COMMERZBANK
Finance & Covered Bond S.A.

COMMERZBANK
Group

Annual Report 2019

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Management Report

1 Management Report

Economic conditions in 2019

The trade dispute between the USA and China had a noticeably chilling effect on the global economy in 2019. China recorded its weakest economic growth in almost 30 years. Not only did the country suffer from higher US tariffs and uncertainty about the future direction of the trade dispute, structural problems such as high corporate debt also weighed on the economy. These factors hampered the measures taken by the Chinese government in the spring to support the economy from achieving their full effect.

The trade dispute also took its toll on the US economy. Given trade policy uncertainty, companies were very reluctant to invest. The momentum for the tax cuts in 2018 also faded significantly. In spite of the increasingly tight supply of labour, economic growth was, however, still a very respectable 2.3 %. The US Federal Reserve did though cut its base rates by a total of 75 basis points in the second half of the year in order to ward off potential risks to the economy.

Economic growth in the eurozone continued to soften during the course of 2019. For the full year 2019, it was just enough to achieve a rise of 1.2 %. Global weakness in demand hit industry especially hard. By contrast, the services sector proved to be surprisingly robust. This was probably primarily due to the ECB's highly expansive monetary policy. Alongside construction, the services sector had, after all, been one of the main beneficiaries from the resulting increase in domestic demand. With the continued slowdown in growth, the decline in unemployment also came to a halt. At 7.4 %, the unemployment rate was, however, almost as low as it was prior to the financial market crisis in 2008. As the labour market tightened in 2019, wage pressure increased, and this gradually fed through to underlying inflation, which edged up slightly. The core inflation rate – i.e. the previous year's rate of the consumer price index excluding volatile energy and food and beverages prices – was 1.3 % in December 2019, 0.3 percentage points higher than at the end of 2018.

From the ECB's point of view, inflation was, however, still far too weak. For this reason, it cut the deposit rate by 0.1 percentage points to -0.5 % in September and has again been purchasing a net €20bn of bonds every month since December.

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

On financial markets, interest rate cuts by the US Federal Reserve and the ECB provided some relief. At the end of 2019, the ten-year German government bond had moved well into negative territory at - 0.3 %, after reaching a new all-time low of - 0.7 % at the end of August. Share prices also rallied despite the trade policy uncertainty. In 2019, the DAX gained 25 %.

The US dollar gained a little more ground against the euro even though the US Federal Reserve Bank loosened its monetary policy much more than the ECB.

Future economic situation in 2020

The current coronavirus pandemic and its impact on the global economy will lead to a significant slump in economic output, particularly in the first half of 2020. This is also confirmed by the economics department of Commerzbank AG, our parent company. The severity and sustainability of this economic downturn will depend on the duration and severity of the measures to contain the pandemic and the effectiveness of economic policies. At present it is not possible to predict how quickly and to what extent an economic recovery can take place.

Germany's gross domestic product is expected to shrink by 3.5 % this year, and its economy is expected to buckle due to the coronavirus crisis and the shutting down of public life, at least in the first half of the year. A particularly hard economic slump of around 7.5 % is expected in the coming second quarter when the closure of many shops and the collapse in restaurants and hotels are expected to have a greater impact. However, if the pandemic subsides, this will allow the German economy to recover from mid-year onwards. The economy is then expected to shift out of reverse gear, and post a growth rate of 4 % in 2021.

Significant events

With effect from 19 June 2019 Mr Hermann Rave was elected Chairman of the Board of Directors and Mr Manfred Bier was elected Deputy Chairman of the Board of Directors of CFCB. Mr Michael Hacker was appointed a member of the Board of Directors of CFCB with effect from 1 October 2019 until the end of the Annual General Meeting in 2020.

Net assets and financial position

The Bank's risk-bearing capacity ratio improved from 37.1 % to 71.2 % in 2019, but the economic risk coverage potential did not fully cover the economic capital requirements. The economic shortfall is covered by a letter of comfort from Commerzbank AG stating that it will ensure the Bank is able to meet its contractual obligations, except for political risks.

Liquidity was maintained throughout 2019. During the year, the Bank complied with its obligations to the Banque Centrale du Luxembourg (BCL) in respect of minimum reserves and the capital and liquidity requirements imposed by the banking supervisor (SREP requirements).

Commerzbank Finance & Covered Bond S.A. is not currently planning to issue any new Lettres de gage. Future funding requirements are being reduced by the sale of assets and covered by repo transactions and internal, unsecured refinancing transactions.

Capital

Including reserves and regulatory deductions, the Bank's Common Equity Tier 1 capital amounts to €1,171.7m (31 December 2018: €979m). Together with the eligible Tier 2 capital, the Bank has a total regulatory capital base of €1,182.1m (31 December 2018: €990m). As at 31 December 2019, the capital adequacy ratio under CRD IV/CRR (CoRep) was 56.21 % (31 December 2018: 37.10 %).

Areas of activity

As a financial institution with a special banking licence, Commerzbank Finance & Covered Bond S.A. is entitled to carry on all activities specified in Art. 12-2 of the Luxembourg Law on Lettres de Gage of 21 November 1997 as most recently amended, including agency transactions as accessory business. The Bank conducted no other types of business as defined by law during 2019. The Bank mainly does business with counterparties within the Group when it comes to any transactions affecting liquidity.

Public-sector loans

Total lending (bonds and other fixed-interest securities, claims on customers and certain claims on banks with the character of loans) fell during the course of the year by a nominal €2,393.9m (carrying amount €3,053.3m) from a nominal €8,663.8m (carrying amount €10,489.1m) at the end of 2018 to €6,269.9m (carrying amount €7,436.1m) as at 31 December 2019. This amount included around €351.1m (carrying amount €354.9m) in scheduled maturities and around €1,974.7m (carrying amount €2,788.0m) in sales. Added to this were partial repayments and contrary currency effects.

The Bank is exposed to risks arising from the current level of public-sector debt, albeit to a substantially lesser extent than in previous years. As at 31 December 2019 the Bank had an exposure of a nominal €1,552.8m (carrying amount €2,208.4m) (31 December 2018: €1.731,3 m) to GIIPS countries, of which the Republic of Italy accounted for €923.0m (carrying amount €1,299.9m), the Kingdom of Spain €367.8m (carrying amount €543.9m) and the Republic of Portugal €232.0m (carrying amount €346.6 m). Further details may be found in the credit risk report (section 6.3.4).

Both this and other upheavals on the capital markets gave rise to the difference between the lower of carrying amount and market value of €–501.2m for financial instruments in the category "financial assets - amortised cost".

The Bank applies the Commerzbank Group's internal rating procedure, which is subject to constant review, recalibration and validation. The internal rating system indicates that the proportion of assets in the total loan portfolio with a rating of AA- or better rose from 37.3 % as at 31 December 2018 to 54.3 % as at 31 December 2019. Compared with the previous year, the proportion of investment grade exposures (as rated using the internal system) decreased from 94.2 % to 93.7 % as at 31 December 2019.

Lending policy

Commerzbank Finance & Covered Bond S.A. is a legally independent bank under the global functional leadership of Group Treasury, in whose strategy it is integrated and to which it reports. At the Bank's request, the CSSF has approved the complete exemption of risks in respect of Group entities subject to the same supervisory authority on a consolidated basis when calculating large exposures, in accordance with Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms. This exemption is also valid under CRD IV/CRR.

Internal governance

Commerzbank Finance & Covered Bond S.A. has complied with all the requirements imposed on it by the current version of circular CSSF 12/552, within the bounds of the proportionality principle. The qualification of the members of the Board of Directors, key management personnel and members of the Board of Managing Directors is ensured by regular "Fit & Proper" training courses. The Board of Directors and management have drawn up guidelines to make the work of their key functions transparent and prevent conflicts of interest. The internal governance policy compiled by Commerzbank Finance & Covered Bond S.A. brings together the circulars of relevance to the Bank and prevents redundancies.

Declaration on corporate governance

Responsible corporate governance constitutes an essential element of how Commerzbank Finance & Covered Bond S.A. sees itself. That is why we expressly support the principles of good governance.

The Bank has the processes and control systems required to compile financial information. Accounting is outsourced under service level agreements to Commerzbank AG, Luxembourg branch, whose Finance department performs the relevant functions.

Transactions are entered in the IT system on a daily basis. The required general ledgers and order books are maintained. The chart of accounts is designed to meet the Bank's requirements and enable accounts to be accurately allocated. Internal accounts are reconciled regularly. Automated and standardised processes applied throughout the Group are used for most valuations.

In addition to daily closing balances, monthly balances are also generated, largely by automated processes but with manual adjustments in some areas.

Weekly internal reports are generated to keep the Board of Managing Directors informed about the Bank's financial position and earnings performance. These reports are based on the transaction data stored in the IT system and prepared in line with information requirements.

The Bank furthermore forms part of the Commerzbank Group, which is supervised by BaFin, Deutsche Bundesbank and the European Central Bank in its entirety and is therefore subject to the corporate governance requirements governing credit institutions. The declaration on

corporate governance is included in the annual financial statements of the Commerzbank Group and published on the homepage of Commerzbank AG.[1]

The internal control system

Commerzbank Finance & Covered Bond S.A.'s internal control system is based on the methodology of Commerzbank AG and hence derived from the international "COSO I" framework developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). It aims to ensure: a) the effectiveness and efficiency of business processes, b) compliance with laws and regulations currently in force and c) the reliability of financial reporting. It includes the three lines of defence required for an effective control system, as defined by the latest version of CSSF Circular 12/552.

Internal Audit, which is outsourced to Commerzbank AG Luxembourg Branch, reviews the appropriateness and efficiency of central administration, management and risk management. It supports the Board of Managing Directors in optimising business activities in order to minimise the associated risks.

It conducts regular audits as required by law and internal rules, examining

- compliance with laws, regulations and CSSF requirements
- the effectiveness and efficiency of internal controls
- the organisation of the administration and accounting functions
- the separation of functions and the conduct of business
- the recording of transactions and the accuracy and meaningfulness of financial statements
- the maintenance of liquidity reserves and capital adequacy
- appropriate risk management
- the efficiency of the compliance and risk control functions
- key functions

Appointments to the key functions of Chief Risk Officer, Chief Compliance Officer and Chief Internal Auditor are permanent and for an unlimited period. Commerzbank Finance & Covered Bond S.A. has outsourced the function of Chief Internal Auditor, while the two other functions remain in-house. All three function holders possess the required competences and enjoy direct access to the Board of Directors, the CSSF and the auditors and regularly, at least once a year, submit summary reports regarding their function and their activities.

Risk measurement

Commerzbank Finance & Covered Bond S.A.'s internal governance regulations, which cover in particular strategies and policies applicable to equity and liquidity reserves, must clearly reflect the whole range of its various risks. The Bank determines in particular its capacity for all the risks it takes on.

[1] https://www.commerzbank.de/de/hauptnavigation/aktionaere/governance_/corporate_governace_1.html

Authority to determine the methods and parameters for the risk measurement programmes rests with Commerzbank AG. It is, however, ensured that Commerzbank Finance & Covered Bond S.A. has a full overview of all its risks.

The Board of Directors sets internal limits. It assigns internal "sub-limits" (e.g. product, currency, etc.) to the Managing Directors of Commerzbank Finance & Covered Bond S.A., which are monitored on a day-to-day basis. Levels and channels for escalation have been put in place. Further information may be found in the risk report (section 6, notes).

Personnel report

As at the end of the 2019 financial year Commerzbank Finance & Covered Bond S.A. had 10 employees (31 December 2018: 11 employees), 5 of whom were female and 5 male (31 December 2018: 5 female and 6 male).

Commerzbank Finance & Covered Bond S.A. has implemented CSSF circular 2010/437 "Guidelines on remuneration policy in the financial sector". Allowing for the requirements of its organisational structure, the Bank has adopted in full the remuneration system of Commerzbank AG, which has been agreed with the German Federal Financial Supervisory Authority (BaFin) and the Financial Market Stabilisation Fund (SoFFin).

Organisation

Both the Board of Directors and the Managing Directors of Commerzbank Finance & Covered Bond S.A. are responsible for the internal control and risk management system used in the financial reporting process.

The allocation of responsibilities is set out clearly in Commerzbank Finance & Covered Bond S.A.'s business allocation plan. The Board of Directors of Commerzbank Finance & Covered Bond S.A. oversees the accounting process and ensures it complies with current legislation, guidelines and regulations. As required by regulations, Internal Audit produces summary reports during the year on audit work and the material findings emerging from it. The Asset Liability Management, Credit Risk Management and Analytics & Regulatory Issues departments are permanent features of the Bank's structure. In the past, in the interests of ensuring operational stability, essential functionalities were outsourced to the Commerzbank Group, underlaid by service level agreements.

The work done is regularly reviewed and evaluated as part of outsourcing controlling. This process also considers any further cascading outsourcings. Where necessary, all organisational changes are agreed with the regulator.

Service level agreements are under continual development. The Bank has no subsidiaries or branches.

Commerzbank Finance & Covered Bond S.A., together with other Luxembourg units belonging to the Commerzbank Group, has, since 2011, constituted a tax group for corporation and business tax purposes. The parent company is the Luxembourg branch of

Commerzbank AG. No treasury shares were acquired during the financial year and Commerzbank Finance & Covered Bond S.A. held no treasury shares as at the reporting date.

Earnings performance

At the end of the reporting period, net interest and commission income was €140.6m, after €207.3m in the previous year. In loan loss provisions, income of €11.1m (31 December 2018: expenses of €1.2m) was mainly attributable to reversals of loan loss provisions on bonds. Net commission income was €7.4m, compared with €8.2m the previous year. Net income from hedge accounting was €–0.3m (31 December 2018: €–3.5m).

In 2019 the Bank reported expenditure of €–167.0m (31 December 2018: €–117.5m) under net income from assets and liabilities at fair value through profit and loss. This includes interest expenses from derivatives in the amount of €–150.6m (31 December 2018: €–178.3m). Other net income from financial instruments stood at €5.2m (31 December 2018: €2.1m). The Bank's operating expenses fell by 9.3 % to €22.6m (31 December 2018: €24.9m).

Overall, losses from the measurement of Mandatorily Fair Value P&L holdings resulted in a negative result before taxes of €–22.2 (31 December 2018: €60.9m). There was a loss after taxes of €–16.3m (31 December 2018: profit of €+64.5m).

Total assets

The Bank's total assets fell to €9.7bn, down €2.3bn (–19.4 %).

Proposal for appropriation of profit

Motions will be proposed to the Annual General Meeting to be held on 24 April 2020 to approve the balance sheet as at 31 December 2019 and the statement of comprehensive income for 2019 and to offset the net loss for the financial year 2019 amounting to €–16,308,237.87 against retained earnings.

Summary of business performance in 2019

The Board of Directors has taken note of the business performance of Commerzbank Finance & Covered Bond S.A. in view of the challenging market environment in 2019.

Report on events after the reporting period and outlook and opportunities report

Report on events after the reporting period

No events or findings of enough importance to require mention in the annual financial statements occurred after the reporting period at the time these financial statements were being prepared, with the exception of the coronavirus crisis, which is a non-adjusting event as defined by IAS 10.3 (b).

Outlook and opportunities report

The outlook and opportunities report covers expectations and forecasts for the future. These forward-looking statements are founded on planning assumptions and estimates derived from all the information available to the Bank as at the date on which the annual financial statements for 2019 were finalised.

Commerzbank Finance & Covered Bond S.A. accepts no obligation to revise these statements in the light of either new information or future events. Forward-looking statements are always subject to risks and uncertainties. Therefore, actual results and performance may differ substantially from those forecasts now. Such differences may result above all from changes to the general economic situation and the competitive situation, as well as from developments on the international capital markets. The Bank's results may also be affected by defaults on the part of borrowers or counterparties to transactions, changes to legislation in Luxembourg and abroad, especially regarding tax rules, as well as other risks, some of which are set out in detail in the risk report.

Forecast

The reduction in risk-weighted assets (RWA) may have an impact on the trend in key management figures. However, lower ratings in the portfolio and the associated increase in impairments may have an adverse effect on capital ratios. Interest income will fall permanently as a consequence of the reduced portfolio volume. The agency business is expected to continue generating stable commission income in future and the repurchase of liabilities may have positive effects which could, however, have a negative impact on future results. Future sales may result in further charges, and this may be reflected in the income from financial investments. Commerzbank Finance & Covered Bond S.A. takes this into account where disposals appear sensible as part of managing the portfolio with an awareness of risk and in such a way as to preserve capital.

Write-downs on lending cannot be completely ruled out. Measurement effects in net trading income may result in volatility. Operating expenses are expected to remain at the same level as last year.

However, numerous risk factors could, if unfavourable developments occur, have a considerable impact on our Bank's forecast net profit for 2020 to an extent that cannot be reliably predicted. These include the geopolitical situation, which continues to be highly uncertain, and increased geopolitical economic risks, particularly given the as yet unforeseeable economic effects of the global coronavirus pandemic, which could put achievement of our financial targets significantly at risk.

The turbulence in major indices observed in the last month had only a limited impact on the Bank's financial performance, given the financial instruments and measurement principles used. However, the slump in economic activity is expected to weigh on the gross domestic product of many economies and will affect credit risk in the medium term. In addition, the uncertainty associated with market fluctuations can produce higher interest rate volatility and affect financial performance.

It is also currently impossible to conclusively assess the impact on our business and on our net assets and financial position due to the dynamically developing situation described above.

Acknowledgements

The Bank wishes to thank all employees, managers and governing bodies of Commerzbank Finance & Covered Bond S.A., not forgetting of course all the employees at Commerzbank Group who work for it. Their constructive and loyal cooperation has helped Commerzbank Finance & Covered Bond S.A. to achieve the demanding objectives set over the past year.

Particularly under the extraordinary circumstances under which it currently finds itself, the Board of Directors does not take this sort of great dedication for granted.

Luxembourg, 2 April 2020

The Board of Directors

Auditors’ opinion

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To the Board of Directors
Commerzbank Finance & Covered Bond S.A.

Report on the audit of the annual financial statements

Audit opinion

We have audited the annual financial statements of Commerzbank Finance & Covered Bond S.A. (hereinafter "the Company") consisting of the balance sheet as at 31 December 2019, the statement of comprehensive income, the statement of changes in equity and the cash flow statement for the financial year ending on this date together with the notes including a summary of the main accounting methodologies.

In our opinion based on the findings of our audit, the enclosed annual financial statements comply with the International Financial Reporting Standards (IFRS) as applied in the European Union and give a true and fair view of the net assets and financial position of the Company as at 31 December 2019 as well as the earnings performance and cash flows for the financial year ended on that date.

Basis for the audit opinion

We carried out our audit of the annual financial statements in accordance with EU Regulation 537/2014, the Law on Audit Activities (the "Law dated 23 July 2016") and the International Standards on Auditing ("ISA") as adopted for Luxembourg by the Commission de Surveillance du Secteur Financier ("CSSF"). Our responsibility for the financial statements pursuant to EU Regulation 537/2014, the Law dated 23 July 2016 and the ISA Standards is described in detail in the section entitled "Responsibility of the auditor".

We are independent from the Company in accordance with the "International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants" ("IESBA Code") adopted for Luxembourg by the CSSF together with the professional standards of conduct with which we must comply within the scope of the audit of the annual financial statements and we have fulfilled all other professional requirements in accordance with these standards of conduct. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance to the audit of the annual financial statements for the current period under review. These matters were addressed in the context of the audit of the annual financial statements

as a whole, and in forming the audit opinion thereon, and we do not provide a separate audit opinion on these matters.

Below, we describe what we consider to be the key audit matters:

1. Calculation of loss provisions for financial instruments not in default

a) Description of the matter
The Company holds claims and fixed-interest securities with a carrying amount of €8,713m, which are measured at amortised cost. This corresponds to 89.6 % of total assets. Provisions for credit risks and credit losses of €13.8m were made for these assets.

Information on financial instruments measured at amortised cost and on provisions for credit risks and credit losses is included in the notes under 5.2, 5.4, 5.11 in the section "Summary of accounting and measurement methods", under 7.2 within the section "Notes on the statement of comprehensive income" and under 8.2 and 8.4 in the section "Notes to the balance sheet".

The credit risks resulting from financial instruments measured at amortised cost are determined on the basis of an expected loss model. Impairments of financial instruments not in default are taken into account depending on the changes in the default risk since the initial recognition date, either in the amount of the expected 12-month credit loss (Stage 1) or in the amount of the credit losses expected over the term (Stage 2) to the extent that the default risk of the financial instrument has deteriorated significantly.

In this context, the criteria for determining a significant deterioration in default risk (Stage 2 allocation), in particular, provide some discretionary scope. There is further scope for discretion in determining the parameters and models used for the calculation. Against the backdrop of the existing scope for discretion and the volume of financial instruments not in default for which a provision for risks is to be set aside pursuant to IFRS 9, we view the calculation of the provision for losses for financial instruments not in default as a key audit matter.

b) Our audit approach
To audit the criteria for determining a significant deterioration in the default risk, we assessed the stage allocation model devised by the Company and its significant assumptions for financial instruments not in default for their conformity with IFRS 9.

We assessed the appropriateness and operating effectiveness of selected controls over stage allocation. Due to the fact that the Company does not transact any new business, these included in particular the procedures and controls in place for loan monitoring (determination of the current default risk).

We performed substantive analytical procedures based on a data excerpt from the credit portfolio, In connection with this, the original default risk stored in the relevant data was analysed for anomalies. We also obtained an understanding of Stage 2 allocation based on qualitative and quantitative criteria.

We reviewed the models used by the Bank to calculate expected credit losses by assessing the IFRS 9-specific parameters used and the parameters for determining credit risk. In this context, we also checked whether appropriate internal validation processes were carried out with regard to the credit risk parameters used.

2. Measurement of derivative financial instruments

a) Description of the matter
In connection with interest rate and currency derivatives, the Company reported positive fair values of €907m and negative fair values of €1,778m. Of this amount, €409m (positive fair values) and €596m (negative fair values) relates to derivatives not used as fair value hedging instruments.

Information on derivative financial instruments is provided in the Notes in sections 5.2, 5.5, 5.9, 5.10 in the section "Summary of accounting and measurement methods", in section 7.4 in the section "Notes on the statement of comprehensive income", in 8.5 and 8.6 of the section "Notes to the balance sheet (assets)" and in sections 9.2, 9.3, 9.12, 9.13 and 9.20 of the section "Notes to the balance sheet (liabilities)".

The Company measures derivative financial instruments in accordance with the provisions of IFRS 13. The fair value of these instruments is initially derived from quoted prices for identical financial instruments on active markets (Level 1). If no quoted prices are available for identical instruments on an active market, their fair value is estimated based on observable market parameters (Level 2). If there are insufficient observable market parameters for a determinant that has a significant effect on the measurement of the financial instrument, the Company must estimate internal inputs using the best information available (Level 3).

The interest rate and currency derivatives used by the Company are not quoted on active markets, which is why valuation models involving scope for discretion are used to measure them. In light of this and owing their size relative to total assets, we consider the measurement of derivative financial instruments to be a particularly important audit issue.

b) Our audit approach
We looked at the procedures and processes used in the measurement process and assessed the appropriateness and operating effectiveness of the controls used.

We gained an understanding of the methodology of the measurement model used by the Company and examined it in accordance with the requirements set out in IFRS 13. We assessed the appropriateness of the inputs in the measurement model on the basis of both data available within the Company and externally available data. In this process, we assessed in particular the appropriateness of the measurement parameters used by the Bank by performing a reconciliation with observable market data.

We gained an understanding of the calculatory accuracy of the method used to establish the fair value. As at the reporting date we performed a subsequent measurement of derivative financial instruments in random sampling and assessed the appropriateness of the Bank's values on this basis.

Further Information

The Board of Directors is responsible for the further information. Further information includes information contained in the management report and in the declaration on corporate governance but not the annual financial statements or our auditor's opinion on them.

Our audit opinion on the annual financial statements does not cover the further information and we give no assurance of any kind in respect thereof.

Our responsibility in relation to the auditing of the annual financial statements is to read the further information and on that basis assess whether there is any material inconsistency with the annual financial statements or the insights gained in the course of the audit or whether the further information appears otherwise to be materially misrepresented. Should we conclude from the work done by us that the further information contains material misstatements, we are obliged to make a report to that effect. We have nothing to report on this point.

Responsibility of the Board of Directors

The Board of Directors is responsible for the preparation and proper presentation of the annual financial statements in accordance with the IFRS as applicable in the European Union and the internal controls which the Board of Directors regards as necessary to facilitate the preparation of annual financial statements free from material misrepresentations, whether intended or unintended.

In preparing the annual financial statements, the Board of Directors is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors intends to liquidate the Company or suspend business operations or has no other realistic alternative but to do so.

Responsibility of the auditor for the annual financial statements

The objective of our audit is to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misrepresentations – whether intended or unintended – and to issue an auditor's opinion on this which contains our audit opinion. Reasonable assurance corresponds with a high level of assurance, but is not a guarantee that an audit conducted in accordance with EU Regulation 537/2014, the law dated 23 July 2016 and the ISAs adopted for Luxembourg by the CSSF will always detect a material misrepresentation, if one exists. Misrepresentations can arise from error or fraud and are considered material if, individually or in the aggregate, they could reasonably be expected to influence economic decisions of users taken on the basis of these annual financial statements.

We use our best judgement and take a critical approach within the scope of an audit of financial statements in accordance with EU Regulation 537/2014, the law dated 23 July 2016 and the ISAs adopted for Luxembourg by the CSSF. Furthermore:

- We identify and assess the risk of material misrepresentations in the annual financial statements resulting from error or fraud, plan and conduct audit procedures as a response to these risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinion. The risk of not detecting a material misrepresentations resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- We obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- We evaluate the appropriateness of the accounting policies used by the Board of Directors, accounting estimates and the corresponding information in the Notes.

- We draw conclusions about the appropriateness of the Board of Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's opinion to the related disclosures in the annual financial statements or, if such disclosures are inadequate, to modify our audit opinion. These conclusions are based on the audit evidence obtained up to the date of the auditor's opinion. However, future events or conditions may cause the Company to cease to continue as a going concern.

- We assess the overall presentation, structure and contents of the annual financial statements, including the information in the Notes, and we evaluate whether they accurately represent the underlying transactions and events.

We communicate with those charged with governance regarding multiple matters, including the planned scope and timing of the audit, significant audit findings and any significant deficiencies in the internal control system that we identify during our audit.

We have provided those charged with governance with a statement that we have complied with the relevant requirements regarding independence and communicated to them all relationships and other matters that may reasonably be thought to bear on our independence and, if relevant, the related safeguards.

With regard to the matters communicated to those charged with governance, we identify those matters that were of greatest significance to the audit of the consolidated financial statements of the current period under review as the key audit matters. We describe these matters in our report unless the law or other regulations preclude public disclosure of the matter.

Report on further legal and regulatory obligations

We were appointed as auditors by the Board of Directors on 11 April 2019. The uninterrupted term of our mandate, including previous extensions and reappointments, is two years.

The Management Report is consistent with the financial statements and has been drafted in accordance with the requirements of the law.

The declaration on corporate governance is the responsibility of the Board of Directors. The information required according to Article 70bis (1) (c) and (d) of the amended law dated 17 June 1992 on the annual financial statements and consolidated financial statements of banks subject to Luxembourg law is consistent with the annual financial statements and has been drafted in accordance with the current requirements of the law.

We confirm that we have not rendered any prohibited non-audit services as defined by EU Regulation 537/2014 and that we remained independent of the Company during the performance of the audit.

Other

The declaration on corporate governance includes the information required on account of Article 70bis (1) of the amended law dated 17 June 1992 governing the annual financial statements and consolidated financial statements of banks subject to Luxembourg law.

Ernst & Young
Société anonyme
Auditors, Luxembourg, 2 April 2020

Represented by
Christian Brüne

Annual financial statements of Commerzbank Finance & Covered Bond S.A.

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All details in this Annual Report are derived from information and business performance figures of Commerzbank Finance & Covered Bond S.A. (CFCB) as at 31 December 2019.

Unless otherwise indicated, all amounts are shown in thousands of euros (€ thousand).

Due to rounding, slight deviations may occur in totals and calculations of percentages.

3 Annual financial statements of Commerzbank Finance & Covered Bond S.A.

Statement of comprehensive income

in €000	Notes	1.1.-31.12.2019	1.1.-31.12.2018	Change in €000	Change in%
Interest income accounted for using the effective interest method		299,566	291,106	8,460	2.9
Interest income accounted for not using the effective interest method		3,943	87,045	–83,102	–95.5
Interest income	7.1	303,509	378,151	–74,642	–19.7
Interest expenses	7.1	162,907	179,015	–16,108	–9.0
Net interest income	**7.1**	**140,601**	**199,136**	**–58,535**	**–29.4**
Risk result/loan loss provisions	7.2	–11,101	1,205	–12,306	>–100
Net interest income after loan loss provisions		**151,703**	**197,931**	**–46,228**	**–23.4**
Commission income	7.3	8,357	8,765	–408	–4,7
Commission expenses	7.3	944	573	371	64.8
Net commission income	**7.3**	**7,413**	**8,192**	**–779**	**–9.5**
Net income from hedge accounting	7.4	–318	–3,519	3,201	–91.0
Net income from financial assets and liabilities measured at fair value through profit and loss	7.4	–166,956	–117,463	–49,493	42.1
Gain or loss on disposal of financial assets – amortised cost	7.5	–3,830	1,079	–4,909	>–100
Other sundry profit or loss on disposal of financial instruments	7.5	9,025	1,016	8,009	>100
Other profit or loss from financial instruments/Net investment income	7.5	5,195	2,096	3,099	>100
Operating expenses	7.6, 7.7, 7.8, 7.9, 7.10, 9.5	22,562	24,883	–2,321	–9.3
Other net income	7.11	3,374	–1,473	4,847	>–100
Operating profit/loss		**–22,150**	**60,880**	**–83,030**	**>–100**
Taxes on income	7.12	–5,842	–3,583	–2,259	63.0
Surplus/shortfall for the year		**–16,308**	**64,463**	**–80,771**	**>–100**
Change from remeasurement of defined benefit plans not recognized in the income statement	9.5	–1,717	34	–1,751	>–100
Items not recyclable through profit or loss		**–1,717**	**34**	**–1,751**	**>–100**
Change in revaluation reserve		0	0	0	n/a
Items recyclable through profit or loss		**0**	**0**	**0**	**n/a**
Other comprehensive income		**–1,717**	**34**	**–1,751**	**>–100**
Total comprehensive income		**–18,025**	**64,497**	**–82,522**	**>–100**

The Notes are an integral part of these financial statements.

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Balance sheet

Assets in €000	Notes	31.12.2019	31.12.2018	Change in %
Cash reserve	5.6, 8.1	71,392	5,263	>100
Financial assets – Amortised cost	5.4, 5.7, 5.11, 8.2, 8.4	8,713,091	8,576,147	1.6
Financial assets – Mandatorily Fair Value P&L	5.4, 5.8, 8.3	20,005	2,633,044	–99.2
Financial assets – Held for Trading	5.4, 5.9, 8.5	408,818	338,301	20.8
Positive fair values of derivative hedging instruments	5.5, 5.10, 8.6	498,479	486,614	2.4
Intangible assets	5.13, 8.7, 8.8	3,341	6,682	–50.0
Fixed assets	5.13, 8.7, 8.8	371	32	>100
Other assets	8.10	912	6,640	–86.3
Total		**9,716,410**	**12,052,723**	**–19.4**

Liabilities in €000	Notes	31.12.2019	31.12.2018	Change in %
Financial liabilities – Amortised cost	5.4, 5.15, 9.1	6,749,252	8,301,251	–18.7
Financial liabilities – Held for Trading	5.4, 5.9, 9.2	596,018	1,433,076	–58.4
Negative fair values of derivative hedging instruments	5.5, 5.10, 9.3	1,181,719	1,091,038	8.3
Provisions	5.16, 9.4, 9.5, 9.6	11,255	10,490	7.3
Current tax liabilities	5.14, 9.7	0	20,655	–100.0
Other liabilities	9.8	1,263	1,284	–1.7
Equity	5.18, 9.9	1,176,904	1,194,928	–1.5
Subscribed capital	5.18, 9.9	235,000	235,000	0.0
Capital reserve	5.18, 9.9	1,859,000	1,859,000	0.0
Retained earnings	5.18, 9.9	–900,788	–963,535	–6.5
Surplus/shortfall for the year	5.18, 9.9	–16,308	64,463	>–100
Total		**9,716,410**	**12,052,723**	**–19.4**

The Notes are an integral part of these financial statements.

Statement of changes in equity

in €000	Notes	Subscri-bed capital	Capital reserve	Retained earnings	IAS 19 reserve	Surplus/ shortfall for the year	Total
Balance as at 01.01.2018		**235,000**	**1,859,000**	**–877,746**	**–2,179**	**–83,644**	**1,130,432**
Net income for the year	5.18, 9.9					64,463	64,463
Capital allocation	5.18, 9.9						0
Withdrawal from retained earnings	5.18, 9.9			–83,644		83,644	0
Change in IAS 19 reserve	5.18, 9.9				34		34
Balance as at 31.12.2018		**235,000**	**1,859,000**	**–961,390**	**–2,145**	**64,463**	**1,194,928**
Balance as at 01.01.2019		**235,000**	**1,859,000**	**–961,390**	**–2,145**	**64,463**	**1,194,928**
Net income for the year	5.18, 9.9					**–16,308**	**–16,308**
Capital allocation	5.18, 9.9						0
Transfer to retained earnings	5.18, 9.9			64,463		–64,463	0
Change in IAS 19 reserve	5.18, 9.9				–1,717		–1,717
Balance as at 31.01.2019		**235,000**	**1,859,000**	**-896,927**	**-3,862**	**-16,308**	**1,176,904**

The Notes are an integral part of these financial statements.

Cash flow statement

in €000	Notes	31.12.2019	31.12.2018
Surplus/shortfall for the year		**–16,308**	**64,463**
Non-cash positions in net income for the year and reconciliation with cash flow from operating activities:			
Write-downs, depreciation, write-ups on financial assets, intangible assets, changes in provisions and net changes due to hedge accounting	8.4, 8.8, 9.4, 9.5, 9.6, 7.4	–6,596	27,927
Change in other non-cash positions		17,477	–906,033
Net gain or loss on the sale of financial assets and liabilities	7.5	–5,195	–2,096
Other adjustments			–13,530
Sub-total		**–10,622**	**–829,269**
Changes to assets and liabilities from operating activities after adjustment for non-cash positions:			
Financial assets – Amortised cost		150,769	1,463,544
Financial assets – Mandatorily Fair Value P&L	8.2, 8.3	2,577,680	27,294
Other assets from operating activities	8.7, 8.8, 8.10	47,500	–765,945
Financial liabilities – Amortised cost	9.1	–1,718,902	–10,738
Other liabilities from operating activities	9.6, 9.7, 9.8	–985,759	404,194
Interest received	7.1	302,540	–390,664
Interest paid	7.1	–288,297	1,521
Income taxes received			
Income taxes paid		–8,779	
Cash flow from operating activities		**66,129**	**–100,063**
Cash and cash equivalents as at 1.1.	8.1	**5,263**	**105,326**
Cash flow from operating activities		66,129	–100,063
Cash and cash equivalents as at 31.12.	8.1	**71,392**	**5,263**

The Notes are an integral part of these financial statements.

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4 Notes on the separate financial statements for Commerzbank Finance & Covered Bond S.A.

4.1 Legal background

Commerzbank Finance & Covered Bond S.A. (hereinafter also referred to as CFCB or Bank) was established as a "Europäische Hypothekenbank der Deutschen Bank" (European mortgage bank of Deutsche Bank) on 24 April 1989 according to deed no. 529/89, as announced on 20 July 1989 in the public gazette of the Grand Duchy of Luxembourg under C, number 200, and is recorded as a "Societé Anonyme" in the Commercial Register of Luxembourg District Court under register number B 30.469. The Bank was granted a special banking licence (no. 356/99) by the Luxembourg Ministry of Finance on 23 September 1999 to issue covered bonds under Luxembourg law. As at 31 August 2012 the Bank was renamed Hypothekenbank Frankfurt International S.A.

Commerzbank AG as the ultimate parent holds 100% of the shares in the Bank, which was established on 1 September 2014 – with retroactive effect in accounting terms to 1 January 2014 – by the merger of Erste Europäische Pfandbrief- und Kommunalkreditbank Aktiengesellschaft in Luxemburg (EEPK) with Hypothekenbank Frankfurt International S.A. (HFI) while retaining its name, EEPK.

As part of the reorientation of Commerzbank's operations in Luxembourg, EEPK was renamed as Commerzbank Finance & Covered Bond S.A. with legal effect on 15 February 2016. Publication took place in the public gazette of the Grand Duchy of Luxembourg on 8 February 2016 under C, number 342 and on 31 May2016 under C, number 1559.

4.2 Object of the Bank

The object of the company is to conduct all such business as is permitted to a Pfandbrief bank by Art. 12-1 to 12-12 of the Law on the Financial Sector of 5 April 1993 as most recently amended. The Bank is thus authorised to issue Lettres de gage (covered bonds under Luxembourg law) and conduct related secondary and ancillary business.

4.3 Compliance Statement

Commerzbank Finance & Covered Bond S.A. is a credit institution with its registered office in Luxembourg, Grand Duchy of Luxembourg. The annual financial statements as at 31 December 2019 were prepared in conformity with Regulation (EC) No. 1606/2002 (the IAS Regulation) of the European Parliament and Council of 19 July 2002, with the Law on 17 June 1992 on annual financial statements and consolidated financial statements of banks subject to Luxembourg law and with other regulations on the adoption of certain international accounting standards based on the International Accounting Standards (IAS) adopted and published by the International Accounting Standards Board (IASB) and the International Financial Reporting Standards (IFRS) as interpreted by the International Financial Reporting Interpretations Committee (IFRIC). All standards and interpretations which are mandatory within the EU in 2019 have been applied.

4.4 Date of release for publication

The annual financial statements for the year ending on 31 December 2019 were released by the Board of Directors on 2 April 2020.

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5 Summary of accounting and measurement methods

5.1 General information

All standards and interpretations which are mandatory within the EU in 2019 have been applied. The Bank has not applied standards and interpretations which do not enter into force until the financial year 2020 or later.

5.1.1 Standards to be applied for the first time

In January 2016 the IASB published the new accounting standard IFRS 16 on accounting for leases. The change was transposed into EU law in the fourth quarter of 2017. The standard must be applied in the EU for financial years beginning on or after 1 January 2019. The previous standard IAS 17 and the associated interpretations IFRIC 4, SIC-15 and SIC-27 were replaced. The reconciliation table as at 1 January 2019 in accordance with IFRS 16 is presented in Note 5.2 of the Annual Report. As at 1 January 2019, the application of IFRS 16 increased total assets by €467 thousand. Instead of the previously recognised operating expenses, the income statement for financial year 2019 will in the future show depreciation on the recognised rights of use.

On 7 June 2017, IFRIC Interpretation 23 (Uncertainty over Income Tax Treatments) was published. This interpretation aims to clarify the recognition and measurement of income taxes in accordance with IAS 12 when uncertainty prevails regarding the treatment for income tax purposes. The IFRIC Interpretation must be applied in the EU for financial years beginning on or after 1 January 2019. The application of IFRIC 23 had no impact on the Bank's financial statements as at 31 December 2019.

5.1.2 Revised standards

The revised standards IFRS 3, IFRS 11, IAS 12 and IAS 23 under the Annual Improvement Project 20152017 and the revision of IAS 19 had no material impact on the financial statements. The revised standards must be applied for all financial years beginning on or after 1 January 2019.

The revisions to IAS 1 and IAS 8 published on 31 October 2018 are amendments that tighten the definition of materiality for the inclusion of information in the financial statements and harmonise it within the conceptual framework and the different standards. These changes do not have any material impact on the Bank's financial statements. The revised standards must be applied for financial years beginning on or after 1 January 2020.

The amendment to IAS 28 published on 11 February 2019 also did not result in any changes to the financial statements.

The Amendments to References to the Conceptual Framework in IFRS Standards were endorsed in November 2019 (EU Official Journal Regulation EU/2019/2075). This Regulation incorporates amendments to references to the conceptual framework in IFRSs. The amendments affect the following standards: IAS 1, IAS 8, IAS 34, IAS 37, IAS 38, IFRS 2, IFRS 3, IFRS 6, IFRIC 12, IFRIC 19, IFRIC 20, IFRIC 22 and SIC 32. They must be applied for all financial years beginning on or after 1 January 2020.

The Interest Rate Benchmark Reform saw revisions to IFRS 9, IAS 39 and IFRS 7. The revisions must be applied in the EU for financial years beginning on or after 1 January 2020. As things currently stand, no significant impact on the Bank's financial statements is expected.

5.1.3 New standards

The new IFRS 17 Insurance Contracts, which was published in May 2017, will replace IFRS 4. The new standard applies not only to insurance companies, but to all entities that issue insurance contracts within the scope of the standard. IFRS 17 aims to achieve consistent, principles-based accounting for insurance contracts. It stipulates that insurance liabilities must be measured at the current settlement amount, instead of at amortised cost. It also aims to create a uniform basis for the recognition, measurement, presentation and disclosure of insurance contracts in the notes. The standard must be applied in the EU for financial years beginning on or after 1 January 2021 and still needs to be transposed into European law. As things currently stand, no significant impact on the Bank's financial statements is expected.

5.2 Accounting and measurement methods Classification and measurement of financial instruments

IFRS 9 sets out four types of subsequent measurement of financial assets, which depend on the respective business model and the fulfilment of the SPPI criterion (solely payment of principal and interest):

- measurement at Amortised cost (AC)
- measurement at Fair value OCI with recycling (FVOCI with recycling)
- measurement at Fair value OCI without recycling (FVOCI without recycling)
- measurement at Fair value through P&L (FVPL) subdivided into Mandatorily Fair Value through P&L (mFVPL) and Held for Trading (HFT).

The management has allocated the financial assets to one of the business models set out below, based on how the financial assets are managed to generate cash flows:

- “hold” business model: receipt of contractual cash flows with only rare or immaterial sales activities;
- “hold-and-sell” business model: receipt of cash flows through holding and also through sales.
- residual business model: all portfolios that are not allocated to the “hold” or “hold-and-sell” business model. These include primarily trading portfolios and portfolios managed on a fair-value basis. The receipt of contractually agreed cash flows is of minor importance; the main objective is instead to maximise cash flows through purchases and sales.

The second criterion for classifying financial assets is the characteristics of their cash flows. When assessing these cash flows, the crucial consideration is whether they are solely unleveraged interest and principal payments on the outstanding capital, i.e. the SPPI criterion. In principle, a financial instrument is SPPI-compliant only if its contractual cash flows are equivalent to those of a simple loan.

The allocation to the business model can be made on a portfolio basis, whereas the SPPI criterion must always be assessed for each individual financial instrument that was allocated to the “hold” or “hold-and-sell” business model. Measurement at amortised cost (AC) requires that the financial asset has cash flows which correspond to the SPPI criterion and that it has been allocated to a portfolio with the “hold-to-collect” business model.

A financial asset is measured at fair value through other comprehensive income with recycling (FVOCI with recycling) if its cash flows also correspond to the SPPI criterion and it has been allocated to a portfolio with the “hold-and-sell” business model. The subsequent measurement at fair value with recognition of the value fluctuation in the income statement (FVPL) is required if either the financial instrument has been allocated to a portfolio that is part of the residual business model or its cash flows are not SPPI-compliant. This measurement category is therefore subsidiary in nature. i.e. if the asset cannot be clearly allocated to one of the two other measurement categories, it must be measured according to this category. A reporting distinction is made in this measurement category between financial instruments Held for Trading (HFT) purposes and other financial instruments requiring recognition at fair value with the resulting value fluctuation being recorded in the income statement (Mandatorily Fair Value P&L/mFVPL). Besides the fair value option (FVO), there is also the possibility of voluntarily allocating financial assets on acquisition to the mFVPL category if accounting mismatches can be avoided.

The methodology for measuring financial assets is based on the allocation of the asset to one of the following three groups:

Derivatives:
As derivatives do not have fixed redemption amounts, subsequent measurement at amortised cost is not possible. They must always be measured at fair value, with the fluctuation in value being recorded in the income statement. If derivatives are not used for hedge accounting, they must always be allocated to the trading portfolio (HFT).

Under IFRS 9, financial assets are assessed in their entirety. As a result, the host contract is not separated from the embedded derivative. Instead, financial assets are classified based on the business model and their contractual terms and conditions.

Equity instruments:
This category includes financial instruments which correspond to the definition of equity under IAS 32 for the issuing entity. As equity instruments do not involve fixed redemption amounts and instead represent only a proportional right, the SPPI criterion is not fulfilled and measurement at AC or FVOCI with recycling is precluded. However, an irrevocable decision can be made when the equity instrument is acquired to instead measure the instrument based on the FVOCI without recycling method. All value fluctuations are recognised

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in other comprehensive income and are not reported in the income statement upon the disposal of the financial instrument (without recycling). This option is not available for financial instruments that have been acquired for trading purposes or as conditional payment for the acquisition of a company. These must be measured at FVPL.

Debt instruments:

All financial instruments not considered to be derivatives as defined in IFRS 9 or equity as defined under IAS 32 are measured based on the business model and SPPI criteria described above, or in the case of an accounting mismatch using the fair value option.

Debt instruments on the asset side of the balance sheet may thus subsequently be accounted for in one of the following ways:

- Subsequent measurement at amortised cost is required if the financial instrument is held only to realise the contractually agreed cash flows ("hold-to-collect" business model) and, in addition, the contractually agreed cash flows are exclusively interest and principal payments as defined under IFRS 9 (SPPI-compliant). Subsequent measurement at fair value with recognition of the change in value in other comprehensive income with recycling (FVOCI with recycling) is required if the financial instrument is allocated to a portfolio with the "hold-and-sell" business model and, in addition, the contractually agreed cash flows are solely payments of principal and interest.
  The financial instrument is thus SPPI-compliant. Upon disposal of the financial instrument, the cumulative valuation fluctuations that have been recognised in other comprehensive income are then recognised in the income statement (with recycling).
- Subsequent measurement at fair value with recognition of the value fluctuation in the income statement (FVPL) is required if the financial asset has been allocated to a portfolio with the residual business model. This is also applicable in the case of non-SPPI-compliant cash flows and when exercising the fair value option.

As a rule, financial liabilities must be measured at amortised cost. In addition, the possibility exists of applying the fair value option. The remeasurement effect for financial liabilities designated in the fair value option resulting from own credit risk is recognised in other comprehensive income without effect on income. Financial liabilities Held for Trading and all derivatives must be reported in the balance sheet in a separate line item and measured at fair value through profit or loss.

Impairment

IFRS 9 stipulates that an impairment must be recognised in the amount of the expected credit losses (ECLs) for all loans, off-balance-sheet items and financial guarantees that are not measured at fair value through profit or loss. A risk provision must be created for financial assets (debt instruments) to be measured at amortised cost or at fair value and booked to equity. The expected loss for one year must be booked as a loan loss provision upon initial recognition. If the borrower's credit risk increases significantly, but the borrower is not yet in default, a provision must be recognised for the full lifetime expected credit losses. If an instrument is in default, a provision must be recognised for the lifetime expected loss on the basis of the estimated cash flows that can still be expected. However, a portfolio loan loss provision is recognised for insignificant defaulted claims using internal parameters.

Fundamentally, the Group determines the expected credit losses by dividing the financial instruments that are not measured directly at fair value through profit or loss, off-balance sheet lending commitments and financial guarantees into three stages. Stage 1 and Stage 2 contain the financial instruments that do not display any default criteria.

Stage 3 contains financial instruments that meet the default criteria. Financial instruments deemed to be in default at initial recognition (purchased or originated credit-impaired financial assets (POCI)) are not allocated to any of the three stages and are instead handled and disclosed separately.

Every financial instrument must be allocated to stage 1 upon initial recognition (except for POCI). In addition, stage 1 contains all transactions with only limited default risk. A limited default risk exists in cases involving an investment-grade internal credit rating (rating 2.8 or better). The provisioning for transactions in stage 1 equals the amount of the 12-month expected credit loss (12-month ECL).

Stage 2 includes financial instruments whose default risk has risen significantly since initial recognition and which are not classified as cases with limited default risk. The basis for recognising impairments or provisions in Stage 2 is the lifetime expected credit loss (LECL).

The LECL based on individual cash flow estimates is also the foundation for recognising impairments or provisions for

financial instruments in default (Stage 3). In the case of financial instruments classified as POCI, no impairment or provision is established upon initial recognition. They are measured at fair value. The provisioning recognised in subsequent measurement equals the cumulative change in the LECL since initial recognition. A financial instrument classified as POCI remains in this classification until it is derecognised. The LECL remains the basis for the measurement, even if the rating improves.

Hedge accounting

The Bank has decided to continue applying the IAS 39 regulations on hedge accounting, even after adopting IFRS 9. For further details on hedge accounting see Note 5.5.

Leases

In January 2016, the IASB published the new accounting standard IFRS 16 on accounting for leases. The change was transposed into EU law in the fourth quarter of 2017. The standard must be applied in the EU for financial years beginning on or after 1 January 2019.

The previous standard IAS 17 and the associated interpretations IFRIC 4, SIC-15 and SIC-27 were replaced. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to recognise most leases in the balance sheet.

In accordance with the transitional provisions of IFRS 16, the modified retrospective method was applied for initial application. The practical relief for the transition which states that it is not necessary to reassess whether or not a contract constitutes or contains a lease as at 1 January 2019 was also used. Instead, the standard is only applied to those contracts that were previously classified as leases under IAS 17 and IFRIC 4 at the time of initial application.

The effects of the first-time application of IFRS 16 as at 1 January 2019 were as follows:

in €000	
Fixed assets	467
Other liabilities	467

CFCB has only two leases: a motor vehicle and its business premises. Prior to the first-time application of IFRS 16, leases (as lessee) were classified as either finance or operating leases at the inception of the lease. For further information on the accounting method applied since 1 January 2019, refer to Notes 5.13 and 5.17.

The standard contains specific transitional provisions and practical reliefs that were applied as follows:

The Bank recognised rights of use and lease liabilities for leases previously classified as operating leases. In measuring the rights of use, an amount equal to the lease liability was recognised. Lease liabilities were measured at the present value of the remaining lease payments, discounted using the marginal interest rate on borrowings at the date of initial application. The weighted average marginal interest rate on borrowings was 0%.

CFCB made use of practical reliefs.

- An impairment test was therefore not carried out. Instead, immediately prior to the date of first-time application, an assessment was carried out as to whether its leases were onerous contracts.
- In addition, the term of leases with an extension or termination option was assessed on the basis of the current facts and not on the basis of the retrospectively determined probability of exercise at the inception of the contract.

The following postings were made as at 1 January 2019:

- Right-of-use assets amounting to €467 thousand were recognised under fixed assets. The adjustment related solely to assets leased under operating leases.
- Additional lease liabilities amounting to €467 thousand were reported under "Other liabilities".

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The lease liabilities existing as at 1 January 2019 can be reconciled with the liabilities under operating leases existing as at 31 December 2018 as follows:

in €000	
Liabilities under operating leases as at 31 December 2018	**555**
of which not relevant to IFRS 16	88
Discounting	0
Discounted liabilities under operating leases as at 1 January 2019	**467**
less	
• liabilities from short-term leases	0
• liabilities from low-value leases	0
plus	
• liabilities previously classified as finance leases	0
Lease liabilities as at 1 January 2019	**467**

5.3 Significant principles and uncertainties in estimates

The IFRS financial statements as at 31 December 2019 include the additional national details (Notes and Management Report) required by the Law of 17 June 1992 on the financial statements of banks subject to Luxembourg law (version as at May 2016). The financial statements comprise the statement of comprehensive income, the balance sheet, the cash flow statement, the statement of changes in equity and the Notes. The internal evaluations carried out by the Board of Directors and the Managing Directors do not consider individual segments, which is why there is no segment reporting in the separate financial statements. Commerzbank Finance & Covered Bond S.A. is an independent bank within the Commerzbank Group which is assigned to Group Treasury (GM-T).

The reporting and functional currency of the financial statements is the euro. Unless otherwise indicated, all amounts are shown in thousands of euro. The financial year is the calendar year. The German edition of the Annual Report is the authoritative version.

Significant principles

Uniform accounting and measurement methods explained in the notes below are used throughout the Bank in preparing the financial statements. The financial statements are based on the going concern principle. Financial assets and liabilities are generally measured at amortised cost, unless a different form of measurement is required by IFRS standards. This applies in particular to certain financial instruments classified in accordance with IFRS 9.

Income and expenses are accounted for on an accrual basis; they are recognised in the income statement for the period to which they are attributable in economic terms. Interest from all contractual agreements relating to financial assets or liabilities is reported in net interest income on an accrual basis and, for derivatives, in net income from financial assets and liabilities at fair value. We have reported negative interest separately in net interest income (see Note 7.1). Dividend income is only recognised where a corresponding legal entitlement exists. The Bank recognises commission income and expenses based on the accounting treatment of the associated financial instruments and on the nature of the activity.

Commission income for services which are performed over a certain period is recognised on an accrual basis. Fees which are associated with the completion of a particular service are recognised at the time of completion of the service. Performance-related fees are recognised when the performance criteria are met.

Borrowing costs that are directly attributable to the acquisition, construction or production of a significant tangible or intangible asset are capitalised in the balance sheet, provided that a period of at least 12 months is required to prepare the asset for its intended use.

In Note 9.12.4 the reconciliation of gross amounts before netting to net amounts after netting, as well as the amounts for existing netting rights that do not meet the accounting criteria for netting are presented separately for all financial assets and liabilities carried on the balance sheet that are subject to an enforceable, bilateral master netting agreement or a similar agreement but are not netted in the balance sheet. For the netting agreements, we conclude master agreements with our counterparties, e.g. 1992 ISDA Master Agreement (Multicurrency – Cross Border) and German Master Agreement for Financial Futures. By means of such netting agreements, the positive and negative fair values of the derivatives contracts included under a master agreement can be offset against one another. This netting process reduces the credit risk to a single net claim on the party to the contract (close-out netting).

Note 9.13 contains a breakdown of all balance-sheet items into short-term and long-term items. This note also reports cash flows for all financial instruments with contractual due dates. Monetary assets and liabilities denominated in foreign currencies are translated at the spot mid-rate on the reporting date. Realised expenses and income are generally translated using the spot rate applying on the date of realisation.

The expenses and income resulting from the translation of items in the balance sheet are fundamentally recognised in the net income from financial assets and liabilities measured at fair value through profit and loss.

Non-monetary items are translated using the current rate method. Gains and losses on the translation of profits or losses on non-monetary items are recognised either in equity or profit or loss depending on the way the net gain or loss is recognised.

Uncertainties in estimates

The financial statements include values which are determined, as permitted, on the basis of estimates and assumptions. The estimates and judgements used are based on past experience and other factors, such as planning and, based on current estimates, expectations or forecasts of future events. The assumptions and parameters underlying the estimates we have made are based on the exercise of appropriate judgement by the Board of Directors. This applies in particular to the appropriate selection and use of parameters, assumptions and modelling techniques when valuing financial instruments for which there are no market prices and no comparative parameters observable on the market. Where differing valuation models lead to a range of different potential values, the Board of Directors uses its judgement to determine the choice of the model to be used.

The estimates and judgements themselves and the underlying estimation methods and judgement factors are reviewed on a regular basis and compared with actual events. The Board of Directors regards the parameters used as reasonable and appropriate. Nonetheless, the actual results may differ from the estimates in the instances listed below.

Uncertainties in estimates may arise, for example, in the calculation of fair value (Note 9.19.1) or the expected cash flows of financial instruments, and in connection with impairments of loans and securities and the recognition of provisions for off-balance-sheet commitments in the lending business (Note 8.4). The risk report provides details about how economic conditions are taken into account and expected cash flows calculated.

Uncertainties also exist regarding the calculation of pension obligations. Pension obligations are measured based on the projected unit credit method for defined benefit pension plans. In measuring such obligations, assumptions have to be made, in particular regarding the discount rate, the long-term rate of increase in salaries and pensions, and average life expectancy. Changes in the underlying assumptions from year to year and divergences from the actual annual effects are reported as remeasurements without effect on income in retained earnings (see Note 9.5 on the impact of changes in parameters).

5.4 Financial assets and liabilities in accordance with IFRS 9

General classification and measurement

Under IFRS 9 all financial investments and liabilities – including financial derivatives – must be recognised in the balance sheet. A financial instrument is a contract that simultaneously gives rise to a financial asset for one entity and a financial liability or equity instrument for another. On initial recognition, financial instruments are measured at amortised cost, which usually corresponds to fair value. For financial instruments that are not measured at fair value through profit and loss, directly attributable transaction costs are included as acquisition-related costs. IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value is a price observed on an active market (mark-to-market) or determined using valuation models (mark-to-model). The relevant inputs for the valuation model are either observed directly on the market or, if not observable on the market, are estimates made by experts.

Depending on their respective category, financial instruments are measured subsequently either at (amortised) cost or fair value.

a) Recognition and derecognition of financial instruments

A financial asset or financial liability is generally recognised in the balance sheet when the Bank becomes a party to the contractual provisions of the financial instrument. For regular-way spot purchases or sales of financial assets in the cash market the trading and settlement dates normally differ. These ordinary spot purchases or sales may be recognised using either trade date or settlement date accounting. Regular-way spot purchases or sales of financial assets are recognised and derecognised on the settlement date.

The derecognition rules of IFRS 9 are based both on the concept of risks and rewards and on the concept of control. However, when deciding whether an asset qualifies for derecognition, the evaluation of the transfer of the risks and rewards of ownership takes precedence over the evaluation of the transfer of control. If the risks and rewards are transferred only partially and control over the asset is retained, the continuing involvement approach is used. The financial asset continues to be recognised to the extent of the Group's continuing involvement, and special accounting and measurement policies apply. The extent of the continuing involvement is the extent to which the Bank continues to be exposed to changes in the value of the transferred asset. A financial liability (or part of a financial liability) is derecognised when it is extinguished, i.e. when the obligations arising from the contract are discharged or cancelled or expired. The repurchase of own debt instruments is also a transfer of financial liabilities that qualifies for derecognition. Any differences between the carrying value of the liability (including discounts and premiums) and the purchase price are recognised in profit or loss; if the asset is sold again at a later date a new financial liability is recognised at cost equal to the price at which the asset was sold. Differences between this cost and the repayment amount are allocated over the term of the debt instrument.

Some amendments of contractual terms and conditions, for example as a consequence of forbearance measures or restructuring, between borrowers and the Bank could lead to derecognition. A substantial modification of the contractual terms and conditions of a financial instrument between an existing borrower and the Bank leads to the derecognition of the original financial asset and the recognition of a new financial instrument.

Similarly, a substantial modification of the contractual terms and conditions of an existing debt instrument is to be treated as a repayment of the original financial liability. In quantitative terms, an amendment of the contractual terms and conditions is regarded as substantive if the present value of the cash flows discounted under the new contractual terms and conditions varies by at least 10% from the discounted present value of the residual cash flows of the original debt instrument.

b) Classification of financial instruments and their measurement

The Bank classifies financial assets and financial liabilities in accordance with the applicable IFRS 9 categories:

Financial assets

- Amortised Cost (AC)
- Fair Value OCI (FVOCI)
- Fair Value Option (FVO)
- Mandatorily Fair Value P&L (mFVPL)
- Held for Trading (HFT)

Financial liabilities

- Amortised Cost (AC)
- Fair Value Option (FVO)
- Held for Trading (HFT)

The Bank subdivides the IFRS 9 categories into the following classes:

Financial assets

- Loans and Receivables
- Securitised debt instruments
- Derivatives that do not qualify for hedge accounting (non-cover pool derivatives)
- Derivatives that qualify for hedge accounting

Financial liabilities

- Deposits
- Bonds and notes issued
- Derivatives that do not qualify for hedge accounting (non-cover pool derivatives)
- Derivatives that qualify for hedge accounting
- Financial guarantees

and irrevocable lending commitments

c) Net gains or losses

Net gains or losses include fair value measurements recognised in profit or loss, foreign currency effects, impairments, impairment reversals, gains realised on disposal, subsequent recoveries on written-down financial instruments and changes recognised in the revaluation reserve classified in the respective IFRS 9 categories. The components are detailed in the condensed statement of comprehensive income and in the notes on net interest income, risk result, gain or loss from financial assets and liabilities measured at fair value through profit and loss and other net gain or loss from financial instruments.

d) Financial guarantees

A financial guarantee is a contract that requires the issuer to make specified payments that reimburse the holder for a loss they incur because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. This may include, for example, bank guarantees and sureties. If the Bank is the guarantee holder, the financial guarantee is not recognised in the financial statements and only taken into consideration when determining an impairment of a guaranteed asset. As the issuer, the Bank recognises the liability arising from a financial guarantee at inception. Initial measurement is at fair value at the time of recognition. In general terms, the fair value of a financial guarantee contract at inception is zero because for contracts in line with market conditions the value of the premium agreed normally corresponds to the value of the guarantee obligation (net method). As part of subsequent measurement, provisions are set aside for expected credit losses.

e) Embedded derivatives

Embedded derivatives are derivatives that are integrated into primary financial instruments.

In accordance with IFRS 9, we have separated only those derivatives that are embedded in financial liabilities and non-financial host contracts. Financial assets are assessed in their entirety. As a result, the host contract is no longer accounted for separately from the embedded derivative. Instead, financial assets are classified based on the business model and their contractual terms and conditions.

The separation must be made for financial liabilities in the financial statements if the following three conditions are met:

- The economic characteristics and risks of the embedded derivative are not closely related to those of the host contract.
- A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative under IFRS 9.
- The primary financial liability is not measured at fair value through profit or loss.

In this case, the embedded derivative to be separated is regarded as part of the held-for-trading category and is recognised at fair value. Changes on remeasurement are recognised in the gain or loss from financial assets and liabilities measured at fair value through profit and loss. The host contract is accounted for and measured applying the rules of the category to which the financial instrument is assigned.

If the above three conditions are not cumulatively met, the embedded derivative is not shown separately and the hybrid financial instrument or structured product is measured as a

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whole in accordance with the general provisions of the category to which the financial liability is assigned.

5.5 Hedge accounting

The improvements for hedge accounting contained in IFRS 9 aim to achieve further harmonisation between the accounting treatment of hedging relationships and (economic) risk management. As a result of the option provided in the standard, a decision was made to apply the previous IAS 39 regulations.

IAS 39 contains comprehensive rules on accounting for hedges, i.e. on the accounting treatment of hedging instruments (derivatives in particular) and the underlying transactions hedged by them. The general rule is that derivatives are classified as trading transactions (trading assets or liabilities) and measured at fair value, with the measurement result reported in net trading income.

Where derivatives are demonstrably used to hedge risks other than from trading, IAS 39 permits the use of hedge accounting, subject to certain conditions. Under IAS 39, hedges may be recognised in the form of fair value hedges or cash flow hedges. At present, the Bank only uses micro fair value hedge accounting.

On executing a transaction, the Bank documents the hedge between instrument and underlying, the risk it is intended to manage and the strategy on which the hedge is based. The full fair value of the derivatives designated as hedging instruments is reported as a non-current asset or liability if the residual term of the underlying transactions hedged is longer than twelve months, and a current asset or liability where it is shorter than twelve months.

Fair value hedge accounting

IAS 39 prescribes the use of hedge accounting to avoid distorted effects on profit or loss for derivatives used to hedge assets or liabilities carried at amortised cost. The Bank's issuing and lending business is particularly subject to such a market value risk where fixed-interest financial instruments are involved. At present, only interest rate swaps are used to hedge these risks. In line with the regulations for fair value hedge accounting, financial derivatives used for hedging purposes are recognised at fair value under the balance-sheet items "Positive fair values of derivative hedging instruments" and "Negative fair values of derivative hedging instruments". Changes in measurement are reported in the statement of comprehensive income as "net income from hedge accounting". For the hedged asset or hedged liability, the offsetting fair value changes are recognised in the balance sheet and also recognised in the statement of comprehensive income as net income from hedge accounting.

Fair value hedge accounting for interest rate risk can take the form either of a micro fair value hedge or a portfolio fair value hedge:

- In micro fair value hedge accounting an underlying transaction is linked with one or more hedging transactions in a hedging relationship. If they change in value, the carrying amounts of individual hedged and hedging transactions are adjusted through profit or loss.
- In a portfolio fair value hedge, interest rate risks are hedged at the portfolio level. What is hedged is not individual transactions or groups of transactions with a similar risk structure, but rather an amount of underlying fixed-interest transactions in a portfolio grouped by maturity bands.

The Bank only uses micro fair value hedge accounting. Hedges are dissolved once the criteria for the use of hedge accounting are no longer met. In this event, any hedge adjustments from the moment of dissolution of the hedge are released over the remaining term of the underlying transaction.

Application of the hedge accounting rules contained in IAS 39 is subject to the condition that there must be evidence of an effective hedge throughout the period of the hedge. Effectiveness of the fair value hedge means the relationship between the change in fair value of the hedged underlying transaction and the change in fair value or cash flow of the hedging instrument. If these changes offset each other almost fully, a high degree of effectiveness exists.

Proof of effectiveness requires, on the one hand, that a high degree of effectiveness can be expected from a hedge in the future (prospective effectiveness), and, on the other, that when a hedge exists, it must be regularly demonstrated that it was highly effective during the period under review (retrospective effectiveness). Both retrospective and prospective effectiveness must be within a range of 0.8 to 1.25. The Bank uses the statistical methods of regression analysis for the prospective effectiveness test of micro fair value hedge accounting.

The changes in fair value of the hedged transaction and the hedging instrument are determined by means of historical simulations, while the actual changes in fair value are used for the retrospective effectiveness test.

Within micro fair value hedge accounting, the causes of ineffective hedging lie primarily in the risk contained in the measurement of the fair value of the hedging instruments – mainly interest rate swaps – which cannot be used in determining the fair value of the hedged item. As a result, the changes in fair value of the respective hedging instrument are not fully offset by the changes in fair value of the hedged item, even though the hedging relationship is fully hedged economically. The most significant risk in this context is the underlying risk.

5.6 Cash reserve

The Bank's cash reserve is made up of credit balances with central banks. These are reported at their nominal value.

5.7 Financial assets – Amortised cost

If the contractually agreed cash flows of a financial asset merely constitute interest and principal payments (i.e. they are SPPI-compliant) and the asset has been allocated to the "hold to collect" business model, the asset is measured at amortised cost. The carrying amount of these financial instruments is reduced by the loan loss provision (see Note 8.4).

Interest payments for these financial instruments are recognised in net interest income according to maturity, and premiums and discounts are recognised through the income statement in net interest income over the life of the liability.

5.8 Financial assets – Mandatorily Fair Value P&L

This item includes financial instruments that are allocated to the residual business model and not reported in "Financial assets – Held for Trading". Transactions allocated to the "hold to collect" business model and that are not SPPI-compliant are also reported here.

5.9 Financial assets and liabilities – Held for Trading

This category includes derivative financial instruments (derivatives that do not qualify for hedge accounting) as well as other trading portfolios allocated to the residual business model and Held for Trading.

Irrespective of the type of product, these financial assets are measured at fair value through profit or loss. The fair value changes of the transaction in question are thus reported through profit and loss in the income statement. Where the fair value cannot be ascertained from active market data, the measurement is generally carried out on the basis of comparative and indicative prices from pricing service providers or other banks (lead managers) or internal measurement procedures (net present value or option price models).

Interest income and expenses and gains or losses on measurement and disposal from these financial instruments are recorded in the income statement under net income from financial assets and liabilities measured at fair value through profit and loss.

5.10 Positive and negative fair values of derivative hedging instruments

This item shows derivative financial instruments that are used for hedging purposes and qualify for micro fair value hedge accounting. The hedging instruments are measured at fair value. Measurement gains or losses on fair value hedges from hedge accounting are reported under net income from hedge accounting in the statement of comprehensive income. Interest income and expenses from derivative hedging instruments are now recorded under net income from financial assets and liabilities measured at fair value through profit and loss.

5.11 Credit risks and credit losses

Authority to determine the methods and parameters for the risk measurement programmes rests with Commerzbank AG. Risk management at Commerzbank Finance & Covered Bond S.A. is closely integrated within the Commerzbank Group methodologically and organisationally. The various risks are managed using a framework of guidelines, structured limits and a holistic risk management system, all of which are standard throughout the company. For the purpose of the quantitative measurement, monitoring and control of specific risks,

the Group uses established systems and control mechanisms, which are regularly reviewed and adapted to current business trends.

In managing its risks, Commerzbank Finance & Covered Bond S.A. uses the methodologies and systems established in the Commerzbank Group. This is reflected in the close integration of the Bank's local risk functions with their Group counterparts.

Principles and measurements in accordance with IFRS 9

IFRS 9 stipulates that impairments for credit risks from loans and securities that are not recognised at fair value through profit or loss must be recognised using a 3-stage model based on expected credit losses. The following financial assets are generally included in the scope of this impairment model:

- financial assets in the form of loans and advances as well as securitised debt instruments measured at amortised cost;
- financial assets in the form of loans and advances as well as securitised debt instruments measured at fair value through other comprehensive income (FVOCI with recycling);
- lease receivables;
- irrevocable lending commitments which under IFRS 9 are not measured at fair value through profit or loss;
- financial guarantees within the scope of IFRS 9 that are not measured at fair value through profit or loss.

The Bank determines the impairment using a 3-stage model based on the following requirements:

In **Stage 1**, all financial instruments are recognised if their risk of a loan loss (hereinafter default risk) has not risen significantly since their initial recognition. In addition, Stage 1 includes all transactions with limited default risk as at the reporting date for which the Bank utilises the option provided for in IFRS 9 to refrain from making an assessment about a significant increase in the default risk.

A limited default risk exists for all financial instruments with an investment grade internal credit rating as at the financial reporting date (corresponds to a Commerzbank rating of 2.8 or better). An impairment must be recognised for financial instruments in Stage 1 in the amount of the expected credit loss over the next 12 months (12-month ECL).

Stage 2 includes those financial instruments with default risk that has risen significantly since their initial recognition and which, as at the financial reporting date, cannot be classified as transactions with limited default risk. Impairments in Stage 2 are recognised in the amount of the financial instrument's lifetime expected credit loss (LECL).

Financial instruments that are classified as impaired as at the reporting date are allocated to **Stage 3.**

The Bank's criterion for this classification is the definition of a default in accordance with Art. 178 of the Capital Requirements Regulation (CRR). This approach is consistent because the ECL calculation also uses statistical risk parameters derived from the Basel IRB approach, which are modified to meet the requirements of IFRS 9. The following events can be indicative of a customer default:

- Imminent insolvency (over 90 days past due).
- The Bank is assisting the customer in its financial rescue/restructuring measures, with or without restructuring contributions;
- The Bank has demanded repayment of its claims.
- The customer is in insolvency proceedings.

The LECL is likewise used as the value of the required impairment for Stage-3 financial instruments in default. Apart from the fact that only loans which meet the definition of default can be allocated to Stage 3, stages 2 and 3 also differ regarding the recognition of interest income. In Stage 2 (as in Stage 1) interest and impairments are recognised separately and interest income is calculated on the basis of the gross carrying amount. By contrast, in Stage 3 interest income is calculated on the basis of amortised cost (i.e. based on the gross carrying amount after deducting provisions for losses).

When determining the LECL in Stage 3, the Bank essentially distinguishes between significant and insignificant cases.

The amount of the LECL for insignificant transactions (volumes up to €5m) is determined based on statistical risk parameters. The LECL for significant transactions (volumes greater than €5m) is the expected value of the losses derived from individual expert assessments of future cash flows based on several potential scenarios and their probability of occurrence. The scenarios and probabilities are based on assessments by recovery and resolution specialists. For each scenario – whether it is a continuation or sale scenario – the timing and amount of the expected future cash flows are estimated.

Both the customer-specific and the macroeconomic situation are taken into account (for example currency restrictions, currency value fluctuations, commodity price developments), as well as the sector environment, with a view to the future. The estimate is also based on external information. Sources include indices (e.g. World Corruption Index), forecasts (e.g. by the IMF), information from global associations of financial service providers (e.g. the Institute of International Finance) and publications from rating agencies and auditing firms.

If there is no longer a default criterion, the financial instrument recovers and is no longer allocated to Stage 3. After recovery, a new assessment is made based on the updated rating information to see if the default risk has increased significantly since initial recognition in the balance sheet, and the instrument is allocated to Stage 1 or Stage 2 accordingly.

Financial instruments which when initially recognised are already considered impaired as per the aforementioned definition (purchased or originated credit-impaired, or POCI) are handled outside the 3-stage impairment model and are therefore not allocated to any of the three stages. The initial recognition is based on fair value without recording an impairment, using an effective interest rate that is adjusted for creditworthiness. The impairment recognised in subsequent periods equals the cumulative change in the LECL since the initial recognition in the balance sheet. The LECL remains the basis for the measurement, even if the value of the financial instrument has risen.

Receivables are written off and derecognised from the balance sheet as soon as they become uncollectible. Firstly, uncollectibility may arise in the resolution process based on various objective criteria.

These can be, for example, completed insolvency proceedings without further prospect of payments. Secondly, loans are generally regarded as (partially) uncollectible at the latest by 720 days after their due date, and are (partially) written down to the recoverable amount within the framework of existing loan loss provisions. Such a (partial) write-down has no direct impact on ongoing debt collection measures.

Calculation of the expected credit loss in accordance with IFRS 9

The Bank calculates the LECL as the probability-weighted, unbiased and discounted expected value of future loan losses over the total residual maturity of the respective financial instrument, i.e. the maximum contractual term (including any renewal options) during which the Bank is exposed to credit risk. The 12-month ECL used for the recognition of impairments in Stage 1 is the portion of the LECL that results from default events which are expected to occur within twelve months following the end of the reporting period.

The ECL for Stage 1 and Stage 2 as well as for insignificant financial instruments in Stage 3 is determined on an individual transaction basis taking into account statistical risk parameters. These parameters have been derived from the Basel IRB approach and modified to meet the requirements of IFRS 9. The significant main parameters used in this determination include the:

- customer-specific probability of default (PD);
- loss given default (LGD); and the
- exposure at default (EaD).

The Bank derives the PD by applying an internal ratings procedure, which is based on the respective customer group. The determination includes a wide variety of qualitative and quantitative variables, which are taken into account or weighted based on the respective procedure. The allocation of the PD ranges to the internal rating categories and the reconciliation to external ratings can be found in the master scale contained in the risk report.

The LGD is the forecast loss given default as a percentage of the exposure at default (EaD), taking into account collateral and the capital recovery potential on the unsecured portion. The Bank's estimates, which are made specifically for different types of collateral and customer groups, are determined using both observed historical portfolio data and diverse external information, such as indices and data regarding the development of purchasing power.

The EaD is the expected loan utilisation as at the default date, taking into account a (partial) drawing of open lines.

All risk parameters used from the Bank's internal models have been adjusted to meet the specific requirements of IFRS 9, and the forecast horizon has been extended accordingly to cover the entire term of the financial instruments. For example, the forecast for the change in the exposure over the entire term of the financial instrument therefore also includes, in particular, contractual and statutory termination rights.

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The Bank estimates the risk parameters specific to IFRS 9 based not only on historical default information but also, in particular, on the current economic environment (point-in-time perspective) and forward-looking information. This assessment primarily involves reviewing the effects which the Bank's macroeconomic forecasts will have regarding the amount of the ECL, and including these effects in the determination of the ECL. A baseline scenario is used for this purpose which relies on the respective applicable consensus (forecasts of different banks on significant macroeconomic factors, such as GDP growth and the unemployment rate). This baseline scenario is then supplemented with additional macroeconomic parameters that are relevant for the model. The transformation of the macroeconomic baseline scenario into the effects on the risk parameters is based on statistically derived models. If needed, these models are supplemented with expert-based assumptions. Potential effects from non-linear correlations between different macroeconomic scenarios and the ECL are corrected using a separately determined adjustment factor.

All parameters used when determining the ECL are regularly validated by an independent unit (usually once a year). If needed, they are adjusted accordingly.

Assessment of a significant increase in default risk

Commerzbank AG's rating systems, which are also used for the Bank, combine into the PD all available quantitative and qualitative information relevant for forecasting the default risk. This metric is based primarily on a statistical selection and weighting of all available indicators. In addition, the PD adjusted in accordance with IFRS 9 requirements takes into account not only historical information and the current economic environment, but also, in particular, forward-looking information such as the forecast for the development of macroeconomic conditions.

As a consequence, the Bank uses the PD only as a frame of reference for assessing whether the default risk of a financial instrument has risen significantly since the date of its initial recognition. By anchoring the review of the relative transfer criterion in the robust processes and procedures of the Bank's credit-risk-management framework (in particular, early identification of credit risk, controlling of overdrafts and the re-rating process), the Bank ensures that a significant increase in the default risk is identified in a reliable and timely manner based on objective criteria. For cases with an overdraft that exceeds 30 days, it has been demonstrated that this trigger is already covered by the ratings and/or the rating process. No such overdrafts were in existence as at the reporting date, however.

For further information on the Bank's processes and procedures as well as governance in credit risk management, please refer to the explanatory information in the risk report (section 6).

The review to determine whether the default risk as at the financial reporting date has risen significantly since the initial recognition of the respective financial instrument is performed as at the end of the reporting period. This review compares the observed probability of default over the residual maturity of the financial instrument (lifetime PD) against the lifetime PD over the same period as expected on the date of initial recognition.

Thresholds are set using a statistical procedure in order to determine whether an increase in the PD compared with the initial recognition date is "significant". These thresholds, which are differentiated by rating models, represent a critical degree of variance compared with the average change in PD.

In order to ensure an economically sound assignment of the stage, transaction-specific factors are taken into account, including the extent of the PD at the initial recognition date, the term to date and the remaining term of the transaction.

Financial instruments are retransferred from Stage 2 to Stage 1 if at the end of the reporting period the default risk is no longer significantly elevated compared with the initial recognition date. The relevant rating information determines whether a retransfer back to a stage with a lower credit risk takes place.

5.12 Transferred financial assets and collateral pledged for own liabilities

Repo transactions combine the spot purchase or sale of securities with their forward sale or repurchase, the counterparty being identical in both cases. Securities sold under repurchase agreements (spot sale) continue to be recognised and measured in the balance sheet in accordance with the underlying category as part of the securities portfolio. The securities are not derecognised, as all risks and rewards associated with the ownership of the security sold under the repurchase agreement were retained. The same risks and opportuni-

ties that apply to non-transferred financial assets thus also apply to financial assets that have been transferred but not derecognised.

In securities lending transactions, securities are lent for a fee. These transactions are reported in a similar manner to genuine repurchase transactions. Securities lent remain in the Bank's securities portfolio and are classified and measured according to the rules of IFRS 9. Borrowed securities do not appear in the borrower's balance sheet, nor are they measured. In securities lending transactions, the counterparty credit risk can be avoided by obtaining collateral, which may be provided in the form of cash, for example. Collateral furnished for a lending transaction is referred to as "cash collateral out" and collateral received as "cash collateral in". In addition, cash collateral is deposited or received in connection with derivative transactions.

5.13 Fixed and intangible assets

Fixed assets are shown at acquisition or production cost. Acquisition costs comprise expense directly attributable to the purchase. Where such assets are subject to wear and tear, they are depreciated on a straight-line basis over their expected useful life.

Fixed assets are depreciated over their expected useful life as follows:

	Impairment Rate	Method
Office furniture and equipment	20 %	linear
IT (hardware)	25 %	linear

Fixed assets are tested for impairments if events or changed circumstances suggest that an impairment might have occurred. In such situations, the impairment test under IAS 36 is carried out. Unscheduled write-downs are carried out where the impairment can be expected to be permanent. If the reasons for the write-down cease to apply, it is reversed up to no more than the amortised cost of acquisition or production.

For reasons of materiality, acquisition costs of low-value assets are recognised directly as administrative expense during the period. Maintenance work on fixed assets is recorded as administrative expense in the financial year in which it is carried out. Depreciation is reported as administrative expense. Gains and losses from the sale of fixed assets are reported under other net income in the statement of comprehensive income.

CFCB also reports rights-of-use assets under fixed assets. These are recognised at the date of provision (i.e. when the underlying leased asset is ready for use). Rights-of-use assets are measured at cost less any accumulated depreciation and any accumulated impairment losses and are adjusted for any revaluation of the lease liabilities. Rights-of-use assets are amortised on a straight-line basis over the term of the lease and tested for impairment. By applying IFRS 16, the Bank recognised rights-of-use assets under leases for the first time as at 1 January 2019. The capitalised rights-of-use assets are amortised over the contractually agreed periods of use.

The Bank recognises an acquired customer base as intangible assets, at amortised cost. Due to its finite useful economic life, the customer base is written off on a straight-line basis over its prospective useful life of 4.5 years. The assets are also reviewed at every reporting date to determine whether the carrying amount exceeds the amount recoverable. If so, an impairment is recognised.

5.14 Taxes

CFCB is a member of an income tax group to which several units of the Commerzbank Group in Luxembourg belong. The parent company is the Luxembourg branch of Commerzbank AG. The members of the tax group have entered into an apportionment agreement that determines the allocation of the total tax expense of the tax group to the members of the tax group. This also contains a provision on compensation payments which loss-making units of the tax group receive from the profitable units for making their losses available.

Current tax assets and liabilities are calculated using the currently applicable tax rates at which payment is made to, or reimbursement received from, the tax authority concerned.

Deferred tax assets and liabilities are recognised to reflect differences between the IFRS carrying amounts of assets or liabilities and their taxable value (liability method), where these are likely to result in increases or reductions in future taxes on income (temporary differences). In addition, deferred tax assets are recognised for both tax loss carryforwards and unused tax credits, subject to the applicable conditions being met.

The measurement of deferred taxes is based on income tax rates set as at 31 December 2019 and applicable upon realisation of the temporary differences. Deferred tax assets are recognised only if it is probable that taxable profits will arise in the same tax unit or tax group in future. Tax assets and liabilities may not be discounted. Depending on the treatment of the underlying situation, deferred tax assets and liabilities are recognised and carried forward either under taxes on income in the income statement or directly in equity in the relevant equity item. The Bank classifies deferred tax items in the balance sheet as non-current.

Deferred income tax assets and liabilities are netted if there is a right to net current taxes on income and the deferred tax assets and liabilities relate to taxes on income levied by the same fiscal authority on the same taxable entity.

Tax income and expense are reported as taxes on income in the statement of comprehensive income and broken down in the Notes into current and deferred tax assets and liabilities in the financial year. Other taxes not dependent on income are shown under other net operating income. Current and deferred income tax assets and liabilities are reported in the balance sheet as asset and liability items respectively.

The distinctions between current and deferred tax assets and between current and deferred tax liabilities are explained in Notes 8.9 and 9.7.

5.15 Financial liabilities – Amortised cost

Financial liabilities must be subsequently measured at amortised cost. We have detailed the exceptions to this general classification in the above items within Notes 5.2 and 5.4. Deposits essentially include cash due on demand and time deposits.

Under other debt instruments issued we also report subordinated securitised and non-securitised issues which, in the event of an insolvency or liquidation, are only repaid once all non-subordinated creditors have been satisfied.

5.16 Provisions

A provision must be recognised if on the reporting date, as the result of an event in the past, a current legal or factual obligation has arisen, an outflow of resources to meet this obligation is likely and it is possible to make a reliable estimate of the amount of this obligation. For that reason, provisions are made for liabilities of an uncertain amount to third parties and anticipated losses arising from pending transactions in the amount of the claims expected.

The amount recognised as a provision represents the best possible estimate of the expense required to meet the current obligation as at the reporting date. This estimate takes account of risks and uncertainties. If the interest rate effect is material, provisions are recognised at net present value.

Allocations to the different types of provisions are made through various items in the statement of comprehensive income. Provisions for lending business are charged to loan loss provisions. Other provisions are generally recognised as administrative expense.

5.16.1 Provisions for pensions and similar commitments

Occupational pension provision for active and former employees and their survivors is based on various schemes (defined benefit and defined contribution plans).

Under a defined contribution plan, employees acquire an entitlement to a pension from an external pension scheme on the basis of contributions made. The Bank helps to fund this by paying a fixed contribution to external pension providers.

In this case, the amount of present and future pension benefits is determined by the contributions paid and the income generated by associated assets. The IFRS accounting rules for defined contribution plans are applied to such indirect schemes, so the contributions to the external pension provider are recognised as personnel expenses. No provisions are created.

There are also obligations arising out of entitlements to pensions and current benefits under the defined benefit plans operated by the Bank, based on a direct pension commitment on its part, where the level of the pension payment is predefined and dependent on factors such as age, salary level and length of service. As IAS 19 accounting principles for defined benefit pension plans apply to these pension schemes, provisions are recognised.

The pension expenses recorded under personnel costs for direct pension commitments is made up of several components: First, from the service cost, which represents the entitlements earned by members during the financial year, and

secondly from the interest cost on the net present value of the pension obligations, since the moment at which the pension obligations have to be met has moved closer by one period. Moreover, the amount of pension expense is influenced by the change in actuarial gains or losses not previously recognised in profit or loss. Where direct pension commitments have been changed, resulting in a change to the obligation to pay benefits, past service cost or income is reported.

With defined benefit plans, pension obligations and similar obligations (age-related short-time working, early retirement, long service awards) are calculated annually by an independent actuary using the projected unit credit method. In performing this calculation, the actuary draws not only on biometric assumptions (e.g. the Heubeck mortality tables) but also and in particular on an up-to-date market interest rate on prime long-term corporate bonds, fluctuation and career trends and expected rates of increase in salaries and pensions.

Actuarial gains and losses are reported immediately in equity and to their full amount.

At the same time, past service costs resulting from retrospective plan changes are reported immediately and in full through profit or loss. As a consequence of these changes, the netting of pension obligations and plan assets leads to the full net pension obligation being shown in the financial statements. In addition, where pension obligations are funded from plan assets, the amended IFRS requires net interest costs to be determined. This is the interest applied to the net liabilities or net assets (the defined benefit obligation less fair value of the plan assets) using a consistent interest rate.

Apart from the usual pension plan risks such as inflation risks and biometric risks the Bank has no discernible unusual risks.

5.16.2 Restructuring provisions

Restructuring provisions are recognised if the Bank has a detailed formal restructuring plan and has already begun implementing this plan or has announced the main details of the restructuring. The detailed plan sets out the costs associated with the restructuring and the period over which the restructuring is to be carried out. The detailed plan must be communicated in such a way that those affected can expect it to be put into effect.

5.16.3 Employee remuneration plans

1. Description of the Commerzbank Incentive Plan (CIP)

The Commerzbank Incentive Plan (CIP), which was first launched in 2011, sets out the detailed rules for variable remuneration and applies to the entire Commerzbank Group. Accordingly, CFCB is also part of this programme. The CIP is an equity-settled plan with a cash settlement option for the employer, which falls within the scope of IFRS 2.

Under the CIP, employees designated as risk takers can receive parts of their individual variable remuneration as a cash component and a stock component, linked to the performance of the Commerzbank share. The variable remuneration consists of a short-term incentive (STI) and, in the case of risk takers whose variable remuneration exceeds the risk taker limit, a long-term incentive (LTI).

A risk taker is an employee whose activities have a significant impact on the Bank's overall risk profile. The criteria include the function carried out by the employee, the group to which the employee belongs and whether certain requirements determined by the Bank are met. Depending on the employee's hierarchical level and the risk relevance of their role, the Bank designates what kind of risk taker the employee is: "risk taker I" or "risk taker II". Risk taker I status applies to employees whose role entails a higher risk relevance.

The risk taker limit is the amount up to which the payment of a risk taker's entire variable remuneration for a financial year as a cash STI payment is tolerated by the supervisory authorities, subject to general salary levels in the banking sector. For risk takers whose variable remuneration does not exceed the risk taker limit, and for employees without risk taker status (non-risk takers), variable remuneration is paid entirely as STI in cash rather than shares. Only if the risk taker limit is exceeded is the variable remuneration divided up into STI and LTI components subject to the CIP rules applying to these components.

No risk taker exceeded the limit during the year under review.

The following rules apply once the risk taker limit has been exceeded:

For the risk taker I category, the STI component is 40 % and the LTI component is 60 % of the potential variable remuneration. 50 % of both the STI and LTI are paid in shares.

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For the risk taker II category, the STI component is 60 % and the LTI component is 40 % of the potential variable remuneration. 50 % of both the STI and LTI are paid in shares.

An individual's variable remuneration is determined on the basis of the results of their annual target attainment meeting (performance appraisal I), which is held in the first three months of the following financial year. The number of Commerzbank shares granted is set at the same time as the variable remuneration for both the STI and the LTI. If risk takers receive share-based remuneration components, the number of Commerzbank shares is calculated by dividing 50% of the euro amounts in the STI and the LTI by the subscription price. If there are any fractional amounts the number of shares is rounded up.

The subscription price for the variable remuneration set until the financial year 2019 was the simple arithmetic average of the Xetra closing prices of the Commerzbank share on all trading days during the reference period (December of the previous year and January and February of the next year). For the variable remuneration that has been set from the financial year 2020 onwards, the reference period for the subscription price is January of the year following the financial year.

Under the rules of the share-based remuneration components the employer has the right to make a payment in cash rather than in shares. Since the beginning of 2019, the retention period has been at least 12 months. This means that the share component of the STI of the financial year will be paid out in April of the second following financial year (n+2) instead of in October of the following financial year (n+1).

Under the LTI, since the beginning of 2019 entitlement to variable compensation can arise after five years at the earliest for those classified as risk taker I and after three years at the earliest for risk taker II.

Performance appraisal II is held after the end of the deferral period and consists of a review of the underlying performance appraisal I and fulfilment of individual and Group-specific qualitative targets during the deferral period. In the LTI, if a claim arises, the shares or the optional cash settlement are also subject to a retention period, as in the STI. Until now the LTI has been paid out in October of the fourth year after the underlying financial year.

The payment of variable remuneration which is set from the 2019 financial year onwards will be made after completion of the performance appraisal II for risk taker I, for LTI cash in November of the sixth year (n+6), and for LTI equity in October of the seventh year (n+7). For those classified as risk taker II, LTI cash will be paid in November of the fourth year (n+4) and LTI equity in October of the fifth year (n+5).

In the event of cash settlement of the share component the cash amount is calculated on the basis of the simple arithmetic average of Xetra closing prices of the Commerzbank share on all trading days during the reference period. The reference period for entitlement from the financial year 2019 onwards is the last full calendar month preceding the end of the retention period of the respective share-based remuneration components.

From the financial year 2019 onwards, no entitlement to compensation for dividends or subscription rights paid or granted to shareholders arises in the deferral period, unlike the retention period.

The various remuneration components are estimated in the underlying financial year on the basis of budget forecasts, and provisions are recognised proportionally over the lifetime of the plans. Moreover, regular reviews, revaluations based on movements in the share price and/or adjustments of the amounts are carried out throughout the lifetime of the CIP.

The changes to the remuneration entitlement in the three-year retention period are treated as non-vesting conditions.

Accounting and valuation of share-based payment and bonus plans

The CIP is accounted for under the rules of IFRS 2 – Share-based Payment. Benefits to employees/risk takers who have not exceeded the exemption limit are accounted for in accordance with IAS 19; the limit was not exceeded in the reporting period. A distinction is made between share-based remuneration payments settled in the form of equity instruments and those settled in cash. For both types of remuneration, however, the grant of share-based payments has to be recognised at fair value in the annual financial statements.

2. Accounting

Equity-settled share-based remuneration transactions:

The fair value of share-based remuneration payments settled in the form of equity instruments is recognised as personnel

expense and reflected within equity in retained earnings. The fair value is determined on the date on which the rights are granted. If rights cannot be exercised because the conditions for exercise are not met due to market conditions, no change is made to the amounts already recognised in equity.

However, if rights cannot be exercised because other conditions for exercise are not met (service and non-market conditions), the amounts already recognised in equity are adjusted through profit or loss.

Cash-settled share-based remuneration transactions:

The portion of the fair value of share-based remuneration payments settled in cash that relates to services performed up to the date of measurement is recognised as personnel expense while at the same time being recorded as a provision. The fair value is recalculated on each reporting date up to and including the settlement date. Any change in the fair value of the obligation must be recognised through profit or loss. On the date of settlement, therefore, the provision must correspond as closely as possible to the amount payable to the eligible employees.

The provisions fluctuate on each subsequent reporting date in parallel with the performance of the Commerzbank Aktiengesellschaft share price. This affects the portion of the share-based variable remuneration that was determined using an average price for the Commerzbank share. The price itself is determined as the average Xetra closing price of the months of January and February plus December of the previous year.

If Commerzbank Aktiengesellschaft pays dividends during the vesting period, a cash payment equal to the dividend, or cash compensation for a capital action, will be paid out for each CIP and share award at the payout date in addition to the payout value. Provisions are recognised for these payments if applicable. Payouts under the CIP are spread over the three financial years, which form the basis for the achievement of individual targets.

Measurement

The provision for the Commerzbank Incentive Plan is measured by multiplying the number of shares earned by participants by the closing price of the Commerzbank share on 31 December of the reporting year. The expense for the allocations to the provisions can also be recognised over the vesting period of four years, depending on the remuneration plan.

5.17 Other liabilities

CFCB includes lease liabilities under other liabilities. Lease liabilities are recognised at the date of provision at the present value of the lease payments to be made over the term of the lease. Lease payments include fixed payments (including de facto fixed payments), variable lease payments linked to an index or (interest) rate and amounts that are expected to have to be paid under residual value guarantees. In calculating the present value of the lease payments, CFCB uses the marginal interest rate on borrowings at the date of provision, as the interest rate underlying the lease cannot be readily determined. After the date of provision, the amount of lease liabilities is increased to reflect the higher interest expense and decreased to reflect the lease payments made. In addition, the carrying amount of lease liabilities is remeasured in the event of changes in the lease, changes in the term of the lease, changes in lease payments (for example, changes in future lease payments resulting from a change in the index or interest rate used to determine those payments).

5.18 Equity

According to IFRS, equity constitutes a residual interest in the assets of an undertaking after deduction of all its obligations or claims and is not capable of being cancelled by the provider of capital.

5.19 Irrevocable lending commitments

Irrevocable lending commitments are obligations potentially giving rise to a credit risk in future. These include obligations to grant loans (e.g. lines externally notified to customers), to buy securities or provide financial guarantees or acceptances. Provisions for risks in respect of irrevocable lending commitments are included in provisions for loan losses. No irrevocable lending commitments existed as at 31 December 2019, only a contingent liability to the Single Resolution Board.

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6 Risk Report

6.1 Central administration, internal governance and risk management

The duties imposed by the current version of circular CSSF 12/552 are an established fact of life and day-to-day business practice at Commerzbank Finance & Covered Bond S.A. The key functions are in place and guidelines on them have been published for internal use. The process is reviewed annually.

The Bank complies in full with its requirements within the bounds of the proportionality principle.

6.2 Risk strategy

Risk management at Commerzbank Finance & Covered Bond S.A. is methodologically and organisationally integrated within the Commerzbank Group. The various risks are managed using a framework of guidelines, structured limits and a holistic risk management system, all of which are standard throughout the company. For the purpose of the quantitative measurement, monitoring and control of specific risks, the Group uses established systems and control mechanisms, which are regularly reviewed and adapted to current business trends.

6.3 Risk-oriented overall bank management

6.3.1 Risk management organisation

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

As a wholly-owned subsidiary, CFCB uses the classification of Commerzbank AG when classifying risk types as quantifiable or non-quantifiable. Non-quantifiable In this context, risk types are subject to a qualitative management and controlling process.

6.3.2 Integration into the Group

In managing its risks, Commerzbank Finance & Covered Bond S.A. collaborates very closely with the risk functions of the Commerzbank Group and, as a result, uses the methodologies and systems established in the Group.

Due to this close integration in the Group risk functions, the decision-making with regard to management parameters, e.g. the limits, takes place in close consultation between Commerzbank Finance & Covered bonds S.A., its governing bodies and the governing bodies of the Commerzbank Group.

6.3.3 Risk-bearing capacity

Risk-bearing capacity analysis is a key part of overall bank management of the Internal Capital Adequacy Assessment Process (ICAAP) and Commerzbank Finance & Covered Bond S.A.'s Internal Liquidity Adequacy Assessment Process (ILAAP).

ICAAP

ICAAP considers the economic risk-bearing capacity in terms of capital as a resource.

The objective of the risk-bearing capacity analysis is to determine a level of capital adequacy appropriate to the Bank's risk position. To this end, Commerzbank Finance & Covered Bond S.A. uses Commerzbank AG's risk-bearing capacity concept. As part of the risk-bearing capacity calculation, the economically required capital is compared against the risk coverage potential.

When determining the economically required capital, allowance is made for potential unexpected fluctuations in value. Such fluctuations must be covered by the available economic capital to absorb unexpected losses (risk coverage potential). The quantification of the 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 risk coverage potential comprises in particular the main equity items, but also economic deductions such as hidden liabilities.

The economically required capital is quantified using the internal economic capital model. Economically required capital makes reflects the types of risk at Commerzbank Finance &

Covered Bond S.A. that are classified as material and quantifiable in the annual risk inventory. It also comprises risks that are not included in the regulatory requirements for banks' capital adequacy. The risks considered in the economic capital model are divided into counterparty risk including reserve risk, market risk including market risks for the banking book and operational risk.

The measurement of the risk-bearing capacity calculation is shown using the risk-bearing capacity ratio (RBC ratio), which compares the economically required capital to the risk coverage potential.

Risk-bearing capacity CFCB in €m	31.12.2019	31.12.2018
Economic risk coverage potential[1]	**680**	**504**
Economically required capital	**956**	**1,369**
of which: for credit risk	555	677
of which: for market risk	400	691
of which: for OpRisk	1	1
of which: diversification effects	0	0
RBC ratio[1]	**71.12 %**	**37.10 %**

[1] RBC ratio = economic risk coverage potential/economically required capital

The RBC ratio increased markedly from 37.10 % in the prior year to 71.12 % as at 31 December 2019. The minimum risk-bearing capacity is deemed to be met as long as the RBC ratio is higher than 100 %.

The RTF ratio improved markedly compared with the previous year. There are two main reasons for this:

- The sale of a large portfolio in sterling significantly reduced the need for economic capital in both credit risk and market risk.
- The risk coverage potential improved in particular because the hidden liabilities on securities positions have decreased.

As the economic capital requirement still cannot be covered by the economic risk coverage potential, the Bank is focusing on its regulatory risk-bearing capacity. The shortfall in economic capacity is underwritten by the letter of comfort given by Commerzbank AG in respect of Commerzbank Finance & Covered Bond S.A.'s liabilities. The Bank has taken various steps to comply with the economic risk-bearing capacity requirements. The Bank's regulatory risk-bearing capacity is assured.

ILAAP

ILAAP considers the Bank's economic risk-bearing capacity in terms of liquidity as a resource.

To map the requirements for risk-bearing capacity in terms of liquidity as a resource, the Bank carries out an internal, business model-specific stress test every month in the form of checking compliance with the "survival period". In the stress test, the Bank must have sufficient liquidity to last for a liquidity horizon of one month.

The Bank simulates unexpectedly strong liquidity outflows in this extreme scenario by the contractually agreed provision of margin for the (negative) fair value of derivatives ("collateral") to other banks. The simulation is based on interest rate and currency scenarios from the 2008 financial crisis, during which such liquidity outflows were observed.

This condition was met at all times during the year under review, so the Bank's risk-bearing capacity in terms of liquidity is assured.

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6.3.4 Credit risk

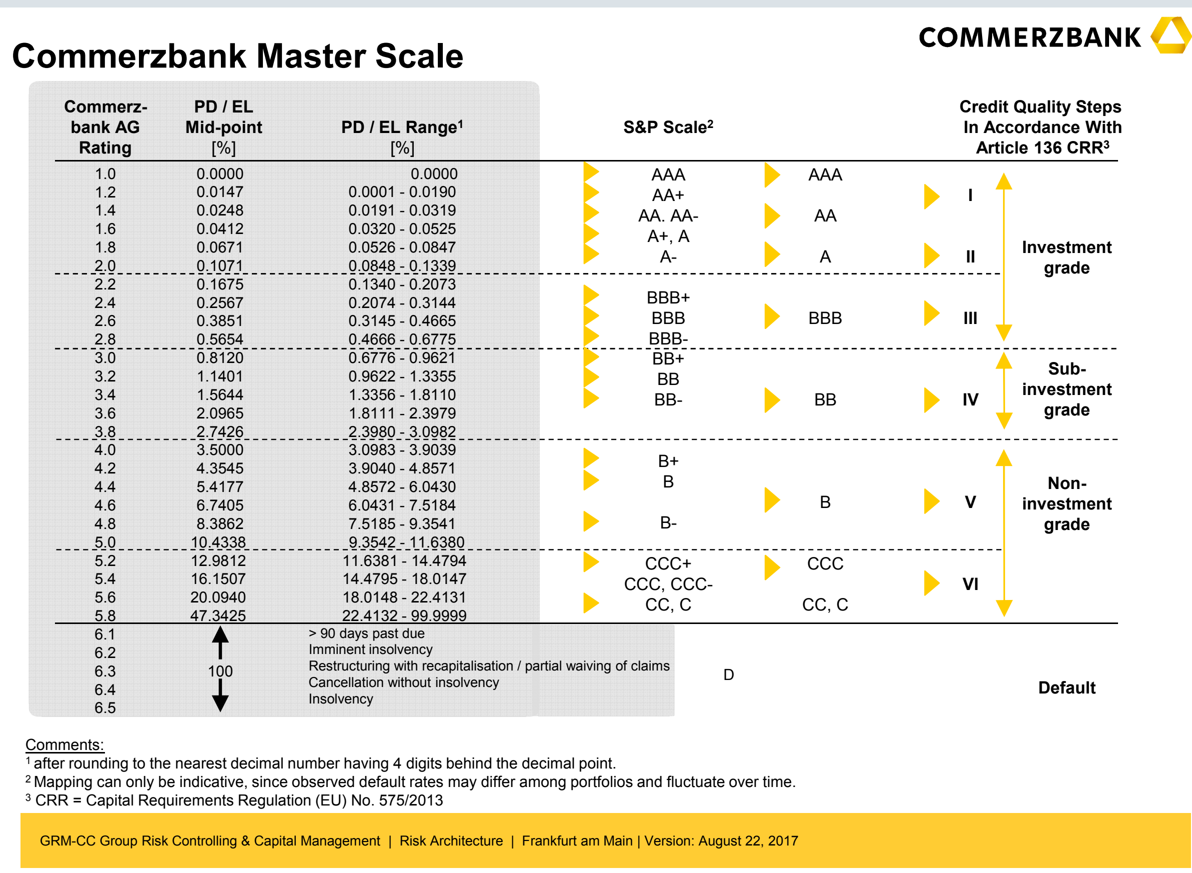
Default risk

Default risk refers to the risk of losses due to defaults by counterparties and to changes in this risk. Under the heading of default risk, Commerzbank Finance & Covered Bond S.A. lists not only credit default and third-party debtor risk but also counterparty, issuer, settlement and replacement risk, as well as country and transfer risk.

Rating systems

As part of the check to be carried out on the creditworthiness of every borrower, the Bank assigns an internal rating (a reconciliation of internal ratings to external ones is provided in the attached master scale). It also calculates a loss given default (LGD) using various parameters including collateral and market value, recovery ratio and realisation period. In view of the Bank's integration into the Group-wide limit and management system, rating, further development, validation and monitoring are carried out by Commerzbank AG.

In Group Management Treasury's collaboration with Commerzbank AG, the latter's rating procedure for states (sovereigns), sub-sovereigns and banks is used.



Commerzbank Master Scale COMMERZBANK

Commerzbank AG Rating	PD / EL Mid-point [%]	PD / EL Range[1] [%]	S&P Scale[2]		Credit Quality Steps In Accordance With Article 136 CRR[3]	
1.0	0.0000	0.0000	AAA	AAA		Investment grade
1.2	0.0147	0.0001 - 0.0190	AA+		I	
1.4	0.0248	0.0191 - 0.0319	AA. AA-	AA		
1.6	0.0412	0.0320 - 0.0525	A+, A			
1.8	0.0671	0.0526 - 0.0847	A-	A	II	
2.0	0.1071	0.0848 - 0.1339				
2.2	0.1675	0.1340 - 0.2073				
2.4	0.2567	0.2074 - 0.3144	BBB+			
2.6	0.3851	0.3145 - 0.4665	BBB	BBB	III	
2.8	0.5654	0.4666 - 0.6775	BBB-			
3.0	0.8120	0.6776 - 0.9621	BB+			Sub-investment grade
3.2	1.1401	0.9622 - 1.3355	BB			
3.4	1.5644	1.3356 - 1.8110	BB-	BB	IV	
3.6	2.0965	1.8111 - 2.3979				
3.8	2.7426	2.3980 - 3.0982				
4.0	3.5000	3.0983 - 3.9039	B+			Non-investment grade
4.2	4.3545	3.9040 - 4.8571	B			
4.4	5.4177	4.8572 - 6.0430				
4.6	6.7405	6.0431 - 7.5184		B	V	
4.8	8.3862	7.5185 - 9.3541	B-			
5.0	10.4338	9.3542 - 11.6380				
5.2	12.9812	11.6381 - 14.4794	CCC+	CCC		
5.4	16.1507	14.4795 - 18.0147	CCC, CCC-		VI	
5.6	20.0940	18.0148 - 22.4131	CC, C	CC, C		
5.8	47.3425	22.4132 - 99.9999				
6.1	100	> 90 days past due	D			Default
6.2		Imminent insolvency				
6.3		Restructuring with recapitalisation / partial waiving of claims				
6.4		Cancellation without insolvency				
6.5		Insolvency				

Comments:
[1] after rounding to the nearest decimal number having 4 digits behind the decimal point.
[2] Mapping can only be indicative, since observed default rates may differ among portfolios and fluctuate over time.
[3] CRR = Capital Requirements Regulation (EU) No. 575/2013

GRM-CC Group Risk Controlling & Capital Management | Risk Architecture | Frankfurt am Main | Version: August 22, 2017

Credit risk management

Commerzbank Finance & Covered Bond S.A. is directly integrated in the Commerzbank Group's overall bank management concept.

To manage and limit default risk, the following risk parameters are used: exposure at default (EaD), loss at default (LaD), expected loss (EL), risk density (EL/EaD), credit value at risk (CVaR = economically required capital for credit risk with a confidence level of 99.91 % and a holding period of one year),

and risk-weighted assets. The "All-in" approach is used for cluster risks. Stress scenarios are modelled on the basis of the credit value at risk (CVaR) of the loan portfolio model, both regularly and as and when required. CVaR changed as follows during the financial year:

Credit Value at Risk (CVaR) in € million											2019
January	February	March	April	May	June	July	August	September	October	November	December
240.0	234.0	291.0	281.0	277.0	269.0	333.0	382.0	359.0	341.0	295.0	293.0

Taking economic capital as a fundamental concept makes it possible to ensure that the concentration of risks in clusters, countries, target groups and products is limited. Concentrations of credit risk may arise through business relations with individual borrowers or groups of borrowers which share a number of features and which are individually able to service debt and influenced to the same extent by changes in certain conditions relating to these factors.

Since CFCB's portfolio is limited to public sector finance, the main criteria for risk concentration are the legislation, and the economic, political and geographical location of the countries in which CFCB has its exposure.

The table below sets out a geographical breakdown of the Bank's nominal volume by country.

Country in €m	31.12.2019 Nominal	31.12.2019 IFRS carrying amount	31.12.2019 Proportion %	31.12.2018 Nominal	31.12.2018 IFRS carrying amount	31.12.2018 Proportion %
United States of America	4,024	4,282	64.2	4,188	4,349	48.3
Italy	923	1,300	14.7	1,101	1,477	12.7
Canada	402	486	6.4	446	536	5.2
Spain [1]	368	544	5.9	392	538	4.5
Portugal	232	365	3.7	238	344	2.7
Supranational	196	257	3.1	193	241	2.2
Japan	93	148	1.5	93	139	1.1
Great Britain	32	55	0.5	2,013	2,866	23.2
Total	**6,270**	**7,437**	**100.0**	**8,664**	**10,490**	**100.0**

[1] incl. EIF guaranteed exposure

The collateral held by Commerzbank Finance & Covered Bond S.A. to minimise credit risk is mainly in the form of guarantees given by public bodies in respect of that part of the portfolio that does not directly constitute sovereign risk.

Public finance

The portfolio of Commerzbank Finance & Covered Bond S.A. includes international state financing and financing for financial institutions. The public finance business focuses on the governments of national governments, provinces, federal states, regions, cities and municipalities in EU member states and OECD countries, as well as supranational institutions and a small proportion of covered bonds. The product groups to which it is exposed are bonds and loans/promissory note loans.

Broken down by product group, bonds made up 98.8 % (€6.191.7m nominal/carrying amount €7,357.9m) and loans/promissory note loans 1.2 % (€78.2m nominal/carrying amount €78.2m) of the overall portfolio as at 31 December 2019. As at 31 December 2018, bonds made up approximately 75.7% (€6,556.4m nominal/carrying amount €7,577.3m) and promissory note loans approximately 24.3 % (€2,107.4m nominal/carrying amount €2,911.7m).

Overall, the hidden liabilities within financial assets carried at amortised cost resulting from the difference between carrying amount and fair value amounted to €501.2m (31 December 2018: €610.5m).

Ongoing portfolio reduction resulted in a change to the debtor structure, which was consequently reflected in the rating breakdown.

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Commerzbank PD rating / in €m	31.12.2019 Nominal	31.12.2019 IFRS carrying amount	31.12.2019 in %	31.12.2018 Nominal	31.12.2018 IFRS carrying amount	31.12.2018 in %
cb1.0	0	0	0.0	0	0	0.0
cb1.2	2,703	2,790	43.1	2,567	2,593	29.6
cb1.4	702	806	11.2	668	734	7.7
cb1.6	132	166	2.1	586	657	6.8
cb1.8	377	468	6.0	1,357	1,903	15.7
cb2.0	195	262	3.1	901	1,256	10.4
cb2.2	168	209	2.7	159	216	1.8
cb2.4	327	490	5.2	107	159	1.2
cb2.6	77	107	1.2	219	272	2.5
cb2.8	1,194	1,620	19.0	1,600	2,105	18.5
>cb2.8	396	518	6.3	499	594	5.8
Total	**6,270**	**7,436**	**100.0**	**8,664**	**10,489**	**100.0**

It also includes securities and loans in Europe, North America and Asia, and positions guaranteed by public bodies.

6.3.5 Market price risk

Commerzbank Finance & Covered Bond S.A. defines market risk as the possibility of losses of economic value in its portfolio potentially resulting from changes to market prices. The main sub-risk types are general market risk (interest rates, exchange rates, basis risk, volatility) and specific market risk (credit spreads).

The Bank measures its market risk on the basis of the value at risk (VaR) concept, using Commerzbank AG's systems and methodologies. Risks arising from extreme market conditions are simulated and limited using Group-wide market risk stress tests.

VaR quantifies the potential loss from financial instruments due to changed market conditions within a set time horizon and at a specific probability. For internal management purposes, a confidence level of 97.5 % and a holding period of one day are assumed. The value at risk concept makes it possible to compare risks over a variety of portfolios and/or business areas. It enables many positions to be aggregated, taking account of correlations between different assets. This ensures a consistent view of market risk at all times.

The main drivers of the market risk shown are interest rate and basis risk and credit spread risk.

Value-at-Risk (VaR 97.5 % / 1D) in €m	2019	2018
Year-end	**1.6**	**11.9**
Minimum	1.6	8.3
Maximum	12.0	18.3
Average	2.4	11.2
Median	2.1	11.4

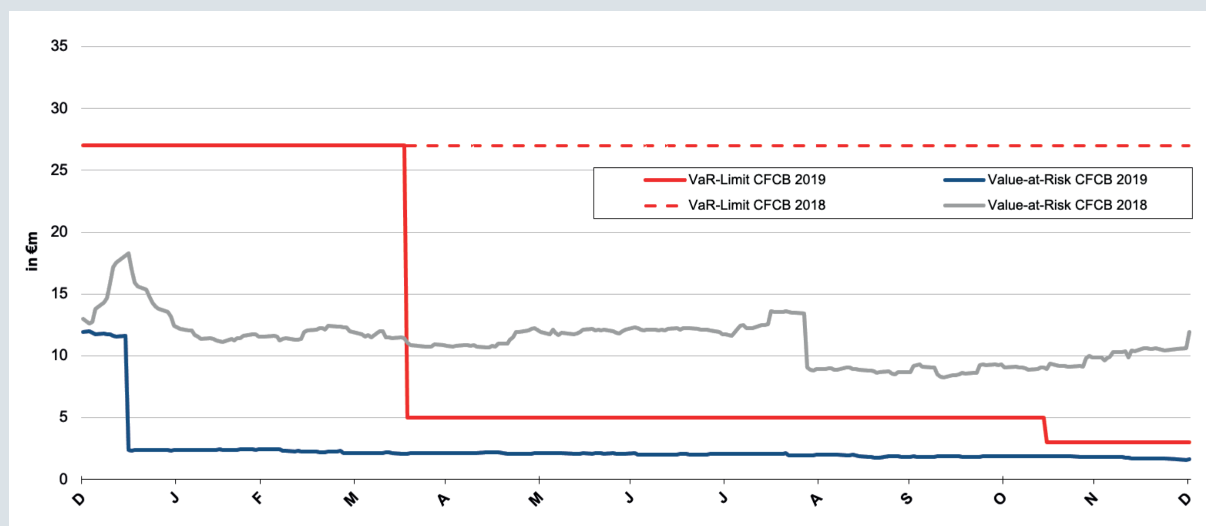
The table above shows Commerzbank Finance & Covered Bond S.A.'s limited VaR. The figure at the end of the year under review was markedly below the previous year's level.

The main driver behind the sharp decline in VaR was the sale of a significant portfolio in sterling on 15 January 2019.

Following the sale and liquidation of the related business unit, the overall limits of CFCB were reduced accordingly in March. Towards the end of the financial year, the limits of the other segments – and hence also the overall limits of CFCB – were reduced as part of the annual limit review.

Change in value at risk in 2019

CFCB Value at Risk: 31 December 2018 – 31 December 2019



Credit spread sensitivities were as follows as at 31 December 2019:

Credit spread sensitivities Ratings 31.12.2019	CS01 Limite in €000	CS01 Exposure in €000	Utilisation in %
AAA or lower	-6,000	-4,348	72
AA or lower	-5,500	-4,042	73
A or lower	-3,000	-2,272	76
Below A	-2,500	-1,837	73

Credit spread sensitivities Ratings 31.12.2018	CS01 Limite in €000	CS01 Exposure in €000	Utilisation in %
AAA or lower	-14,500	-9,894	68
AA or lower	-13,500	-9,546	71
A or lower	-11,000	-7,815	71
Below A	-2,800	-1,769	63

The exposure to all credit spread sensitivities on all securities fell markedly from €–9.9m as at the end of 2018 to €–4.3m as at the end of 2019. Once again, most of this decline is attributable to the sale of the portfolio mentioned above.

As required by the regulator for a bank with only a banking book, Commerzbank Finance & Covered Bond S.A. also quantifies the effects of interest rate change shocks on the economic value of its portfolio. The Bank uses a number of stress test scenarios, including two for sudden and unexpected changes in interest rates (+/– 200 basis points as "standard shock"). The outcome of the +200 basis points scenario would be a potential change in value of €–19.1m as at 31 December 2019 (previous year: €+28.6m), while the –200 basis points scenario would result in a potential change in value of €+2.5m as at the same date (assuming a 0 % floor) (previous year: €–34.6m). Based on current interest rate levels the floor stipulated by the regulators results in an improvement versus the +200 basis points scenario without floor of around €+15m, although it should be noted that this scenario is not the relevant negative outcome scenario.

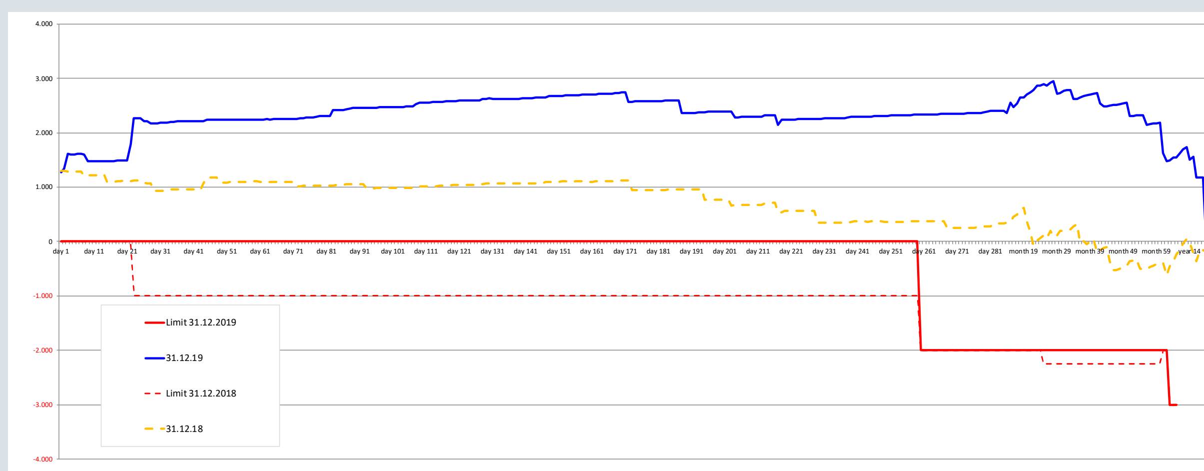
6.3.6 Liquidity risk

The Bank defines liquidity risk in the narrower sense as the risk of being 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.

Commerzbank Finance & Covered Bond S.A. is fully integrated into the Group-wide management and monitoring of liquidity risk and uses Commerzbank AG's liquidity risk system for the internal management of liquidity risk, which applies a liquidity gap profile. The liquidity gap profile is limited overall and for each significant currency. In 2019 the liquidity gap profile (overall) was within the set limit at all times.

The following chart compares the liquidity gap profile of CFCB at the end of 2019 with that of the previous year. This profile shows the cumulative future cash flows of the Bank. It is based on the contractual maturities of all products and is supplemented by other assumptions, e.g. on the ability to realise assets. The significant year-on-year increase is due in part to the significant portfolio reduction during the financial year and the inclusion of a significant liquid portfolio in the model assumptions for the liquidity gap profile.



For ILAAP and the calculation of the CFCB survival period, please refer to the comments on risk-bearing capacity.

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

The liquidity coverage ratio (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. The Bank significantly exceeded the stipulated minimum ratio on every reporting date in 2019. Over the course of the year, the LCR ratio was between 106 % and 463 %.

Please also refer to the presentation of the LCR in the Notes to the balance sheet (liabilities).

6.3.7 Operational risk

The risk of losses resulting from the inappropriateness or failure of internal procedures and systems, the human element or external events is defined as operational risk. The definition also covers legal risk, but not reputational or strategic risk.

Commerzbank Finance & Covered Bond S.A. is integrated into Commerzbank AG's operational risk management system for the purpose of complying with the requirements of the Group and the regulator. This means it is also integrated into Commerzbank AG's system for collecting loss data and the other main elements of its operational risk management approach. All quantitative and qualitative requirements for managing operational risks, including the associated steering mechanisms, have been met.

Commerzbank Finance & Covered Bond S.A. calculates its capital adequacy using Commerzbank AG's advanced measurement approach (AMA) and an allocation formula.

As at 31 December 2019, the capital allocated by the Bank to operational risk amounted to €1.07m (31 December 2018: €0.95m).

Outsourcing

Given its small size, the Bank does not have an in-house internal audit department. During the year under review, the functions of internal audit at the Bank were performed by the Group Audit department (GM Audit) of Commerzbank AG under a service level agreement, as in the previous year. The CSSF approved the outsourcing in a letter dated 20 March 2003.

In order to meet the Minimum Requirements for Risk Management (MaRisk), which do not apply directly in Luxembourg, the divisions responsible for central credit risk management at Commerzbank AG process applications for loans, prepare loan documentation, use appropriate systems to compile ratings and perform the related functions, on behalf of Commerzbank Finance & Covered Bond S.A.

The Bank has outsourced invoicing/accounting, settlement/payments, IT, organisation and security, compliance, legal and risk controlling within the Group.

Service level agreements to this effect have been concluded and are subject to regular review as part of the monitoring of outsourcing. The departments remaining within the Bank are Asset Liability Management (ALM), Credit Risk Management (CRM) and Analytics & Regulatory Issues (ARI).

The monitoring and ongoing quantification of outsourcing risks as part of operational risk is accomplished by integrating the Bank in the Group-wide outsourcing policy, the processes established for this purpose and the methods and procedures defined for it.

Other risks

To meet the requirements of pillar 2 of the Basel framework, an integrated approach to risk that also includes unquantifiable risk categories is necessary. All the risk types set out below are likewise subject to a Group-wide qualitative control and monitoring process.

Human resources risk

Within the Commerzbank Group, human resources risk is divided into four categories:

- **Adjustment risk**
  All employees must have the knowledge, experience and skills required to perform their task and duties and discharge their responsibilities. This is ensured on an ongoing basis by appropriate training and continuous professional development.

- **Motivation risk**
  Systems of remuneration and incentivisation must be constructed in such a way that they do not result in conflicts of interest and false incentives, especially among senior management.

- **Departure risk**
  The absence or departure of staff must not result in long-term disruption to the conduct of business. The criteria governing appointments, especially to senior positions, must be specified.

- **Supply risk**
  The quality and number of staff recruited must be appropriate to requirements, specifically in terms of its business operations, strategy and risk situation.

Business strategy risk

Business strategy risk is the risk of negative influences on the achievement of strategic goals as a result of changes in market and competitive, capital market requirements, banking regulation and policy or inadequate implementation of Group strategy and/or inconsistent performance by the business areas.

Commerzbank Finance & Covered Bond S.A. aligns itself with Commerzbank AG's Group strategy. Material changes and developments are detected by means of ongoing obser-

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vation and continuing analysis of the market and competitive environment in Germany and other countries and the requirements of regulators and the capital markets, with the measures to secure the company's long-term success being derived from these.

Reputational risk

Commerzbank Finance & Covered Bond S.A. introduced reputational risk management as part of the implementation of the minimum requirements of MaRisk at Group level. A company's reputation is becoming more and more crucial in today's competitive environment. This is attributable not least to the effects of the financial crisis and to the associated loss of confidence in banks, as well as to the influence of reports in the media and elsewhere. The Bank is aware of its responsibility in this regard. As the sum of its stakeholders' perceptions, Commerzbank Finance & Covered Bond S.A.'s reputation is of significant value and needs to be protected, as a good reputation is an indicator of, among other things, trustworthiness, a commitment to values and an awareness of corporate responsibility. Commerzbank Finance & Covered Bond S.A. avoids business policy measures and transaction with inherent tax or legal risks or that are in breach of business policy as expressed in its articles of association or other public statements.

Compliance risk

The monitoring of compliance with relevant laws, regulations and internal rules and adherence to standards and codes of conduct customary on the market in the course of business operations is carried out by the local Chief Compliance Officer, who works closely with Group Compliance at Commerzbank AG. The objective is to identify at an early stage compliance risks with potential to jeopardise the company's integrity and hence its success, prevent them if at all possible, manage them, or resolve them appropriately in the interests of all parties.

6.4 Summary

Risks of significance in terms of the overall assessment of Commerzbank Finance & Covered Bond S.A. have been reported. There is no indication of any other risk criteria or circumstances that might put the continued existence of the Bank at risk. The possibility of further impairments, notably within the US sub-portfolio, cannot be entirely ruled out, but there is at present no evidence of any need for them.

6.5 Disclaimer

The risk measurement methods and models used at Commerzbank Finance & Covered Bond S.A., which form the basis for the calculation of the figures shown are state of the art and based on banking sector practice. The results produced by the risk models are suitable for managing the Bank. The measurement approaches are regularly reviewed by risk control and internal audit, external auditors and the 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 show only examples of the risks to which a portfolio may be exposed in extreme market situations; stress testing of all imaginable scenarios is not feasible. Stress tests cannot therefore offer a final estimate of the maximum loss should an extreme event occur.

7 Notes on the statement of comprehensive income

7.1 Net interest income

in €000	2019	2018
Interest income accounted for using the effective interest method	**299,566**	**291,105**
Interest income Amortised cost from loans and receivables	25,187	12,619
Interest income Amortised cost from securitised debt instruments	277,978	279,173
Negative interest on financial instruments held as assets	–3,599	–687
Interest income accounted for not using the effective interest method	**3,943**	**87,045**
Interest income Mandatorily Fair Value P&L from loans and receivables	3,943	87,045
Interest income Mandatorily Fair Value P&L from securitised debt instruments	0	0
Interest expenses – Amortised cost	**162,907**	**179,015**
Securitised liabilities	37,190	49,478
Deposits and repos	132,547	133,863
Other interest expenses	122	123
Negative interest on financial instruments held as liabilities	–6,952	–4,449
Total	**140,601**	**199,136**

All interest income and interest expense – including interest related income and expense – are reported in this item unless they result from the held-for-trading portfolio or from derivative hedging instruments.

7.2 Risk result

The risk result contains changes to provisions recognised in the income statement for on and off-balance-sheet financial instruments for which the IFRS 9 impairment model is to be applied. This also includes changes in loan loss provisions when derecognition occurs because of scheduled redemptions, write-ups and amounts recovered on claims written-down and direct write-downs not resulting from a substantial modification.

Changes to provisions for losses recognised in the income statement for certain off-balance-sheet financial instruments which do not constitute financial guarantees within the meaning of IFRS 9 are also included.

There were no write-ups, amounts recovered on claims written down and direct write-downs not resulting from a substantial modification during the financial year.

Risk result in €000	2019	2018
Allocation to loan loss provisions	977	1,307
Reversals of loan loss provisions	–12,079	–102
Write-ups on claims written-down	0	0
Total	**–11,101**	**1,205**

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7.3 Net commission income

in €000	2019	2018[1]
Commission income	**8,357**	**8,765**
Income from agency business	8,149	7,801
Other income	208	964
Commission expenses	**944**	**573**
Securities business	507	436
Payment transactions and foreign business	116	128
Other expenses	321	9
Net commission income	**7,413**	**8,192**
Income from agency business	8,149	7,801
Securities business	–507	–436
Payment transactions and foreign business	–116	–128
Other income	–113	955
Total	**7,413**	**8,192**

[1] Previous year restated

We report income from agency business under net commission income. This includes annual processing fees for the management of loans and/or collateral. These are recognised on payment. It also includes expenses from the covered bond business (essentially custody fees).

7.4 Net income from financial assets and liabilities measured at fair value through profit and loss and net income from hedge accounting

The item net income from financial assets and liabilities measured at fair value through profit and loss contains the net gain or loss from financial instruments in the held-for-trading category and the net gain or loss from financial instruments in the Mandatorily Fair Value P&L category.

The net gain or loss from financial instruments in the held-for-trading category illustrates the Bank's net trading income and is reported as the net balance of expenses and income. This item therefore includes:

- interest income and interest expenses from derivatives;
- net gain or loss from fair value measurement;
- net gain or loss from derivative financial instruments;
- net gain or loss from fair value adjustments (credit valuation adjustment/CVA, debit valuation adjustment/DVA, funding valuation adjustment/FVA) (CVA, DVA, FVA)

The net gain or loss from financial instruments in the Mandatorily Fair Value P&L category contains only net measurement gains or losses and realised profit or loss.

Expenses and income are each presented on a net basis.

in €000	2019	2018
Net income from financial assets and liabilities measured at fair value through profit and loss		
Net income derivatives not qualifying for hedge accounting	**12,711**	**148,510**
Net interest income derivatives	–150,557	–178,280
Profit or loss from financial instruments – Mandatorily Fair Value P&L	–30,233	–88,870
Net income from currency transactions	1,123	1,176
Total	**–166,956**	**–117,463**

Net income from hedge accounting shows measurement gains or losses on effective hedges under hedge accounting.

in €000	2019	2018
Net income from hedge accounting micro fair value hedges		
Measurement hedging derivatives	**–97,778**	**68,006**
Measurement hedged items	97,460	–71,525
Total	**–318**	**–3,519**

Net income from hedge accounting results entirely from hedge ineffectiveness.

7.5 Other net gain or loss from financial instruments

This item contains the gain or loss on disposals of financial assets in the amortised cost category as well as the gain or loss from the repurchase of financial liabilities in the amortised cost category.

Gain or loss on disposal of financial assets in the amortised cost category includes effects from sales of financial instruments measured at amortised cost that are not triggered by a change in credit rating.

The disposal of financial liabilities in the amortised cost category results in a net realised gain or loss which arises directly from the difference between the sale price and amortised cost on the day of disposal.

in €000	2019	2018
Realised gain or loss from financial liabilities – Amortised cost	**9,025**	**1,016**
Gains on disposals	10,772	1,016
Losses on disposals	–1,747	0
Gain or loss on disposal of financial assets – Amortised cost	**–3,830**	**1,079**
Gains on disposals	0	1,609
Losses on disposals	–3,830	–530
Total	**5,195**	**2,096**

As at 31 December, 2019, financial instruments with carrying amounts totalling €8,713,091 thousand (previous year: €8,576,147 thousand) were measured at amortised cost. This classification requires that the financial instruments included therein be allocated to a portfolio with the “hold to collect” business model and that no SPPI-non-compliant side agreements exist. These portfolios can involve both redemptions and sales of assets, while still remaining fundamentally in compliance with this business model.

The net gain or loss from the sale of financial instruments (amortised cost) in the amount of €–3,830 thousand resulted when the Bank sold securities and promissory note loans as part of permitted portfolio measures and repayments of securities and loans.

7.6 Operating expenses

Operating expenses were €22,562 thousand (31 December 2018: €24,883 thousand) and included personnel expenses of €1,355 thousand (31 December 2018: €1,350 thousand), and administrative expenses of €17,730 thousand (31 December 2018: €20,192 thousand), amortisation of intangible assets of €3,341 thousand (31 December 2018: €3,341 thousand), thousand and rights-of-use assets of €135 thousand (first time in 2019).

These expenses are broken down as follows:

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7.7 Personnel expenses

in €000	2019	2018
Wages and salaries	1,155	1,136
Social security contributions	128	143
Expenses for pensions and similar employee benefits	72	72
Total	**1,355**	**1,350**

Expenses for pensions and similar employee benefits are shown in Note 9.5.

7.8 Staff numbers, directors' and officers' remuneration, employee remuneration plans

7.8.1 Staff numbers and directors' and officers' remuneration

The average number of staff during the financial years stood at 11 employees, made up as at 31 December 2019 as follows:

Employees (number)	2019	2018
CEO	2	2
Senior executives	1	1
Salaried employees	8	9
Total	**11**	**12**

As at 31 December 2019, the Bank had 10 employees, 5 of whom were female and 5 male.

in €000	2019	2018
Payments to active officers	**387**	**357**
of which CEO and senior staff	387	357
of which BoD	0	0
Pension expenses	**20**	**18**
of which CEO and senior staff	20	18
of which BoD	0	0
Advances, loans, contingent liabilities	**0**	**0**
of which CEO and senior staff	0	0
of which BoD	0	0

In 2019, managers and executive were paid a total of €387 thousand. Expenditure in 2019 on pension provision for the persons mentioned above amounted to €20 thousand. Pension obligations in respect of former members of management and their survivors as at 31 December 2019 amounted to €4,667 thousand. Members of the Board of Directors received no remuneration.

7.8.2 Employee remuneration plans

Expenses relating to the Commerzbank Incentive Plan (CIP, see 5.16.3) were incurred in 2019, as in previous years, in connection with services already rendered by employees (including management).

They were as follows:

in €000	2019	2018
Commerzbank Incentive Plan	82	66

Provisions for the Commerzbank Incentive Plan are as follows:

in €000	2019	2018
Provisions	128	94

7.9 Administrative expenses

in €000	2019	2018
Occupancy expenses	16	153
Expenditure on IT	3	0
Expenditure on consultancy services, other operating expenses and expenses required to comply with company law	771	1,051
Expenditure on advertising, public relations and representation	18	8
Personnel-related operating expenses	39	27
Workplace and information expenses	176	271
European bank levy	2,566	2,994
Services charged within Group	14,058	15,504
Other non-personnel expenses	84	184
Total	**17,730**	**20,192**

The fee paid to the auditor in the financial year is made up in detail (excl. VAT) as follows:

Auditors' fees in €000 (excluding VAT)	2019	2018
Audit of financial statements	107	124
Other audit services	59	65
Total	**166**	**189**

7.10 Amortisation

in €000	2019	2018
Rights-of-use assets	135	0
Intangible assets	3,341	3,341
Total	**3,476**	**3,341**

Amortisation on the acquired customer base in connection with the agency business is reported under intangible assets.

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7.11 Other net operating income

in €000	2019	2018
Income from reversals of provisions	2,728	1,811
Sundry other operating income	53	36
Total other operating income	**2,782**	**1,847**
Other taxes	–592	3,320
Other operating expenses	0	0
Total other operating expenses	**–592**	**3,320**
Total other net operating income	**3,374**	**–1,473**

Other operating income and expenses include items that cannot be assigned to other headings in the statement of comprehensive income. Wealth tax is reported under other taxes.

7.12 Taxes on income

The breakdown of taxes on income was as follows:

in Tsd. €	2019	2018
Current taxes on income	5,842	3,583
Tax expense/income for the current year	0	0
Tax expense/income for previous years	5,842	3,583
Deferred taxes on income	0	0
Tax expense/income due to change in temporary differences and loss carryforwards	0	0
Total	**5,842**	**3,583**

The current income taxes for the years 2019 and 2018 are refunds received from the parent company in accordance with the apportionment agreement existing between the members of the tax group. Deferred tax assets are not recognised as it is not probable that sufficient taxable profit will be available within the planning period.

The tax rate applicable as at 31 December 2019 was 24.94 %. This is made up of a corporation tax rate including Labour Fund premium of 18.19 % and a trade tax rate of 6.75 %.

The following reconciliation shows the relationship between net pre-tax profit according to IFRS and tax expense in the financial year. Calculated income tax was ascertained by multiplying pre-tax profit by the local tax applicable in the financial year, which was 24.94 %.

in Tsd. €	2019	2018
Pre-tax profit or loss under IFRS	**-22,150**	**60,880**
Expected tax rate	24.94%	26.01%
Calculated income tax expense in financial year	**5,524**	**-15,835**
Tax effects		
a.) from previous years' taxes recognised in the financial year	5,842	3,583
b.) from tax-free income	0	0
c.) from temporary differences between values recognised for tax purposes and those recognised for IFRS purposes	0	0
d.) tax effect from tax group	-5,524	15,835
e.) from other differences	0	0
Taxes on income	**5,842**	**3,583**

The effective tax rate is 26.37 %. Neither in 2019 nor in 2018 were deferred taxes recognised directly in equity.

7.13 Net income

Net income consists of remeasurements to fair value, net interest income, dividend income, foreign exchange translation effects, impairments, impairment reversals, realised profit or loss, and recoveries on written-down financial instruments.

in €000	2019	2018
Net income from		
Financial assets and liabilities- Held for Trading and derivative hedging instruments	–234,501	-32,113
Financial assets – Amortised cost	456,477	297,132
Financial assets – Mandatorily Fair Value P&L	-26,290	-1,824
Financial liabilities – Amortised cost	–206,062	–184,151
Total	**–10,376**	**79,044**

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8 Notes to the balance sheet (assets)

8.1 Cash reserve

in €000	31.12.2019	31.12.2018
Balances with central banks	71,392	5,263
Total	**71,392**	**5,263**

8.2 Financial assets – Amortised cost

If the contractually agreed cash flows of a financial assetsmerely constitute interest and principal payments (i.e. theyare SPPI-compliant) and the asset was allocated to the "holdto collect" business model, the asset is measured atamortised cost. The carrying amount of these financial instruments is reduced by any loan loss provision (see Note 8.4). Interest payments for these financial instruments arerecognised in net interest income. Premiums and discounts are recognised through the income statement in net interestincome over the life of the liability.

in €000	31.12.2019	31.12.2018
Securitised debt instruments	**7,325,869**	**7,520,733**
Banks	256,655	240,926
Other financial corporations	2,343,827	2,347,809
Corporate clients	12,222	133,772
General governments	4,713,165	4,798,227
Loans and Receivables	**1,387,222**	**1,055,414**
Banks	1,310,304	963,873
General governments	76,918	91,541
Total	**8,713,091**	**8,576,147**

8.3 Financial assets – Mandatorily Fair Value P&L

This item includes financial instruments that are allocated to the residual business model and not reported in financial assets – Held for Trading. In addition, transactions allocated to the "hold to collect" and "hold to collect and sell" business model are included here if they are not SPPI-compliant.

in €000	31.12.2019	31.12.2018
Securitised debt instruments	**20,005**	**34,853**
Other financial corporations	20,005	34,853
Loans and Receivables	**0**	**2,598,191**
General governments	0	2,598,191
Total	**20,005**	**2,633,044**

The decrease in loans and receivables from general governments is due to the completed sale of a portfolio of receivables from UK local authorities at the beginning of the year. Refer to Note 9.21 for further details.

8.4 Credit risks and credit losses

For the principles and the valuation of credit risks, the calculation of expected credit loss and an assessment of a significant increase in the default risk, please refer to Note 5.11.

Credit risks and credit losses in €000	As at 31.12.2018	Net additions/ reversals	Utilisation	Exchange rate changes/ reclassifications	As at 31.12.2019
Value adjustments for risks from financial assets					
Financial assets – Amortised cost	**24,863**	**–11,101**	**0**	**82**	**13,844**
Loans and Receivables	3,127	–1,280	0	0	1,847
Securitised debt instruments	21,736	–9,822	0	82	11,996
Provisions for indemnity agreements	**0**	**0**	**0**	**0**	**0**
Total	**24,863**	**–11,101**	**0**	**82**	**13,844**

The breakdown into stages is as follows:

Value adjustments for risks from loans and advances

in €000	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as at 31.12.2018	**598**	**2,529**	**0**	**0**	**3,127**
New business	**0**	**0**	**0**	**0**	**0**
Changes in positions resulting from stage transfers	**0**	**0**	**0**		**0**
in Stage 1	0	0	0		0
in Stage 2	0	0	0		0
in Stage 3	0	0	0		0
Disposals	**0**	**0**	**0**	**0**	**0**
Changes of parameters/models	**11**	**–1,291**	**0**	**0**	**–1,280**
Utilisation			**0**	**0**	**0**
Exchange rate changes/Reclassification/Unwinding	**0**	**0**	**0**	**0**	**0**
Provisions for indemnity agreements	**0**	**0**	**0**	**0**	**0**
Balance as at 31.12.2019	**610**	**1,238**	**0**	**0**	**1,847**

Value adjustments for risks from securitised debt instruments

in €000	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as at 31.12.2018	**3,849**	**17,886**	**0**	**0**	**21,736**
New business	**0**	**0**	**0**	**0**	**0**
Changes in positions resulting from stage transfers	**112**	**–2,070**	**0**		**–1,959**
in Stage 1	112	–2,070	0		–1,959
in Stage 2	0	0	0		0
in Stage 3	0	0	0		0
Disposals	**–550**	**–1,673**	**0**	**0**	**–2,223**
Changes of parameters/models	**–136**	**–5,504**	**0**	**0**	**–5,641**
Utilisation			**0**	**0**	**0**
Exchange rate changes/Reclassification/Unwinding	**33**	**50**	**0**	**0**	**82**
Balance as at 31.12.2019	**3,308**	**8,689**	**0**	**0**	**11,996**

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The change in value adjustments shown is based on the change in the portfolio of relevance for the value adjustments set out below. The reductions in loan loss provisions, loans and receivables and securitised debt instruments reported under changes of parameters/models are mainly attributable to improvements in the credit quality of portfolios assigned to Stage 2.

in €000	31.12.2019	Net change	31.12.2018
Loans and Receivables	**1,389,069**	**330,528**	**1,058,541**
Stage 1	1,357,061	336,330	1,020,731
Stage 2	32,008	–5,802	37,810
Stage 3	0	0	0
Securitised debt instruments	**7,337,865**	**–204,604**	**7,542.46.9**
Stage 1	7,067,249	–151,242	7,218,491
Stage 2	270,617	–53,361	323,978
Stage 3	0	0	0
Total	**8,726,935**	**125,925**	**8,601,010**

The carrying amounts of the financial assets for which value adjustments have been made are allocated to the rating classes as follows:

in €000	12m ECL	ECL Lifetime	POCI	Total
Loans and Receivables	**1,357,061**	**32,008**	**0**	**1,389,069**
1.0-1.8	931,321	0		931,321
2.0- 2.8	395,577	0		395,577
3.0- 3.8	30,163	32,008		62,171
4.0- 4.8	0	0		0
5.0- 5.8	0	0		0
6.1- 6.5	0	0		0
Securitised debt instruments	**7,067,249**	**270,617**	**0**	**7,337,865**
1.0 -1.8	4,182,894	0		4,182,894
2.0- 2.8	2,698,944	0		2,698,944
3.0- 3.8	185,411	257,375		442,786
4.0- 4.8	0	5,761		5,761
5.0- 5.8	0	7,480		7,480
6.1- 6.5	0	0		0
Total	**8,424,309**	**302,625**	**0**	**8,726,935**

8.5 Financial assets – Held for Trading

Financial assets – Held for Trading shows derivative financial instruments (derivatives that do not qualify for hedge accounting).

in €000	31.12.2019	31.12.2018
Positive fair values of derivative financial instruments (without hedge accounting)		
Interest-rate-related transactions	220,079	141,879
Currency-related transactions	188,739	196,423
Total	**408,818**	**338,301**

Irrespective of the type of product, these financial assets are measured at fair value through profit or loss. The fair value changes of the transaction in question are thus recognised in the statement of comprehensive income through profit

or loss. Where the fair value cannot be ascertained from active market data, measurement generally uses comparative and indicative prices from pricing service providers or other banks (lead managers) or with the help of internal measurement procedures (net present value or option pricing models).

Interest income and expenses and gains or losses on measurement and disposal from these financial instruments are recorded in the statement of comprehensive income under net income from financial assets and liabilities measured at fair value through profit and loss. The impact in the presentation of the statement of comprehensive income is shown in Note 5.3.

8.6 Positive fair values of derivative hedging instruments

This item shows derivative financial instruments used for hedging purposes and qualifying for hedge accounting. The instruments are measured at fair value.

in €000	31.12.2019	31.12.2018
Positive fair values of effective fair value hedges	**498,479**	**486,614**

8.7 Fixed and intangible assets

in €000	31.12.2019	31.12.2018
Intangible assets	**3,341**	**6,682**

The carrying value of the agency business customer base acquired in 2016 is reported as intangible assets.

in €000	31.12.2019	31.12.2018
Rights-of-use assets (leasing)	339	0
Office furniture and equipment	32	32
Total	**371**	**32**

The figure of €32 thousand reported under office furniture and equipment refers to works of art which have not been subject to depreciation.

The rights-of-use assets include the rented business premises and motor vehicles used for the Bank's business activities.

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8.8 Changes in fixed and intangible assets

Changes in intangible assets in 2019 were as follows:

in €000	2018
Acquisition and production costs	**15,314**
As at 1.1.2018	15,314
Additions	0
Disposals	0
As at 31.12.2018	15,314
Depreciation and amortisation	
As at 1.1.2018	5,290
Planned depreciation and amortisation in the financial year	3,341
Disposals	0
As at 31.12.2018	8,632
Carrying amount as at 31.12.2018	**6,682**

in €000	2019
Acquisition and production costs	**15,314**
As at 1.1.2019	15,314
Additions	0
Disposals	0
As at 31.12.2019	15,314
Depreciation and amortisation	
As at 1.1.2019	8,632
Planned depreciation and amortisation in the financial year	3,341
Disposals	0
As at 31.12.2019	11,973
Carrying amount as at 31.12.2019	**3,341**

The assets are not divided into groups within the changes in fixed and intangible assets table. Refer to Note 8.7. Changes in fixed assets in 2019 were as follows:

in €000	2018
Acquisition and production costs	**184**
As at 1.1.2018	**184**
Additions	0
Disposals	0
As at 31.12.2018	184
Depreciation and amortisation	
As at 1.1.2018	152
Planned depreciation and amortisation in the financial year	0
Disposals	0
As at 31.12.2018	**152**
Carrying amount as at 31.12.2018	**32**

in €000	2019
Acquisition and production costs	**651**
As at 1.1.2019	651
Additions	7
Disposals	0
As at 31.12.2019	659
Depreciation and amortisation	
As at 1.1.2019	152
Planned depreciation and amortisation in the financial year	135
Disposals	0
As at 31.12.2019	287
Carrying amount as at 31.12.2019	**371**

The change in acquisition and production costs amounting to €467 thousand between 31 December 2018 and 1 January 2019 was due to the application of IFRS 16 and the resulting capitalisation of rights-of-use assets.

8.9 Tax assets

Deferred income tax liabilities represent the potential income tax reliefs arising from temporary differences between the values assigned to assets and liabilities in the consolidated balance sheet in accordance with IFRS and their values for tax accounting purposes in accordance with the local tax regulations. In addition, deferred tax assets are also recognised for tax loss carryforwards. As taxable income is allocated to the tax group of the parent company, there is no loss carryforward at CFCB level.

Deferred tax claims have been capitalised only in so far as business performance figures and the business environment make it probable that there will be sufficient taxable income at the level of the tax group within the planning period. Deferred income tax assets and liabilities are netted if there is a right to net current taxes on income and the deferred tax assets and liabilities relate to taxes on income levied by the same fiscal authority on the same taxable entity. For unrecognised deferred tax assets please refer to Note 5.14.

in €000	31.12.2019	31.12.2018
Current tax assets	**0**	**0**
Deferred tax assets	**0**	**0**
Tax assets recognised in income statement	0	**0**
Tax assets not recognised in income statement	0	**0**
Total	**0**	**0**

Deferred tax assets were recognised in connection with the following items:

in €000	31.12.2019	31.12.2018
Fair values of derivative hedging instruments	281,683	269,383
Financial assets and liabilities– Held for Trading	115,759	335,833
Provisions	1,237	822
Financial liabilities – Amortised cost	116,589	117,946
Sub-total	**515,267**	**723,984**
Unrecognised deductible temporary differences	0	-84,006
Total	**515,267**	**639,977**
Netting	515,267	639,977
Total after netting	**0**	**0**

In addition, deferred tax assets are also recognised for tax loss carryforwards where appropriate. However, since CFCB is within a tax group, the losses incurred by it are formally transferred to the parent company and can be used by all members of the tax group, including CFCB. Hence deferred tax assets are not capitalised at CFCB level. At tax group level, losses carried forward as at 31 December 2019 amounted to €705.9m). These can be carried forward up to 2035 (€406.2m) and 2036 (€299.7m).

8.10 Other assets

Other assets mainly comprise a receivable from the Single Resolution Fund amounting to €514 thousand (31 December 2018: €514 thousand) and other receivables in the amount of €398 thousand (31 December 2018: €6,126 thousand).

8.11 Subordinated assets

The portfolio contained no subordinated assets either as at 31 December 2019 or as at 31 December 2018.

9 Notes to the balance sheet (liabilities)

9.1 Financial liabilities – Amortised cost

in €000	31.12.2019	31.12.2018
Deposits	**5,728,233**	**7,090,099**
Banks	4,491,572	5,760,754
Other financial corporations	1,235,008	1,311,670
Corporate clients	1,653	1,653
General governments	0	16,022
Securitised liabilities	**1,021,019**	**1,211,152**
Covered bonds	1,021,019	1,211,152
Total	**6,749,252**	**8,301,251**

9.2 Financial liabilities – Held for Trading

This position shows derivative financial instruments (derivatives that do not qualify for hedge accounting).

in €000	31.12.2019	31.12.2018
Negative fair values of derivative financial instruments (without hedge accounting)		
Interest-rate-related transactions	467,171	1,321,455
Currency-related transactions	128,847	111,622
Total	**596,018**	**1,433,076**

The significant decline in interest-related transactions was mainly due to the early termination of derivatives used to hedge interest rates on a portfolio of receivables from UK local authorities sold at the beginning of the financial year (see also Note 9.21).

9.3 Negative fair values of derivative hedging instruments

Derivative instruments held for purposes other than trading, used for effective hedging and with a negative fair value are reported under this item. The financial instruments are measured at fair value.

in €000	31.12.2019	31.12.2018
Negative fair values of effective fair value hedges	1,181,719	1,091,038
Total	**1,181,719**	**1,091,038**

9.4 Provisions

in €000	31.12.2019	31.12.2018
Provisions for pensions and similar commitments	8,214	6,521
Other provisions	3,041	3,969
Total	**11,255**	**10,490**

9.5 Provisions for pensions and similar commitments

Pension obligations are calculated annually by independent actuaries using the projected unit credit method:

in €000	2019	2018
Calculatory interest rate	1.1 %	1.9 %
Change in salaries	2.5 %	2.5 %
Adjustment to pensions	1.5 %	1.5 %

The changes in the pension obligations were as follows:

in €000	2019	2018
Pension obligations as at 1 January	**6,521**	**6,622**
Service cost	18	19
Interest cost	122	124
Pension payments	–164	–210
Change in actuarial gains/losses	1,717	–34
Experience adjustments	601	–34
Adjustments in financial assumptions	1,103	0
Other changes (changes to exchange rates, reclassifications, changes to the plan)	0	0
Pension obligations as at 31 December	**8,214**	**6,521**

The expenses for pensions and other employee benefits consist of the following components:

in €000	2019	2018
Service cost	18	19
Interest cost	122	124
Amortisation of actuarial gains (–) / or losses (+)	0	0
Expenses for defined benefit plans	**139**	**143**
Expenses for defined contribution plans	26	29
Other pension benefits (age-related short-time working, early retirement)	0	0
Other expenses for pensions and similar employee benefits	28	24
Expenses for pensions and similar employee benefits	**194**	**196**

In 2020, expenses for defined benefit plans are expected to total €102 thousand.

The sensitivity analysis shown here reflects the changes in an assumption; the other assumptions remain unchanged from the original calculation, i.e. potential correlation effects between the individual assumptions are not taken into account.

The individual influencing factors (interest rate, salary, pension adjustments and mortality rate) are varied individually and the other influencing factors are kept unchanged.

A change in the corresponding assumptions as at 31 December 2019 would have the following effects:

in €000	31.12.2019	31.12.2018
Interest rate sensitivity		
Discount rate +50bps	–740	–453
Discount rate – 50bps	839	506
Salary change sensitivity		
Adjustment to salary +50bps	69	10
Adjustment to salary –50bps	–66	–9
Pension adjustment sensitivity		
Adjustment to pensions +50bps	1,465	424
Adjustment to pensions –50bps	–685	–386
Mortality rate (life expectancy) change sensitivity		
Reduction in mortality of 10%[1]	330	121

[1] Corresponds to a change in life expectancy of around one year.

The weighted average duration of pension obligations as at 31 December 2019 was 17.6 years (compared with 14.9 years as at 31 December 2018).

9.6 Other provisions

in €000	Provisions for the personnel	Restructuring area	Other provisions	Total
As at 1.1.2018	**166**	**549**	**340**	**1,055**
Allocation	145	0	3,315	3,460
Utilisation	119	44	42	204
Release	92	0	250	342
As at 31.12.2018	**101**	**505**	**3,362**	**3,969**
As at 1.1.2019	**101**	**505**	**3,362**	**3,969**
Allocation	125	0	0	125
Utilisation	72	332	0	404
Release	3	0	646	649
As at 31.12.2019	**151**	**173**	**2,716**	**3,041**

Provisions for special human resources payments have been recognised. Service anniversary payments, which have also been provisioned, are by their nature long-term and the provisions for them will progressively be used up over future periods.

The provisions recognised for the restructuring measures are associated with the task of winding up and cover future HR-related liabilities and liabilities arising out of rental agreements. There was no discounting on the grounds that, apart from the provisions for service anniversaries/restructuring, the terms generally extend over no more than one year. The discounting effect on provisions for service anniversaries would not be significant. Restructuring provisions are reviewed annually and are therefore not discounted.

The allocations to the remaining other provisions in the financial year mainly relate to a provision for wealth tax.

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9.7 Tax liabilities

Provisions for taxes on income are potential tax liabilities which have not yet been formally assessed. Deferred tax liabilities represent the potential income tax charge arising from temporary differences between the values assigned to assets and liabilities in the consolidated balance sheet in accordance with IFRS and their values for tax accounting purposes in accordance with the local tax regulations.

in €000	31.12.2019	31.12.2018
Current tax liabilities	**0**	**20,655**
Provisions for income tax	0	20,655
realised after more than twelve months	0	20,655
Deferred tax liabilities	**0**	**0**
Tax liabilities recognised in income statement	0	0
Total	**0**	**20,655**

Deferred income tax assets and liabilities are netted if there is a right to net current taxes on income and the deferred tax assets and liabilities relate to taxes on income levied by the same fiscal authority on the same taxable entity.

Deferred tax liabilities were recognised in connection with the following items:

in €000	2019	2018
Fair values of derivative hedging instruments	116,049	116,611
Financial assets and liabilities– Held for Trading	120,694	14,886
Financial assets – Amortised cost and Mandatorily Fair Value	296,997	481,185
Other balance-sheet items	0	27,296
Sub-total	**533,740**	**639,977**
Deductible temporary differences not recognised	-18,473	0
Total	**515,267**	**639,977**
Netting	515,267	639,977
Total after netting	**0**	**0**

9.8 Other liabilities

in €000	31.12.2019	31.12.2018
Accrued and deferred items	2	12
Lease liabilities	339	0
Other liabilities	921	1,272
Total	**1,263**	**1,284**

Other liabilities mainly comprise taxes and social contributions payable in the amount of €664 thousand (31 December 2018: €893 thousand). Trade payables amounting to €247 thousand (31 December 2018: €373 thousand) were reported under this item again. The other liabilities are due within one year.

9.9 Notes on equity

in €000	31.12.2019	31.12.2018
Subscribed capital	235,000	235,000
Capital reserve	1,859,000	1,859,000
Retained earnings	–900,788	–963,535
Surplus/shortfall for the year	–16,308	64,463
Equity	**1,176,904**	**1,194,928**

The sole shareholder is Commerzbank AG.

As at 31 December 2019, the share capital, being subscribed and fully paid up, was divided into 235,000 (31 December 2018: 235,000) registered shares with a nominal value of €1,000 each.

The capital reserve, amounting to €1,859,000 thousand is made up of capital contributions from shareholders amounting to €1.322.863 thousand in earlier years and the absorption into the capital reserve, on the merger of former EEPK with former HFI in 2014, of the equity of former EEPK, which totalled €536,137 thousand.

Retained earnings consist of the statutory reserves and other retained earnings including the IAS 19 reserve). From the surplus for 2018, €64,463 thousand was allocated to other retained earnings. As at 31 December 2019, statutory reserves amounted to €23,500 thousand (31 December 2018: €23,500 thousand) and are subject to a limit on distribution. The other retained earnings of €–924,288 thousand (31 December 2018: €–987,035 thousand) comprise the Bank's reinvested profits and the effect of the first-time adoption of IFRS 9.

The return on capital, calculated as net profit divided by total assets, is –0.17 %.

9.10 The Bank's foreign currency position

The following assets and liabilities in foreign currencies were recognised as at 31 December 2019:

in €000	USD	CHF	GBP	Other	Total 31.12.2019	Total 31.12.2018
Cash reserve	0	0	0	0	0	0
Financial assets – Amortised cost	5,175,694	565	304,773	12,278	5,493,309	5,601,688
Financial assets – Mandatorily Fair Value P&L	0	0	0	0	0	2,598,191
Positive fair values of hedging instruments	76,556	68,093	0	3,127	147,776	173,729
Financial assets – Held for Trading	286,913	19,168	72,752	11	378,844	307,721
Other balance-sheet items	19	0	0	0	20	73
Foreign currency assets	**5,539,183**	**87,825**	**377,525**	**15,415**	**6,019,948**	**8,681,402**
Financial liabilities – Amortised cost	2,124,473	606,472	484,285	54,131	3,269,360	5,265,900
Negative fair values of hedging instruments	490,126	0	0	1,709	491,835	478,742
Financial liabilities – Held for Trading	232,611	43,907	313,348	3,127	592,993	1,458,187
Other liabilities	7	0	2	0	9	0
Foreign currency liabilities	**2,847,217**	**650,378**	**797,635**	**58,966**	**4,354,196**	**7,202,829**

The open balance sheet positions are matched by corresponding forward foreign exchange contracts or currency swaps with matching maturities.

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9.11 Derivatives

The following tables show the Bank's transactions in derivatives as at the reporting date.

A derivative is a financial instrument with a value determined by an underlying asset, which may, for example, be a currency or a bond.

The derivatives transactions involve OTC derivatives, where the contract specifications are agreed between the Bank and its counterparties.

The nominal amount shows the volume traded by the Bank. However, the positive and negative fair values listed in the table are the expenses which would be incurred by the Bank or the counterparty for terminating the transaction. From the Bank's point of view, a positive fair value thus indicates the maximum potential counterparty-specific default risk present from derivative transactions on the balance-sheet date.

In order to minimise both the economic and regulatory credit risk arising from these instruments, the Bank enters into master agreements (bilateral netting agreements) with its counterparties (such as the ISDA Master Agreement).

By concluding such netting agreements, the positive and negative fair values of the derivatives contracts included under a master agreement can be offset against one another, and the future regulatory risk add-ons for these products can be reduced.

This netting process reduces the credit risk to a single net claim on the party to the contract (close-out netting).

For both regulatory reports and the internal measurement and monitoring of credit commitments, such risk-mitigating techniques are used only where they are regarded as enforceable in the jurisdiction in question if the counterparty should become insolvent.

Similar to the master agreements are the collateral agreements (e.g. the Credit Support Annex), which Commerzbank Finance & Covered Bond S.A. enters into with its counterparties to secure the net claim or liability remaining after netting (receiving or providing security). As a rule, this collateral management reduces credit risk by means of prompt (usually daily or weekly) measurement and adjustment of the customer exposure.

9.12 Derivatives – further details

The following list shows the nominal amounts and fair values of derivatives broken down by interest rate-based contracts, currency-based contracts and contracts subject to other price risks, and the maturity structure of these transactions. The fair values are the sum totals of the positive and negative amounts per contract and are shown without deducting collateral and without taking account of any netting agreements, since these work on a cross-product basis. The nominal amount represents the gross volume of all sales and purchases. The maturity dates listed for the transactions are based on the term to maturity of the contracts and not the maturity of the underlying.

9.12.1 Maturity breakdown of derivatives

	Nominal values / Residual terms						Fair values	
2018 in €000	Due on demand	up to 3 months	3 months up to 1 year	over 1 year up to 5 years	over 5 years	Total 31.12.2018	Positive 31.12.2018	Negative 31.12.2018
Foreign-currency-based forward transactions not capable of being used for hedge accounting								
OTC products								
Foreign exchange spot and forward contracts	0	968,288	0	0	0	968,288	10,642	5,139
Interest rate / currency swaps	0	18,963	53,951	1,249,241	193,129	1,515,285	185,781	106,483
Total	**0**	**987,252**	**53,951**	**1,249,241**	**193,129**	**2,483,573**	**196,423**	**111,622**
Interest-based forward transactions								
OTC products								
Interest rate swaps not capable of being used for hedge accounting	0	60,587	58,824	480,657	2,278,973	2,879,042	137,316	1,321,455
Interest rate swaps, used as hedging derivatives	0	123,567	121,742	1,361,670	3,844,958	5,451,938	486,614	1,091,038
Other interest rate contracts not capable of being used for hedge accounting	0	0	0	73,000	0	73,000	4,563	0
Total	**0**	**184,154**	**180,567**	**1,915,328**	**6,123,932**	**824,915**	**628,493**	**2,412,493**
Total pending forward transactions	**0**	**1,171,406**	**234,518**	**3,164,569**	**6,317,061**	**10,887,553**	**824,915**	**2,524,115**

	Nominal values / Residual terms						Fair values	
2019 in €000	Due on demand	up to 3 months	3 months up to 1 year	over 1 year up to 5 years	over 5 years	Total 31.12.2019	Positive 31.12.2019	Negative 31.12.2019
Foreign-currency-based forward transactions not capable of being used for hedge accounting								
OTC products								
Foreign exchange spot and forward contracts	0	1,229,949	0	0	0	1,229,949	23,151	4,535
Interest rate / currency swaps	0	44,889	22,131	1,197,238	197,043	1,461,302	165,588	124,312
Total	**0**	**1,274,838**	**22,131**	**1,197,238**	**197,043**	**2,691,251**	**188,739**	**128,847**
Interest-based forward transactions								
OTC products								
Interest rate swaps not capable of being used for hedge accounting	0	54,091	23,380	523,147	1,419,433	2,020,051	214,422	467,171
Interest rate swaps, used as hedging derivatives	0	226,646	108,504	886,915	3,742,645	4,964,710	498,479	1,181,719
Other interest rate contracts not capable of being used for hedge accounting	0	0	0	73,000	0	73,000	5,658	0
Total	**0**	**280,736**	**131,885**	**1,483,062**	**5,162,078**	**7,057,760**	**718,558**	**1,648,891**
Total pending forward transactions	**0**	**1,555,574**	**154,016**	**2,680,300**	**5,359,121**	**9,749,011**	**907,297**	**1,777,737**

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9.12.2 Counterparty breakdown of derivatives

The table below shows the positive and negative fair values of the Bank's derivative business broken down by counterparty.

The Bank conducts derivative transactions with credit and financial institutions with excellent credit ratings based in an OECD country.

in €000	Fair values Positive 31.12.2019	Fair values Negative 31.12.2019	Fair values Positive 31.12.2018	Fair values Negative 31.12.2018
OECD banks	901,640	1,464,825	820,353	2,288,492
OECD financial institutions	5,658	312,912	4,563	235,623
Total	**907,297**	**1,777,737**	**824,915**	**2,524,115**

9.12.3 Use of financial derivatives

The following table shows how financial derivatives are used. Derivatives are used for hedging purposes. The applicable criteria are described in the accounting and measurement methods (Note 5.10).

in €000	Fair values Positive 31.12.2019	Fair values Negative 31.12.2019	Fair values Positive 31.12.2018	Fair values Negative 31.12.2018
Hedging derivatives not capable of being used for hedge accounting	408,818	596,018	338,301	1,433,076
Derivatives used as hedging instruments	498,479	1,181,719	486,614	1,091,038
for micro fair value hedge accounting	498,479	1,181,719	486,614	1,091,038
Total	**907,297**	**1,777,737**	**824,915**	**2,524,115**

The fair values of the derivatives used as hedging instruments for micro fair value hedge accounting are included under positive fair values of derivative hedging instruments and negative fair values of derivative hedging instruments.

The above hedging transactions are used to hedge the following assets and liabilities as part of micro fair value hedge accounting.

Hedging of underlying transactions in €000	Carrying amount 31.12.2019	Cumulative carrying amount adjustment 31.12.2019	Carrying amount 31.12.2018	Cumulative carrying amount adjustment 31.12.2018
Financial assets – Amortised cost	**4,592,074**	**1,158,129**	**4,863,791**	**1,065,785**
Securitised debt instruments	4,592,074	1,158,129	4,863,791	1,065,785
Financial liabilities – Amortised cost	**2,126,871**	**467,321**	**2,423,015**	**453,463**
Deposits and other financial liabilities	1,234,958	326,438	1,327,490	289,675
Securitised liabilities	891,913	140,883	1,095,525	163,788

9.12.4 Information on netting of financial instruments

We set out below the reconciliation of gross amounts before netting to net amounts after netting, as well as the amounts for existing netting rights that do not meet the accounting criteria for netting, presented separately for all financial assets and liabilities carried on the balance sheet that are already netted in accordance with IAS 32.42, and are subject to an enforceable bilateral master netting agreement or a similar agreement but are not netted in the balance sheet. For the netting agreements, we conclude master agreements with our counterparties, e.g. The 1992 ISDA Master Agreement (Multicurrency – Cross Border) and the German Master Agreement for Financial Futures. By means of such netting agreements, the positive and negative fair values of the derivatives contracts included under a master agreement can be offset against one another. This netting process reduces the credit risk to a single net claim on the party to the contract (close-out netting).

2018 in €000	Derivatives Positive fair values	Derivatives Negative fair values
Gross amount before balance-sheet netting	**824,916**	**2,549,398**
Netting recorded in the balance sheet	**0**	**0**
Netting not recorded in the balance sheet	**595,655**	**1,346,019**
From master netting agreements not yet recognised	448,324	609,767
From cash collateral	147,331	736,252
Values in the balance sheet without netting agreement	**229,261**	**1,203,379**

2019 in €000	Derivatives Positive fair values	Derivatives Negative fair values
Gross amount before balance-sheet netting	**907,297**	**1,779,430**
Netting recorded in the balance sheet	**0**	**0**
Netting not recorded in the balance sheet	**828,911**	**1,330,834**
From master netting agreements not yet recognised	668,872	668,872
From cash collateral	160,038	661,962
Values in the balance sheet without netting agreement	**78,387**	**448,595**

9.13 Maturity breakdown

The residual term is defined as the period of time between the reporting date and the date on which the claim or liability falls contractually due.

Maturities of assets and liabilities

The Bank defines the residual term or date of anticipated performance or settlement as current if the period between the reporting date and the maturity date is less than one year. Financial instruments in trading assets and liabilities without contractual maturity dates, the cash reserve, assets and liabilities held for sale, and current taxes on income, are generally classified as current. However, the Bank generally classifies fixed assets as non-current. When it comes to the breakdown of other assets and liabilities, an estimate of the main items is made. Please refer to Note 9.12.1 for the breakdown of the nominal value of derivatives.

In the breakdown of residual terms, the residual terms are presented based on undiscounted cash flows. As a result, a reconciliation with the values in the balance sheet is basically not possible.

in €000	Due on demand	Residual term up to 3 months	Residual term 3 months to 1 year	Residual term 1 year up to 5 years	Residual term over 5 years	Total
Loans and Receivables	833,077	313,029	15,893	95,188	709,481	**1,966,668**
Securitised debt instruments	0	64,361	339,031	1,820,167	6,442,264	**8,665,824**
Derivatives with positive fair values	0	61,317	58,494	385,942	482,598	**988,350**
Deposits	-645,115	-1,172,833	-802,952	-1,572,889	-2,150,823	**-6,344,612**
Securitised liabilities	0	-160,958	-9,138	-221,218	-707,767	**-1,099,080**
Subordinated liabilities	0	0	-751	-7,253	-9,767	**-17,772**
Negative fair values from derivatives	0	-42,141	-172,605	-807,735	-1,035,761	**-2,058,242**

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9.14 Repo and reverse repo transactions, securities lending transactions and cash collaterals

The money received from repo transactions where Commerzbank Finance & Covered Bond S.A. is the borrower (i.e. where it is under an obligation to take the securities back) is shown in the balance sheet as a liability to banks or customers.

We conclude securities lending transactions with other banks in order to meet delivery commitments or to enable the Bank to effect securities repurchase agreements. We report these transactions in a similar manner to securities repurchase transactions. Securities lent remain in our securities portfolio and are classified and measured according to the rules of IFRS 9.

Borrowed securities do not appear in the balance sheet, nor are they measured. In securities lending transactions, the counterparty credit risk can be avoided by obtaining collateral, which may be provided in the form of cash, for example. Collateral furnished for a securities lending transaction is referred to as "cash collateral out" and collateral received as "cash collateral in". In addition, cash collaterals are deposited or received as collateral in connection with derivative transactions.

In repo transactions, the Bank sells or purchases securities with the obligation to repurchase or return them.

The repo and securities lending transactions executed up to the reporting date and the cash collaterals received or paid broke down as follows:

in €000	31.12.2019	31.12.2018
Repurchase agreements as borrower financial liabilities		
Amortised cost	949,798	1,387,537
Cash collaterals received		
Financial liabilities – Amortised cost	160,038	147,331
Total	**1,109,837**	**1,534,868**
Cash collaterals paid		
Financial assets – Amortised cost	739,272	741,082
Total	**739,272**	**741,082**

Assets were transferred as collateral for the following liabilities from genuine repurchase agreements where the Bank is the borrower.

in €000	31.12.2019	31.12.2018
Financial liabilities – Amortised cost	949,798	1.,387,537

The following assets were transferred as collateral for the above liabilities:

in €000	31.12.2019	31.12.2018
Financial assets – Amortised cost		
Carrying amount of securities transferred	1,218,919	1,388,558

Securities lent in securities lending transactions:

in €000	31.12.2019	31.12.2018
Financial assets – Amortised cost		
Carrying amount of securities transferred	807,253	892,103

The collateral was provided to borrow under securities repurchase agreements (repos). The transactions were carried out on standard market terms for securities lending and repo transactions.

9.15 Maximum credit risk

The maximum credit risk exposure under IFRS 7 – excluding collateral or other credit enhancements – is equal to the carrying amounts after impairments of the relevant assets in each class, or the nominal values of irrevocable lending commitments. The table below shows the carrying amounts or nominal values of financial instruments with a potential default risk:

in €000	31.12.2019	31.12.2018
Financial assets – Amortised cost	8,713,091	8,576,147
Loans and Receivables	1,387,222	1,055,414
Securitised debt instruments	7,325,869	7,520,733
Financial assets – Mandatorily Fair Value P&L	20,005	2,633,044
Loans and Receivables	0	2,598,191
Securitised debt instruments	20,005	34,853
Financial assets – Held for Trading	408,818	338,301
Derivatives	408,818	338,301
Positive fair values of derivative hedging instruments	498,479	486,614
Contingent liabilities	514	514
Total	**9,640,907**	**12,034,620**

The maximum credit risk exposures listed above are not part of internal credit risk management, as credit risk management also takes account of collateral, probabilities of default and other economic factors. These amounts are therefore not representative of the Bank's assessment of its actual credit risk. For the fair value of the derivatives the Bank has received collateral in the form of cash collaterals amounting to €160,038 thousand (2018: €147,331 thousand). See also Note 9.14.

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9.16 Regulatory capital requirements

The Bank uses the standard approach for credit and market risk to determine its capital adequacy; authorisation to do so has been confirmed by the regulator, the CSSF. Operational risk is determined using the advanced approach.

The Bank's regulatory capital as at 31 December 2019 was €1,182.1m (31 December 2018: €990m), and its overall ratio 56.21 % (31 December 2018: 37.10 %). Capital adequacy is determined by application of Regulation (EU) No 575/2013.

Due to the Lobo transfer to Commerzbank Frankfurt, the prudent valuation fell from €151.7m as at 31 December 2018 to €8.6m at the beginning of 2019, which resulted in an increase in the capital ratios.

Regulatory capital in €000	31.12.2019	Change	31.12.2018
Tier 1 capital			
Subscribed capital	235,000	0	235,000
Reserves	958,212	62,747	895,465
Result carried forward		0	0
Shortfall for the year	-16,308	-16,308	0
Deductions from tier 1 capital	-5,239	146,470	-151,709
Total tier 1 capital	**1,171,665**	**192,909**	**978,756**
Tier 2 (capital			
Subordinated loans	10,407	-1,014	11,421
Deductions from tier 2 capital		0	
Total tier 2 capital	**10,407**	**-1,014**	**11,421**
Total equity	**1,182,072**	**191,895**	**990,177**
Own funds requirements			
from credit risk	158,660	-45,234	203,894
from CVA RCC	8,516	-131	8,647
from operational risks	1,070	120	950
Total own funds requirements	**168,246**	**-45,246**	**213,492**
Capital ratio	**56.21**	**19.11**	**37.10**

Own funds requirements in €000	31.12.2019	Change	31.12.2018
Credit risk positions			
Exposure class			
Claims on central government and central banks	86,770	-54,059	140,829
Claims on institutions	26,239	12,915	13,324
Claims on companies	465	-2,414	2,879
Securitisation positions	45,111	-191	45,302
Other assets (other loan obligations)	75	-1,484	1,559
CVAs	8,516	-131	8,647
Operational risk	1,070	120	950
Own funds requirements	**168,246**	**-45,246**	**213,492**

9.17 Leverage ratio

The CRD IV/CRR has introduced the leverage ratio as a tool and indicator for quantifying the risk of excessive leverage. The leverage ratio shows the ratio of Tier 1 capital to leverage exposure, consisting of the non-risk-weighted assets plus off-balance-sheet positions. The way in which exposure to derivatives, securities financing transactions and off-balance-sheet positions is calculated is laid down by regulators. The leverage ratio at the end of financial year 2019 was calculated on the basis of the CRR as revised in January 2015.

The leverage ratio, as a non-risk-sensitive key indicator, is a supplementary key indicator of risk-based capital adequacy.

Avoiding the risk of excessive leverage is an integral part of the Bank's management of its balance sheet. Quarterly regulatory reporting to the CSSF takes place on the basis of regulatory requirements.

The ratio as at 31 December 2019 stood at 12.82 %.

9.18 Liquidity coverage ratio

The liquidity coverage ratio (LCR) is the regulatory minimum liquidity ratio. It is a measure of the near-term solvency of the Bank under a predetermined stress scenario. Based on the requirements of the Basel Committee, the EU Commission set out the legal foundation for the LCR in the Capital Requirements Regulation (CRR) and in Regulation (EU) No 575/2013, in conjunction with Delegated Regulation (EU) No 2015/61 (D–REG). The ratio itself is defined as high quality liquid assets (HQLA) divided by net liquidity outflows (NLOs) within a 30-day period. It has been reported to the supervisory authorities in this form since 30 September 2016. Under the CRR, a minimum value of 100 % has had to be complied with since 1 January 2018. The Bank has integrated the LCR into its internal liquidity risk model as a binding secondary condition, and the change in the LCR is monitored regularly.

The ratio as at 31 December 2019 stood at 463 %.

9.19 Fair value of financial instruments

9.19.1 Determination of fair value

This note provides more information on the determination of fair values of financial instruments which are not recognised at fair value in the balance sheet, but for which a fair value has to be stated under IFRS 7.

The methods used to determine the fair values of financial instruments reported in the balance sheet at their fair values are set out in the accounting and measurement methods, Note 5.4 and in the section "Fair Value Hierarchy" (Note 9.19.2) below.

The nominal value of financial instruments that fall due on demand is taken as their fair value. These instruments include the cash reserve and claims on and liabilities due on demand.

In the case of financial instruments for which there are no organised markets on which they are traded and for which therefore no direct market prices are available, fair value is determined using recognised measurement methods with observable market parameters. A discounted cash flow model is used with parameters based on a risk-free yield curve, credit spreads, and a fixed premium to cover liquidity spreads and administration and capital costs. The fair value of liabilities is also determined using a risk-free yield curve, with Commerzbank AG's credit spread and a premium for administration costs applied separately. Market credit spreads for public and registered Lettres de gage and loans received are also used.

The fair value of securitised and subordinated liabilities is generally determined by reference to listed market prices. A number of different factors, including current market interest rates and the credit rating of the Commerzbank Group, are taken into account in determining fair value. If no quoted prices are available, fair values are calculated using mathematical valuation models (discounted cash flows, option price models) that are themselves based on yield curves, volatilities, own credit spreads, etc.

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The table below compares the fair values of the balance sheet items with their carrying amounts, taking into account recognised loan loss provisions:

	Fair value		Carrying amount	
Assets in €000	31.12.2019	31.12.2018	31.12.2019	31.12.2018
Cash reserve	**71,392**	**5,263**	**71,392**	**5,263**
Financial assets – Amortised Cost	**8,211,895**	**7,965,606**	**8,713,091**	**8,576,147**
Loans and Receivables	1,387,854	1,055,919	1,387,222	1,055,414
Securitised debt instruments	6,824,041	6,909,687	7,325,869	7,520,733
Financial assets – Mandatorily Fair Value P&L	**20,005**	**2,633,044**	**20,005**	**2,633,044**
Loans and Receivables	0	2,598,191	0	2,598,191
Securitised debt instruments	20,005	34,853	20,005	34,853
Financial assets – Held for Trading	**408,818**	**338,301**	**408,818**	**338,301**
Derivatives	408,818	338,301	408,818	338,301
Positive fair values of derivative hedging instruments	**498,479**	**486,614**	**498,479**	**486,614**

	Fair value		Carrying amount	
Liabilities in €000	31.12.2019	31.12.2018	31.12.2019	31.12.2018
Financial liabilities – Amortised Cost	**6,580,378**	**8,080,122**	**6,749,252**	**8,301,251**
Deposits	5,620,974	6,957,040	5,728,233	7,090,099
Securitised liabilities	959,404	1,123,082	1,021,019	1,211,152
Financial Assets – Held for Trading	**596,018**	**1,433,076**	**596,018**	**1,433,076**
Derivatives	596,018	1,433,076	596,018	1,433,076
Negative fair values of derivative hedging instruments	**1,181,719**	**1,091,038**	**1,181,719**	**1,091,038**

When netted, the difference between the carrying amount and fair value across all items as at 31 December 2019 is €–332.3m (31 December 2018: €–389.4m).

9.19.2 Fair value hierarchy

Under IFRS 13, financial instruments are assigned to the three levels of the fair value hierarchy as follows:

Level 1:
Financial instruments where the fair value is based on quoted prices for identical financial instruments in an active market.

Level 2:
Financial instruments where no quoted prices are available for identical instruments in an active market and the fair value is established using valuation techniques which rely on observable market parameters.

Level 3:
Financial instruments where valuation techniques are used that incorporate at least one material input for which there is insufficient observable market data and where at least this input has a more than insignificant impact on the fair value.

With respect to the methods of model-based measurements (Level 2 and Level 3) relevant for banks, IFRS 13 recognises the market approach and the income approach. The market approach relies on measurement methods that draw on information about identical or comparable assets and liabilities.

The income approach reflects current expectations about future cash flows, expenses and income. The income approach may also include option price models. These valuations are subject to the Board of Directors' judgement to a greater extent. Market data or third-party inputs are relied on to the greatest possible extent, and company-specific inputs to a limited degree.

Valuation models must be consistent with accepted economic methodologies for pricing financial instruments and must incorporate all factors that market participants would consider appropriate in setting a price. The fair values that can be realised at a later date may fundamentally deviate from the estimated fair values. All fair values are subject to the Commerzbank Group's internal controls and procedures, which set out the standards for independently verifying or validating fair values. These controls and procedures are carried out and coordinated by the Independent Price Verification (IPV) Group within the finance function of Commerzbank AG. The models, inputs and resulting fair values are reviewed regularly by senior management and the risk function.

Disclosure obligations

The respective disclosure requirements regarding these financial instruments are set out in IFRS 7 and IFRS 13. For example, they require explanatory statements on the valuation techniques applied and the inputs used for Levels 2 and 3, as well as quantitative disclosures on unobservable inputs (Level 3). The reporting entity must also provide the date of, reasons for and information about reclassifications between fair value hierarchy levels, reconciliations between the opening and closing balances for Level 3 portfolios as at the respective reporting dates, and unrealised gains and losses. In addition, sensitivities for the unobservable inputs (Level 3) are to be presented, and information on the day one profit or loss is to be provided.

Under IFRS 13, the fair value of an asset is the amount for which it could be sold between knowledgeable, willing, independent parties in an arm's length transaction. The fair value therefore represents an exit price. The fair value of a liability is defined as the price at which the debt could be transferred to a third party as part of an orderly transaction.

The measurement of liabilities must also take account of the Bank's own credit spread. If third parties provide security for our liabilities (e.g. guarantees), this security is not taken into account in the valuation of the liability, as the Bank's repayment obligation remains the same.

IFRS 9 requires that all financial instruments be measured at fair value upon initial recognition. This is usually the transaction price. If a portion relates to something other than the financial instrument being measured, fair value is estimated using a valuation method.

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In the tables below, the financial instruments reported in the balance sheet at fair value are grouped by IFRS 9 measurement category and by class.

Financial assets in €000	Level I	Level II	Level III	Total 31.12.2018
Cash reserve	**0**	**5,263**	**0**	**5,263**
Financial assets – Amortised cost	**1,079,225**	**6,886,381**	**0**	**7,965,606**
Loans and Receivables	0	1,055,919	0	1,055,919
Securitised debt instruments	1,079,225	5,830,462	0	6,909,687
Positive fair values of derivative hedging instruments	**0**	**486,614**	**0**	**486,614**
Financial assets – Held for Trading	**0**	**338,301**	**0**	**338,301**
Derivatives	0	338,301	0	338,301
Financial assets – Mandatorily Fair Value P&L	**0**	**34,853**	**2,598,191**	**2,633,044**
Loans and Receivables	0	0	2,598,191	2,598,191
Securitised debt instruments	0	34,853	0	34,853
Total	**1,079,225**	**7,751,412**	**2,598,191**	**11,428,828**

Financial liabilities in €000	Level I	Level II	Level III	Total 31.12.2018
Financial liabilities – Amortised cost	**0**	**8,080,122**	**0**	**8,080,122**
Deposits	0	6,957,040	0	6,957,040
Securitised liabilities	0	1,123,082	0	1,123,082
Negative fair values of derivative hedging instruments	**0**	**1,091,038**	**0**	**1,091,038**
Financial liabilities – Held for Trading	**0**	**1,433,076**	**0**	**1,433,076**
Derivatives	0	1,433,076	0	1,433,076
Total	**0**	**10,604,237**	**0**	**10,604,237**

Financial assets in €000	Level I	Level II	Level III	Total 31.12.2019
Cash reserve	**0**	**71,392**	**0**	**71,392**
Financial assets – Amortised cost	**1,173,504**	**7,038,391**	**0**	**8,211,895**
Loans and Receivables	0	1,387,854	0	1,387,854
Securitised debt instruments	1,173,504	5,650,537	0	6,824,041
Positive fair values of derivative hedging instruments	**0**	**498,479**	**0**	**498,479**
Financial assets – Held for Trading	**0**	**408,818**	**0**	**408,818**
Derivatives	0	408,818	0	408,818
Financial assets – Mandatorily Fair Value P&L	**0**	**20,005**	**0**	**20,005**
Loans and Receivables	0	0	0	0
Securitised debt instruments	0	20,005	0	20,005
Total	**1,173,504**	**8,037,085**	**0**	**9,210,590**

Financial liabilities in €000	Level I	Level II	Level III	Total 31.12.2019
Financial liabilities – Amortised cost	**0**	**6,580,378**	**0**	**6,580,378**
Deposits	0	5,620,974	0	5,620,974
Securitised liabilities	0	959,404	0	959,404
Negative fair values of derivative hedging instruments	**0**	**1,181,719**	**0**	**1,181,719**
Financial liabilities – Held for Trading	**0**	**596,018**	**0**	**596,018**
Derivatives	0	596,018	0	596,018
Total	**0**	**8,358,115**	**0**	**8,358,115**

A reclassification to a different level occurs where a financial instrument is reclassified from one level of the three-level valuation hierarchy to another. This may be caused, for example, by market changes that impact on the input factors used to value the financial instrument. The Bank reclassifies items at the end of the reporting period. In 2019, as in 2018, no reclassifications were carried out.

The changes in financial instruments in Level 3 recognised at fair value were as follows:

in €000	Financial assets – Mandatorily Fair Value P&L
Fair Value as at 01.01.2018	**3,131,905**
Gains or losses recognised in income statement during the period	-90,601
Sales	**0**
Redemptions	-443,113
Fair Value as at 31.12.2018	**2,598,191**

in €000	Financial assets – Mandatorily Fair Value P&L
Fair Value as at 1.1.2019	**2,598,191**
Gains or losses recognised in income statement during the period	-31,461
Sales	-2,566,730
Fair Value as at 31.12.2019	**0**

9.20 Off-balance-sheet liabilities

Other warranties relates to the irrevocable payment obligation which the Single Resolution Board (SRB) granted following approval of the Bank's application for the provision of security to partially settle the amount of the bank levy. This is allocated to the longest maturity band.

in €000	31.12.2019	31.12.2018
due on demand	0	0
up to three months	0	0
three months to one year	0	0
one year to five years	0	0
over five years	514	514
Total	**514**	**514**

9.21 Details of material transactions with related parties and persons

IAS 24 defines related parties as companies and persons capable of being influenced by Commerzbank Finance & Covered Bond S.A., capable of exercising influence over it, or under the influence of another of the Bank's related parties.

In the course of its ordinary activities, Commerzbank Finance & Covered Bond S.A. enters into business relationships with related parties, both persons and companies. Persons in key positions are defined as members of the Board of Managing Directors and the Supervisory Board of Commerzbank AG, the Board of Directors of Commerzbank Finance & Covered Bond S.A., members of their families, and companies controlled by these persons.

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Related parties are the parent company, its parent and affiliated companies and their subsidiaries. Furthermore, Commerzbank AG has issued a letter of comfort for CFCB ensuring, except in the case of political risks, that the Bank is able to meet its contractual liabilities (see also Note 6.3.3).

The table below shows the carrying amounts of claims on and liabilities to related parties and persons in key positions.

2018 in €000	**related parties**	**related persons**
Financial assets – Amortised Cost	169,470	-
Positive fair values of derivative hedging instruments	244,415	-
Financial assets – Held for Trading	203,909	-
Other assets	6,034	-
Assets in relation to related parties and persons	**623,827**	**-**
Financial liabilities – Amortised Cost	5,619,423	-
Negative fair values of derivative hedging instruments	462,993	-
Financial Assets – Held for Trading	1,107,580	-
Other liabilities	6	-
Liabilities to related parties and persons	**7,190,002**	**-**

2019 in €000	**related parties**	**related persons**
Financial assets – Amortised Cost	646,895	-
Positive fair values of derivative hedging instruments	262,087	-
Financial assets – Held for Trading	279,001	-
Other assets	0	-
Assets in relation to related parties and persons	**1,187,983**	**-**
Financial liabilities – Amortised Cost	4,331,534	-
Negative fair values of derivative hedging instruments	515,117	-
Financial Assets – Held for Trading	160,045	-
Other liabilities	0	-
Liabilities to related parties and persons	**5,006,696**	**-**

Transactions with related parties in the financial year under review resulted in interest income of €20,729 thousand (31 December 2018: €4,395 thousand) and interest expense of €95,835 thousand (31 December 2018: €80,816 thousand).

Further information on expenses relating to the remuneration of board members may be found in Note 7.8.1.

Moreover, expenses amounting to €14,058 thousand were incurred in the context of service charges within the Group.

All claims and liabilities as at 31 December 2019 and 31 December 2018 relate solely to the parent company.

At the beginning of the financial year, a portfolio of receivables from UK local authorities was sold to Commerzbank AG. This comprised 171 loans with a total nominal volume of £1.6bn (equivalent to around €1.8bn at the time of sale). The selling price was £2.3bn (€2.6bn).

As this portfolio was already recognised at fair value, there was no significant gain on the sale. In connection with this transaction, interest rate swaps with Commerzbank AG, which were used to hedge the interest rate risks from the portfolio that was sold, were terminated early. After netting, closing fees of £0.8bn (€0.9bn) were paid to Commerzbank AG. The nominal volume of the interest rate swaps totalled £1.2bn (€1.3bn). There was no significant gain from this transaction either.

9.22 Cash flow statement

The cash flow statement is compiled in accordance with IAS 7. It shows the structure of and changes in cash and cash equivalents during the financial year. It is broken down into operating activities, investing activities and financing activities.

Net cash from operating activities includes payments (inflows and outflows) relating to financial assets and also other assets. Increases and decreases in financial liabilities and other liabilities also come under operating activities. The interest and dividend payments resulting from operating activities are similarly reflected in net cash from operating activities.

Net cash from investing activities is made up of cash flows relating to financial investments and fixed assets. Net cash from financing activities consists of the proceeds of capital increases as well as payments made or received on subordinated debt.

Cash and cash equivalents consist of items that can be rapidly converted into liquid funds and are subject to a negligible risk of changes in value. This includes the "cash reserve" item, which is made up of cash on hand and credit balances with central banks (Note 8.1). Claims on banks which are due on demand are not included.

The cash flow statement is not very informative with regard to Commerzbank Finance & Covered Bond S.A. For the Bank, the cash flow statement replaces neither liquidity planning nor financial planning, nor is it employed as a management tool.

Changes in liabilities from financing activities were as follows:

in €000	Notes	31.12.2018	Cash items	Exchange rate change	Other non-cash items	31.12.2019
Financial liabilities – Amortised cost	5.4, 9.1	17,369	–750	0	583	**17,202**
Total		**17,369**	**–750**	**0**	**583**	**17,202**

In the cash flow statement, interest payments on subordinated loans, €750 thousand for the year 2019, are allocated to cash flow from operating activities.

9.23 Events after the reporting date

In recent years, the Bank has improved its resilience through various measures, including significantly strengthening its capital base. However, numerous risk factors could, if unfavourable developments occur, have a considerable impact on the forecast net profit for 2020 to an extent that cannot be reliably predicted. These include the geopolitical situation, which continues to be highly uncertain, and increased global economic risks, especially given the as yet unforeseeable economic impact of the coronavirus pandemic.

Apart from this, no events of particular significance in relation to the Bank's equity capital, financial position or results occurred during the period from 31 December 2019 to 2 April 2020.

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10.1 Cover holdings and public mortgage bonds

The cover holdings required by Articles 12-1 to 12-12 of the amended Law of 5 April 1993 on the financial sector consist solely of securities subject to monitoring by a trustee.

The cover holdings are broken down by balance-sheet item as follows:

Public Lettres de gage/ordinary cover	2019 in €000	2019 in % of cover assets	2018 in €000	2018 in % of cover assets
Claim on banks	-	-	-	-
Claim on customers				
Public-sector loans	78,227	3.07	1,234,838	51.17
Bonds and notes				
issued by public-sector borrowers	2,222,465	87.17	1,168,621	48.43
other (secured by public bodies)	10,275	0.40	9,612	0.40
Substitute cover	**238,599**	**9.36**		
Total cover assets	**2,549,567**	**100.00**	**2,413,071**	**100.00**
Public Lettres de gage for which cover is required	**1,932,364**	**75.79**	**2,239,715**	**92.82**
Cover surplus	**617,203**	**31.94**	**173,356**	**7.74**

Using internal ratings on a prescribed scale between 1.0 and 6.5, cover holdings broken down at the end of the financial year as follows:

Ratings	2019 in €000	2019 in % of cover assets	2018 in €000	2018 in % of cover assets
1.0 - 1.2	1,534,036	60.17	121,062	5.02
1.4 - 1.6	198,440	7.78	346,682	14.37
1.8 - 2.0	170,380	6.68	1,208,597	50.09
2.2 - 2.8	457,567	17.95	520,751	21.58
3.0 - 3.6	184,315	7.23	163,112	6.76
3.8 - 5.0	4,829	0.19	42,852	1.78
5.2 - 5.8	0	0.00	10,013	0.41
6.1 - 6.2	0	0.00	0	0.00
Total portfolio	**2,549,567**	**100.00**	**2,413,071**	**100.00**

By size	Number	2019 in €000	2019 in % of cover assets	Number	2019 in €000	2019 in % of cover assets
up to 5m	43	87,132	3.42	57	133,127	5.52
up to 10m	34	216,619	8.50	72	454,605	18.84
up to 25m	27	411,995	16.16	57	830,249	34.41
over 25m	28	1,833,821	71.93	21	995,090	41.24
Total	**132**	**2,549,567**	**100.00**	**207**	**2,413,071**	**100.00**

Cover holdings broken down by country as follows:

Countries	2019 in €000	2019 in % of cover assets	2019 in €000	2019 in % of cover assets
Canada	49,843	1.95	54,526	2.26
United Kingdom	31,588	1.24	1,176,400	48.75
Italy	205,621	8.06	302,102	12.52
Luxembourg	238,599	9.36	0	0
Japan	93,100	3.65	93,100	3.86
Portugal	32,000	1.26	37,800	1.57
Spain	42,273	1.66	50,682	2.10
United States of America	1,856,544	72.82	698,461	28.94
Total	**2,549,567**	**100.00**	**2,413,071**	**100.00**

10.2 Group Financial Statements

The Bank's annual financial statements are included in the Group financial statements of Commerzbank AG, Frankfurt am Main.

These may be obtained from the following address:

Commerzbank AG
Investor Relations
Kaiserplatz
60261 Frankfurt am Main Germany

Or as download from:
https://www.commerzbank.de/de/hauptnavigation/aktionaere/publikationen_und_veranstaltungen/unternehmensberichterstattung_1/index.html

10.3 Deposit guarantee scheme

The Luxembourg law on the resolution, recovery and dissolution measures of banks and securities firms and on deposit guarantee and investor compensation schemes ("the Law") was adopted on 18 December 2015; this transposes into Luxembourg law EU directives 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms and 2014/49/EU on deposit guarantee and investor compensation schemes. The deposit guarantee and investor compensation scheme that had been in place until then and which were introduced by the AGDL, were replaced by a new deposit guarantee and investor compensation scheme based on contributions.

The new system guarantees all recoverable deposits from the same depositor up to €100,000 ("Fonds de garantie des dépôts Luxembourg" (FGDL/Luxembourg deposit guarantee fund)) and investment transactions up to €20,000 per investor ("Système d'indemnisation des investisseurs Luxembourg" (SIIL/Luxembourg investor compensation scheme)).

Provisions recognised in the past in banks' annual financial statements for the purposes of the AGDL will be progressively used up in line with the contributions to be paid by banks to the Luxembourg deposit guarantee fund ("Fonds de garantie des dépôts Luxembourg" (FGDL)) and/or the Luxembourg resolution fund ("Fonds de résolution" (FDR)).

Since the Bank neither accepts deposits from private individuals nor conducts securities transactions for its customers, it is under no obligation in the event of the failure of another bank. No provision for this purpose has therefore been recognised.

10.4 Registered office

Commerzbank Finance & Covered Bond S.A.
25, rue Edward Steichen, L-2540 Luxembourg
PO Box 321, L-2013 Luxembourg

Tel.: + 352 477 911- 1
Fax: + 352 477 911- 5348
Website: www.commerzbank-fcb.com
Email: info@commerzbank-fcb.com

Commercial Register:
R.C.S. Luxembourg, B 30.469
VAT ID No. LU14147251

Responsibility statement by the Board of Managing Directors and committees of the Bank

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Responsibility statement by the Board of Managing Directors

To the best of our knowledge, and in accordance with the applicable reporting principles, the financial statements give a true and fair view of the net assets, financial position and results of operations of Commerzbank Finance & Covered Bond S.A., and the management report includes a fair review of the development and performance of the business and the position of the Bank, together with a description of the principal opportunities and risks associated with the expected development of the Bank.

Luxembourg, 2 April 2020

Commerzbank Finance & Covered Bond S.A.
The Managing Directors

Gerard-Jan Bais Markus Blaes

Bank Committees

Board of Directors

Hermann RAVE
Bad Soden am Taunus, Germany,
Chairman of the Board of Directors
(since 19 June 2019)
Head of Group Accounting, Commerzbank AG,
Frankfurt am Main

Manfred BIER,
Goergeshausen, Germany
Deputy Chairman of the Board
of Directors (since 19 June 2019)
Head of Group Treasury Investment Office (IO),
Commerzbank AG, Frankfurt am Main

Gerard-Jan BAIS,
Steinsel, Luxembourg
Member of the Board of Directors
and Managing Director,
Commerzbank Finance & Covered Bond S.A.,
Luxembourg

Markus BLAES,
Freudenburg, Germany
Member of the Board of Directors
and Managing Director,
Commerzbank Finance & Covered Bond S.A.,
Luxembourg and Head of Treasury,
Commerzbank AG, Luxembourg branch

Michael HACKER
Bad Nauheim, Germany
Managing Director of Commerzbank AG
Frankfurt am Main, Group Accounting,
Management Investments, Commerzbank AG,
Frankfurt am Main (since 1 October 2019)

Arno KRATKY,
Hofheim, Germany
Managing Director of Commerzbank AG, Frankfurt
am Main, Principal Project Manager, GRM-MR Group
Market Risk Management,
Commerzbank AG, Frankfurt am Main

General Management

Gerard-Jan BAIS,
Steinsel, Luxembourg
Member of the Board of Directors
and Managing Director

Markus BLAES,
Freudenburg, Germany
Member of the Board of Directors
and Managing Director

Heads of Department

Markus BLAES
Asset Liability Management

Robert THÖMMES
Analytics & Regulatory Issues

Auditors

Ernst & Young S.A., Luxembourg

Trustees (Cover Pool Auditors)

KPMG Luxembourg,
Société coopérative, Luxembourg

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