Finanzgruppe
Deutscher Sparkassen- und Giroverband

FINANCIAL REPORT 2016

of the Savings Banks Finance Group

4. MANAGEMENT REPORT

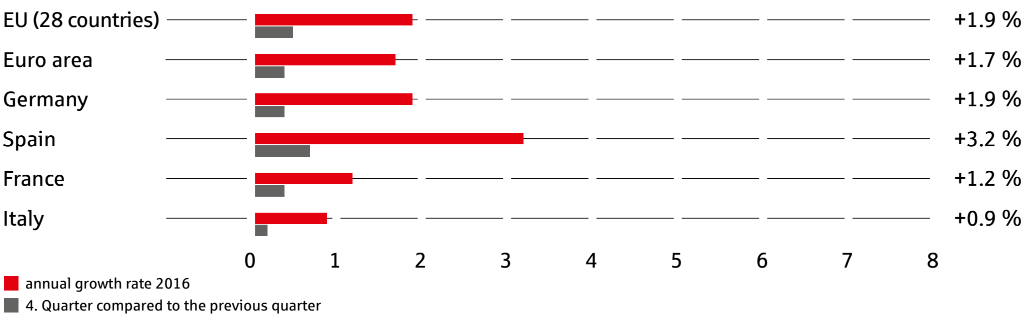
Economic report

Macroeconomic situation

Despite the global political upheavals of recent years, economic developments in 2016 were characterised by a consolidation and extension of the recovery. Nearly all of the major global economic regions contributed to this development. While Russia and Brazil were still bogged down in recession, all the major industrialised nations and emerging economies grew. Events such as the U.K. referendum on leaving the European Union did not (as yet) have a noticeable impact on growth trends in 2016.

The growth rate achieved in the euro area in this environment amounted to 1.7 percent in 2016. With an increase in productivity of the same order of magnitude, unemployment was reduced very gradually; to a limited extent, this also applied to most southern countries of the euro area. However, the baseline of unemployment in southern European countries is still very high. Differences in progress made with regard to reforms and growth remain visible within the euro area. In the recent past, France has again come closer to matching Germany's growth. For a number of years now, Spain has been the winner in the euro area, with real growth rates of over 3 percent. Growth in Italy, however, once again remained modest in 2016, amounting to not even 1 percent.

GDP growth in selected countries, in %



With a growth rate of 1.9 percent, which was above the potential for production, Germany excelled for the third year in a row. Employment also continued to increase. New record levels were reached in the labour market, with a working population of over 43.5 million persons. Germany's unemployment rate continued to decline, despite immigration.

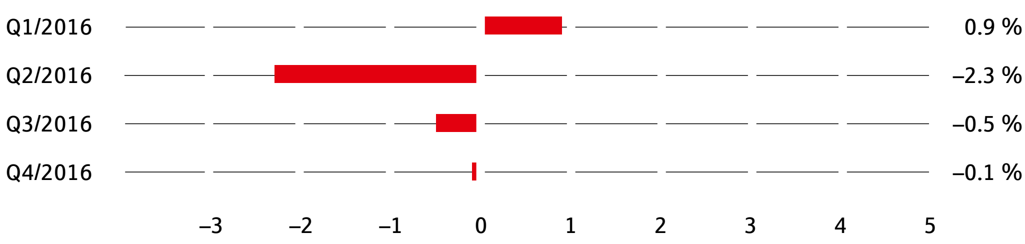
On the demand side, Germany's upswing was driven exclusively by the domestic economy in 2016. In foreign trade, real growth of goods imports was significantly higher (3.7 percent) than real growth of exports (2.6 percent). Nevertheless, Germany once again posted a record current account surplus (in nominal terms) of approx. 8.5 percent of the gross domestic product. This was due, among other things, to price reductions in the import bill. Crude oil prices were particularly low – especially in the first half of the year – which also had an impact on consumer prices. In the first half of 2016, inflation rates were even negative for a while. On an annual average, inflation rates increased by 0.5 percent. Towards the end of the year, the rates then picked up in the wake of the oil price recovery.

Private consumption was supported not only by the high level of employment and moderately rising wages but also by high purchasing power due to the very moderate development of prices. Private consumption increased by 2.0 percent in real terms. Government spending once again rose significantly at 4.0 percent, mainly due to the fact that, for the first time, expenditure for refugees who had immigrated into Germany in 2015 had a full-year impact in 2016.

Growth, along with the positive development of employment and income, also provided rising revenues for the national budget. General government, including all levels of regional authorities and social security institutions, achieved a surplus of 0.8 percent of GDP in 2016. As a result, the debt level was reduced to a ratio of below 70 percent of GDP in the course of the year.

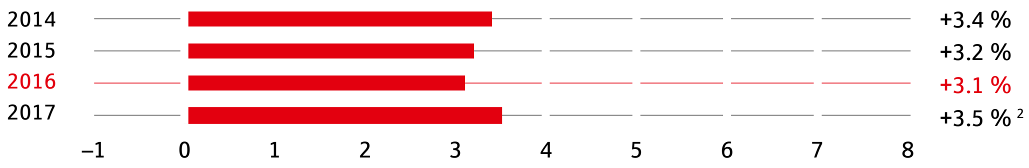
The development of investments was somewhat restrained. In the construction sector, growth was mainly achieved in the sub-segment of housing construction. Investments by enterprises in plant and equipment increased only moderately by 1.1 percent (adjusted for prices). This is relatively low given the cyclical stage, i.e. the third year of recovery, and in light of the capacity utilisation, which is now slightly above the normal level.

Capital expenditure, seasonally adjusted change year-on-year

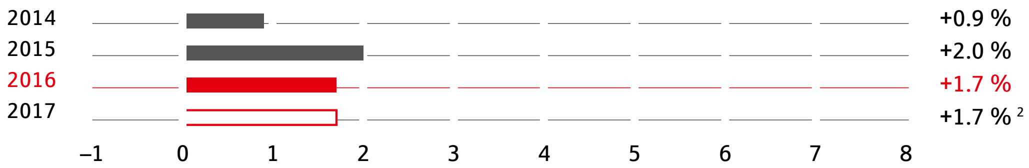


Economic development – Review and outlook 2014 – 2017

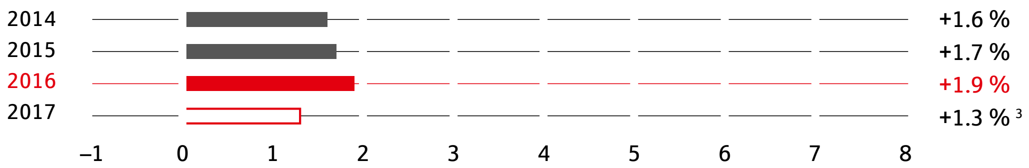
Growth of real domestic product (GDP), as % (world)[1]



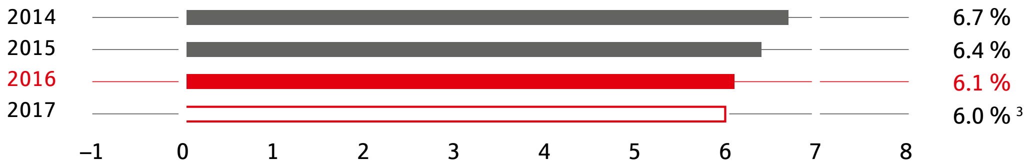
Growth of real domestic product (GDP), as % (euro area)



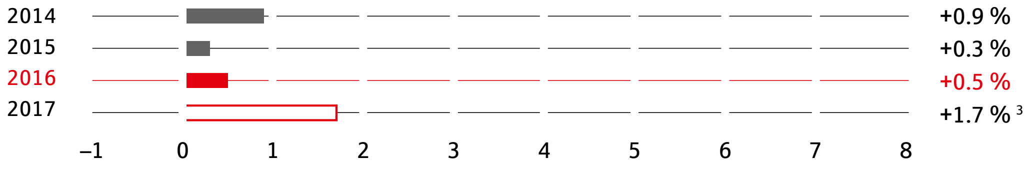
Growth of real domestic product (GDP), as % (Germany)



Unemployment rate as a percentage of total working population (Germany)



Changes in cost-of-living price index, as a percentage (Germany)



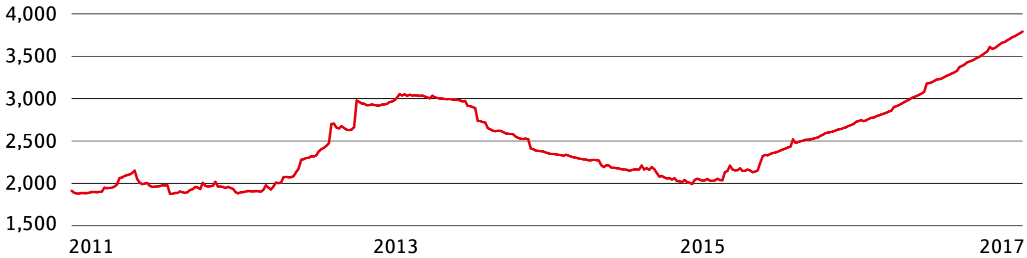
Actual data for 2014 to 2016 from official statistics
[1] Global economic growth as defined by the International Monetary Fund
[2] Forecast for global output and the euro area for 2016 from the IMF's World Economic Outlook of 18 April 2017
[3] Forecasts for Germany from the joint forecast of the chief economists of the Savings Banks Finance Group of 23 January 2017

Developments in money and capital markets

Since inflation remained very low in the euro area in 2016, as it had been in 2015, the European Central Bank (ECB) continued to pursue its highly expansionary monetary policy. The interest rates of the deposit facility, which had already been reduced to a negative level in previous years, were lowered even further in March 2016, to –0.4 percent. Since then, the rate for the main refinancing operations, which had previously been slightly positive, has been zero.

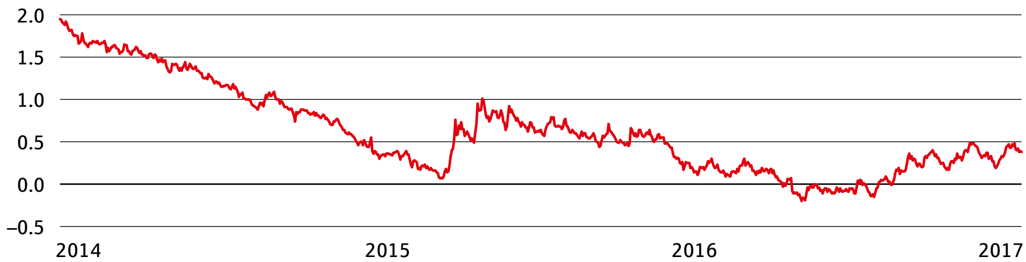
In addition, the Eurosystem – which is composed of the ECB and the national central banks – continued the securities purchase programme. As of March 2016, the monthly purchase volume was increased to as much as EUR 80 billion. As of June 2016, corporate bonds were also included in the programme.

Consolidated balance sheet total of the Eurosystem in € billions



In view of this highly expansionary monetary policy, interest rates in money and capital markets continued to decline. The prices of fixed-income securities were driven up significantly by the central banks' purchases. For securities with short maturities, current yields settled at a level which was even significantly below the interest rate of the deposit facility. Current yields on German government bonds turned negative for large parts of the maturity spectrum. Yields on German government bonds with a remaining maturity of up to twelve years were temporarily negative. The lowest levels were reached in September 2016. Subsequently, yields on ten-year bonds were below –0.2 percent.

Current yield from German federal bonds with a remaining term of ten years

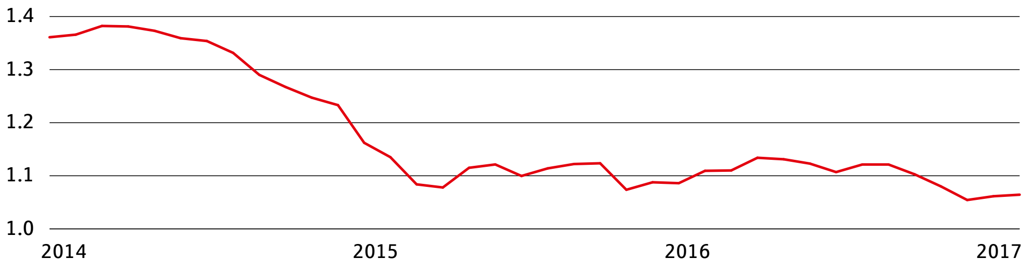


The rising inflation rate towards the end of the year and subsequent expectations that interest rates might turn around in the medium or long term led to a turnaround in yields on securities with long maturities. In December, ten-year German government bonds were again above the mark of 0.2 percent plus.

In early 2016, equity markets went through a period of turbulence. Initially, share prices fell due to concerns about the situation in China and losses of oil producers as a result of the crude oil lows at the time. The DAX, for instance, fell from over 10,700 points as of the end of 2015 to below 9,000 points for a short period in early February. Subsequently, it steadily increased, reaching just under 11,500 points by the end of 2016. A direct comparison of the year-end levels showed an increase of 6.9 percent.

Despite all the rhetoric around protectionism, trade wars, isolationism and competitive devaluation, the exchange-rate performance of the most important currencies was relatively stable in foreign exchange markets. Following the significant depreciation of the euro until spring 2015, the bilateral exchange rate between the US dollar and the euro remained within a relatively narrow band of between 1.03 and 1.16 USD/EUR in the course of 2016.

Euro reference rate USD/Euro



Major markets and positioning

General overview

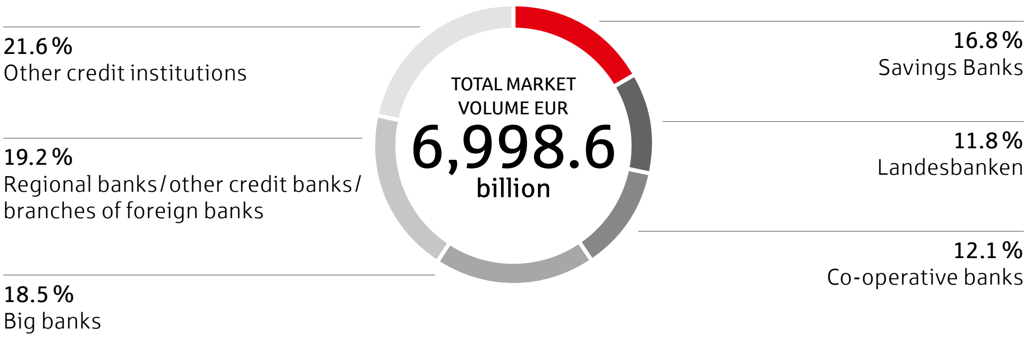
As at the end of 2016, the combined business volume[1] of the institutions affiliated with the Savings Banks Finance Group[2] amounted to EUR 1,996.2 billion, which is equivalent to a share of 28.6 percent of the total market volume of EUR 6,998.6 billion.

This means that the Savings Banks Finance Group's share of the on-balance-sheet banking business of the German banking sector decreased slightly (by 1.3 percentage points) against the previous year. While the business volume of Savings Banks continued to increase by EUR 28.1 billion to EUR 1,172.9 billion (up 2.5 percent), there was another sharp decline in the business volume of Landesbanken, which decreased by EUR 54.8 billion to EUR 823.4 billion (down 6.2 percent). Since the end of 2008, Landesbanken have cut their business volume nearly in half.

This reduction clearly reflects the resizing process which, in line with their strategy, Landesbanken have implemented by drastically cutting back their credit substitution business and by discontinuing business segments that are no longer part of the core business. In fiscal year 2016, the group of Landesbanken had primarily reduced interbank loans and deposits.

Credit banks account for the largest share of the business volume, with 37.7 percent (of which big banks account for 18.5 percent, while regional banks / other credit banks / branches of foreign banks account for 19.2 percent). Co-operative banks account for 12.1 percent of the total market volume, and "Other credit institutions" account for 21.6 percent (of which special-purpose banks account for 17.6 percent and mortgage banks for 4.0 percent).

Market shares by business volume*
As at 31 December 2016



* Excluding derivative financial instruments of trading portfolio

Source of all market share charts: Deutsche Bundesbank and own calculations

In fiscal year 2016, the retail business of the German banking sector was once again consistently characterised by portfolio growth in loans to enterprises, loans to households for house purchases, consumer loans, deposits from private individuals, and deposits from enterprises.

[1] Excluding derivatives of the trading portfolio and excluding own debentures repurchased

[2] The term "Savings Banks Finance Group" as used in this Chapter refers to Savings Banks and Landesbanken (excluding foreign branches and excluding domestic and foreign group subsidiaries of Landesbanken). Landesbausparkassen are not included here.

In the customer lending business, the market shares of the Savings Banks Finance Group declined slightly in loans to enterprises and increased marginally in loans to households for home purchases in fiscal year 2016. Losses of market shares in the consumer credit business were again significant for the Savings Banks Finance Group. In 2016, the Savings Banks Finance Group also continued to lose market shares in the retail deposit business. However, when measured in terms of the share of this segment, the Savings Banks Finance Group is still far ahead of other banking groups. In deposits from domestic enterprises, the share of the Savings Banks Finance Group decreased significantly in 2016 due to the ongoing decline in the portfolios of Landesbanken.

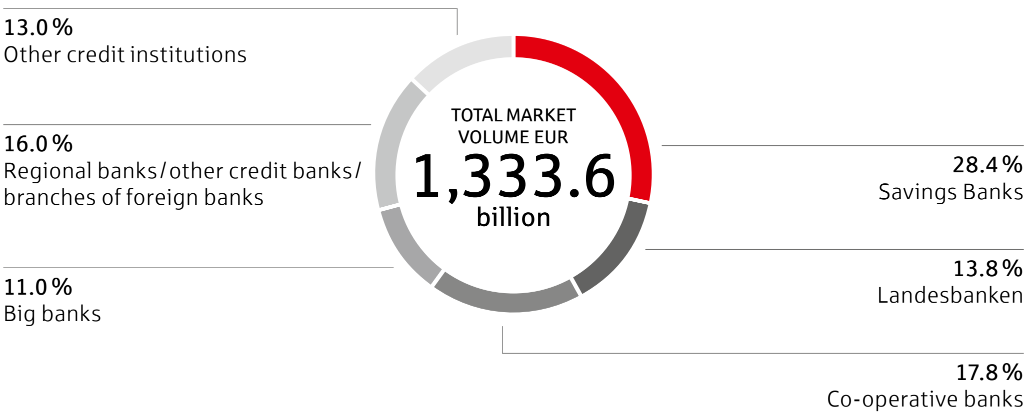
Customer lending business

Following an increase by EUR 23.6 billion (1.8 percent) in the previous year, the total volume of the market for loans to enterprises continued to grow dynamically in fiscal year 2016, increasing by EUR 35.5 billion (2.7 percent) to EUR 1,333.6 billion.

With an increase of EUR 10.2 billion (1.9 percent), the portfolio growth of the Savings Banks Finance Group was slightly lower than the average for banks, which meant that the Savings Banks Finance Group suffered a slight loss of market share. At the end of 2016, the volume of loans extended to enterprises amounted to a total of EUR 562.3 billion. This is equivalent to a share of 42.2 percent, with Savings Banks accounting for 28.4 percent and Landesbanken for 13.8 percent.

This means that the Savings Banks Finance Group continues to be the most important financial partner in the German banking sector, in particular for small and medium-sized enterprises.

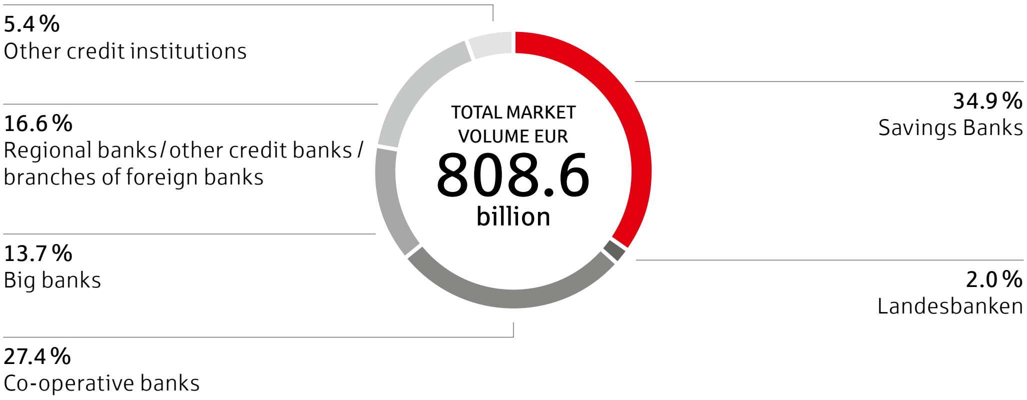
Market shares in loans to enterprises*
As at 31 December 2016



* Loans to enterprises and self-employed persons (including commercial housing loans)

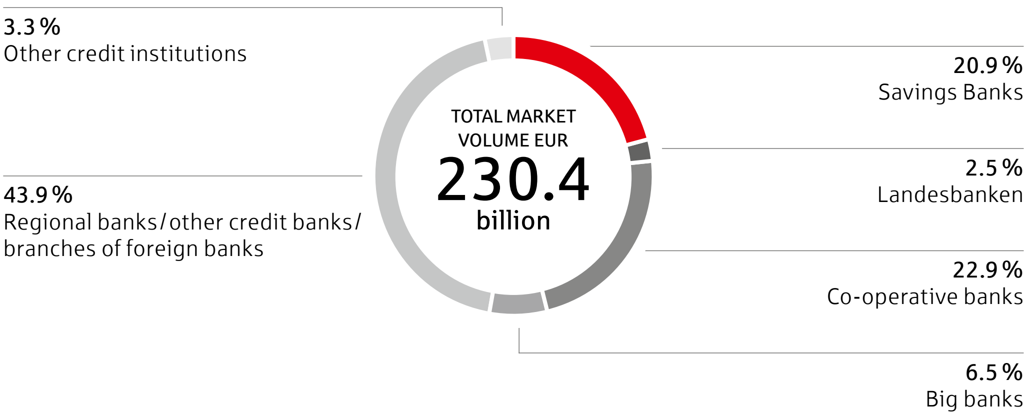
Since 2010, the demand for residential housing loans has picked up significantly, mainly because of interest rates. As a result, the total market volume of residential housing loans continued to increase significantly in the year under review (by EUR 29.2 billion to EUR 808.6 billion, or by 3.7 percent). The portfolio growth achieved by the Savings Banks Finance Group in 2016 amounted to 3.3 percent, which was slightly below the average for banks. The Group's portfolio volume increased by EUR 9.4 billion to EUR 298.6 billion, of which Savings Banks alone accounted for EUR 282.5 billion, which is equivalent to a share of 34.9 percent. Together, Savings Banks and Landesbanken account for a share of 36.9 percent, followed by co-operative banks as the second largest banking group, with a share of 27.4 percent.

Market shares in residential housing loans
As at 31 December 2016



As in the previous year, the consumer credit business was characterised by significant portfolio growth across all banking groups in 2016. As at the end of 2016, the market volume increased by EUR 5.8 billion to EUR 230.4 billion, or by 2.6 percent.

Market shares in consumer credits
As at 31 December 2016



The portfolio held by the institutions affiliated with the Savings Banks Finance Group continued to decline, decreasing by EUR 2.0 billion, i.e. by –3.5 percent (2015: –1.3 percent), which meant that their market share continued to fall. With a portfolio volume of EUR 53.9 billion and a market share of 23.4 percent, the Savings Banks Finance Group ranks second after the banking group of regional banks / other credit banks / branches of foreign banks (share: 43.9 percent). In 2016, this group, which includes nearly all providers of specialist finance, continued to substantially expand its share of the consumer credit segment. The consumer credit portfolio of co-operative banks declined marginally (–0.1 percent); their market share decreased to 22.9 percent as of the end of 2016.

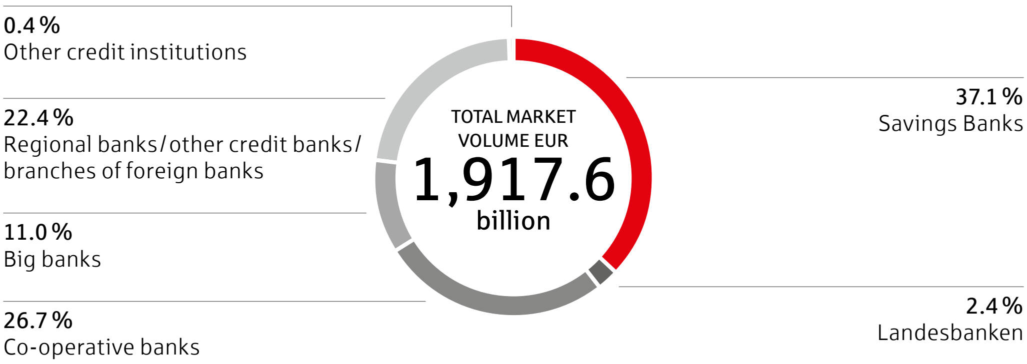
Retail deposits

In the past year, the total market volume of deposits from private individuals continued to increase significantly, rising to EUR 1,917.6 billion, i.e. by 5.1 percent. At EUR 93.9 billion, absolute growth was far higher than in the previous year (EUR 70.7 billion).

Within the various investment categories, only the portfolio of sight deposits from private individuals grew in 2016 for the second year in a row due to interest rates; the increase recorded in sight deposits was once again significant (9.7 percent after 10.4 percent in 2015). On the other hand, the portfolios of time deposits, savings deposits, and savings bonds of private individuals decreased, as in the previous year. The developments in the Savings Banks Finance Group thus follow the general market trends.

More so than other segments, the market segment of time deposits from private individuals has been largely marginalised in Germany due to the development of interest rates in recent years.

Market shares in deposits from private individuals[1]
As at 31 December 2016



Overall, the current development clearly demonstrates the continuing preference of private individuals for liquidity. This is mainly due to the persistently low level of interest rates, and it also reflects the fact that many investors continue to have a wait-and-see attitude with regard to their investment decisions.

In the year under review, the Savings Banks' deposits from private individuals increased by EUR 28.4 billion, i.e. by 4.2 percent (2015: +3.2 percent). However, Savings Banks once again participated only disproportionately in 2016 in the expansion of the total market volume and continued to lose market share. As of the end of the year, the portfolio of Savings Banks reached a volume of EUR 710.5 billion, which is equivalent to a market share of 37.1 percent.

However, in the retail deposits segment, Savings Banks continue to be significantly ahead of co-operative banks, which also have a strong position in the retail business. As at the end of the year, the co-operative banks' portfolio of retail deposits amounted to a total of EUR 511.4 billion, which

[1] Excluding term deposits with a maturity of more than two years.

was 26.7 percent of all the deposits from private individuals. The group of regional banks / other credit banks / branches of foreign banks ranked third, with a portfolio of EUR 431.0 billion and a share of 22.4 percent. This group of credit institutions, which includes all direct banks (including car manufacturers' banks), continued to catch up significantly with Savings Banks in 2016.

Together with Landesbanken, for which the retail deposit business is of only minor importance, Savings Banks reached a market share of 39.5 percent as at the end of 2016.

Deposits from domestic enterprises

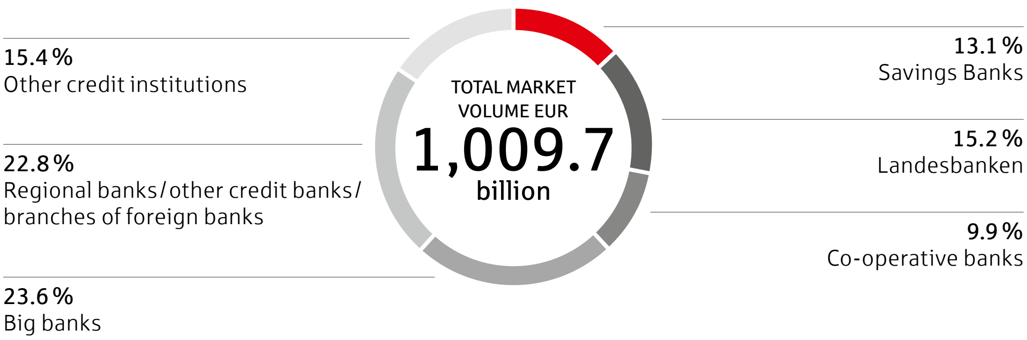
After retail deposits, deposits from domestic enterprises constitute the second largest segment of the German banking sector's overall customer deposit business. As at the end of 2016, deposits from domestic enterprises amounted to EUR 1,009.7 billion.

In fiscal year 2016, the overall portfolio of deposits from domestic enterprises increased slightly by EUR 4.7 billion (0.5 percent). The development of this segment varied widely in the various banking groups. While the portfolio of these deposits once again decreased significantly in the group of Landesbanken and in the group of "Other credit institutions" including mortgage banks, the portfolio of deposits from enterprises increased in the case of Savings Banks, co-operative banks, big banks, and the group of regional banks / other credit banks / branches of foreign banks.

In the Landesbanken group, the portfolio of deposits from domestic enterprises continued to decrease, declining by EUR 9.3 billion (5.7 percent) to EUR 153.2 billion in 2016 (2015: EUR –6.6 billion; –3.9 percent) as of the end of the year under review. The continued decline in the portfolio reflects the ongoing reduction of the refinancing requirements of Landesbanken, which is a result of the implementation of measures designed to reduce their balance sheet total in line with their strategy. Although the portfolio and the market share of Landesbanken continued to decrease (their market share fell by 1 percentage point in 2016), they still hold a strong market position in deposits from domestic enterprises, with a market share of 15.2 percent.

In the year under review, Savings Banks increased their portfolio of deposits from enterprises by EUR 2.7 billion to EUR 132.4 billion, i.e. by 2.1 percent, so that their market share grew to 13.1 percent. Together with Savings Banks, Landesbanken reached a market share of 28.3 percent in this deposit segment as of the end of 2016.

Market shares in deposits from domestic enterprises
As at 31 December 2016



Continuing enhancement of international expertise in 2016

Once again, Germany is the world champion in exports. The country exported goods worth EUR 1,207.5 billion and imported goods worth EUR 954.6 billion in 2016. This led to a new export surplus of EUR 252.9 billion. To a considerable extent, this success is due to Germany's small and medium-sized enterprises, which have regional roots but are internationally positioned. Germany's SMEs, which are also referred to as "the engine of the German economy", are also recognised internationally. The quality of their products is in demand worldwide. Small and medium-sized enterprises account for 98 percent of Germany's exporters; however, their share of export revenues is only about one-fifth. German SMEs are acting globally, far beyond the borders of the European Union.

Rising exports and imports have important business implications for Savings Banks. Many of the enterprises that are increasingly active internationally are Savings Banks customers. For this reason, Savings Banks are successively enhancing their international expertise to give comprehensive support to their customers, also on an international level. Owing to the Savings Banks' international network, the "S-CountryDesk", the Landesbanken and Deutsche Leasing, any enterprise can reach almost every country in the world via its local Savings Bank. The six Landesbanken Groups are represented at 100 locations and have a network of over 10,000 correspondent banks worldwide. As a result, they can support Savings Banks and their customers directly, on site and in German. Another service used by the enterprises is the "EuropaService" of Germany's Savings Banks Association DSGV which – due to its cooperation with 600 institutions in more than 60 countries – helps to establish business relations between German firms, on the one hand, and foreign enterprises, on the other.

The services provided to enterprises, of course, extend beyond the basic range of foreign payment transactions. The Savings Bank's international specialists are consulted before planned international transactions are executed. They develop customised solutions that are suitable for the customers' business strategy. It goes without saying that the use of funding and support programmes provided by the German government is examined and taken advantage of in this context.

As "the key provider of finance to Germany's SMEs" for domestic business, Savings Banks are local partners for internationally operating corporate customers as they appreciate the broad-based global network and efficient solutions provided by Savings Banks – which are regionally rooted and globally networked.

Business performance and financial position

Performance of the institutions covered by the Institution Protection Scheme – an aggregated view

The operational performance of the Savings Banks Finance Group[1] in fiscal year 2016 was marginally better than in the previous year.

In the year under review, the results of operations of the Savings Banks Finance Group were characterised by a higher valuation result[2] than in the previous year and a slight easing of the burden on the extraordinary result[3]. This was the main reason for a decline in net income (before and after taxes) compared with 2015.

↘ **See pages 41, 48 and 53 for more information about the business performance of Savings Banks, Landesbanken, and Landesbausparkassen.**

In 2016, the Savings Banks Finance Group achieved an operating result before valuation of EUR 12.6 billion compared with EUR 12.5 billion in the previous year, which led to a marginal improvement of income by +1.0 percent. This growth was due to a slight increase in net trading income (net income from financial transactions) and an improvement of net commission income. Net trading income, which is only relevant for Landesbanken within the Savings Banks Finance Group, increased from EUR 0.5 billion in the previous year to EUR 1.0 billion. The net commission income of the Savings Banks Finance Group increased by 6.1 percent to EUR 8.0 billion. The net interest income of EUR 30.8 billion fell significantly short of the previous year's level (–5.6 percent).

Administrative expenses decreased by 2.5 percent to EUR 27.3 billion, in particular due to lower material costs.

In fiscal year 2016, the cost-income ratio[4] of the Savings Banks Finance Group as a whole increased slightly to 70.4 percent (2015: 69.8 percent), mainly due to the decline in Net Interest Income.

The valuation result of the Savings Banks Finance Group included an increase in the negative valuation balance in 2016. Net valuation expenses increased from EUR –1.1 billion in the previous year to EUR –3.0 billion. The additional expenses were due, in particular, to the increase in provisions for contingent losses in the lending business of Landesbanken.

The Extraordinary Result had a similar adverse impact on the profitability of the Savings Banks Finance Group in 2016, as in the previous fiscal year. The negative balance of EUR –4.4 billion was below the previous year's level of EUR –4.8 billion.

[1] This chapter describes the aggregated performance of Savings Banks, Landesbanken and Landesbausparkassen (Landesbanken excluding foreign branches, excluding domestic and foreign group subsidiaries, and excluding Landesbausparkassen).

[2] Valuation allowances and write-downs on receivables and securities held in the liquidity reserve (net of write-ups on receivables and securities held in the liquidity reserve) as well as changes in contingency reserves within the meaning of Section 340(f) German Commercial Code.

[3] Balance of other and extraordinary income/expenses. Unlike the P&L statistics of Deutsche Bundesbank, additions to and withdrawals from the fund for general banking risks are recognised in the "Extraordinary Result" in accordance with Section 340(g) German Commercial Code.

[4] Ratio of administrative expenses to the sum total of net interest income and net commission income

Key financial indicators of the Savings Bank Finance Group

Selected balance sheet items

	As at year-end 2016 billion EUR	As at year-end 2015 billion EUR	Change in %
Loans and advances to banks (MFIs [1])	**265.2**	294.2	–9.9
Loans and advances to non-banks (non-MFIs [1])	**1,204.6**	1,193.0	+1.0
Liabilities to banks (MFIs [1])	**371.4**	408.9	–9.2
Liabilities to non-banks (non-MFIs [1])	**1,211.2**	1,192.9	+1.5
Equity	**157.9**	152.9	+3.3
Balance sheet total	**2,118.8**	2,157.7	–1.8
Tier-1 ratio pursuant to CRR [2] (as a percentage; change in percentage points)	**15.6**	15.1	+0.5

Selected items of the P&L account [3]

	2016 [4] billion EUR	2015 billion EUR	Change in %
Net interest income	**30.812**	32.627	–5.6
Net commission income	**8.049**	7.588	+6.1
Net income from financial transactions	**1.041**	0.516	>100 %
Administrative expenses	**27.339**	28.050	–2.5
Operating result before valuation	**12.620**	12.492	+1.0
Operating result after valuation	**9.635**	11.441	–15.8
Net income before taxes	**5.190**	6.611	–21.5
Income taxes	**3.499**	3.723	–6.0
Net income after taxes	**1.691**	2.888	–41.4
of which net income of Savings Banks after taxes	2.037	1.977	+3.0
of which net income/loss of Landesbanken after taxes	–0.386	0.868	– [5]
of which net income of Landesbausparkassen after taxes	0.041	0.043	–4.7

[1] Monetary Financial Institutions

[2] Savings Banks and Landesbanken only (excluding Landesbausparkassen)

[3] As in the "original" P&L account under German GAAP, additions to the fund for general banking risks pursuant to Section 340(g) of the German Commercial Code are recognised as expenses that reduce net income; in the DSGV's Financial Reports until 2010, such additions were treated – in line with Deutsche Bundesbank's P&L statistics – as appropriation of profits which increased net income

[4] Provisional figures from financial statements prepared in accordance with German GAAP, some of which are as yet unaudited

[5] Calculation is not reasonable

Overall, the institutions affiliated with the Savings Banks Finance Group achieved net income of EUR 5.2 billion before taxes. The Group had closed the previous year with net income of EUR 6.6 billion before taxes. After taxes, the Savings Banks Finance Group's net income amounted to EUR 1.7 billion, compared with EUR 2.9 billion in the previous year.

In the past fiscal year, the decline in the aggregated balance sheet total of the Savings Banks Finance Group gathered momentum, compared with the previous year. This was due to the fact that the strategic measures designed to realign and resize the Landesbanken entailed a further reduction of the balance sheet total.

As of the end of the year, the balance sheet total of the Savings Banks Finance Group had fallen by 1.8 percent from EUR 2,157.7 billion to EUR 2,118.8 billion (2015: –4.2 percent). The Group – in particular the Landesbanken – had continued to significantly reduce receivables and liabilities in the interbank market, while slight increases were achieved in the retail business portfolio. In the year under review, loans and advances to non-banks increased by 1.0 percent to EUR 1,204.6 billion. Liabilities to non-banks increased by 1.5 percent to EUR 1,211.2 billion.

The Savings Banks Finance Group's equity as reported on the balance sheet continued to increase in 2016. It rose by 3.3 percent to EUR 157.9 billion (2015: +2.4 percent). The Group thus continued to increase its equity base in the past fiscal year.

EUR 157.9 billion

TOTAL EQUITY OF THE SAVINGS BANKS FINANCE GROUP

As of the end of 2016, the tier-1 capital of the Savings Banks Finance Group calculated in accordance with CRR/CRD IV[1] increased to EUR 147.3 billion (end of 2015: EUR 146.5 billion); the total risk exposure (borrower default risks, market risk positions, and other risks) amounted to EUR 942.7 billion (end of 2015: EUR 969.7 billion). As a result, the Savings Banks Finance Group improved its tier-1 ratio to 15.6 percent by the end of 2016 (end of 2015: 15.1 percent).

Based on its solid equity base, the Savings Banks Finance Group will therefore continue to make a sustainable contribution to the supply of credit for the German economy, in particular for the large number of small and medium-sized enterprises.

Business performance of Savings Banks

Germany's Savings Banks performed successfully in their lending and deposit business in 2016. Their balance sheet total increased by EUR 27.8 billion (+2.4 percent) to EUR 1,173 billion. The number of Savings Banks decreased by 10 to 403 Savings Banks (2015: 413; as of 15 June 2017: 393).

EUR 1,173 billion

BALANCE SHEET TOTAL OF SAVINGS BANKS

In the customer lending business, Savings Banks achieved substantial growth; the business grew by EUR 23.6 billion (i.e. by 3.2 percent) to EUR 768.8 billion. As in the previous year, the business was characterised by considerable momentum. New lending business, overall, fell just short of the historical high of the previous year. Loan repayment remained at a high level, just slightly below the previous year's figure.

[1] CRR = Capital Requirements Regulation, CRD = Capital Requirements Directive.

Loans to households for home purchases were again one of the main growth drivers in 2016. The portfolio increased by EUR 10.3 billion (+3.8 percent) to EUR 282.5 billion. In terms of new business, Savings Banks made loan commitments totalling EUR 48.5 billion – a good performance which, however, was 6.9 percent below the record level of 2015, due to the entry into force of the Mortgage Credit Directive.

The portfolio of loans to enterprises and self-employed persons also continued to grow in 2016. With an increase of EUR 16.5 billion (+4.6 percent) to EUR 378.1 billion, growth was significantly above average. Both investment loans and commercial housing loans were responsible for the increase in the portfolio. New loan commitments made by Savings Banks amounted to EUR 80.3 billion, which fell just short of the record level of 2015.

The performance of Savings Banks was also strong in the customer deposit business in 2016. With an increase of EUR 28.6 billion (+3.3 percent) to EUR 890.1 billion, business in this segment grew more rapidly than in the previous year (+3.0 percent). From a structural perspective, the Savings Banks' performance in this business was similar to 2015 due to the interest-rate environment: sight deposits increased, while other forms of investment (own issues, time deposits, savings deposits) decreased.

In the off-balance-sheet customer securities trading business, the turnover generated by Savings Banks was significantly lower than in the previous year (–11.5 percent). The fact that net sales – i.e. purchases less sales by customers – were clearly positive is very encouraging. At EUR 9.6 billion, Savings Banks achieved the best performance in this business segment since 2003.

As a result, direct financial investment once again benefited from inflows from the deposit business and from the securities trading business in the year under review.

Including the home savings and loan business and the life assurance business attributable to Savings Banks, new funds deposited – directly or indirectly – by Savings Bank customers amounted to EUR 41.4 billion, an increase of 18.6 percent compared with the previous year, and the highest level since 2001.

Profitability

As expected, the Savings Banks' earnings from the operational business (operating result before valuation) declined in fiscal year 2016. At first glance, the changes compared with the previous year may seem to be relatively minor; however, the continuing period of extremely low interest rates had a significant impact on the Savings Banks' profit and loss account.

The operational business of Savings Banks is still primarily determined by the net interest income from the highly competitive business of loans to and deposits from private individuals as well as small and medium-sized enterprises. The significant decline by 4.0 percent resulted in net interest income of EUR 22.4 billion for Savings Banks in fiscal year 2016 (2015: EUR 23.3 billion).

In the retail segment, the volume expansion and margin improvements in the lending business were no longer sufficient to compensate for the decline in earnings resulting from the significant pressure on margins in the customer deposit business due, primarily, to the low interest-rate environment. As expected, the Savings Banks' earnings from maturity transformation continued to fall slightly in 2016, due to the largely flat interest rate curve.

On the other hand, the Savings Banks' net commission income increased by 2.8 percent to EUR 7.0 billion (2015: EUR 6.8 billion). This improvement was due, in particular, to a continued increase in commission income from current account transactions as a result of adjustments to the pricing models. As in the previous year, Savings Banks also recorded significant increases in revenues from brokerage business with partners within the Savings Banks Finance Group, in particular brokerage of insurance policies from the group of public insurers as well as real estate brokerage.

On balance, however, the decline in net interest income was only partly offset by the improvement in net commission income.

In fiscal year 2016, administrative expenses decreased by 0.9 percent to EUR 20.3 billion (2015: EUR 20.5 billion). In the year under review, material expenses of Savings Banks fell slightly by 2.5 percent to EUR 7.4 billion (2015: EUR 7.6 billion). Personnel expenses remained unchanged at EUR 13.0 billion. This was mainly due to the fact that the substantial salary increases as a result of the most recent pay settlement were fully offset by continuing staff consolidation measures (including part-time work for older employees) and natural staff turnover.

In fiscal year 2016, the cost-income ratio (ratio of administrative expenses to the sum total of net interest income and net commission income) increased from 68.3 percent to 69.4 percent. Despite the decline in interest income, the increase in CIR was relatively moderate because of lower administrative expenses and higher commission income.

Total operating earnings (operating result before valuation) decreased significantly to EUR 8.7 billion (2015: EUR 9.3 billion).

With reference to the valuation result [1], Savings Banks achieved a modest net valuation income of EUR 0.7 billion in 2016, after reporting a valuation income of EUR 0.1 billion in the previous year. Once again, additions to provisions for contingent losses in the lending business are higher than reversals, so that the Savings Banks' valuation income amounted to EUR 0.3 billion (2015: EUR 0.2 billion). The historically low provisions for contingent losses are due, on the one hand, to the stable economic development with slightly rising growth rates. On the other hand, Savings Banks continued to benefit from the fact that they have not had any "legacy liabilities" in their loan portfolio for several years now.

The current level of provisions for contingent losses is therefore an indication of the fact that the Savings Banks' risk measurement and management processes, which have been considerably refined in the past few years, deliver reliable results and hence facilitate efficient and at the same time needs-based risk coverage.

The valuation of securities held in the liquidity reserve did not lead to any additions or reversals in 2016. After valuation expenses of EUR 0.4 billion in the previous year, this means that the valuation decreased by the same amount compared with the previous year.

In fiscal year 2016, the Savings Banks' "Extraordinary Result" [2] was once again strongly affected by additions to the Fund for General Banking Risks in accordance with Section 340(g) German Commercial Code. At EUR 5.1 billion, the increase in "340g reserves" was much greater than in the previous year (2015: EUR 4.1 billion). Overall, the "extraordinary result" closed once again with a negative balance of EUR 4.5 billion in 2016.

This stable development of the "extraordinary result" and the positive valuation result offset the declining operating earnings (operating result before valuation). With net income before taxes of EUR 5.0 billion, the Savings Banks' overall performance in fiscal year 2016 was 1.8 percent above the previous year's level of EUR 4.9 billion.

EUR 5.0 billion

NET INCOME OF SAVINGS BANKS BEFORE TAXES

In fiscal year 2016, net income after income taxes remained constant at EUR 2.0 billion.

[1] The valuation result is composed of provisions for contingent losses in the lending business as well as additions to and reversals of contingency reserves pursuant to Section 340(f) of the German Commercial Code.

[2] Balance of other and extraordinary income/expenses. Unlike the P&L statistics of Deutsche Bundesbank, additions to and withdrawals from the fund for general banking risks are recognised in the "Extraordinary Result" in accordance with Section 340(g) German Commercial Code.

Selected items of the P&L account of Savings Banks[1]

	2016[2] billion EUR	2015 billion EUR	Changes 2016 vs. 2015 billion EUR	Changes 2016 vs. 2015 %
Net interest income	**22.354**	23.286	–0.9	–4.0
Net commission income	**6.965**	6.775	+0.2	+2.8
Net income from financial transactions	**0.015**	–0.007	+0.0	–[4]
Administrative expenses	**20.335**	20.520	–0.2	–0.9
Personnel expenses	12.952	12.950	+0.0	+0.0
Non-personnel expenses (including depreciation of fixed assets)	7.383	7.570	–0.2	–2.5
Operating result before valuation	**8.747**	9.277	–0.5	–5.7
Valuation result (excluding equity investments)	**0.741**	0.076	+0.7	–[4]
Operating result before valuation	**9.488**	9.353	+0.1	+1.4
Balance of other and extraordinary income/expenses[1,3]	**–4.510**	–4.463	–0.0	+1.1
of which: additions to the fund for general banking risks in accordance with Section 340(g) German Commercial Code	–5.072	–4.158	–0.9	+22.0
Net income before taxes	**4.978**	4.890	+0.1	+1.8
Income taxes	**2.941**	2.913	+0.0	+1.0
Net income after taxes	**2.037**	1.977	+0.1	+3.0
Return on equity before taxes (as a percentage, changes in percentage points)	**10.2**	9.7	–	+0.5
Cost-income ratio (as a percentage, changes in percentage points)	**69.4**	68.3	–	+1.1

[1] As in the "original" P&L account under German GAAP, additions to the fund for general banking risks pursuant to Section 340(g) of the German Commercial Code are recognised as expenses that reduce net income; in the DSGV's Financial Reports until 2010, such additions were treated – in line with Deutsche Bundesbank's P&L statistics – as appropriation of profits which increased net income.

[2] Provisional figures from financial statements prepared in accordance with German GAAP, some of which are as yet unaudited.

[3] Including the net balance of profits from the disposal of financial investments and investment securities, write-downs and write-ups on financial investments and investment securities, as well as changes in the fund for general banking risks in accordance with Section 30(g) of the German Commercial Code (additions to the fund for general banking risks with negative sign).

[4] Calculation is not reasonable

EUR **768.8** **billion**
CUSTOMER LOANS

Lending business

In 2016, the overall customer lending business grew by EUR 23.6 billion, which meant that the portfolio increased by 3.2 percent to EUR 768.8 billion (2015: +3.4 percent).

Although new business decreased by 3.6 percent compared with the previous year, the total volume of new business generated by Savings Banks amounted to EUR 149.9 billion, which was a very strong performance. New business did not have a greater impact on the portfolio because repayments continued to be very high: at EUR 116 billion, repayments were only slightly below the previous year's level. This positive development in the customer lending business was driven, on the one hand, by loans to enterprises and, on the other hand, by loans to private households for home purchases.

In the course of 2016, Savings Banks committed EUR 80.3 billion in new loans to enterprises and self-employed persons, only EUR 0.9 billion or 1.1 percent less than in the record-breaking previous year.

Medium und long-term loans continued to account for the largest proportion (90.6 percent) of the commitments made in 2016, and therefore had the character of investments.

This strong new business also had an impact on loan portfolios. In 2016, the portfolio grew by EUR 16.5 billion or by 4.6 percent (portfolio at year-end: EUR 378.1 billion).

Investment loans to enterprises and self-employed persons increased by EUR 9.6 billion, or by 3.8 percent, to a volume of EUR 263.5 billion (2015: +2.4 percent). The Savings Banks' performance in commercial housing construction loans reflects the positive general environment (favourable interest rates, general increase in rental levels). The loan portfolio grew by EUR 6.9 billion (6.4 percent) to a level of EUR 114.6 billion.

The new business of Savings Banks in loans to private individuals decreased compared with the record level in the previous year. For the full year 2016, loan commitments made totalled EUR 59.9 billion, which was a decline by EUR 4.9 billion (–7.5 percent) compared with 2015. Compared with earlier years, this was still a very strong performance. The portfolio also increased quite significantly once again, by EUR 8.8 billion (2.7 percent) to EUR 330.6 billion (2015: +3.5 percent).

In terms of volume, the decline in new business was mainly due to the development of loans to private households for home purchases. Despite improvements in the general environment (further decrease in interest rates below the level of 2015, highly attractive as an investment, strong upswing in construction sector), new business amounted to "only" EUR 48.5 billion, a drop by EUR 3.6 billion (–6.9 percent) compared with the record level in the previous year. This was due, inter alia, to the entry into force of the Mortgage Credit Directive (MCD) in March 2016; year-on-year, this led to a substantial decline of new business in the second and third quarters. In the fourth quarter, the new business was then slightly above the previous year's level. Compared with earlier years, however, the Savings Banks' 2016 performance in terms of the new business generated has to be rated as strong.

In the course of the year, the portfolio of loans to private households for home purchases increased by over EUR 10.3 billion (+3.8 percent) to EUR 282.5 billion, which fell only slightly short of the high growth rate of the previous year (+4.5 percent).

On the other hand, the Savings Banks' performance in the consumer credit business was again less than satisfactory in 2016. New loan commitments made by Savings Banks amounted to EUR 11.4 billion, which was € 1.2 billion (–9.8 percent) less than in the previous year. The loan portfolio continued to decrease (EUR –1.5 billion, i.e. by –3.0 percent). In this context, however, it must be borne in mind that Savings Bank customers have considerable liquid funds, which they are increasingly using for consumption due to the interest-rate environment.

In 2016, the portfolio of loans to domestic public budgets decreased by EUR 2.9 billion (–6.2 percent) to EUR 43.5 billion (2015: –0.9 percent). At EUR 6.4 billion, new business was 0.6 percent above the previous year's level.

Customer lending business of Savings Banks

	2016 billion EUR	2015 billion EUR	Change in billion EUR	Change in %
Customer loans	**768.8**	745.1	+23.6	+3.2
Loans to enterprises [1]	**378.1**	361.6	+16.5	+4.6
Loans to private individuals	**330.6**	321.8	+8.8	+2.7
Residential housing loans	282.5	272.3	+10.3	+3.8
Consumer credits	48.1	49.6	–1.5	–3.0
Loans to general government	**43.5**	46.4	–2.9	–6.2
Total loan commitments / disbursements to domestic customers	**149.9 / 139.7**	155.4 / 141.9	–5.6 / –2.2	–3.6 / –1.6
Loan commitments / disbursements to enterprises and self-employed persons [1]	**80.3 / 73.4**	81.2 / 72.9	–0.9 / +0.6	–1.1 / +0.8
Loan commitments/disbursements to private individuals	**59.9 / 57.4**	64.8 / 59.9	–4.9 / –2.6	–7.5 / –4.3

[1] including commercial housing loans

Customer securities trading business

In the off-balance-sheet customer securities trading business, the total turnover generated by Savings Banks in 2016 amounted to EUR 102.0 billion, which wfell short of the previous year's level (EUR –13.2 billion, i.e. –11.5 percent). Turnover declined in all categories: in fixed-income securities by 12.4 percent, in equities by 17.7 percent, and in investment funds by 6.1 percent. In the course of the turbulent development of securities trading market in 2016 (due, inter alia, to Brexit, the attempted coup in Turkey, the presidential elections in the United States), Savings Bank customers have again become somewhat more cautious in the securities trading markets. However, the number of customer securities accounts (Savings Bank accounts, DekaBank accounts, S-Broker accounts) remained unchanged at the end of 2016, compared with the previous year (6.32 million).

Net sales (purchases less sales) were clearly positive in 2016, amounting to EUR 9.6 billion, the best performance since 2003. The drivers included high positive net sales of investment funds (EUR +7.7 billion) and equities (EUR +1.7 billion), as well as a slight increase of EUR 0.2 billion in fixed-income securities. The highest positive balances among the investment funds were achieved by equity funds (EUR 2.5 billion), open-ended property investment funds (EUR +2.2 billion), and funds of funds (EUR +2.0 billion).

Customer securities trading business of Savings Banks

	2016 billion EUR	2015 billion EUR	Change in billion EUR	Change in %
Securities trading volume	**102.0**	115.3	–13.2	–11.5
Net sales of securities [1]	**9.6**	7.2	+2.4	+32.6

[1] Net sales is the balance of customer purchases and sales

Refinancing

Savings Banks refinance themselves largely by using deposits taken from private individuals and from enterprises. In 2016, the Savings Banks' customer deposit business grew by EUR 28.6 billion, i.e. by +3.3 percent, to a total portfolio volume of EUR 890.1 billion, which was more than in previous years (most recently: +3.0 percent in 2015).

EUR 890.1 billion

CUSTOMER DEPOSITS OF SAVINGS BANKS

In this context, the interest-rate driven development of the past few years continued: sight deposits continued to increase (by EUR 43.2 billion, or 8.8 percent, to a portfolio volume of EUR 536.0 billion), while savings deposits decreased slightly by EUR 2.8 billion (0.9 percent) to EUR 293.4 billion. Own issues (EUR –5.8 billion, i.e. –12.0 percent) and time deposits (EUR –6.0 billion, i.e. –24.9 percent) continued to decrease significantly.

Deposits from domestic enterprises grew by EUR 1.8 billion, or 1.3 percent, to EUR 144.7 billion, which was somewhat higher than in the previous year (+0.9 percent). Deposits from private individuals increased by EUR 28.2 billion (i.e. by 4.3 percent) to EUR 685.8 billion, which was a higher growth rate than in 2015 (+3.6 percent).

As in previous years, Savings Banks are therefore characterised by a comfortable refinancing situation. Savings Banks were able to refinance their entire customer lending business from customer deposits.

Customer deposit business of Savings Banks

	2016 billion EUR	2015 billion EUR	Change in billion EUR	Change in %
Customer deposits	**890.1**	861.5	+28.6	+3.3
of which savings deposits	293.4	296.2	–2.8	–0.9
of which own issues	42.5	48.3	–5.8	–12.0
of which time deposits	18.2	24.2	–6.0	–24.9
of which sight deposits	536.0	492.8	+43.2	+8.8

Creation of financial assets

Because of the higher year-on-year portfolio growth in the deposit business and clearly positive net sales in the securities trading business, the acquisition of financial assets improved significantly. Including the home savings and loan business and the life assurance business attributable to Savings Banks, customers acquired additional financial assets worth EUR 41.4 billion via Savings Banks in 2016. This was an increase of 18.6 percent compared with 2015, and the best performance since 2001.

+18.6 %

INCREASE IN ACQUISITION OF FINANCIAL ASSETS BY SAVINGS BANKS CUSTOMERS

With reference to private individuals, the previous year's level was exceeded by 21.9 percent. Overall, the growth in financial investment amounted to EUR 36.9 billion. This means that private individuals also achieved the highest growth in financial assets since 2001.

Acquisition of financial assets by Savings Banks customers

	2016 billion EUR	2015 billion EUR	Change in billion EUR	Change in %
Acquisition of financial assets by customers [1]	**41.4**	34.9	+6.5	+18.6
Private acquisition of financial assets [1]	**36.9**	30.3	+6.6	+21.9

[1] Deposit-taking business, customer securities trading business, intermediated home savings and loan deposits, intermediated life insurance policies

15.2 %

TIER-1 RATIO OF SAVINGS BANKS

Equity

The regulatory capital of Savings Banks amounted to EUR 110.3 billion at the end of fiscal year 2016. The German Savings Banks total capital ratio and tier-1 ratio in accordance with CRR [1] have steadily increased in the past few years. At the end of 2016, the total capital ratio amounted to 16.9 percent. Since Savings Banks continued to increase tier-1 capital exclusively, the tier-1 ratio rose substantially to 15.2 percent. Net of hybrid tier-1 capital components, the common equity tier-1 ratio amounted to 15.1 percent. This means that, today, Savings Banks already exceed the Basel III requirements which will apply as of 2019.

The Savings Banks' comfortable equity base underlines their financial independence and their ability to adapt to stricter regulatory requirements.

Regulatory capital ratios of Savings Banks in accordance with CRR

	2016 in %	2015 in %	Change in percentage points
Tier-1 ratio	**15.2**	14.8	+0.42
Common equity tier-1 ratio	**15.1**	14.7	+0.43
Total capital ratio	**16.9**	16.7	+0.23

Business performance of the Landesbanken

In fiscal year 2016, the business performance of the Landesbanken was characterised by the continuing significant reduction of their balance sheet total. In the course of the implementation of the strategic measures adopted during the financial market crisis to resize and realign the Landesbanken, their balance sheet total was reduced by more than EUR 680 billion (nearly 44 percent) from the end of 2008 to the end of 2016.

In 2016, the balance sheet total of the institutions [1] decreased by EUR 68.2 billion (7.2 percent) to EUR 879.1 billion. This means that the decline in on-balance-sheet business was slightly lower than in the previous year (2015: –10.7 percent). This was mainly due to the significant reduction of interbank exposures and of own investments in securities.

[1] This Chapter deals with the 6 Landesbanken Groups with Bremer Landesbank as part of the Nord/LB Group, Berliner Sparkasse/LBB and DekaBank.

In addition, the Landesbanken reduced their liabilities to non-banks (customer deposits) in 2016. This was primarily achieved by significantly reducing the portfolio of deposits taken from financial enterprises (financing institutions and insurance companies). This reduction was much more pronounced than the reduction of liabilities to enterprises operating in the real economy.

Lending business

On the asset side of the interbank business, the Landesbanken portfolio of loans to banks decreased by EUR 23.6 billion (–11.5 percent) to EUR 181.2 billion (2015: –12.9 percent). The reduction was most pronounced with regard to amounts due from foreign banks, which were reduced by EUR 12.4 billion to EUR 71.7 billion. Amounts due from domestic banks (excluding Savings Banks) were reduced by EUR 7.1 billion to EUR 57.8 billion. The Landesbanken portfolio of loans to Savings Banks was reduced by EUR 4.2 billion to EUR 52.6 billion.

In the customer lending business, Landesbanken reported a slight reduction of the volume of their portfolio in the past fiscal year. Overall, exposures to non-banks were reduced by 3.1 percent, from EUR 420.7 billion to EUR 407.8 billion (2015: –4.1 percent).

EUR 407.8 billion

CUSTOMER LOANS BY LANDESBANKEN

In the year under review, the volume of exposures to domestic and foreign enterprises decreased by 2.2 percent to EUR 296.8 billion (2015: EUR -8.3 billion; –2.6 percent). Loans to domestic and foreign general government decreased by 4.5 percent, from EUR 81.9 billion to EUR 78.3 billion. Loans to resident individuals (including non-profit organisations) were reduced by 6.8 percent, from EUR 35.1 billion to EUR 32.7 billion.

Securities trading business

In 2016, Landesbanken continued to significantly reduce their own investments in securities. Overall, their portfolio decreased by 16.1 percent to EUR 150.6 billion (2015: –16.0 percent). Investments were reduced in all classes of securities. The portfolio of bank bonds was reduced by 12.4 percent to EUR 65.0 billion. The portfolios of corporate bonds decreased by 3.6 percent to EUR 22.3 billion. In addition, portfolios invested in variable-yield securities (equities, investment certificates) were reduced by 29.0 percent to EUR 8.2 billion. With a portfolio of EUR 1.6 billion at the end of 2016, money market paper continued to play only a minor role.

While, in the previous year, the portfolios of government bonds and debentures had still been rising (+3.8 percent), their portfolios were reduced in the year under review by 22.4 percent, from EUR 69.0 billion to EUR 53.5 billion.

As at the end of 2016, own investments of Landesbanken (securities account "A") were focused on bank bonds with a structural share of 43.1 percent, followed by government bonds and debentures with 35.5 percent, and corporate bonds with 14.8 percent. The portfolios of variable-yield securities and money market paper play a minor role, with structural shares of 5.5 percent and 1.1 percent, respectively.

EUR 273.4 billion

CUSTOMER DEPOSITS OF LANDESBANKEN

Refinancing

The Landesbanken portfolio of customer deposits decreased significantly in 2016, declining from EUR 287.7 billion to EUR 273.4 billion (–5.0 percent). In 2015, the reduction of customer deposits had been marginal (–0.5 percent).

Once again, this was due mainly to the development of liabilities to domestic and foreign enterprises, which were reduced from EUR 159.1 billion to EUR 149.9 billion (–5.8 percent) and from EUR 32.1 billion to EUR 29.0 billion (–9.8 percent), respectively.

A more differentiated analysis in the segment of domestic enterprises shows that the decline in the portfolio in the year under review was primarily due to the development of liabilities to insurance companies and to financing institutions, while the decline was due, to a limited extent only, to the development of liabilities to enterprises operating in the real economy. Liabilities to insurance companies decreased by EUR 3.1 billion (–4.2 percent), from EUR 74.4 billion to EUR 71.2 billion. The Landesbanken portfolio of liabilities to financing institutions declined by EUR 4.7 billion to EUR 28.7 billion (–14.1 percent), and the portfolio of liabilities to enterprises operating in the real economy decreased slightly by EUR 1.4 billion (–2.7 percent), from EUR 51.4 billion to EUR 50.0 billion.

As a result, the weight of the segment of enterprises operating in the real economy has continued to increase within the customer deposit business of Landesbanken.

While deposits from domestic general government decreased by EUR 3.8 billion (–7.3 percent), i.e. from EUR 52.5 billion to EUR 48.7 billion, deposits from resident individuals (including non-profit organisations) increased by EUR 2.4 billion (+5.6 percent), from EUR 43.3 billion to EUR 45.8 billion.

In 2016, the reduction of interbank liabilities by Landesbanken was once again more significant than the reduction of their liabilities to customers. Interbank liabilities decreased by 11.3 percent, from EUR 268.1 billion to EUR 237.8 billion (2015: 10.9 percent). In the past year, liabilities to domestic credit institutions (excluding Savings Banks) decreased from EUR 179.2 billion to EUR 155.4 billion (–13.3 percent), while liabilities to Savings Banks declined from EUR 30.4 billion to EUR 25.8 billion (–15.1 percent). Liabilities to foreign banks decreased by 3.3 percent, from EUR 58.5 billion to EUR 56.6 billion (2015: –14.2 percent).

Unlike the previous year, the Landesbanken portfolio of securitised liabilities decreased marginally in 2016. The portfolio declined from EUR 190.3 billion to EUR 189.8 billion (–0.3 percent). In 2015, Landesbanken had recognised a significant reduction of the portfolio in this segment by 18.5 percent.

Equity

In 2016, the equity of Landesbanken as reported on the balance sheet decreased from EUR 54.7 billion to EUR 53.5 billion (–2.1 percent). This decline was mainly due to the repayment of part of one institution's silent partnership contributions.

By the end of 2016, the regulatory tier-1 capital of Landesbanken, as calculated on the basis of CRR/CRD IV, had decreased to EUR 48.1 billion (end of 2015: EUR 53.0 billion). In comparison, however, the total risk exposure (borrower default risks, market risk positions and other risks) was reduced even more by 14 percent to EUR 291.6 billion (end of 2015: EUR 338.9 billion). As a result, the Landesbanken Group improved its tier-1 ratio in accordance with CRR/CRD IV to 16.5 percent (end of 2015: 15.6 percent).

16.5 %

TIER-1 RATIO OF LANDESBANKEN

In 2016, Landesbanken continued to pursue their sustained course of consolidation upon which they had embarked after the financial crisis by systematically reducing their risk assets and further improving their tier-1 ratio. Fewer high-risk transactions, more financial solidity. This in essence summarises the performance of the nine institutions during the past year.

Selected balance sheet items of Landesbanken (including DekaBank)

	As at year-end 2016 billion EUR	As at year-end 2015 billion EUR	Change in %
Loans and advances to banks (MFIs[1])	**181.2**	204.8	–11.5
Loans and advances to banks (non-MFIs[1])	**407.8**	420.7	–3.1
Liabilities to banks (MFIs[1])	**237.8**	268.1	–11.3
Liabilities to non-banks (non-MFIs[1])	**273.4**	287.7	–5.0
Balance sheet total	**879.1**	947.3	–7.2

[1] Monetary Financial Institutions

Profitability[1]

In the year under review, Landesbanken improved their operating earnings, due to the development of their net income from financial transactions, which increased from EUR 0.5 billion in the previous year to EUR 1.0 billion. At EUR 1.2 billion, their net commission income was also above the previous year's level (EUR 1.0 billion). Net interest income declined from EUR 8.3 billion to EUR 7.6 billion, and administrative expenses were reduced from EUR 6.9 billion to EUR 6.4 billion.

Overall, Landesbanken achieved an operating result before valuation amounting to EUR 3.7 billion in 2016 (2015: EUR 3.1 billion). Due to the reduction of administrative expenses, the cost-income ratio[2] increased to 73.1 percent (2015: 74.7 percent).

While the development of the valuation result in the lending business was in line with that of the "extraordinary result"[3] in 2015, the profitability of Landesbanken was characterised by a disparate development in 2016. In the valuation result of the lending business, there was a significant year-on-year increase in expenses. On the other hand, Landesbanken achieved a slight increase in "Other and extraordinary income" which, however, did not offset the increase in loan loss provisions.

The valuation result of Landesbanken in the lending business had a major adverse impact on net income in 2016. The net valuation expenses of EUR 3.7 billion were significantly above the previous year's level (EUR 1.1 billion). While the valuation result of Landesbanken had a slightly positive effect on net income in the previous year, the substantial increase in 2016 was mainly due to high charges in case of two institutions. The earnings of these two institutions were particularly affected by the impact of the continuing and worsening shipping crisis. In view of the further deterioration of market conditions, the provisions for contingent losses in the ship finance sector were adjusted to reflect the changes in expected earnings.

[1] Source: Individual financial statements of Landesbanken (including DekaBank) prepared in accordance with German GAAP

[2] Ratio of administrative expenses to the sum total of net interest income and net commission income

[3] Balance of other and extraordinary income/expenses. Unlike the P&L statistics of Deutsche Bundesbank, additions to and withdrawals from the fund for general banking risks are recognised in the "Extraordinary Result" in accordance with Section 340(g) German Commercial Code.

Unlike the previous year in which “Other and extraordinary expenses” of EUR 0.3 billion had a minor adverse impact, Landesbanken achieved minor income of EUR 0.2 billion in 2016, primarily driven by the valuation and financial investment business. In fiscal year 2016, the performance of the Landesbanken was moderately positive, with net valuation income of EUR 0.7 billion. In the previous year, the valuation and financial investment business had only been marginally positive, with net valuation income of EUR 0.1 billion.

In fiscal year 2016, Landesbanken achieved pre-tax earnings of EUR 119 million. Landesbanken had closed the year before with net income before taxes of EUR 1.6 billion. The substantial decline in pre-tax earnings has been due to high extraordinary charges of two institutions of the Landesbanken group.

After income taxes, Landesbanken closed the fiscal year 2016 with a net loss after taxes of EUR 0.4 billion, while in 2015 Landesbanken had posted a net income of EUR 0.9 billion after taxes.

Selected P&L account items of Landesbanken (including DekaBank) [1]

	2016 [2] billion EUR	2015 billion EUR	Change in %
Net interest income	**7.560**	8.320	–9.1
Net commission income	**1.216**	0.983	+23.7
Net income from financial transactions	**1.026**	0.523	+96.2
Administrative expenses	**6.412**	6.946	–7.7
Operating result before valuation	**3.681**	3.081	+19.5
Valuation result (excluding equity investments)	**–3.725**	–1.120	> +200 %
Operating result after valuation	**–0.045**	1.961	– [4]
Balance of other and extraordinary income/expenses [1,3]	**0.163**	–0.328	– [4]
of which: withdrawals from (+) / additions to (–) the fund for general banking risks pursuant to 340(g) German Commercial Code	0.664	–0.219	– [4]
Net income before taxes	**0.119**	1.632	–92.7
Income taxes	**0.505**	0.764	–33.9
Net income/loss after taxes	**–0.386**	0.868	– [4]

[1] As in the “original” P&L account under German GAAP, additions to the fund for general banking risks pursuant to Section 340(g) of the German Commercial Code are recognised as expenses that reduce net income, while withdrawals are recognised as income; in the DSGV’s Financial Reports until 2010, such additions and withdrawals were treated – in line with Deutsche Bundesbank’s P&L statistics – as appropriation of profits which increased net income (in the case of additions) or reduced net income (in the case of withdrawals).

[2] Provisional figures from financial statements prepared in accordance with German GAAP, some of which are as yet unaudited

[3] Including the net balance of profits from the disposal of financial investments and investment securities, write-downs and write-ups on financial investments and investment securities, as well as changes in the fund for general banking risks in accordance with Section 30(g) of the German Commercial Code (additions to the fund for general banking risks with a negative sign; withdrawals from this fund with a positive sign).

[4] Calculation is not reasonable

Business performance of Landesbausparkassen

In 2016, the new business generated by Landesbausparkassen in terms of the target contract sums amounted to EUR 33 billion. This constitutes a decrease of 9 percent compared with the record year 2015. However, this is an understandable development: on the one hand, 2015 was a record year, and on the other hand, building society contracts are increasingly perceived as an advantageous way of financing one's own home, and less as a form of investment. Building society contracts provide an opportunity for people to protect themselves in the long term from the risk of rising interest rates, in particular in the current interest-rate environment. The growing importance of interest rate hedges is also apparent from the continued increase in the average target contract sum. In the past fiscal year, it amounted to EUR 41,000, which was 15 percent higher than in the previous year.

The "building societies of the Savings Banks" are the undisputed market leader in Germany's home savings and loan business. Their market share amounts to 36.5 percent in terms of the number of new contracts concluded in 2016 and to 36.3 percent in terms of the target contract sum. In respect of the portfolio of contracts, Landesbausparkassen hold a market share of 35.6 percent (number of contracts) and 33.0 percent (target contract sum). In the "Riester" home loan and savings segment, the market share held by Landesbausparkassen in new business is even higher (46.9 percent), which is equivalent to approx. 792,000 contracts (+7.1 percent) and a target contract sum of EUR 33.2 billion (+11.3 percent).

At the end of 2016, the eight Landesbausparkassen had 8.5 million customers, for whom they managed a total of 10.3 million contracts (–2.9 percent) with a volume of EUR 291.6 billion (+1.0 percent).

In the past fiscal year, Landesbausparkassen were also major lenders for financing residential housing measures. Capital payments amounted to EUR 7.8 billion (–11.4 percent). The portfolio of deposits under building society contracts had increased to EUR 57.3 billion (+4.4 percent) by the end of 2016. The total volume of building society loans increased by 3.4 percent to EUR 26.6 billion; the volume of preliminary and interim financing loans increased by 7.5 percent to EUR 22.0 billion.

Landesbausparkassen run approx. 600 information centres and have approx. 7,500 employees working in their offices and in their field force. The LBS Group's cumulative balance sheet total reached a new record high of EUR 67.0 billion (+2.5 percent) at the end of 2016.

Business performance of Landesbausparkassen

	2016	2015	Change in %
New contracts concluded			
Number (millions)	**0.80**	1.01	–20.8
Target contract sum (billion EUR)	**32.8**	36.0	–9.0
Portfolio of contracts			
Number (millions)	**10.26**	10.56	–2.9
Target contract sum (billion EUR)	**291.6**	288.8	1.0
Money received (billion EUR)			
Total	**11.8**	12.4	–5.2
of which savings contributions	9.5	9.5	0.0
New capital commitments	**7.9**	9.0	–11.8
Capital disbursements	**7.8**	8.8	–11.4
Balance sheet total	**67.0**	65.3	2.5
Employees (including field force)			
Total	**7,455**	7,857	–5.1
of which apprentices	144	170	–15.2
	2016 in %	2015 in %	Change in percentage points
Market shares (number of contracts)			
New contracts concluded	**36.5**	37.2	–0.7
Portfolio of contracts	**35.6**	35.7	–0.1

Responsibility and social commitment

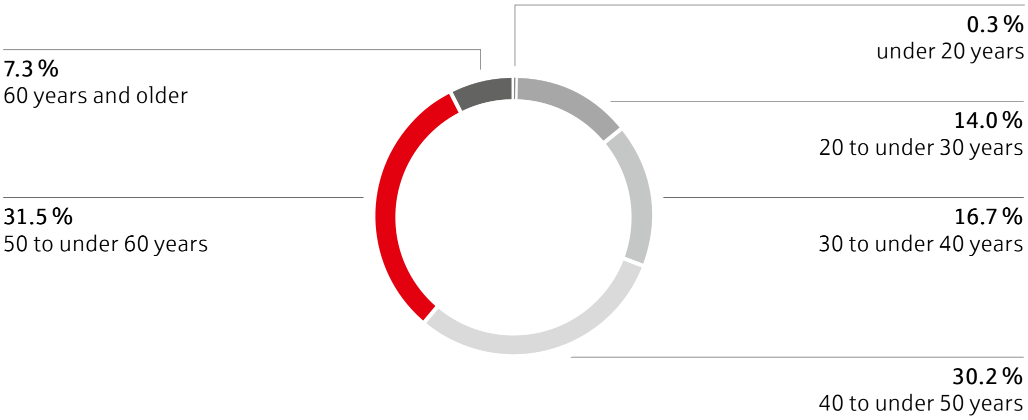
The Savings Banks Finance Group invests in communities, and it actively addresses and helps shape developments in society. Its long-standing strong social commitment is to the benefit of both customers and non-customers – very much in line with the Savings Banks' public service mission. The past year was characterised by staff restructuring, branch closures and mergers in the banking and financial sector – a consolidation process that has also set the framework for 2017. Our current staff numbers show that the previous year's trends have continued.

Employees are the key to success

Our employees are and will continue to be our most important link to our customers. They are brand ambassadors who advocate the Savings Banks' unique business philosophy throughout Germany: understanding people, providing security and preparing for the future.

Despite the slight decline in the total workforce, the Savings Banks Finance Group continues to be one of the most important employers with 313,300 employees and one of the leaders in training in Germany. A total of 224,671 people were employed by a Savings Bank in 2016.

Savings Bank employees: age structure [1]
As at 31 December 2016



[1] Number of active banking employees (headcount).

The Savings Banks Finance Group as an attractive employer

Being an attractive employer plays a key role our human resources strategy. The Savings Banks' positive image is of major importance, in particular for recruiting junior staff as well as qualified professionals and managers. For career starters, Savings Banks were the employer of choice among all the financial providers in 2016, as in the previous year. This is the result of "trendence Schülerbarometer 2016", Germany's largest survey among pupils. In addition, Savings Banks ranked third in the 2016 employer branding awards of trendence in the category of "Best Marketing to Pupils". We received this award for our innovative target-group-oriented communication formats. The technical optimisation of the Savings Banks Finance Group's career portal for mobile use via smart phones meets the expectations of this young target group.

In addition, with a view to the upcoming challenges posed by changes in customer behaviour and the ongoing digitalisation in Savings Banks, we also focused on high-potential employees and developed measures to retain this target group. This will enable our qualified junior staff – in co-operation with our experienced staff – to shape the changes for our future market presence.

It is very important to the institutions affiliated with the Savings Banks Finance Group that their employees are able to align their work and their private lives. To this end, we offer our staff flexible models in terms of their workplace and their working time, as well as professional career development and a variety of support measures.

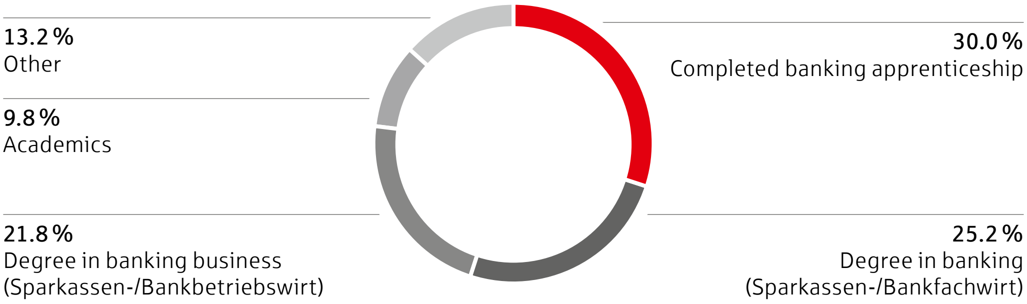
Excellent vocational training and continued professional development

In 2016, a total of 5,007 young people began their vocational training at a Savings Bank, Landesbank or Landesbausparkasse. The decline relative to the previous year reflects adjustments in the institutions' staffing requirements. With a total of 15,200 apprentices and trainees, Savings Banks continue to be the largest provider of training in the German banking sector and one of Germany's largest training providers nationwide. The comprehensive commitment to training is an integral part of the Savings Banks Finance Group's social responsibility, and this commitment is paying off: apprentices of Savings Banks regularly achieve the best marks in the exams held by the German Chamber of Commerce and Industry, and they receive prestigious awards at local, regional and national level. In 2016, 86.4 percent of our apprentices were offered permanent employment upon completion of their training.

Germany's dual vocational education scheme, which combines hands-on training in Savings Banks with theoretical lessons at vocational schools, is typical of the majority of apprenticeships. Most apprentices opt for training as a bank clerk. In addition, however, school leavers are also interested in work-study programmes, which combine vocational training with university studies. Savings Banks increasingly offer such programmes in co-operation with the Savings Banks Finance Group's University. These programmes reflect the growing demand for highly qualified professionals and managers due to the Savings Banks' sales strategy.

Increasing the share of women in leadership positions continues to be a key development target for the entire Group. With the nationwide measures implemented to date, we have achieved an intensification of the debate within the Savings Banks Finance Group. The share women in leadership positions including executive board members increased slightly in 2016 to 25.0 percent.

Savings Bank employees: qualification structure[1]
As at 31 December 2016



[1] Active banking employees (headcount).

Continuing focus on digitalisation in human resources development

The Savings Banks Finance Group's internal training system is one of its key success factors. The Savings Banks Finance Group offers high-quality and attractive career prospects to its employees, including entry-level and leadership positions as well as demanding specialist roles. The Group-wide training architecture – with eleven regional academies, the Management Academy and the Savings Banks Finance Group's University in Bonn – comprehensively supports these development opportunities by conveying the necessary expertise as well as the skills and capabilities required for each career level.

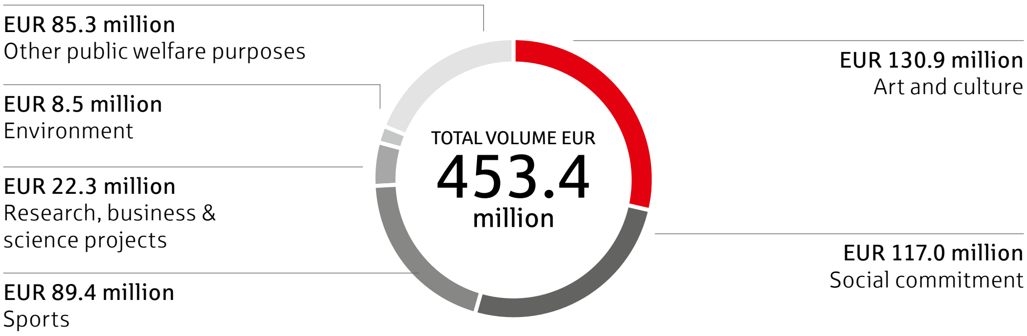
The Savings Banks' business model is centred on providing advice to customers, with the aim of achieving a high level of customer satisfaction. Customers have a choice of channels for contacting service staff – whether in branches, online or by mobile phone. Due to changes in customer needs, there is a significant shift towards online contacts. Regardless of the channel used by customers, Savings Banks want to keep the human touch that sets them apart from competitors, despite the necessary reorganisation of their branch structure. For this reason, Savings Banks continue to place special emphasis on enabling their employees to provide cross-channel customer support.

The range of training courses provided by the academies responds to the need to upgrade and systematically develop the employees' own "digital fitness". Current training formats include seminars organised at the academies, but also online courses and in-house seminars held directly on the premises of Savings Banks.

Broad-based commitment to society strengthens public welfare

In 2016, the Savings Banks Finance Group invested EUR 453 million in social responsibility projects (2015: EUR 470 million). Savings Banks and Landesbanken are actively involved in an range of local social interaction through their sponsorship of art and culture, by engaging in social projects, supporting sports and providing assistance in the fields of education and environmental protection.

Social commitment of Savings Banks Finance Group
As at 31 December 2016



Art and culture

In 2016, the Savings Banks Finance Group provided the arts and culture with supporting totalling around EUR 131 million (previous year: EUR 136 million), making them the largest non-governmental promoters of culture in Germany. Their commitment includes regional, national and internationally significant projects.

Social commitment

Savings Banks support children, young people and senior citizens in a variety of ways. Their sponsorship is addressed to society as a whole and supports, for instance, social counselling centres, neighbourhood centres and integration projects for immigrants. With a total amount of EUR 117 million in 2016 (2015: EUR 126 million), social responsibility projects are the second largest sponsorship area for the Savings Banks Finance Group.

Sporting activities

The Savings Banks Finance Group sponsors a variety of sports. The largest share of the contributions goes to sports clubs in all of Germany's regions. In addition, the Savings Banks Finance Group also sponsors the sporting activities of top athletes, amateurs and persons with disabilities, including the athletes of the German Olympic and Paralympic teams, as well as elite sports schools. In 2016, a total of EUR 89.4 million (2015: EUR 91.8 million) was spent to sponsor sports and members of sports clubs. A total of 33 foundations of the Savings Banks Finance Group are devoted – either exclusively or predominantly – to sponsoring sports activities.

Environmental protection

Savings Banks also assume responsibility for the environment in a wide variety of local and regional activities that address environmental and climate concerns. A large number of local environmental organisations, for instance, can count on the support of Savings Banks. The sponsorship scheme also includes selected ecological projects in schools. In 2016, the funds spent by Savings Banks amounted to approx. EUR 8 million, as in the previous year.

Education

Our sponsorship of education and integration is a key element of the Savings Banks Finance Group's activities aimed at supporting sustainable social development. In 2016, a total of EUR 22 million (2015: EUR 21 million) was spent on research projects and on projects designed to promote business and science. Across the whole of Germany, Savings Banks are committed to ensuring that all sections of the population can benefit from community life and further their personal development in their surroundings. Savings Banks invest in the financial education of children from an early age, for instance by providing teaching materials on economic and financial topics via the "Sparkassen-SchulService" (Savings Banks School Service). Outside of schools, the Savings Banks Finance Group's "Money and Household" advisory service provides all consumers with free-of-charge information designed to improve their financial literacy and to help them prevent debt.

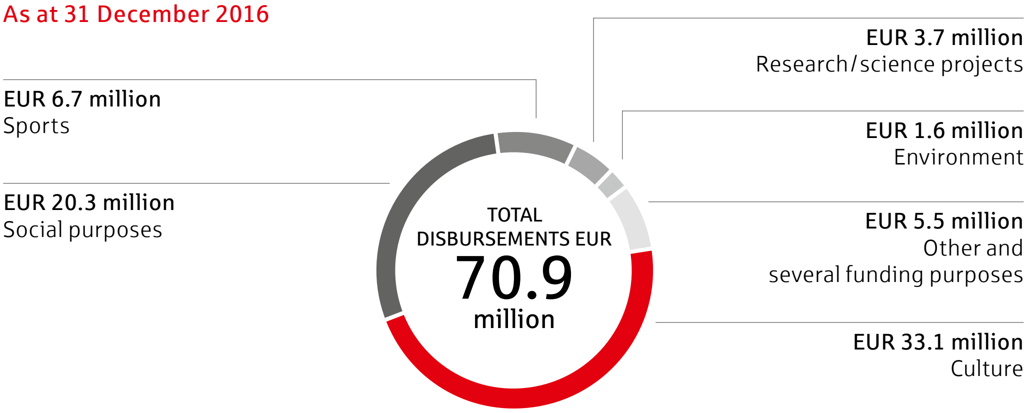
Foundations

The commitment of the Savings Banks Finance Group, as reflected in the member institutions' sponsorship and donations, is carried on by the Group's charitable foundations in a particularly sustainable manner. In 2016, the 738 foundations (2015: 748) of the Savings Banks Finance Group helped to strengthen regional development and supported active citizenship at a local level. At the end of 2016, the foundations' aggregate capital amounted to more than EUR 2.5 billion, which means that their endowment capital has nearly doubled over the past ten years. In the past year, funds distributed by the foundations amounted to EUR 71 million (2015: EUR 70 million).

For regularly updated information on the social responsibility activities of the Savings Bank Finance Group, please visit:
↘ s.de/responsibility

For information on how the Savings Banks Finance Group responds to social issues by supporting specific projects, please read:
↘ s.de/sustainability

Disbursements in million EUR
As at 31 December 2016



Risk report

As in previous years, overall bank management also played an important role for the institutions affiliated with the Savings Banks Finance Group in fiscal year 2106, not only in terms of achieving purely economic objectives. First and foremost, it was necessary to respond to growing regulatory requirements and the challenges posed by the period of low and negative interest rates.

Market situation and regulatory environment

The institutions affiliated with the Savings Banks Finance Group performed well in this challenging environment – although the effects of the financial markets crisis and the European debt crisis were still manifest, and the European Central Bank continued to maintain a low interest rate environment, resulting in negative market interest rates on a broad scale.

Regulatory environment

As in the previous year, a large number of regulatory initiatives were taken forward in 2016. At EU level, particular mention should be made of the comprehensive proposals published on 23 November 2016: in addition to proposals to revise the Capital Requirements Directive and Regulation for banks (CRD V / CRR II), there are proposals to integrate the requirements of the Financial Stability Board (FSB) with regard to the total loss absorbing capacity (TLAC) for global systemically important banks (G-SIBs) into the CRR and also into the Bank Resolution and Recovery Directive (BRRD), as well as the associated Single Resolution Mechanism (SRM) Regulation. The negotiations on these proposals will probably extend to the end of 2018.

The Basel Committee had planned to conclude negotiations on its regulatory package referred to as “Basel IV” before the end of 2016. This was not achieved; the outcome of the process of finding a compromise is still open. This package includes the revision of the Credit Risk Standard Approach (CRSA), which is applied by nearly all the Savings Banks to determine the capital requirements for their lending business. In addition, there are plans to introduce what is referred to as “output floors”, which limit the capital savings that can be achieved by applying the Internal Ratings-Based Approach (IRBA) instead of the CRSA. Nearly all Landesbanken apply the IRBA.

At national level, the amendment to the Minimum Requirements for Risk Management (MaRisk) merits attention. The amendment is focused on requirements with regard to risk data aggregation and risk reporting, based on a regulation issued by the Basel Committee (BCBS 239).

In view of the persistently high intensity of new regulatory requirements, the Savings Banks Finance Group has centrally bundled its implementation support in an entity called Sparkassen Rating and Risikosysteme GmbH (SR). SR – which is a wholly-owned subsidiary of the German Savings Banks Association (DSGV) – supports Savings Banks in fulfilling bank management responsibilities driven by regulation. The development of the necessary resources and structures was completed at the end of 2016.

Risk management by the institutions affiliated with the Savings Banks Finance Group
Identifying, monitoring and managing general banking risks is part of the core tasks of any bank. Banks are exposed, inter alia, to the following major risks:

- Counterparty default risks,
- Market price risks,
- Liquidity risks, and
- Operational risks.

The institutions affiliated with the Savings Banks Finance Group manage the earnings and risk classes associated with their business operations in a professional and forward-looking manner. Changes in the market environment and new regulatory requirements call for continuing adjustments to risk management methods, models and instruments.

DSGV, SR and the regional Savings Banks associations develop, update and improve the tools and methods applied in close co-operation with their affiliated institutions. This provides many advantages, including:

- establishing practical and uniform standards at the level of the Savings Banks Finance Group,
- developing a broad database by pooling data nationwide, based on these standards,
- reducing the workload for individual institutions and avoiding duplication,
- bundling all of the expertise of the Savings Banks Finance Group.

Regardless of the development of uniform procedures at the level of the Savings Banks Finance Group as a whole, each member institution takes its own decisions on specific transactions and the associated risks, such as the design of its customer products and its own-account investment policy. This also applies to the definition of an institution's specific risk profile and its application of risk quantification methods.

Categories of general banking risks

Counterparty default risks	– Losses incurred due to the unexpected default or downgrade of the rating of business partners, especially credit risks, issuer and counterparty risks, as well as settlement and replacement risks
Market price risks	– Losses incurred due to unexpected changes, for instance in interest rates, foreign exchange rates and equity prices, real estate and commodity prices
Liquidity risks	– Insolvency risk: liquid funds available are not sufficient to meet payment obligations – Structural liquidity risks or cost-of-funding risks
Operational risks	– Losses incurred due to inadequacy or failure of internal processes, employees, internal infrastructure or due to external factors
Other risks	– Reputational risks, for instance: losses in value due to damage to the bank's reputation

Institutions use jointly developed procedures to measure risks, aggregate these risks to determine the risk-bearing capacity, manage the portfolio and allocate capital, so as to optimise their risk/ return ratio. In view of the large number of specific decisions, the Savings Banks Finance Group as a whole remains very well diversified.

Risk management procedures are optimised on an ongoing basis within the Group.

Safeguarding the institutions' risk bearing capacity
For many years, the institutions affiliated with the Savings Banks Finance Group have applied risk management methods and IT tools designed, on the one hand, to measure capital and assets and, on the other hand, to identify risks. The data collected are aggregated and compared in the context of the risk bearing capacity concepts. To this end, the institutions use centrally developed concepts which integrate the various procedures and methods and embed them in risk limits defined at the level of the overall bank and for each category of risk.

As a rule, Savings Banks pursue a "going concern" approach, while Landesbanken usually apply a "gone concern" approach because of their capital market orientation. The objective of the management methods anchored in the risk bearing capacity concepts is to safeguard the long-term future of each institution, and hence, to protect creditors.

The S-KARISMA/S-RTF software developed jointly within the Savings Banks Finance Group provides wide-ranging IT support for the Group's institutions, including the bundling of risk management data, scenario-based simulations and regulatory reporting systems on risk bearing capacity pursuant to the German Ordinance on the Provision of Financial and Risk Bearing Capacity Information (FinaRisikoV – Finanz- und Risikotragfähigkeitsinformationenverordnung); at the same time, the software covers the capital planning requirements under Basel pillars I and II. The software is based on the Savings Banks Finance Group's capital allocation, risk bearing capacity and capital planning concepts. It includes the institutions' specific risk values, and hence their requirements in terms of capital and net assets, based on the business structure of each Savings Bank. In mid-2016, SR assumed responsibility for the support and further development of the software.

To ensure that risks are backed by capital at all times, the software compares capital levels with risk exposures in accordance with the definitions in pillar I (Basel III) and pillar II (Minimum Requirements for Risk Management – MaRisk). Each institution's aggregate risk exposure and the exposure to the underlying individual types of risk is restricted by a system of limits which permits a timely response.

The institutions affiliated with the Savings Banks Finance Group carry out capital planning processes to be able to recognise the development of capital ratios as well as future scope for action at an early stage. Should it be necessary to adopt measures in terms of capitalisation and earnings, such actions can be initiated at an early stage. The jointly developed S-KARISMA/S-RTF software is also used for this purpose because of the need for a close linkage between risk bearing capacity and earnings planning.

The earnings planned for the next few years and their retention will enable Savings Banks and Landesbanken to increase their overall risk coverage potential. As a result, the lending business can continue to grow steadily, which will lead to increasing minimum capital requirements, despite rising capital requirements due to the introduction of the capital conservation buffer.

In 2016, the first Savings Banks underwent the supervisory evaluation process in accordance with the EBA Guidelines for the Supervisory Review and Evaluation Process (SREP).

Institution-specific capital requirements were defined on the basis of the risks identified within the framework of the determination of the risk bearing capacity, or on the basis of the results of the Basel interest rate shock.

The new capital requirements have to be taken into account both when determining capital adequacy and when assessing the risk bearing capacity. DSGV has issued central recommendations for this purpose.

Even if their current risk profile remains unchanged, the free risk coverage potential available in the institutions will be sufficient for the next few years.

Safeguarding solvency

The Savings Banks' traditionally solid capitalisation continued to improve in 2016. At the end of the year, their common equity tier-1 ratio amounted to 15.1 percent, and their total capital ratio amounted to 16.9 percent.

This means that, on average, Savings Banks significantly exceed the Basel capital requirements of 4.5 percent for common equity tier-1 capital and 8 percent for the total capital ratio, which have been applicable since 1 January 2014. The Savings Banks' capitalisation also covers the capital conservation buffer, which will be introduced in stages by 2019. The minimum levels for common equity tier-1 capital under Basel III will then amount to 7 percent, and the total capital ratio will be 10.5 percent. What is referred to as additional SREP surcharges will also be covered. These are the institution-specific capital requirements which were defined by the German Financial Markets Supervisory Authority (BaFin) for the first time in 2016 in implementation of the EBA Guidelines for the Supervisory Review and Evaluation Process (SREP).

At the end of 2016, the average common equity tier-1 ratio of the Landesbanken (including DekaBank) amounted to 15.3 percent. On average, the total capital ratio was 21.3 percent. Both figures refer to the level of individual institutions.

Management of individual types of risk

Due to stricter regulatory requirements in terms of the quantity and quality of reports required for risk management and risk controlling, it has become necessary to define principles for data management, data quality and the aggregation of risk data.

In co-operation with Finanz Informatik, SR ensures that the common data repository of the Savings Banks Finance Group meets regulatory and commercial requirements.

Managing risks and returns is a permanent balancing act between the economic market conditions, the regulatory environment and changing customer expectations. In the current interest-rate environment, Savings Banks therefore focus in particular on the management of risks and returns. In this context, particular attention is paid to managing the counterparty risk because this type of risk has a major impact on the institutions' risk bearing capacity and the stability of their earnings. However, extensive risk measurement procedures are used to secure the lending capacity of Savings Banks and Landesbanken in a sustainable manner. In addition, SR is co-operating with Savings Banks and Regional Associations to develop a best practice guide for implementing the risk inventory, including centralised recommendations with regard to the criteria to be applied to the risk materiality assessment and the determination of the risk measurement frequency. The rollout of this standardised process model is scheduled for the end of 2017.

Risk classification tools

For corporate banking: Savings Banks Standard Rating	– The Savings Banks Standard Rating is applied to business clients of Savings Banks. Creditworthiness is assessed by means of a modular approach: as a first step, the Savings Bank / Landesbank will examine what information is available on a given enterprise and can be included when establishing the rating score. This information is subdivided as follows: – Analysis of the financial statements or net income accounts, – Qualitative rating, i.e. assessing the qualities of the enterprise and the entrepreneur or managing director, – Taking into account existing business relationships with the client, including the client's account behaviour, – Potential downgrades due to warning signals of a forthcoming crisis of the enterprise – Taking into consideration third parties that may affect the enterprise's creditworthiness (joint liability) if there is a "parent-subsidiary relationship", – An approved customer rating can be used for automatically generating a strength/potential profile which can be used for communicating with the customer, – For customers with low exposure, institutions can use an automated procedure based on account data (Compact Customer Rating) to asses the customers' creditworthiness on an ongoing basis
For commercial real estate investments: Savings Banks Real Estate Business Rating	– The Savings Banks Real Estate Business Rating is used to assess the creditworthiness of real estate business clients. Both quantitative indicators such as balance sheets and qualitative factors such as the expected business performance are used for this assessment. As the key risk driver, the property that is to be financed or has already been financed is valued using property-specific information and indicators. In this context, the focus is on assessing how likely it is that loans will be repaid from the property's rental income in the years to come. – To ensure that the assessment is as realistic as possible, all the information available is given due consideration in establishing a rating score for the customer.
For retail banking: Savings Banks Customer Scoring	– The Savings Banks Customer Scoring is the risk classification procedure for retail banking. It enables customer relationship managers to objectively assess the creditworthiness of new or existing customers applying for a loan, where possible using all the relevant information available. – In addition, this tool can also be used by the institutions for automated portfolio monitoring of their retail banking exposure, so as to identify risk in good time.
For investments in renewables: Project Financing Rating	– The Project Financing Rating is a procedure that is tailored to the financing of renewables projects (wind, photovoltaic systems, biogas/biomass). Loan commitments are primarily based on the cash flows generated from the operation of the plants. Hence, the core risk is not the financial position of the equity investor (also referred to as sponsor) but the project performance. – Since the project company is to be analysed in its entirety, qualitative factors such as the expertise of the parties involved in the project, information on the project environment and the contractual terms and conditions are also included in the assessment process.

Managing counterparty default risks

In co-operation with representatives from Regional Associations, Savings Banks, Landesbanken, Landesbausparkassen and Finanz Informatik, SR develops and maintains the necessary procedures for efficient and needs-based credit risk measurement of Savings Banks, based on the data provided by the Savings Banks Finance Group. Such procedures are also used throughout the Savings Banks Finance Group for managing default risks.

The fact that SR centrally maintains and develops the procedures guarantees their high quality and consistency. This ensures that the data pooled by Savings Banks and Landesbanken will be used in compliance with data protection laws, that they will be qualitatively and quantitatively validated, and that the tools will be regularly subjected to a regulatory review.

The risk classification tools described in the table on page 57 refer to the corporate lending business, as well as the real estate and the retail banking business.

In addition, the institutions affiliated with the Savings Banks Finance Group also have tools for assessing ratings to allow the calculation of the fair values of credit spreads (risk spreads) and for measuring the risk exposure (value at risk) of the overall credit portfolio. The "fair" credit spread calculated is also used for risk transfers among the institutions and within the framework of what is referred to as "credit pooling".

The Savings Banks Finance Group is continually striving to increase the efficiency of its counterparty risk management, and hence, to generate more precise forecasts because only a balance between precise risk assessment and effective use of financial resources will ensure fair terms for customers.

In 2016, a total of 480,000 commercial and business customers were classified in rating categories. Some of these ratings were conducted or updated several times. Overall, the data pool of the Savings Banks Finance Group comprises more than ten million commercial customer ratings. This database gives the credit ratings a high degree of reliability and, at the same time, enables the institutions to provide their customers with qualified advice.

The use of common uniform rating procedures in the Savings Banks Finance Group offers the following advantages:

→ a very broad data base,

→ high selectivity of the procedures,

→ precise and fair classification of our customers in accordance with their creditworthiness,

→ stable default rates,

→ early and objective risk identification, and

→ centralised regulatory approval of the tools used to determine capital requirements in accordance with the internal ratings based approach.

All the rating and scoring procedures have received regulatory approval and are regularly audited by banking supervisory authorities.

The models and methods used for the Savings Banks' management of counterparty risks take into account their heterogeneity in terms of the size of individual institutions, as well as the type, scope and complexity of the counterparty risk portfolio.

This permits an ideal counterparty risk management approach, involving five stages.

In the context of implementation,

- → Savings Banks leverage synergies due to the efficient use of risk measurement tools and their integration into the overall bank management,
- → Savings Banks optimise their equity utilisation by flexibly reducing or increasing their counterparty risk exposure,
- → Savings Banks create more scope for sales by clearly defining responsibilities between sales, back office, and portfolio management,
- → Savings Banks exploit growth opportunities in the lending business (including for new business) by systematically avoiding concentration risks and making consistent use of risk management tools,
- → Savings Banks find it easier to offer competitive terms due to improved risk structures in their loan portfolio.

Efficient management of their loan portfolio enables Savings Banks to continue to grow their lending business in a sustainable manner without exposing themselves too much to the associated risk.

As in previous years, the portfolios of the Savings Banks Finance Group were well positioned in fiscal year 2016. The ratings of 47 percent of all business clients of Savings Banks and Landesbanken were investment-grade ratings (better than BBB–), indicating high credit quality. This figure was as high as it had been in the previous year.

Managing the counterparty risk at portfolio level
In fiscal year 2016, Germany's Savings Banks reported another increase in lending by 3.2 percent (customer loans overall, excluding loans and advances to banks). To retain their capacity to act and their competitiveness in the lending business over the long term, Savings Banks comprehensively register the risk exposure associated with lending and are applying the efficient credit risk management (eCRM) concept to manage these risks in a more targeted manner. Active and efficient loan portfolio management – i.e. systematically optimising the risk/return ratio of their loan portfolio – gives them a competitive edge, which enables them, not least, to achieve efficiency gains and earnings growth. The credit market and the customer lending business continue to be more profitable than the capital market business, in particular in a low interest-rate environment and after risk costs.

Diversifying counterparty risks:
Syndicated customer lending as an example
Savings Banks have been engaged in the traditional syndicated lending business for many years. This includes not only sharing loans and risk exposures with their Landesbank and partner institutions within the Savings Banks Finance Group; increasingly, larger customer loans are also financed jointly by several Savings Banks. The organisation of this co-operation takes on different shapes and forms, including direct lending, loan sub-participation and release from liability. Promissory note loans have also been used by many Savings Banks for targeted investments in loans to enterprises. All of these instruments can be used both to hedge credit risk exposure and to invest in credit risks.

Tools for managing counterparty risks

Savings Banks Risk-Adjusted Pricing	– The risk-adjusted pricing procedure enables credit institutions to determine credit spreads on the basis of individual credit exposures and collateral provided, which ensures that low and high risks will be treated differently. The purpose of the credit spreads, which are taken into account in the determination of fair credit terms, is to cover expected losses from the lending business.
Savings Banks CreditPortfolioView	– CreditPortfolioView enables Savings Banks and Landesbanken to identify, measure and provide an up-to-date view of counterparty risks associated with a loan portfolio. This is based on the P&L (periodic) and/or cash flow (value-based). The analysis takes into account changes in creditworthiness and loan defaults, as well as industry-specific and macroeconomic scenarios.
Savings Banks Loss Data Collection	– The loss data collection is used to determine liquidation and recovery rates of previously defaulted customers. The calculation of the risk costs for future transactions is based on these data. In this way, historical data on losses from lending transactions are integrated into the bank management in a transparent manner. The pooled loss data of the Savings Banks Finance Group are also used to estimate loss ratios, prepare comprehensive reports and supply parameters, for example, for the Hard Test report.

What is crucial is that the Savings Bank granting the loan will retain responsibility for the customer relationship. At the same time, however, the Savings Bank will have "financing partners", so that the Savings Bank's scope for originating loans is enhanced because of the liquidity and capital relief provided by its partners. The systematic co-operation with the other Savings Banks, Landesbanken and partner entities within the Savings Banks Finance Group creates new opportunities for more credit growth, in particular for supporting the growth of large SMEs.

Hedging counterparty risks:
Savings Banks Credit Baskets
For the past twelve years, Savings Banks have had another efficient tool at their disposal for hedging credit risks and for managing concentration risks: Savings Banks Credit Baskets. Unlike syndicated lending, Credit Baskets provide an opportunity to synthetically hedge credit risks.

Credit Baskets are designed like a "mutual insurance society". Once a year, participating Savings Banks contribute their hedging requirements for the overall lending relationships with larger customers to a basket and, at the same time, they invest in the diversified portfolio created in this manner.

More than one-third of all Savings Banks have participated in at least one of the Savings Banks Credit Baskets to date, mutually hedging a total risk exposure of close to EUR 4.1 billion. Credit Baskets are also based on the underlying principle that the Savings Bank granting the loan will retain responsibility for the customer relationship. At the same time, however, the Savings Banks gain more scope for lending to new and existing clients. In this way, Savings Banks can systematically manage their risk exposure in the lending business.

Managing market price risks
The management of market price risks is based on the recognition of the assets invested in this segment. The sum of these asset items is subject to market price fluctuations which may lead to an increase or a decrease in the value of the assets held. The institutions affiliated with the Savings Banks Finance Group are supported by DSGV, SR and the Regional Associations with regard to the methodology used to quantify market price risks and optimise assets, as well as regarding the

technical implementation in dealing with these risks. At the end of 2017, Savings Banks are supported by SR with standardised parameters for quantifying the interest-rate, spread, equity and foreign-exchange risk.

The interest rate risk is a key market price risk. In the Savings Banks Finance Group, this risk is represented as value at risk (VaR), using the modern historical simulation method and, at the same time, compared with the expected performance. To manage these parameters, the institutions have tools at their disposal which enable them to generate specific management measures while taking into account the risk bearing capacity and internal limits. The consistent use of these methods also broadens the institutions' basis for decision-making and makes it easier to define effective measures for managing the interest-rate risk.

For the Savings Banks Finance Group, managing interest-rate risks remains very important, also in today's persistent low interest-rate environment because

- the capital invested in the interest-earning business accounts for a major share of the total capital allocated,
- intense competition and the European Central Bank's low interest-rate policy permit only low margins,
- member institutions have to be prepared for a potential interest-rate hike,
- new refinancing structures call for a separation of the refinancing function from the interest-rate risk management function,
- when issuing debt securities, credit spreads and interest-rate risks are linked more closely than before, and
- supervisory authorities monitor interest-rate risk exposure by means of standardised parameters and intend to introduce capital backing requirements for interest-rate risk.

The potential provided by the management of interest-rate risks has been utilised throughout the Savings Banks Finance Group for many years. Nearly all Savings Banks have the necessary methods and the technology required to apply them. On this basis, more than two-thirds of all Savings Banks regularly report their interest-rate risk exposure to DSGV, and exchange comparative data among each other.

Analyses of the Savings Banks' interest-rate risk exposure for 2016 demonstrate that the measures implemented to manage interest-rate risks were purposely adjusted in response to prevailing market conditions. As in previous years, Savings Banks generated stable earnings contributions to net interest income in 2016. At the same time, the differences in risk appetite and in interest-rate expectations within the Savings Banks Finance Group ensure a very high degree of diversification within fixed-income investments across the entire Group.

The European Central Bank's persistently low interest-rate policy poses new challenges for all the institutions. It is increasingly difficult for Savings Banks – but also for all the other banks – to generate stable income on the basis of a reasonable risk budget. The sustained low interest-rate levels have continued to significantly depress margins in the deposit-taking business, and to erode the attractiveness of secure own-account investments.

Managing liquidity risks

The liquidity risk is driven by the insolvency risk and the refinancing risk (which has an impact on the P&L account). In this context, the insolvency risk – which describes the liquidity risk in the narrower sense – is directly derived from the definition of liquidity. The insolvency risk describes the current or future risk that a given institution may becomes insolvent and would no longer be able to meet its payment obligations fully, or in good time, within a defined period. The refinancing risk affects the P&L account in the event of a liquidity shortage, which can then only be refinanced at higher market rates.

The liquidity risk is affected by the market liquidity risk, which has to do with products and markets and is defined as the risk that, due to market disruptions or insufficient market depth, financial securities cannot be traded on the financial markets at a certain point in time and/or cannot be traded at fair prices. Hence, the focus is on the selling price of securities and on the refinancing capacity available in the market.

The national regulatory framework for managing liquidity risks continues to be defined by Section 11 of the German Banking Act (KWG), the Liquidity Ordinance (LiqV), and sections BTR 3.1. and BTR 3.2 of MaRisk. The Savings Banks' liquidity is more than sufficient to comply with current quantitative requirements stipulated in the Liquidity Ordinance. Almost without exception, Savings Banks have excess liquidity due to their stable customer deposits.

In 2016, Savings Banks no longer sufficiently complied with the new European liquidity standard LCR (liquidity coverage ratio) pursuant to the EU Commission's Delegated Regulation. Efforts are currently being made to further improve the simulation and planning options for this liquidity standard. After dealing with strategic management, the focus is now increasingly on operational fine-tuning.

In general, the attention of the institutions and associations of the Savings Banks Finance Group is focused on continuous improvements of qualitative and quantitative liquidity risk management. A key technical platform used for this purpose is the Group-wide "sDIS OSPlus" software and a management concept tailored to this software. The supply of granular data to the data centres enables Savings Banks to analyse their liquidity flows to any level of detail. Centrally developed parameters such as the "survival period" make risk management comparable and accessible for interpretation by senior management.

In the past year, another focus was on further refining the management tools to offset direct liquidity costs and benefits as defined in Section 3.1 no. 5 of MaRisk. Savings Banks are now consistently in a position to allocate and quantify the liquidity contributions due to banking transactions. The resulting information is made available to Controlling, where it is used for pragmatically managing liquidity maturity mismatches.

Managing operational risks
Their sustainable business policy obliges the institutions affiliated with the Savings Banks Finance Group to regularly deal with future risks and the professional prevention of those risks. This is the only way to safeguard current values for the future.

Operational risks are ubiquitous and yet are easily overlooked. Losses incurred due to the inadequacy or failure of internal processes, employees, internal infrastructure or external factors may jeopardise an institution's very existence.

As a rule, Savings Banks employ the basic indicator approach (BIA) to securitise operational risks with regulatory capital. They use the "database of loss events", the "risk map" and/or the "risk inventory" available from SR for the commercial management of their operational risk exposure. Loss events that have occurred are systematically recorded and analysed in the database of loss events. The risk inventory and the risk map are used to assess potential operational risks and the associated loss potential and to define risk-prevention measures.

In addition to the operational risk management tools, Savings Banks have also had access as of 2017 to the OpRisk Assessment Tool, a standardised tool to assess operational risks for the periodic risk-bearing capacity reports. The OpRisk Assessment Tool takes into account not only the institution's own loss events but also the losses recorded in the nationwide OpRisk data pool.

Savings Banks supply their data to a nationwide data pool, which also gives them access to loss data and risk scenarios. The mutual exchange of this information helps to avoid losses and contain operational risks. Owing to the Savings Banks' homogeneous business model, the data collected in the pool can be considered to be representative.

The tools made available – the database of loss events, the risk inventory and the risk map – help the institutions to comply with MaRisk.

How the Savings Banks Finance Group protects members through its Institution Protection Scheme

The institution protection scheme set up by the Savings Banks Finance Group protects all customer deposits held with the 403* independent Savings Banks, the Landesbanken, DekaBank, the Landesbausparkassen and S-Broker.

The scheme created by the Savings Banks Finance Group was conceived as an Institution Protection Scheme. Its primary objective is to avoid having to pay compensation and to protect the member institutions themselves, in particular to safeguard their liquidity and solvency (institution protection). This is designed to ensure that member institutions can maintain their business relations with their customers as contractually agreed. In line with the statutory requirements, this voluntary institution protection scheme averts imminent or remedies existing commercial difficulties. Moreover, the Institution Protection Scheme run by the Savings Banks Finance Group is officially recognised as a deposit guarantee scheme pursuant to Germany's Deposit Guarantee Act ("EinSiG"). Under a statutory deposit guarantee scheme, customers have a legal entitlement to have up to EUR 100,000 of their deposits refunded by the guarantee scheme. This is stipulated in Germany's Deposit Guarantee Act.

The Group's Institution Protection Scheme encompasses 13 individual guarantee funds: eleven regional Savings Bank Guarantee Funds, the Guarantee Fund of the Landesbanken and Girozentralen, and the Guarantee Fund of the Landesbausparkassen.

For more than four decades now, the Institution Protection Scheme of the Savings Banks Finance Group has proven its worth. Since its establishment in 1973, no customers have ever lost any deposits or interest. No depositors have ever had to be indemnified. No affiliated institution has ever become insolvent.

Financial market players recognise the effective guarantees provided by the Institution Protection Scheme. Three international ratings agencies – Moody's Investors Service, Fitch Ratings und DBRS – explicitly cite the Institution Protection Scheme as one of the reasons for their decision to award very good ratings to the Savings Banks, the Landesbanken and Landesbausparkassen.

Risk monitoring for the Institution Protection Scheme of the Savings Banks Financial Group

The guarantee funds include an early warning system for the identification of potential risks, permitting counter-measures to be triggered in good time. This risk monitoring is based on qualitative and quantitative parameters.

In addition to standardised key ratios, qualitative reports are integrated into the assessment of an institution. On the basis of this information, member institutions are classified according to one of four monitoring grades.

The guarantee funds carry out risk monitoring in accordance with standardised principles. Monitoring committees observe the risk exposure in their member institutions, request supplementary information from them where appropriate, and initiate counter-measures if required.

The individual guarantee funds report regularly to a central Transparency Committee of the German Savings Banks Association, which monitors the overall risk exposure within the protection system and verifies its transparency.

* As at 31 December 2016; 393 Savings Banks as at 15 June 2017

Scope for action by guarantee funds
The guarantee funds have rights of information and intervention that are laid down in the statutes.

Aside from general rights, such as the right to conduct an audit at any institution and at any time, there are additional information and intervention rights that depend on the outcome of the risk monitoring.

Institutions with no particular risk exposure are obliged to provide all the information necessary for risk monitoring and, within the scope of their due diligence obligations, must report any extraordinary occurrences. If the risk situation deteriorates, the guarantee fund determines counter-measures accordingly. Institutions with a particular risk exposure are required by the guarantee funds to submit a restructuring concept and to introduce suitable measures in relation to assets or personnel.

If an institution requires support, the guarantee funds of the scheme have a broad range of measures to draw on. As a rule, support is linked to a restructuring agreement with conditions, e.g. repayment of the support measures as soon as the financial position of the institution improves. A merger with another institution is also an option. The decision-making bodies enjoy a large degree of flexibility in responding to the specific circumstances of the challenge.

The various guarantee funds within the scheme are interlinked.

Eleven regional guarantee funds are maintained by the Regional Savings Banks Associations. They are interlinked by the Supra-regional Compensation Mechanism. This mechanism is used whenever the resources required to support a troubled institution exceed those of the region's own guarantee fund. In this event, all the other guarantee funds participate in whatever measure is required to support the institution concerned. In this way, all eleven regional guarantee funds of the Savings Banks are interconnected.

There is a separate fund for the Landesbanken and Girozentralen and another one for the Landesbausparkassen:

→ the Guarantee Fund for the Landesbanken and Girozentralen, and

→ the Guarantee Fund for the Landesbausparkassen.

If necessary, all of these guarantee funds work together within the System-wide Compensation Mechanism, which encompasses:

→ all of the Savings Banks' guarantee funds,

→ the Guarantee Fund for the Landesbanken and Girozentralen, and

→ the Guarantee Fund for the Landesbausparkassen.

This mechanism is used whenever the resources required to support a troubled institution exceed those of the guarantee fund concerned. Due to the System-wide Compensation Mechanism, the combined resources of all these guarantee funds will be available in a crisis to support measures to safeguard the institution.

This means that the guarantee funds making up the Institution Protection Scheme have at their disposal the resources and powers they need to identify and resolve financial problems confronting their members at an early stage. The aim of every support measure is to restore the sustainable competitiveness of the member institution concerned.

Assessing risk-based contributions to the Institution Protection Scheme of the Savings Banks Financial Group
Contributions to the Institution Protection Scheme of the Savings Banks Finance Group reflect the size and business volume of each institution as well as its specific risk-bearing capacity. Each member's contribution is assessed, as set out in the regulatory requirements, on the basis of regulatory risk parameters. Member contributions increase in line with business volume and the regulatory risk parameters. This creates incentives for risk-aware behaviour, thereby helping to ensure the solidity of member institutions.

The law requires the Institution Protection Scheme to continue building up its financial resources between now and 2024. The statutory target is for funds to amount to 0.8 percent of the covered deposits held by the members of the protection scheme. Since a significant proportion of the resources required has already been paid in from existing asset pools, the Savings Banks Finance Group's Institution Protection Scheme has sound financial resources at its disposal today.

Provision of funds to protect institutions

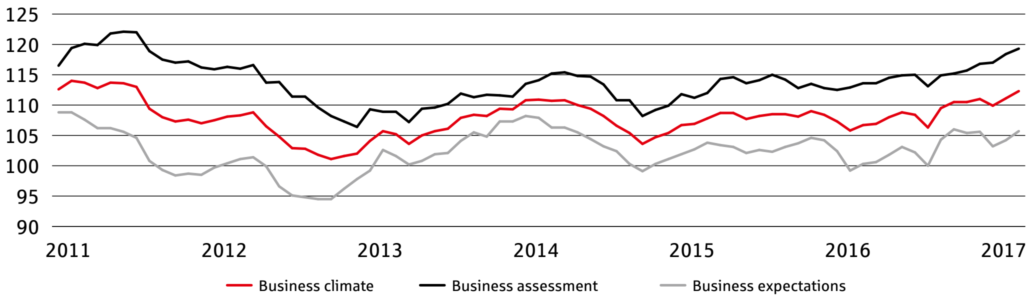
Sequence of actions to support a Savings Bank	Sequence of actions to support a Landesbank
Cash injection from the Regional Savings Bank Guarantee Fund	Cash injection from the Landesbanken Guarantee Fund
↓	↓
Capital injection from the Regional Savings Bank Guarantee Fund	Funding obligation of the Landesbanken Guarantee Fund
↓	↓
Cash injection from the other Regional Savings Bank Guarantee Funds (Supra-regional Compensation Mechanism)	Cash injection from the System-wide Compensation Mechanism (Savings Banks and Landesbausparkassen)
↓	↓
Capital injection from the other Regional Savings Bank Guarantee Funds (Supra-regional Compensation Mechanism)	Funding obligation of the System-wide Compensation Mechanism (Savings Banks and Landesbausparkassen)
Funds from the Landesbanken and Landesbausparkassen (System-wide Compensation Mechanism)	The same sequence of actions is adopted to support a Landesbausparkasse.

Report on expected developments

Economic environment in 2017

The new year got off to a strong start. Production, orders and sentiment indicators reached good or very good values, at least in the German economy. This suggests that, once again, there will be more growth in 2017, at least at the level of the production potential.

ifo Business Climate Index for Trade and Industry



In their joint forecast of late January, the chief economists of the Savings Banks Finance Group anticipated GDP growth of 1.3 percent for Germany. In this context, it should be borne in mind that, in 2017, there are three fewer working days than in 2016 because of the timing of public holidays and because Reformation Day was celebrated nationwide to commemorate 2017 as the "Year of Luther". In accordance with the standard working day adjustment methods, this is likely to have an impact of roughly 0.3 percentage points on the GDP. In terms of economic momentum, this would increase the chief economists' forecast to as much as 1.6 percent.

In light of the positive development that has occurred since then, this forecast also seems to have been rather conservative and at the lower end of what is possible. In their spring report, Germany's leading economic research institutes expect 1.5 percent growth for Germany (not adjusted for working days), while the International Monetary Fund expects 1.6 percent growth in its World Economic Outlook of April.

Once again, private consumption will probably be the most reliable demand component in 2017. With regard to investment activity, on the other hand, there is considerable uncertainty about whether momentum will develop during the current cycle. For foreign trade, most forecasts expect exports to grow, although the effect on net exports will be lower, if they are positive at all.

Growth once again ranging above the production potential is likely to lead to rising employment. A balanced State budget also seems to be within reach. Before the upcoming parliamentary election in Germany, it will not be possible to assess what fiscal policy will be pursued in the medium term beyond 2017.

After the past two years in which prices had been strongly depressed due to the oil price, the development of prices is likely, to some extent, to return to normal in 2017. Nevertheless, most forecasts assume that the inflation rate in the euro area and also in Germany will remain below the European Central Bank's target of "under, but close to, two percent". However, the inflation rate is rapidly approaching this mark.

Nevertheless, the ECB has already largely defined its monetary policy for 2017. According to the ECB's current position, the central bank will probably continue its current purchase programme, at least until the end of 2017. Increases in the key interest rate are also unlikely before then. However, this does not mean that, due to the effect of expectations, yields may not pick up in the capital market as early as in 2017 for longer maturities.

Expected business performance of Savings Banks

In Q1/2017, Savings Banks performed very well in new loans to enterprises and self-employed persons – even slightly better than in the strong first quarters of the previous years. In the first three months, the volume of loan commitments to private individuals was somewhat lower than in the same period of the two previous years; however, the level remains high. In the full year 2017, Savings Banks will therefore again make a major contribution to financing small and medium-sized enterprises in Germany and strongly support private individuals in the implementation of their housing construction projects.

In the deposits business, the previous year's performance did not immediately continue in Q1/2017: the customary decline in the first quarter – normally accompanied by a structural shift towards sight deposits – initially did not materialise. For the full year, however, overnight deposits can be expected to increase in importance. The share of savings deposits will probably remain largely stable, while the shares of time deposits and own issues will continue to decline, albeit at a slower pace. Overall, we expect deposits to remain largely stable in 2017. In the customer securities trading business, trading volumes in Q1/2017 were clearly above the previous year's level and roughly in line with 2015.

In light of the current interest rate and economic development, net interest income can be expected to decrease significantly while net commission income can be expected to increase slightly. At the same time, net personnel and other administrative expenses are expected to increase slightly. These trends will probably lead to a reduction of the Savings Banks' operating result compared with 2016.

Expected business performance of Landesbanken

The continuation of the extremely low interest-rate environment and stricter regulatory requirements also had a major impact on the performance of the Landesbanken in the past year. In addition, the massive increase in loan loss provisions for ship financing had a significant adverse impact on the performance of some Landesbanken.

Despite this challenging environment, most Landesbanken managed to further increase their capital ratios in 2016 and to achieve a solid performance in operational business.

The positive development of operational business shows the high level of trust placed by customers in Landesbanken, even in uncertain times. In a comparison with European competitors, most Landesbanken have also proven to be robust and reliable credit institutions.

The ongoing development of efficient IT systems will continue to pose challenges for Landesbanken regarding how best to remain fit for the future and how to continue to be successful in a highly competitive environment. In 2017, first applications will be launched on the basis of the "Digitalisation Strategy Projects". The digital agenda will lead to the introduction of new products and the revision of processes: the goal of the Landesbanken is to enhance their development by means of continuous market-driven innovation in order to remain attractive for customers and thereby increase their own competitiveness.

With reference to the year 2017, the Landesbanken expect an extremely challenging political and economic environment. Some of the Landesbanken have therefore drawn the conclusion that their earnings will decline, while other Landesbanken expect that ongoing efficiency programmes which go beyond mere cost reduction measures, as well as synergy effects, will lead to significantly positive annual results.

Expected business performance of Landesbausparkassen

Saving money for the purpose of building one's own home will continue to be indispensable for solid financing of home ownership in future. Home savings and loan agreements are ideal for this purpose, especially in the current interest-rate environment, because they enable customers to "secure" an interest rate for the future. The eligibility conditions for home savings and loans have remained stable. The State rewards the long-term savings process within certain income limits by granting employees a savings allowance and a home ownership savings bonus; subsidies for private retirement pension provisions – referred to as the "Riester Housing Scheme" – provide additional impetus to the home savings and loans segment. The German Building Societies Act as amended at the end of 2015 improved lending opportunities for building societies. The volume of new business can therefore be expected to remain stable in 2017.

Management outlook

Savings Banks are facing major challenges in 2017. More than ever before, we will have to fight for regulation that respects our business model. And we will continue to work on modernising our Group internally.

Above all, however, we want to remain "Savings Banks" despite negative market interest rates. To this end, we will have to cope with the increasingly adverse effects on our earnings due to the low-interest-rate period. To increase the Savings Banks' market success, we will need a new mix of access channels and services in view of changing customer behaviour and the increasing digitalisation in the lives of our customers.

We have adopted comprehensive entrepreneurial measures to prepare ourselves for the adverse effects of the low-interest-rate period. In the next few years, net interest income will of course decline significantly. This is inevitable for highly interest-dependent institutions. However, we cannot and do not want to change our business model. Savings Banks will not suddenly immerse themselves in international capital markets or withdraw from the normal banking business.

For this reason, we will consistently pursue the approaches we already adopted in 2016: we will invest in qualitative growth, mainly in the lending business, in international business with business clients and in private banking. And we will expand our commission business. Reducing costs also includes socially acceptable downsizing of the workforce. And we will have to charge fair prices for our services, making use of the scope provided by the market.

Another major challenge will continue to be posed by changes in customer behaviour and digitalisation. We want to be the preferred financial partner of Germans, both in local branches and on the web. To this end, we will have to recalibrate the access channels to Savings Banks and the range of our services. Much more than in the past, branches will focus on providing qualified advice locally, throughout Germany. In the course of this process, we will attach even greater attention to quality.

At the same time, we will consistently work on shifting services and transactions to the web. Our objective is to be the market leader in the introduction of innovations aimed at the mass market in the banking business. All innovations will be in line with the Savings Banks Finance Group's principle of securing maximum data security and handling data with the utmost care.

All of these activities will require a transformation process in the Savings Banks, which will involve the use of more standardised processes and also a cultural change among our employees as their fields of work change. This leadership challenge will be a top priority f our institutions in 2017.

Report on material events after the reporting date

There have been no material events since the balance sheet date of 31 December 2016.

5. AGGREGATED FINANCIAL STATEMENTS

Explanatory notes on aggregation

Scope of aggregation
The aggregated balance sheet and the aggregated profit and loss account (P&L) presented by the DSGV includes the financial statements of all the Savings Banks, Landesbanken, and Landesbausparkassen.

Regardless of their legal form (legally independent entities or legally dependent units of the Landesbanken), the Landesbausparkassen are fully incorporated into the scope of aggregation.

The foreign branches of Landesbanken, as well as their domestic and foreign Group subsidiaries, and Landesbausparkassen are not taken into consideration.

Aggregation approach
The Savings Banks and Landesbanken data used in the preparation of the aggregated balance sheet were taken from the 2015 and 2016 December reports for the monthly balance sheet statistics ("Bista") of Deutsche Bundesbank. The corresponding balance sheet data of the Landesbausparkassen were taken from the respective annual reports.

The Savings Banks and Landesbanken figures used for the aggregated profit and loss (P&L) accounts of fiscal years 2015 and 2016 are based on the results of the external analysis of Savings Banks and the published German GAAP individual financial statements of the Landesbanken; the results of the external analysis of Savings Banks were reclassified in accordance with German GAAP. The Landesbausparkassen figures for both fiscal years were taken from the respective annual reports (also prepared in accordance with German GAAP).

The result of this data compilation is a non-consolidated aggregate balance sheet and a non-consolidated aggregate profit and loss account of the institutions affiliated with the institution protection scheme of the Savings Banks Finance Group. Other institutions affiliated with the Institutional Protection Scheme of the Savings Banks Finance Group include: BerlinHyp, S-Broker, DEG Deutsche Investitions- und Entwicklungsgesellschaft, Frankfurter Bankgesellschaft (Deutschland) AG, Landesbank Berlin Holding AG, Deutsche Hypothekenbank, Portigon AG, and Weberbank.

Aggregated profit and loss account of the Savings Banks Finance Group*

	2016[1] million EUR	2015 million EUR
Net interest income	**30,812**	32,627
Interest income	53,791	61,434
Interest expenses	22,979	28,807
Net commission income	**8,049**	7,588
Commission income	10,549	10,440
Commission expenses	2,500	2,852
Net income from financial transactions	**1,041**	516
Administrative expenses	**27,339**	28,050
Personnel expenses	16,163	16,772
Non-personnel expenses	11,176	11,279
Other operating income	**58**	–188
Operating result before valuation	**12,620**	12,492
Valuation result (excluding equity investments)	**–2,985**	–1,052
Operating result after valuation	**9,635**	11,441
Balance of other and extraordinary income/expenses[2]	**–4,446**	–4,830
of which: additions to the fund for general banking risks pursuant to Section 340(g) German Commercial Code[3]	–4,457	–4,504
Net income before taxes	**5,190**	6,611
Income taxes	**3,499**	3,723
Net income after taxes	**1,691**	2,888
of which net income/loss of Savings Banks after taxes	2,037	1,977
of which net income/loss of Landesbanken after taxes	–386	868
of which net income/loss of Landesbausparkassen after taxes	41	43
Return on equity[4]	in %	in %
before taxes	6.2	7.3
after taxes	4.0	4.9
Cost-income ratio	**70.4**	69.8

* Savings Banks Finance Group: 1. Savings Banks 2. Landesbanken excluding foreign branches, domestic and foreign Group subsidiaries, and excluding Landesbausparkassen (LBS), 3. LBS (legally independent LBS and legally dependent units of Landesbanken); rounding differences are possible

[1] Provisional figures from financial statements prepared in accordance with German GAAP, some of which are as yet unaudited

[2] Including the net balance of profits from the disposal of financial investments and investment securities, write-downs and write-ups on financial investments and investment securities, as well as changes in the fund for general banking risks in accordance with Section 30(g) of the German Commercial Code (additions to the fund for general banking risks with negative sign)

[3] As in the "original" P&L account under German GAAP, additions to the fund for general banking risks pursuant to Section 340(g) of the German Commercial Code are recognised as expenses that reduce net income; in the DSGV's Financial Reports until 2010, such additions were treated – in line with Deutsche Bundesbank's P&L statistics – as appropriation of profits which increased net income

[4] Savings Banks and Landesbanken only

Source: External analysis of the Savings Banks, annual reports of the Landesbanken (individual financial statements in accordance with German GAAP), DSGV/Main Office of the Landesbausparkassen, Deutsche Bundesbank.

Aggregated balance sheet of the Savings Banks Finance Group*

Assets	As at 31 Dec. 2016 million EUR	As at 31 Dec. 2015 million EUR
Cash reserve [1]	**50,869**	30,837
of which due from central banks	40,946	22,117
Treasury bills [2]	**0**	0
Other bills	**0**	0
Loans and advances to banks (MFIs)	**265,222**	294,241
Loans and advances to non-banks (non-MFIs)	**1,204,587**	1,192,957
Debt securities and other fixed-income securities	**355,061**	383,735
Equities and other non-fixed-income securities	**92,179**	91,427
Equity interests	**14,887**	14,792
Investments in affiliated undertakings	**10,150**	10,938
Trust assets	**10,146**	10,488
Equalisation claims	**0**	0
Tangible fixed assets	**12,319**	12,596
Other assets	**103,346**	115,681
Total assets	**2,118,765**	**2,157,691**

* Savings Banks Finance Group: 1. Savings Banks, 2. Landesbanken excluding foreign branches, domestic and foreign Group subsidiaries, excluding Landesbausparkassen, 3. LBS: legally independent LBS and legally dependent units of Landesbanken

[1] Cash on hand and balances held with central banks

[2] Including non-interest-bearing treasury notes and similar public-sector debt

Liabilities	As at 31 Dec. 2016 million EUR	As at 31 Dec. 2015 million EUR
Liabilities to banks (MFIs)	**371,418**	408,855
Liabilities to non-banks (non-MFIs)	**1,211,164**	1,192,943
Savings deposits	363,227	364,259
Other liabilities	847,938	828,685
Securitised liabilities	**203,340**	204,104
of which: debt securities issued	190,032	178,654
money market instruments issued	13,293	25,449
Trust liabilities	**10,146**	10,488
Write-downs on loans and securities	**3,153**	2,942
Provisions	**25,964**	25,738
Subordinated liabilities	**21,473**	22,009
Profit participation certificates	**1,957**	2,149
Equity [3]	**157,943**	152,858
Other liabilities [4]	**112,207**	135,604
Total equity and liabilities	**2,118,765**	**2,157,691**
Contingent liabilities [5]	**0**	0
Bills for collection	**3**	7
Business volume	**2,118,769**	2,157,698
Guarantees	**62,764**	61,825

[3] Dotation capital and retained earnings (including fund for general banking risks)

[4] Including special items with an equity portion

[5] From rediscounted credit bills (including own bills drawn)

Source: DSGV, Balance sheet statistics/business performance of Savings Banks, Landesbanken (excluding LBS, excluding foreign branches and excluding domestic and foreign Group subsidiaries) and Landesbausparkassen

6. GERMAN SAVINGS BANKS ASSOCIATION (DSGV)

The Deutscher Sparkassen- und Giroverband e. V. (DSGV – German Savings Banks Association) is the umbrella organisation of the Savings Banks Finance Group.

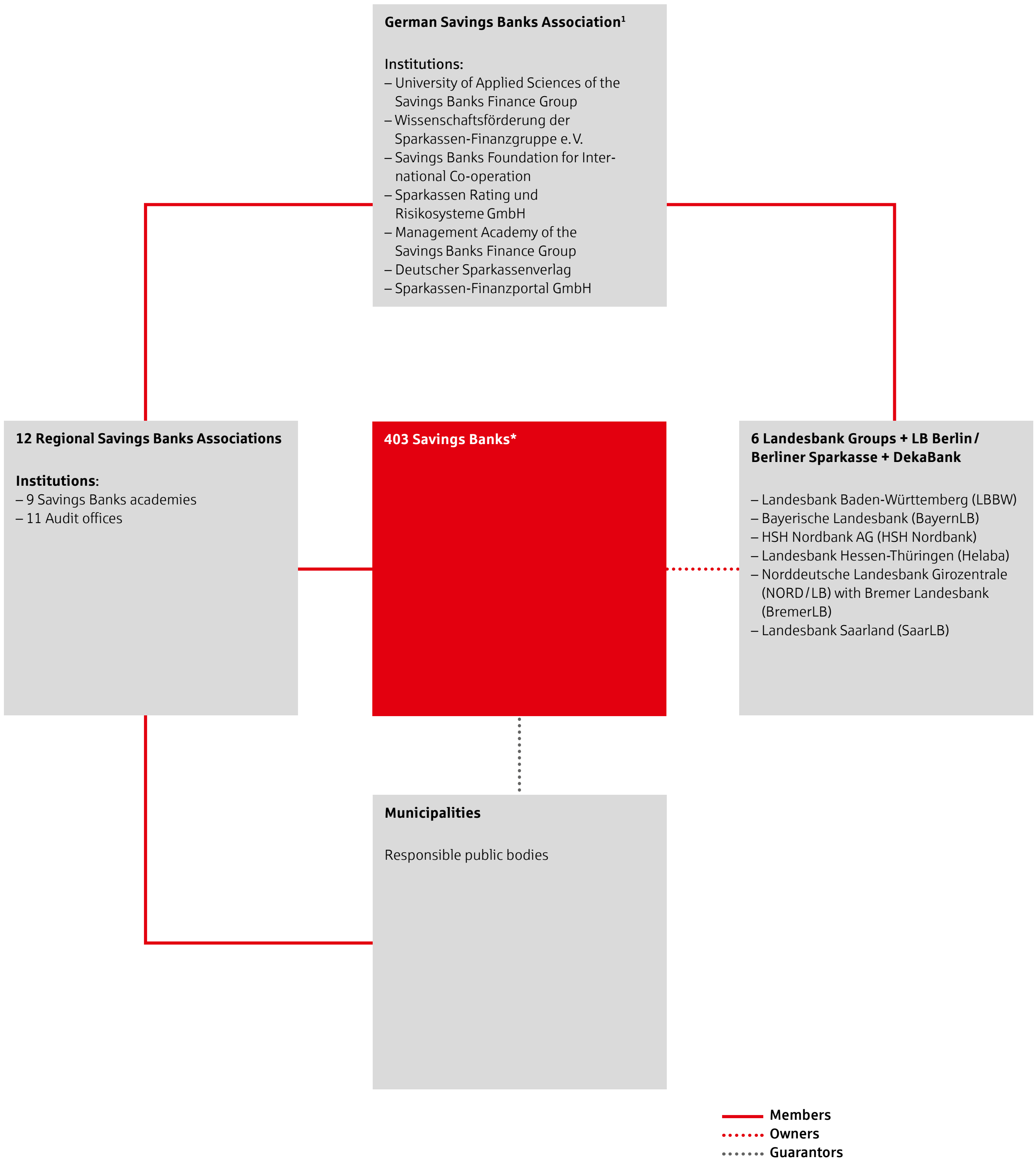
The DSGV represents the interests of all the entities associated with the Savings Banks Finance Group with regard to banking policy, the banking sector and regulation, vis-à-vis national and international institutions and the general public. In addition, the DSGV defines the strategic direction of the Savings Banks Finance Group.

To this end, its members and associated entities develop concepts in cooperation with the DSGV for a successful market approach. This comprises strategic issues in terms of the market and operations, including product development and handling, risk management and overall bank management, card and payment transactions, as well as comprehensive advisory approaches for each of the customer segments.

The DSGV also funds the central educational institutions of the Savings Banks Finance Group: the Management Academy and the University of Applied Sciences of the Savings Banks Finance Group. Other joint institutions include the Verein Wissenschaftsförderung (Research Funding Association) of the Savings Banks Finance Group, the Eberle Butschkau Foundation, as well as the Savings Banks Foundation for International Co-operation.

In addition, the DSGV manages the schemes protecting its affiliated institutions under the German Deposit Guarantee and Investor Compensation Act and the Institution Protection Scheme of the Savings Banks Finance Group, as well as the Guarantee Fund of the Girozentralen and the Guarantee Fund of the Landesbausparkassen.

Excerpt of the Savings Banks Finance Group's association structure



[1] Including Main Office of Landesbausparkassen.

* As of 31 December 2016.
393 Savings Banks as of 15 June 2017

DSGV[1]

Management

Georg Fahrenschon
President of the German Savings Banks Association

Dr Karl-Peter Schackmann-Fallis
Member of the Executive Board of the German Savings Banks Association (Department A)

Dr Joachim Schmalzl
Member of the Executive Board of the German Savings Banks Association (Department B)

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Executive Committee

Ordinary members	Deputy members
Georg Fahrenschon President of the German Savings Banks Association, Berlin **– Chairman –**	
Thomas Mang President of the Lower Saxony Savings Banks Association, Hanover	**Peter Schneider** President of the Baden-Württemberg Savings Banks Association, Stuttgart
Herbert Hans Grüntker Chairman of the Board of Landesbank Hessen-Thüringen Girozentrale, Frankfurt/Main and Erfurt	**Rainer Neske** Chairman of the Board of Landesbank Baden-Württemberg, Stuttgart/Karlsruhe/Mannheim
Helmut Schleweis Chairman of the Board of the Savings Bank of Heidelberg	**Georg Sellner** Chairman of the Board of the Savings Bank of Darmstadt
Roland Schäfer President of the Association of German Towns and Municipalities, Berlin and Mayor of the City of Bergkamen	**Professor Dr Hans-Günter Henneke** Managing member of the Executive Committee of the Association of German Counties, Berlin

[1] All data: status as of editorial deadline 22 June 2017

Management Board

Chairman of the Management Board

Georg Fahrenschon
President of the German Savings Banks Association, Berlin

Deputies to the Chairman of the Management Board (Vice-Presidents)

Thomas Mang
President of the Lower Saxony Savings Banks Association, Hanover
1st Vice-President

Herbert Hans Grüntker
Chairman of the Board of Landesbank Hessen-Thüringen Girozentrale, Frankfurt/Main and Erfurt
2nd Vice-President

Helmut Schleweis
Chairman of the Board of the Savings Bank of Heidelberg
3rd Vice-President

Roland Schäfer
Mayor of the City of Bergkamen and President of the Association of German Towns and Municipalities, Berlin
4th Vice-President

Members of the Management Board

Chairmen of Associations

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Michael Breuer
President of the Rhineland Savings Banks Association, Dusseldorf

Professor Dr Liane Buchholz
President of the Westfalen-Lippe Savings Banks Association, Münster

Dr Michael Ermrich
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Dr Johannes Evers
President of the Berlin Savings Banks Association and Chairman of the Board of Landesbank Berlin AG/Berliner Sparkasse

Gerhard Grandke
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Cornelia Hoffmann-Bethscheider
President of the Saarland Savings Banks Association, Saarbrücken

Beate Läsch-Weber
President of the Rhineland-Palatinate Savings Banks Association, Budenheim

Thomas Mang
President of the Lower Saxony Savings Banks Association, Hanover

Dr Ulrich Netzer
President of the Bavarian Savings Banks Association, Munich

Peter Schneider
President of the Baden-Württemberg Savings Banks Association, Stuttgart

Dr Harald Vogelsang
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Chairman of the Board of Norddeutsche Landesbank, Hanover / Brunswick / Magdeburg

Stefan Ermisch
Chairman of the Board of HSH Nordbank, Hamburg and Kiel

Herbert Hans Grüntker
Chairman of the Board of Landesbank Hessen-Thüringen Girozentrale, Frankfurt / Main and Erfurt

Rainer Neske
Chairman of the Board of Landesbank Baden-Württemberg, Stuttgart / Karlsruhe / Mannheim

Dr Johannes-Jörg Riegler
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Werner Severin
Chairman of the Board of Saar LB, Saarbrücken

Christian Veit
Chairman of the Board of Bremer Landesbank – Kreditanstalt Oldenburg, Bremen

National Chairman of Savings Banks board members

Helmut Schleweis
Chairman of the Board of the Savings Bank of Heidelberg

Regional Chairmen of Savings Banks board members

Götz Bormann
Chairman of the Board of the Savings Bank of Kiel

Michael Bräuer
Chairman of the Board of the Oberlausitz-Niederschlesien Savings Bank, Zittau

Carsten Claus
Chairman of the Board of the Savings Bank of Böblingen

Volker Goldmann
Chairman of the Board of the Savings Bank of Bochum

Peter Klett
Chairman of the Board of the Weser-Elbe Savings Bank, Bremerhaven

Ludwig Momann
Chairman of the Board of the Emsland Savings Bank, Meppen

Siegmar Müller
Chairman of the Board of the Germersheim-Kandel Savings Bank, Kandel

Hans-Werner Sander
Chairman of the Board of Savings Bank of Saarbrücken

Georg Sellner
Chairman of the Board of Savings Bank of Darmstadt

Walter Strohmaier
Chairman of the Board of the Niederbayern-Mitte Savings Bank, Straubing

Alexander Wüerst
Chairman of the Board of the Savings Bank of Cologne

Representatives of municipal umbrella organisations

Association of German Cities

Helmut Dedy
Managing member of the Executive Committee of the Association of German Cities, Berlin and Cologne

Dr Eva Lohse
Mayor of the City of Ludwigshafen am Rhein and
President of the Association of German Cities, Berlin and Cologne

Association of German Counties

Professor Dr Hans-Günter Henneke
Managing member of the Executive Committee of the Association of German Counties, Berlin

Bernhard Reuter
Administrator of the District of Göttingen und Vice-President of the Association of German Counties, Berlin

Association of German Towns and Municipalities

Dr Gerd Landsberg
Managing member of the Executive Committee of the Association of German Towns and Municipalities, Berlin

Roland Schäfer
Mayor of the City of Bergkamen and
President of the Association of German Towns and Municipalities, Berlin

DekaBank Deutsche Girozentrale

Michael Rüdiger
Chairman of the Board of DekaBank Deutsche Girozentrale, Berlin and Frankfurt/Main

Chairman of the Building Societies Conference

Dr Franz Wirnhier
Chairman of the Board of LBS Bayerische Landesbausparkasse, Munich

Other members of the Management Board of DSGV e.V.

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Member of the Executive Board of DSGV, Division A, Berlin

Dr Joachim Schmalzl
Member of the Executive Board of DSGV, Division B, Berlin

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