Bausparkasse Schwäbisch Hall AG

Financial Report 2018

Genossenschaftliche FinanzGruppe
Volksbanken Raiffeisenbanken

Schwäbisch Hall
Auf diese Steine können Sie bauen

At a glance

Bausparkasse Schwäbisch Hall AG	2018	2017
New business		
Bausparen (presented)		
Number	554,285	557,508
Bauspar sum (in € billion)	29.70	27.95
Housing financing (total, in € billion)	15.17	14.61
Contracted business		
Bauspar sum (honoured, in € billion)	305.70	298.96
Contracts (in millions)	8.34	8.46
No. of customers (in millions)	7.24	7.34

Schwäbisch Hall Group non-domestic incl. joint ventures	2018	2017
New business		
Bausparen (presented, in € billion)	12.04	10.48
Contracted business		
Bauspar sum (in € billion)	62.09	59.68
Contracts (in millions)	3.40	3.27
No. of customers (in millions)	3.02	2.94

Profit figures of the Schwäbisch Hall Group pursuant to the IFRS in € million	2018	2017
Profit/loss before taxes	295	334
Profit	212	247
Balance sheet total	71,667	68,337
Equity	5,157	5,103

Regulatory indicators of the Bausparkasse Schwäbisch Hall Group in %	2018	2017
Common Equity Tier 1 capital ratio	30.4	28.6
Total capital ratio	30.4	28.6
Leverage ratio	5.9	5.6

Human Resources	2018	2017
Employees (number of persons) Schwäbisch Hall Group domestic [1]	3,167	3,174
Trainees and apprentices	216	220
Employees (based on full-time equivalents)	2,882	3,040

[1] As at 31 December including permanent employees but not including trainees and apprentices

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Board of Managing Directors of Bausparkasse Schwäbisch Hall AG: Peter Magel, Reinhard Klein (Chief Executive Officer), Jürgen Gießler and Alexander Lichtenberg (from left to right)

DEAR READERS,

Our business is geared towards providing people with solid financing for their real estate, ensuring that they can realise their dream of owning and settling into their own home.

We succeeded in doing this once again over the past financial year. We have impressively confirmed our position as Germany's leading provider for Bausparen (contractual savings for housing) and housing financing, thanks in no small part to the collaboration with our partners in the Genossenschaftliche FinanzGruppe. New *Bauspar* business increased by 6.3 per cent to €29.7 billion; in housing financing we concluded a contract volume of €15.2 billion, which equates to an increase of 3.6 per cent.

This success reflects people's wish for affordable housing, a subject of debate that is currently raging in Germany and is likely to continue in the coming years. After all, living space is scarce – demand outstrips supply every year many times over, while there is already a deficit of around one million homes. Good financing products are the ideal tools to fix this issue. Given these general conditions, we are thoroughly optimistic about the ongoing financial year.

We are also satisfied with the performance of net profit, since even in light of the current low interest environment, we have significantly exceeded our own expectations, with net profit of €295 million.

Nevertheless, over the past year, we have also invested heavily in our future and plan to do this in 2019 as well. Our buzzwords for investment are digitalisation, IT technology and process optimisation.

The strong positive impact we had in 2018 would not have been possible without the tireless commitment and motivation of our employees. We would like to sincerely thank all of our employees for their dedication.

Sincerely,

Reinhard Klein (Chief Executive Officer)

Jürgen Gießler

Alexander Lichtenberg

Peter Magel

Combined management report

On the following pages we report on how the Schwäbisch Hall Group has developed over the 2018 financial year. The consolidated financial statements cover Bausparkasse Schwäbisch Hall AG, Schwäbisch Hall Kreditservice GmbH and the Hungarian Bausparkasse FLK as a subgroup. The joint venture Bausparkassen in China, Slovakia and the Czech Republic have been included in the consolidated financial statements under the equity method. The accounting was performed in accordance with the international accounting standard IFRS.

Basic information concerning the Group

The management report of Bausparkasse Schwäbisch Hall AG and the Group management report are combined pursuant to the German Accounting Standard (GAS) 20. Accordingly, as well as the Bausparkasse Schwäbisch Hall Group which reports in accordance with the International Financial Reporting Standards (IFRS), the parent company Bausparkasse Schwäbisch Hall AG is also included in this management report, with disclosures on the basis of the German Commercial Code (HGB). The annual financial statements of Bausparkasse Schwäbisch Hall AG prepared according to the German Commercial Code and the combined management report are announced at the same time in the German Federal Gazette (*Bundesanzeiger*).

BUSINESS

Schwäbisch Hall Group (SHG) is a socially responsible real estate financing provider for building society operations and a member of the DZ BANK Group. As a subsidiary partner of the cooperative banks, SHG primarily supports the vision of the DZ BANK Group of jointly focusing on the cooperative banks so as to enable Genossenschaftliche FinanzGruppe (GFG) to consolidate its position as a leading all-round financing provider in Germany on a long-term basis. In Germany, together with the cooperative banks SHG offers tailored concepts for private future provision, asset building and home ownership as well as housing financing from a single source. The customer service employees at Schwäbisch Hall as well as more than 3,300 sales force experts ensure more than 7.2 million customers receive qualified advice and optimal customer service.

Non-domestically, Schwäbisch Hall is represented in China, Luxembourg, Slovakia, the Czech Republic and Hungary. Its foreign affiliates – excluding Schwäbisch Hall's Luxembourg branch – together have more than 3.0 million customers.

GENOSSENSCHAFTLICHE FINANZGRUPPE

Bausparkasse Schwäbisch Hall AG is part of the DZ BANK Group and firmly embedded in Genossenschaftliche FinanzGruppe cooperative banks. The DZ BANK Group's strategic focus is line with its guiding principle of operating as a "group-oriented central bank and all-round finance group". Its business activities concentrate on the cooperative banks and their customers in their domestic market. Together with specialist institutions such as Bausparkasse Schwäbisch Hall, the cooperative banks are a strong and effective team: Genossenschaftliche FinanzGruppe cooperative banks. GFG's business model is based on the values of solidarity, partnership and support for their members and customers. From old-age provision, real estate and housing financing to insurance and funds, it offers a comprehensive range of services. With its approximately 900 cooperative banks, their more than 11,000 banking offices and 30 million customers, it is the leading all-round finance partner in Germany and intends to further consolidate this position.

Bausparkasse Schwäbisch Hall is a member of the protection scheme set up by the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (National Association of German Cooperative Banks – BVR), Berlin. It has concluded a profit and loss transfer agreement with DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main.

ARCHITECTURE AND BUSINESS MODEL OF THE SCHWÄBISCH HALL GROUP

Architecture of the Schwäbisch Hall Group

The Bausparkasse Schwäbisch Hall Group mainly consists of its parent company, Bausparkasse Schwäbisch Hall AG. Except where expressly stated otherwise, the information provided in this combined management report refers to the Bausparkasse Schwäbisch Hall Group as well as Bausparkasse Schwäbisch Hall AG. The Schwäbisch Hall Group includes Bausparkasse Schwäbisch Hall AG and its subsidiaries and affiliates in Germany and other countries. Bausparkasse Schwäbisch Hall AG pursues *Bauspar* (contractual savings and loans for housing) and housing financing business in Germany and manages the domestic and foreign activities of its subsidiaries and affiliates.

Its domestic subsidiaries provide services for SHG.

Its largest subsidiary is Schwäbisch Hall Kreditservice GmbH (SHK), which handles new and existing business on behalf of the Bausparkasse Schwäbisch Hall AG. With a portfolio of more than ten million contracts and approximately 1,750 employees, together with its subsidiary VR Kreditservice GmbH, Hamburg, SHK is a market leader in the field of standardised processing of loans and *Bauspar* products.

The responsibilities of Schwäbisch Hall Facility Management GmbH (SHF) include building management and operation of the Group's head office in Schwäbisch Hall. It also serves further external customers in the Schwäbisch Hall region as well as GFG customers. Schwäbisch Hall Training GmbH (SHT) provides training and personnel development activities for the Schwäbisch Hall Group and other GFG institutions.

The Group's foreign subsidiaries and equity investments in China, Slovakia, the Czech Republic and Hungary are *Bausparkassen* (home savings and loan companies) which pursue *Bauspar* and housing financing business in their domestic markets in accordance with the German model.

Segments of the Schwäbisch Hall Group

The Schwäbisch Hall Group consists of the following three segments: *Bausparen* Domestic, *Bausparen* Non-domestic and *Bauspar* and Loan Processing. These segments serve as the basis for the Group's segment reporting pursuant to IFRS 8. Their development is separately presented in this annual report.

The following companies are included in the consolidated financial statements:

Segments of the Schwäbisch Hall Group

BAUSPAREN DOMESTIC	*BAUSPAREN* NON-DOMESTIC	*BAUSPAR* AND LOAN PROCESSING
Bausparkasse Schwäbisch Hall AG, Schwäbisch Hall (parent company) **with the core business segments:** – *Bausparen* – Housing Financing **and the business segment** – Cross-Selling **Specialised securities fund** UIN Union Investment Institutional, Frankfurt/Main, (UIN Fund No. 817)	**Fundamenta-Lakáskassza Lakás-takarékpénztár Zrt., Budapest, Hungary (as subgroup)** **Joint venture *Bausparkassen*:** – Českomoravská stavební spořitelna, a. s., Prague, Czech Republic (ČMSS) – Prvá stavebná sporiteľňa, a. s., Bratislava, Slovakia (PSS) – Sino-German Bausparkasse Co. Ltd., Tianjin, China (SGB)	**Schwäbisch Hall Kreditservice GmbH (SHK), Schwäbisch Hall**

The ***Bausparen* Domestic segment** comprises the *Bausparen* and Housing Financing core business segments as well as the Cross-Selling business segment.

The *Bausparen* core business segment consists of traditional *Bauspar* business in Germany as well as Schwäbisch Hall's Luxembourg branch.

The Housing Financing core business segment comprises Schwäbisch Hall's building loan business (immediate financing and *Bauspar* loans) as well as brokerage of real estate loans for cooperative banks. As the DZ BANK Group's centre of excellence for retail property finance, Schwäbisch Hall helps the local cooperative banks to safeguard and expand their market position in the field of housing financing in a tough competitive environment.

In the Cross-Selling business segment, the *Bausparkasse* provides its sales force with a product range which is attuned to the needs of its target groups. The core products in this business segment are the real estate-related insurance policies of R+V Versicherung – which likewise belongs to GFG – as well as pension products offered by the cooperative banks. This is rounded off with further products such as Union Investment's fund solutions for government-subsidised old-age provision.

The *Bausparen* Domestic segment also includes the specialised securities fund UIN Fund No. 817, established for Schwäbisch Hall's own investments.

FLK (*Bausparkasse*) is a subsidiary which is incorporated in the ***Bausparen* Non-domestic segment**. The joint venture *Bausparkassen* ČMSS, PSS and SGB have been included in the consolidated financial statements in accordance with the equity method. All of these companies pursue collective *Bausparen* in their domestic markets in line with the German model.

In its ***Bauspar* and Loan Processing segment,** SHK handles new and existing business on behalf of the *Bausparkasse* and is responsible for core IT support services. High-quality customer support as well as effective and efficient processing (optimal cost structures) for *Bauspar* and lending business are a key competitive advantage. Together with expertise in the area of IT and its permanent ongoing development, this represents a core aspect of the commercial success of SHG.

Business model

SHG's business model is true to DZ BANK's vision of itself focusing on the cooperative banks as their subsidiary partner, so as to enable GFG to consolidate its position as a leading, responsible, all-round finance provider. As GFG's socially responsible real estate financing provider for private customers, SHG pursues the goal of market leadership in Germany and the profitable development of its business on the basis of competitive products and processes in its core business segment of *Bausparen*. With its strategic target vision "HORIZONT 2025", Schwäbisch Hall has defined the framework for a process of transformation: from being a "*Bausparkasse* with a housing financing business segment" to becoming a leading real estate financing business with *Bausparen* and Housing Financing as its two core business segments. In its Housing Financing core business segment, Schwäbisch Hall operates as a partner of the cooperative banks. It concentrates on traditional *Bauspar* loans, its own *Bauspar*-backed immediate financing products including Riester-subsidised financing (*Wohn-Riester* home ownership pensions), building loans and brokerage of real estate loans for the cooperative banks. In its *Bausparen* core business segment, Schwäbisch Hall's product range is to undergo further development in order to improve product profitability. As well as adjustments to the traditional range of *Bauspar* products, product innovations are regularly examined. The two core business segments reinforce one another and jointly contribute to the growth path for real estate financing which Schwäbisch Hall has embarked upon, regardless of interest rates. In case of low interest rates, demand for non-collective building loans is high. But if interest rates rise, collective *Bauspar* loans are increasingly popular. Its *Bausparen* and Housing Financing core business segments enable Schwäbisch Hall to operate as a subsidiary partner of the cooperative banks and thus generate genuine added value here as a member of the cooperative financial network.

Factors influencing the core business segments

Bausparen is at the core of Bausparkasse Schwäbisch Hall's product range. It is based on an earmarked advance saving scheme which is strictly regulated and subject to strict statutory safety standards. At the heart of this model is the closed loop of payments made by *Bauspar* customers into savings accounts and the repayments made by borrowers which provide the funds that serve as a basis for housing financing. This closed system is independent of the situation on the capital markets in immediate terms. The development of capital market interest rates indirectly affects Schwäbisch Hall's business situation and financial performance: firstly, since the rate of interest for potential financing alternatives influences the development of new *Bauspar* loan business, and secondly because the rate of interest achievable on the capital market for the investment of free funds has a significant impact on the net interest income trend.

The relevant regulatory environment is another key factor. This covers not only the statutory framework for *Bausparen* and housing financing specifically but also systems for the promotion of asset building – such as within the framework of private old-age provision (*Wohn-Riester*), housing construction as well as the refurbishment and upkeep of residential buildings.

Key performance indicators

The KPIs for profit, volume, productivity and capital adequacy, as well as the economic return on risk-adjusted capital (RORAC), are outlined below for SHG:

- **Profitability figures pursuant to the International Financial Reporting Standards (IFRS):**
  The profitability figures (in particular, loss allowances in lending business, net profit before taxes and net profit) are presented in the chapter "Financial performance of the Group and the segments" in this Group management report as well as in the loss allowances section (note 16) of the notes to the consolidated financial statements.

- **IFRS volume figures:**
  Equity and the balance sheet totals are the key indicators for volume figures. These are included in the "Group financial position" chapter in this Group management report as well as in the consolidated financial statements (balance sheet as of 31 December 2018) and note 48 of the consolidated financial statements.

- **Productivity:**
  The cost/income ratio is one of the key productivity indicators. This indicator is provided in the "Financial performance of the Group and the segments" chapter of this Group management report.

- **Capital adequacy:**
  The capital adequacy indicators (total capital ratio, Tier 1 capital ratio and Common Equity Tier 1 capital ratio) in line with regulatory requirements are stated in the "Regulatory indicators pursuant to the CRR" chapter of this Group management report.

- **Economic RORAC:**
  The economic return on risk-adjusted capital (RORAC) is a risk-adjusted performance measure. In the reporting period, it reflects the ratio of net profit before taxes to the economic risk capital figure. The economic RORAC thus expresses the rate of interest on committed risk capital. This indicator is provided in the "Financial performance of the Group and the segments" chapter of this Group management report.

The envisaged trend for SHG's key performance indicators is provided in the Outlook section of this annual report.

Economic report

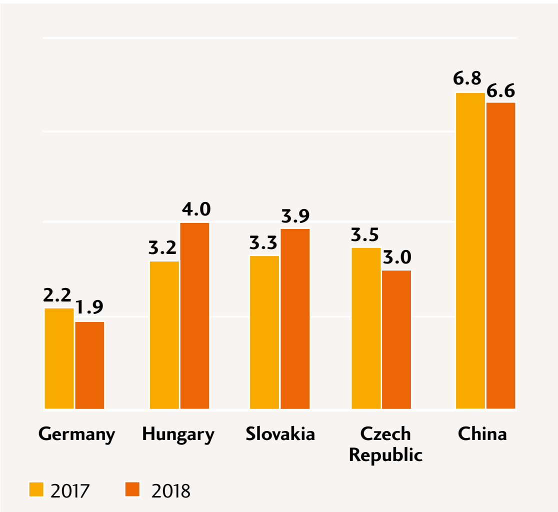
DEVELOPMENT OF OUTLINE CONDITIONS

Overall economic environment

In 2018, the world economy maintained the considerable pace of growth seen in the previous year. For 2018, the International Monetary Fund (IMF) expects global gross domestic product (GDP) growth of approximately 3.7 per cent. In view of the generally expansionary financial policies in most countries, the domestic economy remained the key factor. Uncertainty over the future world trade order had a negative impact.

In the markets of relevance for SHG (SH markets), gross domestic product developed as follows:

GDP development in SH markets
in %



The German economy once again maintained a high level of activity in 2018. However, the upturn in the German economy which has been intact for the last nine years suffered a loss of momentum in 2018. On the one hand, this reflected unfavourable external parameters and significant production-related problems in the automotive industry. On the other hand, capacity constraints resulted in a decline in the pace of expansion in terms of potential growth. The shortfalls in production shaped by temporary factors were therefore only made up for to a limited extent. The upturn continues to be underpinned by relatively broad foundations. In particular, internal demand has increased robustly due to continuing employment growth, wage rises and brisk construction activity. The situation on the labour market continued to improve; the number of persons in gainful employment reached a new all-time high in December 2018 at 44.9 million, taking the season into account. At the end of 2018, at 2.21 million (a rate of 4.9 per cent) the number of registered unemployed had reached at its lowest level since German reunification in 1990. The rate of GDP growth declined to 1.6 per cent, compared to 2.2 per cent in 2017.

According to data from the European Bank for Reconstruction and Development (EBRD), economic activity in eastern Europe picked up by 4.3 per cent in 2018, compared to 3.3 per cent in the previous year. In the view of the EBRD, this trend was driven by consumption growth on the part of private households as well as stronger investment. Negative effects due to the lack of qualified employees only slightly curbed GDP growth.

In Hungary, economic growth remained strong in 2018. In the view of the Austrian Economic Chambers (WKO), this trend is mainly attributable to the increase in EU development funds for the period from 2014 to 2020 and the resulting public contracts in the construction sector in particular. Cohesion funding provided by Brussels in the period from 2015 to 2017 represented more than 50 per cent of all government investments. As well as industry, the country's economy is also being increasingly buoyed by Hungarian households' growing purchasing power. Tax relief for families, the statutorily prescribed reduction in operating costs and government intervention in relation to foreign-currency loans have boosted private consumption (4.0 per cent). The rating agency Fitch has confirmed its "BBB–" credit rating for Hungary, likewise with a positive outlook.

Slovakia's economic growth continued to pick up in 2018. Car exports in particular resulted in a continuing high level of momentum. However, increasing government and corporate investments and higher wages in the public and private sectors also buoyed economic activity. The jobless rate fell to an all-time low and inflation picked up to 2.5 per cent. The lack of qualified employees proved to be an impediment to growth. The rating agency Moody's has confirmed Slovakia's "A2" credit rating, with a positive outlook.

In the Czech Republic, the economic upturn weakened in 2018. The successful Czech export sector was affected by the slightly weaker pace of demand in its key target markets. In addition, higher unit labour costs, the appreciation of the Czech crown and declining economic activity in western Europe had a negative impact. The bottlenecks on the labour market were also a major problem. Many companies were operating at full capacity and were unable to hire any new personnel. Due to the inflationary pressure, the Czech national bank raised its key interest rate five times in 2018. Private households' consumption remained the key driving force for the economy. Companies' high volume of investment likewise boosted economic activity.

In China, with a growth rate of 6.6 per cent in 2018 the pace of economic expansion fell to its lowest level since 2009. The collapse on the Chinese stock markets also had a negative impact on consumers. Experts do not consider the slowdown of the economy to be problematic. They are convinced that the reduction of debt and financial risks has played a particularly important role in this economic slowdown. The influence of China's traditional growth drivers continued to decline in 2018. This is attributable to the changeover from manufacturing industry to the service sector, from exports to imports and from high-speed growth to high-quality growth.

Financial markets and interest rates

In bringing to a close its trillion-euro bond-purchasing programme at the turn of the year, the European Central Bank (ECB) took a further step towards the normalisation of its monetary policy. From October onwards, the ECB initially halved its monthly bond-buying activities to €15 billion before terminating them entirely in December. However, the ECB intends to continue to reinvest the proceeds from maturing bonds for "an extended period of time". On the other hand, the ECB left its key interest rate at 0.0 per cent and its deposit rate for commercial banks which park surplus liquidity with the central bank at – 0.4 per cent. It also emphasised that, in principle, all of its monetary instruments might be adjusted if the inflation outlook were to necessitate this, with its bond-purchasing programme remaining one of the instruments available to the ECB.

Consumer prices in the Eurozone picked up by 1.7 per cent in 2018. The inflation rate was thus higher than the previous year's level of 1.4 per cent but still fell clearly short of the ECB's 2.0 per cent target.

A persistently low interest rate has a particularly strong impact on *Bausparkassen* and an extraordinarily negative effect on their net interest income, a key earnings component.

In 2018, the yields on the bond market which influence the market interest rate for real estate loans remained at a very low level in historical terms, despite a slight temporary rise at the start of the year. At the end of 2018, the German Bund with a 10-year maturity was yielding 0.25 per cent, compared to 0.47 per cent at the end of 2017.

Housing construction activity

The upward trend intact since 2010 for private housing construction in Germany continued in 2018, in line with expectations. A significant investment backlog for housing construction is continuing to stimulate new construction activity. However, with an estimated 300,000 housing units completed in 2018 (Central Association of German Construction Companies), the German government's target of 375,000 homes was clearly missed. Construction of apartments was the key factor driving this trend. This area of construction experienced growth due to the influx into the metropolitan areas which offer jobs and university places. In this segment, approximately 138,000 housing units represented a growth rate of 12 per cent by comparison with 2017. In the period from January to September 2018, the construction of a total of 262,800 homes was approved. This was 2.3 per cent or approximately 6,000 construction permits more than in the same period in the previous year. The number of permits for apartments thus reached its highest level in two decades. At approximately 107,000 housing units, the completion rates for detached and semi-detached houses were roughly in line with the previous year's level.

According to the Hungarian statistics office, with 6,517 housing units the number of homes completed in Hungary in the first half of 2018 was more than 30 per cent higher than the equivalent figure for the first half of 2017. This trend is partly attributable to the CSOK home-buying subsidy programme launched by the government. Families with three children receive a government subsidy equivalent to approximately €32,400 when they construct or purchase a home and can obtain a bank loan with a favourable interest rate in the same amount for the purpose of financing. In the period up to September 2018, according to the Hungarian government around 84,000 applications were submitted for aid under this programme. Moreover, in the period from 2016 to 2019 the rate of value-added tax on new residential properties was reduced from 27 per cent to 5 per cent. Initial warning signs on the housing market were apparent towards the end of the year. In Budapest, due to the rise in prices the average period required for the sale of a home increased significantly.

The construction industry in Slovakia enjoyed strong growth in 2018. While the number of completed homes had already increased by 8 per cent, to almost 17,000 in 2017, in the first half of 2018, 18 per cent more homes were handed over to their new owners than in the same period in the previous year. As well as the country's capital, Bratislava, where several new districts were built, housing construction was concentrated in the Nitra region. According to estimates of the European market research network for the housing sector (EUROCONSTRUCT), 18,300 housing units were completed in 2018, significantly more than in the previous year.

The Czech Republic also experienced strong housing construction growth in 2018. According to EUROCONSTRUCT estimates, more than 30,000 homes were completed in 2018. Many construction firms were operating at full capacity, and the first few firms were forced to decline or else postpone projects. In the first half of 2018, throughout the country almost 15,000 homes were completed – 17 per cent more than in the same period in the previous year. Persistently low mortgage interest rates combined with strong income growth resulted in a strong rise in demand for home ownership. While purchase prices rose faster than wages, demand outstripped supply. According to the country's statistics office, central Bohemia – the region surrounding Prague – is currently experiencing the highest volume of construction activity, since prices in the capital are no longer affordable for many families.

For many years now, the Chinese real estate sector has only known one direction: upward. The key factor in 2018 was the strong rate of housing construction growth as a result of the continuing trend of urbanisation. In the first seven months of 2018, the volume of real estate investments realised by Chinese property developers once again picked up strongly, by 10.2 per cent to almost 6.6 trillion RMB (US$963 billion). While the construction of office and retail space declined, housing construction increased by 14.2 per cent. As in 2017, small and medium-size cities in particular enjoyed dynamic growth. On the other hand, in the major cities and provincial capitals various measures implemented by the local authorities – such as higher down payments – dampened the rate of sales growth. Demand for new homes declined accordingly. For instance, according to the China Index Academy, in the first half of 2018, the number of homes sold fell by 37.6 per cent in Beijing and by 19.2 per cent in Shanghai by comparison with the same period in the previous year.

Amendments to regulatory framework conditions for *Bausparkassen*

The German Real Property Creditworthiness Review Guidelines Ordinance (ImmoKWPLV) came into effect on 1 May 2018. This ordinance prescribes specific conditions for consumer loans. ImmoKWPLV provides lenders with interpretive guidelines on the requirements of the Mortgage Credit Directive regarding consumer property loan agreements. However, ImmoKWPLV is not intended to cover every aspect of the creditworthiness review process.

The new ordinance focuses on the following core topics:

- **Probability requirements**
  In Section 3 (2) of ImmoKWPLV, the legislator clarifies that the forecast period is always the entire loan term. In case of the very long forecast periods for real estate financing, the credit institution may also refer to its own empirical data.

- **Creditworthiness review requirements**
  The lawmaker clarifies here that real estate loans may also be granted to older consumers, provided that they are able to repay the principal out of their income (during their lifetime). A probability of survival up to the final instalment is thus not required.

  With regard to positive trends, the lawmaker likewise clarifies that probable developments such as a temporary employment contract becoming permanent, a promotion or a parent returning to work following parental leave may also be taken into consideration.

- **Specific provision in case of replacement of existing housing financing**
  If the creditworthiness review implemented following an application for a replacement loan establishes that the borrower is not creditworthy on the basis of the above criteria, lending may nonetheless be compatible with the requirements of this ordinance where the customer has made principal repayments to his previous credit institution without any interruptions.

  This is likewise a useful clarification on the part of the legislator, since there was previously considerable uncertainty on how to handle borrowers who apply to another credit institution for a replacement loan following the expiry of the initial fixed interest-rate period.

In October 2018, the Hungarian parliament surprisingly passed a law abolishing the government aid for *Bauspar* contracts which had been introduced in 1996. However, the Hungarian Bausparkassen Act (BauSparkG) and the aid for contracts already signed were unaffected by this change in the law. Before their parliament's decision passed into law, many Hungarians therefore concluded *Bauspar* contracts, thus securing the 30 per cent government aid. Savers paying in a monthly amount of Ft20,000 (approximately €63) were able to obtain the maximum annual subsidy amount of Ft72,000 (approximately €226). Upon expiry of the term of the agreement after a period of between four and ten years, savers can not only use the available funds to purchase real estate but also to cover expenses for renovation or repairs. According to data provided by the Hungarian national bank, the *Bauspar* volume had increased from Ft488 billion in 2012 to Ft798 billion by the end of 2017. In the same period, the value of *Bauspar* loans increased from Ft111 to Ft356 billion.

BUSINESS TREND FOR THE GROUP AND THE SEGMENTS

Group

The key trends of the past few years – the low interest rate, the high level of regulatory activity and rapid technological change – remained intact in 2018. In this challenging environment, SHG expanded its new business in its *Bausparen* Domestic and *Bausparen* Non-domestic segments. In its *Bausparen* Domestic segment, in its *Bausparen* and Housing Financing core business segments as well as its Cross-Selling business segment, Bausparkasse Schwäbisch Hall achieved an overall sales performance of €46.1 billion, a growth rate of 3.7 per cent. In its *Bausparen* Non-domestic segment, FLK reached record levels with a new business volume of €3.6 billion for *Bausparen* and €410 million for Housing Financing. In the view of the management board, SHG has thus achieved a strong sales performance in overall terms.

Bausparen Domestic segment

The business performance of the *Bausparen* Domestic segment is differentiated in terms of the *Bausparen* and Housing Financing core business segments as well as the Cross-Selling business segment.

Bausparen core business segment

Schwäbisch Hall has clearly maintained its position as the number 1 *Bausparkasse* in Germany. Its market share for new business honoured reached 30.6 per cent and thus once again exceeded the 30 per cent mark (2017: 30.9 per cent). As of the end of 2018, Bausparkasse Schwäbisch Hall had approximately 7.2 million customers (2017: 7.3 million), with an honoured stock of contracts amounting to 8.3 million contracts (2017: 8.5 million).

With a volume of €29.7 billion, new *Bauspar* business in Germany has thus increased by 6.3 per cent year-on-year (€28.0 billion). With 554,285 contracts concluded, this corresponds to a decrease of 0.6 per cent by comparison with the equivalent figure for 2017 (557,508). The average *Bauspar* sum for contracts newly concluded amounted to €53,583 (2017: €50,136) and thus clearly exceeded the previous year's value. This is attributable to the continuing low interest-rate phase.

The age structure of *Bauspar* customers who concluded new contracts in the year under review is as follows:

	in %
under 20 years old	7.3
20 to 25 years old	8.1
25 to 30 years old	10.6
30 to 40 years old	20.9
40 to 50 years old	18.1
50 to 60 years old	19.2
60 years old or more	15.8

In the 2018 financial year, 64,000 contracts were concluded at Schwäbisch Hall within the scope of subsidised old-age provision *Wohn-Riester* (home ownership pension). Schwäbisch Hall's portfolio thus now includes more than 678,000 *Wohn-Riester* contracts.

The volume of *Bauspar* deposits increased by €3.3 billion or 5.7 per cent in 2018 to €60.6 billion. This resulted from the high volume of savings deposits received and a proportionately low allocation volume on account of the low interest rate.

The *Bauspar* sum for the stock of contracts increased by 2.3 per cent, from €299.0 billion in late 2017 to €305.7 billion as of the end of 2018. The average *Bauspar* sum for the stock of contracts increased from €35,329 at the end of 2017 to €36,672 at the end of 2018, which corresponds to a growth rate of 3.8 per cent. Additions to the allocation fund increased slightly, by €10 million to €11.1 billion.

355,026 *Bauspar* contracts (2017: 374,146) were allocated in 2018. The allocated *Bauspar* volume was at €9.1 billion, 6.4 per cent lower than the previous year's level of €9.7 billion. The volume of loan amounts provided after allocation cancellations and loan waivers amounted to €5.7 billion (2017: €6.0 billion).

Housing Financing core business segment

In its Housing Financing business segment, Schwäbisch Hall once again achieved a record new business volume in 2018. The brokerage of the company's own suspended repayment financing, interest-only loans (€6.0 billion) and brokerage of *Fuchs* building loans (€0.8 billion) accounted for the largest shares of this volume of €15.2 billion (2017: €14.6 billion). In addition, financing schemes were brokered for GFG institutions with a volume of €6.5 billion. Schwäbisch Hall *Bauspar* loans and bridging loans accounted for a further €1.9 billion. These figures do not include pre-financing loan business with the cooperative banks, which is backed by a *Bauspar* contract, which amounted to €6.8 billion (2017: €6.6 billion). The continuing dynamic trend for new housing financing business has resulted not only from the favourable outline conditions due to the increased level of demand for residential properties but also from the strong relationship with the company's GFG partner banks. At the end of the year, the total volume of current building loans (calculated according to the German Commercial Code) was €43.8 billion and thus approximately 10.7 per cent higher than at the end of 2017 (€39.5 billion). Of this amount, €2.4 billion related to *Bauspar* loans (– 5.2 per cent), €39.1 billion to advance financing loans and bridging loans (+ 11.4 per cent) and €2.3 billion (17.9 per cent) to other building loans.

Cross-Selling business segment

In 2018, with a total volume of €1.3 billion (2017: €1.9 billion) Cross-Selling product sales fell significantly short of the previous year's level (– 34.4 per cent). The overall volume does not include the volume of term life insurance policies brokered in connection with building loans, which remained virtually unchanged at approximately €761 million.

Within the scope of its sales partnership, the sales force of Schwäbisch Hall brokered around 117,000 financing and investment products for the company's cooperative partner institutions (– 16.1 per cent compared with 2017).

Bausparen **Non-domestic segment**

Outlook

The Group's *Bausparkassen* outside Germany likewise held their own as market leaders in a difficult environment. Overall, the foreign *Bausparkassen* included in Schwäbisch Hall's consolidated financial statements newly concluded 628,509 contracts in 2018, compared with 546,352 in 2017. The average *Bauspar* sum for these newly concluded contracts was €19,200 and thus matched the previous year's level. The new business volume increased significantly year-on-year and amounted to €12.0 billion (2017: €10.5 billion). The companies' stock of contracts within the scope of their foreign business increased slightly at the end of 2018 to 3.4 million (2017: 3.3 million contracts); the *Bauspar* sum rose to €62.1 billion (2017: €59.7 billion), a growth rate of 4.8 per cent.

Except where otherwise indicated, the percentage deviations have been calculated on the basis of the respective national currency.

Hungary

With 273,900 contracts concluded and a *Bauspar* sum of around €3.6 billion, FLK's new business in Hungary in 2018 clearly exceeded the figures for the previous year (200,700 contracts, *Bauspar* sum: €2.6 billion). This also reflected the announcement of the abolition of the house-building premium for new *Bauspar* contracts in mid-October. Many Hungarians made the most of the period until this decision passed into law and concluded a bonus-carrying *Bauspar* contract. At the end of 2018, FLK's market share of new business in Hungary amounted to approximately 50 per cent and thus matched the previous year's level. At €536 million, incoming savings funds clearly exceeded the previous year's figure of €484 million (14.8 per cent). *Bauspar* deposits rose by 15.4 per cent to €1.6 billion (2017: €1.4 billion). The volume of *Bauspar* loans granted increased by 12.5 per cent on the previous year (€151 million) and amounted to €164 million. Overall, FLK's stock of housing financing loans amounted to €1.3 billion at the end of the year and was thus 19.1 per cent higher than the previous year's volume of €1.1 billion. In 2018, FLK granted approximately 15.9 per cent of all of the housing loans provided by Hungarian banks.

Slovakia

With a total of 112,225 *Bauspar* contracts concluded (2017: 144,300), with an overall *Bauspar* sum of €2.0 billion (2017: €2.8 billion), PSS maintained its strong position in the Slovak housing financing market. Incoming savings funds amounted to €639 million, compared to €662 million in the previous year. The volume of *Bauspar* deposits increased from €2.7 billion to €2.8 billion (+1.9 per cent). *Bauspar* loans reached a total volume of €174 million, which represents a decline of 11.9 per cent on the previous year's figure of €197 million. PSS fared well in 2018 with a product offered over the Internet (online tariff). The number of online contracts sold (2018: 50,600; 2017: 53,000) and the contract volume of €703 million (2017: €734 million) both developed in line with expectations. Moreover, in numerical terms more than 45 per cent of contracts were concluded over the Internet. At the end of the past year, PSS's portfolio included housing financing loans with a total volume of €2.3 billion. Its overall stock of housing financing loans was thus 3.1 per cent higher than in the previous year.

Czech Republic

In 2018, ČMSS was once again the largest *Bausparkasse* outside of German-speaking countries and the market leader in the Czech Republic, with a market share of approximately 33 per cent. The number of *Bauspar* contracts concluded in 2018 was at 174,700 contracts significantly higher than in the previous year (2017: 152,100). The *Bauspar* sum for new business amounted to €2.8 billion (2017: €2.4 billion). The new business volume realised was thus 20.5 per cent higher than the previous year's level. Incoming savings funds amounted to €0.9 billion, which corresponds to an increase of 4.9 per cent. *Bauspar* deposits (€5.3 billion) were close to the previous year's level (– 1.0 per cent). *Bauspar* loans reached a total volume of €563 million, which represents a decline of 13.1 per cent on the previous year's figure of €652 million. The company's stock of housing financing loans was slightly higher than in the previous year (€4.5 billion; + 1.7 per cent).

China

With a new business volume in excess of €3.5 billion, in 2018 SGB once again achieved significant growth by comparison with the previous year (€2.8 billion). In terms of the number of *Bauspar* contracts concluded, it reached a new record level of approximately 67,600 (2017: 49,300). *Bauspar* deposits rose from €822 million in 2017 to €1,139 million. Incoming savings funds increased to €2,715 million (2017: €1,068 million). At €364 million, due to exchange-rate movements, *Bauspar* loans are in line with the previous year's level (€366 million) but have increased slightly when measured in national currency terms. Including mortgage loans, the volume of housing financing totalled €2.6 billion; on account of exchange-rate movements, this increased only slightly by €3 million.

Bauspar and Loan Processing segment

In the 2018 financial year, SHK developed and implemented additional quality improvement and assurance measures. The goal was a further increase in the already high level of satisfaction with SHK's customer service.

In the area of processing, as well as standard processes in particular, measures were implemented in order to maintain Bausparkasse Schwäbisch Hall's *Bauspar* inventory. In 2018, further strong investments were made in employee training to support the professionalisation of Bausparkasse Schwäbisch Hall's Housing Financing business segment. A core area of focus for Processing was the significant increase in project activities by comparison with previous years, in particular for the extensive preparations for the first stage of the SAP-based modernisation of Bausparkasse Schwäbisch Hall's core banking system. In addition, SHK fulfilled the organisational and procedural requirements for the first Bausparkasse Schwäbisch Hall Pfandbrief (German covered bond) issue, which was envisaged for 2019. SHK responded to increased customer demands with innovative processes, such as by piloting video-based authentication as well as services for Bausparkasse Schwäbisch Hall's platform business.

In its government-supported lending business, SHK processed around 63,000 new loan applications on behalf of DZ BANK AG, compared to 58,000 in 2017. A stronger increase had been expected here due to the merger of DZ BANK and WGZ BANK. SHK is continuously working on improvements to its processing efficiency.

In summary, in 2018 SHK once again provided a valuable contribution to SHG's strategic development.

FINANCIAL PERFORMANCE OF THE GROUP AND THE SEGMENTS

Group

Schwäbisch Hall's net profit before taxes declined strongly in 2018 by comparison with the previous year. However, at €295 million, its profit exceeded its envisaged level of €245 million. Due to the outline conditions which remain challenging for *Bauspar* business in particular, in the view of the management board, Schwäbisch Hall's performance is satisfactory.

The decline in net interest income by comparison with the previous year reflects the continuing low interest rates. The slight decrease in interest income relative to the previous year's figure has resulted from the low capital market interest rates for financial investments. The significant rise in bridging loans and suspended repayment loans due to the growth of business over the past few years has only partly made up for this decline.

Interest expenses are mainly attributable to *Bauspar* deposits. Despite the significant increase in volume, through the introduction of low-interest *Bauspar* tariffs and portfolio measures, a decrease was achieved here by comparison with the previous year. The increase in interest expenses has resulted from the additions to provisions due to the changes in *Bauspar* customers' behaviour on account of the interest rate.

The decline in the income from investments in joint ventures using the equity method is mainly due to a correction in the carrying amount of the investment in the joint venture SGB (€– 18 million).

Financial performance of the Schwäbisch Hall Group

			Changes	
in EUR million	**2018**	**2017**	**absolute**	**in %**
Net interest income	766	833	– 67	– 8.0
Interest income	1,605	1,640	– 35	– 2.1
Interest expenses	– 841	– 831	– 10	– 1.2
Income from investments in joint ventures using the equity method	2	24	– 22	– 91.7
Loss allowances in lending business	– 11	– 20	9	45.0
Net fee and commission income	– 40	– 48	8	16.7
Fee and commission income	86	86	0	0.0
Fee and commission expenses	– 126	– 134	8	6.0
Gains and losses on investments	13	18	– 5	– 27.8
Other gains or losses on valuation of financial instruments	8	1	7	> 100
Administrative expenses	– 480	– 470	– 10	– 2.1
of which personnel expenses	– 221	– 221	0	0.0
of which other administrative expenses	– 214	– 199	– 15	– 7.5
of which depreciation/amortisation	– 45	– 50	5	10.0
Other net operating income	39	20	19	95.0
Net profit/loss before taxes	**295**	**334**	**– 39**	**– 11.7**
Income taxes	– 83	– 87	4	4.6
Net profit	**212**	**247**	**– 35**	**– 14.2**

The net measurement gain from lending business improved by €9 million. This primarily results from adjustments to credit risk parameters at Bausparkasse Schwäbisch Hall. If these are excluded, loss allowances for credit risk is at the very positive level reached in the previous year, despite the significant increase in housing financing business over the past few years.

Bausparkasse Schwäbisch Hall includes contract fees and sales commissions in its effective interest rate calculation where these are directly associated with the acquisition of *Bauspar* deposits. Fee and commission expense was thus reduced by €107 million in 2018 (2017: €106 million). On the other hand, net interest income was negatively affected by the amortisation of accrued commissions. The improvement in net fee and commission income reflects the loss of portfolio commission paid to the cooperative banks. This was offset in part by the significant increase in new *Bauspar* business. This resulted in correspondingly higher, non-accrued commission payments.

Gains and losses on investments have resulted from the sales of stock exchange-listed bearer bonds and is attributable to the UIN Fund No. 817 (€–9 million), FLK (€+8 million) and Bausparkasse Schwäbisch Hall (€+14 million).

The other gains or losses on measurement of financial instruments includes the change in value for interest rate swaps of Bausparkasse Schwäbisch Hall (€+8 million). These exclusively serve as an economic hedge of the interest rate risk in the banking book.

Personnel expenses are at the same level as in the previous year. An increase in wages and salaries has been entirely offset by a decrease in the cost of retirement provisions.

The increase in other administrative expenses mainly reflects strategic projects and measures for the ongoing development of the *Bausparen* and Housing Financing core business segments.

The increase in other net operating income resulted from provision addition included in the previous year's balance.

The cost/income ratio as a ratio of administrative expenses to total operating income was 61.1 per cent for the Schwäbisch Hall Group in the year under review, compared to 57.0 per cent in 2017.

The economic return on risk-adjusted capital (RORAC) amounted to 11.0 per cent (2017: 12.4 per cent).

After deduction of non-controlling interests in the amount of €11 million (2017: €11 million), Bausparkasse Schwäbisch Hall has realised net profit before the transfer of profits in the amount of €202 million (2017: €236 million).

Financial performance of the *Bausparen* Domestic segment

The following presentation of the financial performance in the various segments only provides specific information regarding individual indicators where further aspects have played a key role in this trend, in addition to the trend at Group level.

The significant decline in net interest income by comparison with 2017, the decrease in gains and losses on investments and the considerable increase in administrative expenses played a key role in the decline in earnings in the *Bausparen* Domestic segment.

The decrease in current income from investments in subsidiaries, joint ventures and dividend income is attributable to PSS (€– 7 million). In order to strengthen the equity basis, no dividend was distributed.

Gains and losses on investments have been shaped by the adjustment of the carrying amount in the joint venture (€– 20 million).

Expenses for loss allowances in lending business almost halved. The decline in loss allowances by comparison with the previous year has resulted from the validation of the credit risk parameters. Expenses for loss allowances in lending business have otherwise remained stable. This reflects the positive economic situation in Germany, in particular unemployment which remains low and is continuing to decline.

The other factors have already been outlined in the section providing information on net profit.

Financial performance of the *Bausparen* Non-domestic segment

The *Bausparen* Non-domestic segment comprises the joint venture *Bausparkassen* ČMSS, PSS and SGB as well as the FLK subsidiary. The profit contribution which Schwäbisch Hall receives from the joint venture *Bausparkassen* is reported under income from joint ventures using the equity method. The decline in segment profit before taxes to €28 million (2017: €51 million) is mainly attributable to income from investments in joint ventures using the equity method. This includes an impairment loss on the equity carrying amount of the SGB in the amount of €18 million. With a cumulative figure of €87.6 million, the *Bausparkassen* included in the

Financial performance of the *Bausparen* Domestic segment

			Changes	
in € million	**2018**	**2017**	**absolute**	**in %**
Net interest income	714	766	– 52	– 6.8
Interest income	1,516	1,556	– 40	– 2.6
Interest expenses	–826	– 821	– 5	– 0.6
Current income from investments in subsidiaries, joint ventures and dividend income	24	31	– 7	– 22.6
Loss allowance in lending business	– 10	– 19	9	47.4
Net fee and commission income	– 39	– 45	6	13.3
Fee and commission income	76	77	– 1	– 1.3
Fee and commission expenses	– 115	– 122	7	5.7
Gains and losses on investments	– 16	10	– 26	< – 100
Other gains or losses on valuation of financial instruments	8	1	7	> 100
Administrative expenses	– 460	– 429	– 31	– 7.2
of which personnel expenses	– 88	– 87	– 1	– 1.1
of which other administrative expenses	– 332	– 297	– 35	– 11.8
of which depreciation/amortisation	– 40	– 45	5	11.1
Other net operating income	22	0	22	–
Segment profit before taxes	**219**	**284**	**–65**	**– 22.9**

Bausparen Non-domestic segment achieved profit before taxes which were considerably lower than in the previous year (2017: €107.2 million). This decrease is mainly attributable to lower net interest income as a result of the low interest rates.

FLK was able to match its strong result for the previous year in 2018. The Hungarian government's October 2018 decision to end government aid for *Bausparen* did not have any effect on its earnings figures. FLK achieved a slight improvement in its net interest income. The volume-based increase in interest income for suspended repayment and bridging loans has more than made up for the decline in interest income for financial investments as well as the increase in interest expenses for *Bauspar* deposits. The increase in lending business has resulted in an increase in loss allowances, at a very low level. Negative net fee and commission income was halved. While fee and commission expenses remained at the previous year's level, fee and commission income increased strongly. Administrative expenses rose significantly. In particular, this related to personnel expenses, due to the increase in the volume of business and the general salary increases in Hungary. FLK's profit

Financial performance of the *Bausparen* Non-domestic segment

2018 in € million	**FLK**	**ČMSS**	**PSS**	**SGB**	**Total**	**Reconciliation Equity JV**	**Segment *Bausparen* Non-domestic**
Net interest income	68	80	49	43	240	– 172	68
Interest income	86	165	96	129	476	– 390	86
Interest expenses	– 18	– 85	– 47	– 86	– 236	218	– 18
Income from investments in joint ventures using the equity method	–	–	–	–	–	2	2
Loss allowances in lending business	– 2	– 7	– 1	– 3	– 13	11	– 2
Net fee and commission income	– 1	22	16	– 2	35	– 36	– 1
Fee and commission income	10	41	17	9	77	– 67	10
Fee and commission expenses	– 11	– 19	– 1	– 11	– 42	31	– 11
Gains and losses on investments	8	–	–	–	8	–	8
Other gains or losses on investments	–	– 2	–	–	– 2	2	–
Administrative expenses	– 44	– 51	– 35	– 36	– 166	122	– 44
of which depreciation/amortisation	– 5	– 11	– 4	– 4	– 24	19	– 5
Other net operating income	– 3	–	– 7	– 4	– 14	11	– 3
Profit before taxes/ segment profit before taxes	**26**	**42**	**22**	**– 2**	**88**	**– 60**	**28**
Income taxes	– 4	– 8	– 5	–	– 17	13	– 4
Profit or loss after tax from continued operations	22	34	17	– 2	71	– 47	24
Other comprehensive income or loss	– 5	– 5	–	– 4	– 14	9	– 5
Total comprehensive income Non-domestic	**17**	**29**	**17**	**– 6**	**57**	**– 38**	**19**
Equity investment ratio	51.25%	45.00%	32.50%	24.90%			
Pro rata profit/loss for the year	11	16	5	–			
Dividend received	4	19	–	–			

before taxes therefore decreased slightly, by €0.5 million to €26.2 million.

At ČMSS, the low interest rate resulted in a decline in net interest income in 2018. Expenses for credit risks were at the same level as in the previous year. Net fee and commission income increased moderately by comparison with the previous year. Thanks to stringent cost management, administrative expenses decreased significantly. Profit before taxes therefore declined by €7 million to €42 million.

In Slovakia, PSS likewise recorded a decrease in interest income from customer business on account of the low interest rate. The fall in interest income was mitigated by lower interest expenses for savings deposits. The decline in net interest income has mainly resulted from sales. In terms of net fee and commission income, a result in line with the previous year's level was achieved in 2018, with a strong decline in the volume of new business. The slight increase in administrative expenses is attributable to personnel expenses. This reflects the general salary increases in Slovakia. Expenses for loss allowances in lending business were reduced consider-

Financial performance of the *Bausparen* Non-domestic segment

2017 in € million	**FLK**	**ČMSS**	**PSS**	**SGB**	**Total**	**Reconciliation Equity JV**	**Segment *Bausparen* Non-domestic**
Net interest income	68	88	57	39	252	– 184	68
Interest income	84	175	106	140	505	– 421	84
Interest expenses	– 16	– 87	– 49	– 101	– 253	237	– 16
Income from investments in joint ventures using the equity method	–	–	–	–	–	24	24
Loss allowances in lending business	– 1	– 7	– 9	2	– 15	14	– 1
Net fee and commission income	– 3	21	16	3	37	– 40	– 3
Fee and commission income	8	39	17	14	78	– 70	8
Fee and commission expenses	– 11	– 18	– 1	– 11	– 41	30	– 11
Gains and losses on investments	8	–	–	–	8	–	8
Other gains or losses on investments	–	–	–	–	–	–	–
Administrative expenses	– 42	– 54	– 35	– 35	– 166	124	– 42
of which depreciation/amortisation	– 4	– 10	– 4	– 6	– 24	20	– 4
Other net operating income	– 3	1	– 7	– 1	– 10	7	– 3
Profit before taxes/ segment profit before taxes	**27**	**49**	**22**	**8**	**106**	**– 55**	**51**
Income taxes	– 4	– 8	– 5	– 2	– 19	15	– 4
Profit or loss after tax from continued operations	23	41	17	6	87	– 40	47
Other comprehensive income or loss	– 1	– 1	– 3	– 23	– 28	27	– 1
Total comprehensive income Non-domestic	**22**	**40**	**14**	**– 17**	**59**	**– 13**	**46**
Equity investment ratio	51.25%	45.00%	32.50%	24.90%			
Pro rata profit/loss for the year	12	19	6	1			
Dividend received	4	20	7	–			

Financial performance of the *Bauspar* and Loan Processing segment

			Changes	
in € million	**2018**	**2017**	**absolute**	**in %**
Net interest income	5	5	–	–
Interest income	5	5	–	–
Interest expenses	–	–	–	–
Loss allowance in lending business	–	–	–	–
Net fee and commission income	–	–	–	–
Fee and commission income	–	–	–	–
Fee and commission expenses	–	–	–	–
Gains and losses on investments	–	–	–	–
Other gains or losses on valuation of financial instruments	–	–	–	–
Administrative expenses	–120	– 127	7	5.5
of which personnel expenses	– 115	– 117	2	1.7
of which other administrative expenses	– 5	– 9	4	44.4
of which depreciation/amortization	–	– 1	1	100
Other net operating income	164	151	13	8.6
Segment profit before taxes	**49**	**29**	**20**	**69**

ably. Accordingly, a figure for profit before taxes was achieved which was in line with the positive figure for the previous year (€22 million).

SGB in China continued its growth strategy for new *Bauspar* business in 2018. Incoming savings funds also registered dynamic growth. On the other hand, net fee and commission income declined, which is mainly attributable to a high volume of new *Bauspar* business. Moreover, an increased amount was allocated to loss allowances, while in the previous year, provisions in this category were released due to a one-off effect in particular. The increase in administrative expenses was limited. The company's profit before taxes amounted to €– 1.7 million (2017: €8 million).

Financial performance of the *Bauspar* and Loan Processing segment

SHK considerably improved its profit in the year under review. Lower administrative expenses contributed to this. They were in turn influenced by cost reduction and efficiency enhancement measures already initiated in previous years. The sales revenue reported under other net operating income rose significantly. This growth occurred due to the fact that cost increases on account of revised Heubeck tables were passed on to customers. Net interest income resulted from the investment of liquid resources.

GROUP FINANCIAL POSITION

Development of the Schwäbisch Hall Group's balance sheet

The balance sheet total of the Schwäbisch Hall Group rose by €3.3 billion or 4.9 per cent as of 31 December 2018 to €71.7 billion. On the asset side, this extension of the balance sheet is mainly attributable to increased loans and advances to customers, while on the liabilities side it reflects higher deposits from customers. These two developments are attributable to the increased volume of business.

Loans and advances to banks mainly comprise financial investments of liquid resources from *Bauspar* business in the form of registered securities and borrower's note loans.

In the loans and advances to customers item, the Group's volume of non-collective housing financing has increased by 11.6 per cent to €40.5 billion (2017: €36.3 billion).

Bausparkasse Schwäbisch Hall's loan-deposit ratio I – i.e. the ratio of *Bauspar* loans to *Bauspar* deposits – had decreased from 4.3 per cent to 3.9 per cent at the end of 2018. On the other hand, its loan-deposit ratio II – i.e. the ratio of *Bauspar* loans plus suspended repayment and bridging loans to *Bauspar* deposits – had increased from 65.5 per cent to 68.4 per cent at the end of 2018. This trend has mainly resulted from the positive new business trend for housing financing over the past few years.

As in previous years, investments almost exclusively comprise bonds and other fixed-income securities.

Due to statutory requirements, FLK's liquid resources in the amount of €378 million (nominal value: €365 million) are mainly invested in bonds issued by the Hungarian government.

The derivative financial instruments (interest rate swaps) concluded with DZ BANK with a volume of €450 million (nominal amount) are exclusively for management of the *Bausparkasse*'s general interest rate risk. The fair value of the interest rate swaps amounted to €12 million as of 31 December 2018.

Financial position

			Changes	
in € million	**31 Dec 2018**	**31 Dec 2017**	**absolute**	**in %**
Assets				
Loans and advances to banks	12,440	14,005	– 1,565	– 11.2
Loans and advances to customers (net)	47,826	43,551	4,275	9.8
Positive fair values from derivative financial instruments	12	–		
Investments	10,979	10,396	583	5.6
Other assets	410	385	25	6.5
Total assets	**71,667**	**68,337**	**3,330**	**4.9**
Equity and liabilities				
Deposits from banks	4,476	4,465	11	0.2
Deposits from customers	60,335	56,910	3,425	6.0
Negative fair values from derivative financial instruments	–	–		– 100.0
Provisions	1,454	1,564	– 110	– 7.0
Other liabilities	245	295	– 50	– 16.9
Equity	5,157	5,103	54	1.1
Total equity and liabilities	**71,667**	**68,337**	**3,330**	**4.9**

Deposits from banks exclusively relate to domestic credit institutions, of which €2.7 billion (2017: €2.7 billion) to DZ BANK. They include *Bauspar* deposits in the amount of €1.6 billion (2017: €1.6 billion).

Deposits from customers mainly comprise *Bauspar* deposits in the amount of €60.0 billion (2017: €56.6 billion).

The further increase in *Bauspar* deposits to a record level of €61.6 billion (2017: €58.3 billion) has primarily resulted from the high volume of new business in the past few years as well as lacklustre demand for *Bauspar* funds.

The Schwäbisch Hall Group's equity growth has resulted from the positive financial performance. Equity also includes the technical security reserve in the amount of €278 million (2017: €278 million).

REGULATORY INDICATORS PURSUANT TO THE CRR

The Group's regulatory capital calculated pursuant to the Capital Requirements Regulation (CRR) totalled €4,372.8 million as of 31 December 2018 (2017: €3,808.3 million). Bausparkasse Schwäbisch Hall does not have any Additional Tier 1 or Tier 2 instruments. Its Common Equity Tier 1 capital primarily consists of subscribed capital, capital reserves, revenue reserves and accumulated other comprehensive income. The increase in Common Equity Tier 1 capital is attributable to the retention of earnings as well as taking into account dissolution and/or reallocation of the technical security reserve amounting to €425 million as of 31 December 2017.

As of 31 December 2018, the regulatory capital requirements were calculated as amounting to €1,149.2 million (2017: €1,082.4 million). This growth is mainly attributable to the increase in lending business.

Regulatory indicators pursuant to the CRR

in € million	31 Dec 2018[1]	31 Dec 2017
Capital		
Common Equity Tier 1 capital	4,372.8	3,808.3
Additional Tier 1 capital	0.0	0.0
Tier 1 capital	4,372.8	3,808.3
Total Tier 2 capital	0.0	0.0
Total capital	4,372.8	3,808.3
Capital requirements		
Credit risk (including equity investments)	997.3	936.0
Market risk	41.3	35.8
Operational risk	110.6	110.6
Total	1,149.2	1,082.4
Capital ratios		
Common Equity Tier 1 capital ratio (minimum value: 4.5%)	30.4%	28.2%
Tier 1 capital ratio (minimum value: 6.0%)	30.4%	28.2%
Total capital ratio (minimum value: 8.0%)	30.4%	28.2%

[1] Provisional figures

The total capital ratio, Tier 1 capital ratio and Common Equity Tier 1 capital ratio of Bausparkasse Schwäbisch Hall rose from 28.2 per cent as of 31 December 2017 to 30.4 per cent as of the reporting date. The minimum figures required according to regulatory requirements were clearly exceeded at all times during the year under review.

Target/Actual comparison of the previous year's forecast

Overall, the development of the key business and earnings indicators was in line with the expectations outlined in the Outlook section of the 2017 Annual Report. For net interest income in particular, as expected, the low interest rate in 2018 had a clearly negative impact. For net fee and commission income, despite adjustments made to the commission payments to Schwäbisch Hall's sales force and the cooperative banks, the expenses decreased only slightly.

The goals and expectations for the 2018 financial year outlined in the Outlook section of the Group's 2017 Annual Report are compared with the actual trend and any discrepancies are accounted for.

Forecast (FR* 2017)	Actual performance	Comparison
Business development		
New *Bauspar* business in the *Bausparen* Domestic segment matches the previous year's level	New *Bauspar* business €29.7 billion (2017: €28.0 billion)	Forecast exceeded
Slight increase in housing financing business in *Bausparen* Domestic segment	New housing financing business: €15.2 billion (2017: €14.6 billion)	Forecast fulfilled
Slight decline in new *Bauspar* business in *Bausparen* Non-domestic segment	New *Bauspar* business €12.0 billion (2017: €10.5 billion)	Forecast exceeded
Bauspar and Loan Processing segment: almost stable revenues	Significant increase in revenue to €164 million (2017: €151 million)	Forecast exceeded
Financial performance		
Group: strong decline in net interest income and slightly increased administrative expenses result in significant decrease in profit before taxes	Significant decline in net interest income, with slight increase in administrative expenses	Decline in earnings lower than expected, forecast almost fulfilled
Group: moderate increase in loss allowance expenses in lending business in line with loan portfolio	Loss allowances in lending business significantly lower than the previous year	Decrease exclusively attributable to a one-off effect
***Bausparen* Domestic:** significant decline in profit before taxes mainly attributable to the low interest rate	Significant decrease in net interest income and profit before taxes	Forecast fulfilled
***Bausparen* Domestic:** The envisaged stable volume of new *Bauspar* business with adjusted fee and commission payments to the Schwäbisch Hall sales force and to the cooperative banks will result in a slight decline in fee and commission expense and improved net fee and commission income	New *Bauspar* business better than expected and net fee and commission income worse than expected	Forecast almost fulfilled
***Bausparen* Non-domestic:** Overall, the non-domestic *Bausparkassen* expect a positive performance, with profit before taxes slightly under the previous year	In profit before taxes, there was a significant decline	Forecast not fulfilled
***Bauspar* and Loan Processing:** marginal profit	Clear profit	Performance better than expected

* Financial report

Personnel report

Bausparkasse Schwäbisch Hall is exempt from the requirement to provide a non-financial statement in its consolidated financial statements under Section 315b (2) HGB. Bausparkasse Schwäbisch Hall is included in the non-financial Group statement provided by DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main. This non-financial Group statement may be downloaded in German from the following website: www.berichte2018.dzbank.de.

The core aspects of human resources management at Schwäbisch Hall and key measures implemented are outlined below.

MANAGEMENT AND CORPORATE CULTURE, DIVERSITY

The objectives of a family-friendly work environment, equal treatment of employees, active promotion of women and recognising the workforce's diversity as an opportunity have been enshrined in the corporate culture of Schwäbisch Hall for many decades now. A comprehensive system of human resources initiatives and activities is continuously reviewed and developed. Schwäbisch Hall not least thus establishes the basis for human resources activities which are compatible with long-term demographic trends.

Equal treatment of all employees – irrespective of their gender, age, origin, sexual orientation and world view – is a natural and fundamental aspect of Schwäbisch Hall's corporate culture. This is documented through acts such as its signing of the "Diversity Charter". In practical terms, this commitment is reflected in opportunities such as career coaching, multiple-group mentoring and events such as Schwäbisch Hall's diversity day.

In 2018, the "compatibility of work and family life" was once again a core area of focus. The high benchmark already achieved was maintained in 2018 and further developed through targeted measures. A highlight was the German Federal Ministry for Family Affairs, Senior Citizens, Women and Youth's appointment of Schwäbisch Hall's general agent Claudia Klug as Baden Württemberg's corporate ambassador promoting families as a key success factor.
At Schwäbisch Hall, a "family-friendly approach" is not limited to the parents of children or young people. It also includes a comprehensive range of advisory and support services covering the area of care, for employees who have relatives with care needs, as well as guidance for employees in difficult personal situations.

In 2011, in a letter of intent, Schwäbisch Hall already committed itself to achieving a long-term increase in the proportion of women in management positions.

INITIAL AND ADVANCED TRAINING, RECRUITMENT OF JUNIOR EMPLOYEES

Schwäbisch Hall is responding to the challenges associated with the process of demographic change by means of human resources activities attuned to the various stages of life. This includes initial and advanced training.

At the end of 2018, Schwäbisch Hall had a total of 200 (end of 2017: 207) apprentices, students and trainees. As well as bank officers for its back office and sales force, Schwäbisch Hall also provides students with training for three-year dual-study courses in the fields of business administration, business information technology and digital business management, in cooperation with Baden-Wuerttemberg Cooperative State University. Schwäbisch Hall also offers a one-year trainee programme for business administration, (business) mathematics, law and (business) information technology graduates who are starting out in their careers.

Training has likewise been adjusted in line with Schwäbisch Hall's strategic business segment focus. Junior staff for the back office and sales force are now even more strongly prepared for their various tasks in the field of housing financing. Schwäbisch Hall remains strongly committed to advanced training. Changes in customer requirements and digitalisation of business processes are reshaping the tasks and competence profiles of employees, particularly in the areas of application development as well as advisory services and processing of financing solutions. Moreover, in 2018, training measures covering agile project management, housing financing and the introduction of Schwäbisch Hall's SAP-based core banking system were key areas of focus. Digital learning opportunities such as explanatory films are being increasingly used and facilitate location-independent and flexible learning. As in previous years, Schwäbisch Hall pursued its successful junior staff and potential development programmes, with the positive outcome that it was able to fill more than 80 per cent of management positions internally.

Sales force employees are likewise offered comprehensive training opportunities. In addition, via e-learning platforms and webinars, all sales force employees are able to learn about the possibilities for their own web and social network presences and to undergo relevant training.

To ensure the consistently high quality of advice, each sales force employee takes examinations leading to a "certificate of advisory excellence". These examinations comprise both theoretical and practical modules. Employees will only be awarded this "certificate of advisory excellence" if an external test purchase by a neutral institution confirms the required level of advisory quality.

HEALTH MANAGEMENT AND PREVENTIVE HEALTHCARE

In the year under review, Schwäbisch Hall continued to pursue its activities within the scope of its holistic healthcare and performance management concept "Schwäbisch Hall in Balance". An important task here was examining workplaces in terms of potential risks for employees' mental health.

To sensitise employees and managers in relation to health issues, specialist presentations and health days were offered which focused on the following core areas: a healthy back, sleep and relaxation as well as nutrition. The support process initiated in 2017 for teams with high illness rates was maintained and optimised. By means of a systematic process, the causes were analysed together with the relevant managers, countermeasures identified and implemented and the effectiveness of the measures initiated reviewed.

EMPLOYER MARKETING, RANKING

In 2018, Schwäbisch Hall began to rework its image as an employer in line with its current product campaign and its "local experts" ("Heimatexperten") theme. Schwäbisch Hall's attention-catching employer image is supported by the DZ BANK Group's umbrella brand campaign.

Schwäbisch Hall has reorganised its talent recruitment process, with a further focus on the acquisition of junior employees, specialists, digital talents and sales force staff.

In the year under review, Bausparkasse Schwäbisch Hall was once again recognised as the number one employer out of all of the financial institutions in Germany. It took fifth place in the overall rating for all industries. This is the outcome of the Top Employers Study 2018 carried out by the independent Top Employers Institute.

As in the previous year, Schwäbisch Hall achieved strong results in particular for its talents strategy and management development activities and in the training and development categories. Its corporate culture and its career and succession planning were likewise found to be "outstanding". Schwäbisch Hall won particularly strong plaudits for its human resources development activities covering junior staff as well as professional and management personnel.

PERFORMANCE-RELATED COMPENSATION

The basic aspects of the compensation structure for the employees of the Schwäbisch Hall Group remained unchanged in the 2018 financial year. This is mainly determined by the applicable collective bargaining agreements and is supplemented by collective agreements at company level. Employment contracts with managers (including executives) are outside the scope of collective bargaining agreements. A consistent compensation system is in place at every level, from employees covered by collective bargaining agreements and employees outside the scope of these agreements, right up to executive personnel. In the year under review, adjustments were required and implemented due to new regulatory requirements resulting from the German Regulation on Institutions' Compensation Schemes (InstitutsVergV).

Outlook

MACROECONOMIC CONDITIONS

Development of overall economy

At the turn of the year 2018 – 2019, many economic experts slightly adjusted their growth forecasts downward. The Organisation for Economic Cooperation and Development (OECD) and the International Monetary Fund (IMF) both reduced their forecasts for world economic growth by 0.2 percentage points, to 3.5 per cent and 3.7 per cent respectively. Global economic growth thus remains strong, but has already peaked. It is generally suffering due to a further rise in the level of uncertainty on the markets. Besides the negative effects of trade measures, the IMF also attributes this trend to the increasing difficulties which a series of emerging markets and developing countries are experiencing – including stricter financing conditions due to more expensive loans and higher oil prices.

With regard to Germany, the leading economic research institutes reduced their forecasts for 2019 shortly before the turn of the year. According to Munich's ifo Institute, gross domestic product will increase by just 1.1 per cent in 2019. Its researchers had previously assumed a growth rate of 1.9 per cent. However, this economic setback is mainly attributable to the automotive industry. Manufacturers were unable to sell as many cars as they had envisaged in 2018, due to problems with certification in line with the EU's new emission and consumption standards, and therefore curbed their production levels. The forecasts also state that the large number of uncertainties will dampen economic activity in 2019. In particular, these include Brexit, Italian fiscal policy and US trade policy. The flourishing construction industry and the stable job market situation will have a positive impact. This will increasingly make itself felt in wage levels. Private consumption will in turn benefit from this.

For Hungary, the leading Budapest economic research institute GKI Economic Research Co. expects GDP growth to fall from 4.2 per cent to 3.2 per cent in 2019. On the other hand, an inflation rate of approximately 3.5 per cent is expected in 2019, in particular due to the continuing weakness of the Hungarian currency, the forint. While industrial output will maintain its momentum with a growth rate of 4.5 per cent (2018: 4.0 per cent), the researchers expect a decrease in the pace of growth for investments and in the retail sector. GKI's researchers attribute this declining growth trend to the decrease in investment financing provided through EU transfers and to moderation of the level of consumption which had been encouraged among the population during the 2018 election year.

Thanks to major projects in the automotive industry, at the turn of the year 2018 – 2019 the Slovak economy is operating at full capacity. For 2019, the government expects GDP to pick up by 4.5 per cent. According to forecasts from the government-affiliated Institute for Financial Policy, exports will increase by 7.9 per cent and imports by 6.8 per cent. Car exports in particular are driving the continuing high level of momentum. Slovakia's private households are also extremely enthusiastic spenders. For 2019, the government predicts a nominal wage growth rate in excess of 6 per cent. The number of unemployed is expected to continue to decline, and the jobless rate is set to fall below 6.5 per cent.

The successful Czech export sector will be affected by the weaker pace of demand in its key target markets in 2019. Increasing uncertainties due to protectionist tendencies around the world and concerning the implementation of Brexit will have an impact on an export-oriented economy such as the Czech Republic. In addition, due to the scarcity of personnel in the Czech Republic, employees have been able to enforce high wage demands Private consumption thus remains the key pillar of economic growth in 2019. In the view of the Czech national bank (CNB), in 2019 the Czech economy will continue to outperform its potential. This might mean that further interest-rate increases are necessary. For 2019, the Czech government therefore expects slower growth and a 2.9 per cent rise in GDP.

The Chinese economy found itself in choppier waters at the turn of the year 2018–2019. The threat of a trade war with the USA, the ongoing structural reforms promoting a sustainable service sector and the rising level of government and household debt are jeopardising the country's growth. Infrastructure investments and an easing of fiscal policy are intended to serve as direct economic stimulus measures. For 2019, OECD and McKinsey envisage GDP growth of +6.3 per cent. Goldman Sachs expects the government's growth target to decrease to between +6.0 and 6.5 per cent in 2019. The threat of punitive tariffs in the USA as well as declining levels of exports and consumption will jeopardise consumption in 2019. According to Goldman Sachs, economic growth of at least 6.1 per cent will be necessary in 2019 and 2020 to achieve the political goal of doubling incomes in the period from 2010 to 2020.

DEVELOPMENT OF THE HOUSING CONSTRUCTION AND BUILDING REFURBISHMENT SECTORS

Germany

The trend of rising purchase prices which has been under way for eight years now is expected to slow in 2019. Significant regional differences are apparent, and a similar picture will apply for rents. Overall in 2019, demand for housing will increase considerably more slowly than in previous years, since foreign immigration (refugees, other EU countries) has declined significantly. As well as immigration, the trend of shrinking household sizes is driving an increase in the number of homes required. Here too, the rate of increase is expected to decline considerably, from 300,000 extra households in 2016 to an estimated 100,000 in 2020. At the same time, the supply of housing is increasing at a stronger rate than previously. The Central Association of German Construction Companies (ZDB) predicts 315,000 completed homes in 2019, compared to 300,000 in 2018. The housing market is thus continuing to head towards a balanced situation, which will slightly relieve the level of pressure on rents. Moreover, since mortgage interest rates are not expected to fall any further, their price-driving effect on the purchase market will cease to apply. However, the housing market is nonetheless not likely to ease in the short term. Rising construction prices and a lack of craftsmen are putting the brakes on housing construction, and development sites are scarce, particularly in metropolitan areas. The Zentraler Immobilien Ausschuss (German Property Federation – ZIA) is also complaining about drawn-out approval processes, costly requirements and high taxes.

Non-domestic

Hungary's housing construction will continue to benefit from a favourable economic environment in 2019. Rising incomes and an optimistic outlook for business prospects are drawing international investors to the Hungarian market for residential property. On the other hand, a lack of specialist workers and rising costs are grounds for concern. Demand for residential property is also being driven by government subsidy measures, in particular the CSOK home-buying subsidy programme. Housing construction will pick up further momentum through the temporary decrease, up to the end of 2019, in the rate of value-added tax for new residential properties from the normal rate of 27 per cent to 5 per cent. The European research and advisory network EUROCONSTRUCT predicts approximately 35,000 newly constructed housing units in Hungary in 2019, a growth rate of more than 16 per cent.

In Slovakia, according to EUROCONSTRUCT's forecasts with 17,800 units in 2019 slightly fewer homes will be completed than in 2018. The construction industry is only benefiting from the current upturn in Slovakia to a limited extent. Construction firms are suffering problems due to the increasing lack of specialists, while in Bratislava especially strong rises in residential property prices are dampening consumer demand. The refurbishment of the approximately 600,000 prefabricated flats which were built in the period between 1960 and 1990 remains an important step, so as to be able to provide adequate living space over the next few years.

In the Czech Republic, the growth trend of the past few years for housing construction is likely to continue to pick up. Experts estimate that 34,000 housing units will be newly constructed in 2019, compared to 30,100 in 2018. The Czech Republic's volume of housing construction is thus not far off its previous peak levels. Following the country's EU accession in 2004, up to 40,000 homes were built per year. Mortgage interest rates, which remain low alongside strong rises in income levels, are stimulating demand. The Czech national bank is dampening demand. It has raised the percentage of equity required in order to purchase a property to 20 per cent.

The real estate market in China is still one of the main drivers of the economy. According to Bloomberg, directly or indirectly it accounts for a GDP share of 30 per cent. The trend for real estate prices varies greatly from one region to the next, but the risk of a bubble remains intact, particularly in major cities due to high price increases. The risk of a real estate bubble is being heightened by the rising level of debt among property developers. Moreover, according to McKinsey more than half of the volume of debt on the part of private households, companies and the public sector is directly or indirectly associated with real estate. Real estate prices are expected to continue to rise. Together with the tight rules regulating the purchase of real estate in major cities, this will result in a shift in demand towards smaller and less strictly regulated cities in the hinterland of major cities.

Experts do not expect real estate price growth to match the rate seen in 2018, but prices are expected to pick up by +3.3 per cent in the first half of 2019 (compared to +5 per cent in 2018). The government will continue to focus on the issue of affordable housing, and the construction of more rented flats is intended to provide more adequate living space for the population, particularly in major cities, and thus bring real estate speculation under control. The rental market in China remains somewhat underdeveloped, but in view of double-digit growth rates for rents, this market is currently attractive for investors.

EXPECTED DEVELOPMENT OF THE BUSINESS AND FINANCIAL POSITION OF THE SCHWÄBISCH HALL GROUP

Development of the Group

The enduring low interest rate on the capital market continues to shape expectations in terms of the business development of the Schwäbisch Hall Group (in line with MaRisk) in the 2019 financial year. A slight rise in capital market interest rates towards the end of the year will only have an impact in the 2020 financial year. For the *Bausparen* and Housing Financing core business segments, stable new business volumes are envisaged.

The intact extremely low interest rate, higher costs due to continuously increasing regulatory requirements and significant scheduled investments recorded as expenses in the strategic core business segments of *Bausparen* and, in particular, Housing Financing with modernisation of IT platforms at Bausparkasse Schwäbisch Hall especially will once again have a negative impact on the financial performance in 2019.

The cost-limitation measures initiated will be unable to make up for the above-mentioned negative effects on earnings in 2019. Profit before taxes are therefore expected to decline strongly by comparison with the 2018 financial year.

Net interest income is expected to fall strongly in 2019. This is due to the continuing low interest rate together with old tariffs with high interest rates. The further portfolio growth for non-collective loans and the newly introduced low-interest *Bauspar* tariffs will have a positive impact. An unexpected adjustment of the ECB's key interest rate and deposit interest rate might have an additional negative impact on net interest income in the 2019 financial year.

Loss allowance expenses in lending business will increase only slightly by comparison with the previous year. They will develop in line with the loan portfolio and the standard risk costs of many years. The expected moderate trend for credit loss allowances reflects the solid economic situation and the high level of employment in Germany.

Net fee and commission income in 2019 is expected to match the previous year's level. A virtually stable volume of new business in the *Bausparen* and Housing Financing core business segments is contributing to this.

Administrative expenses are expected to increase slightly in 2019. While the strategic projects and measures implemented for the ongoing development of the core business segments of *Bausparen* and, in particular, Housing Financing will result in increased investments, stringent cost discipline at Bausparkasse Schwäbisch Hall will limit the increase in administrative expenses.

The Schwäbisch Hall Group continues to pursue a strategic goal of limiting the rise in its cost/income ratio despite further additional expenses, thanks to rigorous cost management. Nonetheless, a slight rise is expected in the 2019 financial year.

The economic RORAC figure will likely decline in the 2019 financial year due to a significant decrease in the outlook for earnings.

Liquidity and financial position

For the 2019 financial year, Bausparkasse Schwäbisch Hall once again assumes a stable level of saving for *Bauspar* contracts from the point of view of its management of operational liquidity. Financial resources provided by institutional investors and DZ BANK are available in addition. For the purpose of the structural refinancing of Bausparkasse Schwäbisch Hall, a volume of new *Bauspar* business at a persistently high level is assumed.

At the present time, Schwäbisch Hall expects to continue to fulfil the economic and regulatory requirements in relation to capital adequacy in the 2019 financial year.

DEVELOPMENT OF THE SEGMENTS

Development of *Bausparen* Domestic

In Germany, the *Bausparkasse* will continue to operate in a challenging environment in 2019, which is expected to be shaped by low interest rates, high regulatory requirements as well as increasing digitalisation.

Following an increase to a new record level, Schwäbisch Hall expects Housing Financing business to stabilise in 2019. The *Bausparkasse* aims to jointly leverage optimisation potential throughout *Genossenschaftliche FinanzGruppe* and to fine-tune the division of labour in this respect. New *Bauspar* business is expected to consolidate in 2019, following the increase in the year under review. In view of the above-mentioned outline conditions which remain favourable, the volume of new *Bauspar* business will match the previous year's level.

Net interest income is expected to fall significantly in 2019, year-on-year, due to a low interest rate which will remain stable in all likelihood. The probable further increase in the stock of non-collective loans and the newly introduced "*Fuchs*" *Bauspar* tariffs are having a positive impact, but are unable to compensate for the decrease attributable to the interest rate, particularly in the area of financial investments.

Loss allowances in lending business will likely increase only slightly, despite the volume growth of the past few years. The predicted favourable employment situation in Germany will have a positive impact here.

New *Bauspar* business, which is expected to increase only slightly, will result in stable net fee and commission income.

Administrative expenses will probably decrease slightly. Despite continuing strong investments in order to strengthen the strategic core business segments of *Bausparen* and, in particular, Housing Financing, the administrative expenses will remain lower than in the previous year, due to the cost reduction measures initiated.

Accordingly, in its *Bausparen* Domestic segment in 2019, Schwäbisch Hall envisages a significant decline in profit before taxes, even if all of its sales and cost targets are achieved. This will mainly be attributable to the low interest rate.

Development of *Bausparen* Non-domestic

Overall, the non-domestic *Bausparkassen* in the Rest of the World are expected to register a positive performance in 2019. With the economic trend remaining buoyant and with the support of low interest rates, demand for financing products is expected to remain as high as ever. In line with expectations, thanks to attractive financing opportunities, the *Bausparkassen* in the eastern European EU member states will benefit particularly strongly from this trend. Due to the specific situation in Hungary on account of the loss of government aid for *Bausparen*, a strong decline in new *Bauspar* business is expected here. Furthermore, the plan is to sell the 45 per cent share in ČMSS in 2019 (see “Events after the balance sheet date”, note 61 in the notes). Besides that, total new business figures in the core business segments of Housing Financing and *Bausparen* will fall slightly below the very good level of the previous year. Profit before taxes are expected to be slightly lower than in the previous year.

In 2019, FLK will continue to pursue the strategic reorientation already initiated, focussing on Housing Financing business. FLK nonetheless envisages a significant decline in new *Bauspar* business. On account of the limited time frame due to the loss of government aid for *Bausparen* late in the year, it is not possible to predict new business figures with an adequate degree of certainty. Nor is it possible to predict the extent to which the stepped-up Housing Financing sales activities will pay off. Net interest income and net fee and commission income are expected to match the previous year’s levels. Marginally higher administrative costs are anticipated. Profit before taxes are expected to fall slightly short of the previous year’s figure. FLK is still benefiting here from its positive business performance of the past few years.

In Slovakia, PSS expects the volume of new business in 2019 to match the positive level seen in the previous year. It will continue to clearly focus on lending business with attractive financing opportunities. PSS expects its net interest income to increase slightly, due to the adjustment in the rate of interest on *Bauspar* contracts. While net fee and commission income is expected to match the previous year’s level, the higher administrative expenses will only partially offset the improvement in net interest income. However, other net operating income is also expected to decrease. Profit before taxes are therefore expected to fall slightly short of the previous year’s level.

For the 2019 financial year, SGB envisages a stable new business volume. The focus in 2019 will be on an increase in *Bauspar* deposits and the *Bauspar* loan portfolio (including suspended repayment and bridging loans). On the other hand, on account of regulatory requirements, a significant reduction in the volume of mortgage loans is envisaged. This is intended to result in a decrease in interbank deposits, in order to improve the refinancing structure. The securitisation measure implemented is expected to result in another loss in 2019 and to prevent the return to profitability which would otherwise be expected.

Bauspar and Loan Processing Development

SHK is continuously working with Bausparkasse Schwäbisch Hall on the ongoing strategic development of the Schwäbisch Hall Group. IT modernisation will lay the foundations for digitalisation of the value chain. The first stage of the new SAP-based core banking system should come into operation in March 2019. The preliminary work for the subsequent stages is continuing in parallel. At the same time the consulting systems will be completely restructured from a content and technical perspective. New software *Beratung//Neu* (consulting/new) will be rolled out for the entire sales force in the first quarter of 2019. This will result in changes to and streamlining of *Bauspar* contract processing. SHK intends to respond to the challenges resulting from cost pressure and customers' heightened service and speed requirements by providing innovative and high-quality services. With virtually unchanged processing volumes, year-on-year sales are expected to fall and a marginal loss before taxes are envisaged in 2019, due to one-off effects in 2018.

COMMENTARY ON SCHWÄBISCH HALL'S UNCONSOLIDATED ANNUAL FINANCIAL STATEMENTS UNDER HGB

FINANCIAL PERFORMANCE

Income statement

The operating profit after loss allowances fell by €123 million to €61 million compared to the previous year (€184 million). The profit is characterised by a significant decline in net interest received and an increase in administration expenses. Higher fee and commission expenses due to significantly improved new *Bauspar* business also contributed to the decline in earnings. This was counteracted by lower addition for loss allowances and an increase in other net operating income.

Bausparkasse Schwäbisch Hall's interest income, including current income from specialised funds, equity investments and profit transfer, fell by €91 million. Despite the continuing low interest rate, interest income from bridging loans and suspended repayment loans saw a volume-driven increase in earnings (€ +24 million) due to significant business growth in recent years. This more than compensated for the decline in earnings from *Bauspar* loans and other building loans (€– 13 million). Significant declines were seen in interest income from the investment of free funds in registered securities and bearer bonds including specialised funds (€– 84 million), while current income from investment companies fell by €7 million. This includes expenses amounting to €20 million from a method change in the measurement of registered bonds. Income from profit transfer in the amount of €10 million (2017: €11 million) were allocated to SHK.

Bausparkasse Schwäbisch Hall's interest expenses fell by €12 million to €788 million. Interest expenses for *Bauspar* deposits fell by €6 million despite significant growth in the *Bauspar* deposits portfolio and slightly higher addition to *Bauspar*-specific provisions (€– 8 million). This has been impacted by the new Schwäbisch Hall tariffs with their lower interest rate level. Other interest expenses generated earnings of €6 million.

The negative fee and commission balance increased from €– 206 million to €– 239 million. This is due to the slight increase in new *Bauspar* business and record new business in the core business segment of housing financing,

Income statement

			Changes	
in € million	**2018**	**2017**	**absolute**	**in %**
Net interest income	779	858	– 79	– 9.2
Net fee and commission income	– 239	– 206	– 33	– 16.0
Administrative expenses	– 473	– 416	– 57	– 13.7
Partial operating income	67	236	– 169	– 71.6
Other net operating income	5	– 18	23	> 100
Loss allowances	– 11	– 34	23	67.6
Operating profit after loss allowances	**61**	**184**	**– 123**	**– 66.8**
Reversal of technical security reserve	–	425	– 425	– 100.0
Allocationto fund for general banking risks	– 1	– 517	516	– 99.8
Income taxes	– 44	– 67	23	34.3
Profit transfer	– 16	– 25	9	36.0
Profit for the year	–	–	–	–

which led to higher commission payments to Schwäbisch Hall's field sales force and cooperative banks. Furthermore, in the case of the provision of immediate Schwäbisch Hall building loans, the timing of remuneration was aligned with standard market rules. As regards profit, this led to earlier inclusion of fee and commission expenses amounting to €24 million. In contrast, the elimination of portfolio commission for industrial and rural cooperative banks led to a €29 million improvement in the fee and commission balance.

Administration expenses of €473 million, netted with cost allocations to subsidiaries amounting to €4 million (2017: €4 million), were higher than the previous year by €57 million.

€26 million of this amount is allocated to personnel expenses. A significant increase was seen here in expenses for pension obligations. This was caused by the application of the new 2018 G mortality tables, the actuarial interest rate that fell further compared to the previous year as well as both the agreed salary increases in 2018. Further burden was placed on pension obligations by the measurement at fair value of plan assets invested in a specialised fund within the framework of a CTA.

The €35 million increase in other administration expenses is attributed to the implementation of strategic projects and measures for further developing the core business segments of *Bauspar* and particularly housing financing. Targeted modernisation of back-office applications in processing and sales based on standard SAP software should ensure that the *Bausparkasse* is well positioned for the future and can increase its competitiveness.

Depreciation of fixed assets fell by €4 million.

The net measurement gain from lending business improved by €16 million to €– 3 million. The increase resulted from the validation of credit risk parameters in the 2017 reporting year. Without taking this into account, loss allowances are slightly above the very good level of the previous year, despite the significant expansion of the housing financing business in recent years.

The gains and losses on valuation of the securities portfolio amounted to €15 million in the reporting year compared to €– 17 million in the previous year. These earnings can be attributed to the disposal of bearer bonds and registered bonds. Due to the redesignation of listed bearer bonds from the liquidity reserve to fixed assets it was not necessary to undertake any write-down to the lower of cost or market value pursuant to section 252(2)(3) HGB in the reporting year.

The gains or losses on equity investments in the amount of €– 23 million concern a correction to the carrying amount of the investment in SGB.

As of 31 December 2018, €278 million is allocated to the technical security reserve (TSR). This therefore amounts to 0.5 per cent (2017: 0.5 per cent) of *Bauspar* deposits. €1 million was allocated to the fund for general banking risks.

The profit to be transferred to DZ BANK due to a profit and loss transfer agreement amounts to €16 million (2017: €25 million). The cost-income ratio was 86.9 per cent (2017: 65.8 per cent).

Financial position

The Bausparkasse Schwäbisch Hall balance sheet total as of 31 December 2018 increased by €3.2 billion to €69.4 billion, reaching a new high.

Business volume amounted to €74.2 billion (2017: €70.5 billion). This amount includes both the balance sheet total as well as other financial obligations totalling €3 million and loan commitments of the *Bausparkasse* amounting to €4.8 billion.

The *Bausparkasse* was able to significantly expand the lending volume in 2018. Building loans increased by €4.2 billion to a new record high of €43.8 billion as of the end of 2018. While modest demand for *Bauspar* loans due to the interest rate level led to a decline in these loans, the volume of non-collective housing financing increased significantly. Here Schwäbisch Hall also profited from high demand for residential property supported by the good economic situation in Germany.

A further consequence of the high demand for loans was a significant decline in financial investments. These were primarily transacted with German issuers. They include financial investments from the *Bauspar* business in the form of registered bonds (€12.2 billion) and promissory note loans (€0.07 billion). Securities comprised listed bearer bonds (€8.0 billion) and shares in UIN Fund No. 817 (€2.3 billion).

The increase in *Bauspar* deposits to the record high of €60.6 billion was driven primarily by

Financial position

			Changes	
in € million	**31 Dec 2018**	**31 Dec 2017**	**absolute**	**in %**
Building loans	43,759	39,522	4,237	10.7
thereof: *Bauspar* loans	2,357	2,485	– 128	– 5.2
Suspended repayment and bridging loans	39,090	35,076	4,014	11.4
Other	2,312	1,961	351	17.9
Financial investments	25,233	26,241	– 1,008	– 3.8
Loans and advances	14,948	16,706	– 1,758	– 10.5
Securities	10,285	9,535	750	7.9
Fixed assets	346	351	– 5	– 1.4
Other assets	46	38	8	21.1
Bauspar deposits	60,583	57,309	3,274	5.7
Other liabilities	3,410	3,546	– 136	– 3.8
thereof: borrowing	2,966	3,160	– 194	– 6.1
Provisions	1,318	1,225	93	7.6
Technical security reserve	278	278	–	0.0
Fund for general banking risks	1,983	1,982	1	0.1
Equity	1,812	1,812	–	0.0
Balance sheet total	**69,384**	**66,152**	**3,232**	**4.9**

the high level of new business in recent years as well as the modest demand for *Bauspar* loans due to the interest rate level. As a result, the milestone of €60 billion in *Bauspar* deposits was exceeded for the first time in the history of the *Bausparkasse*.

The *Bausparkasse* transferred funds to a CTA in order to externally finance pension provisions. Pension claims and employee entitlements were netted with the created plan assets, which are administered by DZ BANK Pension Trust e. V. using fund shares.

The derivative financial instruments concluded with DZ BANK (interest rate swaps) amounting to €450 million (nominal amount) serve exclusively to manage the *Bausparkasse*'s general interest rate risk. They were included in the loss-free valuation of the banking book. The fair value of the interest rate swaps including accrued interest amounted to €12 million as of 31 December 2018.

Financial position

The liquidity position is in order. There are only insignificant changes compared to the previous year. Since 2018 it has been necessary to comply with a 100 per cent Liquidity Coverage Ratio (LCR). Pursuant to Article 412 (5) of the Capital Requirements Regulation (CRR), the national provisions in the area of liquidity no longer apply. In the 2018 financial year, the LCR as per CRR was always complied with. As of 31 December 2018, the LCR was 406.9 per cent (2017: 793.7 per cent).

The management of Bausparkasse Schwäbisch Hall's longer-term liquidity integrates any liquidity-related business positions of the *Bausparkasse* using liquidity gap analyses and then compares these to the existing liquidity reserves. Liquidity risk is managed using established limits, which ensure management actions can be taken at an early stage. The liquidity reserves taken into account within the framework of liquidity management primarily consist of highly liquid securities as well as the option of borrowing from the ECB, which is determined by the value of the securities portfolio eligible as collateral with the ECB.

With the ECB guideline, "Annex to Regulation of the ECB on the exercise of options and discretions available in Union law", the ECB offers the option of voluntary application of IFRS for reports to which the national accounting framework is to be applied. Bausparkasse Schwäbisch Hall made use of this and since 30 June 2017 has generated its regulatory reports based on IFRS. Bausparkasse Schwäbisch Hall's regulatory capital calculated pursuant to CRR amounted as of 31 December 2018 to a total of €4,178.5 million (2017: €3,583.3 million). Schwäbisch Hall does not have any Additional Tier 1 or Tier 2 instruments. Its Common Equity Tier 1 capital primarily consists of subscribed capital, capital reserves, revenue reserves and accumulated other comprehensive income. The increase in Common Equity Tier 1 capital is due to the allocation to the fund for general banking risks. In addition to the retention of earnings this allocation primarily involves taking account of the dissolution or reallocation of the technical security reserve amounting to €425 million as of 31 December 2017.

As of 31 December 2018, the regulatory capital requirements were calculated as amounting to €951.6 million (2017: €881.4 million). This growth is mainly attributable to the increase in lending business.

The total capital ratio, Tier 1 capital ratio and Common Equity Tier 1 capital ratio of Bausparkasse Schwäbisch Hall rose from 32.5 per cent as of 31 December 2017 to 35.1 per cent as of the reporting date. The minimum figures required according to regulatory requirements were clearly exceeded at all times during the year under review.

CRR introduced the concept of a leverage ratio for credit institutions. This figure represents the Tier 1 capital of a bank in relation to its overall risk position. In contrast to risk-based equity requirements underpinned by model assumptions, individual items within the framework of the leverage ratio are not assigned an individual risk weighting but rather are taken into account on an essentially unweighted basis.

Regulatory indicators according to the CRR

in € million	IFRS 31 Dec 2018[1]	IFRS 31 Dec 2017
Capital		
Common Equity Tier 1 capital	4,178.5	3,583.3
Additional Tier 1 capital	0.0	0.0
Tier 1 capital	4,178.5	3,583.3
Tier 2 capital	0.0	0.0
Total capital	4,178.5	3,583.3
Capital requirements		
Credit risk (including equity investments)	858.1	788.4
Market risk	0.0	0.0
Operational risk	93.5	93.0
Total	951.6	881.4
Capital ratios		
Common Equity Tier 1 capital ratio (minimum value: 4.5%)	35.1%	32.5%
Tier 1 capital ratio (minimum value: 6.0%)	35.1%	32.5%
Total capital ratio (minimum value: 8.0%)	35.1%	32.5%
Liquidity coverage ratio (LCR)	**406.9%**	**793.7%**
Leverage Ratio	**5.9%**	**5.3%**

[1] Provisional figures

MISCELLANEOUS

Declaration on corporate management in accordance with § 289f(4) HGB [German Commercial Code]
In the context of the new German Act on the Equal Participation of Women and Men in Leadership Positions in the Private and Public Sectors, which has been in force since May 2015, Bausparkasse Schwäbisch Hall has set targets for the proportion of women in leadership positions that are to be met by 30 June 2019.

Equal participation of women and men in leadership positions as of 31 December 2018

	in %
Supervisory Board	35.0
Management Board	0.0
Management level 1	9.5
Management level 2	18.8

A target of 30 per cent was set for the Supervisory Board (currently 35 per cent) while a target of 0 per cent was set for the Management Board.

Furthermore, a target of 12.5 per cent was set for the proportion of women at management level M1 and 20.0 per cent for management level M2. As of the 31 December 2018 reporting date, the targets had not been met due to restructuring and age-related retirement among other things. A push is underway to meet these targets by 30 June 2019.

In order to achieve these targets, Schwäbisch Hall is encouraging and supporting women in the assumption of management responsibility and to this end has implemented various measures to better balance family life and work. Additional flexible and individual solutions are being offered under the motto "The work of the future", e.g. sabbaticals, remote working and part-time hours for management.

Share of women in leadership positions

Management level	Target 2019
M1	12.5
M2	20.0

Opportunity and risk report

FUNDAMENTALS

Preliminary remarks

The risk report meets the requirements of the German Commercial Code (HGB) and German Accounting Standard No. 20 (GAS 20, group management report).

Data on loss allowances is no longer disclosed in the opportunity and risk report due to the changes arising from IFRS 9 regarding the formation of loss allowances. The data is now only reported on the consolidated financial statements.

The statements on the risk position are presented on the basis of the management approach. In this way, the risk position of the Schwäbisch Hall Group (in line with MaRisk) is shown based on the data used for internal risk management and therefore also for internal reporting to the Board of Managing Directors and the other committees.

The internal view on risk deviates partly from the balance sheet reporting. Significant differences between internal management and external financial reporting can be seen in the differing scopes of consolidation and valuation methods.

Within the meaning of the minimum requirements in risk management (MaRisk) the Schwäbisch Hall Group (SHG in line with MaRisk) comprises Bausparkasse Schwäbisch Hall AG, Schwäbisch Hall Kreditservice GmbH as well as Schwäbisch Hall Facility Management GmbH. The composition of the Schwäbisch Hall Group (in line with MaRisk) from a risk perspective is reviewed at least once a year or as needed and harmonised with current developments.

Risk strategy

By means of a systematic strategy process, the Schwäbisch Hall Group ensures, in accordance with MaRisk, the regular review of the sustainable business strategy defined by the Board of Managing Directors as well as the associated appropriate risk strategy. The process here comprises the planning, implementation, assessment and, as applicable, adjustment of strategies.

The risk strategy is developed on the basis of the business strategy and takes into account the relevant strategic requirements and objectives when designing risk management processes as well as within the context of deriving general operating conditions. A significant role is played here by the strategic business segments defined within the Schwäbisch Hall Group (in line with MaRisk) as well as by the strategic direction set in this context.

The integration of business policy objectives takes place via cross-business segment risk policy requirements in the risk strategy. Their implementation is ensured by two committees set up by the Board of Managing Directors: the Credit Committee (for credit risk and operational risk – KreCo) and the Asset Liability Committee (for market risk, liquidity risk, technical risk of a *Bausparkasse* and equity investment risk – ALCO). Reputation risk is handled by both committees.

Schwäbisch Hall Group (in line with MaRisk) deems “risk appetite” to be the type and extent of risks that are accepted in implementing the business model. The risk appetite statement contains the risk policy principles of the Schwäbisch Hall Group (in line with MaRisk). The principles are higher-level statements that are in harmony with the business model and risk strategy. These are supplemented by quantitative figures that represent the targets for the Schwäbisch Hall Group (in line with MaRisk).

Risk culture

The risk culture of the Schwäbisch Hall Group (in line with MaRisk) is characterised by shared values and trusting collaboration. The risk culture within the Schwäbisch Hall Group (in line with MaRisk) has been shaped primarily by experiences of the past, management insight as well as an error management culture and accountability.

The features of the risk culture are documented in a framework accessible to all employees of the Schwäbisch Hall Group (in line with MaRisk).

OPPORTUNITIES

With its clear focus on the Genossenschaftliche FinanzGruppe, Bausparkasse Schwäbisch Hall has ensured that its business model has proven itself to be resilient even in times of crisis. The forecast report presents the expected trend in the 2019 financial year for the business segments and the financial position. These factors are key figures for determining strategic positioning and the resulting potential opportunities for increased earnings and cost savings.

By founding BAUFINEX GmbH, the new intermediary market place for housing financing, Bausparkasse Schwäbisch Hall has developed a new sales channel and increased opportunities can be seen as regards the growth potential in the area of housing financing.

2019 opportunities can particularly be seen in the area of retirement provisions. Continued growth in new business for Wohn-*Riester* (home ownership pensions) is expected due to the improvement in general conditions, in particular due to the increase in the basic allowance from 2018.

On 14 November 2016, the German Federal Cabinet approved the “2050 climate protection plan”. A key component stipulates that the building stock should become almost entirely climate-neutral in the long term. In order to achieve this improvement, significantly more should be invested much more quickly in today’s stock. The *Bausparkasse* sees opportunities particularly in the additional stimulus for housing construction, an area in which it can profit over the long term as an expert around all matters of housing financing.

Furthermore, Bausparkasse Schwäbisch Hall expects increased business opportunities from optimising the business model in line with the amended German *Bausparkassen* Act and the Regulation on the German *Bausparkassen* Act from December 2015. In particular the possibilities in the area of refinancing should be exploited from 2019 in the form of *Pfandbriefe* (covered bonds).

Despite the challenges that the entire housing financing sector sees itself confronted with particularly in the 2019 financial year, the Board of Managing Directors expects the available opportunities to outweigh the stated risks for Bausparkasse Schwäbisch Hall.

RISK MANAGEMENT SYSTEM

Basic principles of risk management

The Schwäbisch Hall Group (in line with MaRisk) adheres to the principle that for all activities, risks should only be taken on to the extent that they are necessary to achieve business policy goals and insofar as the risks appear to be manageable. This requires the ability to effectively identify, measure and manage risks as well as put in place adequate capital backing and ensure sufficient liquidity. The overriding goals of risk management as integrated into comprehensive bank management are the existence of the company, ensuring appropriate interest on risk capital in line with the capital market as well as the creation of general organisational conditions for the management of risks.

Emphasis is placed here on a holistic overall risk assessment. A "live" collective portfolio must be simulated as a particular feature of a *Bausparkasse*. In order to measure risk, the *Bausparkasse* deploys a simulation model, which can represent the multi-optionality of *Bausparen* (contractual savings for housing) by using a large number of parameters. The special legal requirements that apply to *Bausparkassen* (German *Bausparkassen* Act and German *Bausparkassen* Regulation) are taken into account at the same time as part of this process.

As a part of the DZ BANK Group, Bausparkasse Schwäbisch Hall is integrated into the Group management of the DZ BANK Group and is accordingly subject to its risk policy requirements. The strategic and operational planning process as well as the Group-wide risk management and controlling processes of DZ BANK ensure that, in addition to coordinating business planning, there is consistency between the business strategy, risk appetite statement and risk strategy as well as risk management of the Schwäbisch Hall Group (in line with MaRisk) and DZ BANK.

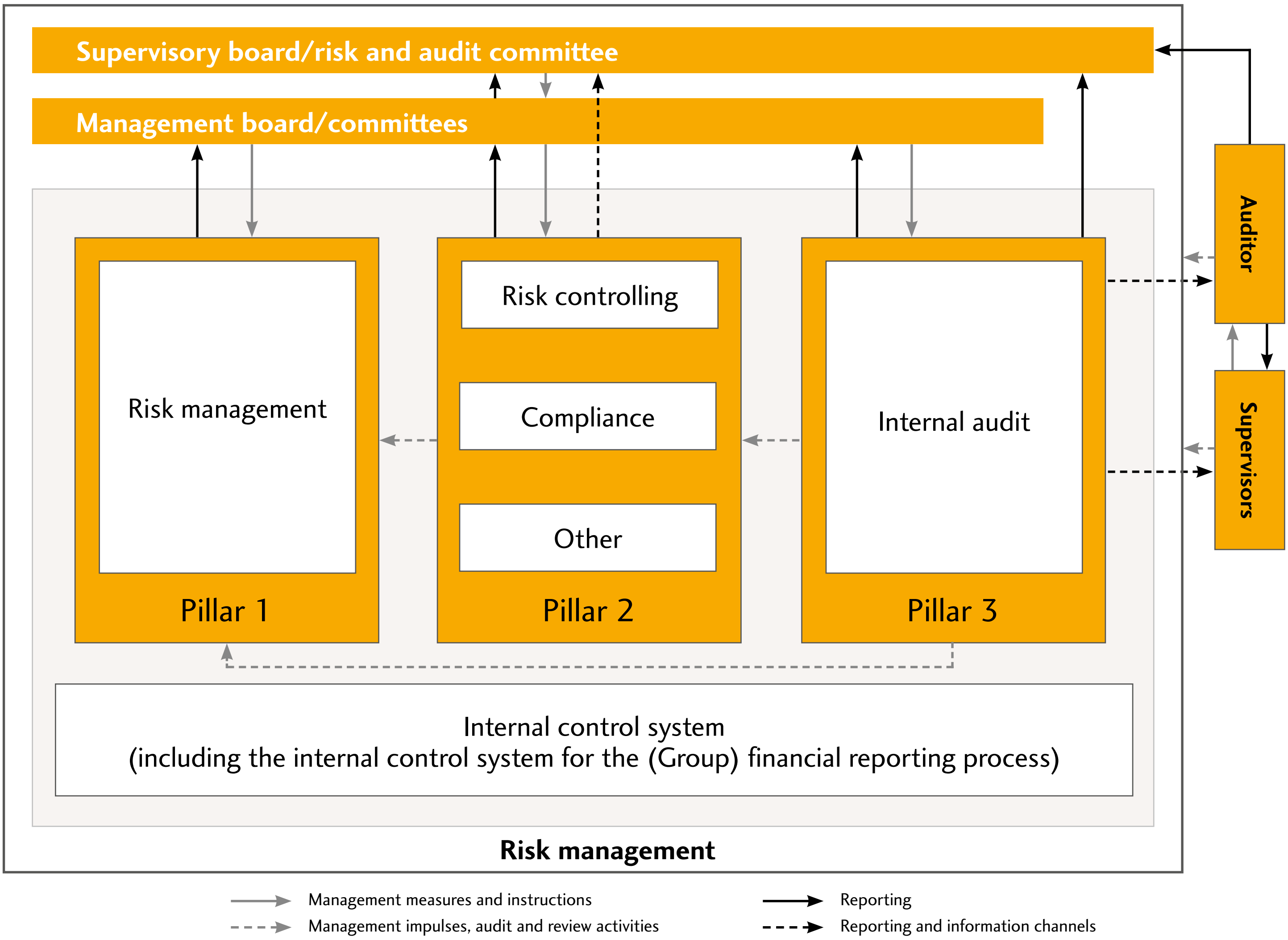
A return on capital calculated in accordance with § 26a KWG (German Credit Sector Act) is not meaningful due to the profit and loss transfer agreement between Bausparkasse Schwäbisch Hall AG and DZ BANK AG. A return on capital in accordance with § 26a(1)(4) KWG is therefore not disclosed.

Governance

The risk management of the Schwäbisch Hall Group (in line with MaRisk) builds on the risk strategy approved by the Board of Managing Directors. It is supported by three interconnected pillars integrated into the control and monitoring system. This governance structure of risk management is shown schematically in the following figure.

The three-pillar model illustrates how risk management is understood and stipulates clearly formulated and distinct roles and responsibilities. The interaction of the three pillars is a prerequisite for effective risk management. As part of this, the individual pillars take on the following tasks:

Pillar 1: Operational assumption of risks and their management
Pillar 2: Setup and enhancement of a framework for risk management; monitoring of compliance with framework by pillar 1 and relevant reporting to the Supervisory Board and Board of Managing Directors.
Pillar 3: Process-independent review and assessment of risk management and controlling processes in pillars 1 and 2; reporting to the Board of Managing Directors as well as the Supervisory Board; communication with external supervisory authorities.



The Supervisory Board monitors corporate management and evaluates the appropriateness of the risk management system and internal control system.

External auditors and banking supervisory authorities form the external supervisory environment.

Risk management

"Risk management" is to be understood as the operational implementation of risk strategies in individual areas of risk. The committees responsible for risk management and risk controlling prepare for decisions on the conscious assumption or avoidance of risks. During this process, they take into account the general conditions and risk limits set by the Board of Managing Directors.

The Asset Liability Committee (ALCO) is responsible for asset-liability management. ALCO manages market risk, liquidity risk, equity investment risk and the technical risk of a *Bausparkasse* at the comprehensive bank level and prepares for or takes relevant decisions. The Credit Committee (KreCo) has lead responsibility for credit risk management, i.e. it manages credit risk and prepares relevant recommendations for the Board of Managing Directors. Furthermore, KreCo is responsible for the handling of operational risks in the Schwäbisch Hall Group (in line with MaRisk). Reputation risk as regards risk measurement is covered via technical risk of a *Bausparkasse* and operational risk. Responsibility for questions arising in this regard falls to the respectively relevant risk committee, that is ALCO and/or KreCo.

Risk controlling is in charge of coordinating both committees.

Risk controlling

Risk controlling supports business management in all risk policy issues, particularly in the development and implementation of the risk strategy as well as in the design of a system to limit risks.

In addition to performing the risk inventory and generating the overall risk profile, risk controlling supports business management in setting up and enhancing risk management and controlling processes. Risk controlling is responsible for setting up and enhancing a system of risk indicators and a risk early warning process. Further duties comprise ongoing monitoring of the risk situation of the institution, risk-bearing capacity as well as monitoring compliance with the established risk limits. Furthermore, risk controlling compiles regular risk reports for the Board of Managing Directors and is responsible for the processes for the immediate forwarding of any information significant from a risk perspective to the Board of Managing Directors, the respective responsible parties and, if applicable, to Internal Audit.

Risk controlling at Schwäbisch Hall Group (in line with MaRisk) is performed by the Risk Controlling division. This is organisationally and functionally separate from the other corporate management divisions.

The risk control function is responsible for the independent monitoring and communication of risks. This is fulfilled by the Risk Controlling division. The management of the risk control function is involved in all risk policy decisions of the Schwäbisch Hall Group (in line with MaRisk). This is achieved by, for example, early integration into the process for preparing decisions by the Board of Managing Directors.

Compliance

The duties of the compliance function are fulfilled by the Legal and Compliance division. The compliance management system comprises the introduced principles and measures that aim to ensure compliant conduct by company employees. The compliance function counteracts risks that could arise from non-compliance with legal regulations and requirements. The compliance management system serves to recognise and monitor compliance risks, prevent compliance breaches and, in cases where they nonetheless occur, discover, work through and sanction such breaches as applicable.

Further functions: Data protection and information security

The Schwäbisch Hall Group (in line with MaRisk) has taken precautions in order to ensure compliance with data protection provisions as regards customers, business partners and employees. In particular, the Data Protection Officer role has been put in place and uniform data protection guidelines have been issued. Furthermore, employees are regularly made familiar with the currently applicable data protection provisions.

The Schwäbisch Hall Group (in line with MaRisk) has implemented an information security management system that is intended to ensure the confidentiality, integrity, availability and authenticity of information assets and information media (IT applications, IT systems and infrastructure components). The implemented governance model defines methods, processes, roles, responsibilities, competencies and reporting paths that are required to operationalise the strategic goals and duties. At the same time, it represents the framework for action as regards the standard quantitative and qualitative measurement and management of information security risks as part of operational risks.

Internal Audit

As a process-independent unit, Internal Audit systematically and regularly reviews the functional capability and effectiveness of risk management systems. Particular attention is paid here to reviewing risk measurement processes and risk reporting. In addition, Internal Audit reviews compliance with statutory and regulatory requirements. The results are reported directly to the Board of Managing Directors. Internal Audit is therefore another independent component of the internal control system of the Schwäbisch Hall Group (in line with MaRisk).

INTERNAL CONTROL SYSTEM OF THE (CONSOLIDATED) FINANCIAL REPORTING PROCESS

Objective and responsibilities

Bausparkasse Schwäbisch Hall is obligated to compile annual financial statements and a management report and voluntarily compiles consolidated financial statements and a combined Group management report. The Schwäbisch Hall Group is integrated into the consolidated financial statements of DZ BANK.

The primary goal of the external (consolidated) financial reporting of the Schwäbisch Hall Group and Bausparkasse Schwäbisch Hall is the provision of information that is useful in decision making for the recipients of the report. Connected with this is the ambition to ensure the orderly nature of (consolidated) financial reporting and thereby to avoid significant breaches of financial reporting standards, which can lead to incorrect information being provided to report recipients or to mismanagement of the Group.

Bausparkasse Schwäbisch Hall and its subsidiaries have set up an internal control system related to the (consolidated) financial reporting process as a component of the control system implemented for general risk management in order to limit operational risks in this area. Within this framework, the actions of employees, the implemented controls, the deployed technologies and the design of workflows is geared towards ensuring the objective connected with (consolidated) accounting is met.

Overall responsibility for (consolidated) group financial reporting iin the first instance lies with the corporate divisions of Accounting and Risk Controlling within Bausparkasse Schwäbisch Hall. Responsibility for preparing and controlling quantitative and qualitative information required for (consolidated) financial reporting is borne by all consolidated companies within the Schwäbisch Hall Group.

Instructions and rules

The methods and rules to be applied when preparing the consolidated financial statements within the Schwäbisch Hall Group are laid down in a group manual of the higher-level parent company, DZ BANK AG, as well as in the supplement to the group manual and the allocation guideline, as well as being laid down in writing in directives. Internal rules are continuously updated. The disclosure guideline of the DZ BANK Group as well as the risk manual of Bausparkasse Schwäbisch Hall form the basis for external risk reporting.

Resources and methods

Within Bausparkasse Schwäbisch Hall and its subsidiaries, processes have been put in place that are intended to enable – when using suitable IT systems – efficient risk management as regards financial reporting.

Consolidated accounting of the Schwäbisch Hall Group is organised in a decentralised manner. Preparing and controlling quantitative and qualitative information required for (consolidated) financial reporting lies with the organisational units of the Schwäbisch Hall Group. The divisions of Accounting and Risk Controlling of Bausparkasse Schwäbisch Hall conduct corresponding controls and tests as regards data quality and the observance of all regulations of the Schwäbisch Hall Group and/or the DZ BANK Group. The standards for safeguarding data quality in the process of economic capital adequacy management are defined in a guideline on data quality management and the internal control system that applies to Risk Controlling within the management units.

Financial reporting processes for individual transactions are performed by the organisational units. Consolidation processes are primarily performed by the Group Accounting department of Bausparkasse Schwäbisch Hall. This serves the orderly control and recording of all accounting and consolidation processes.

(Consolidated) financial reporting is primarily the responsibility of employees from the Schwäbisch Hall Group. Certain financial reporting-related business processes, such as Treasury settlement and the measurement of collateral, are outsourced to external service providers.

As regards consolidated accounting, agreed binding workflows apply between the Group Accounting department of Bausparkasse Schwäbisch Hall and the accounting departments in the individual organisational units of the Schwäbisch Hall Group. They regulate the collection and generation of quantitative and qualitative data necessary for the compiling of statutory company reports and as the basis for internal management of the operating units of the Schwäbisch Hall Group.

The consolidated financial statements and the combined Group management report as well as the annual financial statement are compiled on the basis of generally recognised valuation procedures, the appropriateness of which is regularly reviewed.

In order to ensure (consolidated) financial reporting is cost effective, the underlying data is processed in a largely automated way using suitable IT systems. As part of this, comprehensive control measures are intended to ensure processing quality and contribute to limiting operational risks. In this way, the input and output data for (consolidated) financial reporting is subject to numerous machine and manual test steps.

Information technology

The IT systems used for (consolidated) financial reporting must meet the necessary security requirements as regards confidentiality, integrity, availability and authenticity. IT-supported controls are intended to ensure that the processed data relevant to (consolidated) accounting meets the relevant requirements for compliance and security. In connection with IT-supported (consolidated) financial reporting processes this particularly concerns controls for consistent authorisation assignments, checks on changes to master data and logical access controls as well as controls in the area of change management in connection with the development, introduction and alteration of IT applications.

The information technology used for consolidated accounting purposes has functionality for undertaking consolidation processes within Group Accounting at Bausparkasse Schwäbisch Hall.

The review of IT-supported (consolidated) financial reporting processes is an integral part of the internal audits of Bausparkasse Schwäbisch Hall and the other companies of the Schwäbisch Hall Group.

Ensuring and improving effectiveness

Introduced processes are regularly reviewed as regards being fit for purpose and appropriate and are adjusted as regards new products and circumstances as well as altered legal regulations. In order to ensure and enhance the quality of (consolidated) financial reporting in Bausparkasse Schwäbisch Hall and the other companies of the Schwäbisch Hall Group, the relevant employees responsible for reporting are trained as needed regarding legal regulations and the IT systems in use. When implementing statutory amendments, external consultants and auditors are brought in early in order to ensure the quality of reporting. Internal Audit performs reviews at regular intervals of the internal control system related to the (consolidated) financial reporting process.

RISK FACTORS

Overarching risk factors

A multitude of market- and sector-related risk factors pose great challenges to the business model of a *Bausparkasse* in general and therefore also to the Schwäbisch Hall Group (in line with MaRisk).

Low-interest environment

In an historically low-interest rate environment, the risk exists of declining earnings from collective business. With an interest rate level that continues to be very low, *Bauspar* loans are less appealing to customers while higher-interest *Bauspar* deposits become more attractive in particular. As a result, interest income from *Bauspar* loans fall and interest expenses for *Bauspar* deposits increase.

Furthermore, the amount of liquidity available could only be invested at low interest. This would lead to an additional negative impact on earnings. Among other things, measures to optimise the *Bauspar* inventory and enhancements to the *Bauspar* product serve to mitigate risks from the low interest rate.

Risks could also be connected with a rapid increase in the interest rate level on the capital market. The price losses for fixed-income securities resulting from such a development could negatively impact the reserve for fair value OCI debt capital instruments and therefore capital.

Regulatory environment

German *Bausparkassen* Act

The amendment to the German *Bausparkassen* Act enacted in 2015 and the German *Bausparkassen* Regulation was a reaction by legislators to the continued low interest rate level on the capital market. Among other things, the amendment concerns the granting of a *Pfandbrief* privilege to *Bausparkassen* and an expansion to the list of permitted financial investments. The use of new regulations can impact the respective risk types.

Other risk factors arising from the regulatory environment

The ECB and European Banking Authority (EBA) are of the view that profit and loss transfer agreements are damaging for recognising ordinary shares including the related premiums as core Tier 1 capital. Bausparkasse Schwäbisch Hall is also affected by this due to the existing profit and loss transfer agreement with DZ BANK AG. The supervisory authority justifies this by citing, among other things, the lack of distribution discretion on the part of Bausparkasse Schwäbisch Hall regarding the ordinary shares. During a transition period from 2018 to the end of 2020, the affected capital instruments can still be fully counted as core Tier 1 capital. As part of the revision of CRR, there is a planned addition to 28(3) of CRR II to the effect that the profit and loss transfer agreement does not preclude being recognised if certain prerequisites are fulfilled. For example, it must be ensured that the subsidiary has the option of strengthening its reserves before distributing its profit to the parent company. The planned amendment eliminates the doubts of the supervisory authority. As Bausparkasse Schwäbisch Hall can meet the required criteria, the status quo can be maintained. CRR II is almost final, the tripartite political negotiations between the European Commission, European Council and European Parliament have already been completed. The final regulations are expected to come into force in the second quarter of 2019. The date of first-time application of the new regulation in Article 28(3) CRR II is currently unconfirmed. The *Bausparkasse* assumes that it will start to apply by the end of 2020 at the latest in order to avoid an offsetting gap for a time.

Furthermore, risks exist in the regulatory environment due to the increasingly stringent equity and liquidity standards as per CRR. As part of the revision to CRR (CRR II), comprehensive new regulations are being prepared in sub-areas of regulatory risk calculation. An increase in risk assets is expected for Bausparkasse Schwäbisch Hall once CRR II comes into force. In addition, the introduction of a mandatory leverage ratio of three per cent is expected from 1 January 2020. This figure relates the Tier 1 capital of a bank to its overall commitments. A difference from the risk-based equity requirements is that the leverage ratio does not provide for any differentiation between different risk weightings. As a result only the unweighted value is taken into account. The introduction of a binding upper limit could lead in the long term to limitations to ongoing business for Bausparkasse Schwäbisch Hall given the present and currently growing business volume.

The MaRisk amendment, which was adopted on 27 October 2017, has integrated into national law the January 2013 principles of the Basel Committee on Banking Supervision regarding the effective aggregation of risk data and risk reporting. Risks could arise here from the current implementation of new requirements and from a possibly insufficient implementation, as the case may be.

Significant risks and associated risk factors

In general, risks are defined as unfavourable future developments that may adversely impact the net assets, financial position and result of operations of the company. The following risk types are differentiated here: credit risk, market risk, liquidity risk, technical risk of a *Bausparkasse*, equity investment risk, operational risk and reputation risk. This selection is underpinned by a materiality concept, which uses various criteria to review whether the financial position, financial performance or liquidity situation could be significantly impaired.

Other risks may not be taken anyway due to the German *Bausparkassen* Act, do not currently exist or are not significant.

Risks for Bausparkasse Schwäbisch Hall and associated risk factors

Credit risk

Credit risk is the risk of losses from the default or deterioration in creditworthiness of counterparties (borrowers, issuers, counterparties including specialised funds).

Credit risks can arise both from traditional lending transactions, securities transactions as well as derivative and money market transactions. The traditional lending business corresponds mainly to the lending business in the *Bausparen* and housing financing business segments including financial guarantee contracts and loan commitments. In the context of credit risk management, securities transactions are products from the Capital Market sector such as banking book securities and promissory note loans. “Derivatives and money market transactions” are to be understood as derivatives (e.g. swaps) for hedging purposes.

The key risk factors are deteriorations in the economic climate (particularly an increasing unemployment rate, real estate prices) and rating deteriorations.

Market risk

Market risk comprises the original market risk as well as spread and migration risk.

The original market risk describes the risk of losses from financial instruments caused by a change in interest rates or other price-influencing parameters.

Spread risk denotes the risk of losses from financial instruments caused by a change in the credit spread with the rating remaining constant.

Migration risk is the risk of losses from financial instruments caused by a change in the issuer/issue rating as a price-influencing parameter.

Market risks are entered into within the framework of the business model particularly in the business segments of *Bausparen* and housing financing as well as own investments. The key risk factors for market risk are a change in the general interest rate level as well as the widening of credit spreads.

Liquidity risk

Liquidity risk can be subdivided into liquidity risk in the narrow sense, refinancing risk and market liquidity risk.

Liquidity risk is the risk that liquid funds are not available in sufficient quantity to meet payment obligations. Liquidity risk is therefore understood as insolvency risk.

Refinancing risk refers to the risk of a loss resulting from a deterioration in the liquidity spread (as a component of the own issue spread) of the Schwäbisch Hall Group (in line with MaRisk).

If a growing liquidity spread occurs, future liquidity needs can only be met with additional costs.

Market liquidity risk is the risk of a loss resulting from detrimental changes in market liquidity, for instance due to a decrease in market depth or market disruptions, with the result that assets can only be liquidated on the market with mark-downs and active risk management can only occur on a limited basis.

Liquidity risks result from the operating business of the *Bausparkasse* and from all business segments.

The key risk factors are the refinancing structure of lending transactions, the uncertainty of liquidity commitment, market value fluctuations and saleability of securities as well as their hypothecation capability in secured refinancing, the exercising of liquidity options as well as collective and non-collective new business.

Technical risk of a *Bausparkasse*

Technical risk of a *Bausparkasse* comprises two components: new business risk and collective risk. New business risk is the risk of negative repercussions from possible deviations from the budgeted new business volume. Collective risk denotes the risk of negative effects that can arise from deviations between actual and forecast developments in the *Bauspar* collective due to persistent and significant non-interest related changes in customers' behaviour.

The key risk factors are a decline in new business and altered customer behaviour (that is not interest-related).

The business risk of Bausparkasse Schwäbisch Hall is also covered as part of the institution-specific technical risk of a *Bausparkasse*. Business risk denotes the risk of losses from earnings fluctuations that may arise with the given business strategy and are not covered by other risk types. In particular this includes the risk that the losses cannot be counteracted in purely operating terms due to changes in significant general conditions (e.g. economic and product environment, customer behaviour, competitive situation).

Equity investment risk

Equity investment risk refers to the risk of losses due to negative changes in value within the equity investment portfolio, the risks of which are not subsumed under other risk types.

Equity investment risks result from the equity investment strategy of Bausparkasse Schwäbisch Hall and the Non-domestic business segment.

The key risk factors are negative changes in equity investment values.

Operational risk

Operational risk describes the risk of losses resulting from human conduct, technological malfunctions, process or project management weaknesses or external events. Legal risk and IT risk are included in the definition.

Operational risks result from the operating business of the *Bausparkasse* and from all business segments.

The key risk factors according to the Basel event types are internal or external fraud, disturbances in employment practice and workplace safety, disturbances with customers, products and business practices, material damage, business interruptions and system failures as well disturbances in execution, delivery and process management.

Reputation risk

Reputation risk refers to the risk of losses as a result of events that damage the reputation of the companies within the Schwäbisch Hall Group (in line with MaRisk) or in the products and services, especially in relation to customers (also including cooperative banks), shareholders, employees, in the labour market and the general public. Reputation risks can occur as an independent risk (“primary reputation risk") or as an indirect or direct consequence of other risk types (e.g. liquidity risks, operational risks; “secondary reputation risk”).

The key risk factors are unethical practices and loss of reputation due to losses from other risk types.

Risk and earnings concentrations

The business model of the Schwäbisch Hall Group (in line with MaRisk) is mainly focused on *Bauspar* products including advance financing and bridge financing as well as building loans. This gives rise to a fundamental risk concentration, which has been consciously entered into.

Earnings concentrations exist at the product and/or tariff level. The key figures for monitoring these transactions are regularly collected within the Schwäbisch Hall Group (in line with MaRisk) by the Finance Controlling division and reported to decision makers. To this end, a comprehensive system of various early warning indicators is available within the *Bausparkasse*.

Risk concentrations may arise due to one-sided debtor or investment structures. In principle, the Schwäbisch Hall Group (in line with MaRisk) follows a diversification strategy to avoid risk concentrations. This is reflected in the general credit risk principles, for example, on sovereign risk, sector risk, product risk and maturity policy. Within the framework of own investments, an effort is made to achieve the best possible diversification via prescribed minimum ratings and tradability of securities, as well as via issuer and counterparty limits and a corresponding maturity structure. With the focus on the *Bauspar* products, including advance financing and bridge financing and building loans, possible risk concentrations should be avoided in rating classes with high default rates and/or large default amounts.

RISK MANAGEMENT IN COMPREHENSIVE BANK MANAGEMENT

Risk monitoring and risk management system

Within the framework of integrated comprehensive bank management, risk management is comprised of risk controlling and risk management. Risk controlling comprises in particular the identification, assessment and monitoring of risks. To this end, various early warning indicators have been designed and implemented. These ensure that significant risks are recognised early, fully recorded and monitored and managed in an appropriate way.

Risk management denotes deciding on and implementing measures for active configuration of the risk profile while observing prescribed general conditions and limits.

The risk strategy of the Schwäbisch Hall Group (in line with MaRisk) stipulates the central principle of only entering into risks to the extent that it is necessary to achieve business policy goals. In addition, they should be entered into in a targeted and controlled way under observance of earnings goals, as well as being effectively identified, assessed, managed, monitored and communicated. Risks must be appropriately hedged with economic and regulatory capital.

As part of risk identification, there is a complete and systematic determination of which risks exist for the Schwäbisch Hall Group (in line with MaRisk). Building on this, the risks are then classified into significant and insignificant risk types. In this process, a review is made of which risks could significantly impair the financial, earnings or liquidity position. The significance of a risk type then essentially determines the appropriate backing with economic capital.

The following risks were identified as significant for 2018:

- Credit risk
- Market risk
- Operational risk
- Equity investment risk
- Technical risk of a *Bausparkasse*
- Liquidity risk
- Reputation risk.

Liquidity risk is currently not taken into account as regards risk-bearing capacity as liquidity risks cannot be meaningfully backed with equity.

The technical risk of a *Bausparkasse* also covers the specific business risk of the *Bausparkasse*.

A critical analysis of the validity of the quantified risks takes place as part of a suitability review at least once a year. Furthermore, a regular quantitative and qualitative validation takes place for complex methods and processes.

At the Schwäbisch Hall Group (in line with MaRisk), various methods and key figures are used for risk management in order to recognise risk-relevant circumstances early in the respective business segments.

Risk-bearing capacity

In principle, the term "risk-bearing capacity" is understood as the ability to cover all significant risks taking into account concentrations by means of so-called risk coverage potential (RCP) and thereby ensure economic capital adequacy, i.e. appropriate capital resources. Existing RCP is defined as the overall amount of available capital that can be deployed to cover unexpected risks.

In order that this capital is not entirely consumed when risks occur, the Board stipulates the proportion of assets that the unexpected loss may not exceed. This proportion is termed "risk cover funds" and is used to cover the different risk types (credit risk, market risk, technical risk of a *Bausparkasse*, equity investment risk and operational risk). The risk cover funds therefore represent the basis for setting risk limits. Net present values are limited and measured within the framework of the risk-bearing capacity of the Schwäbisch Hall Group (in line with MaRisk).

A distinction is made between a liquidation approach and a going-concern approach, which pursue differing hedging goals. The liquidation approach is the leading approach for the Schwäbisch Hall Group (in line with MaRisk).

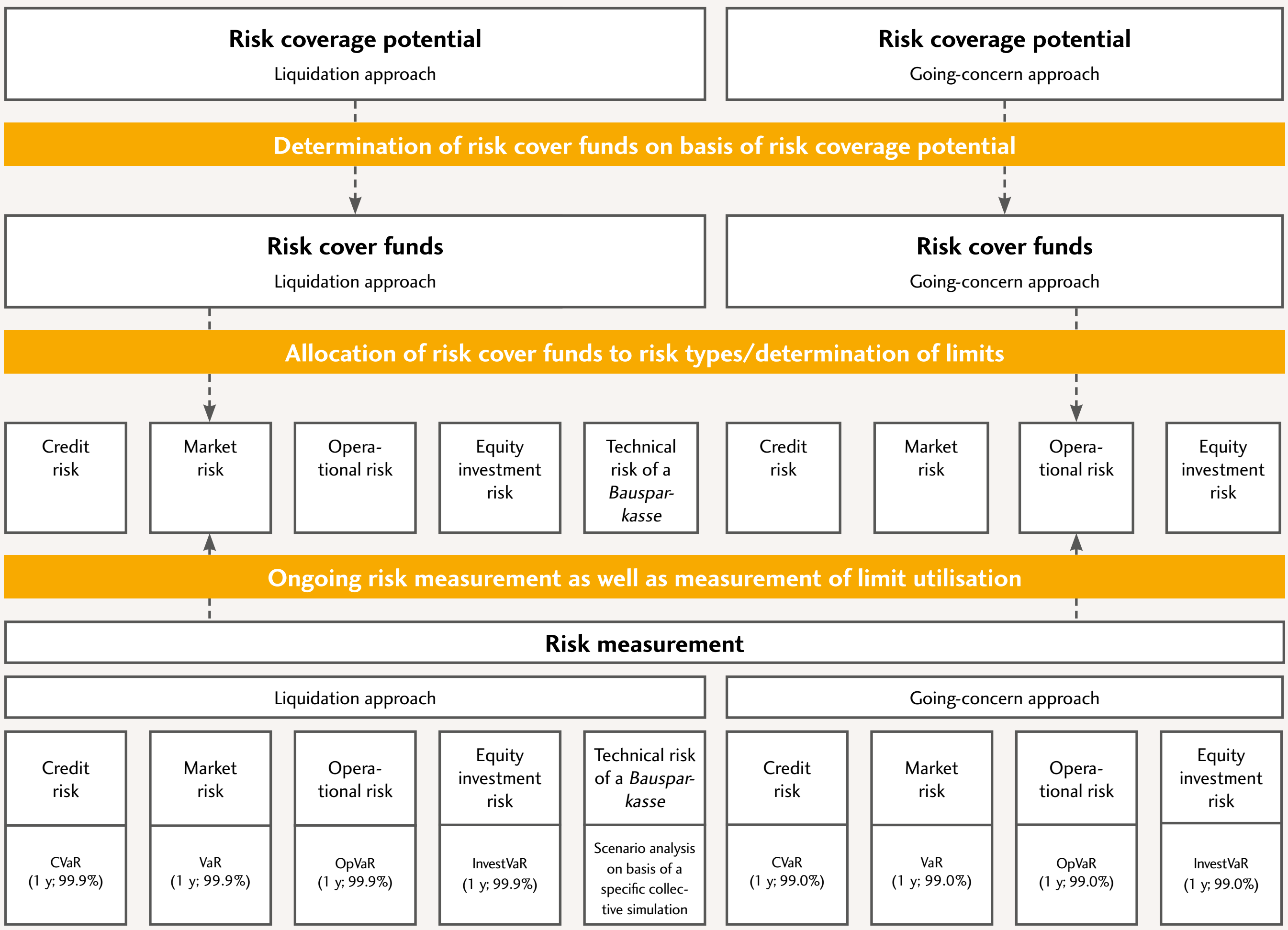
The hedging goal of the liquidation approach is to protect claims from outside creditors (e.g. *Bauspar* customers) with a confidence level of 99.9 per cent when risks occur. Under the going-concern approach, the intention is to ensure with a confidence level of 99.0 per cent that the Schwäbisch Hall Group (in line with MaRisk) will survive even if all items of the defined risk coverage potential were to be consumed by arising risks.

In 2018 the risk capital requirement was clearly within the respective risk coverage potential under both the liquidation approach and the going-concern approach. Economic capital adequacy amounted to 163 per cent as of the 31 December 2018 reporting date. In the course of the financial year it was always above the internal minimum goal of 120 per cent.

A more extensive capital planning process has been implemented as a supplement to the analysis of risk-bearing capacity with a traditional one-year horizon. The primary goal here is the timely identification of any possible future capital requirement (economic and regulatory) in order to introduce suitable measures at an early stage.

Capital planning was performed using the liquidation approach and the going-concern approach respectively for the next five years. No additional economic or regulatory capital requirement arose.

Comprehensive bank limit system at a glance



For the 2019 financial year the intention is to implement the requirements arising from the European Central Bank Guide to the internal capital adequacy assessment process (ICAAP). As part of this, risk-bearing capacity will in future differentiate between a normative and economic perspective.

The normative perspective is based on the capital ratios of pillar 1 and aims to comply with these in an actual analysis and in future-oriented scenarios.

The economic perspective corresponds to an internally defined view and aims to back all significant risks with capital.

Stress tests

In addition to results from risk measurement for normal risk situations, various scenarios are quantified for elevated risk situations. When defining the scenarios, there is a conscious decision to assume unusual but nonetheless thoroughly plausible events. Such scenarios – "stress tests" – check whether the risk-bearing capacity of the Schwäbisch Hall Group (in line with MaRisk) can be guaranteed even in the face of extreme general economic conditions.

In addition, inverse stress tests are performed, where an examination is made of which events could endanger the ability of the institution to survive.

The internal methods for risk measurement are used when performing stress tests. The input parameters for risk measurement are scaled during this process so that they simulate extremely negative economic scenarios.

Furthermore, stress scenarios exist with parameters that are particularly unfavourable for the *Bauspar* collective, in order to assess the impact of unusual developments in the *Bauspar* collective and thereby ensure its long-term bearing capacity. In order to assess the relevance of scenarios, early warning indicators were developed for risk-bearing capacity, which enable timely countermeasures. Like the scenarios themselves, the early warning indicators are also subject to the annual review process and are adjusted as needed in order to take into account changes in general conditions.

Risk reporting and documentation

The most important medium for risk reporting within the Schwäbisch Hall Group (in line with MaRisk) is the quarterly risk report, which provides a detailed overview of the quantified risks of the Schwäbisch Hall Group (in line with MaRisk) and is the basis for reporting to the Board of Managing Directors and Supervisory Board. Within the framework of the quarterly reporting the Board of Managing Directors and Supervisory Board receive portfolio- and commitment-related management information on credit risk as well as management information on other risk types of significance to the Schwäbisch Hall Group (in line with MaRisk).

The risk manual of the Schwäbisch Hall Group (in line with MaRisk), which is available to all employees, presents information on the methods, processes and responsibilities within the Schwäbisch Hall Group (in line with MaRisk) in addition to the general conditions for risk capital management and the management of risk types.

CREDIT RISK

Definition and causes

Credit risk denotes the risk of losses from the default or deterioration in creditworthiness of counterparties (borrowers, issuers, counterparties, including specialised funds). The credit risk of the Schwäbisch Hall Group (in line with MaRisk) is at a comparatively low level due to the granular portfolio made up of residential retail customer loans and the concentration of own investments in issuers and/or debtors with high creditworthiness.

Credit risk strategy

The basis of the strategic direction is the concentration on low-risk residential retail customer business.

Due to *Bausparkassen*-specific requirements, the customer lending business can only issue loans for housing purposes as per the German *Bausparkassen* Act. This is primarily achieved by issuing loans to private individuals for personal use and therefore leads to a high level of credit risk diversification both by size category and region. In contrast, financing that is commercial in nature plays almost no role at all. This is also stipulated by section 10 of the German *Bausparkassen* Regulation, according to which the proportion of loans that serve to finance construction projects that are commercial in nature may only make up a maximum of three per cent of the overall loan portfolio. Restrictive regulations from the German *Bausparkassen* Act exist in the area of own investments in order to safeguard customer deposits. In the case of new investments, in general, only credit ratings are permitted that have at least a rating of 1b (equal to A– pursuant to the rating classifications of Standard & Poor's). A minimum rating of AA– is required for securities from regional/local public authorities, public bodies, state banks, development banks, supranational institutions (multilateral development banks and international organisations), agencies, covered bonds and government bonds. In addition, Bausparkasse Schwäbisch Hall can also execute own investments in *Pfandbriefe* with an issue rating of at least AA–, regardless of the issuer rating. The majority of securities are invested in covered papers or in papers in the AAA rating class. A portion of our own investments is invested in foreign bank bonds, government bonds and corporate bonds as well as a specialised fund. For these investments as well, the defined minimum rating of 1b was observed, which in the case of the specialised fund relates to the fund level. In addition, there is a fund to cover pension obligations. For this purpose, Bausparkasse Schwäbisch Hall is using the options within the framework of section 4 (3a) of the German *Bausparkassen* Act.

Reporting

Various credit risk reports contribute to the prompt notification of decision makers regarding changes in the risk structure of the credit portfolio and form the basis of active management of credit risks. The KreCo committee has primary responsibility for credit risk management. It manages credit risk and prepares relevant recommendations. This includes in particular the adjustment of the scoring system described below.

Internal rating systems

The identification of credit risks takes place via the scoring process. This delivers as an output the necessary credit risk parameters for risk measurement.

The Schwäbisch Hall Group (in line with MaRisk) has deployed the following scoring systems that have been approved by the banking supervisory authority:

- Application and conduct scoring to calculate probability of default (PD),
- LGD (loss given default) scoring to calculate loss ratios,
- Credit rating for the Schwäbisch Hall Group (in line with MaRisk)'s own investments based on the rating system of DZ BANK AG (loss ratio for own investments is usually adopted from DZ BANK AG).

All scoring processes are validated quantitatively and qualitatively on an annual basis.

Economic credit portfolio management

Within the framework of economic credit portfolio management, a distinction is made between expected losses from individual transactions and unexpected losses from the credit portfolio. The expected loss is calculated using PD and LGD and covered by the calculated risk premium. The unexpected loss is quantified with the aid of a credit portfolio model on the basis of a credit-value-at-risk approach (CVaR). The CVaR is calculated as a risk indicator for the customer lending business as well as own investments, specifying a certain confidence level and a certain holding period. In the Schwäbisch Hall Group (in line with MaRisk), CVaR is calculated on the basis of the confidence level of 99.9 per cent (liquidation approach) and/or 99.0 per cent (going concern approach) and a one-year risk horizon.

Internally managed lending volume

<table>
<tr><th></th><th colspan="2">Internally managed lending volume</th><th colspan="4">Reconciliation</th><th colspan="2">Lending volume of consolidated financial statements</th><th></th></tr>
<tr><th></th><th colspan="2"></th><th colspan="2">Lending volume allocation</th><th colspan="2">Scope of consolidation</th><th colspan="2"></th><th></th></tr>
<tr><th>in € million</th><th>31 Dec 2018</th><th>31 Dec 2017</th><th>31 Dec 2018</th><th>31 Dec 2017</th><th>31 Dec 2018</th><th>31 Dec 2017</th><th>31 Dec 2018</th><th>31 Dec 2017</th><th></th></tr>
<tr><td rowspan="3">Traditional lending business</td><td rowspan="3">42,697.8</td><td rowspan="3">39,100.8</td><td rowspan="3">6,422.2</td><td rowspan="3">5,413.8</td><td rowspan="3">1,305.2</td><td rowspan="3">1,133.2</td><td>0.1</td><td>2.1</td><td>Loans and advances to banks</td></tr>
<tr><td>45,618.2</td><td>41,232.5</td><td>Loans and advances to customers</td></tr>
<tr><td>4,806.9</td><td>4,413.2</td><td>Loan commitment and financial guarantee contracts</td></tr>
<tr><td rowspan="4">Own investments</td><td rowspan="4">25,512.0</td><td rowspan="4">26,303.5</td><td rowspan="4">– 312.8</td><td rowspan="4">– 167.9</td><td rowspan="4">346.3</td><td rowspan="4">455.2</td><td>2,376.7</td><td>2,486.9</td><td>Loans and advances to customers</td></tr>
<tr><td>12,441.1</td><td>14,002.5</td><td>Loans and advances to banks</td></tr>
<tr><td>12.2</td><td>0.0</td><td>Positive fair values from derivative financial instruments</td></tr>
<tr><td>10,715.4</td><td>10,101.4</td><td>Bonds and other fixed-income securities</td></tr>
<tr><td>Total</td><td>68,209.8</td><td>65,404.3</td><td>6,109.4</td><td>5,245.9</td><td>1,651.5</td><td>1,588.4</td><td>75,970.6</td><td>72,238.6</td><td>Total</td></tr>
</table>

Reconciliation of lending volume with consolidated financial statements

The lending volume underlying internal group management is reconciled with the consolidated financial statements using the following table (refer to the table internally managed lending volume above).

Significant causes for differences between the values of internal management and external financial reporting lie in differing scopes of consolidation as well as the allocation of the lending volume.

Credit risk limiting

The *Bausparkasse* has a broadly diversified and granular customer credit portfolio.

Due to the portfolio structure and the credit risk strategy, there are no cluster risks in the *Bausparkasse*'s customer credit portfolio, which would otherwise require a limit on the issuing of new loans based on certain dimension criteria.

Credit rating-dependent limits are issued for all counterparties and issuers in the area of own-account investing.

Collateral

Another key tool for risk mitigation is the acceptance and consideration of standard banking collateral. In the customer lending business, this is in particular real estate liens on residential property. The measurement of the pledged object is based on the German *Bausparkassen* Act, German Mortgage Lending Value Regulation (BelWertV), General Business Principles (AGG) and General *Bauspar* Terms and Conditions (ABB).

Of the traditional lending business amounting to €42,697.8 million (2017: €39,100.8 million)

Secured lending volume by collateral type

	Traditional lending business		Securities business		Derivatives and money market business		Total	
in € million	**31 Dec 2018**	**31 Dec 2017**	**31 Dec 2018**	**31 Dec 2017**	**31 Dec 2018**	**31 Dec 2017**	**31 Dec 2018**	**31 Dec 2017**
Guarantees/warranties/ risk sub-participations	130.9	111.3	9,468.3	10,784.5	–	–	9,599.2	10,895.8
Credit insurance	–	–	–	–	–	–	–	–
Land charges/ mortgages/ registered liens	39,661.0	36,058.5	–	–	–	–	39,661.0	36,058.5
Chattel mortgages/assignments/ pledging of receivables	–	–	–	–	–	–	–	–
Financial collateral	–	–	–	–	–	–	–	–
Other collateral	209.0	270.5	–	–	–	–	209.0	270.5
Total	**40,000.9**	**36,440.3**	**9,468.3**	**10,784.5**	**–**	**–**	**49,469.2**	**47,224.8**

€39,661.0 million (2017: €36,058.5 million) is secured by property and €339.9 million (2017: €381.8 million) by other collateral.

Own investments are mainly invested in issues from public issuers, in development banks of the German federal states and in German covered bonds. As of the 2018 balance sheet date, 69 per cent of securities were covered or invested in the credit rating classes 0a and 0b.

The volume of derivative and money market transactions does not fall under the internal management definition of secured lending volume.

Early warning

The early identification of commitments with elevated risks takes place using defined early warning indicators, which are a component part of monthly reporting. If defined threshold values are exceeded, an ad hoc notification is sent to KreCo.

Commitments in default are transferred early into intensive management/problem loan processing with the goal of reducing potential defaults for the *Bausparkasse* and if possible returning the loan to normal management.

ANALYSIS OF THE CREDIT PORTFOLIO

Analysis of economic capital requirement for credit risk

The economic capital requirement for credit risks of the *Bausparkasse* amounted at the end of the financial year to €540 million (2017: €521 million) under the liquidation approach, and to €201 million (2017: €214 million) under the going-concern approach.

Under the liquidation approach this was counterbalanced by a limit of €728 million (2017: €700 million), while under the going-concern approach this amounted to €285 million (2017: €285 million). The limits were always adhered to over the course of the financial year.

The extent of the risk capital requirement is determined by, among other things, the lending volume, credit ratings and the expected loss ratio of the commitments. The following section delves into these influence factors and elucidates their trend over the financial year.

Volume-oriented credit portfolio analysis

The lending volume is calculated for the instruments bearing credit risk – traditional lending business (customer lending business), securities business (own investments) as well as money market transactions – pursuant to the procedure for internal management of the *Bausparkasse*. The differentiation by credit risk-bearing instruments corresponds to the classes to be formed for external reporting on risks from financial instruments.

The following quantitative data for the overall credit portfolio represents the maximum credit risk to which the *Bausparkasse* is exposed. The maximum credit risk of internal management represents a gross value as the risk-bearing financial instruments are measured without allowances for credit risk mitigation techniques and before loss allowances. The gross lending volume in the case of loans and open commitments as well as in the case of banking book securities is based on nominal values, while in the case of derivative transactions it is based on credit equivalent amounts.

Lending volume trend

The lending volume of the customer lending business continued to increase in the financial year due to the continuous expansion of private housing financing.

Structure of the overall credit portfolio

The sector structure of the credit portfolio displayed in the 'Lending volume by sector' figure shows a similarly broad diversification of the customer lending business of Bausparkasse Schwäbisch Hall compared to the previous year. Free liquidity is primarily invested in securities or specialised funds. The lending volume in the finance sector fell by around 4 per cent to €19.0 billion compared to 2017. The lending volume in corporates increased significantly by 12 per cent to €209.1 million. The lending volume in the core retail business also grew significantly by 9 per cent to €42,479.5 million due to the expansion of the immediate financing business.

The "Lending volume by country group" figure presents the geographic distribution of the credit portfolio broken down by the sovereign risk groups. As of 31 December 2018, the loans in the customer lending business and securities investments were concentrated in Germany with a share of 97 per cent (2017: 97 per cent) of the overall lending volume.

The distribution of the lending volume across maturity ranges can be seen in the "Lending volume by residual maturity" table. In general, retail residential property financing exhibits long-term original maturities. This is reflected at the *Bausparkasse* for the most part in long-term residual maturity periods. Due to the high new business volume, the share of customer loans with a maturity of more than five years was 96 per cent at year end (2017: 96 per cent).

The "Lending volume by credit rating" figure shows the distribution of the credit portfolio across individual credit ratings. Receivables in default represented by the credit ratings 4a and 4b had a share of 1.2 per cent of the customer lending business as of 31 December 2018 and were therefore slightly below the level of the previous year.

Lending volume by sector

in € million	Traditional lending business		Securities business		Derivatives and money market business		Total	
	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017
Finance sector	0.1	0.1	18,934.1	19,580.7	86.7	147.4	19,020.9	19,728.2
Public sector (administration/state)	22.2	14.1	6,282.1	6,389.0	–	–	6,304.3	6,403.1
Corporates	–	–	209.1	186.4	–	–	209.1	186.4
Retail	42,479.5	38,923.6	–	–	–	–	42,479.5	38,923.6
Commercial	184.0	151.4	–	–	–	–	184.0	151.4
Retail customers	42,295.5	38,772.2	–	–	–	–	42,295.5	38,772.2
Other	196.0	163.0	–	–	–	–	196.0	163.0
Total	**42,697.8**	**39,100.8**	**25,425.3**	**26,156.1**	**86.7**	**147.4**	**68,209.8**	**65,404.3**

Lending volume by country group

in € million	Traditional lending business		Securities business		Derivatives and money market business		Total	
	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017
Germany	42,392.0	38,793.2	23,631.3	24,831.5	48.5	106.5	66,071.8	63,731.2
Industrialised countries	288.8	290.0	1,794.0	1,324.6	38.2	40.9	2,121.0	1,655.5
Advanced economies	3.9	4.4	–	–	–	–	3.9	4.4
Emerging markets	13.1	13.2	–	–	–	–	13.1	13.2
Total	**42,697.8**	**39,100.8**	**25,425.3**	**26,156.1**	**86.7**	**147.4**	**68,209.8**	**65,404.3**

Lending volume by residual maturity

in € million	Traditional lending business		Securities business		Derivatives and money market business		Total	
	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017
≤ 1 year	137.4	177.1	2,154.5	2,389.0	38.2	–	2,330.1	2,566.1
> 1 year to ≤ 5 years	1,490.9	1,543.5	8,932.1	9,300.8	41.6	88.6	10,464.6	10,932.9
> 5 years	41,069.5	37,380.2	14,338.7	14,466.3	6.9	58.8	55,415.1	51,905.3
Total	**42,697.8**	**39,100.8**	**25,425.3**	**26,156.1**	**86.7**	**147.4**	**68,209.8**	**65,404.3**

Lending volume by credit rating (BVR II)

	Traditional lending business		Securities business		Derivatives and money market business		Total	
in € million	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017
0a	–	–	10,732.5	8,311.3	–	–	10,732.5	8,311.3
0b	–	–	331.6	3,193.2	–	–	331.6	3,193.2
0c	22.3	14.2	9,353.4	9,671.3	6.9	56.2	9,382.6	9,741.7
0d	–	–	219.7	190.9	–	–	219.7	190.9
0e	–	–	73.5	27.2	–	–	73.5	27.2
1a	–	–	2,428.3	190.4	–	–	2,428.3	190.4
1b	0.1	0.1	1,332.5	3,425.6	38.2	40.9	1,370.8	3,466.6
1c	32.1	36.9	25.4	–	–	–	57.5	36.9
1d	304.4	315.0	428.3	479.2	–	–	732.7	794.2
1e	1,384.8	1,250.1	423.7	489.8	41.6	50.3	1,850.1	1,790.2
2a	8,323.7	7,308.1	76.4	76.4	–	–	8,400.1	7,384.5
2b	11,659.3	10,653.8	–	100.8	–	–	11,659.3	10,754.6
2c	10,258.4	9,230.2	–	–	–	–	10,258.4	9,230.2
2d	5,018.9	4,756.3	–	–	–	–	5,018.9	4,756.3
2e	2,095.5	1,994.2	–	–	–	–	2,095.5	1,994.2
3a	1,035.5	952.5	–	–	–	–	1,035.5	952.5
3b	525.6	590.8	–	–	–	–	525.6	590.8
3c	376.5	426.0	–	–	–	–	376.5	426.0
3d	225.0	226.5	–	–	–	–	225.0	226.5
3e	711.9	659.8	–	–	–	–	711.9	659.8
4a	279.4	269.6	–	–	–	–	279.4	269.6
4b	248.4	253.7	–	–	–	–	248.4	253.7
Other	196.0	163.0	–	–	–	–	196.0	163.0
Total	**42,697.8**	**39,100.8**	**25.425.3**	**26,156.1**	**86.7**	**147.4**	**68,209.8**	**65,404.3**

Structure of credit portfolio with faultless creditworthiness

Own investments were neither overdue nor were value adjustments necessary. As in the previous year, the lending volume from the traditional lending business with faultless creditworthiness dominated with a 98 per cent share.

The portfolio of the traditional lending business, which was neither value-adjusted nor overdue, amounted as of the previous year's reporting date of 31 December 2017 to €38,213 million, out of an overall portfolio of €39,101 million.

The lending volume that is overdue but not subject to a specific loan loss provision amounted to €364 million as of the previous year's reporting date of 31 December 2017. This data point relates to the retail business.

The amount after specific provision as of the previous year's reporting date of 31 December 2017 amounted to €438 million, while the fair value of collateral for impaired lending volume amounted to €474 million. This data point relates to the retail business.

Loss allowances

Due to changes in IFRS 9, internal economic credit risk management is directly connected with the processes used to form loss allowances. In particular the parameters used to calculate the expected loss are being adjusted in order to fully meet the impairment provisions of IFRS 9. The procedure here is as follows:

- The multi-year probabilities of default calculated for economic management are based on long-term average migration behaviour. They are being modified for the purposes of external financial reporting in order to take account of the currently available macroeconomic outlook in particular.
- The assessment of the loss expected at the date of default from lending transactions is being adjusted in order to meet the requirements of IRFS 9 regarding parameter-based calculation of loss allowances.

This means that loss allowances from the financial year onwards will no longer be disclosed in the opportunity and risk report. This also applies to the lending volume to be specified in relation to loss allowances pursuant to IFRS 9, with said lending volume to be based on balance sheet valuations.

The data is now only reported on the consolidated financial statements.

MARKET RISK

Definition and causes

Market risk at Bausparkasse Schwäbisch Hall is composed of the original market risk as well as spread and migration risk. The original market risk describes the risk of losses from financial instruments caused by a change in the issuer rating or other price-influencing parameters. Spread risk denotes the risk of losses from financial instruments caused by a change in the credit spread with the rating remaining constant. Migration risk is the risk of losses from financial instruments caused by a change in the issuer rating as a price-influencing parameter.

The investment of free *Bauspar* deposits in a specialised fund also in principle causes fund price risks for Bausparkasse Schwäbisch Hall. However, the specialised fund is broken down into its individual components for market risk measurement and is not treated as a fund position. The calculated risks are managed within the framework of existing limits in line with other risk types.

Other individual risks of market risk such as commodity risk, equity risk, currency risk, volatility risk, market liquidity risk and real estate risk, result either from transactions not permitted under the German *Bausparkassen* Act and so accordingly cannot arise, or are currently not significant.

Market risk strategy

As regards market risks, a particular risk exists in the Schwäbisch Hall Group (in line with MaRisk) due to the collective *Bauspar* business.

Here a binding interest guarantee is made to customers both for credit balance interest as well as for loan interest, the utilisation of which lies in the future. This is taken into account by the *Bauspar*-specific form of the risk quantification models. Capital market activities are concluded as hedging transactions for the collective, with the focus on the goal of risk reduction. The *Bausparkasse* does not operate any proprietary trading in the sense of exploiting short-term price fluctuations. The management of interest rate risks therefore takes place at the level of the comprehensive bank and exclusively within the framework of the banking book (non-trading book institution).

Management of market risks

The risk measurement of the original market risk within the framework of risk-bearing capacity takes place at net present value. Technical simulation models for *Bauspar* business are run monthly on the basis of standard interest rate trend scenarios in order to determine cash flows from the *Bauspar* business that are dependent on interest rate scenarios. The comprehensive bank cash flow is calculated for each interest rate scenario together with the non-collective cash flows.

On the basis of an internal model, a Value at Risk (VaR) is calculated that takes into account the interest-dependent cash flows from the collective. Operating VaR is quantified daily using a historical simulation with the following parameters:

- 6-year history
- 10-day holding period
- Confidence level of 99 per cent.

The regulatory limit for the standard interest rate shock (ad hoc interest rate shift of +2.0 per cent/–2.0 per cent) of 20 per cent of regulatory capital was adhered to throughout 2018. Furthermore, net present value risk is calculated monthly with a parallel shift in the yield curve of +/– 100 basis points.

The net present value risk measurement of spread and migration risks is based on a credit metrics model. The risk value calculated monthly expresses the net present value loss from own investments due to changes in credit spreads with unchanged creditworthiness and/or due to credit rating changes. It is not exceeded in a single year with a probability (confidence level) of 99.9 per cent.

The Bausparkasse Schwäbisch Hall portfolio contains interest rate swaps amounting to €450 million in order to reduce interest rate risks in the overall interest book. There is high sensitivity in the case of falling interest rates due to the existing high duration on the liabilities side of the balance sheet (*Bauspar* deposits). The conclusion of receiver swaps reduces the sensitivity to falling interest rates and only takes place for hedging purposes within the framework of risk management in the Schwäbisch Hall Group (in line with MaRisk).

Limiting

The market risk classified by the Schwäbisch Hall Group (in line with MaRisk) as significant is accordingly supported with risk capital within the comprehensive bank limit system under the respective approach. For the calculation of the risk capital requirement in the original market risk, a scaled VaR is calculated with a confidence level of 99.9 per cent (liquidation approach) or 99.0 per cent (going concern approach) with a holding period of one year.

The risk capital requirement limit is static and is reset as part of the annual revision of the comprehensive bank limit system and approved by the Board of Managing Directors.

In addition to the comprehensive bank limit system there is a sub-limit system for ALCO. This limit system serves the operational management of market risks.

In spread and migration risk, the risk capital requirement under the liquidation approach is also calculated and limited on the basis of a VaR approach. The confidence level (99.9 per cent) and holding period (one year) match the assumptions used in the other market risk sub-types.

Reporting

The key figures and risk indicators of market risk are communicated to decision makers via various risk reports.

A monthly report with data on relevant risk figures is provided to the Board of Managing Directors and members of ALCO. The quarterly risk report provided to the Board of Managing Directors and Supervisory Board presents the market risk in the comprehensive bank limit system along with current utilisation.

Backtesting

Backtesting in interest rate risk serves to test the forecasting quality of the VaR approach. Here the daily profit and loss is compared with the VaR figures calculated using the risk modelling. In the financial year, one instance was identified where the measured VaR was exceeded by actual losses from value changes. The number of overruns as a result remained within the range expected and therefore confirms the appropriateness of the methodology.

Stress test

The ongoing analyses that determine the potential losses under normal market conditions are also supplemented with scenarios for extraordinary events, so-called “stress tests”. Here the corresponding risk factors are altered drastically, i.e. subjected to a change pursuant to predefined stress scenarios. Stress tests therefore represent a valuable enhancement to the comprehensive presentation of potential risks. The calculation of stress tests takes place both separately for market risk as well as at the comprehensive bank level.

The key input parameters as regards market risk for stress tests, derived from the specific business direction and therefore from the risk profile of the Schwäbisch Hall Group (in line with MaRisk) are:

- Changes in yield curve (position, twist) and credit spreads,
- changes in migration probabilities of issuers,
- changes in collective cash flows (existing and/or new business).

The results of stress tests supply important information on existing and potential risks as well as their impact on the Schwäbisch Hall Group (in line with MaRisk). The results of stress tests are also taken into account as part of the annual revision of limits, with the result that planning feedback is also ensured.

Analysis of market risks

The capital requirements for original market risks of the Schwäbisch Hall Group (in line with MaRisk) amounted, as of 31 December 2018 under the liquidation approach (VaR, 99.9 per cent confidence level, one-year holding period), to €313 million (2017: €280 million) with a limit of €744 million (2017: €736 million). In 2018 this included a capital buffer requirement of €9 million for property risks. Under the going concern approach, risk capital requirements at year end amounted to €227 million (€555 million limit). Operating VaR (99 per cent confidence level, ten-day holding period) amounted as of 31 December 2018 to €47 million (2017: €43 million). The VaR was within the limit at all times throughout the entire financial year.

The capital requirements for spread and migration risks amounted as of 31 December 2018 under the liquidation approach (CVaR, 99.9 per cent confidence level, one-year holding period) to €885 million (2017: €828 million) with a limit of €1,200 million (2017: €1,300 million).

LIQUIDITY RISK

Definition and causes

Liquidity risk can be subdivided into liquidity risk in the narrow sense, refinancing risk and market liquidity risk. Liquidity risk in the narrow sense is the risk that liquid funds are not available in sufficient quantity to meet payment obligations. It is therefore understood as insolvency risk. Refinancing risk refers to the risk of a loss resulting from a deterioration in the liquidity spread (as a component of the own issue spread) of the Schwäbisch Hall Group (in line with MaRisk). If a growing liquidity spread occurs, future liquidity needs can only be met with additional costs. A market liquidity risk occurs if transactions cannot be executed or closed out as needed, or only with a loss/discount, due to inadequate market depth or market disturbances.

Liquidity risk strategy and management of liquidity risk

The goal of liquidity management is ensuring solvency at all times. From a regulatory perspective, liquidity is measured using the liquidity coverage ratio (LCR). The trend in LCR is calculated at least once a month for subsequent months and is subject to an internal early warning limit.

The liquidity position contains all liquidity-related items and is presented using the expected liquidity trend as well as various stress scenarios for a period of up to ten years.

The measurement of insolvency risk takes place using liquidity trends and associated liquidity reserves for a period of one year. The measurement is performed daily for a normal scenario as well as for liquidity trends in stress situations (stress tests). Appropriate limiting ensures that possible liquidity shortfalls within a one-year time window are covered in all scenarios by freely available liquidity reserves. In this way, potential liquidity problems can be identified early and countermeasures can be introduced as the case may be.

The liquidity reserves taken into account within liquidity risk controlling consist primarily of the option to borrow from the ECB, with the maximum amount depending on the value of the securities portfolio eligible as collateral with the ECB. Furthermore, there are refinancing options with the Volksbanken Raiffeisenbanken cooperative financial network. In future, new refinancing sources (e.g. *Pfandbrief* issue) will be opened up in order to diversify further.

Market liquidity risk is taken into account using stress scenarios, where interest- and creditworthiness-related discounts are calculated on the market value of securities in the liquidity reserve.

Reporting

Adherence to liquidity risk limits for solvency over a one-year view is monitored daily while the LCR is reviewed at least once a month. The Board of Managing Directors is informed of this at least monthly and the Supervisory Board is informed at least quarterly.

Backtesting

The system for measuring and managing liquidity risk is validated annually via a multi-stage process. Among other things, the data used as input factors is examined. Both the data sources and the data quality are verified and tested accordingly. Furthermore, the assumptions underlying the model are specified, justified and reviewed.

Stress test

Comprehensive stress scenarios have been defined that derive from the comprehensive bank stress tests and were adapted for the liquidity perspective. These are taken into account in daily risk measurement. They contain both internal as well as external factors that have a negative influence on the liquidity position.

The minimum liquidity surplus in the respective stress scenarios fluctuated in 2018 between €804 million and €1,993 million.

Analysis of liquidity risk

In 2018 the liquidity risk limits were adhered to at all times. The LCR fluctuated between 372 per cent and 616 per cent and was therefore clearly above the 100 per cent regulatory minimum value in force for 2018.

TECHNICAL RISK OF A *BAUSPARKASSE*

Definition and causes

Technical risk of a *Bausparkasse* comprises two components: new business risk and collective risk. New business risk is the risk of negative repercussions from possible deviations from the budgeted new business volume. Collective risk denotes the risk of negative effects that can arise from deviations between actual and forecast developments in the *Bauspar* collective due to persistent and significant non-interest related changes in customers' behaviour.

The distinction from interest rate risk can be guaranteed due to altered customer behaviour that is not interest-related in the technical simulation model. Accordingly, in return, only interest-induced changes in customer behaviour are relevant to interest rate risk.

Risk strategy for technical risk of a *Bausparkasse*

Technical risk of a *Bausparkasse* is closely connected with the business model of the *Bausparkasse* and can therefore not be avoided. Against this backdrop, the risk strategy aims to avoid the uncontrolled expansion of risk. Management takes place particularly via a forward-looking tariff and product policy as well as via suitable marketing measures and corresponding sales management.

Management of technical risk of a *Bausparkasse*

Risk measurement takes place on the basis of a special technical simulation model in which a decline in new business and (negatively) altered customer behaviour can be shown in an integrated way.

The results of the technical simulation model are carried over into a long-term profit and loss account. The deviation between the actual result in the risk scenario and the result of a basic variant on the same reporting date is used as a risk measure. The net present value of the differences is determined via discounting. The total of net present value differences represents the technical risk of a *Bausparkasse* and therefore the risk capital requirement for this risk type.

Limiting

Technical risk of a *Bausparkasse* is limited for the net present value analysis under the liquidation approach and supported with risk capital.

Analysis of technical risk of a *Bausparkasse*

The capital requirements for technical risk of a *Bausparkasse* for 2018 amounted as of 31 December 2018 to €553 million (2017: €558 million), with a limit of €667 million. Over the course of the financial year, the risk capital requirement was always within the limit.

Reporting

The responsible risk committee (ALCO) and – within the framework of the quarterly report – the Board of Managing Directors as well as the Supervisory Board are informed of the risk capital requirement for the technical risk of a *Bausparkasse*.

Stress test

In order to calculate the technical risk of a *Bausparkasse* in the risk type-specific stress situation, a technical simulation model is created in which the relevant parameters are stressed compared to standard risk measurement. They are evaluated in line with the methodology for ongoing risk measurement.

The stress tests are performed on a quarterly schedule. In addition, other stress scenarios with extreme parameter values are performed within the framework of the comprehensive bank stress test, the inverse stress test as well as economic stress tests at the level of the DZ BANK Group.

EQUITY INVESTMENT RISK

Definition and causes

Equity investment risk refers to the risk of losses due to negative changes in value within the equity investment portfolio, the risks of which are not subsumed under other risk types.

Equity investment risk strategy and management of equity investment risk

Investment companies are assigned to various levels using a materiality analysis and included differently in risk management depending on their assignment. The quantification of equity investment risk takes place with the aid of a VaR approach based on a variance/covariance model and/or a Monte Carlo simulation model.

Equity investment risks arise particularly from international equity investments in *Bausparkassen*. Benchmarks exist in order to limit risk concentrations abroad, with benchmarks set based on the business activity of the respective participation and a country-specific factor.

Limiting

For equity investment risk the VaR is limited with a confidence level of 99.9 per cent under the liquidation approach as well as 99.0 per cent under the going-concern view. Equity investment risk is integrated into the comprehensive bank limit system. Risk measurement takes place quarterly.

Reporting

The Board of Managing Directors and Supervisory Board are informed of equity investment risk as part of quarterly reports.

Stress test

The ongoing measurement of equity investment risk is supplemented by performing stress tests. Stress scenarios are defined for equity investment risk within the framework of the comprehensive bank stress test.

Analysis of equity investment risk

The economic capital requirement for equity investment risks was measured as of 31 December 2018 under the liquidation approach as €269 million (2017: €211 million). In 2018 this included a capital buffer requirement of €4 million for foreign currency risks. The limit assigned on 31 December 2018 amounted under the liquidation approach to €310 million (2017: €450 million). Under the going concern approach the capital requirements amounted at year end to €214 million (2017: €166 million) with a limit of €300 million (2017: €360 million). The increase in capital requirements under both approaches can be attributed to a model change. The limits were not exceeded at any point over the course of the year. The volume of participations for which equity investment risk is measured amounted as of 31 December 2018 to €432 million (2017: €487 million).

OPERATIONAL RISKS

Definition and causes

Operational risk (OpRisk) describes the risk of losses resulting from human conduct, technological malfunctions, process or project management weaknesses or external events. Legal risk and IT risk are included in the definition.

Operational risks strategy

The task of OpRisk management and controlling is to systematically record and monitor all significant operational risks. The primary goal is not the avoidance of risks but active risk management, i.e. the controlled and/or conscious taking on of opportunities and risks.

Analyses and findings from risk evaluation and risk reporting supply the basis for management decisions, depending on the consequences of the respective operational risk.

In general, operational risks are analysed under a differentiated approach and managed independently by the organisational units concerned. This takes place in line with the existing strategies under observance of the defined principles, in particular the risk-return ratios. There are four basic management strategies that impact the risk profile and are actively designed:

- Accept the risk insofar as the costs of possible risk reduction measures outweigh the benefits,
- Reduce the risk, e.g. through process optimisation and emergency planning,
- Transfer the risk, e.g. via insurance and outsourcing,
- Avoid the risk, e.g. by dispensing with certain transactions and processes.

Management of operational risks

Basic management responsibility lies locally in the specialist divisions and/or the equity investments. Central controlling by the Risk Controlling division ensures that existing risks are systematically recorded company-wide in a standard fashion. To this end a framework was approved for the Schwäbisch Hall Group (in line with MaRisk) within which the deployed methods are described.

The following methods are used at the Schwäbisch Hall Group (in line with MaRisk) to manage and control operational risks:

Loss database

The aim of this method is to use a central loss database for the structured recording of all losses occurring within the Schwäbisch Hall Group (in line with MaRisk) resulting from operational risks and to introduce measures as applicable. Losses with a gross loss amount of €1,000 or more are recorded. The log contains in particular the categorisation of losses by event as well as by the loss amount.

Risk indicators

Risk indicators are key figures that can be informative regarding the risk situation of the company by acting as early warning indicators. They are collected and reported by local responsible parties. Risk situations are classified using a traffic light colour on the basis of prescribed threshold values. Risk indicators are systematically and regularly collected within the Group on a wide basis.

Scenario analysis

A risk scenario is the concrete description of potential losses as well as events and factors that could lead to these losses.

In the context of risk self-assessments scenarios for assessing particularly unfavourable constellations, which may not as yet have occurred, are identified and measured according to the loss amount and probability of occurrence. A distinction is drawn here between division-specific and inter-divisional scenarios.

The methods are reviewed and adjusted at least once a year by Risk Controlling in collaboration with the responsible OpRisk staff and/or experts.

Limiting

Operational risks are integrated into the comprehensive bank limit system.

One of the key management elements for operational risk is adequate support with regulatory as well as economic capital. The standard approach (STA) is used for determining regulatory risk capital requirements.

The determination of economic capital requirements occurs via the calculation of Operational Value at Risk (OpVaR). Operational risks are quantified using the actually realised losses from loss cases (ex post) as well as on the basis of scenarios (ex ante). Assumptions on the impact and occurrence of these scenarios are based on internal and external losses as well as expert evaluations. The data from both methods is transformed into distributions with the aid of assumptions and mathematical processes. In the case of the basic approach of the quantification model, the so-called 'loss distribution approach' is used. These distributions are then aggregated using the Monte Carlo simulation into a loss distribution for the ex post database and a loss distribution for the ex ante database. Finally both loss distributions are combined into a complete overview. This occurs by merging the datasets received from the Monte Carlo simulation from the ex post perspective with the datasets from the ex ante perspective. Finally, the loss distribution of the complete overview is then used to determine the risk measure of Value at Risk at the desired confidence level. Under the liquidation approach, the confidence level of 99.9 per cent is used, while the going concern approach uses 99.0 per cent.

Reporting

The Board of Managing Directors and Supervisory Board are informed of operational risks via regular reports. In addition, ad hoc reports are compiled as needed.

Identified operational risks are reported by Risk Controlling and/or within the individual organisational units to the relevant management level. Within the framework of the existing risk management process, the active management of identified operational risks then takes place with a particular focus on prevention.

Furthermore, KreCo is informed regularly regarding the status of operational risks in the Schwäbisch Hall Group (in line with MaRisk).

Stress test

The ongoing risk measurement via OpVaR is also supplemented with stress tests.

The risk parameters (loss amount and probability of occurrence) are updated annually for the calculation of the economic comprehensive bank stress test. OpVaR is then calculated for the individual comprehensive bank stress scenarios.

Analysis of operational risk

On 31 December 2018 an economic capital requirement for the operational risks of the Schwäbisch Hall Group (in line with MaRisk) was calculated under the liquidation approach as being €195 million (2017: €160 million). At no time has the value exceeded the respectively applicable limit. On 31 December 2018 the limit for operational risks amounted to €230 million (2017: €200 million). Under the going concern approach the risk capital requirements amounted at year end to € 33 million (2017: €31 million) with a limit of €80 million (2017: €80 million).

REPUTATION RISK

Definition and causes

Reputation risk refers to the risk of losses as a result of events that damage the reputation of customers, shareholders, employees, sales partners and the public in the companies of the Schwäbisch Hall Group (in line with MaRisk) or in the products and services offered. Causes of reputation risk can be the realisation of other risks, but also other publicly available negative information regarding the group companies.

Risk strategy for reputation risk

The framework for the objective of managing reputation risk is formed by the business strategy and the resulting general risk management goals of the *Bausparkasse* as well as Group requirements.

The business strategy gives rise to goals for qualitative growth (minimum return) and for new business in individual business segments. It is assumed for reputation risk that an expansion in new business leads to increased sales activities and therefore also to a stronger market presence. Increased reputation risks can also result from the resulting higher profile and strength of the Schwäbisch Hall brand.

The risk cannot be avoided due to the aforementioned statements.

Management of reputation risk

Management measures should be introduced by the managers of the organisational units at a local level and/or by the Board of Managing Directors. Their implementation must be supported by the organisational units concerned. The ongoing monitoring of the risk trend takes place with the aid of various evaluation instruments, which are enhanced in close coordination with the relevant organisational units (e.g. social media report, service satisfaction index).

In addition, there are other preventative and reactive methods for risk management (e.g. new product processes, crisis communication, compliance risk assessment). The risk capital requirement for reputation risk is not to be quantified independently and is to be taken into account on the risk side of risk-bearing capacity. The corresponding risk capital requirement is covered via technical risk of a *Bausparkasse* and operational risk.

(Negatively) altered customer behaviour and a decline in new business (among other things, for example, due to “damage to *Bausparkasse* image”/“reputational damage”) are presented in an integrated way in the technical simulation model underlying the technical risk of a *Bausparkasse*. This thereby covers the possible impact on the *Bausparkasse* of a reputation loss.

The quantification of operational risks contains information on pure loss amounts as well as information regarding individual potential loss components via division-specific and inter-divisional scenarios (loss of earnings, ex gratia payments, damages), which in turn relate to the reputation of the *Bausparkasse*. Furthermore, original reputation risks are identified and modelled in the inter-divisional scenario analysis for operational risks.

The loss components of reputation risk currently flow into the calculation of OpVaR and are accordingly taken into account in risk-bearing capacity.

Limiting

The risk amounts calculated in the technical risk of a *Bausparkasse* and operational risk are integrated into the overall bank limit system and are supported with economic capital. In this way, the influence of reputation is included in risk-bearing capacity.

Reporting

The reputation of the *Bausparkasse* is monitored at various points with different tools and is constantly being strengthened. The Marketing and Communications divisions in particular report to decision makers regarding significant findings or changes. In this way, the management of the *Bausparkasse* is informed of how the *Bausparkasse* is perceived among interest groups and is in the position to take management decisions.

Furthermore, central analysis and monitoring takes place within Risk Controlling on a quarterly basis. The various perspectives of the interest groups are then summarised using an index model into a risk overview. The Board of Managing Directors is informed of the index model and its respective form.

Stress test

Reputation risk causes follow-on and/or secondary risks for other risk types. This impact on the relevant risk types is contained in the cross-risk type stress scenarios.

ENHANCEMENT OF RISK MEASUREMENT METHODS AND THE RISK MONITORING SYSTEM

Risk measurement methods and risk monitoring systems are continuously improved and enhanced while observing new European and national statutory regulations.

MEASUREMENT OF OVERALL RISK PROFILE

The risk management of the Schwäbisch Hall Group (in line with MaRisk) meets statutory and regulatory requirements. It is suitable for efficiently monitoring and managing all risks that impact the Schwäbisch Hall Group (in line with MaRisk), with the result that the Schwäbisch Hall Group (in line with MaRisk) takes on risks in a controlled way and is therefore able to realise and secure earnings potential. The regulatory capital ratios of Bausparkasse Schwäbisch Hall are shown in the economic report on page 26f.

Due to the limit system geared towards risk-bearing capacity, i.e. stress testing that covers all significant risk types and flexible internal reporting, management is always in the position to introduce targeted countermeasures as needed.

In 2018 the Schwäbisch Hall Group (in line with MaRisk) saw some movement as regards risk capital utilisation within its economic risk-bearing capacity. The risk capital requirement for each risk type always experienced movement within the corresponding limit in the financial year under review.

The Schwäbisch Hall Group (in line with MaRisk) has a risk management and risk controlling system that enables it to promptly identify existing and foreseeable future risks, measure these in an appropriate manner as well as manage and communicate them.

Risks have not been identified that could endanger the existence of the Schwäbisch Hall Group (in line with MaRisk).

Consolidated financial statements

Income statement for the period 1 January to 31 December 2018

Income statement

in € thousand	(Notes)	2018	2017
Net interest income	(23)	766,321	832,916
Interest income calculated by using the effective interest method		1,602,794	1,639,427
Current income		1,672	870
Interest expenses		– 840,830	– 831,877
Income from joint ventures using the equity method		2,685	24,496
Net fee and commission income	(24)	– 39,853	– 47,724
Fee and commission income		85,790	85,729
Fee and commission expenses		– 125,643	– 133,453
Gains and losses on investments	(25)	12,409	17,594
Other gains or losses on measurement of financial instruments	(26)	8,286	1,413
Loss allowances	(27)	– 11,388	– 19,871
Administrative expenses	(28)	– 480,040	– 470,213
Other net operating income	(29)	39,073	19,819
Profit/loss before taxes		**294,808**	**333,934**
Income taxes	(30)	– 82,346	– 86,894
Total profit/loss		**212,462**	**247,040**
Attributable to:			
Shareholders of Bausparkasse Schwäbisch Hall		201,650	235,884
Non-controlling interests		10,812	11,156

Statement of comprehensive income for the period 1 January to 31 December 2018

in € thousand	(Notes)	2018	2017
Net profit		**212,462**	**247,040**
Other comprehensive income/loss		**– 84,962**	**– 36,895**
Items that may be reclassified to the income statement		**– 75,027**	**– 46,948**
Gains and losses on debt instruments measured at fair value through other comprehensive income *		– 97,570	– 56,197
Gains (+)/losses (–) arising during the reporting period		– 93,028	– 40,143
Gains (+)/losses (–) reclassified to the income statement on disposal		– 4,542	– 16,054
Exchange differences on currency translation of foreign operations		– 4,619	– 113
Share of other comprehensive income/loss of joint ventures using the equity method		– 3,235	– 6,907
Income taxes	(30)	30,397	16,269
Items that will not be reclassified to the income statement		**– 9,935**	**10,053**
Gains and losses arising from remeasurement of defined benefit plans		– 14,687	14,654
Share of other comprehensive income/loss of joint ventures using the equity method **		93	– 36
Income taxes	(30)	4,659	– 4,565
Total comprehensive income		**127,500**	**210,145**
Attributable to:			
Shareholders of Bausparkasse Schwäbisch Hall		118,940	199,617
Non-controlling interests		8,560	10,528

* Gains and losses from available-for-sale financial assets in the previous year in accordance with IAS 39
** Includes change in reserve from fair-value OCI equity instruments

Balance sheet as of 31 December 2018

Assets

in € thousand	(Notes)	31 Dec 2018	31 Dec 2017
Cash and cash equivalents	(8, 32)	36,763	43,558
Loans and advances to banks	(9, 33)	12,441,200	14,004,639
Loans and advances to customers	(9, 34)	47,994,902	43,719,385
Positive fair values from derivative financial instruments	(10, 35)	12,197	–
Investments	(11, 36)	10,725,256	10,107,705
Investments using the equity method	(12, 36)	254,811	288,243
Intangible assets	(13, 37)	148,557	134,318
Property, plant and equipment	(14, 38)	117,921	116,645
Current income tax assets	(15, 39)	2,029	925
Deferred income tax assets	(15, 39)	75,650	64,709
Other assets	(40)	29,010	24,789
Loss allowances	(16, 41)	– 170,895	– 168,148
Total assets		**71,667,401**	**68,336,768**

Equity and liabilities

in € thousand	(Notes)	31 Dec 2018	31 Dec 2017
Deposits from banks	(17, 43)	4,475,976	4,465,102
Deposits from customers	(17, 44)	60,335,346	56,909,655
Negative fair values from derivatives financial instruments	(10, 45)	–	278
Provisions	(18, 46)	1,453,505	1,563,451
Current income tax liabilities	(15, 39)	59,361	79,117
Deferred income tax liabilities	(15, 39)	–	6,872
Other liabilities	(47)	185,896	208,987
Equity	(48)	5,157,317	5,103,306
Subscribed capital		310,000	310,000
Capital reserve		1,486,964	1,486,964
Retained earnings		3,103,150	2,895,051
Reserve from fair value OCI equity instruments		– 11,961	n/a
Reserve from fair value OCI debt instruments[1]		1,921	94,155
Currency translation reserve		7,891	11,743
Non-controlling interests		73,702	94,509
Net profit		185,650	210,884
Total equity and liabilities		**71,667,401**	**68,336,768**

[1] Revaluation reserve in the previous year in accordance with IAS 39

Statement of changes in equity

in € thousand	Subscribed capital	Capital reserve	Earned equity	Reserve from fair value OCI equity instruments*	Reserve from fair value OCI debt instruments**
Equity as at 1 Jan 2017	**310,000**	**1,486,964**	**2,884,999**	**–**	**141,849**
Net profit	–	–	235,884	–	–
Gains and losses from available-for-sale financial assets	–	–	–	–	– 39,354
Exchange differences on currency translation of foreign operations	–	–	–	–	–
Revaluation of defined benefit plans	–	–	10,089	–	–
Share of other comprehensive income of joint ventures using the equity method	–	–	– 36	–	– 8,340
Total consolidated income	**–**	**–**	**245,937**	**–**	**– 47,694**
Dividends paid	–	–	–	–	–
Profit transferred due to profit and loss transfer agreement	–	–	– 25,000	–	–
Equity as at 31 Dec 2017	**310,000**	**1,486,964**	**3,105,936**		**94,155**
Adjustments due to first-time adoption of IFRS 9			**7,145**	**– 11,957**	**– 23,311**
Equity restated as at 1 Jan 2018	**310,000**	**1,486,964**	**3,113,081**	**– 11,957**	**70,844**
Net profit	–	–	201,650	–	–
Other comprehensive income/loss	–	–	–	–	– 67,173
Exchange differences on currency translation of foreign operations	–	–	–	–	–
Revaluation of defined benefit plans	–	–	– 10,028	–	–
Share of other comprehensive income of joint ventures using the equity method	–	–	97	– 4	– 1,750
Total consolidated income			**191,719**	**– 4**	**– 68,923**
Dividends paid	–	–	–	–	–
Profit transferred due to profit and loss transfer agreement	–	–	– 16,000	–	–
Equity as at 31 Dec 2018	**310,000**	**1,486,964**	**3,288,800**	**– 11,961**	**1,921**

* Historical impairments are transferred from retained earnings to the reserve from fair value OCI equity instruments due to application of the fair value OCI option for equity instruments. In the reporting year the change is included in the share of other comprehensive income of joint ventures using the equity method in the statement of comprehensive income.

** The reserve from fair value OCI debt instruments pursuant to IFRS 9 corresponds to the revaluation reserve pursuant to IAS 39 in the previous year. The breakdown of equity is presented in note 48.

Currency translation reserve	Shareholders' equity	Non-controlling interests	Total equity	in € thousand
10,368	**4,834,180**	**87,878**	**4,922,058**	**Equity as at 1 Jan 2017**
–	235,884	11,156	247,040	Net profit
–	– 39,354	– 574	–39,928	Gains and losses from available-for-sale financial assets
– 58	– 58	– 55	– 113	Exchange differences on currency translation of foreign operations
–	10,089	–	10,089	Revaluation of defined benefit plans
– 1,433	– 6,943	–	– 6,943	Share of other comprehensive income of joint ventures using the equity method
1,375	**199,618**	**10,527**	**210,145**	**Total consolidated income**
–	–	– 3,897	– 3,897	Dividends paid
–	– 25,000	–	– 25,000	Profit transferred due to profit and loss transfer agreement
11,743	**5,008,798**	**94,508**	**5,103,306**	**Equity as at 31 Dec 2017**
0	**– 28,123**	**– 25,466**	**– 53,589**	**Adjustments due to first-time adoption of IFRS 9**
11,743	**4,980,675**	**69,042**	**5,049,717**	**Equity restated as at 1 Jan 2018**
–	201,650	10,812	212,462	Net profit
–	– 67,173	0	– 67,173	Other comprehensive income/loss
– 2,367	– 2,367	– 2,252	– 4,619	Exchange differences on currency translation of foreign operations
–	–10,028	–	– 10,028	Revaluation of defined benefit plans
– 1,485	– 3,142	–	– 3,142	Share of other comprehensive income of joint ventures using the equity method
– 3,852	**118,940**	**8,560**	**127,500**	**Total consolidated income**
–	–	– 3,900	– 3,900	Dividends paid
–	– 16,000	–	– 16,000	Profit transferred due to profit and loss transfer agreement
7,891	**5,083,615**	**73,702**	**5,157,317**	**Equity as at 31 Dec 2018**

Cash flow statement

in € thousand	2018	2017
Net profit	**212,462**	**247,040**
Non-cash items included in net profit and reconciliation to cash flows from operating activities		
Depreciation, impairment losses, reversals of impairment losses on assets, and other non-cash changes in financial assets and liabilities	43,054	74,894
Non-cash changes to provisions	6,324	– 65,623
Other non-cash income and expenses	– 65,660	– 54,037
Gains and losses on the disposal of assets and liabilities	– 800	– 19,642
Other adjustments (net)	– 772,440	– 838,952
Subtotal	**– 577,060**	**– 656,320**
Cash changes in assets and liabilities arising from operating activities		
Loans and advances to banks	1,549,650	1,361,881
Loans and advances to customers	– 4,339,521	– 3,799,373
Other assets from operating activities	– 5,515	– 1,317
Positive and negative fair values from derivative financial instruments	– 77,720	1,004
Deposits from banks	11,547	– 362,374
Deposits from customers	3,437,941	2,910,686
Other liabilities from operating activities	– 130,361	– 149,862
Interest, dividends and income received from joint ventures using the equity method	1,699,364	1,749,939
Interest paid	– 791,952	– 804,459
Income taxes paid	– 241	– 3,721
Cash flows from operating activities	**776,132**	**246,084**
Proceeds from the sale of investments	2,545,463	2,231,018
Proceeds from the sale of property, plant and equipment	4,165	3,874
Proceeds from the sale of intangible non-current assets	3,272	5,010
Payments for the acquisition of investments	– 3,195,552	– 2,419,053
Payments for the acquisition of property, plant and equipment	– 23,456	– 21,228
Payments for the acquisition of intangible non-current assets	– 43,101	– 49,224
Cash flows from investing activities	**– 709,209**	**– 249,603**
Dividend paid to non-controlling interests	3,900	3,898
Profit transfer	– 25,000	– 18,000
Net change in cash and cash equivalents from other financing activities	– 52,618	– 7,117
Cash flows from financing activities	**– 73,718**	**– 21,219**

in € thousand	1 Jan – 31 Dec 2018	1 Jan – 31 Dec 2017
Cash and cash equivalents as at 1 Jan	**43,558**	**68,296**
Cash flows from operating activities	776,132	246,084
Cash flows from investing activities	– 709,209	– 249,603
Cash flows from financing activities	– 73,718	– 21,219
Cash and cash equivalents as at 31 Dec	**36,763**	**43,558**

The cash flow statement presents the changes in cash and cash equivalents during the financial year. Cash and cash equivalents consist of cash on hand, balances with central banks and other government institutions, debt instruments from public bodies that are eligible for refinancing with central banks . The cash and cash equivalents do not include any financial investments with residual maturity of more than three months at the date of acquisition. Changes to cash and cash equivalents are allocated to operating activities, investing activities and financing activities.

Cash flows from operating activities comprise cash flows mainly arising in connection with the revenue-producing activities of the Group and other activities that cannot be classified as investing or financing activities. Cash flows related to the acquisition and disposal of non-current assets are allocated to investing activities. Cash flows from financing activities include cash flows arising from transactions with equity owners and from other borrowing to finance business activities.

The liquidity position is in order. There are no negative changes compared to the previous year.

Notes to the consolidated financial statements General disclosures

01 BASIS OF PREPARATION

Bausparkasse Schwäbisch Hall AG, Schwäbisch Hall (hereinafter referred to as Bausparkasse Schwäbisch Hall), is the *Bausparkasse der Volksbanken und Raiffeisenbanken* and is firmly embedded in the Genossenschaftliche FinanzGruppe. It is a subsidiary of DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main (DZ BANK).

The registered office and business address of Bausparkasse Schwäbisch Hall is Crailsheimer Strasse 52 in Schwäbisch Hall, Germany. The company is registered in the Commercial Register of the Local Court of Stuttgart, Germany, under the number HRB 570105.

The present consolidated financial statements of BAUSPARKASSE SCHWÄBISCH HALL AKTIENGESELLSCHAFT, *Bausparkasse der Volksbanken und Raiffeisenbanken*, Schwäbisch Hall, for the 2018 financial year have been prepared pursuant to Regulation (EC) No. 1606/2002 (IAS Regulation) of the European Parliament and of the Council of 19 July 2002 pursuant to the provisions of the International Financial Reporting Standards (IFRS) as adopted in the European Union (EU).

The consolidated financial statements of Bausparkasse Schwäbisch Hall are included in the consolidated financial statements of DZ BANK. DZ BANK prepares the consolidated financial statements of the largest group of affiliated companies and is registered in the Commercial Register of the Local Court of Frankfurt am Main, Germany, under the number HRB 45651.

By exercising the option under section 315e (3) HGB ["Handelsgesetzbuch": German Commercial Code], the Board of Managing Directors of Bausparkasse Schwäbisch Hall decided, under the application of section 315e (1) HGB, to prepare voluntary consolidated financial statements in accordance with IFRS as at 31 December 2018.

The financial year is the same as the calendar year. The consolidated subsidiaries have prepared their annual financial statements using 31 December 2018 as the reporting date.

In the interest of clarity, some items in the balance sheet and the income statement have been aggregated and supplemented with additional disclosures in the notes. Unless otherwise indicated, all amounts are shown in thousands of euros (€ thousand). All figures are rounded to the nearest whole number. This may result in very small discrepancies in the present consolidated financial statements in the calculation of totals and percentages.

The consolidated financial statements of Bausparkasse Schwäbisch Hall have been released for publication by the Board of Managing Directors following approval by the Supervisory Board on 6 March 2019.

02 ACCOUNTING POLICIES AND ESTIMATES

Changes in accounting policies

The financial statements of the entities consolidated in the Bausparkasse Schwäbisch Hall Group have been prepared using uniform accounting policies.

The consolidated financial statements as at 31 December 2018 have been prepared in accordance with the IFRS that had been published by 31 December 2018 and that must be applied in the EU to the IFRS consolidated financial statements as at 31 December 2018.

First-time application in 2018 of changes in IFRS

The consolidated financial statements of Bausparkasse Schwäbisch Hall for the 2018 financial year takes into account for the first time the following amended financial reporting standards, amendments to and clarifications of IFRS, interpretations of the IFRS Interpretations Committee and the following improvements to IFRS:

- IFRS 9 – Financial Instruments,
- IFRS 15 – Revenue from Contracts with Customers,
- Clarifications of IFRS 15 – Revenue from Contracts with Customers,
- Amendments to IAS 40 – Transfers of Investment Property,
- IFRIC 22 – Foreign Currency Transactions and Advance Consideration,
- Annual Improvements to IFRS, 2014–2016 Cycle.

The provisions of IFRS 9 *Financial Instruments* superseded the content of IAS 39 *Financial Instruments: Recognition and Measurement* on 1 January 2018. IFRS 9 includes requirements relating to the following areas, which have been fundamentally revised: the classification and measurement of financial instruments, the impairment model for financial assets and hedge accounting.

As a result of the classification and measurement rules in IFRS 9, financial assets need to be recategorised. In the case of debt instruments, both the business models of the portfolios and the characteristics of the contracted cash flows for the individual financial assets must be taken into account for the purposes of the recategorisation.

This analysis is carried out by the individual Group entities in line with their individual business models and in compliance with Group rules laid down centrally. The results of the analysis enable the financial assets to be classified as “financial assets measured at fair value through profit or loss” (fair value PL), “financial assets measured at fair value through other comprehensive income” (fair value OCI) or “financial assets measured at amortised cost” (AC). If individual financial assets are classified as “financial assets measured at fair value through other comprehensive income” or “financial assets measured at amortised cost”, in case of accounting mismatches the standard also allows the reporting entity the option of classifying the financial assets as “financial assets designated as at fair value through profit or loss” (fair value option).

For equity instruments not held for trading that would normally have been measured at fair value through profit or loss, reporting entities have the option of recognising the changes in the fair value of these equity instruments irrevocably through other comprehensive consolidated income in subsequent measurement (fair value OCI option). This option is used by the Bausparkasse Schwäbisch Hall Group and concerns strategic investments in entities held in the long term.

The new impairment model requirements for financial assets measured at amortised cost or at fair value through other comprehensive income have resulted in a fundamental change in the recognition of impairment losses, because losses that are expected to occur now have to be recognised to losses that have actually been incurred.

The amount at which expected losses must be recognised depends on whether the credit risk attaching to the financial assets has increased significantly since their initial recognition. If such an increase has occurred, all expected losses are to be recognised from this point onwards over the entire lifetime of the asset. Otherwise, only those expected losses are to be recognised that result from possible loss events within the next twelve months.

A significant increase in credit risk is identified by comparing the current probability of default over the maturity of the instrument (as determined at the reporting date) with the probability of default originally expected for the same period. This test can be supplemented with qualitative criteria that indicate increased credit risk. Payment default of 30 days is used in particular here as a qualitative criterion for a significant increase in credit risk. However, payment default of 30 days is generally factored directly into the probability of default by means of a re-rating.

Furthermore, the exemption provided in IFRS 9 is used for securities whereby the requirement to test for a significant increase in credit risk can be disregarded for instruments with a low credit risk.

Modification circumstances such as deferral agreements are of secondary importance and therefore an adjustment in accordance with IFRS 9 has not been made.

IFRS 9’s new hedge accounting model helps to improve presentation of internal risk management and entails numerous disclosure requirements.

Within the Bausparkasse Schwäbisch Hall Group, no hedge accounting was used as at the 1 January 2018 date for transitioning to IFRS 9 or during the reporting period.

With the first-time application of IFRS 9 as at 1 January 2018, no retrospective adjustment is made to the 2017 comparison period at the Bausparkasse Schwäbisch Hall Group due to the available option under IFRS 9. Instead, in the opening balance sheet as at 1 January 2018, either the retained earnings or the reserve from fair value OCI debt instruments are adjusted by the difference between the previous carrying amount under IAS 39 and the carrying amount under IFRS 9. Due to the non-retrospective adjustment of the 2017 comparison period to be in line with the rules of IFRS 9, reporting on the consolidated financial statements must always be guided by the IFRS 9 provisions in force for the 2018 reporting period. If the reporting for the reporting period does not differ from that for the comparison period, the corresponding information under IAS 39 shall be disclosed for the comparison period. However, if the reporting for the reporting period differs from the reporting for the comparison period and if it is the case that corresponding information under IAS 39 is available for the 2017 comparison period, this information will then be provided separately under the heading “Comparative information in accordance with IAS 39”. If no corresponding information under IAS 39 is available for the 2017 comparison period, then no corresponding comparative information will be provided. The procedure outlined above is deviated from for individual components of the financial statement and its sections. For the statement of changes in equity, the revaluation reserve for debt instruments under IAS 39 is transferred to the “reserve from fair value OCI debt instruments” under IFRS 9. “Gains and losses on available-for-sale financial assets” in the statement of comprehensive income under IAS 39 is transferred to the following component reported in the statement of comprehensive income under IFRS 9: “gains and losses on debt instruments measured at fair value through other comprehensive income”.

With the transition to IFRS 9, various points in the consolidated financial statements were changed in terms of reporting, with these changes also included in the tables of the reconciliation under the column “Adjustments due to first-time application of IFRS 9”. The key reporting changes are described below in the order they appear in the consolidated financial statements:

Loss allowances under IFRS 9 are in principle reported as a gross amount in all balance sheet line items for financial instruments classified as “financial assets measured at amortised cost”. As a result, financial instruments within “Investments” and “Other assets” are reported as gross amounts under IFRS 9. Consequently, the loss allowances for “Financial assets measured at amortised cost” are now reported on the balance sheet under the “Other assets” line item. Accordingly, loss allowances are reported in the income statement under the item “Other gains or losses on measurement of financial instruments”. Under IAS 39, the Bausparkasse Group did not have any loss allowances under “Other assets” nor under debt instruments classified as “Available-for-sale financial assets” reported under “Investments”.

Loss allowances for financial instruments classified as “Financial assets measured at fair value through other comprehensive income” are reported under equity within the reserve from fair value OCI debt instruments.

Due to the first-time application of requirements under IFRS 9, equity after taxes declined by €– 53,589 thousand. Of this, €– 4,811 thousand is allocated to retained earnings, €– 23,311 thousand is allocated to the reserve from fair value OCI debt instruments and €– 25,466 thousand to non-controlling interests.

The transition effect of €53,589 thousand includes €– 14,471 thousand from the transition to IFRS 9 for joint ventures using the equity method. The use of the fair value OCI option for equity instruments led to a reporting change within equity. The historical impairments of €– 11,957 thousand were transferred from retained earnings to the reserve from fair value OCI equity instruments. This transfer, in combination with the aforementioned impact on retained earnings, generated a transition effect of €+ 7,145 thousand.

In the following tables, the balance sheet items of assets and liabilities, the loss allowances and the classes pursuant to IFRS 7 have been reconciled to the categories that are applicable since 1 January 2018 under IFRS 9 on the basis of the following three categories applicable under IAS 39 as at 31 December 2017: “Financial instruments held for trading” (HfT), “Available-for-sale financial assets” (AfS) and “Loans and receivables” (LaR).

The gross carrying amounts of the balance sheet items under assets and their categories pursuant to IFRS 9 are generated from the balance sheet items and categories pursuant to IAS 39 reconciled to IFRS 9 in the following table:

in € thousand	IAS 39 carrying amount as at 31 Dec 2017	Recategorisation amount with IAS 39 carrying amount as at 31 Dec 2017	Effect of transition from IAS 39 to IFRS 9	IFRS 9 carrying amount as at 1 Jan 2018
Cash and cash equivalents	**43,558**	**43,558**		**43,558**
AC		43,529		43,529
amount from cash and cash equivalents – LaR		43,529		43,529
Further cash and cash equivalents		29		29
Loans and advances to banks	**14,004,639**	**14,004,639**		**14,004,639**
AC		14,004,639		14,004,639
from loans and advances to banks – LaR		14,004,639		14,004,639
Loans and advances to customers	**43,719,385**	**43,719,385**		**43,719,385**
AC		43,719,385		43,719,385
from loans and advances to customers – LaR		43,719,385		43,719,385
Loss allowances	**– 168,148**	**– 168,148**	**1,679**	**– 166,469**
Investments	**10,107,705**	**10,107,705**	**– 41,212**	**10,066,493**
AC		2,436,705	– 41,212	2,395,493
from investments – AfS		2,436,705	– 41,212	2,395,493
Fair value OCI		7,664,656		7,664,656
from investments – AfS		7,664,656		7,664,656
Fair value OCI option		6,344		6,344
from investments – AfS (AC)		6,344		6,344
Investments using the equity method	**288,243**	**288,243**	**– 14,471**	**273,772**
Intangible assets	**134,318**	**134,318**		**134,318**
Property, plant and equipment	**116,645**	**116,645**		**116,645**
Income tax assets	**65,634**	**65,634**	**– 3,611**	**62,023**
Other assets	**24,789**	**24,789**	**33**	**24,822**
AC		10,455	33	10,488
from other assets – LaR		10,455	33	10,488
Additional other assets		14,334		14,334
Total assets	**68,336,768**	**68,336,768**	**– 57,582**	**68,279,186**

Due to the transition of categorisation requirements for financial assets from IAS 39 to IFRS 9, the measurement categories changed for the following reasons as at first-time application:

Due to assignment to the “hold” business model and the fulfilment of the cash flow criterion, financial assets in the IAS 39 category “available-for-sale financial assets” were recategorised to the IFRS 9 category “financial assets measured at amortised cost”.

The fair values of financial assets that were recategorised during the transition from IAS 39 to IFRS 9 from the category "available-for-sale financial assets" to the category "Financial assets measured at amortised cost" amounted as at the 31 December 2017 reporting date to €2,436,705 thousand. If this recategorisation had not taken place, there would have been a fair value of €2,431,221 thousand and a loss from the change in fair value amounting to €5,484 thousand at the end of the financial year.

The gross carrying amounts of the balance sheet items under liabilities and their categories pursuant to IFRS 9 are derived from balance sheet items and categories pursuant to IAS 39 presented in the following table:

in € thousand	IAS 39 carrying amount as at 31 Dec 2017	Recategorisation amount with IAS 39 carrying amount as at 31 Dec 2017	Effect of transition from IAS 39 to IFRS 9	IFRS 9 carrying amount as at 1 Jan 2018
Deposits from banks	**4,465,102**	**4,465,102**		**4,465,102**
AC		4,465,102		4,465,102
from deposits from banks – AC		4,465,102		4,465,102
Deposits from customers	**56,909,655**	**56,909,655**		**56,909,655**
AC		56,909,655		56,909,655
amount from deposits from customers AC		56,909,655		56,909,655
Negative fair values from derivative financial instruments	**278**	**278**		**278**
Fair value PL				
from negative fair values from derivative financial instrument – HfT		278		278
Provisions	**1,563,451**	**1,563,451**	**231**	**1,563,682**
Income tax liabilities	**85,989**	**85,989**	**– 4,224**	**81,765**
Other liabilities	**208,987**	**208,987**		**208,987**
AC		34,965		34,965
from other liabilities – AC		34,965		34,965
Additional other liabilities		174,022		174,022
Equity	**5,103,306**	**5,103,306**	**– 53,589**	**5,049,717**
Total equity and liabilities	**68,336,768**	**68,336,768**	**– 57,582**	**68,279,186**

Despite the transition of categorisation requirements for financial liabilities from IAS 39 to IFRS 9, the measurement categories did not change as at first-time application.

The transfer of loss allowances from IAS 39 to IFRS 9 – broken down by the balance sheet item under assets and their categories pursuant to IFRS 9 – is derived from the balance sheet items and categories pursuant to IAS 39 presented in the following table:

in € thousand	Loss allowances under IAS 39 as at 31 Dec 2017	Recategorisation amount with IAS 39 carrying amount as at 31 Dec 2017	Effect due to transition from IAS 39 to IFRS 9	Loss allowances under IFRS 9 as at 1 Jan 2018	Loss allowances under IFRS 9 as at 1 Jan 2018
				AC financial instruments	FVOCI debt instruments
Cash and cash equivalents			**13**	**13**	
AC			13	13	
from cash and cash and cash equivalents – LaR			13	13	
Loans and advances to banks			**807**	**807**	
AC			807	807	
from loans and advances to banks – LaR			807	807	
Loans and advances to customers	**168,148**	**168,148**	**–3,282**	**164,866**	
AC		168,148	–3,282	164,866	
from loans and advances to customers – LaR		168,148	–3,282	164,866	
Investments			**732**	**732**	**968**
FVOCI			–	–	968
from investments – AfS			–	–	968
AC			732	732	
from investments – AfS			732	732	
Other assets			**51**	**51**	
AC			51	51	
from other assets – LaR			51	51	
Total loss allowances	**168,148**	**168,148**	**–1,679**	**166,469**	**968**

The introduction of IFRS 9 has caused changes in the assignment of financial assets and financial liabilities to the classes of financial instruments pursuant to IFRS 7. The recategorisation of financial assets and financial liabilities under IFRS 9 has led to a change in the net carrying amounts of the classes of financial assets, as presented in the following table:

in € thousand	IAS 39 carrying amount as at 31 Dec 2017	Recategorisation amount with IAS 39 carrying amount as at 31 Dec 2017	Effect due to transition from IAS 39 to IFRS 9	IFRS 9 carrying amount as at 1 Jan 2018
Classes of financial assets	**67,717,565**	**67,717,565**	**– 39,500**	**67,678,065**
Financial assets measured at fair value	10,107,705	10,107,705	– 2,436,705	7,671,000
Financial assets measured at amortised cost	57,609,860	57,609,860	2,397,205	60,007,065
Classes of financial liabilities	**61,410,000**	**61,409,722**		**61,409,722**
Financial liabilities measured at fair value	278	278		278
Financial liabilities measured at amortised cost	61,409,722	61,409,722		61,409,722
Financial guarantee contracts and loan commitments	**5,926**	**5,926**	**231**	**6,157**
Provisions for loan commitments	5,926	5,926	231	6,157

The new requirements of IFRS 9 on accounting for the impairment of financial assets has led to a change in the loss allowances portfolio formed on the basis of the classes of financial assets, as presented in the following table:

in € thousand	Loss allowances under IAS 39 as at 31 Dec 2017	Recategorisation amount with IAS 39 carrying amount as at 31 Dec 2017	Effect due to transition from IAS 39 to IFRS 9	Loss allowances under IFRS 9 as at 1 Jan 2018	Loss allowances under IFRS 9 as at 1 Jan 2018
				AC financial instruments	FVOCI debt instruments
Loss allowances	**168,148**	**168,148**	**– 1,679**	**166,469**	**968**
Financial assets measured at fair value	–	–	–	–	968
Financial assets measured at amortised cost	168,148	168,148	– 1,679	166,469	–

The regulations of IFRS 15 *Revenue from Contracts with Customers* replace both the regulations of IAS 18 *Revenue* and IAS 11 *Construction Contracts* as well as the associated interpretations of IFRIC 13 *Customer Loyalty Programmes*, IFRIC 15 *Agreements for the Construction of Real Estate*, IFRIC 18 *Transfers of Assets from Customers and SIC-31 Revenue – Barter Transactions Involving Advertising Services*. According to IFRS 15, revenue should be realised if the customer has power of disposition over the agreed goods and services and can derive benefit from them. The principles standardised in IFRS 15 for the recognition and measurement of revenue derive from the five steps defined in IFRS 15. The new standard does not distinguish between different types of orders and services but rather puts in place standard criteria for when the provision of a service is to be realised based on a point in time or a period of time. Furthermore, IFRS 15 gives rise to additional qualitative and quantitative disclosure requirements regarding the nature, amount, timing and uncertainty of revenue and cash flows from contracts with customers. The amendments from IFRS 15 have no impact on the receipt of income that is accounted for in connection with financial instruments pursuant to IFRS 9, or on income arising from insurance contracts pursuant to IFRS 4 or leases pursuant to IAS 17.

Contract assets and contract liabilities may arise within the implementation of IFRS 15. If one of the parties has fulfilled its contractual obligations, a contract asset or contract liability must be reported, depending on whether the entity has provided its services and this claim is not merely linked to the passage of time or whether the customer has made the payment. Any unconditional right to receive consideration is reported in loans and advances. Impairments on receivables and contract assets accounted for in accordance with IFRS 15 are to be determined pursuant to IFRS 9. In this context, IFRS 15 refers to the rules for the simplified approach in IFRS 9, which require the expected losses over the lifetime to be recognised immediately. With regard to loss allowances for IFRS 15 items, it is not necessary to measure any significant increase in credit risk within the framework of the stage allocation.

On the first-time application of IFRS 15 as at 1 January 2018, no retroactive adjustment was made to the 2017 comparison period at the Bausparkasse Schwäbisch Hall Group due to the available option under IFRS 15. Instead, IFRS 15 is applied in accordance with the modified retrospective application method. Under this method, IFRS 15 is applied to new and existing contracts that have not yet been completed as at first-time application. In order to determine the effect of the first-time application of IFRS 15, the revenue recognised under IAS 18 for every as yet incomplete contract from the beginning of the contract to 31 December 2017 is to be compared with the revenues that would have been recognised if IFRS 15 had been applied from the time the contract began.

The difference between these two amounts is to be recognised as an accumulated adjustment to retained earnings in the opening balance sheet as at 1 January 2018. No accumulated adjustments to retained earnings arose within the Bausparkasse Schwäbisch Hall Group from the first-time application of IFRS 15. An impact assessment for IFRS 15 was performed at the end of the previous year. The Group companies performed the contract analysis in accordance with the five steps defined in IFRS 15. The Group companies found the revenue falling within the area of application of IFRS 15 in fee and commission income. The result of this analysis showed that the circumstances identified are only affected by the new regulations in an insignificant manner.

The implementation of the changes therefore has no significant impact on the measurement or the reporting of revenue from contracts with customers on the consolidated financial statements. Data on revenue from contracts with customers is shown under note 24.

The amendments to IAS 40 *Transfers of Investment Property* relate to the accounting for investment property that is under construction or development. IAS 40 stipulates that a classification as investment property begins or ends with a change of use. IAS 40.57 lists cases where there is a change of use. As this list was formulated as an exhaustive list, it was uncertain whether a property under construction or development would be covered by this principle. The amendments to IAS 40 clarify that this principle also applies to unfinished property. The list in IAS 40.57 is now explicitly described as non-exhaustive. There is no material impact on Bausparkasse Schwäbisch Hall's consolidated financial statements.

IFRIC 22 *Foreign Currency Transactions and Advance Consideration* clarifies the exchange rate that should be used for suspended payments in the case of foreign currency transactions. The deciding factor for determining the exchange rate is accordingly the point in time when the non-monetary asset or non-monetary liability resulting from the suspended payment is recognised for the first time. If there are several suspended payments received or made, the transaction date and therefore also the exchange rate is determined for each individual payment. There is no impact from the amendments to the consolidated financial statements of Bausparkasse Schwäbisch Hall.

The amendments to IAS 28 *Investments in Associates and Joint Ventures* as part of *Annual Improvements to IFRS, 2014–2016 Cycle* clarify that the option for venture capital organisations, investment funds and similar entities to measure their investments in associates and joint ventures at fair value through profit or loss may be exercised separately for each individual investment. These amendments have no material significance to the consolidated financial statements of Bausparkasse Schwäbisch Hall.

Changes in IFRS endorsed by the EU but not yet adopted
The Bausparkasse Schwäbisch Hall Group has decided against voluntary early adoption of the following new financial reporting standards and amendments to IFRS:

- IFRS 16 – Leases,
- Amendments to IFRS 9 – Prepayment Features with Negative Compensation,
- IFRIC 23 – Uncertainty over Income Tax Treatments.

The provisions of IFRS 16 *Leases* will replace the contents of IAS 17 *Leases*. The key reforms due to IFRS 16 concern the accounting for lessees. In future, lessees must recognise right-of-use assets in the balance sheet for all leases and corresponding lease liabilities for the contracted payment obligations received. Application discretion is granted for leasing objects of low value and for short-term leases. The notes for lessees and lessors in IFRS 16 are considerably expanded in comparison to IAS 17. All Group companies that have rented, leased or hired objects are affected by the new provisions of IFRS 16 as lessees. On the basis of the contract analysis by the Group companies, a portion of the payment terms from irrevocable lease contracts meet the definition of a lease pursuant to IFRS 16, with the result that the Bausparkasse Schwäbisch Hall Group must account for corresponding rights of use and lease liabilities when applying IFRS 16, insofar as in individual cases the exceptions for short-term leases or assets of minor value do not apply.

The amendments to IFRS 16 must be applied to financial years beginning on or after 1 January 2019. Here, either the fully retrospective application method or the modified retrospective application method is stipulated. IFRS 16 is applied within the Bausparkasse Schwäbisch Hall Group in accordance with the modified retrospective application method, under which the cumulative adjustment amounts from the first-time application as at 1 January 2019 are recognised in retained earnings. In this method, IFRS 16 is applied to new and existing contracts that have not yet been completed as at first-time application.

The contract analysis pursuant to IFRS 16 was completed in the reporting year and concluded that the implementation of IFRS 16 has no significant impact on the consolidated financial statements of Bausparkasse Schwäbisch Hall.

The amendments to IFRS 9 *Prepayment Features with Negative Compensation* provide clarity on the classification and measurement of financial instruments with symmetrical termination rights. According to this, the cash flow criterion under IFRS 9 is expressly not infringed, even in the case of an appropriate negative prepayment penalty. The amendments must be applied on a mandatory basis for the first time from 1 January 2019 onwards. There is no impact on the consolidated financial statements of Bausparkasse Schwäbisch Hall.

The interpretation IFRIC 23 *Uncertainty over Income Tax Treatments* contains regulations on the recognition and measurement of tax risk positions and thereby closes existing regulatory loopholes in this regard in IAS 12 *Income Taxes*. IFRIC 23 concerns itself in particular with the decision on whether a company should assess uncertain tax treatments of particular circumstances separately or together, with the assumptions that a company makes in relation to reviewing tax treatments by the tax authorities, with the determination of taxable profit (tax loss), bases for determining tax, unused tax losses and unused tax credits and tax rates, and with taking into consideration changes in facts and circumstances. Tax risks should be measured using the most probable value or the expected value. According to the interpretation, the measurement method that best depicts the existing risk should be used. The interpretation is to be applied on a mandatory basis for the first time from 1 January 2019 onwards. There is no impact on the consolidated financial statements of Bausparkasse Schwäbisch Hall.

Changes in IFRS that have not been endorsed by the EU

The following new accounting standards approved by the International Accounting Standards Board, amended accounting standards and interpretations and improvements to IFRS by the International Financial Reporting Interpretations Committee (IFRIC) have not yet been adopted by the EU:

- Amendments to IAS 28 – Long-term Interests in Associates and Joint Ventures,
- Amendments to IAS 19 – Plan Amendment, Curtailment or Settlement
- Amendments to IFRS 3 – Business Combinations,
- Amendments to IAS 1 and IAS 8 – Definition of Material
- Amendments to References to the Conceptual Framework in IFRS Standards,
- Annual Improvements to IFRSs 2015–2017 Cycle.

The amendments to IAS 28 *Long-term Interests in Associates and Joint Ventures* clarify that an entity applies the provisions of IFRS 9 to long-term interests in associates and joint ventures that form part of its net investment in the associate or joint venture but to which the equity method is not applied. The amendments apply for the first time as at 1 January 2019. Early adoption is permitted subject to incorporation into EU law.

The amendments to IAS 19 *Plan Amendment, Curtailment or Settlement* mean that in future it will be mandatory in the case of an amendment, curtailment or settlement of a defined benefit pension plan that the current service cost and net interest will have to recalculated for the rest of the financial year using the current actuarial assumptions that were used for the required remeasurement of net debt (asset). Furthermore, supplementary information for the clarification was included as to how a plan amendment, curtailment or settlement would impact requirements regarding the asset ceiling. The changes must be applied on a mandatory basis for the first time from 1 January 2019 onwards. Early adoption is permitted subject to incorporation into EU law.

Amendments to IFRS 3 *Business Combinations* aim to better differentiate between acquisitions of business operations and acquisitions of a group of assets. In order to be deemed a business, an acquisition must, under the new definition of the term “business”, consist of resources (inputs) and a substantive process that together create the possibility of generating an output. The amended definition is to be applied to acquisition where the acquisition date is on or after the start of the first annual reporting period that begins on or after 1 January 2020. Early adoption is permitted subject to pending incorporation into EU law.

The amendments to IAS 1 *Presentation of Financial Statements* and IAS 8 *Definition of Material* pursue the goal of sharpening the definition of the term "materiality" without fundamentally altering the application of the principle of materiality. In particular, the amendments introduce the new criterion of concealment of information and equate concealment with the omission or misrepresentation of information. Subject to their incorporation into EU law, the amendments are expected to apply to financial years that begin on 1 January 2020 or later.

A review is currently being examined as to the impacts on the consolidated financial statements of Bausparkasse Schwäbisch Hall of the aforementioned amendments and improvements to the IFRS and the new IFRIC interpretations. No changes are currently expected to result for the consolidated financial statements of Bausparkasse Schwäbisch Hall.

The dates of the first-time application of the issued amendments to IFRS and the IFRIC interpretations are subject to the proviso that the amendments must first be incorporated into EU law.

Accounting assumptions and estimates

Assumptions and estimates are to be made in accordance with the relevant financial reporting standards in order to determine the carrying amounts of assets, liabilities, income and expenses recognised in the consolidated financial statements. These are based on historical experience, planning and – according to current assessment – probable expectations or forecasts of future events.

Assumptions and estimates are primarily used to determine the fair value of financial assets and financial liabilities and to determine impairment of financial assets.

Financial assets and financial liabilities resulting from *Bauspar* business are described in note 6 *Bausparen*.

Furthermore, estimates have significant influence on the measurement of provisions for employee benefits and other provisions, and therefore also under certain circumstances on accounting for the related deferred income tax assets and deferred income tax liabilities.

Estimation uncertainties in connection with provisions for employee benefits primarily result from defined benefit pension obligations, the measurement of which is significantly influenced by actuarial assumptions. Actuarial assumptions include numerous long-term future-oriented factors such as salary and pension trends or future average life expectancies.

Cash outflows that actually occur in the future due to circumstances for which other provisions were formed may deviate from the expected utilisation.

Further comments on assumptions and estimates are presented in the notes below.

03 SCOPE OF CONSOLIDATION

The consolidated financial statements of Bausparkasse Schwäbisch Hall for the year ending on 31 December 2018 include, in addition to Bausparkasse Schwäbisch Hall as the parent company, all significant subsidiaries that are directly or indirectly controlled by Bausparkasse Schwäbisch Hall AG, including significant structured entities. This includes Schwäbisch Hall Kreditservice GmbH, Schwäbisch Hall (hereinafter referred to as SHK) and special fund UIN Union Investment Institutional Fund No. 817, Frankfurt am Main (hereinafter referred to as UIN Fund No. 817), as subsidiaries, and Fundamenta-Lakáskassza Lakás-takarékpénztár Zrt., Budapest (hereinafter referred to as FLK), as a subgroup.

The consolidated financial statements use the equity method to include the following joint ventures under joint management with at least one other non-Group company: Českomoravská stavební spořitelna, a.s., Prague (hereinafter referred to as ČMSS), Prvá stavebná sporitel'ňa, a.s., Bratislava (hereinafter referred to as PSS) and Zhong De Zuh Fang Chu Xu Yin Hang (Sino-German-Bausparkasse) Co. Ltd., Tianjin, and Zhong De Zuh Fang Chu Xu Yin Hang (Sino-German-Bausparkasse Co., Ltd., Tianjin, Tianjin [hereinafter referred to as SGB]).

The list of shareholdings pursuant to section 315e (1) HGB in conjunction with section 313 (2) HGB is a component of the notes, under note 66.

04 PROCEDURES OF CONSOLIDATION

Inclusion in the scope of consolidation in principle takes place from the point at which Bausparkasse Schwäbisch Hall acquires control over the investee. Pursuant to IFRS 10, Bausparkasse Schwäbisch Hall controls an investee if, regardless of its type of commitment, it directly or indirectly possesses power of disposition over the investee, is thereby exposed to significantly fluctuating returns from the investee and due to its power of disposition can influence the level of fluctuating returns from the investee and the key activities of the investee.

If voting rights are decisive and if there are no other contractual agreements to the contrary, the Group controls a company if it directly or indirectly holds more than half of the voting rights in the entity. When assessing control, potential voting rights are also taken into account insofar as these are deemed substantial.

Specialised funds and other structured entities are included as subsidiaries in the consolidated financial statements in accordance with the standard criteria of IFRS 10. Furthermore, they are deemed to be consolidated structured entities within the meaning of IFRS 12 *Disclosure of Interests in Other Entities*. Pursuant to IFRS 12, structured entities are entities that are structured in such a way that voting rights or similar rights are not a decisive factor as to who controls the company.

The consolidation of subsidiaries in the consolidated financial statements is performed by offsetting the carrying amount of the interests in subsidiaries against the consolidated interest in the equity of the respective subsidiary. Interests in the equity of subsidiaries that are not attributable to the parent company are reported under equity as non-controlling interests.

Interests in joint ventures are included in principle in the consolidated financial statements using the equity method. The financial statements of the entities using the equity method are prepared using the reporting date of the parent entity.

Intra-Group assets and liabilities as well as intra-Group income and expenses are eliminated in full. Intra-Group profits or losses resulting from transactions within the group are also eliminated in full.

Subsidiaries and joint ventures of subordinate importance to the net assets, financial position and results of operations of the Group are neither fully consolidated nor using the equity method, but rather are accounted for as investments.

05 CURRENCY TRANSLATION

All monetary assets and liabilities with unsettled spot transactions are translated at the closing rate on the balance sheet date into the relevant functional currency of the entities in the Schwäbisch Hall Group. Foreign currency is translated using the buying rate on the balance sheet date. The translation of non-monetary assets and liabilities follows the measurement standards used for them. Insofar as non-monetary assets and liabilities are measured at amortised cost, the translation is performed using the historical exchange rate. Non-monetary assets measured at fair value are translated using the closing rate. In principle, income and expenses are translated using the closing rate on the date when they are recognised through profit or loss.

Insofar as the functional currency of the subsidiaries included in the financial statements of the Schwäbisch Hall Group differs from the euro as the Group reporting currency, all assets and liabilities are translated using the closing rate on the reporting date while historical rates are used to translate equity. The resulting difference is reported in the reserve from currency translation. Income and expenses are translated using the average exchange rate. The functional currency of the entities included in the consolidated financial statements is predominantly the Group reporting currency, the euro.

06 *BAUSPAREN*

The conclusion of a *Bauspar* contract is economically comparable to an interest rate hedge. By concluding the contract, the *Bauspar* customer gains the right to a loan at a guaranteed rate of interest. The Schwäbisch Hall Group functions in this regard as the option writer who, after the preconditions for allocation have been met and after the savings phase has concluded, must grant the loan if this right is exercised.

Embedded derivatives

The cycle of a *Bauspar* contract essentially comprises the savings and allocation phase in the form of a financial liability, as well as the repayment phase in the form of a financial asset. All phases are characterised by diverse option rights that cannot be separated from the host contract. Accordingly, the *Bauspar* contract qualifies as a hybrid contract pursuant to IFRS 9.

IFRS 9 does not provide for any separation of the embedded derivative, insofar as the host contract concerns a financial asset. Embedded derivative financial instruments that have been combined with a non-derivative financial liability (host contract) into a combined financial instrument should then in principle be separated from the host contract and accounted for and measured separately if their economic features and risks are not closely connected with the economic features and risks of the host contract, a separate instrument with the same terms would meet the definition of a derivative and the overall instrument is not measured at fair value through profit or loss. If all these requirements are not cumulatively fulfilled, the embedded derivative may not be separated from the host contract.

The value of significant embedded options of the *Bauspar* contract in the savings and allocation phase, such as a loan option, termination rights or savings intensity, depends on the market interest rate performance regarding its impact on the financial performance of the host contract. Furthermore, the exercising of possible options is determined by a multitude of parameters that cannot be reliably determined and quantified. The influence of economic and behavioural factors on the loan waiver rate is demonstrable but not quantifiable. In addition to fiscal policy and economic factors, the value of options is also determined in particular by subjective behavioural patterns of Bauspar customers. Decisions by *Bauspar* customers based on personal preferences cannot be reliably predicted and measured. In principle, individual savings goals are taken into account by differing tariff versions that reflect both the traditional *Bauspar* customers as well as the return-oriented *Bauspar* customers; other individual factors are not taken into account. To this extent, there is no separation and separate accounting for embedded derivatives.

Bauspar deposits

Bauspar deposits are classified as financial liabilities measured at amortised cost (AC) and are recorded as a liability at the time of their receipt at the fair value of the consideration received. Subsequent measurement occurs at amortised cost using the effective interest rate method.

The calculation of the effective interest rate includes all directly attributable fees and other remuneration paid or received that should be taken into account for reasons of materiality. These primarily include fees received from the conclusion of a *Bauspar* contract or an increase in the *Bauspar* sum and the directly related brokerage commissions.

Depending on their personal preferences, the *Bauspar* customer is granted the possibility of influencing the performance of their *Bauspar* deposits, and thereby the allocation of the *Bauspar* loan, via special savings contributions or by reducing contributions to a savings scheme.

The *Bauspar* customer is guided in the decision on exercising this option by the market interest rate performance. If the market interest rate is above the credit balance interest rate of the *Bauspar* deposit, the rationally acting *Bauspar* customer uses alternative forms of investment on the market and refrains from making special contributions. If the option is exercised, the level of the *Bauspar* deposit and the level of interest changes.

Bauspar loans, advance financing and bridge financing loans

The strictly regulated statutory system of *Bausparen* is in itself a closed loop consisting of payments made into a savings account by the *Bauspar* customers and repayments by the borrowers, which generates funds to issue housing financing and is independent of the capital markets. Accordingly, the Schwäbisch Hall Group issues housing financing with the goal of collecting the cash flows up to the maturity of the loan.

Bauspar loans are issued if the preconditions for allocation are met. Repayment of the *Bauspar* loan is done via a minimum monthly instalment, while special repayments of the principal are possible at any time and to any degree. These special repayments of the principal do not harm cash flows as they only cover unpaid repayments and interest on the outstanding amount.

Collective funds are issued for advance financing and bridge financing within the legally permissible framework. Advance financing loans cover periods until the minimum *Bauspar* contractual sum is reached and the *Bauspar* loan is allocated; bridge financing is granted when the minimum *Bauspar* contractual sum has been reached but the allocation has not happened as yet. Advance or bridge financing loans are replaced by *Bauspar* loans once the minimum *Bauspar* contractual sum is reached and allocation occurs. Until the suspended payment loan is replaced by the *Bauspar* loan, the cash flows represent interest payments on the outstanding capital. The replacement of the loans corresponds to the repayment of the nominal amount.

Due to allocation to the “hold” business model and the fulfilment of cash flow criteria, *Bauspar* loans and advance and bridge financing loans are classified as financial assets measured at amortised cost (AC) and are measured at amortised cost using the effective interest rate method.

Bonuses/*Bauspar*-specific provisions

The *Bauspar* customer exercises option rights by drawing on the *Bauspar* loan or alternatively through a loan waiver after allocation or continuing the *Bauspar* contract. If various requirements are met, the tariff conditions provide for bonuses in the form of a refund of parts of the contract fee or in the form of bonus interest on deposits. The bonuses represent independent payment obligations and are to be included in the application of IAS 37.

Technical simulation models that forecast the future behaviour of *Bauspar* customers are deployed to measure these obligations. Uncertainty in the measurement of provisions results from the applicable assumptions regarding the future customer behaviour with consideration of scenarios and measures. The loan waiver rate and the termination behaviour of *Bauspar* customers are key input parameters of the technical simulation models.

Unconditional bonuses in the form of additional interest credits are accounted for as a component of the amortised costs of Bauspar deposits pursuant to IFRS 9.5.2.1 in conjunction with IFRS 9.4.2.1.

Fees and commissions

Contract fees represent income that, on the basis of the terms and conditions of the *Bausparkassen* of the Schwäbisch Hall Group, is directly connected with the initiation of a *Bauspar* contract and therefore is included in principle in the effective interest rate calculation and amortised over the maturity of the *Bauspar* contract (IFRS 9.B5.4.1).

Within the framework of commissions, different services are awarded depending on the fee and commission system. Pursuant to IFRS 9.B5.4.1 in conjunction with IFRS 9.B5.4.8, the effective interest rate calculation only includes additional, directly attributable transaction costs incurred that are directly connected with the purchase or sale of a financial asset or a financial liability. This means that commissions paid in accordance with their purpose for information services and general or future support services or general address provisions are not measured as transaction-related even if they were paid due to the conclusion of a contract. Additional fee and commission payments and fee and commission refunds resulting from fee and commission systems with quality components (saving-dependent) likewise represent transaction costs to be included in the effective interest rate calculation.

The amortisation period of the balance from contract fees and transaction costs regularly covers the savings period up to the allocation of the *Bauspar* contract or its early termination.

Other commissions, for example, from tariff changes, contract transfers and contract terminations are immediately recognised through profit or loss pursuant to IFRS 15 after the service has been performed.

Fair value

Active markets are to be consulted for the fair value calculation of financial instruments. If no active markets are available, the fair value calculation can be performed by applying measurement policies, for example, by comparing with the current fair value of another essentially identical financial instrument or by analysing discounted cash flows or option pricing models.

For collectively financed building loans and *Bauspar* deposits, there is neither an active market nor are there comparable fair values of essentially identical financial instruments. First, the number of providers of the specialised product of a *Bauspar* contract is very limited; permission to operate as a *Bausparkasse* is subject to comprehensive statutory requirements. Second, there is considerable variety in the tariff versions of the *Bausparkassen*. Furthermore, *Bauspar* contracts contain a considerable number of potential options, which are exercised depending on a number of fiscal policy, economic and subjective parameters that cannot be reliably determined and quantified.

Calculating fair value using measurement models, particularly interest rate option models or discounted cash flow analyses, is based on the assumption of ideal circumstances. However, the assumption of a financially rational *Bauspar* customer ignores real-world conditions.

Particularly in the savings period, *Bauspar* contracts offer a wide range of options. The right of the *Bauspar* customer to vary the contributions to a savings scheme to a limited extent results in the difficulty of assessing the observation period. This is defined as the savings phase until the *Bauspar* contract is ready for allocation. Readiness for allocation is not an event that is only dependent on individual saving behaviour. Rather, its occurrence depends on the respective collective development. The identified uncertainties open up broad discretion when defining calculation parameters. In this respect, this option alone leads to the impossibility of an informed and clear quantification of the payment period and the respective payment amount.

In contrast to other building loans with a special principal repayment right, *Bauspar* loans are not connected with an obligation to pay a prepayment penalty. The fair value of *Bauspar* loans is particularly influenced by the value of the special principal repayment option. The option value itself is significantly dependent on the market interest rate and therefore on possible aspects of refinancing.

Bauspar-specific simulation model can provide support when estimating the behaviour of *Bauspar* customers. They forecast saving and repayment behaviour as well as loan waiver rates, i.e. the development in the *Bauspar* collective (probabilities of behaviour) based on past experience and current market parameters. The technical collective simulations work with a variety of default parameters to structure new business for subsequent periods that does not yet exist as at the reporting date. The inflow of new savings as a source of refinancing and steady new business are prerequisites for the approval of the *Bausparkasse*. However, the fair value analysis only takes account of assets and liabilities that, as at the reporting date, can in principle be reported in the balance sheet, which corresponds to the settlement case of a *Bausparkasse*. To this extent, the results of the technical collective simulation models cannot be used for the purposes of calculating fair value.

For the non-collective financing business of the Schwäbisch Hall Group, a fair value measurement based on a discounted cash flow (DCF) can be performed based on discounted cash flows. The fixed interest rate period serves as the period under review. After the fixed interest period expires, the borrower has the right to repay the loan. For advance and bridge financing loans, the date of allocation of the replacement *Bauspar* loan is decisive, which is dependent on the respective collective development and individual savings behaviour where relevant. The discount interest rate is based on the market level for comparable loans under comparable conditions.

However, partial indication of fair values leads to considerable anomalies, which can lead to misinterpretations by the audience of the financial statements. For this reason, the provision of fair value data pursuant to IFRS 7.25 and the classification of the relevant financial instruments in the levels of the fair value hierarchy is dispensed with.

Significant restrictions
The business activity of *Bausparkassen* is subject to a special legal framework (BauSpkG, Hungarian Act CXIII/1996), which leads to the fact that, in addition to business activities, assets, liabilities and to a limited extent retained earnings accounted for in the context of *Bausparen* (see note 48) are subject to restrictions in the form of earmarking. Furthermore, restrictions exist due to earmarking of non-collective refinancing funds and assignments of assets as collateral.

07 FINANCIAL INSTRUMENTS

Classes of financial instruments

Financial assets measured at fair value through profit or loss (fair value PL)
Financial assets that are not measured at amortised cost or at fair value through other comprehensive income are to be classified as "Financial assets measured at fair value through profit or loss".

Financial assets mandatorily measured at fair value through profit or loss
The item "Financial assets mandatorily measured at fair value through profit or loss" comprises financial assets that do not meet the cash flow criterion pursuant to IFRS 9 or are acquired with the intention of short-term resale. It concerns derivative financial instruments (interest rate swaps) that are in an economic hedging relationship and are not designated as hedging instruments in effective hedging relationships.

Financial assets measured at fair value through other comprehensive income (fair value OCI)
A classification occurs in this category if the financial asset is held in accordance with a business model aimed both at collecting contractual cash flows and at selling financial assets. Furthermore, the contractual terms of the financial asset must give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Due to the cash flow criterion, these financial assets only comprise debt instruments. They are measured at fair value. Interest income, impairment losses and currency translation effects must be recognised in profit or loss. Differences between amortised costs and fair value are reflected in other comprehensive income. The amounts recognised in other comprehensive income must be recycled to the income statement upon disposal.

Furthermore, the irrevocable option exists to designate equity instruments upon initial recognition as “Financial assets designated at fair value through other comprehensive income” (fair value OCI option). Changes in fair value, except for dividends not recycling capital, are recognised in other comprehensive income. Subsequent recycling of cumulative other comprehensive income to the income statement – possibly due to the disposal of the instrument – does not take place. After disposal of these equity instruments, the cumulative other comprehensive income is reclassified to retained earnings. The fair value OCI option can generally only be exercised for equity instruments that are not held for trading and do not constitute contingent consideration recognised by the acquirer in a business combination pursuant to IFRS 3.

Financial assets measured at amortised cost (AC)
A classification occurs in this category if the financial asset is held in accordance with a business model aimed at holding financial assets to collect contractual cash flows. The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (the cash flow criterion).

Financial assets in this category only comprise debt instruments because of the cash flow criterion. They are measured at amortised cost using the effective interest method. Interest income, impairment losses and currency translation effects must be recognised in profit or loss.

Financial liabilities at fair value through profit or loss (fair value PL)
Financial liabilities that are not measured at amortised cost are classified as “Financial liabilities measured at fair value through profit or loss”.

Financial liabilities mandatorily measured at fair value through profit or loss
“Financial liabilities mandatorily measured at fair value through profit or loss” covers financial liabilities that are issued with the intention of repaying them in the near future. To this end, these financial liabilities must be part of a portfolio of clearly identified and jointly managed financial instruments for which there is evidence of a recent actual pattern of short-term profit-taking, or that are derivatives, except for derivatives that are designated and effective hedging instruments.

Financial liabilities measured at amortised cost (AC)
Financial liabilities are to be classified as “financial liabilities measured at amortised cost” for measurement subsequent to first-time recognition. Exceptions: “Financial liabilities measured at fair value through profit or loss”, financial liabilities that arise if a transfer of a financial asset does not meet the condition for derecognition or is accounted for based on continuing involvement. Also excluded are financial guarantee contracts, loan commitments with an interest rate below the market interest rate and contingent consideration recognised by the acquirer in a business combination pursuant to IFRS 3.

The classification requirements of IAS 39 also provided for the category “held-to-maturity investments” for non-derivative financial assets with fixed or determinable payments and a fixed maturity where the intention and ability existed to hold these to final maturity. They were measured at amortised cost. IAS 39 also provided for the category of “available-for-sale financial assets” for financial assets not assigned to any other category. They are measured at fair value, with changes to fair value between two reporting dates recognised through other comprehensive income. The category “loans and receivables” was assigned non-derivative financial assets with fixed or determinable payments that were not quoted on an active market and were not classified as “available-for-sale financial assets”. They were measured at amortised cost.

First-time recognition and derecognition of financial assets and financial liabilities
Derivatives are recognised for the first time on the trade date. Regular way purchases and sales of non-derivative financial assets are generally recognised and derecognised using settlement date accounting. Consolidated investment funds and issues of certain securities are also recognised on the trade day. Changes in fair value between the trade day and settlement date are recognised in accordance with the category of the financial instrument.

All financial instruments are generally measured at fair value on first recognition. In the case of financial assets or financial liabilities not measured at fair value through profit or loss, recognition occurs with consideration of transaction costs to be attributed directly to the purchase or issue of the financial asset or financial liability.

Differences between transaction prices and fair values calculated with measurement techniques based on active market data are recognised through profit and loss on first recognition. There are no differences to be recognised in future financial years between transaction prices and fair values, which are determined using measurement techniques that incorporate a significant measurement parameter not observable on the market.

Financial assets are derecognised if the contractual rights to the cash flows from the financial assets have expired or these rights have been transferred to third parties and no substantive risks or rewards of ownership in the financial assets remain. If the criteria for derecognising financial assets are not satisfied, the transfer to third parties is recognised as a secured loan. Financial liabilities are derecognised if the contractual obligations have been settled, extinguished or have expired.

Impairments under IFRS 9

Impairments under IFRS 9 are recognised only on those financial assets that are debt instruments. In contrast, equity instruments do not fall within the scope of the IFRS 9 impairment model. Impairment losses are to be recognised for the following financial assets:

- Financial assets in the IFRS 9 category “financial assets measured at amortised cost”
- Financial assets (debt instruments only) in the IFRS 9 category “financial assets measured at fair value through other comprehensive income”,
- Undrawn loan commitments where there is a current legal obligation to grant credit (irrevocable loan commitments), provided they are not measured at fair value through profit or loss,
- Financial guarantee contracts, provided they are not measured at fair value through profit or loss,
- Lease receivables and
- Trade receivables and contract assets that fall within the scope of IFRS 15

Upon acquisition, all financial assets are assigned to stage 1. The only exception is purchased or originated credit-impaired assets (POCI). Loss allowances for assets in stage 1 must, as a minimum, be recognised in an amount equal to the 12-month expected credit loss.

At each balance sheet date, assets are assigned to stage 2 if their credit risk has significantly increased since first-time recognition and there is no objective evidence of impairment. The impairment for these assets is to be measured as the amount of the lifetime expected credit losses.

For the sake of simplification, it can be assumed that the credit risk of a financial instrument has not increased significantly since first recognition if the financial instrument has low credit risk at the balance sheet date (low credit risk exemption).

The Bausparkasse Schwäbisch Hall Group does not exercise the low credit exemption for loans and, consequently, not for promissory notes either.

Financial assets that are deemed to be impaired on the basis of objective evidence are assigned to stage 3. For these assets, impairment is measured as the amount of lifetime expected credit losses.

Financial assets subject to impairment rules pursuant to IFRS 9 must be reviewed at every balance sheet date as to whether one or more events have occurred with sustained impacts on the estimated future cash flows of this financial asset.

Purchased or originated credit-impaired assets (POCI) are to be initially recognised at their carrying amount less the lifetime expected credit losses and amortised using a risk-adjusted effective interest rate. At the balance sheet date, only the cumulative changes to the lifetime expected credit losses since first-time recognition are recognised as an impairment loss. A stage allocation is not required for these assets.

In contrast to the expected loss approach under IFRS 9, impairment loss up to now under IAS 39 were formed using the incurred loss model. For financial assets that were not measured at fair value through profit or loss, a review is conducted on each reporting date as to whether objective evidence of impairment existed. Financial difficulties of the issuer or debtor, defaults or delay in payment of principal and interest of the loan represent, among other things, objective indications of impairment of debt instruments. In the case of equity instruments, a significant (> 20% compared to average amortised costs) or prolonged decline (> 6 months) in fair value served as objective evidence.

Classes of financial instruments

Financial instruments in the scope of IFRS 7 are classified to the classes of financial instruments below according to information about the significance of the financial instruments to the net assets, financial position and financial performances.

Classes of financial assets

Financial assets measured at fair value

The class of financial assets measured at fair value contains financial assets in the following IFRS 9 categories:

- “financial assets mandatorily measured at fair value through profit or loss”,
- “financial assets measured at fair value through other comprehensive income” with their subcategories “Financial assets mandatorily measured at fair value through OCI” and “Fair value OCI option”.

Financial assets measured at amortised cost

The class of financial assets measured at amortised cost includes loans and advances to banks and customers measured at amortised cost and investments measured at amortised cost.

Classes of financial liabilities

Financial liabilities measured at fair value

Financial liabilities in the category “Financial liabilities mandatorily measured at fair value through profit or loss” form the class of financial liabilities measured at fair value.

Financial liabilities measured at amortised cost

The class of financial liabilities measured at amortised cost is identical to the category of financial liabilities of the same name.

Financial guarantee contracts and loan commitments
This class comprises provisions for financial guarantee contracts and provisions for loan commitments within the scope of IAS 37 that are subject to the derecognition and impairment provisions of IFRS 9.

08 CASH AND CASH EQUIVALENTS

Cash and cash equivalents, balances with central banks and other government institutions as well as debt instruments from public bodies and bills eligible for refinancing with central banks are reported as cash and cash equivalents.

Cash comprises cash and cash equivalents denominated in euros and foreign currencies, which are measured at nominal value or translated using the closing rate on the reporting date. Balances with central banks and other government institutions are classified to the category “Financial assets measured at amortised cost (AC)”. Interest income from these balances is recognised as interest income from lending and money market business.

09 LOANS AND ADVANCES TO BANKS AND CUSTOMERS

All on-demand and fixed-term loans and advances from lending and money market business as well as promissory note loans and registered bonds are accounted for as “Loans and advances to banks and customers”.

Loans and advances to banks and customers are measured at amortised cost using the effective interest rate method.

Interest income from loans and advances to banks and customers is recognised under interest income from lending and money market business. This also includes profit from the disposal of loans and advances to banks and customers classified as “Financial assets measured at amortised cost (AC)”.

10 POSITIVE AND NEGATIVE FAIR VALUES FROM DERIVATIVE FINANCIAL INSTRUMENTS

These items report derivative financial instruments that are used to manage interest rate risks, such as interest rate swaps in the interest ledger.

Measurement gains and losses from derivative financial instruments are recognised in other gains or losses on measurement of financial instruments as “Gains or losses on derivative financial instruments used for purposes other than trading”. Interest income from derivative financial instruments and interest expenses on derivative financial instruments used for purposes other than trading or used to hedge “Financial instruments measured at fair value through profit or loss” are reported under net interest income.

11 INVESTMENTS

Bearer bonds and other fixed-income securities, shares and other variable-yield securities, and other bearer or registered shareholdings in entities where there is no significant influence are reported as investments, insofar as these securities or shares are not held for trading purposes. Investments also include investments in subsidiaries and joint ventures.

The first-time recognition of investments is at fair value. Other shareholdings, investments in subsidiaries and joint ventures that are not fully consolidated or use the equity method are to be measured at fair value when first recognised. Subsequent measurement of investments takes place in accordance with the principles of the measurement category to which they were classified.

Impairment losses on investments are determined according to the IFRS 9 requirements applicable to the relevant category of financial assets or in accordance with the financial reporting standards relevant to the financial assets concerned. They are generally reported as a separate line item on the asset side of the balance sheet or in the reserve from other comprehensive income.

Interest and premiums or discounts amortised over the maturity of the investment using the effective interest method are recognised in net interest income. Dividends from equity instruments are recognised as current income under net interest income. Gains or losses on investments using the equity method are also reported in net interest income.

12 INVESTMENTS USING THE EQUITY METHOD

Investments in joint ventures are recognised at the time of acquisition at amortised cost in the consolidated balance sheet. In the following years, the recognised equity value is adjusted by the pro rata changes in equity of the investee. The share of annual profit of the investee is included in the item “Income from investments in joint ventures using the equity method” in the consolidated income statement.

If there are indications of impairment of the shares in a company using the equity method, these are subjected to an impairment test and, if necessary, an impairment loss is recognised. An impairment loss is reversed if the reasons for the impairment no longer apply. Impairment losses and reversals of impairment losses are recognised in the income statement under “Income/loss from joint ventures using the equity method”.

Gains and losses from disposal of investments using the equity method are also presented in “Income/loss from investments in joint ventures using the equity method”.

13 INTANGIBLE ASSETS

Intangible assets are recognised at cost. Software and other intangible assets with defined useful lives are reduced at subsequent measurement by cumulative amortisation and cumulative impairment losses.

Amortisation of intangible assets is recognised as administrative expenses. Impairment losses and reversals are included in other net operating income.

Software is amortised over a useful life of one to ten years.

14 PROPERTY, PLANT AND EQUIPMENT

“Property, plant and equipment” comprises land and buildings, office furniture and equipment and other property, plant and equipment with an estimated useful life of more than one year used by the entities in the Schwäbisch Hall Group.

Property, plant and equipment is measured at acquisition or production cost, less cumulative depreciation and cumulative impairment losses in subsequent financial years.

Depreciation of property, plant and equipment is recognised as administrative expenses. Impairment losses and reversals are reported under other net operating income.

The underlying useful life in the case of buildings is 25 to 50 years and in the case of operating and office equipment is three to 13 years.

15 INCOME TAX ASSETS AND LIABILITIES

Current and deferred income tax assets are reported in the item “Income tax assets”, while current and deferred income tax liabilities are reported in the item “Income tax liabilities”. Current income tax assets and liabilities are recognised in the amount of any expected refund or future payment.

Deferred tax assets and liabilities are recognised for temporary differences between the carrying amounts recognised in the financial statements in accordance with IFRS and those in the financial statements for tax purposes, insofar as their realisation is sufficiently probable. Measurement takes place using the national and entity-specific tax rates expected to apply at the time of their realisation. A profit and loss transfer agreement exists between Bausparkasse Schwäbisch Hall as a subsidiary company and DZ BANK AG. Current and deferred taxes are shown as if the Schwäbisch Hall Group were an independent entity for tax purposes. A standard consolidated tax rate is used for Group entities that have a consolidated income tax relationship with Bausparkasse Schwäbisch Hall.

Deferred income tax assets and liabilities are not discounted. Insofar as temporary differences have arisen in other comprehensive income, the resulting deferred tax assets and liabilities are also recognised in other comprehensive income. Income and expenses recognised through profit or loss for current and deferred income taxes are included in the item “Income taxes” in the income statement.

16 LOSS ALLOWANCES

Loss allowances for cash and cash equivalents, loans and advances to banks and customers, investments and other assets measured at amortised cost is deducted openly from the assets side as a separate balance sheet item. Additions to and reversals of loss allowances under these items are also recognised as loss allowances in the income statement.

Loss allowances for investments measured at fair value through other comprehensive income is not deducted from the assets side but rather reported in the reserve from fair value OCI debt instruments. Additions to and reversals of loss allowances are recognised as loss allowances in the income statement.

The recognition of loss allowances also includes changes in the provisions for loan commitments and financial guarantee contracts. Any additions or reversals under these items are also recognised in profit or loss under loss allowances.

17 DEPOSITS FROM BANKS AND CUSTOMERS

In addition to liabilities from the *Bauspar* business, this also particularly includes fixed-term refinancing funds from DZ BANK AG.

Deposits from banks and customers are measured at amortised cost using the effective interest method. Interest expenses on deposits from banks and customers are recognised separately under net interest income. Interest expenses also include gains and losses on early redemption.

18 PROVISIONS

Provisions for employee benefits pursuant to IAS 19 and other provisions are reported under provisions.

Provisions for defined benefit pension obligations
Provisions for defined benefit pension obligations primarily concern pension plans that are no longer accepting any further employees (closed plans).

Other defined benefit plans exist for members of the Board of Managing Directors or Managing Directors. New employees are almost exclusively offered defined contribution pension plans, for which in general a provision is not required.

The company retirement plan agreed with the employees of the Schwäbisch Hall Group comprises both defined contribution and defined benefit pension plans.

Defined contribution plans are paid to external pension providers as part of the commitment to a defined contribution pension plan. The amount of the contributions and the return on plan assets determine the amount of future pension benefits. Risks arising from the obligation to pay corresponding benefits in the future are borne by the pension provider. No provisions are recognised for these indirect pension commitments. The contributions made are recognised as expenses for pensions in administrative expenses.

Under a defined benefit plan, the employer promises a specific benefit and bears all the risks from this promise. The measurement of pension obligations for defined benefit pension plans is based on the process for determining the present value of accrued defined benefits. The measurement is underpinned by various actuarial assumptions. Assumptions are made in particular here regarding long-term salary and pension development and average life expectancy. Assumptions about salary and pension development are based on past developments and take into account expectations regarding future changes in the labour market. The process of estimating average life expectancy is based on the accepted biometric tables (2018 G mortality tables published by Prof. Klaus Heubeck). The transition to the new 2018 G mortality tables has led to an increase in DBO (defined benefit obligation) of €3,887 thousand. The discount rate used to discount future payment obligations is an appropriate market interest rate for investment-grade, fixed-income corporate bonds with a maturity equivalent to that of the defined benefit pension obligations.

Actuarial gains and losses arising from experience-based adjustments and the impact of changes to actuarial assumptions for defined benefit pension obligations and gains and losses arising from the remeasurement of plan assets and reimbursement rights are recognised in other comprehensive income in the reporting period in which they occur.

The plan assets of defined benefit plans primarily consist of a building that is managed by the *Unterstützungskasse* (pension fund) of Bausparkasse Schwäbisch Hall and a Contractual Trust Arrangement (CTA) between Bausparkasse Schwäbisch Hall AG and Schwäbisch Hall Kreditservice GmbH, which is managed as trust assets by DZ BANK Pension Trust e. V., Frankfurt am Main.

The provisions for employee benefits include, in addition to provisions for defined benefit pension plans, provisions for other long-term employee benefits, provisions for termination benefits and provisions for short-term employee benefits. Provisions for early retirement schemes and loyalty bonuses are recognised for obligations in connection with termination of employment.

Other long-term employee benefits include provisions for anniversaries.

Other provisions

Provisions are liabilities in which the amount or due dates are uncertain. They are recognised for present obligations arising out of past events, in which it is probable that there will be an outflow of resources with economic benefit and the amount of the obligation can be reliably estimated.

Provisions are recognised and measured using the best estimate of the present value of their anticipated utilisation. The risks and uncertainties connected with the respective circumstances and future trends are taken into account here. Cash outflows that actually occur in the future may deviate from the estimated utilisation.

Other provisions comprise *Bauspar*-specific provisions, other provisions and provisions for loan commitments. Other provisions recognise provisions for commissions paid to sales representatives and banks. These concern quality commissions for savings under *Bauspar* contracts. *Bauspar*-specific provisions are formed in case agreed bonuses have to be paid pursuant to the tariff conditions of *Bauspar* contracts. These may occur in the form of a refund of portions of contract fees or in the form of bonus interest on deposits. Expenses for the compounding of provisions are recognised as interest expenses in net interest income. Provisions for loan commitments take account of uncertainties to the extent customary in the industry. Past experience is factored into the underlying assumptions.

19 CONTINGENT LIABILITIES

Contingent liabilities are possible obligations arising from past events and the existence of these obligations will only be confirmed by future events outside the control of the Schwäbisch Hall Group. Furthermore, present obligations arising out of past events but not recognised because of the improbability of an outflow of resources embodying economic benefit, or because the amount cannot be measured with sufficient reliability, also constitute contingent liabilities.

The amount of contingent liabilities is disclosed in the notes, unless the probability of an outflow of resources embodying economic benefit is remote.

Contingent liabilities are measured at the best estimate of possible future outflows of resources embodying economic benefits.

20 LEASES

According to IAS 17, a lease is classified as an operating lease if substantially all the risks and rewards incidental to ownership are not transferred to the lessee. In contrast, contractual relationships in which the lessee bears all material risks and rewards are deemed to be finance leases. In principle, the decisive factor as regards the allocation of opportunities and risks is generally decisive the cash value of the cash flows associated with the leasing contracts. If the present value is at least equal to the investment sum of the leasing object, this leads to classification as a finance lease.

In the Schwäbisch Hall Group, expenses from operating leases are generally recognised on a straight-line basis over the maturity of the lease and reported as administrative expenses.

21 INCOME

Interest and dividends received
At the Schwäbisch Hall Group, interest income is accrued and recognised in the relevant period using the effective interest method.

The cash flows used to calculate the effective interest rate take into account contractual agreements in connection with the respective financial assets and financial liabilities.

Premiums and discounts are allocated with a constant effective interest rate over the term of the financial instruments. Additional directly assignable transaction costs are included in the calculation of the effective interest rate if they are directly connected with the acquisition or sale of a financial asset or a financial liability. This includes in particular received contract fees and commissions that are directly connected with the initiation of *Bauspar* contracts and commitment fees for loans.

Dividends are recognised as soon as a legal entitlement to the payment of such a dividend is established.

Disclosures relating to the income statement and the statement of comprehensive income

22 SEGMENT INFORMATION

2018 financial year in € thousand	***Bausparen* Domestic**	***Bauspar* and loan processing**	***Bausparen* Non-domestic**	**Consolidation**	**Total**
Net interest income	723,661	4,865	70,222	– 32,427	766,321
Net fee and commission income	– 39,328	–	– 525	–	– 39,853
Gains or losses on investments	– 15,689	–	7,867	20,231	12,409
Other gains or losses on measurement of financial instruments	8,286	–	–	–	8,286
Loss allowances for loans and advances	– 9,876	–	– 1,512	–	– 11,388
Administrative expenses	– 460,468	– 119,963	– 43,750	144,141	– 480,040
Other net operating income	22,172	164,477	– 3,435	– 144,141	39,073
Profit/loss before taxes	**228,758**	**49,379**	**28,867**	**– 12,196**	**294,808**
Cost/income ratio in %[1]	65.9	70.8	61.2	–	61.1

2017 financial year in € thousand	***Bausparen* Domestic**	***Bauspar* and loan processing**	***Bausparen* Non-domestic**	**Consolidation**	**Total**
Net interest income	776,072	4,944	92,830	– 40,930	832,916
Net fee and commission income	– 44,572	–	– 3,152	–	– 47,724
Gains or losses on investments	9,704	–	7,890	–	17,594
Other gains or losses on measurement of financial instruments	1,413	–	–	–	1,413
Loss allowances for loans and advances	– 18,865	–	– 1,006	–	– 19,871
Administrative expenses	– 429,354	– 126,953	– 42,272	128,366	– 470,213
Other net operating income	– 351	151,669	– 3,133	– 128,366	19,819
Profit/loss before taxes	**294,047**	**29,660**	**51,157**	**– 40,930**	**333,934**
Cost/income ratio in %[1]	58.0	81.1	44.8	–	57.1

[1] The *Bausparen* non-domestic segment only includes fully consolidated companies.

General information on segment reporting

The information on business segments has been prepared using the management approach pursuant to IFRS 8. Under this standard, external reporting must include segment information that is used internally for the management of the entity and for the purposes of reporting to the chief operating decision-makers. The information on the business segments of the Schwäbisch Hall Group has therefore been prepared on the basis of the internal management reporting system.

Delineation of segments

The Schwäbisch Hall Group manages its activities based on an internal reporting system to the Board of Managing Directors. Its central component is business reporting regarding domestic and non-domestic business activities, which correspond to the organisational structure of the Group.

The *Bausparen* domestic segment includes the activities of Bausparkasse Schwäbisch Hall. This comprises the core business segments of *Bausparen*, housing financing and the business segment Cross-Selling. Furthermore, the activities of UIN Fund No. 817 are reported in this segment.

The *Bauspar* and loan processing segment comprises the processing and IT services of SHK.

The activities of FLK and the foreign joint ventures ČMSS, SGB are reflected in the *Bausparen* non-domestic segment.

Presentation of segment information

Interest income and the associated interest expenses generated by the segments are offset and reported as net interest income in the information on segments because the segments from a group perspective are managed solely on the basis of the net figure.

Measurement

Internal reporting to the chief operating decision-makers of the Schwäbisch Hall Group is based on accounting principles in accordance with IFRS applicable to the Schwäbisch Hall Group.

Cross-segmental intra-Group transactions are carried out on an arm's length basis. These transactions are reported internally using the financial reporting standards applied to external financial reporting.

The key indicators for assessing the performance of segments are profit/loss before taxes and the cost/income ratio. The cost/income ratio shows the ratio of administrative expenses to operating income and reflects the cost-efficiency of segments.

A detailed presentation of the segments can be found in the combined management report from page 6 onwards.

Consolidation

The adjustments shown under consolidation to reconcile segment profit/loss before taxes to profit/loss before taxes are exclusively attributable to the elimination of intra-Group transactions.

Intra-Group dividend payments are consolidated in net interest income.

Income and expense consolidation in the area of administrative expenses and in other net operating income result in particular from the services between Bausparkasse Schwäbisch Hall and SHK.

Schwäbisch Hall Group-wide disclosures
Information about geographic areas: Information on geographic areas is implicitly contained in the breakdown of segments.

Information about products and services
Information on the products and services offered by the Schwäbisch Hall Group is included in income statement disclosures below.

23 NET INTEREST INCOME

in € thousand	2018	2017
Interest income	**1,602,794**	**1,639,427**
calculated by using the effective interest method	**1,602,794**	**1,639,427**
Bauspar loans	74,134	83,367
Advance and bridge financing loans	910,923	885,807
Other building loans	58,922	62,896
Lending and money market transactions	419,155	474,914
Fixed-income securities of investments	139,893	132,593
Financial assets with negative effective interest rate	– 233	– 150
Current income	**1,672**	**870**
Current income from FVOCI-categorised equity instruments held on the reporting date	1,672	n/a
Current income from equity instruments classified as available-for-sale	n/a	870
Interest expenses on	**– 840,830**	**– 831,877**
Deposits from banks and customers	– 854,552	– 840,841
of which: for *Bauspar* deposits	– 851,658	– 837,263
Financial liabilities with positive effective interest rate	7,308	6,702
Provisions	–	– 4
Interest income from derivative financial instruments	6,414	2,266
Income from joint ventures using the equity method	**2,685**	**24,496**
Total	**766,321**	**832,916**

Income from joint ventures using the equity method contains an impairment for SGB amounting to €18.1 million.

Interest income includes disposal gains of €10.8 million and disposal losses of €4.8 million from financial instruments measured at amortised cost.

24 NET FEE AND COMMISSION INCOME

in € thousand	2018	2017
Fee and commission income	**85,790**	**85,729**
Bauspar business	30,548	24,941
Fees from contract conclusion and brokerage	–	1,112
Other fees	30,548	23,829
Other	55,242	60,788
Fee and commission expenses	**– 125,643**	**– 133,453**
Bauspar business	– 89,491	– 96,743
Commissions for contract conclusion and brokerage	– 89,491	– 96,356
Other fee and commission expenses	–	– 387
Other	– 36,152	– 36,710
Total	**– 39,853**	**– 47,724**

Fee and commission income during the reporting period contains revenue from contracts with customers pursuant to IFRS 15 amounting to €85,790 thousand.

Revenue from contracts with customers includes fee and commission income from the brokering of building loans to primary banks, from fund investments at Union Investment and from the brokering of insurance at R+V Versicherung.

At the brokering of building loans, the performance obligation is established when the contract is concluded and is accordingly recognised.

When brokering fund investments and insurance contracts, fee and commission income arises upon conclusion of the contract over the entire insurance term or the entire investment period. The total amount of fee and commission income would have to be recognised principally at the time of contract conclusion. However, this concerns variable consideration depending on the insured amount and fund assets. The uncertainty as regards the variable consideration is only eliminated at a later stage. Accordingly, this revenue can only be calculated and recognised subsequently, on a monthly basis. Commission loans and advances include normal maturities without financing components.

Disclosures on revenue from contracts with customers by operating segment

in € thousand	*Bausparen* domestic	*Bausparen* non-domestic	Total
Income types	**75,813**	**9,977**	**85,790**
Fee and commission income from the *Bauspar* business	22,807	7,741	30,548
Other fee and commission income	53,006	2,236	55,242
Main geographical markets	**75,813**	**9,977**	**85,790**
Germany	75,813	–	75,813
Rest of Europe	–	9,977	9,977
Type of revenue recognition	**75,813**	**9,977**	**85,790**
At a point in time	75,813	9,977	85,790

Other than fee and commission income, no other revenue from contracts with customers is included in the income statement.

25 GAINS AND LOSSES ON INVESTMENTS

in € thousand	2018	2017
Gains and losses on the disposal of bonds	12,409	16,054
Bonds measured at fair value through other comprehensive income	4,542	16,054
Bonds measured at amortised cost (gains)	7,867	n/a
Gains and losses on the disposal of shares and other variable-yield securities	n/a	1,540
Total	**12,409**	**17,594**

Losses from the sale of bonds measured at amortised cost were not incurred.

26 OTHER GAINS AND LOSSES ON MEASUREMENT OF FINANCIAL INSTRUMENTS

Gains and losses on measurement amounting to €8,286 thousand (previous year: €1,413 thousand) results from derivative financial instruments used for purposes other than trading to hedge the interest rate risks in the interest book.

27 LOSS ALLOWANCES

in € thousand	2018
Loss allowances for cash and cash equivalents	**12**
Additions	– 26
Reversals	38
Loss allowances for loans and advances to banks	**– 27**
Additions	– 345
Reversals	318
Loss allowances for loans and advances to customers	**– 12,130**
Additions	– 143,798
Reversals	133,605
Directly recognised impairment losses	– 8,056
Recoveries on loans and advances to customers previously impaired	6,119
Loss allowances for investments	**– 764**
Additions	– 2,249
Reversals	1,486
Loss allowances for other assets	**– 19**
Additions	– 135
Reversals	131
Directly recognised impairment losses	– 18
Recoveries on other assets previously impaired	3
Other loss allowances for loans and advances	**1,540**
Change in provisions for loan commitments	1,540
Total	**– 11,388**

Comparative information pursuant to IAS 39

in € thousand	2017
Loss allowances for loans and advances to customers	**– 17,783**
Additions	– 83,655
Reversals	68,119
Directly recognised impairment losses	– 8,283
Recoveries on loans and advances previously impaired	6,036
Changes in provision for loan commitments	**– 2,088**
Total	**– 19,871**

28 ADMINISTRATIVE EXPENSES

in € thousand	2018	2017
Employee expenses	**– 220,773**	**– 221,051**
Wages and salaries	– 173,764	– 169,083
Social security contributions	– 26,625	– 26,363
Pensions and other post-employment benefit expenses	– 20,384	– 25,605
General administrative expenses	**– 214,564**	**– 199,560**
Contributions and fees	– 17,667	– 13,482
Consultancy	– 12,742	– 15,518
Office expenses	– 68,116	– 64,783
IT expenses	– 72,797	– 63,575
Property and occupancy costs	– 12,597	– 10,950
Public relations/marketing	– 25,082	– 25,276
Other general and administrative expenses	– 5,563	– 5,976
Depreciation and amortisation	**– 44,703**	**– 49,602**
Property, plant and equipment	– 19,862	– 19,692
Intangible assets	– 24,841	– 29,910
Total	**– 480,040**	**– 470,213**

Net pension expenses are comprised as follows:

in € thousand	2018	2017
Net pension expenses	**– 15,822**	**– 21,158**
Current service cost	– 10,088	– 10,457
Unrecognised past service cost and gains and losses at settlement	163	48
Net interest	– 5,897	– 10,749
of which: interest expenses	– 13,164	– 13,428
of which: planned income	7,267	2,679
Other pensions and other post-employment benefit expenses	**– 4,562**	**– 4,447**
Total	**– 20,384**	**– 25,605**

Other pensions and other post-employment benefit expenses include expenses for defined contribution plans amounting to €69 thousand (previous year: €457 thousand).

29 OTHER NET OPERATING INCOME

in € thousand	2018	2017
Income from the processing and administration of loans	10,948	11,876
Income from IT application service and IT application development	881	897
Other changes in provisions and accruals	4,904	9,525
Expenses for other taxes	– 4,264	– 4,340
Residual other net operating income	26,604	1,861
Total	**39,073**	**19,819**

30 INCOME TAXES

in € thousand	2018	2017
Current tax expense	– 64,480	– 79,374
Deferred tax expense	– 17,866	– 7,520
Total	**– 82,346**	**– 86,894**

Deferred taxes include expenses amounting to €17,892 thousand (previous year: €7,520 thousand) arising from the appearance and disappearance of temporary differences. Income amounting to €26 thousand is included in deferred taxes that is based on changes to tax rates (previous year: €0 thousand). Of current taxes, €3,372 thousand (previous year: €5,796 thousand) is attributed to expenses for previous years.

Unchanged from the previous year, an effective corporation tax rate of 15.825 per cent was used for the reconciliation, based on a corporation tax rate of 15.000 per cent taking into account the solidarity surcharge in order to calculate current taxes for German limited companies. The effective trade tax rate to be used for the reconciliation is 15.365 per cent (previous year: 15.330 per cent). The slight increase in the trade tax rate results from a change in the average assessment rate.

The calculation of deferred tax should be based on the tax rates that are expected to be in force at the time of their realisation. Here, the tax rates are used that are in force as of the reporting date or have been announced for the relevant point in time.

The reconciliation below presents the connection between the expected and recognised income taxes based on application of the current tax law in Germany.

Tax reconciliation

in € thousand	2018	2017
Net profit/loss before taxes	**294,808**	**333,934**
Group income tax rate	31.190%	31.155%
Expected income taxes	**– 91,951**	**– 104,037**
Income tax effects	**9,605**	**17,143**
Impact of tax-exempt income and non-deductible expenses	– 1,391	4,738
Adjustments resulting from other types of income tax or trade tax assessment rates and changes in tax rates	9,208	9,953
Tax rate differences on income subject to taxation in other countries	– 1	– 1
Current and deferred taxes relating to prior years	1,027	752
Other effects	762	1,701
Recognised income taxes	**– 82,346**	**– 86,894**

31 INCOME TAXES RELATING TO COMPONENTS OF OTHER COMPREHENSIVE INCOME

The following tax effects are attributed to the components of other comprehensive income:

in € thousand	Amount before taxes 2018	Income taxes 2018	Amount after taxes 2018	Amount before taxes 2017	Income taxes 2017	Amount after taxes 2017
Items that may be reclassified to the income statement	**– 105,424**	**30,397**	**– 75,027**	**– 63,217**	**16,269**	**– 46,948**
Gains and losses from debt instruments measured at fair value through other comprehensive income[1]	– 97,570	30,397	– 67,173	– 56,197	16,269	– 39,928
Exchange differences of currency translation of foreign operations	– 4,619	–	– 4,619	– 113	–	– 113
Share of other comprehensive income/loss of joint ventures using the equity method	– 3,235	–	– 3,235	– 6,907	–	– 6,907
Items that will not be reclassified to the income statement	**– 14,594**	**4,659**	**– 9,935**	**14,618**	**– 4,565**	**10,053**
Gains and losses arising from remeasurement of defined benefit plans	– 14,687	4,659	– 10,028	14,654	– 4,565	10,089
Share of other comprehensive income/loss of joint ventures using the equity method	93	–	93	– 36	–	– 36
Profit/losses through other comprehensive income	**– 120,018**	**35,056**	**– 84,962**	**– 48,599**	**11,704**	**– 36,895**

[1] Gains and losses from available-for-sale financial assets in the previous year in accordance with IAS 39

Balance sheet disclosures

32 CASH AND CASH EQUIVALENTS

in € thousand	31 Dec 2018	31 Dec 2017
Cash on hand	26	29
Balances with central banks and other government institutions	36,737	43,529
Total	**36,763**	**43,558**

The average target minimum reserve for the financial year amounted to €2,633 thousand (previous year: €1,896 thousand).

33 LOANS AND ADVANCES TO BANKS

Loans and advances to banks break down as follows by business type:

in € thousand	31 Dec 2018	31 Dec 2017
Bauspar loans	–	271
Suspended payment and bridging loans	–	1,277
Other building loans	88	567
Registered bonds	12,276,345	13,849,729
Money market placements	38,207	49,493
Other loans secured by mortgages	41,594	50,310
Other loans and advances	84,966	52,992
Total	**12,441,200**	**14,004,639**

Registered bonds include *öffentliche Namenspfandbriefe* (registered German public sector covered bonds) amounting to €1,092 million (previous year: €1,912 million) and *Hypotheken-Namenspfandbriefe* (registered German mortgage covered bonds) amounting to €1,092 million (previous year: €1,142 million).

	Repayable on demand		Other loans and advances		Total	
in € thousand	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017
Domestic banks	73,762	44,177	12,318,027	13,902,154	12,391,789	13,946,331
Non-domestic banks	11,204	8,814	38,207	49,493	49,411	58,308
Total	**84,966**	**52,992**	**12,356,234**	**13,951,647**	**12,441,200**	**14,004,639**

34 LOANS AND ADVANCES TO CUSTOMERS

Loans and advances to customers break down as follows by business type:

in € thousand	31 Dec 2018	31 Dec 2017
Housing loans	45,453,702	41,005,673
from allocations (*Bauspar* loans)	2,548,939	2,668,421
for suspended payment and bridge financing	40,521,729	36,310,855
Other	2,383,034	2,026,397
Other loans and advances	2,541,200	2,713,712
Total	**47,994,902**	**43,719,385**

in € thousand	31 Dec 2018	31 Dec 2017
Loans and advances to domestic customers	46,690,362	42,583,539
Loans and advances to non-domestic customers	1,304,540	1,135,846
Total	**47,994,902**	**43,719,385**

35 POSITIVE FAIR VALUES FROM DERIVATIVE FINANCIAL INSTRUMENTS

As at 31 December 2018, Bausparkasse Schwäbisch Hall has six interest rate swaps (nominal amount: €450 million) with a fair value of €12,197 thousand in its portfolio. All interest rate swaps were concluded in euros with DZ BANK for the targeted separation of interest rate risks in the interest book.

The swaps are counterbalanced by a liability (collateral) of €11,840 thousand, which is reported under deposits from banks.

36 INVESTMENTS AND INVESTMENTS USING THE EQUITY METHOD

in € thousand	31 Dec 2018	31 Dec 2017
Bonds and other fixed-income securities	**10,715,412**	**10,101,361**
Mandatorily measured at fair value through other comprehensive income	8,055,642	n/a
Measured at amortised cost	2,659,770	–
Available-for-sale	n/a	10,101,361
Shares and other variable-yield securities	**2,606**	**2,606**
Fair value OCI option	2,606	n/a
Available-for-sale	n/a	2,606
Interests in subsidiaries	**7,238**	**3,738**
Fair value OCI option	7,238	n/a
Available-for-sale	n/a	3,738
Interests in joint ventures using the equity method	**254,811**	**288,243**
Total	**10,980,067**	**10,395,948**

Bonds and other fixed-income securities include *öffentliche Inhaberpfandbriefe* (German public sector bearer covered bonds) amounting to €568 million (previous year: €338 million), *Hypotheken-Inhaberpfandbriefe* (German mortgage bearer covered bonds) amounting to €876 million (previous year: €586 million) and bonds from public-sector issuers amounting to €4,475 million (previous year: €4,381 million).

Investments include shares and other variable-yield securities as well as interests in subsidiaries with a carrying amount of €9,844 thousand (previous year: €6,344 thousand), for which the fair value OCI option has been exercised.

During the financial year, Bausparkasse Schwäbisch Hall and the financial technology company Hypoport founded Baufinex GmbH. Bausparkasse Schwäbisch Hall holds 70 per cent of shares in Baufinex GmbH (carrying amount of €3,500 thousand).

For strategic reasons, the previous year saw the sale of other shareholdings measured at amortised cost with a carrying amount of €982 thousand and a capital gain amounting to €1,540 thousand.

No sales of equity instruments took place in the 2018 financial year.

As in the previous year, Bausparkasse Schwäbisch Hall has an additional contribution liability amounting to €3,300 thousand to DOMUS Beteiligungsgesellschaft der Privaten Bausparkassen mbH in the case of a shareholder resolution.

Financial data for interests in joint ventures using the equity method
Interests in joint ventures concern the banks ČMSS, PSS and SGB (see note 66), which operate *Bauspar* business in accordance with German principles in the Czech Republic, Slovakia and China (see *Bauspar* Loans and Savings Non-domestic segment in the combined management report). Schwäbisch Hall is pursuing the goal of transferring the benefits of the *Bauspar* system to non-domestic markets and, in this way, taking advantage of additional growth opportunities.

Presented below is the summarised financial information as well as the reconciliation statement on the carrying amount of joint ventures using the equity method:

in € million	ČMSS 2018	PSS 2018	SGB 2018	ČMSS 2017	PSS 2017	SGB 2017
Current assets	**1,085**	**636**	**618**	**1,201**	**721**	**1,268**
of which: cash and cash equivalents	60	69	467	873	103	649
Non-current assets	**4,670**	**2,443**	**2,662**	**4,627**	**2,301**	**2,424**
Current liabilities	**1,246**	**762**	**2,497**	**1,160**	**904**	**2,948**
of which: current financial liabilities	1,165	744	2,459	1,125	885	2,928
Non-current liabilities	**4,185**	**2,074**	**415**	**4,322**	**1,864**	**372**
of which: non-current financial liabilities	4,182	2,062	414	4,282	1,851	362
Total net assets [1]	**324**	**243**	**120**	**348**	**254**	**197**
Equity investment ratio	45.0%	32.5%	24.9%	45.0%	32.5%	24.9%
Carrying amount under the equity method	**146**	**79**	**30**	**157**	**83**	**49**

[1] including adjustments of the Group from an investor perspective

in € million	ČMSS 2018	PSS 2018	SGB 2018	ČMSS 2017	PSS 2017	SGB 2017
Net interest income	**80**	**49**	**43**	**88**	**57**	**39**
Interest income	165	96	129	175	106	140
Interest expenses	– 86	– 47	– 86	– 87	– 49	– 101
Net fee and commission income	**22**	**16**	**– 2**	**21**	**16**	**3**
Fee and commission income	41	17	9	39	17	14
Fee and commission expenses	– 19	– 1	– 11	– 18	– 1	– 11
Administrative expenses	**– 51**	**– 35**	**– 36**	**– 54**	**– 35**	**– 35**
of which: depreciation and amortisation	– 11	– 4	– 4	– 10	– 4	– 6
Income taxes	**– 8**	**– 5**	**–**	**– 8**	**– 5**	**– 2**
Profit from continuing operations	**34**	**17**	**– 2**	**41**	**17**	**6**
Other comprehensive income or loss	**– 5**	**–**	**– 4**	**– 1**	**– 3**	**– 23**
Total comprehensive income or loss	**29**	**17**	**– 6**	**40**	**14**	**– 17**
Dividends received	19	–	–	20	7	–

37 INTANGIBLE ASSETS

in € thousand	31 Dec 2018	31 Dec 2017
Internally generated intangible assets	21,086	23,687
Other intangible assets	127,471	110,631
Total	**148,557**	**134,318**

€95.2 million of other intangible assets is attributed to Project NEXT.

38 PROPERTY, PLANT AND EQUIPMENT

in € thousand	31 Dec 2018	31 Dec 2017
Land and buildings	63,069	68,401
Office furniture and equipment	54,852	48,244
Total	**117,921**	**116,645**

39 INCOME TAX ASSETS AND LIABILITIES

in € thousand	31 Dec 2018	31 Dec 2017
Current tax assets	2,029	925
Deferred tax assets	75,650	64,709
Income tax assets	**77,679**	**65,634**
Current tax liabilities	59,361	79,117
Deferred tax liabilities	–	6,872
Income tax liabilities	**59,361**	**85,989**

Deferred tax assets and liabilities are recognised for temporary differences in respect of the items shown below:

in € thousand	Deferred tax assets		Deferred tax liabilities	
	31 Dec 2018	31 Dec 2017	31 Dec 2018	31 Dec 2017
Loans and advances to banks and customers	–	–	79,561	60,426
Loss allowances	35,227	35,049	–	–
Positive and negative fair values from derivative financial instruments	–	–	3,025	440
Investments	704	–	15	35,276
Property, plant and equipment	305	24	4	333
Intangible assets	–	–	2,823	5,371
Deposits from banks and customers	3,390	1,312	148,429	133,380
Provisions for employee benefits	127,980	122,386	–	–
Other provisions	136,493	130,962	1,687	1,902
Other balance sheet items	7,095	5,232	–	–
Total (gross)	**311,194**	**294,965**	**235,544**	**237,128**
Netting of deferred tax assets and deferred tax liabilities	– 235,544	– 230,256	– 235,544	– 230,256
Total (net)	**75,650**	**64,709**	**–**	**6,872**

There are deferred tax assets recognised in other comprehensive income amounting to €74,413 thousand (previous year: €69,753 thousand) that concern provisions for employee benefits and deferred tax assets recognised in other comprehensive income amounting to €– 1,045 thousand (previous year: deferred tax liabilities recognised in other comprehensive income of €32,975 thousand) that concern investments.

Furthermore, there are deferred tax liabilities recognised in other comprehensive income amounting to €2,144 thousand (previous year: €2,219 thousand) that concern the settlement provision of FLK.

Deferred tax assets that are expected to only be realised after twelve months have elapsed amount to €75,650 thousand (previous year: €64,709 thousand). There are no deferred tax liabilities that are expected to only be realised after twelve months have elapsed (previous year: €6,872 thousand).

No deferred tax liabilities were recognised for temporary differences in interests in subsidiaries and joint ventures amounting to €20,771 thousand (previous year: €17,733 thousand) as it is unlikely that these differences will be reversed by realisation in the foreseeable future.

40 OTHER ASSETS

in € thousand	31 Dec 2018	31 Dec 2017
Other financial receivables	8,015	10,456
Deferred items and payments in advance	17,648	10,189
Remaining other assets	3,347	4,144
Total	**29,010**	**24,789**

Other financial receivables primarily include trade receivables.

41 LOSS ALLOWANCES

The development of loss allowances recognised on the assets side was as follows:

	Loss allowances							
	Cash and cash equivalents	Loans and advances to banks	Loans and advances to customers			Investments	Other assets	Total
in € thousand	Stage 1	Stage 1	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	
Balance as at 1 Jan 2018	**13**	**807**	**19,065**	**54,130**	**91,671**	**732**	**51**	**166,469**
Additions	26	345	15,696	82,636	45,466	452	135	144,756
Utilisations	–	–	–	–	– 5,903	–	–	– 5,903
Reversals	– 38	– 318	– 70,569	– 33,632	– 29,404	– 403	– 131	– 134,495
Change due to stage transfer	–	–	61,157	– 52,032	– 9,125	–	–	–
Transfer from stage 1	–	–	– 649	593	56	–	–	–
Transfer from stage 2	–	–	59,296	– 59,465	169	–	–	–
Transfer from stage 3	–	–	2,510	6,840	– 9,350	–	–	–
Other changes	– 1	0	– 48	– 17	156	– 24	2	68
Balance as at 31 Dec 2018	**0**	**834**	**25,301**	**51,085**	**92,861**	**757**	**57**	**170,895**

Comparative information pursuant to IAS 39

	Loss allowances for loans and advances to customers			
in € thousand	Specific loan loss allowances	Specific loan loss allowances evaluated on a Group basis	Portfolio loan loss allowances	Total
Balance as at 1 Jan 2017	**10,870**	**76,893**	**73,928**	**161,691**
Additions	804	38,406	44,445	83,655
Utilisations	– 1,697	– 7,316	–	– 9,013
Reversals	– 3,027	– 14,137	– 50,955	– 68,119
Other changes	– 338	– 5,846	6,118	– 66
Balance as at 31 Dec 2017	**6,611**	**88,001**	**73,536**	**168,148**

42 CHANGES IN NON-CURRENT ASSETS

The development of property, plant and equipment and intangible assets is as follows:

in € thousand	Intangible assets: Internally generated intangible assets	Intangible assets: Other intangible assets	Property, plant and equipment: Land and buildings	Property, plant and equipment: Office furniture and equipment
Carrying amount as at 1 Jan 2017	**24,029**	**95,997**	**82,115**	**36,113**
Costs as at 1 Jan 2017	80,995	198,991	268,599	139,972
Additions	9,030	40,194	808	20,420
Reclassifications	– 256	256	– 8,242	8,242
Disposals	–	– 6,759	–	– 15,785
Changes attributable to currency translation	–	– 9	–	– 4
Costs as at 31 Dec 2017	**89,769**	**232,673**	**261,165**	**152,845**
Depreciation, amortisation and impairment losses as at 1 Jan 2017	– 56,966	– 102,994	– 186,484	– 103,859
Additions	– 9,116	– 20,794	– 6,280	– 13,412
Disposals	–	1,745	–	12,668
Changes attributable to currency translation	–	2	–	2
Depreciation, amortisation and impairment as at 31 Dec 2017	**– 66,082**	**– 122,041**	**– 192,764**	**– 104,601**
Carrying amount as at 31 Dec 2017	**23,687**	**110,632**	**68,401**	**48,244**
Costs as at 1 Jan 2018	89,769	232,673	261,165	152,845
Additions	7,302	35,799	752	24,127
Reclassifications	– 21	21	–	–
Disposals	–	– 3,335	– 2,145	– 10,989
Changes attributable to currency translation	–	– 970	–	– 491
Costs as at 31 Dec 2018	**97,050**	**264,188**	**259,772**	**165,492**
Depreciation, amortisation and impairment as at 1 Jan 2018	– 66,082	– 122,041	– 192,764	– 104,601
Additions	– 9,882	– 14,959	– 5,785	– 14,132
Disposals	–	63	1,846	7,829
Changes attributable to currency translation	–	220	–	264
Depreciation, amortisation and impairment as at 31 Dec 2018	**– 75,964**	**– 136,717**	**– 196,703**	**– 110,640**
Carrying amount as at 31 Dec 2018	**21,086**	**127,471**	**63,069**	**54,852**

The carrying amount of buildings include advance payments amounting to €53 thousand (previous year: €0 thousand). The carrying amount of office furniture and equipment include advance payments amounting to €39 thousand (previous year: €20 thousand), while those of other intangible assets include advance payments amounting to €86,230 thousand (previous year: €64,388 thousand).

43 DEPOSITS FROM BANKS

Deposits from banks break down as follows by business type:

in € thousand	31 Dec 2018	31 Dec 2017
Bauspar deposits	1,652,017	1,633,213
Current business accounts	1,706,786	2,013,061
Promissory note loans	576,441	576,438
Money market business	399,935	99,860
KfW subsidised loans	140,797	142,530
Total	**4,475,976**	**4,465,102**

Deposits from banks exhibit the following maturities:

in € thousand	31 Dec 2018	31 Dec 2017
Deposits from domestic banks	4,475,976	4,465,102
of which: repayable on demand	1,706,786	2,013,061
with agreed maturity or notice period	1,117,173	818,828
with indefinite maturity	1,652,017	1,633,213
Total	**4,475,976**	**4,465,102**

44 DEPOSITS FROM CUSTOMERS

in € thousand	31 Dec 2018	31 Dec 2017
Deposits from domestic customers	**58,109,373**	**54,895,735**
Bauspar deposits	57,773,782	54,629,782
Other deposits	335,591	265,953
of which: repayable on demand	295,802	229,760
with agreed maturity or notice period	39,789	36,193
Deposits from non-domestic customers	**2,225,973**	**2,013,920**
Bauspar deposits	2,222,704	2,011,834
Other deposits	3,269	2,086
of which: repayable on demand	3,269	2,086
Total	**60,335,346**	**56,909,655**

45 NEGATIVE FAIR VALUES FROM DERIVATIVE FINANCIAL INSTRUMENTS

As at 31 December 2017, Bausparkasse Schwäbisch Hall had five interest rate swaps (nominal amount: €400 million) in its portfolio. Of these, four exhibited positive fair values totalling €3,756 thousand, while one interest rate swap had a negative fair value of €–204 thousand. The balance of all swap transactions and a uniformly calculated cash collateral of €–3,830 thousand amounted to €–278 thousand after netting and was reported under "Negative fair values from derivative financial instruments".

46 PROVISIONS

in € thousand	31 Dec 2018	31 Dec 2017
Provisions for employee benefits	**290,895**	**490,457**
Defined benefit obligations	255,361	451,140
Long-term employee benefits	7,615	7,776
Provisions for termination benefits	27,919	31,541
of which: Loyalty bonus	16,591	16,591
Early retirement schemes	3,350	4,357
Other provisions	7,978	10,593
Other provisions	**1,162,610**	**1,072,994**
Bauspar-specific provisions	1,071,978	982,840
Other provisions	86,023	84,228
Provisions for loan commitments	4,609	5,926
Total	**1,453,505**	**1,563,451**

Other provisions include provisions in connection with the lending and *Bauspar* business amounting to €59,295 thousand (previous year: €59,697 thousand).

Provisions for defined benefit plans

Provisions for defined benefit obligations primarily concern pension plans that are no longer accepting any further employees (closed plans). Other defined benefit commitments exist for members of the Board of Managing Directors or Managing Directors. New employees are almost exclusively offered defined contribution plans, for which in general a provision is not to be recognised.

The present value of defined benefit obligations can be divided into the following risk classes:

in € thousand	31 Dec 2018	31 Dec 2017
Defined benefit obligations	**764,864**	**766,416**
of which: active participants	268,193	281,725
departed participants	91,664	97,802
retirees	405,007	386,889

in € thousand	31 Dec 2018	31 Dec 2017
Defined-benefit obligation	**764,864**	**766,416**
of which: final-salary-dependent pension commitments	733,640	734,320
capital commitments	31,224	32,096

The predominantly final-salary-dependent plans concern pension commitments by the employer to the employee that depend on the level of the final remuneration before the retirement (x per cent of this remuneration for every year of service). It must largely be assumed that there will be a lifelong payment obligation, for which pursuant to section 16(1) BetrAVG (German Occupational Pensions Act) an adjustment review must be carried out as regards the consumer price index and remuneration developments.

In addition to longevity and salary developments, a significant risk factor that cannot be influenced by the company is the market interest rate, as the interest rate affects both the amount of the obligations and the income from plan assets.

The total amount of defined benefit obligations is attributed to Germany.

The present value of defined benefit obligations has developed as follows:

in € thousand	2018	2017
Present value of defined benefit obligations as at 1 Jan	**766,416**	**781,555**
Current service cost	10,088	10,457
Past service cost	– 163	– 48
Interest expenses	13,164	13,428
Pension benefits paid	– 26,779	– 26,495
Remeasurements	2,449	– 12,498
of which: actuarial gains (–)/losses(+) from changes in demographic assumptions	3,887	–
Experience adjustments	– 1,438	– 12,498
Transfer payments	– 311	17
Present value of defined benefit obligations as at 31 Dec	**764,864**	**766,416**

When measuring defined benefit obligations the following actuarial assumptions were used:

in %	31 Dec 2018	31 Dec 2017
Discount rate	1.75	1.75
Salary increase	1.80	1.80
Pensions increase	1.75	1.75

Sensitivity analysis

A risk assessment using sensitivity analyses of the significant actuarial measurement parameters is made apparent by the change in present value of defined benefit obligations (DBO). It is clear what the hypothetical impact on profit/loss and equity would have been if a change had occurred on the reporting date. It is assumed here that the portfolio on the reporting date is representative of the entire year and that the assumed change would have been possible on the reporting date.

The following table shows the sensitivity of defined benefit obligations to the central actuarial assumptions. The effects presented here are based on an isolated analysis of a change in an assumption while the remaining assumptions remain constant. Correlation effects between individual parameters are therefore not taken into account.

Present value of defined benefit obligations	Change in actuarial assumptions	Impact on defined benefit obligations 31 Dec 2018		Impact on defined benefit obligations 31 Dec 2017	
		in € thousand	in %	in € thousand	in %
Discount rate	Increase by 1.0 percentage points	– 105,027	– 14.04	– 107,617	– 14.28
	Decrease by 1.0 percentage points	135,572	18.09	138,641	18.46
Salary increase	Increase by 1.0 percentage points	9,326	1.27	9,756	1.36
	Decrease by 1.0 percentage points	– 8,874	– 1.21	– 9,269	– 1.28
Pensions increase	Increase by 0.25 percentage points	23,045	3.04	23,326	3.06
	Decrease by 0.25 percentage points	– 21,988	– 2.91	– 22,268	– 2.92
Life expectancy	Increase by 1 year	31,910	4.21	32,275	4.21
	Decrease by 1 year	– 31,820	– 4.21	– 32,302	– 4.22
Financing maturity age	Increase by 1 year	– 8,979	– 1.08	– 8,308	– 1.11
		8,333	1.07	7,813	1.07

The calculations were performed on an isolated basis for the actuarial parameters classified as significant in order to display separately the impact on the present value of defined benefit obligations calculated as at 31 December.

The assumed interest rate is to be determined on the basis of prime-rated, fixed-income corporate bonds and should match the expected maturity of the services to be performed. The derivation is averaged over the total portfolio.

The economic measurement parameters “Salary increase” and “Pensions increase” represent a sensitivity to the long-term development of salaries including career tendencies and an assessment of future pensions adjustments pursuant to section 16(1) BetrAVG.

In the case of demographic actuarial assumptions, the “life expectancy” of a 65-year-old man born in 1953 and the earliest possible “financing maturity age”, usually 63 years of age, were both modified by one year respectively to adjust the duration of retirement. In the cited example the mortality rates were changed by approximately 12 per cent.

Duration pursuant to Macaulay
The weighted average maturity of defined benefit obligations as at 31 December 2018 amounts to 15.88 years (previous year: 16.16 years).

Plan assets
The defined benefit obligations are offset by the plan assets of Bausparkasse Schwäbisch Hall AG and Schwäbisch Hall Kreditservice GmbH. Of these, €504,172 thousand (previous year: €309.931 thousand) is attributed to the Contractual Trust Arrangement (CTA) of DZ BANK, which is managed as trust assets by DZ BANK Pension Trust e. V., Frankfurt am Main. The investment guideline and strategy is set for the investment trust by the CTA Investment Committee of Bausparkasse Schwäbisch Hall.

Furthermore, plan assets include a building valued at €5,330 thousand (previous year: €5,345 thousand), which is managed by the pension fund of Bausparkasse Schwäbisch Hall.

Trustees or administrators are responsible for the administration and management of plan assets and compliance with regulatory requirements.

The financing status of defined benefit obligations is as follows:

in € thousand	31 Dec 2018	31 Dec 2017
Present value of defined benefit obligations funded by plan assets	764,864	766,416
Present value of defined benefit obligations	**764,864**	**766,416**
less fair value of plan assets	– 509,503	– 315,276
Provisions for defined benefit plans	**255,361**	**451,140**

The development of plan assets is as follows:

in € thousand	2018	2017
Fair value of plan assets as at 1 Jan	**315,276**	**25,634**
Employer contributions to plan assets	200,000	285,680
Interest income	7,267	2,679
Return on plan assets (excluding interest income)	– 12,237	2,156
Pension benefits paid	– 803	– 873
Fair value of plan assets as at 31 Dec	**509,503**	**315,276**

Contributions to plan assets of €867 thousand (expectations in the previous year: €200,790 thousand) are planned for the following financial year. All allocations of plan assets are performed by the employer.

Plan assets (CTA) are primarily invested in fixed-income assets (approximately 84 per cent). This thereby takes into account the interest sensitivity of defined benefit obligations. Plan assets are primarily invested in the eurozone.

Plan assets are divided into the segments of "core portfolio" and "income portfolio".

The core portfolio (approximately 62 per cent) primarily has fixed-income investments in *Pfandbriefe*, government and corporate bonds. The investments have a minimum rating of Investment Grade AAA to BBB.

The second segment (approximately 38 per cent) represents the "income portfolio" and primarily consists of investments in subordinated and high-yield bonds, such as non-fixed-income securities (shares, commodities, balanced funds, etc.) on global markets.

Derivative financial instruments are also used as part of portfolio management. Defined benefit obligations and plan assets are in euros.

The fair value of plan assets is broken down by asset class as follows:

in € thousand	31 Dec 2018			31 Dec 2017		
	With quoted market price in an active market	Without quoted market price in an active market	Total	With quoted market price in an active market	Without quoted market price in an active market	Total
Cash and money market investments	–	12,592	12,592	–	34,604	34,604
Bonds and other fixed-income securities	424,674	–	424,674	275,327	–	275,327
Shares	46,098	–	46,098	–	–	–
Derivative financial instruments	– 19	–	– 19	–	–	–
Land and buildings	–	5,020	5,020	–	5,020	5,020
Other assets	20,828	310	21,138	–	325	325
Total	**491,581**	**17,922**	**509,503**	**275,327**	**39,949**	**315,276**

Other provisions

Other provisions have developed as follows:

in € thousand	*Bauspar*-specific provisions	Other provisions	Provisions for loan commitments	Total
Balance as at 1 Jan 2017	**914,929**	**47,994**	**3,839**	**966,762**
Additions	190,533	52,382	2,095	245,010
Utilisation	– 122,620	– 15,049	–	– 137,669
Reversals	–	– 1,578	– 8	– 1,586
Reclassification	–	475	–	475
Interest expenses	–	4	–	4
Other changes	– 2	–	–	– 2
Balance as at 31 Dec 2017	**982,840**	**84,228**	**5,926**	**1,072,994**
Additions	196,455	12,248	2,745	211,448
Utilisation	– 107,082	– 9,033	–	– 116,115
Reversals	– 235	– 1,300	– 4,285	– 5,820
Reclassification	–	–	–	–
Interest expenses	–	–	–	–
Other changes	–	– 120	223	103
Balance as at 31 Dec 2018	**1,071,978**	**86,023**	**4,609**	**1,162,610**

Depending on the tariff, the Schwäbisch Hall Group grants Bauspar customers interest incentives that are tied to the fulfilment of various conditions. Furthermore, fees are fully or partially refunded depending on the loan drawdown.

The respective expected future payment obligations are recognised at present value on the basis of past and forecast values.

The expected maturities of other provisions break down as follows:

Status as at 31 Dec 2018 in € thousand	**≤ 3 months**	**> 3 months – 1 year**	**> 1 year – 5 years**	**> 5 years**
Bauspar-specific provisions	5,378	494,630	449,883	122,087
Other provisions	4,427	66,248	14,985	363
Provisions for loan commitments	234	–	4,375	–
Total	**10,039**	**560,878**	**469,243**	**122,450**

Status as at 31 Dec 2017 in € thousand	**≤ 3 months**	**> 3 months – 1 year**	**> 1 year – 5 years**	**> 5 years**
Bauspar-specific provisions	5,501	474,905	389,969	112,465
Other provisions	850	60,393	22,985	–
Provisions for loan commitments	–	–	5,926	–
Total	**6,351**	**535,298**	**418,880**	**112,465**

47 OTHER LIABILITIES

in € thousand	**31 Dec 2018**	**31 Dec 2017**
Accruals	113,110	124,295
Liabilities to DZ BANK AG arising from profit and loss transfer agreement	16,000	25,000
Other tax liabilities to taxation authorities	42,800	45,577
Other financial liabilities	9,285	9,965
Residual other liabilities	4,701	4,077
Total	**185,896**	**208,987**

48 EQUITY

in € thousand	31 Dec 2018	31 Dec 2017
Subscribed capital	310,000	310,000
Capital reserve	1,486,964	1,486,964
Retained earnings	3,103,150	2,895,051
Other retained earnings	3,070,526	2,844,960
Remeasurements of defined benefit plans	– 164,166	– 154,138
Remeasurements of defined benefit plans of joint ventures using the equity method	– 926	– 1,024
Other retained earnings (equity)	197,716	205,253
Reserve from fair value OCI equity instruments	– 11,961	n/a
Reserve from fair value OCI debt instruments[1]	1,921	94,155
Currency translation reserve	7,891	11,743
Non-controlling interests	73,702	94,509
Net profit	185,650	210,884
Total	**5,157,317**	**5,103,306**

[1] Revaluation reserve in the previous year in accordance with IAS 39

Loss allowances included in the reserve from fair value OCI debt instruments developed as follows:

in € thousand	Stage 1
Balance as at 1 Jan 2018	**968**
Additions	1,797
Utilisation	– 879
Reversals	– 1,083
Other changes	51
Balance as at 31 Dec 2018	**854**

Subscribed capital

Subscribed capital (share capital) of Bausparkasse Schwäbisch Hall is divided into 6,000,000 no-par-value shares. Each share grants the holder one vote.

Disclosures on shareholders

Due to the merger of DZ Bank AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main, and WGZ Bank AG Westdeutsche Genossenschafts-Zentralbank, Düsseldorf, the interest of DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main, in share capital at the end of the financial year is 96.941 per cent. The remaining 3.059 per cent is mainly owned by primary banks.

Capital reserve

The capital reserve includes the amounts from the issue of Bausparkasse Schwäbisch Hall shares in excess of the imputed par value of the shares.

Retained earnings

Retained earnings include consolidated capital generated but not distributed and the actuarial gains and losses from remeasurement of defined benefit plans taking into account deferred taxes. Accumulated actuarial gains and losses amount to €– 165.1 million (previous year: €– 155.2 million).

Retained earnings include undistributed profits amounting to €277.8 million (previous year: €277.8 million) that are to be allocated to the technical security reserve in application of section 6 *Bausparkassen* Act (BauSparkG), as well as €25.5 million (previous year: €27.7 million) that was formed with the same earmarking on the basis of the Hungarian Act CXIII/1996 on *Bausparkassen*.

Reserve from fair value OCI equity instruments

The reserve from fair value OCI equity instruments shows the changes in fair values of equity instruments that pursuant to IFRS 9.4.1.4 were designated irrevocably to the measurement category “Fair value through other comprehensive income” (fair value OCI option). After the disposal of equity instruments for which the fair value OCI option was exercised, accumulated gains and losses are to be reclassified from net profit through other comprehensive income to retained earnings.

Reserve from fair value OCI debt capital instruments

The reserve from fair value OCI debt instruments shows the changes in the fair values of financial assets in the measurement category “Fair value through other comprehensive income” taking into account deferred taxes. Gains and losses are only recognised through profit or loss if the corresponding asset has been derecognised. Loss allowances are included in the reserve from fair value OCI debt instruments.

Currency translation reserve

The currency translation reserve results from the translation of foreign currency financial statements of subsidiaries and joint ventures into euros as the Group reporting currency.

Non-controlling interests

Non-controlling interests comprise interests in the equity of subsidiaries that are not attributable to the Bausparkasse Schwäbisch Hall Group.

Capital management

Bausparkasse Schwäbisch Hall AG manages equity using the following key indicators:

	Bausparkasse Schwäbisch Hall Group	
in %	**31 Dec 2018**	**31 Dec 2017**
RORAC	11.0	12.4
Overall capital ratio under SolvV [German Solvency Regulation]	28.6	28.6
Core Tier 1 capital ratio	28.6	28.6

Financial instruments disclosures

49 DISCLOSURES ON FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

	Carrying amount	
in € thousand	**31 Dec 2018**	**31 Dec 2017**
Financial assets measured at fair value	**8,077,683**	**10,101,361**
Financial assets mandatorily measured at fair value through profit or loss	12,197	–
Positive fair values from derivative financial instruments	12,197	–
Financial assets measured at fair value through other comprehensive income	8,065,486	10,101,361
Debt instruments	8,055,642	10,101,361
Equity instruments	9,844	n/a
Financial assets measured at amortised cost	**62,969,729**	**57,616,204**
Cash and cash equivalents	36,737	43,529
Loans and advances to banks	12,440,366	14,004,639
Loans and advances to customers	47,825,655	43,551,237
Investments	2,659,013	6,344
Other assets	7,958	10,455

	Carrying amount	
in € thousand	**31 Dec 2018**	**31 Dec 2017**
Financial liabilities measured at fair value	**–**	**278**
Negative fair values from derivative financial instruments	–	278
Financial liabilities measured at amortised cost	**64,836,607**	**61,409,722**
Deposits from banks	4,475,976	4,465,102
Deposits from customers	60,335,346	56,909,655
Other liabilities	25,285	34,965
Financial guarantee contracts and loan commitments	**4,806,889**	**4,413,193**

Pursuant to IFRS 7.25, a fair value must be given for every class of financial assets and liabilities, consequently also for *Bauspar* deposits and *Bauspar* loans. In general, the contracts should be measured separately here.

However, due to the special features of the *Bauspar* product, i.e. the complex structure of a *Bauspar* contract and the multitude of tariff configurations, there is currently no suitable method for calculating a one-dimensional fair value on the basis of an individual contract according to the reporting date principle. Consequently fair values pursuant to IFRS 7.25 cannot be determined using either comparative market prices or suitable option pricing models. The models developed in practice to manage Bausparkassen only serve comprehensive bank management and likewise do not offer sufficient basis for measurement on the basis of fair values pursuant to the IFRS Standards (see note 6). Accordingly, Bausparkasse Schwäbisch Hall refrains from citing a fair value in the notes and from classifying relevant financial instruments into the levels of the fair value hierarchy. Although potential hidden charges are not shown, they are taken into account via a deduction within the framework of calculating the risk coverage potential (RCP). The consideration of any hidden reserves to increase the RCP are omitted for reasons of prudence. At the end of the reporting period, there are no hidden liabilities to be taken into account in the determination of the RCP. On the basis of the *Bausparkasse*'s models for comprehensive bank management, which comprise both the collective and non-collective business including deposits, the overall amount during the financial year was positive.

50 COLLATERAL

On the reporting date, loans and advances to customers amounting to €140,404 thousand (previous year: €143,209 thousand) were provided as collateral for building loans issued pursuant to promotional programmes of the Kreditanstalt für Wiederaufbau (KfW). Securing the loans and advances of the Kreditanstalt für Wiederaufbau against Bausparkasse Schwäbisch Hall occurs via the assignment of loans and advances arising from the forwarding of the earmarked loan and the fiduciary holding of collateral made available for this purpose.

51 ITEMS OF INCOME, EXPENSE, GAINS AND LOSSES

The influence of the financial instruments on the earnings positions of the Schwäbisch Hall Group is presented below in accordance with IFRS 7 by supplementary disclosures.

Net gains and losses

The breakdown of net gains and losses on financial instruments by IFRS 9 category for financial assets and financial liabilities is as follows:

in € thousand	2018	2017
Derivative financial instruments mandatorily measured at fair value through profit or loss	**14,700**	**3,679**
Financial assets measured at fair value through other comprehensive income	**105,350**	**148,091**
Financial assets mandatorily measured at fair value through other comprehensive income	103,678	n/a
Financial assets designated at fair value through other comprehensive income	1,672	n/a
Available-for-sale financial assets	n/a	148,091
Financial assets measured at amortised cost	**1,498,597**	**1,489,051[1]**
Financial liabilities measured at amortised cost	**– 847,244**	**– 834,139**

[1] Reported in the previous year under the category "Loans and receivables"

Net gains or net losses comprise gains and losses on fair value measurement through profit or loss impairment losses and gains and losses from the sale and early repayment of the financial instruments concerned. These items also include interest income and expenses, current income, profit-transfer agreements and expenses from the transfer of losses.

Interest income and expenses

The following total interest income and expenses arose for financial assets and financial liabilities that are not measured at fair value through profit or loss:

in € thousand	2018	2017
Interest income from financial instruments not measured at fair value through profit or loss	1,602,794	1,639,427
Interest expenses for financial instruments not measured at fair value through profit or loss	– 847,244	– 834,139

Income and expense items from commissions

Net fee and commission income include fee and commission income amounting to €24,941 thousand (previous year: €10,721 thousand) and fee and commission expenses amounting to €97,924 thousand (previous year: €120,264 thousand) from financial assets and financial liabilities that are not measured at fair value through profit or loss.

Impairment losses on financial assets

in € thousand	2018	2017
Financial assets measured at amortised cost	**– 152,831**	**– 91,938**
Cash and cash equivalents	– 26	–
Loans and advances to banks	– 345	–
Loans and advances to customers	– 151,854	– 91,938
Other assets	– 154	–
Investments (bonds and other fixed-income securities)	– 452	–
Financial assets mandatorily measured at fair value through other comprehensive income	**– 1,797**	**–**
Investments (bonds and other fixed-income securities)	– 1,797	–

52 FAIR VALUE HIERARCHY

Financial instruments accounted for at fair value are classified hierarchically according to the fair value measurement method and the underlying assumptions.

Fair values in hierarchy level 1 are calculated using active market prices for the respective financial instrument (quoted market prices). In the reporting year, investments in the category “Financial assets mandatorily measured at fair value through other comprehensive income” amounting to €8,055,641 thousand (previous year: “available-for-sale” assets amounting to €10,101,361 thousand) were accounted for at the quoted market price in hierarchy level 1.

The previous year saw financial instruments amounting to €2,437 thousand that were reclassified as "Financial assets measured at amortised cost" with the transition from IAS 39 to IFRS 9.

The measurement of the fair value of financial instruments assigned to level 2 of the measurement hierarchy takes place using active market prices for comparable but non-identical financial instruments or using measurement techniques that are predominantly based on observable measurement parameters. The calculation of the fair value of derivative financial instruments occurs by applying standard models customary in the industry while using observable input parameters. The discounting of cash flows of derivative financial instruments takes place with a yield curve that takes collateralisation into account. In the reporting year, interest rate swaps in the category "Financial instruments measured at fair value through profit or loss" with a positive fair value amounting to €12,197 thousand (previous year: negative fair value of €278 thousand) were accounted for in hierarchy level 2.

The measurement of the fair value of equity instruments such as shares and other variable-yield securities and interests in subsidiaries in the fair value OCI category that are assigned to level 3 of the measurement hierarchy takes place using the capitalised value approach, in the course of which future income or dividends based on budgeted values and estimates are discounted using risk parameters.

Equity instruments assigned to level 3 in the fair value OCI category increased by €3,500 thousand in the financial year from €6,344 thousand to €9,844 thousand due to acquisitions.

In the case of equity instruments, this concerns strategically held interests for which the option under IFRS 9 (fair value OCI option) was exercised. In the previous year, equity instruments were measured at cost pursuant to IAS 39.

53 NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS

Information regarding the type and extent of risks arising from financial instruments (IFRS 7.31–42) is, with the exception of qualitative and quantitative data pursuant to IFRS 7.35–36 and the maturity analysis pursuant to IFRS 7.39 (a) and (b), included in the risk report of the Group management report. The selected data pursuant to IFRS 7.35–36 and the maturity analysis (note 54) are disclosed in the notes to the consolidated financial statements.

Credit risk management practices
The rules for recognising impairment losses are based on the calculation of expected losses in the lending business, from investments and from other assets. The application of the impairment loss rules is limited to financial assets as well as loan commitments and financial guarantee contracts that are not measured at fair value through profit or loss. This includes:

- financial assets measured at amortised cost,
- debt instruments held as financial assets measured at fair value through other comprehensive income.

Furthermore, the impairment rules apply to:

- loan commitments and financial guarantee contracts pursuant to IFRS 9 and that are not measured at fair value through profit or loss,
- lease receivables,
- trade receivables and contract assets pursuant to IFRS 15.

Pursuant to IFRS 9, the three-stage approach along with additional consideration of POCIs is used to calculate expected losses:

- Stage 1: a 12-month expected credit loss is taken into account for financial assets without a significantly increased credit risk compared to when they were acquired and which were not subject to impairment at acquisition.
- Stage 2: loss allowances are calculated for the amount of lifetime expected credit losses for financial assets with a credit risk that has increased significantly since initial recognition.
- Stage 3: financial assets are classified as impaired if one or more events have occurred that present a sustained impact on the expected future cash flows of the financial asset or if they are deemed to have been defaulted on pursuant to Article 178 of the Capital Requirements Regulation (CRR). The latter also matches the definition of default within the Bausparkasse Schwäbisch Hall Group. Loss allowances are likewise recognised in the amount of the lifetime expected credit losses. In addition, interest income is calculated using the effective interest method on the amortised cost after loss allowances.
- POCI: financial assets that are already classified as impaired at acquisition are not assigned to the three-stage model but rather are measured separately. Financial assets impaired at initial recognition are not measured at their gross carrying amount but rather are recognised at fair value. Accordingly, interest income for financial assets impaired at acquisition is generated using a risk-adjusted effective interest rate.

Financial assets already impaired at acquisition, known as “purchased or originated credit-impaired assets” (POCI), were not identified during the reporting period.

The review of whether there is a significant increase in the credit risk of financial assets or financial guarantee contracts and loan commitments compared to the credit risk at the time of acquisition takes place monthly with a special focus on every reporting date. The assessment takes place at the level of the financial asset with the aid of quantitative and qualitative analyses.

The quantitative analyses usually take place with the aid of the expected credit risk over the entire residual life of the financial instruments under review. Macroeconomic information is also taken into account here. In general, the credit risk on the reporting date for the residual maturity is compared to the credit risk of the asset estimated at the time of acquisition for the respective maturity. The threshold values that indicate a significant increase in credit risk are in principle calculated separately for each portfolio in relation to its historical migrations in the probability of default. Internal risk measurement systems and risk forecasts are used for this purpose in order to assess the credit risk of financial assets. This review is supplemented with qualitative criteria that increase credit risk, insofar as these are not already taken into account in the probability of default. In principle, a transfer into Stage 2 is assumed in the case of a payment default of 30 days at the latest. Depending on the business segment, the criterion is defined as a supplementary backstop criterion or payments past due are already part of the rating and scoring system and are reflected in this way.

A review as regards a significant increase in credit risk is dispensed with for securities with low credit risk. Securities with an Investment Grade Rating are therefore assigned to Stage 1. This exception does not apply to loans and advances.

If it is established on the reporting date that there is no longer a significant increase in credit risk compared to earlier reporting dates, the financial assets concerned are transferred back again to Stage 1 and loss allowances are again reduced to the stage of the expected 12-month expected credit loss.

Expected losses are calculated as the probability-weighted present value of expected defaults over the entire expected maturity from default events within the next twelve months for assets assigned to Stage 1 of the impairment model and from default events over the entire residual life for assets assigned to Stages 2 or 3. The expected losses are discounted with their original effective interest rate. The calculation for this purpose takes place in principle using the regulatory model harmonised with the requirements of IFRS 9, with the model consisting of probability of default, loss rate and expected loan amount at the time of default. The estimated probability of default in this regard contains not only historical but also forward-looking default information.

The calculation of expected losses is based on loss histories, which are adjusted to forecast future defaults. In addition, a macroeconomic scenario is taken into account on the basis of estimates rooted in experience. This scenario includes, for example, future developments in the employment market. The methods and assumptions, including the forecasts, are regularly validated.

Directly recognised impairment losses reduce the carrying amounts of assets directly. In contrast to loss allowances, directly recognised impairment losses are not estimated but rather are fixed at their exact amounts (for example, by disclosing an insolvency rate). Directly recognised impairment losses are usually performed after the conclusion of all recovery and enforcement measures.

Maximum exposure to credit risk

The Bausparkasse Schwäbisch Hall Group is exposed to a credit risk arising from financial instruments. The maximum credit risk is represented by the fair values, amortised cost or nominal values of financial instruments. Collateral is not taken into account here.

Within the Bausparkasse Schwäbisch Hall Group, the following collateral and other loan collateral are held in order to hedge the maximum credit risk:

	Maximum credit risk	of this secured with			
in € thousand		**Warranties, guarantees**	**Land charges, mortgages**	**Financial collateral**	**Other collateral**
Financial assets measured at fair value	**8,067,839**	**–**	**272,396**	**11,840**	**121,640**
Financial assets measured at fair value through profit or loss	12,197	–	–	11,840	–
Financial assets measured at fair value through other comprehensive income	8,055,642	–	272,396	–	121,640
Financial assets measured at amortised cost	**62,969,729**	**18,637**	**37,836,816**	**6,293,920**	**9,847,717**
of which: credit-impaired financial assets		–	83,765	–	14,966
Financial guarantee contracts and loan commitments	**4,806,889**	**–**	**4,762,905**	**–**	**3,854**
of which: credit-impaired financial assets		–	246	–	10

For further analysis of the credit portfolio, please refer to the opportunities and risk report in the combined management report.

Loss allowances and gross carrying amounts

At the Bausparkasse Schwäbisch Hall Group, loss allowances are formed for the amount of expected loan losses for the classes “Financial assets measured at fair value”, “Financial assets measured at amortised cost” and “Financial guarantee contracts and loan commitments”. Trade receivables and contract assets pursuant to IFRS 15 are part of the class “Financial assets measured at amortised cost”.

Financial assets measured at fair value

in € thousand	Stage 1	
	Loss allowances	Fair value
Balance as at 1 Jan 2018	**968**	**7,664,656**
Addition/increase in credit utilisation	1,797	2,982,068
Utilisation/directly recognised impairment losses to gross carrying amounts	– 879	–
Reversals	– 1,083	– 2,486,534
Amortisation, changes in fair value	–	– 104,548
Other changes	51	–
Balance as at 31 Dec 2018	**854**	**8,055,642**

Financial assets measured at amortised cost

in € thousand	Stage 1		Stage 2		Stage 3	
	Loss allowances	Gross carrying amount	Loss allowances	Gross carrying amount	Loss allowances	Gross carrying amount
Balance as at 1 Jan 2018	**20,617**	**55,395,341**	**54,181**	**4,189,270**	**91,671**	**588,923**
Additions/increase in credit utilisation	7,240	27,460,489	1,068	405,475	5,945	342,610
Change to financial assets by an allocation	61,157	386,745	– 52,032	– 246,431	– 9,125	– 140,314
Transfer from stage 1	– 649	– 271,369	593	266,900	57	4,469
Transfer from stage 2	59,296	542,280	– 59,465	– 555,238	168	12,958
Transfer from stage 3	2,510	115,834	6,840	41,907	– 9,350	– 157,741
Loss allowances/directly recognised impairment losses to gross carrying amounts	–	– 10	–	– 19	– 5,903	– 8,047
Reversals	– 2,679	– 24,554,704	– 8,062	– 391,305	– 16,008	– 172,057
Changes in risk parameters	– 59,370	–	56,002	–	26,125	–
Additions	9,279	–	81,703	–	39,521	–
Reversals	– 68,649	–	– 25,701	–	– 13,396	–
Amortisation	–	– 122,838	–	58,448	–	– 518
Changes attributable to currency translation and other changes	– 73	– 49,406	– 15	– 2,212	156	1,184
Balance as at 31 Dec 2018	**26,892**	**58,515,617**	**51,142**	**4,013,226**	**92,861**	**611,781**

Financial guarantee contracts and loan commitments

in € thousand	Stage 1		Stage 2		Stage 3	
	Loss allowances	Nominal amount	Loss allowances	Nominal amount	Loss allowances	Nominal amount
Balance as at 1 Jan 2018	**6,157**	**4,413,193**	**–**	**–**	**–**	**–**
Additions/increase in credit utilisation	2,729	508,670	–	60	–	315
Change to financial assets by a stage allocation	– 387	– 14,187	379	13,725	8	462
Reversals	– 3,867	– 101,496	– 380	– 13,759	– 15	– 479
Changes in risk parameters	– 20	–	3	–	11	–
Changes attributable to currency translation	– 9	385	–	–	–	–
Balance as at 31 Dec 2018	**4,603**	**4,806,565**	**2**	**26**	**4**	**298**

Credit risk concentration

Credit risk, to which the Bausparkasse Schwäbisch Hall Group is exposed due to financial instruments, is broken down by sector pursuant to the industrial sector codes of the German Central Bank and geographically using the annually updated country group classification of the International Monetary Fund (IMF). Risk volume, measured using fair values and gross carrying amounts of financial assets or the credit risk arising from financial guarantee contracts and loan commitments, is broken down based on the following rating classes:

- Investment Grade: equivalent to the internal rating grades 1A–2A
- Non-Investment Grade: equivalent to the internal rating grades 2B–3E
- Default: equivalent to the internal rating grades 4A–4B
- Not classified: no rating necessary or not classified.

A detailed overview of internal rating grades can be found in the opportunities and risk report in the combined management report. The “Not classified” category is made of up business partners for whom a rating classification is not required.

Credit risk concentrations by sector

in € thousand		Financial sector	Public sector (adminis-tration/ government)	Corporates	Retail
Investment grade		**16,870,390**	**7,564,463**	**1,255,357**	**16,913,998**
Fair value	Stage 1	2,797,569	4,096,180	1,161,893	–
Gross carrying amount	Stage 1	14,066,521	3,467,643	2,337	11,832,346
	Stage 2	2,426	640	71	374,295
Nominal amount	Stage 1	3,873	–	91,057	4,707,359
Non-investment grade		**15,017**	**–**	**455,222**	**32,327,905**
Gross carrying amount	Stage 1	14,954	–	417,058	28,714,030
	Stage 2	63	–	37,170	3,597,332
	Stage 3	–	–	384	12,551
Nominal amount	Stage 1	–	–	599	3,677
	Stage 2	–	–	–	26
	Stage 3	–	–	10	288
Default		**–**	**–**	**6,607**	**592,239**
Gross carrying amount	Stage 3	–	–	6,607	592,239
Not classified		**151**	**–**	**1,071**	**735**
Gross carrying amount	Stage 1	–	–	14	714
	Stage 2	151	–	1,057	21

Credit risk concentrations by country

in € thousand		Germany	Other industrialised countries	Advanced economies	Emerging Markets
Investment grade		**37,281,868**	**5,320,212**	**562**	**1,568**
Fair value	Stage 1	4,161,992	3,893,650	–	–
Gross carrying amount	Stage 1	27,987,639	1,381,094	67	48
	Stage 2	374,228	3,204	–	–
Nominal amount	Stage 1	4,758,009	42,264	495	1,520
Non-investment grade		**32,245,560**	**536,979**	**3,700**	**11,904**
Gross carrying amount	Stage 1	28,708,602	423,447	3,438	10,554
	Stage 2	3,536,958	95,994	262	1,350
	Stage 3	–	12,936	–	–
Nominal amount	Stage 1	–	4,276	–	–
	Stage 2	–	26	–	–
	Stage 3	–	298	–	–
Default		**577,525**	**20,971**	**–**	**349**
Gross carrying amount	Stage 3	577,525	20,971	–	349
Not classified		**–**	**1,957**	**–**	**–**
Gross carrying amount	Stage 1	–	728	–	–
	Stage 2	–	1,230	–	–

54 MATURITY ANALYSIS

Balance as at 31 Dec 2018 in € thousand	≤ 1 month	> 1 month – 3 months	> 3 months – 1 year	> 1 year – 5 years	> 5 years	Indefinite maturity	Total
Financial assets	**720,822**	**1,017,393**	**4,857,047**	**25,439,617**	**49,648,171**	**9,844**	**81,692,894**
Cash and cash equivalents	36,737	–	–	–	–	–	36,737
Loans and advances to banks	177,500	168,825	1,592,089	6,627,489	5,087,665	–	13,653,568
Loans and advances to customers	453,761	816,136	2,403,152	15,953,568	36,188,838	–	55,815,455
Positive fair values from derivative financial instruments [1]	140	1,205	5,332	18,365	– 10,981	–	14,061
Investments	45,521	31,219	856,473	2,840,158	8,381,843	9,844	12,165,058
Other assets	7,163	8	1	37	806	–	8,015
Financial liabilities	**– 2,215,578**	**– 19,183**	**– 207,850**	**– 568,832**	**– 211,784**	**– 62,169,301**	**– 65,392,528**
Deposits from banks	– 1,907,222	– 1,649	– 207,629	– 561,576	– 181,005	– 1,652,017	– 4,511,098
Deposits from customers	– 299,071	– 1,534	– 221	– 7,256	– 30,779	– 60,517,284	– 60,856,145
Other liabilities	– 9,285	– 16,000	–	–	–	–	– 25,285
Financial guarantee contracts and loan commitments	**– 4,805,135**	**–**	**–**	**– 11**	**– 1,743**	**–**	**– 4,806,889**

[1] Net values

Balance as at 31 Dec 2017 in € thousand	≤ 1 month	> 1 month – 3 months	> 3 months – 1 year	> 1 year – 5 years	> 5 years	Indefinite maturity	Total
Financial assets	**568,037**	**984,985**	**4,734,520**	**23,943,533**	**48,277,515**	**6,344**	**78,514,934**
Cash and cash equivalents	43,529	–	–	–	–	–	43,529
Loans and advances to banks	104,637	223,615	1,780,222	6,969,915	6,410,326	–	15,488,715
Loans and advances to customers	343,301	704,368	2,399,813	13,839,212	34,608,803	–	51,895,497
Investments	66,955	57,002	554,485	3,134,370	7,257,581	6,344	11,076,737
Other assets	9,615	–	–	36	805	–	10,456
Financial liabilities	**– 2,254,981**	**– 124,316**	**– 6,294**	**– 553,195**	**– 232,727**	**– 58,779,461**	**– 61,950,975**
Deposits from banks	– 2,009,667	– 101,597	– 8,333	– 564,961	– 186,621	– 1,633,213	– 4,504,392
Deposits from customers	– 231,849	1,073	– 2,692	– 3,048	– 30,927	– 57,146,248	– 57,413,691
Negative fair values from derivative financial instruments[1]	– 3,691	1,208	4,731	14,814	– 14,988	–	2,073
Other liabilities	– 9,774	– 25,000	–	–	– 191	–	– 34,965
Financial guarantee contracts and loan commitments	**– 4,411,073**	**–**	**–**	**–**	**– 2,121**	**–**	**– 4,413,194**

[1] Net values

For the quantitative presentation of liquidity risks, the maturity analysis shows contractually agreed cash inflows with a plus sign and contractually agreed cash outflows with a minus sign. For financial guarantee contracts and loan commitments, the cash outflow is given as at the earliest possible stage.

The contractually agreed maturities are not equivalent to the actually expected cash inflows and outflows, particularly in the case of financial guarantee contracts and loan commitments. The management of liquidity risks is presented in the risk report within the combined management report.

Other disclosures

55 FINANCIAL GUARANTEE CONTRACTS AND LOAN COMMITMENTS

in € thousand	31 Dec 2018	31 Dec 2017
Loan commitments to customers	**4,804,782**	**4,410,511**
Financial guarantee contracts	**2,107**	**2,682**
Loan guarantees	934	1,558
Other guarantees and warranties	1,173	1,124
Total	**4,806,889**	**4,413,193**

The data on financial guarantee contracts and loan commitments is provided as the level of nominal values of the obligations respectively entered into.

56 REVENUE FROM CONTRACTS WITH CUSTOMERS

The income statement does not contain any revenue from contracts with customers other than the revenue from contracts with customers in net fee and commission income presented in note 24.

57 LEASES

The Schwäbisch Hall Group acts in the role of lessee within the framework of operating lease relationships, which primarily relate to the leasing of office spaces and cars.

The following table presents future minimum lease payments arising from leases:

in € thousand	31 Dec 2018	31 Dec 2017
Total amount of future minimum lease payments under non-cancellable leases	**28,006**	**5,431**
Up to 1 year	3,586	2,574
More than 1 year and up to 5 years	14,079	2,857
More than 5 years	10,341	–

The increase in future minimum lease payments compared to the previous year results in particular from FLK leasing a new office building with a minimum duration of contract of ten years. Minimum lease payments amounting to €3,479 thousand (previous year: €2,335 thousand) were recognised as expenses during the financial year.

58 EMPLOYEES

The average number of employees comprises the fully consolidated companies of the Schwäbisch Hall Group by employee group:

	31 Dec 2018	31 Dec 2017
Female employees	**1,991**	**1,932**
Full-time employees	1,108	1,041
Part-time employees	883	891
Male employees	**1,284**	**1,282**
Full-time employees	1,158	1,159
Part-time employees	126	123
Total employees	**3,275**	**3,214**

	31 Dec 2018	31 Dec 2017
Female junior employees	86	97
Male junior employees	106	113
Total junior employees	**192**	**210**

59 GROUP AUDITORS AND CONSULTING FEES

The total fees charged by Group auditor Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Stuttgart, broken down by type of service are as follows:

in € thousand	31 Dec 2018	31 Dec 2017
Audit services	546	731
Other attestation services	4	22
Other services	166	144
Total	**716**	**897**

The fees for audits comprise expenses for the audit of the consolidated financial statements and the combined management report of Bausparkasse Schwäbisch Hall as well as for the statutory audits of the annual financial statements and management report of Bausparkasse Schwäbisch Hall and the subsidiaries included in the consolidated financial statements and audited by the Group auditor.

60 REMUNERATION FOR THE BOARD OF MANAGING DIRECTORS AND SUPERVISORY BOARD OF BAUSPARKASSE SCHWÄBISCH HALL

The remuneration of the Board of Managing Directors of Bausparkasse Schwäbisch Hall in the Group pursuant to IAS 24.17 amounts to €4,591 thousand in the financial year (previous year: €4,224 thousand). This breaks down into current employee benefits amounting to €3,375 thousand (previous year: €3,539 thousand) and post-employment benefits amounting to €1,216 thousand (previous year: €685 thousand). Remuneration for the Supervisory Board amounts to €317 thousand (previous year: €339 thousand) and represents current benefits.

Defined benefit obligations exist for members of the Board of Managing Directors amounting to €8,794 thousand (previous year: €13,144 thousand). Provisions were recognised for current pensions and pension entitlements totalling €56,850 thousand (previous year: €51,096 thousand), which are for former members of the Board of Managing Directors or their surviving dependants.

The total remuneration granted to the Board of Managing Directors of Bausparkasse Schwäbisch Hall for fulfilling its duties within Bausparkasse Schwäbisch Hall and its subsidiaries pursuant to section 314 (1) (6) (a) HGB amounts to €3,375 thousand (previous year: €3,539 thousand) in the financial year, and to €317 thousand (previous year: €339 thousand) for the Supervisory Board. Total remuneration for former members of the Board of Managing Directors and their surviving dependants pursuant to section 314 (1) (6) (b) HGB amounts to €3,099 thousand (previous year: €2,825 thousand). Provisions were formed for current pensions and pension entitlements amounting to €48,467 thousand (previous year: €41,522 thousand) for former members of the Board of Managing Directors or their surviving dependants. The members of the Board of Managing Directors did not receive any loans -at fair market conditions (previous year: €0 thousand) pursuant to section 314 (1) (6) (c) HGB, while members of the Supervisory Board were granted loans of €67 thousand at fair market conditions (previous year: €90 thousand).

Non-share-based remuneration that depends on the occurrence or discontinuation of future conditions did not occur.

61 EVENTS AFTER THE REPORTING PERIOD

Československá obchodní banka a.s., Prague (ČSOB) expressed its interest in acquiring Bausparkasse Schwäbisch Hall's 45 per cent interest in Českomoravská stavební spořitelna, a.s., Prague (ČMSS). As a result, the Board of Managing Directors decided to enter into purchase negotiations with ČSOB in January 2019. Subject to approval by the Supervisory Board, the sale is expected to take place in the first half of 2019. A positive contribution to profit is expected from the sale.

As a joint venture of ČSOB and Schwäbisch Hall, ČMSS is included in these consolidated financial statements under the equity method. In these statements, the company is assigned to the *Bausparen* Non-domestic segment.

62 RELATED PARTY DISCLOSURES

In the course of usual business activity, transactions are concluded with related parties. The transactions with related parties concern typical *Bauspar* products and financial services that were concluded on an arm's length basis.

Related persons are persons in key positions who are directly or indirectly responsible and accountable for the planning, management and supervision of the activities of Bausparkasse Schwäbisch Hall, as well as their immediate family. At the Schwäbisch Hall Group, members of the Board of Managing Directors and Supervisory Board are deemed to be persons in key positions for the purposes of IAS 24.

The following table shows the relationships with majority shareholders, non-consolidated subsidiaries, affiliates and joint ventures:

in € thousand	31 Dec 2018	31 Dec 2017
Interest income and current income	**206,864**	**225,178**
Majority shareholder	144,314	148,709
Affiliates	62,550	76,469
Interest expenses	**12,012**	**7,298**
Majority shareholder	12,224	7,504
Subsidiaries	– 212	– 206
Fee and commission income	**18,026**	**22,531**
Affiliates	18,026	22,531
Fee and commission expenses	**– 1,070**	**– 1,011**
Majority shareholder	– 59	– 60
Affiliates	– 1,011	– 951
Loans and advances to banks	**6,736,742**	**7,190,329**
Majority shareholder	5,199,603	5,139,560
Affiliates	1,537,139	2,050,769
Investments	**2,281,278**	**2,015,724**
Majority shareholder	1,231,422	1,206,462
Affiliates	1,049,856	809,262
Other assets	**5,038**	**8,237**
Majority shareholder	163	250
Subsidiaries	539	95
Affiliates	4,336	7,880
Joint ventures	–	12
Deposits from banks	**2,673,459**	**2,681,748**
Majority shareholder	2,673,459	2,681,748
Deposits from customers	**39,797**	**36,193**
Subsidiaries	39,797	36,193
Negative fair values from derivative financial instruments	**–**	**278**
Majority shareholder	–	278
Other liabilities	**762**	**1,432**
Subsidiaries	762	1,432
Financial guarantee contracts	**734**	**668**
Subsidiaries	734	668

63 BOARD OF MANAGING DIRECTORS

Reinhard Klein
Chief Executive Officer

Jürgen Gießler

Alexander Lichtenberg

Peter Magel

General Executive Managers
Mike Kammann
(since 1 September 2018)

Claudia Klug

64 SUPERVISORY COMMITTEES

Supervisory Board

Wolfgang Kirsch
– Chairman of the Supervisory Board –
Former Chief Executive Officer
DZ BANK AG Deutsche
Zentral-Genossenschaftsbank
(Member of the Supervisory Board until
31 December 2018)

Dr Cornelius Riese
– Chairman of the Supervisory Board –
(since 1 January 2019)
Co-Chief Executive Officer
DZ BANK AG Deutsche
Zentral-Genossenschaftsbank

Rainer Baier
– Vice Chairman of the Supervisory Board –
Employee (ret.)
Schwäbisch Hall Kreditservice GmbH
(Member of the Supervisory Board until
16 May 2018)

Ninon Kiesler
– Vice Chairman of the Supervisory Board –
(since 16 May 2018)
Employee
Bausparkasse Schwäbisch Hall AG

Ralf W. Barkey
Chief Executive Officer
Genossenschaftsverband – Verband der
Regionen e. V.
(Member of the Supervisory Board since
16 May 2018)

Michael Bockelmann
Association President (ret.)
Celle
(Member of the Supervisory Board until
16 May 2018)

Leni Breymaier
Member of the German Parliament
Berlin
(Member of the Supervisory Board until
16 May 2018)

Ulrike Brouzi
Member of the Board of Managing Directors
DZ BANK AG Deutsche
Zentral-Genossenschaftsbank
(Member of the Supervisory Board since
1 January 2019)

Uwe Fröhlich
Co-Chief Executive Officer
DZ BANK AG Deutsche
Zentral-Genossenschaftsbank
(Member of the Supervisory Board until
16 May 2018)

Bernhard Hallermann
Member of the Board of Managing Directors
Volksbank Süd-Emsland eG

Andrea Hartmann
Employee
Bausparkasse Schwäbisch Hall AG

Frank Hawel
Regional Head of Financial Services
ver.di – Regional district of Baden-Württemberg

Roland Herhoffer
Employee
Schwäbisch Hall Kreditservice GmbH

Klaus Holderbach
Chief Executive Officer
Volksbank Franken eG

Manfred Klenk
Employee
Schwäbisch Hall Facility Management GmbH

Olaf Klose
Member of the Board of Managing Directors
Deutsche Apotheker- und Ärztebank eG

Marija Kolak
President
Bundesverband der Deutschen Volksbanken
und Raiffeisenbanken e.V. (BVR) (National
Association of German Cooperative Banks)
(Member of the Supervisory Board since
16 May 2018)

Dr Volker Kreuziger
Executive
Bausparkasse Schwäbisch Hall AG

Marianne Kugler-Wendt
Managing Director
ver.di – German district of Heilbronn-Neckar-Franken

Rosemarie Miller-Weber
Bank manager (ret.), Leutkirch im Allgäu
(Member of the Supervisory Board until
16 May 2018)

Sascha Monschauer
Member of the Board of Managing Directors
Volksbank RheinAhrEifel eG
(Member of the Supervisory Board since
16 May 2018)

Wilhelm Oberhofer
Member of the Board of Managing Directors
Raiffeisenbank Kempten-Oberallgäu eG

Silvia Ofori
Employee
Schwäbisch Hall Kreditservice GmbH

Heiko Schmidt
Employee
Bausparkasse Schwäbisch Hall AG
(Member of the Supervisory Board since
16 May 2018)

Helmut H. Seibert
Bank manager (ret.), Magdeburg
(Member of the Supervisory Board until
16 May 2018)

Werner Thomann
Chief Executive Officer
Volksbank Rhein-Wehra eG
(Member of the Supervisory Board since
16 May 2018)

Susanne Wenz
Deputy Regional District Manager
ver.di – Vereinte Dienstleistungsgewerkschaft
(Member of the Supervisory Board since 16 May 2018)

Ombudsman
Pursuant to section 12 BauSparkG (the German *Bausparkassen* Act)

Burkhard Balz
(until 30 August 2018)
Member of the European Parliament, Brussels

Carsten Schneider
(since 1 September 2018)
Member of the German Parliament, Berlin

65 SUPERVISORY MANDATES HELD BY MEMBERS OF THE BOARD OF MANAGING DIRECTORS AND EMPLOYEES

Within Bausparkasse Schwäbisch Hall AG

As of the reporting date, members of the Board of Managing Directors and employees also held mandates on the statutory supervisory bodies of major companies. These and other notable mandates are listed below. Mandates in companies included in the consolidation are indicated with an asterisk (*).

Member of the Board of Managing Directors

Reinhard Klein (Chief Executive Officer)	Českomoravská stavební spořitelna, a. s., Prague (Böhmisch-Mährische Bausparkasse AG) (*)
	Schwäbisch Hall Kreditservice GmbH, Schwäbisch Hall (*)
	Sino-German Bausparkasse Co. Ltd., Tianjin (*)
	V-Bank AG, Munich
Jürgen Gießler	Fundamenta-Lakáskassza Lakás-takarékpénztár Zrt., Budapest (Fundamenta-Lakáskassza Bausparkasse AG) (*)
	Sino-German Bausparkasse Co. Ltd., Tianjin (*)
Alexander Lichtenberg	Sino-German Bausparkasse Co. Ltd., Tianjin (*) (until 20 August 2018)
Peter Magel	Prvá stavebná sporiteľňa, a. s., Bratislava (Erste Bausparkasse AG) (*)
	Schwäbisch Hall Kreditservice GmbH, Schwäbisch Hall (*)

Employees

Claudia Klug (General Executive Manager)	Schwäbisch Hall Facility Management GmbH, Schwäbisch Hall
Dr Thomas Hamann	Českomoravská stavební spořitelna, a. s., Prague (Böhmisch-Mährische Bausparkasse AG) (*)
Christian Oestreich	Fundamenta-Lakáskassza Lakás-takarékpénztár Zrt., Budapest (Fundamenta-Lakáskassza Bausparkasse AG) (*)

Also within the Group

As of the reporting date, members of the Boards of Managing Directors and employees also held mandates on the statutory supervisory bodies of the following major companies in Germany.

Andrea Hartmann	DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt/Main

66 LIST OF SHAREHOLDINGS

Name	Location of registered office	Country	Capital share %	Voting share %
Fully consolidated subsidiaries				
Schwäbisch Hall Kreditservice GmbH	Schwäbisch Hall	Germany	100.00	100.00
Fundamenta-Lakáskassza Lakás-takarékpénztár Zrt.	Budapest	Hungary	51.25	51.25
Fundamenta-Lakáskassza Pénzügyi Közvetitö Kft.	Budapest	Hungary	51.25	51.25
Fully consolidated structured subsidiaries				
UIN Union Investment Institutional Fonds Nr. 817	Frankfurt/Main	Germany	0.00	0.00
Joint ventures included using the equity method				
Českomoravská stavební spořitelna, a. s.,	Prague	Czech Republic	45.00	45.00
Prvá stavebná sporiteľ ňa, a. s.	Bratislava	Slovakia	32.50	32.50
Sino-German Bausparkasse Co. Ltd.	Tianjin	China	24.90	24.90
Non-consolidated subsidiaries				
Schwäbisch Hall Facility Management GmbH	Schwäbisch Hall	Germany	51.00	51.00
Schwäbisch Hall Wohnen GmbH	Schwäbisch Hall	Germany	100.00	100.00
SHT Schwäbisch Hall Training GmbH	Schwäbisch Hall	Germany	100.00	100.00
BAUFINEX GmbH	Schwäbisch Hall	Germany	70.00	70.00
VR Kreditservice GmbH	Hamburg	Germany	100.00	100.00
Joint ventures not included using the equity method				
Raiffeisen Banca Pentru Locuinţe S. A.	Bucharest	Romania	33.325	33.325

67 INFORMATION ON THE *BAUSPAR* COLLECTIVE OF BAUSPARKASSE SCHWÄBISCH HALL AG

The following table provides an overview of the development and movement of the *Bauspar* contract portfolio over the course of the 2018 financial year:

	Not allocated		Allocated		Total	
	Number of contracts	*Bauspar* sum in € thousand	Number of contracts	*Bauspar* sum in € thousand	Number of contracts	*Bauspar* sum in € thousand
A. Portfolio at end of previous year	**7,808,225**	**281,261,410**	**653,931**	**17,697,762**	**8,462,156**	**298,959,172**
B. Additions in financial year by						
1. New business (honoured contracts)[1]	523,070	26,735,679	0	0	523,070	26,735,679
2. Transfer	21,056	636,894	676	17,284	21,732	654,178
3. Allocation waiver and revocation of allocation	6,553	261,479	0	0	6,553	261,479
4. Splitting	151,242	0	32	0	151,274	–
5. Allocation or acceptance of allocation	0	0	355,026	9,056,185	355,026	9,056,185
6. Other	68,737	2,326,483	21	816	68,758	2,327,299
Total	**770,658**	**29,960,535**	**355,755**	**9,074,285**	**1,126,413**	**39,034,820**
C. Disposals in financial year by						
1. Allocation or acceptance of allocation	355,026	9,056,185	0	0	355,026	9,056,185
2. Reduction	0	856,068	0	0	–	856,068
3. Dissolution	316,174	8,293,793	299,989	7,807,220	616,163	16,101,013
4. Transfer	21,056	636,894	676	17,284	21,732	654,178
5. Merging[1]	64,302	0	1	0	64,303	–
6. Contract expiration	0	0	120,072	3,040,510	120,072	3,040,510
7. Allocation waiver and revocation of allocation	0	0	6,553	261,479	6,553	261,479
8. Other	68,737	2,326,483	21	816	68,758	2,327,299
Total	**825,295**	**21,169,423**	**427,312**	**11,127,309**	**1,252,607**	**32,296,732**
D. Net additions/disposals	**– 54,637**	**8,791,112**	**– 71,557**	**– 2,053,024**	**– 126,194**	**6,738,088**
E. Portfolio at end of financial year	**7,753,588**	**290,052,522**	**582,374**	**15,644,738**	**8,335,962**	**305,697,260**

[1] including increases

The development of the allocation fund of the *Bauspar* collective of Bausparkasse Schwäbisch Hall AG, Schwäbisch Hall, is as follows in the financial year:

in €	Total in €
A. Additions	
I. Carried forward from the previous year (surplus):	
Amounts not yet disbursed	**55,106,093,420.66**
II. Additions in financial year	
1. Savings amounts (including offset house-building premiums)	9,251,168,244.36
2. Repayment amounts[1] (including offset house-building premiums)	1,158,625,024.01
3. Interest on *Bauspar* deposits	689,563,995.69
4. Technical security reserve	–
Total	**66,205,450,684.72**
B. Withdrawals	
I. Withdrawals in financial year	
1. Allocated sums, insofar as disbursed	
a) *Bauspar* deposits	5,183,067,468.09
b) Building loans	1,027,508,573.49
2. Repayment of *Bauspar* deposits on as yet unallocated *Bauspar* contracts	1,481,731,943.41
3. Technical security reserve	0.00
II. Additions surplus	
(amounts not yet disbursed) at end of the financial year[2]	**58,513,142,699.73**
Total	**66,205,450,684.72**

[1] Repayment amounts are the sole portion of repayment instalments.
[2] The additions surplus includes, among other things:

a) *Bauspar* deposits not yet disbursed of allocated *Bauspar* contracts	93,166,098.59
b) *Bauspar* loans not yet disbursed from allocations	3,173,984,913.46

Schwäbisch Hall, 13 February 2019

Bausparkasse Schwäbisch Hall Aktiengesellschaft
Bausparkasse der Volksbanken und Raiffeisenbanken

Board of Managing Directors

Klein Gießler Lichtenberg Magel

Independent Auditor's Report

Translation of the German independent auditor's report concerning the audit of the consolidated financial statements and combined management report prepared in German.

INDEPENDENT AUDITOR'S REPORT

To Bausparkasse Schwäbisch Hall Aktiengesellschaft – Bausparkasse der Volksbanken und Raiffeisenbanken –, Schwäbisch Hall

REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS AND OF THE GROUP MANAGEMENT REPORT

Opinions

We have audited the consolidated financial statements of Bausparkasse Schwäbisch Hall Aktiengesellschaft – Bausparkasse der Volksbanken und Raiffeisenbanken –, Schwäbisch Hall (the "Company"), and its subsidiaries (the "Group"), which comprise the consolidated balance sheet as of 31 December 2018, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity, segment reporting and consolidated cash flow statement for the fiscal year from 1 January to 31 December 2018, and notes to the consolidated financial statements, including a summary of significant accounting policies. In addition, we have audited the group management report of Bausparkasse Schwäbisch Hall Aktiengesellschaft – Bausparkasse der Volksbanken und Raiffeisenbanken –, Schwäbisch Hall, which has been combined with the management report of the Company for the fiscal year from 1 January to 31 December 2018. In accordance with the German legal requirements, we have not audited the content of the group non-financial statement included in the "Personnel report" section of the management report or the statement on corporate governance included in the "Other" section of the management report.

In our opinion, on the basis of the knowledge obtained in the audit

- the accompanying consolidated financial statements comply, in all material respects, with the IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to Sec. 315e (1) HGB ["Handelsgesetzbuch": German Commercial Code] and, in compliance with these requirements, give a true and fair view of the assets, liabilities, and financial position of the Group as of 31 December 2018, and of its financial performance for the fiscal year from 1 January to 31 December 2018, and

- the accompanying group management report as a whole provides an appropriate view of the Group's position. In all material respects, this group management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our opinion on the group management report does not cover the content of the statement on corporate governance or the non-financial statement referred to above.

Pursuant to Sec. 322 (3) Sentence 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the consolidated financial statements and of the group management report.

Basis for the opinions

We conducted our audit of the consolidated financial statements and of the group management report in accordance with Sec. 317 HGB and the EU Audit Regulation (No 537/2014, referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's responsibilities for the audit of the consolidated financial statements and of the group management report" section of our auditor's report. We are independent of the group entities in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinions on the consolidated financial statements and on the group management report.

Key audit matters in the audit of the consolidated financial statements

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the fiscal year from 1 January to 31 December 2018. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon.

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

1. MEASUREMENT OF BUILDING SOCIETY PROVISIONS

Reasons why the matter was determined to be a key audit matter:

Building society provisions mainly include provisions for term-sheet-related customer loyalty bonuses and interest rate bonuses at Bausparkasse Schwäbisch Hall AG (BSH). The amount of the provisions to be recognized is determined by BSH based on the results of the collective simulation (building society forecast). The underlying probability of customer behavior (e.g., whether they use a customer loyalty bonus or not) is determined using assumptions regarding the future behavior of the saver based on historical data as well as the forecast capital market yield, which have a material impact on the measurement of the provisions. BSH verifies the plausibility of the amount of the provisions determined in this way using a supplementary process simulation based on experts' estimates regarding the effect of the measures implemented by BSH to reduce the use of customer loyalty bonuses and interest rate bonuses. The forecast quality of the collective simulation model is subject to annual validation checks using backtesting, among other things.

The measurement of building society provisions was a key audit matter due to the complexity of the simulation model and the necessary inclusion of assumptions and estimates associated with a degree of uncertainty, which have a material impact on the amount of the provisions.

Auditor's response:
We assessed the design and effectiveness of the internal control system with regard to the process to determine the amount of the provisions for term-sheet-related customer loyalty bonuses and interest rate bonuses for appropriateness and effectiveness.

We reviewed the method as well as the clerical accuracy of the calculations performed by BSH to determine the amount of the provisions using the results of the collective simulation. This involved examining the model used to determine whether the key estimation parameters were included in the model and whether the model selected with the corresponding model assumptions appropriately determined the amount of the provisions in terms of accuracy of the estimates customary for the industry with similar types of mathematical models.

We also reviewed the expert appraisal used by BSH on how the measures performed to reduce the use of customer loyalty bonuses and interest rate bonuses work and their consideration in the building society simulation model.

To validate the estimation parameters, we analyzed the BSH's current calculations using historical data as well as the periods used and their weighting in the model by comparing the result of the current validation report with the parameters estimated in prior years taking into account the past accuracy of forecasts.

Within the audit team, specialists with particular specialist knowledge in the area of buildings society mathematics were used for these reviews of the building society simulation model.

Our audit procedures did not lead to any reservations relating to the measurement of building society provisions.

Reference to related disclosures:
Disclosures on the measurement of building society provisions under the statement of financial position item "Provisions" are included in section "18 and 45" of the notes to the consolidated financial statements.

2. DETERMINING THE AMOUNT OF RISK PROVISIONING FOR BUILDING LOANS TO PRIVATE CUSTOMERS WITHIN LEVEL 2

Reasons why the matter was determined to be a key audit matter:
Since 1 January 2018, non-defaulted financial instruments have been recognized in accordance with the regulations of IFRS 9 for the first time. IFRS 9 replaces the incurred loss model under IAS 39 with the expected credit loss model.

Impairment losses for non-defaulted financial instruments, where measured at amortized cost or at fair value through other comprehensive income, are now taken into account depending on the changes in credit quality since the time of addition either in the amount of the 12-month expected credit loss (level 1) or in the amount of the credit losses expected over the term (level 2) provided that the credit risk of the financial instrument has significantly worsened since the time of addition.

To determine the amount of risk provisioning for building loans to private customers within level 2, Bausparkasse Schwäbisch Hall AG uses complex internal procedures to determine the credit risk. The bank uses these procedures to automatically determine impairment at a single transaction level for risk provisioning.

For each transaction, Bausparkasse Schwäbisch Hall AG uses the credit risk parameters probability of default (PD), loss given default (LGD) and exposure at default (EAD) over the residual term of the respective agreement. These parameters form the basis for calculating the risk provisioning pursuant to IFRS 9. Determining the corresponding parameters is associated with a degree of uncertainty and includes various different assumptions and influencing factors. Small changes in these assumptions can lead to a significant divergence in the resulting parameters, which can in turn result in higher or lower impairment. Due to the key role the parameters play, Bausparkasse Schwäbisch Hall AG imposes stringent requirements as to their validation.

As risk provisioning is at its highest in the area of non-defaulting in this level 2 and the modelling of the parameters is at its most complex in level 2, reviewing the amount of risk provisioning for building loans within level 2 is a key audit matter. In this regard, uncertainty or discretionary judgments exercised when setting the assumptions on which the measurement of the loan portfolio is based can have a major impact on measuring risk provisioning.

Auditor's response:
We assessed the design and effectiveness of the internal control system with regard to the significant accounting-related lending processes for appropriateness and effectiveness. The focus was on the process used to automatically calculate impairment, which is based on the internal rating models. Specifically, we verified the calculation of the risk provisioning during the valuation process conceptually with regard to the requirements resulting from IFRS 9 as well as in terms of clerical accuracy. This relates to the calculation of the provisioning for credit risks using the credit risk parameters in the "DataWarehouse".

We also reviewed the appropriateness of the process to calculate the risk provisioning pursuant to IFRS 9 as well as the appropriateness and effectiveness of its validation. In particular, this involved reviewing the internal PD and LGD models using the appropriateness of the validation concepts available as well as the effectiveness of the validations performed (including backtesting). We verified the risk provisioning determined according to the data extract from the "DataWarehouse" using the risk provisioning posted in the accounting system.

Within the audit team, specialists with particular specialist knowledge in the area of quantitative valuation models were used for this review of the determination of the amount of risk provisioning for building loans to private customers within level 2.

Our audit procedures have not led to any reservations regarding risk provisioning for building loans to private customers within level 2.

Reference to related disclosures:
Disclosures on risk provisioning for building loans to private customers within level 2 under the statement of financial position item "Risk provisioning" are included in section "16, 27 and 41" of the notes to the consolidated financial statements.

Other information:
The executive directors are responsible for the other information. The other information comprises the content of the group non-financial statement included in the "Personnel report" section of the group management report, the statement on corporate governance included in the "Other" section of the group management report as well as the report of the supervisory board.

Our opinions on the annual financial statements and on the management report do not cover the other information, and consequently we do not express an opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- is materially inconsistent with the annual financial statements, with the management report or our knowledge obtained in the audit, or

- otherwise appears to be materially misstated.

Responsibilities of the executive directors and the supervisory board for the consolidated financial statements and the group management report

The executive directors are responsible for the preparation of consolidated financial statements that comply, in all material respects, with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Sec. 315e (1) HGB, and that the consolidated financial statements, in compliance with these requirements, give a true and fair view of the assets, liabilities, financial position and financial performance of the Group. In addition, the executive directors are responsible for such internal control as they have determined necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the executive directors are responsible for assessing the Group's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the Group or to cease operations, or there is no realistic alternative but to do so.

Furthermore, the executive directors are responsible for the preparation of the group management report that, as a whole, provides an appropriate view of the Group's position and is, in all material respects, consistent with the consolidated financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a group management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the group management report.

The supervisory board is responsible for overseeing the Group's financial reporting process for the preparation of the consolidated financial statements and of the group management report.

Auditor's responsibilities for the audit of the consolidated financial statements and of the group management report

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the group management report as a whole provides an appropriate view of the Group's position and, in all material respects, is consistent with the consolidated financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our opinions on the consolidated financial statements and on the group management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sec. 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements and this group management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements and of the group management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures (systems) relevant to the audit of the group management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of these systems.

- Evaluate the appropriateness of accounting policies used by the Executive Directors and the reasonableness of estimates made by the Executive Directors and related disclosures.

- Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements and in the group management report or, if such disclosures are inadequate, to modify our respective opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to be able to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Sec. 315e (1) HGB.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express opinions on the consolidated financial statements and on the group management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinions.

- Evaluate the consistency of the group management report with the consolidated financial statements, its conformity with [German] law, and the view of the Group's position it provides.

- Perform audit procedures on the prospective information presented by the executive directors in the group management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

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

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

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OTHER LEGAL AND REGULATORY REQUIREMENTS

Further information pursuant to Art. 10 of the EU Audit Regulation
We were elected as group auditor by the annual general meeting on 16 May 2018. We were engaged by the supervisory board on 28 May 2018. We have been the group auditor of Bausparkasse Schwäbisch Hall Aktiengesellschaft – Bausparkasse der Volksbanken und Raiffeisenbanken –, Schwäbisch Hall, without interruption since fiscal year 2003.

We declare that the opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Art. 11 of the EU Audit Regulation (long-form audit report).

In addition to the financial statement audit, we have provided to the Company or entities controlled by it the following services that are not disclosed in the consolidated financial statements or in the group management report:

- Quality assurance/project-related audit within the framework of the "NEXT" IT project of Bausparkasse Schwäbisch Hall AG, Schwäbisch Hall

- Project-related quality assurance of "written organizational rules" within the framework of the "NEXT" IT project of Bausparkasse Schwäbisch Hall AG, Schwäbisch Hall

- Consulting services regarding alternative collective simulation models of Bausparkasse Schwäbisch Hall AG, Schwäbisch Hall

- Review of the IFRS reporting package for the period from 1 January 2018 to 30 June 2018 of Bausparkasse Schwäbisch Hall AG, Schwäbisch Hall, and Schwäbisch Hall Kreditservice GmbH, Schwäbisch Hall

- Certification of the review of the IFRS reporting package for the period from 1 January 2017 to 31 December 2017 of Bausparkasse Schwäbisch Hall AG, Schwäbisch Hall, to meet the requirements for regulatory reports pursuant to Art. 24 (2) CRR in conjunction with the ECB Guide on the options and discretions available in European Union law

- Agreed-upon review procedures in connection with determining the assessment basis for the 2018 contribution to the protection scheme of Bundesverband der Deutschen Volksbanken und Raiffeisenbanken e.V. (BVR), Bonn, for Bausparkasse Schwäbisch Hall AG, Schwäbisch Hall

- Reporting on our audit pursuant to Sec. V No. 11 (1) AGB/BBk (KEV [“Krediteinreichungs-verfahren”: loan submission program] at Deutsche Bundesbank) of Bausparkasse Schwäbisch Hall AG, Schwäbisch Hall
- Agreed-upon review procedures with regard to the regulatory banking provisions to be complied with by the Luxembourg branch of Bausparkasse Schwäbisch Hall AG
- Agreed-upon review procedures with regard to the certification required by the financial supervisory authority in Luxembourg for implementing IFRS 9 at the Luxembourg branch of Bausparkasse Schwäbisch Hall AG
- Separate reporting to the Hungarian National Bank particularly with regard to the corporate governance structure, risk management and capital resources of Fundamenta-Lakáskassza Lakás-takarékpénztár Zrt., Budapest/Hungary
- Agreed-upon review procedures with regard to the remuneration strategy of Fundamenta-Lakáskassza Lakás-takarékpénztár Zrt., Budapest/Hungary

German Public Auditor responsible for the engagement
The German Public Auditor responsible for the engagement is Werner Frey.

Stuttgart, 14 February 2019

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Frey	Seifert
Wirtschaftsprüfer	Wirtschaftsprüfer
[German Public Auditor]	[German Public Auditor]

Report of the Supervisory Board

Supervisory Board and committees
The Supervisory Board of Bausparkasse Schwäbisch Hall AG monitored the management activities of the Board of Managing Directors during the 2018 financial year in accordance with the legal provisions and Articles of Association and decided on items of business presented to it that required approval.

In order to fulfil its duties and to comply with the statutory provisions, the Supervisory Board formed a joint Risk and Audit Committee, a Remuneration Control Committee, a Nominations Committee and a Mediation Committee pursuant to section 27 (3) German Co-Determination Act (MitbestG).

On 7 March 2018, the Supervisory Board performed a self-evaluation in accordance with the requirements of the German Banking Act (KWG). It found that the structure, size, composition and performance of the Supervisory Board and the knowledge, skills and experience of both the individual members of the Supervisory Board and the board as a whole met the legal requirements and the requirements of the Articles of Association. The simultaneous evaluation of the Board of Managing Directors and the individual members of the Board of Managing Directors by the Supervisory Board led to the same conclusion. Insofar as there were indications of relevant conflicts of interest among members of the Supervisory Board in individual cases, those members of the Supervisory Board concerned did not take part in the vote. The target of at least 30 per cent of the Supervisory Board being female also continued to be met following the new elections to the Supervisory Board that took place in 2018.

The Supervisory Board has adequate financial and human resources at its disposal to be able to support new members in becoming familiar with their role and to provide the training that is necessary to maintain members' required level of expertise. For example, Bausparkasse Schwäbisch Hall AG offers to cover the costs for members of the Supervisory Board to participate in an external provider's modular advanced training programme tailored specifically to the needs of Supervisory Board members, which they can make use of on an individual basis as needed. In the 2018 financial year, an internal technical workshop was also held for the Supervisory Board, focusing particularly on Bauspar-specific issues around comprehensive bank management at BSH, the planned first-time issue of a *Hypothekenpfandbrief* (German mortgage covered bond) and regulatory topics.

Cooperation with the Board of Managing Directors
The Board of Managing Directors has reported regularly, promptly and comprehensively, both in writing and verbally, to the Supervisory Board regarding the position and development of the *Bausparkasse* and the Schwäbisch Hall Group and regarding the general course of business. Furthermore, the Board of Managing Directors informed the Supervisory Board on an ongoing basis of the strategic development. Additionally, the Board of Managing Directors reported in detail on the financial performance, operational and medium-term planning, the modernisation of the IT infrastructure and the performance of domestic and non-domestic investees. The risk report, audit report and compliance report were also dealt with.

The Supervisory Board discussed the aforementioned issues with the Board of Managing Directors, advised it and monitored its management activities. The Supervisory Board was always involved in decisions of fundamental importance.

Meetings of the Supervisory Board and its committees

The Supervisory Board met three times during the 2018 financial year. The joint Risk and Audit Committee met twice. The Nominations Committee and the Remuneration Control Committee each met once. It was not necessary for the Mediation Committee to meet during the 2018 financial year. The members of the Supervisory Board and its committees participated regularly in the meetings during the 2018 financial year and in the written decision-making process of the respective board.

In its meetings, the Supervisory Board primarily discussed the report from the Board of Managing Directors regarding current business performance, financial performance, the risk position and the strategic outlook. The Supervisory Board has reviewed the annual financial statements and management report of Bausparkasse Schwäbisch Hall AG as well as the consolidated financial statements and the Group management report dated 31 December 2017 and approved them in accordance with the recommendation from the joint Risk and Audit Committee. Furthermore, the Board has focused in detail on operational and strategic planning as well as the implementation of the strategy and has acknowledged these. Pursuant to the recommendations of the aforementioned committee, the Supervisory Board has also approved the report of the Supervisory Board at the Annual General Meeting and on the agenda of the ordinary Annual General Meeting on 16 May 2018, including the resolutions contained therein. Following its election there, the new Supervisory Board held a constitutive meeting.

The committees of the Supervisory Board have fulfilled their prescribed duties pursuant to the law and the Articles of Association and, where necessary, submitted relevant recommendations to the Supervisory Board. The committee chairs have reported regularly to the Supervisory Board as regards the work done in the committees.

Furthermore, the Supervisory Board has addressed human resources issues and, where necessary, passed resolutions pursuant to the recommendations of the Remuneration Control Committee. In the context of the regularly scheduled review of remuneration for the Board of Managing Directors, an adjustment was also made to the remuneration system and the service contracts for members of the Board of Managing Directors in order to reflect altered requirements pursuant to the Institutsvergütungsverordnung. (German Institutional Remuneration Regulation). Furthermore, the Supervisory Board noted and reviewed the structure of employee remuneration systems, the remuneration control report and the total amount of variable remuneration for the 2017 financial year and has acknowledged the appointment of a new Remuneration Control Officer. In addition, the Supervisory Board has dealt with the nominations for the upcoming new election of shareholder representatives onto the Supervisory Board of the Bausparkasse pursuant to section 25d KWG as well as the regulatory requirements that continue to be applicable to this process, and has submitted the relevant proposed resolution to the Annual General Meeting in accordance with the recommendations of the Nominations Committee.

As part of its duties, the joint Risk and Audit Committee also focused on the selection of auditor for the 2018 financial year, the supervision of the commissioning of non-audit services and preparation for changing the (Group-wide) auditor.

In urgent cases, the Supervisory Board has approved significant business transactions via the written decision-making process. Furthermore, the Chairman of the Supervisory Board was also kept informed outside of the regular meetings as regards significant developments and decisions. Additionally, the Chairs of the Supervisory Board and the Board of Managing Directors of Bausparkasse Schwäbisch Hall AG as well as the Chairs of the committees of the Supervisory Board and the responsible members of the Board of Managing Directors have had regular discussions ahead of key decisions and important transactions. The members of the Supervisory Board and its committees participated regularly in the meetings during the 2018 financial year and in the written decision-making process of the respective board.

Cooperation with auditors
Ernst & Young GmbH, Wirtschaftsprüfungsgesellschaft, Stuttgart has reviewed the annual financial statements and consolidated financial statements prepared by the Board of Managing Directors for the 2018 financial year as well as the management report and Group management report, including accounting, and has in each case issued an unqualified auditor's opinion. The audit reports were submitted in a timely manner to the members of the Supervisory Board and were discussed in detail. The Supervisory Board agrees with the findings of the audit.

Adoption of the annual financial statements
During their meetings, the Supervisory Board and the joint Risk and Audit Committee formed from its members have reviewed the annual financial statements and management report of Bausparkasse Schwäbisch Hall AG and the consolidated financial statements and the Group management report in detail. The Chairman of the joint Risk and Audit Committee has comprehensively informed the Supervisory Board about the extensive deliberations of the committee regarding the aforementioned annual financial statements and management reports. The representatives of the auditor took part in the meeting of the Supervisory Board to approve the annual financial statements and in the preparatory meeting of the joint Risk and Audit Committee in order to report in detail on the material findings of the audit. They were also available to members of the Supervisory Board to provide information. The Supervisory Board did not raise any objections to the financial reporting.

It is not necessary to draft a report on the relationships with affiliated companies (dependency report) due to a profit and loss transfer agreement between DZ BANK AG, Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main and Bausparkasse Schwäbisch Hall AG, Schwäbisch Hall, which was extended for a further five years in February 2016.

As part of their audit of the 2018 annual financial statements, the auditor did not find any indications that transactions were processed with affiliated companies not at arm's length during the reporting period.

In its meeting on 6 March 2019, the Supervisory Board approved the annual financial statements of Bausparkasse Schwäbisch Hall AG and the consolidated financial statements prepared by the Board of Managing Directors dated 31 December 2018. The annual financial statements are therefore adopted.

Changes to the Supervisory Board and Board of Managing Directors
Upon completion of the ordinary Annual General Meeting on 16 May 2018, the following people stepped down from the Supervisory Board: Rainer Baier, Leni Breymaier, Michael Bockelmann, Uwe Fröhlich, Rosemarie Miller-Weber and Helmut Seibert. Wolfgang Kirsch resigned his seat due to his retirement on 31 December 2018. The Supervisory Board would like to thank these colleagues for their positive collaboration and many years of commitment. Ralf Wilhelm Barkey, Marija Kolak, Sascha Monschauer, Heiko Schmidt, Werner Thomann and Susanne Wenz were newly elected to the Supervisory Board. Ulrike Brouzi was appointed by the court effective 1 January 2019.

The Supervisory Board thanks the Board of Managing Directors and all employees for their work in 2018.

Schwäbisch Hall, March 2019

Bausparkasse Schwäbisch Hall AG
– Bausparkasse der Volksbanken und Raiffeisenbanken –

Dr Cornelius Riese
Chairman of the Supervisory Board

Advisory Board of Bausparkasse Schwäbisch Hall AG

The Advisory Board has the task of advising the Board of Managing Directors within the framework of an active exchange of opinions.

The Advisory Board of Bausparkasse Schwäbisch Hall consists of up to 40 members and at least 75 per cent comprises full-time members of the Board of Managing Directors from cooperative banks. The remaining members may be made up of individuals from cooperative associations, central banks and other network companies or customer groups:

Christoph Ochs
– Chairman of the Advisory Board –
(since 16 May 2018)
Chief Executive Officer
VR Bank Südpfalz eG, Landau

Carsten Jung
– Chairman of the Advisory Board –
Chief Executive Officer
Berliner Volksbank eG, Berlin
(Member of the Advisory Board
until 16 May 2018)

Jochen Kerschbaumer
– Vice Chairman of the Advisory Board –
(since 16 May 2018)
Member of the Board of Managing Directors
Wiesbadener Volksbank eG, Wiesbaden

Uwe Arendt
Member of the Board of Managing Directors
Bank 1 Saar eG, Saarbrücken

Jürgen Beerkircher
Chief Executive Officer
Volksbank Backnang eG, Backnang
(Member of the Advisory Board since 16 May 2018)

Dr Thomas Brakensiek
Member of the Board of Managing Directors
Hamburger Volksbank eG, Hamburg
(Member of the Advisory Board
since 16 May 2018)

Werner Braun
Member of the Board of Managing Directors
VR Bank HessenLand eG, Alsfeld

Bernhard Brudermiller
Spokesman of the Board of Managing Directors
Volksbank Beilstein-Ilsfeld-Abstatt eG, Beilstein

Bernhard Carl
Spokesman of the Board of Managing Directors
Volksbank Kurpfalz eG, Heidelberg

Markus Dauber
Chief Executive Officer
Volksbank in der Ortenau eG, Offenburg

Thomas Diederichs
Spokesman of the Board of Managing Directors
Volksbank Rhein-Ruhr eG, Duisburg

Albert Griebl
Member of the Board of Managing Directors
VR-Bank Rottal-Inn eG, Pfarrkirchen

Dr Hauke Haensel
Chief Executive Officer
Volksbank Pirna eG, Pirna

Gerd Haselbach
Spokesman of the Board of Managing Directors
Raiffeisenbank im Kreis Calw eG, Neubulach

Stephan Heinisch
Member of the Board of Managing Directors
Volksbank Freiburg eG, Freiburg

Josef Hodrus
Spokesman of the Board of Managing Directors
Volksbank Allgäu-Oberschwaben eG, Leutkirch/Allgäu

Jörg Horstkötter
Chief Executive Officer
Volksbank Delbrück-Hövelhof eG, Delbrück

Michael Joop
Chief Executive Officer
Volksbank Hameln-Stadthagen eG, Hameln

Friedhelm Kemper
Chief Executive Officer
Raiffeisenbank eG, Ebsdorfergrund

Jens Klingebiel
Member of the Board of Managing Directors
Volksbank Raiffeisenbank eG, Greifswald

Horst Klumb
Bank manager (ret.)
Raiffeisenbank im Grabfeld eG, Römhild
(Member of the Advisory Board until 16 May 2018)

Dr Ralf Kölbach
Member of the Board of Managing Directors
Westerwald Bank eG Volks- und Raiffeisenbank, Hachenburg

Birger Kriwet
Member of the Board of Managing Directors
Vereinigte Volksbank eG, Brakel

Rouven Lewandowski
Member of the Board of Managing Directors
Raiffeisenbank Kitzinger Land eG, Obernbreit

Guido Lohmann
Chief Executive Officer
Volksbank Niederrhein eG, Alpen
(Member of the Advisory Board until 8 November 2018)

Dr Veit Luxem
Chief Executive Officer
Volksbank Mönchengladbach eG,
Mönchengladbach

Wolfgang Mauch
Former Chief Executive Officer
Volksbank Kirchheim-Nürtingen eG,
Nürtingen
(Member of the Advisory Board
until 30 May 2018)

Andreas Mertke
Member of the Board of Managing Directors
Berliner Volksbank eG, Berlin
(Member of the Advisory Board
since 16 May 2018)

Willi Obitz
Member of the Board of Managing Directors
Volksbank eG Gera•Jena•Rudolstadt,
Rudolstadt
(Member of the Advisory Board
since 16 May 2018)

Jens-Uwe Oppenborn
Member of the Board of Managing Directors
Brandenburger Bank Volksbank-
Raiffeisenbank eG, Brandenburg

Hermann Ott
Member of the Board of Managing Directors
Volksbank Raiffeisenbank
Nordoberpfalz eG, Weiden

Hubert Overesch
Member of the Board of Managing Directors
VR-Bank Kreis Steinfurt eG, Rheine

Frank Overkamp
Chief Executive Officer
Volksbank Gronau-Ahaus eG, Gronau

Jürgen Pütz
Chief Executive Officer
Volksbank Köln Bonn eG, Cologne
(Member of the Advisory Board
until 16 May 2018)

Martin Rudolph
Member of the Board of Managing Directors
Raiffeisenbank eG, Handewitt

Thomas Ruff
Member of the Board of Managing Directors
Volksbank eG Bad Laer-Borgloh-Hilter-Melle,
Hilter

Ekkehard Saueressig
Chief Executive Officer
Volksbank Neckartal eG, Eberbach

Stefan Schindler
Chief Executive Officer
Sparda-Bank Nürnberg eG, Nürnberg

Bernd Schnabel
Chief Executive Officer
VR Bank Bayreuth-Hof eG, Bayreuth

Roland Seidl
Member of the Board of Managing Directors
Volksbank Raiffeisenbank
Rosenheim-Chiemsee eG, Rosenheim

Bernhard Slavetinsky
Chief Executive Officer
PSD Bank Karlsruhe-Neustadt eG, Karlsruhe

Manfred Stevermann
Chief Executive Officer
Sparda-Bank West eG, Düsseldorf

Georg Straub
Member of the Board of Managing Directors
Volksbank Lindenberg eG, Lindenberg

Dr Gerhard Walther
Chief Executive Officer
VR-Bank Mittelfranken West eG, Ansbach

Horst Weyand
Chief Executive Officer
Volksbank Rhein-Nahe-Hunsrück eG,
Bad Kreuznach
(Member of the Advisory Board
until 16 May 2018)

Holger Wrobel
Member of the Board of Managing Directors
Volksbank Stormarn eG, Bad Oldesloe
(Member of the Advisory Board
until 16 May 2018)

Addresses

Bausparkasse Schwäbisch Hall AG

Crailsheimer Strasse 52
74523 Schwäbisch Hall, GERMANY
Phone +49 (791) 46-4646, Fax +49 (791) 46-2628
Website: Internet: www.schwaebisch-hall.de
Email: service@schwaebisch-hall.de

Regional offices

Division	Address	Telephone	Fax
North All federal states except for Bavaria and Baden-Württemberg	Lyoner Strasse 15 60528 Frankfurt/Main	+49 (69) 669097-60	+49 (69) 669097-70
South Bavaria and Baden-Württemberg	Crailsheimer Strasse 52 74523 Schwäbisch Hall	+49 (791) 46-2276	+49 (791) 46-5680
Specialised banks Cooperative insitutions (throughout Germany)	Lyoner Strasse 15 60528 Frankfurt/Main	+49 (69) 669097-0	+49 (69) 669097-77

Abroad

Country	Address	Telephone	Fax	Website
China	**Sino-German Bausparkasse Co. Ltd.** No. 19, Guizhou Road, Heping District Tianjin 300051 PEOPLE'S REPUBLIC OF CHINA	+86 22 58086699		www.sgb.cn
Luxembourg	**Bausparkasse Schwäbisch Hall AG** 4, rue Thomas Edison 1445 Luxembourg-Strassen LUXEMBOURG	+352 46-6040	+352 46-6041	www.schwaebisch-hall.lu
Romania	**Raiffeisen Banca Pentru Locuinţe S. A.** Calea Floreasca nr. 246 D 6th Floor, Zone A, Sector 1 Postcode 014476, Bucharest ROMANIA	+40 372 13 31 10		www.rbl.ro
Slovakia	**Prvá stavebná sporiteľňa, a. s.** Bajkalská 30 829 48 Bratislava 25 SLOVAKIA	+421 2 58231-111	+421 2 43422-919	www.pss.sk
Tschechien	**Českomoravská stavební spořitelna, a. s.** Vinohradská 3218/169 100 17 Praha 10 TSCHECHIEN	+420 225 221-111	+420 225 225-999	www.cmss.cz
Hungary	**Fundamenta-Lakáskassza** Lakás-takarékpénztár Zrt. Váci utca 19–21, III-IV em. 1052 Budapest HUNGARY	+36 1 411-8000	+36 1 411-8001	www.fundamenta.hu

Memberships

THE GERMAN BAUSPARKASSE SCHWÄBISCH HALL IS A MEMBER OF THE FOLLOWING PROFESSIONAL ASSOCIATIONS AND INSTITUTIONS OF THE HOUSING AND LENDING INDUSTRIES:

National Association of German Cooperative Banks (BVR), Berlin

German Cooperative and Raiffeisen Confederation – reg. assoc. (DGRV), Berlin

German Raiffeisen Confederation – reg. assoc. (DRV), Berlin

German Association for Housing, Urban and Spatial Development – reg. assoc. (DV), Berlin

Association of Private Bausparkassen – reg. assoc., Berlin

vhw – Bundesverband für Wohnen und Stadtentwicklung e.V.
(Federal association for housing and urban development), Berlin

Arbeitsgemeinschaft Baden-Württembergischer Bausparkassen
(Working group of Baden-Württemberg home savings and loan companies), Stuttgart

European Federation of Building Societies, Brussels

IUHF International Union for Housing Finance, Brussels

The Institute of International Finance (IIF), Washington DC

Profile – The DZ BANK Group at a glance

The DZ BANK Group forms part of the German cooperative financial network, which comprises around 850 local cooperative banks and is one of Germany's largest private-sector financial services organizations measured in terms of total assets. Within the cooperative financial network, DZ BANK AG functions as a central institution. Its task is to support the work of the local cooperative banks and to boost their competitiveness. It is also active as a corporate bank and is the holding company for the DZ BANK Group.

The DZ BANK Group includes Bausparkasse Schwäbisch Hall, DZ HYP, DZ PRIVATBANK, R+V Versicherung, TeamBank, Union Investment Group, VR Smart Finanz and various other specialized institutions. With their strong brands, the companies of the DZ BANK Group constitute key pillars in the range of financial products and services offered by the cooperative financial network. The DZ BANK Group sets on its strategy and range of services for the cooperative banks and their customers through its four business lines – Retail Banking, Corporate Banking, Capital Markets and Transaction Banking.

This combination of banking, insurance, home savings, and personal investment products and services has a long and successful tradition in the cooperative financial network. The specialized institutions in the DZ BANK Group provide highly competitive products at reasonable prices within their specific areas of expertise. This ensures that the cooperative banks in Germany are able to offer their clients a comprehensive range of outstanding financial services.

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Glossary

Allocation
A determination that the *Bauspar* customer, due to their payments made into a savings account up to now, can claim the disbursement of the *Bauspar* deposits and the granting of a *Bauspar* loan. The period until allocation depends on observing a minimum waiting time as well as on the level of payments made into a savings account and the saving period measured using the valuation figure.

Allocation fund
The sum of funds available for the allocation of *Bauspar* contracts, including savings amounts, interest credited on *Bauspar* deposits, credited house-building premiums and capital repayment amounts.

***Bauspar* collective**
Firstly, comprises all *Bauspar* customers and their *Bauspar* contracts, which make up the common allocation fund with their savings and repayment cash flows, and, secondly, describes all the *Bauspar* contracts and the associated assets and liabilities as well as rights and obligations from a technical *Bausparkasse* perspective.

***Bauspar* contract**
A contract between a *Bauspar* customer and a *Bausparkasse*, under which the *Bauspar* customer commits to making regular savings and acquires a legal claim to a subsequent *Bauspar* loan at a fixed interest rate depending on the tariff.

Bausparen
It is based on an earmarked advance-saving scheme which is strictly regulated and subject to strict statutory safety standards. At the heart of this model is the closed loop of payments made by *Bauspar* customers into savings accounts and the repayments made by borrowers which provide the funds that serve as a basis for housing financing. Although this self-contained system is directly independent of the situation on capital markets, there is however an indirect dependency on the trend in capital market interest rates.

***Bauspar* loan**
A secured subordinated loan for housing purpose granted following the allocation of the *Bauspar* sum within the framework of a *Bauspar* contract.

***Bauspar* tariffs**
These classify different variants of *Bauspar* contracts, which vary as regards their key contractual terms such as minimum savings deposit, regular savings contribution and capital repayment, interest paid on credit balances and loans as well as possible options.

Bridge financing loan
A Loan with suspension of repayments that is replaced by a *Bauspar* contract for which, at the time the bridge financing loan is disbursed, the minimum savings deposit has been paid in (regardless of the residual savings period until allocation).

Change of tariff
A change, subject to approval by the *Bausparkasse*, from the *Bauspar* tariff selected when the contract was concluded to another *Bauspar* tariff with different conditions (e.g. interest rates, minimum savings deposit, regular savings contributions), with the existing contract remaining in place so that no additional contract fee is levied. In connection with a tariff change, the Bauspar customer usually has to pay a tariff change fee, which has the effect of treating the customer as if they had selected this new tariff from the start of the contract.

Collective management
The management and monitoring of the risks of the *Bauspar* collective.

Comprehensive bank management
An integrated system to manage the income and risk of a financial institution.

Contract fee
A contract fee of one per cent of the *Bauspar* sum is usually levied upon conclusion of a *Bauspar* contract.

General *Bauspar* Terms and Conditions (ABB)
The General *Bauspar* Terms and Conditions (ABB) stipulate the key component parts of a *Bauspar* contract. The terms and conditions are approved by the German Federal Financial Supervisory Authority (BaFin) and form a component part of the *Bauspar* contract.

Internal capital
The internal capital at Bausparkasse Schwäbisch Hall is understood as total available capital that can be used to cover unexpected losses. DZ BANK uses a different term in German for this, namely *Risikodeckungsmasse* (risk cover fund). The Bausparkasse Schwäbisch Hall term is used hereinafter.

Management approach
The management approach aims to contribute to a convergence of external and internal accounting. The associated transfer of internal data into external reporting is intended not only to reduce costs but also to make reporting more useful for decision-making.

Non-collective loan
A *Bausparkasse* loan that is not taken from the allocation fund. This includes suspended repayment loans, bridge financing loans, pass-through loans or other building loans. These loans are refinanced using the *Bausparkasse*'s capital, debt capital from the capital market and – to a legally regulated degree – collective funds.

Regular savings contribution
Regular savings contribution is to be understood as the monthly savings contribution amount agreed under the contract terms. The size of the amount depends on the *Bauspar* sum and the tariff version.

Suspended repayment loan
A loan that is combined with a *Bauspar* contract of equal value. Only interest payments must be made on the suspended repayment loan, while the consumer makes savings under the *Bauspar* contract in parallel until it is allocated. The repayment of the suspended repayment loan occurs upon allocation of the *Bauspar* contract.

Technical simulation for *bauspar* business
Process for analysing and projecting the future trend of a *Bauspar* collective while taking into account predefined parameters, particularly tariff parameters, interest rate trend scenarios, sales targets and behaviour patterns based on experience. The *Bauspar*-specific simulation aids in particular in forecasting the trend in *Bauspar* deposits and loans as well as collective interest income and expenses.

Valuation figure
Under *Bausparen* the valuation figure determines the order in which the savers are paid their *Bauspar* funds. It is calculated based on the interest you have received for your deposits, the Bauspar sum for which you have concluded your contract, the selected assessment ratio as well as possibly the accelerated allocation ratio.

Valuation indices (SKL)
Measures the ratio of *Bauspar* customer payments made into a savings account to payments made by the *Bausparkasse*. The collective valuation indices must be at least 1.0 at all times.

Bausparkasse Schwäbisch Hall AG

Crailsheimer Strasse 52, D-74523 Schwäbisch Hall, www.schwaebisch-hall.de, service@schwaebisch-hall.de, Phone +49 (791) 46-4646

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