2015 to 9.6% in December 2016. However, this was not sufficient to generate a stronger increase in wages. In fact, wage inflation in the eurozone has remained weak. Accordingly, there was no change in the low underlying inflation in 2016. The core inflation rate, i.e. the year-on-year rate of the consumer price index excluding highly volatile food and energy prices, remained below 1%.

The cautious inflation outlook prompted the ECB to cut its deposit rate once again and extend the bond purchase programme which was launched in 2015 until at least the end of 2017. However, from April onwards its monthly bond purchases will be reduced from €80bn to €60bn.

The German economy grew slightly more strongly in 2016 (1.9%) than it did in 2015 (1.7%). In view of the weaker global demand and the tighter supply of labour, this is a very decent result. Unemployment at year-end was 6.0%, the lowest level since German reunification. The economy was mainly bolstered by private household and public-sector consumption, but investments also increased. Stronger domestic demand more than offset the weaker increase in exports.

Financial markets were once again dominated in 2016 by the extremely loose monetary policies pursued by the leading central banks. Investors continued to be forced into riskier forms of investment such as equities, corporate bonds and the government bonds of periphery countries. At the same time, the global depreciation race continued, with many central banks seeking to weaken their currencies in order to stoke domestic inflation.

Sector environment

Global economic growth remained modest in 2016 despite the slight acceleration in the second half. Particularly in the first half of last year, security was paramount on the financial markets in the face of fears of a sharp decline in growth in China and other emerging markets. In the middle of 2016, the markets were dominated by the United Kingdom's referendum decision to leave the EU, and growing uncertainty about the effectiveness of the very expansive monetary policy led to repeated nervousness in the financial market environment. The outcome of the US presidential election, which took many observers by surprise, then affected the financial markets. The subsequent increase in yields reflected greater expectations of higher inflation and a more expansive fiscal policy in the USA. In spite of the outcome of the Italian constitutional referendum, the leading stock markets still experienced an agreeable end to a turbulent year thanks to the expansion of the European Central Bank's bond purchasing programme and the rise in the price of European bank stocks.

However, the risks to the global economy have not diminished. Deleveraging by governments, companies and private households has not yet been completed and continues to weigh on the profitability of banks throughout the eurozone. In eurozone bond markets, expansionary monetary policy has to some extent served only to paper over the tensions; and in sub-markets, the banks' withdrawal – due to the regulatory framework – is causing anomalies in prices. The Eurosystem's expanded asset purchase programme is improving banks' liquidity position and financing conditions, but at the same time it is putting pressure on net interest margins and thus having a significant adverse impact on earnings.

While the banks' efforts to reduce solvency and liquidity risks were recognised, there were persistent fears about a sustained weakening of the profitability of the banking system in the eurozone and the ability of banks to generate profitable returns on interest-rate-based business.

It has become clear over recent years that political surprises have a significant impact on the performance of the global economy and financial markets, even if they are not reflected in the financial markets or the economy in the short term to the extent that was previously expected. In contrast to risks, uncertainties are much more difficult to predict and can affect the banking business to a particularly high degree if private economic operators reduce their demand for financial services due to uncertainty. For example, global investment expenditure has recently grown much more slowly than before due to widespread uncertainties over growth. Last but not least, the importance of cyber-security was demonstrated once more in the year under review. The protection of data networks and appropriate staff training are an ongoing process which the banking sector must take very seriously, despite its already strong understanding of IT security.

Earnings performance, assets and financial position

Commerzbank faced a market environment for banks that remained difficult in 2016. Business performance was affected by persistently low interest rates, volatile capital markets and marked caution among our customers.

The Commerzbank Group's operating profit for 2016 came to €1,399m, a fall of 28% year-on-year. Consolidated profit attributable to Commerzbank shareholders for the period under review came to €279m.

Total assets as at 31 December 2016 were €480.5bn, 9.8% below the figure for year-end 2015. The reduction in assets is reflected both in claims on banks and in trading assets and financial investments.

The decline in risk-weighted assets to €190.5bn was mainly due to a reduction in risk assets from credit risk due to active portfolio management with increasing focus in the business, boosted by the relief effects from a securitisation. These effects were partly offset by rises in risk-weighted assets in the areas of market risk and operational risk.

The Common Equity Tier 1 ratio under full application of Basel 3 rose to 12.3% at end-December 2016.

Income statement of the Commerzbank Group

The individual items in the income statement were as follows in 2016:

Net interest and trading income fell by a total of 13.2% year-on-year to €5,397m. Net interest income for the reporting period declined by €650m year-on-year to €5,077m, while net trading income and net income from hedge accounting was down €174m to €320m. In the Private and Small-Business Customers segment, the decline in net interest income reflected the impact of low and negative interest rates, which led to significantly lower income from the domestic deposit business. This was only partially offset by further growth in portfolio volume in lending business and the positive income trend at mBank. Growth at mBank was attributable both to the increase in business volume and to the continuous improvement of the interest margin. Corporate Clients posted a significant fall in net interest and trading income year-on-year. This was due in particular to the negative interest rate environment and a considerably lower contribution to earnings from structured investment products business. The ongoing reduction of the portfolio transferred from the ACR segment also led as expected to a fall in net interest income. Net interest and trading income in the ACR segment fell by €146m to €85m. This was linked primarily to the additional income generated in 2015 from measures to restructure funding that were not repeated in the period under review. The continuing reduction in the portfolio also entails a corresponding reduction in current interest income. Net trading income for the period included positive measurement effects from both counterparty risks and the measurement of own liabilities of €528m, compared with €–17m in the equivalent period last year.

Net commission income fell by 6.4% year-on-year to €3,212m. The highly volatile equity markets in the reporting period created continuing uncertainty among market participants and corresponding caution on the part of clients in the Private and Small-Business Customers segment. By contrast, persistently strong customer demand for instalment loans and the adjustment in pricing policy had a positive impact. In Corporate Clients, there was a significant year-on-year fall in net commission income. This was due in particular to a decrease in documentary business against the backdrop of the strategic focusing in the Financial Institutions division and the generally weak global economy with its effect on foreign trade. Income from derivatives and capital market-related advisory business also fell.

Table 7

Statement of comprehensive income I €m	**2016**	**2015[1]**	**Change**
Net interest income	5,077	5,727	– 650
Loan loss provisions	– 900	– 696	– 204
Net commission income	3,212	3,430	– 218
Net trading income and net income from hedge accounting	320	494	– 174
Net investment income, income from at-equity investments and other net income	790	144	646
Operating expenses	7,100	7,157	– 57
Operating profit/loss	**1,399**	**1,942**	**– 543**
Goodwill-Abschreibungen	627	–	627
Restructuring expenses	129	114	15
Pre-tax profit/loss	643	1,828	– 1,185
Taxes on income	261	629	– 368
Consolidated profit/loss	**382**	**1,199**	**– 817**
Consolidated profit/loss attributable to Commerzbank shareholders	279	1,084	– 805

[1] Prior-year figures restated due to a change in reporting plus other restatements (see notes page 139 ff.).

Net investment income in the year under review was €344m, compared with €–7m the previous year. The increase of €351m was chiefly attributable to write-ups of €141m on HETA Asset Resolution AG and a one-off effect of €123m from the sale of the stake in Visa Europe Limited.

Current net income from companies accounted for using the equity method was €150m (previous year: €82m). This included a positive effect from the remeasurement of the assets of Commerz Real, reflecting the very good situation in the market for commercial real estate.

Other net income was €296m for the reporting period, compared with €69m a year earlier. The increase of €227m was driven largely by positive one-off effects from the sale of real estate. The net income figure for the period under review also includes reversals of provisions in respect of legal and litigation risks.

The net allocation to loan loss provisions rose by 29.3% year-on-year to €900m. The increase was due primarily to a higher provisioning requirement in the Asset & Capital Recovery segment, reflecting the ongoing difficult situation on the shipping markets.

The Corporate Clients segment also recorded a higher net allocation to loan loss provisions due to higher provisioning requirements in connection with individual exposures. The need for loan loss provisions in the Private and Small-Business Customers segment fell, however, due to good solvency among German households.

Operating expenses in the reporting period were €7,100m, down 0.8% year-on-year. Personnel expenses were €3,723m, representing a year-on-year fall of 4.5% due in particular to lower variable remuneration components. By contrast, other operating expenses, including depreciation on fixed assets and amortisation of other intangible assets, rose by 3.7% to €3,377m. The increase was mainly due to higher compulsory contributions including the newly introduced Polish bank tax of €74m and the European bank levy of €155m, an increase in consultancy and audit costs and ordinary amortisation of intangible assets.

As a result of the developments described above, the Commerzbank Group posted an operating profit of €1,399m in the year under review, a fall of 28% year-on-year.

In connection with the downsizing of trading activities as part of the strategic realignment, goodwill and intangible assets of around €627m were written off in the period under review. Restructuring expenses of €129m also impacted on profit in the period under review. These related mainly to the bundling of product and market expertise in London and New York and the optimisation of internal processes.

Pre-tax profit came to €643m, compared with €1,828m the previous year. Tax expense for the reporting period was €261m, compared with €629m the previous year.

Profit after tax for 2016 was €382m, compared with €1,199m in the previous year. Net of non-controlling interests of €103m, the consolidated profit attributable to Commerzbank shareholders was €279m, down from €1,084m in the previous year.

As Commerzbank Aktiengesellschaft is reporting its results for the 2016 financial year in accordance with the German Commercial Code (HGB), the plan is to service all profit-sharing certificates issued by Commerzbank Aktiengesellschaft for the 2016 financial year; no dividend will be paid.

The statement of comprehensive income, which includes both consolidated profit/loss and other comprehensive income for the period, showed a net total of €–301m in 2016. Other comprehensive income of €–683m consists of the sum of changes in the revaluation reserve (€–135m), the cash flow hedge reserve (€62m), the currency translation reserve (€–143m), the value of companies accounted for using the equity method (€1m) and actuarial gains and losses (€–379m), along with the change from assets held for sale and disposal groups (€–89m).

Operating profit per share came to €1.12, and earnings per share to €0.22. The comparable figures in the prior-year period were €1.61 and €0.90 respectively.

Balance sheet of the Commerzbank Group

Total assets of the Commerzbank Group as at 31 December 2016 were €480.5bn. This was a fall of 9.8% or €52.3bn compared with the adjusted figure as at end-2015. The reduction in assets is reflected both in claims on banks and customers and in trading assets and financial investments.

The cash reserve increased by €6.3bn to €34.8bn. This increase compared with the end of 2015 was due in particular to larger deposits with central banks.

Claims on banks were €58.5bn, down €13.3bn year-on-year. While claims on banks due on demand rose slightly by €0.1bn, other claims fell by €3.9bn and claims from secured money market transactions by €10.4bn, due in particular to the reduction of the bank portfolio in the Financial Institutions division.

Claims on customers were 2.8% below the previous year's level at €212.8bn. The volume decline was mainly driven by a €2.6bn fall in secured money market transactions in the form of reverse repos and cash collaterals and by reductions in non-strategic business.

As at the reporting date, total lending to customers and banks stood at €224.1bn, down 2.7% on year-end 2015. While loans to banks fell by €2.7bn to €19.9bn, customer lending business was slightly below the year-end 2015 level, down 1.7% to €204.2bn. The increase in lending volume in the Private and Small-Business Customers segment was more than offset by a decline in lending volume in the Corporate Clients segment.

Trading assets at the reporting date were €88.9bn, a fall of 22.6% compared with the end-2015 level. Holdings of equities, other equity-related securities and investment fund units fell by €5.9bn, while positive fair values of financial derivatives, in particular interest-rate-related derivative transactions, fell by €14.5bn compared with year-end 2015.

Financial investments decreased compared with year-end 2015, down 14.4% to €70.2bn. Bonds, notes and other interest-rate-related securities were down by €11.7bn to €69.1bn, while equities and other equity-related securities and participations were unchanged at €0.9bn.

Table 8

Assets I €m	31.12.2016	31.12.2015[1]	Change in %
Claims on banks	58,529	71,805	– 18.5
Claims on customers	212,848	218,875	– 2.8
Trading assets	88,862	114,824	– 22.6
Financial investments	70,180	81,939	– 14.4
Other assets	50,031	45,258	10.5
Total	**480,450**	**532,701**	**– 9.8**

Liabilities and equity I €m	31.12.2016	31.12.2015[1]	Change in %
Liabilities to banks	66,948	83,154	– 19.5
Liabilities to customers	250,920	261,179	– 3.9
Securitised liabilities	38,494	40,605	– 5.2
Trading liabilities	71,644	86,454	– 17.1
Other liabilities	22,804	31,184	– 26.9
Equity	29,640	30,125	– 1.6
Total	**480,450**	**532,701**	**– 9.8**

[1] Prior-year figures restated due to a change in reporting plus other restatements (see notes page 139 ff.).

On the liabilities side, liabilities to banks fell sharply by €16.2bn to €66.9bn, largely in connection with the reduction in sight deposits at banks, short-term financing from central banks and a decline in money market transactions. The decrease in volume related exclusively to foreign bank liabilities.

Liabilities to customers fell by 3.9% to €250.9bn compared with year-end 2015. This was due to lower volumes of time deposits and liabilities from money market transactions, partly compensated by a rise in sight deposits among both corporate and private customers.

Securitised liabilities were €38.5bn, €2.1bn lower than at year-end 2015. While bonds and notes issued fell by €2.7bn to €32.9bn – owing in particular to repurchases and maturities of public-sector Pfandbriefe – money market instruments issued rose by €0.6bn to €5.6bn.

Trading liabilities decreased in volume by €14.8bn overall to €71.6bn. This was mainly due to the decline in interest-rate-related derivatives transactions and short sales of bonds and equities, partly offset by a rise in currency-related derivatives transactions.

Off-balance-sheet liabilities rose overall year-on-year, with contingent liabilities down 5.8% year-on-year at €35.0bn and irrevocable lending commitments up €5.8bn to €78.2bn.

Capital and reserves

The equity capital (before non-controlling interests) reported in the balance sheet as at 31 December 2016 was €28.6bn, €1.7% below the figure for year-end 2015. The slight decrease was due to lower retained earnings, which were down €0.3bn to €11.2bn. As at the reporting date, the revaluation reserve stood at €–0.8bn. This was a deterioration of €–0.2bn compared with the previous year, attributable in particular to higher risk premiums on Italian government bonds. Together with the negative cash flow hedge reserves and currency translation reserves, this amounted to a deduction of €–1.0bn from equity compared with €–0.8bn at year-end 2015.

Risk-weighted assets were €190.5bn as at 31 December 2016, €7.7bn below the year-end 2015 level. The decline was mainly due to a reduction in risk assets from credit risk due to active portfolio management with increasing focus in the business, boosted by the relief effects from a securitisation. These effects were partly offset by rises in risk-weighted assets in the areas of market risk and operational risk.

Regulatory Tier 1 capital fell by around €0.8bn to €26.5bn compared with year-end 2015, chiefly as a result of the next stage in the Basel 3 phase-in. The Tier 1 ratio rose slightly to 13.9%. Common Equity Tier 1 capital was €26.5bn. Under Basel 3 phase-in rules, this is identical to Tier 1 capital. The total capital ratio was 16.9% on the reporting date. The Common Equity Tier 1 ratio (on a fully phased-in basis, i.e. on the basis of fully implemented regulations according to our interpretation) reached 12.3% as at the reporting date. The leverage ratio based on the CRD IV/CRR rules applicable on that date (delegated act), which compares Tier 1 capital with leverage exposure, was 5.4% (phase-in) or 4.8% (fully phased-in).

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

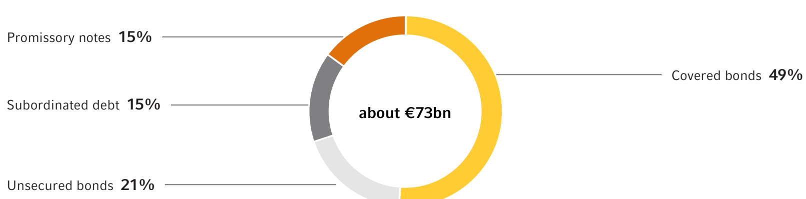
Funding and liquidity of the Commerzbank Group

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.

Figure 3

Capital market funding structure[1]
As at 31 December 2016



[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 €7.4bn in long-term funding on the capital market in 2016.

An unsecured benchmark subordinated bond with a volume of €1bn was issued in the first quarter. The issue has a term of ten years.

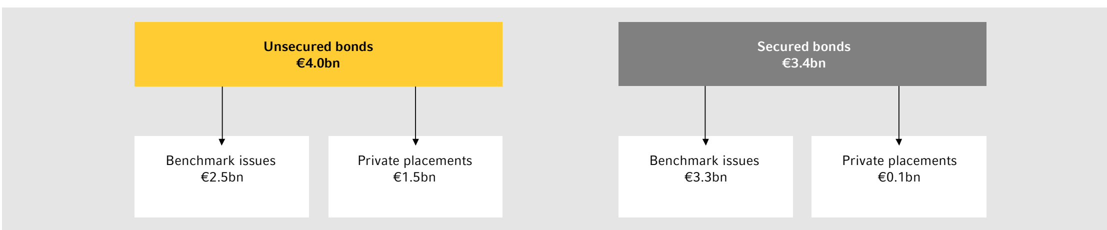
In the third quarter, a seven-year senior unsecured benchmark bond was also issued. In addition, €1.5bn was raised through private placements, including a US$400m subordinated bond with a 12-year term. The Polish subsidiary mBank also issued a senior unsecured bond with a benchmark volume of €500m and a term of four years.

In the collateralised area, around €3.4bn was raised. Over the course of the year, four benchmark bonds were placed on the capital market, of which two were increased in the third quarter. Mid-year, a ten-year mortgage Pfandbrief was issued with a total volume of €1bn. It was followed by an eight-year mortgage Pfandbrief, also with a volume of €1bn, and a mortgage Pfandbrief with a volume of €750m and a term of just over ten years. A further mortgage Pfandbrief with a volume of €500m and a term of just over six years was issued in November. The Pfandbriefe were placed mainly in Germany, although foreign investors also showed very strong interest in the mortgage Pfandbriefe. In addition, the Polish mortgage banking subsidiary of mBank issued covered bonds under Polish law with a volume of €0.1bn.

The average term of all issues was around eight years.

Figure 4

Group capital market funding of 2016
Volume €7.4bn



As at the reporting date, the Bank had a liquidity reserve of €80bn in the form of highly liquid assets. The liquidity reserve portfolio consists of highly liquid assets and functions as a buffer in stress situations. This liquidity reserve portfolio is funded in line with liquidity risk appetite in order 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, in the amount of €23.8bn, is held in a separate stress liquidity reserve portfolio managed by 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 €8.4bn as at the reporting date.

The regulatory liquidity requirements of the German Liquidity Regulation were met at all times in the reporting period. As at the reporting date, Commerzbank Aktiengesellschaft's key liquidity ratio calculated using the German Liquidity Regulation's standard approach was 1.52, again significantly higher than the minimum regulatory requirement of 1.00. 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 2016 business position

In 2016 Commerzbank once again found itself in a difficult environment for banks, with continued low or negative interest rates. In addition, regulatory requirements for banks are continuing to weigh significantly on earnings. In this challenging environment we demonstrated last year the increased resilience of the Commerzbank business model and by growing customers, gaining market share and continuing to run down riskier non-core portfolios we laid the foundations for achieving sustainably higher profitability in the years to come.

Our operating profit for 2016 contains various positive effects including from our Heta exposure and sales from our real estate portfolio. Overall, however, the operating business performed solidly in 2016. The earnings performance forecast for the most profitable segment, Private and Small-Business Customers (PSBC), was largely in line with our expectations. From the Group perspective, it was not possible to entirely separate the performance of operating income from the negative impact of the interest rate environment and customer caution in areas such as securities business and corporate financing, while another downturn in the shipping markets made it necessary to recognise more impairments.

Goodwill of around €627m was written down in the third quarter of 2016 in connection with the focusing on the core business as part of the strategic realignment. The objectives of a slight improvement in the consolidated surplus and a largely stable return on equity were therefore not achieved. Accordingly, the return on equity based on consolidated profit fell from 3.9% in 2015 to 1.0%.

The PSBC segment, which also includes contributions to earnings from the Polish subsidiary mBank and smaller companies with turnover of between €2.5m and €15m from the former Mittelstandsbank segment, performed successfully in financial year 2016. The targets set for the German private customer business in terms of customer growth, assets under custody (total credit, deposit and custody account volumes) and customer satisfaction were achieved or exceeded, contributing to the forecast slight increase in operating profit and – thanks to lower capital commitments – the marked improvement in operating return on equity. mBank also performed better than expected thanks to an improved interest rate margin, so the negative impact of the introduction of the bank levy in Poland was largely made up. The segment benefited from one-off effects in both Germany and Poland, including gains on disposal of the stake in Visa Europe Limited. The cost/income ratio in the PSBC segment remained largely stable due to the above-mentioned Polish bank levy.

During the period under review, activities in the Corporate Clients (CC) segment suffered from the low interest rate environment and declining customer activity in many areas; hence, contrary to expectations of a stable performance, it was unable to match the previous year's level of operating income. For example, despite the continuing good market position, the unusually high volatility on the equity markets had a dampening effect on investor demand in the Equity Markets & Commodities area, leading to a fall in trading volumes. Structured products business for institutional customers also suffered a significant drop in income due to the challenging situation on the capital markets. The marked slowdown in international trade flows in recent years led to a decline in commission-bearing documentary business. Commerzbank's strategic decision to implement a stronger focus in the Financial Institutions division also had a negative impact on income. The prompt reduction of the portfolio transferred from the Asset & Capital Recovery (ACR) segment at the beginning of 2016 brought about a drop in interest income, but this helped ensure ongoing high credit quality in the CC segment in line with the strategy. On the cost side, factors such as the strengthening of the compliance function led to a slight rise in operating expenses. Overall, the above factors resulted in a low operating return on equity and a higher cost/income ratio. Here too we had assumed stable ratios.

With global trade remaining weak and new capacity continuing to surge onto the market, charter rates for containers and bulkers in particular fell once again from a level that was already not high enough to cover many ship owners' costs. As a result, the forecast of a decrease in loan loss provisions in the ACR segment and thus of significantly smaller operating losses was not achieved. The considerable increase in impairments not only covered additions to the black book, however, but also allowed the cover ratio for problem loans in ship financing to be maintained at the high level of 64% recorded in the previous year.

At Group level, significant income from financial investments and equity holdings and other net operating income, some of which was one-off in nature, was not sufficient to offset the pressure on income from interest rate-based and commission-bearing income. In this challenging market environment, total income before loan loss provisions fell by 4% to €9.4bn. Operating profit was down by €0.5bn to €1.4bn. The performance of the shipping markets led to higher-than-expected loan loss provisions in the ACR run-off segment and thus for the Group as a whole. A renewed cost-cutting and efficiency drive allowed Commerzbank to exceed its forecast and not only offset the expenses for bank levies and ongoing high regulatory charges, which doubled to almost €230m, but in fact reduce operating expenses by just under €0.1bn to €7.1bn.

The goodwill write-down of €0.6bn carried out in connection with the strategic realignment was another reason why the forecast in the Annual Report 2015 of a slight increase in the consolidated surplus for financial year 2016 was not met. Consolidated earnings attributable to shareholders were €279m (previous year: €1,084m). Operating return on equity, which does not take goodwill write-downs into account, was down on the year-earlier figure of 6.7% at 4.7%, while the cost/income ratio increased somewhat more strongly than expected, rising two percentage points to 75.5%.

Commerzbank further strengthened its comfortable equity position in 2016. While Common Equity Tier 1 capital under full application of Basel 3 rules remained almost unchanged at €23.4bn, the fall of just under 4% in risk-weighted assets pushed the Common Equity Tier 1 ratio up from 12.0% to 12.3% as at the end of December 2016 (under full application of Basel 3).

Segment performance

Private and Small-Business Customers

The Private and Small-Business Customers (PSBC) segment encompasses branch business in Germany, comdirect Group, Commerz Real and the mBank Group. Small-Business Customers combines business customers and smaller Mittelstand customers with an annual turnover of up to €15m served by the branch bank in Germany. The segment continued to grow during the year under review, and with over 12 million customers in Germany and more than five million customers in Central and Eastern Europe it is one of the leading banks in these markets.

Performance

Table 9

€m	2016	2015[1]	Change in %/%-points
Income before provisions	4,819	4,845	−0.5
Loan loss provisions	−119	−167	−28.7
Operating expenses	3,621	3,627	−0.2
Operating profit/loss	**1,079**	**1,051**	**2.7**
Capital employed	4,125	4,760	−13.3
Operating return on equity (%)	26.2	22.1	4.1
Cost/income ratio in operating business (%)	75.1	74.9	0.3

[1] Prior-year figures restated due to a change in reporting plus other restatements (see notes page 139 ff.).

The Private and Small-Business Customers segment achieved a pleasing operating profit in 2016. In Germany, adverse factors resulting from the low interest rate environment and lower income due to customer caution in the securities business were offset by persistently dynamic credit growth, the ongoing solid trend in new customers and non-recurring income effects. mBank's contribution to earnings remained basically stable compared with the previous year, but was impacted by an additional charge from the Polish bank tax. Consequently, operating profit rose by €28m to €1,079m.

At €4,819m in the year under review, income before loan loss provisions almost matched the high level of the previous year (€4,845m). The decline of €105m in net interest income to €2,479m reflects the adverse impact of low and negative interest rates, which led to significantly lower income from the domestic deposit business. This was only partially offset by further growth in portfolio volume in lending business and the positive income trend at mBank.

Growth at mBank is attributable both to the increase in business volume and to the continuous improvement of the interest margin. Net commission income fell by €64m year-on-year to €1,956m. Over the year as a whole, significantly higher commission income from real estate business at Commerz Real was offset by lower commission income from the domestic securities business due to lower customer activity. The share of volume-related income from mandate business and premium custody accounts was further increased and will continue to have a stabilising effect on net commission income due to its lower exposure to market volatility. Net commission income at mBank was basically stable. Net investment income of €140m (previous year: €65m) was favourably impacted by one-off income from the sale of the stake in Visa Europe Limited in the amount of €123m, shared across Commerzbank and its subsidiaries comdirect and mBank. However, mBank had also recorded a positive one-off effect of €46m in the previous year from the sale of the insurance business to the AXA Group.

The increased income of €131m from companies accounted for using the equity method included a positive effect from the remeasurement of the assets of Commerz Real, reflecting the very good situation in the market for commercial real estate.

Loan loss provisions fell once again by €48m to €119m, testifying to the high quality of the loan portfolio. Valuation allowances were largely recognised by mBank, whose loan loss provisions were down €15m year-on-year at €83m. Net loan loss provisions of just €36m were booked in Germany, a historically very low figure.

Operating expenses remained virtually unchanged at €3,621m due to the continued strict cost management of personnel expenses and other operating expenses. The increase in operating expenses at mBank was largely attributable to the Polish bank tax of €74m introduced in 2016. With regard to the European bank levy, the expense in the Private and Small-Business Customers segment rose from €15m to €20m.

Overall, the Private and Small-Business Customers segment posted pre-tax profit of €1,079m in the 2016 financial year, which represents an increase of 2.7% year-on-year.

Main developments in 2016

In the 2016 financial year, the Private and Small-Business Customers segment remained on course for growth and built on the successes of the previous year, consistently continuing the digitalisation of products and processes. Key objectives for 2016, which were set as part of the private customer strategy, were fully achieved by October. Within four years, we have managed to convince one million new customers to join Commerzbank. In the year under review alone, customer numbers in Germany rose by around 320,000, an increase of 12.3%. The business performance at mBank was also more than satisfactory in 2016: all the measures envisaged for implementation by 2016 under the “One Bank” strategy were achieved and the number of customers increased by 8.1% (around 400,000) year-on-year to 5.4 million.

The comdirect Group, Commerz Real and the mBank Group all contributed significantly to positive earnings performance in the segment with their income growth.

Private Clients and Small-Business Customers

The branch bank in Germany offers the range of services of a full-service bank to private, small-business and wealth management customers at around 1,000 locations and via digital channels. The new Small-Business Customers segment includes both previously managed business customers as well as Mittelstand customers previously managed by the former Mittelstandsbank segment, with an annual turnover of between €2.5m and €15m.

Driving ahead with the strategic focus

As part of the continued strategic focus, the international wealth management activities of the Luxembourg subsidiary were sold in the year under review. Business with Commerzbank’s international wealth management customers is being continued from the branch bank in Germany.

High quality and profitable growth

In the past financial year the branch bank has once again made good progress with its core objectives of quality and growth and has been able to stimulate a sustained improvement in profitability. The “Performance Plus” programme was continued and important measures for profitable growth were initiated. Prices and fees were brought into line with the market and costs remained stable despite investments in digitalisation, marketing and the branch network. The “Quality First!” initiative has been used to implement new regulatory requirements in our business processes for our customers.

Customer satisfaction remained at a constantly high level throughout the whole year. This is according to the net promoter score (NPS), which measures customers’ willingness to recommend the Bank. The quality of the advice provided by Commerzbank was once again recognised externally: for the fourth time running, Commerzbank won the nationwide City Contest run by Focus Money in the private customers section of the test, and for the second time in the business customers category launched two years ago.

In 2016 everything pointed once again to growth: in customers, accounts and assets. In addition to traditional advertising campaigns, new marketing methods were also pursued: since December 2015, individual offers have been created in online banking, defining the best offer for a customer using advanced analytics. As a result, product sales to online banking customers who have consented to their data being used were increased by 10% compared with a comparator group. By systematically approaching prospects, over 50,000 customers were acquired during the year under review. Partnership banking has also developed promisingly. New cooperations with partners such as Rewe, Amazon and Tchibo provide access to numerous potential new customers.

In the lending business, the strong trend continued in 2016. Sales of instalment loans were extremely positive: the volume of new business was up by about 31% year-on-year to €2.3bn. A year-on-year increase of 15% was achieved in individual loans, with a volume of around €3.2bn. With new business volume of just under €11.9bn in mortgage lending, we almost equalled the excellent new business figure of €12.2bn achieved in 2015, and with higher profitability compared to the previous year.

In pension business, the volume of new insurance products business was increased by 13% to €2.3bn. This result was mainly due to pension and term life insurance. In home loan savings, new business volume of €2.4bn was generated, which corresponds roughly to the previous year's level. In the current low interest rate environment, home loan savings remain attractive to hedge interest rates and for modernisation requirements.

The continued low interest rate phase and a volatile year on the stock market in 2016 presented investors with a challenge once again. The total volume of securities business including wealth management amounted to €98.6bn. Customers of Commerzbank can choose from a variety of custody account models for their securities investments. At the end of the year under review, €17.4bn was invested in premium custody accounts, which is 43% more than in the previous year. This significant increase serves to highlight the continued trend towards flat-rate models. Good volume growth was also recorded in mandate business. In wealth management products, an increase of around 4% was recorded on a portfolio volume of €21.3bn. Wealth management recorded growth of around 6%, to a total of €11.5bn portfolio volume. As a result, portfolio income from securities rose once again, accounting for around 77% of total income in the securities business in 2016 (2015: 69%). In response to increased demand for ethically irreproachable and environmentally sound financial investments, Commerzbank started to offer a sustainable asset management service for private individuals in 2016. The offer is available to customers who wish to invest amounts of €500,000 or more.

Expansion of digitally networked multi-channel bank

In the Private and Small-Business Customers segment, the future is both digital and personal. As an important strategic milestone on the road to a multi-channel bank, the "ONE" sales application was introduced in October. For the first time, customer advisors in the branch offices and online banking customers can access the same platform. This means Commerzbank has a single user interface for employees and customers. Our IT infrastructure will therefore become more efficient in future, as any changes will need to be made on just one platform.

The banking app, which has been downloaded over 1.4 million times since launch, also sets new standards. This app allows the user to preview balances and transactions for up to five accounts and cards. Transfers can be carried out quickly and conveniently: authorisation can be given using the photoTAN app without requiring a second device. There was another digital development in April: our free current account can now be opened online with no paperwork in just a few minutes, including the identification process. In addition, with the account switching app, we offer our customers the convenient and simple option of switching from one bank to another in just 10 minutes.

Particularly for entrepreneurs, it is essential to be able to settle financial matters quickly and easily with their bank and take advantage of the possibilities afforded by digitalisation. For this reason, we are continually expanding our range of digital products and services for entrepreneurs. In the year under review, for example, we added a development funds finder to our digital range of advisory services. With just a few clicks, our customers can check whether they can apply for development loans from KfW or the state development institutions for their project. In the summer of 2016 the digital funding marketplace "Main Funders" was launched, opening up new opportunities for small and medium-sized business customers of Commerzbank to obtain direct, rapid financing and investment opportunities. From the middle of the year under review, customers have been able to obtain support with electronic payment transaction solutions via the multi-channel manager function. We also offer online dialogue for business customers. This allows all our customers to get advice on products, services and all banking-related questions via text, audio and video chat.

Even in times of digital change, the branches remain an essential part of multi-channel banking. Commerzbank continues to rely on its dense network of branches at around 1,000 locations, which receive around 450,000 customer visits a day. In June 2016, the distribution structure which was implemented in 2015 was finally put into practice, with five market regions and 65 branches nationwide, and in particular business with profitable customer groups was strengthened. Our geographic presence was more than doubled, offering wealth management advisory services for wealthy customers in around 100 locations. We offer advisory services tailored to the needs of our business customers in around 330 locations.

Flagship branches in larger cities will operate as centres of competence and will thus be the main showcase for Commerzbank in future. After the success of the pilot projects in Berlin and Stuttgart, the final concept was rolled out in the year under review with the opening of three new flagship branches in Bochum, Bremen and Hanover. The first new city branch opened in Frankfurt's East End in December. Commerzbank is testing this cost-effective and efficient branch model, where customers can obtain the services they need quickly and locally.

In order to make products and processes easier, faster and more digital, the subsidiary "Neugelb Studios" was founded – a service design agency intended to provide new impetus on the way to a multi-channel bank.

comdirect Group

The comdirect Group (comdirect bank AG and ebase GmbH) is the German market leader in online securities business with 1.9 million securities accounts, customer assets under custody of well over €75bn and 24.8 million securities transactions executed in the past year. In addition, comdirect bank AG is one of the leading direct banks in Germany.

In the year under review, the comdirect Group grew again despite the difficult interest rate and trading environment and was able to increase the number of customers and custody accounts in both direct banking and business with institutional partners (ebase). Due to net inflows of funds, the portfolio volume in Investing in both areas was significantly higher than in the previous year. In addition, the higher number of current accounts led to an increase in deposit volume. In securities trading, the high volume of orders executed in the previous year was further increased despite a slight fall in market volatility.

comdirect bank AG is designed to operate as a smart financial advisor to inspire new customers to invest, save and trade in securities. This development was driven ahead in 2016 by new intelligent solutions such as the comdirect trading app, the Multibanking service, the updated smartPay app and the MoBox app for young people. In addition, the instalment loan product launched in the year under review complements the portfolio in the direct banking business. Innovations are also expected to reach the market quickly in the future, thanks to interdisciplinary innovation teams, intensive collaboration with fintech companies and the entrepreneurs-in-residence programme launched in 2016.

In December, comdirect bank AG acquired OnVista AG with OnVista Bank GmbH, an online broker with around 90,000 customers with an interest in trading, and OnVista Media GmbH, which has established www.onvista.de as one of Germany's leading financial portals. This acquisition is still subject to approval by the banking supervisory and competition authorities and is expected to be completed in the first half of 2017.

Commerz Real

Commerz Real can look back on the most successful year of its history, with new business volumes and the overall result rising again year-on-year. As asset manager for physical assets in the Commerzbank network, the company combines more than 40 years of experience in asset and investment management with extensive structuring expertise and a unique portfolio of investment products and individual financing solutions.

The product portfolio includes hausInvest, which was created in 1972 and is one of the most successful open-end real estate funds, as well as institutional investment vehicles and equity investments under the CFB-Fonds and CFB Invest brands.

The portfolio ranges from commercial real estate of various types through solar parks, wind farms and aircraft to infrastructure and production facilities.

In addition, as a leasing company for the Commerzbank Group, Commerz Real offers need-based real estate and equipment leasing concepts as well as asset structuring. At the end of the period under review, assets under management amounted to around €32bn.

hausInvest surpassed the €11bn mark, and by the end of 2016 it had a volume of around €11.8bn, or about €1.5bn more than 2015. With a current market share of just over 13%, it is the second largest open-end retail real estate fund in Germany. 94 properties in 18 countries and 55 cities with a market value of around €9.5bn generated a return of 2.2% by the end of 2016. Aided by the persistently high demand for real estate, the fund management team has further optimised the portfolio.

Commerz Real is also an established partner for institutional investors. Many years of experience in structuring and managing investments in physical assets, together with licences for German and Luxembourg investment vehicles, allow it to offer tailored investment solutions. Institutional capital totalling around €56m was acquired in the period under review. Under the Commerz Real Institutional brand there are currently four special AIF (alternative investment fund) vehicles in distribution.

In 2016, Commerz Real Asset Structuring GmbH (CRAS) focused on structuring individual financing solutions, developing long-term financing structures for real estate, big-ticket items, current assets and infrastructure projects, and its involvement as a minority shareholder in customers with large real estate portfolios. New transactions amounted to around €74m in total – an increase of almost 50% compared to 2015.

The focus of the activities of Commerz Real Mobilienleasing GmbH (CRM) in the year under review was once again on leasing machinery and equipment, sale and leaseback solutions and hire purchase models. Like CRAS, CRM works closely with the Corporate Clients segment. New transactions amounted to around €0.8bn.

mBank Group

The Group division comprises activities in universal banking and direct banking business in Central and Eastern Europe and is represented by the mBank brand, under which it serves customers in retail, corporate and investment banking in Poland, and in retail banking in the Czech Republic and Slovakia. mBank is one of the largest financial institutions in Poland.

Growth in mobile and transaction banking

mBank Group performed extraordinarily well in 2016, reflecting stable growth in its customer base, business model and customer service technology.

The "One-Bank strategy" for the period from 2012 to 2016 was fully implemented, with almost all targets being met. Overall, mBank gained around 400,000 new private customers in the year under review, boosting total customer numbers to 5.4 million by the end of 2016. This was due first and foremost to acquisition activities, which focused in particular on marketing measures and the development of the product mix, enabling mBank to simplify its offering for private customers and implement effective cross-selling. The customer base in the Czech Republic and Slovakia grew by around 73,000 year-on-year to reach around 893,000 customers by the end of the year under review.

The volume of private customer deposits – especially in current accounts – increased significantly by 15.5% year-on-year. This proves the worth of mBank's business model, which focuses on banking transactions. mBank also recorded further growth in card transactions in 2016, with the number increasing by 27% year-on-year.

mBank continued to develop and optimise its lending business in 2016, particularly in the consumer credit sector, which posted an increase of more than 20% in new business volume compared to the previous year. mBank also grew its business strongly in the Czech Republic and Slovakia. The main contributors to this were lending business and private customer deposits. In the year under review, mBank's foreign branches concentrated on stepping up their acquisition efforts and continuously expanding their leading position in mobile banking.

In addition, the Group's corporate client business reported a positive performance, with the customer base increasing by around 1,400 customers in 2016 to a total of almost 21,000. The volume of corporate customer deposits increased slightly by 1.8% in 2016. mBank focused on the small and medium-sized corporate customer segment, in which the Bank aims to strengthen its position through the targeted expansion of its offering. mBank was able to further expand its leasing business; its retail leasing portfolios have now shown consistent growth for three years.

mBank was honoured with a series of awards and prizes in 2016 for its innovative business activities. It was ranked first in the mobile banking category by Newsweek Friendly Bank, with second place in the mobile banking category going to the Orange Finance mobile app developed with partner Orange Polska. Global Finance named mBank Poland's best online bank and gave it the award for best online treasury services.

The British financial magazine Euromoney ranked mBank as Poland's best bank for private customers for the eighth time. mBank was also selected as the best bank for trade financing in Poland.

Its mobile app won first place in the mobile banking category at the Mobile Trends Awards (decided by a jury) and first place in the special prize category (online public vote).

Outlook for Private and Small-Business Customers

Further acceleration of growth in customers, accounts and assets and improved profitability are the objectives of activities in the Private and Small-Business Customers segment during 2017. The "Commerzbank 4.0" strategy will provide the strategic path to achieve this. Branch business in Germany will essentially focus on the further digitalisation of processes, products, services and marketing. The "ONE" platform will be further expanded as a central sales platform for all channels which supports an individual, targeted customer approach via the branches using advanced analytics. We want to increase marketing efficiency, so in future we will be focusing on performance-oriented campaigns, supplemented by various measures along the entire customer life cycle, as well as online sales and new cooperations within partnership banking. The product offering will be supplemented with innovative, digital products, such as a digital instalment loan in the lending business. The securities business will also be further digitalised and expanded. The premium custody account is a new type of custody account on the market which enables customers to purchase funds for a flat fee without paying an issue surcharge. In addition, the branch bank, together with the comdirect Group, is developing digital asset management as a robo-advice solution specifically for investors who only want to manage their securities transactions online. On the whole, however, the product range is to be streamlined in order to further reduce the Bank's internal complexity.

In November, Commerzbank and BNP Paribas agreed to divide the joint company Commerz Finanz GmbH into two parts. In 2017, Commerzbank plans to take instalment loan business back on to its own books as a profitable growth area.

The business model for small-business customers is being further developed, and the focus here will also be on the expansion of our digital offering in addition to the provision of special offers for certain sectors and entrepreneurs. We will continue to develop our support and management model to ensure the sustainability of our branch network as a key part of an efficient multi-channel bank.

This also means that we are redesigning our sales structure to reflect our multi-channel approach. The city branch pilot will be extended to other branches in Stuttgart and Frankfurt, while additional flagship branches will be opened in the market regions. We will further strengthen our compliance culture in order to secure our position as a fair and responsible partner for our customers by providing financial services in accordance with the regulations.

At the comdirect Group, we will focus on developing mature multibanking solutions to attract even more banking customers. Furthermore, new customers will be encouraged to become active holders of securities by means of attractive investment offers. The comdirect Group is supporting its institutional partners in the digitalisation of customer acquisition and investment processes and as a future provider of robo-advice solutions.

In 2017, Commerz Real also intends to build on the operating success of the prior year and lay the foundations for a permanent increase in its market presence. The main focus here is the expansion of institutional business and digitalisation. Commerz Real wants to become the first digital asset manager and integrated investment services provider. The goal is to automate business processes wherever possible, as well as to make products and services even more flexible, faster and more transparent in order to help customers achieve their objectives. Consequently, online business and direct sales will also be expanded.

mBank in Poland is facing a challenging year. The main area of instability is the uncertainty surrounding mortgage loans issued in foreign currencies. The Strategy 2020 action areas (empathy for customers, mobile first and efficiency) will be fleshed out with a range of initiatives and projects. The objectives are still to continue to promote customer growth in Poland, the Czech Republic and Slovakia, to offer the best mobile and transaction banking on the market and to increase the active users of mobile applications as the number of customers grows. Internal and customer-related processes are to be simplified through further digitalisation.

Corporate Clients

The new Corporate Clients segment combines the expertise of the former Mittelstandsbank and Corporates & Markets segments. The new segment is divided into five reporting divisions. The Mittelstand, International Corporates and Financial Institutions divisions are responsible for business with our core customers: The Mittelstand division covers larger Mittelstand customers and domestic large corporates with turnover in excess of €15m and bundles the relevant products they require. Business with smaller Mittelstand companies with turnover of between €2.5m and €15m was transferred to the Private and Small-Business Customers segment as part of the new "Commerzbank 4.0" strategy. The International Corporates division looks after corporate clients headquartered abroad, large German multinational companies and international insurance companies. The Financial Institutions division is responsible for relationships with banks in Germany and abroad and with 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 international business, investment and hedging products, through to customer-oriented investment banking products and customised capital market solutions. The performance of the Equity Markets & Commodities (EMC) division is reported separately since it is due to be spun off in the medium term. The Other Result division handles all business that 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. Measurement effects relating to own liabilities are also contained in this division.

Performance

Table 10

€m	2016	2015[1]	Change in %/%-points
Income before provisions	4,445	4,833	−8.0
Loan loss provisions	−185	−108	71.3
Operating expenses	2,973	3,030	−1.9
Operating profit/loss	**1,287**	**1,695**	**−24.1**
Capital employed	11,580	12,401	−6.6
Operating return on equity (%)	11.1	13.7	−2.6
Cost/income ratio in operating business (%)	66.9	62.7	4.2

[1] Prior-year figures restated due to a change in reporting plus other restatements (see notes page 139 ff.).

The Corporate Clients segment faced a number of challenges in the 2016 financial year such as the ongoing low level of interest rates, the very volatile capital market environment in the wake of numerous geopolitical events and the still challenging regulatory environment. This was also reflected in its earnings performance, with the segment posting an operating profit of €1,287m in the year under review after €1,695m in the previous year. The year-on-year fall was primarily the result of negative market interest rates, the challenging capital market environment, effects from the strategic focusing in the former Mittelstandsbank and Corporates & Markets segments and higher loan loss provisions. The Mittelstand division benefited from the segment's solid market position and stable earnings, although these were adversely affected by the negative interest rate environment.

The International Corporates division recorded stable earnings from commercial business. As a result of the challenging capital market environment, however, earnings were unable to match the high level achieved in the previous year. The Financial Institutions division recorded a drop in earnings due to the strategic realignment carried out in the year under review to comply with stricter internal risk and compliance requirements. Contrary to the previous year, the greater than average volatility in the capital market environment resulted in significantly lower customer activity and weaker trading in the EMC division. The high volatility had a particularly adverse impact on structured products business for institutional clients. The decision to restructure the securities lending and collateral management business to reflect the changed market conditions also led to a lower contribution to earnings compared with the previous year.

In the period under review, income before loan loss provisions fell 8.0% year-on-year to €4,445m. Net interest and trading income was €3,035m, down 10.7% year-on-year. While earnings, predominantly from Debt Capital Markets, were comparatively stable, the fall was attributable in particular to the negative interest rate environment, a considerably lower contribution to earnings from structured investment products business and the realignment of the EMC business. The ongoing reduction of the portfolio transferred from the ACR segment also led as expected to a fall in net interest income from lending. Net commission income fell 10.4% year-on-year to €1,279m. This was due to a decrease in documentary business against the backdrop of the strategic focusing in the Financial Institutions division and the generally weak global economy with its effect on foreign trade. The decline in income from derivatives- and capital-market-related advisory business also played a role.

Loan loss provisions were €–185m in the year under review, an increase of €77m year-on-year. The provisioning requirement was mainly in respect of additions for individual exposures.

At €2,973m, operating expenses were 1.9% lower than in the previous year. Higher investment expenses for IT and compliance were thus offset by ongoing stringent cost management.

The pre-tax result was €638m, with the fall of 61.1% year-on-year attributable to a significant degree to goodwill write-downs of €627m.

Main developments in 2016

The new Corporate Clients segment – agile, efficient and even more needs-oriented

The organisational merger of the former Mittelstandsbank and Corporates & Markets segments to form a single area of responsibility as part of the "Commerzbank 4.0" strategy has laid the foundations for an even more agile and needs-oriented relationship management model. Our tried-and-tested regional advisory approach is now supported by comprehensive centralised product, market and sector expertise. Bundling the strengths of the two segments creates the basis for responding flexibly and efficiently to market developments and changing customer requirements in order to further consolidate our market-leading position in the corporate customer business.

Digitalisation

The dual approach towards digital transformation was rigorously pursued in 2016, with traditional personal advice alongside digital services and offerings. For example, the Corporate Banking portal now also offers online money market loans, online fixed-term deposits in foreign currencies, a development funds finder and a photoTAN function. A pilot version of the online offering also displays any powers of attorney that have been issued. The mobile version of the multi bank capable Cash Management app was expanded with the addition of an approval function for payment orders.

We also support and advise our customers with regard to their own digitalisation strategy. For example, we have developed and successfully piloted a digital readiness check for corporate clients. The online tool allows customers to assess their own digital maturity, including an initial benchmarking against the sector. Based on the assessment, we support our customers in their digital transformation and offer financing solutions.

We developed an initial prototype of a comprehensive sales application for corporate customer advisors to provide digital support for traditional advisory services. This new platform offers a holistic view of customers, allowing us to optimise the advice we give them. The first prototypes of big data concepts were also tested successfully. This infrastructure will in future help generate system-based sales leads for traditional and digital advisory services.

Attractive asset management solutions for our customers in the low interest rate environment

The current low and negative interest rates present huge challenges for European banks in particular. It has now become standard market practice to pass the associated costs on to large corporate clients and institutional investors in the form of a credit balance fee for sight deposits. So that we can also offer solutions to our customers rather than simply passing costs on to them, we advise them on alternatives to sight deposits. Asset management solutions are currently the most popular choice for our customers: we attracted around €1bn in assets under management over the course of 2016.

Leading role in the fast-growing promissory notes market

The promissory notes market achieved the largest volume growth in its history in 2016, while the internationalisation of this form of financing, which began around five years ago, is also continuing at an rapid pace.

Commerzbank's know-how has played a key role in this development, and in addition to providing financing in Germany the Bank has also supported numerous transactions in other European countries such as France, Belgium, Austria, Ireland and, for the first time, Spain.

Greater demand for currency hedging in volatile foreign exchange markets

While the ongoing low interest rate environment meant there was little demand for interest rate hedging, the foreign exchange markets were highly volatile. The main reasons for this were the UK's decision to leave the European Union and the outcome of the US elections. This led to increased use of our eFX platform FX Live Trader and a corresponding rise in the number of customer transactions. FX Week rated our product expertise in this area within the top 10 in various areas, including "Best bank for FX in the eurozone for bank clients" and "Best bank overall for FX globally".

Trading activities geared more strongly to customer requirements

As part of the "Commerzbank 4.0" strategy, the decision was taken to streamline trading activities and focus more strongly on the requirements of the Bank's core customers. In a first step, Commerzbank is therefore planning to spin off the former Equity Markets & Commodities division, which over the past few years has helped the Bank become one of the biggest providers of investment and financial products and the leading market maker in Europe and Asia, into a separate legal subsidiary. The medium-term aim is to place this business, which remains attractive but no longer has a sufficiently strong connection to our core customer base, on the market.

We are also withdrawing from the complex and exotic interest rate and foreign exchange derivatives business and significantly reducing bond trading in Fixed Income & Currencies. In this regard, we are to cease trading in emerging market bonds where there is no connection with our Advisory & Primary Markets business or with issues we are supporting.

Commodity hedging is still part of the Commerzbank service offering

Unlike exotic commodity-related financial products, we will continue to offer hedging of commodity risks. This will ensure that our corporate clients can continue to benefit from the full range of capital market-oriented risk management solutions.

Mittelstand

The Mittelstand division caters for larger Mittelstand customers and domestic large corporates with turnover in excess of €15m and provides them with the products they require. Following the optimisation of our sales structure at the beginning of 2015, our domestic customers benefit from greater responsibility in local units, shorter consultation paths and thus more efficient services to support their business activities.

Expansion of our leading position in the financing market

Commerzbank once again underlined its strong commitment to the Mittelstand in 2016. Our expertise in syndicated loan business led to an increase in activity, with a substantial number of debut mandates being implemented successfully. In the year under review we also confirmed our position as one of the leading banks in Germany and Europe for leveraged buy-outs.

Commerzbank's business performance was recognised once again in the 2016 financial year. The Bank's comprehensive range of products and services for domestic companies, and in particular its proven and innovative business model for supporting Germany's foreign trade, led to Commerzbank being named Best Commercial Bank Germany by World Finance magazine. We also received the Leasing Life Europe External Investment Award, which recognise those who help stimulate the leasing industry.

Innovative ongoing development of the Corporate Banking portal

The division focused on further expanding the Corporate Banking portal and hence the digital advisory offering in order to support our Mittelstand customers. We are adapting our advisory approach to the digital age, but without losing sight of customer requirements. Corporate customer advisors remain the central contact for our customers.

A development funds finder was also introduced in the year under review. Commerzbank is thus the first bank in Germany to enable its customers to check, by entering just a few details, whether development loans from KfW or the state development institutions may be available for projects. Corporate customer advisors still advise on and structure the financing, drawing on the expertise of development funds specialists where necessary. We were able to convince more customers of the benefits of real-time foreign exchange trading with Commerzbank's FX Live Trader trading platform, with the proportion of currency transactions traded online rising continuously over the course of the year under review. Other online functionalities also improve the transparency and flexibility of our customers' business activities.

Strong market position in domestic and foreign bond issues

We gained a large share of the bond mandates in the Mittelstand market segment once again in 2016 and were able to place the bonds successfully.

We were particularly active not only in the German market but also across Europe. We also joined an innovative platform that promotes better communication between banks and investors in the bond market.

Expansion of international M&A presence
Commerzbank's existing customer relationships and improved sector approach led to it acting as an advisor in various acquisition transactions with an international dimension for German customers and with a German dimension for international customers. Overall, we confirmed our position in the year under review as one of the leading advisors on mergers and acquisitions in the Mittelstand segment.

International Corporates

The International Corporates division handles business with corporate clients headquartered abroad, large German multinational companies and international insurance companies.

Best Performing Bank in 2016
In a volatile and intensely competitive global economy, we once again assisted and supported numerous export companies with their delivery transactions in emerging markets. Long-term export financing guaranteed by government export credit agencies such as Euler Hermes helped to secure orders despite cautious investment activity in emerging markets. We have close relationships with all leading European and international export credit agencies (ECAs). Commerzbank's particular expertise in structuring export financing was recognised in an international study conducted by Clevis Research, with the Bank receiving the Importers Choice Award as the Best Performing Bank in 2016 in the area of export finance. The award is further evidence of our expertise in international business and our global locations in more than 50 countries. Supporting companies in their worldwide markets has been a key element of Commerzbank's activities ever since the Bank was first established. We now offer international companies access to our know-how and services through a dedicated corporate customer advisor.

International presence expanded
Commerzbank opened a subsidiary in the Brazilian metropolis of São Paulo in July 2016 as part of its internationalisation strategy.

Offering a wide range of banking services, the subsidiary provides local support for German and European companies and also assists large, capital-market-oriented firms in Brazil who are looking to expand into Europe. A number of significant transactions have already been concluded.

Key role in the syndicated loan and bond issue market
2016 was dominated by large-volume acquisition financing. Commerzbank played a leading role not only in the German and European markets but also in America and Asia.

In a year characterised by at times high market uncertainty, our international corporate bonds issuance activity was broadly based and reflects our successful sector approach, which will be further expanded going forward. Our regional focus is on issuers from Germany, the rest of Europe and the UK, supplemented by issuers from the USA. In addition to an increase in the number of issuers and greater international diversification, we also recorded significant growth in liability management business and green bond financing.

Position maintained in the declining market for equity transactions
Despite a positive stock market performance, the number of IPOs worldwide fell sharply in 2016. While Commerzbank was unable to escape this trend entirely, it did leverage its longstanding advisory, structuring and placement expertise to successfully support numerous equity transactions: IPOs, capital increases and secondary placings, primarily for German Mittelstand customers and selected international companies and financial institutions.

Financial Institutions

The Financial Institutions division is responsible for relationships with banks in Germany and abroad and with central banks. In carrying out its activities, Financial Institutions makes use of a global network of correspondent banks and established links in emerging markets, thus promoting the Group's global foreign trade activities and supporting other segments in their international activities and strategies. Financial Institutions assists its customers throughout the world with foreign payment transactions, hedging of foreign trade risks and funding for foreign trade deals. The Financial Institutions division also provides its customers with bilateral loans, supports them in syndicated loans and offers solutions for active risk management.

New strategic orientation to strengthen existing position and reduce the complexity of the bank portfolio

Financial Institutions realigned its correspondent banking strategy in 2016 in view of the changed global market environment and increasingly strict regulatory requirements and significantly reduced the complexity of its bank portfolio. The division has a worldwide network of correspondent banks that are hugely important for private customers and corporate clients in particular or are relevant for other areas of Commerzbank. Financial Institutions thus ensures that Commerzbank will remain the market leader for the settlement of Germany's foreign trade in the future. As such, Commerzbank will continue to support German and European export-oriented corporate clients with their international trading business in the world's main trade corridors. To promote trade financing, Financial Institutions has constantly expanded its involvement in trade facilitation programmes in the last few years to include new target markets, joining the programmes of the European Bank for Reconstruction and Development, the Asian Development Bank, the Inter-American Development Bank, the International Finance Corporation, the European Investment Bank and the African Development Bank.

Significant contribution to the digitalisation of international trade finance business

Alongside the traditional support for our customers' international business, Commerzbank now offers new, digitally-based solutions for financing the international trading activities of corporate clients and is thus playing its part in strengthening and optimising corporate clients' international supply chains. Commerzbank has taken a leading position in Europe with regard to the launch of the Bank Payment Obligation and is thus making a significant contribution to the digitalisation of international trade finance business. The Bank Payment Obligation is a new payment protection instrument in trade finance business which for the first time creates the additional possibility of confirming and thus making financeable a payment liability arising under an open invoice between banks.

Syndicated loan business hit by geopolitical events

In the Financial Institutions division, syndicated loan business is chiefly relevant for emerging markets. Market activity was considerably more modest in 2016 than in the previous year in certain markets, such as Africa or Eastern Europe, due to political, economic and strategic issues. However, Commerzbank nevertheless performed well even in this highly competitive environment.

Leading position in the Pfandbrief market and in unsecured bonds

We demonstrated our strong market position in the global Pfandbrief segment in the year under review, picking up various awards. For example, Global Capital named our successful Pfandbrief syndicate the Best Covered Bond Syndicate Manager. We became the leader in the German unsecured bonds market with a market share of just under 10%.

Equity Markets & Commodities

As part of the new "Commerzbank 4.0" strategy, in the medium term Commerzbank will spin off the business with investment and financial products and the associated market-making from the former Equity Markets & Commodities (EMC) area into a subsidiary. This is to concentrate exclusively on its core business as one of the leading European and Asian providers and market-makers for financial products. The next stage in the plan is to float the new subsidiary on the stock market.

EMC's performance in the year under review was significantly affected by various events. Muted investor demand, challenges associated with managing the risks of investment products, which arose due to the high level of stock market volatility, and the repositioning of the Securities Finance unit all had a negative impact on the division's earnings after several very successful years.

Despite these challenges EMC maintained its strong market position in 2016. The division actually further increased its market share thanks to its customer-oriented approach and state-of-the-art technology coupled with high-quality customer service and the ongoing development of its range of innovative solutions.

The division reaffirmed its position as one of Europe's leading producers and market-makers of financial products. This was borne out by the various accolades won by the Bank in 2016. In Certificate Awards, Commerzbank was named best issuer of the year in Germany by both the jury (Best Issuer 2016) and the public (Certificate House of the Year). Finanzen Verlag, meanwhile, named Commerzbank ETF House of the Year for its ComStage ETF platform. At the Structured Products Awards Europe 2016 we were named Nordic Region House of the Year for the fourth year in a row and Iberia House of the Year for the second year in a row. At the International Alternative Investment Review Awards 2016 Commerzbank was ranked first as Best ETF Market Maker Asia for the third time in succession.

Finally, Commerzbank was awarded Deal of the Year in the Structured Retail Products Asia Pacific Awards for its first transaction on Commerzbank EPFR Fund Flow Indices, a project developed jointly with and distributed by the United Overseas Bank in South East Asia.

Outlook for Corporate Clients

Following its strategic realignment and having clearly defined its core business, Commerzbank is now well positioned in the classic banking sector and has a business model that is fit for the future. In previous years the former Mittelstandsbank and Corporates & Markets segments, which have now been merged to form the new Corporate Clients segment, have been rigorously aligned with the real economy. They are to remain on this path. Based on the customer-centric advisory approach, over the next few years the Corporate Clients segment will implement initiatives designed to leverage earnings potential, increase efficiency and reduce complexity and to press ahead with the digital transformation.

We will leverage earnings potential by combining the two segments' strengths. Building on the new sales structure implemented in 2015 and the resulting improvement in our market position, we want to significantly expand our domestic customer base and increase our share of the core German market by acquiring and developing a further 10,000 customers by 2020. We want to maintain and strengthen Commerzbank's existing position as Germany's top debt house and use this as the basis for extending our leading role to the rest of Europe. In particular, the existing sector expertise of the former Corporates & Markets segment, which is currently geared to the needs of large multinational customers, will be gradually extended within the new Corporate Clients segment to encompass other Mittelstand companies in Germany and Western Europe. The vast majority of corporate clients should in future still be served by local corporate customer advisors in regional and international locations. When formulating solutions, these advisors will be supported by relevant product specialists and sector teams.

Following on from the realignment of the sales structure in Germany, further efficiency improvements are planned. These chiefly involve measures to ease the administrative burden on sales staff and streamline the IT landscape.

The implementation of the digital transformation will once again be a top priority in the current year as an enhancement to personal advisory services from corporate customer advisors. The online offering is being further expanded through the launch of new digital investment and financing services. This enables customers to view and purchase an increasing number of standard products online as an alternative or add-on to traditional advisory services. The Bank plans to develop some initial API (Application Programming Interface) banking prototypes. This concept will in future allow market participants to link their system landscape with Commerzbank and use this as the basis for offering or using new or integrated services. There will also be ongoing digital support for sales processes to further improve the accuracy, flexibility and efficiency of customer meetings. For our customers this means that they will in future receive even more rapid, flexible and targeted assistance.

Asset & Capital Recovery

The Asset & Capital Recovery segment, which was reported for the first time in the first quarter of 2016, comprises the complex financings of the portfolios in the areas Commercial Real Estate (CRE), Ship Finance (SF) and Public Finance (PF).

The ACR run-off strategy aims to systematically reduce the individual segment portfolios in a way that preserves value and minimises risk. The aim of this asset reduction is to free up capital so that it can be employed in business areas offering higher returns.

Performance

Table 11

€m	2016	2015[1]	Change in %/%-points
Income before provisions	213	76	.
Loan loss provisions	–599	–361	65.9
Operating expenses	128	181	–29.3
Operating profit/loss	**–514**	**–466**	**10.3**
Capital employed	3,313	4,182	–20.8
Operating return on equity (%)	–15.5	–11.1	–4.4
Cost/income ratio in operating business (%)	60.1	238.2	.

[1] Prior-year figures restated due to a change in reporting plus other restatements (see notes page 139 ff.).

Since the transfer of assets with good credit quality and low earnings volatility from the former Non-Core Assets (NCA) segment to various Bank segments with effect from 1 January 2016, we have further run down the assets remaining in Asset & Capital Recovery (ACR), which chiefly comprise more complex sub-portfolios with long maturities.

The total volume (exposure at default, including non-performing loans) was reduced by more than €2bn to €16.2bn over 2016 as a whole. In commercial real estate financing and ship financing in particular – the latter despite opposing currency translation effects and the ongoing very difficult situation on the shipping markets – there were further significant reductions in loan portfolios. In the case of public finance exposures, the majority of which have very long residual maturities, the basic strategy is to hold them to maturity.

The ACR segment recorded an operating loss of €–514m in 2016, after €–466m in the previous year. Total income before loan loss provisions rose by €137m to €213m. A major contributor to this was the partial write-up of €135m on the earlier exposure to HETA Asset Resolution AG (Heta). A substantial expense was incurred in the previous year for the 50% write-down on this exposure.

Net interest and trading income fell by €146m to €85m. This was linked primarily to the additional income generated in 2015 from measures to restructure funding that were not repeated in the period under review. The continuing reduction in the portfolio also entails a corresponding reduction in current interest income. The positive net investment income figure of €141m, compared with €–207m in the previous year, reflects the above-mentioned fluctuations in the value of the Heta bonds, which have now completely been reduced.

The loan loss provisions of €–599m, after €–361m in 2015, were largely attributable to ship financing. By contrast, commercial real estate financing required only minor valuation allowances on a similar scale to the previous year.

The sharp fall of 29.3% in operating expenses to €128m was due to the further reduction in the ACR portfolio year-on-year and a significant adjustment in headcount.

Overall, the ACR segment posted a pre-tax loss of €–514m in 2016. The loss thus increased by around 7% compared with the same period of the previous year, which included restructuring provisions of €16m.

Main developments in 2016

Reduction strategy continued

The first quarter of 2016 saw the planned transfer of some of the remaining assets from the former Non-Core Assets (NCA) segment to what were then the Private Customers and Mittelstandsbank segments and to the Others and Consolidation division. The assets concerned were all non-impaired assets with good internal ratings. The criteria for the transfer of assets were credit quality, volatility of income and the ability to integrate the assets into the refinancing and liquidity structure of the units concerned. The new segment, renamed Asset & Capital Recovery (ACR), essentially retains complex sub-portfolios with long maturities and with volumes of initially around €18bn (EaD including NPLs) which do not meet, or only partly meet, the specified delimitation criteria. A substantial portion of the commercial real estate and ship financing loans (EaD: around €8bn) were transferred to the former Mittelstandsbank segment, while Others and Consolidation took over the lion's share of the Public Finance portfolios (EaD: around €36bn). The Private Customers segment also took over a small volume (EaD: around €2bn) of private real estate loans.

For all assets bundled in the ACR segment, a reduction plan for all ACR portfolios is being drawn up as part of the comprehensive management plan. The focus of the portfolio reduction is on reducing EaD (including NPLs). The priority here is to reduce the more risky assets. The management of ACR also has an efficient toolkit for reducing the portfolio. In addition to active restructuring and the use of market opportunities, improved access to investors and capital markets in recent years has made it possible to reduce assets in a selective manner by selling sub-portfolios, provided capital is freed up as a result. The value-preserving portfolio reduction in 2016 is reflected in the 12% year-on-year fall in EaD (including NPLs) in the ACR segment to around €16bn. The EaD volume of the CRE and ship finance portfolio stood at around €7bn as at the end of 2016. Risk-weighted assets (RWA) fell by €1bn year-on-year to €21bn. The secured funding for ACR's activities comes from lettres de gage publiques and ship Pfandbriefe. Securities repo transactions also play a role in funding the portfolio. Optimising the funding structure – through active cover pool management, for example – is an important component of the reduction strategy. The ACR segment still has sufficient numbers of highly qualified staff with many years of experience in the different asset classes. The operating stability of the units within the ACR segment is assured.

Commercial Real Estate

In 2016 the total CRE volume (EaD, including NPLs) was further reduced by €0.7bn or 21% to €2.5bn through active management. In CRE Germany, which still accounts for around 33% of the total exposure, EaD declined by 41% to €0.8bn. In CRE International, which accounts for around 67% of the total portfolio, EaD fell by 5% over the course of 2016 to €1.6bn. The breakdown of the overall portfolio by type of use is as follows: the main components of the exposure are the sub-portfolios office (€0.5bn), retail (€1.2bn) and logistics (€0.3bn).

Ship Finance

In 2016 the volume of the former Deutsche Schiffsbank AG portfolio (EaD including NPLs) booked in ACR was reduced by €1.3bn from €6.1bn to €4.8bn. As the portfolio is mainly denominated in USD, the net fall of 22% included the effect of euro depreciation during the year, particularly against the US dollar. At constant exchange rates the portfolio reduction would have been €0.1bn greater. Aside from the ongoing reduction in problem loans at individual loan level, the focus of reduction activities in 2016 was on the sale of selected loans from the performing loan book.

The future speed of portfolio reduction will continue to depend crucially on the performance of the shipping markets, where general conditions did not significantly improve in 2016.

The portfolio is divided principally between three standard types of ship, namely containers (€1.7bn), tankers (€1.0bn) and bulkers (€1.1bn). The rest of the portfolio (€1.0bn) consists of various special tonnages which are well diversified across the various ship segments.

Public Finance

The Public Finance portfolio consists mainly of loans to local authorities, other public-sector or quasi-public-sector institutions, companies or financing institutions.

EaD fell by €0.3bn over the year to €9.0bn, primarily as a result of maturities. Most of the exposure is in western Europe and North America.

Outlook for Asset & Capital Recovery

Partly because the ACR segment has in the past comprised a large proportion of high-quality assets, we were able to press on with the continual reduction of non-core portfolios and associated risks.

The run-off strategy for the ACR segment will be rigorously pursued in the coming years. The aim is still to run off the remaining portfolios and residual risks completely over time in a way that preserves value and releases capital. Opportunities to sell assets and portfolios will therefore continue to be taken in cases where a sale makes economic sense. By the end of 2019, the ACR segment aims to further substantially reduce the CRE and SF portfolios to a level in the low single-digit billions. This represents a reduction of at least one-half compared with the value of the portfolios at the time of the transfer, which was just under €10bn.

The low interest rate environment that is set to persist in 2016 and beyond, along with the investment pressure on both large and small investors, continues to make real estate a relatively attractive asset class, especially in the eurozone. Stable market conditions are expected for the short to medium term.

There is still overcapacity in the markets for containers and bulkers, and this was again reflected in very low charter rates. It was not until towards the end of 2016 that charter rates for bulkers began to recover from the historic lows recorded at the start of the year. Tanker charter rates also came under pressure in 2016, although the situation was not as difficult as for containers and bulkers due to the strength of the market in 2014 and 2015. As a result, some of the loans for ships affected by the crisis can no longer be serviced as contractually agreed. This situation does not look like changing in the foreseeable future, so a lasting recovery in the shipping market in 2017 is unlikely.

The future performance of the Public Finance portfolio is dependent on political, economic and monetary developments, particularly in Europe and the USA. The Public Finance division will continue to seek out and make use of opportunities for asset and portfolio reductions that are focused on risks and do not harm profits.

Others and Consolidation

The Others and Consolidation segment contains the income and expenses which are not attributable to the business segments. Reporting for this segment under “Others” comprises equity participations that are not assigned to business segments, overarching Group matters such as costs for Group-wide projects, effects resulting from the purchase price allocation in connection with the Dresdner Bank takeover, specific individual matters that cannot be allocated to the segments, and Group Treasury. The costs of the support functions, which – except for restructuring expenses – are mainly charged to the segments, are also shown here.

Consolidation includes income and expense items that represent the reconciliation of internal management reporting figures shown in segment reporting with the Group financial statements in accordance with IFRS. Shown here too are the costs of the staff and management functions, which – except for restructuring expenses – are also mainly charged to the segments.

The segment recorded an operating loss of €–453m in 2016 compared with €–338m in the previous year. The €115m decline was mainly due to the performance of Group Treasury, which was unable to repeat last year’s very good result. Taking into account restructuring expenses of €107m in connection with the optimisation of internal processes, Others and Consolidation recorded a pre-tax result of €–560m in 2016, compared with €–379m in 2015.

Our employees

Engaged and capable employees make a vital contribution to Commerzbank's success. Our HR activities ensure that our employees work where they can best deploy their talents in line with the needs of the Bank. Our aim is to create an attractive environment for our employees through our working conditions and development prospects. At the same time, we are addressing the demands posed by the Bank's new business model. Our corporate culture is centred around a shared leadership philosophy and our ComValues and Code of Conduct, which, especially during periods of change, are the key pillars supporting fair and competent interactions with colleagues and with our customers and business partners.

Table 12

Actual number employed	31.12.2016	31.12.2015
Total staff Group	49,941	51,305
Total staff parent bank	35,211	36,884

At year-end 2016, the Commerzbank Group employed 49,941 staff, a decrease of 1,364 employees compared with year-end 2015. The number of full-time equivalents was 44,267, compared with 45,419 in the previous year. The following table shows full-time employees at year-end by segment and by staff/management and support function. The staff/management functions perform central Group management tasks. The support functions ensure that the business processes underlying the Bank's operations run smoothly. The costs of the staff/management and support functions are mainly charged to the segments on the basis of an internal allocation formula.

Table 13

Full-time personnel	31.12.2016	31.12.2015
Private and Small-Business Customers	20,946	21,770
Corporate Clients	6,611	6,938
Staff/management functions and Support functions[1]	16,710	16,711
Group total	**44,267**	**45,419**

[1] Staff/management functions: Group Audit, Group Communications, Group Compliance, Group Development & Strategy, Group Finance, Group Human Resources, Group Investor Relations, Group Legal, Group Treasury and the central risk functions. Support functions: Group Banking Operations, Group Markets Operations, Group Information Technology, Group Organisation & Security and Group Delivery Center. The staff/management and support functions are combined in the Others and Consolidation division for reporting purposes.

Most employees in the Commerzbank Group (around 75%) work in Germany. Their average length of service with Commerzbank Aktiengesellschaft (Germany) is around 20 years; 20% have worked for the Bank for up to 9 years, 30% for between 10 and 19 years, and half for 20 years or more. The employee turnover rate in 2016 was 3.7%, compared with 3.2% in 2015.

HR supports the Bank's strategy process

Commerzbank presented its "Commerzbank 4.0" strategy in the year under review. Our new strategy calls for the systematic realignment of the Bank. HR work plays a key role in the successful implementation of the business model. While not the aim, headcount reduction is an unavoidable outcome of this transformation to "Commerzbank 4.0".

HR is advising and supporting the Bank's segments with their change processes and providing assistance with committee negotiations. We will deploy all of our HR tools responsibly and professionally to ensure that the headcount reduction takes place in a socially responsible manner.

Providing direction and anchoring a "culture of integrity" for the long term

The implementation of our strategic objectives entails far-reaching changes in the Bank. We are supporting this in our HR activities by providing professional advice and assistance for managers and employees. Through our value-oriented and binding guidelines on management conduct in the Bank we are creating a uniform standard and supporting skilled and fair interactions between employees and managers.

The ComValues and Code of Conduct on which our corporate culture is based mean we are well positioned to successfully implement the Bank's change process. HR also plays a key role in implementing compliance measures. These range from the recruitment process to compliance training and the long-term anchoring of our Code of Conduct, thus helping to forge a "culture of integrity" in the Bank.

HR activities are geared to the Bank's objectives

HR activities are geared systematically to the Bank's strategic objectives and business model. Commerzbank redefined its HR policy guidelines in 2015 and restructured the HR division in the year under review to ensure it is fit for the future. The restructuring focused in particular on creating an efficient and customer-oriented organisation and working methods. For example, we have already standardised, digitalised and in some cases outsourced a large number of processes. Strategic HR planning also helps us examine medium- to long-term changes in staffing levels and requirements on a systematic and regular basis. Using model-based simulations we can propose management measures at an early stage to indicate how many employees and with what skills we need when and where in the Bank. HR thus helps ensure that the Bank remains competitive and fit for the future.

Identifying and utilising potential in the best possible way

The changing banking sector is also having an effect on the work environment. Life-long learning is the key to long-term success. In an industry marked by upheaval, we need employees who continuously review and expand their skills. With development-oriented procedures and individually customised training we are applying new approaches to the selection, appointment and development of managers and project managers. We have also created uniform Bank-wide standards for employee training and development in the form of the Competence Dialogue. Each employee meets with their line manager to consider the employee's specific competencies. This enables us to determine training and development needs at an early stage and develop and expand the competencies required by our employees. About 17,000 employees took part in the Competence Dialogue in the year under review to evaluate their professional fitness. We have thus laid the foundations for identifying and promoting potential in the best possible way.

Bank and employees are committed to stable pension provision

Occupational pension provision is a key pillar of our HR benefits. To safeguard provision despite the ongoing low interest rate environment, the members of the BVV (BVV Versicherungsverein des Bankgewerbes a. G. and BVV Versorgungskasse des Bankgewerbes e. V.) approved a reduction of the guaranteed interest rate on new contributions under old agreements in order to stabilise pension provision. In the year under review, members on both the employer and the employee side at Commerzbank voted by a large majority to approve this measure. The Bank is compensating the resultant reduction in guaranteed pension entitlements in full, thereby affirming its commitment to ensuring stable pension provision for its employees.

A working environment free of prejudice creates acceptance and trust

Diversity is the cornerstone of our corporate culture and is an integral component of our HR work. We encourage the diversity and individual development of our employees, as we firmly believe that this also benefits us as a company. We want to maintain our clear position on these issues and anchor them even more strongly among our managers and employees.

To mark the tenth anniversary of the "Charta der Vielfalt e. V." (Diversity Charter) association, Commerzbank organised a diversity workshop in September of the year under review along with the fourth Diversity Day, featuring numerous campaigns and workshops on the topic of digitalisation for employees in Frankfurt.

A good work/life balance improves performance for the Bank

We want our employees to achieve the best possible balance between their professional and personal lives. This balance is becoming increasingly important for fathers as well. The Focus on Fathers network initiated by Commerzbank has been making an important contribution to equal opportunities in companies for many years. The number of fathers who take parental leave, work flexibly or work part-time is rising continuously. By way of example, 16.9% of fathers took an average of 2.2 months parental leave in the year under review alone. We believe that employees with a good work/life balance are more motivated and perform better.

For this reason we support fathers and mothers with flexible working time models, opportunities to work from home and child-care services. We also offer information events and networking opportunities on these topics both within and outside the Bank.

Caring for family members is also important to us. With this in mind, Commerzbank in Germany offers a unique range of services for its employees and for many years has provided comprehensive assistance and services on the subject of care in cooperation with professional partners. In the year under review, Commerzbank employees had the opportunity to participate for the first time in a nationwide online seminar and pick up practical tips on caring for family members.

Women in management positions

As in the previous year, putting women in management positions was once again a key target for Commerzbank in 2016. The Bank was able to employ more women in management positions (29.8%) in the year under review than in 2015. Our aim is to further increase the proportion of women in management positions. We therefore pursue an approach whereby a position should be filled solely on the basis of an employee's qualifications and expertise.

Framework for healthy working

We firmly believe that employees only remain motivated and effective over the long term if they are in good physical, mental and social health. We therefore encourage our employees to work and live healthily through our holistic and sustainable approach to occupational health management. Our diverse offering covers topics including movement, nutrition, stress management and addiction prevention. For example, we gave our employees an incentive to get themselves moving by taking part in the Global Corporate Challenge (GCC) step challenge for the third time. Commerzbank's employees exceeded the target of covering at least 10,000 steps daily over a period of 100 days.

Not only the physical but also the psychological health of our employees is very important to us. Commerzbank employees experiencing difficulties in their professional or personal lives can seek expert advice through initiatives such as the Employee Assistance Programme (EAP). Social health is promoted through the roughly 160 company sports groups throughout Germany, with over 16,000 members taking part in more than 50 different sports.

Remuneration

As a result of the increased significance arising from greater regulation, remuneration of all employees below the level of the Board of Managing Directors is disclosed in a separate report (Remuneration Report pursuant to Section 16 of the Remuneration Ordinance for Institutions (Institutsvergütungsverordnung)). This is published annually on the Commerzbank website at www.commerzbank.com.

Outlook and opportunities report

Future economic situation

The development of the global economy in 2017 will once again be determined by geopolitical risks as well as the economic development of emerging markets. The spotlight here remains on China, where inefficient state-owned companies have continued to invest strongly even though their profits have not increased. The investment is funded by the state-owned banks – at the expense of healthy private companies. This is likely to weaken the Chinese economy for many years. The 2017 outlook for other emerging markets also remains modest, however, as the increase in key interest rates in the USA also means the end of a decade of cheap money. Only those countries whose exports are dominated by commodities are likely to see an improvement in their economic situation, as they should benefit from the ongoing recovery in commodity prices.

We expect the US economy to grow by 2.3% in 2017. There is likely to be a renewed sharp increase in domestic demand, but the change of economic policy will not have any greater impact. It is highly unlikely that the tax cuts promised during the election campaign will be implemented in full, as that would trigger an excessively steep rise in the budget deficit. Furthermore, taxes would not fall until the second half of 2017 or early 2018. The planned infrastructure investments will probably also have only a limited impact on demand.

The US Federal Reserve is likely to raise key interest rates again in 2017 as the US economy is nearing full employment. Wages are already rising more quickly, pointing to higher inflation over the medium term.

Table 14

Real gross domestic product Change from previous year	2016	2017[1]	2018[1]
USA	1.6%	2.3%	2.3%
Eurozone	1.7%	1.8%	1.6%
Germany	1.9%	1.6%	1.5%
Central and Eastern Europe	1.1%	1.9%	2.3%
Poland	2.8%	3.3%	2.8%

[1] The figures for 2017 and 2018 are all Commerzbank forecasts.

The eurozone economy is set to grow by 1.8% in 2017, slightly more strongly than in 2016, despite the unresolved problems in emerging markets. The ECB's loose monetary policy is having an ever-greater impact on the real economy: the low interest rates are making the still high debt levels of many companies and households more sustainable. Unemployment will continue to fall thanks to the solid economic growth. However, this is unlikely to have much impact on weak wage inflation. This means that underlying inflation will also remain weak, although the energy price trend will push the average rate of inflation for 2017 to well over 1%. The UK's vote in favour of leaving the EU will have no further impact on the eurozone economy. For one thing, it will probably be several years before the UK actually leaves. We also anticipate that it will ultimately conclude an agreement with the EU that minimises the economic disruption.

The German economy is set to grow slightly more slowly in 2017 (1.6%) than it did in 2016. However, this is due solely to the lower number of working days compared with 2016. The upturn is still being driven by consumption. Although wages will increase more slowly in real terms than in 2016 due to higher inflation, private consumption is likely to increase at a similar rate to the previous year thanks to the ongoing rise in employment. Beneath the gloss, however, there are increasing numbers of undesirable developments. Growth in the unit labour costs of German companies has been outpacing the rest of the eurozone for the last six years. And in the property market, low interest rates are driving up prices, especially in the major cities.

The US interest rate reversal and the continuation of the ECB's expansive monetary policy will once again shape the financial markets in 2017. Yields on ten-year Bunds are likely to rise less than those on the equivalent US securities. The DAX should climb in 2017, albeit with high volatility: its dividend yield of just under 3% looks attractive in light of the ECB's set-in-stone zero interest rate policy, and this gives scope for further rises in the price/earnings ratio. There is unlikely to be any significant further weakening in the euro/dollar exchange rate in 2017, as the markets have already priced in a sufficient number of rate increases by the US Federal Reserve.

Table 15

Exchange rates	31.12.2016	31.12.2017[1]	31.12.2018[1]
Euro/US-dollar	1.05	1.04	0.99
Euro/Sterling	0.85	0.87	0.85
Euro/Zloty	4.40	4.50	4.60

[1] The figures for 2017 and 2018 are all Commerzbank forecasts.

Future situation in the banking sector

Our views regarding the expected development of the banking sector over the medium term have not changed substantially since our statements published in the Interim Report as at 30 June 2016.

The persistently low interest rate environment and modest global economic growth are shaping the international banking environment. Increased political uncertainty in developed economies and ongoing fragility in emerging markets carry the danger of a very sudden reassessment of global risks leading to abrupt contagion effects. The markets appear to have largely priced in the USA's new economic and inflation picture already. Worries over the sustainability of high public and private debt levels keep flaring up and can increase banks' credit risks, which up to now have played a key role in stabilising earnings. Regulators are already showing concern over the volume of non-performing loans in certain eurozone countries. The low interest rate policy has impeded the clean-up of balance sheets in some countries, and the high debt levels will affect the eurozone economy for many years to come. The future course of global banking regulation has also become less certain following the US elections, while changes in the use of proprietary models to calculate capital requirements could have a negative impact on European banks and regulatory uncertainty due to the lack of international consensus may impair the functional capacity of the banking sector. There is therefore no imminent prospect of an "end to the era of regulation", as has occasionally been postulated in recent times.

As outlined above, political developments and events have become considerably more relevant for the banking sector. The financial and debt crises and growing geopolitical risks have now been joined by social trends such as disintegration and nationalism, which have the potential to repeatedly unsettle key financial sector customers such as (private and corporate) investors and exporters, particularly as they cast doubt on fundamental principles of economic policy – such as free global trade and European integration – and create disruptive risks.

There is also ongoing uncertainty on the markets regarding the capital adequacy and profitability of European banks. The focus remains on individual business models for sustainable profit generation and stress resistance in the low interest rate environment. One of the main challenges still facing banks is to adapt their business models – in view of ongoing overcapacity in some countries coupled with new technology-driven competitors – to the changed conditions, reduce costs and increase profitability. This means pushing ahead with the systematic modernisation of banking operations and making sufficient capacity available for digitalisation.

All in all, the eurozone banking sector is still in the middle of a long-term structural transformation triggered by the crisis of the last few years. The stronger capital base is offset by reductions in implicit government guarantees, stricter rules on resolution and greater creditor loss participation. A further reduction in leverage exposure levels and improved asset quality in an increasingly digitalised and automated industry are still essential if the banking sector is to meet the tougher requirements of banking supervisors and fulfil investor expectations.

The pressure on the banking sector has increased as a result of regulation, structural transformation and competition; reducing this is made even more difficult by the limited scope for stabilising margins in the future due to the still low level of investments rates on new lending business – despite a slight increase in long-term yields and a slightly steeper yield curve – and the uncertainty of achieving additional relief by further reducing loan loss provisions. The increased use of internal and alternative external funding sources, together with still relatively weak capital expenditure activity, will prevent a significant revival in lending business with corporate clients. Foreign business is only likely to gain limited momentum, as global trade growth is sluggish. In private customer business, stimulus in Germany is coming mainly from the record-high level of employment and the still good prospects for real estate lending. However, the pressure to adapt and keep down costs in lending business is higher than it has been for a long time.

The outlook for banking in Poland has been dampened by the change of economic policy. While the plan for dealing with mortgage loans denominated in Swiss francs has eased the situation, we still expect the banking sector to come under pressure from the newly introduced bank levy and other potential measures to increase the government's influence.

The Polish economy has also been somewhat disappointing of late, which is primarily attributable to weaker capital spending due to factors such as lower inflows of funds from the EU. Foreign trade has also ceased to be a growth driver, however, while the impact of social transfers fell short of expectations. Although growth forecasts have been revised downwards, Poland remains on a solid growth path in 2017. The predicted economic growth should generally boost credit volumes, and the solid position of private households and the corporate sector will be reflected favourably in banks' risk costs.

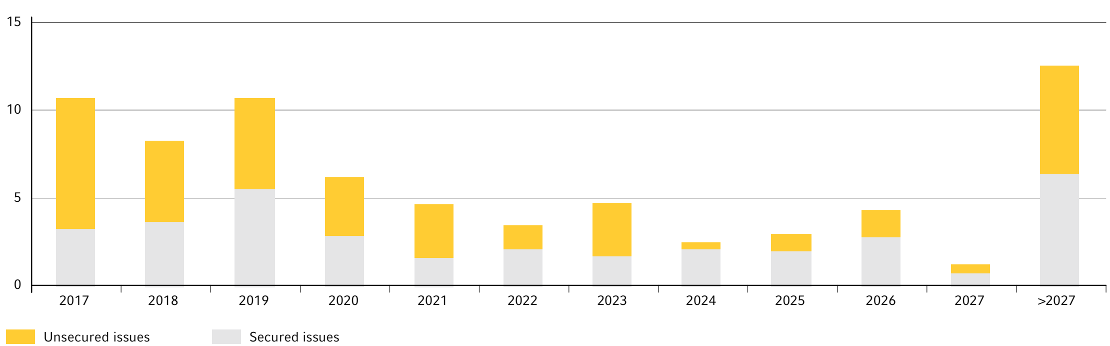
Financial outlook for the Commerzbank Group

Planned funding measures

Commerzbank anticipates a capital market funding requirement of less than €10bn over the coming years. Commerzbank offers a broad range of products in the capital market. In addition to unsecured funding instruments such as senior unsecured and Tier 2, Commerzbank can also issue secured funding instruments, in particular mortgage Pfandbriefe and public-sector Pfandbriefe. These give Commerzbank stable access to long-term funding with cost advantages compared with unsecured sources of funding. As such, Pfandbriefe are a key element of Commerzbank's funding mix. Issuance formats range from large-volume benchmark bonds to private placements.

Figure 5

Group maturity profile of capital market issues as at 31 December 2016
€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 just under €1.2bn in 2017. Around €700m of this will be on IT. The Bank's biggest areas of investment are digitalisation (around 40%), regulation (around 30%) and infrastructure (just under 20%).

Private and Small-Business Customers

The main investment targets for the branch bank in 2017 are initiatives relating to the "Commerzbank 4.0" strategy and compliance with regulatory requirements.

Digitalisation measures include in particular further investment in the new multi-channel platform ONE. The speed of implementation of changes in this multi-channel platform is being further increased through a simplified IT landscape and the systematic expansion of functionalities. Maintenance costs are being reduced by decommissioning individual systems, using individual components throughout the entire Group and increasing standardisation. Compliance requirements can be fulfilled more easily by harmonising processes, products and services. For example, the platform makes it possible to connect fintech companies, thus making the business model more flexible.

There will also be further investment in Commerzbank's sales platform. The findings from analyses of customer needs will be fed in a targeted manner to channels such as branches, customer center or online banking to permit an industrialised, scaled and automated customer approach and customer service. Tailored offerings targeted at specific needs increase customer satisfaction and promote cross and upselling. This calls for the efficient use of big data as part of digital customer relationship management (DCRM). In-depth analysis of internal and external data identifies untapped customer potential and allows the Bank to generate tailored offerings. Analytical DCRM is also used to generate leads: the leads generated (prospects) are collected, managed and processed in a targeted manner in the customer pool. Budgets for marketing and sales campaigns can then be allocated more efficiently.

The Bank will also invest in the creation of its own instalment loan platform this year. Commerzbank and BNP Paribas have agreed to divide the joint company Commerz Finanz GmbH into two parts. In 2017, Commerzbank plans to take instalment loan business on to its own books as a profitable growth area.

Digital asset management rounds out Commerzbank's custody account portfolio and satisfies customer demands for digital offerings in asset management too. Digital asset management will go live in comdirect during 2017.

Implementing the wide range of regulatory requirements in a timely and customer-centric manner remains the Bank's top priority. A significant portion of the Bank's investment is going on implementing the requirements for business processes under the EU's MiFID II Directive and directly applicable MiFIR Regulation published in 2014.

One of the key requirements for improving the efficiency of business with private and small-business customers is a lean infrastructure with modern branch formats. To ensure broad market coverage coupled with cost-effective management, there is clear differentiation between the various branch formats. Flagship branches offering a full range of services for all customer segments are embedded in a network of city branches focusing on day-to-day services and standardised products. Following the design phase in 2016, the branch formats are being rolled out in the current year with the opening of more flagship and city branches.

The main focus of the Small-Business Customers division in 2017 will be on implementing the target vision developed as part of "Commerzbank 4.0". Investments will be geared primarily to further developing the digital offering and expanding the product range for small and medium-sized enterprises.

mBank will continue its organic growth in 2017 and further expand its business model focusing on mobile and direct banking. It will also continue to invest heavily in innovative financial services. The 2017 investments are intended to consolidate and develop mBank's digital expertise as a unique selling point that sets it apart from the competition. As a result, mBank is to invest in the development of the mobile (banking) first approach for both private customers and corporate clients in 2017 to guarantee customer-oriented, multi-channel access to the Bank and boost use of the mobile banking channel among customers. For example, the applications are to be made even more user-friendly, customers are to be given new tools for analysing their financial situation and online communication with customers is to be expanded.

Changing customer behaviour, due not least to demographic trends, calls for the development of a comprehensive understanding of customers and their needs. This is particularly crucial with regard to the younger generation and plays a key role in new customer acquisition and customer retention. Targeted investments should help ensure that a sustainable range of solutions is developed based on knowledge of customers and that the right solutions find the right customers. mBank's efficiency is to be further improved through investments in the standardisation and digitalisation of processes, thereby ensuring it remains profitable in the future.

The optimisation of the mBank branch network will continue as part of the One Network project with the opening of more advisory centres and "light branches". mBank will also invest in a new headquarters for the private customer business in Lodz in 2017. mBank wants to strengthen its innovation culture through a modern working environment that encourages creativity. Investments are also planned in IT security and to improve the IT infrastructure.

Corporate Clients

The systematic digitalisation of corporate customer business will once again be a key investment priority in 2017. The segment plans to significantly expand its range of digital investment and financing services offered online, meaning that corporate clients will in future be able to view and purchase more standard products online. New sales applications will also be made available to customer advisors; in addition to providing a 360-degree view of customers they will also relieve advisors of administrative tasks. The new data analytics platform is also due to be commissioned in 2017.

Investments will also focus on implementing the regulatory requirements relating to market infrastructure and fair advisory services as defined in the MiFID II and MiFIR requirements. These include significantly expanding the capacity available for storing and evaluating order and transaction data and enhancing product advisory documentation, but also improving the recording and evaluation of telephone advisory discussions.

Trading activities are to be simplified, in part by significantly streamlining the IT platform and downstream functions. To achieve this, investment will be necessary during the initial phase to create a highly efficient and clearly simplified IT landscape along the entire value chain and thus generate significant efficiency gains going forward.

The segment will also invest in separating out its equity products and exotic commodity products businesses in order to create a suitable infrastructure for the legal and IT separation.

Campus/journeys

Commerzbank is transforming itself into a digital technology company in order to speed up service provision for customers while improving efficiency and cost-effectiveness within the Bank. One of the Bank's strategic objectives under "Commerzbank 4.0" is to implement end-to-end digitalisation for 80% of relevant business processes in the next four years. To this end, Commerzbank will launch nine major digitalisation projects in the current year, with around 700 employees working on these projects in the first quarter of 2017 alone. The digitalisation will not be approached in the same way as traditional projects, but grouped into thematically related process bundles known as master journeys. Responsibility for each lies with a lead executive, while implementation of each journey is driven by two members of the Board of Managing Directors as sponsors. The objective is not specified in detail but instead defined as a solution space that the teams approach in short intermediate stages known as sprints. The only hard stipulation is the prescribed deadline. Current digitalisation projects have already been bundled together in a digital campus where new working methods are tested and developed.

Back office

Commerzbank will continue with the ongoing optimisation of the back office IT structure. There will also be significant investment in the payment transactions and securities platform. The Group-wide integration of the accounting and risk processes in reporting and the development of a joint risk and finance platform will be continued as part of the Strategic Architecture Finance and Risk (SAFIR) project.

The compliance function will be reinforced in connection with the further development of legal compliance and ethical principles.

Ever stricter regulatory requirements mean Commerzbank needs to make substantial investments in order to comply with national and international standards. Comprehensive reporting requirements such as IFRS 9 and the implementation of regulatory provisions are increasing the cost of gathering information and reporting it to the banking authorities.

Anticipated liquidity trends

In 2016 the eurozone money and capital markets were again characterised by the monetary policy measures implemented by the ECB to support the economic recovery in the eurozone and prevent deflationary trends.

The ECB has made an additional €60bn of liquidity available each month through the securities purchase programme, raising it to €80bn each month from April. The monthly purchase volume will remain at €80bn until the end of March 2017 and will then be reduced to €60bn each month until the end of December 2017. The ECB also plans to purchase securities with a yield below the deposit facility rate and has reduced the minimum remaining maturity under the purchase programme to one year. The ECB further issued three funding tranches in December 2016 under its targeted longer-term refinancing operations (TLTRO-II), thereby providing around €123bn of liquidity for the banking sector after deduction of the repayments under TLTRO-I. The excess liquidity in the system has therefore increased on an ongoing basis and as at the end of 2016 stood at around €1,200bn. We expect a further increase in excess liquidity in the eurozone in 2017 due to the continuation of the purchase programme. The translation into demand for credit will remain modest.

Overall, we expect secondary market liquidity on European bond markets to decline further as a result of the heavy activity by the ECB and the persistently negative yields on many government bonds.

The restrictive regulatory environment and ECB interest rate policy are still having a severe limiting effect on turnover in the repo market. The ECB's asset purchase programme is leading to an even greater shortage of collateral. Owing to the high excess liquidity in the market, the volume of longer-term securities repo transactions is severely restricted.

Liquidity trends on the bond markets will also continue to be dictated largely by the ECB's activities. Secondary market liquidity, which has already been significantly reduced, will continue to fall due both to the situation in the repo markets and to the ECB's activities. We still expect yields to be negative up to maturities of three years and credit spreads to be narrow.

Commerzbank's liquidity management is well prepared to cope with changing market conditions and able to respond promptly to new market circumstances. The Bank has a comfortable liquidity position that is well above internal limits and the currently applicable requirements prescribed by the German Liquidity Regulation and MaRisk.

Our business planning is done such that a liquidity cushion can be maintained commensurate with the prevailing market conditions and related uncertainties. This is supported by the Bank's stable franchise in private and corporate customer business and its continued access to secured and unsecured debt instruments in the money and capital markets.

Managing opportunities at Commerzbank

The demands placed on modern, sustainable banking business have changed markedly in the past few years. The pressure on profitability has increased significantly in respect of both earnings and costs. Whereas in the past, personal customer relationship management was a key element of banking, these days our customers expect multi-channel advisory services, digital financial offerings and individual, tailor-made products. We are rising to these challenges with the strategic initiatives we have launched and in some cases already successfully implemented. But we face additional challenges from increasingly stringent regulatory requirements.

With this in mind, the constant review of internal processes, structures and technical platforms to make ourselves leaner, more efficient and more customer-oriented is not a one-off project but an ongoing process that will occupy us over the coming years and should enable us to largely counteract the significantly tougher requirements.

The "Commerzbank 4.0" strategy announced in autumn 2016 has three main thrusts. Firstly, we are concentrating on businesses with clear competitive advantages and selling non-core activities. Secondly, we are transforming ourselves into a digital technology company. And thirdly, we are simplifying the Bank's structure and thus boosting our efficiency. Our aim is to be the leading bank in Germany for private, small-business and corporate clients. We want to provide a modern and considered range of digital and personal services, close to the customer and offering fast and efficient processing. The Bank will in future concentrate its customer activities in two strong sales segments – Private and Small-Business Customers and Corporate Clients.

By 2020 the Private and Small-Business Customers segment will become Germany's first truly digital multi-channel bank. The key elements of this are digital and analogue service offerings, new sales platforms and a differentiated branch concept.

Our network of around 1,000 branches retains its vital central role, but we want to achieve faster growth by combining digital platform strategies with modern branch formats. The "ONE" sales application launched at the end of last year is a standardised technical platform for online and branch sales. Broad-based market coverage is assured through flagship branches focusing on advisory services and city branches that combine efficient customer service with a reduced infrastructure and lower operating costs. With the aim of gaining two million net new customers in the German market by 2020, the Bank is offering attractive products such as digital instalment loans and digital asset management and working with partners such as Tchibo, Amazon and Lufthansa. Small-business customers are handled in a separate business unit within the Private and Small-Business Customers segment. We combine strong expertise in private customer business with the credit know-how of Mittelstandsbank. New digital offerings coupled with a nationwide local presence will enable us to significantly increase our share of the business customer and smaller Mittelstand customer markets from 5% to 8%. The holistic advisory services take both business and private considerations into account.

The new Corporate Clients segment combines the Bank's traditional strengths in corporate banking – a national presence coupled with support for customers entering international markets, a unique relationship management model and a leading range of trade and export financing services – with the capital market know-how of our investment bank. We are thus creating the optimal framework for developing solutions tailored to the specific needs of larger companies. We will also leverage our expertise in Germany's key industries at a European level in order to better harness it for international growth. Our aim is to be the leading provider of hedging products for corporate clients and the number one debt house in Germany. We strive to ensure a uniformly high quality of advice worldwide. Corporate customer advisors in Germany not only coordinate the involvement of product specialists, they also work with the Bank's global client service teams. The multilingual relationship managers and specialists on the European desks in their global markets are in constant contact with corporate customer advisors in the domestic market.

We will transform the Bank into a digital technology company across all segments. Over the next four years we will implement end-to-end digitalisation for 80% of relevant business processes.

The digital campus will become the engine driving the Commerzbank transformation, testing and developing new, agile working methods and new forms of cooperation. For example, a standardised, cloud-based customer relationship management system for private, small-business and corporate clients is due to be launched in the second half of the year.

The specific opportunities arising for the two customer segments this year are described in the corresponding parts of the "Segment performance" section.

Anticipated performance of the Commerzbank Group

Commerzbank posted a solid result in the 2016 financial year despite some difficult conditions, and with "Commerzbank 4.0" it laid key strategic foundations for achieving a sustainably higher level of profitability in the years ahead. In 2017 Commerzbank will focus on implementing this strategy and on taking further measures to stabilise earnings against the impact of negative interest rates, which are set to weigh on the banking sector for a longer time to come. In the two core business segments Private and Small-Business Customers (PSBC) and Corporate Clients (CC), Commerzbank will accelerate the digitalisation of processes and products in order to exploit additional growth potential and further improve the good competitive position.

By contrast, the steep balance sheet reduction path in the Asset & Capital Recovery (ACR) segment, which groups together complex, long-term and riskier portfolios with no strategic value contribution, will be continued in a value-preserving way to ensure that any capital erosion should be limited even in an ongoing stress scenario.

We expect the environment to remain very challenging in the current financial year and do not anticipate any significant relief from the interest rate environment. Although the successes we anticipate from "Commerzbank 4.0" are only scheduled to be apparent in the years that follow, we are aiming for better quality income and earnings in 2017. With the management of operating expenses and risk remaining strict, the first milestones on the way to higher profitability should be reached.

Anticipated performance of individual earnings components

Strategic measures for 2017 include improving the loan/deposit ratio through rigorous deposit management and growing business in the PSBC and CC segments to counter what we believe will be continued headwinds for interest income due to extremely low market interest rates. We will also seek to manage our risk-weighted assets more efficiently and expand business disproportionately in areas where earnings can be generated with lower capital requirements. A further area of focus is high-margin financing such as consumer loans, which Commerzbank is taking in its own books following the termination of the joint venture with BNP Paribas in the course of the year. While we once again anticipate good growth momentum in the Private and Small-Business Customers segment in Germany and at mBank, business with corporate clients is set to remain slow due to the ongoing comparatively low level of investment activity among companies and muted international trade flows. Excluding the balance of interest income from trading activities, we aim for a slight increase in net interest income overall.

The targeted slight increase in net commission income relates largely to growth in securities business. The aim is to further increase the share of volume-related income from mandate business and premium custody accounts and further reduce the sensitivity to market volatility in the future.

It is difficult to forecast net trading income because of the unpredictability of developments on the global financial markets. Commerzbank continues to apply its risk-oriented, customer-centric approach to ensure as stable a contribution as possible from this business.

Overall, net investment income and other operating income in the current financial year will be significantly below the very high level seen last year. The Bank benefited from significant one-off income in 2016, including write-ups on bonds of Heta Asset Resolution AG, gains on disposal of the stake in Visa Europe Limited and extraordinarily favourable conditions in the real estate business.

All in all, assuming no increase in interest rates we do not expect the positive performance of net interest and net commission income, the key drivers of income, to fully make up for the lack of non-recurring additional income in 2017. Total operating income is therefore likely to remain behind last year's level.

If the interest rate environment were to change, especially with a significant increase at the short end of the yield curve, income could rise significantly. At present, however, we attach only a low probability to this scenario.

In our view, Group loan loss provisions in 2017 will depend largely on the performance of the international shipping markets. We anticipate loan loss provisions of between €450m and €600m for shipping loans. We do not expect to see any improvement in the very difficult environment before the end of the year. However, we anticipate that despite the challenging conditions we can continue reducing the portfolio in the ACR segment as we have done in previous years. Given the cover ratio of 64% for problem loans in ship financing we see a further reduction in risk potential. Loan loss provisions in the PSBC and CC segments are likely to be at the same level as 2016.

Operating expenses excluding restructuring expenses are budgeted to be at the previous year's level again in 2017. Continued efficiency improvements will be used to drive forward digitalisation in all areas of the Group and implement additional investment measures to boost future profitability. A higher degree of flexibility also helps cover regulatory costs such as bank levies, where we expect no relief until further notice. As far as the restructuring expenses totalling €1.1bn to permanently reduce the cost base to €6.5bn by 2020 are concerned, we assume that the progress of the committee discussions geared to implementing measures to reduce complexity and adjust capacity may have a substantial impact on the allocation of the expenses over the financial years 2017 and 2018.

Anticipated segment performance

In the Private and Small-Business Customers segment, the key aim is still to grow earnings by increasing customer numbers and business volumes. The systematic transformation to a multichannel bank with innovative branch and sales concepts and our pioneering role in the digitalisation of products and processes give us a competitive advantage that we expect to help us gain additional market share. We still see growth potential in lending business, with a focus on real estate financing and consumer loans, and from even stronger penetration of the existing customer base.

We also expect greater efficiency gains through process optimisations such as the central "ONE" sales platform and the streamlining of the product range. mBank, which operates one of the most innovative direct banking platforms in its peer group, will further expand the corporate and private customer base that it has already increased significantly over the last few years and thus boost its operating income. Given the continuing uncertainty over which regulatory measures the Polish government will take regarding mortgage loans issued in foreign currencies, an increase in the cost base at our Polish subsidiary cannot be ruled out. Excluding the one-off income received in 2016 (which included the sale of the stake in Visa Europe Limited and real estate transactions) and on the basis of our expectations that loan loss provisions in lending business will remain relatively stable overall in 2017, the operating profit and operating return on equity in the Private and Small-Business Customers segment will increase. There is likely to be a slight drop in the cost/income ratio.

The Corporate Clients segment will exploit the improved market position secured by bundling the strengths of the former Mittelstandsbank and Corporates & Markets segments in order to expand its customer base in 2017. The focus will be on reinforcing its leading position in trade financing and extending its existing sector expertise in various key industries to new customer groups in Germany and the rest of Europe. The digital transformation of advisory and sales processes helps further strengthen customer relationships and achieve efficiency gains. As was the case in 2016, when the decision was taken to withdraw from securities lending and collateral management and to reduce the complexity of the bank portfolio in the Financial Institutions division, we will continue to examine the product portfolio in all business areas this year in terms of customer benefit and earnings potential and thereby assess suitability for our core business. Initial losses of income from terminated activities resulting in overall segment income likely falling slightly in 2017 must be seen against the potential for significant cost savings in the medium term. Given an interest rate, capital market and regulatory environment that remains challenging, we anticipate operating profit will at most equal the level of last year. This forecast is based on the assumption that there will be no material changes in loan loss provisions. The operating return on equity and cost/income ratio will therefore remain largely stable.

In the ACR run-off segment we are sticking to our target of further significant reductions in the portfolio across all business areas – shipping, commercial real estate financing and public finance – in a manner that preserves value. Current income will continue to fall accordingly.

We believe the situation on the international shipping markets will remain difficult, and as a result we expect loan loss provisions in a range of between €450m and €600m. In an ongoing stress scenario, with charter rates in some cases not high enough to cover ship owners' costs, provisioning charges could thus reach the previous year's level again. Given the provisioning ratio achieved for problem loans and the further reduction in the loan portfolio, we are targeting the ambitious lower end of the range. Therefore, excluding measurement effects (which make up a substantial amount of total income but cannot be reliably forecast), we anticipate a similar operating loss to the previous year. The operating loss may be significantly higher in an adverse scenario with larger credit losses.

General statement on the outlook for the Group

The Bank will further strengthen its market position in 2017 and concentrate on implementing the "Commerzbank 4.0" strategy. The Core Tier 1 capital ratio ("fully phased in," i.e. based on our interpretation of all the rules to be implemented) should remain at least 12%, with capital, risk-weighted assets, investments and the income statement including restructuring expenses all balancing each other out. Against this backdrop and given that operating income is likely to be lower and costs stable, we anticipate a similar consolidated net profit to last year.

The return on equity will be slightly lower than last year due to the planned full retention of earnings and associated strengthening of the capital base. The cost/income ratio is set to be slightly higher. Were the interest rate scenario to be more positive, which is contrary to current expectations, the cost/income ratio would improve – especially if short-term rates rise. Economic value added should move on a comparable scale to return on equity.

The first "Commerzbank 4.0" strategy milestones will further strengthen the Bank's resilience to external influences, which has already improved significantly over the last few years. Nevertheless, there are numerous risk factors that could have a major but currently unquantifiable impact on the profit forecast for 2017 should events take an unfavourable turn. These include the very uncertain political situation in Europe and the USA, the consequences of which could have a significantly detrimental effect on the global economy. The strongly export-oriented German economy would be particularly hard hit by this in certain circumstances. Regulatory or legal influences and compliance requirements also still have the potential to bring about a deterioration in the overall conditions for banking business.

Other adverse factors that could also lead to greater volatility on the capital markets include geopolitical tensions in numerous parts of the world.

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.

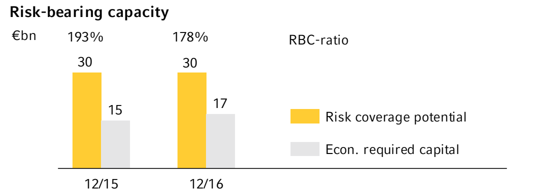
Contents

The following Group Risk Report is also part of the Group Management Report. Due to rounding, numbers and percentages may not add up precisely to the totals provided.

Executive summary 2016

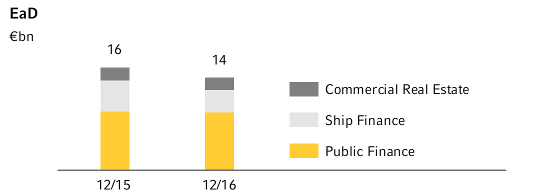
Solid capitalisation and high risk-bearing capacity ratio

- The risk coverage potential remained stable with €30bn.
- The risk-bearing capacity ratio was again on a high level at 178%.



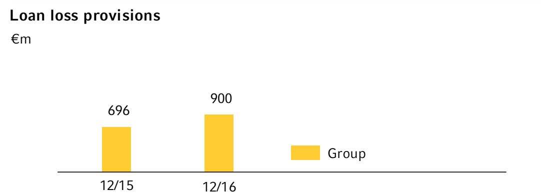
Ongoing exposure reduction in the Asset & Capital Recovery segment

- ACR exposure in the performing loan book totalled €14bn as at 31 December 2016 and was reduced by €1.9bn compared to December 2015.
- Ship Finance accounted for €1.5bn of the reduction.



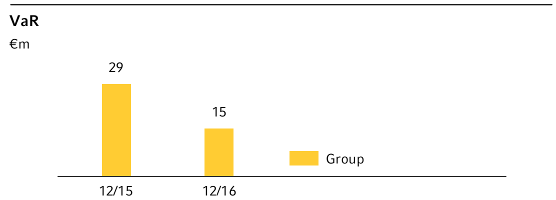
Loan loss provisions for the Group higher at €900m

- Loan loss provisions relating to the Group's lending business in fiscal year 2016 amounted to €900m.
- Main driver remained the ship finance portfolio.



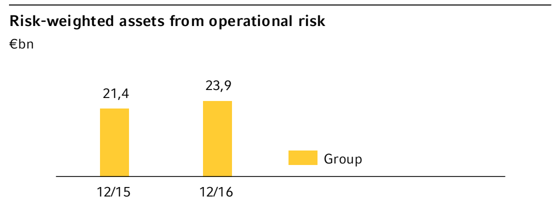
Market risk in the trading book fell in the course of 2016

- The VaR fell from €29m to €15m over the year.
- The decline was mainly caused by a defensive position in light of the political events in 2016 (Brexit, US presidential elections, referendum in Italy).



Operational risks increased year-on-year

- Risk-weighted assets from operational risks rose by €2.5bn to €23.9bn.
- The increase was caused by big external loss events.



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 reputational and compliance risk.

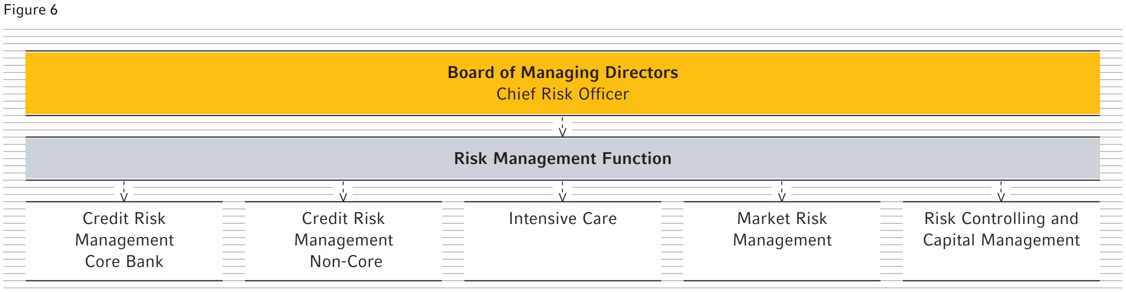
Risk management organisation

Risk Management in Commerzbank is an overarching bank mission and follows the principle of the "three lines of defence". Each unit (segments and functions) forms the first line of defence within its framework of operative responsibility. For credit, market and liquidity risk the responsibility for the second line of defence lies with the Chief Risk Officer (CRO). The CRO is responsible for implementing the Group's risk policy guidelines laid down by the full Board of Managing Directors, and for the controlling of operational risks. For other risks (e.g. IT risks or legal risks) the responsibility for the second line of defence is located outside the risk function depending on the kind of risk. The third line of defence is made up of the internal audit.

The CRO is responsible for risk management and regularly reports to the full Board of Managing Directors and the Risk Committee of the Supervisory Board on the risk situation within the Group.

The responsibilities within the risk function are split between Credit Risk Management Core Bank, Credit Risk Management Non-Core, Intensive Care, Market Risk Management and Risk Controlling and Capital Management. In all segments except for Asset & Capital Recovery (ACR), credit risk management is separated into a performing loan area and Intensive Care, while in ACR it has been merged into a single unit across all rating classes. All divisions have a direct reporting line to the CRO. The heads of these risk management divisions together with the CRO make up the Risk Management Board within Group Management.

Figure 6



The full Board of Managing Directors exclusively has 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. In addition, the CRO is a member of the Asset Liability Committee.

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.

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 interest surplus, in accordance with the regulatory framework. The central Asset Liability Committee 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 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 Management Board:

The **Supervisory Board's Risk Committee** is the Bank's highest risk committee. It comprises at least five 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 Management Board** deals with important current risk topics across all risk types as a discussion and decision-making committee within the risk function. In particular, it makes decisions on strategic and organisational developments for the risk function and is responsible for creating and maintaining a consistent risk culture.

The Chairman of the Board of Managing Directors (CEO) bears responsibility for controlling risks related to the Bank's business strategy, reputational risks and legal risks. The Chief Financial Officer (CFO) assumes responsibility for controlling compliance risk with particular regard to investor protection, insider trading guidelines and money laundering. The Chief Operating Officer (COO) is responsible for monitoring human resources and IT risks.

Risk strategy and risk management

The overall risk strategy, together with the business strategy, defines the strategic risk management guidelines for the development of Commerzbank's investment portfolio. Furthermore, the risk appetite is set 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 for the risk resources capital and liquidity reserve available to the Group are defined. The overarching limits of the overall risk strategy are consistent with the recovery indicators 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, 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. Others 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 is an accepted, inherent, existential risk for Commerzbank in the context of increasing digitalisation. These existential threats are taken on board deliberately in the pursuit of the business targets. 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 takes these "regulatory risks" into account 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 detailed further 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 risk inventory process – which is to be carried out annually or on an ad hoc basis as required – Commerzbank ensures that all risks of relevance to the Group are identified and their materiality is 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 the extent to which the risk coverage potential of the Group should be utilised. On that basis, individual types of quantifiable risk contributing to the capital demand 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 last one results 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 substantial risks and related risk concentrations. Therefore it is ensured that all Commerzbank-specific risk concentrations are adequately taken into account. Stress tests are regularly used to ensure transparency regarding risk concentrations. Management is regularly informed about the results of the analyses so that the potential risk of losses can be avoided in good time.

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 demands appropriate and courageous conduct in compliance with rules, and any failure to comply with rules is penalised.

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 this "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 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 through 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 made up of the 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 that corresponding to a high confidence level (currently 99.91% at Commerzbank) 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.

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 99.91%. 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 business 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.

Commerzbank monitors risk-bearing capacity using a gone concern approach which seeks primarily to protect unsubordinated lenders. This objective should be achieved even in the event of extraordinarily high losses from an unlikely extreme event. The gone concern analysis is supplemented here by elements aimed at ensuring the institution's continuing existence (going concern perspective).

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 (economic risk coverage potential). The quantification of the economic risk coverage potential is based on a differentiated view of the accounting values of assets and liabilities and involves economic valuations of certain balance sheet items.

The capital requirement for the risks taken is quantified using the internal economic capital model. When assessing the economic capital required, allowance is made for all the types of risk at the Commerzbank Group that are classified as material and quantifiable in the annual risk inventory. 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 of 99.91% in the economic capital model is in line with the underlying gone concern assumptions and ensures the economic risk-bearing capacity concept is internally consistent. The quantifiable risks in the economic capital model can be divided into default risk, market risk, operational risk and (although not shown separately in table 16 below) business risk, property value change risk, investment portfolio risk and reserve risk. Business risk is the risk of a loss resulting from discrepancies between actual income and expense and the respective budgeted figures. Business risk is considered as a deductible amount in risk coverage potential. Investment portfolio risk indicates the risk of an unexpected fall in the value of unlisted investments. Property value change risk is the risk of an unexpected fall in the value of owned property which is either already booked as an asset in the Group's balance sheet or which can be capitalised during the next twelve months by contractually assured obligations with option character (especially real estate). Reserve risk is the risk of additional charges being incurred on the portfolio of loans already in default through the creation of additional loan loss provisions. Allowance is made for this risk when considering risk-bearing capacity by means of a risk buffer. 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.

The 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 2016, the RBC ratio was consistently above 100% and stood at 178% on 31 December 2016. The decrease in the RBC ratio compared with December 2015 is mainly due to the enhancements of the market risk methods as well as the market-related developments in the Public Finance portfolio. Although the RBC ratio has fallen since 31 December 2015, it still remains at a high level.

Table 16

Risk-bearing capacity Group | €bn	31.12.2016	31.12.2015
Economic risk coverage potential[1]	**30**	**30**
Economically required capital[2]	**17**	**15**
thereof for default risk	11	11
thereof for market risk	5	3
thereof for operational risk	2	2
thereof diversification effects	– 2	– 2
RBC ratio[3]	**178%**	**193%**

[1] Including deductible amounts for business risk.
[2] Including property value change risk, risk of unlisted investments and reserve risk, which are not shown separately in the table.
[3] RBC ratio = economic risk coverage potential/economically required capital (including risk buffer).

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.

Commerzbank uses macroeconomic stress tests to review the risk-bearing capacity in the event of assumed adverse changes in the economic environment. The scenarios on which they are based take into account the interdependence in development between the real and financial economies and extend over a time horizon of at least two years. They are updated quarterly and approved by the Asset Liability Committee (ALCO). The scenarios describe an extraordinary but plausible adverse development in the economy, focusing in particular on portfolio priorities and business strategies of relevance to Commerzbank. The scenario simulation is run monthly using the input parameters of the economic capital requirements calculation for all material and quantifiable risk types. In addition to the capital required, the profit and loss calculation 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 limit is breached.

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 2016, the risk-weighted assets resulting from Commerzbank's business activities decreased from €198bn to €191bn.

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

Table 17

Risk-weighted assets as at 31.12.2016 | €bn	Default risk	Market risk	Operational risk	Total
Private and Small-Business Customers	28	1	7	36
Corporate Clients	84	10	12	105
Others and Consolidation	22	4	3	29
Asset & Capital Recovery	13	5	2	21
Commercial Real Estate	2	0	2	4
Ship Finance	5	0	0	5
Public Finance	6	5	0	11
Group	**147**	**20**	**24**	**191**

Regulatory environment

With Basel 3, the Basel Committee on Banking Supervision published among other things comprehensive rules on the components of shareholders' equity and ratios as well as the management of liquidity risk. The Capital Requirements Directive and Regulation (CRD-IV) package of measures, constituting the European implementation of Basel 3, has been in force since 1 January 2014. The more stringent capital requirements will be phased in by 2019. Since then, numerous supplementary regulations have been published by the European Banking Authority (EBA) in particular, and these will now gradually enter into force in 2017 and in subsequent years. Commerzbank has prepared itself for the more stringent capital adequacy requirements by taking a number of steps.

In addition, under Basel 3 the leverage ratio is being introduced as a new and non-risk-sensitive debt ratio. Final calibration of the leverage ratio by the Basel Committee on Banking Supervision is intended to be completed in 2017, and the ratio is scheduled to become a minimum supervisory requirement under pillar 1 from 2018 onwards.

However, there has been a requirement to report the leverage ratio to the supervisory authority since the Capital Requirements Regulation (CRR) entered into force. 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. The capital conservation buffer, the buffer for other systemically relevant institutions and the anti-cyclical capital buffer, which was set initially by BaFin at 0% for German exposure, apply from 1 January 2016 onwards. The buffer for other systemically relevant institutions was set by BaFin for Commerzbank at 0.5% for 2017.

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, approved by the Basel Committee in October 2014, is expected to enter into force on 1 January 2018. The NSFR is due to be transposed into European law as part of the Capital Requirements Regulation II (CRR II). 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 principles for risk data aggregation and internal risk reporting in banks, published by the Basel Committee on Banking Supervision in early 2013, were implemented in prior years as part of a Group-wide project in Commerzbank. In the reporting year, the European Central Bank (ECB) started a thematic review of application of these principles by selected banks. This, together with the expected inclusion of the principles in the new MaRisk, may give rise to other activities. Synergies generated by it will be used for the Group-wide project, started in 2015, to implement "AnaCredit". This is a European Central Bank (ECB) initiative under which banks will in future be required to report a host of very detailed data on customers and loans. A first, partial report is to be submitted to the Bundesbank in the third or fourth quarter of 2017. The ECB's official initial stage begins on 31 March 2018; further stages may follow two years after the respective ECB decision.

The ECB, in its capacity as the supervisory authority for the eurozone banks directly subject to it, has conducted the Supervisory Review and Evaluation Process (SREP) and specified individual minimum capital requirements for each bank for 2017.

The EU Bank Recovery and Resolution Directive has been in force since mid-2014. It was transposed into German law in the form of the Bank Recovery and Resolution Act (Sanierungs- und Abwicklungsgesetz, SAG). Based on this law, the Financial Market Stabilisation Authority (FMSA), as the national resolution agency, took over responsibility for the drafting of resolution plans and the resolution of German banks with effect from 1 January 2015. 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 Group-wide recovery plan was updated in 2016 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. As the European and German regulations and requirements are finalised, the Bank will further develop its recovery plan accordingly.

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 risks now published by the Basel Committee on Banking Supervision and the work on finalising the rules on interest rate risks in the banking book and revising the framework for operational risks and credit risks, including the associated floor rules and disclosure requirements. At European level, Commerzbank will monitor the European Commission initiatives to introduce a European deposit insurance scheme and establish a capital markets union, and in particular the associated EU securitisation framework.

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 material 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 structural risk 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. 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. 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 with which the risk resources provided 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.

The responsibilities are separated between the performing loan area on the one hand and Intensive Care on the other. Based hereupon, discrete back-office areas are responsible for operational credit risk management on a portfolio and an individual case basis.

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 lending process.

Higher-risk Core Bank 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. Intensive Care 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.

In the ACR segment, by contrast, there is no separation of responsibilities between the performing loan area and Intensive Care. Credit risk management here has been merged into one unit across all rating classes.

The aim is to fully wind down all the assets grouped in this segment in a way that preserves value. To this end, EaD-based guidelines have been established and an asset management programme has been implemented. This is carried out through regular asset planning. The main aim here is to prioritise the winding down or reduction of those parts of the portfolio and individual loans for which the capital requirement is particularly high. Opportunities for selling sub-portfolios in a way that preserves value may also be used to free up capital as part of the systematic portfolio reduction. For business in Public Finance, the reduction is primarily through regular maturities of assets. Market opportunities that arise are used in a targeted way for the sale of individual assets.

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 overarching Group objectives. They are enhanced at downstream levels by sub-portfolio and product specifics. Risk-based credit approval regulations focus management attention in the highest decision-making bodies on issues such as risk concentrations or deviations from the risk strategy.

Operational credit risk management still aims to preserve the good portfolio quality achieved. It focuses on supporting growth in granular lending business and on limiting risks with regard to poorer credit ratings and exposures with high loss-at-default contributions (concentration management). The Bank also continually carries out checks of its credit processes to identify possible improvement measures. The concern is not only to provide staff with ongoing training and development, but also to reinforce a uniform risk culture throughout the Group and in particular to increase compliance awareness.

Commerzbank's rating and scoring methods, which are used for all key credit portfolios, form the basis for measuring default risks. Both the calibration of the probabilities of default assigned to individual counterparties or loans and the calculation of loss ratios are based on an analysis of historical data from the Commerzbank portfolio.

Country risk management is based on the definition of risk limits as well as country-specific strategies for achieving a desired target portfolio.

Back-office activities in domestic corporate customer business are organised by industry sector, which makes it possible to directly identify issues at sub-portfolio level and implement appropriate measures at individual loan level. This organisation by sector ensures the effectiveness and efficiency of preventative measures and enhances forecasting quality in respect of the development of risk.

Potential negative developments and constantly changing regulatory requirements make responsive credit portfolio management essential, and so ensuring that the credit portfolio is sufficiently flexible is another key action field in credit risk management. In addition, crisis events may pose a risk to the adequacy of the Bank's capital and liquidity resources and thereby to its risk-bearing capacity. Examples include exceptionally large government, bank and/or company defaults, but also extreme trends in sectors, currencies and commodity prices, as well as the impact of sanctions, war and terror. In a crisis, the Risk Mitigation Task Force (RMTF) will manage decisions flexibly in a coordinated, Group-wide process. As part of the process, emergency action plans will ensure that risk-mitigation measures, tailored to the type of risk, are implemented quickly and efficiently.

Management of economic capital commitment

Economic capital commitment is managed in order to ensure that the Commerzbank Group holds sufficient capital. With this object in view, all 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 limit concept for credit risk below Group level, i.e. the Group credit limit is not allocated to segments or business areas.

Figure 7

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 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 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) Uniform, consolidated data repository as basis for Group reporting	Ensuring exchange of information and networking in committees that operate across all risk types 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.) Differenciated credit authorities based on compliance of transactions with the Bank's risk policy	Performance metrics on level of risk categories and sub-portfolios Expansion of Group-wide performance metrics using sub-portfolio-specific indicators	Portfolio batches as per established portfolio calendar Asset quality review and analysis of High Attention Parts (HAP) Trigger monitoring with clear escalation and reporting lines	Interdisciplinary composition of segment committees 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 Monthly report to the Board of Managing Directors on the development of bulk risks Review of individual customers/exposures resulting from asset quality review or HAP analyses	Deal team structures Institutionalized exchange within the risk function, also taking account of economic developments Sector-wise organization of domestic corporate business

Rating classification

The Commerzbank rating method comprises 25 rating classes for loans not in default (1.0 to 5.8) and five default classes (6.1 to 6.5). The Commerzbank master scale allocates a non-overlapping range of probabilities of default that are stable over time to each rating class. The rating methods are validated and recalibrated annually so that they reflect the latest projection based on all actual observed defaults. The default ranges assigned to the ratings are the same for all portfolios. This ensures internal comparability consistent with the master scale method. For the purpose of guidance, 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, credit sub-committees) are graduated by a range of factors including size of exposure and rating class.

Figure 8
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		
1.2	0.01	0–0.02			I	
1.4	0.02	0.02–0.03	AA+	AA		
1.6	0.04	0.03–0.05	AA, AA–			
1.8	0.07	0.05–0.08	A+, A	A	II	Investment grade
2.0	0.11	0.08–0.13	A–			
2.2	0.17	0.13–0.21	BBB+			
2.4	0.26	0.21–0.31	BBB	BBB	III	
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+			
3.2	1.14	0.96–1.34	BB	BB	IV	
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	B+			
4.0	3.50	3.10–3.90				
4.2	4.35	3.90–4.86				
4.4	5.42	4.86–6.04	B	B	V	Non-investment grade
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				
5.4	16.15	14.48–18.01	CCC+, CCC, CCC–, CC, C	CCC, CC, C	VI	
5.6	20.09	18.01–22.41				
5.8	47.34	22.41–99.99				
6.1		>90 days past due				
6.2		Imminent insolvency				
6.3	100	Restructuring with recapitalisation		D		Default
6.4		Termination without insolvency				
6.5		Insolvency				

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

Management of risk concentrations

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 in 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.

Risk mitigation

As at 31 December 2016, the collateral taken into account in Group risk management totalled €96.7bn for positions in the performing book and €2.3bn for positions in the default portfolio. The collateral mainly relates to mortgages on owner-occupied and buy-to-let residential property and on commercial properties and various forms of guarantees. The ship finance portfolio is mostly backed by ship mortgages.

Commerzbank Group

Due to the success of the reduction in the former Non-Core Assets (NCA) segment Commerzbank has set up a new segment structure in the first quarter of 2016 and has reorganised the allocation of capital. High-quality, low-risk portfolios in the value of about €8bn from commercial real estate financing and ship financing have been transferred to the former Mittelstandsbank segment. The remaining mortgage loan portfolio of around €2bn was transferred to former Private Customers segment. Group Treasury in the Others and Consolidation segment took over most of the Public Finance portfolio of about €36bn. The criteria for the transfer of assets were good credit quality, low earnings volatility and suitability for the liquidity portfolio. The remaining assets of originally around €18bn were transferred to the new Asset & Capital Recovery (ACR) segment.

At the end of September, Commerzbank presented its new strategic program "Commerzbank 4.0". Its business will be focused on two customer segments, "Private and Small-Business Customers" and "Corporate Clients". The Mittelstandsbank and Corporates & Markets segments were consolidated into a single unit and trading activities in investment banking were scaled back.

In the following report the previous year's comparative figures have been adjusted to the new segment structure.

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:

Table 18

Credit risk parameters as at 31.12.2016	**Exposure at default** €bn	**Expected loss** €m	**Risk density** bp	**CVaR** €m
Private and Small-Business Customers	140	300	21	2,171
Corporate Clients	195	548	28	5,897
Others and Consolidation	81	103	13	1,974
Asset & Capital Recovery	14	343	239	797
Group	**431**	**1,294**	**30**	**10,839**

When broken down on the basis of PD ratings, 82% of the Group's portfolio is in the internal rating classes 1 and 2, which comprise investment grade.

Table 19

Rating breakdown as at 31.12.2016 EaD | %	**1.0–1.8**	**2.0–2.8**	**3.0–3.8**	**4.0–4.8**	**5.0–5.8**
Private and Small-Business Customers	33	50	13	3	1
Corporate Clients	21	57	17	4	2
Others and Consolidation	54	42	4	0	0
Asset & Capital Recovery	4	58	8	16	15
Group	**30**	**52**	**13**	**3**	**2**

The Group's country risk calculation records both transfer risks and region-specific event risks defined by political and economic events which impact on the individual economic entities of a country. Country risks are managed on the basis of defined credit risk and transfer risk limits at country level. Country exposures which are significant for Commerzbank due to their size, and exposures in countries in which Commerzbank holds significant investments in comparison to the GDP of those countries are handled by the Strategic Risk 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.

Table 20

Group portfolio by region as at 31.12.2016	Exposure at default €bn	Expected loss €m	Risk density bp
Germany	220	403	18
Western Europe	99	224	23
Central and Eastern Europe	38	165	43
North America	30	52	17
Asia	26	41	16
Other	16	409	249
Group	**431**	**1,294**	**30**

Around half of the Bank's exposure relates to Germany, another third to other countries in Europe and 7% to North America. 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 Western Europe. A main driver of the expected loss in the region "Other" is ship finance.

In view of the current geopolitical development, national economies as Russia, Ukraine, Turkey and China are closely monitored. As at the end of the fourth quarter of 2016, exposure to Russia was €2.9bn, exposure to Ukraine was €0.1bn, exposure to Turkey was €2.2bn and exposure to China was €3.9bn.

Also, as a result of the debt crisis, the sovereign exposures of Italy and Spain are still closely monitored. As at the end of the fourth quarter of 2016, Commerzbank's Italian sovereign exposure was €9.5bn, while its Spanish sovereign exposure was €3.6bn.

Loan loss provisions

Loan loss provisions relating to the Group's lending business in 2016 amounted to €900m. This figure includes a one-off charge of €28m net arising from the regular annual update of risk parameters. Loan loss provisions were €204m above the previous year's level.

Write-downs on securities are not recognised in loan loss provisions but in net investment income. Note (36) to the consolidated financial statements gives further details on this.

The anticipated year-on-year increase in loan loss provisions is due to the ongoing difficult environment for ship financing. We expect additional loan loss provisions to also be required in 2017. At the same time, reversals of loan loss provisions in the Corporate Clients portfolio, which remained significant in 2016, will continue to reduce. Loan loss provisions for 2017 in the Private and Small-Business Customers and Corporate Clients segments are likely to be at the same level as in 2016. We anticipate loan loss provisions of between €450m and €600m for ship financing. In the event of a huge, unexpected deterioration in geopolitical or economic conditions, or in the case of defaults of large individual customers, significantly higher loan loss provisions may become necessary.

Table 21

Loan loss provisions | €m	2016	2015
Private and Small-Business Customers	119	167
Corporate Clients	185	108
Others and Consolidation	–3	60
Asset & Capital Recovery	599	361
Group	**900**	**696**

Default portfolio

The default portfolio stood at €6.9bn as at the end of 2016, representing an overall decrease of €0.2bn compared with the previous year.

The following table shows claims in default in the category LaR:

Table 22

Default portfolio Group | €m	31.12.2016	31.12.2015
Default volume	6,914	7,124
SLLP	3,243	3,371
GLLP	673	800
Collaterals	2,256	2,556
Coverage ratio excluding GLLP (%)[1]	80	83
Coverage ratio including GLLP (%)[1]	89	94
NPL ratio (%)[2]	1.6	1.6

[1] Coverage ratio: total of risk provisions, collateral (and GLLP) as a proportion of the default volume.
[2] NPL ratio: default volume (non-performing loans – NPL) as a proportion of total exposure (EaD including NPL).

The default portfolio is divided into five classes based on the nature of the default:

- Rating class 6.1: Over 90 days past due.
- Rating classes 6.2/6.3: Imminent insolvency, or the Bank is assisting in financial rescue/restructuring measures at the customer with restructuring contributions.
- 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 five default classes:

Table 23

Rating classification as at 31.12.2016 | €m	6.1	6.2/6.3	6.4/6.5	Group
Default volume	685	3,116	3,112	6,914
SLLP	162	1,389	1,692	3,243
Collaterals	423	965	868	2,256
Coverage ratio excl. GLLP (%)	85	76	82	80

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 end of December 2016.

Table 24

EaD €m	> 0 ≤ 30 days	> 30 ≤ 60 days	> 60 ≤ 90 days	> 90 days	Total
Private and Small-Business Customers	618	57	27	2	703
Corporate Clients	1,733	46	62	1	1,842
Asset & Capital Recovery	554	2	17	0	573
Group[1]	**2,998**	**105**	**106**	**3**	**3,211**

[1] Including Others and Consolidation.

Private and Small-Business Customers segment

The Private and Small-Business Customers segment comprises the activities of Private Customers, Small-Business Customers, comdirect bank and Commerz Real. mBank is shown with 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 contains 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 €67bn). We provide our business and small-business customers with credit in the form of individual loans with a volume of €18bn. In addition, we meet our customers' day-to-day demand for credit with consumer loans (consumer and instalment loans, credit cards, to a total of €9bn). The portfolio's expansion in 2016 was largely the result of consistent growth in residential mortgage loans.

The year-on-year decline in risk density by 3 basis points to 21 basis points was mainly due to Private Customers and mBank.

Table 25

Credit risk parameters as at 31.12.2016	Exposure at default €bn	Expected loss €m	Risk density bp
Private Customers	84	106	13
Business Customers	24	61	26
comdirect bank	3	7	23
Commerz Real	1	2	39
mBank	29	124	42
Private and Small-Business Customers	**140**	**300**	**21**

Loan loss provisions in the Private and Small-Business Customers segment further fell by €48m year-on-year to €119m. The historically low loan loss provisions for the Private Customers segment were the driver for this reduction as well as a by €15m lower loan loss provisions of mBank.

Along the lines of the positive development of the loan loss provisions the default volume in the segment decreased by €226m to €1,737m compared with 31 December 2015.

Table 26

Default portfolio Private and Small-Business Customers | €m	31.12.2016	31.12.2015
Default volume	1,737	1,963
SLLP	834	945
GLLP	155	168
Collaterals	675	736
Coverage ratio excluding GLLP (%)	87	86
Coverage ratio including GLLP (%)	96	94
NPL ratio (%)	1.2	1.5

Corporate Clients segment

This segment comprises the Group's activities with mid-size corporate clients, the public sector, institutional customers and multinationals. 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 Germany and the rest of western Europe.

The Group's customer-driven capital markets activities remain within this segment.

Table 27

Credit risk parameters as at 31.12.2016	Exposure at default €bn	Expected loss €m	Risk density bp
Mittelstand	85	192	23
International Corporates	65	129	20
Financial Institutions	30	129	43
Equity Markets & Commodities	4	4	10
Other	11	94	86
Corporate Clients	**195**	**548**	**28**

The EaD of the Corporate Clients segment decreased from €205bn to €195bn compared to 31 December of the previous year. Risk density was 28 basis points.

The economic environment in Germany remains stable. However, 2016 was dominated in part by greater political uncertainty, particularly with the referendum in the UK on whether the country should leave the EU and with the US presidential elections. The heightened uncertainty was reflected in market price volatility, which was severe in some cases but did not have a major impact on our credit portfolio.

For details of developments in the Financial Institutions portfolio, please see page 109.

Loan loss provisions in the Corporate Clients segment were still at a low level with €185m although significantly higher than the previous year's figure of €108m which was largely affected by reversals of loan loss provisions.

The default volume of the segment increased by €511m compared to the end of 2015. The rise was mainly due to the default of a few large individual customers.

Table 28

Default portfolio Corporate Clients | €m	31.12.2016	31.12.2015
Default volume	3,363	2,852
SLLP	1,563	1,592
GLLP	323	371
Collaterals	780	429
Coverage ratio excluding GLLP (%)	70	71
Coverage ratio including GLLP (%)	79	84
NPL ratio (%)	1.7	1.4

At the end of December 2016, the volume of new investments entered into since 2014 in the Structured Credit area was slightly below the year-end 2015 level, at €2.4bn overall. 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 show a robust structure and a moderate risk profile.

During 2016, the volume of the Structured Credit positions, which were already in the portfolio prior to 2014, decreased by €3.5bn to a total of €2.4bn (December 2015: €5.9bn) and risk values[1] by €0.7bn to €1.0bn (December 2015: €1.7bn). As before, a large part of the portfolio was made up of CDOs (€1.2bn). Total return swap positions with a volume of €2.8bn matured in 2016 and were repaid in full.

Asset & Capital Recovery segment

After the re-segmentation in the first quarter of 2016 the Asset & Capital Recovery segment comprises positions of the portfolios in the areas of Commercial Real Estate (CRE) and Ship Finance (SF) and complex financings from the Public Finance area. The intention is that all the portfolios in this segment should be completely wound down over time.

EaD for the segment in the performing loan book totalled €14bn as at 31 December 2016, €1.9bn lower than at the end of 2015.

Table 29

Credit risk parameters as at 31.12.2016	Exposure at Default €bn	Expected loss €m	Risk density bp
Commercial Real Estate	2	33	174
Ship Finance	4	288	820
Public Finance	9	22	24
Asset & Capital Recovery	**14**	**343**	**239**

Commercial Real Estate

The portfolio further decreased due to redemptions and repayments. Due to recoveries in the default portfolio the perfoming portfolio decreased only minimally to €1.9bn. There were no major developments on the risk side. Risk density fell to 174 basis points.

Stable market conditions are expected for the short to medium term.

[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.

Ship Finance

Compared with 31 December 2015, ship finance exposure in the performing loan book was reduced by €1.5bn in line with our reduction strategy.

Our portfolio is mainly made up of the following three standard types of ship: container ships, tankers and bulkers. The rest of the portfolio consists of various special tonnages which are well diversified across the various ship segments.

Public Finance

The Public Finance sub-portfolio in the ACR segment is largely made up of exposures with credit quality ranging from satisfactory to good, some of them with very long maturities and complex structures, to local authorities in the UK (€4.7bn EaD), a private finance initiative (PFI) portfolio (€2.7bn EaD) with a regional focus on the UK and further Public Finance debtors, predominantly in the USA (€1.6bn EaD).

The future performance of the Public Finance portfolio is dependent on political, economic and monetary developments, particularly in Europe and the USA.

Loan loss provisions in the ACR segment stood at €599m, representing a rise of €238m compared with the previous year. The rise was almost completely due to the shipping portfolio. Ongoing declining charter rates, the decreasing liquidity of the ship owners and limited resaleability led to new defaults as well as to need for higher loan loss provisions for already defaulted engagements. A comprehensive and sustainable improvement of the difficult environment is not expected for 2017 either.

Table 30

Loan loss provisions I €m	**2016**	**2015**
Commercial Real Estate	42	36
Ship Finance	559	325
Public Finance	– 1	0
Asset & Capital Recovery	**599**	**361**

Despite further inflows in the ship finance portfolio, the default volume decreased further by €394m in 2016 compared with 2015. The fall was mainly due to recoveries and repayments in the Commercial Real Estate area.

Table 31

	31.12.2016			**31.12.2015**		
Default portfolio ACR I €m	**ACR**	**CRE**	**SF**	**ACR**	**CRE**	**SF**
Default volume	1,805	562	1,243	2,199	1,038	1,160
SLLP	838	210	628	733	193	540
GLLP	192	20	172	262	45	213
Collaterals	800	334	466	1,390	787	604
Coverage ratio excluding GLLP (%)	91	97	88	97	94	99
Coverage ratio including GLLP (%)	101	101	102	108	99	117
NPL ratio (%)	11.2	22.7	26.2	11.9	33.0	18.9

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:

Table 32

Corporates portfolio by sector as at 31.12.2016	Exposure at default €bn	Expected loss €m	Risk density bp
Energy supply/Waste management	17	38	22
Consumption	15	40	27
Technology/Electrical industry	12	26	22
Transport/Tourism	12	27	22
Wholesale	12	40	34
Basic materials/Metals	11	38	36
Chemicals/Plastics	10	39	39
Mechanical engineering	10	31	32
Services/Media	9	30	32
Automotive	9	21	23
Pharmaceutical/Healthcare	5	13	25
Construction	5	15	34
Other	5	6	12
Total	**131**	**364**	**28**

Financial Institutions portfolio

The focus remains – after the reduction in the number of our correspondent banks – on the trade finance activities that we carry out on behalf of our corporate clients and on capital market activities.

We are keeping a close watch on the impact of regulatory requirements on banks. In this context, our strategy is to reduce the exposure which might absorb losses in the case of a bail-in.

We are keeping a close eye on developments in some emerging markets with individual issues such as recessions, embargoes or certain dependencies on the price of oil, and have responded 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.

Table 33

	31.12.2016			31.12.2015		
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	6	11	5	6	12
Western Europe	17	21	12	20	46	23
Central and Eastern Europe	5	21	43	5	23	48
North America	2	3	15	2	3	17
Asia	10	27	27	13	36	28
Other	6	36	58	8	32	43
Total	**46**	**114**	**25**	**52**	**146**	**28**

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.

We carry out new business in the interests of our institutional customers, with a focus on attractive opportunities with customers with good credit ratings. We manage our portfolios with the aim of ensuring their high quality and responsiveness.

Table 34

	31.12.2016			31.12.2015		
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	17	26	15	16	23	14
Western Europe	12	24	20	15	48	33
Central and Eastern Europe	1	4	65	1	3	58
North America	8	10	14	8	5	6
Asia	1	1	11	1	2	16
Other	1	1	14	2	1	8
Total	**39**	**67**	**17**	**43**	**83**	**19**

Originator positions

Commerzbank has in recent years securitised receivables from loans to the Bank's customers with a current volume of €6.1bn, primarily for capital management purposes.

As at the reporting date 31 December 2016, risk exposures with a value of €5.7bn were retained. By far the largest portion of these positions is accounted for by €5.6bn of senior tranches, which are nearly all rated good or very good.

Table 35

		Commerzbank volume[1]				
Securitisation pool €bn	**Maturity**	**Senior**	**Mezzanine**	**First loss piece**	**Total volume[1] 31.12.2016**	**Total volume[1] 31.12.2015**
Corporates	2025 – 2036	5.6	<0.1	0.1	6.1	4.1
RMBS	2048	0.0	0.0	0.0	<0.1	0.1
CMBS	2046	0.0	0.0	0.0	<0.1	<0.1
Total		5.6	<0.1	0.1	6.1	**4.2**

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

Conduit exposure and other asset-backed exposures

Commerzbank is the sponsor of the multiseller asset-backed commercial paper conduit Silver Tower. It uses it to securitise receivables, in particular trade and leasing receivables, from customers in the Corporate Clients segment. The transactions are financed predominantly through the issue of asset-backed commercial papers (ABCPs) or through the drawing of credit lines (liquidity lines). The volume and risk values in the Silver Tower conduit increased sharply by €0.9bn year-on-year in 2016, due to new deals and increases in existing transactions, and as at 31 December 2016 stood at €4.1bn.

Liquidity risks from ABS transactions are modelled conservatively in the internal liquidity risk model. Firstly, a worst-case assumption is made that Commerzbank has 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. Secondly, 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 ABSs issued by Commerzbank Finance & Covered Bond S.A. and Commerzbank AG in Germany. In 2016, the volume was €5.3bn (December 2015: €4.7bn) and risk values were €5.2bn (December 2015: €4.6bn), both slightly up year-on-year.

Forbearance portfolio

In 2013 the European Banking Authority (EBA) introduced a new definition of "forbearance". 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. This definition applies irrespective of whether the debtor is in the performing or the non-performing portfolio. Examples of concessions include deferrals, increases in limits or loans and waivers in connection with restructuring.

The definition of forbearance applies independently from whether the debtor is in the performing or the non-performing portfolio. Whereas in the non-performing portfolio a high LLP coverage is ensured by GLLP as well as by SLLP, for engagements in the performing portfolio only GLLP is used. The result is a significantly lower LLP coverage for the forbearance portfolio than for the default portfolio.

The forbearance portfolio is already completely included in the previous representations of the performing book and the default portfolio.

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

Table 36

Forbearance portfolio by segment as at 31.12.2016	Forborne exposure €m	Loan loss allowance[1] €m	LLP coverage ratio %
Private and Small-Business Customers	1,126	129	11
Corporate Clients	3,923	524	13
Asset & Capital Recovery	2,633	495	19
Group	**7,682**	**1,148**	**15**

[1] SLLP and GLLP.

The forbearance portfolio by region is as follows:

Table 37

Forbearance portfolio by region as at 31.12.2016	Forborne exposure €m	Loan loss allowance €m	LLP coverage ratio %
Germany	4,680	546	12
Western Europe	1,681	382	23
Central and Eastern Europe	589	154	26
North America	25	<1	0
Asia	72	15	21
Other	635	50	8
Group	**7,682**	**1,148**	**15**

In addition to the loan loss provisions in the amount of €1,148m, the risks of the forbearance portfolio are covered by collateral in the amount of €1,731m.

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 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 key market risks and drivers of market risk for the Group 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.

Within the Bank, various market risk committees have been established. 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 subsequent risk ratios. The Segment Market Risk Committee, which focuses on the trading-intensive Corporate Clients and Treasury areas, meets once a week. This committee also manages market risks arising from non-core activities (Asset & Capital Recovery).

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 the 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 price 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 market 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 with 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 measures to bring the respective portfolio back within the limit. If the limit breach cannot be remedied within a few days, 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 (IRC).

In internal management, all positions relevant to market risk are covered, and trading and banking book positions are jointly managed. For regulatory purposes, additional stand-alone management of the trading book is carried out (in accordance with regulatory requirements, including currency and commodity risks in the banking book). 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 days' history.

At year end, the VaR for the overall book had fallen by €33m to €85m. The VaR of the trading book also fell over the year, from €29m to €15m. The decline was mainly caused by a defensive position in light of the political events in 2016 (Brexit, US presidential elections, referendum in Italy).

Table 38

VaR contribution | €m	31.12.2016	31.12.2015
Overall book	**85**	**118**
thereof trading book	15	29

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 and Treasury divisions.

The VaR fell from €29m to €15m over the year.

Table 39

VaR of portfolios in the trading book | €m	2016	2015
Minimum	14	17
Mean	30	25
Maximum	46	39
VaR at end of reporting period	**15**	**29**

The market risk profile is diversified across all asset classes. The dominant asset classes are credit spread and foreign exchange risks, followed by interest rate risks and equity price risks. To a lesser extent, value at risk is also affected by commodity and inflation risks.

The VaR trend in 2016 shows a marked decrease in foreign exchange risks. Interest rate and equity price risks declined moderately. Credit spread and commodity risks remained stable in 2016.

Table 40

VaR contribution by risk type in the trading book | €m	31.12.2016	31.12.2015
Credit spreads	5	6
Interest rates	3	4
Equities	2	4
FX	4	14
Commodities	1	1
Total	**15**	**29**

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 is adjusted where necessary. The crisis observation period was changed in the course of the year. This caused a sharp rise in stressed VaR, from €27m at the end of 2015 to €48m at the reporting date.

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 reliability of the internal model is monitored by backtesting on a daily basis. The VaR calculated is set against actually occurring profits and losses. 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 solely result from changes in market prices. In dirty P&L backtesting, by contrast, profits and losses from newly concluded and expired transactions from the day under consideration are included. If the loss actually calculated exceeds the loss forecast from the VaR estimate, 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 2016, we saw three negative clean P&L outliers and one negative dirty P&L outlier. As such, the results are in line with statistical expectations and 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 on the assumption of normal market conditions, it is supplemented by the calculation of 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 interest rate 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 VaR and stress test models are validated regularly. The identification and elimination of model weaknesses are of particular importance. Against this background, in 2016 regulatory and internal model adjustments were implemented as well as an application for a model change to further improve the accuracy of risk measurement was sent to the supervisory authority. This was especially due to a changed market environment for interest rates and volatilities.

In November 2016, a new division was created to bundle validation activities for risk models for all risk types.

Banking book

The key drivers of market risk in the banking book are the Treasury portfolios, with their credit spread, interest rate and basis risks, and the area of Asset & Capital Recovery (ACR) – Public Finance, along with the positions held by the subsidiaries Commerzbank Finance & Covered Bond S.A. and LSF Loan Solutions Frankfurt GmbH.

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) fell modestly by €4m by the end of 2016, reaching €50m as at the reporting date.

Most credit spread sensitivities relate to securities positions classified as loans and receivables (LaR). 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 Banking Directive, the Federal Financial Supervisory Authority has prescribed two 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.

The outcome of the +200 basis points scenario would be a potential loss of €2,120m, while the –200 basis points scenario would result in a potential loss of €558m as at 31 December 2016. Commerzbank does not therefore need to be classified as a bank with higher interest rate risk as the negative changes in present value account for less than 20% of regulatory capital. These figures include the exposures of Commerzbank Aktiengesellschaft and significant subsidiaries.

Pension fund risk is also part of market risk in the banking book. Our pension fund portfolio comprises a well-diversified investment section and the section of 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. 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

In measuring economic capital adequacy, Commerzbank also takes account of market liquidity risk. This 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.

The first step is to create a realistic downsizing profile for each portfolio on the basis of its product and risk strategies and an assessment of the market. This enables portfolios to be classified in terms of their convertibility into cash using a "market liquidity factor". The market liquidity factor takes into account the heightened volatility of portfolio value resulting from the extended holding period for risk positions in line with the portfolio's downsizing profile. The market risk of every portfolio is then evaluated based on a one-year view and weighted with the market liquidity factor.

As at the end of 2016, Commerzbank has earmarked €0.2bn in economic capital to cover market liquidity risk in the trading and banking book. Asset-backed securities and structured products in particular have a higher market liquidity risk.

Liquidity risk

We define liquidity risk in a 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 sub-committees 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. Additional information on this subject can be found in the section "Funding and liquidity of the Commerzbank Group" in 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.

In the event of a liquidity crisis, the emergency plan provides for various measures for different types of crisis that 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, whereas 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. Group Finance 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 historic 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 stricter requirements of 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 a 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, extensions 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 one hand, extensions on the other.

The table below shows the liquidity gap profile after application of the respective stress scenarios for periods of one and three months. Significantly more liquidity flows out in a combined scenario compared with the individual scenarios. As at 31 December 2016, in the one-month and three-month periods, the combined stress scenario leaves net liquidity of €18.5bn and €21.6bn respectively.

Table 41

Net liquidity in the stress scenario | €bn		**31.12.2016**
Idiosyncratic scenario	1 month	23.0
	3 months	27.5
Market-wide scenario	1 month	26.6
	3 months	29.9
Combined scenario	1 month	18.5
	3 months	21.6

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 liquidity risk appetite in order 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 €80.0bn in the form of highly liquid assets. A part of this liquidity reserve is held in a separate stress liquidity reserve portfolio managed by Treasury to cover liquidity outflows should a stress event occur and to ensure solvency at all times. The Bank also operates an intraday liquidity reserve portfolio, which amounted to €8.4bn as at the reporting date.

The liquidity reserves in the form of highly liquid assets consists of the following three components:

- Level 1 contains cash holdings, withdrawable deposits at central banks, assets of central governments, regional and local governments, public-sector entities, multilateral development banks and international organisations, banks with state guarantees, qualifying units or equities of undertakings for collective investment (UCIs) with level 1 assets, excluding extremely high quality covered bonds, as underlyings, covered bonds (min. rating AA–, min. issue volume €500m, min. overcollateralisation 2%).
- Level 2A contains assets of central governments, central banks, regional and local governments, public-sector entities (with a 20% risk weighting); also covered bonds (not contained in Level 1), corporate bonds (min. rating AA–, min. volume €250m, max. original maturity 10 years), qualifying units or equities of UCIs with level 2A assets as underlyings.
- Level 2B contains equities (from main indices), corporate bonds (min. rating BBB–, min. volume €250m, max. original maturity 10 years), qualifying units or equities of UCIs with corporate bonds (credit quality steps 2/3), equities (major equity index) or non-interest bearing assets (held by banks for religious reasons) (credit quality steps 3-5) as underlyings.

Table 42

Liquidity reserves from highly liquid assets | €bn	**31.12.2016**
Exposure of highly liquid assets	80.0
thereof Level 1	64.6
thereof Level 2A	13.6
thereof Level 2B	1.8

Liquidity ratios

In 2016, 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 and with the external regulatory German Liquidity Regulation; at the end of the year, the liquidity ratio under the German Liquidity Regulation stood at 1.52.

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. Following an introductory period, a minimum ratio of 100% must be complied with from 1 January 2018 onwards. At the start of the new financial year 2017, the ratio to be complied with is 80%.

Commerzbank significantly exceeded the stipulated minimum ratio of 70% on every reporting date in 2016, meaning that its LCR remained very comfortably in excess of minimum statutory requirements last year.

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. Given its high economic significance, compliance risk is managed as a separate risk type. In line with the CRR, however, losses from compliance 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 reinforcement of the ICS structure is an essential aspect of the pro-active reduction or prevention of operational risks.

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.

As such, 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 pro-actively 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. Where loss events involve ≥ €1m, lessons learned activities are carried out. 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 from operational risks on this basis amounted to €23.9bn at the end of 2016 (31 December 2015: €21.4bn), while economically required capital was €2.0bn (31 December 2015: €1.8bn).

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

Table 43

	31.12.2016		31.12.2015	
€bn	RWA	ErC	RWA	ErC
Private and Small-Business Customers	7.0	0.6	7.6	0.6
Corporate Clients	11.7	1.0	7.7	0.6
Others and Consolidation	3.3	0.3	3.9	0.3
Asset & Capital Recovery	1.9	0.2	2.2	0.2
Group	**23.9**	**2.0**	**21.4**	**1.8**

The total charge for OpRisk events at the end of 2016 was around €36m (full-year 2015: €130m). The events were dominated by losses in the categories “Process related” and “External fraud”.

Table 44

OpRisk events[1] | €m	31.12.2016	31.12.2015
Internal fraud	1	1
External fraud	26	−1
Damages and IT failure	1	9
Products and business practices	−21	90
Process related	29	45
HR related	0	−14
Group	**36**	**130**

[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 Committees 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 Risk Committee of the Supervisory Board.

Other risks

To meet the requirements of pillar 2 of the Basel framework, MaRisk insists on 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 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 should be 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 Legal Risk 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, 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, and cases brought by shareholders and other investors as well as investigations by US authorities. In addition, changes to rulings by supreme courts as well as to legal conditions, which may render them more restrictive, in private customer business and elsewhere, may result in more claims being brought against Commerzbank or its subsidiaries. In most of these court cases, claimants are asking for the payment of compensation 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, where Commerzbank and its subsidiaries are or have been active, have been investigating irregularities regarding foreign exchange rate fixings and the foreign exchange business in general in the last couple of years. 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 and brought one case. Commerzbank is cooperating fully with these bodies and is also looking into the relevant matters on the basis of its own comprehensive investigations. The possibility of financial consequences arising from some of these matters cannot be ruled out; however, it is not yet possible to make more precise statements in that regard.

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 is cooperating fully with the authorities. It had already initiated a forensic analysis of cum-ex transactions at the end of 2015 which is still ongoing.

In December 2016, the tax authority issued an amended decision to Commerzbank regarding the offsetting of capital gains taxes and the solidarity surcharge with respect to "cum-cum transactions" for the year 2009. Commerzbank lodged an appeal against the tax credit thus refused, which has yet to be decided. The tax authority granted a request based on this legal opinion that enforcement be suspended.

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 sufficiently accurately determined. As there are considerable uncertainties as to how such proceedings will develop, the possibility cannot be excluded that some of the reserves created for them 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 create reserves. 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 (68) regarding provisions and Note (86) regarding contingent liabilities and irrevocable lending commitments in the Group Financial Statements.

Compliance risk

As part of its code of conduct, Commerzbank has defined binding minimum standards for Commerzbank's corporate responsibility, its dealings with customers and business partners, as well as its colleagues with each other, which have a material impact on 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 an important part of its risk culture.

The risk that may arise from the failure to adhere to key legal regulations and requirements is referred to as compliance risk. It includes the risks associated with money laundering, terrorist financing, sanctions and embargoes, markets compliance as well as fraud and corruption.

Commerzbank does not tolerate breaches of applicable laws, rules and regulations. It will not pursue deals where it knows or suspects that the business activities will lead to illegal behaviour. As such, it will not enter into transactions with people or companies who deliberately take part in illegal activities.

To prevent compliance risks, Commerzbank has implemented hedging 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. To take account of Commerzbank-specific characteristics, individual compliance standards for Commerzbank are derived from this standard.

Under this "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. Commerzbank has established an extensive compliance committee structure encompassing committees within the compliance function and cross-segment committees.

Commerzbank is constantly developing its compliance management system in order to meet its responsibilities and cope with the growing complexity and increasing regulatory requirements, thereby enabling it to secure its long-term business success. In this context, the full Board of Managing Directors has launched a global Compliance Change Management Programme to drive a stronger compliance culture within Commerzbank that goes beyond its business-related compliance requirements.

In March 2015, Commerzbank reached settlements with various US authorities regarding violations of US sanctions and anti-money laundering provisions and undertook to implement additional measures to improve compliance-relevant processes The settlement also includes a three-year period of good conduct.

Based on the settlements, the Bank has engaged an independent monitor, selected by the New York State Department of Financial Services (DFS) at its sole discretion. The monitor's mandate is to conduct a comprehensive review of Commerzbank's compliance standards, as measured against the requirements of the Office of Foreign Assets Control (OFAC), the Bank Secrecy Act (BSA) and anti-money laundering laws, where these pertain to or affect the activities of its New York branch. The Bank is cooperating fully with the monitor. This includes, inter alia, granting it immediate access to relevant bank data, documents and employees and supporting its work to the best of its abilities. In light of the experiences of other banks, it cannot be totally ruled out that Commerzbank will be subject to further measures during the period of good conduct and from the activities of the monitor.

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. One of the factors determining it is the Bank's handling of sustainability considerations in its core business (intrinsic reputational risks). Companies are judged not only on the basis of people's personal experiences of them, but also of 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 material 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 for stakeholder groups. It maintains close links with the relevant market 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. Its task is to identify, evaluate and address intrinsic reputational risk in systematic processes at an early stage and suggest or implement appropriate measures (early warning function).

Risk management

Managing intrinsic reputational risk means identifying potential environmental, social and ethical risks at an early stage and reacting to them in order to reduce 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. Depending on the outcome they may be assessed unfavourably, have conditions imposed on them, or even be rejected outright.

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 forwards them to the relevant parts of the Bank. The reputational risks identified and addressed by the department are incorporated into the quarterly report on non-quantifiable risks prepared for the Supervisory Board's Risk Committee and the quarterly report on major and high reputational risks prepared for the CFO and the responsible segment boards.

IT risk

IT risk is a form of operational risk. Our internal definition of IT risk includes risks to the security of information processed in our systems in terms of meeting the four IT protection targets 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 protection targets 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.

The most important 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 externals attacking 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.

[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.

Given the major importance of IT security to Commerzbank, it is continually further developed and improved 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, which we will push ahead with in 2017. In 2016 we also launched a comprehensive analysis of the Bank's internal control system, with the aim of ensuring that the internal control system takes all cyber risks into account.

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: We offer selected internal and external training, continuing education and change programmes to ensure that the level of employee qualifications keeps pace with the current state of developments, structural changes are supported accordingly and our employees can fulfil their duties and responsibilities.

Motivation risk: 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: 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.

Supply risk: Our 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. Our success is based on the specialist knowledge, skills, abilities and motivation of our employees. Human resources risk is systematically managed by Group Human Resources with the aim of identifying, assessing and managing risks as early as possible, 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. Since mid-2016 we have been introducing strategic personnel planning throughout the Bank based on the pilot projects completed by the end of 2015.

Overall, the Bank will continue to monitor human resources risk. There is a risk of the human resources risk situation deteriorating due to the impending structural changes under the Commerzbank 4.0 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 market conditions or the inadequate implementation of the Group strategy.

Group strategy is developed further in a process that takes into account both external and internal factors. 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 implementation 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 representing > 1% of Commerzbank AG's regulatory equity capital) 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). Corresponding to the focus of the Group risk strategy to ensure that the Bank is adequately capitalised, the models for assessing risk-bearing capacity (capital requirements according to Pillars 1 and 2 of the Basel framework) 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.

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 control and internal audit, external auditors and the German and European supervisory authorities. Despite being carefully developed and regularly monitored, 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 particularly 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.